



The Dangerous New World of Private Equity in ESOPs

Private Equity has awakened to what ESOPs have,
and want to change the rules so they can get it.



The Voice of The ESOP Association

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The International Employee Ownership Center
200 Massachusetts Avenue NW, Suite 410
Washington, DC 20001

Phone: (202) 293-2971 • Toll Free: (866) 366-3832 •

Fax: (202) 293-7568

E-mail: media@esopassociation.org

Website: <https://www.esopassociation.org>

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The Dangerous New World of Private Equity in ESOPs

Private Equity has awakened to what ESOPs have, and want to change the rules so they can get it.

By: The ESOP Association Board of Directors



For the first time, The ESOP Association (TEA) is publishing an important special edition of The ESOP Report focused on a rapidly growing threat to the future of Employee Stock Ownership Plans as we know them: Private equity firms are seeking a new legal definition of an ESOP, a new structure of tax benefits only they can receive, and broad exemptions from five decades of employee protections embedded in the Employee Retirement Income Security Act of 1974 (ERISA).

Why are they doing this? If all you see is their public relations campaign, it is about a newfound appreciation for sharing their investment returns with employees. But sober analysis of their public assertions and privately shared plans surfaces tremendous problems for the future of existing, and not yet formed, ESOP companies. **Continued pg. 4**

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A more reasonable explanation for private equity's motivation into ESOPs is much more obvious and aligns with their singular mission of maximizing investor returns: big federal tax breaks, improving a lousy public image and addressing a crisis in retaining and motivating employees at the firms they acquire. Bluntly, it is about the tax breaks and improved productivity they hope to achieve that would, in turn, generate better returns for investors.

Over the last year, The ESOP Association studied their stated “principles”, their privately shared policy proposals, and the effect they could have on our member companies, the taxpayer, and our future. As we continue to prepare to defend what works well about existing ESOPs, the time has come to share this work with you, our membership of ESOP companies, ESOP plan beneficiaries, and professionals.

Many very well-intentioned ESOP supporters are being called upon to support the private equity public relations campaign that is being advanced under the moniker “Expanding ESOPs”. A handful of high-profile professionals

within the ESOP community have welcomed, supported, and even endorsed that new effort. And now, they are actively recruiting clients and peers to sign up as well, even with very thin explanations and few details as to what they may be signing up to support. After all, who doesn't support expanding ESOPs?

Private equity firms are advancing this effort that is well-funded, professionally staffed, and will reach the point in the near future where it will confront every employee

owner, every ESOP company, and every ESOP professional.

TEA considers itself a steward of the good name and five decades worth of good policy that ESOPs have worked hard to build, the \$1.7 trillion in wealth they have

accumulated, and the nearly \$165 billion in annual plan distributions they make to employee owners. Often The ESOP Association is a promoter, cheerleader, or marketer for ESOPs – roles we relish. But now, it is our responsibility to take on the role of guardian, and not allow ourselves or our members to become inadvertently captured to another's agenda, especially if that agenda threatens to significantly change, redefine, or risk the highly successful policy structure for existing ESOPs in consequential ways. [E](#)

...analysis of their public assertions and privately shared plans surfaces tremendous problems for the future of existing, and not yet formed, ESOP companies

ESOP or Short Term Equity Plans (STEPs)?

The term “Broad Based Employee Ownership” is used as a catchphrase that captures the continuum along which many different forms of inclusive capitalism span. ESOPs have been the single most successful form of true employee ownership where individual employees hold a direct and irrevocable ownership interest in the equity (and its growth) of the business where they work. Other forms of employee ownership include cooperatives, and recently different types of Employee Ownership Trusts (some are calling them beneficial trusts).

The ideas advanced by Expanding ESOPs are not captured within any of these existing frameworks. They are something entirely new – they are intentionally short term and impermanent, they would be available only to institutional investors as a tool, they are not a retirement plan specifically, although it would appear the intention is to allow the proceeds from a payout to be placed into a tax preferred retirement fund. They are neither stock option plans, nor do they contain individual ownership accounts because their payout is a formula based upon compensation and tenure. The profits from the portion of the company “owned” by the account do not accrue to the account, they accrue to the investors. And any value eventually paid to the employee is derived entirely and directly from dollar-for-dollar tax breaks received by the investors. This is not a tool whereby the employees buy their ownership stake by accessing the future profits of the firm. The taxpayers are buying the employee stake by granting tax breaks to the investors.

All of these many reasons require a different name than an ESOP, because these proposed plans simply do not meet the definition of an ESOP any more than they meet the definition of a 401k. We believe the term “Short Term Equity Plan” or a STEP much more accurately captures the structure of these new ideas than an ESOP. Given the expected hold period of between 3 and 7 years for the vast majority of these types of arrangements, and the intent of generating an equity interest for employees through a direct tax reduction for the investor funds, and the limited percentage of the equity stake (minority, non-controlling), it seems far more appropriate than calling it an ESOP. [E](#)

Is Suspicion and Caution Justified?

Private Equity is Facing Unusual Challenges.

In recent years, some private equity firms have begun experimenting with loosely defined employee ownership or shared equity strategies to improve employee engagement at firms they purchase and to present a more socially responsible image. In these cases, the PE investors have stated they are sharing upside potential in the hope that it will catalyze higher productivity, more engagement, and stronger retention among their employees. What they don't highlight is that their primary goal remains the same: produce more rapid and better returns for the investors, even while factoring a very small initial dilution of investor equity.

In the few examples that private equity firms have shared publicly, they set aside a small portion of the target company's equity at the time of acquisition. It is never more than 10% but generally more in the 3 - 6% range.¹ The managers then inform their new employees that they, too, can potentially share in the upside of a future liquidation event alongside the investors. By creating this construct, the fund managers leverage the possibility of future employee bonuses to achieve their productivity improvement goals among the workforce.

This strategy alone isn't necessarily controversial, or novel. The concept of providing equity bonuses is routinely used to attract or retain senior executives and key employees, even if dilutive to investors. What is unique is that the equity compensation is being granted to common employees and not just executives. In this regard, The ESOP Association welcomes the possibility that private equity firms might recognize the value of sharing equity and the firm's upside growth with its employees. Unfortunately, this strategy also stretches the definition and boundaries of what constitutes employee ownership. It is formulated much more as a retention and productivity bonus than employee ownership.

But in the last 18 months, these private equity firms have now crossed an additional line and would like to brand



some of these experiments as ESOPs. Congress would need to significantly change federal law. These changes would create a new definition and structure for a new form of

Ultimately, these new and exclusive arrangements are specifically designed to be terminal. Meaning, the goal is to sell and terminate the plan, not create a multi-generational business owned by the employees through a trust in which they hold individual interests and can grow wealth.

what would be called an ESOP. Private equity investor funds would have exclusive access to this new model. The law would also introduce brand-new, highly lucrative tax breaks—again, only available to private equity funds. Ultimately, these new and exclusive arrangements are specifically designed to be terminal. Meaning, the goal is to sell and terminate the plan, not create a multi-generational business owned by the employees through a trust in

which they hold individual interests and can grow wealth.

Continued pg. 6

Continued from pg. 5 So, what is driving this newfound focus on sharing equity at private equity firms? To answer that question, it is important to appreciate the current state of private equity.

1. Average private equity hold periods (the length of time an investment firm owns a company before selling it) are the longest in history.

The impact of this is that investors who expected to see their principal and investment returns in a 3–5-year timeframe are now being forced to wait much longer, and they’re growing impatient. It also impacts the ability to raise new funds for future investing and for deployment of existing funds already on hand, known as “dry powder”.²

2. High turnover and employee engagement are major challenges for private equity firms, particularly given their well-earned reputation for slashing jobs and closing facilities without regard for the impact on people and communities.⁴

By “baking in” a retention bonus into their cost structure and labeling it as “employee ownership”, these PE firms can reduce their turnover and theoretically generate greater employee engagement and productivity. However, despite trying to associate themselves with decades of research on real ESOPs, there is no evidence to demonstrate that redefining a retention bonus as “employee ownership” or as an ESOP will result in the same societal benefit. In reality, these retention bonuses may amount to little more than golden handcuffs on employees who merely want to survive long enough to get a payday after the private equity investor liquidates their investment in the company.

3. Carried interest tax benefits are under threat.

In each of the most recent major tax bills in Congress, increasing scrutiny has been given to the lucrative “carried interest” tax breaks currently granted to PE investors. Even President Trump recently put the tax benefit into play by publicly questioning if it should be continued.³ Private equity firms have recognized it is in their interest to diversify their tax structure as a hedge against future erosion of the carried interest tax benefit.

4. Finally, private equity firms are working hard to rebrand themselves to blunt their highly negative public image.⁵

Their “employee ownership” strategies can reposition their image as inclusive, forward-thinking, and more socially responsible. They are putting on a masterclass in political and business rebranding. By leveraging hard-earned public and lawmaker support for ESOPs, an undeniable aim is to ‘equity-wash’ their reputation—using the language of fairness and inclusion to mask the continuation of extractive business practices. But this isn’t just a PR campaign; it’s a serious policy risk. Private equity is asking for hundreds of billions in taxpayer-funded subsidies to support their transactions, while trying to write their own narrow regulatory treatment to protect themselves. If these models gain traction under the ESOP banner, they could reshape regulatory treatment and threaten the bipartisan support and tax deferrals that ESOP structures rely upon.

The ESOP Association maintains that part of what private equity firms are doing is simply positioning themselves as partners in inclusive capitalism, even when their business practices remain extractive and harmful to the companies and the communities in which they operate. Private equity’s growing interest in ESOPs is not inherently bad, but their desire for taxpayers to directly fund their scheme and a wholesale redefinition of what it means to be an ESOP is fraught with risk for existing ESOP companies and the 14 million current ESOP plan beneficiaries.

The ESOP brand, built on decades of bipartisan support and trust, potentially becomes a shadow of its former self. Worse still, by allowing the conflation of actual ESOPs with this new private equity model, any notable failure would likely produce a cascade of policy reactions that could erase the modest but effective tax deferrals that sustain genuine employee ownership at real ESOPs. Finally, the policy bandwidth that will be consumed by these initiatives will likely swamp and drown out many other, more necessary and productive policy initiatives that could open employee ownership and ESOPs to millions of additional Americans. 

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Launched and Funded by Private Equity: Ownership Works and Expanding ESOPs

Pete Stavros, the Co-Head of Global Equity at KKR, one of the largest and most powerful private equity firms in the world, created, funded, and continues to lead both of these groups. While they are distinct organizations, and promote somewhat unique variations on shared equity, they frequently conflate some of the examples of success provided by Ownership Works with the agenda of Expanding ESOPs. They are also guilty of conflating the societal and individual benefit of current ESOPs with their entirely different form of equity compensation that they wish to label as an ESOP. And finally, the common leadership and funding further complicates discernment by the public and lawmakers between the two.

OWNERSHIP WORKS

Pete Stavros funded and launched Ownership Works in late 2021, then formally introduced it in April 2022. He created the group in part to influence public policy and encourage private equity firms to include employee equity in their business models. However, after a little more than a year, this group shifted its focus away from government intervention and has focused entirely on incubating and testing shared equity arrangements within private equity firms. Its stated goal is to generate \$20 billion in wealth for employees within 10 years. The ESOP Association takes no issue with this.



**Ownership
Works**

Think of it this way: current ESOPs will distribute more wealth before Christmas than Ownership Works hopes to create in a decade.

However, while that effort is certainly better than nothing, it is important to put that figure in context by understanding just how much wealth is already controlled by private equity investors and how little that \$20 billion over ten years represents. Private equity firms currently hold more than \$12 trillion in wealth and over a typical ten-year period realize an average 13.5% annualized rate of return – or as much as \$30 trillion in gains over the same 10 year period. That means, in its stated ten-year period, these experiments in shared equity will only account

for .066% -- less than seven one thousandths of their total investment returns. Another point of context is to compare the wealth that existing ESOPs are already generating and distributing. Current ESOPs already hold more than \$1.7 trillion in wealth and distribute more than \$13 billion in employee wealth every month. Think of it this way: current ESOPs will distribute more wealth before Christmas than Ownership Works hopes to create in a decade.

EXPANDING ESOPs

Organized in early 2024 and formally launched in late September 2024, this group was also created and funded by Pete Stavros of KKR. The organizers created this group with the stated intention of changing government policy around ESOPs. It is critically important to understand that despite its name, they are not seeking to “expand ESOPs” as they have been known and existed for the last five decades. Rather, their agenda is to create an entirely new kind of what they want to call an Employee Stock Ownership Plan under the Employee Retirement Income Security Act of 1974 (ERISA) as well as an entirely new structure of tax deductions and deferrals for which only private equity firms sponsoring the plans would be entitled. Additionally, they want to receive significant exemptions from ERISA and protections from employee beneficiaries to completely shield their valuation of shares and plan administration from oversight and litigation.

Initially, the group posted detailed policy proposals and shared them directly with The ESOP Association. But when they formally launched, they removed those details from their website. The leadership replaced the content with a significantly abbreviated version, presented to the public as ‘principles.’ The major tenets of their detailed policy agenda are subsumed in these principles and remain intact, even when filtered through their public principles. Those principles are discussed at length in other articles.

**Expanding
ESOPs**

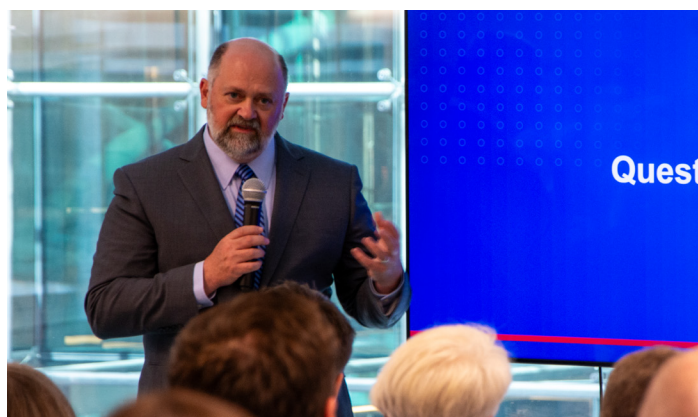
Protecting our Membership's Voice: Ask A Lot of Questions Before Jumping on the Private Equity Bandwagon

By: Jim Bonham, President & CEO, The ESOP Association

Nearly five decades ago, The ESOP Association was created to defend and grow Employee Stock Ownership Plans. Since that time, TEA has been the leading voice on public policy in Washington on behalf of ESOPs and continues to be the only comprehensive national association representing all ESOP companies, ESOP plan beneficiaries, and professional service providers.

Our membership includes nearly 3500 ESOP companies and professional service providers. But our most important constituency is the millions of employee owners who hold a stake in their employer through an ESOP. Our first and foremost obligation is to make sure they are protected, their ESOP does not become vulnerable as a result of changes in policy, and the legacy of our ESOP founders is preserved.

I have been asked by the supporters of “Expanding ESOPs” why I oppose their efforts. Let me respond. As with most policy discussions, there are always nuggets of common agreement about problems, but the challenge comes in finding solutions. Our leaders and I have carefully examined and evaluated what is being proposed by this group; consulted with outside experts in the finance, M & A, and retirement security fields; weighed what it means and could mean for our existing ESOPs and future public policy; and concluded that these proposed plans are neither ESOPs nor in the interest of our membership of ESOP companies and employee owners. The cleverly named “Expanding ESOPs” is taking significant liberties with what it means to be an ESOP, generating political and policy risk, and could eventually subsume the most successful form of Employee Ownership in the world - our ESOP companies.



I also want to be clear as well about the Expanding ESOPs plan. We anticipate the supporters of Expanding ESOPs to respond to this publication and our views with “That’s not our plan. We have something different now.” It’s a clever sidestep but takes advantage of the trusting character of our entire community. I would ask in return, “If your plans have changed from what you shared with us, and others around Washington, then what are the new plans? How are those new plans materially different in

their core parts? And why are you asking employee owners, ESOPs and professionals to sign up and endorse a plan that has not been subjected to public scrutiny?”

TEA considers itself a steward of the good name ESOPs have worked hard to build. We don’t view a system that is paying out more than \$160 billion in

wealth to employee owners each and every year as a failed or outdated system as Expanding ESOPs portrays on its website, videos, and in its communications. We don’t view the \$1.7 trillion in wealth currently held by ESOPs as a failure, or insubstantial. Are there improvements to be made, or changes to policy that could be adopted to revitalize the incentive system for ESOPs? Absolutely. But that does not justify the creation of something entirely new

...why are you asking employee owners, ESOPs and professionals to sign up and endorse a plan that has not been subjected to public scrutiny?”

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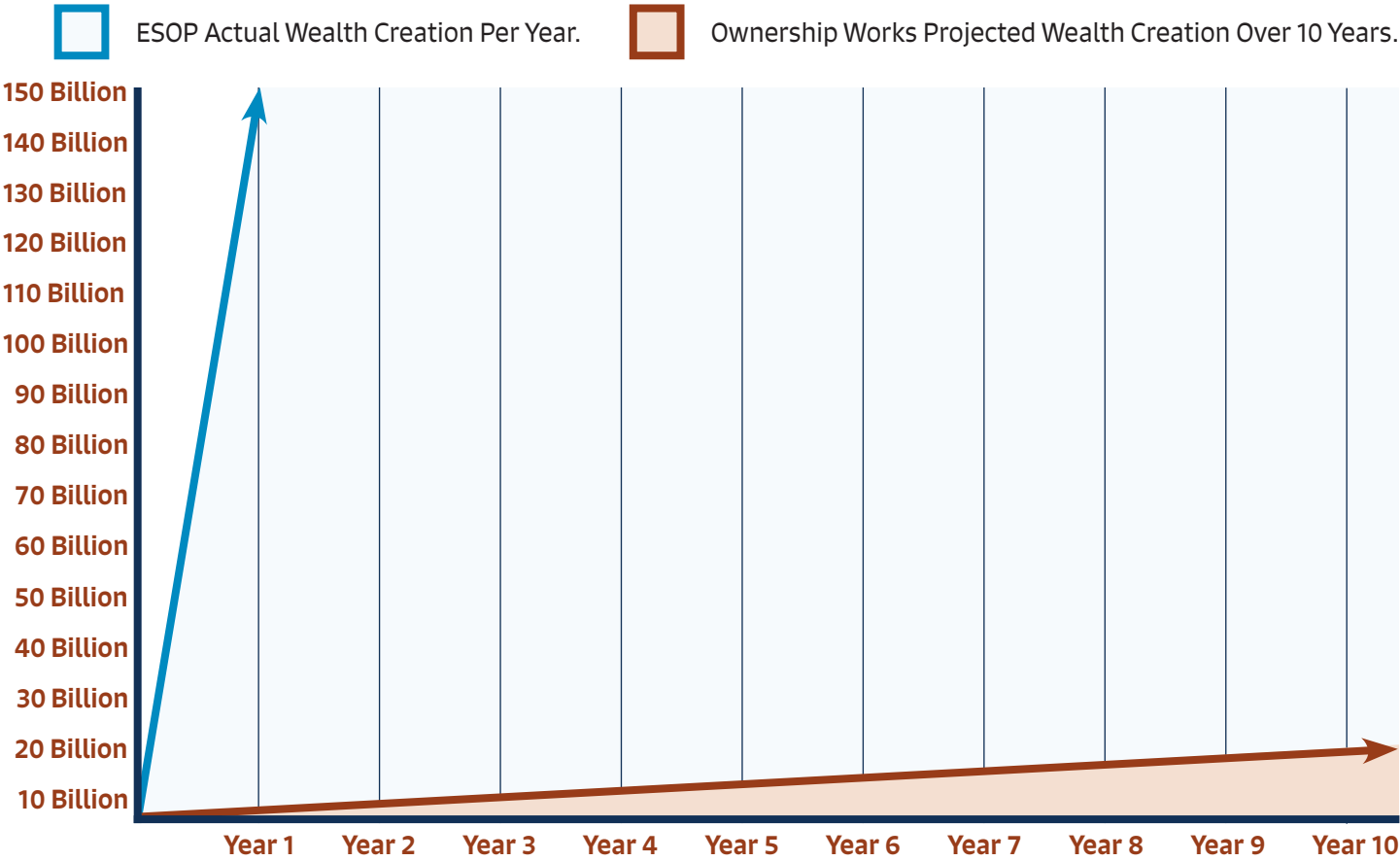
that would be available only to a super-class of wealthy investor firms and labeling it as an ESOP.

Within this publication, our readers will likely see the details and contrary analysis of these new “ESOP” proposals for the first time. It is troubling that the substantive effects or even the unintended consequences of these proposals have not been more widely considered. But, as the bandwagon effect seems to be gaining steam, the time has come to more forcefully protect our employee owners and the very fundamentals of what it means to be an ESOP in America.

“These proposed plans are neither ESOPs nor in the interest of our membership of ESOP companies and employee owners.”

We encourage anyone who may be asked to sign up in support of the group Expanding ESOPs to ask for their specific plans before agreeing to lend an endorsement. And if they can’t give you one, then what are they asking you to support? And if you are concerned, as we are, about the dangers to your ESOP, then ask their supporters what they are supporting. Ask what, exactly, do they want Congress to call an ESOP? Ask who gets what benefits, and what rules and employee protections will be waived? Ask what they will do if it proves, as we believe, to be a massive risk to our existing form of ESOP. €

Ownership Works has a goal to create “\$20 billion in wealth in 10 years” through an entity that is not real employee ownership, while ESOPs have created \$26 billion dollars in irrevocable wealth in just two months.



Sources
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Ownership Works Projected Wealth Creation - based on Ownership Work’s goal: <https://ownershipworks.org/our-impact/>

Expanding ESOPs' Core Principles

Members of the ESOP community have read the brief principles that Expanding ESOPs promotes on its website. A lot of faith and trust is being placed on those 120 words. It may seem exciting at best and harmless at worst. Unfortunately, they do not tell the full story.

01

ALIGN OR "CREATE NEW"?

Align tax incentives as to be suitable for partial ESOPs.

"PARTIAL" = WHAT PERCENTAGE?

WHICH ONES? WHAT COST? FOR WHOM?

02

*SAFE-HARBOR FROM
WHO? EMPLOYEES.*

Offer safe-harbor guidelines in situations where there's a market-based valuation-check to ensure that workers in new ESOPs are treated fairly and to avoid undue litigation risk.

*PRIVATE EQUITY OFTEN
DOESN'T PAY MARKET!*

*SO ELIMINATE EMPLOYEE
RIGHTS UNDER ERISA?*

03

Give disproportionate ESOP benefits to front-line workers (as opposed to highly-compensated executives).

*SOUNDS TOO GOOD... WHAT ARE THEY
GIVING THE EXECUTIVES ON THE SIDE?*

WHAT IS "THE SPIRIT"?

SOUNDS LIKE WEASEL-WORDS...

- REAL OWNERSHIP?
- TRANSPARENCY?
- COMPANY LONGEVITY?
- PROTECTION FOR EMPLOYEE OWNERS?

04

Protect the spirit of the ESOP by assuring workers receive meaningful value in situations where companies utilize tax incentives.

AGAIN, WHICH ONES?

NOT THE SAME AS FAIR MARKET VALUE.

05

Provide the ESOP at no cost to the employees, and ensure that the ESOP is not the sole retirement plan for workers.

YOU MEAN "THE SPIRIT" OF AN ESOP?

IN CONFLICT: A RETIREMENT PLAN
BUT ALSO PENALTY-FREE
ACCESS TO FUNDS EARLY?!

06

Allow workers to access a portion of their ESOP value before retirement* without penalty.

SOUNDS MORE LIKE AN
ANNUAL CASH-OUT BONUS

*ESOPS WERE INSTITUTED TO CREATE
RETIREMENT SECURITY - THAT IS WHY
THEY GET TAX DEFERRALS.

07

Maintain the current structure and benefits that have been highly effective for existing ESOPs (particularly 100% ESOPs).

IF SO, WHY NOT USE THE EXISTING? WHY DIVIDE THEM?
DON'T REDEFINE WHAT'S WORKING.

PUT A DIFFERENT WAY: CREATE OUR OWN
STRUCTURE AND CALL IT AN ESOP, TOO!

A Deeper Dive: Comparing the Expanding ESOPs Principles vs. The Short Term Equity Plan (STEP) Proposal

Pete Stavros, founder of Expanding ESOPs, shared with The ESOP Association a much more detailed public policy proposal with the ultimate aim not to promote ESOPs as we know them today, but to convince Congress to create a new type of qualified retirement plan under the Employee Retirement Income Security Act of 1974 (ERISA) and to call them ESOPs. These plans would only be available to institutional private equity investor funds.

Under this plan, when a private equity firm buys a company, 10% of the equity would be granted to employees, funded by taxpayers via a doubling of its payroll tax deduction, while the firm receives legal immunity pertaining to valuing the price of shares to be bought or sold. The proposal calls this an “Electing C-Corp ESOP,” but it is not an ESOP. It is more accurately a Short Term Equity Plan (STEP). Whenever Expanding ESOPs references this new potential plan, The ESOP Association (TEA) will use the more accurate term: STEP. Below, TEA explains and analyzes how the detailed STEP proposal would implement each Expanding ESOPs principle.

Expanding ESOPs Principle #1:

“Align tax incentives as to be suitable for partial [STEP]s.”

STEP Proposal:

- When a private equity firm buys a company, the firm would establish a STEP into which 10% of the company’s fully diluted common shares would be placed.
- The initial value of this pool would be zero. It would only accrue value based on the level of tax savings that the private equity firm receives through a doubling of its payroll tax deduction.
- The tax benefits the investor receives are limited only by time and profit - 5 years, with carryover – and could therefore substantially exceed any investor dilution resulting from the initial grant. This benefit would be applied after all other tax benefits the firm would be eligible for have been applied and would carry over in the event the firm did not produce enough profits in any given year to make full use. This carryover would likely transfer to a new buyer in a sale.
- The investor would also become eligible for a lucrative new 1042 tax deferral under some conditions.

TEA Analysis:

It is true that as Congress reduced corporate and capital gains taxes over the last three decades, the existing tax incentives encouraging partial ESOP formation have lost a lot of their punch. This newsletter covers this issue in depth on page 19. TEA agrees with Expanding ESOPs that Congress should explore ways to restore the initial value of these eroded tax benefits to better incentivize partial ESOP creation. However, the contemplated tax incentives are grossly disproportionate and appear to be designed more as a tax avoidance system for institutional investment funds rather than a simple incentive system for an employee equity bonus plan. Further, there is no reason to exempt trustees from their fiduciary duties under ERISA to better align the tax incentives.

Another key differentiator is that the STEP proposal avoids using future earnings from the employee-owned portion of the firm to finance the employees’ equity. This transaction is key to employee ownership. Instead, the STEP proposal uses taxpayer funding in the form of dollar-for-dollar tax deductions to pay the investor. It is functionally a redistributive tax policy – taxpayers buy the full value of the employee stake while all the profits of the firm continue to benefit the investors. This arrangement would create a massive boost to free cash flows, all at the disposal and use of the investor.

Finally, existing tax codes incentivize C-corps to sell at least 30% of their equity to their employees. This meaningful share of ownership is a major contributing catalyst for the ESOP culture of empowering employees, improving business success and contributing to local communities.¹ There is no evidence to suggest that a 10% equity stake in a company would contribute these same benefits.

Expanding ESOPs Principle #2:

“Offer safe-harbor guidelines in situations where there’s a market-based valuation-check to ensure that workers in new [STEP]s are treated fairly and to avoid undue litigation risk.”

STEP Proposal:

- STEP’s would be immune from United States Department of Labor and employee litigation.

TEA Analysis:

It is not an unreasonable principle to want clear guidance in cases of genuine arms-length acquisition transactions involving substantial third-party investment. However, blanket immunity from trustee oversight of decisions that materially affect share value, or the price to be paid for the employee shares before or at firm liquidation, leaves employees naked without any protection. Remember, there are limitless ways the investors can protect themselves, particularly with the decision-making authority they hold and the massive free-cash flow that would be generated by the desired tax benefits. Private equity firms have demonstrated extreme talent at returning high value to themselves, even while driving a company into bankruptcy, or breaking it apart to sell off the pieces.

Imagine if a STEP plan had been in place at Red Lobster or Toys R' Us when the private equity funds made decisions that drove those companies into bankruptcy, and then sold off their parts. This type of general immunity would obviate any authority or responsibility of the trustee to protect the employee interest in transactions.

The term "safe harbor" is contrary to an ESOP fiduciary's responsibility to employees. The answer to "undue litigation risk" is not to protect a specific type of transaction, it is to provide clear guidance for all transactions, including those where there is a true arm's length transaction with a third party. TEA has worked for decades to secure an adequate consideration rule that protects all ESOPs, employees and fiduciaries. TEA is on the cusp of achieving that goal and will continue to vigorously advocate for it moving forward.

Expanding ESOP Principle #3:

"Give disproportionate [STEP] benefits to front-line workers (as opposed to highly-compensated executives)."

STEP Proposal:

- The proposal creates TWO pools of equity, both 10% of the company's initial shares – one for top executives and one for all the remaining employees who make no more than \$150,000 per year.

TEA Analysis:

The STEP plan doesn't really follow its own principle here because the 10% equity for front-line employees is matched with an equal amount of equity set aside for highly compensated employees in a different account. It is a bit disingenuous to say all the benefits go to "front-line" workers, when the top earners are given their own, equal, account that gets divided among a much smaller pool of employees.

Functionally, all this does is create an equity compensation plan for average workers that runs in parallel to the equity plan created for top executives. The equity

plan for executives has full value on day one. The equity plan for employees has zero value on day one and only gains value as the tax deductions for the investment firm pile up.

Expanding ESOP Principle #4:

"Protect the spirit of the ESOP by assuring workers receive meaningful value in situations where companies utilize tax incentives."

STEP Proposal:

- The proposal is missing many essential elements of what it means under current law to qualify as an ESOP.
- The "spirit of the ESOP" is not "meaningful" value; it is fair market value as determined in good faith by the trustee.

TEA Analysis:

There would be no need to protect the "spirit of the ESOP" if the plan were an actual ESOP. Imagine for a moment, if ESOP employee owners were told upon retirement that the company would provide them with a "meaningful value" for their shares rather than the actual fair market value of those shares.

ESOPs are legally defined and must meet the standards for qualified retirement plans under ERISA to be eligible for the associated tax benefits designed to incentivize them:

- Vesting schedules that, when met, create irrevocable and known rights to ownership
- Transparent ownership allocation system
- Annual ownership valuation that must be defended by the trustee
- Required payout when leaving the company at any time, for any reason, but with penalty unless rolled into another retirement account
- Individual Capital Accounts (ICAs) where shares accumulate and appreciate, and new allocations are made
- Requirement that the trustee must ensure that fair market value is being paid for shares bought OR sold
- Trustee with governance authority (can overrule management) and a fiduciary duty of loyalty and prudence to the plan beneficiaries

These crucial protections provide the public policy substructure that enables the public good that flows from ESOPs as demonstrated by careful research over 50 years of experience.² ESOP companies empower and invest in workers by training them and involving them in company decisions at much higher rates than businesses with traditional ownership structures. ESOPs not only increase worker satisfaction; they reduce wage and wealth inequality as well.

Employee-owned businesses experience higher productivity, lower turnover, and greater long-term sustainability. Studies show that ESOP-owned companies are more resilient in economic downturns and provide their employees with significantly higher retirement savings than their non-employee-owned counterparts. ESOPs keep businesses rooted in their communities and prevent job loss due to business closures or out-of-state acquisitions. There is no evidence that Expanding ESOPs' plan would provide these same advantages.

The STEP proposal provides no mechanism, oversight, or contract to enforce this principle. STEP employees get nothing if the following situations occur:

- The private equity firm fires the employee for any reason
- The employee retires before the private equity firm sells the company
- The employee dies before the private equity firm sells the company
- The private equity firm fails to meet its pre-determined profit targets

The most likely scenario is that employees only get the bonus if they remain employed on the date the investors exit the company and have achieved their financial goals. That is not the “spirit of the ESOP.”

Expanding ESOPs Principle #5

“Provide the [STEP] at no cost to the employees and ensure that the [STEP] is not the sole retirement plan for workers.”

STEP Proposal:

- Employers must offer a 401(k) plan with a 50% match up to 6% of an employee's annual compensation.

TEA Analysis:

TEA applauds Expanding ESOPs for including this provision. 401(k) plans are a valuable tool to diversify retirement portfolios. That's why 75% of ESOPs also provide 401(k) plans!²

But, this seems to be a hedge (acknowledgement?) that the STEP plan may very well produce zero value for the employees. It begs the question: if there is zero value for the employees at the end of the investment, should the PE firm be required to pay back all the tax breaks?

Expanding ESOPs Principle #6:

“Allow workers to access a portion of their [STEP] value before retirement without penalty.”

STEP Proposal:

With approval from the company's board of directors, employees can sell up to 20% of its vested shares to the company annually with no excise tax.

TEA Analysis:

This principle and its explanation in the STEP proposal exemplify a stark difference between ESOPs and STEPs: STEPs are a bonus; ESOPs are a qualified retirement plan.

The public policy goal of ESOPs is to improve retirement income security for plan participants. Full stop. The only reason it is in the public interest to provide tax incentives for qualified retirement plans such as ESOPs, 401K plans, 457b plans, and other qualified plans is because they build retirement savings.

If every employee can sell back 20% of their “shares” each year, without penalty, the plan is functionally converted into an annual bonus. Management could announce a “buy back” each year, set a price, and wait for the employees to come streaming in. Because there is no tax penalty for early withdrawal from the retirement plan, our view is that the vast majority of employees would simply take the cash as an annual supplement to their income. Furthermore, because Expanding ESOPs' STEP plan caps each employee at no more than \$75,000 in equity allocation, it is likely each employee will be able to sell all shares within even a short hold period for the company by the investment fund.

Management would desire, even encourage, these buybacks, because it would immediately increase the underlying value of the other 90% of shares they already own. It would also be completely corrosive to, and prevent, any ownership culture as the employees routinely divest themselves of any company interest.

Every existing retirement plan, including ESOPs, has tax incentives to encourage workers to save until retirement age because Congress recognizes the societal benefit of retirees having financial security. Retirement is when the most significant ESOP benefits affect employee owners. Employee owners 60-64 years old, have 10 times greater wealth than their non-employee owner peers on average.³ That is the life-changing impact of true employee ownership when they need it most. Allowing workers to sell their equity shares every year with no excise tax is likely to eliminate this benefit. Instead of building for retirement, workers are incentivized to sell their shares annually as a bonus to buy a car, pay down debt, or spend it on any other typical expense. These expenses may be important at the moment, but they are not retirement security.

Expanding ESOP Principle #7:

“Maintain the current structure and benefits that have been highly effective for existing ESOPs (particularly 100% ESOPs).”

STEP Proposal:

- The proposal offers no changes to existing ESOP laws.

TEA Analysis:

This is supposedly the “do no harm” principle.

It is true that the STEP proposal creates an entirely new kind of plan that is distinct from ESOPs. Yet, by labeling these new creations ESOPs, the proponents are inherently violating this principle by placing existing plans at tremendous risk due to the massive new tax expenditure that would be lumped together with existing ESOP plans.

However, the proposal ignores the enormous market distortion that this plan would create. Why should Congress reserve the immense tax incentives and legal immunity described above only for private equity? If an individual or company buys a C-Corp business and wanted to install a STEP plan, they would be denied and be ineligible for any of the lucrative tax benefits. With incentives this lucrative, nearly every deal that the 19,000 private equity firms close

could incorporate it. The STEP proposal would not change existing ESOPs; it would eclipse them.

Closing

TEA agrees with some of the issues Expanding ESOPs highlights in its principles. However, the detailed STEP policy proposal is the wrong solution if the true goal is employee ownership and building retirement wealth for employee owners. Fortunately, nothing in federal law prevents private equity firms from providing their employees with equity in their companies. Many firms already share equity with employees without any new subsidies or changes in federal law. TEA enthusiastically encourages them to keep doing this important work. What TEA cannot support is rebranding STEPs as “ESOPs”, advocating for billions in new tax breaks, and securing special legal immunity. €

STEPS ≠ ESOPs

Expanding ESOPs STEP proposal does not provide the same worker protections and long-term benefits as real ESOPs regulated under ERISA.

Effects on Employees, Businesses, and Communities	STEP	ESOPs
Employee Protections		
Employees hold an irrevocable right to the known value in their individual capital account and its appreciation	✗	✓
Annual ownership allocation	✗	✓
Annual company valuation that is transparent and shared	✗	✓
Require a trustee to ensure that fair market value is paid for shares bought OR sold	✗	✓
Specific vesting schedules and requirements under law	✗	✓
Required payout regardless of reason for employee departure/separation	✗	✓
Trustee with governance authority (can over-rule management) and a fiduciary duty of loyalty and prudence to the plan beneficiaries	✗	✓
Transparency on the terms and conditions of payout	✗	✓
Company profits contribute to employee's ownership stake	✗	✓
Worker Benefits		
Greater retirement savings	?	✓
Employee/employer alignment	?	✓
Lower turnover	✓	✓
Local wealth retention	✗	✓
Creates local job security	✗	✓
Goal is to sell company	✓	✗
Maximum employee ownership	10%	100%

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Five Obvious Ways Private Equity Firms Could Abuse STEPs

Congress needs to consider public policy decisions with worst actors in mind, not the best.

The ESOP Association has admired the commitment to shared equity Pete Stavros has demonstrated through his PR efforts and the voluntary shared equity plans he has championed at his own firm. TEA will concede that were Pete Stavros the only private equity fund leader to try to implement a STEP plan, the likelihood for abuse might be low.

However, there are literally thousands of other private equity funds that have proven over and over that they will take every opportunity and create every possible loophole to make a buck. Just a few of these bad actors could create a cascade of negative media and the following policy recriminations against **all** ESOPs.

Below are five ways that quickly come to mind that show how bad actors could abuse the STEP (and we are not nearly as clever as these experts in finance and leverage).

1.



Slow Roll Allocations and/or Vesting

While the STEP pool may accrue value from tax benefits, a PE firm could choose not to allocate any of the shares held by the plan into individual employees accounts. That way, if employees leave for any reason before the sale, they have no allocation in which to become vested and get paid nothing. Employees are stuck wearing golden handcuffs, with no cost to the company for terminating or spinning off any employee or group of employees.

2.



Exit-Date Arbitrage or Spin-offs

The PE firm has total control over whether or not to lay off employees and spin-off divisions or subsidiaries. Because they set their own terms for how and when employee allocations are made within the plan, what is stopping a PE firm from laying off employees, shifting them to affiliate units, or restructuring the corporation to avoid giving them the STEP payout? Or simply using the STEP plan as an alternative to a severance payment by promising to "immediately vest" the terminated employee in a plan allocation in exchange for waiving their employment rights? An actual ESOP would prevent this type of behavior.

3.



Annual Undervaluation

If a board of directors decides to allow employees to sell their shares back to the company annually, how will they value those shares? The business has a strong incentive to undervalue its shares for early-selling employees. Since the STEP plan sponsor has received an exemption from ERISA oversight and litigation, nothing stops the company from undervaluations, or at a minimum severely “discounting” the minority shares when purchasing from the employees.

4.



Pay Themselves, Sell off the Assets

The STEP proposal specifies that the PE firm would need to pay off bank loans before paying employees their payout. That’s reasonable. But they can also pay themselves off, too. PE firms are also known to replace debt to themselves with additional astronomical levels of outside debt after the initial transaction. Often, they do this to repay their initial investment, to take on other acquisitions, or to shift tangible assets from one portfolio company to another. They are known for “equity stripping” where they sell off tangible assets to their other portfolio companies at a severe discount only to rent back those same assets at above market rates (this is what they did to Red Lobster, Toys R’ Us, and countless others). Sure, it drives the value of the company down, often into bankruptcy. But if they have already shifted anything of value to another business they own, paid themselves back with debt loaded onto the company, what happens when they can barely pay the bank? Employees get nothing, even though the investment firm got their tax cuts.

5.



Liquidation Event Flexibility

Finally, a likely scenario could unfold when preparing a firm for liquidation. Any buyer that wants a reduction in force could make terminations a requirement prior to closing the sale. Because company leadership has adopted a policy under a STEP with no individual vesting, any employees in that pre-close termination don’t need to be paid out. Those employees get laid off and leave with nothing, while the remaining employees get an extra bonus because the equity pool is spread among a smaller number. The surviving employees feel even better about their liquidation bonus.

The Budget Lab at Yale: Expanding ESOPs Plan Costs Taxpayers Nearly \$100BB Over First Ten Years; \$524BB More in Second Ten Years

[The Budget Lab at Yale](#) recently analyzed Expanding ESOPs' policy ideas and concluded they "would cost \$98.6 billion over the [first ten years or] 2026-2036 time-period." The analysis goes on further and concludes that as the proposal is "fully adopted and incorporated into business decisions" it would "cost[s] an additional \$524.8 billion" in the second ten years.

The Budget Lab at Yale is a non-partisan policy research center dedicated to providing in-depth analysis of federal policy proposals for the American economy. Pete Stavros, the founder and principal funder of Expanding ESOPs, provided his policy proposals to The ESOP Association (TEA), which then requested an independent analysis to evaluate them.

The Budget Lab at Yale utilized "conventional" estimates and employs very similar methodologies and assumptions as the Joint Committee on Taxation (JCT), which is the official arbiter of revenue loss or gain to the US Treasury for policy proposals.

"This is an extraordinarily high price tag for Congress to swallow, and validates one of our primary concerns, that the tax breaks being sought by private equity firms will swamp and jeopardize the existing structure of tax deferrals and deductions for our current ESOP companies," said Jim Bonham, President of The ESOP Association. "The analysis also validates that the proposed structures are entirely new and different from existing ESOP structures, thereby creating a new type of ESOP that would be lumped in with existing ESOPs for budget scoring purposes."

In the report, the analysts observe the "proposal significantly expands the tax benefits of ESOPs, specifically to larger companies." It goes on to note, "the proposal essentially creates a parallel system designed for larger companies and institutional capital markets."

This is an extraordinarily high price tag for Congress to swallow, and validates one of our primary concerns, that the tax breaks being sought by private equity firms will swamp and jeopardize the existing structure of tax deferrals and deductions for our current ESOP companies.



the budget lab

The report also discerns that within the first ten-year budget window, the classification of these new plans as "ESOPs" would raise the "per participant cost by roughly \$600 to almost \$1,000 per [plan] participant" functionally tripling the budget exposure for existing ESOPs.

"This would pose an existential threat to ESOPs, especially S-Corp ESOPs, in any future tax bill," Bonham continued. "To put that in context, just in the first ten-year window it would make ESOPs comparable to the deduction for student loan interest, combat pay for military personnel, and medical or dental expense deductions. In

the second ten-year window it would be nearly equivalent to the charitable contributions deduction, state and local tax deduction, and the Earned Income Tax Credit."

"Supporters of this initiative need to get sober real fast about the danger they are creating for ESOPs," Bonham said. "If existing ESOPs get thrown into the same federal tax bucket as these new plans

that aren't even ESOPs, we're married to them in all future tax bills. That is not in the interest of the membership of The ESOP Association." 

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Is It Really Just Awareness? Not Likely. Why Aren't There More ESOPs?



This question comes up frequently, both inside and outside of the ESOP community. The total number of ESOPs is stable, with about 200-250 created and a similar number terminated per year. High-profile campaigns from Ownership Works and Expanding ESOPs focus on the idea that ESOPs are good and we need more of them¹, but they also assert ESOP policies are broken because the number of ESOPs isn't growing (even though the number of employee owners is rapidly growing). Expanding ESOPs specifically has tried to identify some of the problems², but its proposed solution is to create a whole new type of plan with its own entirely new system of tax incentives that only private investment funds would be eligible to access and label as an ESOP.

Many well-intentioned members of the ESOP community have shown support for Expanding ESOPs (the organization) because they genuinely believe in employee ownership, and they really don't hold a preference about what form that ownership takes. However, the community should treat the conversation entirely differently when the approach to expanding the number of ESOPs is to invent something new and just slap the ESOP label on it.

Many people suggest a lack of awareness about ESOPs as a key reason why few companies form them. Expanding ESOPs cites a polling statistic of just 3% having heard about "broad-based employee ownership."³ However, with more than 14 million current plan participants, that alone represents more than 10% of all American households. A

More likely than a lack of awareness, there are three significant reasons that ESOP growth has slowed in the last two decades.

more accurate number comes from the Rutgers Institute for the Study of Employee Ownership and Profit Sharing, which says "67% of business respondents overall and 84% of respondents in companies with 50 or more employees were somewhat or very familiar with ESOPs."⁴ Or the 2024 study conducted by The ESOP Association (TEA) of more than 275 business owners that showed 2/3rds (68%) were likely to consider selling their business through an ESOP, which was on par with other exit strategy options.

TEA has pursued the goal of creating more ESOPs since 1978 and draws on decades of experience. More likely than a lack of awareness, there are three significant reasons that ESOP growth has slowed in the last two decades.

1. Dilution of ESOP Tax Incentives

Two separate long-term trends in tax policy have affected the value of the ESOP tax treatment. First, the 1042 benefit is half as valuable as it once was because capital gains taxes are half as much as they used to be. The primary tax incentive for business owners to sell their company to an ESOP is to take advantage of the IRS Section 1042 tax deferral, first established in 1984. This provision allows business owners to defer paying capital gains taxes on the proceeds of the sale if they meet certain conditions. When Congress raised the top effective capital gains tax rate to 28% in 1986, Section 1042 was a very enticing incentive for business owners to avoid a large tax bill. However, as Congress later decreased the capital gains rate to 20% in 1997 and then even further to 15% in 2003,

the incentive provided through Section 1042 decreased as well. Even among ESOP founders who are initially interested in the 1042 deferral, many ESOP professionals report that their clients ultimately choose not to take the deferral, choosing

instead to structure their deals to minimize tax exposure and then accept the comparably low tax payment of 15% (or lower) so they are not constrained at all in how they use the sale's proceeds.

In addition to the diminishing appeal of the 1042 deferral, a second factor has been the reduction in corporate tax rates, which has steadily reduced the relative advantages of forming a C-corporation ESOP. Expanding ESOPs claims that these changes make alternative

ownership and compensation structures more attractive in comparison. They aren't entirely wrong. C-corporation ESOPs remain a viable and often advantageous structure, particularly in cases where a partial ESOP is desired. For example, if a single family member wishes to exit a family-owned business while maintaining C-corporation status for strategic, liability, or tax reasons, a C-corporation ESOP can offer a flexible and tax-efficient solution. The existing tax incentives for ESOPs have eroded over time, perhaps deeply. Congress, considering its longstanding bipartisan support for ESOPs, should consider this factor in future tax legislation. But at what level should these tax benefits take effect? For decades 30% has been the point at which ESOP tax incentives are triggered, far above the 10% stake contemplated by private equity proposals. Why? Because at this level, the benefits of ownership become more widespread for employees.

2. Excessive Lawsuits, Audits, and Investigations

With both government and the plaintiff's bar looking over the shoulders of business owners and ESOP professionals, excessive litigation has become a significant deterrent to forming an ESOP. The Department of Labor (DOL) has engaged in a National Enforcement Project against ESOPs since 2005.⁵ The Employee Benefits Security Administration (EBSA) has disproportionately investigated ESOPs⁶, and EBSA has colluded with the plaintiff's bar through common interest agreements⁷. All of this has produced a "chilling effect" on ESOP formation, which was evidenced in the Pepperdine Cost of Capital survey from 2021⁸, which showed that business owners believe that government/DOL oversight is a reason to not choose an ESOP.

TEA's own research from 2024 with business owners again showed the chilling effect that out-of-control litigation has on ESOP formation. Among the quotes from the focus group of business owners were, "I have hesitation when I see Department of Labor" and "I deal with the DOL a lot, it can be very complex" and finally "If the government is responsible, that's a deterrent." In short, one business owner summed it up with "If I sell to the business next door, I don't have to deal with the DOL."

Again, Expanding ESOPs' assertion is correct that the regulatory and investigation environment created by the DOL is part of the problem holding back ESOPs⁹. Anyone following The ESOP Association's advocacy efforts over the past five years knows it is actively tackling this serious issue – delivering real progress and preparing for further action. Both Congress and the new administration are actively working, in a very bipartisan manner, to resolve this problem, once and for all.

But the problem isn't that Employee Retirement Income Security Act of 1974 (ERISA) has jurisdiction over

ESOPs – the problem is that the federal regulator has a longstanding, anti-ESOP bias and lack of constraint on its oversight. The solution is not creating new, narrowly targeted "safe harbors" for just certain stock incentive bonus plans (which are being marketed as ESOPs, but don't meet the established definition of one.) Rather, the solution is passing adequate consideration legislation and working with DOL to write proper regulations on this matter.

Setting up an ESOP can be both complex and costly, but the complexity and cost are in many ways being driven by the regulatory environment. TEA and government leaders in both political parties are actively working to fix that problem.

3. Competition

The competition to buy businesses has grown dramatically in the last two decades. This competition is driven almost entirely by the explosion in the number and size of private equity firms, which has risen from 12,000 in 2016 to over 19,000 today.¹⁰ Consider how a business owner decides between two options to sell their company: one to a PE firm, and one to their employees through an ESOP. The PE firm's offer is above market value because it manages portfolios of companies which can be joined or create synergistic opportunities. Plus, PE firms collectively hold record-high dry powder¹¹ and need to put those resources to better use and therefore can justify premiums for the businesses they buy. On the other hand, the ESOP can't offer above market value because it has a fiduciary duty to the employees not to overpay for the company. It's easy to see how a competitive market can drive PE firms to consistently outbid ESOPs, or anyone else.

It's appropriate to ask, "should private equity receive another tax incentive that even further advantages them in the market?" But it's undeniable that private equity has seen tremendous growth in its size and scope, and an increasing percentage of the economy is owned by private equity. [See our size of private equity piece on page 28] What's clear is that private equity is a direct competitor with ESOPs for the purchase of many businesses, regardless of the reason for the company's sale. With private equity already receiving favorable tax treatment, the "silver tsunami" – which should be a huge opportunity for ESOPs¹² – may get swamped by an even bigger wave, one fueled by private equity dollars and supported by taxpayers on an unlevel playing field that eclipses ESOPs entirely.

Like the litigation situation, TEA has been actively addressing access to capital issues for ESOPs¹³ with an alternative strategy. TEA's public policy efforts have included the American Ownership and Resiliency Act (AORA), a bicameral and bipartisan bill.¹⁴ AORA establishes a zero-subsidy investment facility within the U.S. Department of Commerce to enable licensed

private investment entities (called Ownership Investment Companies) to mobilize private capital for the purchase of privately held businesses transitioning to ESOP ownership. This approach would help address a critical financing gap in ESOP transactions, allowing business owners to sell their companies to their employees rather than selling outside of their communities, possibly to a foreign entity, or closing entirely. Incentives to create more equity capital might be directed to family office, institutional, and PE investors but should include protections for ESOPs to prevent equity investors from flipping companies, wresting control, or selling off assets. Protections for any debt or equity incentives scenarios should also include limits on cost of capital, returns on investment, and might be structured similarly to enterprise or opportunity funds. Instead of creating a whole new type of program only available to certain types of investors, AORA keeps what we know works (ESOPs), has a lower cost to the taxpayer, and has support in Congress.

Yes, TEA agrees that the nation needs more ESOPs. And yes, that means building awareness of them. But that's not the main reason for the lack of ESOPs. Rather, ESOP growth has been limited by certain key factors, mostly including the issues above, and TEA is working directly on resolving those issues. Could there be a positive aspect to private equity providing some financial incentive for workers? Perhaps "yes" to that too. But the focus should be fixing what's truly holding ESOPs back, not redefining ESOPs. €

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Not for lack
of awareness

84%

of respondents in
companies with 50
or more employees
were somewhat or
very familiar with
ESOPs

Tax incentives diminished

46%

decrease in the
capital gains
tax rate from
1986 to 2003

Business owners fear
excessive investigations

"I have hesitation when I
see Department of Labor"

Competition

58%

Increase in private
equity firms in
under a decade

We Cannot Call This "Employee Ownership"

Ian MacFarlane, President and CEO, EA Engineering, Science, and Technology, Inc., PBC

Ian MacFarlane is the president and CEO of EA Engineering, Science, and Technology, Inc., PBC, an environmental consulting firm. The firm is 100 percent owned by employees through an ESOP, and it is also a public benefit corporation, following a period of being publicly traded and then privately held since 2001. MacFarlane expressed concerns about the approach by private equity into the ESOP space in May of 2022, in an interview with [Fifty by Fifty](#).



Ian MacFarlane, President and CEO, EA Engineering, Science, and Technology, Inc., PBC

Back in 2022, when I was first approached by a colleague about the entrance of private equity into employee ownership, via the Ownership Works organization, I was admittedly skeptical. My concerns then were largely centered around the cultural clashes between private equity and employee ownership. Part of that clash was internal, as I described our company (not unlike many others) as a “living organism” and an “ecosystem”, a culture I feel is in sharp contrast to private equity. Part of that skepticism was also external, in that ESOPs are a very specific and regulated plan, which is also in contrast to the unregulated private equity industry.

Frankly, today my skepticism feels justified.

This movement from private equity has grown, producing media stories, supporters, and spawning another organization named “Expanding ESOPs.” Many in the ESOP community have found common cause with the PE firms promoting this effort, perhaps through a sincere belief that this new initiative is benign or even beneficial to growing the ranks of “employee ownership.” The Expanding ESOPs’ website is colorful and appealing, and its LinkedIn has posted testimonials from employee owners at 100% ESOP-owned companies. But what is Expanding ESOPs’ actual agenda? There is no

specific policy proposal on the website, but their first “Core Principle” is telling: tax incentives. My understanding is that the core of the Expanding ESOPs effort is tax credits for investors in return for giving a limited financial stake for employees, paid out if (and only if) the company is successfully sold to its next owner. The Core Principles indicate that these new entities should be largely exempt from Employee Retirement Income Security Act of 1974 (ERISA), which is what makes ESOPs retirement vehicles and protects employees.

To me, private equity is the antithesis of employee ownership. PE represents ownership by a few wealthy owners with a short-term investment horizon and very

little transparency. ESOPs are the exact opposite: they represent ownership by all rank-and-file employees together, with the long-term investment view and financial openness that results from being a retirement plan.

My closing question from 2022 remains, and restated here: “The PE money looking for a profitable home, the professional investors, they will likely do just fine, but at whose expense?” I believe that it’s clearer than ever these new proposals are a financial perk, not a commitment to real employee ownership. 

PE represents ownership by a few wealthy owners with a short-term investment horizon and very little transparency.

Equity-Washing: KKR, Ownership Works and The Polished New Face of Corporate Greed

Katie and Brian Boland published the article below on their blog, [Delta-Fund.org](https://delta-fund.org), on July 1, 2025. Reprinted with permission.

Author's Note: The inner workings of multi-billion-dollar private equity deals are, by design, confidential. The following analysis of the KKR-CHI Overhead Doors transaction is a reconstruction based on the few details that are public, combined with an understanding of standard, well-documented private equity and tax strategies. While we cannot know the exact structure of this specific deal, the model it represents is one being actively promoted. This post serves as a critique of that model, using the CHI deal as a powerful, illustrative example of how such transactions likely operate. The reason we chose the CHI Overhead Doors deal is that it is often held up as the best deal KKR has done— and importantly, the only one they have made a few details public.



Brian Boland, Co-founder Delta Fund



Equity-Washing: How Private Equity is Selling You a Story, Not a Stake

There's a new buzzword in the world of high finance, a slick marketing term designed to make you feel warm and fuzzy about private equity buyouts: "shared ownership." Spearheaded by giants like KKR and sanitized through non-profits like Ownership Works, it's a story of enlightened capitalists generously sharing the wealth with the hardworking masses. They host panels, publish glossy reports, and tout feel-good stories of factory workers receiving life-changing checks.

Don't be fooled. This isn't a revolution in worker empowerment. It's Equity-Washing

Equity-Washing is the cynical practice of using the language and aesthetics of employee ownership to boost a private equity firm's reputation, increase portfolio company valuations, and unlock massive tax breaks, all while stopping deliberately short of granting employees any real power or a truly equitable share of the wealth they create.

It's a performance of generosity, a masterclass in PR where the house—as always—wins.

It's a performance of generosity, a masterclass in PR where the house—as always—wins.

Consider two perspectives. First, a worker at CHI Overhead Doors who has spent 20 years on the factory floor, perfecting their craft, taking pride in the quality of the product, and seeing the company through good times and bad. To them, the company is a community and a legacy. Now, consider a private equity analyst in a New York skyscraper. To them, CHI is "the asset"—a line on a spreadsheet, a temporary holding to be financially engineered for maximum return over a 5-to-7-year period before being sold to the next owner. Equity-Washing is the tool used to align the motivations of the former to serve the financial interests of the latter.

The Predator in "Shared Ownership" Clothing

Before we go further, it's critical to understand the predator we're dealing with. Private equity is a multi-trillion-dollar industry of giant investment firms that buy up household-name companies—from pet stores to nursing homes to manufacturers like CHI. Their model is

simple and brutal: use massive amounts of debt loaded onto the company they're buying (a "leveraged buyout"), aggressively cut costs to boost short-term profits, and sell the company for a huge return a few years later.

According to the book [Bad Company](#), this model is so destructive that 20% of PE-owned companies go bankrupt within ten years—a rate ten times higher than their public counterparts. These astronomical profits are extracted on the backs of low-wage workers through mass layoffs and from average consumers through price hikes. Equity-Washing is simply the latest, most sophisticated PR campaign to put a friendly face on this fundamentally damaging business model.

What Real Ownership Looks Like (And Why We Fight For It)

Before we dissect the charade, let's be clear: we deeply believe in the transformative power of broad-based employee ownership when it's done right. The goal isn't just a slightly better version of the status quo. As a recent report from [Transform Finance](#) on [Alternative Ownership Enterprises](#) makes plain, genuine employee ownership is a powerful tool for systemic change. It's about creating an economy that is more resilient, equitable, and democratic. It directly addresses wealth gaps by building real assets for workers, it helps shift the balance of power from distant investors to the people and communities who create value, and it creates more stable, productive, and profitable businesses that are less likely to lay off workers in a downturn. That is the prize.

The problem arises when the language of this powerful movement is co-opted. KKR didn't invent "broad-based employee ownership"—the term and its principles were established over decades by advocates and practitioners like [Project Equity](#). What KKR and its non-profit partner Ownership Works are doing is redefining the term to suit their financial model. Ownership Works acts as the PR engine, a third-party sanitizer that gives a veneer of social good to what is fundamentally an extractive financial strategy, twisting a concept rooted in democratic governance and durable wealth-building into a marketing narrative for temporary, bonus-style payouts.

Let's dissect the poster child of this movement, KKR's sale of CHI Overhead Doors, to see how Equity-Washing works in the wild.

The Illusion of Ownership: A Bonus in Disguise

When KKR sold CHI for a staggering \$3 billion, it made headlines for distributing \$360 million to the company's

800 employees. But to understand this payout, you must first understand the performance. Under KKR's ownership, and fueled by the motivation of its new "employee-owners," CHI saw its revenue grow 120% organically and its EBITDA (a measure of profitability) increase by 3.5 times. Safety incidents fell by over 50%.

These are not just numbers on a page. They represent real operational gains driven by the workforce—the very people, many of whom had been at CHI for decades, who made the company so valuable. KKR, by contrast, was involved for a mere seven years. The people who created the long-term value received a short-term reward. The temporary owners kept the long-term wealth.

The total profit (the "upside") on the deal was roughly \$2.3 billion. That \$360 million payout to the employees who drove this transformation represents about **15.5% of the value they created**. Proponents of genuine employee ownership, like **Project Equity**, advocate for models where employees own a substantial and durable stake—at least **30% or more** of the company. And it is critical to remember that this is the **absolute best case private equity example** - in KKR's 2023 annual report they describe the financial benefits as "typically with opportunities to earn over six months' worth of salary."

Examining the data presented in the 2024 Annual Impact for Ownership Works, the \$570 million spread across 160,000 employee owners amounts to an average of \$3,562 per employee.

The people who created the long-term value received a short-term reward. The temporary owners kept the long-term wealth.

What KKR offered wasn't true ownership. It was a cash-out bonus, a one-time windfall entirely contingent on the private equity firm's decision to sell. Once KKR exits, so does the "ownership" model, leaving the workers with a nice check but no lasting power or stake in the company's future. As [Marjorie Kelly](#) says, "it's a step up on an escalator that's moving rapidly down."

The Magic of Leverage: How 10x Returns Happen

To understand the true disparity, you have to look at how private equity works. KKR bought CHI for \$685 million. A typical leveraged buyout (LBO) structure involves using a large amount of debt placed on the target company. Let's assume (based on reporting) KKR's acquisition was financed with 50% equity from their fund and 50% debt.

- **KKR's Equity:** ~\$342.5 million
- **Debt (placed on CHI):** ~\$342.5 million

True worker voice, as championed by organizations fighting for economic democracy, is about governance.

When CHI was sold for \$3 billion, KKR's initial ~\$343 million equity investment translated into a massive share of the ~\$2.3 billion profit, allowing them to boast of a **10x return on their equity** over just seven years. They used the company's own borrowing power (and the employees' labor which paid down that debt) to amplify their gains. The employees received no such amplified return.

The Myth of "Worker Voice": All Talk, No Power

A core tenet of the Equity-Washing playbook is the promotion of "worker voice." In practice, this means employee engagement surveys, suggestion boxes, and maybe a budget for a new breakroom. At CHI, workers were given a voice on things like getting air conditioning in the factory—basic improvements that any sensible management team would implement to boost morale and productivity.

This is not governance. This is a focus group.

True worker voice, as championed by organizations fighting for economic democracy, is about **governance**. It means:

- **Board Representation:** Workers having a seat at the table where strategic decisions are made.
- **Voting Rights:** Having a say in the company's direction, leadership, and major transactions.
- **Shared Control:** A democratic structure where power isn't concentrated solely in the hands of management and distant investors.

The KKR/Ownership Works model meticulously avoids any transfer of actual control. It's designed to make employees feel like owners so they act like owners, all without giving them the rights of an owner. They want the upside of an engaged workforce without the downside of ceding an ounce of power.

The Tax-Advantaged Playbook: A Tale of Two Tax Rates

The "generosity" of the employee payout is not a simple act; it's the final flourish on a multi-layered tax avoidance strategy. The playbook ensures that at every stage, the deal is subsidized by taxpayers and the benefits are maximized for the private equity firm and its partners.

Part 1: Corporate-Level Tax Breaks (How to Get Taxpayers to Subsidize Your Deal)

To understand how KKR minimizes its tax bill, think of CHI as a house. KKR is the buyer, and the employees are the family living in and maintaining the house, making it more valuable every year. The goal for KKR is to extract as much value as possible while paying as little tax as possible. Here's how the playbook works:

- **Layer 1: The First Mortgage (LBO Interest Shield).** When KKR buys the house, they don't use their own money for the full price. Instead, they force the *house itself* to take out a giant mortgage. For seven years, the employees' hard work goes toward paying down this mortgage. Crucially, the government sees the *interest* on this loan as a business expense, which reduces the house's taxable income year after year. It's a built-in tax break from day one.
- **Layer 2: The Second Mortgage (Dividend Recapitalization).** A few years later, after the employees have increased the house's value, KKR can force the house to take out a *second mortgage*—a "home equity loan." But instead of using the cash to fix the roof, the house gives all the money directly to KKR as a special dividend. KKR gets its money back early (avoiding real risk), while the employees are now left to maintain a house that has two mortgages. The interest on this second loan? Also tax-deductible, creating an even bigger tax shield for the company.
- **Layer 3: The Big "Maintenance" Bill (The Bonus Deduction).** When it's finally time to sell the house, KKR gives the employees their \$360 million payout. On the tax forms, this isn't a gift; it's recorded as a massive operating expense, like a last-minute, half-a-billion-dollar roof repair. This single deduction drastically slashes the taxable profit from the sale, generating a final, massive tax saving for the benefit of the seller, KKR.

Part 2: Personal-Level Tax Breaks (The Final Insult)

This is where the inequity becomes crystal clear. After using corporate deductions to shield billions in profit, the way those profits are taxed for the individuals involved tells the whole story.

- **Workers' Payout:** Taxed as ordinary income (**up to 37%**).
- **PE Partners' Profit:** Taxed as capital gains (**around 20%**).

The people who built the doors and drove the trucks pay the highest tax rate on their small share. The investors who bought the company with borrowed money pay a much lower rate on their massive share. It's a system designed to reward capital over labor at every turn.

The Full Taxpayer Subsidy: A Conservative Estimate

To truly understand the scale of the financial sleight-of-hand at the heart of Equity-Washing, you have to follow the money—specifically, the tax money that *isn't* paid. It's not one tax break that subsidizes the deal, but a cascade of them working together. Here's a conservative estimate of the full corporate-level taxpayer subsidy that benefits the private equity owners:

Tax Advantage	Description	Estimated Taxpayer Subsidy
LBO Interest Shield	Tax savings from deducting interest on the initial loan used to buy the company.	\$50M+
Dividend Recap Shield	Tax savings from deducting interest on a second loan used to pay a dividend to the PE firm.	\$20M+
Bonus Deduction Windfall	Tax savings from deducting the employee payout as a business expense at the time of sale.	\$90M
Total Potential Subsidy		\$160M+

This means a substantial portion of the already small 15.5% employee share wasn't a cost to the firm, but was effectively financed by the public.

The Two Paths: A Tale of Two Buyouts

The chasm between these two approaches is about more than just the percentage points on a spreadsheet. It's a fundamental difference in philosophy, power, and purpose. The Equity-Washing model treats employees as a temporary tool to boost returns, while a true ownership model sees them as long-term partners in building a durable, shared enterprise. The table below illustrates not just the financial differences, but the profound operational and philosophical gap between the two.

Feature	The KKR / "Equity-Washing" Way	A Baseline Real EO Way
Ownership Stake	~15.5% of the upside, structured as a one-time cash bonus.	30%+ of the company, held in a durable trust (like an ESOP).
Voice	"Worker voice" through engagement surveys and feedback.	Formal governance rights, including board representation.
Control	Remains entirely with the PE firm and its appointed managers.	Workers have a real say in the company's long-term direction.
Durability	Ownership ends when the PE firm sells the company.	Ownership is long-term, building wealth throughout an employee's career.
Primary Beneficiary	The private equity firm's investors and partners.	A true partnership between employees and investors.

An Alternative Vision: What Real Sharing Looks Like

To see just how much wealth was left on the table for workers, let's compare three scenarios for splitting the **~\$2.3B in profit** from the CHI deal. We'll look at KKR's Equity-Washing model; a true Real EO baseline model that genuinely rewards employees for the value they built; and a truly Visionary Partnership for a Real EO model that resets how we think about ownership. As you'll see, in every scenario, the private equity investors *still receive an outstanding return* on their initial **~\$343M** investment.

Model	Employee Share (% of Upside)	Employee Payout	KKR & Investor Share	KKR's Return on Equity
Ownership Stake The KKR "Equity-Washing" Model	15.5%	\$360M	\$1.96B	~5.7x
A Baseline EO Model	30%	~\$695M	\$1.62B	~4.7x
A Visionary 70/30 Partnership	70%	~\$1.62B	~\$695M	~2.0x

The numbers are clear: even in a visionary 70/30 partnership, KKR's investors would have still **doubled their money** in seven years—an outstanding return by any reasonable measure. But the difference in these models goes far beyond the payout amount. In the Baseline and Visionary scenarios, the wealth transferred to employees isn't just a one-time bonus; it's a **durable, lasting ownership stake**. This creates a permanent asset that benefits not only the current workers but future employees as well, building generational wealth and securing the company's legacy with its community. The choice not to pursue this path wasn't about financial necessity. It was a choice to hoard the wealth and offer a temporary, tax-subsidized payout with altruistic press from the media instead of real, lasting power.

Truly equitable models aren't just a thought project - people are building them today. Investment funds are proving that you can create durable, high-impact employee ownership that provides both excellent returns for investors and transformative wealth for workers. Funds like [Apis & Heritage](#), which focuses on converting companies with large workforces of color into 100% employee-owned businesses, and [Common Trust's Groundwork Fund](#), which uses a trust model to ensure permanent shared ownership, are pioneering these approaches. [Torana's Essential Owners Fund](#) is another key player, providing flexible capital to help frontline workers become owners. These efforts stand in stark contrast to the Equity-Washing model, proving that real, lasting, and meaningful employee ownership is not only possible, but a powerful investment strategy in its own right.

A Final Note: Tax Incentives are a Tool for Good, Not a Costume for Greed

Let's be unequivocally clear: this is not an argument against tax incentives for employee ownership. On the contrary, we are highly in favor of them. Public policies that encourage and subsidize the transition to genuine employee ownership are critical tools for building a more equitable economy. Many legitimate, broad-based, and democratically governed employee-owned companies use these tax advantages for their success—and that is a good thing.

The outrage is not that tax subsidies are used, but *how* and for *whom*. The critique is aimed squarely at financial engineers who dress up in employee ownership clothes to hijack these benefits. When incentives designed to empower workers are co-opted to simply enhance the returns of a temporary owner, while providing only a fleeting, non-governing, minority benefit to employees, it's a perversion of the policy's intent and an insult to taxpayers. We must champion the policies, but fiercely reject the charade.

How to Spot Equity-Washing: A Quick Guide

Private equity isn't a niche corner of finance anymore; it's a dominant force that now employs nearly 12 million Americans, controlling vast swaths of our economy. As this model continues its takeover of small and mid-sized businesses, we face a dual challenge: we must both build better, more equitable ownership models from the ground up, and simultaneously demand that private equity doesn't get to pillage our communities in the name of 'good'. We cannot let them get away with offering a small step up on a rapidly descending escalator. Holding them accountable starts with asking the right questions.

It's a system designed to reward capital over labor at every turn.

When you see a company touting "shared ownership," ask these three simple questions:

- **What is the stake?** Demand to know the employee-owned percentage of the total company or upside. A dollar amount without context is meaningless.
- **Is it durable?** Does the ownership last beyond the current owner's exit and provide financial and governance to future generations of employees, or is it just a one-time bonus?
- **Is there real governance?** Does "worker voice" include a seat on the board and real voting power, or is it just a suggestion box?

The Path Forward: Building Real Ownership

The good news is that we don't have to settle for the illusion. Across the country, an ecosystem of amazing organizations is building real, durable, and democratic employee ownership. The answers to the questions above will guide you to them. These are the groups creating the best outcomes for workers, which is more critical than ever in a society where wages have stagnated and benefits have eroded.

For investors, the call to action is clear: move your capital away from predatory PE models and toward the organizations doing the real work. Support the funds we've mentioned like **Apis & Heritage**, **Common Trust**, and **Torana**, and the community-based lenders and capital providers like [Seed Commons](#), [Shared Capital Cooperative](#), and the [Boston Impact Initiative](#). These are the groups building a healthier economic system that works for all. Choosing to invest in them is not just a financial decision; it's an empowering step toward the equitable future we all deserve. €

Facts About Private Equity

Private Equity's Explosive Growth

Private Equity (PE) is a Growing Force

The number of PE-backed U.S. companies increased from roughly 2,000 in 2000 to more than 11,500 in 2024. That's a 400% increase, as the number of publicly listed companies fell 35% in the same window. citizensbank.com



9,500 newly PE-backed companies in 20 years

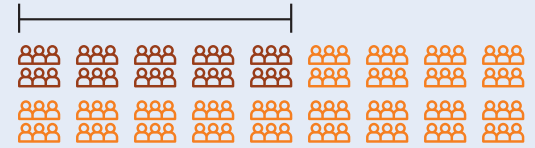
How does Private Equity Impact Workers?

Lost Jobs

Across industries, employment falls about 4.4 % within two years of a PE takeover. papers.ssrn.com

- In the retail sector, PE-driven bankruptcies and store closures have eliminated 597,000 jobs from 2009-2019, and when considering ripple effects at suppliers and local businesses, the toll reaches over 1.3 million total jobs lost. united4respect.org
- During that same period the overall retail industry *added* 1 million jobs, meaning PE-owned retailers bucked the trend by destroying jobs. united4respect.org

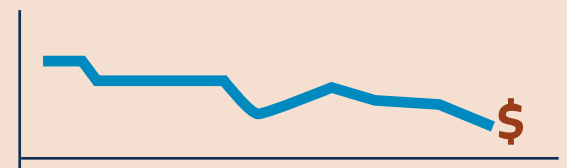
597,000 jobs eliminated due to PE-driven bankruptcies and store closures



Ripple effects have caused the total jobs lost to reach over 1.3 million

Lower Wages

- Overall worker earnings decline ~1.7% on average after a PE takeover. jec.senate.gov
- Those who do lose jobs tend to face steep pay cuts in their next roles: within three years, their wages drop about 18% on average versus similar workers who avoided a buyout. cepr.org



Overall workers earnings decline after a PE takeover

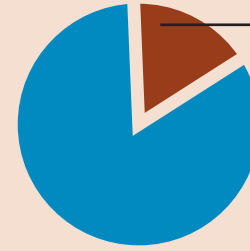
How Does Private Equity Impact Businesses?

Historically: More Companies Go Bankrupt

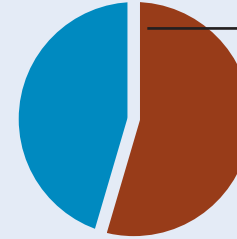
- PE-owned companies are 10x more likely to go bankrupt than non-PE-owned firms. blogs.cfainstitute.org
- ~20% of large companies acquired via Leveraged Buy Outs (LBOs) go bankrupt within 10 years, compared to 2% of similar non-PE firms. institutionalinvestor.com

Recently: Bankruptcies Are Increasing

- 110 PE or venture-backed companies filed for bankruptcy in 2024, a record high and a 15% jump from the prior year. By comparison, overall bankruptcies in the U.S. — everything but companies owned by private equity and venture capital (VC), reached 694, a year-over-year uptick of 9.3 percent. institutionalinvestor.com
- Private equity firms played a role in 56% (27 of 48 filings) of large U.S. corporate bankruptcies during 2024 (bankruptcies with liabilities of \$500 million or greater at the time of filing). pestakeholder.org
- Private equity-owned companies account for 11% (75 out of 697 filings) of all corporate bankruptcies in 2024, despite the fact that private equity accounts for 6.5% of the U.S. economy. pestakeholder.org
- PE/VC-backed firms accounted for 104 bankruptcies, or 16% of all U.S. corporate bankruptcies in 2023. 174% increase from the prior year. spglobal.com



About **20%** of large companies acquired via Leveraged Buy Outs go bankrupt within 10 years



PE firms played a role in **56%** of large U.S. corporate bankruptcies during 2024

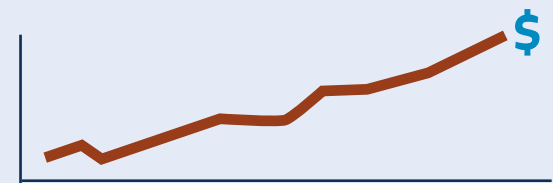
How Does Private Equity Impact Communities and the Broader Economy?

Higher Prices

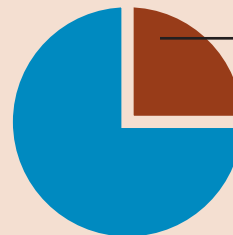
- In 2021 alone, investors carried out 786 private equity buyouts of food and beverage manufacturers (worth over \$31 billion). When interest rates rose in 2022–2023, many of these highly leveraged food companies saw higher debt costs and passed them on to consumers through price hikes. jec.senate.gov
- Research has linked increased grocery concentration to food price inflation as high as 20–50% in affected markets. jec.senate.gov
- The Consumer Price Index (CPI) for veterinary services rose 9.6 % year-over-year in March 2024, 3x more than inflation, now that nearly 30% of U.S. vet clinics are now owned by private equity. theatlantic.com

Worse Services

- Medicare patients treated in PE-owned hospitals experienced 25% more complications and paid 7–16% higher charges than comparable patients elsewhere. hsph.harvard.edu
- Researchers attributed roughly 20,000 premature deaths over a decade to subpar care in PE-owned nursing homes (relative to non-profit homes). jec.senate.gov



The cost of food and beverages and veterinary services have increased due to private equity buyouts



Medicare patients treated in PE-owned hospitals experienced **25%** more complications



The Next Frontier for Employee Ownership: Access to Capital Markets Through AORA

Richard C. May and Christopher Mackin, *American Working Capital*

Just over 50 years ago, the United States Congress passed the first law to encourage the introduction of Employee Stock Ownership Plans or ESOPs. As ESOPs proceed into the second half of their first century of practice, a promising new idea is under consideration that could help to both sustain and grow the ESOP marketplace to a new level of prominence. Introduced on a bi-partisan basis into the 119th Congress in May of 2025, the American Ownership and Resilience Act (AORA) would expand pools of investment capital necessary to grow the field while respecting the original intentions of the founders of ESOP legislation to create not ephemeral employee ownership but stable, long term employee ownership which broadens participation in business ownership and strengthens the American economy.

The Need and the Challenge

In today's economy, business owners sympathetic to the idea of selling their businesses to their employees face a practical dilemma. Because employees do not have the resources to acquire firms they work for, business owners have been forced to help consummate the sale of their own firms through the use of "seller notes." This practice of seller financing, most often undertaken in combination with conventional senior bank lending, has generally been positive. It is abundantly clear however that sellers facing a choice between full and efficient cash offers from deep-pocketed private equity and strategic buyers on the one hand and more complex internal sales that require sellers to maintain an at-risk relationship to the firm they are attempting to sell has put the ESOP alternative at a distinct disadvantage. The challenge this dilemma has long posed to the ESOP field has been how to secure institutional capital that can reduce or remove seller risk in order to create a level playing field for ESOP transactions to compete against the conventional private equity or strategic buyer alternatives.

AORA would extend this practice by providing federal loan guarantees to investment funds that would supply the missing high-risk capital to support both the creation and the recapitalization of existing majority ESOP owned companies.

AORA confronts this challenge by borrowing from a storied tradition of federal legislative initiatives that encourage private financial institutions to undertake worthwhile public policy goals not through the use of direct appropriations but instead through the practice of credit enhancement that reduces investor risk. Beginning with a desire to assist farmers in the 19th century and extending to first-time home owners and small business people and exporters in the 20th century, the strategy of enlisting the "full faith and credit" of the federal government through loan guarantees to reduce risk has provided successful incentives to private financial institutions to achieve outsized results for the American taxpayer.

AORA would extend this practice by providing federal loan guarantees to investment funds that would supply the missing high-risk capital to support both the creation and the recapitalization of existing majority ESOP owned companies. Access to this capital through loan guarantees will enhance the visibility and relevance of the ESOP alternative, enabling it to join in the list of more conventional mergers & acquisition techniques business owners learn about when they decide to sell.

How AORA Would Work

AORA would extend direct credit enhancement to both existing investment groups and newly created investment entities specializing in ESOP transactions. These investment funds would raise private investment capital from limited partners that would be matched on a 1:1 basis. With that private capital in hand, groups would apply to the United States Department of Commerce to receive an Ownership Investment Company (OIC) license. AORA would authorize \$5 Billion-dollars of federal credit on an annual basis to apply to OIC funds. However, this would not be an appropriation—the program is required to operate at zero subsidy cost to the taxpayer. Qualified individual OIC funds could make use of up to \$500M of low-cost debentures issued by the Commerce Department (matched dollar-for-dollar with privately raised institutional capital) that they must deploy over a 10-year period.

OIC investments would focus upon growth capital in existing ESOPs as well as “de-novo” S Corporation ESOP transactions that result in majority ESOP owned firms. OIC funds would be subject to conventional investment risk. OIC funds will attract the investment community due to the existence of a low-cost leverage that enhances their returns. AORA enabled ESOP transactions will be structured on a majority employee ownership basis. Most transactions are likely to take full advantage of tax favored S Corporation ESOP status as 100% ESOP companies. OIC funds will receive their returns from ESOP companies through a combination of debt, synthetic equity, or preferred equity. The “spread” between the credit enhanced cash received by OIC funds and the rate at which those funds are deployed will generate the return for their investors while also allowing the timely repayment of debentures to the federal government.

As has been the case for a range of federal credit enhancement initiatives administered over decades by the Department of Agriculture, the Federal Housing Administration and the U.S. Export-Import Bank, the launching of AORA authorized Ownership Investment Companies overseen by the Department of Commerce will not appreciably contribute to the federal deficit or bureaucratic apparatus. The expected positive return of principal and interest on debentures issued by Department of Commerce for OIC’s “pays for” the OIC program and is designed to make money for the federal government. Credit enhancement programs such as these also make use of the

expertise of qualified professionals operating in the private market. Private OIC fund managers will be in a “first-loss” position in administering their funds and will therefore be incentivized to make prudent investments. The government would not be in the position of picking winners and losers.

The arrival through AORA of much needed capital to grow the ESOP market should not sacrifice fiduciary and corporate governance protections that established ESOP regulations provide. AORA has been drafted to include those standards and to insist upon best practices including requirements for independent trustees and fairness, event protection for participants, and strict prohibitions on employees paying out of pocket for shares either directly or through retirement plan rollovers.

Conclusion

Should AORA be adopted by Congress, an entirely new dimension of capital provider will be added to the ESOP marketplace. The arrival of the Taxpayer Relief Act of 1997 enabling S Corporation ESOP structures to own 100% of company stock introduced the idea of ESOPs as full-fledged control buyers of firms. That development moved the ESOP field closer to the ranks of conventional mergers and acquisition (M&A) practices but also starkly exposed the limitations of financing options that could grow the ESOP idea. Seller financing has proven functional but not attractive to the wide marketplace of business owners wishing to efficiently sell their firms with a minimum of personal risk. As a result, ESOP growth has stagnated.

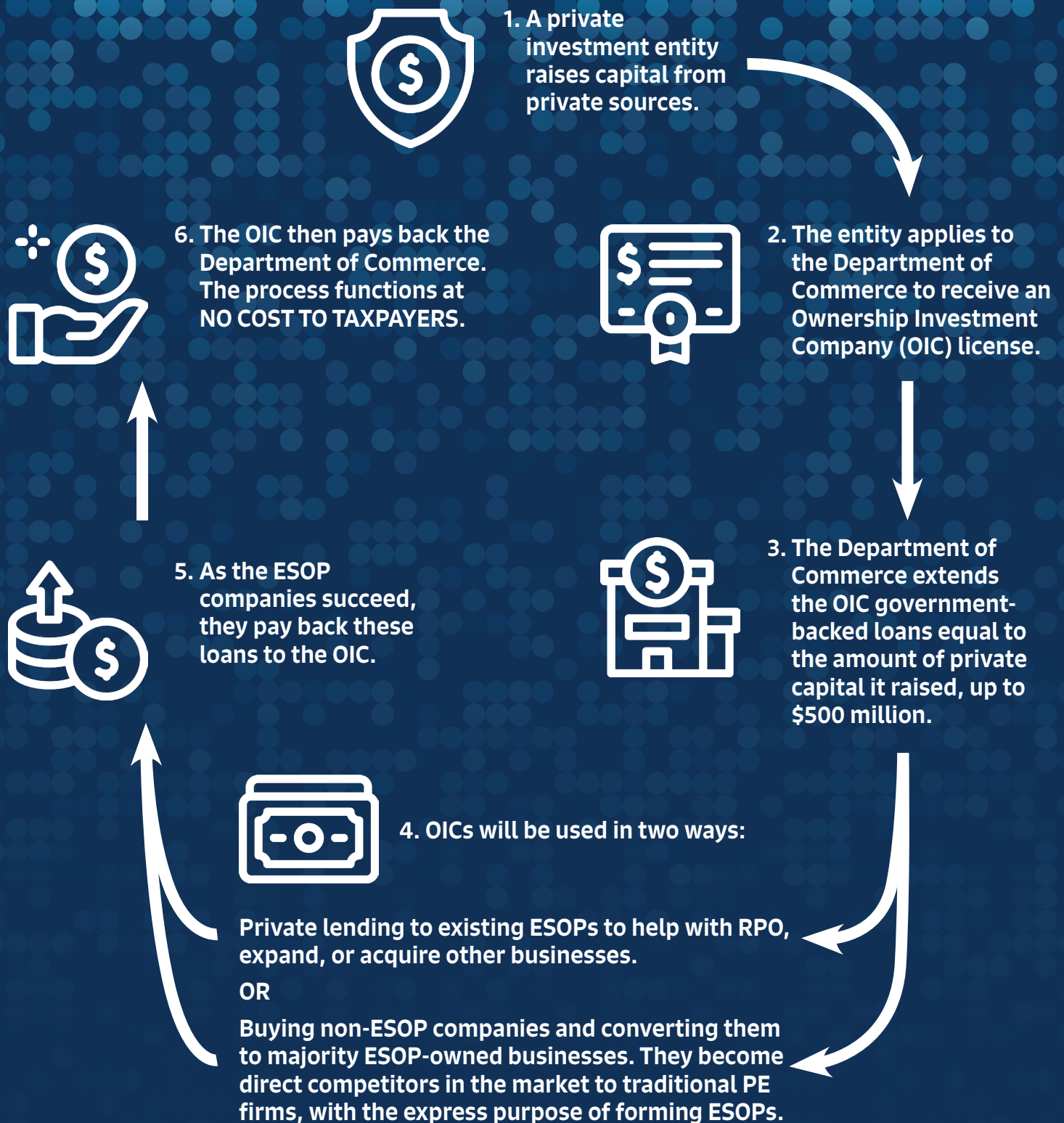
AORA promises to open the ESOP field to a broader and deeper pool of capital sources that can supplement the seller financing option. ESOPs will be able to move from their existing status as a not well known “sell-side” option initiated by sellers and their advisors who have become aware of the ESOP alternative to that of a “buy-side” option on the part of well capitalized and

entrepreneurial funds motivated to seek out and engineer efficient corporate transactions that enable every employee to own a stake in the businesses in which they work.

Because of the credit enhancement feature that reduces their risk, fund managers and investors can be expected to be drawn to this novel approach to the mergers and acquisitions market. Business owners inclined to prefer an internal ESOP sale in order to reward the employees who helped them succeed can expect offers from OIC funds that are fully price competitive and equally efficient to private equity or strategic buyers. €

Should the American Ownership and Resilience Act (AORA) be adopted by Congress, an entirely new dimension of capital provider will be added to the ESOP marketplace.

How AORA Would Work



An Existential Danger to ESOPs

People and organizations nationwide and policymakers from both political parties admire ESOPs for their distinct identity and positive impact. They are built on longevity, transparency, and ownership. While an ESOP company can certainly go out of business or transition to a traditional ownership structure, the ultimate goal of an ESOP company is for employees to carry on the culture, success, and legacy of the business in its community. As the company's stock price grows and the number of employees increases, the benefits of the ESOP grow along with it, rewarding the workers and promoting retirement savings. Congress has consistently supported ESOPs because of these societal benefits. Therefore, no one should be allowed to co-opt ESOPs with a new plan that offers neither permanence nor long-term benefits nor actual ownership.

To emphasize TEA's stance on the efforts by private equity firms to promote their equity-sharing programs: the Association does not oppose private equity firms granting or sharing equity with their employees. Their ongoing effort to share the upside of a transaction with their employees is laudable. However, this proposed new structure is absolutely not an ESOP and should not be labelled as such. In fact, any plan to provide costly private equity tax breaks and exemption from core ERISA worker protections is an existential danger to ESOPs, and one TEA must oppose.

Why? There are several reasons.

1. Redefines ESOPs

The Expanding ESOPs plan (STEPS) proposes a new, special, protected qualified retirement plan labelled an ESOP. But this new plan carries none of the hallmarks of ESOPs – ownership, transparency, longevity, or protections for workers. It is inferior for workers and mostly benefits investors. Calling an apple an orange doesn't make it so.

2. Crowds out ESOPs

Business owners face the choice of selling to their employees and inviting DOL oversight, or selling to private equity, possibly for a premium, without government involvement. If Congress grants private equity huge tax incentives and “safe harbor” immunity from regulations

designed to protect employees, why would any future business owner sell to an ESOP? Every PE firm would use this generously subsidized and legally protected model. Over time, this model would subsume the ESOP market, ironically, in the name of “ESOPs.”

3. PE Failures Jeopardize ESOPs

Not all private equity investments end with successful, profitable businesses anchored in their communities. A large percentage of PE-backed companies cut jobs or even declare bankruptcy. The ESOP community should not allow Congress and the public to conflate the failures, layoffs, and closures of a separate and distinct model with ESOPs, which successfully protect workers and keep jobs in communities.

4. ESOPs Blamed When PE Promises Don't Pan Out

Expanding ESOPs is selling a model to Congress and workers as an “ESOP” with “ownership.” Neither term is accurate. An ESOP's promises are contractual, real, and irrevocable – not so for STEPs. When workers get laid off or depart, when profits don't hit their target, or when the numbers just

don't pencil out, workers will be shortchanged and likely resentful. The current positive reputation of ESOPs and pride in being an owner will evaporate.

5. Current ESOP Tax Treatment Joined to Private Equity

Allowing the new STEP proposal to be called ESOPs joins the two of them together for future tax policy debates. It's understandable why PE wants to connect to ESOPs, but should the ESOP community connect its future to PE? If current ESOP tax provisions are lumped in with those of Expanding ESOPs, then Congress will “score” them together, making ESOPs very “expensive” in the eyes of policymakers. There's a saying that, “Pigs get fat, while hogs get slaughtered.” Expanding ESOPs proposals will place a distinct target on ESOPs' backs in future tax legislation. ESOPs face little danger from Congress in this regard today, so inviting controversy is a mistake.

In fact, any plan to provide costly private equity tax breaks and exemption from core ERISA worker protections is an existential danger to ESOPs, and one TEA must oppose.

6. Jeopardizes the Bipartisan Political Support for ESOPs

For decades, ESOPs have built bipartisan support, cherished by the ESOP community, and which has been positive for employee ownership. Yet PE has been a lightning rod for several reasons. ESOP Champions on both sides of the political aisle will shift positions when private equity deals are rebranded as “ESOPs”.

7. Expanding ESOPs Jeopardizes Other ESOP Issues

ESOPs have seen extraordinary public policy gains over the past year. The ESOP community is on the precipice of landmark changes designed to spark growth for ESOPs. Key personnel in the President’s Cabinet and sub-Cabinet positions are clear supporters of ESOPs, and they reached those positions with bipartisan support. The tax and regulatory proposal by Expanding ESOPs jeopardizes those gains, whether it passes or not. When legislators see a divided community supporting multiple proposals, they typically respond by doing nothing. A unified community with a unified voice is the most effective strategy. This debate, which could last several years, jeopardizes:

- The American Ownership Resiliency Act (AORA), which incentivizes private capital to finance ESOPs, will become more difficult to pass.
- The Employee Ownership Fairness Act, addressing section 404 and 415 limits for employee owners, could be viewed as too costly when combined with PE tax breaks.
- Litigation reform, critical to growing ESOPs, would be complicated by the pursuit of narrow “safe harbors” for a preferred investor class called “ESOPs.”

Expanding ESOP’s public support is largely based on a high-priced public relations campaign, coupled with a stealth lobbying campaign, all resting on just 120 words of carefully crafted principles. The ESOP Association’s members have generated real momentum for removing the existing regulatory roadblocks to ESOP formation, including bipartisan and bicameral support for legislation to bring private capital to the table to support ESOP growth. This is what support for creating more ESOPs should look like.

ESOPs have always been about properly balancing capitalism with values, as evidenced through the widespread treatment of employee owners. Removing the “values” side of this equation leaves it unbalanced. No one should be able to buy or force a redefinition of what makes ESOPs special. [E](#)

Here’s the inescapable conclusion about Expanding ESOPs plans:

They don’t create, protect, or benefit employee owners like ESOPs.

They lack decades of independent research proving their multiple benefits like ESOPs.

They are not retirement plans like ESOPs.

They are not a finance mechanism, as Kelso and Senator Long designed, like ESOPs.

They do not preserve a founder’s legacy or provide long-term succession, like ESOPs.

Simply put, STEP’s should not be called or call themselves ESOPs. Therefore –

They should not trade on research or decades of bipartisan goodwill built up by ESOPs.

They should not receive massive taxpayer incentives in the name of ESOPs.

And they should not pursue special legal immunity (aka a “safe harbor”) as ESOPs.

STEPs are not ESOPs.



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