

Main Street Employee Ownership Act Signed

Labor & Employment Law Update

on October 3, 2018

On August 13, 2018, as part of the John S. McCain Fiscal Year 2019 National Defense Authorization Act, President Trump signed into law the Main Street Employee Ownership Act, which was originally introduced by Senator Gillibrand and Representative Velazquez, a rare bipartisan achievement.

Employee Stock Ownership Plans (ESOPs) are often established using a loan to finance the purchase of company stock by the plan. ESOPs only infrequently default, so this is an area in which the government can be confident that the taxpayers will get their money back. The Small Business Administration (SBA) was authorized to make ESOP loans in 1979, but it was done only infrequently because it was so cumbersome.

The Act facilitates the establishment of ESOPs by revising the rules under which the SBA may assist small employers to transition to employee ownership.

Specifically, it:

- Permits the SBA to make loans to companies that can then re-lend to ESOPs (prior law only allowed direct loans made to ESOPs, but commercial ESOP loans are almost always made to the company and re-lent to the ESOP);
- Permits ESOP loans to be made under the SBA's preferred lender program, which should expedite the process;
- Provides that ESOPs do not need to have full voting rights to qualify, which aligns more closely with Federal income tax rules;
- Makes an exception to an SBA rule that sellers of a company cannot have an ongoing role in the firm (the Act codifies in statute a recently released SBA policy that allows the seller to stay on as an owner, officer, director, or key employee of the company, when the ESOP acquires a controlling interest i.e., 51 percent or more, but any seller who remains as an owner, regardless of percentage of ownership interest, would be required to provide a personal guarantee, which is often required in commercial ESOP loans in any event);
- Helps finance transition costs, which can be expensive, by allowing transaction costs to be financed as part of the SBA loan; and
- Grants SBA the authority to waive equity requirements (SBA currently requires an equity injection of at least 10 percent of the total project cost for loans that finance change of ownership, but under the Act SBA may waive that

requirement on a case by case basis for loans that finance a change of ownership to an ESOP).

Small businesses, which may be considering a switch to employee ownership, should be aware of these changes that may make the transition easier. In some limited circumstances, one or more of these changes may even be the deciding factor in proceeding with a transaction.

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