

# Guidelines on Employee Stock Ownership Plans

*Employee Stock Ownership Plans (ESOPs) are increasingly arising as a collective bargaining issue. Workers are being offered the chance to own part of the firm where they work, sometimes in exchange for wage and benefits concessions, and sometimes as a substitute for their pension plan.*

*However, while the prospect of ownership can be appealing workers can end up with reduced job, benefit,*



*and retirement security through such agreements.*

*The Industrial Union Department (AFL-CIO) has been collecting information from individuals who have experience with employee ownership and particularly with ESOPs, in an effort to identify relevant issues for trade unionists. Below is a preliminary listing of topics the department views as important in negotiating ESOPs.*

## Feasibility Studies

The legal, financial, and organizational complexities of an ESOP require that any proposals be given intense scrutiny. The condition of the firm and the industry within which it operates should be assessed by people with specific expertise in such matters. Workers should have an understanding of all potential options, and be involved in the process at an early date.

## Pension Plans

While ESOPs and traditional pension plans are both regulated by the Employee Retirement Income Security Act (ERISA), pension plans are not guaranteed at all. In some situations, employees are asked to give up their pension plan as a means to provide capital for the ESOP start-up. One of the major drawbacks to this approach is that it puts employees in the position of having their current *and* future security depend solely on the survival and health of a single firm. Pension plans, on the other hand, are invested in a wide variety of ways in order to protect against poor performance by a single firm or industry.

## Employee Participation

Before setting up an ESOP, it is helpful to set up some mechanisms which will allow employees to participate in decision making and information exchange in respect to the company.

Each situation may require a different approach, but the workforce should be included in the decision making regarding the company from the very beginning of the effort for the ESOP to have a chance for success.

## Voting Power

Make sure ESOP members can vote their stock. Although there is some debate about the necessity of voting rights for worker owners, our experts all suggested that such arrangements enable members to better protect their interests and evaluate the kinds of issues they must deal with in the context of ESOP plans. Many ESOPs are created with voting structures that effectively prevent workers from exercising power or even being able to influence the activities of the ESOP. One approach suggests that voting rights should be structured on a one-person, one-vote basis and that any other approach will lessen the opportunity for participation by all segments of the workforce.

## Selecting ESOP Trustees

Particularly if workers cannot vote their stock—and even if they can— they should, from the very inception of the ESOP, be represented on the ESOP board of trustees. There are frequently conflicts between workers' interests and the approach taken by management controlled ESOP boards.

## Equitable Stock Allocation

In setting up a plan, stock can be distributed in a variety of ways, including allocations by salary, tenure, hours worked, or in other ways appropriate to a given situation. This is a very important aspect of ESOP design. Over time, the allocation will determine which groups within the company will be in a position to consolidate ownership control.

## Stock Distributions

It is important to work out in advance what will happen to the stock that is eventually distributed to employees. That is, when employees decide to leave the firm, how can they sell their stock and how will the price for that stock be determined? If companies are actively traded on public markets, this may not be a difficult issue. In closely held firms, however, where there may be no external market for the securities, the method by which an appropriate price for stock is determined becomes very significant.

## Vesting Schedules

Most ESOP transactions place stock in trust for a period of years. It is important that workers have the right to a complete and fully vested interest in that stock within a reasonable period of time. Rapid vesting can be a useful financial goal to reward less tenured or more mobile employees.

### **Initial Evaluation Formula**

Stock that goes into an ESOP can be evaluated in a variety of ways. In one recent case, the company not only attempted to use an ESOP to defeat the union, but was planning to sell 60 percent of the firm's stock to a few managers and financiers at an average price of about \$3.30 and to sell to the remainder of the employees –through the ESOP- at over \$44 per share. In this case, on complaint of the union, ERISA administrators at the U.S. Department of Labor interceded.

### **Defining Employees for Purposes of the ESOP**

It may be to the advantage of the unionized employees to define the eligibility for ESOP participation as broadly as possible- even where that definition includes non-management employees that are not part of the union. Such an approach could also include part-time employees that are not part of the bargaining unit. The idea is to dilute the possibilities of Management being able to create and control a separate ESOP for non-contract employees.

### **Quick Implementation of Personnel Cutbacks**

Many ESOPs start with the assumption that there will be cuts in the workforce at both the supervisory and production levels. Experts suggest that it is very hard to make people owners one day and dismiss them the next. Anticipated reduction in staff should be undertaken as close to the outset of the ESOP undertaking as possible.

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*The IUD's examination of ESOPs was carried out by its Committee on Pension and Benefit Fund Policy, chaired by ACTWU Secretary-Treasurer Jack Sheinkman. Among those who have appeared before the committee are Steven Hester of the Washington law firm of Arnold & Porter, Professor Joseph Blasi of Harvard University, and Corey Rosen, executive director of the National Center for Employee Ownership in Arlington, VA.*

*"Labor and Investments", Industrial Union Department, AFL-CIO, Vol. 6, No.4, May 1986*