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Introducing the ESOP

(Not legal advice — For educational purposes only)

1. Why sell to an ESOP?

(a) An ESOP can only own stock with a combination of greatest voting and equity rights. (ESOP cannot own nonvoting stock.)

(b) An ESOP can own any percentage of stock.

(c) Opportunity for selling shareholder of C Corporation to defer capital gains if ESOP purchases at least 30% of the Company's stock.

(d) Studies show ESOP companies with strong ownership cultures grow faster, are more productive and have lower turnover than non-ESOP companies. Requires commitment of management to create the underlying ownership culture.

2. How does the ESOP buy stock?

(a) The buyer is the ESOP Trust, which is represented by an independent trustee.

(b) ESOP Trust typically borrows money from the Company to purchase the shares from the sellers, or gives the seller a promissory note.

(c) The ESOP Trust is a third party (although friendly) buyer.

(d) The ESOP Trustee will not run the business — management stays in place.

3. What happens after the ESOP buys the stock?

(a) Employees do not own the stock — ESOP Trustee is the sole legal owner, and votes the shares of stock at all regular shareholder meetings. Pass-through voting is only required for extraordinary corporate events.

(b) If the ESOP borrows money to purchase the stock, employees do not receive all stock purchased by the ESOP Trust on day one. The ESOP Trust will hold the stock in a suspense account because the shares are the collateral for the ESOP's loan.

(c) Each year, the ESOP Trustee sets the value of the stock based on advice from an independent appraiser.

(d) As the Company makes annual contributions to provide benefits to employees, the ESOP Trustee uses those contributions to repay the loan.

(e) The ESOP Trustee then "releases" a corresponding number of shares of stock from the suspense account, which are allocated to eligible participants.

4. How are ESOP benefits provided?

(a) The employer defines eligibility for participation and allocation of benefits.

(b) Employees can be required to remain employed for a specified period of time to vest in their benefit (three year cliff or six year graded schedule).

(c) Special rules allow for delayed distributions so as to manage repurchase liability for the shares of stock.

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