MONUMENT ECONOMICS GROUP
1530 Wilson Boulevard • Suite 560
Arlington, VA • 22209 • T: 703.465.5600

Court Finds for Department of Labor in Key Employee Stock Ownership Plan Dispute

In 2016, the Department of Labor (DOL) challenged a 2010 acquisition of the remaining 52% of shares of Sentry Equipment Erectors Inc. by its Employee Stock Ownership Plan (ESOP), claiming it overpaid in its $21 million purchase of the shares from company owner Adam Vinoskey, who was also an ESOP Trustee. The ESOP paid $406 per share for 51,000 shares of Sentry, more than $100 above the 2009 appraised value of $285 per share. Evolve Bank and Trust acted as Special Independent Trustee (SIT) on behalf of the ESOP. Early last month the Court agreed, finding the SIT and Vinoskey caused the ESOP to overpay for company stock by approximately $6.5 million.

In order for Plan fiduciaries to avoid the "prohibited transaction" challenge, the Plan must pay no more than "adequate consideration" in acquiring company stock. The Court here took notice, in particular, of certain favorable adjustments by the appraiser hired by the SIT, who had been valuing Sentry's stock each year, in performing a valuation for purposes of the transaction. Specific criticisms by the Court included that the appraiser made certain inappropriate "normalization adjustments" reducing the company's expenses; inappropriate downward adjustments to the discount rate and capitalization rate, artificially inflating the valuation; and that the valuation assumed minimal ongoing working capital, which was not supported by historical levels of working capital for Sentry. The Court also noted that the $406 per share offer was the first one made by the sellers, and there was no visible negotiation by the SIT. In addition, the Court noticed that each of the appraiser's discretionary adjustments was geared toward arriving at a $406 inflated valuation.

Monument's Cynthia Jones, CFA, recently served as a valuation expert for the plaintiff in a similar ESOP dispute where the purchase price of company shares by an ESOP was alleged to have exceeded "adequate consideration." In the matter of Brincefield v. Studdard et al., the long-standing company appraiser, hired by the SIT to prepare a valuation for the transaction, also computed an implied value for Morton G. Thalhimer, Inc. shares on a controlling interest basis. Also similar to the Vinoskey case, there were no contemporaneous projections of free cash flow and thus, the appraiser relied upon an income capitalization approach. The appraiser made certain normalization adjustments to operating income that would only be available to a controlling shareholder. Ms. Jones disagreed with the appraiser's approach, given that the block of subject shares did not constitute, nor convey control to the ESOP. Pursuant to her analysis of the company's value on a minority-interest basis, Ms. Jones' analysis supported a significantly lower transaction price, including a discount for lack of marketability, giving rise to damages in the case. This matter was recently settled by the parties with an undisclosed award made to the plaintiff.