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## New ESOP Association CEO Announced

### James Bonham Will Become New President and CEO on March 1

**C**oncluding a seven month national search process, The ESOP Association Board of Directors voted unanimously February 1 to name James J. Bonham as The Association's new President and CEO. Bonham will start in the position March 1 and will immediately begin a transition with J. Michael Keeling, who is retiring. Keeling has led The Association since 1991, and ushered in a period of sustained growth while successfully navigating several important legislative initiatives.

Gary Shorman, CEO of Kansas based Eagle Communications and the incoming TEA Board Chairman, led the search committee.

"We had an extremely vigorous, nationwide process, and reviewed dozens of applications for the position. And let me tell you this—there are a lot of really talented people out there," said Shorman. "Because this is the first transition of leadership in nearly three decades, it was a very important decision. We could not be more pleased that Jim has agreed to join our Association."

Others serving on the committee included current Chair Dave Fitz-Gerald of Carris Reels, Inc., Immediate Past Chair Cindy Turcot of Gardener's Supply Company, Employee Ownership Foundation Chair Mark Lomele of Recology, Secretary/Treasurer Ali Jamshidi of CTL Engineering, and Chair of the Advisory Committee Chair's Council Lynn DuBois of the ESOP Law Group.

"Jim has a long and successful track record of high-level, transformational leadership advising some of the most widely recognized companies and leaders in the nation," said Fitz-Gerald. "We were impressed with Jim's breadth of experience both as a leader and in his knowledge and role advising a number of other national trade associations. He is well-versed in the legislative and regulatory priorities of



James Bonham, The ESOP Association's new President and CEO.

ESOPs and our members, and brings a wealth of high level relationships."

Bonham will look to continue to grow The Association and its chapters, and will continue ongoing efforts to increase the value proposition for current and new members.

“This is a really great opportunity, and I have big shoes to fill,” Bonham said. “Michael (Keeling) is one of the most knowledgeable and respected people in the nation when it comes to ESOPs and employee ownership in general. I’m excited to take over the reins after his long and successful tenure.

“I’m also excited for The ESOP Association to talk to more employers and Americans about employee ownership and the benefits it brings to our economy,” Bonham continued. “There is a real opportunity for ESOP growth as baby boomers look toward retirement, millennials who desire ownership become the largest demographic in the

workforce, and the benefits of employee ownership become more widely studied and appreciated.”

Bonham has a personal connection with employee ownership dating back to his grandfather, who ran a chain of small mercantile stores in his home state of Wyoming. Those stores were later sold to James Cash (J.C.) Penney, his grandfather’s best friend. Employee ownership in those stores was a key component to their success.

“My grandfather’s personal and professional relationship with J.C. Penney incubated a shared business philosophy,” said Bonham. “One of their beliefs was granting a form of ownership to their employees in the small mercantile businesses they ran. It was an excellent model that had great success, and I’m proud to have the privilege of attaching my work today to that legacy.”

For more on Bonham’s hiring, see page 11. 

# New ESOP Association Website Launched

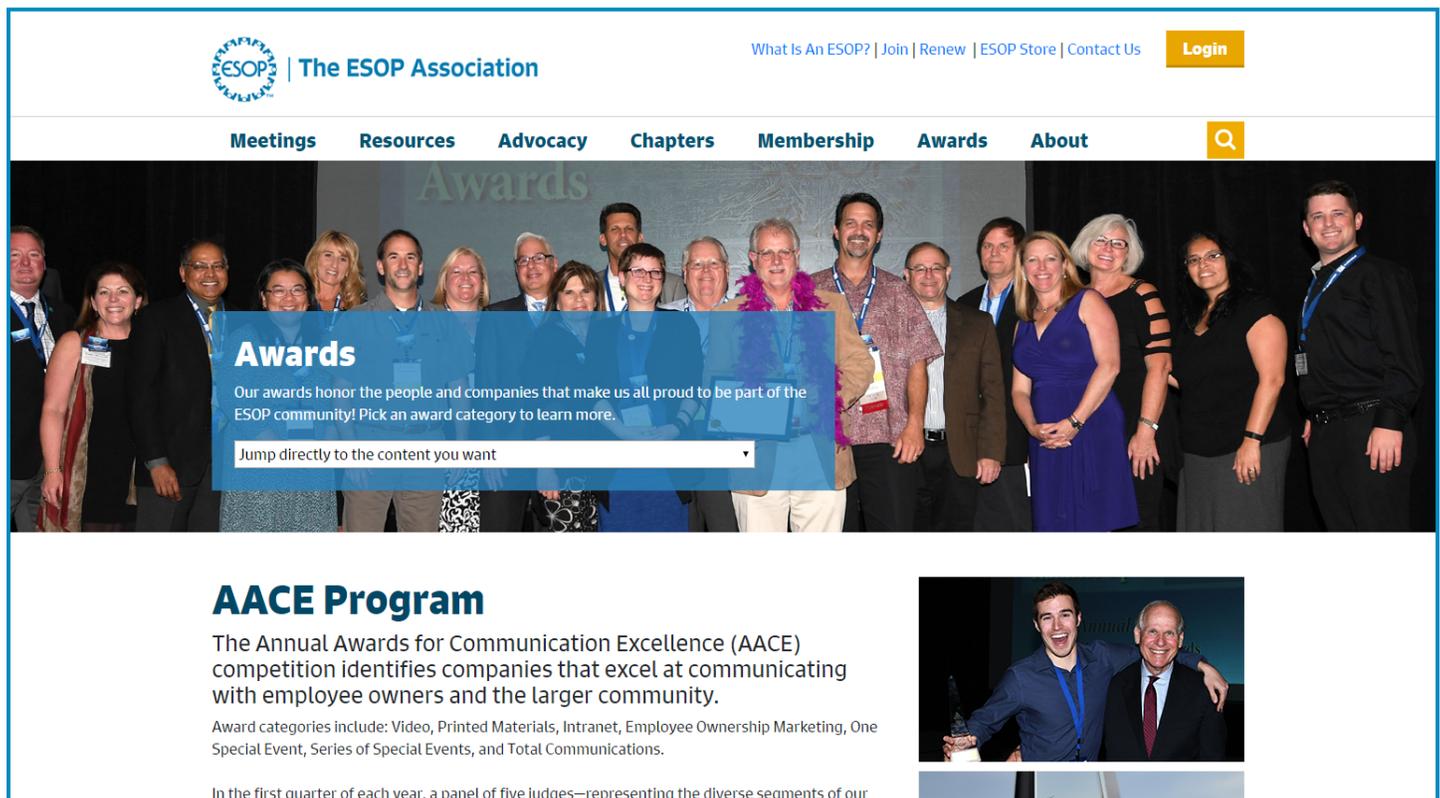
## Members Gain Faster Way to Access Resources, Register for Events

The ESOP Association launched its newly redesigned website this month. The site offers members a faster, more streamlined way to access content, register for events, and more.

The site includes some key features that differentiate it in pretty important ways from the previous version.

### What’s Different?

**Mobile browsing.** The new site is designed to work equally well on mobile devices and computers. Surf all the pages you want and register for any event using your phone or tablet.



The screenshot shows the ESOP Association website. The header includes the ESOP Association logo and navigation links: What Is An ESOP? | Join | Renew | ESOP Store | Contact Us | Login. The main navigation bar lists: Meetings, Resources, Advocacy, Chapters, Membership, Awards, About, and a search icon. The main content area features a large group photo of award winners with a blue overlay containing the text: "Awards. Our awards honor the people and companies that make us all proud to be part of the ESOP community! Pick an award category to learn more." Below this is a dropdown menu labeled "Jump directly to the content you want". At the bottom, there is a section for the "AACE Program" (Annual Awards for Communication Excellence) with a description and a list of award categories. A small photo of two men, one holding an award, is also visible.

**Reorganized content.** Key content has been reorganized and moved to new locations so you can find it quickly and easily.

The all new [Awards](#) tab makes it easy to pull up winners of past honors and get information on entering the latest ESOP Association competitions.

The [Resources](#) tab gathers most key member resources into one place. This is your one-stop shop for:

- [Publications](#) (like this newsletter).
- [Interactive tools](#) (like the ABCs of ESOPs online training module).
- [Networking aids](#) (including the various online and printed member directories).
- [Videos from our members](#) (including those shared on YouTube and those entered in the Annual Awards for Communications Excellence competition).

The [Membership](#) tab is a handy way to access a variety of benefits, including some you may have forgotten about.

The [Chapters](#) section has been streamlined to help you more readily access your chapter's resources and meetings. A new, larger map will help new and returning members find their local chapter in a snap.

**Reorganized ESOP Briefs.** The [ESOP Briefs](#) (formerly *Issue Briefs*) have been rearranged with your needs in mind.

Looking for a way to help educate your fellow employee owners? The *Briefs* that can help you do that are neatly

arranged in one group. They are a perfect way to complement your education efforts during annual stock meetings, celebrations of your ESOP anniversary, or Employee Ownership Month.

Looking for documents to help your executives and board members start tackling a new aspect of ESOP

*The all-new [Awards](#) tab makes it easy to pull up winners of past honors and get information on entering the latest ESOP Association competitions.*

Administration? Never fear—those *Briefs* are close at hand and easy to find too. Just click the link, download the PDF, and start reading.

**A more colorful, fun experience.** ESOPs are a wonderful mechanism for engaging people, sharing wealth, and managing succession planning. But they are also about people.

Our experiences working with you, our members, have shown us that members of the ESOP community are a lively bunch! Hopefully our new website reflects that by sharing photos of our members in a variety of situations, throughout the site.

Check out your new website today—you may see someone you know! 

## ESOP Report



*The Voice of The ESOP Association*

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## Ownership Advantage

### Tips for Setting the Stage for Deep Engagement

By Matt Hancock, Praxis Consulting Group

A hallmark of a strong ownership culture is when employee owners feel they have a voice. Of course, for employee owners to have a voice, their leaders (on the ESOP committee, in their department or team, and on the executive team) need to be listening.

This seems simple but it turns out that listening—deep, active listening—is hard to do.

Why don't you try it now? Take 15 seconds. Stop reading this and turn up your listening. Try to pay close attention to what you hear around you.

Did you hear something you didn't before?

Maybe your computer's fan whirring, or the sound of paper shuffling in another room, someone walking up the stairs, or the "beep" of a horn outside? Of course, those

noises always were there, but you must listen to really hear them.

## Why Is This So Hard?

Part of the reason listening is hard is because of the way our brains work. We speak, on average, at a rate of 125 words per minute (wpm), but we can process at a rate of 400 wpm, or more.

To our brains, zipping around the racetrack like a Ferrari, people speaking seem like a tricycle out for a stroll. It's only natural for our gray matter to look for short-cuts (like jumping to conclusions) or a way out (like multi-tasking) when people are talking to us.

Add to this hardwiring our increasingly distracting environment (TV, e-mail, social media) and the demands of work (to accomplish more in less time and to be in many places at once), and you find an array of forces conspiring against active listening—regardless of our best intentions.

## Who Are You Listening For?

Not all listening is equal. As one employee owner put it, “Sometimes I feel as though I am being heard, but not listened to.”

On one side of the listening continuum is the listening you do for *you*: You're present physically, but your mind is someplace else. In this “pretend” or “distracted” listening, you may even nod and say an occasional “uh huh” but you're just hearing, not listening. (We all spend more time on this end of the spectrum than we'd care to admit—the author included!)

In the middle is “habitual” or “selective” listening. You're more plugged-in to what the person is saying, but you're still listening for your own benefit. You pay attention when words and concepts support your argument or reinforce your prior thinking. This is listening to make a point...your point.

On the other end of the spectrum is the listening you do for the other person—active listening. You're physically and mentally present, you're deeply curious and listening to understand. You're even willing to let what you're hearing change your mind or alter your position. This type of active listening is essential for leaders who want to foster employee engagement and build an ownership culture.

## Active Listening: How to Do It

When it comes to active listening, it's both a set of behaviors (what you do to show you're listening) and a mindset (you believe listening is important).

Let's look at mindset first.

Because you can't do it all the time, it's important to be intentional about when you will really turn it on. It is okay to say: “What you have to say is important and I want to take the time to understand. Can we talk in 15 minutes so I can finish what I'm working on?” This may run counter to the idea of an open-door policy. But employee-owners will appreciate that you are finding the time to deeply listen—rather than just conducting pretend listening whenever they pop in. Active listening is a time to suspend judgment, resist distractions, and be curious.

In terms of behaviors, making eye contact and posture (for example, leaning in) are key signals that you're listening. Nodding, and the occasional “uh huh,” tell the speaker you're still tracking the conversation.

Active listening is about communicating information; restating what you have heard and checking for accuracy help ensure you're really getting it. Phrases like “What I'm hearing is...” and “It sounds like you're saying...” give you the chance to check if you understood the speaker. Asking “Have I understood correctly?” invites the speaker to confirm that you are hearing him or her, or to correct what you might not have gotten.

A note of caution: What works well at a cocktail party can hurt when you're trying to actively listen. “Joining in,” (e.g.,

# ESOPs Rock!

## This Annual Conference will get turned up to 11.

May 22-24, 2019

“I know exactly what you mean, my boss does the same thing”) can make for great conversation, but in terms of active listening, it shifts attention from the speaker, back to you. Remember: Active listening is all about the other person.

## Listening and Employee Ownership

The research is conclusive: When broad-based ownership (as in an ESOP) is combined with employee participation,

the result is measurably superior performance. The challenge is that employee participation takes time. It requires that leaders do something that doesn't always come naturally: slowing down. A commitment to practice deliberate active listening can help us all hit that pause button.

Finally, participation means sharing information and authority more broadly than we may have in the past. It requires giving more employees a voice. And for them to have a voice, someone must listen. 

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# Advisory Committee on Administration

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## Common Administrative Errors and Correction Options

By Barbara M. Clough, QPA, QKA, Director, ESOP, Newport Group

Reviewed by: Dolores Lawrence, CPA, QKA, Managing Director, Blue Ridge ESOP Associates

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**D**espite best efforts, mistakes commonly occur in qualified plans. ESOPs are particularly complex, with special rules that may result in errors. The goal of this article is to explain several of the most common errors that occur and to provide some guidelines as to potential fix methodologies.

The Internal Revenue Code, Treasury Regulations, and your Plan Document are the three sources for guidance when administering your ESOP.

### Compensation

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Plan documents define the compensation to be used for allocation and testing purposes. Common compensation reporting errors typically are related to a need for further understanding of what the plan's definition states and what it means in practice.

Two common plan definitions in plans are:

1. Code Section 3401(a) compensation (compensation subject to income tax withholding) plus employee 401(k) deferrals and section 125 deductions.
2. W-2 compensation plus employee 401(k) deferrals and section 125 deductions.

These definitions have one key difference: The Code Section 3401(a) compensation definition excludes the taxable cost of excess group-term life insurance.

Another item to think about with respect to your compensation definition is whether there are types of excluded compensation, such as bonuses, overtime, shift differentials, etc. Does the plan exclude compensation prior to a participant's entry date into the plan? What about post-severance compensation?

Most third party administrator (TPA) firms provide a census report for review and verification. The items noted above are important for review and confirmation prior to proceeding with the allocations for a given year. But if—after the allocation work is completed—you determine that an error occurred, how do you proceed?

The goal with any correction is, of course, to return affected participants to the same place they would have been if the error had not occurred. If the error is found within a short period of time, it may be possible to rework the allocation and provide updated reporting to the plan participants.

However, many times this is not the case, and the correction may span several plan years. In these instances, an analysis would be performed to determine each affected individual and the amount of the required correction for those individuals.

The corrections often affect more than the employer contribution allocation alone, as there may have been forfeiture reallocations or allocations of dividends on suspense shares that were based on compensation, or other transactions that included the current year's contribution as part of the allocation basis.

Once a determination has been completed, the net effect can be posted to each affected participant's account. If terminated employees who have been fully paid out are affected, this may require additional payments to the plan participant; or in some instances, an overpayment could have occurred.

In the case of an overpayment, the best practice is to write the participants and request that they return the excess distribution. This is much easier if the participant received a rollover, as the rollover institution will assist in returning amounts that were not rollover eligible. Oftentimes the Plan Sponsor must make an additional

contribution to the plan to make all participant accounts return to their originally intended position.

## Eligibility

The eligibility provisions define when employees become eligible to participate in the ESOP and receive allocations as defined in the plan document. To determine who is eligible for plan participation, your TPA will request census demographic information that includes date of birth, hire, termination, and rehire data (if applicable), as well as the number of hours worked by an individual during the plan year.

The most common errors occur when incorrect date information is provided. For example, if your plan has an age requirement to enter the plan—say 21—and the census data incorrectly reported the year of birth, then a person could be determined to have satisfied the requirement in error.

For example, let's say your plan year ending is 12/31/2018 and your plan requires attainment of age 21. Let's further say that if you work at least 1,000 hours in one year, you will enter the plan on the following January 1 or July 1.

Now, let's look at an employee with the following information:

- Date of Hire: 1/7/17
- Date of Birth: 5/25/1997
- Age: 21 on 5/25/2018
- 2017 Hours: over 1,000
- 2018 Hours: over 1000

In this situation, the participant will enter the plan on July 1, 2018.

But, if the employee's date of birth is actually 5/25/1998, entry in the plan would occur in 2019.

If this type of error occurs and you have the wrong group of individuals in your eligibility determination, then your contributions, forfeitures, and any other allocations will be incorrect because they are being allocated to the wrong group of employees.

As noted previously in this article, early detection is best. However, it is common that these errors are not found until sometime after the year-end reporting has been finalized. In these instances you should take the following actions:

- Correct all dates, including adjustments for date of participation.
- Review allocations to determine the impact of allocations to plan participants, i.e., too much or too little.
- Review plan document provisions for guidance on removing incorrect contributions or making up missed allocations. Missed allocations are commonly corrected by an additional deposit from the plan sponsor; forfeitures may be used if the plan document allows.

## Vesting

Vesting is another common provision that can create administrative errors. Your plan document will define the vesting schedule, periods that may not be included for vesting purposes, and the definition of a year of service (YOS). A participant's vested percentage determines the amount of a participant's account balance that he "owns." This percentage is applied to account balances upon termination to determine the distributable amount.

There are two definitions available to determine years of vested service. The less common definition is elapsed time. Plans that utilize the elapsed-time definition are measuring a participant's period of employment.

The more common definition of a year of service is a specific number of hours (typically 1,000) during the plan or anniversary year. This is best shown by the following example:

**Participant:** Joe ESOP (full time employee)

**Date of Hire:** May 15, 2015

**Date of Termination:** July 25, 2018

	2015	2016	2017	2018	2019	YOS
1,000 Hour Plan Year	Yes	Yes	Yes	Yes	N/A	4
1,000 Hour Anniversary Year	N/A	Yes	Yes	Yes	No	3
Elapsed Time	N/A	Yes	Yes	Yes	No	3

The lesson in this case is not only do you need to have accurate census information; you also must apply the terms of your document when determining years of service and vested percentage. Incorrect determination of vesting can result in overpayments or underpayments.

Underpayments can be corrected by making a corrective residual distribution to make the participant whole. Overpayments must be returned to the Trust, either by the participant as noted earlier in the article or by an additional deposit.

Incorrect vesting also can result in improper determination of forfeited amounts. As with most errors, early detection makes the corrective process much smoother. Redo of the allocations in years affected would be required to bring participants to the same place they would have been had the error not occurred.

## Share-Release Calculations

ESOPs that take on debt to purchase the stock of a privately held company are called leveraged ESOPs. A leveraged ESOP will have a loan whereby each year, according to the terms negotiated as part of the ESOP sale, payments will be

made towards the outstanding debt. As payments are made on the ESOP debt, shares are released from encumbrance and allocated to the accounts of eligible plan participants.

There are two acceptable release methodologies as defined in the Treasury Regulations Section 54.4975-7(b)(8). These methods are referred to as:

**General Rule (Principal & Interest Method)**

$$\frac{\text{PIPY}^1}{(\text{PIPY} + \text{PIFY}^2)} \times \text{Suspense Shares}$$

<sup>1</sup>Principal & Interest for Plan Year  
<sup>2</sup>Principal & Interest for All Future Years

**Special Rule (Principal Only Method)**

$$\frac{\text{PPY}^3}{(\text{PPY} + \text{PFY}^4)} \times \text{Suspense Shares}$$

<sup>3</sup>Principal for Plan Year  
<sup>4</sup>Principal for All Future Years

There are special regulatory requirements for the principal-only release, the most important of which is that the loan term cannot extend beyond 10 years. One very common administrative error is that shares are released based upon the principal-only methodology for loan terms that extend beyond 10 years.

It is important to review all loan documents, pledge agreements, and the share-release calculation to ensure that the proper release method is being applied.

Another common mistake is with respect to interest calculations for leveraged loans. Plans with fluctuating

*Incorrect interest calculations will release an incorrect number of shares, which will affect the allocation to participant accounts.*

interest rates must recalculate amortization schedules to reflect the future payments required on the loan. The reason: Changes in interest rates will change the total interest paid on the ESOP loan over time. If your plan loan is in excess of 10 years, the future interest is included in the denominator of the share-release calculation. Incorrect interest calculations will release an incorrect number of shares, which will affect the allocation to participant accounts.

It is also important to confirm the language in your loan documents with respect to the number of days that should be counted in a plan year. The two definitions we typically find are:

- 365/366 days per year.
- 360 days per plan year.

For illustrative purposes, please see the chart below, which demonstrates the slight difference in interest and

number of shares releases in the first and final years of the note:

		Release Year 1	Release Year 30
Encumbered Shares	10,000		
Principle Amount	10,000,000		
Interest Rate	2.88%		
365/366 Days Total Interest	4,467,156.06	429.4786	237.0609
360 Days Total Interest	4,529,199.93	430.3976	236.1405

Calculations of future interest also are affected when a plan makes pre-payments against the outstanding debt. Two important factors need to be addressed when completing the share release in a year when prepayments have been made.

First, the loan documentation must be reviewed to determine the ordering in which such pre-payments are posted. The loan documents either post in a manner that maintains the original payoff date (meaning each payment over the original loan term becomes slightly smaller), or are applied in reverse order of maturity (which decreases the length of the loan).

In any event, a pre-payment of principal will change the future interest that must be paid on the note and accordingly adjust the number of shares released in a plan year.

Now that we have laid out the various reasons a share-release calculation may change, let's discuss how the corrections should occur.

First, any affected loan amortization schedules must be re-amortized to reflect the appropriate provisions or activity that has occurred. Once the amortization schedules have been corrected, the share-release calculations should be reworked.

If too many shares were allocated under the original allocation methodology, the excess should be forfeited from participant accounts. Conversely, if insufficient shares were released and allocated, you should adjust the allocation to participants by adding additional shares.

As always, our goal is to put participants in the position they would have been if corrections were not needed. 

### Calendar of Deadlines and Important Dates

**May 22** ESOP Association Annual Awards Banquet

**May 23-24** [Annual Conference](#)

**June 23-28** [Leading in an Ownership Setting](#)

**Nov. 14-15** Las Vegas ESOP Conference & Trade Show

To see all national and chapter meetings, visit us online at: [www.esopassociation.org](http://www.esopassociation.org).

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# Washington Report

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## ESOPs: Built to Last, No Matter the Election Results

By J. Michael Keeling, ESOP Association President

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**A**s I travel and visit with ESOP fans, I hear some concern that our longtime supporters in Congress are moving on, due to electoral defeat, retirement, or moving into new public offices outside of Congress. The fear is that legislative and regulatory support for ESOPs has been weakened, or at least is less certain.

There is no question that the defeat of ESOP advocates—such as former Representatives Erik Paulsen (R-MN) and Peter Roskam (R-IL), who served as senior members of the extremely important House tax committee—is not a welcome development for ESOPs.

The retirement of the Chair of the Senate tax committee, Senator Orrin Hatch (R-UT), and defeat of Senators Dean Heller (R-NV) and Claire McCaskill (D-MO) is not great news for ESOP support. Another concern: With Republicans now in the minority in the House, strong ESOP Champion Rep. Virginia Foxx (R-NC) no longer chairs the House committee that oversees the Department of Labor and how it regulates ESOPs.

The list could go on.

Do these changes in the Congress bode troublesome days for ESOPs?

I say “no.”

Why?

The past is prologue, even though it is not always perfectly repeated. And a look at our past shows that ESOPs have staying power and always attract new champions to replace those who have moved on.

In recent days, I have reviewed ESOP Association newsletter articles I have written going back to 1982. What did I see in these 37 years of articles?

I saw many super ESOP champions in the House who were defeated in their bids for re-election, or who sought offices outside of Congress, or who decided it was time to move on to a new chapter in their lives. I saw the same developments in the Senate.

And still ESOPs survived and thrived. For example, in the 1980s and 1990s, particularly in the House and sometimes because of Administration proposals, our community faced proposals that would have reduced or even eliminated laws that benefit ESOP creation and operations. These proposals were debated, and—thanks to the support of our ESOP advocates on the Hill—they were rejected.

Our community has thrived because of the help of the women and men who have served on Capitol Hill. And we have survived after they left Capitol Hill for other endeavors.

Some of the many ESOP Congressional advocates—from both chambers and both parties—who have helped ESOPs over the years include: Anthony (D), Pickle (D), Rangel (D), Nancy Johnson (R), Ramstad (R), Packwood (R), Snowe (R), Dole (R), Breaux (D), Bingham (D), Landrew (D). The list could go on and on, including literally hundreds of former members of Congress and ESOP supporters from 1981 through 2018.

Why did these individuals support ESOPs? Was it because The ESOP Association paid super-duper lobbyists or DC swamp dwellers to “tell” them to support ESOPs? No, of course not.

Was it because The ESOP Association PAC gave \$500 to \$10,000 per election cycle to the women and men in Congress who publicly supported positive ESOP law? Again, the answer is no.

It was because the leaders of ESOP companies asked their elected officials to visit their businesses so they could learn for themselves what being an ESOP means.

Over the years I have attended literally hundreds of fundraising events for ESOP advocates in Congress. More

***Members of Congress come and go.  
The ESOP spirit remains.***

times than I can remember, they saw my name badge and recognized the name of The ESOP Association, and their faces brightened. “ESOPs are special!” they would tell me sincerely.

ESOPs thrive in the legislative arena because of you and your fellow ESOP participants—whether you are machine operators or CEOs—showing outsiders, such as members of Congress, what working in an ESOP company is like. The result is a palpable feeling, and it impresses Senators and Representatives more than anything we in Washington can do.

Members of Congress come and go. The ESOP spirit remains.

So memorable was the panic that set in among leaders of the ESOP world when the “Godfather of ESOP law,” the late Senator Russell Long (D-LA), announced he would retire at the end of 1986.

The women and men involved with The ESOP Association at that time were alarmed—to say the least—almost begging the Senator to stay. They feared that if their champion retired, all his good work on behalf of ESOPs would be undone.

Senator Long’s response was: “If ESOPs cannot survive when I am gone, they do not deserve to exit.”

And what happened? ESOPs not only survived, they actually gained additional favor in the law. Take note of the law that passed in the late 1990s that permitted S

corporation ESOPs to exist and to avoid paying any Federal taxes.

We will miss our friends who are no longer in Congress. But as Russell Long knew, ESOPs will continue for the simple reason that they deserve to do so. €

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# Legal Update

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## Sellers, Company Unable to Escape DOL Lawsuit

By Gregory Jacob and Natasha Fedder, O’Melveny & Myers LLP

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In April 2018, the Department of Labor (DOL) sued the following parties with respect to the Bowers + Kubota Consulting, Inc. ESOP Transaction: Brian Bowers and Dexter Kubota (the individual sellers); Nicholas Saakvitne and his law firm, the trustee; Bowers + Kubota Consulting (the company); and the Bowers + Kubota Consulting, Inc. Employee Stock Ownership Plan.

The company and the sellers moved to dismiss. The company argued that the DOL failed to allege the company had done anything wrong, and the sellers primarily asserted they were not fiduciaries with respect to the transaction and otherwise had no knowledge of any breach committed by the trustee.

The court denied both motions in the case (*Acosta v. Saakvitne*, No. 18-00155, 2019 BL 18093 (D. Haw. Jan. 18, 2019)). For purposes of such a motion, the court generally was required to accept as true the allegations of the DOL’s complaint as written.

### Background

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Bowers + Kubota Consulting provides architectural, engineering, and consulting services in Waipahu, Hawaii, to public and private sector clients. The company prides itself on its TEAM (Together Everyone Achieves More) approach to work, and through the years has received numerous awards for its professional expertise, work environment, and business achievements—including being honored as the Best Civil Engineering and Architectural firm to Work For in the United States.

The DOL’s complaint alleged that in the summer of 2012, Bowers and Kubota—the sole owners of the company—hired an attorney and began discussions to create an ESOP. In the fall of 2012, the DOL’s complaint alleged that they hired valuation firm Libra Valuation Associates (LVA) and provided it with a variety of business information.

LVA issued a preliminary appraisal report, a final valuation report, and a fairness opinion of the company. The DOL later alleged that the valuations were based on unreasonable revenue projections, and that LVA improperly

applied a 30 percent control premium even though the ESOP obtained no actual control.

The DOL’s complaint alleged that the sellers hired Saakvitne to serve as the ERISA independent fiduciary for the ESOP. The DOL faulted the legal counsel for the company for providing Saakvitne with a document listing the purchase price of the company and another document estimating the “Valuation under the heading ‘Basis of Deal—General.’”

According to the DOL’s complaint, Saakvitne flew to Hawaii to negotiate a sale, received an initial offer from the sellers, and after a single day of negotiations agreed to purchase the company.

The DOL’s complaint alleged that the sellers provided inflated revenue projections to LVA, failed to meaningfully review the LVA valuation, and failed to monitor Saakvitne. It also alleged that the ESOP transaction constituted a prohibited transaction under ERISA, and that all of the indemnification provisions in the various engagement documents were void under ERISA.

### The Company’s Motion

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One might best describe the company’s motion to dismiss as asking: “What am I doing here, exactly?” The company pointed out that the complaint did not allege any wrongdoing on the part of the company, and did not seek any relief from it. Seeing no reason that it should be dragged into court, and unexcited about the associated attorney expense, the company sought to be dismissed.

The DOL conceded that it was not alleging any wrongdoing on the part of the company, but asserted that the company should be joined as a necessary party under Rule 19 of the Federal Rules of Civil Procedure to ensure that the court’s final order could afford full relief.

The court agreed, noting that, depending on the outcome—the company might “need to be involved in modifying the ESOP’s governing documents and restructuring the ESOP’s fiduciaries.” The court stated that the Rule 19 joinder extends to any party it is “desirable”

to include in litigation and is not strictly limited to truly indispensable parties.

The company tried one last gambit, offering in exchange for dismissal to enter into a consent decree agreeing to be bound by the court's final ruling. But the company indicated that it was willing to extend the decree only to relief that the complaint actually requested.

That limitation was unacceptable to the court, which hypothesized that additional issues not included in the pleadings might arise, or that additional relief might be required. The company was apparently unwilling to write such a blank check, but it appears an unlimited consent decree might have secured a dismissal.

## The Seller's Motion

The sellers primarily contended they were not fiduciaries with respect to the transaction or otherwise: after all, the company hired Saakvitne to make decisions for the ESOP. But the court determined—based upon factual allegations in the complaint that the court had to accept as true for purposes of the Motion to Dismiss—that the sellers were both functional fiduciaries with respect to the transaction, and appointing fiduciaries with respect to Saakvitne.

The court's functional fiduciary analysis was thin. The court relied on the complaint's allegations that the sellers "established the ESOP," "appointed Saakvitne as trustee," and allegedly told Saakvitne prior to his appointment that the company's value was \$40 million.

To be sure, the DOL alleged that the sellers did exercise discretionary authority in appointing Saakvitne. (The sellers contested this alleged fact and indicated in their Motion to Dismiss pleadings that the documents referenced in the complaint or an integral part of the complaint belied the DOL's factual allegations in this respect). Note that the complaint does not allege that the appointment of Saakvitne involved any wrongdoing. Under a proper ERISA analysis, however, the act of appointment would not make them functional ERISA fiduciaries with respect to the transaction itself, because the company delegated full authority for the ESOP to Saakvitne.

The analysis might be different if the sellers had bindingly directed Saakvitne to accept a valuation of the company at \$40 million, because he would then no longer be truly independent, and the sellers would bear ultimate responsibility for the purchase valuation decision.

But it would have been wildly improper for the sellers to exercise any fiduciary responsibility at all for the ESOP in the transaction. The selling parties were aware that they were deeply conflicted, which is why they appointed Saakvitne as the sole member of the ESOP's board of trustees and independent fiduciary in the first place.

Indeed, if the sellers were acting as fiduciaries in the transaction, their "eye single" duty to the ESOP would have required them to reduce the company's sale price to nothing, because every dollar spent cost the ESOP and

benefited them. The court's shaky fiduciary status analysis would thus effectively render ESOP transactions impossible.

The court's duty to monitor analysis, however, rested on stronger ground (although the sellers strongly argued otherwise in their Motion to Dismiss pleadings and at the Motion to Dismiss hearing).

It is black letter law that an appointing fiduciary has a duty to monitor the performance of the appointee. The sellers contended the company appointed Saakvitne, not them. But the sellers made the decision on the company's behalf, squarely rendering them the appointing fiduciaries according to some case law that the sellers distinguished in their Motion to Dismiss pleadings and at the hearing.

Appointing fiduciaries, of course, have only limited responsibilities. They must make a prudent selection, and must monitor the performance of the appointee. The complaint did not assert wrongdoing in the appointment process, and its specific allegations focused on the sellers' alleged failure to monitor.

Because appointing sellers are directly adverse to appointed trustees in ESOP transactions, there are significant legal questions about what kind of monitoring is possible by selling shareholders—and the sellers argued as such at the hearing. The court held that the complaint

*If the sellers were acting as fiduciaries in the transaction, their "eye single" duty to the ESOP would have required them to reduce the company's sale price to nothing.*

stated a cognizable duty to monitor claim by alleging that the sellers knowingly providing flawed revenue projections to Saakvitne, and then knowingly allowing him to overstate the value of the shares for purposes of the transaction.

## Practice Pointer: Robustly Negotiate, and Document It!

The motions to dismiss were decided on the pleadings, and the DOL still needs to prove its case: All of the DOL allegations were assumed to be true at this motion stage of the case.

Interestingly, however, the DOL acquiesced in the district court's consideration of a number of documents submitted by the sellers without converting the motion into one for summary judgment. The core of the DOL's case seems to be its (as yet unproven) narrative that the sellers picked their own inflated sale price and delivered it to the trustee prior to his appointment, and that the trustee then failed to kick the tires on the valuation or put up much of a fight on the sale price.

It is also interesting to note that the trustee, Saakvitne, recently passed away. The strength of the evidence of the trustee's (1) examination of the valuation and (2) robust pursuit of the ESOP's interests in the ensuing negotiations will likely be important as the case develops. **E**

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# Farewell From the Chair

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## The Time Has Come for Leadership Changes at Your Association

By Dave Fitz-Gerald, Chair of The ESOP Association Board of Directors

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I can't believe it! My time as Chair of The ESOP Association is quickly coming to an end. I have enjoyed getting to know so many wonderful, inspiring employee owners and service providers from across the country.

The ESOP Association accomplishes its mission because of the efforts of its phenomenal volunteers and its dedicated staff. I love working within this community of people. It is a deeply, personally rewarding experience. I am humbled to have had the opportunity to serve.

During my time as Chair I had several major objectives I wanted to tackle.

First, I wanted to bring more warmth to the Annual Conference and to make it more fun and engaging. I think there's more we can do, but I think we've come a long way.

Second, as provided for in The ESOP Association's Strategic Plan, we completed a brand audit and a communications audit, then worked to implement the recommendations. Congratulations to the staff on the new website and branding. I think it looks a lot more like "us" now.

Third, I knew The ESOP Association's long-term president, J. Michael Keeling, would be retiring.

Kudos to your vice chair, Gary Shorman, for running the search committee and finding our next great leader. I am proud of the thorough, professional, fair process we conducted, and I'm proud of the choice we made: Jim Bonham will be a great leader.

Jim has run campaigns. He has experience winning. He has led staffs. He has worked for ESOP champions in Congress. He has been a lobbyist. He knows how Washington works, and he knows lots of people in town after 25 years in a variety of DC positions.

I also like that he originally comes from my favorite state: Wyoming. He wants to work in a mission-based organization, and he's quite taken with our vision statement.

Early in the succession process, I heard people say, "How can we find someone to replace Michael? Could one person do all the things Michael does?"

In many ways, Michael will be a hard act to follow. I have every confidence that Jim Bonham can do it. What better compliment could we give Michael Keeling than to bring in a leader who can take The ESOP Association and the ESOP movement to even greater heights?

A legacy doesn't do much good if people don't come along afterwards and build upon it. That sounds kind of like ESOP-lingo, doesn't it?

Since the first time I heard Michael speak, I have been a fan. I am amazed at how he can deliver a speech, cast a spell on his audience, and tell stories that will be remembered—holding nothing more than a yellow post-it note to remind him of what he wants to say.

Perhaps I love working with Michael because he reminds me of my favorite uncle, in some way I can't quite explain, or maybe because we're both history buffs. Many in our community have had the pleasure of experiencing Michael's lessons in leadership on the Gettysburg Battlefield. I remember the first time I went on that tour. On the way I asked Michael for some advice, since I was just about to take over as president of the New England chapter. His response came fast, and intensely. He said: "Members are the lifeblood of The Association."

Sometimes at the end of a great career, people coast into retirement. Not president Keeling. Michael has been 100 percent, on the job, dedicated to retaining members and protecting ESOPs. When it comes to Michael, "I could go on, and on, and on." Have you heard that one before? Classic Michael Keeling phrase right there.

During his career, Michael worked with 20 chairs of The ESOP Association. As the last in that line, I'm very drawn to the notion that Michael Keeling has earned our highest respect and deserves a hero's send-off for all that he has done for us during his long tenure. I'm getting wordy because "thank you" seems too simple, when I'd really just like to convey a wealth of gratitude and offer the highest praise I can. Yet I think a simple "thank you" does that well.

On behalf of the staff, volunteers, and members, THANK YOU, MICHAEL. Job well done!

On my own behalf, I want you to know I loved working with you, Michael.

So, not only do you get a new president, you also get a new chair. My friend, Gary Shorman is the president and CEO of Eagle Communications in Hays, Kansas. He is a dynamic, gifted, seasoned leader, and if anyone can follow in the footsteps of the guy who gave the speech of his lifetime in a heart suit, it is Gary. His service as your chair really started with his vice chair initiative, which was leading the search committee. Gary is fired up, he's ready to go, and I'm excited to see where Gary's leadership takes us. As your new "past chair" I look forward to assisting Gary any way I can.

I want you to know it has been my pleasure, and the honor of my lifetime to serve as chair of *your* ESOP Association. ☺



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## Publication Highlight

### ESOP Accounting Standards

It's almost Tax Season! This booklet is your guide to SOP 93-6. Inside this publication you will gain insights on: Traditional Leveraged ESOP Rules, Two-Step Loans/Inside ESOP Loans/Mirror Loans, Current Liability, and ESOP Dividends.

**Members \$12.00 / Non-Members \$38.00**

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