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DEVELOPMENT, GROWTH AND EXPERIENCE OF ESOPS AND DEMOCRATIC EMPLOYEE BUYOUTS IN THE USA

by

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I. Introduction

In this presentation I will attempt to synthesize the US experience to date and the lessons I have learned about the uses and policy implications of employee ownership in my practice as an employee ownership attorney for unions and employees.

II. Historical/ Political Context of the Development of Employee Ownership in US

A. History of Employee Ownership in the USA

Worker ownership was one of the core ideas favored by the first trade union confederation in the USA, the Knights of Labor, founded in the 1870's. Although the Knights promoted the idea of worker cooperatives and established 135 of them between 1878 and 1886, during that era of rapid and massive industrialization, worker cooperatives could not accumulate the capital necessary to make cooperatives a significant alternative. Collective bargaining advances far outpaced worker ownership as a method of increasing power and the material well being of workers.

Worker ownership as an alternative to unemployment again became a real tool during the depression of the 1930's. A number of the cooperatives created by Unions in that period remain, primarily Plywood cooperatives in the Pacific Northwest. However, the form of equity ownership they used led to the destruction of many of those coops.

Individual members purchased shares, which appreciated as the value of the firm grew. In order to cash out a member, a new member had to buy the share. Over the years, the shares became too expensive for younger workers to afford. Many of the cooperatives had to sell to private concerns for the worker owners to cash out. Others devolved into a two-class system of owner and non-owner workers.

In the 1980's the Mondragon system of share ownership was introduced in the US by the Industrial Cooperative Association, which enabled new employees to purchase shares over time, while paying out retiring members also over time. However, industrial cooperatives never became a significant trend in the US.

The economic progress obtained through collective bargaining from the end of World War II until the late 1970's eclipsed any other strategies for obtaining worker rights. The US labor movement (unlike many European unions) did not demand greater workplace control in the 1970's.

In 1975, Louis Kelso, an investment banker who believed that capital, not labor, was the source of all value, convinced the conservative populist, Senator Russell Long of Louisiana, to introduce legislation creating a wide variety of tax deductions for the employee stock ownership plan (ESOP). Neither Kelso, nor Long, were great friends of labor. So the political status of ESOPs has never been labeled as an idea of the left or of the right. It is supported by politicians of all stripes, from Ronald Reagan to Bill Clinton to the socialist Michael Harrington.

It was not initially sponsored or promoted by labor. In the early years most trade union leaders were quite skeptical or openly hostile to ESOPs, and for good reason. ESOPs have been used to bust unions and have been abused to strip all the valuable assets out of companies leaving the employees with a debt ridden, over-priced empty shell. When they were first created, most of the promoters and practitioners worked for the sellers or company managers. Until the mid-1980's the trade unions did not have the expertise to control ESOP transactions for the benefit of the workers.

However, during the recessions of the early 1980's and 1990's, the enormous pressures from foreign competition, the industrial carnage and massive job loss caused by the LBO craze of the 1980's, the weakening of labor law enforcement in the Reagan and Bush years, and the decreasing efficacy of strikes, forced US trade unions to adopt a host of new strategies in order to survive. A number of these were capital strategies, such as corporate campaigns and worker ownership.

The United Steel Workers (USWA), the Airline Pilots Association (ALPA), and the Amalgamated Clothing and Textile Workers (ACTWU) unions took the lead.

In 1984, the USWA research director stated that employee ownership was their only alternative to no US steel industry or one owned by the Japanese. They developed an active strategy of proposing employee ownership where they felt that the management was killing the company or where significant concessions were necessary.

ALPA similarly took an aggressive position with their leading airlines, as soon as they saw the damage being done to their industry by deregulation and leveraged buyouts. In order to fight the two tier wage system as long as they could, they began efforts to buy United AirLInes (UAL) five or six years ago. While their initial efforts did not lead to employee ownership, they did manage to severe the airline from a conglomerate into which it had been merged, and to get the CEO replaced.

Currently, the union coalition at UAL is seeking majority employee ownership in exchange for concessions[1]. Recently Northwest Airlines employees concluded negotiations giving them 37.5% of company equity and board seats in exchange for concessions provided the company raises $500 million in new equity. The company plans to use the new agreement to "define new standards of meaningful participation for our employee owners"[2]. Similarly, at TWA the unions have negotiated 45% equity ownership and board seats[3].

As labor has gained more skills in handling capital strategies, their use is increasing. Employee ownership is becoming a more commonly accepted labor strategy. However, it is still used haphazardly. Few unions have developed coherent positions on many of the key issues and contradictions raised by unionized employee ownership. However, both the USWA and the AFL-CIO have issued guidelines to assist their members in employee ownership negotiations[4].

Although majority employee ownership is the exception, and not the rule, the number of employee controlled and highly participative ESOPs is increasing. Unions have taken the lead in creating many of the new mechanisms of majority employee ownership and participation, while struggling with the changes in their own role caused by these changes in workplace organization.

III. Overview of Employee Ownership Mechanisms and Uses in the USA

A. What ESOPs Are and How They Work

1. We have many varieties of employee ownership in the USA, however this presentation will focus on Employee Stock Ownership Plans (ESOPs) because they are the most common form, largely due to favorable tax treatment. (See attached copies of slides and Summary of Employee Stock Ownership Provisions and Changes.)

2. An ESOP is:

a) a type of defined contribution pension plan - that is the basis for its exemption from taxes;

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[1] Interview of Capt. Roger Hall, Airline Pilots Association United Airlines Master Executive Council Chairman by D. Olson Oct. 4, 1993.

[2] Northwest Sr. V.P. Chris Clouser quoted in BNA Pension Reporter Vol. 20 p. 1702 (8/9/93).

[3] Id note 1.

[4] As of November 1990, 50,000 USWA members were participants in ESOP plans which owned part or all of 23 companies. For a systematic treatment of the Steelworkers' position, see Steve Newman and Mike Yoffee, "Steelworkers and Employee Ownership," Journal of Employee Ownership Law and Finance, v. 3, no. 2 (Spring 1991), pp. 51-74. See also "IUD Guidelines on Employee Stock Ownership Plans as Adopted by the AFL-CIO Executive Committee," Labor & Investments, July-August 1987, p. 4-5.

b) enjoys many exemptions from taxes on the corporation, lenders, selling shareholder and the ESOP participant, which causes ESOPs to be a preferred method of employee ownership;

c) were designed to attract retiring owners to sell their companies to their employees;

d) hold the employee stock in a trust controlled by a trustee, who may or may not be appointed by the owner or elected by the participants, or some combination thereof.

(Attached, or available separately, is a detailed summary of the lengthy rules and regulations surrounding ESOPs.)

B. Major Uses of ESOPs and Coops

1. Anchoring jobs and business in local communities;

2. Creating a local market for selling stockholders;

3. Cheap capital for business investment, expansion or divestiture:
   a) principal and interest tax deductible;
   b) 50% exclusion for lenders on interest income;
   c) deduction for dividends to employees;
   d) deductions for dividends used by ESOP for debt retirement;

4. Local employee control over investment and disinvestment.

C. Comparison of ESOPs with Cooperatives

1. Coops

a) Coops in the US are generally defined in state and not federal law. Although to avoid corporate double taxation under federal tax law they must meet federal requirements for cooperatives. They seem structurally fairly similar to Irish cooperatives.

b) In the US there are significant agricultural cooperatives, but few industrial ones. Most of the industrial ones are in smaller concerns. They have neither the familiarity and tax advantages of ESOPs nor the ability for entrepreneurs to control them that traditional business corporations do.

c) A problem that cooperatives face, if they require equal ownership among all members, and 100% employee ownership, is a lack of equity capital.

d) By contrast, many ESOPs have successfully created partnerships with private investors so that, some blocks of shares are owned by equity investors, while the ESOP owns the remainder of the stock being purchased with borrowed funds. Under this arrangement, the private investors also have the ESOP as a tax advantaged exit vehicle.

2. Cooperative ESOP

Our firm has specialized in using the tax and finance advantages of the ESOP, while incorporating as much employee control and democracy as possible, under the law and within the financial constraints of the needs of the deal for investors, management and equity.

D. Other Employee Ownership Mechanisms (Partnerships, Sub-S Corporations, Non-Qualified Stock Purchase Plans, Incentive Stock Options)

These non-ESOP mechanisms provide many fewer or no tax advantages but allow the company to choose those employees to whom it will provide stock.

IV. Overview of the Current Extent and Uses of Employee Ownership

A. Number of Employee Owned Enterprises

As of June 1991, the National Center for Employee Ownership reported 10,000 employee owned companies employing 12% of the US workforce, ranging from tiny cooperatives to our largest corporations, including 15% of the publicly traded companies. There are approximately 1500 majority employee owned firms.

B. Percentage Employee Ownership

The median amount of stock owned by employees is 27 - 30% and growing[5].

C. Job Creation and Retention

Although not specifically designed as a job retention scheme, employees, unions and communities frequently turn to it when a plant closing is threatened. These are often not the best circumstances for employee ownership success. Yet we have had some successes among these attempts.

An independent feasibility study is critical to success in these cases. The great difficulty in these situations is that people can easily overlook, market or technological factors that make an employee buyout untenable. For example, the GM Hyatt Clark bearing plant. Employee ownership was accomplished at the oldest of GM's four bearing plants, where GM had consolidated its oldest equipment. The UAW local at the plant was also one of the most militant in the GM-UAW system. Although the employees succeeded in raising over $50 million for the buyout, the company failed in a few years because: 1) its business plan did not extend beyond the few years that its bearings would be needed for rear wheel drive cars, and 2) labor-management relations never changed from adversarial to cooperative.

However, three companies spun off from the ailing giant, LTV, have been very successful majority employee owned firms, Republic Container, Republic Storage Systems and Republic Engineered Steels. These companies were marginally profitable subsidiaries. In each of them efforts have been made to increase employee participation in decision-making.

Republic Engineered Steels, the former bar division of LTV Steel, has 4,700 employees in eight facilities in five states. An employee purchase of the facility was considered when the USWA International thought that no other buyer would make the capital investments necessary,

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[5] Amongst the GAO's 1990 survey respondents, the median ownership increased from 8% in 1981 to 23% in 1987. In privately held companies the median ESOP ownership was 27%, as compared with 13% in publicly traded companies. In the 1993 Ohio study the median employee ownership of stock was 30%, up from 20% in 1985, US General Accounting Office, <u>ESOPs: Participants' Benefits Generally Increased, But Many Plans Terminated</u>, (1990).

an estimated $500 million, to modernize the facilities. There was much disagreement on whether or not the employees should purchase the company. Union local presidents representing a majority of members opposed the employee buyout. The membership, however, approved the buyout by a two-to-one margin in November 1989[6].

Republic Container was the first 100% employee buyout for the USWA. The business was marginally profitable. The employees took wage concessions to buy the facility. We created a very flat co-op type of ESOP there. Stock value has increased there from $475 per share upon the EBO in 1985 to over $1200 per share now. Participants have been retiring with accounts valued at over $77,000.

Fifteen percent of the Ohio ESOPs surveyed cited avoidance of job loss or plant shutdown as a reason for their creation. 49% of the ESOP firms created more jobs than their industry average, 50% matched their industry average and only 1% did worse.

However, the Ohio survey found that the <u>single most significant reason for creating ESOPs was buying stock from a retiring owner</u>.

29% of the Ohio ESOPs were created to provide financing for business expansions.

D. ESOPS Have Broadened Capital Ownership, But Have They Increased the Power, Dignity or Job Security of Workers?

ESOPs were initially created as a means of broadening capital ownership and of providing an alternative means of financing capital growth. According to the US General Accounting Office most recent (1990) study of ESOPs, they have accomplished this goal. When ESOPs were first made tax deductible, they had no broad constituency. No one was promoting them as a means to save jobs, increase employee participation or control over corporate decision-making, or alter labor strategy. As various constituencies have used and abused ESOPs, there has been heated debate over their value and the continuation of their significant tax advantages.

In the 1980's and 90's as job loss escalated, often as a direct result of the capital squandered in ever larger leveraged buyouts, many of them financed by ESOPs, policymakers were increasingly concerned about whether ESOPs increased productivity, profitability, promoted capital formation and gave employees more control over their workplaces.

The 1990 GAO study found that ESOPs have <u>not</u> significantly affected those areas. However, more recent and in depth studies (particularly the 1993 Ohio study and the CESCO-AFL-CIO study of unionized employee owned companies)
have shown more positive and interesting trends especially in majority employee owned companies, which are still a small minority of the employee ownership universe, but form a more significant portion of the <u>unionized</u> employee owned companies.

E. Participation, Profitability and Productivity

[6] J. Bado, J. Logue, <u>Organized Labor as Organized Owners</u>, Northeast Ohio Employee Ownership Center, Kent State University (1992:3) p. 14.

In its 1987 report the GAO found that employee owned companies only surpass their traditional competitors in productivity and profitability when they include significant employee participation programs[7].

Those conclusions are confirmed and expanded by several recent studies, by the ESOP Association[8] and the Northeast Ohio Employee Ownership Center[9].

The NEOEOC 1993 study found employee ownership is closely associated with improved productivity and quality, decreased employee turnover, and improved worker motivation and job satisfaction. Minority ESOPs with less than 10% holdings seem to have a less pronounced impact on firms than more significant levels of employee ownership. Majority ESOPS are more likely to involve non-managerial employees in decision making than minority ESOP companies. All ESOP firms however, invest more in training non-managerial employees after their ESOPs are in place than they did before. 80% of the managers surveyed said the ESOP had a positive effect on employee attitudes. 69% said that the ESOP had a positive effect on employees' on-the-job performance. 54% said customer service improved and that employee participation increased in 78% of the surveyed firms.

F. Stock Value - ESOPs as Retirement Plans

Stock value in ESOPs is very much a question of who controlled the deal when the company was purchased, and is secondarily subject to the market. When ESOP participants are truly independently represented for stock valuation and negotiation of the buyout, their stock tends to maintain its value. When the seller controls the transaction, the value usually falls precipitously immediately after the purchase.

As I mentioned previously, at Republic Container the purchase price of the shares was $475 per share, which the employees paid for through pay concessions. The value of their share

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[7] "The only statistically significant coefficient is for employee participation in corporation decision-making, which is positively related to changes in (the) measure of productivity." Government Accounting Office, <u>ESOPs: Evidence of Corporate Performance</u>, (October 1987), p. 30.

[8] According to a survey responded to by 460 companies who are members of the ESOP Association, 55% said their performance was better in 1992 than in 1991, 54% said the ESOP improved employee productivity, 52% had created employee participation programs and 81% said that creation of the ESOP was a good decision for the company. 87% of the companies which established participation plans felt the ESOP was a good decision which helped the company. ESOP Association, <u>The ESOP Report</u>, August 1993 p. 9.

[9] The most through and extensive studies of employee owned companies in the USA are studies done by the North East Ohio Employee Ownership Center (NEOEOC) at Kent State University concerning companies in the State of Ohio. NEOEOC is a very effective employee ownership and training program, which has organized the Employee Owned Network. The Newtwork is a group of the employee owned companies in Ohio which regularly hold joint training sessions on employee ownership topics, and make an effort to patronize each other, and occasionally to invest in each other.

The NEOEOC conducted two major studies of Ohio's employee-owned companies, in 1986 and in 1993. Based on 154 respondent ESOP companies in 1993 the NEOEOC reached the conclusions reported in text of this paper, J. Logue & H. Cross, <u>Employee Ownership in Ohio's Economy, Effect on Job Growth, Corporate Performance and Employee Involvement, A Preliminary Report (NEOEOC)</u> 1993:4.

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ESOP Association, <u>The ESOP Report</u>, August 1993 p. 9

is now $1,200. Many of the participants who have recently retired have had distributions of $65,000 to over $77,000. I also have union member clients whose ESOP sold out to another company two years after the employee buyout. There, the average manufacturing employee received approximately $5-6,000 for his stock. But, I have also litigated cases on behalf of non-unionized ESOP participants in which the ESOP bought stock from the owners at $250 per share, when its value was probably closer to $100 or $625 per share when its true value was approximately $400 per share. In the first case the company is now in bankruptcy and the ESOP stock is worth nothing. That case is still in litigation. The second case was settled in favor of the participants.

According to the GAO 1990 study, stock value in ESOPS, on average were somewhat lower than those in other types of defined contribution plans, but were growing at a faster rate. The average vested account balance was higher, $22,756 and the range of values of individual accounts was from $0 to $387,472.

G. Voting Rights and Making Decisions About Working Conditions

ESOPs in public companies must pass through full voting rights on all shareholder issues to ESOP participants.

In privately held firms the law only requires pass through of voting rights on major issues such as merger, acquisition, and dissolution, but does not require pass through of voting for board of director seats. Traditionally, many ESOPs in privately held companies did not allow employees to vote for board seats. In fact the board often appointed the ESOP trustees, who, in turn appointed the board. However, in recent years this has been changing as the percentage of employee ownership has been increasing in firms.

Congress created ESOPs primarily to expand equity ownership, and partially as a strategy to encourage owners of prosperous businesses to sell or give stock to their employees, over time, without having to give up control until they were ready, while providing them with a mechanism to sell at a fair price. The long range hope was that they would become willing to share more traditional ownership rights after they became comfortable with employee ownership. There is a significant trend in that direction, noted in the Ohio study contrary to the conclusion of the 1990 GAO study.

In the 1993 Ohio study, 40% of the closely held ESOP firms extended the right to vote for board of director members to ESOP participants. In 1993, 1 in every 6 ESOP companies had non-managerial employees on their boards, whereas in 1986 only 1 in 25 had such board members. The study showed increased employee participation in making decisions about working conditions. While 80% of the Ohio ESOP respondents received some employee input in decisions about working conditions, nearly half (48%) of the majority ESOP companies involved employees in <u>making</u> those decisions.

V. The Dynamic Tension Caused by the US System of ESOP Tax Incentives, Its Interplay with the Restrictions of Pension and Labor Law and the Labor Movement's Evolving Self-Concept:

A. Providing Employees an Opportunity to Own Stock in Profitable Companies and Abuse of the System by Self-Serving Sellers, Managers and Consultants

1. Advantages of US ESOP Law

a) Substantial incentive for employers, particularly retiring owners, to provide employees with stock in healthy firms where jobs are not threatened even where ESOPs investment will not be used for expansion; (Consequently most of our ESOP companies are profitable and growing.)

b) Flexibility as to size of investment in ESOP for all parties;

c) Seller controls the timing and extent of his/her loss of control;

d) Outside investors receive tax incentives to invest with employees and are also guaranteed an exit vehicle.

2. Problems with the US Law

a) Selling shareholders, managers and financial consultants have used the complexity of the law and their superior access to knowledge and financial resources to cheat employees in many ESOPs, abusing the tax incentive structure, and in some instances causing Congress to withdraw tax incentives which are generally helpful to those who use them with honest intentions. Employees have legal recourse, but it is sufficiently expensive and complex that most do not pursue their rights. (Our firm handles this type of litigation and faces the frustrations of its cost for working people.)

b) ESOPs are regulated by pension law (see below). Social investing is frowned upon by the pension regulatory agency.

B. Labor's Desire to Preserve Unionized Jobs, Its Struggle to Develop Strategic Uses of Employee Ownership and to Define its Role in Employee Owned Companies, and the Need to Maintain Competitive Efficiency

(I have written a number of papers on many subjects related to this topic, which I will gladly share with interested parties, including copies of "Negotiating, Creating and Governing ESOP Plans and Companies" which is available here.)

1. Employee Ownership is one of the Capital Strategies for Labor which evolved when traditional labor strategies were weakened by political and economic forces.

a) Spectrum of Positions Taken by Various Unions -

From the hostility of the IBT and other unions that experienced ESOPs used for union busting, to the USWA (see appended resolution stating USWA policy) and ACTWU proactive policies using employee ownership to protect industry and thus jobs in US.

An example of the USWA position is the new labor management agreement at Republic Engineered Steels[10].

UAW leaves it to the locals, no policy, but requires International supervision if International funds are used.

IBT formerly refused to negotiate Employee Ownership and left the companies to seek concessions for stock directly from the members. Now it investigates at an International level, and has provision for profit sharing in exchange for local rider concessions in the National Master Freight Agreement.

2. Pro-Active Use of Employee Ownership vs. Reacting to Management or Owners Actions

a) Proactive

1. First Right of Refusal- Federal Forge, BMEA
2. Divesting Subsidiary - Profitable or Not - Republic Container, Republic Storage Systems
3. Company for Sale where Union or Workers Fear Buyer - UPIU -Georgia Pacific
4. Undervalued Company - assets worth more than stock
5. Good Product, Market, Incompetent Management - Franklin Forge
6. Fight Industry Attack on Union Standards- United Air Lines Round I
7. Good Local Management, Bad Corporate Management - James River Ashland
8. As Quid Pro Quo Where Concessions are Unavoidable - United, TWA and Northwest Airlines 1993; Rosauers

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"Article One of the [new Republic Engineered Steels /[10]] contract spells out the intent of the new company's approach to labor-management relations. It requires
the involvement of all employees in the continued success of the business. This can only take place through a change in attitude and atmosphere and by an understanding on the part of each employee as to what the business must accomplish to reach its goals. To begin this process, a program will be established to provide that quarterly meetings will be held with all Local Union Presidents... at such meetings the CEO and his staff will review the meetings the CEO and his staff will review the state of the business, strategic planning, and marketing. These meetings will be designed to provide a forum to discuss significant employee and business issues and developments (Agreement between Republic Engineered Steels, Inc., and the United Steelworkers of America, Production and Maintenance Employees (28 November 1989), Article 1, Section 1, pages 2, 3).

The joint labor-management committee formed as a result of Article One is the H-1 Committee, named after the contract addendum in which it is described. Republic's H-1 Committee includes the eight local union presidents, the eight plant managers, and senior management of the company; two co-opted white collar representatives were subsequently added. The committee has worked to open new lines of communication between the union leadership and the company's managers. 'H-1 was designed so the union would have access to upper management,' said Dick Holland, president of USWA local 1566. The committee meets according to need. 'Part of our contract is to change the culture of the company. H-1's goal is to create total employee involvement, free of adversarial relations. We're striving for that goal,' stated Rudy Kogut, then president of USWA local 1200. One of the first decisions made by the committee was to set up an educational program for Republic's 4,700 employee owners.

To get employees more involved, the company has developed a new management system as well. Designed to disseminate information and to increase labor-management cooperation on all levels -- not just among corporate and union leaders -- these efforts are still in their early stages. Although just beginning, labor-management efforts at Republic have already received national recognition. The firm won the US Department of Labor's LIFT Award (Labor Investing for Tomorrow) this year." J. Bado, J. Logue, Organized Labor as Organized Owners. Employee Ownership and the American Labor Movement NEOEOC 1992:3.

9. Fight Union Busters

10. As an Organizing Tool -in the construction industry where there are no unionized contractors in a region; or in ESOPs where participants are dissatisfied

b) Reactive

1. Plant Closing Response- White Pine Mine; Wierton Steel

2. Corporate Takeover or Defense- Polaroid

3. Organizing Union at an ESOP Company - Carpenters/ Wisconsin

3. Role of the Union as Catalyst for and as a Safeguard Against Transactions. A union staff person can be:

a) an informed party,

b) with resources,

c) looking out for the interests of workers, with knowledge of the industry,

d) with the ability to detect the early warning signs of a company becoming available for purchase or being at risk for closing or relocation,

e) with the detachment to get an independent feasibility study and kill a bad deal before it hurts the workers.

4. Will the Employees Still Need a Union After Employee Ownership?

Yes, but its role may change to providing co-determination support to a more sophisticated form of bargaining and planning with management, and advising employees in their roles as owners in addition to protecting their rights as employees.

5. The Generally Positive Effect of Employee Buyout Efforts on Ongoing Bargaining Relationships where employee buyout is not the outcome -Federal Forge, Ludlow Flexpak

6. Successful Employee Buyout in a Unionized Firm Requires that the Union Leadership Understand the Requirements for a Successful Business (and Have Knowledgeable Consultants who Sympathize with Their Aims)

Some necessary items less obvious than, Market, Management and Capital, are:

a) Relationships with Customers, Suppliers, Lenders and Employees;

b) relationships between various groups of shareholders;

c) Governance Structures;

d) Problem Identification vs. Problem Solving Authority -

One should only have decision-making authority over those areas in which he is willing and able to make and carry out solutions to problems and not over those matters where he is only capable of identifying problems.

7. Much of the US Labor Role Conflict is Built Into the Archaic Structure of Our Labor Laws

a) US labor law presumes conflict between labor and management, not cooperation and certainly not co-determination. Therefore many of our issues and problems can be overcome in European countries where a social contract is the method of labor-management relations. Labor Union representatives should be allowed to serve on boards of directors of companies as labor union representatives, without the legal conflicts our laws impose.

8. Areas where our experience is probably most useful to you:

a) Unions need to develop sophisticated business analysis departments to determine feasibility of employee buyouts proactively and reactively, and to use this knowledge of their industry to have a long range capital strategy as well as a labor strategy for their members.

b) Unions need to weave employee ownership into their plans so that there is a clear place in the Union for employee owners, and clear benefits available from the Union for employee owner members.

c) Union members need education on how to be effective employee owners and participative workers. This may include courses on reading financial statements, proxy solicitation, effective participation with management, technology, etc.

9. New Opportunities for Trade Unions Created by Employee Ownership

a) Proposal for greater employee voting and information rights in ESOP, with sliding scale tax incentives based on the percentage of employee ownership, with some options for unionized ESOPs to negotiate away some of these new rights in collective bargaining.

b) Proposal for Canadian style labor venture capital funds.

c) Changes in Labor Organizing Strategy Which May Occur as the Number of Employee Owners Approaches the Number of Union Members.

"Sometime between 1991 and 1995, the percentage of workers in companies that have more than 10 percent employee ownership will exceed the membership of the entire trade union movement." prediction by J. Blasi and D. Kruse[11]. As of that writing there were approximately 10.5 million employee owners in the USA and approximately 13 to 14 million unionized employees[12]. The number of employee owners is growing and mostly non-union. The number of private sector union members is shrinking.

C. The Evolution of Participative Management as a Major Trend has Enhanced the Development and Growth of Democratic ESOPs, Majority Employee Ownership and Control

1. Increase in Participation Programs

a) In all types of workplaces is necessary to maintain a flexible and well-educated workforce to keep up with advances in technology.

b) Established ESOP Companies are clamoring for participation programs to increase their productivity.

The ESOP Association, formerly geared more toward the selling shareholder/CEO/retiring owners, now has employee participation as a strong part of its program, due to demand from the maturing ESOP companies which are increasingly controlled by the buying employees and no longer by the selling shareholders.

2. Statistics on Number of Majority ESOPs

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[11] J. Blasi and D. Kruse, The New Owners: The Mass Emergence of Employee Ownership in Public Corporations (Harper Collins) 1991, as stated by Blasi and Kruse in Workplace Topics, AFL-CIO Dept. of Economic Research, Vol.2, No.1, July 1991 p. 17.

[12] "Today less than 12% of the workers in private industry are unionized... [The AFL-CIO represents] 13.3 million members of 95 unions." New York Times (10/4/93) p. A-11.

The number of majority employee owned companies grows annually, as does the amount of involvement, influence and responsibility workers in those facilities have for decisions which were once solely the prerogative of management. Many employees now have full shareholder rights including non-management board seats, the right to nominate board members and raise issues at board meetings, as well as full disclosure of company financials. In many workplaces they are also deeply involved in making decisions about product and production changes[13].

CESCO, the Oregon Community Economic Stabilization Corporation, has compiled a study on unionized employee owned companies. CESCO has located approximately 256 unionized employee owned companies employing 250,000 and estimates that there are a total of 300 to 500 such firms, which may employ up to 500,000 employees[14].

<u>Of the 79 majority employee owned unionized companies</u> in the CESCO study, on which sufficient data could be collected, it appears that approximately 30% (24) were coops and 70% (55) were ESOPs. However, <u>the coops had an average of 33 employees, with many having 5 or fewer; while the ESOPs had an average of 863 employees</u>[15].

The 1993 Ohio study found 60 majority employee owned companies in Ohio, with combined sales of $2.2 billion, over 18,000 employees, over 12,000 ESOP participants, and plan stock value (exclusive of debt) of $225 million./[16]

D. The Increasing Pace of World Competition and the Need to Anchor Productive Capital and Jobs at Home

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[13] According to a survey conducted by the National Center for Employee Ownership (NCEO), as of 1992, there were approximately 150 to 200 ESOP firms which were both majority employee owned, with full pass through voting rights, including the right to elect the board of directors. The NCEO estimates that there are 500 - 600 firms that will fit this criteria when they complete their buyout plans. Approximately one-third to one-half of these are union led distressed buyout situations. Additionally there are 200 to 500 worker cooperatives all of which are employee owned and controlled on the basis of one vote per person. David Snyder, "A Survey of Voting and Board Participation in Employee-Controlled Firms", <u>The Journal of Employee Ownership Law & Finance</u>, Vol.IV, No. 3, Summer 1992, pp. 49 -66.

In its survey of 40 of these majority ESOPs, the NCEO found: 38% of these firms were unionized. 77% provided employees full voting rights, as well as the right to nominate board members, vote for the board and make shareholder resolutions. 62% had non-management representatives on the board. All of the unionized majority ESOPs had union or non-management employee representatives on their board of directors. 35% of the majority ESOPs provided voting on the basis of one vote per person, rather than on the basis of one vote per share.

[14] C. Spencer, <u>Preliminary Analysis of Data from CESCO Research, Unions in Employee Ownership Companies</u>, Sept. 1, 1993, and interview of Spencer by D. Olson on Sept. 27, 1993. Our law firm, in conjunction with the AFL-CIO, the United Steelworkers, and several other professional firms which work with unions, have cosponsored this study.

[15] Id.

[16] J. Logue, as yet unpublished preliminary research results of 1993 Kent State University Ohio Employee Ownership Study.

Employee ownership is increasingly seen as a way to keep productive capital assets from being moved offshore. The difficulty with such a plan is that if the market can get the same product from lower wage workers offshore, there may be no market for higher wage workers in the field. However, sometimes the differential can be closed by the convergence of several factors:

1. the proximity of the employee owned company to market, saving transportation costs and delivery time;

2. the ability of the employee owners to find new efficiencies; and

3. the willingness of employee owners to let their compensation fluctuate with the market to ensure their own employment.

E. The Pros and Cons of Employee Ownership Tied to the Pension System

1. ESOPs as Pension Plans Force Capital Accumulation for Workers.

Tying ESOPs to the pension system has had the positive (though unproven) effect of keeping retained earnings tied up in the company over many years; increasing the retained earnings available for reinvestment in the company; increasing the value of employee stock and ultimately the wealth of the employees. The tax incentives cause companies to make ESOP contributions even after they have paid off their debts. The pension system virtually requires that employees leave their ESOP accounts alone until retirement.

2. The Rights Employees Wish to Exercise as Shareholders are Limited by their Legal Status as Pension Beneficiaries.

ESOPs are regulated as pension plans, which makes it very difficult for employee owners to be treated as full shareholders. ESOP participants are beneficiaries of an ESOP trust where only the trustee is the legal stockholder. In turn, the trustee must handle the stock on behalf of the ESOP participants as retirees, not as current employee owners, and may have to ignore their need for job security. If the trustee does not do so, he may be liable personally for any financial losses to the participants. Thus, all the market risk that an employee owner might wish to undertake is instead handled for him by a trustee who is personally liable for losses. This protects employees in the majority of ESOPs, which are not majority employee owned companies, where the employees have virtually no control whatsoever over the future direction of the company. It is constricting for those companies, which are employee controlled. Additionally, employees must act through the Trustee to take action as shareholders, which diminishes their power. Although it could empower them to act as a block, in fact it weakens them because of the narrow interpretations of the duties of an ESOP and an ERISA trustee.

VI. The Future of Employee Ownership in the USA

A. More labor involvement in and collective bargaining of codetermination arrangements.

B. More employee ownership of companies in world competition and of those that took a beating from the 1980's LBO's and deregulation such as airlines, trucking and other transportation businesses.

C. More retiring owner ESOPs. This will increase greatly if the new proposals are passed, which would permit Sub-S corporations to have ESOPS, and would allow lower paid workers to receive contributions in excess of 25% of their pay.

D. More employee participation everywhere, and especially in employee owned companies.

E. More majority employee ownership of ESOP companies.

F. More creation of stock option plans instead of ESOPs in traditional non-union firms, as regulations have tightened on ESOPs and ERISA and as the recession makes it easier to give stock options which do not require the funding and other obligations of ESOPs

G. Coops have not taken off significantly in the industrial sector, although they are popular with some small enterprises and generally groups of less than 20 employees which are not highly capital intensive.

VII. Lessons from the USA

A. If you organize tax incentives primarily to save distressed firms, employees will own marginally competitive or uncompetitive firms for which there was no other buyer.

B. If you provide general incentives for employee ownership, some of your tax money will be wasted on scam employee ownership. However, this problem can be overcome in a highly unionized country, where labor can serve as a watchdog over the scams, as it does in the unionized employee owned sector in the US. Our experience is that the unionized employee owned firms generally have the most independent stock valuations, the most legal voting control, the most board of director representation, and the most participative management structures.

C. Unions can play a significant and constructive role in employee owned companies:

1. protecting employee rights as employee owners;

2. providing technical assistance to enable union members to negotiate a buyout on equal footing with other investors and management;

3. bargaining for workplace governance structures which provide employees a voice without encroaching on management efficiency.

D. The most financially secure ESOPs were profitable before they became ESOPs and usually were sold to the employees by a retiring owner.

Foras Aiseanna Saothair (FAS)
CONFERENCE ON STRATEGIES FOR DEMOCRATIC EMPLOYEE OWNERSHIP
DUBLIN, IRELAND
October 21, 1993

DEVELOPMENT, GROWTH AND EXPERIENCE OF ESOPS AND DEMOCRATIC EMPLOYEE BUYOUTS IN THE USA

by
Attorney Deborah Groban Olson

In this presentation I will attempt to synthesize the US experience to date and the lessons I have learned about the uses and policy implications of employee ownership in my practice as an employee ownership attorney for unions and employees.

I. Introduction
II. Historical/Political Context of the Development of Employee Ownership in U.S.
  A. History of Employee Ownership in the USA

III. Overview of Employee Ownership Mechanisms and Uses in the USA
  A. What ESOPs Are and How They Work
  B. Major Uses of ESOPs and Coops
  C. Comparison of ESOPs with Cooperatives

IV. Overview of the Current Extent and Uses of Employee Ownership
  A. Number of Employee Owned Enterprises
  B. Percentage Employee Ownership
  C. Job Creation and Retention
  D. ESOPS Have Broadened Capital Ownership, But Have They Increased the Power, Dignity or Job Security of Workers?
  E. Participation, Profitability and Productivity
  F. Stock Value - ESOPs as Retirement Plans
  G. Voting Rights and Making Decisions About Working Conditions

V. The Dynamic Tension Caused by the US System of ESOP Tax Incentives, Its Interplay with the Restrictions of Pension and Labor Law and the Labor Movement's Evolving Self-Concept:
  A. Providing Employees an Opportunity to Own Stock in Profitable Companies and Abuse of the System by Self-Serving Sellers, Managers and Consultants
  B. Labor's Desire to Preserve Unionized Jobs, Its Struggle to Develop Strategic Uses of Employee Ownership and to Define its Role in Employee Owned Companies, and the Need to Maintain Competitive Efficiency

C. The Evolution of Participative Management as a Major Trend has Enhanced the Development and Growth of Democratic ESOPs, Majority Employee Ownership and Control

D. The Increasing Pace of World Competition and the Need to Anchor Productive Capital and Jobs at Home

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