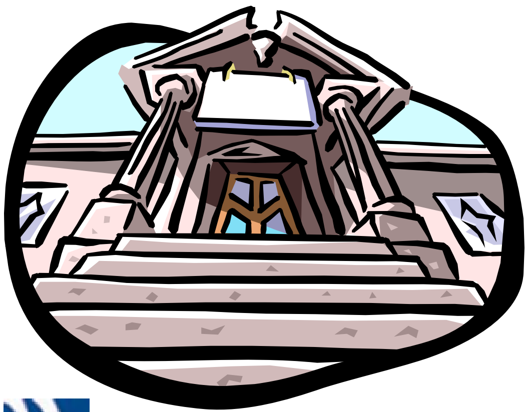

The Employee Benefits Group

THE ESOP ADVISOR

Some ESOP Issues In Tough Economic Times

Many companies have been experiencing financial difficulties over the past year. In some cases, companies have already or will reduce their workforce or close a facility. Those actions impact an ESOP in unique ways.

Partial Termination of ESOP

Closing a facility or a reduction in force may be considered a partial termination of an ESOP. If an ESOP has a partial termination, all of the affected participants must be 100% vested. So how do you know if an ESOP has had a partial termination? Although that is a determination made on all the facts and circumstances, the IRS presumes there has been a partial termination if more than 20% of the participants in an ESOP are involuntarily terminated. A partial termination typically occurs due to a layoff (or a series of layoffs extending over more than one plan year) or a facility closing, although it is also possible to have a partial termination due to a reduction in benefits, discontinuing contributions, or excluding groups of employees from an ESOP.

Partial terminations are significant events due to the combination of participants becoming 100% vested and entitled to a distribution of the ESOP benefit. That combination may result in significantly increased and accelerated repurchase liability. Another potential impact for a leveraged ESOP (an ESOP with an outstanding loan obligation) is that the remaining participants may receive larger future allocations of stock in the ESOP.

Due to the increased repurchase liability upon a partial termination, ESOP companies may want to consider one or all of the following distribution methods to soften the impact of a partial termination on the company's cash flow:

- Delaying distribution for up to five years after termination of employment.
- Distributing stock and repurchasing that stock with a down payment and a promissory note over up to five years.
- Distributing stock from the ESOP in five annual installments rather than a lump sum.

Refinancing ESOP Loan

Often ESOP companies faced with financial difficulties and reductions in force ask about the possibility of revising ESOP loan documents. Several factors may indicate that the original loan structure may no longer be appropriate:

- The ESOP has fewer participants.
- The company has less cash flow to make ESOP contributions.
- The remaining participants in the ESOP are receiving larger allocations of stock than originally intended.

Refinancing an ESOP loan is a fiduciary decision that the Trustee should not take lightly. The Department of Labor will give special scrutiny to the refinancing of an ESOP loan to determine whether the Trustee made a decision in the best interest of the plan participants. Job protection or improving the company's cash flow may not be justifications for an ESOP Trustee to agree to the refinancing of an

ESOP loan. The ESOP Trustee may need to consider additional terms that could justify extending the length of an ESOP loan, such as:

- The employer's obligation to make more contributions to the ESOP over time than the company is currently obligated to make, or to sell additional stock to the ESOP.

- An agreement from the holder of the ESOP loan that if the ESOP is terminated, the ESOP loan will be forgiven and any shares remaining in the ESOP will be allocated to the participants.

- "Price protection" providing a floor price for repurchases of ESOP stock from terminated participants.

The IRS has approved refinancing an ESOP loan when it is necessary to maintain the intended level of benefits that were anticipated to be provided to the participants when the ESOP transaction was first put in place. Due to the larger allocations that result from fewer ESOP participants remaining in the ESOP after a partial termination, the participants' benefits *may* have increased and refinancing the ESOP loan may allow those benefits to remain at the intended level. However, you should account for the share value when determining if the participants' benefits have actually increased. If the share value has decreased along with the number of participants, it is possible that there are simply larger allocations of a lower valued stock so that the participants ultimately are not receiving an increased benefit.

If you would like to learn more about ESOPs, please contact Vern Saper at 616.752.2116 or at vsaper@wnj.com, or Justin Stemple at 616.752.2375 or at jstemple@wnj.com.

EDITOR'S NOTE: This mailing from the Warner Norcross & Judd LLP Employee Benefits Group is being e-mailed to current WN&J ESOP clients, clients who have expressed interest in ESOPs, and other ESOP professionals and interested parties. If there are others within or outside your organization who might benefit from this newsletter, please send their names, organizations and e-mail addresses to vsaper@wnj.com and we will add them to our mailing list.

For more information, please contact your WN&J attorney or Vern Saper at 616.752.2116

Warner Norcross & Judd LLP

- Grand Rapids
- Holland
- Lansing
- Muskegon
- Southfield
- Sterling Heights

Visit us on the web at wnj.com