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Steve Leimberg's Employee Benefits and Retirement Planning Email Newsletter - Archive Message #747

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From: Steve Leimberg's Employee Benefits and Retirement Planning Newsletter

Subject: [Mary Vandenack on Lee v. Argent Trust Company](#)

"In the Lee case, plaintiff filed suit against an ESOP Trustee and others claiming that the amount paid by the ESOP for stock was too high based on the stock purchase price being \$198 million with an ESOP valuation less than a month later at \$64.8 million. The case was dismissed because the claim failed to recognize that a comparison was being made between pre transaction unleveraged value of the company stock to post transaction equity of the ESOP. Because the ESOP had to borrow to finance the transaction, immediate post transaction equity was zero. An increase in value to \$64.8 million a few weeks later was actually a significant improvement.

This case illustrates an issue that has commonly resulted in claims against ESOPs – understating valuation. An amicus curiae brief filed in the matter on behalf of the American Society of Appraisers explained the difference between the pre-transaction fair market value of a company and the post-transaction equity value of the ESOP stock."

Mary E. Vandenack provides readers with commentary on [Lee v. Argent Trust Company](#).

Mary E. Vandenack is founding and managing member of **Vandenack Weaver LLC** in Omaha, Nebraska. Mary is a highly regarded practitioner in the areas of tax, benefits, private wealth planning, asset protection planning, executive compensation, equity fund development, business and business succession planning, tax dispute resolution, and tax-exempt entities. Mary's practice serves businesses and business owners, executives, real estate developers and investors, health care providers, companies in the financial industry, and tax-exempt organizations. Mary is a member of the American Bar Association Real Property Trust and Estate Section where she serves as Co-Chair of the Futures Task Force, Co-Chair of the Law Practice Group and on the Planning Committee. Mary is a member of the American Bar Association Law Practice Division where she currently serves as Editor-in-Chief of Law Practice Magazine. Mary was named to ABA LTRC 2018 Distinguished Women of Legal Tech, received the James Keane Award for e-lawyering in 2015, and serves on ABA Standing Committee on Information and Technology Systems. Mary is a frequent writer and speaker on tax, benefits, asset protection planning, and estate planning topics as well as on practice management topics including improving the delivery of legal services, technology in the practice of law and process automation.

Here is her commentary:

EXECUTIVE SUMMARY:

In the [Lee](#) case, plaintiff filed suit against an ESOP Trustee and others claiming that the amount paid by the ESOP for stock was too high based on the stock purchase price being \$198 million with an ESOP valuation less than a month later at \$64.8 million. The case was dismissed because the claim failed to recognize that a comparison was being made between pre transaction unleveraged value of the company stock to post transaction equity of the ESOP. Because the ESOP had to borrow to finance the transaction, immediate post transaction equity was zero. An increase in value to \$64.8 million a few weeks later was actually a significant improvement.

FACTS:

In late 2016, Choate Construction Company (“CCC”) adopted an Employee Stock Ownership Plan (“ESOP”) with Argent Trust Company as Trustee. At the end of 2016, the ESOP purchased 8 million shares (80%) of CCC for \$198 million. At about the same time, CCC redeemed shares of the former owners for non-voting stock and warrants. To finance the purchase of CCC shares by the ESOP, CCC borrowed \$57 million from the bank and then loaned that amount to the ESOP. The balance of the purchase price was paid by the ESOP providing notes payable to the selling shareholders in the total amount of \$141 million with annual interest of 4%.

For purposes of valuing the stock for the transaction, the ESOP Trustee, Argent Trust Company retained Stout Risius Ross to provide the initial appraisal and ongoing valuations.

Sharon Lee filed suit against Argent, the CCC ESOP committee, the CCC board of directors and various other parties claiming that the CCC ESOP had not been created in the best interest of the employees. The specific claims made included breach of fiduciary duties and prohibited transaction. In making her claim, the plaintiff pointed to a valuation of the CCC ESOP stock on December 31, 2016 in the amount of \$64.8 million. Such valuation was less than a month after creation of the CCC ESOP.

In the district court action, the defendants moved to dismiss all plaintiff’s causes of action. The United States District Court for the Eastern District of the North Carolina Western Division dismissed plaintiff’s complaint.^[1] The dismissal was upheld by the 4th Circuit Court of Appeals.

The district court noted that the plaintiff failed to show that she suffered an injury traceable to the conduct of the defendant that would be likely to be redressed by a favorable judicial decision.

Plaintiff’s complaint was based on valuation. The CCC ESOP purchased 8 million of shares for \$198 million. Plaintiff’s analysis concluded that such shares had a value of \$24.78 each based on that valuation. The ESOP shares were valued at \$64.8 million a few weeks later. Plaintiff’s theory was that the value of the shares had dropped to \$8.10 a few weeks later.

The district court explained that the Plaintiff’s theory ignored the reality that the value of the ESOP was zero on the date that the ESOP was created. To purchase shares worth \$198 million, the ESOP had to borrow \$198 million. Thus, while the share value equaled

\$198 million, when one looks at the ESOP balance sheet immediately after the transaction, the ESOP was worth zero in that the assets consisted of \$198 million in stock but liabilities to acquire the stock totaled \$198 million.

The fact that the CCC ESOP value was \$64.8 million actually reflected a move from zero equity in the CCC stock to an equity position for the ESOP. In part, the increase in value was due to the fact that the ESOP had purchased the shares at a discount.

The court used the analogy of buying a house for \$198,000 and borrowing the entire purchase price. The day after the house is purchased, the owner has no equity. Equity results from increases in value and payments of principal. At the date of purchase, the house is still worth \$198,000 but if the entire amount to purchase the house is borrowed, the purchasing owners have no initial equity.

COMMENT:

ERISA^[iii] is a federal law created to protect the interests of participants in employee benefit plans. ERISA imposes fiduciary duties on plan fiduciaries including duties of loyalty and prudence.^[iii] One of the duties imposed by ERISA is that a fiduciary act in the interest of plan participants with the exclusive purpose of providing benefits to such participants.^[iv] In the context of an ESOP, the duty includes protecting participants and beneficiaries.

While Employee Stock Ownership Plans can be a useful tool for business succession planning purposes and employee engagement, a common claim against ESOPs is that the ESOP was not created for the best interests of the employee. That was the complaint in the *Lee* case. A common basis for such a complaint is that the ESOP overpaid for the shares purchased.

This case illustrates an issue that has commonly resulted in claims against ESOPs – understanding valuation. An amicus curiae brief filed in the matter on behalf of the American Society of Appraisers explained the difference between the pre-transaction fair market value of a company and the post-transaction equity value of the ESOP stock.

HOPE THIS HELPS YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Mary Vandenack

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CITATIONS:

^[i] *Lee v. Argent Tr. Co.*, 5:19-CV-156-BO (August 6, 2019).

^[ii] Employee Retirement Income Security Act of 1974, 88 Stat. 829, as amended, 29 U. S. C. §1001 et seq.

^[iii] 29 U.S.C. §1104.

^[iv] 29 U.S.C. §1104.

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