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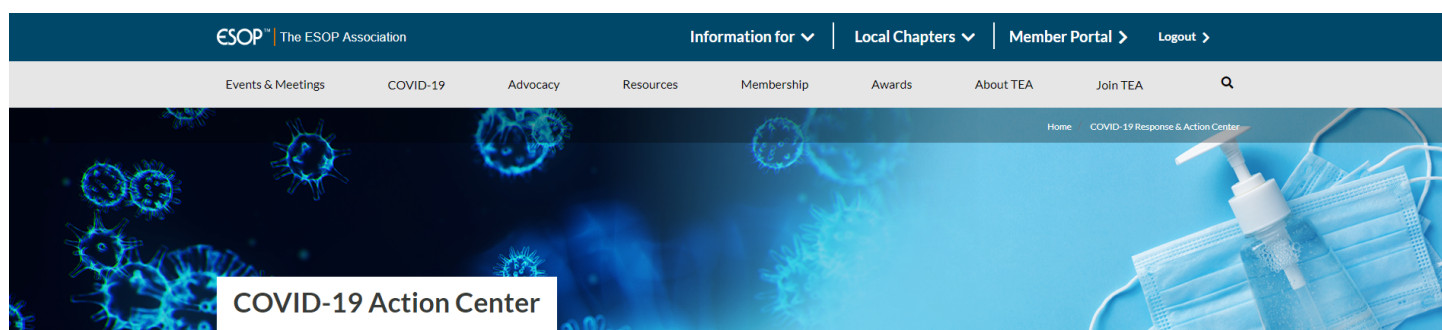
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Come here to get the help you need. The ESOP Association has created this clearinghouse of resources to help your ESOP weather the COVID-19 pandemic, collaborate and learn strategies under use across the ESOP Community, and guide you to the resources your business will need to survive and thrive.

## New COVID-19 Action Center Helps Members Cope with Crisis

Center Provides Webinars, News Alerts, and More, All Tailored to Helping ESOP Companies Adapt to the COVID-19 Pandemic

**E**SOP companies are facing a uniquely challenging environment today, but a new slate of well-timed, one-of-a-kind benefits ensure you won't have to face those challenges alone.

In the past two weeks, The ESOP Association has launched a series of new benefits designed to provide ESOP companies with the insights and information they need to push through the COVID-19 crisis and arrive safely on the other side.

TEA's staff has been working overtime to produce the [COVID-19 Action Center](#), a new online resource that features a wealth of new tools and data.

### Webinars

The COVID-19 Action Center offers a new series of [webinars](#) featuring information and insights from the experts on our

*Initial reaction to these webinars has been fantastic, with more than 2,000 members registering for the first week's programs.*

six Advisory Committees. This information is specifically tailored to the immediate needs of ESOP companies facing the COVID-19 crisis.

Initial reaction to these webinars has been fantastic, with more than 2,000 members registering for the first week's programs.

The initial round includes 20 webinars on extremely timely topics, such as pandemic valuations, overcoming cash flow challenges, managing distributions when cash is tight, the role of business leaders and boards in a crisis, and engaging employee owners who are now working remotely.

Content for all these webinars is vetted and developed by the expert volunteers serving on The ESOP Association's six Advisory Committees: Valuation, Finance, Legal & Regulatory, Administration, Fiduciary Issues, and Ownership Culture.

More webinars will be added soon. (See the box below for a list of upcoming webinars; click the name of each webinar to be taken to our [website](#) and see full the description of each event and new additions to the slate of webinars.)

Upcoming TEA Webinars		
Date	Time	Topic
April 6	1:00 PM EDT	<a href="#">Cyber Security for a Larger Remote Workforce</a>
April 7	1:00 PM EDT	<a href="#">Qualifying and Applying for the SBA's Coronavirus Relief Programs</a> <b>Just Added!</b>
April 8	1:00 PM EDT	<a href="#">Engaging a Remote Workforce</a>
April 10	1:00 PM EDT	<a href="#">The Leaders' Role in a Crisis</a>
April 13	1:00 PM EDT	<a href="#">Dealing with ESOP Distributions When Cash Is Tight</a>
April 15	1:00 PM EDT	<a href="#">How Boards Should Help Manage Crises</a>
April 17	1:00 PM EDT	<a href="#">Establishing New Workplace Norms in a Crisis</a>
April 20	1:00 PM EDT	<a href="#">How the Pandemic Might Affect Repurchase Obligations</a>
April 22	1:00 PM EDT	<a href="#">Tap Your ESOP Committee During a Crisis</a>
April 24	1:00 PM EDT	<a href="#">Pandemic Impacts on Executive Compensation</a>

All webinars are offered for free to members of The ESOP Association. For your convenience, you can watch webinars

live and ask questions of the speakers and panelists, or view the recorded versions at a later date.

Please note that registration for all webinars ends 90 minutes prior to the start of the event. This deadline helps



provide the smoothest possible experience for all attendees, ensuring that all registrants receive an e-mail with a link to the event one hour before it starts, and that registrants have adequate time to set up their systems so they do not miss the start of the program.

These webinars are made possible by major funding from the Employee Ownership Foundation, and the generous support of our sponsors.

ESOP | Report

*The Voice of The ESOP Association*

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## Washington Alerts

On March 17, The ESOP Association launched [Washington Alerts](#)—timely updates on events in Washington that can help ESOP companies survive and thrive in spite of the current health and economic crises.

These alerts provide insights and up-to-date information about legislation, regulatory developments, and advocacy efforts that The ESOP Association is undertaking on your behalf. As the only organization advocating for all ESOP companies, TEA is uniquely positioned to provide these insights.

Washington Alerts are provided exclusively to members of The ESOP Association.

Below is the list of the [Washington Alerts](#) published so far. To read more about any of the alerts listed below, please click the title and follow the link to the relevant article on our website.

Please check our website regularly for the latest updates and the newest information.



### APRIL 2

#### [Resources for Employee Owners](#)

Sharing these three informational resources with your employee owners can help them grapple with today's challenges.

### APRIL 1

#### [CARES Act Employee Retention Credits](#)

The CARES Act offers credits to businesses that take steps to retain their employees. This Q&A can help ESOP Association members better understand these credits and how they are applied.

### MARCH 30

#### [New Law Provides Historic Loans to Small Businesses](#)

ESOP companies can apply for greatly expanded federal financial assistance that may qualify for partial or full debt forgiveness.

### MARCH 26

#### [ESOP Advocacy & Phase III Legislation](#)

See how the latest bill for COVID-19 relief, just passed by the Senate, can help ESOP companies grapple with the economic downturn.

### MARCH 25

#### [TEA Requests Regulatory Relief for ESOP Companies, Asks DOL to Respond](#)

The ESOP Association today sent a letter to the Secretary of Labor asking for emergency plan flexibility, regulatory guidance, and investigatory relief for active or new routine EBSA investigations.

### MARCH 23

#### [Relief for Businesses, Phase 3 Relief Bill](#)

In votes held last night and today, the Senate was unable to move forward on a proposed multi-trillion dollar “Phase 3” piece of legislation that would provide a massive infusion of cash and loan relief for private sector businesses. The legislation is currently stalled over disagreements between Republicans and Democrats over the nature of corporate relief and its uses.

### MARCH 19

#### [Nation's Response to COVID-19](#)

These slide decks show the nation's response to COVID-19 in a quick, easy to read format.

### MARCH 18

#### [ESOP Association, Members, Ask for Congressional Loan Support](#)

As Congress considers various aid packages for businesses negatively affected by the coronavirus pandemic, The ESOP Association is working to ensure the needs of the ESOP community are part of the discussion.

### MARCH 17

#### [New Bill Seeks to Expand Medical Leave](#)

H.R. 6201 would expand the Family and Medical Leave Act (FMLA), creating a new form of mostly paid job-protected leave for affected employees. It also would create a new form of immediately available, short-term paid sick leave. These provisions would take effect within 15 days of enactment by the President.



## Business Resources


This curated list of online resources can connect you instantly to an exceptional list of the best public resources and information available. If you are looking for something specific, this is a great place to start.

Resources currently available will help ESOP companies gather the latest information on business issues (including taxes and Small Business Administration loans); health and occupational safety; and legal and consulting information.

Check back frequently as we will be adding other sections, including state-by-state based resources as they ramp up and come online.

## Economic Recovery Events

Once it is responsible to again gather our community, The ESOP Association and its nationwide network of state and regional chapters will begin sponsoring small, high-level, one-day sessions throughout the nation to give the opportunity for ESOP leaders to learn, share ideas, and collaborate.

Our experience after the 9/11 attack as well as the 2008 great recession was that the sooner ESOPs could get together to share ideas and solve problems, the faster they were able to recover. We fully expect that these events will help speed that process. 

# Coming Soon: The ESOP HUB, the New Member-Only Online Community

## Online Networks Will Offer Safe New Ways to Share and Interact

**W**e know the value ESOP Association members place on the networking and educational opportunities we provide through our conferences and programs throughout the year. To build on that value, we are entering a new phase of member networking by providing a safe, exclusive, online environment where members can connect, engage, and share critical information and best practices in real time.

This resource—named The HUB—is especially important now, as our community looks to stay connected while maintaining recommended social distancing in the face of a global pandemic. With state and national restrictions on meetings, this resource will be an invaluable and unique place for our members to safely gather and learn.

### COVID-19 Network

At launch we will be opening a special education and collaboration network for COVID-19 which will supplement the [COVID-19 Action Center](#) found on our website. The COVID-19 Network will be a place where you and your peers can discuss the impacts of the pandemic on your business and share tips and ideas for coping. Together we can weather the storm, and the COVID-19 Network will help us do that.

### Other Networks at Launch

While our main focus has been launching the COVID-19 Network, we also will have networks for Chapter Officers and Advisory Groups. These will be collaborative, private spaces for our leadership groups to discuss ideas, share

materials, and work together for the good of the entire ESOP community. Other networks also are in the works.

### Looking Forward

When business returns to normal, the HUB will remain an invaluable resource helping to supplement our live national and chapter events. While our chapter events will continue to provide a unique and unparalleled opportunity

*While our chapter events provide a unique and unparalleled opportunity to network locally, our networks will enable broader networking across the entire nation on roles and topics of interest to you, our members.*

to network locally, our HUB networks will enable broader interaction across the entire nation and on roles and topics of interest to you, our members.

The HUB networks also will enable members of our chapters to stay connected before and after meetings, extending and enlarging conversations for the benefit of all.

The HUB also will help TEA communicate more dynamically with our members, by responding more quickly to your needs and receiving your input on critical industry issues. This will only strengthen our ability to implement our mission to protect, enhance, and promote employee ownership.


The HUB is an evolving community. We will introduce new topics and tools in the coming weeks to enhance your experience. We look forward to your feedback and

suggestions on how we can make The HUB an indispensable part of your membership experience.

## Logging in

Logging in will be easy. First, you will log in to the ESOP Association website. Then you will click “The HUB” in the

main navigation at the top of our website. From there you will be directed to the home page of The HUB.

Once you are in The HUB, you will be able to see recent discussions, announcements, and networks by clicking “Networks.” We recommend visiting the COVID-19 Network first for timely information and networking to help you manage the current health and economic crises. 

# President's Corner

## Why The ESOP Association Is More Critical Now Than Ever for Our Member Companies and Their Employee Owners

By James Bonham, ESOP Association President and CEO

**W**hile we are all hoping for a rapid recovery of our nation's health and economy, the reality may be that we are at the start of one of the most challenging economic periods in modern history.

This week's new unemployment filings demonstrate that our nation's businesses are entering an entirely unprecedented period. In less than two weeks, more than 10 million Americans have filed for unemployment. Millions of small businesses are at risk of bankruptcy or closure. And while our nation shelters in place, our economy is unplugged and is running on the equivalent of battery power in the form of \$2 trillion in emergency government assistance.

Everyone is hopeful for a fast snap-back, but prudent leaders are making plans and preparations for the long haul.

In preparation to serve our membership, The ESOP Association has been sharply focused on these events for more than a month—since the beginning of March when the earliest indications of domestic spread of the virus became clear. On March 6 we began preparations to shift our organization to a remote workforce, postpone events, and position ourselves to become a resource to our members throughout the crisis. Just one week later, on March 13, TEA shifted to a 100 percent remote workforce and was fully operational for our members.

Early on, TEA reprioritized our focus and deployed our considerable resources to do everything within our reach to help our members survive this crisis and be positioned to thrive as quickly as possible when our economy goes back online. None of our efforts to help ESOPs and employee owners are possible without your ongoing membership and support.

First and foremost, we immediately and aggressively engaged in an entirely new level of advocacy, designed to present the interests of all ESOPs to Congress as it considered legislative and regulatory relief for businesses. We immediately engaged with the highest leaders, including

the Senate Majority and Minority Leaders, and the Chairs and Ranking members of the Senate Small Business, Health Education Labor and Pension, and Finance Committees.

We did the same with the Speaker of the House, Minority Leader, and the analog committees in the House of Representatives.



We advocated for ESOPs to be treated on an equal basis as all other businesses and fought for tax related relief to be based on employment tax credits rather than corporate income tax credits, to ensure ESOPs could fully participate. We targeted the

small business provisions of relief bills, to ensure ESOPs would not be left out or be required to have any special hurdles.

We also focused on relief that could be provided by the agencies. We are seeking reporting delays, investigatory relief, and plan administration guidance from the Department of Labor. We've reached out to the Small Business Administration about lending requirements and procedures for ESOPs. And we are engaging with the IRS on their areas of regulatory focus.


Beyond advocacy, we launched a series of very timely webinars on topics specific to the COVID-19 crisis. In our first week alone, more than 2,000 attendees have registered for these webinars, and each presentation has been rated highly in post-webinar surveys. Another seven weeks of programming is either already open for registration or will be rolled out soon. New, hot topic sessions are being added almost daily as new developments arise and as members request specific topics be covered.

We are also launching “The Hub”—an entirely membership driven network of collaborative online spaces and content for our membership community. You can

use The Hub to connect with other ESOP companies and professionals in your region, fellow employee owners, your chapter, and volunteer leaders. The Hub will become a central clearinghouse where ESOP Association membership can come together to share, learn, and network for solutions and great ideas.

Once our nation is able to reopen for business and it becomes safe to schedule meetings, TEA is planning for a nationwide series of events that will have a sharp focus on connecting our member companies with resources to accelerate recovery. We are planning a special focus

on our corporate leaders to spotlight the most pressing issues businesses will be facing. We will be bringing in government leaders to share their program resources and to hear directly from our members about the needs of our companies and our employee owners.

The ESOP Association is proud to be doing the work we are doing on your behalf. We are humbled by the enormity of the challenge ahead, but even more so we are inspired by the bravery and determination we are seeing and hearing every day from our member companies and employee owners. 

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# Use Your 401(k) to Provide Financial Relief to Employees and Your Company

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## Consider These Options—including Ones Just Allowed Under the CARES Act—for Providing Invaluable Financial Flexibility

By Dolores Lawrence, Managing Director, Blue Ridge ESOP Associates

Reviewed by Jamie Zveitel Kwiatek, Polsinelli

**I**n the current economic crisis, employees and businesses alike are looking for ways to conserve cash and obtain financial relief. If your ESOP company is one of the many that also offers a 401(k), you may be able to utilize one or more strategies involving your 401(k) to provide financial relief to both employee owners and your ESOP company.

### Relief for Employee Owners

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During the current period of instability, employee owners may want to take advantage of relief provisions that are related to their 401(k) and that are included in the new CARES Act, which was enacted on March 27, 2020.

At any time during 2020, you may permit distributions from your 401(k) plan of up to \$100,000, free of the otherwise applicable 10 percent early distribution penalty. These distributions may be made available to plan participants who meet any of the following conditions:

- Have been diagnosed with SARS-CoV-2 or COVID-19 by a test approved by the Centers for Disease Control.
- Have a spouse or dependent who has been diagnosed by such a test.
- Experience adverse financial consequences as a result of being quarantined—including being furloughed or laid off, having work hours reduced, or being unable to work due to a lack of childcare.

The CARES Act allows your plan administrator to rely on certification provided by participants and stating that they

satisfy the above-described criteria. Unlike typical hardship distributions, this special COVID-19-related distribution may be repaid to the plan, or contributed to another eligible retirement plan, at any time over a three-year period that starts on the date that the distribution was received. There is no requirement that the repayment occur in a single payment.

Further, federal income tax withholding is not required at the time of distribution. In addition, participants may spread the taxes due on the distributions they receive over a three-year period, to the extent that they do not otherwise repay the amount to the plan during that three-year period.

The CARES Act also allows plans to be amended to provide increased loan limits (up to the lesser of \$100,000 or 100 percent of vested account balance) for the first 180 days after enactment, and for participants who meet the same COVID-19 qualifying conditions.

Participants who currently have a plan loan and who meet the COVID-19 qualifying conditions must be permitted to delay payments due through December 31, 2020 for one year from the original payment date.

You also may elect to delay required minimum distributions under the 401(k) plan for one year.

You will need to amend your 401(k) plan for any of the above relief provisions. However, while the plan should be operated in accordance with the provisions that will apply, the amendment does not need to be adopted earlier than the end of the 2022 plan year.

## Relief for ESOP Companies

While the CARES Act provisions apply to both ESOPs and 401(k) plans, the greatest impact from the Coronavirus participant loan and in-service provisions will be in Section 401(k) plans

With that in mind, if your company is looking for ways to conserve corporate cash, here are five changes to consider:

- Suspend your non-safe harbor match for all participants, or suspend the match just for highly compensated participants. If the match is being carried out each pay period, you may be able to amend the plan to provide for a year-end discretionary match in addition to any matching contributions made each pay period.
- Retain the non-safe harbor match but change the formula to be less generous or provide a cap on the maximum annual match per participant.
- If necessary, consider suspending safe harbor contributions. Consult with advisors regarding whether such contributions could be suspended mid-year just for highly compensated participants, as there is no official IRS guidance on this issue.
- To suspend a safe harbor contribution: (i) the plan must be amended to adopt the suspension, (ii) participants must receive supplemental notices that explain the amendment, its effective date, and the procedures by which participants may change salary deferral elections, (iii) eligible participants must have a reasonable opportunity prior to the suspension to change their elections, and (iv) the plan must be amended to require ADP/ACP testing for the entire year using the current year testing method. Consult your 401(k) third party administrator and legal counsel for details.
- If you are dealing with a workforce shrinkage that could be permanent or long lasting, consider whether it would make sense to amend your plans to provide that future matching or safe harbor contributions will be funded in your ESOP, where these contributions can become a source of funding.
- Consider having expenses for plan operations (recordkeeping, administration, required amendments, etc.) paid from the 401(k) trust. Consult with legal counsel on which expenses qualify as reasonable expenses that may be paid from the trust. €

## Five Options for ESOP Companies That Are Looking to Conserve Cash

### As the Economy Slows Down, These Suggestions May Help Your ESOP Company Hang on to Urgently Needed Dollars

By Ashleigh Newlin and Ryan Graham, Chartwell Financial Advisory  
Reviewed by Kjersti Cory of Greatbanc Trust Company

**W**hile the full extent of the current economic instability facing our nation is not yet known, and ESOP companies can only make an educated guess as to the ultimate impact on future cash flows, there is a common desire to plan for the worst and hope for the best.

This article discusses five changes to plan administration practices that can help ESOP companies seeking to conserve corporate cash.

#### 1. Avoid segregating the accounts of terminated participants

This idea pertains to ESOP companies that typically segregate terminated participants' accounts, i.e., convert the accounts from employer stock to cash or other investments. Companies that segregate accounts most often segregate in

the year following termination, even though the participant may not receive a distribution for several additional years.

The problem with segregating accounts is that it typically makes ESOP repurchase obligations (RO) more expensive, even under normal circumstances. Companies that segregate need to repurchase the terminated participant's shares sooner—at the time of segregation, instead of at the time of distribution—which accelerates the cash requirement.

The repurchased shares are then reallocated to other participants sooner, which means the next person who terminates will have more shares in his or her account, representing a higher RO for the company.

If, in the current environment, there are additional terminations and share value grows more slowly (or declines), segregating will increase the ESOP RO even more, at a time when the company needs to conserve cash.



## More Information on Financial Relief

ESOP companies looking for more ideas on ways to attain financial relief can check out these three webinars.

**Qualifying and Applying for the SBA Coronavirus Relief Programs** will take place April 7, 1:00 PM. There is still time to register for this live event.

Two previous webinars also can offer help: The recordings for **Overcome Your Cash Flow Challenge**, and **What Payments Can I Delay?** soon will be available to ESOP Association members on our website.



At the least, an economic disruption warrants a review of any segregation language in the ESOP plan document, in partnership with your ESOP attorney.

Are there any conditions or caveats tied to when accounts are segregated, such as “to the extent of cash in the trust”? If the language is inflexible, discuss with your attorney whether an amendment makes sense. Remember to consider whether the amendment would apply retroactively to participants who already have terminated.

### 2. Pay distributions over multiple installments

If distributions to terminated participants are normally paid in a single lump sum, review the ESOP distribution policy to see whether it is permissible to pay distributions over multiple substantially equal annual installments. If not, an amendment could be considered to stretch out the cash requirements associated with distributions.

There is general consensus in the ESOP community that amending the form of distribution from lump sum to installments is acceptable, whereas amending the timing of distributions (increasing the delay period) is more controversial.

### 3. Eliminate small balance and minimum installment provisions

Many ESOP documents indicate that small accounts—for example, accounts with vested balances less than \$5,000—are paid out in a lump sum following termination, while larger accounts are distributed after a five-year delay period.

The plan document also may include “force-out” provisions stipulating that small vested balances will be paid in a lump sum if the participant fails to consent to distribution when offered.

These small balance provisions may seem like small potatoes, but when combined they can add up to a very significant difference, especially if many lower-paid employees with small balances are terminated in the same year.

A variation on the lump sum threshold provision described above is a minimum installment amount provision, whereby accounts generally are paid out over five substantially equal annual installments, but each

***Many plan expenses, including fees for record-keeping and annual valuations, can be paid directly from the ESOP trust.***

installment must equal at least a minimum amount (if the account balance exceeds that minimum amount). This provision also accelerates distributions for accounts under a certain value.

Amending the ESOP and revising the ESOP distribution policy to eliminate these provisions—so that all distributions are paid out over a longer time period—will help conserve cash flow.

### 4. Use ESOP cash for plan expenses

Many plan expenses, including fees for record-keeping and annual valuations, can be paid directly from the ESOP trust.



Of course, this suggestion only reduces the demand on company cash if there are existing cash balances in the plan, which have accumulated from prior years' contributions, dividends, or S corporation earnings distributions.

## 5. Consider an interim valuation for distributions

Continuing a recurring theme of this article, review the language in the ESOP plan document to determine if there is a requirement that distributions must be made at the prior plan year-end valuation, or if there is flexibility in the document allowing for an interim or alternate valuation date to be selected.


If the former is the case, there is not much to be done about 2020 distributions, which will need to be paid based on the prior year-end value (December 31, 2019 for calendar-year plans). While a plan amendment is possible, it may not be a good idea to amend the plan so that distributions pending for the current plan year are subject to a different value.

If, however, the plan language does not specify "prior year end" value, you might consider an interim valuation. An interim valuation is prudent for mature ESOP companies with cash flows that have been significantly disrupted.

Keep in mind that the decision of whether to get an interim valuation for distributions can likely be delayed until later in the year, when more information is known. (Most plan documents allow distributions to be paid out at any point during the plan year, in which case there is no need to follow the same monthly timeline as in previous years.)

However, we suggest starting the conversation with your ESOP attorney and ESOP trustee now, so that everyone is on the same page regarding the situation and the decision timeline.

All these items—particularly interpreting plan provisions and considering plan amendments—require discussion with your ESOP attorney. In addition, completing a repurchase obligation or sustainability analysis will help you estimate the impact of any proposed change on the company's cash flow.

These five ideas are simply a starting point for discussion with your ESOP advisors. There are, of course, other ways for ESOP companies to improve corporate cash flow. These include internal measures (such as managing working capital, controlling expenses, and deferring capital expenditures) and external measures (such as refinancing, exploring SBA loans, etc.). 

# Partial Plan Terminations

## Understand How Dramatic Decreases in Your Number of Employee Owners Might Trigger a Partial Termination of Your ESOP Plan

By Barbara M. Clough, QPA, QKA, Director, Newport Group  
Reviewed By Lisa Durham, Esq., Krieg DeVault LLP

**O**n January 22, 2020 the first case of COVID-19 in the United States was reported by the Centers for Disease Control and Prevention. The number of cases has continued to grow since then, causing businesses to voluntarily close or change the way they operate, and prompting state governments to close non-essential businesses and to issue orders requiring residents to stay at home.

These changes have resulted in layoffs or furloughs at many ESOP companies, which may result in a partial plan termination. This article will discuss partial plan terminations, determination of whether a partial plan termination occurs, vesting requirements, and affected employees.

Revenue Ruling 2007-43 provides details regarding the determination of whether a partial termination occurred. This ruling established that a turnover rate of 20 percent or greater in the applicable period creates a rebuttable presumption that a partial plan termination occurred. The

determination of whether a partial plan termination occurs is a facts and circumstances test with further details in Internal Revenue Code §411(d)(3).

The turnover rate (TR) is found by dividing the number of participants who had an *employer-initiated* severance during the applicable period (A) by the sum of all participants at the beginning of the applicable period (X), plus the number of new participants during the applicable period (Y):

$$TR = A / (X + Y)$$

The applicable period is one plan year but may extend longer if there is a series of related severances. Although this test typically is performed on a plan year basis there may be circumstances that would require an off-plan year determination.

An employer-initiated severance generally includes any severance from employment other than one that is on account of death, disability, or normal retirement. Employer-initiated severance also includes events outside


of the employer's control, such as those related to the COVID-19 virus.

To determine the turnover rate, plan sponsors should retain records that clearly indicate the reason for an employee's termination. Voluntary terminations should have appropriate documentation, including information from personnel files and employee statements.

In the event of a partial plan termination, all affected participants—including those who voluntarily terminated employment during the applicable period—must be fully vested.

It is important to note that the partial plan termination determination requires termination of employment.

Employees who are furloughed or placed on temporary lay-off typically are considered employed by the plan sponsor. Many plan documents include language to this effect as well as providing employer contributions to eligible employees on lay-off at the end of a plan year.

Plan sponsors should review their plan documents and discuss appropriate amendments with legal counsel if concerned about a partial plan termination. Many of the required compliance tests, including Code §409(p) tests, may be affected by a partial plan termination. A prudent approach for plan sponsors is to work closely with their third party administrator and involve legal counsel as appropriate. 

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# Ownership Advantage

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## Help Employee Owners Thrive While Working Remotely

By Jason Wellman, Director of Ownership Culture, ESOP Partners

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**D**ue to the unforeseen changes in our country through the medical crisis created by the COVID-19 pandemic, many employee owned companies now have employee owners working from home. I am sure everyone has a lot of questions about how to manage a remote workforce and maintain productivity goals.

Here are several keys to ensuring your employee owners will meet and exceed these expectations within a new remote work environment.

### Expectations and Guidelines

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It is important to ensure that all virtual employee owners understand what is expected of them in this new situation. Here are some suggestions for accomplishing that.

**Set Clear Expectations.** The first step in making sure your newly transitioned employee owners can succeed in a remote setting is to establish clear expectations. These expectations will be different for all employee owners based

*Set expectations around work hours, so all employee owners can be available for each other and ensure collaboration continues to occur on a frequent basis.*

on their unique situations and challenges. For example, some may need to provide childcare during this time away from their normal work environment, so be mindful of these types of challenges in this new workplace.

Set expectations around work hours, so all employee owners can be available for each other and ensure collaboration continues to occur on a frequent basis. Another expectation you can set is to have an agreement

with employee owners that they will respond to all communication within 24 hours, even if they don't have the answer.

Set clear expectations for deliverables and deadlines for these deliverables. Establish a culture of ownership and accountability by holding yourself to the highest standard.

**Open Lines of Communication.** Maintaining open lines of communication during this time of uncertainty can and will reduce stress and anxiety in the workplace. It is extremely important that companies maintain a safe and structured workplace through open communication.

**Equip Employee Owners with the Right Tools and Support.** All virtual employee owners will need some formal training on how to utilize technology for instant messaging and video conference calls. Considering asking your IT department to produce a how-to guide with commonly asked questions associated with these items.

**Engagement Is the Key.** One option is to have daily fitness challenges, to ensure virtual employee owners are taking regular breaks from their work. Another engagement activity would be to conduct a happy hour and/or water cooler session with your virtual employees to provide an opportunity for everyone to unwind with their colleagues in a relaxed environment.

### Challenges of Remote Work

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Here is a list of common challenges that face remote employee owners, and tips to combat these challenges.

**Loneliness and Isolation.** You must increase your communication through additional check-ins and team regroups. Encourage all virtual employee owners to turn on their camera to have face-to-face contact. Mail company

swag and/or gifts to virtual employee owners. And continue to celebrate birthdays and team successes as a group.

**Communication and Collaboration.** Engage regularly across multiple channels with your fellow employee owners by leveraging your technology and resources. Focus on completing the small talk that everyone enjoys, as a means of building rapport. Keep things light by utilizing GIFs and emojis during your communications, where appropriate.

Please don't forget to be mindful of others with childcare needs during this time of uncertainty. Be considerate with your meetings by being mindful of the time zones of each employee owner and limit your background noise.

**Accountability and Motivation.** Maintain your alignment with the major initiatives and goals within the company. Conduct personality assessments to understand communication preferences and unique motivators based on behavior to drive employee owners to the next level.

Allow time for training to ensure all employee owners are up to speed on the various resources. Praise and reward employee owners throughout this entire process.

## Don't Lose Sight of Mental Health

How do you and your fellow employee owners maintain mental balance during these unique times in our country's history?

**Maintain a Consistent Schedule.** This means showering and getting dressed every day. Also set up a home office and dedicated workspace with set boundaries and a closed door.

**Schedule Breaks.** Don't forget to move and workout on a consistent basis. This is another reason to complete these workout challenges on a daily basis.

If you have children, please maintain a schedule for them with time for your meetings and don't be afraid of screen

## More Information on Remote Work

Looking for additional information on managing remote work?

**Engaging a Remote Work Force** will take place April 8, 1:00 PM. There is still time to register for this live event.



time. Focus on leaving work at work even though you currently are working from home.

**Schedule Fun Activities Just Like Work Tasks.** For a few minutes every day, focus on your hobbies, self care, and anything else that makes you happy. This attention to your emotional needs will help you maintain your mental balance throughout your experience as a remote employee owner.

**Get Outside.** Enjoy nature when possible, especially now that it's officially spring. Time in nature can help treat anxiety, stress, and depression.

The transition to becoming a new remote employee owner may be challenging, but remember that tomorrow is always a fresh start. Live within that 24-hour period and do everything you can do for yourself and your fellow employee owners who also may be working remotely. [€](#)

# Adjusting to Remote Work

## These Technical, Practical Tips Can Help Ensure Employee Owners Have a Positive Experience Working from Home

By Jon Forst, Fractional CIO, Datawise Technologies LLC

**T**he COVID-19 pandemic has forced businesses to send employees home. While many companies already had technical capabilities in place to allow employees to work outside the office, few were ready to broadly enact the programs. What's more, few employees and managers had the opportunity to practice remote work at scale, or for extended periods of time.

We have learned that successfully working from home requires more than a company laptop and a good Internet

connection. For those who are new to remote work, here are some tips to help make the adjustment to the new normal.

## Manage WiFi Bandwidth

Be mindful of the devices connected to your home Wi-Fi. One of the early lessons from the current rush to remote work is that there's often competition for Internet bandwidth as everyone in the house tries to access online

content. Video chats with the office can get bogged down if multiple people in your home—such as roommates or family members—are engaging in bandwidth-intensive activities at once.

Here are some of the devices and platforms that can compete for Internet bandwidth:

- Streaming services, such as Netflix, Roku, Hulu, Amazon Prime, and YouTube.
- File sharing/syncing applications, including OneDrive, DropBox, and Google Drive.
- Video games on computers or consoles (Xbox, PlayStation).
- Mobile phones connected to WiFi.
- Internet-based telephone systems.
- Home Security systems (especially if they have cameras and constantly stream video).
- Malware-infected computers.

Streaming services such as Netflix and online games are notorious bandwidth hogs that can make it nearly impossible to participate in that important Zoom meeting. Turning off video feeds or switching mobile phones from Wi-Fi to cellular data may be necessary to free bandwidth for important activities.

It's also important to recognize that some devices can tax your Internet connection even if you aren't using them. If your connection starts to lag, consider shutting off any cell phones, laptops, tablets, smart speakers (such as Alexa and Google Home), household security systems, or other Internet devices you aren't currently using.

## Pay Attention to Information Security

The rapid transition to a work-from-home paradigm expands cybersecurity risks because many of the protective capabilities available at the office may not extend to employees' homes. This is especially true if the company had to quickly assemble capabilities to enable a large-scale migration.

These risks present a huge business opportunity for the bad guys who seek to profit from stolen information or ransomware—the repercussions of which may not be covered by an existing cyber insurance policy.

(For the latest information on cyber insurance, don't miss TEA's webinar, [Cyber Security for a Larger Remote Workforce](#). The webinar takes place April 6 and a recording of the event will be available to members afterwards.)

Employees working from home still have a responsibility to protect corporate and customer information to the best of their ability. This means that only the authorized employee uses the company laptop, and only for corporate business. The computer is locked when not in use, and passwords are not shared with other members of the household.

Employee owners should resist the temptation to download new software to help with file sharing, editing, chat, collaboration, reporting, and so on. Adding freeware

or unlicensed software to a company laptop may create security issues and legal liabilities for the company. Employee owners should not install or use any new tools without the express permission of the folks responsible for information security in the company.

Employees owners also should make sure their home wireless networks are protected with strong passwords and have enabled "WPA2" encryption. To limit the possibility of infection from another computer on the home network, select the option to treat the network as public when first connecting the corporate laptop.

If it is necessary for employee owners to use their personal computers to access company information, the computers should have an up-to-date operating system (Windows 8 or later for Microsoft, macOS High Sierra or later for Apple) and anti-virus/anti-malware software from a major provider. A full anti-virus scan should be performed prior to doing any company work on an employee's computer.

Also, firewalls should be enabled through the operating system or the anti-virus software. Ideally, the computer will be backed up at least once a day.


This is also a good time to revisit cyber-security training. We've already seen an uptick in phishing attempts offering compelling COVID-19 information or impersonating an executive working offsite who needs a funds transfer. The hackers are counting on paranoia, fewer security mechanisms, and the lack of a co-worker's second opinion to trick employees into compromising personal or corporate information.

## Set Up a Dedicated, Distraction-Free Workspace

Setting up an appropriate workspace is key to working effectively from home. Much like the office, a well-lit, comfortable, and functional workspace enables productivity.

Set aside a space in the home with the tools needed to get the job done: a desk with enough room to spread out, a chair suitable for hours of sitting, common office supplies, and ready access to a phone and printer.

Ideally, the home office will be physically separate from other activities in the home. This helps maintain focus and creates an appropriate boundary between home and work. Use distance or a set of headphones to limit distractions from the television and other activities in the house. Unless it's part of your job, intentionally tune out of social media during the workday.

*Jon Forst is a technology consultant who has been instrumental in helping The ESOP Association manage its multi-faceted technology upgrade. His work last year in proactively preparing TEA to work remotely has enabled our staff to transition readily to a full work-from-home environment. He also is a veteran of remote work, having worked out of his home since 2000. *



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# Effects of the COVID-19 Pandemic on ESOP Administration

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## Here Is an Early Take on Evolving Questions and Initial Considerations for ESOP Companies Braving Uncharted Waters

By Alan Kandel, Husch Blackwell LLP; David Burdette, Applied Economics; Merri Ash, TI-TRUST, Inc.; Chuck Coyne, Empire Valuation Consultants, LLC; Elyse Bluth, Duff & Phelps, LLC; Tim Lee, Mercer Capital Management, Inc.

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**T**he global economy is being affected by a pandemic declared by the World Health Organization (WHO) as of March 11, 2020. The pandemic involves the novel coronavirus and the associated disease referred to by WHO as COVID-19. The disease initially was reported by Chinese Health officials to WHO on December 31, 2019, but its effect on world financial markets and the global economy was then unknown. COVID-19 has now spread throughout the world and is having a dramatic—if not unprecedented—detrimental effect on world markets and the global economy.

As the severity of the crisis became evident, members of The ESOP Association's Professional Advisory Committees began collaborating to identify and respond to the myriad of daunting challenges and questions facing the entire ESOP community and most notably plan trustees and administrators who are actively working on 2019 plan year valuations and other annual duties.

Following is a compilation of initial questions and issues along with responses. Be aware that new questions will emerge and responses to those questions will evolve as the ESOP community rallies to identify best practices for dealing with this highly unusual situation.

We caution that not all ESOP plan documents are the same; some can vary in significant ways with respect to the requirements and powers of the trustee and other ESOP stakeholders. Trustees are tasked with seeking advice and counsel regarding the specific requirements of their plan to formulate strategies to manage their duties and fulfill their responsibilities in the best interest of their plans and the plan's respective stakeholders.

**Is the ESOP trustee required to get an annual plan year (December 31, 2019) appraisal?** Generally, the plan requires the trustee to determine the value of plan assets annually. For most ESOPs, the plan year aligns with the fiscal and/or calendar year of the company, which for the vast majority of ESOPs is December 31.

**Is the plan administrator required to use the appraiser's value for ESOP administration purposes?**

Theoretically no, because an ESOP trustee is responsible for the determination of value of the employer stock held by the ESOP, and the appraiser who prepares the annual valuation is not a fiduciary. However, determining a value that is different from the appraiser's value entails risk.

First, a claim could be made that the fiduciary breached its fiduciary duties by determining a value that is not supported by an independent appraisal.

Second, the Internal Revenue Code requires all valuations of employer securities that are not publicly traded to be performed by an independent appraiser. Determining a different value could be seen by the IRS as a failure to satisfy a requirement of tax qualification. Trustees are advised to work with their appraisers to achieve an acceptable appraisal.

The trustee will direct the plan administrator to use the appropriate value as required by the plan documents. The trustee or other applicable ESOP plan fiduciary might be given discretion in the plan documents to request an interim valuation date to be used for various purposes, including benefit payments such as distribution and diversification—or the plan documents might expressly require or permit interim valuations.

If the ESOP plan document does not provide for an interim valuation date, or the discretion to require one, then it might be possible for the company's board of directors to amend the plan. But there are limitations on permissible plan amendments, and amendments should be done only after careful consideration and legal guidance.

**I just received my 12/31/19 valuation. Is it now wrong, given the expected downturn in the economy?**

No. The 12/31/19 valuation is an estimate of the value of your company's stock as of December 31, 2019. It reflects the financial markets, investor sentiment, and your company's history and outlook as of that date.

**I haven't received my 12/31/19 valuation yet. Will it be lower now that the stock market has fallen, and my business prospects have changed?** No. The reason your 2019 plan year valuation could drop is due to the company's

2019 position and performance as measured at the end of 2019. Again, your company's stock value should reflect everything as of 12/31/19. On 12/31/19, the economy generally was unaware that COVID-19 was a material concern, and the disease's still-evolving impact was not yet understood; that's why financial market pricing and valuation multiples did not change until well after the last day of 2019.

**My ESOP valuation date isn't 12/31, but another date (let's say 3/31/20). Will the valuation be a lot lower than it would have been were the valuation date 12/31/19?** That might be the case, for most industries. (Obvious exceptions include companies that produce products or services urgently needed to manage the current health crisis). For many companies, though, demand has slowed, supply chains have been disrupted, workers are unavailable (and, tragically, some are sick with the virus). For some businesses this is a temporary setback; others may not recover. How your stock price is affected depends on your company's outlook as of your ESOP valuation date, the risk achieving that outlook, and how investors evaluate that risk.

**Has my company's 12/31/19 stock value changed (declined)?** Probably. Unless you operate in one of the few industries that is unaffected by, or profiting from, COVID-19 or related economic changes, your company's stock price has likely declined since your most recent valuation.

**Is the 12/31/19 valuation affected by events after that date?** In general, no. The exception is events that were foreseeable and expected to occur as of the date of the valuation. The economic impact of COVID-19 was *not* known or reasonably knowable of 12/31/19. In fact, numerous bellwether stock indices continued rising to peak levels through mid-February.

**My company's outlook hasn't officially changed since 12/31/19: We haven't put together a new budget or projections, and we really don't know whether anything has changed. My valuation firm uses these projections in its discounted cash flow analysis. If the projections haven't changed, why would my company's stock value change?** The projections as of 12/31/19 are estimates of future performance. They are inherently uncertain. Valuation firms usually analyze a range around a set of projections, and sometimes include in their analyses different hypothetical scenarios that assess ranges above and below the projections. Company projections typically are (or should be) the "expected case"—that is, the most likely outcome, the scenario that the company has a likely probability of reasonably achieving (with the balance of probability being equally distributed between under- and over-performance of the forecast).

If, however, an interim valuation is being performed with a valuation date of today, new projections might need to be

prepared by the company, or the valuation firm may make substantial adjustments in its analysis to account for the changed circumstances.

In this post-pandemic new reality, however, even if your company hasn't altered its projections, the uncertainty of achieving the forecast has most likely increased significantly. Consider the following two scenarios:

**A Relatively Quick Business Recovery.** The effect of the virus on your employees does not substantially disrupt your operations, and the duration of the impact on your business is short, mainly timing-related, and relatively mild. The effect on your customers and vendors (and hopefully all businesses) is similar.

**Prolonged Economic Issues.** The effect of the virus on your employees significantly disrupts your operations, and the business suffers potentially long-term consequences (such as lost or bankrupt customers, compromised supply chains, and government mandates that prevent employees from working or prohibit commerce as usual).

Either of these scenarios is possible, in potentially varying combinations. The variability of outcomes, or risk, has grown. For most businesses, the upside hasn't changed but the risk of underperforming the projections has increased, which lowers value. Technically these risks could be captured through a combination of considerations and treatments, including the quantification of the discount rate, the scenarios modeled, the selection of market multiples, and the appraiser's judgment.

**I can see the stock market is down, and comparable company valuation multiples are lower, but my company isn't like those other companies; they are bigger, in many different industries, and far more geographically diverse. Why would my valuation firm pick lower valuation multiples now?** The selection of valuation multiples is subject to the appraiser's experience and knowledge of valuation principles, and the process of selecting multiples involves assessing similarities and differences among the guideline companies and the subject company. The factors appraisers consider include business mix, customer base, size, geographies serviced, etc. Each company, whether public or private, is unique. The selection of valuation multiples might change based on changes to any one of a number of factors.

**I have determined that, under our plan, my company does not need a new valuation. That said, I am pretty sure our stock price has gone down since 12/31/19 (or an earlier date). How might buying back stock at the 12/31/19 (or earlier date) price affect future stock prices?** If your company buys back stock from terminating employees at more than its fair market value, all things held constant the future stock price will decline—but you may or may not experience it.

Consider this example: A company's stock price on 12/31/19 was \$10 per share. During the year, the stock price falls to \$8 per share and the company buys back stock for \$10. This would be dilutive to remaining shareholders because the value of the stock being bought is less than the value of the money paid to the shareholder. But if the stock increases in value during the rest of the year to \$12 per share, you may not even notice. In fact, it will appear that you bought stock for less than it was worth.

Alternatively, if the stock at the following year-end is \$5 per share, the repurchase at an amount in excess of fair market value may have contributed to the decline.

A company's stock price is continuously changing, something we can see by watching how the stock of a publicly traded company performs on a single trading day. Private companies, though, don't show or report stock price changes throughout the year because most obtain a valuation only once a year. This is not a new phenomenon, though you may not have considered it before.

**Our business has slowed, and we have debt. I am worried that we will breach a debt covenant. What should we do?** Many companies are in this situation. First and foremost, we recommend you speak with your lender and legal counsel. Given the nature of evolving government assistance programs, business managers should keep an eye out for opportunities to secure financial assistance. And the effects of those financings on the financial position and expectations of the company should be explained to all the pertinent ESOP stakeholders.

*(Editor's Note: For insights on engaging in new loan and grant options through the Small Business Administration, register for the April 7 webinar [Qualifying and Applying for the SBA's Coronavirus Relief Programs](#).)*

**My employee owners understand that the stock price has probably declined, and I am worried that lots of them will leave to get the last, higher stock price. Also, since the business slowed, we have laid off people so even our known repurchase liability has increased, when we can least afford it. What should I do?** Each company's options are different and depend on the company's plan document, cash flow forecast, leverage, and employee population. We recommend you speak with legal counsel, your trustee and its financial advisor, and the firm developing your repurchase liability studies to assess the company's potential options.

**I'm an internal trustee and I am concerned that paying participants at a 12/31/19 price will materially harm the company, cause breach of bank covenants, and spark other cash flow problems. Does ERISA permit a delay in payments?** Yes, if your ESOP document provides for delay. The Internal Revenue Code allows an ESOP to delay the commencement of distributions upon termination other than retirement generally until

the fifth plan year following the plan year of termination. Distribution with respect to shares in a participant's account that were acquired with an ESOP loan can be delayed until the loan is fully repaid.

However, the timing of distributions must follow the terms of the ESOP document. If the plan document provides for earlier commencement of distribution than the latest dates allowed by the Code, then the plan administrator must follow the plan terms.

**Does ERISA permit distributions in stock, rather than cash?** Yes, if the ESOP document provides for distribution in stock. An S corporation owned by an ESOP that allows distributions in stock typically will require an immediate redemption by the company of the distributed stock. In such a case, the valuation that is used for the redemption might be different from the valuation as of the prior year-end.

**What options are there in financially difficult circumstances?** Several options are available, depending on the terms of the ESOP document.

For one, the distribution requirements of the Internal Revenue Code allow the commencement of distributions to be delayed in certain circumstances.

Second, if an ESOP allows distribution in stock, the repurchase of the shares by the ESOP is required to be based on a valuation as of the date of purchase; if the shares are redeemed by the company, the purchase price can be based on a valuation subsequent to the annual valuation.

Third, if the ESOP document allows, distributions can be paid in installments—generally over five years.

Fourth, unless the ESOP plan requires diversification to be at the value determined in the annual valuation, the value of the diversified shares may be determined by a valuation close in time to the date that diversification is implemented.

Fifth, if an ESOP provides discretion for the trustee to order a different valuation date for purposes of distributions, the trustee might be able to order an interim valuation for certain cash distributions. We strongly advise you check with legal counsel and review the terms of your plan.

**I'm on the board of an ESOP company. What are my responsibilities with respect to the annual valuation and administration of the ESOP?** Generally, directors of an ESOP company are not directly responsible for the valuation. ESOP plan documents typically name the company and its board as the principal fiduciary with the obligation to select and monitor the trustee. Note that, as one court explained, the duty to monitor is not a duty to "meddle" in the affairs of another fiduciary.

The trustee selects a financial advisor to perform the valuation. If the company is the ESOP's plan administrator, the board is responsible for administering the ESOP in

accordance with its terms—which can include selecting interim valuation dates, depending on the ESOP document. If the plan administrator is responsible for picking an interim valuation date and circumstances warrant, then it might be appropriate for the board to consider whether an interim valuation should be performed.

**My plan allows for interim valuations. Can we disregard the 12/31/19 valuation and instead use an alternative date in 2020 for distributions and diversification?**

The 12/31/19 valuation must be used for certain purposes, such as reporting the value of plan assets on the schedule to Form 5500. Depending on the terms of the ESOP document, and applicable limitations on amending plans to permit interim valuations, it may be possible to use an interim valuation for 2020 distributions and diversification.

**If so, what date in 2020 can we choose?** Generally, the trustee must select any date required by the plan documents and may consider discretionary dates if allowed by the plan document, so long as the trustee acts with reasonable discretion and the specific date chosen does not violate ERISA (such as restrictions on discrimination in favor of highly compensated employees).

**My plan does not allow for interim valuations. Can we adopt a plan amendment to permit an interim valuation and use it for ESOP administration purposes?** This entails some risk. A case from 1990 (*Pratt v. Petroleum Production Management, Inc. Employee Savings Plan & Trust*, 920 F.2d 651 (10th Cir. 1990)) ruled that an ESOP amendment to allow interim valuations could not be effective to reduce the amount distributed to a participant who terminated employment prior to the date the amendment was adopted. The court in *Pratt* did, however, consider a plan document that did not grant any discretion to the trustee to select a different valuation date, and it did not expressly consider whether such an amendment would be binding as to participants who had not separated from the company before the amendment was adopted.

The decision is binding in the states covered by the 10th Circuit, which include Wyoming, Utah, Colorado, Kansas, New Mexico, and Oklahoma. Courts in other Circuits might rule differently. (For more on the *Pratt* decision and another relevant court ruling, see the article on page 17.)

In general, the board may make a decision to adopt a plan amendment to provide for an interim valuation, but the amendment might not be permissible with respect to certain categories of plan participants. The amendment should be made in consultation with ESOP counsel to be sure an interim valuation can be used as a basis to pay benefits to plan participants and their beneficiaries.

**If we have an interim valuation in 2020, will the trustee require a full report, or will an update**

**memorandum suffice?** The interim/alternative valuation should be documented with sufficient information and formality to fully support the concluded value at the selected date. To adhere to generally recognized valuation reporting disciplines (USPAP, RR 59-60, ASA, AICPA, general practice, etc.) the appraiser may develop a letter or memorandum that incorporates by reference the fully documented plan year-end appraisal report and then augment with the necessary changes and/or additions relevant to the selected interim valuation date.

Ultimately, however, the trustee has the fiduciary obligation to value the shares, and if the trustee believes it is prudent to obtain additional information, the trustee should make that request. Given the potential challenges faced by many ESOP companies, the appraiser and trustee may determine that a stand-alone, fully documented report is best to memorialize the interim/alternative valuation date opinion.

**How should we be memorializing and documenting our decisions during this time?**

In general, fiduciary decisions should be documented in writing. Consider whether it might be important, years from now, to remember the actions, evaluations, and discussions you are having now to assess this novel global situation.

If plan-related issues are considered in meetings of the fiduciary committee or board, the minutes from those meetings should include attachments detailing the recommendations made and considered, and the reasons for the decisions that were chosen. Counsel should review drafts of minutes and other documentation, and the final minutes should be formally placed in the relevant records.

**What should we be communicating to participants?**

The specifics of participant communications depend on the company, the participants, and the decisions reached. If a plan amendment is adopted in 2020 that changes something in the summary plan description, the plan administrator is legally required to provide plan participants a summary of material modifications within 210 days after the end of the 2020 plan year (i.e., by July 29, 2021 in the case of a calendar year plan).

Aside from legal requirements, communications are an opportunity to educate participants, and to engage participants to take responsibility for overcoming the company's challenges to work towards a successful rebound from crisis.

**What type of disclosure might I expect to see in the 12/31/19 valuation report concerning the COVID-19 pandemic? Here is an example of a valuation report disclosure for subsequent events:**

This report does not include specific and/or direct consideration of economic and market events occurring subsequent to the valuation date that could influence the value of the subject interest as of the issuance date of this report. There are numerous potential financial,




operating, capital markets, and other issues that may have materially changed as of the issue date of this report relative to the effective valuation date defined at the beginning of this report. The valuation conclusions expressed in this report pertain to the effective date of the valuation rather than the issuance date of this report.

As of the issuance date of this report, the global economy was being affected by a pandemic declared by the World Health Organization (WHO) as of March 11, 2020. The pandemic involves the novel coronavirus referred to by WHO as “COVID-19.” The disease was initially reported to WHO in late December 2019. COVID-19 is considered highly dangerous, particularly for the elderly and/or those with pre-existing conditions and chronic ailments that compromise the human immune system.

Since its discovery, COVID-19 has spread throughout the globe. Health officials in numerous countries expect the incidence of infection and mortality to persist through the first half of 2020. Governmental authorities in the U.S. and abroad have mandated limits on social gatherings and recommended that civilian populations take measures to isolate themselves in order to curtail

further spread of the disease. All manner of public and private events have been canceled throughout the world. Travel and border restrictions have been enacted by the U.S. and many other nations. These restrictions are expected to negatively affect economic growth for an indeterminate period.

As of the issue date of this report, no specific timeframe for the abatement of the crisis has been declared. Multiple reputable health authorities suggest that COVID-19 could take several months to reach its peak saturation before abating.

The evolution of the pandemic, the extent of its economic and cultural consequences, and the results of steps taken and yet to be taken by governments and financial institutions are fluid and evolving in real-time. The general consensus of the world’s central bankers and other leading authorities on the economy includes an expectation for a significant downturn in economic activity for 2020 and the likelihood of a global recession. The U.S. Federal Government has taken and continues to pursue unprecedented legislative measures to mitigate the economic fallout of COVID-19 and to promote recovery for both businesses and the citizenry at large. 

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## Valuation Dates and Distribution Policies: the *Pratt* and *Amsted* Decisions

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### Two Cases Help Shed Light on How ESOP Companies Might Best Handle Today’s Difficult Questions Regarding Interim Valuations

By Ted Becker and Rick Pearl, McDermott, Will & Emery LLP

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**I**n view of the economic effects of the coronavirus, ESOP owned companies and their fiduciaries may be considering interim valuations or modified distribution policies.

Two commonly referenced federal court cases address such actions. *Pratt v. Petroleum Production Management, Inc.* involved a plan amendment that affected participants who had departed before the amendment was adopted. *Armstrong v. Amsted Industries, Inc.* considered obligations of fiduciaries in connection with interim valuations or changes in the method of distribution.

#### ***Pratt v. Petroleum Prod. Mgmt., Inc.***

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In the *Pratt* case, which took place in the 10<sup>th</sup> Circuit Court of Appeal in 1990, a former employee sued the company and two trustees for amending the plan (after he separated from

the company) to change the valuation date for his account distributions. While Pratt’s plan account included employer contributions of stock, the court opinion does not indicate precisely what type of plan it was.

In September 1985, the trustee valued the stock and Pratt’s shares were worth \$27,692.32. The company’s value began to decline substantially just as Pratt separated from the company in February 1986.

At the time Pratt separated, the plan stated that a separating participant’s distribution “shall” be valued according to the annual valuation immediately prior to separation. For Pratt, that was the September 1985 value. The plan also had a general provision that allowed discretionary additional valuations of the trust.

In April 1986, before Pratt received his distribution, the plan was amended retroactive to October 1985, to allow an interim valuation if there was a material change in the fair

market value of the fund. An interim valuation was then performed under which Pratt’s shares were worth \$7,184.37.

The chart below summarizes the plan before and after the amendment:

Before Amendment	After Amendment
Separating participants entitled to immediate distributions that “shall” be valued based on the immediately preceding year’s annual valuation.	Interim valuation deemed necessary to account for a material change in the fair market value of the fund.
	Interim valuation done as of January 31, 1986.
	Pratt’s claim for benefits valued pursuant to September 1985 valuation was denied.

The court held that ERISA did not permit the amendment as it affected Pratt. The court approached the issue largely as a question of when Pratt’s right to a distribution vested and became fixed under both contract principles and ERISA.

The court reasoned that the plan document in effect when Pratt separated entitled Pratt to a distribution upon separation, thus, the right to the distribution became fixed. The plan document also stated that the distribution “shall” be valued according to the preceding year’s annual valuation. The court determined that even though the plan had a general provision permitting additional valuations of the trust, the provision addressing distributions and individual account values was more specific and clearer. Because the plan entitled separating participants to benefits valued at a specific valuation date, the court concluded that the contract could not be amended unilaterally once Pratt’s rights were fixed, which occurred at his termination of employment, when his right to the benefit distribution was established.

The court observed that ERISA § 204(g)(1) prohibits amendments that decrease “accrued” benefits, and the court opined that Pratt’s benefits accrued upon his separation and could not be reduced by an amendment.

The court considered the fact that the IRS had obtained a copy of the amendment but did not disqualify the plan, and IRS regulations stated that valuation dates are not protected benefits. The court ruled, however, that this was not evidence that the amendments were permissible with respect to Pratt specifically. The court was of the opinion that the IRS’s determination and the IRS regulations did not consider the precise issue of an amendment’s effect on participants who already had separated; thus, the amendments could not be enforced against Pratt, who had departed before the amendments were adopted.

The court did not determine whether the amendment and interim valuation could be applied to participants who had not terminated employment when the amendment was adopted. The court focused on the date on which the participant’s right to a distribution at a specific valuation date became fixed.

### Armstrong v. LaSalle Bank Nat’l Assoc.

The *Armstrong* case—in contrast to *Pratt*—involved an amendment enacted before the plaintiffs’ departures. *Armstrong* was handled by the U.S. District Court for the Northern District of Illinois in 2000, and by the Seventh Circuit Court of Appeals in 2006.

In August 1999, Amsted, an ESOP-owned company, acquired Varlen Industries. Before the acquisition, Amsted analyzed the effects the transaction might have on Amsted’s repurchase obligation. In September 1999, after the acquisition, the ESOP’s stock was valued at an all-time high—a 32 percent increase over the prior year’s value.

The Amsted plan permitted departing participants to receive lump-sum payments at the prior valuation. By January 2000, employee departures caused Amsted to revise its repurchase obligation upward by about \$68 million.

In April 2000, Amsted’s board of directors voted to adopt two plan amendments. The changes to the plan are summarized in the table below:

Before Amendment	After Amendment
Participants separating for reasons other than retirement, death, or disability entitled to lump-sum payment.	Separating participants received a note payable in installments over a four-year period.
Provided optional joint and survivor annuity.	No optional joint and survivor annuity.
Valuations performed annually.	Quarterly valuations instead of annual valuations.
Participants terminating due to retirement or disability entitled to lump-sum payment.	Participants who retired at 65, at 55 with 30 years of service, or who were permanently disabled, received distributions immediately; all other participants had to wait five years after terminating, or until the ESOP loan was repaid, whichever occurred later.

The plaintiffs were participants who separated from the company after the amendments were adopted. They initially alleged that the amendments were unlawful, but

later changed their theory and alleged that the amendments were necessary but should have been adopted earlier. Their position was that if the amendments had been adopted earlier, then quarterly valuations would have been applied and the timing of distributions would have changed, thus saving Amsted money and increasing the value of the plaintiffs' shares.

The court considered whether the defendants breached their fiduciary duty in not adopting the amendments earlier. (Even though amending a plan is a settlor function, and not a fiduciary function, the court assumed, for the sake of providing a complete analysis, that the defendants had a fiduciary duty when amending the plan.)

The court found that the amendments were prudently designed to protect the company and the plan as a whole. The fact that some time passed between the defendants' knowledge of a liquidity issue, and the date Amsted's board of directors approved the first amendment, did not trouble the court because the defendants were researching alternatives during that period.

The defendants hired legal experts, ESOP consultants, and financial advisors to assist them in making an informed decision, and this was evidence that the defendants acted prudently.

## Lessons for Boards of Directors and Trustees

Some courts addressing similar issues in other cases have ruled consistent with the *Pratt* court, although other cases that were decided after *Pratt* raise questions about the analysis the *Pratt* court applied in reaching its decision.

The court in *Pratt* relied in part on principles of contract law in reaching its conclusion that the amendment could not be applied to Pratt's distributions. More recent cases suggest that principles of contract law should *not* be used to create rights or limitations beyond those provided in ERISA, although contract principles may be used to fill in gaps in ERISA's legislative scheme.

It is important for ESOP companies to follow the plan documents, unless doing so would be contrary to ERISA. Plan sponsors and plan trustees should be aware that unless the plan expressly provides for discretion in selecting valuation dates and distribution procedures, the plan document likely would have to be amended to permit interim valuations and modified distribution policies.

As for participants who separated before an amendment was adopted, their rights to distributions and particular valuation dates may have accrued on the date they separated, and ERISA may not permit an amendment that reduces their benefits. Although both the *Pratt* and *Amsted* courts reviewed the defendants' decisions deferentially (a claim denial may be overturned only if the decision was arbitrary or capricious), it could be arbitrary and capricious to apply a plan amendment to a particular participant if that amendment is prohibited by ERISA.

Note that the *Pratt* and *Armstrong* court opinions do not address the question of whether a trustee must comply with a plan provision requiring a particular valuation date and distribution method if compliance would endanger the solvency of the company. There are, however, other legal provisions beyond the scope of this article that might permit companies with significant going concern issues to take certain steps to protect the plan. €

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# ESOP Report Moves to Digital Distribution

## Change Gives All Members—including Those Working Remotely—Immediate Access to The ESOP Association's Monthly Newsletter

Starting with the April issue, The *ESOP Report* has moved to all-digital distribution. You will continue to receive the same content, but in a different format—one that is delivered in a faster, more environmentally friendly manner, and includes active links to relevant online materials and web pages.

The decision to shift to digital-only distribution was made partly in response to the challenges of the COVID-19 pandemic. As many of our members shift to remote work, receiving the newsletter in their offices—or sharing paper copies with colleagues who are no longer right down the hall—is no longer a practical option. To address this challenge and offer speedier delivery, we are now sending the *ESOP Report* via e-mail to *all* our members.

If someone in your member company is not receiving a digital copy of the newsletter and would like to do so, please ask them to create an account either by visiting our [website](#) or by contacting our membership department at [membership@esopassociation.org](mailto:membership@esopassociation.org).

One reason for this change is to free up funds that are being invested in urgently needed member benefits, most notably the [COVID-19 Action Center](#). This new online resource offers information that ESOP companies need right now to adapt to and overcome the COVID-19 health and economic crises.

We encourage members to visit this center today. (For more information on the COVID-19 Action Center, see the cover story of this issue.) €



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