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Employee Ownership Report

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2011 Employee Ownership 100

The NCEO is excited to release its 2011 Employee Ownership 100 list. The list includes the nation's largest companies that are at least 50% owned by an ESOP or other broad-based employee ownership plan.

The companies on the list employ 614,000 people worldwide, up from 597,000 last year. Companies that were on this list in both 2010 and 2011 saw their employment rise just over one percent. Several new companies were added to the list, and this year the smallest company on the list had 1,200 employees, up from 1,050 last year and 675 in 2001.

See the list on pages 8–9

Two very large companies dropped from the list in 2011, as they are no longer majority employee owned (SAIC and Golub Corporation). Another company (Tribune Corporation) went into bankruptcy and was removed. Together, they accounted for 79,000 employees.

If your company should be on the list, please let us know. There are no readily available data sources to compile the list, so we do it based largely on personal information and news stories, with employment information from the company or, if not available, Hoover's or similar data sources.

The NCEO has many lists of employee-owned companies, including our list of ESOPs and broad-based equity grants in S&P 900 companies ($50 for members; $100 for nonmembers) and our ESOP company database, available by region or nationally. See www.nceo.org/main/misclist.php.

New Research on the Impact of Employee Ownership

At the 2011 annual conference on employee ownership, Richard Freeman of Harvard University and Joseph Blasi of Rutgers presented new research on employee stock plans, which was conducted with their colleague Douglas Kruse of Rutgers. The new research draws on data from the Great Place to Work Institute (GPTWI)—information that has never before been made available to independent researchers—and represents the largest study ever on the connections among various forms of shared capitalism, organizational culture, and company performance. The data is from companies that applied to *Fortune* magazine's competition, the 100 Best Companies to Work

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1981...2011!

National Center for Employee Ownership

Celebrating our 30th year of providing objective and reliable information

Working Better

Myth Management

Loren Rodgers, NCEO Executive Director

Better information means better decision making, but psychologists have consistently demonstrated that people tend to filter out facts that do not fit their existing belief systems. The most effective leaders strive to recognize and overcome the myths of management that they have internalized, and thanks to behavioral economics, they have more and more help doing so.

One management myth is the so-called free rider or 1/N problem. It comes from traditional economics, and its logic is simple. A worker can either loaf or work hard. Working hard creates value, and a hardworking employee who is also an owner shares in that value. But, the argument goes, the worker only receives a portion of the value she created. If there are N owners, then she receives only 1/Nth of the value added. By contrast, a worker who loafs gets to enjoy 100% of the benefit of loafing. David Erdal *(see page 13)* cites numerous economists who believe this theory so strongly that they simply cannot see evidence to the contrary.

However, that evidence is easy to find. Thirty years of research reveals that employee ownership creates more-productive firms on average, suggesting that the free rider myth simply is not a problem. Richard Freeman, Joseph Blasi, and Douglas Kruse *(see page 1)* used survey data from over 300,000 employees from the 1,300 companies that applied for the Great Place to Work award. They found that employees at companies with employee ownership and profit sharing were *more* likely to use high-performance work practices. The opposite of loafing, those practices are one explanation for the productivity advantage of employee ownership.

The results of an earlier study, the Shared Capitalism Research Project, are even more striking. The study found that workplaces with low levels of supervision, which theoretically provides employees more opportunity to loaf, actually result in higher productivity. In particular, the study shows that employee ownership works best when combined with four factors: HR practices such as teams and generous training programs, compensation at or above market, reasonable economic security, and low levels of supervision. In fact, the data indicated that high levels of supervision weakened the positive impact of worker ownership.

The NCEO has found similar results in our employee surveys at ESOP companies. We looked at results from companies that have certain survey questions in common (50 companies with over 7,000 respondents), and found that people who feel micromanaged are half as likely to feel like owners. Further, the vast majority of respondents who feel like owners (over 80%) agree that they "feel an obligation to challenge poor performance by [their] fellow employees." That is much higher than the 50-50 split among people who do not feel like owners. In other words, employee-owners are not only less likely to loaf when they have a chance, but also more likely to make sure that their coworkers do not loaf either.

Shared rewards make employees less likely to be free riders.

The free rider myth shares an assumption with traditional economics, that individual behavior is motivated by profit maximization. Account balances and profit sharing may be the yardstick that people use to measure their impact on the world, but the root of their motivation is deeper and more complex. As Jerry Kauffman, the CEO of Windings Inc., says *(see page 4),* people have an "intrinsic motivation to do something good in the world." Actively contributing to making their companies viable is one way to do that. Thus, the conventional wisdom of traditional economics is backward: In practice, shared rewards make employees less likely to be free riders. No matter how impeccable the logic of 1/N is in theory, it does not describe reality. ■

NCEO

Employee Ownership Report

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Making Good Use of a Directed Trustee

Many ESOP companies have a directed trustee. Our 2009 corporate governance survey revealed that approximately 19% of respondents use a directed trustee to help administer their plans. The data also show that larger companies are more likely to use these services than smaller ones, and that a vast majority of directed trustees are from large institutions such as a bank trust department, with only a few companies using individuals specializing in ESOPs.

At first glance, the widespread use of directed trustees might seem surprising. One of the obvious benefits of investing in an outside trustee is to reduce fiduciary liability. Under ERISA, the person (or persons) who effectively makes a decision or causes a decision to be made is liable as a fiduciary. Thus, an outside trustee that is responsible for making plan decisions provides some protection for the board of directors or other internal officers from liability.

A **DIRECTED TRUSTEE** does not provide that same legal protection as an **INDEPENDENT TRUSTEE**, because directed trustees are only liable where he or she knew or should have known that the decision was contrary to the plan document requirements or ERISA. The courts have consistently interpreted this narrowly, limiting the directed trustee's exposure to liability to cases where the decisions made were clearly in violation. In our review of ESOP litigation since 1990, we did not see a single case where a directed trustee was ultimately held responsible for a decision.

The Benefit

What, then, is the benefit? In a recent study the NCEO conducted on fiduciary practices in large ESOP companies (about 25% of whom used a directed trustee), the answer was that directed trustees did a lot of the work an inside fiduciary would normally do and executed it with a great deal more expertise. While the inside fiduciaries still had ultimate responsibility, they could base their decisions on much better information and advice.

With a directed trustee, the company maintains a decision-making body that acts as the plan's fiduciary —either the board of directors, an ESOP fiduciary committee (usually made up of officers of the company), or, very rarely, a single officer of the company. The decisions involve such matters as voting the shares (except for any issues where participants have pass-through rights to direct a vote), selecting an appraiser, approving the ESOP valuation, making acquisition decisions, buying or selling shares, and various other plan operational issues. While many companies perform these tasks internally, a directed trustee can make the process easier.

For example, in a valuation assignment, the directed trustee would select the appraiser, go over the report in detail making suggestions for any possible changes, and make a recommendation on the appraisal to the ESOP committee or other decision-making body that then has the ultimate decision-making authority. Many ESOP companies find that they lack the internal expertise, time, or willingness to undertake the kind of extensive review of an appraisal that should be done, including identifying potential problem areas and asking the appraiser to explain and rectify the issues if needed. The fiduciaries still must determine the price is appropriate, but they are in a much stronger position, both in legal and practical terms, if they have relied on the level of expertise offered by a directed trustee.

Multiple Roles

Although valuation is where directed trustees generally play the largest role, they also serve other functions. Often, the trustee works with the board's compensation consultant to assess executive compensation review processes. The trustee's input can be particularly valuable in this context because it is not subject to the conflict-of-interest issues that are inherent when the fiduciary committee is comprised of officers.

Another typical role for a directed trustee is meeting with the fiduciaries on a regular basis (e.g., quarterly or semiannually) to go over plan operational issues and changes that may be needed, such as making sure procedures are in place for timely distributions. The trustee may also sit in on board meetings or make presentations to the board about ESOP issues. However, the trustee rarely plays a role in recommendations on voting ESOP shares for board selection or other matters.

During unsolicited acquisition offers, the trustee may also provide input if needed. However, if the ESOP company is actually in negotiations for a sale, then it would be more common to hire a transactional trustee or designate the directed trustee as independent in this role.

The Costs

Another consideration in determining whether a directed trustee is right for your company is the expense. Costs for directed trustees are somewhat lower than for independent trustees because their fiduciary exposure is less. In our 2009 governance study, costs ranged from about $15,000 to $50,000. Company size factors in slightly, but the scope of work is more significant in determining the final cost. When making that large of an investment, it is sensible to select an experienced trustee. Consider firms that have multiple clients in the subject area, that routinely send attendees and speakers to professional ESOP meetings, and that can provide a reference list. ■

The study mentioned here was done under contract with a large ESOP company, and the results could only be made available to that company and those participating in the survey. If you have a specific project you would like us to research, please call Loren Rodgers or Corey Rosen at 510-208-1300.

Windings Inc.

Minnesota-based custom manufacturer Windings structured its ESOP to create a gradual change in ownership, which also paved the way for another transition at the company—from CEO Roger Ryberg at the helm to his successor, Jerry Kauffman.

Founded in 1965, Windings makes components for electric motors and generators, often in the form of custom-built prototypes or low-run high-quality products for research and development. In 1983, Roger Ryberg took a mortgage on his house to purchase the company, and he remained the CEO until 2008. Thinking of his future retirement, Ryberg put an ESOP in place in 1998 to handle the company's equity transition. The ESOP began with 17% of shares, which increased in tranches until the company became 100% ESOP owned in 2008.

The Management Transition

In 2000, long before his retirement, Ryberg began planning a management transition. He recruited Jerry Kauffman, who was working at a larger company. "When I was looking for a successor, I wanted to find someone with character, integrity, and a certain way of interacting with people," says Ryberg. "I also wanted to take at least five years to see how he fit at Windings. I made sure Jerry knew I was committed to the ESOP. I gave him challenges and then just got out of the way to see how he would handle them."

Kauffman joined Windings partly because he wanted to work for a smaller company, and having an equity stake was important to him. "The basic values that Roger and Windings exemplified were the most important reason I decided to join the company," he says. Those values are evident in the way Kauffman describes his goals as CEO. "I can give someone the opportunity to have satisfaction in their job by tapping into their intrinsic motivation to do something good in the world."

In his retirement, Ryberg is sometimes gone for months at a time, but he maintains a presence at Windings. He admits that it has been a challenge for him to see the company making decisions that are different than he would have, but, he says, "I don't want to be one of those old bulls that endanger some companies." So Ryberg has found new roles for himself. He walks the plant floor, talking with employees. He asks questions to guide their thinking when they bring a concern to him, but he stays out of making any decisions or commitments. "If I have any observations or concerns, I take them to Jerry alone," he says.

The board at Windings helped smooth the leadership transition. Ryberg is the board chair, and Kauffman is a director, but the other three directors are outsiders, all of whom are or have been CEOs of other companies. According to the company's bylaws, every year each director needs the consent of three other directors to remain on the board. The board used this provision to shift from majority insiders to majority outsiders in connection with the CEO transition.

Economic Value Added

The company uses economic value added (EVA) as a decision criteria, communications tool, and educational device. Kauffman proposed the idea, and the company adopted it in 2005. At Windings, a project's EVA is essentially accrued profit minus a charge to "rent" the capital used for that project. In other words, two equally profitable projects will have different EVAs if one makes a lesser demand on the plant, equipment, or overhead. Kauffman says, "Nothing comes close to EVA in helping people connect the dots between what they do and the value of the company. We can run the EVA on any project, any time."

Windings calculates companywide EVA monthly, and managers use it in all discussions about the direction of the business. The company practices open-book management, posts EVA monthly, and discusses it in monthly and quarterly meetings. Employees track the numbers closely because their bonuses are calculated as a percentage of EVA.

EVA is a motivator, but Kauffman also goes out of his way to nurture the talents of the workforce. He tells the story of a woman who came into his office because "she did not feel she was welcome to use her gifts at work. I worked with her one-on-one to develop some improvement suggestions, and she ended up finding a way for us to replace cotton swabs that cost $1.19 with ordinary Q-tips from the local drugstore. They cost $0.03 each. She not only saved money for all of us; she knows she made a difference, and her engagement is at a new level."

To Kauffman, employee ownership is dramatically different from conventional ownership. "Profit is shared by all of us, instead of just helping a guy with a Lexus put another one in the garage." From his perspective, Ryberg knows he could have more money from the sale of the company if he had not sold to an ESOP, but, he says, "Other objectives were more important to me. I know that people with bigger pots of money aren't necessarily as fulfilled as I am." ■

To see an example of the way Windings uses EVA, see the case study resources area in the members-only area of the NCEO Web site.

Employee Ownership Q&A

ESOPS

Q. Can you provide me guidance for record retention with regard to ESOPs?

A. There is some disagreement on this question, and no law makes a clear determination about what is required of companies. Generally speaking, an ESOP company should retain copies of documents supporting the filing of its form 5500 for at least three years. That three-year period begins with the filing of the 5500, not with the close of the tax year to which that filing applies. The Department of Labor has argued in some cases that the documentation may be relevant to the determination of a fiduciary breach, and therefore such documents should be retained indefinitely. Each company should research what its own state's requirements are for document retention.

Q. When I am doing the test to determine who is a highly compensated employee, one factor is the percentage of the company's stock the person owns. Does stock in the ESOP count as part of that percentage? And what are the current compensation thresholds?

A. A highly compensated employee is defined as any (1) 5%-or-more owner or (2) an employee whose compensation for the preceding year was more than $110,000. That amount is current for 2010 and will be indexed for inflation in steps of $5,000. Companies can elect to limit the over-$110,000 category to those who are in the highest paid 20% of all employees. Stock held in the ESOP does not count toward the 5% for purposes of this test.

Q. Can S corporation earnings distributions on both allocated and unallocated shares in the ESOP be used for loan repayment?

A. Yes, as a result of changes made in the American Jobs Creation Act of 2004.

EQUITY COMPENSATION

Q. We want to issue restricted stock in our S corporation to key employees. Will their ownership be taxable in the same way the stock of existing owners is and thus require us to make a distribution to them to pay their taxes?

A. Under Code Section 1.1361-1(b)(3), if the employee does not make an 83(b) election to pay taxes at the time of the grant of the right, then the shares are not considered outstanding until the restrictions lapse, so they would not be taxable. However, many companies pay employees a dividend, taxable as a bonus, to provide an interim benefit on the restricted stock. If the employee does make an 83(b) election, then the shares are considered outstanding, and taxes on pro-rata profits would be due. A restricted stock unit (where the stock is not delivered until the restrictions lapse) is not considered ownership until the shares actually transfer.

The IRS issued a useful private letter ruling on this issue in 2001, PLR 200118046.

Q. I have a question on the Rule 701 calculation, specifically about calculating 15% of the outstanding amount of the class of securities (in this case the common stock) being offered and sold in reliance on Rule 701. Do you include convertible preferred stock that will convert to common or just those awards that are currently denominated in common (stock, options, warrants, notes)? There are two sources that confuse the issue. *The Stock Options Book* says the calculation only includes "15% of the outstanding securities of the same class of stock," implying that preferred is not the same class. But in the Rules for Calculating Prices and Amounts for Rule 701 out of the Securities Lawyer's Deskbook, it states, "In calculating outstanding securities, treat the securities underlying all currently exercisable or convertible options, warrants, rights or other securities, other than those issued under this exemption, as outstanding," which appears to include all "currently" convertible securities.

A. The short answer is that the calculation includes all outstanding securities that are by their terms convertible to common, whether or not the conversion date is known.

The Stock Options Book provides a summary of the actual text of the rule, which references: "15% of the outstanding amount of the class of securities being offered and sold in reliance on this section." It does not address how the "outstanding amount of the class of securities being offered" is calculated. The answer is in Rule 701(d)(3)(iii), which states,

> In calculating outstanding securities for purposes of paragraph (d)(2)(iii) of this section, treat the securities underlying all currently exercisable or convertible options, warrants, rights or other securities, other than those issued under this exemption, as outstanding.

There is further clarification in Section 2.5.2 Rule 701 in *Selected Issues in Accounting,* Volume 8, under Limitations on Issuance (quoting from a September 6, 1988 SEC No-Action Letter):

> This amount does not include options, warrants, or rights that are not presently exercisable, and *it also does not include presently non-convertible securities.* The amount of outstanding securities does not include securities issuable pursuant to Rule 701. That is, the amount of outstanding securities does not include exercisable options, warrants, or rights issued pursuant to Rule 701 that have not yet been exercised *(emphasis added).*

By thus calling out the non-convertible securities as not included in the calculation, the SEC is including in the "currently convertible" group those securities that are by their terms convertible, whether or not the conversion date is known.

Change of Control Provision Problems

In 2005, a company adopted a stock option plan that included a change in control provision. Under the plan definitions, a change in control would occur if, following a merger, the shareholders of the company held an interest of less than 60% in the resulting company. The company granted options under this plan for several years.

When the plan started running low on available shares in 2009, the company decided to adopt a new incentive plan. The board decided that the old threshold for a change in control was too easily triggered and changed it in the new plan from less than a 60% interest to less than a majority of the shares in the resulting company.

While the company would have preferred a uniform change in control definition that applied to all outstanding awards, any change to the options under the initial plan would require consent of all of the holders. Accordingly, they decided to leave the 2005 plan unchanged and to allow the existing options to remain subject to the old change in control definition.

Post-2009

After adoption of the 2009 plan, the compensation committee did not specify which plan new awards were to be issued under. The stock plan administrator decided to make full use of all the shares under the 2005 plan and continued to grant awards under that plan until the share reserve was exhausted. After that, new awards were allocated to the 2009 plan.

As time went on employees left the company and forfeited their options under the 2005 plan. According to the terms of the plan, these shares again became available for grant, and the stock plan administrator issued the next few options under that plan, again to exhaust the share reserve. Over time, there was little consistency in whether employees received 2005 plan options or 2009 plan options; the administrator simply used up shares in the old plan whenever they became available. The result was a more or less random allocation of plan shares after 2009.

2010: The Merger

In 2010, the company was approached by a similarly sized company interested in a "merger of equals." As a result of the merger, the company's shareholders would control approximately 53% of the equity in the resulting company. While preparing the option schedules for the due diligence report, the stock plan administrator was horrified to realize that, upon closing of the merger, options would vest under the terms of the 2005 plan but would not vest under the 2009 plan. Thus, options granted to different employees in the same year would have completely different treatment depending on which plan they were granted under.

To avoid this disparate treatment among employees, the board of the company decided to accelerate everyone's awards. Employees at the other company in the merger were upset that employees at the first company had their awards accelerated, so the other company's board decided to accelerate all of their awards as well. This caused a great deal of heartburn at both companies and resulted in a significant expense.

Lessons

Any time a new plan has terms that are inconsistent with grants made under an old plan, it is best to cut off grants under the old plan all at once. It is much easier to track the awards and to explain to employees and investors that all awards issued prior to a certain date were under the old plan, and all subsequent awards were under the new plan.

The efficient use of plan shares is a good idea, but rather than dip back into the old plan as awards are forfeited, it is better practice to pass board resolutions instructing that:

1. No awards will be issued under the old plan after the new plan is in place.
2. The number of shares authorized under the new plan is x shares, plus a number of shares that would have again become available for grant under the old plan due to forfeiture or cancellation (not to exceed y shares).

More importantly, where two plans are in place, it is imperative that the compensation committee indicate which plan an award is being granted under. Where the terms of the plans differ (particularly around a provision as important as a change in control accelerator), the choice of plans directly affects the terms of the awards, and only the committee has the authority to set the terms of the awards.

In this case, while the stock plan administrator did not have corporate authority to set the terms of the options by allocating them between the plans, the employees had all been given stock option agreements denoting the plan under which their awards were issued and award agreements with the facsimile signature of the CEO. The company realized that it would be difficult to get all of the employees who had received options in 2009 and later that were issued under the 2005 plan to consent to the stricter change in control treatment under the 2009 plan and felt compelled to extend the vesting acceleration to all employees.

This article is excerpted from *If I'd Only Known That,* a forthcoming publication by the NCEO.

Tricky Issues in Plan Administration

Equity compensation is highly regulated. Your awareness of potential issues will make you a more valuable contributor to your company's success. Here are some of the regulations to keep in the back of your mind as you go about your administration activities.

SEC Registration/Exemption and Blue Sky Laws. No securities (stock) can be sold in the United States without either being registered with the SEC under the Securities Act of 1933 or being eligible for an exemption from registration. Corporate counsel will be responsible for complying with these regulations but may request reports from the administrator and, if the administration is outsourced to corporate counsel's office, the administrator may be responsible for completing or filing the exemptions. The regulations that the nonpublic company administrator should be aware of are:

- Regulation D, which exempts sales of stock under limited offerings that meet restrictions on dollar amounts, time periods, and types of investors that can participate. This is the exemption that will govern the investor purchases.
- Rule 701, which exempts sales of stock under equity compensation plans when specific conditions are met. This is the exemption that governs the plans that you administer and that allows shares purchased under those plans to be saleable if and when the company does finally have a public market for its stock.
- Blue sky laws, which are state regulations that govern the sales of securities.

Unless you are an equity administrator who works in a law firm, you will likely never see the documents associated with these exemptions. If you are responsible for completing or filing these exemptions, corporate counsel will instruct you on the proper handling of the forms. The most common situations when these regulations come into play for an in-house equity administrator is a friends-and-family round of investment and a bridge round of investment with angel investors outside the control of corporate counsel. In these cases, corporate counsel may ask for the administrator's assistance in obtaining a statement of accredited investor from the early investors. Counsel will provide the form of statement that needs to be completed by the investors.

Reporting Company Status. Public companies are required to file certain periodic reports with the SEC, and nonpublic companies are not. However, if a nonpublic company has more than $10 million in assets *and* 500 or more equity holders, it will be considered a nonpublic reporting company and become subject to SEC reporting requirements. Of course, it is not that simple—the SEC has taken the position that it will not count shareholders and option holders together, so technically a company could have 499 shareholders and 499 option holders and not trigger the reporting requirement. The SEC has also adopted an exemption for options issued to employees and consultants under a compensatory stock option plan. Even if these numbers seem large, it's a good idea to keep an eye on the number of shareholders and the number of option holders.

Insider Trading. This may appear to be an issue only for public companies, but it becomes important to the nonpublic company equity administrator when the decision is made to begin the IPO process. You may not be on the company's official list of executives and insiders, but you have access to confidential information that, if made known to others, could affect their investment decisions. Remember always that the work you do is highly confidential and should not be discussed even with workmates who are not directly involved in equity administration.

International Administration Issues. Today, many early-stage U.S. companies have operations and staff in foreign countries. If your company issues equity compensation to employees and consultants in foreign countries, you will want to be sure that corporate counsel is consulting with specialists in the foreign jurisdictions that can advise on tax, accounting, and securities law issues that will be triggered by the issuance of awards to your foreign-based staff. Many foreign jurisdictions have very strict privacy laws with severe penalties for violations. Particular care should be taken to assure that you have appropriate consents from foreign staff for the electronic transmission of their personal information between the foreign office and the domestic office, as foreign privacy and data security laws are much stricter than U.S. laws. ■

This article is excerpted from *The Nonpublic Company Equity Administration Handbook,* a forthcoming publication from the NCEO.

TOP 100

The 2011 Employee Ownership 100

Companies on the list must be at least 50% owned by an ESOP or similar plan or, where there is a stock purchase plan, at least 50% of the full-time employees must participate. Some companies have combination plans. Employment size includes all full- and part-time employees in the U.S. and worldwide.

America's Largest Majority Employee-Owned Companies

COMPANY	CITY	STATE	TYPE OF PLAN	BUSINESS	EMPLOYEES
Publix Super Markets	Lakeland	FL	ESOP, stock purchase	Supermarkets	146,000
Hy-Vee	West Des Moines	IA	Profit sharing	Supermarkets	51,000
Daymon Worldwide	Stamford	CT	ESOP/others	Food distribution	30,000
CH2M Hill	Englewood	CO	ESOP	Engineering/construction	23,500
Lifetouch	Eden Prairie	MN	ESOP	Photography studios	18,000
Nypro	Clinton	MA	ESOP	Plastics manufacturing	17,000
Houchens Industries	Bowling Green	KY	ESOP	Supermarkets and other services	17,000
Penmac	Springfield	MO	ESOP	Staffing	14,000
WinCo Foods	Boise	ID	ESOP	Supermarkets	13,100
Parsons	Pasadena	CA	ESOP	Engineering/construction	10,500
Black & Veatch	Overland Park	KS	ESOP	Engineering	9,600
Amsted Industries	Chicago	IL	ESOP	Industrial components	9,200
W.L. Gore & Associates	Newark	DE	ESOP	Manufacturing	9,000
Graybar Electric	St. Louis	MO	Stock purchase	Electrical equipment wholesale	8,400
HDR	Omaha	NE	ESOP	Architecture/engineering	7,950
Alliance Holdings	Abington	PA	ESOP	Holding company	7,700
Burnett Staffing	Houston	TX	ESOP	Staffing services	7,077
Davey Tree Expert	Kent	OH	ESOP	Tree services	7,000
Austin Industries	Dallas	TX	ESOP	Construction	6,000
Brookshire Brothers	Lufkin	TX	ESOP	Supermarkets	5,856
EmpRes Healthcare	Vancouver	WA	ESOP	Health-care staffing	5,400
Schreiber Foods	Green Bay	WI	ESOP	Cheese manufacturing	5,000
Piggly Wiggly Carolina	Charleston	SC	ESOP	Supermarkets	5,000
Blue Tee	New York	NY	ESOP	Steel distribution and manufacturing	5,000
McCarthy	St. Louis	MO	ESOP	Construction	4,800
Tharaldson Motels	Fargo	ND	ESOP	Motel management	4,500
EOD Technology	Lenoir City	TN	ESOP	Security and munitions services	4,000
General Growth Management	Chicago	IL	ESOP	Land development	4,000
Columbia Forest Products	Portland	OR	ESOP	Plywood	4,000
Guckenheimer Enterprises	Redwood City	CA	ESOP	Food distribution	4,000
Hanson Pipe & Precast	Irving	TX	ESOP	Pipe manufacturing	3,885
Sammons Enterprises	Dallas	TX	ESOP	Diversified holdings	3,800
HNTB	Kansas City	MO	ESOP	Architecture/engineering	3,800
Herff Jones	Indianapolis	IN	ESOP	Awards and gifts	3,500
Harps Food Stores	Springdale	AR	ESOP	Supermarkets	3,200
Alion Science and Technology	McLean	VA	ESOP	Technology services	3,100
Lewis Tree Service	West Henrietta	NY	ESOP	Tree services	3,100
Appleton	Appleton	WI	ESOP	Paper products	3,100
American Cast Iron Pipe	Birmingham	AL	Stock trust	Manufacturing	3,000
Terracon	Olathe	KS	ESOP	Engineering/consulting	3,000
Scheels All Sports	Fargo	ND	ESOP	Retail sporting goods	3,000
MWH Americas	Broomfield	CO	ESOP	Engineering/consulting	3,000
Miller's Health Systems	Warsaw	IN	ESOP	Nursing homes	3,000
KI	Green Bay	WI	Profit sharing	Furniture manufacturing	3,000
Gensler	San Francisco	CA	ESOP	Architecture	3,000
Food Giant	Sikeston	MO	ESOP	Supermarkets	3,000

COMPANY	CITY	STATE	TYPE OF PLAN	BUSINESS	EMPLOYEES
Bi-Mart	Eugene	OR	ESOP	Discount stores	3,000
Recology	San Francisco	CA	ESOP	Waste management	2,600
Hensel Phelps Construction	Greeley	CO	ESOP	Construction	2,500
KeHE Distributors	Romeoville	IL	ESOP	Food distribution	2,500
S&C Electric	Chicago	IL	ESOP	Electrical equipment	2,500
Cianbro	Pittsfield	ME	ESOP	Construction	2,500
Schweitzer Engineering	Pullman	WA	ESOP	Engineering	2,500
Round Table Pizza	Concord	CA	ESOP	Franchisor	2,400
Acadian Ambulance	Lafayette	LA	ESOP	Ambulance services	2,385
Medicalodges	Coffeyville	KS	ESOP	Nursing homes	2,363
Reasor's	Tahlequah	OK	ESOP	Supermarkets	2,324
Omaha World-Herald	Omaha	NE	ESOP	Newspapers	2,323
Kleinfelder	San Diego	CA	ESOP	Engineering	2,200
Kinney Drugs	Gouverneur	NY	ESOP	Drugstores	2,100
The Weitz Company	Des Moines	IA	ESOP	Construction	2,000
Rosendin Electric	San Jose	CA	ESOP	Electrical work	2,000
CentiMark	Canonsburg	PA	ESOP	Roof repair	2,000
Burns & McDonnell Engineering	Kansas City	MO	ESOP	Architecture/engineering	2,000
Abt Associates	Cambridge	MA	ESOP	Consulting and research	2,000
Weston Solutions	West Chester	PA	ESOP	Environmental engineering	1,800
Osmose Holdings	Buffalo	NY	ESOP	Wood treatment and utilities	1,800
John Henry	Lansing	MI	ESOP	Real estate, printing	1,800
Sundt	Tempe	AZ	ESOP	Construction	1,719
TRAX International	Las Vegas	NV	ESOP	Professional services	2,200
Ebby Halliday Realtors	Dallas	TX	ESOP	Real estate	1,700
STV Group	Douglassville	PA	ESOP	Engineering/architecture	1,700
Bureau of National Affairs	Arlington	VA	Stock purchase	Business information publisher	1,638
Roberts Hawaii	Honolulu	HI	ESOP	Tour bus operator	1,600
Woodman's Food Market	Janesville	WI	ESOP	Supermarkets	1,600
TDIndustries	Dallas	TX	ESOP	HVAC supplies	1,600
Cooperative Home Care Associates	Bronx	NY	Coop	Health care	1,600
Kelly-Moore Paints	San Carlos	CA	ESOP	Paint manufacturing/retail	1,500
Dunn-Edwards Paints	Los Angeles	CA	ESOP	Paint manufacturing	1,500
Dahl's Foods	Des Moines	IA	ESOP	Supermarkets	1,500
Jasper Engines & Transmissions	Jasper	IN	ESOP	Eng. and trans. remanufacturing	1,500
Remke Markets bigg's	Erlanger	KY	ESOP	Supermarkets	1,500
Pinnacle Builders	West Sacramento	CA	ESOP	Framing	1,500
MMC	Overland Park	KS	ESOP	Construction	1,500
Martin & Bayley	Carmi	IL	ESOP	Convenience stores	1,500
Brown and Caldwell	Walnut Creek	CA	ESOP	Engineering	1,500
American Systems	Chantilly	VA	ESOP	Engineering	1,500
HDOS Enterprises	Carlsbad	CA	ESOP	Fast food outlets	1,500
Okonite	Ramsey	NJ	ESOP	Wire and cable manufacturing	1,494
Barton Malow	Southfield	MI	Stock Bonus	Construction	1,415
Applied Research Associates	Albuquerque	NM	ESOP	Engineering research	1,380
Swinerton	San Francisco	CA	ESOP	Construction	1,325
Ditch Witch	Perry	OK	ESOP	Backhoes	1,315
Border States Industries	Fargo	ND	ESOP	Electrical supplies	1,270
Bradford White	Ambler	PA	ESOP	Water heaters	1,219
Zandex Health Care	Zanesville	OH	ESOP	Nursing homes	1,200
Cobham Analytic Solutions	Lake Forest	CA	ESOP	Defense and security services	1,200
Riesbeck Food Markets	St. Clairsville	OH	ESOP	Supermarkets	1,200
SecTek	Reston	VA	ESOP	Security	1,200
Scitor	Herndon	VA	ESOP	Aerospace	1,200

Cases&Rulings

HIGHLIGHTS:

- Tribune case moves forward as a class action with no cap on damages
- Another court prevents defendant fiduciaries from raising the safe harbor defense in a "stock-drop" case
- Courts in numerous jurisdictions continue to apply the *Moench* presumption and other prudence presumption standards to dismiss "stock-drop" cases
- Ninth Circuit court follows the general trend of refusing to allow deferral of tax consequences for stock options where value plummets under §83(c)(3)
- Citigroup wins another challenge to its Capital Accumulation Plan

ESOPS

■ **District Court certifies class, refuses to cap damages in Tribune "stock-drop" case:** In *Neil, et al. v. Zell, et al.,* No. 08-C-6833 (N.D. Ill. Mar. 4, 2011), the district court held that Tribune Co. employees who participated in the company's ESOP (and their beneficiaries) were eligible to form a class in their lawsuit against the ill-fated company. In the same week, the district court also denied the defendants' request to cap damages. The defendants argued that the $250 million sale of shares to the ESOP was an illusory transaction and that the ESOP was essentially paying for shares in installments, the sum of which should constitute the basis for any potential recovery. The court instead found the shares to be a genuine asset, thus making $250 million the basis for a damages calculation. The court further rejected the argument that the proposed damages would necessarily result in a windfall because of the likelihood that the remainder of the loan will be forgiven as part of a bankruptcy settlement. The court explained that the maximum recovery "would simply put employees in the place they would have been in had the $250 million been prudently, properly, and legally invested." The court suggested that a reasonable measure of the damages may be the $250 million plus a reasonable return on that investment, minus the debt forgiveness at the time the ESOP terminates.

■ **Class certified in case against hotel owner for misappropriating millions:** In *McKay v. Tharaldson,* No. 3:08-cv-113 (D.N.D. Mar. 31, 2011), the district court approved class certification in a case against the owner of Tharaldson Motels, Inc. for breach of fiduciary duty. The owner, Gary Tharaldson, is being sued in his capacity as an ESOP fiduciary for allegedly paying his ex-wife nearly $4 million for worthless consulting services. This case follows an earlier ERISA action against Mr. Tharaldson and other plan fiduciaries for purchasing the company stock at an inflated price.

■ **Following a recent Seventh Circuit decision, district court strikes safe harbor defense in "stock-drop" case:** In *In re YRC Worldwide Inc. ERISA Litigation,* No. 2:09-cv-02593-JWL-JPO (D. Kan. Apr. 15 2011), the Kansas district court prevented defendants from asserting an ERISA Section 404(c) affirmative defense. Section 404(c) provides a defense to a breach of fiduciary duty claim where the loss resulted from the participant's exercise of control over his or her own investments. Circuit courts have been split on whether the safe harbor defense, as it is commonly known, is appropriate in "stock-drop" cases where plaintiffs make investment decisions based on a limited menu of choices provided by defendants. In determining the issue, the district court in this case relied on the most recent appellate court decision on point, *Howell v. Motorola Inc.,* 663 F.3d 552 (7th Cir. 2011), where the Seventh Circuit adopted the reasoning of the Secretary of Labor's amicus curie brief, holding that "the selection of plan investment options and the decision to continue offering a particular investment vehicle are acts to which fiduciary duties attach, and [] the safe harbor is not available for such acts."

■ **Settlement reached in PFF Bancorp "stock-drop" case:** In *In re PFF Bancorp Inc.,* C.D. Cal., No. CV 08-01093-SVW (C.D. Cal. Apr. 27, 2011), the district court approved a $3 million settlement between PFF Bancorp and the participants of the company's ESOP and 401(k) plan. The plaintiffs alleged that the plan fiduciaries continued to invest in PFF securities as the company headed for bankruptcy. In the settlement, the court certified the case as a class action with approximately 1,000 potential class members.

PRESUMPTION OF PRUDENCE CASES

■ In a number of "stock-drop" cases where plan fiduciaries are being sued for remaining invested in company stock or continuing to offer it as an investment option when it was no longer prudent, the central issue is the "presumption of prudence." This controversial legal doctrine entitles ERISA fiduciaries to a rebuttable presumption that they acted prudently if the plan documents encouraged investment in company stock. While there are varying standards for how plaintiffs can overcome this presumption, the most widely applied standard is articulated in the Third Circuit case *Moench v. Robertson,* 62 F.3d 553 (3rd Cir. 1995), which requires a showing that the fiduciary abused its discretion by investing in employer securities. Common issues in these cases include whether the presumption applies to EIAPs other than ESOPs, whether it is appropriate in a motion to dismiss (which is typically brought before any fact finding has occurred), and if so, what pleading requirements plaintiffs must meet to overcome the presumption.

■ **Following recent Ninth Circuit precedent, Nevada district court applies *Moench* presumption:** In *Carr v. International Game Technology,* No. 3:09-cv-00584-ECR-RAM (D. Nev. Mar. 16, 2011), the defendants won a major victory when the court applied the *Moench* presumption of prudence to dismiss a large part of the plaintiffs' case. The district court based its ruling on a recent appellate decision, *Quan v. Computer Sciences Corp.,* 623 F.3d 870 (9th Cir. 2010), where the Ninth Circuit joined the Third, Fifth, and Sixth

Circuit appellate courts in adopting the presumption. The court also held that employees who signed severance releases had standing to sue because the releases only waived individual claims, not those brought on behalf of the plan. Additionally, the court found that the plan's administrative committee fell under the broad statutory definition of a "person" capable of being sued under ERISA.

■ **Another Wall Street "stock-drop" case dismissed based on presumption of prudence:** In *In re UBS AG ERISA Litigation,* No. 1:08-cv-06696-RJS (S.D.N.Y. Mar. 24, 2011), the Southern District of New York dismissed another "stock-drop" case against a Wall Street firm, citing the presumption of prudence. Although the Second Circuit has not yet officially adopted any particular standard, district courts in that circuit have consistently applied the *Moench* presumption when deciding these cases.

■ **District court dismisses "stock-drop" case against Flagstar Bancorp, Inc.:** In *Griffin v. Flagstar Bancorp Inc.,* No. 2:10-cv-10610 (E.D. Mich. Mar. 31, 2011), a Michigan court granted a motion to dismiss based on the *Moench* presumption. In doing so, the court held that the *Moench* presumption is applicable even if the plan documents do not explicitly state a preference for investment in company securities, that it applies to EIAPs other than ESOPs, and that the presumption is appropriate in a motion to dismiss. The court held that in order to defeat the presumption, plaintiffs' allegations would have had to demonstrate that Flagstar was on the verge of impending collapse or other dire circumstances.

■ **Seventh Circuit declines to address *Moench* presumption in upholding liability against Rock Island Corporation:** In *Peabody v. Davis,* No. 09-3428 (7th Cir. April 12, 2011), the Seventh Circuit affirmed the lower court's holding that Rock Island Corporation (RIC) officials breached their fiduciary duty by staying invested in RIC's stock despite a five-year decline in value that was likely to continue. In its analysis, the court declined to address the applicability of the *Moench* presumption, finding that regardless of whether a presumption exists, the defendants' actions were sufficiently imprudent to establish liability.

■ **In two "stock-drop" cases that survive a motion to dismiss, courts sidestep presumption-of-prudence issue:** In two recent cases, district courts in New York and Maryland allowed "stock-drop" cases to go forward without an analysis on the presumption of prudence. In *In re American Int'l Group Inc.,* No. 1:08-cv-05722-LTS (S.D.N.Y Mar. 31, 2011) the defendants failed to raise the presumption of prudence in their motion to dismiss, instead arguing three unrelated theories. The court rejected these arguments, allowing plan participants to move forward with discovery on the case. In *In re Coventry Health Care Inc. Securities Litigation,* No. 8:09-cv-02850-AW (D. Md. Mar. 31, 2011) the court similarly denied a motion to dismiss claims that Coventry Health Care Inc. officials breached their fiduciary duties by offering company stock in the pension plan when it was imprudent to do so. Here, the defendants raised the *Moench* presumption, but the court summarily dismissed the argument, reasoning first that it was not universally accepted, and second that several courts have held that it is not appropriate in a motion to dismiss.

EQUITY COMPENSATION

■ **Another appellate court refuses to allow deferral of tax consequences under §83(c)(3):** In *Strom v. U.S.,* No. 09-35175 (9th Cir. Apr. 6, 2011), the Ninth Circuit reversed and remanded a district court decision that allowed the former COO of InfoSpace.com to defer the tax consequences of her stock options. Under the Internal Revenue Code (IRC), taxes on stock options are calculated when the options are exercised. As in a number of similar cases, the plaintiff-employee in this case exercised the options when the stock was at a high point, but was unable to sell the options due to company policy until after a sharp drop in the share price. Courts have consistently held that the plain language of IRC Section 83(c)(3) only allows deferral of taxes where 16(b) short-swing profit liability is implicated, which the Ninth Circuit found was not applicable here. However, because the sale restrictions in this case involved mergers and acquisitions, the court remanded the case to determine whether taxes could be deferred under Treasury Regulation §1.83, which allows deferral if property rights are subject to "restrictions on transfer to comply with the 'pooling-of-interests accounting' rules."

■ **In one of many similar cases, a district court upholds the legality of Citigroup's restricted stock plan:** In *Weems v. Citigroup Inc.,* No. 1:00-cv-11912-NG (D. Mass. Mar. 31, 2011), the district court ruled in favor of Citigroup, holding that the company's Capital Accumulation Plan did not violate state or federal laws despite having a forfeiture clause. Under the voluntary plan, employees could elect to have some of their wages paid in the form of restricted stock, with the condition that the shares would be forfeited if the employee voluntarily left the company or was dismissed for cause before the shares vested. While wage forfeiture clauses are generally disfavored in employment contracts, the court held that Citigroup's plan was not against public policy given its voluntary nature and unambiguous, evident forfeiture provisions. The plan has been challenged in numerous other jurisdictions with the same result.

■ **Ninth Circuit reverses district court ruling, allowing option backdating lawsuit to proceed:** In *Lynch v. Rawls,* No. 09-17379 (9th Cir. Apr. 26, 2011), the Ninth Circuit held that the district court abused its discretion by dismissing plaintiffs' option backdating case against Finisar Corporation. Under federal procedural rules, plaintiffs in derivative suits must demand the corporation's directors bring a corrective action or demonstrate that doing so would be futile. Applying Delaware law (where Finisar is incorporated) the court found that plaintiffs had met the pleading requirements under the rule. ■

Ownership News

HIGHLIGHTS:

- Legislation to encourage S corporation ESOPs introduced in U.S. House of Representatives
- Decreasing number of IPOs encourages private markets
- SEC to consider relaxing the 500-shareholder rule
- South Africa increases incentives for employee ownership
- White paper on inclusive capitalism released by Center for American Progress

House Members Introduce Pro-ESOP Legislation

On March 29, Congressman Ron Kind (D-WI) introduced the Promotion and Expansion of Private Employee Ownership Act of 2011. The bill is cosponsored by Reps. David G. Reichert (R-WA), Charles W. Boustany, Jr. (R-LA), Earl Blumenauer (D-OR), Erik Paulsen (R-MN), and Bill Pascrell (D-NJ).

The bill would:

- allow owners of stock in an S corporation to have the same opportunity as owners of C corporation stock currently have to defer taxation on gains made from the sale to a qualifying ESOP;
- permit lenders to S corporations with 50% or more ownership through an ESOP to exclude 50% of the interest from the loan if used to acquire stock for the ESOP;
- set up an office in the Department of the Treasury to provide technical assistance to S corporations with ESOPs; and
- provide that companies that are 50% or more owned by an ESOP that were previously qualified under one of the various Small Business Administration set-aside programs (the most important of these are for minority- and woman-owned companies) to continue to qualify if, after the ESOP gaining 50% or more ownership, the workforce remains substantially the same.

Similar legislation has been introduced in prior Congresses. While bills such as these rarely pass as is, elements can be incorporated into larger tax bills.

Broad-Based Employee Ownership Grows in Large European Companies

According to a survey from the European Federation of Employed Shareholders, 53.7% of large publicly traded European companies now have broad-based share-ownership plans (most often stock purchase plans or stock bonus plans for broad-based plans and stock options for executives), up slightly from the last few years and from 46.1% in 2006. There are now 9.6 million employee-owners in these companies, out of a total employee population of 37 million. That is up from 8.5 million. The percentage of ownership held by employees remained about 2.7%, a number that has fluctuated only marginally in recent years. This includes holdings by top executives. Total capital owned is €192 million, again including top executive holdings. The numbers suggest that employee ownership in Europe in large public companies, much as in the U.S., is broad but generally shallow.

The full report is available for €155 for individuals and €550 for companies at www.efesonline.org/Annual Economic Survey/2010/Subscription Survey 2010.pdf.

IPO Market Decline Spurring Secondary Private Markets: SEC Considers Relaxing 500-Shareholder Rule

In the past few years, the number of venture-capital backed IPOs has dropped to 50 or fewer, and total IPOs now are about 100 per year, down from about 500 in the 1990s. Many IPOs are not startup companies, but companies that are being spun off from established companies. The average company completing an IPO is also much larger than was the case a decade ago. While the numbers are on an upward trend so far this year, a still-uncertain economy is having a dampening effect

More important, there is a greater reticence among entrepreneurs to go public given the stronger regulatory requirements of the Sarbanes-Oxley Act and the expectations of public shareholders for quarter-to-quarter results.

The rise of secondary markets has made that reluctance easier to sustain. These markets provide a way for investors and employees to get liquidity for their shares absent an IPO. Companies such as SharesPost and SecondMarket allow investors to buy and sell shares in private transactions. SecondMarket lists 140 companies whose stock it has created markets for on its Web site; SharesPost says it has brokered $500 million in transactions.

The rules for these markets mean that only “accredited investors,” primarily meaning people and institutions rich and/or sophisticated enough to take the risks, can buy shares on them. So the enormous wealth these companies may create may be largely captured by a very small number of people.

Many, but not all, of the firms whose shares are traded on these markets limit sales of exercised equity awards for current employees, or restrict them altogether. A few large private companies like Facebook and Zynga charge employees hefty fees when they sell their shares on private markets. Still, the markets make it possible for employees in these companies who do end up with shares when they leave to cash them in rather than wait for an uncertain IPO or eventual sale of the company. Most of the companies on the SecondMarket list are believed to make equity awards broadly available to employees.

Earlier this year, Goldman Sachs withdrew an effort to attract U.S. investors to buy Facebook stock through these markets after media and SEC scrutiny questioned whether the approach they were taking was a way to get around the current rules that any company with 500 or more shareholders is a de facto public company and must register its stock. Goldman then limited the offer to less-regulated foreign investors.

Now the SEC is looking into whether the 500-shareholder rule should be changed to some larger number and whether the rules for who is allowed to invest in such transactions should be changed as

well (it is not clear if this would ease or restrict the kinds of investors who would be eligible). The idea behind the existing rules is to protect unsophisticated investors from poor investments. Presumably, the SEC will look into whether and how that should change. For an interesting column questioning the need for the change, go to finance.fortune.cnn.com/2011/04/08/sec-private-share-move-presents-big-problem-for-venture-capitalists.

■ *Beyond the Corporation: Humanity Working*

The discussion about employee ownership as public policy touches on business, philosophy, psychology, and economics, and few people are qualified to write on all its aspects. David Erdal is one of the few people who is. After a stint in China and Harvard Business School, Erdal led his family's company, Tullis Russell, to employee ownership and then became managing director at Baxi Partnership, a firm that supports companies interested in employee ownership. Erdal's prior book, *Local Heroes,* tells the story of Loch Fyne Oysters from its founding to becoming employee owned.

Erdal widens his focus in his new book, *Beyond the Corporation: Humanity Working.* In it, he explores the beliefs the support conventional ownership and management as the primary form of economic activity in the U.K., the U.S., and elsewhere in the world. He raises his challenge with data, stories, and deep understanding based on his business experience and love of evolutionary psychology. With examples from his own life and from some of the best known employee ownership companies in the world, such as John Lewis Partnership and SAIC, Erdal draws on sources as diverse as 18th century testimony before Parliament, employee interviews, academic psychology, economic philosopher David Ellerman, and extensive conversations with experts in employee ownership around the world.

Currently available in the U.K. and electronically from Amazon, Erdal's work is entertaining, challenging, and inspiring for people who believe in employee ownership, and it offers a wonderful entry point for those unfamiliar with the field.

■ South Africa to Encourage Employee Ownership More

South Africa's current Black Economic Empowerment program provides favored government contracting to companies that meet rules for expanding ownership to blacks. The program has been criticized as too easily favoring political favorites of people who already have substantial wealth because it does not emphasize broad distribution of wealth but only that one or more blacks own a sufficient stake in the company. Under new rules, the point system for awarding contracts will be changed to put more emphasis on broad-based employee ownership plans. Because so many businesses deal with the government in one way or another, the program has broad reach in the South African economy.

■ Inclusive Capitalism

In a white paper published by the Center for American Progress and freely available, Richard Freeman, Joseph Blasi, and Douglas Kruse outline a public policy position. Their goal is to encourage policies that reestablish a prosperous middle class by providing incentives for U.S. firms to adopt compensation systems that link broad-based employee earnings to the performance of the firm in the form of employee ownership and profit sharing. Despite research that supports the effectiveness of broad-based plans, most firms that have any form of incentive pay limit such pay to a small number of high earners. See www.americanprogress.org/issues/2011/03/worker_productivity.html.

■ Pam Chernoff to Move to CEPI

Pam Chernoff, who has worked for the NCEO first as a full-time staffer and later as a part-time consultant on equity issues, has taken a new position at the Certified Equity Professional Institute (CEPI). Pam will still be available to us for special projects. Pam has been an invaluable contributor to our work, both for her technical expertise and her unmatched editing skills. We will miss her greatly, but we are pleased that we will still be working closely with her in her new capacity at the CEPI. ■

New Research on the Impact of Employee Ownership

Continued from front page

for in America from 2006 to 2008, and it covers more than 300,000 employee surveys from all 1,300 corporations that applied. Here are six highlights:

- Applicant companies are more likely than average to have some form of employee ownership. Namely, 15% of applicants have ESOPs, 10% are majority employee-owned, and 16% give options to most employees.
- The amount of shared capitalism (different types of employee ownership and profit sharing) in a company is associated with a significantly higher Trust Index, which is GPTWI's principal measure of credibility, respect, fairness, pride, and camaraderie within each company's workforce.
- The combination of shared capitalism and the Trust Index is associated with significantly lower turnover in a company, and this is true when actual turnover is reported by the company and when expected turnover is reported by the worker.
- As shared capitalism and the Trust Index go up together, the firm is more valuable to shareholders, as measured by one of the most accepted measures of shareholder value used by researchers, Tobin's q (the market value of the firm relative to the book value of its historical assets).
- ESOPs specifically are associated with lower workers compensation claims.
- Greater shared capitalism in a company is associated with higher return on equity.

These and other conclusions of the study support the findings of an earlier ten-year study summarized in their book, *Shared Capitalism at Work* by the University of Chicago Press, now available in paperback. ■

Companies

■ **Fagor Electrodomésticos**, the flagship company in the famed Mondragón cooperatives, is looking for partners to strengthen its presence outside Europe and says it will not rule out the possibility of a merger. With its revenues concentrated in the mature markets of Europe, Fagor seeks better access to Asia, the Americas, and Eastern Europe through collaboration, creation of joint ventures, or merging with another company. The cooperative's management team set the condition that Fagor would not enter any alliance that would result in the sale of the company or dilution of its worker-owners. The cooperative's managers also said that the cooperative would not agree to any merger in which it was a junior partner, though they acknowledge that a merger of equals "would require a change of mentality and the assumption of certain sacrifices" on the part of its worker-owners.

■ ESOP-owned **C.C. Myers** in Rancho Cordova, California, won an Aon Build America Merit Award for deftly sliding out a section of the old San Francisco Bay Bridge and rolling in the new S-curve section over just four and a half days—all 150 feet in the air. The company won the eternal gratitude of Bay Area commuters a few years ago when it repaired a major stretch of highway near the Bay Bridge after a tanker truck rolled over and exploded. The work was completed in a small fraction of the time everyone expected, saving endless hours of commuting nightmares.

■ Illinois-based ESOP company **Alion** won a "contractor of the year" award from the Army's Armed Scout Helicopter (ASH) program office. The company's Rapid Engineering Solutions team was honored for its contributions for designs and innovative ideas in support of the Kiowa Warrior helicopter. Alion is 100% owned by its ESOP and was formed in 2002 when employees of the IIT Research Institute purchased the company's assets and created a new company.

■ **Jasper Engine & Transmission**, which provides vehicle parts to the U.S. Postal Service and other fleets (see the Employee Ownership 100 list), used its ESOP to acquire Canam Marketing. Canam also works with the USPS and has developed replacement parts for which original parts are no longer available. The resulting company intends to both provide a single point of contact for customers and strengthen both companies by combining infrastructure and new product development.

■ **Procter & Gamble's** board decided in April to increase the company's dividend by 9%, including its common shares and the convertible preferred shares in its ESOP. This increase marks the 121st consecutive dividend for at the company and the 55th consecutive year with an increase.

■ The employee-owners of **Stanbury Uniforms** faced a problem that they hope to never encounter again. When a pipe burst in the ceiling of their office, 55,000 gallons of water flowed out, destroying sales ledgers and other irreplaceable records stretching back to the company's founding in 1917. The company was forced to dismantle its offices and move them down the street. Remarkably, despite the disruption, the company did not lose a single manufacturing hour. It has long attributed its reputation to the longevity of its employee-owners, and the commitment of the employees was evident in their hands-on reaction to the flood. ■

NCEOBookshelf

The NCEO is the leading publisher of books and other materials on employee ownership and ownership culture. Listed here are a few of our recent publications. For a complete listing, plus convenient online ordering, visit us at www.nceo.org.

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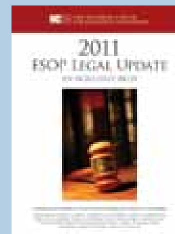
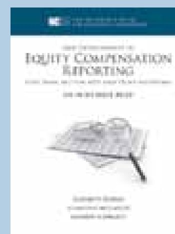
2011 ESOP Legal Update



Our 2011 ESOP Legal Update summarizes the previous year's judicial, regulatory, and legislative developments affecting ESOPs and 401(k) defined contribution plans that invest in employer stock, with some coverage of events in early 2011. (40 pp.)

$15 for members, in print or PDF format

New Developments in Equity Compensation Reporting



This issue brief addresses recent developments in equity compensation reporting. The first article discusses the factors to consider when designing processes for implementing and complying with the new cost basis reporting rules. The second article discusses the newly expanded reporting requirements under Internal Revenue Code Section 6039. The third and final article discusses the Dodd-Frank rules and relevant Institutional Shareholder Services policies and guidelines related to executive compensation, followed by some best-practices recommendations for companies to consider when drafting their proxy statements. (48 pp.)

$15 for members, in print or PDF format

The Power of Plan B

Budgets and strategic plans are predictions about the future, and every investment and each new hire are based on the expectation that the investment or hire will create enough future benefit to offset the cost today. But what happens when those predictions are wrong?

All of these predictions involve guess work, and no one guesses right every time. Consider the case of a simplified fictional company where the projections were not quite right. Let's say the company expects $1 million in sales. It will have $200,000 in overhead (costs that do not change, such as rent, administrative staff, and ESOP administration), $300,000 in direct labor (the compensation and benefits of the people who make their product), and $400,000 in direct materials (buying the supplies to make their product). According to their projection, that makes for a $100,000 profit.

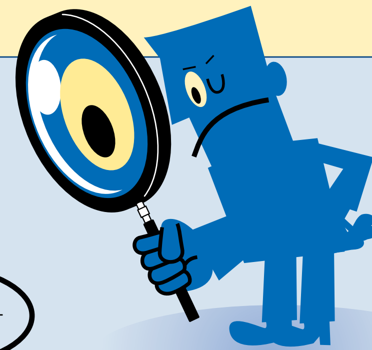
Projection vs. Reality

What happens if materials are a bit more expensive than the company planned? Suppose commodity prices go up and add 10% to the cost of materials. That adds $40,000 in expenses, reducing the company's profit by 40%.

While a change of 10% in one line item of a company's income statement can have a big impact on its profits, when it comes to stock, the impact is even more dramatic. To oversimplify a bit, one way to determine the value of stock is to multiply profit by a ratio known as the price-earnings multiple, or P/E ratio. For a privately held company, the P/E ratio may be somewhere around 5. Based on the company's original projection, its stock is worth $100,000 times 5, or $500,000. After the change in commodity prices, the value of the stock has dropped to $60,000 times 5, or $300,000, for a $200,000 difference.

What does all this mean for employee-owners? First, learn what drives your company's success, especially the pieces that you can influence. Second, watch the numbers, because

	PROJECTION	REALITY
Revenue	$1,000,000	$1,000,000
minus overhead	-$200,000	-$200,000
minus direct labor	-$300,000	-$300,000
minus direct materials	-$400,000	-$440,000
Profit	$100,000	$60,000



you need to know how the company is doing. Third, control expenses. Not everyone can affect revenue, but everyone can cut expenses. The last piece of advice draws from the practices of a company called SRC Holdings. At the Great Game of Business conference, several speakers talked about how SRC uses the power of plan B, and its story is something every employee-owner can learn from.

Developing Plan B

At SRC, every department comes up with its best plan to reach the company's growth target. Let's call that plan A, and there's nothing special about that. What is special is that every department does another planning exercise, this time starting with the assumption that plan A turns out to be a complete failure. They come up with plan B, a totally separate way to reach their growth target.

Developing a plan B has lots of advantages, one of which is that the company might actually need it when times get tough. Plan B also involves some creative thinking. People put the most likely scenarios in plan A, so for plan B they need to dig a little deeper and brainstorm a little more to come up with a whole new set of ideas. Some of those ideas might end up being good enough to pursue even if plan A ends up working perfectly.

Plan B is not always about finding ways to meet numeric targets. Sometimes, plan B is about people. What if someone gets sick, dies, or leaves the company? Every team should consider the "bus test:" can the team keep functioning even if a key person gets hit by a bus? If it cannot, then the team needs leadership development. Companies often fail because they do not have someone ready to take over for their chief executives, but a lack of leadership succession at lower levels can have a devastating impact on the organization as well. It is the responsibility of everyone in the company to make sure that their teams are ready to pass the bus test.

What If...?

Many companies develop both a conservative and a liberal projection for planning purposes, but often those scenarios are only 10% apart. This type of planning is important, but companies should also spend some time thinking about massive changes. This is a what-if exercise, and it can be scary. What if laws change and we need to retool everything we do? What if the price of oil triples? What if there is an earthquake or a flood or a tornado? What if our bank terminates our line of credit? These situations are remote, but they have such a large potential impact that they should not be ignored. And plan B is not just about hard times. One of the most difficult things to manage is unexpected growth, and companies should spend time thinking about how they would manage the need to ramp up quickly.

The booms and crashes that have defined the last two decades illustrate how unpredictable the economic climate can be. Many companies were unable to weather the changes. With a creative contingency plan in place, your company will be better prepared for the uncertainties of the future and more capable of seizing unanticipated opportunities for growth. ■

NCEO Events

Fall Live Seminars

Is an ESOP Right for You?
September 20–21 / San Jose, CA

Get the Most Out of Your ESOP
September 26–28 / St. Louis, MO

Register for one, two, or all three days.

- Plan Design Features that Support Ownership Culture
- Effective ESOP Communications
- Creating a Company of Owners

The ESOP Company Symposium
October 11–13 / Dallas, TX

Register for one, two, or all three days.

- Handling the ESOP Repurchase Obligation
- Challenges and Solutions for Mature ESOP Companies
- Strategic Planning for Your ESOP

NEW: Best Practices for S Corporation ESOPs
October 18 / Arlington Heights (Chicago), IL

Upcoming Live Webinars

SUMMER 2011

INTRODUCTORY TOPICS
- The Rollout: Introducing a New ESOP to Employees (7/21)
- ESOP Overview (8/4)

ONGOING ESOP ISSUES
- Valuation Challenges for Ongoing ESOPS (7/19)
- Communicating Valuation (8/2)

OWNERSHIP CULTURE
- Meet the Innovations Award Winners 7/28
- Revitalizing Your Ownership Culture 8/4

FALL 2011

INTRODUCTORY TOPICS
- Answer to the Most Frequently Asked ESOP Questions (9/8)
- Becoming an S Corporation ESOP (9/27)
- S Corporation ESOPs – Legal Issues (10/4)
- S Corporation ESOPs – Administrative Issues (10/5)
- S Corporation ESOPs – Valuation Issues (10/6)
- ESOP Feasibility (12/6)
- What You Need to Know as an Internal ESOP Fiduciary (12/13)

ONGOING ESOP ISSUES
- Don't Do That with Your ESOP (9/13)
- Fiduciary Implications of Stock Drop Lawsuit in 401(k)s and ESOPs (9/15)
- Using ESOPs as an Acquisition Strategy (9/29)
- ESOP Distribution Policies (10/20)
- Running an Effective Board (10/25)
- Effective Wellness Plans in Employee-Owned Companies (11/17)
- Handling the Repurchase Obligation – Legal (11/29)
- Handling the Repurchase Obligation – Planning (11/30)
- Handling the Repurchase Obligation – Valuation (12/1)

OWNERSHIP CULTURE
- Incentive Plans That Support Employee Ownership (10/27)
- Communicating Your Ownership Culture (11/22)

ESOP COMPANY CASE STUDIES
- ESOP Company Case Studies (12/15)

For more information and to register, go to www.nceo.org

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