

## ISSUE HIGHLIGHTS

- Employee ownership companies are once again heavily represented on *Fortune* magazine's list of 100 best companies to work for. *Details are on page 13.*
- The Supreme Court's ruling on company stock in retirement plans has changed the outcomes of cases around the country. The NCEO's annual reviews of stock plan litigation and rulings examine the practical implications of judiciary and regulatory rulings, including the impact of *Dudenhoeffer v. Fifth Third*. *See page 3.*
- Employee surveys can take your company culture to a new level...or create new problems. Learn about best practices in harnessing the power of employee surveys *on page 9.*
- Innovative new structures allow nonprofit organizations to benefit from ESOPs, and the IRS announces steps to allow prototype and volume submitter plan documents. *See page 6.*
- This issue's case study looks at management succession, hiring in an employee ownership company, and "feedback with a high five." *See page 8.*
- Other stories inside include big developments in Pennsylvania, Employee Ownership Day in the United Kingdom, declining levels of employee stock ownership in Germany, and new NCEO publications.

# EMPLOYEE OWNERSHIP REPORT

SEPTEMBER–OCTOBER 2015  
VOLUME XXXV, NO. 5

## NCEO OUTREACH

### Finding the Next Generation of Employee Ownership

As a self-sustaining nonprofit organization, all of the NCEO's core activities must pass a market test: our members tell us whether our events, publications, and other resources are valuable to them by deciding whether to pay for them. Although that is still true, the NCEO has been initiating a series of projects that are taking us into new realms.

The changes started when Bill Marshall proposed creating the Rosen Ownership Opportunities Fund (ROOF) in 2010. His purpose was to allow the NCEO to do things that we would not have been able to do without it, and we did. ROOF put the NCEO on a new path, solidified most recently with a grant award from the W.K. Kellogg Foundation (WKKF). —Continued on page 4.



APRIL 12–14, 2016 / MINNEAPOLIS, MN

### Call for Annual Conference Sponsors and Speaker Proposals

The NCEO began accepting speaking and sponsorship applications on August 27, 2015, for the 2016 Employee Ownership Conference. Sponsors and speakers can submit proposals online at [www.nceo.org/conference](http://www.nceo.org/conference). That page has links to information and applications for sponsorship and instructions and applications for speaking at the conference.



The Conference will be April 12–14, 2016, in Minneapolis with a preconference session on April 11. It has grown every year since 2009, and in 2015 more than 1,400 attended. We welcome your ideas and support for this industry-leading event!

Sponsorships and exhibit tables are awarded on a first-come, first-served basis, so early submissions are more likely to be

included. Speaking proposals are due by the hard deadline of October 2, 2015. Speaking proposals go through a selection process with an outside committee. Speakers will generally be notified of their acceptance by the end of December. ■



Contact Deborah Krant, NCEO conference director, at (510) 208-1304 or [dkrant@nceo.org](mailto:dkrant@nceo.org).

# A Reason to Focus

By Loren Rodgers, NCEO Executive Director



Lots of factors determine whether a business succeeds or fails. The power of employee ownership comes from its effect on internal factors, and those internal factors all come down to this: each person needs to focus on doing the right thing. If that sounds too simple, let's look at what happens in most companies.

Most employees are not focused. They are constantly distracted by smart phones, the swirl of micro-tasks, unexpected requests from supervisors, incoming emails, and their own personal lives. Multitasking gives us a hit of pleasurable brain

chemistry, but the psychologists who study work say that focusing on a single task for a blocks of time is by far the most productive way for the average person to work.

Sometimes employees are focused, but on the wrong things. If my promotion depends more on impressing my supervisor than on the health of the business, I'm going to be focused more on politics than on the company's strategic goals. Or maybe my focus is taken up by meetings of committees that themselves do not have a clear goal.

Employee-owned companies have unique advantages because every employee-owner has a profit motive to focus on business success. That is powerful, but the ownership advantage has deeper roots.

One of the most effective ways to reduce distractions is to build trust among coworkers, and that's because one of the major sources of distraction is delegation stress. Suppose I ask a coworker to answer a complaint from a longtime customer.

**Employee-owned companies have unique advantages because every employee-owner has a profit motive to focus on business success. That is powerful, but the ownership advantage has deeper roots.**

No one really wants to do that, so worry about that customer will still be buzzing around my head. If, however, I know I can fully trust my coworker to make sure the issue is resolved—she owns this company too, after all—then I can focus.

In fact, I believe that employee-owners are better focused on the right things because many employee-owned companies are not just companies;

they are communities that invest in building relationships among their coworkers. For example, the case study on Butler/Till in this newsletter (see page 8) talks about a program the company built to encourage employee-owners to acknowledge each other's accomplishments.

Talking about community may sound a few steps removed from the theme of this article—focusing on the right things—but one of the most distracting patterns at work is people handling conflict poorly. When people care, they will disagree, and you want people discuss and wrestle with those disagreements. Sometimes they will get angry with each other, and when those conflicts happen, people have a natural tendency to shift focus away from thinking about the decision that's best for the company and toward how people will feel about the decision: Will someone be insulted or worry about a turf war? Is my role in the new project a good omen or a bad one? Should I say something about a coworker who is not doing good work?

Some of our member companies train employee-owners about how to have difficult conversations. Others post the Myers-Briggs scores of each employee-owner. These steps make it easier for people to raise contradictory viewpoints and, often, find creative solutions.

Employee-owned companies have good reason to invest more in building communities that can handle conflict productively. They invest more in their workforces and involve more people in more decisions.

Owning stock gives people an incentive to focus. A sense of community gives them the tools to focus, even when times are challenging. ■

## EMPLOYEE OWNERSHIP REPORT

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## MEET THE NCEO BOARD

### Neil Brozen

Neil Brozen has been providing ESOP trustee services since 2005. He has been responsible for 70 ongoing ESOPs and 100 transactions. He is a frequent national speaker and has written articles for the NCEO issue brief *Responding to Acquisition Offers in ESOP Companies* and the book *Executive Compensation in ESOP Companies*. Neil has been a CPA since 1981 and has worked for the IRS, Arthur Andersen & Co., several private companies, and his own consulting business. Being an ESOP trustee is the best job he's ever had. ■



# ESOP Litigation and Rulings Reviews

Each year, the NCEO publishes the *ESOP and 401(k) Plan Employer Stock Litigation Review* and *ESOP Regulatory Rulings*, which summarize and tally all the litigation and federal rulings on employer stock in ESOPs, 401(k) plans, and related plans. Since 1990, the year of the earliest rulings in the litigation review, there have been 311 cases that have made it to court specifically concerning ESOPs, 252 of which were in privately held companies. Some of these cases involved multiple issues, such as valuation, distribution, standing, and so on.

The litigation review references and summarizes all rulings by decision category. The most common areas of decisions have been who is a fiduciary (35); management of assets, such as administrative errors (33); and valuation (30). Some instances cover more than one issue, so some companies appear in multiple categories.

Over the 25 years of the review, the number of cases concerning private companies is on par with the number concerning public companies, although few cases have made it to court in closely held companies. There are far more private companies with substantial holdings of company stock than public companies, so private companies are less likely in percentage terms to be involved in litigation. In public companies, where most of the cases involve company stock in 401(k) plans, most cases have occurred since 2004.

## Remands After the *Dudenhoeffer* Ruling on the Presumption of Prudence

A number of cases were remanded to lower courts after the Supreme Court eliminated the presumption of prudence for company stock in ESOPs and for 401(k) plans designed to have company stock as a match or a deferral option. In most of the remands, plaintiffs continued to be unsuccessful. In *In re UBS ERISA Litig.*, the case was dismissed over standing, but the judge noted that the *Dudenhoeffer* ruling did not apply, since the plan in question was not required or encouraged to hold company stock. The second circuit

dismissed a remanded case in *In re Citigroup ERISA Litig.*, ruling the statute of limitations had lapsed, but said that the plaintiffs could not have sustained an argument under *Dudenhoeffer*'s "special circumstances" rule. In *In re HP ERISA Litig.*, the Ninth Circuit said the new standards under the *Dudenhoeffer* decision also protected fiduciaries.

There could be several more remanded cases under the *Dudenhoeffer* ruling, so the ultimate direction is still not clear. Early indications are, however, that plaintiffs will not find the ruling as helpful as some hoped and others feared. On the other hand, it is likely that public companies will continue a trend to move away from company stock in their 401(k) plans as the elimination of the presumption of prudence adds one more potential risk.

## Would Have or Could Have

After a decade of litigation, in *Tatum v. R.J. Reynolds Tobacco Inc.* an appeals court overturned a lower court's dismissal of the case, saying the relevant standard should have been not what a prudent trustee "would have" done but rather what it "could have" done. Some observers say this creates a much more demanding burden on fiduciaries, but others said the "could have" standard was not that different. In 2015, the Supreme Court declined to review the case.

## Valuation

Only two significant ESOP valuation cases were decided. In *Perez v. Bruister* a district court ruled that, in addition to the two named fiduciaries, the

seller to an ESOP was also a fiduciary because he exerted influence over the named fiduciaries concerning the appraisal. In *Defazio v. Hollister Emp. Share Ownership Trust* the Ninth Circuit rejected an appeal of a ten-year-old lawsuit over alleged fiduciary violations over the valuation of company stock in 1999. The court agreed that the fiduciaries failed to follow proper procedures in obtaining a valuation, but concluded the plaintiffs suffered no material harm as a result.

## Who Is a Fiduciary?

In *Gedek v. Perez*, a district court ruled that even though BNY Mellon was a directed trustee in a stock-drop case, it still could be liable as a fiduciary, albeit the plaintiffs would have a high bar to overcome to prove their case.

## Regulatory Rulings

There were few new rulings from the IRS or DOL in the last year. One important one (PLR 201510061) allowed a multinational company to include employees in other countries into the ESOP. A second (Revenue Procedure 2015-36) allowed, for the first time, multiemployer and volume plan provider submissions of prototype ESOPs for letters of determination. The revenue ruling included sample language of key plan features (see page 6).

More important is a ruling that did not happen. For a number of years, the Department of Labor had been proposing that ESOP valuation advisors be considered fiduciaries. Many people in the ESOP community worried that this would raise the costs of ESOPs substantially. This year, the DOL dropped that idea from its redrafted proposal, saying that it still has concerns about ESOP appraisals, but that it had "concluded that the concerns regarding valuations of closely held employer stock in ESOP transactions raise unique issues that are more appropriately addressed in a separate regulatory initiative." ■



**ESOP and 401(k) Plan Employer Stock Litigation Review 1990–2015 and ESOP Regulatory Rulings 1990–2015** summarize hundreds of cases and rulings. See page 15 or visit [www.nceo.org/r/litigation](http://www.nceo.org/r/litigation) and [www.nceo.org/r/rulings](http://www.nceo.org/r/rulings).



# Finding the Next Generation of Employee Ownership



## Programs Supported by the Kellogg Foundation

The grant from the Kellogg Foundation is the first time since the 1980s that the NCEO has received a substantial foundation grant. The Kellogg Foundation awarded the grant as part of its efforts to break the cycle of poverty for children and increase the economic security of families by supporting income and asset building among parents. The grant will support the NCEO's work on five projects:

- Outreach to decision makers in non-employee-owned companies, especially through regional organizing and trade associations.
- Research on the relationship between employee ownership and wealth, especially among low-income workers.
- Investigating ways to better use agency rules and regulations on purchasing preferences, loan preferences, set-asides, and special-status certification to support ESOP companies that have substantial ownership by low-wage workers.
- Providing financial support to companies that establish English as a second language (ESL), financial literacy, and business literacy programs for employees, with the goal of enabling workers with native languages other than English and workers constrained by low business literacy to more effectively participate in their companies.
- Development of a primer on ESOPs for private foundations. The primer will help employees of foundations (a) understand how ESOPs work, (b) determine the types of projects they may wish to support, and (c) provide suggestions for ways foundations can make program related investments that would support employee ownership.

The NCEO has already begun work on several of these projects.

*Note: The NCEO is not seeking subcontractors or subgrantees for these projects, and all funds from the Kellogg Foundation grant will be used for these projects.*

## The Pennsylvania Center for Employee Ownership

One of the outreach projects supported by the Kellogg Foundation is the Pennsylvania Center for Employee Ownership (PCEO), a new volunteer-driven organization that is intended to serve as the pilot case to facilitate the development of other state centers. The core goal of the state centers is promoting employee ownership through education, primarily for business owners and secondarily for people who interact with them. The PCEO is planning to hire a full-time in-state director in the fall to build content, make connections to potentially allied organizations, educate state-level policy makers, and promote employee ownership in the media.

The NCEO's funding is a match to more than \$60,000 in contributions that people connected with the PCEO have made, especially Ken Baker (CEO of NewAge Industries), SES Advisors/Steiker, Greenapple & Croscut, Cecil Ursprung, and Restek. The NCEO and some of the in-state contributors have committed to funding the PCEO in future years as well.

The PCEO is a new entity in the already well-populated world of employee ownership organizations. It is different from existing organizations because it will reach out to non-employee-owned companies (rather than serving existing companies), it will not have members, and it will promote all forms of employee ownership. The PCEO, and all other state centers created through partnership with the NCEO, will seek to collaborate rather than compete with existing state centers in Ohio, Vermont, and the Rocky Mountains.

## The Rosen Ownership Opportunities Fund

As of March 2015, the Rosen Ownership Opportunities Fund (ROOF) has fully expended the more than \$140,000 in contributions it received. ROOF honors NCEO founder Corey Rosen. Since 2011, five scholars have been awarded Corey Rosen Fellowships through Rutgers, and Dr. Frank Shipper at Salisbury University was able to write a number of well-received case studies. ROOF money also supported ongoing outreach through states and trade associations, the development of a compendium of state-level policies, and infographics and other resources aimed at the general public.


The NCEO offers its profound thanks to Bill Marshall and Phelps County Bank, the primary movers behind ROOF, and the 78 organizations and individuals who made contributions.

### Next Steps

Some of the projects funded by the Kellogg Foundation will depend on participation from members who are interested in outreach, purchasing preferences, and employee literacy training.

The NCEO will focus primarily on the Pennsylvania center in the near term, but we want to hear from potential volunteers in other states.

More than 100 members made donations to the NCEO last year. Please consider making your own donation so that we can continue these projects. ■

 **Donations to the NCEO can be made during your annual membership renewal, by contacting Loren Rodgers at (510) 208-1307 or [LRodgers@nceo.org](mailto:LRodgers@nceo.org), or online at [www.nceo.org/r/donate](http://www.nceo.org/r/donate).**

# EMPLOYEE OWNERSHIP Q&A

**Q Can a company transfer investments to the ESOP instead of cash and allow the ESOP to sell the investments? If so, would the transfer allow both the company and the ESOP not to have to recognize the gain on the disposition of the investments?**

**A** Although it is possible in some cases to make in-kind contributions instead of cash contributions to an ESOP, it may prove not to be feasible in practice. Allison Wilkerson of K&L Gates notes four conditions:

1. The contribution of in-kind, unencumbered property should not offset an obligation otherwise owned by the plan sponsor to the plan. If the plan sponsor has a set, required contribution owed to the plan or a funding obligation with respect to the plan, the contribution of property for such obligation would likely be a prohibited transaction as an exchange of property between a disqualified person (company) and the plan.

However, in a defined contribution plan where the plan is funded solely in the discretion of the plan sponsor, the contribution of property would simply be a discretionary contribution and not an offset/exchange. This should not implicate the prohibited transaction rules. Note: If the ESOP has an outstanding exempt loan and the plan sponsor has covenanted to provide sufficient wherewithal to allow the ESOP to repay the loan, the contribution of property (likely) should not offset that contribution requirement. If it is simply an extra/discretionary contribution, the transfer should be permitted.

2. The fiduciary must make a fiduciary decision that accepting the property is appropriate. This means the fiduciary must ensure that the contribution is in the interests of participants

(i.e., reflects proper diversification or a means to continue diversification [sale and investment] or to promote other goals of the plan [sale and purchase of company stock] and minimizes losses [the property can be sold/liquidated properly and without loss]). This must be a prudent holding by the plan or the plan fiduciary faces risk.

3. When the time comes to sell the property, the fiduciary will need to make sure that the sale is in the interests of participants/defraying reasonable costs of the plan. So we would advocate that the property be fairly liquid and insulated from large losses before the trustee agrees to accept such amounts.

4. If the plan sponsor is an S corporation, the holding of an investment by the plan may cause the plan to incur unrelated business income tax (UBIT).

**Q I have been asked to be one of the trustees for our ESOP. Is this position typically compensated?**

**A** Insider trustees (i.e., people who are both employees of a company and one of that company's trustees) are very rarely compensated beyond what they receive for their normal jobs. The NCEO surveyed corporate governance practices in ESOP companies in 2012 (and will do a similar survey later this year). Among the 503 respondents to the survey, the most common type of trustee was an institutional trustee (37% of respondents), and they are compensated (their median compensation was \$25,000 per year, though it may be higher now; trustees have reasons to raise their fees following the Fiduciary Process Agreement between the Department of Labor and GreatBanc). Of the 21% of respondents that have an individual employee as trustee, 3% provide compensation. Of the 29% that have a committee of employees as trustee, 1.5% provide compensation.

**Q Our company had a substantial increase in profits this year, partly due to a one-time event. If we move extra cash into a sinking fund or the ESOP to handle repurchase obligations, will that change the valuation?**

**A** In theory, it should not. A valuation should be done based on normalized earnings. One-time events are heavily discounted. Funds that are used to pay more than competitive pay or set aside cash for repurchases or other uses that a buyer would not normally employ should be recalculated into normalized earnings. Similarly, money set aside for repurchases should reduce the discount for repurchase obligation that might otherwise occur, pushing the value up. But if that money is not set aside, the profits will look higher, but the repurchase discount will be larger as well. From a balance sheet perspective, cash in excess of required working capital is added back to enterprise value. In short, it is difficult to manage the value of a company by assigning funds to different purposes, albeit certain uses of funds, such as reinvestment, may have long-term effects of performance.

**Q I just became a participant in my company's ESOP. What documentation does the company need to provide me?**

**A** Plan participants are required to receive a summary plan description (SPD) and annual account statements. They do not automatically get copies of the plan itself or any other filings. However, they must be given the right to inspect the plan, the trust agreement, annual reports to the government, the letter of determination and the application for it, and any contracts under which the plan was established or operates. All companies that sponsor ESOPs (and many other benefit plans) must submit federal Form 5500, which is available online. ■

# New Approaches to ESOPs

**This summer brought two events many ESOP experts never expected to see: the possibility of prototype plan documents preapproved by the IRS and a mechanism allowing employee ownership in nonprofit organizations.**

## The IRS and Prototype ESOPs

The IRS announced in a revenue procedure that it will, for the first time, allow prototype and volume submitter ESOP plan documents. It also issued sample plan language for ESOPs.

In Revenue Procedure 2015-36, the IRS allowed ESOPs that meet certain requirements to qualify for pre-approval for initial and cyclical letters of determination if they adopt a prototype plan or volume submitter plan.

Under a prototype plan, an employer can adopt a plan from a “sponsor” (here meaning the sponsor of the prototype, not the sponsor of the ESOP) that is preapproved or can use a plan submitted by a volume submitter (in the ESOP case, generally a law firm that submits a standard plan for multiple clients). The number of adopting employers for the same plan in either case must be at least 15 or 30 if the volume provider has multiple basic plan documents the clients use.

Under this system, every preapproved plan must be submitted to the IRS for a new opinion or advisory letter every six years (rather than five for individual plans) during the applicable on-cycle submission period. A principle benefit of this new approach is that providers and plan sponsors will be able to fit their plans into the six-year cycle for pre-approved plans and would not need to vary language based on the latest cumulative list.

In that same revenue procedure, the IRS issued what it calls required modifications to plan documents seeking approval under the new procedure, although they are more accurately described as sample plan provisions.

ESOPs that are a part of a money purchase pension plan (which is now rare) or that use preferred stock cannot

participate in this program. The ruling also sets out specific requirements the plan must include, all of which would currently be included in any individually drafted plan, such as diversification procedures, an independent appraisal, testing for compliance with S corporation ESOP anti-abuse rules, and so on. It also makes clear that the plan eligibility is limited to employees of the sponsor company and its controlled groups. Companies can make minor modifications of the plan and, probably, different allowable options on allocation, vesting, eligibility, and similar rules, although the ruling does not specifically say that.

It is not clear how much this will accomplish its intended effect to lower plan implementation costs. Most ESOP providers already have standard plan language, so having a preapproved plan should, in theory, not significantly lower plan drafting costs. On the other hand, some providers may charge a substantial fee for customizing a plan, and this could create market pressure to use preapproved plan language.

## Nonprofit Sets Up Innovative ESOP Structure

In what could be a model for other nonprofits, Supportive Concepts for Families (SCFF), a Pennsylvania-based nonprofit organization, set up a subsidiary S corporation holding company that will be 49% owned by an ESOP. SCFF provides supportive group home services for people with developmental disabilities.

It has 1,100 employees and anticipates becoming larger.

The subsidiary holding company will own the real estate assets of SCFF and lease them back to SCFF. In the future, SCFF plans for the holding company to acquire other operating assets, such as a manufacturer of energy efficient equipment that is used in the group homes that SCFF operates.

Nonprofits, including SCFF, traditionally have had difficulty in acquiring real property, partly because they cannot raise equity capital to fund down payments or take a tax deduction for mortgages. With this new model, appreciated real estate assets were transferred to the newly created holding company and exchanged for stock. As the holding company acquires additional properties, the process will be repeated.

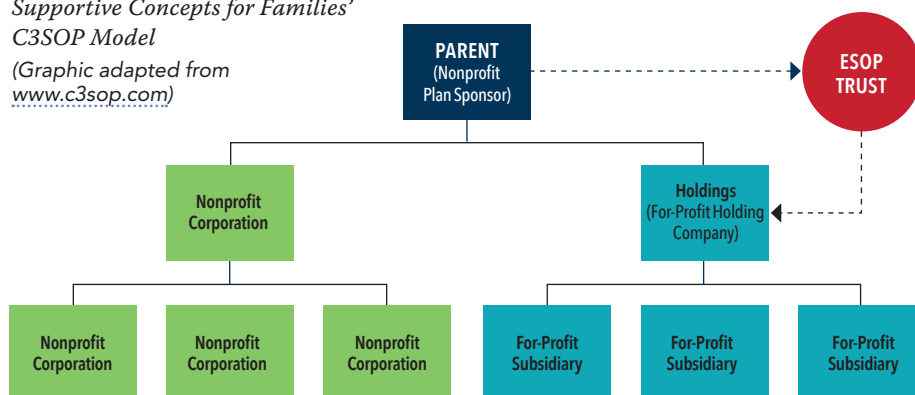
The value of the ESOP assets depends on the value of the property and its leases. SCFF will receive distributions from the holding company to pay its unrelated business income tax on any profits attributable its 51% ownership of the holding company; the ESOP will receive a pro rata share.

The transaction was put together by Angler West Consultants, which has dubbed (and trademarked) the plan a “C3SOP” (see diagram below).

Although this particular plan is complicated and involves multiple operating entities, the core idea of partly or wholly spinning off profitable activities to an operating company with an ESOP could be done by other nonprofit organizations. ■

*Supportive Concepts for Families’ C3SOP Model*

(Graphic adapted from [www.c3sop.com](http://www.c3sop.com))



# Center for American Progress Report

On July 21, the Center for American Progress released a report, *Capitalism for Everyone*. The authors, Karla Walter, David Madland, and Danielle Corley, make a case for policies designed to encourage companies to adopt employee ownership programs and broad-based profit sharing, to paraphrase the report’s subtitle.

## EXCERPTS FOLLOW:

When a company does well, so should its workers. American workers have helped the economy grow by becoming more productive. Yet, even as productivity has increased, many middle- and working-class households have experienced stagnant wages and declining household incomes over the past few decades. This means workers currently receive only a small share of the wealth they help create.

Broad-based sharing programs—such as granting workers an ownership stake or a share of profits based on workers’ collective performance—can help ensure that workers are rewarded for the wealth they generate.... Collectively, these programs hold the potential not only to benefit workers: Research shows that firms and investors also receive tangible benefits from sharing with their workers (p. 1).

Yet, far too few workers receive the significant benefits available from inclusive capitalism, and there are a number of issues that inhibit the growth of broad-based profit sharing programs. Business owners and executives are often unaware of inclusive capitalism programs and the mutual benefits they provide. In addition—while not born out by existing research—owners and executives often believe that company success is driven by a small number of “key” employees, particularly executives; this leads them to focus incentive pay on these individuals, not ordinary employees. Moreover, some government policies provide perverse incentives not to share; existing policies to encourage companies to share ownership with their employees are inadequate; and the federal government does not have a unified vision for how to encourage more sharing (p. 2).

While focusing incentive pay exclusively on top executives based on company performance has a very mixed record, there is growing evidence that providing workers with a stake in firm performance—when coupled with good pay and benefits and a say on the job—leads to good results for the firm, its shareholders, and the workers.

Inclusive capitalism or broad-based profit sharing—granting workers ownership stakes in the company or a share of its profits based on workers’ collective performance—includes everything from profit sharing and stock options that are sufficiently broad-based, to worker cooperatives, and employee stock ownership plans.

This sort of profit sharing often empowers workers by increasing their participation in decision making and trust in the company and management; it is associated with higher pay and benefits and greater long-term wealth accumulation. Studies measuring the benefits of various types of broad-based inclusive capitalism programs find that—when compared to workers in similar companies without sharing programs—workers’ wages are significantly higher, they are four times more likely to have defined benefit pension plans, and more than five times more likely to have 401(k) plans. Moreover, employee ownership does not replace other types of wealth; rather, research finds that it results in a substantial net gain in wealth. These results demonstrate the potential of these programs to help stem the tide of income stagnation and rising wealth inequality and ensure middle- and working-class American families see the benefits of economic growth.

For businesses, inclusive capitalism is often associated with increased

productivity, profitability, and likelihood of survival, as well as greater worker loyalty and effort, lower turnover rates, and a greater willingness on the part of workers to suggest innovations. For example, research shows that both public and private companies with broad-based sharing plans are less likely than their counterparts without employee ownership to go bankrupt or disappear for another reason. And companies and investors that adopt partnership approaches make profits over and above the cost of sharing ownership with employees, according to a review of more than 70 empirical studies (p. 4–5).

The report details policy recommendations, including tax provisions that encourage “sharing [stock incentives] only with top executives,” such as the exclusion of performance-based pay from the maximum allowable compensation expense per employee. Another is to create an Office of Inclusive Capitalism to promote inclusive capitalism and provide technical assistance. The authors also support the Promotion and Expansion of Private Employee Ownership Act, which supports S corporation ESOPs. The report suggests that “a \$350 million annual investment could increase the number of ESOPs by up to 5 percent per year.” One recommendation in particular is relevant to a new NCEO project to support employee ownership among low-income workers (see pages 1 and 4 in this newsletter):

A company that is majority-owned by an employee stock ownership plan—even if most of its employee owners are people of color or women—would not qualify for federal contracting set-asides for minority-owned and women-owned businesses. This can force a small business to choose between doing business with the government or becoming a majority-owned employee stock ownership plan, or ESOP, business (p. 6–7). ■



# Butler/Till

## Media and Communications Agency

**Sue Butler and Tracy Till founded Butler/Till, a media and communications agency based in Rochester, NY, in 1998. Since its inception and before becoming employee-owned through an ESOP in 2011, cultivating a culture of empowered and engaged employees has been a cornerstone of both the company's values and its success.**



*Sue Butler (left) and Tracy Till*

In 2014, the company completed two major transitions: it became 100% ESOP-owned, and it began its leadership succession. During this period of transition, Butler/Till has not only maintained a high standard with regard to its ownership culture, but the company's financial performance, employee retention, and client satisfaction have never been stronger.

### The Second Important Succession

For Butler and Till, the company's people and culture were central to the ESOP decision. Amanda DeVito, Butler/Till's VP of Engagement, says there were aspects of the industry that Butler and Till did not want to mimic. People were everything, and the ESOP was an important part of differentiating the company from the competition.

Also central to maintaining the high-engagement culture they helped create was Butler/Till's carefully orchestrated leadership transition.

Butler and Till, who still serve on the company's board, selected and announced the new management team well in advance of the actual transition. In fact, the new leadership team began assuming their roles nine months before the two would eventually step down. According to Butler/Till president Kimberly Jones, the entire process was transparent from the start in an effort to avoid surprising the staff. Assuming these roles so early made for a seamless transition in early 2015.

### Hiring and Cultural Alignment

One of the main roles and expectations for the new leadership team was the continued stewardship of Butler/Till's culture, aiming to empower employees through participation and engagement. For Jones and DeVito, it would be giving too much credit to leaders to suggest that the success of the company culture stems solely from leadership. While management is an integral part of creating structures and opportunities for employees to engage in different facets of the business, many of the company's committees are employee led. One of these committees is what Butler/Till calls the Culture Crew, which is composed primarily of non-management employees.

The Culture Crew has been integral in the development of companywide principles that help shape the roles and responsibilities of each employee owner, and it is also a large part of determining whether potential new hires are a good fit during the hiring process. Where the traditional hiring process focuses solely on a person's skills, qualifications, and work experience, Butler/Till's Culture Crew puts an emphasis on the alignment of agency principles during a second interview the committee itself conducts with all new interviewees before reporting back to the hiring manager. The actual decision depends on both a person's qualifications and perceived fit. When asked, Jones could not think of an instance where a new hire did not pass the Culture Crew interview.

### Feedback with a Hive-Five

While developing a set of principles and values may seem like a no-brainer, according to DeVito, "If they're not

turned into actions and behaviors that create value, they're just words." Butler/Till relies on the principles and purpose in nearly every aspect of its business; the principles are literally painted all over the company's walls.

One important way they turn these principles into behavior is through the company's process for giving feedback and recognition to one another. At Butler/Till, managers are not the only people expected to assess the actions and performance of others. The company empowers junior staff members to recognize other junior staff members through what they call their High Five program. The High Five program ties recognition to the principles of the company, and the idea for this peer-to-peer feedback system came from employees in one of the surveys the company conducts each month to solicit feedback and suggestions.

Here is how it works: When a staff member acts out one of the company's core principles, other staff members can recognize their actions with handwritten cards that people can collect and display at their workspace. For instance, one of Butler/Till's principles is to "Step up, not out," so the card might read, "Thank you, Jessica, for stepping up and not out the other day when you stayed late to help me finish a project before its deadline." This recognition is also stored in an employee management system the company uses to track performance for annual reviews. When employee reviews occur, leadership can see how many times an employee's peers have recognized them for acting out the company's values when working with others.

For Butler/Till, giving employees the tools to, as the company calls it, be superheroes to coworkers and clients is central to creating a great culture and achieving their purpose: creating connections and making a difference. According to Jones, "It's not that hard to engage people and value input, because most people are very eager to participate." The key is providing structured opportunities to engage in such behavior. When employees are genuinely part of the process, they own the outcome, whether or not the outcome is exactly what they wanted, and for Butler/Till, the outcome could not be more positive. ■



# Using Employee Surveys: Five Tips

Research shows that employee ownership alone does not create the competitive advantages associated with ESOPs. The ownership advantage comes from ownership culture, and, like any improvement process at your company,

measuring your performance helps ensure success. Most companies would not make a large investment without understanding the full picture, and making decisions on how to improve your culture is no different.

Employee surveys are an effective way to ensure your ESOP committees are not flying blind in their efforts to improve various aspects of your organizational culture. They help assess strengths and weaknesses, engage employees, solicit suggestions,

create actionable plans based on results, and measure progress over time. Here, we discuss five tips to ensure your survey strategy is effective.

### 1. Begin with Action in Mind

The planning process may take longer than you think. Consider not only what your company wants to measure, but also how to ensure you will be able to take action based on the results. Asking employees whether or not they are satisfied working at the company, for example, does not tell you what the company needs to do next.

Effective surveys focus on specific aspects of your culture that can be improved upon, such as employee perspectives on how to find answers to specific questions, education and training, access to information, or their opportunities to engage in the business and provide input. Do the mental exercise of asking yourself what you will do if people agree with a question and what you will do if they do not. If there is no clear answer, you might need to rethink the question.

### 2. Make It Comprehensive

Other elements, such as demographic questions and written-response questions, can make your survey even more effective. Demographic survey items are questions that allow you to break the survey results down into employee subgroups based on tenure, age, department, location, or roles in management for instance. This is especially important for companies with multiple locations, seeing as one location may have completely different needs or issues than another. While there may be fears among employees about how such items might be used to identify respondents, third-party survey administrators can help you ensure employee anonymity.

Written responses can help add color to the quantitative results of your survey. You might ask a question such as, "What is the most important area in need of improvement

at our company?" or "What can our company do to make you feel more like an employee-owner?"

### 3. Be Honest and Transparent

Results, especially negative results, can be overwhelming for companies, but do not fret. The point of the survey is to identify the most important areas in need of improvement. By soliciting the honest answers and perspectives of employees, you are presenting yourself with an opportunity and the first step toward improvement. Accept that the results are an honest reflection of your company's culture. Do not be afraid to share the results with employees and tell them exactly what your committee is planning to do address specific issue areas. Doing so builds more trust in the process and shows you take the feelings of employees seriously. Not sharing the results may have a negative impact on employee attitudes and your company's culture.

### 4. Create an Action Plan

The worst possible outcome of employee surveys is a lack of action. If you conduct a survey and fail to respond to employee concerns, your company risks lowering employee morale and trust rather than improving the company's culture. Before starting a survey, commit to the hard work that follows. While there may be several issue areas that your company wants to focus on, trying to take them on all at once may result in no issue receiving sufficient attention. Some companies create a prioritized action plan that focuses on the aspects of their culture with the most negative responses.

By addressing the most pressing issues first and fast, you show employees that you take their concerns seriously. During this stage of the process, it is also important to engage middle managers and involve them in the process of improving specific measures. Your team might ask managers of various groups to respond to specific results. Their insights will be important to understanding why certain measures are lower than others, and engaging them in the process from the start will help your team find the best ways to make improvements.

### 5. Track Progress over Time

The goal of your company's first survey is to measure current strengths and weaknesses, but surveying employees just once does not allow you to track progress over time. The most successful ESOP committees engage employees regularly. Many do a survey annually. Butler/Till, the ESOP company featured in this issue's case study (see page 8), conducts internal, open-ended surveys every month to solicit feedback and suggestions. Your team should create a plan to ensure that the money and resources you spend on such initiatives are making progress over time.

Following these survey guidelines will improve the effectiveness of your engagement strategy. ■



The NCEO works with companies to develop and administer employee surveys that are exclusively designed to measure and track progress on various aspects of your ownership culture. Contact Dallan Guzinski, director of workplace development, at [dguzinski@nceo.org](mailto:dguzinski@nceo.org), to learn more.

# CASES & RULINGS

## HIGHLIGHTS:

- Supreme Court Denies Review of Prudence Standard in "Would Have" or "Could Have" Case
- Ninth Circuit Says Amgen Should Have Revealed and Acted on Nonpublic Information
- Citicorp Prevails in Remanded Stock-Drop Case
- Hewlett-Packard Prevails in Remanded Stock-Drop Case Under New *Dudenhoeffer* Standards
- FASB Issues New Rules for Accounting for Tax Impact of Share-Based Payments

### Supreme Court Denies Review of Prudence Standard in RJR Case:

In *RJR Pension Inv. Comm v. Tatum*, No. 14-656 (U.S., cert. denied, June 29, 2015), the Supreme Court, following a recommendation from the Solicitor General, declined to consider a case in which the Fourth Circuit ruled that the standard for prudence for fiduciaries is what a prudent fiduciary would have done, not could have done, with respect to an investment. In this case, RJR employees had sued over the removal of RJR stock at a time when the stock value was very low. The stock subsequently rose substantially.

The district court ruled for the defendants even though it affirmed that the defendants had spent little time considering the issue. The court said that the fiduciaries simply had to show that a prudent person *could* have made the same decision. Plaintiffs argued that the standard should have been that a majority of hypothetical prudent persons *would* have made the decision. The appeals court overturned the decision, and the defendants have sought to have the Supreme Court take it up, arguing in part that there is a split in circuit court rulings, a contention the Solicitor General argued was incorrect.

Many observers have said that this "would have" standard could substantially raise the bar for fiduciaries

concerning employer stock, but many others have said existing case law already uses this standard.

### Citicorp Prevails in Stock-Drop Case Remand:

In *In re Citigroup ERISA Litig.*, 2015 BL 148422, S.D.N.Y., No. 1:11-cv-07672-JGK (S.D.N.Y., May 13, 2015), Citicorp again prevailed in a stock-drop lawsuit. The case had originally been decided on the now defunct presumption of prudence rule. On remand, the district court ruled that the statute of limitations had passed because the suit was filed more than three years after the alleged violations of fiduciary duties concerning employer stock in the 401(k) plan occurred. However, the court added that even had this not been the case, the plaintiffs could not sustain an argument that "special circumstances" would have required that the fiduciaries remove Citicorp stock. The court said that the allegation that Citicorp stock was excessively risky was insufficient to meet the *Dudenhoeffer* requirements and that it was implausible to allege that fiduciaries had undisclosed insider information.

In June, the plaintiffs asked for reconsideration, arguing that the recent Supreme Court ruling in *Tibble v Edison* required that trustees be held responsible for actions dating back to 2008 when they knew or should have known that Citicorp stock was under pressure. In *In re Citigroup ERISA Litig.*, No. 1:11-cv-07672-JGK (S.D.N.Y., July 6, 2015) the court ruled, however, that the three-year statute of limitations period still applied because plaintiffs themselves had already said the information on which they argued trustees should have removed Citicorp stock was public. Thus they had actual knowledge as early as 2008 and could have filed based on that. Interestingly, the court also ruled that *Tibble* applied to buying mutual funds at too high a price, creating an accrual of problems over time, whereas this case concerned holding on to company stock, a decision the court ruled distinguishable.

### Hewlett-Packard Prevails in Remanded Stock-Drop Case:

In *In re HP ERISA Litig.*, No. 3:12-cv-06199-CRB (N.D. Cal., June 15, 2015), a district court said that actions of Hewlett-Packard 401(k) plan trustees in not selling or removing company stock as an option in the plan did not violate ERISA.

The court originally based its ruling on the presumption of prudence. On remand, it said the new standards under the *Dudenhoeffer* decision also protected fiduciaries. The court said that plaintiffs could not show that fiduciaries had a viable alternative in dealing with employer stock after improprieties in accounting for an HP acquisition were discovered that, when disclosed, would cause the stock to fall. If they did have insider information, they could not disclose it under SEC rules, and any action they could have taken to reduce stock in the plan could have sent a signal to the market that would harm plan participants.

### Ninth Circuit Amends, but Does Not Reverse, Amgen Opinion; Delays Enforcement Pending Appeal:

In *Harris v. Amgen, Inc.*, No. 10-56014 (9th Cir., opinion amended and en banc review denied, May 26, 2015), the Ninth Circuit denied an en banc review of its prior opinion in this stock-drop case, but amended its prior decision. The case involved a sharp drop in Amgen stock. Plaintiffs had argued that fiduciaries had nonpublic information that, when it became known, would cause a sharp drop in share value. Defendants argued that if they had acted on that information by selling the shares, it would have caused the very decline the plaintiffs wanted to avoid. The defendants prevailed, but the Supreme Court remanded the case after it rejected the presumption of prudence standard in the *Dudenhoeffer* case.

The Ninth Circuit said that the fiduciaries should have removed Amgen stock, which would have the same effect on the market as disclosure of the potentially adverse information. The court said that securities laws would ultimately require that decision anyway.

In a sharp dissent, Judge Alex Kozinski, joined by three others concurring, said that the decision failed to incorporate the heightened pleading standards of *Dudenhoeffer* and would result in fiduciaries scrambling to remove or sell stock any time any potentially adverse news arose.

The court then stayed enforcement of the decision pending an appeal to the Supreme Court (*Harris v. Amgen, Inc.*, No. 10-56014 (Ninth Cir. order staying mandate, June 9, 2015)).

### Temporary Restraining Order Requires Continued Funding of Life Insurance Policy in ESOP Case:

In *Perez v. Bruister*, S.D. Miss., No. 3:13-cv-01001-DPJ-FKB (S.D. Miss., May 14, 2015), a district court extended a restraining order requiring the continued funding of a life insurance policy that the court said could be the most promising asset to fund a judgment against the holder of the policy in a case involving a valuation the court found deficient. The defendant wanted to unfreeze the fund to provide living expenses for his family. The court agreed to a partial unfreezing for this purpose.

### Seller to an ESOP Lacks Standing as a Beneficiary Under the Plan for Reduced Payment of Note:

In *Abadie v. CCG Sys., Inc.*, No. 2:15-cv-00164-RBS-TEM (E.D. Va., May 29, 2015), a court ruled that the payment of a note from a seller to an ESOP did not make the seller (the former CEO) a beneficiary of the ESOP. The seller was suing because the ESOP trust refused to pay the full amount on the note pursuant to an investigation by the Department of Labor finding that there had been improprieties in the transaction. The plan sought to have ERISA preempt her state law claims, but the court ruled that she was not a beneficiary of the plan and her IOU from the plan to buy her shares did not make her one.

### Terminated ESOP Not a Proper Defendant:

In *Hoover v. Besler*, No. 3:14-cv-05786-MAS-DEA (D.N.J., unpublished, June 30, 2015), a district court ruled that a terminated ESOP was not a proper party to a lawsuit alleging that the stock had been sold to the ESOP at an excessively low price. The judge ruled that the ESOP could not do anything to resolve the dispute and was unnecessary to add as a defendant.

### Judge Issues Mixed Ruling in Stiefel Lab ESOP Case:

In *Wagner v. Stiefel Labs., Inc.* (N.D. Ga., No. 1:12-cv-03234-MHC, 6/18/15), a district judge ruled that three plaintiffs lacked standing to sue because of releases they filed, but allowed a fourth plaintiff to continue his claims. The claims would have to be for the individual, not the plan, however, because the plaintiffs had not notified other participants about their claims. The court also ruled that because Stiefel was a private company, it cannot claim it could not disclose information about issues concerning the company's value to plan participants because of securities laws. The court also allowed claims to continue over the failure to obtain an interim valuation in the light of a proposed merger and plan termination. Finally, the court ruled that allegations that company actions in encouraging participants to sell their shares through termination of employment, diversification options, and offering to buy stock at an excessively low value could constitute a prohibited transaction.

### Plaintiffs Lose Again in Long-Running Suit over Company Stock Valuation in ESOP:

In *DeFazio v. Hollister Emp. Share Ownership Trust*, No. 12-15973 (9th Cir., May 15, 2015), the Ninth Circuit rejected an appeal of a ten-year-old lawsuit over alleged fiduciary violations over the valuation of company stock in 1999. The courts have agreed that the fiduciaries failed to follow proper procedures in obtaining a valuation, but concluded the plaintiffs suffered no material harm as a result and thus lacked standing to sue for monetary damages. The plaintiffs sued for equitable relief, but the district court ruled, and the Ninth Circuit concurred, that this was just a

back-door route to monetary claims. The court also dismissed claims regarding transactions in the 1980s on statute of limitations grounds.

### Antioch Plaintiffs Can Seek Constructive Trust of Assets Transferred to Family Trust:

In the latest ruling in the long-running case *Fish v. Greatbanc Trust Co.*, No. 1:09-cv-01668 (N.D. Ill., June 12, 2015), a district court has ruled that plaintiffs can sue for constructive receipt of \$40 million held in a family trust set up by sellers to an ESOP. Antioch had been a very successful ESOP company, but fell on hard times after rapid growth and went bankrupt. Employees sued, saying the plan overpaid for the stock. There have been multiple decisions so far, but this one focused on whether assets transferred to a family trust from the sellers could be taken by plaintiffs. Defendants argued the family trust could not be liable as it was not a fiduciary. The court ruled that the funds were traceable to the Morgan family, which was a fiduciary, and thus were not exempted.

### FASB Issues New Rules for Accounting for Tax Impact of Share-Based Payments:

On June 8, the Financial Accounting Standards Board issued an exposure draft titled *Improvements to Employee Share-Based Payment Accounting*. It proposes new rules intended to simplify the way companies account for the income tax effects of share-based payments. The new rules require that all excess tax benefits and tax deficiencies be recognized as an income tax expense or benefit in the income statement, even if an excess benefit would not reduce taxes in a specific reporting period. ■

## Who Makes Contributions to ESOPs?





# OWNERSHIP NEWS

## HIGHLIGHTS:

- IRS will end periodic determination letters
- Bipartisan group in Senate supports employee ownership
- SEC to investigate trading of derivatives based on pre-IPO shares
- Updates from the UK, Australian, and Germany

### IRS to Eliminate Periodic Determination Letters

In 2006, the IRS issued rules requiring companies to file a new letter of determination every five years, based on a five-year reporting cycle determined by employer identification numbers. In Announcement 2015-19, the IRS said it would eliminate the five-year remedial amendment cycles effective after January 1, 2017. Because of the timing of the change, the IRS will continue accepting applications for Cycle A plans through January 31, 2017, which is the end of that cycle's submission period.

The change in requirements for periodic letters of determination should reduce some costs for ongoing ESOP compliance, but it also means that companies will not have any assurances that changes they make to a plan are acceptable to the IRS on audit. As a result, companies will need to be particularly diligent in making sure any changes they make to their plans are

fully compliant with the law, including periodic internal reviews to make sure plan requirements are being followed.

### Bipartisan Senate Working Supports S Corporation ESOPs

Last week, the Senate Finance Committee released several reports, and the one on savings and investment mentions ESOPs. The working group that produced the report singled out the Promotion and Expansion of Private Employee Ownership Act (S. 1212), noting that it "contains several provisions to further encourage employee-ownership in S corporations, including extending the gain-deferral provisions of Code section 1042 to sales of employer stock to S-ESOPs, providing resources to small businesses contemplating making the transition to an ESOP, and ensuring that SBA-certified small businesses do not lose their status by becoming employee owned" (p. 13).

### SEC Launches Probe into Derivatives Trading Based on Pre-IPO Employee and Investor Shares

The SEC announced that it is investigating several transactions where investment firms have traded derivatives in hot pre-IPO companies there are based on employees and investors selling rights to appreciation in their equity. While secondary markets for such shares are not illegal, the SEC is concerned about fees for these securities and claims by the packagers about what they are selling. Because many of these firms release limited financial information, the field can be ripe for fraud. Employees may also be violating company policies at some firms by agreeing to trades. The investigation does not focus on established secondary markets, such as

the NASDAQ National Private Market, which allows firms to allow employees to sell their equity investments on a regulated exchange.

### July 3: Employee Ownership Day in the United Kingdom

On July 3, the United Kingdom celebrated Employee Ownership Day. The president of Employee Ownership Association (EOA) of the UK, Iain Hasdell, said, "Employee-owned companies now account for over £30 billion [47 billion USD] of UK GDP."

A group of employee ownership organizations released The MoralDNA of Employee Owned Companies, a preliminary report of an ongoing study of 829 employee-owners at 14 companies by Roger Steare and colleagues. The report finds that "the cultures of employee owned businesses are much less hierarchical and more collegiate than others" (p. 6) and that "90% of people working in employee owned companies experience high-performing visionary, affiliative, democratic and coaching leadership styles," compared with 59% among a comparable group of non-employee-owners. The study also found higher rates of commitment, improved recruitment, and longer-term decision making.

Graeme Nuttall is the author of the report that served as the basis for the UK government's push to promote employee ownership, and his law firm, Field Fisher Waterhouse, partnered with EOA, Prospects, and the UK's Chartered Institute of Public Finance and Accountancy to release a second report on employee ownership in public services.

## A Blog Post to Share

Inc. magazine recently published a post by Corey Rosen, A Belated Graduation Speech to Baby Boomer Business Owners ([www.tinyurl.com/coreyblog](http://www.tinyurl.com/coreyblog)). It starts:

“Graduation speeches have come and gone again, urging young grads to go out and pursue their dreams. Well, you did that. You built a successful company that has created financial security for your family, jobs for employees, taxes for your community, and useful products and services for your customers. ¶ But now you are thinking about graduating too. It's time to start scaling back your involvement in the business and getting some liquidity for all that equity you have built up in the company.”



Consider sharing this post with business owners you know. Inc.'s site makes it easy to promote via social media, or you can just forward this paragraph. ESOPs everywhere benefit when more business owners hear the message of Corey's blog post: "There are few better ways to preserve your legacy—and keep an active role in it if you like—than an ESOP."

## New Equity Compensation Legislation in Australia

On June 25, the Australian Senate passed the [Tax and Superannuation Laws Amendment \(Employee Share Schemes\) Bill 2015](#), designed to encourage equity compensation plans. The amendments would reverse a 2009 bill that caused a dramatic reduction in the use of equity compensation plans in Australia. The changes in the current bill, effective July 1, 2015, will improve the tax treatment of options and discounted shares, including having options taxable at exercise rather than vesting and providing certain qualifying employees in startup companies with capital gains treatment. [Employee Ownership Australia](#) and [New Zealand estimates](#) that the change would add AUS 1.4 billion (\$1.1 billion USD) to the Australian economy over the following ten years.

## Levels of Employee Ownership Declining in Germany

The German Share Institute (Deutsches Aktieninstitut) [issued a call](#) for policy makers to increase the amount of employee ownership in Germany. Christine Bortenlänger, the CEO of the institute, noted, "The number of employee shareholders is declining in Germany. In fact, it has never been so small." The institute reports that the current number of employee-owners in Germany is 800,000, down from 1.6 million in 2000 and far fewer than the 3.3 million employee-owners in France and 2.2 million in Great Britain.

## Do ESPPs Bolster Retirement Security?

[In ESPPs Can Help Insulate Retirement Savings](#), Sara Kelly of *Plan Sponsor* magazine argues that, although employee stock purchase plans (ESPPs) are not retirement plans, they can help protect employees' retirement savings. Dave Gray at Charles Schwab notes that although equity compensation and retirement plans are often in separate organizational silos, their messaging and planning should reflect the current trend toward integration. Emily Cervino of Fidelity agrees that ESPPs are by no means retirement plans, but that they can still be "an effective way that companies can help their employees insulate their retirement savings." A study by Fidelity found that employee behavior often supports that insulation: 57% of ESPP participants in the survey plan to use their ESPP assets for retirement or later investment rather than current expenses. ■

## FORTUNE 100 BEST COMPANIES TO WORK FOR

# Employee Ownership in Best 100

Once again, the annual *Fortune* 100 Best Companies to Work For is filled with companies with broad-based employee ownership plans. Thirty-six of the 71 (51%) organizations on the list that are U.S. for-profit stock corporations have some sort of employee ownership plan. This percentage has been consistent over the last decade.

Of these companies:

- Six are majority employee-owned (four through ESOPs)
- One is a non-majority ESOP
- Twenty-four have tax-qualified ESPPs, ten of which also have another employee stock plan
- Three have non-qualified employee stock purchase plans
- Ten have broad-based stock grant programs (one in phantom stock)
- For the qualified ESPP plans, 11 of the 24 companies offer a 15% discount and a look-back feature

To be on the list, created by the Great Place to Work Institute, companies must have 1,000 or more employees.

RANK	NAME	PLAN
1	Google	Restricted stock
5	Robert W. Baird*	Stock purchase
6	Edward Jones	ESPP
7	Wegmans	ESPP
8	Salesforce	ESPP
9	Genentech	Stock appreciation rights
10	Camden Property Trust	ESPP
15	Burns & McDonnell*	ESOP
17	W.L. Gore & Associates*	ESOP
18	NuStar	ESPP
19	Stryker	ESPP
21	Ultimate Software	Restricted stock
22	Workday	ESPP
24	Twitter	Restricted stock, ESPP
31	Intuit	ESPP
35	NetApp	ESPP
48	FactSet Research Systems	ESPP
49	Aflac	ESPP
50	Goldman Sachs	Individual equity awards
52	Autodesk	Stock options, ESPP
54	QuikTrip	ESOP
55	Whole Foods	Stock options, ESPP
64	CarMax	ESPP
65	VMware	ESPP
67	PCL Construction*	Stock purchase
70	Cisco	ESPP, options
71	Cadence	ESPP
81	Publix*	Stock purchase, ESOP
83	TDIndustries*	ESOP
90	Adobe	ESPP, restricted stock
91	Capital One	ESPP
93	Nordstrom	ESPP
96	Activision	ESPP, stock options

\*majority employee-owned

# The Board Can't Just Sell Our Company, Can It?



The most important decision just about any business faces is whether or not to sell. That decision is usually tough enough when ownership is limited to one or a few people, but what about when employees are owners too? Then things get even tougher.

**So just what happens when a company receives an offer from a buyer? And what role do employee-owners play?**

## ESOPs

The board of a company may receive offers to buy or may even seek them out without necessarily having to tell anyone. But when an offer seems serious, there are several steps the board must take:

**Determine whether the offer is legitimate:** The board and top management will review the offer to make sure that it is legitimate. Does the buyer really have the assets and/or borrowing capacity to make the purchase? Does the price seem even worth considering? Would there be any legal barriers to the sale, such as antitrust laws or environmental liability problems? These and many other factors might lead the board to dismiss the offer.

**Determine whether the offer is in the best interest of shareholders:** This is a broader issue than just whether it benefits the ESOP. The board must decide that the offer is one that will maximize the financial benefit to all shareholders. Could a better offer be found? Would staying independent yield a better result long-term?

**Determine whether the offer is fair to ESOP participants:** The board will need the advice of an attorney and probably a financial analyst to help determine if the offer is good for the ESOP. An offer could be good for other shareholders but not so good for ESOP participants if, for instance, there are

a lot of shares in the ESOP yet to be allocated. In a purchase, these shares would be sold and employees would get the excess of the share price over what is still owed on the shares (the amount of the loan that was taken out to buy the shares in the first place that hasn't been paid yet). But it could be that staying independent and releasing the shares in future years would provide a bigger benefit, especially if the share price is going up.

**Have the ESOP trustee decide whether or not to go along:** There is no deal until the ESOP trustee agrees that the offer is in the best interest of participants. The ESOP should have its own legal counsel and an independent appraiser for this. The law is clear, however, that the trustee can only look to whether the deal is in the best long-term interest of employees as shareholders, not whether it is best for them as employees (such as if their jobs would be at stake). That's because ESOPs are part of retirement law, the goal of which is to maximize the value of plan assets. The trustee may demand that changes be made before accepting the offer as well.

**Have the employees decide—maybe:** The law requires that employees be able to direct the trustee whether or not to approve a sale if the company is selling "all or substantially all" of its assets. Assets include machinery, property, the company's reputation, bills owed to the company, and just about anything else of value

except its own stock. In an asset sale, the stock essentially just goes away when the sale is complete. In a stock sale, the acquiring company buys all the stock instead. Buyers don't like stock sales because any liabilities of the company (environmental cleanup problems, lawsuits, etc.) go along with stock sales, but not with asset sales. Sellers don't like asset sales because there may be additional taxes owed. So sales can go either way. If it is a stock sale, however, the law does not require employees to direct the vote, although some companies provide that employees get a say anyway.

## Equity Compensation

If employees own stock options, performance shares, restricted stock, stock appreciation rights, or phantom shares in a company, the situation is much simpler. Options are the right to buy stock in the future. They do not carry any kind of shareholder rights, except in very unusual circumstances, and neither do most other forms of equity compensation. So the board has no obligation, as it does in an ESOP, to consider the rights of employees holding equity compensation. Instead, it focuses on whether the sale is good for shareholders.

Still, there are issues for employees that must be negotiated in a sale. What will happen to the awards after the sale? Will they be cashed out? Exchanged for options in the new company? Will unvested awards vest immediately, later, or not at all? Many equity compensation plans are designed to pay out to employees when there is a change in control of the company, which usually means a purchase, so you will often find the answers to these questions in the award documentation you received with your award. ■

*This article appeared in our newsletter ten years ago. It has been lightly edited.*



*Member companies are encouraged to share this and other pages with employees.*



# COMPANY HIGHLIGHTS

- Chinese networking and telecommunications behemoth **Huawei** posted record sales revenue of \$46.5 billion and net profits of \$4.5 billion and is today the only Chinese company with greater sales abroad than in China itself. Founder Ren Zhengfei credits the company's success to, among other things, its employee ownership plan, which places 98.6% of Huawei's shares in the hands of most of its 82,471 employees through performance awards. Huawei is run by a series of CEOs who rotate through the job for six months each, a process designed to slow down decision making in order to ensure careful consideration.
- **Liberty Pumps**, a manufacturer of effluent and sewage pumps based in Bergen, New York, has sold to an ESOP. The company has been family owned since 1965, and the ESOP will not alter the operations of the company, reinforcing the Liberty Pumps' commitment to the community. "The ESOP will enhance an already-positive culture where our [employees] feel empowered, appreciated and respected," said president and CEO Charlie Cook. "We believe the ESOP will take this to the next level. When a customer calls in, they will now be speaking to an owner."
- Bozeman, Montana's **Vann's**, a chain of appliance and electronic stores that filed for bankruptcy in 2012, has come under investigation by the FBI and the Department of Labor. Letters sent by the FBI to former Vann's employees indicate that it is investigating the way in which the company handled its ESOP and retirement plans. The investigation follows a lawsuit brought by 200 former employees against the company's former CEO and CFO, alleging \$9.2 million in damages due to ERISA violations.
- **Odell Brewing Company** has adopted an ESOP. The Fort Collins, Colorado-based brewer, which was formed in 1989, is now 19% owned by the new plan, with all 115 employees taking part in the new ownership structure. Founder Doug Odell explained the family's decision to sell to employees, saying, "The craft beer industry is changing dramatically, and we have seen several of our friends and neighbors selling their companies, in whole or part, to major brewers and private equity firms.... While these options are more lucrative than the one we chose, we believe that the people who built OBC are the best ones to lead us successfully into the future."
- Another Colorado brewery, **Left Hand Brewing**, the state's fourth-largest brewery, has sold to its employees through an ESOP. Employee eligibility for the plan will occur after 1,000 work hours, making 100 of the brewery's 106 employees currently eligible. Left Hand was founded in 1993, and its employees now own 54% of the company. Cofounder Eric Wallace explained the motivation behind the ESOP, saying, "The idea is to have everyone have a stake in the game, to create long-term employees.... We have been working on ownership culture for a long time—half of our employees already own stock—so this is just another step. It's a big step, though." ■

## NCEO BOOKSHELF

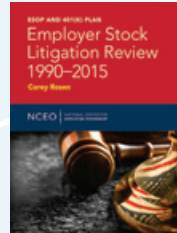
### Performance-Based Equity Compensation



Performance units, performance shares, and performance awards have become commonplace in both public and private companies. Proper diagnosis, design, execution, and adaption of these plans is critical in defining their future success or failure. Best practices will continue to evolve, but we have a good idea of what success entails and what results in failure. This issue brief, written by leading

expert and former NCEO board member Dan Walter, provides the insight needed to create and manage a successful performance equity program. Current issue brief subscribers have received a download link, or a mailed copy if they have a hard-copy subscription. If you aren't a subscriber, you can either buy the brief separately or start an issue brief subscription. Visit [www.nceo.org/r/performance](http://www.nceo.org/r/performance) for details or to order. (38 pp.) \$15 for members, in print or PDF format

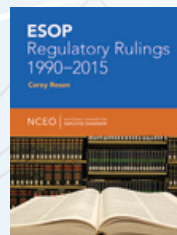
### ESOP and 401(k) Plan Employer Stock Litigation Review 1990-2015



This updated 68-page publication categorizes, describes, and summarizes 311 ESOP lawsuits (252 in private companies and 59 in public companies) between 1990 and 2015. Dozens of cases were added for the 2015 edition. The publication also categorizes all the court decisions in 401(k) company stock cases from 1990 through mid-2015 and provides brief summaries for decisions starting in 2010. We have

tried to be comprehensive, but advisors must always supplement this with their own research. Visit [www.nceo.org/r/litigation](http://www.nceo.org/r/litigation) for details or to order. (68 pp.) \$75 for members, in print or PDF format

### ESOP Regulatory Rulings 1990-2015



Now updated for 2015, this publication provides practitioners and other interested people with a summary of rulings and regulations on ESOPs and related plans. It includes guidance from the IRS and the DOL through IRS private letter rulings (PLRs), DOL advisory opinions, DOL field assistance bulletins, IRS Technical Assistance Memoranda, and similar pronouncements such as the "ESOP Cadre" guidance. Visit [www.nceo.org/r/rulings](http://www.nceo.org/r/rulings) for details or to order.

(25 pp.) \$25 for members, in print or PDF format

### Sustainable ESOPs



Sustainability, largely ignored until the 1990s, has become one of the most talked-about ESOP issues. It entails having effective leadership succession strategies, a governance structure consistent with employee ownership, a strategy for sustained growth, and more. This book discusses all of these issues, with references to other material that explores each topic in depth. Visit [www.nceo.org/r/sustainable](http://www.nceo.org/r/sustainable) for details or to order. (160 pp.) \$25 for members, in print or PDF format

## UPCOMING EVENTS

Stay up-to-date on employee ownership issues with the NCEO's online and in-person presentations on legal, governance, HR, communications, and financial topics.

### Fall 2015 Seminars

#### Is an ESOP Right for You? An In-Depth Look at Employee Stock Ownership Plans / San Diego, CA / September 16-17

Enhance your company's legacy and benefits plan with an ESOP, the most tax-efficient method of exit planning. This one-and-a-half-day seminar brings together leading experts from around the country to provide a comprehensive, practical guide to help you determine whether an ESOP will work for your company, and if it does, how to set up a plan that will work.

#### Get the Most Out of Your ESOP: An ESOP Communication and Culture Forum / Baltimore, MD / September 28-30

This interactive working forum features presentations by ESOP experts, organizational development experts, and insiders from successful companies. Each day also integrates structured activity sessions in small groups and unstructured opportunities to network with fellow ESOP companies working on similar issues. The forum consists of two days of meetings; registration is separate for each day, so you can attend either or both days. *New for 2015: an afternoon pre-forum meeting on September 28, free if you sign up for one or both full days.*

#### The ESOP Symposium: Ownership Solutions for Established ESOPs / Atlanta, GA / October 6-7

The market, the regulatory environment, and your workforce are all changing: shouldn't your ESOP as well? The ESOP Symposium uses presentations by experts and structured networking to bring your knowledge up to date, help you learn from other companies, and give you best practices in ESOP areas such as governance, financing, operations, repurchase obligations, and culture. Register for either or both days of this seminar and move freely between the tracks.

#### The S Corporation ESOP Seminar / St. Louis, MO / October 28-29

If your company is, or is thinking about becoming, an S ESOP corporation, this new in-depth two-day seminar will help you identify the best practices in taking full advantage of the unique opportunities of this highly tax-favored way to organize a company.



#### Seminars:

[www.nceo.org/events](http://www.nceo.org/events)

#### Webinars:

[www.nceo.org/r/webinars](http://www.nceo.org/r/webinars)



### Fall 2015 Webinars

Our live Webinars are free for members and provide CPE, HRCI, and in some cases IRS continuing education credit (*see individual Webinars for details*).

#### Introductory Topics

- Financing an ESOP Transaction (Sep 15)
- ESOP Overview: An Introduction to ESOPs (Sep 29)
- ESOPs: Preparing Your Employees for Retirement (Oct 6)
- Serving as an Internal ESOP Fiduciary: Essential Knowledge and Skills (Nov 3)

#### Ongoing ESOP Issues

- Executive Compensation in ESOP Companies (Sep 1)
- Managing the Repurchase Obligation: Financing Choices (Sep 8)
- Don't Do That with Your ESOP: Financial and Administrative Issues (Oct 13)
- ESOP Distribution Policies (Oct 20)
- Effective ESOP Administrative Committees (Nov 17)

#### Ownership Culture

- Best Practices for ESOP Boards of Directors (Sep 22)
- Decision Making for ESOP Sustainability (Nov 10)
- **NEW:** What's Different About Serving on an ESOP Board? ESOP Governance Overview for Experienced Independent Directors (Nov 24)
- Succession Planning and Leadership Development (Dec 1)

#### Equity Compensation

- Equity Compensation for LLCs (Oct 27)

*"Great material presented at this seminar."*

*"No one has mastered the art of the Webinar better than the NCEO."*