



Connection

THE MID-ATLANTIC CHAPTER ESOP ASSOCIATION NEWSLETTER

August 2006

President's Message

It's the employees, stupid.

This phrase, of course, is a variation on the famous line by Democratic political strategist James Carville during the 1992 Presidential election. His point was all issues were secondary to the issue of fixing the economy.

Similarly, the primary focus at our workplaces should be the employees. We've probably all read numerous articles that describe ways to attract, motivate and retain employees and likely received inquiries from vendors eager to help you recruit and provide incentives to your workforce.

Some companies intuitively understand that employees are the key to business success. Our favorite sports analogies illustrate this point. For example, when was the last time an owner hit a home run or a coach shot the winning basket? Putting aside those who can still remember player coaches, like Bill Russell of the Boston Celtics, the point is that the players, not the coaching staff or the front office, ultimately must perform the game plan for the team to triumph.

It naturally follows that teams pay their best players more than they pay coaches and general managers. We'll admit that in recent years this gap has shrunk somewhat, particularly for superstar coaches who have been heavily recruited by owners. Nonetheless, this pay differential recognizes who actually wins games and who the fans come to see.

ESOP companies that create a vibrant employee-ownership culture have a leg up on the competition because their employees understand the company's strategic plan and receive the tools, training and incentives to maximize performance. These companies realize that putting employees first may cost a bit more -- but that the cost of not doing so is much greater.

Can a team succeed in an environment where the players do not understand the game plan, do not have the proper equipment or facilities, and are not properly rewarded for both team and individual performance? The likelihood of success is small for any team or company with such attributes.

On the other hand, a positive environment that results in satisfied employees translates into satisfied customers, and satisfied customers mean more business. We've all had experiences where poor employee service made us so unhappy that we would do anything to avoid further interaction with the offending business. ESOP companies do a better job avoiding such situations because they can create environments of opportunity where employees are motivated to exceed customer expectations. To do anything less for employees would be just ... *stupid*.

Paul Horn

MAC Meeting in Tysons -

ESOPs and Executive Compensation

By Thomas Roback, Jr., CEP, QKA of Blue Ridge ESOP Associates

Record numbers turned out for our July 27th seminar at Ernst & Young in Tysons Corner. Our first speaker, Michael Coffey of Corporate Capital Resources, got the program rolling with his comforting words -- "Don't worry; you can get there from here" and "we shucked this topic down to the cob" so everyone understood the basics.

He discussed how ESOP funding of stock purchase and repurchase obligations can work together to support ownership transition programs. Michael introduced the various forms of executive compensation like stock options (ISOs and NSOs), deferred compensation (defined contribution and target benefit), cash bonuses, restricted stock, phantom stock, SARs, and stock purchases. It is clear that these awards will all impact ESOP share value, but it's important to note that these awards may motivate key employees to drive company value to a higher level benefiting all. However, if the cost involved does not grow the business, the awards are not prudent.



The risk/reward paradigm Michael outlined involves executives taking more risk for possibly more reward while other employees are exposed to less risk through the ESOP retirement plan. One case study shared involved executives getting performance based awards at different thresholds of company growth. For example, no compensation incentives if share price appreciates less than 2%, bonuses and profit sharing when growth is from 2% to 6%, and funded deferred compensation arrangements when annual growth is more than 6%. Michael opined that executive compensation plans are best implemented well before an actual ESOP transaction.

Finally, Michael showed how these forms of employee ownership and share price appreciation directly impact corporate repurchase obligations. Michael ran the numbers right before our eyes using visual aids that helped the audience understand how modest increases in share price growth can balloon repurchase obligations.

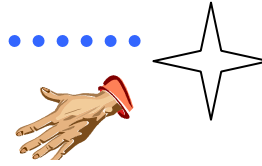
Our second speaker, Lou Diamond of Buchanan Ingersoll, then reviewed the options available to S and C corporations planning and operating ESOPs where key executive compensation is a concern. Lou summarized the use of restricted stock, options and deferred compensation, in the context of an ESOP transaction. Lou has found ESOPs to be very beneficial for many of his clients over the years and shared some live examples when an ESOP worked perfectly. Mr. Diamond concluded by outlining some pitfalls relative to IRC §409A and §409(p), which can



(MAC meeting cont.)

occasionally cause headaches, but are usually not a problem if expert professionals are involved.

There were a few provocative questions from the audience as well as practical stories from ESOP professionals involved in complex ESOP transactions. Special thanks to Sonia Roberts and Ruth Wimer of Ernst & Young for their hosting the event.



Change at the Top

Paul

Good leadership is really good stewardship because titles should be treated as but temporary. Good stewardship means improving the organization, fostering consensus, broadening involvement, and identifying individuals for succession planning. It also means putting organizational and member needs first, something I call selfless leadership (or leadership without ego).

I have enjoyed serving as President of MAC ESOP for the last six years and believe we have stayed true to these goals. One of these goals is to give others the opportunity to lead. In a scenario akin to English parliamentary members switching cabinet portfolios, I will be swapping officer titles with Keith Robertson effective October 1. Our Chapter is certainly fortunate to have someone of Keith's ability to lead us in the years ahead. As you may know, Keith was TEA 2001 Employee Owner of the Year from Comsonics, Inc.

In the past six years we have seen significant growth in Chapter membership as well as our programs and meetings. Significant Chapter accomplishments include the Chapter of the Year Award in 2006, the Chapter membership recruitment award in 2005, and two Chapter officers receiving national TEA recognition (Rick Mapp and myself). Our newsletter is informative and entertaining and our Chapter conferences have reached new levels of excitement with record attendance levels.

Our Chapter accomplishments would not have been possible without the efforts of many:

Our Chapter Administrators who worked with us during this period,
Our Chapter Officers,
Our Chapter Steering Committee,
Our Conference Sponsors, and of course
Our Chapter Members!

So while I will be stepping aside, I will not be stepping away. I look forward to continued learning and fun with my fellow MAC ESOP members.

Paul Horn

TEA Chapter of the Year



Keith

It's usually pro forma to start this article by thanking your predecessor. But a simple thank you just won't sum up what Paul Horn has done for the Mid-Atlantic Chapter. I have been continually amazed at Paul's creativity and his ability to think outside of the box time and again while planning the chapter events. His never ending stream of catchy themes has been fantastic. This is especially amazing for a guy that deals in benefits administration; maybe all of his creative juices are bottled up and he uses them for ESOP. Whatever the case, the MAC has definitely been the beneficiary (no pun intended).

So although Paul is a couple of shirt sizes smaller than me, I definitely have some very big shoes to fill. Our chapter has enjoyed, year after year, exceptional attendance at both of our annual conferences, and we're somewhat the envy of many other chapters in the association. We've also seen very good participation among our member companies in the Annual Awards for Communication Excellence (AACE) competition, where quite a few awards have been garnered. Finally, we were honored as the Chapter of the Year in 2006.

All of this requires good leadership at the top and also active and enthusiastic participation from everyone in the chapter. It's not just the chapter officers. It's also the many people at the corporate member companies. Plus, don't overlook the folks that make presentations at our events. In addition, a lot of thanks is in order for the contributions made by our very strong and supportive professional members and their firms.

I will work hard to continue the MAC's high standard of achievement. A lot of that will result from simply providing good educational sessions that are a value to our members. However, doing that will require feedback and suggestions from you, the members. Let the chapter leadership know what you'd like to see, what topics are of interest, and any other suggestions you may have.

That's enough for now especially since you will be hearing more from me in the future. Thanks again for all of your past support, and please continue to stay involved in ESOP events.

T. Keith Robinson



Eggs 'n ESOP's



Candid Shots from The ESOP Association May Conference

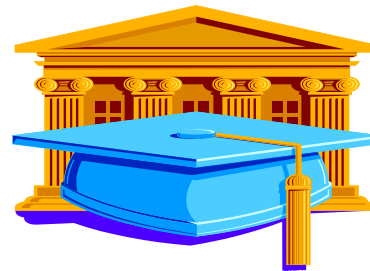


Eastern Region Breakfast Meeting August 3, 2006

The MAC Eastern Region held its summer "Eggs 'n ESOPs" Breakfast meeting on Thursday, August 3, at the Holiday Inn Executive Center in Virginia Beach. The heat from Michael Coffey's presentation on Executive Compensation in ESOP Companies was matched only by the scorching 105 degree temperatures outside the hotel. Mr. Coffey addressed the use of equity and other incentive programs funded by investment products such as COLI as a means to both (1) reward executives for achieving superior results and (2) manage and fund ESOP repurchase liability. Following this presentation, Shad Fagerland from the ESOP Team at Kaufman & Canoles, P.C. ("Virginia's ESOP Law Firm") spoke on recent case law impacting the compensation decisions of ESOP Company Trustees and Boards of Directors. In the words of one attendee, Shad really "Mapped out" the rules in this complex legal arena. A good time was had by all.



Michael Coffey sheds light on issues for breakfast audience.



ESOP University: Learning to Make a Difference

Class Date

When: Thursday, October 26, 2006

Where: Doubletree Inn
Charlottesville, VA

*Pre-class sessions begin on October 25 with a day of golf at the Birdwood Golf Course and dinner at the Star Hill Brewery.

Coming your way soon:

- Program information and registration
- Sponsorship opportunities
- Golf information and registration

Dr. ESOP



Dr. ESOP:

My ESOP has a graded five-year vesting schedule of 20% each year. Does that mean I have to work a full five years to become fully vested in ESOP account and what happens if I leave before becoming fully vested?

Sincerely,

Vexed in Virginia

Dear Vexed in Virginia:

As you seem to understand, those stock allocations to your account won't be yours to keep if you don't stick around long enough to fully vest.

Most plans require 1000 hours of service during the year to earn a year of vesting service. Thus, if you were hired on July 1 and are working full-time, you could earn five years of vesting service in as little as four years (48 consecutive months).

Other events, such as death, total disability or attainment of normal retirement age (typically age 65 under the plan) while employed, also may result in immediate, full vesting under the plan.

If you leave before becoming fully vested you will forfeit your unvested shares. These shares will be allocated to other active participants in the year of forfeiture. ESOPs that have a six-year delay for benefit commencement following termination of employment usually delay forfeitures for five years.

Why? If the forfeiture was immediate and then the former employee came back before five break-in-service years, the forfeited shares would have to be restored and that can get complicated. Why again? First, the accrued benefit required to be restored cannot be less than the amount in the participant's ESOP account balance of the employee, *unadjusted by any subsequent gains or losses*. So if the participant had 10 shares worth \$100 that were forfeited but now the shares are worth \$20 each, only 5 shares need to be restored (if the plan so provides). Second, if in the preceding sentence the participant was 25% vested and received an immediate distribution of \$25, the participant, if rehired, would need to repay the \$25 to restore the forfeited \$75.

Be vexed no more Virginia because with ESOPs, V is for Vesting.

Sincerely,

Dr. ESOP

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Pension Protection Act of 2006

The Pension Protection Act of 2006 ("Act") was signed by the President on August 17. The Act is over 900 pages with many of its provisions requiring further guidance from government agencies.

The Act's primary focus is defined benefit plans. However, it also has a variety of provisions affecting defined contribution plans. Some of the major provisions that may affect your ESOP and/or 401(k) plan are discussed below.

Note: The IRS issued voluminous final 401(k) regulations recently and those changes will need to be reflected as necessary amendments to your 401(k) plans.

1. 401(k) Auto-enrollment

Explicitly protects auto-enrollment from any state law interference on payroll withholding consent issues. Plan may allow employee a 90-day window to elect out of plan and receive back deferrals without any penalty tax. If use auto-enroll, have 6 months, rather than 2½ months, to refund excess deferrals without 10% penalty to the employer if flunk ADP test. New auto enroll rules take effect in 2008.

All 401k refunds now taxed in year of distribution. Previously, if refund made within 2½ months of year-end, it was taxed in prior year. This was confusing to employees. Income earned in plan by refunded deferrals after-year-end will no longer be added to the final refund amount.

2. Investment Advice

Plan vendors have less restriction on providing investment advice, beginning in 2007.

3. Vesting

All contributions must now vest no later than 3-year cliff or 6-year graded, effective for plan years beginning on and after 1/1/07. Leveraged ESOPs with loans outstanding on September 25, 2005, are grandfathered from the faster vesting schedule until the loan is repaid.

4. Extension of EGTRRA Limits

EGTRRA in 2001 made a number of changes liberalizing contribution limits and related provisions that would have expired in 2011. Upon expiration, the limits would have reverted back to the pre-EGTRRA levels (as adjusted for inflation.) For example, the higher 401(k) and catch-up limits are preserved. The Roth 401(k) feature also is made permanent. These changes are effective immediately.

5. Diversification Acceleration for Employer Stock

Does not apply to private company ESOPs.

6. Missing Persons

Current law provides PBGC as clearinghouse for missing defined benefit plan participants. Basically plan pays \$ over to PBGC after reasonable search efforts exhausted and PBGC assumes responsibility of locating person. This approach now expanded to defined contribution plans. May be very helpful in dealing with missing ESOP persons. Effective upon issuance of regs by PBGC.

7. Fidelity Bond

Bond increased from \$500,000 to \$1M where plan holds employer securities effective 1/1/2007. If no exemption for private securities, bond will need to be increased for ESOP.

8. Rollovers

Non-spouse beneficiaries receiving eligible rollover distributions from a qualified plan may now make direct rollovers to IRAs. The IRA accepting the direct rollover must be set up solely to receive the death benefit, will be subject to the minimum required distribution rules applicable to beneficiaries, and cannot accept additional contributions or permit rollovers of distributions from the IRA. The death benefit distribution to the non-spouse beneficiary will not be subject to the 20 percent mandatory withholding rules even though a rollover option is now available. This provision is effective for distributions after 2006.



Welcome New MAC Members 2006*

CORPORATE MEMBERS

Jaclyn White., Mid-Atlantic Door Group, Inc.
Stuart Morgan, Construction Associates, Richmond, VA
Bob Martin, McDaniel, Inc., Elkton, VA
Richard Walther, FoodPro Corporation, Frederick, MD
Deidra Eland, Progress Printing Company, Lynchburg, VA

PROFESSIONAL MEMBERS

Dean A. Martinelli, Hantzmon Wiebel, LLP, Charlottesville, VA
Tracy Holzman, Blue Ridge ESOP Associates, Charlottesville, VA
Sean Geoghan, CTS Capital Advisors, LLC, Bethesda, MD
Nathan Perkins, Morgan Stanley, Washington, DC
Douglas Bayer, Morgan Stanley, Washington, DC

**Please let us know if we missed you.*

Please make
sure that MAC has your current e-mail address. Simply send
your e-mail to midatlanticesop@comcast.net today!

TO:

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ESOP Association P.O.
Box 625, Stow, MA 0

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