WORKING TOWARD EMPLOYEE OWNERSHIP

The democratic principle upon which this nation was founded should not be restricted to the political process but should be applied to the industrial operations as well.[1]

INTRODUCTION

Concentrated power is a threat to democracy.[2] One of the basic tenets of democracy is "majority rule."[3] When power becomes centralized in the hands of the few, the few are tempted to lord it over the many, and the aim of democracy is thwarted. The system of checks and balances in the United States Constitution guards against concentrations of political power.[4] But power takes on other forms, one of which is capital. Extreme concentrations of capital are prevalent in American society. A 1976 study of the Joint Economic Committee of Congress found that the wealthiest one percent of the United States population owned nearly twenty-six percent of the country's total net worth.[5] This one percent of the population owned more than half of all corporate stock as well as more than half of all outstanding debt.[6] Half of this small group, just over one million people, owned fifty percent of the nation's total outstanding corporate stock in 1972.[7]

The closest reservoir of capital to the average American is the company for which he works. Employee ownership of businesses and corporations allows for a more equitable distribution of capital by

1. Albert Gallatin, former Secretary of the Treasury under Presidents Jefferson and Madison. As reported by the Council of Profit Sharing Industries from the personal papers of Albert Gallatin in PROFIT SHARING TRENDS, May-April 1959, at 3 (a publication of the Council of Profit Sharing Industries). Albert Gallatin is said to be the father of profit sharing in America. The profit sharing plan he instituted in his glass works in 1794 is set out, *id.* at 24-25.
2. The United States Government and traditional American political theory generally disfavor concentrations of political or economic power. For example, the Homestead Act equitably distributed the western lands, guarding against the possibility of wealthy land barons buying all the land. Antitrust laws ensure that corporations do not monopolize the market or combine to restrain trade.

   Ronald Reagan while campaigning for President of the United States stated:

   > Our Founding Fathers well understood that concentrated power is the enemy of liberty and the rights of man. They knew that the American experiment in individual liberty, free enterprise, and republican self-government could succeed only if power were widely distributed. And since in any society social and the political power flow from economic power, they saw that wealth and property would have to be widely distributed among the people of this country.

   Letter from Ronald Reagan to the New Orleans Times-Picayune (October 31, 1980).
3. ARISTOLE, 3 POLITICS ch. 8, 1279(b) (20-21).
4. STORY, 1 COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES 363-80 (3d ed. Boston 1858).
5. *Joint Economic Committee*, 94th CONG. 2D SESS., BROADENING THE OWNERSHIP OF NEW CAPITAL: ESOPS AND OTHER ALTERNATIVES 7, table 1-Personal Wealth 1972 (Comm. Print 1976).
6. *Id.*
7. *Id.* at 13.

allowing the ultimate producers of capital, the workers, a "piece of the action."

Employee ownership in its various forms is quickly gaining popularity nationwide.[8] This surge of interest in employee ownership stems more from pragmatic rather than idealistic concerns. While some employee-ownership advocates hope to effect a redistribution of national wealth, more often employee ownership is the only means by which workers can keep their jobs in the face of potential plant shut-downs.[9] Government officials view employee ownership as a means through which local communities can maintain their tax base and avoid the fiscal burdens of large-scale unemployment that follow in the wake of plant closings.[10] Members of business and managerial communities regard employee ownership as an opportunity to simultaneously raise productivity, undermine labor's efforts to unionize, and put a lid on wage and benefit increases.[11]

Whatever the origins of the trend towards employee ownership, the results, though mixed, are chiefly positive. Approximately 1,000 to 3,000 employee stock ownership plans (ESOP's) are in effect in the United States today, most of which provide employees with only a minority of stock in their company.[12] Of these companies owned by both management and labor, employees in more than ninety companies own a majority of the assets.[13] These companies range in size from several

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8. *See generally Quiet Revolution*, ECONOMIST, March 13, 1982, at 24.
9. *See generally* D. ZWERDLING, WORKPLACE DEMOCRACY 53-79 (1980). This book contains a study of the Vermont Asbestos Group, probably the most widely publicized example of workers successfully using employee ownership to save their jobs after being threatened with a plant closing. Other examples discussed include Saratoga Knitting Mills, Mohawk Valley Community Corporation, and South Bend Lathe. An account of the South Bend Lathe takeover is contained in Ross, *What Happens When the Employees Buy the Company*, FORTUNE, June 2, 1980, at 108.

   Other recently publicized employee takeovers spurred on by threatened plant closings include the Rath Packing Company, *see generally* Foote, *When Employees Take Over (the Rath Packing Company)*, NEWSWEEK, June 1, 1981, at 74; the Republic Hose Manufacturing Corporation, *see generally Buying Jobs: Republic Hose Corporation, Formerly Aeroquip*, TIME, Dec. 24, 1979, at 65; and, more recently the Weirton Works of the National Steel Corporation, *see* N.Y. Times, March 14, 1983, at 1, col. 1. Not only unprofitable firms are shut down. Sometimes a conglomerate closes a profitable subsidiary simply because it fails to meet a certain target rate of return on investment capital. Sperry Rand Corporation, for example, opted to close its library furniture plant in Herkimer, New York because it failed to meet its quota 22% rate of return. The Herkimer plant had shown a profit for all but one of the previous 20 years. *See* Bluestone and Harrison, *Why Corporations Close Profitable Plants*, WORKING PAPERS FOR A NEW SOCIETY, May-June 1980, at 15-23.
10. *See generally* Zwerdling, *Workplace Democracy: A Strategy for Survival*, PROGRESSIVE, August 1978, at 16; Blasi and Whyte, *Worker Ownership and Public Policy*, POLICY STUDIES JOURNAL, Dec. 1981, at 320; Toscano, *Employee Ownership and Democracy in the Workplace*, SOCIAL POLICY, May-June 1981, at 16.
11. M. CARNOY AND D. SHEARER, ECONOMIC DEMOCRACY: THE CHALLENGE OF THE 1980S 135-43 (1980).
12. M. CONTE, A. TANNENBAUM, AND D. MCCULLOCH, EMPLOYEE OWNERSHIP 2 (1981) (done by the Survey Research Center Institute for Social Research of the University of Michigan and presented to the Economic Development Administration of the United States Department of Commerce); SENATE SELECT COMM. ON SMALL BUSINESSES, 96TH CONG., 2D SESS., THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS 2 (Comm. Print 1980).
13. THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra*

employees to several thousand.[14] In 1981, the University of Michigan Survey Research Center published a study of ninety-eight employee-owned firms for the Economic Development Administration.[15] Of the thirty firms making data available, profits were one and a half times higher in employee-owned firms than non-employee-owned firms.[16] The Survey Research Center found that as employees' equity ownership increased, profits also increased.[17] Managers who were surveyed in the study reported much higher levels of employee satisfaction with employee ownership compared to the previous conventional ownership of their companies.[18] The managers also contended that employee ownership improved both productivity and workers' attitudes toward management and toward their jobs.[19]

This note will discuss the three forms of employee ownership prominent in the United States, as well as current state and federal legislation. Additionally, this note proposes ideas for future employee ownership legislation.

THE DIFFERENT FORMS OF EMPLOYEE OWNERSHIP

There are three principal types of employee-owned companies in the United States: the direct worker ownership firm (the "mock conventional" firm), the producer cooperative, and the employee stock ownership plan firm (the ESOP firm).[20]

DIRECT WORKER OWNERSHIP

The direct worker ownership firm is clearly the simplest arrangement of the three forms of employee ownership. When economic factors force a company to consider closing or relocating, the workers form an organization to sell stock in a new company which will buy the old plant from its previous owner, sometimes in cooperation with local government.[21] Thus, the workers own the stock "directly" rather than "beneficially," as through stock deposited in the workers' names as

note 12, at 1, 24-6. This figure does not include companies owned only by management employees.

14. *Id.* at 1.
15. CONTE, TANNENBAUM and MCCULLOCH, *supra* note 12.
16. *Id.* at 23.
17. *Id.* at 25.
18. *Id.* at 30, 33 (table 15). The study found that in employee-owned firms, workers' attitudes toward both management and their jobs improved. Regarding workers' attitudes toward management, the study found that workers and management reported that they worked better together and improved communication and relations resulted. Concerning workers' attitudes toward their jobs, the study found that workers and management reported that workers were more conscientious, determined, and self-fullfilled. *Id.* at 48 (tables 5, 6), 51 (tables 7, 8).
19. *Id.* at 36, 37 (table 17), 48 (tables 5, 6), 51 (tables 7, 8).
20. *See* THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 4-14; Toscano, *supra* note 10, at 16-21; C. ROSEN, EMPLOYEE OWNERSHIP: ISSUES, RESOURCES AND LEGISLATION 8-18 (1982).
21. Toscano, *supra* note 10, at 17-18; ROSEN, *supra* note 20, at 18; THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 13-14.

beneficiaries of a trust. To help raise the necessary capital, the stock offering generally is not limited to employees.[22]

Employees or employee-community groups directly own about one-quarter of the employee-owned firms in the United States.[23] A direct worker ownership firm, once established, differs little from the conventional enterprise that preceded it (thus the term "mock conventional"), except that workers hold a larger amount of shares in the company than workers generally own, and they own these shares in conjunction with other outside investors. Generally though, operations and structure of the company remain unaltered.[24]

Direct employee ownership has certain drawbacks. For instance, the workers seldom sit on the board of directors nor participate in company management, but like other stock owners, they have voting privileges. Additionally, workers frequently fail to plan for the transfer of stock from retiring employees. Consequently, outside investors increase their percentage stock holdings, and the plant soon returns to its pre-employee-owned organization.[25] Thus, although the workers initially purchase the company because only they are willing to put up the necessary capital and take the risk, they slowly lose their ownership control because their interest is not reflected in the company's managerial structure.

The Vermont Asbestos Group (VAG) exemplifies a successful company owned directly by its employees, but whose employees are not adequately represented in management.[26] In January 1974, the GAF Corporation announced it would close its small asbestos mine and plant in northern Vermont.[27] The workers and townspeople formed VAG, sold stock, and obtained a bank loan guaranteed by the State of Vermont to purchase the mine and plant.[28] They completed the purchase in March, 1975. The employees, including both management

22. Toscano, *supra* note 10, at 17; THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 13. Raising the necessary capital may be extremely difficult. Employees may need to raise hundreds of thousands of dollars in as little as a few months or a few weeks. Banks are often unwilling to loan money because this endeavour is filled with uncertainty. *See*, for example, the problems of the Mohawk Valley Community Corporation in purchasing the Sperry Rand library furniture factory in Herkimer, New York. Faced with a shut-down, the workers and other members of the community formed the Mohawk Valley Community Corporation which then needed to raise $1,800,000 in 90 days. ZWERDLING, *supra* note 9, at 75-9.

23. THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 13.

24. Toscano, *supra* note 10, at 17. *See also* THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 13. The experience of the asbestos miners at the Vermont Asbestos Group in Lowell, Vermont is a good example of direct ownership and also demonstrates the deficiencies of this type of employee ownership. ZWERDLING, *supra* note 9, at 53-63.

25. THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 14.

26. ZWERDLING, *supra* note 9, at 53-63.

27. *Id*. at 54.

28. *Id*. at 56-57.

and labor, managed to retain seventy-eight percent of the stock.[29]

The shareholders of VAG, including the employees, elect a fifteen member board of directors which votes on general policies and any corporate expenditures exceeding $7,000.[30] Nevertheless, a five-member executive board, essentially the same management that operated the firm under GAF Corporation, makes most of the important decisions.[31] The board of directors and the executive board are no more responsive to workers' demands than the previous management.[32] Although VAG has profitted, the workers are disillusioned. They no longer control the company they purchased to save from closing.[33]

PRODUCER COOPERATIVES

Workers facing a plant closing often establish a second form of employee ownership called "producer cooperatives" or "worker cooperatives".[34] Although there is no reliable figure for the number of producer cooperatives in the United States, sources estimate that at least several thousand currently exist.[35] Producer cooperatives vary in form, but most cooperatives are small retail businesses such as bakeries, bookstores, and restaurants.[36] Yet, there have been a number of successful industrial cooperatives, the best known and most prosperous of which are the plywood cooperatives of the Pacific Northwest.[37]

Traditionally only the workers in an American producer cooperative can become members and each member buys one share or pays a membership fee.[38] Unlike a conventional corporation in which ownership is determined by the amount of stock held, a cooperative distributes ownership equally among its members.[39] In theory, each worker is entitled to an equal share of annual total earnings.[40] Workers receive an advance on their share of the total earnings as their wage.[41] The cooperative actually reinvests any earnings in excess of costs, or alternatively, allocates the money to member shareholders as a "patronage

29. *Id.* at 57.
30. *Id.* at 58.
31. *Id.*
32. *Id.*
33. *Id.*
34. Toscano, *supra* note 10, at 20-1.
35. *See* THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 10; Rosen, *supra* note 20, at 15.
36. *A Survey of U.S. Producer Cooperatives: Summary of the Initial Phase: Hearings on the Small Business Employee Ownership Act Before the Select Committee on Small Business*, 96th Cong., 1st Sess. 536 (1979) (report by Joyce Crain of the Center for Economic Studies); Rosen, *supra* note 18, at 16.
37. *See generally* K. BERMAN, WORKER OWNED PLYWOOD COMPANIES (1967).
38. Rosen, *supra* note 20, at 16; Carnoy and Shearer, *supra* note 9, at 183-94; R. OAKESHOTT, THE CASE FOR WORKER CO-OPS 229 (1978); I. PACKEL, THE ORGANIZATION AND OPERATION OF COOPERATIVES 92 (1970).
39. Packel, *supra* note 38, at 87-115.
40. *Id.* at 187.
41. Rosen, *supra* note 20, at 16.

dividend."[42] The shareholders' receipts are not taxable to the cooperative; thus, the cooperative avoids corporate "double taxation."[43] The government allows this special tax advantage because cooperatives are not designed to make a "profit." Instead of generating a profit, producer cooperatives grant their members a return on their investment of capital and labor.[44] In conventional corporations profits are the excess of receipts over expenses. A producer cooperative uses its excess receipts to equally benefit each of its members, or as patronage dividends, whereas conventional corporations allow management to invest profits as it sees fit.[45]

Each member of a producer cooperative has one vote. The members, as owners and workers, select the cooperative's management. Generally, the power to select management is delegated to an elected board of directors.[46] The board of directors embodies the democratic control of the cooperative.[47] The members can remove a director for cause after notice and a hearing.[48] Some cooperatives provide for the initiative, which allows a fixed percentage of the membership to compel consideration of a proposal at a regular or special meeting. If adopted, the proposal becomes effective irrespective of any decision by the board of directors.[49]

Producer cooperatives almost always limit the transferability of their shares. Usually shareholders must first offer their shares to the cooperative at par or cost. This restraint is important because it allows the cooperative to bar persons with antagonistic interests from membership.[50]

The plywood cooperatives of the Pacific Northwest are the most successful producer cooperatives in the United States. The first plywood cooperative, Olympic Veneer, was formed in 1921 by a group of 125 lumberworkers, carpenters and mechanics.[51] Olympic Veneer's success inspired the formation of thirty other plywood cooperatives.[52] Although the precise structure changes from one cooperative to the next, the basic principles remain the same. Each worker owns one share and casts one vote in elections. The workers elect the board of directors (usually seven to nine people from inside the mill) and also

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42. *Id.*
43. I.R.C. §§ 1381-3 (CCH 1983). Briefly, these "patronage dividends" (generally allotted to members based on the number of hours worked) are deducted by the worker cooperatives from corporate taxable income. "Patronage dividends" may be either cash or a credit to members' individual capital accounts. Thus, cooperatives are able to avoid double taxation as well as retain and reinvest a portion of the earnings allocated to members.
44. Rosen, *supra* note 20, at 16.
45. Packel, *supra* note 38, at 186.
46. *Id.* at 106-15.
47. *Id.* at 112.
48. *Id.* at 115-16.
49. *Id.* at 116-17.
50. *Id.* at 97-102.
51. ZWERDLING, *supra* note 9, at 95-6.
52. *Id.*

vote on company policies, including purchases and investments, at company meetings at least twice a year.[53] Also, every worker, from the janitor to the president of the cooperative, earns equal pay.[54]

EMPLOYEE STOCK OWNERSHIP PLANS

Employee stock ownership plans (ESOP's), the third form of employee ownership, is by far the most popular. Workers can use an ESOP as a means to buy out their company or to establish an employee benefit plan for an existing company.[55] While ESOP's have existed since the 1950's, they have only gained popularity since the mid-1970's. A series of laws clarifying and expanding the tax benefits available to such plans largely contributed to their increased popularity.[56]

Under an ESOP a company sets up an Employee Stock Ownership Trust (ESOT)[57] to arrange a loan from a bank or other credit source.[58] Creditors generally demand that the company fully guarantee any borrowing done by the ESOT.[59] The trust then uses its borrowed funds to buy company stock on behalf of the employees, the beneficiaries of the trust. The stock remains in the trust as collateral, and the company agrees to repay the tax-deductible principal and interest on the loan.[60]

The company may deduct the payments on both the interest and principal of the loan to the ESOT.[61] The company benefits from this arrangement because generally only interest is tax-deductible.[62] The employees also benefit because the stock "vests" in them as the loan is repaid.[63] "Vesting" is a process, beginning a few years after a loan is

53. *Id.* at 96-7.
54. *Id.* at 96.
55. CONTE, TANNEBAUM and MCCULLOCH, *supra* note 12, at 7; THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 3.
56. Marsh and McAllister, *ESOPs Tables: A Survey of Companies with Employee Stock Ownership Plans*, THE JOURNAL OF CORPORATION LAW, SPRING 1981, no. 3, at 558-63.
57. Under the Internal Revenue Code all Employee Stock Ownership Plans (ESOP's) belong to the defined contribution category of deferred compensation plans. I.R.C. § 414(i) (CCH 1983). Defined contribution plans must provide that the sponsoring employee establish a trust to receive the employer's contribution to the plan. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 403(a), 88 Stat. 829, 876 (codified at 29 U.S.C. § 1103(a) (1976)) [hereinafter cited as ERISA].
58. *See generally* EMPLOYEE STOCK OWNERSHIP PLANS: PROBLEMS AND POTENTIALS 43 (Reichter ed. 1977).
59. The employer normally guarantees contributions to the ESOT in an amount that will ensure the trust meets loan installments as they come due. *See generally* EMPLOYEE STOCK OWNERSHIP PLANS 231-57 (J. Bachelder ed. 1979).
60. *Id. See also* Treas. Reg. § 54.4975-11(c) (1977).
61. The amount deductible of the principal, however, may not exceed 25% of the compensation otherwise paid or accrued during the taxable year to the employees under such employee stock ownership plans. I.R.C. § 404(a)(10) (CCH 1983) (added by Pub. L. No. 97-34, § 333(a) applicable to tax years beginning after Dec. 31, 1981).
62. I.R.C. § 163 (CCH 1983).
63. Stock usually vests with employees according to a "vesting schedule." Typically, an employee will be 30% vested after three years, 40% vested after four years, etc., up to the tenth year, after which the employee will be 100% vested, that is, fully entitled to the stock which has accumulated in the account over the years. *See* Rosen, *supra* note 20, at 11. As the loan is repaid, the shares are allocated to the individual accounts of the participants. *See* Treas. Reg. § 54.4975-7(b)(8) (1977).

made, which entitles the employees to receive a distribution of the stock held for their benefit in the trust.[64] Thus, ownership of the company is slowly transferred to the employees.

While the stock is held in trust any dividends received can be either retained or passed through to the employees. The Internal Revenue Code requires that voting rights on publicly traded shares must be passed through to individual employees.[65] For non-publicly traded shares, the vote need only pass through to employees for major corporate issues such as mergers or dissolution, which require a greater than majority vote by law or corporate charter.[66] Alternatively, companies may choose to pass voting rights to the individuals on all issues, thus giving workers greater democratic control.

An employee who leaves a company that has established an ESOT is entitled to the vested portion of his individual account. Although the employee has a right to receive the actual shares, a distribution of the fair market value of the shares is generally preferred. By distributing the fair market value of the shares, the company's stock, and thus the company ownership, remains with the current employees.[67]

Workers at South Bend Lathe in South Bend, Indiana used an ESOP to purchase their business from Amsted Industries of Chicago in 1975.[68] Federal and private loans financed the $9.6 million purchase. Although South Bend Lathe suffered heavy losses during its last five years under Amsted, it prospered under employee ownership. Throughout the first four years under employee ownership, sales increased fifty-three percent, after-tax profits quintupled, and productivity rose six to twelve percent a year.[69]

At South Bend Lathe, the stock vests with workers according to a formula based on compensation and length of service. Eventually the employees will own all the stock. Until then, workers vote only the minority of stock with which they are vested, and the trust votes the majority.[70] Management and labor relations have changed little since the buy-out, primarily because no changes were ever considered by the employees. Assumably, changes will follow once a majority of the stock is fully vested with the employees and the employees assert their ownership rights. In any case, South Bend Lathe proves that employee ownership can work.

64. *See* Marsh and McAllister, *supra* note 56, at 594-5, (table 9); CONTE, TANNENBAUM and MCCULLOCH, *supra* note 12, at 8, (table 1).

65. I.R.C. § 409A(e) (2) (CCH 1983).

66. Id. § 409A(e) (3).

67. Rosen, *supra* note 20, at 12. *See also* EMPLOYEE STOCK OWNERSHIP PLANS, *supra* note 59, at 45.

68. Ross, *What Happens When the Employees Buy the Company*, FORTUNE, June 2, 1980, at 109.

69. *Id.*

70. *Id.*

EXISTING EMPLOYEE OWNERSHIP LEGISLATION

THE FEDERAL GOVERNMENT

In recent years the Federal Government has enacted numerous laws supporting employee ownership through government loans and tax incentives. The most notable of these laws are briefly summarized here.

The primary tax benefit accorded ESOP's by the Internal Revenue Code (IRC) is their status as a qualified employee benefit plan empowered to borrow funds.[71] "Qualified" means that all contributions to the plan are tax deductible and comply with all the requirements of the Employee Retirement Income and Security Act (ERISA).[72] Only since Congress adopted ERISA in 1974 have ESOP's been recognized as a distinct type of benefit plan.[73] Employee benefits are taxed only when the employee actually removes stock from the plan.[74] An ESOP, however, is a specialized type of bonus plan in that it must invest its assets primarily in employee securities.[75] Thus, the IRC allows an ESOP the unique opportunity to borrow funds through a trust and, in effect, have both the principal and the interest of the loan treated as tax deductible.[76]

Another law supporting ESOP's is the Tax Reduction Act of 1975 which added a one percent investment tax credit for any company setting up a qualified ESOP.[77] To qualify for the tax credit, the ESOP had to distribute stock according to each employee's salary (ignoring amounts over $100,000); stock voting rights had to be passed through to

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71. I.R.C. § 4975(e)(7) (CCH 1983). An employee stock ownership plan specifically designed to borrow money from lending institutions to fund the employee stock ownership trust is a "leveraged ESOP." Although loan guarantees from a sponsor of a deferred compensation plan are generally prohibited transactions, *id.* § 4975(c)(1)(B), leveraged ESOP's are exempted from this prohibition, *id.* § 4975(d)(3).
72. *Id.* § 401(a).
73. ERISA, *supra* note 57, § 406(d)(6)(a) (codified at 29 U.S.C. § 1107(d)(6)) (1976). Generally, an employer contributing to an employee stock ownership plan may claim a federal income tax deduction equal to the amount contributed but not to exceed 15% of the compensation paid to the participants in the plan for the year, I.R.C. § 404(a)(3)(A) (CCH 1983) ("compensation" as defined in Treas. Reg. § 1.404(a)-9(b) (1956).
74. An employee may exclude from his gross income contributions made by an employer to a deferred employee compensation plan. I.R.C. § 402(a) (CCH 1983); Treas. Reg. § 1.402(a)-1(a) (1956). All employee stock ownership plans belong to the defined contribution category of deferred compensation plans, I.R.C. § 414(i) (CCH 1983). In general, any contributions made by an employee to the employee stock ownership plan which is returned to him in a lump sum distribution is not subject to taxation, *id.* § 402(e)(4)(D)(i). Any remainder of the lump sum distribution that is in the form of employer stock is included in the employee's gross income at the lesser of the original cost of the shares or the market value of the shares at the time of the distribution, *id.* § 402(a)(1); Treas. Reg. § 1.402(a)-1(a)(iii), -1(b)(1)(i), -1(b)(2)(i) (1956). If the distribution does not qualify as a lump sum distribution, the portion of the contributions made by the employer will be taxed at ordinary income tax rates, the value determined by the fair market value of the stock at the time of the distribution. I.R.C. § 402(a)(1) (CCH 1983), Treas. Reg. § 1.402(a)-1(a)(iii) (1956).
75. ERISA, *supra* note 57, § 407(d)(6)A (codified at 29 U.S.C. § 1107(d)(6)) (1976), I.R.C. § 409A(a)(2) (CCH 1983)).
76. *See supra* note 61.
77. Tax Reduction Act of 1975, Pub. L. No. 94-12, 89 Stat. 26 (1975) (codified in scattered sections of 26 and 42 U.S.C.).

the employees; and vesting had to be immediate.[78] A one percent credit meant that, by establishing an ESOP, a company making investments which qualify under the investments credit provisions could receive a return of 1% of the cost of the investment from the government. Essentially, the government contributes to the ESOP. In 1976, Congress extended availability of this credit until January 1, 1981, and increased the credit to 1.5%, provided that the employees also contributed .5%. If the employees do not contribute .5%, the one percent credit was applied.[79] In 1978, the credit was further extended through 1983.[80]

Producer cooperatives receive certain tax advantages as well. When cooperatives return net earnings, or "patronage dividends," to their members, only the members—not the business—incur tax liability on the earnings.[81] Cooperatives receive tax treatment similar to a Subchapter S corporation.[82]

In addition to tax advantages, some federally-financed loans and loan guarantees are also available to employee-owned companies and companies attempting to become employee-owned. There are five principal potential sources for these loans.

First, Title V of the 1980 Small Business Development Act authorizes the Small Business Administration to make loan guarantees either to employees seeking to buy-out their companies or to companies with established employee ownership plans.[83] These loan guarantees are available only to small businesses, generally those with 500 or fewer employees, and have a loan guarantee limit of $500,000.[84]

78. *Id.* § 301(d)(2) (codified in sections of 26 U.S.C.).
79. Tax Reform Act of 1976, Pub. L. No. 94-455, § 803(d), 90 Stat. 1520, 2587-8 (1976) (amending § 301 of the Tax Reduction Act of 1975).
80. Revenue Act of 1978, Pub. L. No. 95-600, § 141, 92 Stat. 2763, 2787-96 (1978) (codified in scattered sections of 15, 26 and 29 U.S.C. 1981).
81. I.R.C. § 1382 (CCH 1983).
82. Rosen, *supra* note 20, at 23. Section 1361 of the Internal Revenue Code (1983) allows a qualified entity to elect status as a Subchapter S Corporation thereby receiving preferential tax treatment.
83. Title V of the 1980 Small Business Development Act, Pub. L. No. 96-302, 94 Stat. 833, 850-54 (1980) (This title may be cited as the Small Business Employee Ownership Act of 1980). The second section of Title V reads:

    Sec. 502. The Congress hereby finds and declares that—
    (1) employee ownership of firms provides a means for preserving jobs and business activity;
    (2) employee ownership of firms provides a means for keeping a small business small when it might otherwise be sold to a conglomerate or other large enterprise;
    (3) employee ownership of firms provides a means for creating a new small business from the sale of a subsidiary of a large enterprise;
    (4) unemployment insurance programs, welfare payments, and job creation programs are less desirable and most costly for both the Government and program beneficiaries then loan guarantee programs to maintain employment in firms that would otherwise be closed, liquidated, or relocated; and
    (5) by guaranteeing loans to qualified employee trusts and similar employee organizations, the Small Business Administration can provide feasible and desirable methods for the transfer of all or part of the ownership of a small business concern to its employees.

84. Small Business Act of 1953, § 7(a), 15 U.S.C. § 636(a)(3) (1976 & Supp. V 1981), as amended

Second, the Economic Development Administration (EDA) has established its own policy to assist employee buy-outs.[85] The EDA can make direct loans or loan guarantees to employees seeking to buy a firm that might otherwise close.[86] Additionally, the EDA can make a grant to a community development agency which can, in turn, loan the money to the employees at a low interest rate.[87] The EDA provides assistance only in areas meeting certain unemployment or poverty levels;[88] however, EDA assistance has no statutory dollar limitation.[89]

Third, the Urban Development Action Grant (UDAG) of the Department of Housing and Urban Development, which provides aid for urban development in certain distressed areas, allows for grants to support employee ownership.[90] The grants are made directly to city governments which then loan the money to an employee organization to purchase the company. Presently, the UDAG program has been used to support employee ownership only once.[91]

Fourth, the Farmers Home Administration (FmHA) also supports employee ownership. The FmHA may make loans to advance employee ownership both in plant buy-outs, and in ongoing employee ownership plans.[92] These loans have no dollar limitations but are restricted to non-metropolitan cities with fewer than 50,000 people.[93]

Finally, the National Consumer Cooperative Bank, created by Congress, may allocate up to ten percent of its resources to loans for worker cooperatives.[94] These funds, which may amount to $30 million annually sometime in the near future, are allocated mostly through small loans.[95] The Cooperative Bank can also provide technical assistance in the form of management training sessions, seminars, and an analysis of

by Omnibus Budget Reconciliation Act of 1981, § 1902, U.S. CODE CONG. & AD. NEWS (95 Stat.) 357.

85. THE ROLE OF THE FEDERAL GOVERNMENT IN EMPLOYEE OWNERSHIP OF BUSINESS, *supra* note 12, at 16-17; Rosen, *supra* note 20, at 24.
86. Although such loans are not statutorily mandated, they are authorized by the Public Works and Economic Development Act of 1965, 42 U.S.C. §§ 3142, 3171 (1976 & Supp. V 1981).
87. *Id.*
88. *Id.*
89. *Id.*
90. Although not statutorily mandated, these grants in support of employee ownership are statutorily authorized by Title I of the Housing and Community Development Act of 1974, 42 U.S.C. §§ 5301-5317 (1976 & Supp. V 1981) *as amended by* Title I of the Housing and Community Development Act of 1977, § 110, 42 U.S.C. 5304 (1976 & Supp. 1981), and *as amended by* Title I of the Housing and Development Act of 1980, Pub. L. No. 96-399, 94 Stat. 1614 (codified at various sections of 12, 13, 15, 42 U.S.C. (1981)). *See also* the Omnibus Reconciliation Act of 1981, U.S. CODE & AD. NEWS (95 Stat.) 357.
91. An Urban Development Action Grant (UDAG) was used to help finance the Hyatt-Clark Corporation buy-out. *See* N.Y. Times, Oct. 31, 1981, at 34, col. 6.
92. Although such loans are not statutorily mandated, they are authorized by the Consolidated Farm and Rural Development Act, § 310B, 7 U.S.C. § 1932 (1982).
93. *See* 7 C.F.R. § 1980.401-.495 (1983). *See generally* Farmer's Home Administration Instructions 1980-E § 1980.45 (telephone interview with representative of FmHA).
94. National Consumer Cooperative Bank Act, 12 U.S.C. §§ 3001, 3018 (1976 & Supp. V 1981), as amended by Title III of the Omnibus Budget Reconciliation Act of 1981, U.S. CODE & AD. NEWS (95 Stat.) 357.
95. Rosen, *supra* note 20, at 25.

the cooperative's program and its needs.[96] The Cooperative Bank was founded on the premise that the United States Treasury Department would provide the initial capital, but the Bank eventually would become entirely private. The Bank received federal funding in 1981 and became private in 1982.[97] The Bank has significantly less capital now than it would have had if government funding had been continued.[98]

STATE GOVERNMENTS

Because of their close relationship with businesses within their borders and their awareness of these businesses' special needs, various states have given more creative and substantial support to employee ownership. Following are some examples of typical current state employee ownership legislation. These statutes indicate that states have responded favorably to the growing number of employee-owned businesses, and they may provide other state legislators with ideas for similar legislation in their own states.

Maryland

The State of Maryland has passed four laws in support of employee ownership. The *Maryland Broadened Ownership Act* of 1980 provides:

> It is the policy of this state . . . that broadening the ownership of capital should be a twin pillar of economic policy, along with achieving full employment. The General Assembly of Maryland finds that Employee Stock Ownership Plans . . . make an important contribution toward the broadening of capital ownership, increase the income and financial security of citizens of the State, assure citizens greater control over their economic futures, improve productivity and labor-management relations, contribute to the national effort to combat inflation, strengthen the free enterprise system, and put the state in the forefront of contemporary economic trends. It is the policy of this State to encourage the broadening of the base of capital ownership among wider numbers of Maryland citizens, and to encourage the use of Employee Stock Ownership Plans as one means of broadening the ownership of capital.[99]

The Act requires several state agencies (including the Division of Economic Development of the Department of Economic and Community Development, the Maryland Industrial Financing Authority, and others) to annually report their efforts to promote these policies.

This Maryland statute reflects what many states believe are the benefits to the state from employee ownership: citizens with greater eco-

96. *See* Title II of the National Consumer Cooperative Bank Act, 12 U.S.C. §§ 3044-3048 (1976 & Supp. V 1981), as amended by Title III of the Omnibus Budget Reconciliation Act of 1981, U.S. CODE & AD. NEWS (95 Stat.) 357.
97. *See* N.Y. Times, June 27, 1982, at C9, col. 1.
98. *Id.*
99. Maryland Broadened Ownership Act, 1980 Md. Laws 821 (codified at MD. ANN. CODE art. 41, § 14J (1957).

nomic control, improved productivity, better labor-management relations, and a strengthening of the free enterprise system. All of these goals are likely to follow from employee ownership.[100] Unfortunately, this statute only specifically endorses ESOP's. While ESOP's are an important part of employee ownership, cooperatives achieve these goals and also allow for greater democratic control of the business.

Maryland adopted a second act in 1980 which provides that employees receive notice of take-over efforts made to the management, and that options under employee ownership plans be explained to employees.[101] The law requires employers to post a notice informing employees of the possibility of an ESOP and giving them the address of a local government official who will provide free information. This "pre-notification" statute avoids forcing employees into a hurried decision upon a suddenly-announced plant closing and gives them time to consider whether they want to buy their plant. Also, workers are often not aware that they *can* buy their company. Thus, this statute ensures that the employees will receive necessary information early enough to allow them to make an intelligent decision.

The third act adopted by the General Assembly of Maryland recognized that in certain states public utility regulatory agencies have taken actions to deter public utility companies from establishing ESOP's. To prevent this result in Maryland, the state legislature passed an act in 1980 prohibiting the Public Service Commission from discouraging the use of ESOP's in public utilities.[102]

A fourth act adopted by the General Assembly of Maryland in 1980 exempts any sale of securities to an ESOT from state securities regulations requiring a prospectus to be filed with the state Securities Exchange Commission.[103] Stock registration and filing requirements entail costly and time-consuming procedures which may hinder an ESOP, and they provide unnecessary safeguards in the sale of stock to an ESOT.

California

Similar to the Maryland ESOP securities exemption, California legislation enacted in 1982 provides that offers or sales of securities to employee stock ownership plans are exempt from certain qualification requirements of the state's Corporate Securities Law of 1968.[104] This act also creates a state policy supporting employee stock ownership plans, and incorporates much of the language of the Maryland Broad-

100. CONTE, TANNENBAUM and MCCULLOCH, *supra* note 12.
101. 1980 Md. Laws 119 (codified at MD. CORPS. & ASS'NS CODE ANN. § 11-902(b)(9) (Supp. 1983)).
102. 1980 Md. Laws 847 (codified at MD. ANN. CODE art. 78 § 69(d) (1980)).
103. 1980 Md. Laws 598 (codified at MD. CORPS. & ASS'NS CODE ANN. § 11-602(14) (Supp. 1983)). *See also* MD. CORPS. & ASS'NS CODE ANN. §§ 11-205, 11-501, 11-602 (Supp. 1983).
104. 1982 Cal. Stat. chapter 1524 (codified at CAL. CORP. CODE § 25102(M) (West Supp. 1983)).

ened Ownership Act of 1980.[105]

Delaware

Delaware has adopted a similar policy of encouraging "the broadening of the base of capital ownership among wider numbers of Delaware citizens, and [encouraging] the use of employee stock ownership plans as one means of broadening the ownership of capital."[106] The act requires certain state agencies to report annually their efforts to comply with this policy.[107]

Michigan

One of the first and most novel state laws to support employee ownership, House bill 4119 (H.R. 4119), was enacted in Michigan in 1979. House bill 4119 pertains only to potentially employee-owned firms in which at least fifty percent of the employees control the management.[108] In other words, H.R. 4119 ensures that employees will have voting rights, from which management rights spring. Thus, H.R. 4119 would apply to ESOP's that pass through voting rights, as well as to producer cooperatives.

House bill 4119 requires the Michigan Department of Labor, in cooperation with the State Department of Labor and the State Department of Commerce, to establish a program to develop such employee-owned businesses.[109] The program must be designed to go into effect when a plant closes or when twenty-five or more jobs are lost due to a plant relocation.[110] The program obligates the State Department of Labor to: 1) develop, collect, and disseminate information; 2) evaluate the feasibility and viability of a proposed employee-ownership plan; 3) provide technical assistance and training in the operation of employee-owned corporations; 4) promote and coordinate local, state, federal and private efforts; 5) assist those seeking financial aid; and 6) recommend appropriate legislative or executive actions to enhance opportunities for employee-owned corporations in Michigan.[111]

This statute illustrates Michigan's concern with keeping businesses within the state. Michigan supports employee buy-out attempts to retain businesses that would otherwise close or relocate. The statute sets

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105. *Id.*
106. 63 Del. Laws 35 (1981) (codified at DEL. CODE ANN. tit. 29 § 6508(c) (Supp. 1982)).
107. *Id.*
108. 1979 Mich. Pub. Acts 44 (codified at MICH. COMP. LAWS ANN. 450.751-.759 (Supp. 1983)).

> "Employee-owned corporation" means a business operation the management rights of which are represented by voting stock which may be owned only by the employees of the operation, a nonprofit community development corporation, or an employee-owned stock ownership plan any portion of which is owned by not less than 50% of the employees. The operation shall be controlled by a board of directors which is selected by the shareholders on a basis of 1 vote per shareholder.

109. *Id.* § 2.
110. *Id.* §§ 1, 2.
111. *Id.* § 3.

out a simple, workable program that gives crucial support to employee ownership attempts that might otherwise fail. Other states could initiate such a program with ease and minimal cost.

More recently, Michigan adopted the Michigan Economic Development Authority Act of 1982.[112] This Act established an economic development authority to issue bonds, make loans, and provide tax concessions for various economic development efforts. The Act specifically allows for loans to employee stock ownership trusts; however, no loan may exceed fifty percent of the project's cost.[113] This Act, when combined with H.R. 4119, will greatly aid employee buy-outs where the employees decide to use an ESOP.

New Jersey

New Jersey's Worker Owned Corporation Study Act of 1981 directs the state's Department of Labor and Industry to determine the best means for encouraging and assisting the formulation of employee stock ownership plans.[114] The Department of Labor and Industry must then develop a plan to encourage employee ownership of businesses that face closing or relocation.[115]

Illinois

The Illinois Employee Ownership Assistance Act of 1982 encourages the "employees of plants that are about to close or be relocated to take over and acquire such plants, and to continue to operate them as employee-owned enterprises."[116] The Illinois Act authorizes the Department of Commerce and Community Affairs to give the employees technical assistance. Furthermore, the Act provides state loans to employee ownership associations through the Illinois Industrial Development Authority, thus enabling workers to complete acquisitions of plants after they have obtained at least fifty percent of their funding from other sources.[117] No loan from the Industrial Development Authority may exceed fifty percent of the project's cost.[118]

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112. Michigan Economic Development Authority Act, 1982 Mich. Pub. Acts 70 (codified at MICH. COMP. LAW ANN. § 125.1901-.1934 (Supp. 1983)).
113. *Id.* § 16(3). This section states:
> The Authority may use the money held in the fund to make loans in accordance with this act for the following purposes:
> > . . . (b) To finance industrial facility conversion projects located in a distressed area for the purpose of financing working capital, if the loan is to an employee stock ownership trust in which the allocated and unallocated shares are voted by the plan participants.

114. Worker Owned Corporation Study Act, 1981 N.J. Laws 82 (codified at N.J. STAT. ANN. 34:1B-30 to -35 (West Supp. 1983)).
115. *Id.* § 5.
116. Employee Ownership Assistance Act, 1982 Ill. Laws 991, § 1 (codified at ILL. ANN. STAT. ch. 48, § 1301-13 (Supp. 1983)). Section two of this act states that " 'Employee Ownership' here means a business controlled and at least 60% owned by its employees."
117. *Id.* §§ 4-8(1).
118. *Id.* § 9(6).

The Employee Ownership Assistance Act also creates an Employee-Owned Enterprise Advisory Council composed of seven members.[119] The Council provides information and approves loan applications in conjunction with the Industrial Development Authority.[120] Much like the Michigan employee ownership acts, this Illinois statute should greatly facilitate employee buy-outs.

West Virginia

In the 1983 regular session, West Virginia passed Senate bill 659 which allows any manufacturing company to deduct the value of its ESOP contributions from its state taxes.[121] Thus, ESOP manufacturing firms may have little or no state tax liability.

Massachusetts

Massachusetts' unique Employee Cooperative Corporations Act of 1982 is perhaps the most democratic of all the current forms of employee ownership legislation.[122] The first statute of its kind in the United States, this law creates statutory authority and legal certainty for worker cooperatives within the state. Until the Massachusetts legislature passed this statute, the law in Massachusetts regarding worker cooperatives was unsettled, as it presently remains in most states.

The 1982 law requires a new class of voting stock for members of worker cooperatives.[123] Although each cooperative corporation may establish its own criteria for membership, each member may only own one share of stock.[124] The Employee Cooperative Corporations Act limits membership to persons employed by the cooperative and requires that members vote their shares on a one person-one vote basis.[125] The new law expressly allows the cooperative to apportion earnings and losses to members based on the members' work, as measured by hours, rather than on relative capital investment.[126] The new law also permits the use of an internal accounting system and a capital structure appropriate for a worker cooperative.[127] The Employee Cooperative Corporations Act authorizes the internal organizational structures which cooperatives have long used, but the Act gives cooperatives the legal legitimacy they have long lacked.

119. *Id.* § 5. The seven members are the Lieutenant Governor ex officio, the Director of Commerce and Community Affairs ex officio, and five persons active in community service, organized labor, or the business community.
120. *Id.* §§ 5(f), 9.
121. 1983 W. Va. Acts. 177 (codified at W. VA. CODE § 11-13-3a (Supp. 1983)).
122. Employee Cooperative Corporations Act, 1982 Mass. Acts 104 § 3 (codified at MASS. ANN. LAWS ch. 157A, § 1-11 (Michie/Law Co-op Supp. 1983)).
123. *Id.*
124. *Id.*
125. *Id.*
126. *Id.* The new law spells out a procedure for such "patronage allocations" that is consistent for Subchapter T requirements for certain cooperative tax advantages. Subchapter T of § 1381 of the Internal Revenue Code (1980) deals with cooperatives and their patrons.
127. *Id.*

This statute clarifies the law regarding cooperatives in Massachusetts. The unique arrangement between the worker and the cooperative does not fit neatly into the traditional notions of labor and management that permeate many laws. As cooperatives become an increasingly popular form of employee ownership, it becomes increasingly important to clarify their economic status in the state.

LEGISLATIVE PROPOSALS

THE FEDERAL GOVERNMENT

For employee ownership to take hold in the United States, the workers, businessmen, and union leaders will have to be convinced of its worth. In the absence of support from these groups, the Federal Government could do little to promote employee ownership. Therefore, the Federal Government's role in advancing employee ownership will not determine the future of employee ownership plans. Yet, federal legislation could contribute to employee ownership in this country.

Open Support of Employee Ownership

A national policy supporting employee ownership would increase public awareness of this option and set a clear direction for future legislation. A governmental policy advocating employee ownership would make legislators who favor employee ownership more successful in their efforts to promote it. Legislators opposed to employee ownership might be persuaded to reexamine its concepts. Agencies that inadvertently hinder employee ownership might reexamine their regulations in light of governmental policy. Perhaps other agencies would fund research in this area. Admittedly, policy statements, by their very nature, often lack any real teeth and have limited effect on actual conditions. Although a policy statement is a small step, it must be taken in order to clarify the Federal Government's position on employee ownership options and potential federal involvement.

Financial Assistance for Employee Ownership

Employees of a company facing closing or relocation often have great difficulty raising the capital necessary to purchase the company. Loans and loan guarantees would aid employees in this endeavor. While some programs are available, these programs are often too restricted and underfunded. By providing greater availability of loans and loan guarantees to employee and community organizations or groups, the government can avoid considerable costs that follow in the wake of a plant closing. Through loans the community gains a taxpaying business full of taxpaying employees rather than allowing a plant to remain idle. Larger loan programs have been proposed in the past but have as yet failed to become law.[128]

STATE GOVERNMENTS

State governments stand in a unique position allowing them to enact innovative and progressive legislation promoting employee ownership. Their size makes them well-suited to creatively use resources for advancing the growth of employee ownership. Employee ownership provides an opportunity for state governments to strengthen their economic growth, secure jobs for citizens, and effect a more equitable distribution of capital.

Increasing Public Awareness

Each state must take several steps to encourage employee ownership. First, state legislators should enact legislation designating employee ownership as a goal of state economic policy. This legislation should include a plan to educate the public and improve its understanding and awareness of employee ownership options. Second, states should designate an official or an agency to serve as an objective informational resource on employee ownership. Third, state Departments of Commerce should organize meetings to familarize the business community with various forms of employee ownership and seek their advice in planning state involvement in employee ownership and employee buy-outs.

Plant Closing Legislation

Employees most commonly consider plant ownership as an alternative to a plant shut-down. Frequently though, employees do not learn of a plant closing until a few weeks or even a few days before the plant actually closes.[129] Employee buy-outs become increasingly difficult in such circumstances, because financing is difficult to obtain with such short notice. Thus, states should enact pre-notification requirements to give employees an early warning of at least ninety days of impending plant shut-downs.[130]

After a plant shut-down, parent firms are often unwilling to aid employees who are attempting a buy-out because they view the employees

128. During the 95th Congress, Congressmen Kostmayer (D-Pa.), Lundine (D-N.Y.), and McHugh (D-N.Y.) introduced H.R. 11222 "The Voluntary Job Preservation and Community Stabilization Act." This bill would have created a $100 million loan fund in the Economic Development Administration (EDA) to make loans to employees purchasing plants that would otherwise close or relocate. The EDA would first require a feasibility study before approving the loan. This study would have to include a plan for repayment of the loan, with provisions for employee payroll deductions if necessary. The bill would also allow community members to participate in ownership. *See* 124 CONG. REC. 5114-16 (1978). For technical reasons, the bill died in committee. [95th Cong.] 2 CONG. INDEX (CCH 1978) 28,288.

129. *See supra* note 7.

130. *See Advance Notice of Plant Closings: Toward National Legislation*, 14 *U. Mich. J.L. Ref.* 283 (1981).

as potential future competitors.[131] Such uncooperativeness can only undercut employees' attempts at purchasing the plant. Thus, states should facilitate cooperation by requiring firms to negotiate with employee groups in good faith and to make any financial records necessary for plant operation available to the employees.

Technical Assistance

Owners and employees may be unwilling and unable to spend large amounts of money to investigate the feasibility of employee ownership for their plants. By providing free or low cost legal and financial advice concerning employee-owned business or employee buy-outs, states will, to their own economic advantage, increase the number of employee-based businesses. States should grant special assistance to employees who, faced with a shut-down, are unable to finance private feasibility studies.

Financial Assistance

Although states continue to trim their budgets, it still makes sound economic sense for states to support employee ownership. When states help workers retain their jobs, they reduce the number of workers reliant upon welfare, unemployment benefits, and other temporary help measures.

States can provide the necessary financial assistance to employee purchasers through several means. First, states should loan or grant money as "bridge financing" to aid employee purchasers facing a plant shut-down between notification of the shut-down and attainment of purchase financing. These funds will help the employees span a critical period in their employee ownership process.

Second, states should require companies in dissolution to provide severance pay to their employees. This provision would only slightly burden the dissolving company because, having anticipated liquidating costs from the start, the company would likely have set up an account to cover the expense. Although financial difficulties precipitate plant closings, plants are often subsidiaries of large corporations, and thus have access to adequate capital for severance pay.

The amount of severance need not be large; a suggested standard is one week's pay for each year the employee has worked for the company. Should employees wish to pool their severance pay to purchase the company, then the state, at the request of the employees, should contribute the unused portion of the employer's unemployment compensation account to the severance pay pool. The employees originally contributed these funds, so the state would bear minimal additional costs. The employees would be risking the loss of this money if the employee-owned company failed, but since they can receive unemploy-

131. Rosen, *supra* note 20, at 31.

ment compensation, using this money in attempting to save their jobs represents a good investment.

Third, states frequently use Industrial Development Bonds (IDB's) to encourage companies to locate in a certain area. Generally, these bonds are used only to finance new facilities. Yet, the bonds could provide a potential source of financing for employee ownership if legislation authorized employee ownership as an activity eligible for IDB financing. If an employee-owned business were too small to qualify for an IDB, then the state should allow several small employee-owned companies to share a single IDB.

Fourth, the Department of Housing and Urban Development's UDAG program, which makes grants for urban governments in certain economically distressed areas, has been broadened to include employee stock ownership.[132] Local governments receive these grants directly and loan the money to employee-owned enterprises in their locality. By taking full advantage of this program, states can save considerable expense in establishing employee-owned enterprises.

Reforming "Blue Sky" Securities Laws

States should exclude employee-owned firms from their "Blue Sky" securities laws since these laws were designed to ensure that stock purchasers have adequate information regarding their purchase. The thrust of Blue Sky laws does not apply to the employee stock ownership situation and compliance with them can be extremely expensive. In lieu of Blue Sky laws, firms should be required to negotiate with employee purchasers in good faith, and make financial records necessary for continuing the company available to them.

Finally, states should make direct or guaranteed loans to businesses wishing to become employee-owned. These loans should be available to all types of businesses, but may be restricted to small businesses if required by state finances. These loans can be financed by general revenues or bond issues.

CONCLUSION

The lopsided distribution of capital in the United States gives to a few people an enormous amount of power, while leaving others nearly powerless. One way to affect a more equitable distribution of capital is through employee ownership of businesses and corporations. Employee ownership allows workers to own a fraction of their company, and with it a voice in its management. Employee ownership also boosts productivity and strengthens relations between workers and management. The national economy benefits when employees avert large-scale unemployment in the face of a plant shut-down by purchas-

132. *See supra* note 90.

ing their company. The Federal Government and several state governments have already passed legislation supporting employee ownership. With broader support, employee ownership can take root in the United States to benefit working individuals and the national economy.

*Timothy G. Merker**

* B.A., The University of Dayton, 1981; J.D. Candidate, Notre Dame Law School, 1984.