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## Bipartisan, pro-ESOP bill H.R. 4837 introduced in the House

Source: *esca.us*

A new bipartisan bill designed to promote employee ownership was introduced in the House of Representatives on June 11. The Promotion and Expansion of Private Employee Ownership Act of 2014 (H.R. 4837) will make it easier for companies to implement ESOPs, which is especially important today as nearly half of American workers do not have retirement accounts.

The S corporation ESOP structure was meant to encourage and expand the retirement savings for workers in private companies, and this bill will eliminate some barriers that business owners currently face when establishing a new S corporation ESOP or when expanding employee-ownership stake in an S corporation.

Some provisions in the bill are measures that will:

- Enable owners of S corporations to sell their stock to an ESOP
- Encourage the flow of bank capital to ESOP-owned S corporations
- Provide needed technical assistance for companies that may be interested in forming an S corporation ESOP
- Ensure that small businesses that become ESOPs retain their SBA certification
- Affirm the importance of preserving the S corporation ESOP structure in the Internal Revenue Code

There are a total of 11 cosponsors for H.R. 4837 from both sides of the aisle, showing a broad base of interest in securing the ability for Americans to participate in employee ownership and to increase their retirement funds.

H.R. 4837 is the companion bill to S.742, which was introduced in the Senate in 2013. The only difference between the bills is that the House bill would allow banks to deduct 50% of the interest income received on loans made to an ESOP or S corporation sponsoring an ESOP to purchase S corporation stock for the ESOP. ■

## DOL delays fiduciary rule again, but appraisers already affected

Sources: American Society of Appraisers (ASA) and *online.wsj.com*

In 2010, the DOL proposed regulation that would make ESOP plan appraisers fiduciaries under ERISA. Although the DOL withdrew its proposal, it has promised to reissue it several times, and is on track to introduce the idea again in January 2015. Any regulation that makes ESOP appraisers ERISA fiduciaries will cause confusion as to whether the appraiser, the trustee(s), or other current fiduciaries make the decisions about the acquisition of shares on behalf of employees.

Additionally, current tax law requires ESOP appraisers to be independent, while the DOL proposal would require appraisers to act solely in the best interest of the ESOP participants. The two criteria are clearly at odds, causing a conflict of interest. Such a change would leave ESOP companies open to more lawsuits.

*The Wall Street Journal* reports that over the last few years, the DOL has been increasing its scrutiny of ESOP plans, which provide a crucial source of retirement savings for millions of American workers. The DOL is plaintiff in 15 lawsuits concerning ESOPs; nearly all of them allege poor estimates of company shares. Since October 2009, the department has doubled the number of lawsuits filed in the prior 6 years.

According to the ASA, the DOL's main concerns are:

- ESOP advisors not investigating the credibility and reliability of companies' projections.
- Advisors being retained by a company to conduct a feasibility study and then retained by a trustee to prepare a proposal could be seen as having conflicting roles.
- Parties that sell stock to an ESOP at a control price without transferring sufficient control to the ESOP
- Interest rates obtained in ESOP transaction seller financing that are discounted to below face value
- Inconsistencies within valuation reports

Appraisers are taking it upon themselves to improve their practices in ways to counteract these perceived problems. ESI is continuously reviewing and incorporating best practices. ■

# U.S. Supreme Court rules on “presumption of prudence”

Source: [nceo.org](http://nceo.org)



At the end of 2013, we brought to your attention an important case that would be heard before the Supreme Court this year. The issue

under review had to do with the “presumption of prudence,” in which an ERISA plan fiduciary is allowed the benefit of the doubt that he or she acted in the best interest of plan participants by allowing them to invest in their own company’s private stock. Precedence was set for this issue in the 1995 case *Moench v Robertson*, and the presumption of prudence has been upheld in seven circuit courts.

The Supreme Court ruling, which came down on June 25, 2014, overturned the presumption of prudence and stated that, “the law does not create a special presumption favoring ESOP fiduciaries. Rather, the same standard of prudence applies to all ERISA fiduciaries, including ESOP fiduciaries, except that an ESOP fiduciary is under no duty to diversify the ESOP’s holdings.”

However, the presumption was replaced with a pleading requirement in which plaintiffs must demonstrate that the fiduciary acted imprudently by making a plausible case that either:

1. There were special circumstances requiring fiduciaries to recognize on the basis of public information that the market was over or undervaluing the stock, or
2. Based on nonpublic information, the fiduciaries should have taken an alternative action that would not violate securities laws and would not do more harm than good.

Fiduciaries may not sell off stock based on nonpublic information they are aware of as that would amount to insider trading.

The Court reiterated Congress’ support of employee ownership through ESOPs, and stated that its decision is to clarify a standard for ESOP lawsuits that can be better accomplished through “careful, context-sensitive scrutiny of a complaint’s allegations.”

The NCEO states that this ruling appears to have been made with public companies in mind, and is unlikely to have too great an effect on privately held businesses.

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For ESOPs in closely held companies, fiduciaries have few options that could form the basis for plaintiffs arguing a plausible, alternative action. Laws already governing ESOPs and their fiduciaries make the Court’s ruling unlikely to increase the number of suits filed against closely held ESOPs

Long-term effects on public ESOPs will largely be determined by decisions and interpretations made by the lower courts. ■

## Get to know our team

Nicola Giordano

Financial analyst Christopher Kraft joined the ESI team in March 2014. Chris holds a Bachelor of Arts degree in Finance from Western Michigan University—Kalamazoo, and brings with him an extensive background in operational, inventory, and data management in the retail industry. Additionally,



Christopher Kraft

his e-commerce and merchandising experience at several large, public companies has allowed him to build strong financial, analytical, and reporting skills.

*“Chris’ work experience and cross functional exposure has provided a solid foundation of business success. His attention to detail, critical thinking skills, and enthusiasm are key elements of his success at ESI. As a valuation analyst, he is able to apply his skills from both a qualitative and quantitative perspective, working with both numbers and people. Chris’s engaging personality is one of his many strengths, and we look forward to you meeting him soon.”*

—Sandra Paavola, COO, Vice President, Principal

Chris likes working with ESI as a valuation analyst because it allows him the opportunity to understand the stories behind the numbers. He has already had the opportunity to communicate with a number of our clients, and enjoys interacting with the diverse industry sectors that they represent. ■

**“Good business leaders create a vision, articulate the vision, passionately own the vision, and relentlessly drive it to completion.”**  
~Jack Welch