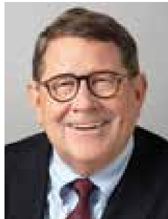
FOODSERVICENEWS
Volume 30• Issue 10 *The News and Information Source for Restaurants and the Foodservice Industry* November 2019
www.foodservicenews.net

# ESOP Fable: How Hell's Kitchen implemented an employee buyout where both sides are happy



**Dennis Monroe**

THERE HAVE BEEN VERY FEW Employee Stock Ownership Plans (ESOPs) implemented for restaurant companies, particularly for single-unit restaurants. With the turnover in restaurants, it's extremely difficult to administer, as well as to implement, an ESOP.

But ESOPs can be a great tool for ownership transition, altruistic goals and tax efficiency. A tax efficient structure involves an ownership buyout that uses levered debt. It can be bank debt or loans from the selling owner. The tax rules are favorable for borrowed funds under an ESOP. In its most simplistic sense, the principal loan payments made under the leveraged ESOP are deductible as contributions to the ESOP. Further, if you are a flow-through entity, such as an S Corporation or an LLC, you can also shelter income because those entities are owned by a tax-exempt trust.

**Cynthia Gerdes, above, and her partner Steve Meyer have done the due diligence, and paperwork, to turn the company over to the management team and employees.**

If you want a local example, we have a good one in Hell's Kitchen, owned by Cynthia Gerdes and Steve Meyer. Hell's Kitchen has always been in the forefront of creativity and new ideas, whether it's employee relationship, delivery or its colorful marketing. It is a unique, employee-based company. If you've ever been to Hell's Kitchen, you get the sense that the employees enjoy working there.

All of that leads me to my interview with Gerdes. They've structured the ESOP through a 100 percent buyout by an ESOP trust, which is then owned by the employees, so they will end up with 100 percent of Hell's Kitchen. The owners are selling their interest on a promissory note, known as an installment sale. They'll be paid off over eight to 10 years, and the structure, as stated above, has some distinct tax advantages for the employees and the trust, but as it relates to Gerdes and Meyer, they merely get capital gains tax rates paid off over the period of the note, which would be 10 years.

What's unique about their ESOP is how they've treated the employees. First off, to be a participant in the ESOP, you have to have been an employee for one year and be over age 21. The nice thing is that an employee, for purposes of participating in the ESOP, only has to have 700 hours worked in a given year, which includes a lot of pseudo part-time

**An example of Hell's Kitchen's creativity is skyway delivery, which was taken to an all-time high with these highly decorated— and expensive— carts. One of the downsides, Cynthia Gerdes has said, is that employees were constantly stopped by people in the skyway wanting to take selfies with the carts.**

employees. They have 143 employees and least 100 of those will be able to participate in the ESOP. Further, it's key, too, that this ESOP really has been the result of a management team, which has been trained and is more than capable. They are extraordinarily good at running Hell's Kitchen, so the existing

*Reprinted with the permission of Foodservice News, November 2019*

management team will stay in place and they will be the key people making this ESOP work. Additionally, Gerdes will stay on as CEO for a couple years during the transition.

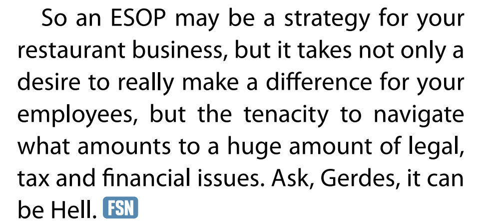
What's also important is that the culture of Hell's Kitchen will be carried out, meaning all employees will basically have a say and input into the running of the company. The company will be run by the management team—which is key—but it will also have this gratifying feeling of employee participation. This type of employee ownership often results in superior financial performance as owner-employees tend to be more productive overall.

They are looking at completing the ESOP beginning January 1, 2020, and are currently going through what amounts to a fairly arduous process. ESOPs, because they are tax-exempt and because they are a product of the Internal Revenue Code, require a great deal of background work and specifically, they have to get stock valuations when transactions occur and on an annual basis thereafter. Once a valuation is agreed to, there are IRS filings, a lot of legal work and then the actual sales document, the same as if they were selling to a third party—which in effect, they are.

This is why you rarely have ESOPs implemented in the restaurant space. It should be noted that Parasole implemented an ESOP for its Bucca di Beppo concept, and when the chain went public, the ESOP was bought out and a number of employees were able to pay off mortgages and it made a big difference in their lives. But the ESOP didn't work with the public offering. Additionally, there have been franchisees of large restaurant companies that have tried to do ESOPs, but in most cases, franchise documents prohibit ESOPs and there's only one that I'm aware of— a Burger King franchisee in the San Francisco area—and I'm not sure it's still in existence anymore.

Gerdes said Grand Central Oyster Bar in New York did a 100 percent ESOP about 12 years ago, and she spoke with them before she considered the ESOP. They informed her that it was a huge success. The salon business is analogous to the restaurant business and I was involved more than 20 years ago with the implementation of an ESOP for Cole's Salon for You. They have five salons and the ESOP has been a success in terms of employee retention, morale and wealth-building for employees. My research reveals that this is the only hair salon company in the country that has implemented an ESOP.

So an ESOP may be a strategy for your restaurant business, but it takes not only a desire to really make a difference for your employees, but the tenacity to navigate what amounts to a huge amount of legal, tax and financial issues. Ask, Gerdes, it can be Hell. FSN



Dennis L. Monroe is a shareholder and chairman of Monroe Moxness Berg PA, a law firm specializing in multi-unit franchise finance, mergers and acquisitions and taxation in the restaurant industry. You can contact him at (952) 885-5999 or dmonroe@mmblawfirm.com. For more information, please refer to www.MMBLawFirm.com.