

Employee Ownership Report

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Floor Price Protection in ESOP Companies

When an ESOP company does a second-stage transaction, usually to buy more shares from existing owners, the debt typically used to make the purchase has the effect of at least temporarily reducing the value of the shares held by existing employees. Employees who remain with the company for many years generally benefit: they receive more shares in their accounts, and they do not need to sell their shares until the debt has been repaid and its impact on stock value is erased. But the temporarily lower stock price will have a dramatic effect on employees who retire, diversify, or take any other action that depends on the stock price in the years just after the second-stage transaction.

A new NCEO issue brief looks at this issue in detail; this article looks at a few key points.

Some companies address this problem by providing a floor price. The floor price protects certain people from the impact of debt by allowing them to receive ESOP distributions at a share price that excludes or reduces the impact of that debt.

Floor price protection raises weighty issues for ESOP trustees. On the one hand, providing the protection clearly is good news for the

most affected employees and shows that the company cares about employee well-being. On the other hand, the protection comes at a price, and that will have the effect of lowering the value of the remaining shares relative to what they would have been absent the protection. NCEO issue brief authors Aziz El-Tahch and Joe Demetrius note that the higher price created for some participants is a premium that “can be thought of as a transfer of value from the unprotected current and future shares to the protected shares.” Trustees are charged to act for the exclusive benefit of plan participants, and in the case of floor price protection, they need to weigh the interests of one subset of participants against the interests of another subset.

According to the NCEO 2010 study on repurchase obligations, the great majority of ESOP companies (71%) do not use floor price protection and have no plans to do so. Only 5% say they currently use floor price protection, although among leveraged ESOPs that figure rises to 9%. In addition, one in five companies (21%) that do not use floor price protection are planning to consider adopting it at some point. A new NCEO issue brief looks at this issue in detail; this article looks at a few key points.

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Shareholders Share the Wealth

Reaching a goal it had been pursuing since 2002, Torch Technologies, a technical services company in Alabama, announced that it had become 100% ESOP owned. In an interesting twist, employees and others contributed over \$1 million to charities in connection with the transaction. “When the ESOP transaction came about, we wanted shareholders to be aware of the opportunity to set aside a portion of their good fortune for charitable giving,” CEO Bill Roark said. Torch Technologies’ leadership followed the example of ESOP-owned Dynetics, where employees used company stock to make contributions of \$3.2 million to a local charity.

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