FINANCING EMPLOYEE OWNERSHIP PROGRAMS: AN OVERVIEW

HEARING

BEFORE THE

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FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

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WITNESSES

TUESDAY, JUNE 10, 2003

APPENDIX

FINANCING EMPLOYEE OWNERSHIP PROGRAMS: AN OVERVIEW

Tuesday, June 10, 2003

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to call, at 2:02 p.m., in Room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the subcommittee] presiding.

Present: Representatives Bachus, LaTourette, Royce, Lucas of Oklahoma, Gillmor, Tiberi, Feeney, Hensarling, Brown-Waite, Barrett, Sanders, Maloney, Watt, Sherman, Lucas of Kentucky, and Frank (ex officio).

Chairman Bachus. Good afternoon. The Subcommittee on Financial Institutions and Consumer Credit will come to order. Today's hearing, which was requested by subcommittee ranking minority member, Mr. Sanders, will provide an overview of employee ownership programs. Employee ownership programs allow employees to buy out their employer in response to an announcement that the business will be closing its doors.

Employee buyouts are accomplished through the creation of employee stock ownership plans, ESOPs, or eligible worker owner cooperatives, EWOCs. Currently, there are about 10,000 ESOPs in the U.S. While ESOPs are found in all industries, more than 25 percent of them are in the manufacturing sector. Employees own a majority of the shares in about 2,500 of these ESOPs. There are about 500 EWOCs. Unlike ESOPs, EWOCs are found in all types of industries.

In some cases, worker buyouts using ESOPs and EWOCs have led to the creation of successful employee-owned companies that are profitable and thriving today. In fact, in Birmingham, my hometown, the largest producer of cast iron pipe, ACIPCO, which is a model company, is an employee-owned company and was bought out from the original owner and has been a fantastic success.

In other cases, U.S. workers have failed in their attempts to purchase businesses due to a lack of financing. This lack of financing is caused by a variety of factors. For this reason, this hearing will examine proposals to provide financial institutions incentives to finance employee buyouts through the creation of employee stock ownership plans or eligible worker-owned cooperatives.

This hearing will consist of two panels. The first panel includes ESOP trade association representatives and experts in the field. During the second panel, we will hear from two successful ESOP companies as well as two employees who failed in their attempts to purchase their companies due to a lack of financing. We will also hear from a union representative who is currently involved in an attempted buyout.

I look forward to the witnesses' testimony on this important topic and welcome the first panel. In closing, I would like to thank Mr. Sanders, who is passionate about this issue and who is a leader in the Congress in bringing this matter to our attention. I want to stress that this hearing is the result of his work and his dedication to bringing this issue to our attention. I cannot stress enough his passion and resolve to introduce and see meaningful legislation passed, so I commend him on that.

Now, I will be on the floor of the House because our Internet gambling legislation, which I have introduced, is coming onto the floor I understand around 2:30 or 2:45. We have anticipated this for about 2 days, and Mr. LaTourette, the gentleman from Ohio, is going to take my place in the chair. But he and other members are very interested in this hearing, as I am, and I don't want my absence to mean anything other than I will be on the floor and don't plan the agenda of the overall Congress.

The Chair now recognizes the ranking member of the subcommittee, Mr. Sanders, for an opening statement

[The prepared statement of Hon. Spencer Bachus can be found on page 48 in the appendix.]

Mr. SANDERS. Before you leave, Mr. Chairman, I do want to thank you very much. While the chairman was very gracious in mentioning that I had requested this hearing, this hearing would not have taken place unless the chairman had wanted it. And his staff has done a terrific job. And I hope very much this is an issue we can work together on, but I do want to thank you very much for allowing us to have this important hearing.

Chairman BACHUS. Thank you. Mr. Sanders and I pride ourselves, and I think this entire committee does, on our bipartisan work on issues, and I think because of our cooperation we have had many successes in our committee and I hope in addressing this matter we will have additional successes.

At this time I will ask the vice chairman of the committee, the gentleman from Ohio, to take the chair. And, gentlemen, I have read some of your submitted testimony and look forward to working with you on this issue.

Mr. SANDERS. Thank you again, Mr. Chairman.

I recognize that today the NBC, CBS, and ABC Television lights are not on us, and the New York Times is not here, but, nonetheless, the way things work in the United States Congress is sometimes you start off with an idea and that idea expands. The fact that we are having this hearing, that Chairman Bachus has called this hearing, is a huge first step in what I consider to be the effort to make some fundamental changes in the way our economy works and in protecting the livelihood of millions of American workers.

Now, why is this hearing important and why is worker ownership important? I think everybody here, and I will be interested to hear what Mr. LaTourette has to say in a moment, because Ohio is represented here and his State has shared, along with Vermont, many of the same problems of deindustrialization, but one of the least talked about and most important economic issues facing our country is the collapsing of our manufacturing sector. It is not talked about too much, and yet in the last 2 years we have lost close to 2 million manufacturing jobs.

I know that has happened a lot in Ohio, it has certainly happened in Vermont, and it has happened all over this country. We have lost, if you can believe it, over 10 percent of our manufacturing sector in the last 2 years. We are now at the same level, at 16-1/2 million manufacturing jobs, where we were 40 years ago. So I think it is terribly important that we address that issue.

My own view is we have to take a very hard look at our trade policies, which are putting jobs in China and Mexico. But the bottom line is that we also have got to figure out a way that we can protect and expand manufacturing in the United States, and I believe that employee ownership can and should be one of the essential strategies in combating the decline of manufacturing in America.

Employee ownership has been proven to increase employment, increase productivity, increase sales and increase wages in the United States. Yet despite the important role that worker ownership can play in revitalizing our economy, the Federal Government has failed to commit the resources needed to allow employee ownership to realize its true potential. On that issue, what I want to say is there will be bipartisanship on this. You will find some very conservative Members and some progressive Members coming together and trying to expand employee ownership.

Mr. Chairman, I am drafting legislation to create a U.S. Employee Ownership Bank to provide loan guarantees, subordinated loans, and technical assistance to manufacturing employees who would like to purchase factories through an employee stock ownership plan or an eligible worker-owned cooperative to correct this problem. A lot of folks around this country would like to move in that direction. They cannot get the money, the capital they need, and they do not have the technical expertise. We hope this legislation will be able to do that.

In order for employees to receive this assistance, a determination must be made that the factory they will be purchasing will be profitable in the future so that they will be able to pay back the loans and other financial assistance. In other words, we just do not want to throw money out there. We want to know it is viable. But what is interesting, and we have seen this in Vermont, is that companies that are profitable are still shut down because some of these owners think they can make more money in China. So it is not a question of being profitable or not profitable, it is a question of how much profit you need. And if you have worker ownership and people making good solid middle class wages and benefits, they will be delighted to keep that plant going.

Mr. Chairman, we have a wonderful, just a terrific group of panelists here, and I want to thank all of them for being with us. This afternoon we will hear from many good people, including Larry Owenby with the PACE International Union, and we thank him for being with us. Mr. Owenby worked for the RFS Ecusta mill in Brevard, North Carolina, for 30 years. Although this mill was making profits of $1 million a month, the company closed its doors, and we will hear about what they tried to do and were not successful in doing.

Monty Payne, also a PACE Union representative, in Hattiesburg, Mississippi, will testify today about profitable factories that were shut down by International Paper in Mobile, Alabama, and Moss Point, Mississippi, and we will be hearing about what we should be doing in the South as well.

In addition, Dave McCune, a representative with the Steelworkers, will be testifying about an employee buyout of Massillon Stainless, Incorporated, in Ohio, that has not succeeded due to a lack of financial support, and we will see what we can learn from Mr. McCune.

Mr. LATOURETTE. [presiding.] That is Massillon.

Mr. SANDERS. I wasn't even close. Massillon. All right. Well, same company, different pronunciation.

Steve Clem, with the Ohio Employee Ownership Center, will be testifying about three other factories that could have been saved. And, Mr. Chairman, in Ohio I believe we have probably more activity on this issue than any other State in the country, so we have a lot to learn from people in your State.

So, Mr. Chairman, thank you very much and I look forward to working with you. We are really excited about this hearing and we thank all of the folks, including those from Vermont, for being here today. Thank you.

Mr. LATOURETTE. Mr. Sanders, thank you very much for your insightful remarks.

I want to take time to personally extend a warm welcome to the two Ohioans that Mr. Sanders mentioned, Mr. Clem from the Ohio Employee Ownership Center at Kent State University, and Dave McCune, who of course is the President of the United Steelworkers, and focusing on Local 1124-01 in Massillon, Ohio.

And if you ever come to Massillon, Ohio, is known as sort of the birthplace of football coaches. They all started there, Woody Hays and that bunch, and then they all went down to Dennison, and then they all figured out how to lose to Michigan until recently.

So this is an exciting hearing, Mr. Sanders. I thank you very much for the suggestion that we have this hearing. The idea of employee ownership is something in these changing times, and you have cited the statistics relative to manufacturing job losses, which I know concern us all. I saw a forecast the other day that while certain sectors of the economy may be recovering, it looks like manufacturing will lag behind regardless of those other sectors.

The other thing that I thought was interesting, we had a facility in a place called Garfield Heights, and for 50 years the firm was engaged by contract with Rubbermaid in making those dish drainers that everybody has on your drain board. I think you can go to the store and buy them for $3.50. The folks at Rubbermaid determined it was cheaper to outsource that work to China for a $3.50 product than it was to continue to manufacture it in Ohio.

So I congratulate you for your interest on this subject, and I look forward, with Chairman Bachus, in working with you on this, and with that I yield back my time and, Mr. Sherman, ask you if there are any observations you would like to make?

Mr. SHERMAN. Oh, many. I share the concern of the gentleman from Vermont about a loss of manufacturing jobs. I think it is critical that the administration end its ineffectual and doomed efforts to support a value for the dollar that is inconsistent with our huge trade deficit. And of course the trade deficit is a jobs deficit, and when the dollar adjusts, our manufacturing companies will be able to deal with many of the problems, and of course you have identified others that they face.

This committee focuses a lot of its time on encouraging home ownership. Just as we want to be a Nation of homeowners, property owners, we want to be a Nation in which there are many, many people who own a share of enterprise, particularly the enterprise in which they spend their time. ESOPs are an extremely way effective way to achieve that. Another way to achieve it, in a more limited sense, is broad-based, I want to emphasize broad-based, stock ownership programs. So we want to encourage ESOPs.

Of course we want to do that in a cost effective way, because many of the programs, whether it be done at the Committee on Ways and Means or this committee, will cost the Federal Government money. I would point out that the chief incentives have been on the tax side and they have been unintentionally slated for repeal. I would hope that we would get either testimony from the panel or perhaps more authoritatively from Ways and Means and from the Joint Committee on Taxation to tell us what is the cost to the government of the ESOP incentives that are in the code today and what would those costs be if you imagined an income tax structure in which there was no estate tax and we had a 15 percent tax on capital gains, a 15 percent tax on dividends.

Under such a structure, all of the things written into the code last decade and the decade before to encourage ESOPs become less significant and, on the other side, less costly to the Federal Government. So, then, unless this Congress wants to diminish our efforts to encourage ESOPs, we ought to look for ways to spend at least an equal amount encouraging ESOPs, and that may be through the Tax Code or it may be through what the gentleman from Vermont proposes.

He points out that he would focus on manufacturing businesses. I do not know whether manufacturing businesses should be targeted or whether we would go broader, but I would point out that we do have a special reason to help those companies that face foreign competition. Because if a restaurant closes down in my district, it just means more people eat at the restaurant across the street. If a manufacturing company closes down, that just means we buy stuff from across the ocean.

I am not sure we should have a bill in which government employees are picking the winners and losers. I doubt that that is what your proposal involves. I would prefer to see us encourage banking institutions to evaluate lending opportunities but to encourage them to do the right thing.

I think it is important that each person looking at their own retirement, each family looking at their own retirement be adequately diversified. And the downside of ESOPs is that we encourage people to invest their career and their retirement in one enterprise. That is why at a very minimum we have to preserve Social Security as a guaranteed retirement and not create a circumstance in which there are separate accounts, which then could also be invested in the company's stock to create a trifecta investment all in one company, which even if employee run may not be profitable.

So I look forward to these hearings. I especially commend our chairman, who is not here, but I will tell him how I waxed eloquently in his praise for holding these hearings, and especially for inviting Mr. Keeling to testify, because Mr. Keeling had the incredible wisdom to cite the experience of Chatsworth Products in his written testimony, which is in my district, and is literally the poster boy or poster girl for the success of the ESOP movement.

So I look forward to ESOPs playing an important role in our surviving in world competition and look forward to Congressional enactments that at least preserve and perhaps expand our dedication to the ESOP movement.

I yield back.

Mr. LATOURETTE. I thank you, Mr. Sherman, and I will make sure the next time I see Chairman Bachus to tell him of your high praise.

I have been notified that Mr. Lucas of Oklahoma and Mr. Barrett are going to submit opening statements for the record. I would ask the other Mr. Lucas, the gentleman from Kentucky, if he wishes to make any opening remarks before we begin?

Mr. LUCAS OF KENTUCKY. No.

Mr. LATOURETTE. Okay. And Mr. Watt, who has just come in.

Mr. WATT. No, thank you.

Mr. LATOURETTE. Excellent. With that, the hearing is comprised of two panels and we will begin with the first panel today.

Gentlemen, I want to thank you all for coming. We will here from Mr. J. Michael Keeling, who is the President of the ESOP Association of Washington, D.C.; Mr. Steve Clem, the Senior Program Coordinator of the Ohio Employee Ownership Center and Professor of Political Science at Kent State University; Mr. James Megson, Executive Director, ICA Group, Boston, Massachusetts; Frank Adams, President of the Southern Appalachian Center for Cooperative Ownership, Asheville, North Carolina; and Mr. Richard Dines, Director of the Cooperative Business Development and Member Services, National Cooperative Business Association, also in Washington, D.C.

Again, gentlemen, we thank you very much for coming and we are looking forward to your testimony. The subcommittee, as do most subcommittees and committees in Congress, subscribes to a 5-minute rule. We have received your written testimony and each member, I would assume, has reviewed it, and so, without objection, your written testimony will be made a part of the record.

We are anxious to hear from you, but if you could, there is a little box on the other side of the table. It will start out green, and then will go yellow, and red will be the end of 5 minutes. Nothing horrible happens to you if you go beyond 5 minutes, but so that we can get through all the testimony and members have ample time to ask the questions that are on their minds, we would ask you to subscribe to that as closely as possible.

Having said that, Mr. Keeling, welcome, and we are looking forward to hearing from you.

STATEMENT OF J. MICHAEL KEELING, PRESIDENT, THE ESOP ASSOCIATION, WASHINGTON, D.C.

Mr. KEELING. Thank you, Chairman LaTourette, Ranking Member Sanders, and members of the subcommittee. I appreciate the opportunity to be here, and I would tell you that I could spend hours, Mr. Sanders, talking about why I think it is huge that this particular subcommittee and committee of Congress is looking at employee ownership. There are many interesting reasons for that statement.

Before I give a little background and history of ESOPs, in terms of ESOPs today, demographics, let me say that I believe in the vision of the ESOP Association that employee ownership increases productivity through greater employee participation, creates a broader distribution of wealth in our Nation, and maximizes human potential by enhancing the self-worth, dignity and well-being of our people.

ESOPs are tax qualified deferred compensation plans that are primarily invested in employer securities, and unlike other tax qualified plans may use borrowed funds to acquire the assets for the plans, which the assets are employer securities.

Of the 10,000 or so ESOP companies, I would estimate 96 to 98 percent are private companies. Federal law since 1990 has promoted employee ownership in private companies but not in large public companies. There is a general image in Congress, that where employee ownership exists in a private smaller company, a very special and magical environment can be created that is up close and personal, but that is not necessarily true in corporations with thousands and thousands of employees throughout the globe. Let me quickly say many managers and executives of large corporations would vigorously disagree with that image.

The most common reason for creating an ESOP is to provide a buyer for an exiting shareholder of a private company. Our data indicates that 75 to 80 percent of the ESOP companies in America were created in a so-called exiting shareholder transaction.

The second most common transaction is the one that we call the ESOP spin-off transaction. We have data that indicates about 20 percent of the ESOP companies in America were the result of an ESOP spin-off transaction.

An ESOP spin-off transaction often follows this scenario: One day the plant manager gets a call from the home office of a big corporation saying you don't fit into our plan, you don't make enough money, or something similar, and we are going to put you up for sale. After composing him or herself, the plant manager calls in the bookkeeper or the comptroller, tells him what is about to happen and says we are on the block. They frequently then say to themselves, gosh, I wish we could control our destiny, I wish we could buy the company ourselves. And then somehow or another, often in cooperation with an organized bargaining unit, the idea of an ESOP develops.

How do common ESOP exiting shareholder transactions get financing? The financing for the vast majority of exiting shareholder

ESOP transactions is actually fairly simple. Usually, the decision triggers an ESOP exiting shareholder or the management of a company going to a regular bank, taking a loan of less than $10 million, loaning that money to an ESOP, and the ESOP using the money to purchase stock from the exiting shareholder.

Since a spin-off transaction might involve a business that is considered to be in financial difficulty, another source of funds might actually be the senior management of that particular division or plant taking a second mortgage on their homes, borrowing on credit cards, sometimes they are able to get financing from the State Economic Development Administration or employee ownership center. Oftentimes, the lenders will insist on wage and benefit concessions in a situation like that. Sometimes the necessary due diligence and feasibility funds are loaned by a State agency or an employee ownership center.

Actually, there is two distinctions between the types of ESOP loans and transactions. From the years of 1974 to 1984, generally ESOPs were nonleveraged ESOPs, which meant the ESOP itself was not part of the borrowing transaction. There will be a witness on the next panel that has an older ESOP that engaged in a so-called nonleveraged ESOP. There the corporation is borrowing the money and the ESOP is not part of the transaction.

In 1984-86, the Congress created a whole slew of tax incentives for leveraged ESOPs. And since that time nearly all the ESOPs created do involve leveraged ESOPs. So you would estimate that those created from 1974 to 1986, 80 percent are nonleveraged; since 1986, 80 percent are leveraged ESOPs where the ESOP has actually participated in the loan process.

Is there money available for ESOP transactions? Please note my vantage point. I deal with companies with ESOPs. They tend to be very successful companies. Many were very successful companies before or after the ESOP was created, and, candidly, they do not have trouble getting commercial lending for their transactions. I used to get a lot of calls saying where can I get money for ESOPs in the early 1980s. I don't get those kinds of calls anymore.

I do know, however, that in spin-off transactions one does see particular problems in obtaining funding for the crucial feasibility studies, the due diligence studies that will prove the case that the company can afford to support itself with a leveraged ESOP.

I want to touch on something. We think the existing accounting standards impact the financing of ESOPs. We feel that the accounting standards for ESOPs kind of distort the balance in the income statements compared to the cash flow statements. That can be a hindrance in doing ESOP transactions. Also, I want to make it clear that financing of an ESOP company is not just up front. ESOPs in the private sector have the unique responsibility to buy back the stock from departing employees, known as the repurchase obligation. Often that involves the financing either through cash flow, borrowing the money, putting cash into the ESOP, or even buying key man insurance, employee insurance, which of course is a controversial step in today's debates over public policy. But that is another area of financing that I would welcome some exploring by Congress, or someone.

Let me say this one thing in finishing and conclude why I think that this hearing is huge. Think about it. Less than 160 years ago in our Nation, sadly and tragically the relationship between owner and worker was often defined as owner/slave. At the turn of the 20th century, if a man or woman belonged to a labor union, often he or she were beaten or denied a job. Less than 60 years later, in the mid-20th century, the relationship between an organized bargaining unit and management often defined benefits and wages in all American corporations. At the turn of the 21st century, fewer than 11 percent of the private sector of American workers belong to an organized bargaining unit.

So what is the message? The message is anyone who thinks the relationship of owner, employee and capital remains the same, or that it can be reconstituted the way it was 25 years ago, candidly, that person doesn't understand what is happening in the world of work. Whether you agree with his politics or his recommendations on tax policies and health policies, I think Bill Thomas had it correct when he opened the debate on the 2001 Enron ERISA legislation when he said in his opening remarks, "There has been a quiet revolution going on in the United States. That quiet revolution that I am talking about is the change that occurred over the last century, speeding significantly in the last third of the 20th century, that there is becoming less and less a distinction between workers and owners and more and more companies are being owned by the workers."

So this subcommittee is right to say let us make sure that the trend of more employee ownership is financed properly and that everyone, not just the tax committees and the labor committees, get with the trend of growing employee ownership and let us have the legal, financial, and accounting systems that make division of ESOP advocates a reality.

[The prepared statement of J. Michael Keeling can be found on page 73 in the appendix.]

Mr. LATOURETTE. Thank you very much, Mr. Keeling, not only for your testimony but your enthusiasm. The only thing you didn't do so well on was the clock.

Mr. Clem, we are anxious to hear from you. Thank you for coming.

STATEMENT OF STEVE CLEM, SENIOR PROGRAM COORDINATOR, OHIO EMPLOYEE OWNERSHIP CENTER, KENT STATE UNIVERSITY, KENT, OH

Mr. CLEM. Thank you, Mr. Chairman. The Ohio Employee Ownership Center at Kent State University appreciates this opportunity to present its views and your willingness to consider them. First of all, though, I am not a professor at Kent State; I am a Senior Program Coordinator at the Ohio Employee Ownership Center.

The Ohio Employee Ownership Center is a nonprofit university-based program established in 1987 to provide outreach, information and preliminary technical assistance to Ohio employees and businesses exploring employee ownership. We provide ownership training to employee-owned firms. We are partially funded by grants from the Ohio Labor-Management Cooperation Program of the Ohio Department of Development. We also receive funding from private foundations, dues from firms belonging to the Ohio employee-owned network, income from training contracts, donations, and we also administer for the Ohio Department of Job and Family Services, a pre-feasibilities study grant program.

In addition, we administer a program for the U.S. Department of Labor called the National Steel/Aluminum Retention Initiative. This is a national program to assist durable manufacturing firms in dealing with the threat to steel and other durable manufacturing industries. We partner in that particular effort with the ICA, with the Center for Labor and Community Research in Chicago, with the Steel Valley Authority in Pittsburgh, and with the Washington State Office of Trade and Economic Development.

We coordinate a Business Owner Succession Planning Program in the Cleveland area. We work with about 60 small- to medium-sized firms that are part of Ohio's employee-owned network. The network provides these companies with an opportunity to meet on a regular basis and learn from each other's experiences. We also provide various types of training on a number of different kinds of topics.

In addition, we have an annual Ohio Employee Ownership Conference that provides a forum for discussion on various issues relating to employee ownership. It is a one-day event in Ohio and draws about 300 folks each year from Ohio and the surrounding States.

Since the inception of Ohio's program in 1987, the OEOC has worked with roughly 436 company owners and buyout groups investigating whether employee ownership makes sense in their particular case. These company and employee groups represent 83,000 employees. Of these, 63 firms, employing almost 13,000, have implemented partial or complete employee ownership. Many of these employees would have otherwise lost their jobs due to plant shutdowns or some other sort of corporate downsizing.

Now, the cost of jobs retained, created, or stabilized through the Employee Ownership Center at Kent State in calendar year 2002, which is the latest information we have available, in the firms that implemented ESOPs in that particular year, it was $423 per job in Ohio Department of Development funds, a very small number, I think you will agree, when compared to the financial, physical, and psychological costs that are associated with unemployment.

It is a highly cost effective program because essentially we help people help themselves. Nevertheless, every year we have lost at least one otherwise viable employee buyout because of the lack of timely friendly capital. We have seen that happen year after year almost since the inception of the center.

You are going to be hearing from Dave McCune from Massillon Stainless. Let me just say a couple of words about that. This was a facility that could very well be a profitable facility operating today. It had customers. It was mismanaged. A loan or a loan guarantee from something like a U.S. Employee Ownership Bank for a minority ESOP position could have positively influenced some prospective equity investors. As I say, you will hear more about this directly from Dave.

Another more recent instance took place in Youngstown at Cold Metal Products, where 116 employees were given 10 minutes advance notice of the shutdown of their facility. The next day the company filed bankruptcy. Essentially, the banks were pulling the plug. Just 6 months before, the company had announced plans to expand that facility, spend money for new equipment and hire additional employees. In exchange, the county and the municipality had given them various kinds of tax abatements, a $165,000 grant, and the State granted tax incentives as well.

Given the uproar that came with that shutdown, the employees put together an employee buyout group, petitioned the OEOC for a pre-feasibility study grant, which we approved. The study got underway and showed that a successful business could be resurrected at that facility or restarted at that facility. It would be restarted at a smaller manning level but restarted nonetheless and it could be very profitable. Unfortunately, they were not able to attract a minority investor. The plant remains closed.

The folks there are putting together a very small operation, which will continue on into the future. But had something like the U.S. Employee Ownership Bank existed at that point in time, we think that would have certainly helped to have attracted a minority investor and the plant could have continued in operation.

I see that my time is up as well. I would like to make just one very quick comment. I believe the proposed legislation has a provision in there for advance notice and essentially a right of first refusal. In other words, the opportunity to buy should be offered to the employees, and I think that is a very significant part of this particular piece of proposed legislation.

I am reminded of something called Brainard Rivet in Girard, Ohio, which finally wound up employee owned and part of something called Fastener Industries, which is 100 percent employee owned, but it took a long roundabout way to get there. This was a profitable company that shut down simply because the company wanted to move that production to a non-union facility in Virginia. That particular plant was making $2 million a year on $14 million a year in sales. It was a very profitable facility.

The only reason it survived was because of Congressional pressure once it was found out that this company was sending its customers to some of its competitors rather than trying to produce the stuff in Virginia, while in the meantime it was shutting down the plant in Girard. So we think this is good legislation and we certainly would support it.

[The prepared statement of Steve Clem can be found on page 59 in the appendix.]

Mr. LATOURETTE. Thank you, very much, Mr. Clem, and my apologies. Do you want to be a Professor of Political Science at Kent State University?

Mr. CLEM. No, sir.

Mr. LATOURETTE. All right. Because I think once it is in the record, you probably are.

Mr. Megson, we thank you for coming and we look forward to hearing from you.

STATEMENT OF JAMES MEGSON, EXECUTIVE DIRECTOR, ICA GROUP, BOSTON, MA

Mr. MEGSON. Mr. Chairman, members of the committee, thank you for inviting me today. I have worked in the field of employee ownership for the last 16 years, 15 as Executive Director of the ICA Group, a nonprofit organization dedicated to creating employee-owned companies to save and create quality jobs, and more recently as the Executive Director of ICA's sister organization, the Local Enterprise Assistance Fund, or LEAF, a CDFI that provides debt and equity financing to employee-owned companies.

LEAF and ICA have been involved in the creation of more than 50 employee-owned companies employing over 7,000 people. Employee ownership is a powerful tool. It enables ordinary men and women to share in the benefits of capitalism and links very directly the rewards they receive with the efforts they invest. But it is also a sound economic policy. A recent survey of every significant study of employee ownership over the last two decades showed that broad-based employee ownership boosts company productivity by 4 percent, shareholder return by 2 percent, and profits by 14 percent over what otherwise would have been the case.

Employee ownership also makes a significant contribution to our economy by enabling employees to buy businesses that would otherwise close with a resulting loss in jobs. These closures occur when small or medium-sized closely-held businesses close due to inadequate succession planning, or when large corporations close divisions or factories. An employee buyout of a company or division scheduled for closure is not easy. However, when a company is saved, the return on investment is spectacular.

Some years ago, we helped the employees of Market Forge, a manufacturer of kitchen cooking equipment in Everett, Massachusetts, buy their company when the parent decided to close it. The State, the United Steelworkers of America, and the parent company each contributed $10,000 to fund the employee buyout effort. As a result, we were able to save 150 well-paying jobs with generous health and pension benefits, and the company is returning over $500,000 each year to the State of Massachusetts in various forms of taxes.

So given their proven benefits, why aren't there more employee-owned companies in the U.S. today? I believe this is due to a number of factors. First, the employee ownership option is not widely known or understood. To my knowledge, only two States, Ohio and Vermont, have organizations with proactive outreach programs. At its first conference on employee ownership, the Vermont Employee Ownership Center attracted more than 90 businesses, of which 80 say they are now considering this option.

Second is the cost of putting together an employee buyout. This is beyond the resources of ordinary workers, especially those who are about to lose their jobs. They need to hire professional help to explore whether a buyout is feasible and, if it is, to create the business plan and package the financing.

Third, assembling the necessary financing to buy a significant share of ownership of a company is extremely difficult. A bank will provide senior debt, but only up to the liquidation value of available assets. A limited amount of equity can be obtained from senior managers and venture funds. The employee group must seek subordinated debt to complete the financing, and this is extremely difficult to find. My firm, the Local Enterprise Assistance Fund, and other community development financial institutions fill this gap for some smaller transactions, but our resources are minuscule compared to the size of the need.

In 1992, we worked with the employees of a mold making factory in Pittsfield, Massachusetts, that was being closed. To meet the need for subordinated debt in this transaction required the participation of no fewer than four specialty development lenders, all of whom were stretched to their maximum capacity. The story has a happy ending. Since the employees purchased the company, it has more than doubled in size, increased its share price by an average of 20 percent per annum, and returned more than $2 million to the State of Massachusetts.

Not all employee buyout groups are so fortunate. In the spring of 2002, the 350 employees of a machine tool manufacturer in Vermont, a company with a strong brand name and potential customers, failed to complete an employee buyout largely because they could not secure the subordinated debt to plug the gap in the financing package. As a result, 350 well-paying jobs in Vermont were lost.

In summary, I believe that a Federal Government program to encourage the expansion of employee-owned businesses through the provision of loan guarantees, subordinated loans, technical assistance and outreach programs will yield a very high rate of financial return. Some of this return will come from the jobs saved at enterprises that would have otherwise closed. The majority will come from expanding the number of companies that because they are owned by their employees will experience a 4 percent increase in productivity, a 2 percent increase in shareholder return, and a 14 percent increase in profitability.

Thank you.

[The prepared statement of James Megson can be found on page 100 in the appendix.]

Mr. LATOURETTE. Thank you, very much, Mr. Megson. Mr. Adams, thank you for coming, and we look forward to hearing from you.

STATEMENT OF FRANK ADAMS, PRESIDENT, SOUTHERN APPALACHIAN CENTER FOR COOPERATIVE OWNERSHIP, ASHEVILLE, NC

Mr. ADAMS. Mr. Chairman, members of the committee, thank you very much for the invitation.

The Southern Appalachian Center for Cooperative Ownership is only 5 years old. Previously, I worked with the ICA Group out of Boston, and prior to that I worked in eastern North Carolina establishing worker-owned businesses in a very rural and very poor part of the State. I am back in North Carolina now and want to share with you some of the data that is related to the latest collapse of another industrial sector in North Carolina, and that is the forest products and allied paper products industry.

Last year, there were about 440,000 persons still employed in North Carolina's forest products and allied paper products industry, and it was the second largest for-profit sector in the State's economy, at a $20 billion a year business. But furniture and fixture imports, mostly from Asia, along with paper and allied products, mostly from South America, are hammering the State's forest products businesses, leaving apprehensive employees constantly wondering if their job is the next to go.

Last Tuesday, a week ago, La-Z-Boy, Incorporated announced job cuts at manufacturing plants in Morristown, Tennessee, and Monroe, North Carolina, totaling 480 persons.

Since April 1995, the dreaded termination notice has been handed out to 13,740 North Carolinians, 9,415 men and women making furniture and fixtures, 3,315 working in lumber yards or sawmills, and 1,010 making paper or allied products. Western North Carolina's 23 mountainous counties, on average, since June 1, have lost 144 employment positions in that region. That is, since June of 2001, 144 men and women have lost their jobs every month. This is a crisis in small rural communities of dramatic proportions. For many people it is the loss of a third or fourth generation way of making a living and living a way of work.

What happens to these men and women after they are thrown out of their jobs? Lori Kletzner, an economist at the University of California, Santa Cruz, as part of a large study on how American industries were affected by import competition, found that of the half million workers who lost jobs in the forest products industry in America between 1979 and 1999, 38 percent of them never found jobs again. Of those who did find jobs, one in five took pay cuts of more than 30 percent. Today, if you are a logging operator or equipment operator in North Carolina, on average you will earn $11.58. Take a 30 percent pay cut of that and imagine what it does to your pantry and to your pride.

There are some bright spots, however, and I will mention three. Number one was when Champion International Papers announced in—I forget the date, it went on so long—in 1997 that the employees and the mill were nonstrategic assets and that the mill was to be closed or sold at public auction. A small handful of members of PACE Local 507 decided they were going to try to buy the assets out. Two years later, after a rocky, emotional, and draining experience, they were finally able to find bankers, subordinated debt and purchase a 40 percent equity stake in this $253 million transaction that was a division of Champion that it no longer wanted making paperboard for milk cartons and orange juice cartons.

Today, that mill is the second largest producer of paperboard for milk cartons and orange juice and other liquids in the United States. It has grown from 1,600 employees to2,100 employees and it has never failed to make a stock distribution in the years it has operated as an ESOP.

A second one, and a highly unusual situation, a mental health institute in Asheville, North Carolina, where severely handicapped individuals have learned how to operate not only machinery but a business called Sparkling Clean Janitorial Service. They are no longer entirely wards of the State, they are making a living to the degree that Federal law allows harmed individuals to make a living. That I would encourage the committee to consider reviewing. That is to say, if you are on the State, as we say down home, those persons should be allowed to make a living wage and not be capped.

The other one that I would talk about is a cooperative yet to get started at the initiative of the Blue Ridge Electric Membership Cooperative in Wilkes County and the Wilkes County United Way. Wilkes County is the largest in North Carolina and it is the home of Lowes, which itself is an ESOP and has made many people there in Wilkes County millionaires. We have been trying to develop a workers and landowners cooperative to harvest and produce timber for end users in the marketplace, and we are stymied in our efforts by the lack of capital, even though we have the support of the two institutional pillars in that county.

So for our purposes, as a for-profit business, the legislation that you are considering and its purposes stand to serve North Carolinians well, and I wish it were in place today to serve North Carolinians right away.

Thank you for your attention.

[The prepared statement of Frank Adams can be found on page 53 in the appendix.]

Mr. LATOURETTE. Mr. Adams, thank you very much. Mr. Dines, you are the last witness on this panel, and we look forward to hearing from you.

STATEMENT OF RICHARD DINES, DIRECTOR OF COOPERATIVE BUSINESS DEVELOPMENT AND MEMBER SERVICES, NATIONAL COOPERATIVE BUSINESS ASSOCIATION, WASHINGTON, D.C.

Mr. DINES. Good afternoon, and thank you, Mr. Chairman, Congressman Sanders, and other members of the subcommittee for the opportunity to testify on behalf of the National Cooperative Business Association about the need for Federal assistance to help the start-up and expansion of employee-owned businesses. In particular, I will address the importance of worker cooperatives as employee-owned businesses deserving of incentives from the Federal Government.

I am Richard Dines, Director of Co-op Business Development and Member Services for the National Cooperative Business Association, or NCBA. NCBA represents cooperatives across all industries, including agriculture, food retail and distribution, health care, energy, finance, housing, insurance, and many others. Our members include producer cooperatives, consumer cooperatives, and worker cooperatives. NCBA has a long and proud history of helping develop co-ops to meet people's needs. NCBA is now working on an urban cooperative development initiative that will demonstrate how cooperative businesses meet the economic needs of urban residents and build wealth and ownership.

There are thousands of credit unions, housing co-ops, health care co-ops and others already meeting those needs, but community developers and Federal agencies usually overlook the co-op business model. We hope to change that thinking with our initiative.

The first project of our initiative will be the development of a worker cooperative. This project will demonstrate that a worker-owned cooperative will be a critical tool to create jobs that pay livable wages and offer solid benefits. I am sure that my fellow witnesses will make the case that employee ownership works and that Federal assistance to help start and expand employee-owned businesses is in the best interest of the American taxpayer. We at

NCBA also support such Federal assistance, but we do not want worker co-ops to be lost in the discussion.

Employee stock ownership plans, or ESOPs, represent the large majority of employee-owned businesses in the country. In most ESOPs, employees do not own a majority of the company's stock. In the ESOP companies that do give majority ownership to the employees, only a small percentage give those employees democratic control over the business. By contrast, all worker co-ops are owned and democratically controlled by employees of the business. Workers are members of the co-op, own shares of the business, and elect a governing board according to one member, one vote. In some smaller worker co-ops, every member participates on the governing board. Also, in worker co-ops, profits are received when earned, not at retirement, and those profits are taxable.

In my written testimony, I present two excellent examples of worker co-ops that are giving their employees ownership and control: teamX, of Los Angeles, California, a manufacturing worker co-op, and Cooperative Home Care Associates of Bronx, New York, actually a service co-op. These cases demonstrate that worker cooperatives can empower workers and perform well in the marketplace.

NCBA believes that it is good Federal policy to help develop more worker-owned co-ops. The worker co-ops benefiting from Federal policy will generate more wealth and ownership opportunities in some of our Nation's most distressed areas. The small business community will be able to retain jobs and productivity in businesses that might have otherwise shut their doors when their owners retire. The proven business performance results of employee-owned businesses also demonstrates that the growth and expansion of these businesses are good for the American economy.

While legislation to create new financial tools for worker-owned cooperatives is needed, it is also important that existing Federal economic development programs explicitly include development of worker-owned cooperatives as eligible projects. Any new legislation must tackle the issue of equity capital for workers starting up cooperatives. This is no easy task and would certainly require a substantial investment, but the payoff would likewise be substantial.

The prohibition on lending to cooperatives at the Small Business Administration should be eliminated and SBA should even be mandated to offer its services to employee-owned businesses. Funding should be made available to nonprofit and cooperative organizations with expertise in developing employee-owned businesses and worker-owned cooperatives. The Employee Ownership Centers in Vermont and Ohio, the ICA Group, the Southern Appalachian Center, and many universities have the necessary expertise to provide this education and outreach on worker co-ops.

Finally, caution should be taken in defining what a worker co-op is. To truly be a cooperative the members must own and govern the business and control a majority of the seats on the board. While outside investors or the sellers of a business may retain a financial stake, the workers must control the business. If they do not, it is not a co-op.

Thank you again, Mr. Chairman and members of this subcommittee, for the opportunity to testify.

[The prepared statement of Richard Dines can be found on page 67 in the appendix.]

Mr. LATOURETTE. [presiding.] Mr. Dines, my congratulations to you. That was exactly 5 minutes; we commend you.

At this time, the subcommittee will move to questioning this panel under the 5-minute rule. And I will begin.

Mr. Keeling, I want to start with you, if I could, because I was struck by the use of "up close and personal." I think that your observation was that there may be a perception here in the Congress that employee ownership can create this sort of up-close-and-personal relationship in smaller companies, but perhaps—I thought I heard you to say that you may think some of us are of the belief that it can't be replicated in larger companies.

My question to you would be, what factors do you think lead to that perception, if that is in fact your opinion; and what, in your view, can we do to not only change that perception, but to increase employee ownerships in some of the larger corporations and companies in America?

Mr. KEELING. Oh, I could take a 5-hour rule to answer.

First of all, you are absolutely right that it is my view that that is the view of Congress, in dealing 30 years with the tax committees and the labor committees.

The idea that smaller units can create special bonding and special cooperation is just not unique to employee ownership critics and viewpoints. There is a view out there that once you get more than 150 people in any unit—we have employee-owned companies that won't have a factory or a plant with more than 150 employees; once they reach that level, they will go build another one, so that they can maintain that 150 level. So clearly it is something that I scratch my head about.

I didn't lose all of my hair scratching about this question, because the vision of our association is that the majority of American employees are significant owners in the companies where they work. You eliminate the large public companies, you are eliminating 50 percent of the workers in America from participating in "employee ownership."

So I think it is a huge challenge for the employee ownership world, to address the questions you raised.

I don't know if the employee ownership world has good, simple answers to prove that in a large organization you can have the same kind of synergy and magical kind of your work that I know Congressman Sanders has seen in Gardner Supply and King Arthur Flour and Carris Reels, and a lot of companies in Vermont. But I think it is a challenge to those of us who are advocates for employee ownership to address this very issue. I don't think we give great answers right now.

I do know this. I have worked with a lot of large corporations that have a lot of stock ownership, and I have talked to the employees in those companies, both midlevel and lower, and they do feel there is something special about their company.

Of course, it has been crushing to see companies of that size go through the turmoil that we have seen in the last 36 months, a la the Uniteds, the Enrons, the WorldComs, because I can tell you, having visited with employees in those companies during some of their great years, their belief and their loyalty and their dedication to their companies was as strong as what I would see in the smaller companies. So we see some issues.

I don't come to you with answers, but I think it is an imperative that we do get the answers, because I agree with Congressman Sanders and Congressman Bill Thomas, this is something that is not going to go away. I think in the 21st century, more and more people will want to be stakeholders and owners in the companies where they work, and we should get it right.

Mr. LATOURETTE. I thank you for that answer. I think the last couple of sentences of your answer really indicate why this is an issue that can be addressed in a bipartisan manner in the Congress, because you don't often hear Congressman Sanders and Congressman Thomas' name mentioned in the same sentence on an issue. I think that gives hope to the issue that you brought before the subcommittee today.

Mr. Clem, in your testimony—and Mr. Megson might have touched on it, Ohio is only one of 28 States that has passed legislation encouraging the creation of employee-owned businesses, and one of only a handful that has a State-supported program to attempt to encourage that end.

Do you have an opinion as to what barriers or impediments that are seen by other States that prevent them from following the Ohio model? In your role, in your leadership role, even though we have established you are not a professor at Kent State, in your leadership role have other States or organizations sought out what it is that Ohio is doing in an attempt to recreate that in other places in the country?

Mr. CLEM. Well, I am not sure that I can really speak to the reasons why other States haven't followed the same path that we have. Perhaps it has been the efforts of Professor John Logue, who founded the Center in 1987, and has dedicated his life essentially to growing the Ohio Employee Ownership Center.

It is one thing to pass some legislation saying it is good; it is quite another to actually promote it to the businesses and to the employees in the State. It takes an awful lot of work and an awful lot of effort on the part of a number of people.

Mr. LATOURETTE. If I can interrupt you for a second, I didn't write down the number, but I know that Mr. Sanders was impressed by it. Was it your testimony that the cost of each job that had been preserved by your activities is $423, thereabouts?

Mr. CLEM. That is the calendar year 2002, yes. And essentially what that boils down to, that was in the Department of Development funds from the Ohio Department of Development. We got a grant from there. If you divide, you know, the number of jobs that go ESOP during a particular year into the amount of funds, that is where we come up with that number. It is a rough number, but it is a pretty good indication that had there not been something like the Ohio Employee Ownership Center around to provide technical assistance and so forth, some of those facilities, at least some of them would not have been employee-owned. They would have closed, and those jobs would have been lost.

As far as—you asked about replication possibilities. I think that the Vermont Center, for example, kind of has arisen as a result of contact with the Ohio Employee Ownership Center. Dr. John Logue has been working closely with the director of that Vermont Center in more or less mentoring and helping them get this thing off the ground up there. It has worked well.

And we think that the Ohio experience is a good one that can be replicated throughout the United States, and this bill would help do that.

Mr. LATOURETTE. Thank you very much. It is not only rough numbers, but I think it is a pretty impressive number as well.

Mr. Sanders.

Mr. SANDERS. Thank you, Mr. Chairman. And again thank you, panelists, for, without exception, your extraordinarily good testimony.

Let me start off with a simple question, and anybody that wants to answer it can jump in. My experience in Vermont has been that when we talk about employee ownership, it really generates a lot of excitement.

When I was Mayor a long time ago in Burlington, we had a meeting. Hundreds of people came out, including a lot of folks who had started their own business, were now about to retire and didn't just want to sell it; they wanted to know how they could leave it to their workers.

What is your impression in terms of the kind of excitement that worker ownership, or ESOPs, develop? Am I wrong in assuming that a lot of people, when they hear about the idea, are excited? One of you, I can't remember who, mentioned that in fact not a whole lot of people know that that is an option out there.

Who wants to speak to that?

Mr. KEELING. Two things. One, I think that the word employee—the word "worker" is a wonderful word, it conjures up positive images. And in Western society and in modern society the word "ownership" is a positive word. So you are combining two positive words, and you have a natural positive reaction.

Having said that, I of course have pondered, as you have, how could two really exciting words, powerful concepts, end up being in the backwater of the American economy, in terms of awareness and concern? And this is glib. But I think that we have never had national leadership for this kind of policy. I don't think that you have had your top executive branch leadership ever say, This is my priority.

This is my priority. And I have a priority also to increase the ownership equity in America and to increase employee ownership.

And having said that, I think there are also some intrinsic, built-in issues with the ESOP model that we should all honestly look at and examine and talk about and not be scared of talking about them.

Mr. SANDERS. I am sorry to interrupt you.

Mr. Megson. What is your view on that?

Mr. MEGSON. Well, I would like to state that I think it is not as widely known as it should be.

When you hold a meeting on ESOPs, a lot of people turn up. Part of the problem, in my opinion is, short-termism. Outreach programs need to operate for several years to be successful.

The reason that the Ohio Center has been so successful is that they have been there year after year after year. My experience is, based on speaking to people and owners, about selling their business. We hold seminars every spring and fall in the Boston area. Nobody sells their business to their employees because they hear me speak. They think about it for 2 or 3 years and then come back.

So I think there is a lag of about 2 to 3 years. When people first hear about the idea, they kick it around, and think about it. It takes a sustained program and the availability of the kind of resources they have in Ohio. Aftger hearing about ESOPs, owners think about them and when they come back the resources are there to help them proceed.

Mr. SANDERS. Let me ask a self-serving question as the sponsor of the U.S. Employee Ownership Bank. Do you think that something like that would play an important role in addressing the concerns that Mr. Megson and all of you have raised? Could that be a real stimulus to employee ownership in ESOPs throughout this country? Is that something that we need in America?

Mr. Dines.

Mr. DINES. Sure. I would say that the proposed legislation would definitely help create new institutions like the employee ownership centers in Vermont and Ohio.

What we have seen at NCBA, when a grant program was created at the U.S. Department of Agriculture, a rural cooperative development grant—this was a grant program to help fund technical assistance centers around the country— once that money was available, centers flourished around the country; and all of a sudden we see lots of new co-ops being developed in rural America.

This type of an idea, if it would provide grant funding to technical assistance centers like the Southern Appalachian Center, like the ICA group, we would see a lot more of them popping up around the country.

Mr. ADAMS. I think it is both a question of long-term support at the political level.

Certainly Senator Russell Long played a significant part in bringing these ideas to public attention and giving them credibility, ironically, as a Senator from the South. It is the South, at least southern banking institutions, even through consolidation, which is the least well informed or the least supportive of this.

And having worked in the South principally since 1978 developing worker cooperatives or ESOPs on the scale of the Champion International plant, I can say that we are often greeted not with crowds of enthusiastic people, as I saw in Vermont, when I worked up there with Bruce Seifer and others of your staff, but we find no enthusiasm on the part of bankers.

I can tell you a story that came out of Rich Square, North Carolina, that still gives me chilblains of anger. A zipper company that had operated there for 20-some years, and Rich Square closed its doors—this was long before Warren Legislation—had been purchased by YYK Japan, and 80 workers were out of work. And we were contacted with—I was contacted by them.

I went through the process of getting a long-term contract for industrial zippers for the furniture industry in North Carolina, and developed a business plan, had a site ready. Went to the bank with the business plan, went to the bank with the contracts in hand for $250,000 worth of zippers a year, with more promised if the product was serviceable.

The president of the bank was a high school classmate of mine. And I will tell you in all candor in no disrespect to anyone in this room, he told me and the president, who was a woman, and the treasurer, who was a black man, that we don't make loans to niggers and women. And that has been burned into my consciousness ever since.

And there is a great deal of——

Mr. SANDERS. I gather what you are saying is that something like the Employee Ownership Bank could go a long way in educating not only workers but financial institutions. I appreciate that.

My time has run out.

Mr. Chairman, thank you very much.

Mr. LATOURETTE. Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman.

What year was that, Mr. Adams? What period of time was that?

Mr. ADAMS. That was in 1979.

Mr. LUCAS. Well, I would hope that we have come a long, long ways in a lot of attitudes since 1979 surely.

Mr. ADAMS. I hope so, too.

Mr. LUCAS. Surely.

Mr. Keeling, for just a moment, it seems quite clear that one of the common themes here is to get across the knowledge of the options that exist and the potential that ESOPs present. And in addition to—to Mr. Sanders' bill, I understand there are a couple of other efforts out there to generate that kind of attention, if I could deviate off of this particular bill to that one.

But I understand one of my colleagues from the Carolinas, Mr. Ballenger, has introduced a bill to create a presidential commission on employee ownership. Can you offer me an opinion, if you have one, about whether something like that would help to enhance the visibility of these endeavors?

Mr. KEELING. Let the record show that Mr. Sanders is one of the original cosponsors.

Mr. LUCAS. A great American, Mr. Sanders is, all the way through.

Mr. KEELING. So I am sitting before a friendly audience.

We feel very strongly about that legislation. We think that the very essence of Mr. Sanders' question about, why isn't there more attention, is because there has never been a high-level dialogue. You can say "debate," you can say "dialogue," you can phrase it any way you wish. There needs to be some attention focused on a trend that I think is not attracting national attention.

There are many not-fitting-together policies out there that we have developed over the last 30 years to promote employee ownership; and I think we need to come to grips with that. We need to come to grips with where we want to go with employee ownership in this Nation. I think the presidential commission could put us there. I think it could do a lot of answering the questions that the panel—that the subcommittee has raised.

I think what is intriguing about it is, the makeup of the commission would be dominated by nonmanagement employees and management employees of employee-owned companies, and people like the friends we have here on the panel, that are expert in employee ownership, versus people that are looking at employee ownership candidly from a very, very narrow frame of focus.

So I think it is very important. And I think what you are doing here today is absolutely part of that very effort in H.R. 1778, to get a national dialogue going about employee ownership, and that we should get it right for the 21st century.

Mr. LUCAS. Thank you.

Mr. Adams and Mr. Dines, talking about the co-op movements in general. There are a variety of endeavors that are going on out there. In the Third District of Oklahoma, we have a strong tradition of agricultural producer cooperatives both in providing resources to farmers and ranchers and in marketing the results of their efforts.

But it almost seems in recent history—and if you have got some opinions on this, I would appreciate it; it almost seems in recent history like my co-ops in rural Oklahoma have gone two directions. One, they have either become the very successful multifaceted co-ops—the swine industry and certain fruit industries—or they have gone the other direction, as it tends to seem like some of my grain co-ops, that support grain farmers and kind of wilted away.

The ones, I think, that have enjoyed tax exempt status mainly were started in the beginning of the last century.

Are there trends like that across the country? Are ag co-ops under greater strain perhaps than cooperative endeavors in different parts of the country or in different parts of the economy?

Mr. DINES. Yes. I would say that ag cooperatives are under some very particular types of stress because of the farm economy. But also because farmer cooperatives have a very long history in the United States, and I think a lot of the older farmer cooperatives have, quite frankly, managements that have forgotten why they are cooperatives. And it is up to those farmer members to remind them that they are co-ops.

And I think that is a very important message to all different types of cooperatives, whether they be ag co-ops, rural utility co-ops, which you also have a lot of in your State, and worker co-ops, that the purpose of those cooperative businesses is to serve their members. That is why they are there. And what we have seen is a lot of larger agricultural cooperatives and cooperatives in other industries forget their purposes, why they came into being as cooperatives. And some have even sold out to for-profit ventures.

But, fortunately, there is a lot of discussion and debate within the cooperative business community about that, and a lot of those larger and smaller co-ops are recognizing that there is a good reason why they were founded as cooperatives; and they will continue as such.

Mr. ADAMS. If I may add one thing, Richard is absolutely right, that many people have forgotten the purposes, at least in the worker-owner sector, which is growing rapidly enough so that next year there will be a meeting in the Midwest, probably in Minneapolis, to establish the North American Federation of Worker-Owned Cooperatives.

Having said that they are growing, I fear that they may suffer, the successful ones, and they have the same rate of success as any other business, success or failure. I fear that they too may forget their origins, because there is no single academic institution that I know of in the United States, with the exception of the University of California at Berkeley, from time to time, that is offering sustained courses on management of worker-owned cooperatives where the relationship between capital and labor is significantly altered.

And I feel that without the development of informed and educated young men and women to prepare themselves for leadership in these worker-owned cooperatives, we will witness a dearth of leadership and a return to normalcy. It is also a very serious problem in the industrial sector.

Managers in this country are educated to represent the interests of the capital investors. And that, for all intents and purposes, means directing the lives of men and women in the corporation that they are working for.

That said, when there is a transformation through a buy-out or through a 1042 rollover into an employee-owned firm, the managers are seldom prepared for allowing new owners to offer up ideas that can genuinely improve the productivity and efficiency of the corporation. And this has happened on several occasions at Blue Ridge Paper Products, the name of the corporation that resulted from the Champion buy-out. I would be glad to share that with you later, but I don't want to take any more of the committee's time.

But there are innumerable examples in that company alone where good ideas have come up out of the work force and management. Unless they were asked by the board of directors, have you passed this by the joint labor-management committee, have habitually—not out of maliciousness or out of mean-spiritedness, but out of their custom—circumvented asking employees how to get a better product and more efficiency.

Mr. LUCAS. Thank you, Mr. Adams. You, too, are a great American, for the record.

Mr. LATOURETTE. Thank you very much, Mr. Lucas, for your good questions and kind comments.

Mrs. Maloney.

Mrs. MALONEY. Thank you, Mr. Chairman, and Ranking Member Sanders for holding this hearing. And I thank all of the panelists. It is a very exciting idea as a way to expand jobs and ownership and, really, capital in America. I think, if used adequately, it could probably save many manufacturing jobs in America, and other jobs, industrial jobs.

I found your remarks, Mr. Keeling, very interesting when you referred to Dr. Kelso, who envisioned ESOPs not as a tax incentive program, but more as part of the financial services structure of our country; and it is has always been a tax incentive program. So it is very interesting that it is here before Financial Services where he envisioned it to be.

I had the opportunity to work with Dr. Kelso when I was a member of the city council in New York, and tried to save a steel manufacturing company in my district. And what happened at the time we got involved, at the time that the workers came to us and I reached out to Dr. Kelso to package it, they had already sold the equipment, the buyers had gone elsewhere, and we were just at the point where it was impossible to salvage the company and to salvage the jobs.

And I feel that the proposal that my colleague from Vermont has put forward, if we had had technical assistance, if we had had a loan line, possibly that plant would still be in New York providing services, paying taxes, with the employees with a stake in the South Bronx there and still working and helping the economy.

So I would like to join my colleague, Mr. Sanders, in this effort. I think it is a very interesting proposal, and one that could help expand the economy in our country and keep our jobs.

I would like to ask Mr. Keeling—I represent an urban district, and really the backbone of many urban districts are service jobs and small businesses. Most of the businesses in a lot of urban areas are small businesses. And can ESOPs work, say, with a real estate management program, or with a pizzeria that does catering? Or how small can an ESOP be? Do you have models of how it has worked with small businesses? Could you comment on that?

Mr. KEELING. I also want to comment that, I appreciated your reviewing your history with employee ownership when you were on the city council in New York City. You may recall at the time you came to Washington and worked very hard with the New York congressional delegation to preserve a tax incentive that was unique at that time to lenders, where they excluded 50 percent of their interest income for giving loans to ESOP companies. And there was often a feeling that if that had been preserved—we didn't succeed, but you certainly tried mightily, along with others, to preserve it—perhaps some of the distress loans would still be made.

I mentioned that in my written testimony, by the way, and I am happy to hear you relive your experience with Dr. Kelso during that time.

To answer your question, there is a general rule of thumb, that a corporation should have a payroll of at least 20 employees to be viable for a leveraged ESOP.

Having said that, Congresswoman, in your Congressional district, I think we have five or six smaller businesses that are ESOP, and who belong to the association. They are in the printing business, architectural firms and other businesses typical of what you would see in some of the Manhattan office buildings in your district.

The service industries are probably the fastest growing group of companies, in terms of creating ESOPs, of any. I think that is why we have seen a growth of the number of companies in the mid-Manhattan, northern Manhattan areas that you are representing in Congress.

I do believe, once you get below 20 employees it becomes problematic. I think certainly at less than 20, at that size, you are looking at your one person one vote worker co-ops. That is an area that is not being promoted as well, because most businesses are hiring more than ten or eight people.

The only final thing I would say is, some of our more successful companies—Hot Dog on a Stick, Round Table Pizza—we have a lot of restaurant, fast food, service provider-type companies; and I can't cite one for you in New York City, but we will certainly work on that.

Mrs. MALONEY. I always thought that taxi companies would be examples of what would really work for employee stock ownership. I think it is a great idea. It is really a win-win for the economy, for the workers, saving the jobs, saving the businesses. And I really have been interested during my term in Congress, to see really a lack of support or enthusiasm, because if we put our tax incentives there, and our structure there, the opportunity to grow jobs is tremendous, and it has been successful.

I thank all of you for your work. And the inspiration of Dr. Kelso. You bring back a lot of memories. He was an extraordinary individual, and it was an honor to work with him.

Mr. KEELING. One tiny comment about what you just said.

The fact that I think you don't see the enthusiasm that you would have anticipated before you came is that the people who work on employee ownership policy in this nation, both in the congressional committees and in the agencies, the ownership piece is a subset of what they think about. It has not been escalated to being Roman numeral I of the piece of paper of the outline.

That is why it is so important that this committee is interested breaking the barriers to getting another bigger focus on ownership. I think that is why, as Congressman Lucas mentioned, we need a national debate about employee ownership, so it is thought of in grander terms than just being a detail in the Tax Code.

Mrs. MALONEY. I agree. Thank you very much. My time is up.

Mr. LATOURETTE. I thank the gentlelady.

Ms. Brown-Waite.

Ms. BROWN-WAITE. Thank you, Mr. Chairman. I am not sure who to address this to. I recently attended a meeting with SCORE, Service Corps of Retired Executives. They were presenting awards to some of the SCORE members and also to one of the very successful businesses that they helped.

While relating this to a cooperative, having employees who may have built widgets and been darn good at it, then becoming the owners of the company or participating in the cooperative, what kind of support services are given to them so that we are sure that the now employee-owned business or the cooperative is truly a success?

Do you utilize SCORE? What kind of additional kind of management services are available to help those businesses?

Mr. KEELING. Congresswoman, I sit here and I talk about public policy. But probably the biggest thing that this association, and the Ohio Center—and I think the Vermont Center will do the same thing, and the gentlemen at this table—is providing education and technical services on how to manage an employee-owned company. It is not an easy task for the very reasons you mentioned, because a lot of traditional, the ways we used to do things, are being broken.

It is a very rewarding way to manage an organization if you get there. But it takes a lot of education. And one of the things that we preach, and I know all of the organizations preach, it of course takes leadership and a commitment from the executives of those companies—and I think you are going to hear from some in a second—that they are committed to the time, the energy and the effort to have their employees learn about our capitalistic system, free enterprise, profit and loss.

We certainly welcome any organization such as SCORE, or the organizations we run dedicating time and energy, break-out sessions, videos, pamphlets, booklets, we all have them, that are designed to do exactly what you are talking about.

That is an essential piece of making employee ownership work. Absent that, I am afraid that it may just flounder as something that a few people put together for a service fee.

Mr. MEGSON. My organization helps groups, especially inner city groups, start worker co-ops around the country. We do tap SCORE, particularly for board members.

Part of the services we provide are, training and education, SCORE can be extremely valuable in providing a board member to worker owned companies. Outside resources who come in and provide a larger overview, are very valuable. We do use them and we appreciate them.

Mr. CLEM. In Ohio, at the Ohio Employee Ownership Center, we have an employee-owned network. And we provide about 18 days of training each year on various topics, supervisory practices, high performance workplaces, how to read your financial statements, a number of things that they are involved with on how to be an employee-owner.

But those are open to any employee-owned company—well, any nonemployee-owned company, for that matter. But we primarily do it for the employee-owned network. But as I say, others are available or, you know, are certainly permitted the opportunity to attend if they so desire.

And we coordinate this business succession planning program, which tries to educate folks that are thinking about retiring and don't want to see their facility liquidated, and they don't want to see somebody else buy it, close it, send it overseas whatever, and are willing to explore employee ownership and let their employees have a shot at running it.

Ms. BROWN-WAITE. Just a follow-up question. Other than money and maybe management skills, what would you say is the third greatest impediment to more employee-owned business, or cooperatives?

Mr. KEELING. Fear. Fear of letting go. Giving up. Delegation. Losing control. That is a personal opinion of mine, but I have been around ESOPs since 1982. I have been in over 300 ESOP companies in the last 10 years. And it does take a certain set of core values to be willing to, "lead from the center" versus being a top-down leader. And I think that we see in management books and management training the last 25 years, more and more emphasis on that leading from the center.

I think there is a transformation going on. It is not as fast as some of us advocates would like to see.

But I think it is a fear of losing control of something that you created and nursed and grew yourself.

Ms. BROWN-WAITE. Thank you.

Mr. LATOURETTE. I thank the gentlelady.

Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I don't think I will ask any questions. I did want to come back and welcome Mr. Adams, who is from my home State, and thank him for being here, and apologize to the rest of the witnesses other than the first one I heard. And then I had to run out the door to another obligation and couldn't make it back in time to hear any of the rest of their testimony.

But I think we are addressing some things that, especially in North Carolina, are critically important. And if we can figure out a way to make more of these things work, we would solve some of the employment problems that we have had. And we have certainly seen it in the—first, in the textile industry, and now in the furniture industry, and some of the industries related to furniture.

We are having some hard times in North Carolina. So if this has some good possibilities and we can incentivize it to happen, I am certainly going to try to be supportive of it.

So thank you again for being here, and I will yield back and maybe we can expedite the next panel.

Mr. LATOURETTE. I thank you very much, Mr. Watt.

Mr. Sanders.

Mr. SANDERS. Just very briefly.

Thank you, Mr. Chairman. I just again want to thank the panelists. Also I have been very pleased by the number of members from both sides, actually more Republicans than Democrats who have been down here to listen to this. That suggests to me that there really can be a bipartisan approach. We are all losing good-paying jobs in our districts. We are all searching for solutions to rebuild manufacturing and other sectors of our economy.

And I hope very much that this is a start to a good bipartisan effort to create legislation that will move us toward ESOPs and worker-owned plants throughout this country.

So I feel very excited and look forward in a moment to hearing the second panel.

Mr. LATOURETTE. I thank the gentleman very much. We are going to be delayed a couple of moments for that.

Mr. Feeney, you are next.

Mr. FEENEY. Thank you, Mr. Chairman. I will try to be brief. And, really, I just wanted to throw out to some of the panel members that have been advising some of the employee groups in these situations, because I will tell you candidly, it is not typically my party that is trying to protect people from themselves in the area of investments and market decisions. And we are very much, and I certainly am very much a free marketer, and tend to be laissez-faire when it comes to running one's own affairs.

I am also a huge advocate for anything that will help encourage people to put a portion of their savings away for retirement, for future needs for things like ESOPs and for 401(k)s. If everybody would save for retirement 10 percent of everything they earned, I don't care how low their wage scale was, we would be a much better country and they would probably be much better off individually. But having said that, most of those plans rely on professional money managers, and they also rely on diversification.

My wife, for example, is an engineer. For quite a bit of time, if she had lost her job, she would have lost her health care. If she had lost her health care and her job, about 50 percent of her retirement savings, because of the way that things were structured 15 years ago, would have been lost if the company, for example, had gone bankrupt.

Having all of your eggs in one basket is almost always a terrible idea, unless you happen to hit the one wheel on the roulette wheel that finishes first.

And so it occurs to me that, to play devil's advocate for a minute, I certainly am not opposed to ESOPs being given favorable or at least reasonably fair treatment if there is a considered reason and value for employees to go ahead and purchase an employer. It seems to me that next to the employer and his or her accountant, they are probably in the best situation often to know about the future prospects of the business. But it does also tend to have some incentives to put all of your eggs in one basket.

If you are going to lose your job if the plant moves, it may have been a perfectly reasonable decision to move that plant elsewhere, but you are not able to make a reasonable decision in the short run if it means unemployment. If you have got a whole host of people that are incentivized to make an unreasonable decision, it seems to me that what you do is, you take people who are burdened by a potential plant closing or downsizing and you incentivize them into a situation where they have gone from a bad situation to a horrible financial situation.

And then, finally—and I know there are some management folks that advise these employees. But—and again to play devil's advocate and throw it open to whoever would like to say a few words—it occurs to me that a great wide receiver on a football team is not necessarily the best coach. And the best coach on a football team is not necessarily the best general manager when all is said and done.

And it occurs, further, that to the extent that you are going to democratize the process, that possibly the worst way to run a football team is that on the 50 offensive plays or so every game, and the 50 defensive plays, is to huddle up and take a vote, six votes in each huddle wins on what the next play is going to look like.

So, again, I love the idea of making every American a free market capitalist. To the extent that is where we are going in general, I am very sympathetic.

But if you can address some of my concerns.

Mr. KEELING. Let me jump in, because you just raised an issue that I have spent the last 36 months discussing. And with all due respect, I will probably say some things that you totally disagree with, just as you said some things that I don't agree with.

Number one, let me point out that 85 percent of the companies in America with employee stock ownership plans have other diversified plans. In those 85 percent companies, usually their 401(k)s hold no company stock.

Number two, let me point out that in this Nation, oddly enough, company stock compensation has been very normal since the 19th century, long before the Income Tax Code, long before the labor laws, long before Social Security. And, candidly, I defy anyone to point me to a time in our society when there was a significant number of Americans that were living in poverty or near poverty because they had worked for a company that engaged in company stock compensation.

Do I deny that there are exceptions to the rule? No, I am not stupid. I don't deny there are exceptions to the rule.

Number three, I would point out that the concept of diversification comes out of 12th century England, and it arises from a common law concept that once you have something, it is smart to diversify. Our ESOP laws, in essence, endorse that. Lou Kelso endorsed that idea. You don't make a lot of money from taking a little bit of money and spreading it around in little bitty places. John Rockefeller didn't do that. The duPonts didn't do that, et cetera.

Mr. FEENEY. I am talking about the bout. That is where we get into——

Mr. KEELING. Let me go to the next thing.

We had cited on the panel 60 studies in the last 20 years that these companies that were employee-owned, in essence, did better, et cetera. Now, those are average numbers. I accept that. In the capitalistic society, people don't hit home runs all the time; often they are lucky to get a bunt single. But the track record is strong.

Finally, you think about the football team, that one is right down my alley, because I like to give speeches about a well-run employee-owned company being just like a good football team. And probably the best example is to take what the tight-end does. They give him a big playbook. But that tight end has been given the tools and the knowledge and the study time to recognize maybe 50 different defenses that he is going to see when he steps up to that line of scrimmage.

Guess what? He doesn't run over to the coach every time he walks up to the line, and say, coach, they are in this defense, what in the world do I do now? The coach has delegated to him, provided him the education, the tools, to recognize the situation that he, as the tight end, is facing. And he makes the decision, who is his primary blocking assessment on the play—one of about a hundred in the playbook, by the way, to decide.

So the well-run employee company, no, doesn't sit down and have votes on each and every thing. But guess what? People are given the tools to make the decisions right there in a dignified self-sustaining, self-worth way that makes that play work.

And that tight end made the right decision and didn't have to run to the coach or to the quarterback saying, what do I do now?

That is—an example of good employee ownership is a good, well-run coached football team.

Mr. ADAMS. I would encourage the Congressman to look at Springfield Remanufacturing in Missouri. It is a paragon of exactly what our colleague is speaking about where employees have been provided, instead of being excluded from information that is needed to make an assessment about what assets they need to produce Product A or Product B, they are incorporated in the process and encouraged to make a decision about the financial needs that they have, and the hours that they need to do it, to produce a certain number of remanufactured diesel engines.

And that company has spawned several dozen other companies, including the company called the Great Game of Business. So I think that there are examples, certainly in the United States, and certainly in Spain, where the questions that you raise have been answered, and are being answered daily by men and women who are included in understanding the financials, understanding the financial market, understanding their market, and understanding what it takes to make their product or their service competitive and profitable and efficiently done.

Mr. LATOURETTE. Thank you, Mr. Feeney.

Mr. Royce.

Mr. ROYCE. Well, I am going to wait until our next panel.

Mr. LATOURETTE. Well, gentleman, you go with our thanks. I have been reminded that Chairman Bachus has requested that the record of this hearing remain open for 30 days. If there is additional information you wish the subcommittee to receive, and it may have just been as desirous so Mr. Sherman can submit more nice things about him, I am not so sure.

But if there are answers to questions you think need to be supplemented based upon your oral testimony, please feel free to do that. And on behalf of the subcommittee, we thank each of you for your time this afternoon and your informative testimony.

The second panel to come before the subcommittee this afternoon will include Mr. George Ray, who is the CEO of LeFiell Manufacturing Company in Santa Fe Springs, California;

Mr. Dave McCune, who is the President of the United Steel Workers of America, Local 1124-01, on behalf of the Massillon Stainless, Inc., in Massillon, Ohio, Ms. Sherry Ceresa is a Statistical Analyst, Gardener's Supply Company in Burlington, Vermont, Mr. Larry Owenby, who assisted on the employee bout of RFS Ecusta, in Brevard, North Carolina, and Mr. Monty Payne, the International Representative, Pace International Union, AFL-CIO, CLC, Hattiesburg, Mississippi.

As with the last panel, we thank each of you for coming this afternoon. And before we hear from you, a couple of housekeeping matters.

We have been notified by the floor that the Internet Gambling Bill, which has occupied the attention of our chairman, there may be a series of votes between 3:45 and 4:15. And if that is the case, we will take the necessary recess. We apologize for that, but that darn voting thing sometimes gets in the way of what we like to do in the committees.

Before listening to testimony, Mr. Sanders has asked to make a few remarks about our witness from Vermont, and then Mr. Royce also wishes to make some introductory remarks.

Mr. SANDERS. I wanted to welcome all of the panelists, and especially thank Sherry Ceresa for being with us. Gardener's Supply is an outstanding business in Burlington not only in terms of employee ownership, but in a million different contributions to our city and our State.

So, Sherry, thanks very much for being here.

Mr. LATOURETTE. Thank you, Mr. Sanders.

Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman. I want to take this opportunity to introduce one of our witnesses, Mr. George Ray, of LeFiell Manufacturing Company, which is an employee owned ESOP in

Santa Fe Springs, California. George is the chairman of the board and a member of the board of governors of the ESOP association.

But one of the reasons that I think it is important to have him here today is because this has been one of the longest operating ESOPs. I don't think we would find a better example. And he began his career with LeFiell in 1962, working his way to become CEO in 1987.

This is an aerospace firm. It became, as I mentioned about 30 years ago, an early ESOP. Under George's leadership, this ESOP has grown to ownership of 60-some percent of the stock from about 30 percent before his tenure. So this is sort of the ambition of ESOPs.

At the same time, they have put about 15 million in cash into the ESOP.

I am going to take the opportunity to commend you and also our ranking member, Mr. Sanders, for the interest that you have shown in this topic and bringing this issue to the subcommittee.

And I think there is no question, but that ESOPs have played an important role in the U.S. Economy and have allowed thousands of employees to share in the benefits of their respective firms' successes through stock ownership. And there are no doubt ways that we can assist in this.

And so I look forward to hearing from our witnesses. Thank you, Mr. Chairman.

Mr. LATOURETTE. Mr. Royce, thank you very much.

Once again, to all of our witnesses, welcome. I tried to talk to the last panel about the 5-minute rule. They ignored me and they kept talking anyway. But do your best if you can. And the lights are in front of you.

And, Mr. Ray, thank you for coming. We look forward to hearing from you.

STATEMENT OF GEORGE RAY, CEO, LEFIELL MANUFACTURING COMPANY, SANTA FE SPRINGS, CA

Mr. RAY. Good afternoon, Chairman LaTourette, and Ranking Member Congressman Sanders, and members of the Subcommittee on Financial Institutions and Consumer Credit.

First, I would like to thank Congressman Royce for his kind introduction. Back in California, we appreciate all of the good work that he does for us and our communities.

I am here to talk about ESOPs. And the ESOP community, first of all, we appreciate Congressman Sanders and the fact that he has pushed open the door to review how this Nation can finance more employee ownership.

I will tell you a little story about vision and sharing and ESOPs. As Congressman Royce said, I started at LeFiell Manufacturing in 1962 as a machine operator. And today I am the Chairman and CEO.

LeFiell Manufacturing Company traces its roots all the way back to 1930 when Mr. LeFiell began a small machine shop business in southern California in Los Angeles. And from 1930 to 1954 its primary business was supporting the meat packing industry, but in the 1950s, the company began to produce structural parts for the aircraft industry. And when I joined LeFiell in 1962, its primary work was in that industry.

At that time we had about 40 people. Today we have 110 employees, and they are all owners. And we are now the leading supplier of precision tubular parts in the world. We make aerospace assemblies. For example, we produce 6 miles of hydrogen fuel lines for each Space Shuttle.

But in 1954, Mr. LeFiell incorporated to a privately held C Corporation. And the reason he did that was so that he could share the company with the employees, being able to give them stock. And in 1974, when the legislation to allow creation of ESOPs was enacted by Congress, LeFiell was one of the first companies in the United States to form an ESOP. And from 1974 to 1986, the ESOP and the company growth was funded through earnings, company credit, and the issue of new shares.

By 1986, the ESOP then had accumulated 30 percent ownership in the company. With current retired employees owning the balance of the company, there were no shares outside of the company employees.

In 1987, a new strategy was initiated to purchase stock from retired employees, because now the people that started there in the 1940s were trying to retire and trying to get some of their money back out, along with Mr. LeFiell. Today the ESOP has 67 percent ownership. And now, there are over 250 owners of the company.

In fact, it would take the 40 top owners of private and ESOP shares to reach 50 percent ownership of the stock today. And that is what I would consider to be broad-based ownership.

Today, we are also studying a plan to purchase the balance of the shares so that in the next months we can become 100 percent owned by the ESOP.

It has been a wonderful journey for me and my family, and all of the employee-owners of LeFiell, where each employee has received a major benefit for retirement from the company that, in fact, they helped build.

Has an ESOP been good for employees and LeFiell? You bet. Yes, sir. Let me give you some examples. The average employee-owner at LeFiell has an account balance of $129,000. 19 employees with 21 to 25 years of service have average account balances of $217,000. And there are 11 employees who have over 25 years of service, and they have an average account balance of $357,000. This will certainly contribute to a much happier retirement for these employees and their families.

And one other thing. At LeFiell, we pass on the voting to the employee-owners in the ESOP, and they elect the board of directors each year. In fact, I was just elected to the board again last Saturday. We also have pass-through dividends. So the employees as LeFiell understand ownership while they are working. Each year when we have a profit there is an ESOP pass-through dividend.

As the President of The ESOP Association said earlier, 75 to 80 percent of the employee ESOPs created in America are the result of existing owners trying to sell their stock exactly like Mr. LeFiell did. Tax laws enacted in 1984 and 1986 triggered companies to leverage their ESOPs formally, where debt is supported by the ESOP and the stock all goes into ESOP suspense accounts; this is the method that LeFiell is currently considering.

Being an employee-owned ESOP has had many benefits for us over the years. In fact, our customers recognize the value of our ESOP and the stability of working with a company that is 72 years in business.

I know that your full committee oversees the Nation's accounting standards and has reviewed the work and proposals of the Financial Accounting Standards Board, FASB. Oddly enough, the manner in which the accounting standards treat ESOPs, in some instances, healthy companies might be impacted as employee-owned companies get financing more than money is available.

There is no question in my mind that the 1993 accounting standard hinders the creation of ESOPs. Now, I am not an accountant, and today's hearings are not about accounting treatment of ESOPs. I wish to make two comments, however. One, our problems are not about reporting the ESOP stock compensation as expense. In fact, ESOP contributions are reported as expense.

In conclusion, let me summarize my statement. The experience of LeFiell Manufacturing Company with employee ownership through ESOP has been very positive for us. I would state that LeFiell has not had significant issues in getting financing because we have been an ESOP, and those of other companies that I am aware of have not had a problem getting loans. I think that, as President Keeling said, it might have something to do later on with repurchase liability.

I do have a concern that recent accounting standards may make it harder for companies to obtain financing from lenders to execute an ESOP leveraged bout or raise capital for expansion.

We believe that your hearing is sending a signal that employee ownership is more important to the well-being of our economy and our employees than the arcane tax laws or hard-to-fathom retirement income security. Your hearing reveals areas that need more review. I believe, however, that as the Financial Services Committee commits to ownership, we will see more financing available for those companies that might not otherwise have been able to get it, and enable those employees to be owned just like LeFiell Manufacturing Company.

Thank you very much for giving me this time.

[The prepared statement of George Ray can be found on page 111 in the appendix.]

Mr. LATOURETTE. Mr. Ray, thank you very much for your testimony.

The bells that have just gone off indicate that we are in the process of having a 15-minute vote. We are going to try to get your testimony in, if we can, Mr. McCune. I see my tough clock talk really had an impact on Mr. Ray. And let's see if we can get you—we welcome you here, we are thankful you are here. We look forward to your testimony.

STATEMENT OF DAVID MCCUNE, PRESIDENT, UNITED STEELWORKERS OF AMERICA, LOCAL 1124-01, ON BEHALF OF MASSILLON STAINLESS, INC., MASSILLON, OH

Mr. McCune. Thank you, Mr. Chairman and Mr. Sanders and all distinguished members of the committee. I am David McCune, United Steel Workers Local 1124, unit 01, unit chairman.

I represent the employees of a long-standing stainless steel cold rolling facility, last known as Massillon Stainless, Inc., located in Massillon, Ohio.

Mr. McCune. I am here today to provide you a history of our facility along with a brief summary of our ongoing efforts to save and reopen the facility in which we worked. For, you see, we have fought for the last several years to keep our facility operational not only because of our jobs there but also because we believe we fight for a piece of American history.

The facility in which we worked was originally part of the old Republic Steel Corporation. At that time we were known as the Enduro Division of Republic Steel. Our facility was the first all-encompassing manufacturer of stainless sheet and strip in the United States.

As I alluded to earlier, we consider our plant, our facility, as being a part of the history of America. Much of the product that was manufactured in our facility over these past many years contributed to some of the most famous landmarks of our Nation, has aided in the arming of our Armed Forces during war, along with supplying normal everyday businesses as well.

If you have ever had the opportunity to visit the former World Trade Center, the Twin Towers, if you will, when you stood in that big, shiny beautiful lobby, that shiny stainless steel was produced in our facility.

If you ever visited the Empire State Building, again, the shiny stainless steel trim, not to mention some of the unseen heavy construction material was produced in our facility.

The same can be said in regard to the Chrysler Building, for we produced the shiny ornamental stainless that you see on and in that building as well.

These are just but a few examples of our contribution to our Nation's history.

Our facility also contributed to the arming of our Armed Forces in World War II, Korea, and Vietnam. We feel as workers in this facility we have, through the production of high-quality stainless armor plate, contributed not only to our Nation's freedom but to the freedom of many other nations of the world as well.

As I mentioned earlier, our product is seen by nearly all of you, depending on your health and your eating habits, possibly on a weekly if not daily basis. When you are sick, need care, have to visit your physician, these patient care facilities quite probably contain stainless steel produced in our facility. Many, many of the hospitals and doctors' offices east of the Mississippi River quite probably utilize stainless steel produced in our facility in their patient care facilities through many, many different applications.

The same can be said for those of you that might occasionally eat at a McDonald's restaurant built prior to 1999. The stainless steel you see being utilized as countertops in the serving area, anywhere you might see stainless in a McDonald's restaurant east of the Mississippi was more than likely produced in our facility.

So I believe you might understand, with our contributions to our Nation's building history, our contribution in providing armor plate to our forces in time of war, along with our contributions to people's everyday lives, why we are proud of and willing to fight for the continued existence of the facility and our jobs there.

We—and by "we" I mean not only those of us that still hold out hope of reopening the facility and working there again, but also because so many of us are second- and even third-generation steelworkers of the facility, we believe we fight for our fathers and grandfathers as well. We believe we fight not only for our manufacturing facility but also for a piece of American history, a history that not only we but a history that our fathers, grandfathers and, yes, even some of our grandmothers contributed to through these many, many years of stainless production in Massillon, Ohio.

It is because of our willingness to continue to fight for survival that I am here today. For I truly believe that if a vehicle such as The Employee Ownership Bank had existed last year, when I was first made aware of the financial position of the company, we would still be in operation today, rather than hoping and praying that our last interested entity steps forward, purchases the facility and, in the process, saves our jobs and a piece of all of our American history.

I will share with you a brief history of our most recent efforts to save the facility, along with why I believe we were unsuccessful, at least to this point, in saving the facility.

Last April, through a joint Labor/Management Steering Committee, the employees were notified that the company's financial position was eroding and that cost-cutting measures would need to be implemented. At this point, as I had nearly since the initial purchase of the facility by Jindal Strips, I inquired of their interest in a possible ESOP of the company. But I believe, due to our cultural differences, the ownership was unwilling to explore, as they had been unwilling before, a shared ownership of the company with the employees. You see, Jindal is a company from India, where employee involvement is taboo.

Most people were amazed I was able to get management groups to involve themselves in a team-based work system. No one was surprised I could not convince them to share in the ownership of the facility, until July of last year when management approached me with their willingness to explore the possibility of an ESOP. It was at this time we requested representatives of the Ohio Employee Ownership Center to come to the facility and explain the hows and whys ESOP companies make sense in today's business world.

At this meeting, it was decided that pre-feasibility studies should be performed and that its findings would determine what course, if any, could be taken to save the facility and our jobs. The pre-feasibility study rendered a decision that the company had waited too long, the business was now in dire straits, and that an ESOP was at this time not an option. It was also at this time that our efforts became a "save the facility" effort through the hopeful identification of a strategic partner.

We followed the guidelines set forth by the OEOC, and after interviewing several firms it was jointly decided that Locker Associates, headquartered in New York City, presented us the best opportunity to identify a potential strategic partner. Through the funding of the OEOC, along with the generous donations by the City of Massillon, along with both the district and local union, we were able to retain Locker Associates to begin the search.

Locker Associates contacted many entities and were in the process of identifying a potential partner when the owner/CEO of Jindal Strips arrived at the facility and informed everyone he no longer desired to be a part of the facility in any capacity and shortly thereafter announced the impending shutdown of the facility. This was last September.

At this point, the effort to save the facility by now identifying a purchaser became an "employee only" effort.

Rather than bore you with all the many ups and downs we have endured these past several months, I will give you but one example of how, had an employee-ownership bank existed, why I believe we would still be operational today.

Locker Associates identified a long-standing domestic company that was willing to purchase the facility and in the process include the employees in the ownership of. But because of the financial climate not only in the country but in the steel industry in general at the time, this entity was unable to identify a lending institution willing to invest in a shut-down stainless cold rolling facility.

Ladies and gentlemen, it is at this point that I truly believe, had a vehicle such as the proposed Employee Ownership Bank existed, we would have been able to jointly purchase our facility in a partnership with this entity. But because no such vehicle exists, I find myself out of work and hoping that, as I indicated earlier, our last interested party will step forward and purchase the facility and save our jobs.

But should they decide to not purchase, our jobs and a piece of our American history will cease to exist forever. This site will be razed, the equipment sold, most likely to a Third World nation, and the machinery that has produced material that has fought three wars, aided in the construction of some of this Nation's most notable buildings and landmarks will be producing stainless steel in another country only to be shipped back into our country at the cost of American manufacturing jobs.

I appreciate everyone taking the time here today to listen to the story of our plant and of our most recent fight for survival but, most importantly, that you are here today to hopefully take a giant step in the direction of creating a vehicle that will help workers of this Nation help themselves now and into the future.

Mr. LATOURETTE. Mr. McCune, thank you very much for your testimony.

[The prepared statement of Dave McCune can be found on page 95 in the appendix.]

Mr. LATOURETTE. As indicated, we are in the middle of a series of votes. We have about 5 minutes to cast this vote. I understand we have four votes.

The committee will be in recess for probably about half an hour. We will come back as quickly as we can.

[recess.]

Mr. LATOURETTE. The subcommittee will come back into order. Again apologize for the voting schedule getting in the way.

I have finished listening to Mr. McCune's remarks.

Ms. Ceresa, welcome to you; and we look forward to hearing your testimony.

STATEMENT OF SHERRY CERESA, STATISTICAL ANALYST, GARDENER'S SUPPLY COMPANY, BURLINGTON, VT

Ms. CERESA. Thank you, Mr. Chairman and Congressman Sanders.

As stated, I am here to tell the success story of Gardener's Supply Company in Burlington, Vermont. I am a nonmanagement member of our ESOP committee and also represent all the employee owners on the company Advisory Board. We are the largest mail order supplier of garden tools and equipment in the country and last year purchased Dutch Gardens, a bulb and perennial mail order business from Holland that is a perfect complement.

Will Raap, our founder and CEO, started Gardener's Supply Company in 1983 and our ESOP in 1987. As we celebrate our 20th anniversary, we are stronger and prouder of our mission and vision than ever. We have grown from 10 people working out of a carpet factory to over 250 permanent employees, and we expand to as high as 375 seasonally. We now have over 200,000 square feet of office and warehouse space. In addition to our catalogue and award-winning Web site, we have a destination retail store and outlet and we manufacture many of our own exclusive products. We are proud to say that we had our most profitable year in the history of the company last year, and we did it by pulling together all employee owners and having them be proactive in anticipation of hard times ahead.

This could be the story of many companies, but why do we feel ours is different? Because of the reason that we are employee owned. Many ESOPs are started as a part of ownership succession. Ours started for a very different reason. Our founder, at age 35, felt that ownership was key to how employees perceived their jobs. I would like to read from a letter written by Will Raap that describes his philosophy.

"from our very conception, Gardener's Supply Company has been a business that is about much more than just making money. Our vision, mission, and business principles speak to our goals to both create a profitable and sustainable business as well as to make a positive difference for our employees, our community, and our planet. We believe that the key to success to achieve this complex undertaking would be involving employees in ways that perhaps run counter to the conventional rules.

"we felt and still believe that the secret to unleash the potential in our business and to figure out how to achieve what at times seemed contradictory goals lies not only in the minds of corporate management but as much in the insights of every employee at every level. To unlock these insights, we needed a way to help all employees understand our business in a deeper and broader perspective beyond their individual positions and departments. In addition, we needed to create a context of trust and company loyalty and commitment so all employees would see their future linked with Gardener's Supply's, be thinking about these larger issues every day, and be eager and enthusiastic participants in creating our company's success.

"finally, we wanted a way to allow all employees to share in the company's success beyond their regular wage. Although employees are not putting up the financial capital the business needs, they are putting up the physical, intellectual, and emotional capital that are equally important. Therefore, we sought to create an organization and ownership structure to serve our business vision and mission. We chose an open book/participatory structure as the best way to give employees a more complete sense of how we are doing, of what we saw as opportunities and challenges, and of how they as individuals could influence the results of the organization as a whole.

"we coupled that with employee ownership in the form of an ESOP. Our ESOP supports this management philosophy and closes the loop in terms of not only creating a mechanism for all employees to participate in company ownership but to truly feel and act like owners and share in the rewards of the capital value that they are creating. Sixteen years later, we have found the ESOP to be an integral element of our business success. We have weathered the buyout of all outside minority shareholders and the consequential debt burden we took on. We have mastered the dynamics, flexibility, and challenges of managing a fast-growing business, and we have bested an onslaught of new, deep-pocket competition.

"we identify the strength and commitment of our employees and the value of the input we get from each employee each and every day, created through the organizational mechanism and corporate culture of an alive and activist ESOP, as a key sustainable competitive advantage creating our business success."

On a personal note, my official role at Gardener's Supply and Dutch Gardens in Burlington is statistical analyst. My employee owner roles are many. When our telephone sales representatives are overloaded with customers calling in catalogue orders, employee owners, all of us, get on the phones. When our mail trays overflow, we help open mail so that orders are fulfilled in a timely manner. When our warehouse is behind, we pack boxes. It is common to be sitting or standing next to the President, the CFO, perhaps the CEO during any of these activities. We are all employee owners with the same focus. You don't hear "that's not my job." it is our job. Those unanswered phones, that unopened mail, and those unpacked boxes all add up to decreased profits and bad customer service. It is our responsibility as owners to ensure we do all we can to meet our goals.

A bank such as the U.S. Employee Ownership Bank would have made our life much easier. In the earlier years of our ESOP, having loan guaranties and technical assistance would have been a blessing. But we did it alone. We have succeeded, but so many other companies that would have provided much-needed jobs were unable to wend their way through the complex ESOP world. There are many choices to be made early when establishing an ESOP that have long-term ramifications. I believe for those companies that cannot obtain private-sector financing, this would be a tremendous support system.

In closing, I must say that, prior to coming to Gardener's Supply and Dutch Gardens, I had 26 years of working for nonemployee-owned companies. At absolutely no point in time did I feel the immense pride, fierce loyalty to my coworkers or the desire to succeed that I feel now. As an employee owner I make a difference in the life of our customers, our employee owners, and our community.

Thank you.

Mr. LATOURETTE. Thank you very much, Ms. Ceresa.

[The prepared statement of Sherry Ceresa can be found on page 57 in the appendix.]

Mr. LATOURETTE. Mr. Owenby, thank you for coming; and we look forward to hearing from you.

STATEMENT OF LARRY OWENBY, ASSISTED ON THE EMPLOYEE BUYOUT OF RFS ECUSTA, BREVARD, NC

Mr. OWENBY. Thank you, Mr. Chairman, Mr. Sanders, and members of the subcommittee. I thank you for the invitation to be here.

In August, 2001, our mill was sold to a foreign entity that immediately went into contract negotiations with plans to cut wages and benefits by 30 percent. Throughout these times, we were told by the owner that cuts had to be given in order to maintain a level of business that we were accustomed to. Also, we were told that these cuts would be rewarded back to us in due time.

After some investigation of this new owner, it was learned that not only were they trying to destroy our mill but were also in court for spending pensions from another mill that was previously owned by them.

In trying to save our jobs and the impact that would occur should we lose the mill, we tried to raise money to buy the now-struggling facility from certain doom. We learned the hard way that when it came to finding investors who were willing to put money up for a long term was nearly impossible.

Our argument was a very simple one: Who else but the people that had spent 20 to 30 years inside the mill were capable of carrying on a tradition that had been very fruitful for more than 60 years? These people knew the markets, they knew the machines, and they knew the customers.

This mill, through feasibility studies, was still a very viable site and had potential for many types of new markets. It was also turning $1 million profit every month.

Because of a term labeled "labor dispute," the owner put the mill into bankruptcy after raping all assets that could possibly be sold. This created another problem for the workers. How could we show the investors that knew nothing about the business that it was still a viable mill?

We, through our local union, our national union, and local politicians began the process of trying to find other companies that had the same interest in business that we had. There were two such companies that took notice of the situation. One was our strongest competitor, and the other wasn't really sure about the investment capital that had to be spent.

While all this was occurring, the site itself became more involved in court litigations, while the important parts of the operation were slowly wasting away. We began to lose customers because they needed the security that we could no longer provide. We lost important vendors that were not being paid. We lost important staff that could not risk the loss of revenue. And we began losing hope.

We were asked by media—and some of you may be wondering the same—why didn't we try to settle instead of putting everything in jeopardy? As I have already stated, after our investigation, this was normal procedure for our new owner. This put us back to square one with all the people we had asked to help trying to find ways to get investors.

Because of the nature of the mill, this downtime put a strain on all the environmental systems, causing some concerns from the EPA, the North Carolina Attorney General's office, and so on, therefore creating even more problems for potential investors.

This brings to date what has happened now. We are currently a dead mill with no hope of ever starting up again. We have, over the last 3 years, lost more than 1,000 jobs in western North Carolina. This could have been prevented had we had the opportunity to find the funds to save our mill when we first began to seek the assistance that was needed.

I urge you to take into careful consideration the bill that you are discussing because we believe that it could become a very important tool for our manufacturing community to ensure health and stability in our economy.

I appreciate your time.

Mr. LATOURETTE. Mr. Owenby, we appreciate your time and your testimony.

[The prepared statement of Larry Owenby can be found on page 106 in the appendix.]

Mr. LATOURETTE. Mr. Payne, thank you for coming. Look forward to hearing from you.

STATEMENT OF MONTY PAYNE, INTERNATIONAL REPRESENTATIVE, PACE INTERNATIONAL UNION, AFL-CIO, CLC, HATTIESBURG, MS

Mr. PAYNE. Thank you, Mr. Chairman.

Good afternoon, Mr. Chairman and Representative Sanders. It is a privilege and an honor to appear before this committee.

I have been an international representative for PACE International Union for the past 15 years. My duties cover large areas of Mississippi and Louisiana. Prior to that time, I worked in a paper mill and made a very good living for over 20 years.

In the past 4 years, this country has lost many thousands of high-paying manufacturing jobs. Our union alone has lost over 20,000 jobs through partial plant closures or through total plant closures.

Paper workers are the second-highest-paid jobs behind the auto industry in this country. The loss of these high-paying jobs has had an incalculable effect on the communities, counties and States. Many companies look at the bottom line in making decisions on whether to close a plant or sell a plant. They do not look at the effect on employees, their families, or the communities in which the plants are located.

I have personally been involved with several partial closures since 1998 and a number of total closures. I am more in tune with what goes on in the forest products and paper industry. Many companies have purchased other companies and then picked the best and most modern facilities of the two and closed the unwanted facilities.

One company in particular, International Paper Company, has purchased other companies such as Champion International, Union Camp, Federal Paperboard, and then picked the best and most modern mills and closed less profitable mills. Some of these were making money, though not as much as the company wanted—Mobile, Alabama; Moss Point, Mississippi; and, lastly, Natchez, Mississippi, just to name a few.

Moss Point was a profitable mill, had top-quality production, but it was closed, and the company refused to talk with anyone about buying the mill and keeping it open. The same with Mobile and several others. The reason being they did not want competition from the mills.

Natchez, Mississippi, however, is unique in that it was the only International Paper Company facility which made chemical cellulose. Therefore, the company was agreeable to discussing selling the mill. This mill is in a small southwest Mississippi city and is the largest employer in the city and this area of the State as well. It also has a large impact on the southeastern part of Louisiana. In its heyday, this mill employed upwards of 1,000 people. It has reduced the staff to 700; and now the plant will close production forever during the week of July 15, 2003.

When the announcement of the decision to close this plant was made by International Paper Company, there was a meeting of many elected officials, including United States Representative Charles Pickering. The community saw the urgent need to save these good-paying manufacturing jobs. To say the least, there was concern and panic among the employees and members of the community.

PACE International Union stepped forward due to the success of its ESOP effort with Champion International in Canton, North Carolina, and pushed forward this concept. Starting from scratch, the local employees and myself saw a need for large sums of money to conduct feasibility studies, environmental audits, and many other required things to make this happen.

We have received very little help from the government due to the red tape, and banks do not take employees seriously in the early stages of an ESOP effort. We have had to beg money from every source. The employees have contributed several thousand dollars. The International Union donated a matching amount of what the employees could come up with. But it is still a long way from what is needed. Even though in Natchez we have had a unique but rare instance, due to the fact the Natchez Chamber of Commerce president committed $30,000 to our cause, it is still far short to get all done that is needed to be done.

In closing, this legislation that you are considering would be a great help to employees who have dedicated a lifetime to an employer who does not want to continue in operation but who would be willing to sell the plant to the employees. The employees would have an option to save good- paying jobs in their own communities so that they could continue to live where they want to, raise their children in these communities, and also help save the tax bases of the cities, counties and States of this great country.

Thank you, Mr. Chairman.

Mr. LATOURETTE. Mr. Payne, thank you very much.

[The prepared statement of Monty Payne can be found on page 108 in the appendix.]

Mr. LATOURETTE. I was struck, I think, when you were talking, Mr. Owenby, that one of the unique things about Mr. Sanders' proposal is that we have a number of Federal programs, like the emergency steel loan guarantee; and we had a situation in Cleveland where people would go and talk to the board and the answer would be, well, your company is not a good risk so we cannot guarantee the money or loan you the money. It has been my experience that if you are doing well and you have a really thriving business you probably don't need a loan guarantee.

So we sort of have it backwards, and that is I think one of the good things about Mr. Sanders' proposal that he has brought before the committee, and I would again commend him for that.

Mr. Ray, you talked about the fact that, prior to 1987, employee stock ownership was 30 percent; and then in 1987, if I have my dates right, that that jumped up to 67 percent. Can you describe for us the strategy or from whom you sought guidance and advice to go from that 30 to 67 percent figure?

Mr. RAY. Yes, sir. What we did was join the ESOP association and we started studying our options. We have had the same legal advisers since 1974, and so we leaned on them. And, in our particular case, we have not leveraged the ESOP. We have been able to use our corporate earnings and financing. Like you pointed out, if you have a company with a strong balance sheet, it is not hard to get those kinds of funds.

The point that was made by Congressman Sanders in the bill is, okay, what about the companies that can't do that and how does that work? And I certainly support the private sector first, but, on the other hand, I also support H.R. 1778, to be able to study the options where, as a last resort, there would be help for these companies to create employee ownership.

Mr. LATOURETTE. Thank you.

Mr. McCune, Massillon Stainless, I think it is not over yet, if I understood that right.

Mr. MCCUNE. We have one remaining entity that we are hopeful is going to step forward and save the facility. We are still in the waiting period, and they are doing their due diligence.

Mr. LATOURETTE. And are you able to, without revealing any state secrets, give a prognosis? Hopeful? Not hopeful?

Mr. MCCUNE. I met with the VP of acquisitions 6 weeks ago. He requested I sit down with the management team and put together a start-up-in-business plan to be submitted to them, which we did 3 weeks ago. So we are waiting on their decision now. Hopefully, it will be sooner rather than later.

Personally, most of my fellow employees have been out of work since November of last year. I went out in March of this year. So we hope to have it reopened by the end of the year. Do we know that for sure? No.

Mr. LATOURETTE. I will ask Mr. Sanders a gratuitous question so he doesn't have to—but, obviously, if an idea such as his were in place, do you think that would have assisted you?

Mr. MCCUNE. I think it absolutely would have helped us when we had the domestic entity that was interested this past November. But because there was no lending institutions out there that were willing to invest into a shut-down stainless cold rolling facility, we were unable to. But if the bank existed, as Mr. Sanders has proposed, I absolutely believe we would be in operation today.

Mr. LATOURETTE. Let me just ask about traditional lending institutions. Mr. Adams, when he was on the last panel, told, I think, a rather disturbing story; and I trust most people in the financial institutions don't respond the way his former high school classmate did. However, did you and your group make approaches to traditional lending institutions, and is there a flavor as to how your endeavor, without a vehicle like Mr. Sanders proposal being in place, how your group of employees seeking to become employee owners was regarded by banks within Massillon, or wherever you went?

Mr. MCCUNE. We as an employee group never had an opportunity to sit down with a lending institution. Had we, I think possibly I could have convinced them we were worthy of the risk. But the entity itself went to I know of at least three institutions and was turned away.

Mr. LATOURETTE. Thank you very much.

Mr. Sanders.

Mr. SANDERS. Thank you very much, Mr. Chairman.

I will tell you, this has been one of the more interesting hearings that I have attended in a very long time. Both panels have been fantastic, and we are just hearing many aspects of what employee ownership is about.

It seems to me this panel is looking at two different things.

The success stories that we heard from Mr. Ray and Ms. Ceresa seem to indicate—and I want both of them to comment on this—that when employees are involved in a worker ownership enterprise it means more to them than just going to work every single day.

We have millions of Americans who wake up at 8 o'clock in the morning, they go to work at 9 o'clock, and they get their paycheck, and that is about it. They disassociate the moment they leave the plant. But what I heard from Ms. Ceresa and I think from you, Mr. Ray, as well, that when you are involved in an employee ownership effort your work means a lot more to you than just working 9 to 5.

Why don't we start with Ms. Ceresa and then go to Mr. Ray on that.

Ms. CERESA. Absolutely. It is a feeling that is really hard to describe. It is not only how you feel about your work but how your other employee owners feel. You all have a common goal, you all are there to help each other, and it is just a really special feeling that Mr. Keeling was talking about in companies. It is a cohesiveness. It is a just an amazing group of people that are there for the same reason.

Mr. SANDERS. Ms. Ceresa, would you suggest this has an impact on absenteeism and turnover and so forth? Do you find less of that?

Ms. CERESA. Yes. Yes. We have a large seasonal population, which, of course, is a great turnover, but I was thinking about that the other day. In the area that I work in, which is probably about 40 people on my floor, I can think of four people that have come since I started 4-1/2 years ago. Everyone else was there when I came, and I have not heard anybody talking about leaving.

Mr. SANDERS. That is interesting. That is interesting.

And, Mr. Chairman, I know Gardener's Supply very well. It is about 5 minutes away from where I live, and not only do they do a good job in terms of employee ownership, they have cleaned up and improved what we call the Intervale, the largest nondeveloped area in Burlington. Just tremendous community efforts they have made.

Mr. Ray, do you want to respond to that? How is it different from an emotional perspective working for an employee-owned company?

Mr. RAY. Well, I have been there 41 years in August.

Mr. SANDERS. You haven't left.

Mr. RAY. I haven't left, and I enjoy every minute of it.

On the absenteeism question, our absenteeism that we track, because we reward people for being there on time, is less than one-half of 1 percent.

Mr. SANDERS. Wow.

Mr. RAY. Yes, less than one-half of 1 percent.

Mr. SANDERS. Which I gather is a lot better than most?

Mr. RAY. Tremendously. And, frankly, we don't have to hire as many people. Pretty simple.

Mr. SANDERS. What about turnover?

Mr. RAY. Our on-time delivery to our customers is 98.8 percent. Our quality record with all of our customers is 99.8. We are a silver supplier to the Boeing Company, which is only one of 200 companies in the world that have that status. So that takes a lot of tender loving care by a lot of people to be able to do the incredible things.

Mr. SANDERS. What about turnover? Do people stay on the job?

Mr. RAY. Absolutely. Right now, we are at about—average is about 15 years. We are in the aerospace industry, so we are going through some really tough times and we are not immune to that, unfortunately. So will we have layoffs? Yes, unfortunately, Congressman, the toughest thing to do is layoff an employee owner.

Mr. SANDERS. Of course. Of course. But what is interesting here, and perhaps, Mr. Chairman, an added benefit from this, is without absenteeism or with much lower rates of absenteeism and much lower rates of turnover and a dedicated work force, you have a more productive work force, a more cost-effective work force, a more competitive operation, it seems to me. And that is an added benefit.

Now, those are the positives. We are hearing two really wonderful stories, and then we have heard three stories that we don't know the ending yet, and these are folks who are struggling. I think the issue there at this point is financial; and the issue is, as employees who are struggling to hold on to their jobs and their plants, you have had a rocky road of it.

So my question for Mr. McCune and Mr. Owenby and Mr. Payne is, if there was a Federal—if there was Federal help out there providing the kind of technical assistance and these kind of loans, how would it have impacted the struggles you are currently engaged in?

Mr. Owenby, do you want to start on that?

Mr. OWENBY. Be glad to.

I think an institution like that would have helped us tremendously. Because when we did go out and try to find investors, even with the feasibility studies that we did, it was long term because of the damage that the previous owner did. And he did it maliciously. So instead of him just saying, okay, we will sell it to you, he kept things into litigation and tried to destroy the mill. We were in a different situation than most people. We had a vindictive owner.

But if we had had that opportunity, we could have, during the process of the sale itself, when he finally did release it, we could have stepped in and bought it. But at the time we did not have the financing, and we could not make a bid, and they sold it through auction.

Mr. SANDERS. Mr. Payne.

Mr. PAYNE. Yes, sir. I think it would have helped us. It would help us greatly in our effort because we could go somewhere, get the money, spend the time on the feasibility studies, the audits, things of that nature that are required instead of out trying to raise money from individuals, from Chambers of Commerce, from the city. We could spend our time, and it would shorten this time span from start to finish.

Mr. SANDERS. Which is very, very important, as Mr. Owenby just indicated.

Mr. PAYNE. Absolutely, it is important. The longer that time span, the more nervous the employees get. They get itchy. And also the investors, when you have to go to them and they see that, yes, you did this part and then you waited and you did this part, if we could all be real consistent and flow real good and shorten the span on these studies, it would just help tremendously, I believe.

Mr. SANDERS. Mr. McCune.

Mr. MCCUNE. Our studies show that we had a solid business plan in place; we had the ability to be very profitable; we had a customer base that was very loyal, still is loyal. If we show back up on the scene, they will come back. For whatever reason, with all those things in our corner, because the steel industry in general was and still is depressed, we could not get a lending institution to step forward.

I really and truly believe if the Employee Ownership Bank existed, that with all those things behind us and with an entity willing to make a purchase and include the employees within that purchase, as I said earlier, we would be in business still today. But because we ran up against basically the same thing Mr. Owenby and Mr. Payne did, with institutions that would not listen to us or weren't willing to bankroll us, so to speak, the facility shut down; and it shouldn't be shut down.

Mr. SANDERS. Mr. Chairman, I think this has been terrific testimony, and I want to thank each and every one of the panelists who have been with us today. You played a very, very important role and I think have given us some energy to hopefully go forward in a bipartisan way to do something which I think will be extraordinarily important for the working people of this country.

So I want to thank you; and, Mr. Chairman, I want to thank Mr. Bachus, of course, and your staff. Your staff has done a good job, and Warren Gunnels of my staff, in helping to bring together these excellent panelists. So I thank you very much for your efforts.

Mr. LATOURETTE. Well, first of all, I want to thank all of you. It has been a long day, I know. I saw, Ms. Ceresa, when I said we would be gone for half an hour, I got the feeling you had a plane to catch and maybe were not so happy about that. Thank you for being with us all day.

I want to agree with Mr. Sanders that this is one of the better hearings I have been at all year, and it is because of your willingness to share your experiences with us. I want to thank Mr. Sanders again for the idea of the hearing.

If there is nothing else to come before the subcommittee, we stand adjourned, and you go with our thanks.

[Whereupon, at 5:09 p.m., the subcommittee was adjourned.]

A P P E N D I X

June 10, 2003

STATEMENT OF CHAIRMAN SPENCER BACHUS
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT
"FINANCING EMPLOYEE OWNERSHIP PROGRAMS: AN OVERVIEW"

Good morning. The subcommittee will come to order. Today's hearing, which was requested by the Subcommittee's Ranking Minority Member, will provide an overview of Employee Ownership Programs. Employee Ownership Programs allow employees to "buyout" their place of work in response to an announcement that the business will be closing its doors.

Employee buyouts are accomplished through the creation of Employee Stock Ownership Plans (ESOPs) or Eligible Worker Owned Cooperatives (EWOCs). Currently, there are about 10,000 ESOPs in the U.S. While ESOPs are found in all industries, more than 25 percent of them are in the manufacturing sector. Employees own a majority of the shares in about 2,500 of these ESOPs. There are about 500 EWOCs. Unlike ESOPs, EWOCs are found in all types of industries.

In some cases, worker buyouts using ESOPs and EWOCs have led to the creation of successful employee-owned companies that are profitable and thriving today. In other cases, U.S. workers have failed in their attempts to purchase the business due to a lack of financing. This lack of financing is caused by a variety of factors. For this reason, this hearing will examine proposals to provide financial institutions incentives to finance employee buyouts through the creation of Employee Stock Ownership Plans (ESOPs) or Eligible Worker Owned Cooperatives (EWOCS).

This hearing will consist of two panels. The first panel includes ESOP trade association representatives and experts in the field. During the second panel we will hear from two successful ESOP companies as well as two employees who failed in their attempts to purchase their companies due to a lack of financing. We will also hear from a union representative who is currently involved in an attempted buyout. I look forward to the witnesses' testimony on this important topic.

In closing, I would like to thank Mr. Sanders for working with us on this hearing and bringing this issue to our attention.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

June 12, 2003

<u>House Financial Services Committee</u>
<u>Subcommittee on Financial Institutions and Consumer Credit</u>
<u>Hearing entitled "Financing Employee Ownership Programs: An Overview"</u>

Thank you, Mr. Chairman, for holding this hearing on Employee Stock Ownership Plans (ESOPs) and Eligible Worker Owned Cooperatives (EWOCs).

I look forward to our examination of the incentive proposals designed to increase the number of corporations that allow ESOP and EWOC programs when faced with financial difficulty. In recent years, many workers across the country have responded to announcements that their employer is closing its doors by buying their company and creating an employee-owned company. Several of these companies created through ESOP and EWOC programs have become very successful, however many others have failed in their attempt to save the business.

As I understand it, there are approximately 10,000 ESOPs currently in the United States and 500 EWOCs. Twenty-five percent exist in the manufacturing sector. I would like to thank our witnesses for joining us this morning to present their statistical research on these ESOPs and EWOCs.

In particular, I would like to thank Mr. Steve Clen, Ohio Employee Ownership Center Director and Professor of Political Science at Kent State University, and Mr. Dave McCune, President of Local 1124-01, on behalf of Massillon Stainless, Inc., for joining us from the great state of Ohio.

Thank you again, Mr. Chairman, for calling us here this morning and I look forward to a thorough debate of the positive and negative aspects of these programs.

STATEMENT OF Congressman Steven LaTourette
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

"FINANCING EMPLOYEE OWNERSHIP PROGRAMS: AN OVERVIEW"

The subcommittee will come to order.

I am Chairing the hearing today in Mr. Bachus' absence – due to his need to be on the floor for another important piece of legislation. He has asked me to submit his opening statement into the record and I ask that this be done by unanimous consent. Thank you.

It is my understanding that today's hearing, was requested by Mr. Sanders, the Subcommittee's Ranking Minority Member and will provide an overview of Employee Ownership Programs.

This hearing will consist of two panels. The first panel is comprised of trade association representatives and academics who will share with us their perspective on the issue of Employee Ownership Programs. The second panel consists of individuals who have participated in attempts, both successful and unsuccessful, to purchase their companies. In addition, to those folks we will hear testimony from a union representative who is involved in an attempted buyout going on right now.

In particular I would like to personally extend a warm welcome to two Ohioans testifying today. Mr. Steve Clem with the Ohio Employee Ownership Center at Kent State University and Mr. Dave McCune, President of Local 1124-01 from Massillon, Ohio. Welcome, we are glad to have the great State of Ohio represented here today.

I look forward to the witnesses' testimony.

The chair now recognizes the Ranking Member of the Subcommittee, Mr. Sanders, for any opening statement that he would like to make.

Remarks to the House Subcommittee on Financial Institutions and Consumer Credit

Frank Adams
President
Southern Appalachian Center for Cooperative Ownership
Asheville, North Carolina

Members of the Subcommittee:

Last Tuesday, June 3, La-Z-Boy Inc. announced job cuts at manufacturing plants in Morristown, Tennessee and Monroe, North Carolina totaling 480 persons.

For the thousands of nervous North Carolinian's, and thousands of others elsewhere who still have jobs in the forest products industry, the announcement by La-Z-Boy is just the latest permanent lay-off notice they hear about, but not the last they expect.

My remarks focus on North Carolina, but the need for a reliable, dedicated capital source to help arrest industrial job loss is not specific to North Carolina.

Some 140,000 persons are employed in North Carolina's forest products industry, the state's second largest for-profit sector workforce, and $20 billion dollar a year business.

But furniture and fixture imports, mostly from Asia, along with paper and allied products, mostly from South America, are hammering the state's forest products businesses, leaving apprehensive employees constantly wondering if their job is next to go.

The state stands to lose these jobs and it's prominence in the forest products industry during the next five years, according to Pete Stewart, president and CEO of Forest2Market, Inc in Charlotte, who adds, " The parallels with North Carolina's textile industry are frightening." I think all here today are aware of the fall from grace experienced by North Carolina's textile industry. [The Charlotte Observer. January 16, 2003.]

There is data to back Mr. Stewart up:

Since April 1, 1995, the dreaded termination notice has been handed to 13,740 North Carolinians-9,415 men and women making furniture and fixtures, 3,315 working in lumber yards or sawmills, and 1,010 making paper or allied products.

In Western North Carolina's 23 counties, on average, 144 men and women lose jobs every month since June 1, 2001, a total of 3,465 persons. They made livings as fallers, buckers, logging equipment operators, secretaries and bookkeepers, graders, scalers, sawyers, lumberyard workers, papermakers, or by making furniture, fixtures, molding, or picture frames. Their jobs are gone forever. [North Carolina Department of Commerce &North Carolina Employment Security Administration.]

And what happens to these men and women after being let go?

Remarks to the House Subcommittee on Financial Institutions and Consumer Credit

Lori Kletzner, an economist at the University of California, Santa Cruz, as part of a large study on how American Industries were affected by import competition, found that of the half million workers who lost jobs in the forest products industry in America between 1979 and 1999, 38% could not find work again. Of those who did find jobs, 1 in 5 took pay cuts of 30% or more. [The Wall Street Journal September 20, 2002.]

Today, if you operate logging equipment in North Carolina, on average, you earn $11.58 an hour. The average wage is $10.88 if you are a faller or a bucker. Tractor or skidder operators average $9.88 an hour. No job at all can destroy self-esteem; empty the wallet and the pantry. A 30% cut in an $11.58 perhaps only empties the wallet and the pantry.

There are bright spots however.

In the face of incredible odds, some workers are buying-out their employers , becoming employee owners, and profitably re-directing their business.

Others start new firms to keep on doing what they know how to do with trees, pulp, mills, furniture, or as bookkeepers, kindly receptionists. They refuse to go unemployed, to see neither their net worth nor their self worth destroyed. They are challenging the odds mostly in rural America, thus mostly out of the national limelight-in Maine, Ohio, Virginia, North Carolina, Mississippi, Wisconsin, Minnesota, Northern California, and Southern Oregon.

In every case I know of, these women and men face identical problems-how to find the money for experienced advice about buying assets or starting a cooperative, how to define a market, how to reorganize using an Employee Stock Ownership Plan or as one of the many cooperative models, or how to find the capital to buy assets or start operation until a profit turns. But at the end of the day, capital must be made available.

With me today are two men:

One, Larry Owenby, was a paper machine back tender and chemical operator for the bankrupt Ecusta Paper Mill in Brevard, N.C. He speaks for over 600 women and men who were unable to come up with the capital they needed;

The second, Monty Payne, was a papermaker for many years but is now a regional representative for PACE International Union at 12 paper industry plants in Mississippi and Louisiana. He is leading efforts in Natchez to determine if profits can be made, and decent wages can still be made making rayon and cellulose at a mill International Paper no longer wants. He is searching for capital.

They have compelling evidence for your consideration.

Remarks to the House Subcommittee on Financial Institutions and Consumer Credit

In the context then of a collapsing industry, and determined, capable people refusing to buckle under, I have two accounts from North Carolina to share briefly that underscore the importance of the Subcommittee's deliberation's today:

In 1997, Champion International Papers told employees they and the machinery they used were non-strategic assets. So were the mills they worked in to make bleachboard to be folded into milk or fruit juice cartons, and paper for mailing envelopes-2 in North Carolina and 5 scattered from Athens, Georgia to Aims, Iowa.

A handful of North Carolinians in Champion's Canton mill decided to see if they could buy the land and machines. They did, after two years of exhausting effort to find financial support for a feasibility study, to negotiate with lenders, and most importantly, to convince their neighbors that they had a common sense solution: a worker's buy-out.

Today, employees own a 40% equity stake in Blue Ridge Paper Products, Inc., headquartered in Canton, North Carolina, now the nation's second largest manufacturer of bleachboard and mailing envelopes. There are 2,100 employee owners who saved and created jobs. They are among the highest paid industrial workers left in North Carolina even after taking a 14% pay cut for 5 years to buy shares.

Then there is the effort to create jobs which is still on the drawing boards looking for capital investors, the Timber Producers' and Harvesters' Cooperative, a business that may be started in Wilkes County, North Carolina, one of the hardest hit as measured by job loss.

The workers' cooperative will start off with 16 persons full time at a living wage, with an equity stake in the firm, and each with one vote on any matter that significantly or extensively affects the business, including electing a small board of directors who, in turn, hire a manager.

These 16 persons must find 6,000 acres to start harvesting, probably requiring 100 landowners who will become owners of the cooperative, too. The owners must be willing and able to fall and haul tress in accord with high respect for the land. They must be able to bark logs, bagging that bark for mulch.

They must find uses for slab wood and haul sawdust to local industrial chicken houses. Of course, they must know how to saw the logs, then learn how to use methane from landfills to dry the timber, make tongue and groove flooring, then sell their product as flooring, or installing that flooring themselves.

If they can do these tasks, and if they can find the capital, our strictly under-estimated financial projections show these 16 individuals will have a total sales of $5,471,029 the first year. There will be money to pay down debt, and for a small distribution of profits to the worker owners and landowners.

Remarks to the House Subcommittee on Financial Institutions and Consumer Credit

And if they are able to meet or better this earnings target, and then go beyond the second and third years, then many North Carolinians hope this business will be replicated over and over, until these workers' cooperatives can be found throughput North Carolina County.

Thank you.

Frank T. Adams
President
Southern Appalachian Center for Cooperative Ownership
Asheville, North Carolina
June 10, 2003
1,328 words

Testimony of
Sherry Ceresa, Gardener's Supply Company (Burlington, VT)

My name is Sherry Ceresa and I represent Gardener's Supply Company from Burlington, VT. I am a member of our ESOP Committee and also represent the employee owners on the company Advisory Board. We are the largest mail-order supplier of garden tools and equipment in the country and last year purchased Dutch Gardens, a bulb and perennial mail-order business from Holland that is a perfect complement.

Will Raap, our Founder and CEO started Gardener's Supply Company in 1983 and our ESOP in 1987. As we celebrate our 20th anniversary, we are stronger and prouder of our mission and vision than ever. We have grown from 10 people working out of a carpet factory to over 250 permanent employees and we expand to as high as 375 seasonally. We now have over 200,000 sq. ft. of office and warehouse space. We have a destination retail store and outlet and we manufacture many of our own exclusive products. We are proud to say we had our most profitable year in the history of the company last year and we did it by pulling together all employee owners and having them be pro-active in anticipation of hard times ahead.

This could be the story of many companies...why do we feel ours is different? Because of the reason why we are employee owned. Many ESOPs are started as a part of ownership succession. Ours started for a very different reason. Our founder, at age 35, felt that ownership was key to how employees perceived their jobs. I would like to read from a letter written by Will Raap that describes his philosophy.

"From our very conception, Gardener's Supply Company has been a business that is about much more than just making money. Our Vision, Mission and Business Principles speak to our goals to both create a profitable and sustainable business, as well as to make a positive difference for our employees, our community, and our planet.

We have believed that the key to success to achieve this complex undertaking would be involving employees in ways that perhaps run counter to the conventional rules. We felt, and still believe that the secret to unleash the potential in our business, and to figure out how to achieve what at times seem contradictory goals, lies not only in the minds of corporate management, but as much in the insights of every employee at every level. To unlock these insights, we needed a way to help all employees understand our business in a deeper and broader perspective beyond their individual positions and departments. In addition, we needed to create a context of trust and company loyalty and commitment, so all employees would see their future linked with Gardener's Supply's, be thinking about these larger issues every day, and be eager and enthusiastic participants in creating our company's success. Finally, we wanted a way to allow all employees to share in the company's success beyond their regular wage. Although employees are not putting up the financial capital the business needs, they are putting up the physical, intellectual and emotional capital that are equally important.

Therefore, we sought to create an organization and ownership structure to serve our business vision and mission. We chose an open book/participatory structure as the best way to give employees a more complete sense of how we are doing, of what we saw as opportunities and challenges, and of how they as individuals could influence the results of the organization as a whole. We coupled that with employee ownership, in the form of an ESOP. Our ESOP supports this management philosophy, and "closes the loop" in terms of not only creating a mechanism for all employees to participate in company ownership, but to truly feel and act like owners and share in the rewards of the capital value they are creating.

Sixteen years later, we have found the ESOP to be an integral element of our business success. We have weathered the buyout of all outside minority shareholders and the consequential debt burden we took on, we have mastered the dynamics, flexibility and challenges of managing a fast growing business, and we have bested an onslaught of new, "deep pocket" competition. We identify the strength and commitment of our employees, and the value of the input we get from each employee every day, created through the organizational mechanism and corporate culture of an alive and activist ESOP, as a key sustainable competitive advantage creating our business success."

On a personal note, my **official** role at Gardener's Supply and Dutch Gardens in Burlington, VT is Statistical Analyst. My **employee owner roles** are many. When our Telephone Sales representatives are overloaded with customers calling in catalog orders, employee owners get on the phones. When our mail trays overflow, we help open mail so the orders are fulfilled in a timely manner. When our warehouse is behind, we pack boxes. It is common to be sitting or standing next to the President, the CFO or the CEO. We are **all** employee owners with the same focus. You don't hear "that's not my job"...it **is** our job. Those unanswered phones, that unopened mail and those unpacked boxes all add up to decreased profits and bad customer service. It is our responsibility as owners to ensure we do all we can to meet our goals.

A bank such as the U.S. Employee Ownership Bank would have made our life much easier. In the earlier years of our ESOP, having loan guarantees and technical assistance would have been a blessing...we did it alone. We have succeeded, but so many other companies that would have provided much needed jobs were unable to wend their way through the complex ESOP world. There are many choices to be made early when establishing an ESOP that have long-term ramifications. I believe for those companies that cannot obtain private sector financing, this would be a tremendous support system.

In closing, I must say that prior to coming to GSC and DG, I had 26 years of working for non-employee owned companies. At **no** point in time did I feel the immense pride, fierce loyalty to my co-workers, or the desire to succeed that I feel now. As an employee owner, I make a difference in the life of our customers, our employee owners and our community.

STATEMENT OF
THE OHIO EMPLOYEE OWNERSHIP CENTER
KENT STATE UNIVERSITY

TO THE
FINANCIAL INSTITUTIONS AND CONSUMER CREDIT SUBCOMMITTEE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ON
THE U.S. EMPLOYEE OWNERSHIP BANK ACT

JUNE 10, 2003

Mr. Chairman and Members of the Subcommittee:

The Ohio Employee Ownership Center of Kent State University appreciates this opportunity to present its views to this Committee and your willingness to consider them.

Employee Ownership in Ohio

Ohio is one of twenty-eight states that have passed legislation encouraging the creation of employee-owned businesses; it is one of just eight, however, which have created a state-supported program to achieve this end---The Ohio Employee Ownership Assistance Program, first passed by the Ohio Legislature in 1988 and renewed in 1994 and again in 2000; in each instance, the vote was unanimous in both Houses of the Ohio Legislature.

By way of introduction, the Ohio Employee Ownership Center (OEOC) is a non-profit, university-based program established in 1987 to provide outreach, information and preliminary technical assistance to Ohio employees and business owners interested in exploring employee ownership. The OEOC also provides ownership training on a single and multi-company basis to existing employee-owned firms and is partially funded by grants from the Ohio Labor-Management Cooperation Program of the Ohio Department of Development, private foundations, dues from firms belonging to Ohio's Employee-Owned Network, income from training contracts and donations. The OEOC also administers the prefeasibility study grant program for the Ohio Department of Job and Family Services' Rapid Response Unit. In addition, the Center coordinates the U.S. Department of Labor's National Steel/Aluminum Retention Initiative (NSARI), a national program to assist durable manufacturing in dealing with the continuing threat to the steel and other durable goods industries. The OEOC partners with the Industrial

Cooperative Association in Boston, the Center for Labor and Community Research in Chicago, the Steel Valley Authority in Pittsburgh and the Washington State Office of Trade & Economic Development on this effort.

Since 1996, the OEOC has coordinated the Business Owner Succession Planning Program in the Cleveland area in partnership with the Greater Cleveland Growth Association and CAMP, Inc. to help business owners explore a wide range of succession planning options, including selling to their employees. The program works to preserve jobs that might otherwise be lost from an owner's failure to plan for succession. Succession planning can benefit the owner, his family and the employees of the company. Too often, failure to plan for succession leaves liquidation as the only remaining option. That means that the owner likely won't realize full value of the business and the employees will lose their jobs. Through the Spring 2003, 438 business owners and managers from 355 companies employing 31,000 people participated in the program.

The Ohio Employee Ownership Center works closely with the 59 small and medium-sized firms that are members of Ohio's Employee-Owned Network. The Employee-Owned Network provides a forum for employee-owned companies to meet on a regular basis, and learn from each other's experiences. Member firms receive training on topics such as improving supervisory practices, financial education, open book management, employee participation structures, and other aspects of building high performance workplaces. During 2002, for example, the Network provided training for 335 individual employee owners, ranging from union leaders and shop floor workers to CEOs.

The Ohio Employee Ownership Center also hosts an annual Ohio Employee Ownership Conference that provides a forum for discussions on various issues relating to employee ownership. The one-day event typically draws in excess of 300 employee owners and other interested parties from Ohio and surrounding states.

The mission of the OEOC is to broaden ownership among working Ohioans and to deepen that ownership through employee participation, communication and training in the employee-owned sector. Our overall aim is to anchor capital and jobs locally through participatory employee ownership. That builds productive assets for working families and increases community prosperity. Economic development is quite clearly at the heart of the OEOC's mission.

The Results of OEOC's Programs

Since the inception of Ohio's program in 1987, the Ohio Employee Ownership Center has worked with 436 company owners and buyout groups investigating whether employee ownership makes sense in their particular case; these company and employee groups represent 83,133 employees. Of these, 63 firms, employing 12, 825 have implemented partial or complete employee ownership. Many of these employees would otherwise have lost their jobs to plant shutdowns or corporate downsizing. As a consequence, thousands of jobs have been saved in communities throughout the State because the program existed.

Employee ownership provides a unique opportunity for building strong labor-management partnerships and for anchoring capital and securing jobs in Ohio communities. Co-ownership of businesses by employees and managers expands opportunities for cooperative work practices by establishing common goals, achieving a common understanding between labor and management, and developing mechanisms for employee participation from the shop floor to the boardroom.

Employee ownership helps to create stronger common goals among all those who work at the firm. A common set of goals and shared values are key components of developing a high performance workplace to remain competitive in the future. Twenty-eight years of experience with employee ownership clearly has demonstrated that employee ownership, by itself, doesn't necessarily mean improved company performance. What does seem to improve performance is the combination of employee ownership along with employee participation, open communications about the business and employees having the skill to use the participation system and having the knowledge to understand the business information that may be shared. Employee-owned companies that do all of these things are much more likely to improve their performance relative to their competitors than employee-owned companies that don't do them. These basic conclusions have been reached and confirmed by a number of studies done over roughly the last twenty years. Empirical evidence from national studies done by the National Center for Employee Ownership, by the General Accounting Office, by the U.S. Department of Labor, by the Washington State Department of Community, Trade and Economic Development, and yes, by the Ohio Employee Ownership Center since the mid-1980's suggests persuasively that employee-owned firms in which employees have avenues for participation achieve significant improvements in productivity and in other measures of economic performance.

Employee ownership is a proven tool for job retention and job creation and for economic development in Ohio communities. The Ohio ESOP study cited in *The Real World of Employee Ownership* (Cornell University Press, 2001) found that 49% of employee-owned companies outperformed their industries in job creation and retention, 50% matched their industries, and only 1% under-performed their industries. Employee-owned businesses clearly contribute to healthy local economies.

Employee ownership benefits individual Ohio firms and their communities in many ways. For individual firms, it can create a market for a departing owner's stock, provide significant federal tax breaks, reduce debt service burdens, complement a commitment to participative management, and improve corporate performance. For the local community, employee ownership can be an economic development strategy used to retain businesses that might otherwise be liquidated at the retirement of an owner without a successor, anchor the ownership of businesses in the community, secure jobs that might otherwise be moved out of state, provide additional capital for reinvestment and expansion and increase the competitiveness of Ohio businesses.

The Cost

Cost per job retained, created or stabilized through the Ohio Employee Ownership Assistance Program in calendar 2002 in the firms that implemented ESOPs was $423 per job in Ohio Department of Development funds, a small number compared to the costs, financial, physical and psychological, associated with unemployment. The program is highly cost effective because it helps people help themselves.

As an economic development strategy, employee ownership yields long-term benefits in four additional areas:

1) Employee-owned firms reinvest in capital improvements in existing facilities at a higher rate than other firms. While this is motivated primarily by the employee-owners' interest in job security, it helps to increase the competitiveness of Ohio firms and to anchor capital and jobs in our communities;

2) Employee-owned firms also reinvest in their human capital at a higher level than is common in our region. The consequence is a movement up the scale toward high performance work systems with higher productivity and profitability.

3) There is growing evidence that employee-owned firms have a higher economic multiplier effect in their communities, in part because of a preference for local suppliers and in part because anchoring the ownership of productive wealth in a community among employees generally supports higher levels of home ownership, purchases of consumer durables and higher retirement benefits;

4) Employee-owned firms create significant assets for Ohio families. To date, the Ohio Employee Ownership Center has helped more than 12,000 Ohio employees become owners. We have estimated that these employee owners are building roughly $40 million annually in additional assets through their employee ownership plans. That amounts to about $3300 per employee owner and comes from the creation of new employee-owned companies, employees in existing employee-owned companies increasing their number of shares as well as by increases in the valuation of the company. That wealth creation effect also anchors capital locally and helps solidify our communities' economic base.

In short, employee ownership has proven to be an effective means to retain and increase jobs in Ohio. Today, some 425 partially or wholly employee-owned companies headquartered in Ohio employ more than 325,000 people.

Obstacles

Nevertheless, for many years, the Ohio Employee Ownership Center has had to struggle with issues of how to obtain adequate loans and equity for employee-owned companies. In theory, capital looks so easy to obtain; in practice, however, employee-owned companies and small and medium-sized companies in general, have trouble getting financing. The median size of the companies we work with is about 100 employees doing about $10 million in sales. Of the 59 companies that are part of Ohio's Employee-Owned Network, only 3 have more than 500 employees. In short, we work largely with classic small and mid-market companies. And they are often strapped to get capital for growth.

Every year, in our technical assistance at the OEOC, we have lost at least one otherwise viable employee buyout because of the lack of timely, friendly capital. To put it bluntly, almost every year for the last fifteen, we have seen at least one viable employee buyout effort fail with the loss of 100-200 jobs because no one could round up financing in a timely fashion.

Following are four relatively recent potentially viable buyouts in Ohio that could have benefited from a friendly lender:

CSC Steel, Warren, 1,350 employees The closing of CSC was announced in the third quarter of fiscal 2001. The ODJFS Rapid Response program funded a two-stage prefeasibility study. Stage one determined that the facility was viable and that the shutdown occasioned by lack of debtor in possession working capital had dramatically diminished the value of the plant while making a re-start extremely difficult for employees because of the working capital needs. This stage one study found employee ownership could work with an outside equity partner. Stage two determined whether a partner for the employees could be located and apparently found one in Renaissance Partners, a Pittsburgh-based investment fund. Throughout the first quarter of FY02 Renaissance Partners continued their due diligence for a purchase and the employee buyout group was optimistic about a successful sale and re-opening of the facilities. Immediately following the end of the quarter, however, Renaissance Partners announced that it had ended its interest in pursuing the purchase of CSC; there were, Renaissance Partners told the press, better opportunities available for turnarounds in the aftermath of September 11^{th}.

HPM, Mt. Gilead, 500 employees In FY01 a two-phase study was commissioned. Phase one reached positive conclusions about the viability of a restructured HPM provided a partner could be found for the employees. The second phase of the study then offered three potentially viable options for restructuring the company. During the first quarter of FY02, however, HPM failed to keep control of the company. The consequence was that the lender, Fleet/First Boston, seized HPM's assets, threw the company into bankruptcy and closed down the plant. Fleet proceeded to sell the assets of the company to a buyer of dubious ability to perform in terms of keeping the plant open, or, perhaps, even completing the deal. This was in preference to selling to the partner whom the employees had found who pledged to run the company and to sell to the employees as an exit strategy.

Massillon Stainless Inc. Massillon, 92 employees----Massillon Stainless, Inc. was a stainless cold rolling operation. Major markets for stainless steel strips include household appliances, food processing and restaurant equipment, elevators, architectural trims, pipes and tubing and transportation equipment. At the request of the Steelworkers Local Union and members of salaried management, a prefeasibility study was commissioned. The buyout group selected Locker Associates to perform the study. While the study was being conducted, the company announced plans to close the facility.

The study was completed October 24, 2002 and concluded that the facility could restart and operate profitably if it could find an outside equity investment partner and assure itself of a supply of raw materials. The study also noted that a minority ESOP would make sense given the employees' strong commitment to the company and its excellent labor-management relations. A supply of raw materials was found, however at this writing, the search for an outside equity partner is continuing and the plant remains closed, with the possibility that the machinery could be sold to interests in China.

Cold Metal Products, Youngstown, 116 employees----Cold Metal Products was a manufacturer of strip steel products for precision parts manufacturers. The company announced closure of the plant on August 15, 2002 and then filed for bankruptcy the next day. Subsequently, the Cold Metal Employee Buyout Group filed an application for a prefeasibility study grant that the OEOC approved.

The Buyout Group selected Kokkinis & Associates to do the study. The study got underway late in September and was completed in early December 2002. The study found potential for a successful restart of the facility, however, because of the capital requirements of such a restart, it recommended the employees work to get an outside equity investor involved that would entertain a minority employee ownership position for the workers.

The plant remains closed, however, the employee buyout group is working to salvage a portion of the business with a fraction of the number of employees that used to work at the facility and continues to search for financing.

The Proposed Legislation

The impetus behind this draft legislation is the fact that the United States has lost a couple million good-paying manufacturing jobs over just the last few years. The loss of manufacturing jobs has been going on for some period of time, although the pace of job loss has picked up in the more recent past as we have battled with economic recession, the crisis in the steel industry and the adverse effects of massive international trade deficits.

The U.S. Employee Ownership Bank Act is, in essence, aimed at job retention and job creation and proposes to retain more manufacturing in America by helping American workers buy their plants, educating them in employee participation strategies so they can be more competitive while anchoring capital locally in the process.

The Act proposes to establish a "Bank" within the U.S. Treasury Department that will provide grants to the States to provide technical assistance, participation training, education and outreach along with loan guarantees and/or subordinated loans to help employees purchase the business provided a prefeasibility study shows that employee ownership is a viable alternative. The existence of such a "Bank" would, in our opinion, have made a positive difference in the outcome of the four buyout efforts cited above.

The Act also includes a provision that would require an employer closing a plant to provide 90 days advance notice before such plant closing and to offer the employees the opportunity to purchase the business. This provision would have been of particular utility in the case of Brainard Rivet in Girard, OH. Brainard Rivet is now employee owned and part of Fastener Industries, a 100 percent employee owned company in Ohio. However, it was a major struggle to get to that point. Brainard was part of Textron when the parent shut down this profitable specialty fastener operation so that it could move the production to a non-union plant in Virginia. The move didn't work out because the employees in the Virginia plant did not have the skill level needed to be competitive. The turning point in Brainard's road to employee ownership came when it was discovered that Textron was sending much of the Brainard business to competitors rather than running it at its Virginia plant. This revelation resulted in political pressure from the Ohio Congressional delegation as well as from state and municipal representatives. Since Textron was the recipient of a number of government contracts, it became more cooperative in the employee's efforts to buy the facility.

Conclusion

The Ohio Employee Ownership Center at Kent State University supports the proposed U.S. Employee Ownership Bank Act. Its passage would allow our Center and others like us to more fully and effectively focus on our core mission of broadening employee ownership while also providing a needed financing source to help employees buy the facilities where they work rather than see them close and the production move elsewhere.

The OEOC, like other organizations, faces a continual battle to raise the funds needed to carry out its mission. In recent years, Ohio, like many other states has had budget problems which has meant that funding for programs such as ours has been cut. We have, in some cases, had to go away from our core mission in order to get grants to help pay the bills. We could obviously do more with additional funding. The U.S. Employee Ownership Bank, by providing additional funding would allow us, and other centers like us, to more fully concentrate on broadening ownership in the United States.

We believe the track record the OEOC has established over the years makes a good case for the benefits to the American economy that could come from the establishment of a U.S. Employee Ownership Bank.

NCBA

Testimony of
Richard J. Dines
Director, Cooperative Business Development and Member Services
National Cooperative Business Association

Before the
U.S. House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
Hearing on
Financing Employee Ownership Programs: An Overview

June 10, 2003

National Cooperative Business Association
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Richard Dines
June 10, 2003

Good afternoon and thank you, Mr. Chairman, Congressman Sanders, and other members of this subcommittee, for the opportunity to testify on behalf of the National Cooperative Business Association about the need for federal assistance to spur the start-up and expansion of employee-owned businesses. In particular, I will address the importance of worker cooperatives as employee-owned businesses deserving of incentives from the federal government.

I am Richard Dines and I am Director of Cooperative Business Development and Member Services for the National Cooperative Business Association, or NCBA. NCBA represents cooperatives and cooperative service organizations across all industries including agriculture, food retail and distribution, childcare, energy, finance, housing, insurance, childcare and many others. Our members include producer cooperatives, owned by farmers to process and market their products and to provide themselves with credit, equipment and supplies; consumer cooperatives owned by consumers to obtain products and services at a reasonable price; purchasing cooperatives owned by businesses who band together to enhance their purchasing power and competitiveness; and worker cooperatives owned and governed by the employees of their businesses.

NCBA

NCBA provides a broad range of services to its members in the areas of public policy, business development, and education. NCBA was founded in 1916 as the Cooperative League of the U.S.A. and we have a long and proud history of helping develop cooperative businesses to meet people's needs. After World War II, we were instrumental in founding CARE, the Cooperative for American Relief Everywhere, to address the economic reconstruction of a devastated Europe. In the 1950s and 1960s, we began our work helping to organize cooperatives in the developing world to assist groups of consumers and producers access the marketplace. In the 1970s, we led a national campaign to establish a National Cooperative Bank to meet the credit needs of non-agricultural cooperatives. In the 1980's, we launched an effort to revitalize rural America through a network of cooperative development centers that would provide technical assistance to groups forming new co-ops in rural areas. That effort resulted in the Rural Cooperative Development Grants program at the U.S. Department of Agriculture and a national network of centers called CooperationWorks helps rural cooperatives across the country.

NCBA is now working on an Urban Cooperative Development Initiative. This Initiative is focused on demonstrating the effectiveness of cooperative businesses in meeting the economic needs of urban residents and building wealth and ownership. There are thousands of credit unions, housing co-ops, health care co-ops, child care co-ops, and others already meeting those needs, but both community development organizations and federal economic development policies and programs usually overlook the cooperative business model when devising plans to start new businesses in urban settings. We hope to change that thinking with our Initiative.

The first project of our Initiative will be the development of a worker cooperative serving office cleaners in the Washington, D.C. area. We selected this project because we wanted to demonstrate that a worker-owned cooperative can be a critical and viable tool to create jobs that pay livable wages and offer solid benefits. When the workers own their own business, they ensure that they are compensated fairly and tend to be more productive because it is their business on the line if it does not perform well. Once the worker-owned cleaning cooperative is up and running, we plan to replicate it in other cities and help develop other types of cooperatives serving the same population.

Why Employee Ownership Through Worker Cooperatives?

I am sure that my fellow witnesses will ably make the case that employee ownership makes sense for businesses in the U.S. and that federal assistance to help start and expand employee-owned businesses is in the best interests of the American taxpayer. Dr. Douglas Kruse with Rutgers University recently reviewed the research on employee ownership and concluded, "25 years of research shows that employee ownership often leads to higher-performing workplaces and better compensation and work lives for employees."[1]

Much of the research on employee-owned businesses has focused on employee stock ownership plans (ESOPs) since the large majority of employee-owned businesses are ESOP companies. ESOPs are defined-contribution retirement plans that buy and hold stock in the company where the employee works. While ESOPs confer ownership rights to employees, they do not necessarily give the employees any control over their workplace. Most companies with ESOPs do not confer voting rights to the employees to elect the board of directors. There are about 10,000 ESOP companies covering approximately 10% of the American workforce. However, employees own a majority of the companies' shares in only about 1,500 of them. In that group, only a small percentage give the employees democratic control.

By contrast, employee-owners of worker cooperatives adhere to the cooperative principles of democratic ownership and control. Employees are members of the co-op, own shares of the business and elect a governing board according to one member, one vote. In some smaller worker cooperatives, every member participates on the governing board.

TeamX

An excellent example of how worker cooperatives can meet the needs of workers seeking to fashion their own destiny is teamX of Los Angeles, California. A socially responsible investor—Ben Cohen and his Hot Fudge Venture Fund—was determined to show that a clothing manufacturer did not need to operate under sweatshop conditions (including low wages) in order to make a profit. The result was teamX, inc., a worker-owned, casual apparel manufacturing business that stitched its first shirt in March 2002. The co-op pays production workers hourly wages well above prevailing industry levels and benefits that some employees never had before. TeamX boasts that its sweatX brand is the only brand that can provide a 100 percent guarantee that workers are paid a livable wage, receive benefits, and work under good conditions. As of July 2002, the co-op employed 35 production workers and 6 managers.

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[1] Kruse, Douglas, "Research Evidence on the Prevalence and Effects of Employee Ownership," *Journal of Employee Ownership Law and Finance*, Vol. 14, No. 4, Fall 2002, Oakland: National Center for Employee Ownership, p. 77.

Richard Dines
June 10, 2003

Organizers of the teamX business were inspired by the success of Mondragon Corporacion Cooperativa in the Basque region of Spain. Mondragon is a massive network of worker-owned cooperatives that has grown into a global industrial powerhouse. The teamX founders wanted to ensure that the workers would always be in control and the Mondragon example demonstrated that this could be done while the business remains profitable.

Cooperative Home Care Associates

Headquartered in the South Bronx in New York City, Cooperative Home Care Associates is a worker-owned home health care agency that employs more than 550 African American and Latina women – 74% of whom had previously been dependent on public assistance. When the co-op was founded in 1985, Medicare policy was forcing many patients out of hospital beds and back into their homes. At the same time, the home health aides expected to care for these clients were being offered extremely poor jobs with little training, low wages, no benefits and temporary work. The business was organized to provide higher quality jobs to the home health aides and, thus, a higher quality of care to patients.

Today, wages for co-op members average $8 an hour, among the industry's highest, particularly in New York. Benefits for co-op members include individual health insurance, paid vacation, and sick time – also among the best in the industry. Worker turnover is less than 20% a year, compared to an industry average of 40-60%. As a cooperative, 80% of the employees share in the ownership of the business and elect the board of directors from among their own ranks.

Barriers to Start-Up and Expansion

A primary barrier to groups seeking to form a worker cooperative is equity capital. The start-up capital it takes to get a business off the ground is daunting for anyone, but it is unusually difficult for cooperatives because they typically must generate capital from within their membership. Outside investors are often loath to invest in a business that they are not allowed to control. But generating capital is even more difficult for worker-owned cooperatives because, in many cases, the members of those co-ops have limited economic means to buy the business from their current employer or to start a new business. The only way that cooperatives like teamX and Cooperative Home Care Associates were able to get started was with sizable infusions of investment from social entrepreneurs and socially responsible investors.

Another barrier is a bias against cooperatives in the programs of the Small Business Administration. The SBA specifically prohibits lending to cooperatives. SBA loan guarantees, supporting very high loan to value ratios, are not available to worker cooperatives.

Yet another barrier to worker cooperatives is the lack of technical assistance. While some states have been proactive in helping set up institutions to support employee ownership (e.g. the Ohio Employee Ownership Center and the Vermont Employee Ownership Center), the vast majority have not. There are also some excellent private technical assistance providers, including the ICA Group and the Southern Appalachian Center for Cooperative Ownership also represented by witnesses on this panel. In most areas of the country, however, few are knowledgeable about and are able to assist in the formation of worker cooperatives.

And finally, another barrier is the lack of understanding among the small business community about worker-owned cooperatives. The same section of the tax code—Section 1042—that provides significant tax advantages to business sellers who convert their companies to ESOPs also applies to company owners that sell to their employees as a worker-owned cooperative. Section 1042 allows business sellers to defer taxes on capital gains realized by the sale of their business to their employees in either form.

Though Section 1042 gave rise to the birth of thousands of ESOPs, the law has been rarely if ever used by small business owners to convert their companies to worker-owned cooperatives. For many small businesses—those with just a few employees—an ESOP is often not a viable option; it is too costly. Yet few small business owners, looking to exit their industry or retire, are even aware that they can sell their business to their employees as a co-op and defer capital gains. Those that are aware of worker cooperatives often have misperceptions about them. But selling their business to a worker cooperative can provide new and valuable succession planning options for the small business community.

There will be substantial economic gains for both business sellers and buyers if more small businesses took advantage of Section 1042's application to worker cooperatives.

Policy Supporting Worker Cooperative Development

NCBA believes it is sound federal policy to encourage the development of more worker-owned cooperatives in both urban and rural areas. Doing so will not only generate new wealth and ownership opportunities in some of our nation's most economically distressed communities, it will benefit the small business sector by retaining jobs and productivity in business that might have otherwise shut its doors after owners retired. The proven business performance results of employee-owned businesses also demonstrate that the growth and expansion of these businesses is good for the American economy.

While new legislation to create new financial tools for worker-owned cooperatives is needed, it is also important that existing federal economic development programs explicitly include development of worker owned cooperatives as eligible projects.

The legislation proposed by Congressman Sanders to create a U.S. Employee Ownership Bank is a welcome step in the right direction to address these barriers. While subordinated loans, loan guarantees and technical assistance offered by the proposed Bank are appropriate functions, we would also recommend tackling the issue of equity capital for workers starting up cooperatives. This is no easy task and would certainly require a substantial investment, but the payoff would likewise be substantial.

The legislative proposal should also eliminate the SBA prohibition on lending to cooperatives and even mandate that SBA offer its services to employee-owned businesses. In addition, SBA staff will need training and education in the structure, operation and value of employee-owned businesses, and in particular, cooperatives.

Richard Dines
June 10, 2003

While technical assistance is extremely important, it is questionable whether most state governments would be able to make good use of the grant funding the proposed Bank would distribute to support education and outreach, technical assistance, and training. Few states have the expertise on the worker-cooperative business form. We would recommend that the Bank make these grants to non-profit and cooperative organizations with experience in developing employee-owned businesses and worker-owned cooperatives. Organizations such as the Vermont Employee Ownership Center, the Ohio Employee Ownership Center, the CooperationWorks network of 17 cooperative development centers, the ICA Group, the Southern Appalachian Center for Cooperative Ownership, and many Universities do have sufficient expertise to provide the education and outreach that the proposed legislation envisions.

While states have little expertise with worker-owned cooperatives, they do have tremendous experience with small businesses. In this regard, states could be helpful in working to educate the small business community about the succession planning option of converting their businesses to worker-owned cooperatives by selling to their employees under the provisions of Section 1042. Rather than providing states with a primary role in education and training about worker cooperatives and other forms of employee owned businesses, the legislation could provide States with grants to conduct outreach to small business owners to educate them about Section 1042 and the options it provides them.

NCBA urges the committee to carefully define what a worker cooperative is. To truly be a cooperative, the members must own and govern the business and control a majority of the seats on the board. While outside investors, or the sellers of a business may retain a financial stake in the business, they workers must control the business. If they don't, it's not a cooperative.

We would also suggest that the Bank would benefit from ongoing counsel from the employee ownership and worker cooperative business communities. We recommend that any legislation providing the federal government with new functions to promote and support worker-owned cooperatives include the formation of an advisory council made up of representatives of the worker-owned co-op and ESOP community that would guide and support the work of the Bank.

Thank you, again Mr. Chairman and members of this Committee for this opportunity to testify.

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Prepared Statement of
J. Michael Keeling, CAE
President, The ESOP Association
To
Subcommittee on Financial Institutions
And Consumer Credit of
House of Representative
Committee on Financial Services

Hearing on Financing of Employee Ownership: An Overview

June 10, 2003
2:00 PM
2128 Rayburn House Office Building
Washington, DC

Summary of J. Michael Keeling, CAE
President of The ESOP Association
Testimony to Subcommittee on Financial Institutions and Consumer Credit,
"Financing Employee Ownership: An Overview"
June 10, 2003

Mr. Keeling will:

- Give brief description of employee stock ownership plans, or ESOPs;
- Cite statistical information on ESOPs;
- Describe most common reasons for and structures of ESOP transaction;
- Give view whether current financing is adequate to fund all, nearly all, or needed ESOP transactions;
- State view why hearing is important.

The ESOP Association has no federal government contracts or subcontracts, grants on subgrants of any kind.

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Statement of J. Michael Keeling, President, The ESOP Association
To Hearing of Subcommittee on Financial Institutions and
Consumer Credit of the Committee on Financial Services

Chairman Bachus, ranking member Congressman Sanders, and members of the Subcommittee. I am Michael Keeling, the President, or Chief Staff Officer, of The ESOP Association, a 501(c)(6) entity based in Washington, DC that represents over 2,400 members nationwide in both advocating for employee ownership through ESOPs, and in educating its members how to operate their employee ownership structure in a manner that maximizes company performance.

Your Subcommittee with jurisdiction over our nation's financing system goes to the roots of employee ownership through ESOPs.

To explain, using a deferred compensation plan recognized under our Federal tax laws to create employee ownership was perfected by the late Dr. Louis O. Kelso, who after years of agonizing over the suffering during the great depression, developed an economic theory to avoid the collapse of capitalism without turning to the oppressive system of Socialism, evidenced in the Soviet Union. Tax incentives for ESOPs were not, however, part of Dr. Kelso's original recommendations to create more owners in America. His core recommendations had to do with ensuring private lending institutions would be incentivized to grant employee ownership loans because of various Federal Reserve Board policies.

(There are tax incentives because his vision caught the imagination of the late Senator Russell B. Long, who served for years as chair of the Senate Finance Committee. As Senator Long often said, "Heck, the only reason there are tax incentives for ESOPs is because I was chair of the tax committee. If I had been chair of another committee, there would have been different incentives.") (Please See Attachment 1.)

So candidly, we ESOP and employee ownership advocates are today where we should be in the eyes of Dr. Kelso—we are before the Congressional committee that oversees our nation's financing system. And we are thankful and excited for this opportunity. We believe that your interest in employee ownership may open up a new chapter that hopefully leads to the 21st Century being the century of more equitable ownership.

My testimony will attempt to do the following:

One, share demographic information about ESOPs to explain who the ESOP companies are, and the trends over the past decade in terms of creating employee ownership through ESOPs.

Two, explain in more detail the common transactions that create ESOP, and some details about those transactions in terms of how they are structured.

Three, review, from my vantage point, the state of financing for ESOPs in America.

And finally, I will conclude with a statement why I believe employee ownership is a phenomena that will only become more prevalent, and why we need to get a handle on how employee ownership develops to help our people reach their potential.

First, though, let me make what is obvious clear. I believe in ESOPs and the vision of The ESOP Association.

Our Vision is "*We believe that employee ownership improves American competitiveness...that it increases productivity through greater employee participation in the workplace...that it strengthens our free enterprise economy and creates a broader distribution of wealth...and that it maximizes human potential by enhancing the self-worth, dignity, and well-being of our people.*

Therefore, we envision an America where employee ownership is widely recognized as a catalyst for economic prosperity...where the great majority of employees own stock in the companies where they work...and where employee ownership enables employees to share in the wealth they help create...

(Please See Attachment 2 that includes recent research highlighting the success of ESOP companies.)

Also, permit me to give a legalistic description of ESOPs, and the regulatory framework in which ESOP companies operate. ESOPs are tax qualified, deferred compensation plans that are primarily invested in employer securities, and unlike all other deferred compensation tax qualified plans, may, by statute, use borrowed funds to acquire the assets for the plans, the assets being employee securities.

Note that other tax qualified plans may, not must, be primarily invested in employer securities, but no other plan has the statutory green light to borrow money to acquire assets.

An example of tax qualified deferred compensation plans that have a similar structure to ESOPs are 401(k) plans. There are two classes of tax qualified deferred compensation plans: ESOPs, the 401(k)s, profit sharing plans, are all known as defined contribution plans. The other class is known as defined benefit plans, and are correctly referred to as pension plans.

All of these plans are governed by laws known as the ERISA laws, which is the set of U.S. laws that govern and regulate what is referred to the nation's retirement savings plans, or the so-called ERISA plans.

The primary Executive Branch regulators of ESOPs are the IRS and the Department of Labor's, Employee Benefits Security Administration. Nearly all ESOPs are audited by both of these agencies within ten years of ESOP creation to ensure that the complex laws and regulations governing ESOPs are complied with.

Of course, I could spend about eight hours describing all these laws and regulations governing ESOPs, but we are not here today for that purpose.

How many ESOPs are there, what kind of companies have ESOPs, and what trends have we witnessed?

I like to say that there are 10,000 corporations in America that sponsor employee ownership through an ESOP. You may see some figures including 11,000, or 12,500, or even 9,500, as frankly, no one really knows.

10,000 is a good number to stick with absent some major burst of ESOP creation as we saw in the mid-80's.

There are several reasons why it is not possible to know the true number of ESOPs; again, I could take at least an hour discussing this point.

Of the 10,000, I would estimate that 96 to 98% are sponsored by private companies, or companies that are not traded on any stock exchange. This mix is similar to the mix of the U.S. economy measured by the ratio of the public to private businesses.

Having said that, in the late 80's, there was a set of tax incentives that encouraged large public companies to set up ESOPs as their preferred tool of stock compensation. Those laws were changed in 1989, and in 1993 accounting standards were changed for ESOPs—a combination that motivated the large public companies to use either 401(k) plans to compensate employees with a stakehold in the company, or to use broad based stock option or stock purchase programs. Compensating employees with company stock, however, in one form or another, has been common in U.S. corporations since the 19th Century, long before the income tax laws.

Another point, if this nation decides that employee stock ownership is good, and should include a majority of Americans, as us ESOP advocates believe, then policies need to be developed that establish the best way to create employee owners in the large public corporations that employ nearly 50% of the American workforce.

As a side bar comment, federal laws since 1990 have promoted employee ownership in private companies, but not really in large public companies. While it is hard to argue that all the members of Ways and Means sat down in the late 80's and decided ESOPs were good in small private companies, and not so good in large companies, there is a definite image in the tax committees, and the labor committees of Congress, that employee ownership can create a very special environment in a workplace where management and non-management are up close and personal, but it is not so magical in companies operating around the world with thousands and thousands of employees. Let me assure you, however, there are leaders of large companies that reject with vigor the view that employee ownership is meaningless in their companies.

These 9,600 to 9,800 private ESOP companies are a little bigger than the average U.S. private company. We estimate based on our membership data probably those companies average 150 to 250 employees.

What kind of industries do these ESOP companies represent? Our data from a 2000 survey of our members indicates approximately 35% are manufacturing, 15% distribution, 12%

construction, 8% professional, and 7% services, with other industries represented by smaller numbers. We know that classifications are being altered, and fewer businesses are being labeled manufacturing. We also believe the number of ESOP companies in the service industry is growing, as this segment becomes a larger part of the American economy.

Why and how did these private ESOP companies come about?

Ever since the late 50's, when Dr. Kelso began to promote employee ownership, the most common reason for creating an ESOP has been to provide a buyer for an exiting shareholder of a private company.

Think about it, and any small business advisor will agree, at some point the owners of a private company have to convert their shares to cash, or as they say "take their chits off the table." The options for cashing in the stock of a private business are not particularly pretty—going public is out of the question for 80 to 90% of the small businesses because of size and culture, selling to a competitor can be very painful to someone who built a business from scratch, and liquidation is admitting failure. On the other hand, rewarding those who did so much to make the business a success, the employees, has a satisfying aspect. Since 1984, and enhanced in 1986, tax laws enacted by Congress make the ESOP exiting shareholder transaction the most favored of the ESOP transactions as measured by tax benefits. (Please refer to Attachment 3 for more information on the tax benefits related to ESOP exiting shareholders.)

As a result, our data indicates 75 to 80% of the ESOPs in America were created in what we call an exiting shareholder transaction.

The second most common transaction, and candidly in listening to Congressman Sanders' opening remarks, this transaction might be more direct to the concerns he has with American jobs being lost, is what we call the ESOP spin-off transaction. We have data that indicates about 20% of the ESOPs in America were ESOP spin-off transactions. For example, Congressman Sherman is familiar with such an ESOP company that used to be in his district — CPI, Inc., Chatsworth, California.

An ESOP spin-off transaction often follows this scenario: One day the plant manager gets a call from the home office of a big corporation saying, "You don't fit our strategic plan, or you don't make enough money," or something similar, and "We are putting you up for sale." After composing him or herself, the plant manager calls in the bookkeeper, or controller, to break the news, "We are on the block, and who knows what will happen to us." They talk, and will frequently say, "Boy, why can't we control our destiny, why can't we buy the company?" But, the two of them, or perhaps the top salesperson in addition, just do not have the credit or the cash on hand to buy such a business for $10 to $100 million dollars. So they say, "Let's talk to the union business agent," as often these are businesses that are unionized. So in come the union reps, and somehow or another the idea of employees and management buying through an ESOP develops. And it is done.

Now, there is a great deal of money spent, and blood, sweat and tears before the ESOP buys the plant, and today I think you will hear stories where the financing just did not work, as sometimes these plants are also in financial distress.

And while the majority of these 200 or so ESOP spin-off transactions per year do not involve a plant in distress, when it does, there can be trauma in the local community, and often the lenders insist on pay cuts and benefit cuts to help finance the ESOP.

Sometimes diversified 401(k) assets are used to help finance the purchase of the new corporation's stock, or rarely, but it has happened, pension plan assets are used. (This is a risky step under ERISA by the way.)

Let me note that when there is direct and immediate economic pain for employees in exchange for owning the company, the company will have a very big hurdle to get the majority of employees comfortable with employee ownership. The negativism about the employees owning the company through an ESOP will grow if after a few years business looks better, but wage and benefit concessions are not restored.

My last statements, by the way, can be applied to any analysis of United, Polaroid, Weirton, and many other unhappy ESOP stories, including Vermont Abestoes, to a degree.

And for the other 5% of the ESOP transactions that are out there, we just put them in the miscellaneous category. For example, the United ESOP creation does not fit into either of the two major categories, nor do the remaining handful of pure ESOPs in large public companies.

But we are reviewing financing, and how do common ESOP exiting shareholders transactions get financed?

Well, the financing for the vast majority of exiting shareholder ESOPs, is usually pretty simple, with the understanding that the sale of the major block of stock, particularly those having to comply with ERISA, tax, and general business law, can become very complex. Usually, the decision to create an ESOP exiting shareholder transaction involves the corporation going to a regular bank, taking a loan of less than $10 million, loaning that money to the ESOP, and the ESOP using the money to purchase the stock from the exiting shareholder. In smaller companies, the seller shareholder often guarantees the loan in addition to the corporation's agreement to pay.

Certainly, as the value of the transaction goes beyond $10 million, and we have seen ESOP exiting shareholder transactions in some cases go up to $100 to $150 million, you might have mezzanine financing in addition to the prime lender, and maybe even an investment banking firm that specializes in being a partial investor in an employee-owned structure. The remaining management may invest money in transactions of the size referenced.

Since a spin-off transaction might involve a business in trouble, another source of funds, might be local execs of the distressed company taking second mortgages, borrowing on credit cards, and the like, to help finance the purchase of the company. Also, in a distressed buyout, state economic development funds, are available, or the state can guarantee the loan. Sometimes funds for the key due diligence needed to convince other lenders to loan to the employee group comes from a state agency.

Let me note also, a unique lender to ESOPs, in both exiting shareholder transactions, and spin-off transaction, is the National Co-op Bank, or its affiliates. I believe the Co-op Bank somehow falls under the jurisdiction of this committee.

Before talking about whether money is available for ESOP transactions, let me note that there are really two ways to borrow money to purchase stock for an ESOP. And here, unfortunately, I might get into some insider baseball ESOP jargon. What we saw in the 1974 through 1986 timeframe were transactions that were not technically "leveraged" ESOPs, which means the ESOP was not a party to a borrowing transaction. The Association chair, George Ray, on the next panel, will give an example of the non-leveraged ESOP transaction. In this transaction, the company borrows money, buys stock from the exiting shareholder usually, puts the stock in the treasury of the corporation, and each year makes a contribution to, really, an old-fashioned stock bonus plan, which the law has sanctioned since 1921, that has value by creating a tax deduction more or less equal to the annual payment to the lender. I would say, and I feel comfortable in saying this, in 1984, out of the then 350 or so ESOP companies members of the Association, 80 to 85% were non-leveraged ESOPs.

Then, in 1984, and even more so in 1986, Congress created a slew of tax incentives for doing a leveraged ESOP. Some of these incentives were repealed or curtailed in the late 80's and early 90's. Attached is a summary of the current law tax incentives that are available for a leveraged ESOP. So, since 1986, our data shows that nearly 80% of our Association's members are leveraged ESOPs, or if they have paid off their debts, leverageable ESOPs.

What is meant here is that the ESOP obtains the block of stock all at once with borrowed funds that attaches debt to the stock that is held in suspense by the ESOP. As debt is paid, shares are released to the employee's accounts. The release is based on the acquisition cost of the shares, so with a leveraged ESOP, the employees gain the boost in share value as the leverage goes down, just like the Wall Street LBO dealmakers. (Please refer to Attachment 4 on ESOP Financing.)

On the other hand, as we see the capital gains tax rate go down, we may begin to see the 1974 to 1984 style ESOP come back, where the corporation takes the leverage, and the employees get the shares allocated not at the acquisition price, but at the market price. The non-leveraged ESOP has had fewer legal hassles compared to the leveraged ESOP under ERISA.

Is there money available for ESOP transactions? Please note my vantage point—most of the ESOP companies I deal with already have an ESOP, and are very successful companies, candidly, both before and after the ESOP was created.

But, I've been working with ESOP and ESOP situations since 1982. In the early 80's up until the mid-80's, it was not uncommon to get calls from lawyers, business advisors, and company executives, trying to do the basic ESOP exiting shareholder transaction, asking me, "where can we get financing?"

As the basic ESOP law has stabilized over the past decade, and as the outstanding track record of the vast majority of ESOP private companies becomes more obvious, most lenders, or many a bank, is willing to make ESOP loans.

Bluntly, I no longer get calls saying, "Where can I get money?" If I do, maybe one every two or three years.

I do know, however, that in the spin-off transactions, one does see problems with getting money for the feasibility and due diligence work that needs to be done to convince any lender to make a loan. I believe the other panel members will review some of these situations in more detail.

Before concluding, one cutback in law in 1989, and then another in 1995, did hurt the financing of ESOPs in general, and these spin-off transactions specifically, where perhaps underwriting a loan has more risk.

From 1984 until 1989, a lender could exclude 50% of its interest income from an ESOP loan from its (the lenders) federal income. From 1989 to 1995 the lender could exclude 50% of its interest income from federal taxes if the ESOP owned 50% or more of the company. You can imagine the lenders liked these tax incentives, and in the real world, competition among banks to do ESOP loans caused banks to offer loans at rates lower than similar loans to non-ESOP corporations. But the tax committees, needing revenue, thought this tax break for banks was inappropriate in the name of employee ownership.

May I also add we ESOP advocates believe that the accounting standards hinder ESOP financing, as the standards create balance sheets and income statement too different from the cash flow statements.

As with any business, financing issues for an ESOP company does not end with the creation of the ESOP.

The ESOP companies that are private, which are nearly all ESOP companies, have a unique financing issue – an obligation that grows bigger and bigger as the ESOP company matures, to convert the employees' stock to cash. We call this "repurchase obligation." Let us be clear. We want every employee to get fair market value for her or his stock when she or he leaves the company. But facts are facts – the majority of ESOP companies are so successful buying back the shares can after 5, 10, 15, 20 years can drain the company at the wrong time of needed capital. Financing this obligation currently is done out of cash flow, from cash contributed to the ESOP over ten years, or corporate owned life insurance, which of course is controversial. Some ESOP advocates speak of the need to create a semi-public fund to assist companies finance their repurchase obligations.

Finally, let me say again I am a believer in ESOPs. I believe the ESOP is the most efficient tool for creating employee ownership, and can be used by companies with a variety of cultures. In other words, the ESOP can do what we want with our drive to create a more equitable economy, to create a more humane workplace, and to enhance the potential of each individual without relying on a one-shoe-size-fits-all model.

Having said that, The ESOP Association has always prided itself in being reasonable and malleable in all of our public policy positions. I think you would hear that from our friends on the Ways and Means and Finance Committees—passionate, hard charging, yes, but reasonable when it comes to accepting that times change and laws change. As long as we are pointed in the direction of more employee ownership, we ESOP advocates will not fall on our swords over details.

And, the importance of getting it right for employee ownership is huge in my opinion. While what I am about to say might be more appropriate before the Education and Workforce Committee, I think the thought transcend any Congressional committee jurisdiction.

Think about it: Less than 160 years ago, in our own nation, sadly and tragically the relationship between owner and worker was often defined as owner-slave. At the turn of the 20th Century, if a man or woman belongs to a labor union, often he or she was beaten, or denied work. Less than 60 years later, the relationship between management and organized labor dominated how labor in all workplaces was treated in terms of pay and benefits. But then fifty years later, in 2000, less than 11% of the private work force belonged to labor unions, and with the growth of what Peter Drucker labels as the knowledge worker, there is no reason to expect this to change, absent new developments in the world of work.

So, what is the message? The message is that anyone who thinks that the relationship of owner, employee and capital remains the same, or that it can be reconstituted as it was even 25 years ago, that person just doesn't understand what is happening in the world of work.

Whether you agree with his politics, or his recommendations for tax laws and health care laws, I believe that Chair Bill Thomas said it best in the opening remarks he made on April 11, 2001, during the House consideration of the Enron-ERISA reaction legislation. I believe the basic statement is unassailable. He said,

"There has been a quiet revolution going on in the United States, and it was so quiet that a lot of people did not notice...The quiet revolution that I am talking about is the change that has occurred over the last half century, speeding significantly in the last third of the 20th century...that is...there is becoming less and less of a distinction between workers and owners. As...more and more companies are being owned by the workers."

So, distinguished members of the Subcommittee on Financial Institutions and Consumer Credit, you are right to say let's make sure that this trend of more employee ownership is financed properly, and that everyone, not just the tax committees, and the labor committees, get with the trend of growing employee ownership; and let us have the legal, financial, and accounting system that makes the Vision of ESOP advocates a reality.

Issue Brief

Attachment 1
ADVANTAGES FOR BUSINESS PLANNING

Introduction

In order to broaden the ownership of capital to provide employees with a stake in the ownership of their employing corporation and to provide a unique means of financing to corporations, Congress has granted a number of specific incentives meant to promote increased use of the ESOP concept. This is especially true for leveraged ESOPs, which through the use of borrowed funds provide a more accelerated transfer of stock to employees. These ESOP incentives provide numerous advantages to the sponsoring employer and can significantly improve corporate financial transactions. In 1997, Congress also created a unique tax incentive for S Corporations sponsoring ESOPs

Deductibility of ESOP Contributions

As with all tax-qualified employee benefit plans, contributions to ESOPs are tax deductible to the sponsoring corporation, up to certain limits. These contributions can be either in cash (which is then used by the ESOP to buy employer securities) or directly in the form of employer securities. Where employer securities are contributed directly, the employer may take a deduction for the full value of the stock contributed. By doing so, the employer actually increases its cash profits by the value of the taxes saved through the deduction.

The deductibility of contributions to an ESOP becomes even more attractive in the case of a leveraged ESOP. Under this arrangement, an ESOP takes out a cash loan from a bank or other lender, with the borrowed funds being paid to the sponsoring employer in exchange for employer securities. Since contributions to a tax-qualified employee benefit plan are tax deductible, the employer may thereafter deduct contributions to the ESOP that are used to repay not only the interest on the loan, but principal as well. This makes the ESOP an attractive form of debt financing for the employer from a cash flow perspective. Each year, the company can deduct contributions of amounts up to 25% of covered payroll, plus any dividends on ESOP stock (see "Deductibility of Dividends" below) that are used to repay the loan. Further, any contributed amounts used to repay the interest on the loan are deductible without any limit at all. [In an S corporation structure, the deduction would be limited to 25% of the plan sponsor's eligible payroll].

C Corporation ESOP Incentives*

ESOP Tax Deferred Rollover, or I.R.C. 1042 Transaction

An additional ESOP incentive available in C Corporation allows a shareholder, or shareholders, of a closely held company to sell stock in the company to the firm's ESOP and defer federal income taxes on the gain from the sale. In order to qualify for this "rollover," the ESOP must own at least 30% of the company's stock immediately after the sale, and the seller(s) must reinvest the proceeds from the sale in the securities of domestic operating corporations within fifteen months, either three months before, or twelve months after the sale. The seller, certain relatives of the seller, and 25% shareholders in the company are prohibited from receiving allocations of stock acquired by the ESOP through a rollover. Generally, the ESOP may not sell the stock acquired through a rollover transaction for three years.

The ESOP rollover provides a substantial tax advantage that might otherwise be unavailable to current or retiring owners of C Corporations. Normally, a direct shareholder's options would be to sell shares back to the company, if such a transaction is feasible, or to sell out to another company, either for cash or for a block of shares in the other company. Selling to an ESOP, on the other hand, allows the seller to exchange interest in the company for a safely diversified portfolio of securities--or the stock of a single new company--without paying any taxes on the transaction. The seller's tax basis in the employer stock which were sold will be carried over to the replacement property. If the replacement property is held until death, however, a stepped-up basis for those securities is provided under current established tax laws.

In addition to the substantial tax advantages, selling to the ESOP preserves the company's independent identity. A sale to an ESOP also provides a significant financial benefit to valued employees and can assure the continuation of jobs. Moreover, selling to an ESOP allows the seller to sell all or just a part interest in the company, and to do this gradually or all at once.

To qualify for rollover treatment, the stock sold to the ESOP must be common or convertible preferred stock of a closely held domestic corporation and must have been owned by the seller for at least three years.

Often this type of transaction is referred to as a 1042 transaction, because Internal Revenue Code Section 1042 establishes this unique tax benefit.

Deductibility of Dividends

Employers structured as C corporations are also permitted a tax deduction for certain dividends paid on ESOP stock. The deduction is available for dividends paid in cash to employee. Beginning January 1, 2002, the deduction is available for dividends on ESOP stock the individual elects to reinvest back to the plan for more company stock. This provision allows companies to share current benefits of stock ownership with their employees to complement the long-term benefits of capital ownership. Dividends paid to employees are taxable as current ordinary income to employees.

A deduction is also available for dividends paid on ESOP leveraged stock to the extent that the dividends are used to reduce the principal, or pay interest on an ESOP loan incurred to buy that stock. Dividends used in this manner are not counted towards the 25% contribution limit for leveraged ESOPs. Some ESOPs have purchased convertible preferred stock rather than common stock to assure a relatively reliable stream of dividend income to be used in servicing the loan.

These tax-deductible ESOP dividends are sometimes referred to as 404(k) dividends, because Internal Revenue Code section 404 (k) established this unique tax incentive.

*A C Corporation is liable for federal income tax imposed on the corporation's taxable income

S Corporations*

Beginning in 1998, when an ESOP is a shareholder of a S Corporation, the federal tax or its share of its S Corporation sponsor's taxable income is deferred until distributions to the ESOP participants. This statutory provision means that an S Corporation owned 100% by an ESOP pay no current federal tax on its income. And, even if not 100% owned by an ESOP, the S corporation with an ESOP is able to have long-term deferral of federal taxes as its income pro-rated to the ESOP. [Note, complex anti-abuse rules govern this unique ESOP incentive, and close review is required before utilizing the incentive].

*The individual shareholders of an S Corporation are liable for federal tax on each pro-rated share of the S Corporation's taxable income – i.e. there is no federal corporate income tax on S Corporation taxable income.

For further information on any of the aforementioned research, please contact The ESOP Association at 202-293-2971 or via email esop@esopassociation.org

The ESOP Association

Attachment 2

Employee Ownership and Corporate Performance

1. The most comprehensive and significant study to date of ESOP performance in closely held companies was conducted by Dr. Joseph R. Blasi and Dr. Douglas L. Kruse, professors at the School of Management and Labor Relations at Rutgers University, and funded in part by the Employee Ownership Foundation. The overwhelmingly positive and remarkable results indicated that ESOPs appear to increase sales, employment and sales/employee by about 2.3% to 2.4% over what would have been anticipated, absent an ESOP. According to Dr.'s Blasi and Kruse, ESOP companies are also more likely to continue operating as independent companies over the course of several years. In addition, it is substantially more probable that ESOP companies have other retirement-oriented benefit plans than comparable non-ESOP companies.

2. In 2002, The Employee Ownership Foundation, conducting its 11th Annual Economic Performance Survey, found that approximately 71% of ESOP Association company respondents had outperformed both Dow Jones Industrial Average (DJIA), as well as the NASDAQ, in 2001. In addition, for the 11th consecutive year, a majority of surveyed ESOP companies cited an overall increase in productivity and performance, as well as reported that ESOP implementation was a good decision for the company. This survey was conducted in summer 2002 among corporate members of The ESOP Association.

3. Research done by the Washington State Department of Community, Trade and Economic Development of over 100 Washington not publicly-traded ESOP companies compared to 500 not publicly-traded non-ESOP companies showed that the ESOP companies paid better benefits, had twice the retirement income for employees, and paid higher wages than their non-ESOP counterparts. Wealth and Income Consequences of Employee Ownership: A Comparative Study from Washington State, Kardas, Peter A., Scharf, Adria L., Keogh, Jim, November, 1998.

4. Research conducted by Professor Hamid Mehran, while he served on the faculty of the J.L. Kellogg Graduate School of Management, Northwestern University, of nearly 400 publicly traded companies with significant ESOPs both before and after the adoption of the ESOP, compared to non-ESOP companies in similar lines of businesses, showed that the rate of return for the ESOP companies was 2.7% higher, 60% of the ESOP companies experienced share price increases upon announcement of the ESOP program, and 82% indicated that the ESOP had a positive impact on business results.

5. In 1995, Douglas Kruse of Rutgers University examined several different studies between ESOPs and productivity growth. Kruse found through an analysis of all studies that "positive and significant coefficients [are found] much more often than would be expected if there were no true relation between ESOPs and productivity." Kruse concludes that "the average estimated productivity difference between ESOP and non-ESOP firms is 5.3%, while the average estimated pre/post-adoption difference is 4.4% and the post-adoption growth rate is 0.6% higher in ESOP firms. Kruse cites two studies as part of his research: Kumbhakar and Dunbar's 1993 study of 123 public firms and Mitchell's 1990 study of 495 U.S. business units in public firms. Both reports found significant positive effects of greater productivity and profitability in the first few years after a company adopted an ESOP.

6. In 1995, the U.S. Department of Labor released a study entitled "The Financial and Non-Financial Returns to Innovative Workplace Practices: A Critical Review." This study found that companies that seek employee participation, give employees company stock and train employees can positively affect American corporations' bottom lines. In addition, the report cited three studies that analyzed "the market reaction to announcements of ESOPs which found significant positive returns to firms which implemented ESOPs as part of a broader employee benefit or wage concession plan." The three studies are: Chang's 1990 "Employee Stock Ownership Plans and Shareholder Wealth: An Empirical Investigation"; Dhillon and Ramirez' 1994 "Employee Stock Ownership and Corporate Control"; and Gordon and Pound's 1990 "ESOPs and Corporate Control." citation at (202) 293-

2971 or E-mail: esop@esopassocation.org.

For further information on any of the aforementioned research, please call The ESOP Association at 202-293-2971, visit www.esopassociation.org, or via e-mail esop@esopassociation.org.

Issue Brief

Attachment 3

THE ESOP TAX-FREE ROLLOVER, OR 1042 TRANSACTION FOR C CORPORATIONS

One of the most effective tax provisions passed to encourage the growth of ESOPs is the tax-free rollover, allowed to certain shareholders or groups of shareholders in privately-held companies who sell stock to an ESOP. Note, this tax provision is available only if the stock involved is stock of a C Corporation.

This issue brief provides a summary of the mechanics and rules of the tax-free rollover and related matters. (Often referred to as a 1042 transaction, after the Internal Revenue Code Section that governs the transaction.)

Why Sell To An ESOP?

A retiring owner, or shareholder of a privately-held C Corporation who wishes to sell his or her stock, faces some potentially unwelcome choices. Often the seller is forced to choose between selling to outside investors, if any are available; exchanging stock with another company in a merger; or selling stock back to the company, if such a transaction is feasible.

None of these options is taxed as favorably as a sale to an ESOP. And unlike a sale to an ESOP, any other choice may result in unwanted consequences for the company's independent existence and the jobs of employees. A rollover sale to an ESOP establishes a market for future selling shareholders, rewards current employees, and maintains the independence and local ownership of the business. A sale to an ESOP allows an owner to sell out gradually, withdrawing from the business to whatever extent desired, or quickly.

Structuring An ESOP Rollover

A shareholder who sells qualified securities to an ESOP incurs no taxable gain on the sale if two conditions are met. First, immediately after the sale the ESOP must hold either 30% of each class of outstanding stock of the corporation or 30% of the total value of all classes of outstanding stock issued by the corporation. Second, within a 15-month period beginning three months prior to the date of sale, the seller or sellers must purchase qualified replacement property. If the cost of the replacement property is less than the amount derived from the sale of securities to the ESOP, the difference is currently taxable.

For purposes of meeting the 30% requirement, sales of qualified securities by two or more parties may be treated as a single sale if these sales are part of a single transaction. Once the 30% requirement is met, a shareholder who sells any amount of stock to the ESOP in the future is eligible for the tax-free rollover.

The rollover must be elected in writing on a timely filed tax return for the taxable year of the sale. Temporary Treasury Regulations Section 1.1042-1T sets forth the procedure for making the "statement of election" of tax-free treatment and the "statement of purchase" of the new securities.

The seller's basis in the new securities will be adjusted by the amount of gain not recognized as a result of the election. Also, the holding period of the employer securities is "tacked on" to the holding period of the replacement securities. In other words, if the seller bought or received company's stock in year 1 at $10 per share, and sells it to an ESOP in year 10 at $100 per share, the taxable basis in the replacement property is reduced from $100 to $10, and the seller is considered to have held that replacement property for 9 years, for tax purposes. If the replacement securities purchased with that $100 then rises in value to $200 over the next six years and are sold in year 15, the taxable gain is $190, not $100, and the seller will be considered to have held those shares for 15 years, not six years.

Thus the ESOP rollover allows a selling shareholder to defer, not eliminate, taxes on the sale, enabling the seller to invest and earn with money that would have been taxed away. If the replacement property should go into the seller's estate, however, then its basis will be "stepped up" to the property's current value, and the tax on the sale will effectively have been eliminated.

Defining Some Terms

Two technical phrases need to be defined. These are "qualified securities" and "qualified replacement property".

"Qualified securities" are those securities that may be sold to an ESOP. In a privately-held company these include common stock of a C Corporation with voting and dividend rights equal to the classes of common stock having the greatest voting and dividend rights, which is issued by a domestic corporation with no outstanding securities readily tradable on an established securities market. The securities must have been held by the seller for at least three years and cannot have been received by the seller in a distribution from a qualified retirement plan or a transfer under a stock option granted by the company.

"Qualified replaced property" includes any security issued by a domestic (or U.S.) operating corporation that is not the corporation that issued the qualified securities that were sold to the ESOP (or a member of the same controlled group of corporations), and which does not receive more than 25% of its gross receipts during the taxable year in which it is purchased from passive investment (this requirement disqualifies mutual funds). Government securities, and securities acquired by an underwriter, do not qualify. An operating corporation is one whose assets are used in the active conduct of a trade or business. Passive investment income has the same meaning as under the S corporation rules. The replacement securities must be acquired by purchase. Securities acquired by way of gift, inheritance, or property transfer pursuant to a stock dividend don't qualify.

When qualified replacement property is sold, the gain is currently taxable, and may not be deferred by selling to another ESOP, and investing in new qualified replacement property.

Restrictions On The ESOP Stock

No portion of the assets attributable to qualified securities sold to an ESOP through a tax-free rollover may be allocated to the taxpayer seeking tax-free rollover treatment, any person who is related to that taxpayer, or any other person who owns more than 25% of the value of any class of qualified securities of the issuing corporation. If the ESOP disposes of the acquired employer securities within three years after acquiring them, a 10% excise tax is imposed on the employer. The excise tax applies if the total number of shares held by the ESOP is less than before the disposition, or if the value of the ESOPs's share of the company ceases to meet the 30% requirement.

For further information on any of the aforementioned research, please contact The ESOP Association at 202-293-2971 or via email esop@esopassociation.org

Issue Brief

Attachment 4

ESOP FINANCING

Introduction

Using an ESOP in conjunction with debt financing has so many unique characteristics that it is called "ESOP financing." In this issue brief, some of the basic characteristics of ESOP financing are discussed and compared with conventional debt financing. In many financing situations, ESOPs have very desirable advantages.

An ESOP qualified under Sections 401(a) and 4975(e)(7) of the Internal Revenue Code is the only type of employee benefit plan which may be used to borrow money, provided that the loan is primarily for the benefit of the participants, the interest rate is reasonable and the only collateral the ESOP offers is the qualifying employer securities purchased with the loan proceeds. The general outline is simple: the ESOP borrows money and purchases an agreed upon number of shares at their fair market value from the employer or existing shareholders. The shares purchased with the borrowed funds are placed in a suspense account, and may be used as collateral for the loan. As the loan is repaid, the shares in the suspense account must be released from pledge, and allocated to individual employee accounts on a pro rata basis.

In the basic leveraged ESOP three different structures are possible. In the first case, the ESOP simply gives a note to the lender. This note is usually accompanied by a guarantee from the employer that it will make contributions to the ESOP sufficient to enable it to amortize the loan, and may be secured by a pledge of the ESOP's newly acquired shares, or, if the lender requires it, a pledge of the corporation's assets.

Second, if the lender prefers, the loan may be made directly to the corporation, and the corporation may then make a "substantially similar" loan to the ESOP. This may reassure some lenders who are uncomfortable about lending directly to ESOPs.

A third alternative involves the company making the loan, but instead of reloaning it to an ESOP, the company simply sets up a non-leveraged ESOP and makes contributions of stock to it over the years of loan repayment which equal the amount of the loan payment. This allows the company to receive the cash flow benefits of ESOP financing below and also results, in a company with a rising value in the ESOP, holding a smaller percentage of the company at the end of the loan repayment than in the first two cases.

All three of these alternatives share the cash flow benefits of ESOP financing that are described below.

The Cash Flow Benefits of ESOP Financing

The most fundamental characteristic of ESOP financing is that it increases the total cost of borrowing but significantly decreases the cash cost of borrowing. This results from the fact that principal payments as well as interest payments are deductible when repaying an ESOP loan, and that ESOP financing involves transferring employer stock to the ESOP.

A brief example will serve to illustrate the cash flow benefits of ESOP financing. Suppose a company, taxed at the 35% rate, wants to borrow one million dollars. The firm arranges conventional financing at 10% interest and makes annual equal principal payments over five years. In exchange for $1 million, the corporation assumes debt repayment obligations which look like this:

Conventional Debt Case
(1000s)

	(1)	(2)	(3)	(1+2+3) After-Tax Cash
Year	Principal	Interest	Deduction	Cost
1	$200	$100	($35)	$265
2	$200	$80	($28)	$252
3	$200	$60	($21)	$239
4	$200	$40	($14)	$226
5	$200	$20	($7)	$213
Total	$1000	$300	($105)	$1195

In contrast, if the company had used a leveraged ESOP to accomplish the same purpose, its repayment obligations would look like this:

ESOP Financing Case
(1000s)

	(1)	(2)	(3)	(1+2+3) After-Tax Cash
Year	Principal	Interest	Deduction	Cost
1	$200	$10	($105)	$195
2	$200	$8	($98)	$182
3	$200	$60	($91)	$169
4	$200	$40	($84	$156
5	$200	$20	($77)	$143
Total	$1000	$300	($455)	$845

What is not shown in the chart above is in the ESOP financing case the ESOP ends up with $1 million in stock. Thus, the total after-tax cost of the ESOP financing is $1,845,000 as opposed to $1,195,000 for the conventional debt, but the after-tax cash cost of the ESOP financing case is only $845,000, less than the face value of the loan.

From a lender's perspective that is $350,000 pre-tax dollars the company does not have to earn to repay the loan. In other words, ESOP financing makes a company better risk for a lender, because the loan is amortized entirely with pre-tax dollars, which enhances the company's ability to repay the debt considerably.

Conclusion

ESOP debt will lower net earnings and net profits during the period of loan amortization because the cost of interest plus principal plus ESOP contribution exceed the interest and principal payments of conventional financing. Cash flow, however, is greater than it would have been with conventional debt financing; thus an ESOP loan enhances a company's debt servicing ability.

For further information on any of the aforementioned research, please contact The ESOP Association at 202-293-2971 or via email esop@esopassociation.org

Statement of David K. McCune To: The Financial Institutions & Consumer Credit Subcommittee of the Committee on Financial Services U.S. House of Representatives On The Employee Ownership Bank Act Washington D.C. June 10, 2003

Good afternoon, I am David K. McCune, United Steelworkers Local 1124-01 Unit Chairman representing the employees of a longstanding stainless steel cold rolling facility last known as Massillon Stainless Inc., located in Massillon, Ohio.

I am here today to provide you a history of our facility, along with a brief summary of our ongoing efforts to save and reopen the facility in which we worked. For you see we have fought for the last several years to keep our facility operational, not only because of our jobs there, but also because we believe we fight for a *piece* of American history.

The facility in which we worked was originally part of the old Republic Steel Corporation. At that time we were known as the Enduro Division of Republic Steel. Our facility was the first all-encompassing manufacturer of stainless sheet and strip in the United States. It at one time had the ability to produce stainless sheet and strip in widths ranging from 3/8" to 60" wide, and in gauges from .009 to .310. For many, many years we were the only stainless facility in the world with 60" capability.

As I alluded to earlier, we consider our plant, our facility, as being part of the history of America. Much of the product that was manufactured in our facility over these past many years contributed to some of the most famous landmarks of our Nation, has aided in the arming of our forces during war, along with supplying normal everyday businesses as well.

If you ever had the opportunity to visit the former World Trade Center, the Twin Towers if you will… When you stood in that big, beautiful shiny lobby… That shiny stainless steel was produced in our facility.

If you have ever visited the Empire State Building… Again, the shiny stainless steel trim, not to mention some of the unseen heavy construction material was produced in our facility. The same can be said in regard to the Chrysler Building.
For we produced the shiny ornamental stainless you see in and on that building as well.

These are just a few examples of *our* contribution to *our* Nation's history.

Our facility also contributed to the arming of our fighting forces in WWII, Korea, and Vietnam. We feel that as workers in this facility that we have through the production of high quality stainless armor plate contributed not only to our Nation's, but many other Nations of the World's freedom as well.

And as I mentioned earlier our product is seen by nearly all of you depending on your health, and your eating habits possibly on a weekly if not daily basis.
When you are sick, need care, and have to visit your Physician, these patient care facilities quite probably contain stainless steel produced in our facility.
Many, many, of the hospitals and doctors' offices east of the Mississippi river quite probably utilize stainless steel produced in our facility in their patient care facilities through many, many different applications.

The same can be said for those of you that might occasionally eat at a McDonald's Restaurant built prior to 1999. The stainless steel you see being utilized as countertops and in the serving area, anywhere you might see stainless in a McDonald's Restaurant east of the Mississippi river was more likely than not produced in our facility.

So I believe you might understand with our contributions to our Nation's building history, our contribution in providing armor plate to our forces in time of war, along with our contributions

to people's everyday lives, why we are proud of, and willing to fight for the continued existence of the facility and our jobs there.
We, and by we I mean not only those of us that still hold out hope of reopening the facility and working there again, but also because so many of us are second and even third generation steelworkers of the facility, we believe we fight for our Fathers and Grandfathers as well.

We believe we fight not only for a manufacturing facility but also for a *piece* of American history. A history that not only we, but a history that our Fathers, Grandfathers, and yes, even our some of our Grandmothers contributed to through these many, many years of stainless production in Massillon, Ohio.

It is because of our willingness to continue to fight for survival that I am here today. For I truly believe had a *vehicle* such as The Employee Ownership Bank existed last year when I was first made aware of the financial position of the company, we would still be in operation today rather than hoping and praying that our last interested entity steps forward, purchases the facility, and in the process saves our jobs and a piece of <u>all</u> of our American history.

I will share with you a brief history of our most recent efforts to save the facility, along with why I believe we were unsuccessful, at least to this point, in saving the facility.

Last April through a joint Labor / Management Steering Committee, the employees were notified that the Company's financial position was eroding and that cost-cutting measures would need to be implemented. At this point, as I had nearly since the initial purchase of the facility by Jindal Strips ltd., I inquired of their interest in a possible ESOP of the Company, but I believe due to our cultural differences, the ownership was unwilling to explore, as they had been unwilling before, a shared ownership of the Company with the employees. You see, Jindal is a company from India where employee involvement is well… Taboo.

Most people were amazed I was able to get the management group to involve themselves in a team-based work system; no one was surprised I could not convince them to share in the

ownership of the facility. Until… July of last year when management approached me with their willingness to explore the possibility of an ESOP.
It was at this time we requested representatives of the Ohio Employee Ownership Center come to the facility and explain the *how's* and *why's* ESOP companies make sense.

At this meeting, it was decided that a pre-feasibility study should be performed and that it's findings would determine what course if any could be taken to save the facility and our jobs. The pre-feasibility study rendered a decision that the Company had waited too long, the business was now in dire straights and that an ESOP was at this time not an option. It was also at this time our efforts became a "Save The Facility" effort through the hopeful identification of a Strategic Partner.

We followed the guidelines set forth by the OEOC and after interviewing several firms it was jointly decided that Locker Associates headquartered in New York City presented us the best opportunity to identify a potential strategic partner.
Locker Associates contacted many entities and were in the process of identifying a potential partner when the Owner/CEO of Jindal Strips ltd. arrived at the facility and informed everyone he no longer desired to be part of the facility in any capacity, and shortly thereafter announced the impending shutdown of the facility. This was last September.

At this point the effort to save the facility by now identifying a purchaser became an "Employee Only" effort.

Rather than bore you all with the many ups and downs we have endured these past several months, I will give you but one example of how had an Employee Ownership Bank existed why I believe we would be operational today…
Locker Associates identified a long-standing domestic Company that was willing to purchase the facility and in the process include the employees in ownership *of*, but because of the financial climate not only in the Country, but in the Steel Industry in general at the time, this

entity was unable to identify a lending institution willing to invest in a shutdown stainless cold rolling facility.

Ladies and gentlemen, it is at this point that I truly believe had a *vehicle* such as the proposed Employee Ownership Bank existed we would have been able to jointly purchase our facility in a partnership with this entity. But because no such *vehicle* exists, I find myself out of work and hoping that as I indicated earlier our last interested party will step forward and purchase the facility and save our jobs.

But, should they decide to not purchase... Our jobs and a *piece* of our American history will cease to exist forever. The site will be razed, the equipment sold, most likely to a Third World nation, and the machinery that has produced material that has fought three wars, aided in the construction of some of this Nation's most notable Buildings / Landmarks, will be producing stainless steel in another country only to be shipped back into our Country at the cost of American manufacturing jobs.

I appreciate everyone taking the time here today to listen to the story of our plant, and of our most recent fight for survival, but most importantly that you are here today to hopefully take a giant step in the direction of creating a *vehicle* that will help workers of this Nation help themselves now, and into the future.

Sincerely,

David K. McCune
Unit Chairman
U.S.W.A. Local 1124-01
Massillon, Ohio

Subcommittee on Financial Institutions and Consumer Credit
Hearing on " Financing Employee Ownership Programs: An Overview"
Tuesday 10 June 2003

WRITTEN TESTIMONY OF JAMES D. MEGSON

EXECUTIVE DIRECTOR, THE LOCAL ENTERPRISE ASSISTANCE FUND

Thank you for giving me the opportunity to testify today at this hearing on expanding employee ownership and providing financial incentives to employees in order to create Employee Stock Ownership Plans and Worker Owned Cooperatives.

My name is James Megson. I have worked in the field of employee-ownership for the last 16 years. For fifteen years I served as Executive Director of the ICA Group, a non-profit organization dedicated to creating employee-owned companies to save and create quality jobs. For the last year I have served as the Executive Director of ICA's sister organization, the Local Enterprise Assistance Fund (LEAF), a US Treasury Certified Community Development Financial Institution that provides debt and equity financing to employee-owned companies.

LEAF and ICA have been involved in the creation of more than 50 employee-owned enterprises employing over 7,000 people. We work with community groups in inner city areas to create worker cooperatives. We work with unions and employees who are about to lose their jobs due to a business closing, to buy their companies. And we work with the owners and employees of small and medium sized businesses to share some or all of the ownership with the employees.

Employee-ownership is a powerful tool. It enables ordinary men and women to share in the benefits of capitalism and links very directly the rewards they receive with their own efforts. However, in addition to being good for our society and, I believe, the health of our democracy, employee-ownership is sound economic policy.

Over the past 15 years a number of academic studies have demonstrated that employee owned companies outperform their conventionally structured counterparts. A recent publication by Blasi and Kruse of Rutgers University, and Bernstein, a writer for Business Week summarizes these findings. Looking at every significant study of broad based employee ownership over the last two decades they found that broad based employee ownership boosts company productivity by 4%, shareholder return by 2% and profits by 14% over what otherwise would have been the case.

Employee ownership also makes a significant contribution to our economy by reducing job loss in two significant areas – small closely held firms that close due to inadequate succession planning and viable divisions of larger corporations that are closed for strategic reasons.

Small business owners who wish to retire frequently find a limited market for their enterprise. Studies show that a significant proportion of these businesses are lost either by being rundown slowly before the owner retires or by being liquidated. The result is that a significant proportion of small, successful businesses are closed and jobs are lost while a potentially interested buyer – the employees – is close at hand. While some businesses are preserved through a sale to the employees many are lost simply because the business owners and employees are not fully aware of this option. Many of these businesses and jobs could be saved if more information on sales to employees were available to small business owners and employees.

When a large corporation closes a major facility, or division, hundreds of well paying jobs are often lost. If the enterprise is no longer economically viable this is inevitable. Frequently however, other factors including the intent of the parent to focus on certain core competencies, relocation of the factory overseas, or the failure of the enterprise to meet target levels of return, drive the decision. Often in these situations the employees could, with just a little support, use an ESOP or Worker Cooperative to buy the enterprise and save their jobs.

Widening employee ownership through the creation of more Employee Stock Ownership Plans and Worker Cooperatives will create significant benefits for our economy and our society, both by saving jobs that would otherwise have been lost and by making existing companies more productive and profitable.

Given their proven benefits why aren't there more employee-owned companies in the US today?

I believe that this is due to a number of factors.

1) Despite the best efforts of its promoters, the employee ownership option is not widely known or understood by small business owners, employees, unions, state and local economic development organizations and community groups. To my knowledge only two states – Ohio and Vermont - currently have organizations that have pro-active outreach programs and provide resources and assistance on employee ownership to local companies. The Vermont Employee Ownership Center just held its first annual conference on employee ownership. They attracted more than 90 businesses of which about 80 say they are now considering this option.

2) A second barrier that employees face is the cost of putting together an employee buyout. Employees in troubled companies, who wish to explore the option of buying their company, division or factory, face a formidable task. They need to know if a buyout is a feasible option and, if it is feasible, how to go about raising the money and putting together a team to buy and run the enterprise. With few resources and little knowledge of the tasks involved most give up. In a few rare cases trade unions or states provide money to fund the necessary feasibility studies, business planning and financial packaging. As no funds are readily available to meet this need these efforts take time to arrange and precious time is wasted, ultimately making an employee buyout much more difficult.

   However when these difficulties can be overcome and a company is saved the return on investment is spectacular. Some years ago ICA assisted the employees of Market Forge, a manufacturer of kitchen cooking equipment in Everett, Massachusetts buy their company when the parent decided to close it. The state, the United Steelworkers of America, and the parent company each contributed $10,000 to fund a feasibility study and the employee buyout effort. 150 well paying jobs that provide generous health and pension benefits were saved. Since that time employees have built up significant equity in the company and the company is currently returning about $500,000 a year to the state in individual and state taxes. The initial money the state invested in supporting the employee buyout has been returned many, many times over.

3) A third and critical hurdle employee groups face is assembling financing. When a business owner is prepared to sell the company to the employees over a period of several years the current ESOP and Worker Cooperative structures can be used very effectively to achieve this end. However when the employees are faced with the purchase of a majority of an enterprise either because the seller wants to do this or because the enterprise will otherwise close, it is extremely difficult.

   In a typical transaction a bank will provide acquisition financing in the form of senior debt, but will limit that financing to the liquidation value of the available collateral. This leaves the employee group to find the balance of the necessary financing in the form of subordinated debt and equity. While some employees often do make an equity investment, the employee group as a whole rarely has the resources to meet more than a very small part of the need. A few equity funds now exist that are prepared to invest in employee-owned companies. However in order to meet their return objectives they are never, in my experience, able to provide the balance of the financing necessary to complete the transaction. The employee group must seek subordinated debt to fill the gap and this is extremely difficult to find. Community development financial institutions like the Local Enterprise Assistance Fund fill this gap for some smaller transactions but our resources are miniscule relative to the need.

   Subordinated debt is often the critical piece in closing the financing gap for a buyout. In 1992 LEAF and ICA worked with the employees of a mold-making factory in Pittsfield, Massachusetts to buy the company after the owner, Tredegar Industries decided to close it. At that time Pittsfield had an unemployment rate of more than 20%. In a relatively short time we were able to develop a strong business plan, get commitments from potential customers, and assemble a management team and board for the new employee-owned company. Assembling the necessary financing was extremely difficult. The eventual financing package included the local bank as the senior lender, two equity investors and no fewer than four subordinated debt lenders, all stretched to their maximum limits. However the time it took nearly sank the deal. The employee owned company opened as Marland Mold in 1993 with 35 employees and had grown to 88 employees by 2001. During this time it paid off all its initial debt, bought out the equity investors, moved into a new custom build factory, increased its share price by an average of 20% per annum and returned almost $2 million to the state in company and individual taxes.

The employees of Marland Mold were fortunate. Other employee buyout attempts often fail due to the difficulty in filling the gap between the need and what a senior lender and equity investor are prepared to invest. For example: In the spring of 2002 we worked with the employees of a machine tool manufacturer in Vermont. The company had a strong brand name and customers who wanted to continue to order from the new company. The employee group had identified an outside equity investor and a bank prepared to provide the senior debt. However no financing institution could be found to provide subordinated debt financing. As a result the employees were unable to buy the company and 350 well paying jobs were lost in a struggling area of Vermont.

An Employee Ownership Bank that provided loan guarantees and subordinated debt financing would significantly help employee groups wishing to buy their companies using Employee Stock Ownership Plans or through Eligible Worker Owned Cooperatives. The provision of the loan guarantees to senior lenders would enable them to increase the amount they could lend to the employee group without unduly increasing their risk. There would still be a need for subordinated debt financing from the Bank but it would be less than would be the case if there were no guarantees on the senior debt.

In summary I believe that a Federal Government program to encourage the expansion of employee owned businesses in the United States through the provision of loan guarantees, subordinated loans, technical assistance and outreach programs will yield a very high rate of return. Some of this return will come from the jobs saved at factories that would otherwise have closed or small closely held businesses that were in danger of closing due to inadequate succession planning. The majority will come from expanding the number of companies that, because they are owned by their employees, will experience a 4% increase in productivity, a 2% increase in shareholder return and a 14% increase in profitability.

Testimony of
Larry Owenby
Brevard, North Carolina

Members of the subcommittee:

I would like to thank you for the invitation to express my views on ways that the working people of our country can become more self sufficient and less dependent.

In August 2001 our mill was sold to a foreign entity that immediately went into contract negotiations with plans to cut wages and benefits by 30%.

Throughout these times we were told that cuts had to be given in order to maintain the level of business that we were accustomed to. Also we were told these cuts would be rewarded back to us in due time. After some investigation of this new owner, it was learned that not only were they trying to destroy our mill but were also in court for spending pensions from another mill that was previously owned by them.

In trying to save our jobs and the impact that would occur should we lose the mill, we tried to raise money to buy the now struggling facility from certain doom. We learned the hard way that when it cam to finding investors who were willing to put up money for a money for a long term was nearly impossible.

Our argument was a very simple one. Who else but the people that had spent 20 to 30 years inside that mill were capable of carrying on a tradition that had been very fruitful for more than 60 years. These people knew the markets, they knew the machines, and they knew the customers.

This mill through feasibility studies was still a very viable site and had potential for many types of new markets. It was also turning 1-ml in profit every month.

Because of a term labeled" labor dispute", the owner put the mill into bankruptcy after raping all assets that could possibly be sold. This created another problem for the workers, how could we show investors that knew nothing about this business that it was still a viable mill?

We, through our local union, our national union, and local politicians began the process of trying to find other companies that had the same interests in business that we had. There were two such companies that took notice of the situation, one was our strongest competitor, the other wasn't really sure about the investment capital that had to be spent.

While all this was occurring, the site itself became more involved on court litigations while the important parts of the operation were slowly wasting away. We began to lose customers because they needed the security that we could no longer provide. We lost important vendors that were not being paid. We lost important staff that couldn't risk the loss of revenue.

And we also began losing hope.

We were asked by the media and some of you may be wondering why we didn't try to settle instead of putting everything in jeopardy?

As I have already stated, after our investigation this was normal procedure for the new owner.

This put us back at square one, with only the people that we had asked to help, trying to find ways to get investors.

Because of the nature of our mill, this downtime put a strain on all the environmental systems, causing some concerns from E.P.A. and the N.C. Attorney Generals Office. Therefore creating even more problems for potential investors.

This brings to date what has happened now. We are currently a dead mill with no hope of ever starting up again. We have over the last three years lost more than one thousand jobs in western N.C., this could have been prevented had we had the opportunity to find the funds to save our mill when we first began to seek the assistance that was needed.

I urge you to take into careful consideration the bill that you are discussing, because we believe that it could become a very important tool for our manufacturing community to insure health and stability in our economy.

Thank you for your time.

Larry Owenby

Monty Payne
International Representative
PACE International Union
AFL-CIO, CLC

Good Afternoon:

It is a privilege and honor to appear before this committee. I have been an International Representative for PACE International Union for the past fifteen years. My duties cover large areas of Mississippi and Louisiana. Prior to that time I worked in a paper mill and made a very good living for over twenty years.

The past four years this country has lost many thousands of high paying manufacturing jobs. Our Union alone has lost over twenty thousand jobs through partial plant closures or through total plant closures. Paper Workers are the second highest paid jobs behind the auto industry in this country. The loss of these high paying jobs has had an incalculable affect on the communities and counties and states.

Many companies look at the bottom line in making decisions on whether to close a plant or sell plant. They do not look at the effect on the employees, their families or the communities in which the plants are located.

I have personally been involved with several partial closures since 1998 and a number of total closures. I am more in tune with what goes on in the forest products and paper industry. Many companies have purchased other companies and then picked the best and most modern facilities of the two and closed the unwanted facilities.

One company in particular, International Paper Company, has purchased other companies such as Champion International, Union Camp, Federal Paper Board and then picked the best and most modern mills and closed less profitable older mills. Some of these were making money though not as much as the company wanted. Mobile, Alabama, Moss Point, Mississippi and lastly Natchez, Mississippi to name just a few.

Moss Point was a profitable mill and had top quality production but it was closed and the company refused to talk with anyone about buying the mill and keeping it open, the same with Mobile and several others. The reason being they did not want competition from the mills.

Natchez, Mississippi however is unique in that it was the only International Paper Company facility, which made chemical cellulose therefore the company was agreeable to discuss selling the mill. This mill is in a small southwest Mississippi city and is the largest employer in the city and this area of the state. It also has a large impact on the southeastern part of Louisiana. In its heyday this mill employed upwards of one thousand people. It has reduced staff over the past few years and had a big layoff in 2000. It first was reduced to seven hundred and now the plant will end production forever during the week of July 15^{th} 2003.

When the announcement of the decision to close this plant was made by International Paper Company, there was a meeting of many elected officials including United States Representative Charles Pickering. The community saw the urgent need to save these good paying manufacturing jobs. To say the least there was concern and panic among employees and members of the community.

PACE International Union stepped forward due to the success of its ESOP effort with Champion International in Canton, North Carolina and pushed forward this concept. Starting from scratch the local employees and myself saw a need for large amounts of money to conduct feasibility studies and environmental audits and many other required things to make this happen.

We have received very little help from government due to red tape and banks do not take employees seriously in the early stages of an ESOP effort. We have had to beg money from every source. The employees have contributed several thousand dollars; the International Union donated a matching amount of what employees could come up with. But it is still a long way from what is needed. Even though in Natchez we have had a unique but rare instance due to the fact the Natchez Chamber of Commerce President committed thirty thousand dollars to our cause it still is short to get all done that is needed to do.

In closing this legislation would be a great help to employees who have dedicated a lifetime to an employer who does not want to continue an operation but who would be willing to sell the plant to the employees. The employees would have an option to save good paying jobs in their own communities so that they could continue to live where they want to, raise their children in these communities and also help save the tax bases of the cities, counties, and states of this great country.

Prepared Statement of
George A. Ray
Chairman & CEO
LeFiell Manufacturing Company
To
Subcommittee on Financial Institutions
And Consumer Credit of
House of Representative
Committee on Financial Services

Hearing on Financing of Employee Ownership:
An Overview

June 10, 2003
2:00 PM
2128 Rayburn House Office Building
Washington, DC

Statement George A. Ray, Chair and CEO, LeFiell Manufacturing
At Hearing of Subcommittee on Financial Institutions and
Consumer Credit of the Committee on Financial Services
On Financing Employee Ownership: An Overview

Chair Bachus, Ranking member Congressman Sanders, and members of the Subcommittee on Financial Institutions and Consumer Credit.

First I thank Congressman Royce for his kind introduction. Back in California we all know and appreciate the work Ed Royce does for the betterment of our communities and their people.

As Chair of The ESOP Association, the national trade association representing companies with ESOPs, the ESOP community is very excited that the subcommittee is holding this hearing. We know, and appreciate that Congressman Sanders has worked with several outstanding companies in Vermont, who are prime examples of the power of employee ownership, has pushed open the door to review how this nation can finance more employee ownership. I am proud to sit here today with a representative of one of those companies, Sherri Ceresa, Gardeners Supply, Burlington, Vermont. To demonstrate how much The ESOP Association values our outstanding Vermont employee-owned companies, our small ten-person board has two Vermont ESOP company leaders as members.

I started with LeFiell Manufacturing in 1962 at $1.75 an hour working as a machine operator. Today I am Chairman and CEO, a post I have held since 1992.

I will give a brief background on LeFiell, the story of our employee ownership journey, and what we have experienced in terms of financing our transition of being conventionally owned to being employee-owned through an ESOP, and conclude with a brief comment about employee ownership in the 21st Century.

LeFiell Manufacturing traces its beginnings to 1930, when Mr. LeFiell began a gray iron foundry and small machine shop business on Vernon Avenue in Los Angeles. From 1930 to 1954 its primary business was supporting the meat packing industry and its customers were the large meat packing companies.

In the 1950's the company began to transform itself, and began to produce structural parts for the aircraft industry. When I joined the company in 1962, its primary work was in that industry, and its primary customers were the large aircraft companies like the Donald Douglas, Convair, and Boeing. At that time, we had about 40 people. Today, LeFiell is 110 employee owners strong and is the leading supplier of precision tubular parts and assemblies for the aerospace industry. A few examples- - we produce six miles of liquid hydrogen fuel lines for each Space Shuttle; we have assisted in the design and have manufactured the tubular structure for sixty feet of the Space Station, and today, to the best of our knowledge, LeFiell supplies all fuel lines for every liquid hydrogen engine used on expendable rockets to launch satellites in the United States and Japan.

Mr. LeFiell was a difficult person to work for on a day-to-day basis, as he was very demanding on attention to details for whatever you were working on, but he was generous when it came to sharing the company.

In 1954 he incorporated to a privately held California C Corporation so he could give some shares of the company to key employees and also allow employees who wanted to invest in the company to purchase through a payroll deduction plan. In 1974, when the legislation to allow the creation of ESOP's was enacted by Congress, LeFiell was one of the first companies in the United States to form an ESOP. It was a perfect fit to carry on the LeFiell sharing culture. Mr. LeFiell had retired by this time and new employees were leading the company.

From 1974 thru 1986 the ESOP growth was funded with company earnings and company credit line funds. By 1986 the ESOP had accumulated 30% ownership in the company, with current and retired employees owned the balance. In 1987, a new strategy was initiated to purchase stock from retired employees, and today the ESOP has 67% ownership. There are over 250 owners of LeFiell and it would take the forty top shareholders with private and ESOP shares to make-up 50% of the stock today. That's broad-based ownership! Today we are studying a plan to purchase the balance of the shares in the next 12 months and become 100% owned by the employee ESOP. This will require the ESOP to borrow with the company guarantee of the loan and a plan to pay the loan off over a number of years. It has been a wonderful journey for me, my family and all of the employee owners of LeFiell where each employee has received a major benefit for retirement from the company they helped build.

"Has an ESOP been good for our employees, and LeFiell"? Yes sir, and let me give you some examples. The average employee owner at LeFiell has an account balance of $129,000, nineteen employees with twenty-one to twenty-five years of service have average account balances of $217,000 and eleven employees who have over twenty-five years of service have account balances of $357,000. This will certainly contribute to a much happier retirement for these employees and their families when they are ready to retire.

As the President of The ESOP Association said earlier, ever since the beginnings of ESOPs in the late 50's, and certainly with enactment of laws in the 1980's encouraging exiting owners from private businesses to sell to ESOPs, 75 to 80% of the ESOPs created in America are the result of existing owners selling their stock to an ESOP.

Casual observers of the American economy, perhaps fixated on reading the *Wall Street Journal*, or watching the TV cable news with reports on how the stock market did, do not appreciate that over 50% of Americans work for companies that do not have publicly traded stock, and that 95% of the businesses in America are not publicly traded. And even those who understand this fact of the dominance of private companies, really do not appreciate that sooner or later, the owners of these private companies, have to cash out of the company.

When LeFiell in 1974 established its ESOP, like 80 to 85% of the companies then, we did not formally include the ESOP in the financing transaction. We used the corporation's credit, borrowed money, bought stock from Mr. LeFiell, and made contributions to a stock bonus plan from the purchased block of stock, which we held in Treasury. We also printed new shares of

LeFiell treasury stock to contribute to the ESOP. As Michael Keeling explained, tax laws enacted in 1984 and 1986 triggered companies to leverage their ESOPs formally, where debt was supported by the ESOP, and the stock all goes into an ESOP suspense account. This is the method LeFiell is currently considering to purchase the last 33% for the ESOP. There are advantages and disadvantages to either style, but again, since the mid-80's, most ESOPs are "leveraged", and employees get the financial advantage of stock appreciation as the leverage is paid down.

Whether done on corporate credit, or with a leveraged ESOP, the ESOP creates an excellent option for the transaction involving the current owners of private business cashing out of their stock, or ownership position.

Being an Employee Owned-ESOP Company has had many business benefits for us over the years. Our customers recognize the value of a stable company that has been in business for seventy-two years; the auditors from the government who review our government contracts have never questioned our contributions to our ESOP. I believe they recognize the value and legitimate expense of a broad-based employee retirement program through an ESOP.

Chairman Bachus, and members, I know that your full committee oversees the nation's accounting standards, and has reviewed work and proposals of the Financial Accounting Standards Board, or FASB. Oddly enough, the manner in which the accounting standards treat ESOPs in instances of healthy companies might impact employee-owned companies getting financing more than whether money is available. These accounting standards go back to 1976, with the most recent standards being issued in 1993. There is no question in my mind that the 1993 accounting standards hinder the creation of ESOPs.

But even more troubling, we now have FASB issuing standards that are not precisely directed at ESOPs, and their impact may be so drastic that the standard makes the ESOP company look financially unhealthy, when in fact the cash flow statement proves otherwise. The standard, recently release FASB 150, was issued without any input from the ESOP community.

I am not an accountant, and today's hearings are not about the accounting treatment of ESOPs.

I wish to make two comments, however: One, our problems are not about reporting the ESOP stock compensation as an expense, which is the debate in the stock option arena that your committee had hearings on. ESOPs contributions are reported as an expense. New standard FASB 150, some say, will wipe out the value of employee-owned companies through ESOPs, in some instances by 100%. An ESOP cannot get financing when it shows all of its equity as a liability. Two, Mr. Chairman and members, I would ask that as the ESOP community comes to understand FASB 150 better, you keep an open door to hear us out, and to see if we need to put more focus on accounting standards that, contrary to the intent of Congress, may snuff out employee ownership through ESOPs.

In conclusion, let me summarize my statement: One, the experience of LeFiell Manufacturing with employee ownership through ESOPs is very positive. As Chair of The ESOP Association, and former President of the California chapter of ESOP companies, I can say my personal experience with other ESOP companies convinces me that LeFiell's experience is not unique. I would state that LeFiell has not had significant issues in getting financing for its ESOP creation and expansion, nor have we had problems with ongoing financing because we are an ESOP. Let me quickly add, LeFiell's experience, and those of other companies that are ESOPs that I know of, are nearly all strong financially and good candidates to pay lenders back their loans with the interest.

I do have a concern that a recent accounting standard will make it harder to explain the true financial situation of an ESOP company. And it may make it difficult for companies to obtain financing from lenders to execute a leveraged buy-out or raise capital for company expansion.

Finally, we do believe that there are many areas of our nation's ownership, and employee ownership policies that need consolidation. We believe our ownership policies need more support and focus by the Executive Branch.

We believe that your hearing is sending a signal that employee ownership is more important to the well-being of our economy and our employees than arcane tax laws, or hard to fathom retirement income security laws, or the ERISA laws. Your hearing reveals areas that need more review. I believe, however, if the Financial Services Committee commits to ownership we will see more financing available to those companies, that might not make it otherwise, enabling them to become employee owned, like LeFiell Manufacturing.

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