An Employee Stock Ownership Plan: The History of the Weirton Steel Buy-Out

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An Employee Stock Ownership Plan: The History of the Weirton Steel Buy-Out

A leveraged employee stock ownership plan (ESOP) is a congressionally sanctioned technique of corporate financing which attempts to transfer controlling blocks in a corporation from outside stockholders to the employees of the corporation. Proponents argue that such plans not only produce considerable tax advantages and a redistribution of wealth but also increase the productivity of the employees. Such plans must be well-defined and tailored to the right type of business. On the other hand, employees threatened by plant closings, must realize that an employee buy-out is not a magical panacea which can resurrect a dying industry. This comment traces the history of the formation and development of the Weirton Steel Corporation's Employee Stock Ownership Plan, the world's largest one hundred percent employee buy-out. Since its creation in 1983, the employee-owned Weirton Steel has been able to post consecutive quarterly profits. Although the verdict is still outstanding as to its continued viability, its success illustrates the long range advisability of obtaining expert assistance in researching and formulating an ESOP. These techniques not only help evaluate the feasibility of establishing an ESOP but also help eliminate potential legal, as well as labor, conflicts.

I. INTRODUCTION

At 9:10 a.m. on March 2, 1982, a date residents of Weirton, West Virginia, enunciate still with death-like exactness, Mr. Howard M. Love, President of National Steel Corporation (National), stood solemnly at the end of the board room table and pronounced a death knoll for the corporation's Weirton Steel Division (Weirton).1 "Citing the prolonged recessionary business climate, the pressure of lower cost imported steel, accelerated changes in consumption patterns favoring substitute materials for steel,"2 and the resulting financial

1. Interview with David L. Robertson, former Counsel for the Independent Steelworkers Union (ISU), in Weirton, West Virginia, (March 13, 1987) [hereinafter Robertson Interview].

losses, President Love indicated that the corporation was taking the advice of its consultant, Bain and Company, and was planning to down-size its involvement in steel. Therefore, National had decided not to spend the substantial capitalization needed to keep Weirton competitive on an international basis. Love stated that National had four possible options: (1) to sell the Weirton plant outright, (2) to close the plant immediately, (3) to harvest or down-size the plant, or (4) to offer the plant for sale to Weirton employees under an ESOP.

This announcement should not have come as a complete surprise. Discerning eyes would have noticed the signs long before the announcement—the decline in new investment, the orders that increasingly were being funneled to other mills in National's corral, the engineers from the corporation's headquarters who arrived to examine old equipment with the meticulousness of an appraiser preparing for an estate sale.

Moreover, the precarious position of steel in the world outside Weirton was emanating ominous and foreboding signs: continual news releases of nearby plant closings, the omnipresence of foreign cars on the highway, and the ever-increasing use of aluminum in manufacturing soft cans which usurped the market from Weirton's specialty—steel cans made from tinplate. Nevertheless, National's announcement sent a shock wave through the 25,000 inhabitants of Weirton, a town totally dominated by the 400 acre mill. Love's meeting took only twenty minutes; however, those present immediately perceived the enormity of the impending crisis. This was not a management ploy or a prelude for wage and benefit concessions. At the outset, Love had commented that the Board of Directors had already indicated that even a wage concession of ten dollars per hour would be refused.

For the next ninety minutes, the twenty-two members of the executive board of the Independent Steel Union (ISU), the five members from the Independent Guard Union (IGU), and the eight members of Weirton's management discussed their options. Consid-

3. Robertson Interview, supra note 1.
6. Robertson Interview, supra note 1.
7. Id.
8. Id. The ISU represents hourly employees and the IGU represents salaried employees.
ering the unhealthy business climate of domestic steel combined with
the substantial capitalization needed to modernize the Weirton plant,
the group realized that finding a suitable buyer was not a viable
alternative. Closing the plant, on the other hand, was unrealistic
from both National’s as well as Weirton’s vantage point. Generous
lay-off, severance, and pension provisions in the existing collective
bargaining agreement (CBA) would ultimately cost National almost
750 million dollars.9 Not only did National have less than half that
amount in reserve to cover such liabilities but also since National
was not paying any corporate taxes, the corporation could not use
the closure of Weirton as a tax write-off.10 Thus, National financially
could not afford to close the plant. Obviously, Weirton’s employees
were equally adamant in negating this option. The third option,
down-sizing the plant, would convert the integrated steel mill to a
finishing mill, reducing employment from 7,500 to 1,000 employees.11
Such an alternative would create an industrial ghost town and destroy
the largest single location employer in the state of West Virginia.12
Obviously, the fourth option, the purchase of the plant under an
ESOP, demanded consideration. To those assembled, the term was
at best an enigma, if not an entirely unknown quantity. Yet here in
the midst of imminent destruction appeared one small hope of life.
The only chance of survival, the hope of rebirth, became a mysterious
phoenix called ESOP.

II. THE PHILOSOPHY BEHIND AN ESOP

For the next eighteen months, those assembled struggled with this
phoenix, this ESOP. The philosophy for the term, an acronym for
employee stock ownership plan, began in the 19th Century. “Al-
though the origins of the ESOP philosophy can be traced to 19th
Century writings of Johann Heinrich von Thunen, the generally
recognized creator of the concept today is the lawyer-economist Louis
O. Kelso.13 In an analysis of Kelso’s theory in the University of
Michigan’s JOURNAL OF LAW REFORM, Luis L. Granados points out

9. Towers, Perrin, Forster, & Crosby Actuarial Study, prepared by Towers,
Perrin, Forster, & Crosby for the ISU, (November 9, 1982) (relating to the Division’s
Pension Plan) [hereinafter Towers Actuarial Study].
10. See infra note 51 and accompanying text.
11. Robertson Interview, supra note 1.
12. Id.
that Kelso felt that there were two factors at work in the production of goods and services: (1) a person’s labor and (2) physical tools, or capital. As modern society has watched the steady shifting away from labor toward the capital side, our outtake system no longer reflects the realities of our input system. Most employees receive “their income solely from their contribution of labor, owning virtually no capital whatsoever.” On the other hand, employers who are able to separate the two Kelsonian factors have concluded that the owner “of the machine is entitled to the wealth the machine creates . . . .” The result has concentrated the wealth of America into the hands of a few. “Federal government figures show that one percent of the American people own over fifty percent of privately-held corporate wealth, while six percent of the people own over seventy percent of it.” Such inequity has contributed to much of the social difficulty experienced by today’s society. Thus, Kelso’s solution turned upon some type of employee ownership which would spread out the wealth derived from ownership of private property.

III. HISTORICAL DEVELOPMENT OF THE MODERN ESOP

From Kelso’s theory evolved the modern day concept of ESOP. Its historical groundwork began in a 1953 Revenue Ruling which allowed leveraging by a stock bonus plan, thereby providing employer financing repayable with pre-tax corporate dollars. By 1956, Kelso had formed his first ESOP, which saved a small newspaper from a take-over attempt by a national chain. The actual breakthrough for such help came in 1973 when Kelso enlisted the aid of Senator Russell Long. Senator Long prepared legislation which was an attempt to

14. Id.
15. Id. at 17.
16. Id.
17. Id. Kelso contrasts this view to that of Karl Marx who viewed labor as the only factor of production and the machine as congealed labor. Thus, Marx would insist that those laborers who built the machine are those who should receive its wealth.
18. Id. at 18 n.9, citing Staff of Joint Economic Committee, 94th Cong., 2d Sess., Broadening the Ownership of New Capital: ESOP’s and Other Alternatives (1976).
19. Id. at 18.
20. Id.
21. Id.
22. Id. at 19.
23. Id. At the time, Long was Senate Finance Committee Chairman. Id.
prevent the collapse of the Penn Central Railroad. Although the bill was ultimately diluted in committee to no more than a mere study, Senator Long did manage to help the legislation clear the full Senate floor. The amended bill would have provided for employee ownership of Conrail.

The next obstacle was the threat presented by the 1974 Employee Retirement Income Security Act (ERISA). This contained a prohibition of an employer corporation from extending credit to an ESOP trust to obtain a loan to acquire employer securities. Through Senator Long's efforts, ERISA was amended to provide an exception for ESOPs. By 1976, the concept had gained enough support that the Internal Revenue Service's proposed ESOP regulations, which proponents of employee ownership viewed as "chilling," caused Congress to publicly rebuke the Service for "attempting to frustrate congressional intent . . . ." By 1979, Congress was tying federal aid to the establishment of ESOP programs.

IV. THE STRUCTURE OF AN ESOP

The goal of the Weirton employees was the purchase of assets of the Weirton Division from National. The establishment of an ESOP became the mechanism for the acquisition of funds necessary for the purchase as well as modernization of the plant. The term "ESOP," defined within the Internal Revenue Code (Code), provided the

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24. Id.
25. Id.
26. Id. Responding to the demise of Penn Central, the Regional Rail Reorganization Act of 1973 was amended by Senator Long to allow employee ownership of the newly-created Conrail Corporation. After clearing the full Senate, the Conference Committee weakened the ESOP amendment to a mere study. This study "ultimately rejected the idea as impractical." Id.
27. Id.
29. Id.
30. Id. at 20. For example, the Chrysler Loan Guarantee Act, Pub. L. No. 96-185, 93 Stat. 1324 (1980), which gave Chrysler its recapitalization mechanism, required establishment of an ESOP as a condition of federal assistance. An additional act authorized the Small Business Administration to give loan guarantees to ESOP's for acquiring 51% control of a company. Granados further points out that Economic Development funds were disbursed with a preference for ESOP projects. Granados, supra note 13, at 20.
financial incentives which would attract potential lenders.32

The specific plan utilized in Weirton is called a leveraged ESOP. The key characteristic of this plan is that it allows the borrowing of money for the purchase of qualifying employer securities.33 In essence, it serves as a financing vehicle. First, an ESOP trust, called an ESOT, is formed.34 Next, the employer contracts to sell to the leveraged ESOP, and the leveraged ESOP agrees to purchase stock from the employer at an agreed price. The ESOT borrows money from qualified lenders to purchase the company's stock, and the company guarantees the loan, using stock issued to the ESOT as collateral.35 This ESOT money is then paid to the employer in payment for the shares the ESOT has contracted to purchase.36 The employer now has the funds to finance the purchase and then repays the loan annually so that the ESOT can repay its loan.37

The advantage of this plan over conventional debt financing is primarily tax-related. The following scenario, derived from figures supplied by the 1986 Tax Management Inc., provides an excellent illustration of this advantage.38 If a corporation borrowed $1,000,000 directly for a ten year period, it would repay the lender $1,440,000 in principal and interest. Since the interest is deductible, at a 50% bracket, the after-tax cash cost is $1,220,000. However, if the corporation used a leveraged ESOP, the pre-tax amount remains the same. Since the tax code allows deductions for both the interest and the principal for the ESOT contributions, the same 50% tax bracket corporations now can exclude $720,000.39 Thus the ESOP financing provides an after-tax savings of $500,000. In addition, the aggregate compensation of the Weirton participants' contributions used to pay

32. Tax Management, Tax Management, Inc., The Bureau of National Affairs, Inc. AA-1 (November 24, 1986). ESOP is defined in § 4975(e)(7) of the Internal Revenue Code as "[t]he stock, which is held by one or more tax-exempt trusts . . . [and] may be acquired through direct employer contributions or with the proceeds of a loan to the trust. Dividends paid on stock held in trust for employees may be distributed to employees or may be held in trust." Id.
33. Id.
34. Id.
35. Id.
36. Id.
37. Id.
39. Id. If a corporation's tax bracket is 50%, the deduction of one half of the total of the principle ($1,000,000) and interest ($440,000) would amount to $720,000. Id.
off the principal of the ESOP loans are fully deductible up to the lesser of $30,000 or 25% under Code section 413(e)(3).\textsuperscript{40}

The employees in an ESOP receive their stock interest by becoming a participant in the plan.\textsuperscript{41} If an employee meets the requirements as specified in the plan, the stock or cash that has been contributed to the Trust is allocated to his account. The amount accumulated is proportionate to the participant’s compensation. Entitlement to this account is tied to a vesting schedule through Code section 411. Many variations of the vesting schedule exist subject to compliance with the Code.\textsuperscript{42}

"While the stock is held in the Trust, and dividends paid on it can immediately be ‘passed through’ to the employees to provide them with additional income . . . [or] they may be used to accelerate repayment of the loan or used within the trust to purchase stock or other investments . . . ."\textsuperscript{43} In addition, if, as was the case in Weirton, the leveraged ESOP held non-publicly traded shares, voting rights are required only with respect to a corporate matter which (by law or charter) must be decided by more than a majority of outstanding common stock.\textsuperscript{44}

The actual terms agreed upon in the Disclosure Document were that:

Weirton would be initially owned by its employees through a trust under an ESOP. The ESOP will acquire up to 6,650,000 shares of Weirton's authorized Common Stock, of which 6,500,000 shares will

\textsuperscript{40} In response to an inquiry dated December 27, 1982, from T. L. Bryan, the organizational president of the new company, the Internal Revenue Service issued a determination of I.R.C. § 413. Since the ESOP revisions of 1983 were still uncertain, the reply stated the 25% and $30,000 figures cited in the text were correct. Determination Letter, Acquisition of Assets of the Weirton Steel Division and Establishment of Weirton Steel Corporation Employee Stock Ownership Plan, Sec. 7, 1-3 (January 11, 1984).

\textsuperscript{41} Granados, \textit{supra} note 13, at 23-24.

\textsuperscript{42} \textit{Id.} Weirton chose to have full and immediate vesting of allocated stock. Disclosure Document, \textit{supra} note 2, at 79. However, Weirton profited by the Vermont Asbestos Group (VAG) employee buy-out. After financing of $1,500,000 was obtained and the stock value increased 4000% ($50 to $2000), employees sold enough shares to a local businessman that they lost control of the company. Olson, \textit{Union Experiences With Worker Ownership: Legal and Practical Issues Raised By ESOPs, TRASOPs, Stock Purchases and Co-Operatives}, Wis. L. Rev. 729, 743-46 (1982). Therefore, the Weirton ESOP has non-assignability of ESOP accounts until stock is distributed to the participants. Disclosure Document, \textit{supra} note 2, at 80.


\textsuperscript{44} \textit{Id.}
be acquired by issuing a promissory note to Weirton at the time the acquisition is completed. As the note is repaid in the future by annual Weirton contributions to ESOP, the acquired stock will be allocated to ESOP participants according to their relative compensation. Depending on the then existing circumstances, the ESOP may commence distribution of allocated Weirton stock to participants who request it on and after July 1, 1988. A referendum, with participants voting on a "one man/one vote" basis, will be taken to determine whether, in the future, ownership of Weirton stock other than by the ESOP . . . would be allowed. . . . ESOP participants will have rights by means of "pass through" voting to direct the voting of stock on all issues, except that their rights to vote in the elections of Weirton's directors will be limited.45

V. THE EVOLUTION OF THE WEIRTON ESOP

The eighteen-month period between the March 2, 1982, meeting in National's board room and September 23, 1983, the date on which the employees voted by a margin of eight-to-one to purchase the plant, was filled with constant activities and decisions. The first step was the organization of the Joint Study Committee (JSC), a joint effort by the ISU, the IGU, and non-represented employees including Weirton's managers (acting on their own behalf, rather than National's).46 "The primary goal of the Joint Study Committee was to investigate and determine whether the Division, operating as an independent company, could be economically viable in conducting the operations of an integrated steel mill."47 The twenty-five man committee, which incorporated under West Virginia law on June 22, 1982, as a not-for-profit corporation, began by hiring Wall Street experts.48 Funding was received from the State of West Virginia, the ISU, IGU, retirees, management, employees, and various community and civic groups.49

After interviewing two of the nation's most prestigious firms,50 the committee chose McKinsey & Company, Inc. to complete a feasibility study.51 The basis for the decision was twofold: (1) that firm's

46. Id. at 14.
47. Id.
48. Id.
49. Id.
impressive credentials and the number of people whom they would dedicate to the study and (2) their extensive marketing study experience in the world-wide steel and container industry.\textsuperscript{52} The hiring of such a blue-chip adviser was from the outset part of the Committee's strategy. Since Weirton would be a $1 billion-a-year company and a member of the Fortune 500, the Committee wanted "a report which would be unimpeachable on Wall Street."\textsuperscript{53}

The feasibility report (McKinsey Study), issued four months later on July 26, 1982, for a fee of $500,000, concluded that an independent Weirton would work, "but only if the employees are prepared to accept significantly lower total compensation . . . and if, and only if, union and management can forge the leadership necessary to shape and direct the new organization."\textsuperscript{54} The approach centered on two parallel queries: (1) market outlook and (2) industry cost position.\textsuperscript{55} This focus produced projected demand for Weirton's, principle product lines, projected price levels and margins under several scenarios, and optimal product mix.\textsuperscript{56} Based on this analysis, the McKinsey Study concluded that all employees would have to accept a thirty-two percent reduction in pay, the new Weirton would have to invest to be a viable fully-integrated producer (i.e., rebuild one coke battery), and the company would have to cut operating personnel.\textsuperscript{57}

During the four-month period when the study was being prepared, both the JSC and the community remained active. Communications, in a town flooded with ever-present rumors, were an essential. The JSC Journal, a newsletter relaying important messages, began distribution on March 30, 1982. A telephone Message Center was established to answer specific, individualized questions concerning the plan.\textsuperscript{58} A series of speaking engagements were held throughout the

\textsuperscript{52} Joint Study Committee Journal News Release, April 2, 1982.

\textsuperscript{53} Rowe, \textit{supra} note 5, at 36.

\textsuperscript{54} McKinsey & Co. Study [hereinafter McKinsey Study], Assessing the Feasibility of an Independent Weirton Steel, Sec. 2, 1 (July 26, 1982).

\textsuperscript{55} \textit{Id.} at 2.

\textsuperscript{56} \textit{Id.} at 3.

\textsuperscript{57} \textit{Id.} at 4. In addition, the McKinsey Study stated: Operating costs must be cut by another $25 million annually to reach a competitive position . . . . Cost saving investments in such items as the second continuous caster will result in fewer management and union employees. Although we have not been able to study manpower reduction in depth, we do note the immediate need to reduce salaried employees and the eventual need, by the late 1980's to reduce total employment to approximately 7,000. \textit{Id.}

\textsuperscript{58} Joint Study Committee Journal News Release, April 16, 1982.
area, educating the community about ESOP. The community rallied; billboards proclaiming “We Can Do It” and “Let’s Save Weirton” went up around town. Green ribbons, symbolic of a fresh beginning, appeared on car doors, shop windows, trees, and telephone poles. A sense of survival had ignited a community spirit, and a civic crusade ensued.

On April 27th, the JSC hired Alan Lowenstein and John Curtis, as co-counsels. The original concept was for Curtis to handle the drafting of the ESOP document and for Lowenstein to establish a financing package and negotiate an asset price with National. The Lowenstein firm, having had extensive experience with ESOPs, had been recommended by National. This recommendation was, in retrospect, an ominous sign. Finally, on May 19, 1982, stating that the conceptual understanding of labor and management on the JSC was opposed to that taken by Mr. Lowenstein, the two mutually terminated the contract, and the firm of Willkie, Farr & Gallagher was hired to represent the employees.

In addition, since the JSC needed to estimate National’s liabilities for pensions and other benefits if it closed the plant, the actuarial firm of Towers, Perrin, Forster & Crosby was hired. The results of this study, issued November 9, 1982, showed that National’s liability in the event of a shutdown would be $770 million, a fact Weirton used as a bargaining chip in its negotiations with National.

After interviewing such blue-chip firms as Merrill Lynch, Oppenheimer, and Goldman Sachs, the JSC selected Lazard Freres, which had engineered New York City’s bailout, as its investment banker. According to David L. Robertson, the ISU’s attorney, the Committee felt Lazard Freres had a sense of labor’s concern in such a transaction.

59. Lowenstein was from the firm of Lowenstein, Sandler, Brochin, Kohl, Fisher & Boylan of Roseland, New Jersey. Masters, Trust Closes Culture Gap in Weirton Buy-out Deal, 6 Legal Times 32, col. 1-2 (March 10, 1983).
60. Robertson Interview, supra note 1.
61. Id.
63. Towers Actuarial Study, supra note 9, at 1.
64. Id. The actual figures cited in the Towers Actuarial Report showed Weirton’s share of the assets were $489,380,000. Of this, $350 million was in reserve to cover pensions. The additional $400 monthly supplement awarded in case of plant shutdown increased National’s liability to $770.6 million. Id. at 6.
65. Rowe, supra note 5, at 38.
66. Robertson Interview, supra note 1.
Thus, the cast of principle players was set, and on September 29, 1982, "[w]hether National had intended to or not, it now found itself negotiating for real, in the big leagues."\textsuperscript{67} "Lawyers who participated in the deal, as well as outside observers, emphasized its complexity."\textsuperscript{68} Negotiations continued, and finally an Agreement in Principle was reached on March 11, 1983.\textsuperscript{69}

A summary of these proposals which were, in fact, ultimately adopted included a purchase price of $66 million in cash, an amount equal to twenty-two percent of the depreciated book value.\textsuperscript{70} The purchase was to be financed from a $120 million line of credit that Lazard Freres had secured from a consortium of banks headed by Citibank with an interest rate of only 1.5 percent over prime.\textsuperscript{71}

Additionally, a mortgage, held by National, was to be paid over fifteen years with no payment on the principal for six years, and the ten percent interest rate was deferred until the new company reached a net worth of $100 million.\textsuperscript{72} Moreover, to permit raising of new funds from banks, mortgage payments to National would be subordinated to payments on other bank loans.\textsuperscript{73} Twenty-five percent of the cost of current assets would be paid in cash at closing; the remainder would be repaid over 28 years with interest of ten percent or less.\textsuperscript{74}

Perhaps the most favorable item negotiated was National's assumption of certain pension obligations that reduced the workers' cut in compensation by a third.\textsuperscript{75} Of crucial interest to the new

\begin{footnotes}
\footnote{67. Rowe, supra note 5, at 38.}
\footnote{68. Masters, supra note 59.}
\footnote{69. Agreement in Principle, (March 11, 1983), Assessing the Feasibility of an Independent Weirton Steel, Sec. 5, 1 (July 26, 1982) [hereinafter Agreement in Principle].}
\footnote{70. These figures were assessed by both the Towers Actuarial Study, supra note 9, and the McKinsey Study, supra note 54.}
\footnote{71. Id.}
\footnote{72. Id.}
\footnote{73. Id.}
\footnote{74. Id.}
\footnote{75. According to the Disclosure Document, National retained certain pension liabilities for the following: These included charges for certain pension funding (1982 total pension cost—$53.6 million) and cost for retiree life insurance and health care benefits (1982 cost—$8.7 million), accounted for approximately 12.7% of the Division's overall labor costs which were, in effect, already saved. In addition, various decreases (or failures to increase) certain components of compensation were effectuated either on or about April 1, 1982 . . . were credited toward the 32% deduction. Disclosure Document, supra note 2, at 18.}
\end{footnotes}
employee-owners was the fact that pension benefits received from National would never be reduced. In other words, each employee would be vested under National's pension plan with his accrued benefit at transfer, whether or not he had worked ten years. Future service with Weirton would be added to years with National, and the two companies would share the costs of such payments proportionately. Finally, National agreed to provide a five year safety net. Thus, if the plant closed during the first five years, National would still assume responsibility for increased pensions, including the $400 special monthly payments made to each employee. With the issuance of the McKinsey Study, Weirton's workers became aware that reductions were inevitable. They were, of course, a necessity. Additionally, the JSC's emphasis upon instructive communications helped the individual worker understand the basic concept of employee-ownership. Over the next ten years, each employee would forego a salary of approximately $6,000 annually. Yet, if the company remained profitable, the value of the accumulated stock could increase to as much as $90,000.

One of the most difficult areas concerned the issue of pensions. The employees felt that the Rule of 65 and 70-80's was sacrosanct. Additionally, this was a potential area of division between the older employees, who with early retirement under National could have received full pension benefits plus an extra $4000 per month if the mill closed, and those younger, who would not receive such security. Thus from a personal viewpoint, the older worker had more to lose by buying the plant—lower wages plus the possibility of closure under a new company without the vast financial resources of National. Although several employee lawsuits were filed to block the sale, the employee vote in late September ratified the agreement by an eight-to-one margin.

76. Id.
77. Agreement in Principle, supra note 59.
78. Id.
79. Rowe, supra note 5, at 38.
80. According to the Disclosure Document, the Rule of 65 allows any employee to retire who is under age 55 but has at least 20 years continuous service and whose age and continuous service equals 65 or more (i.e., 45 and 20) but less than 80. The 70-80 rule allows retirement if the worker's age (which must be at least 55) and service equals 70 (i.e., 55 and 15) or whose combined age and service equals 80 or more (i.e., 52 and 28). Disclosure Document, supra note 2, at 53-54.
81. On March 30, 1983, 171 hourly employees sued National and the ISU in United States District Court alleging that the sale would entitle them to pension and severance benefits under collectively bargained pension and labor agreements (the
VI. ISSUES RAISED UNDER AN ESOP

What happens when labor governs itself through an ESOP? Obviously, there are both problems and potentialities. In the Weirton ESOP, the administration of that firm would have to provide for two interrelated but conceptually separable functions: organization's governance and the management of work. Normally, in labor law, a company is assumed to be divided into two components: management and labor, usually represented by a union. Such a model is advantageous. "It recognizes explicitly the interests of labor and provides for representatives of the workers to bargain with management on a wide range of issues." In bargaining situations, workers often assume that their gains are at management's expense, and management assumes the same.

In employee ownership, these traditional roles are much more complex. This is a new concept in relatively uncharted fields. According to the Employee Stock Ownership Plan Association, about 5,000 ESOP plans are in effect nationwide, yet these are mostly modest profit-sharing plans in which workers hold a small amount of stock. "Workers probably hold majority control of the stock in only a few hundred of these plans. . . ."

The concept of the corporation's control under employee-ownership has been subject to much dispute. Because an ESOP is set up as a trust in which the trustees have legal ownership, the legal owners, the trustees of the plan, have the right to exercise the voting power
of the stock held by the trust. Yet these voting rights are heavily regulated by the Internal Revenue Code if the corporation is to utilize the substantial tax benefits which the Code provides to ESOPs. First, all ESOPs must satisfy the requirements of section 409(e) with respect to voting rights on employer securities. In the case of Registration Type securities, the Code requires that a participant vote on all corporate matters. The voting rights controversy surrounds participants' voting on all corporate matters. Those advocating these rights feel that employee-owners should have a say in how the corporation is managed, asserting that this improves employee motivation, participation, and productivity. Such control, they feel, establishes a real change in the status of employees.

On the other hand, opponents argue that employees do not have the expertise "to evaluate complex and critical issues of corporate policy." To educate and inform the employees in order that they might vote using sound business judgment poses two additional problems: "(1) the added paperwork and procedural burdens and (2) the disclosure of confidential information." Furthermore, opponents counter the increased productivity argument using empirical data which shows no positive correlation between voting rights and productivity.

Legal issues also exist in relationship to potential conflicts of interest between the union's role in representing employees as employees and in representing employees as owner on boards of directors. In addition, if the employees gain control over the employer, a

87. Granados, supra note 13, at 31.

88. Section 409(e) states in pertinent parts that an employer of registration type securities meets IRS requirements only if each participant "is entitled to direct the plan as to the manner in which voting rights under employer securities . . . allocated to the account . . . are to be exercised with respect to a corporate matter . . . must be decided by more than a majority vote of outstanding common shares voted." I.R.C. § 409(e) (1986).

89. The Securities Exchange Act § 12(g), 15 U.S.C. § 78l(g) (1934) requires registration if the corporation has assets of at least $1,000,000 and 500 or more stockholders. Tax Management, Tax Management, Inc., Bureau of National Affairs, Inc. A-24 n.215 (December 23, 1985).

90. Granados, supra note 13, at 33.

91. Id.

92. Id. at 36.

93. Id. at 34.

94. See Survey Research Center, Univ. of Michigan, EMPLOYEE OWNERSHIP (Report to the Economic Development Administration, U.S. Department of Commerce, Project No. 99-6-09433, 1979) which "show[s] a negative relationship between voting rights and profitability." Granados, supra note 13, at 33 n.76.
conflict may arise concerning the protection of employee benefits.95 “A union may organize its stockholder members to aid them in acting collectively, but the union risks conflicts of interest when it becomes an institutional owner of a company for which it represents employees in collective bargaining.”96 Thus, union representatives must be aware of the legal obligations to the constituency which they represent.

VII. THE WEIRTON SOLUTION

The division of ownership in the Weirton ESOP will give blue-collar workers approximately seventy percent of the stock with white-collar workers receiving the rest.97 Yet, stock evidences not only economic ownership but also some measurement of control over the corporation. Such control is exercised through the stockholders’ voting rights.98 Therefore, Weirton’s ESOP had a variety of factors to weigh in the allocation of these rights. First, to reap the substantial tax benefits, the Code requirements had to be satisfied.99 Second, since Weirton is a Delaware corporation operating in West Virginia, compliance with the corporate laws of both states was required. Finally, if the employees were to be owners of the new company, they wanted some voice in the operation of the company. Therefore, the structure of the voting rights to Weirton’s stock is complex.

Delaware corporate law requires that stockholder action involves decision-making in (1) the election and removal of members of the Board of Directors and (2) structural changes (i.e., amendments to incorporation such as changes in authorized capital) and major transactions (i.e., mergers, consolidations, or dissolution).100 To comply with the Delaware law, Weirton’s charter provides that during the time that shareholder stock is held by the ESOT, all shareholders shall participate by voting upon those transactions listed above and that an approval of such issues shall require a minimum of a two-thirds majority of stockholders.101 In general, Weirton stockholders

95. Olson, supra note 42, at 780.
96. Id.
97. Corrigan, supra note 85, at 1678.
98. Some claim that an ESOP is an attempt at “union busting.” However, since the mechanism is quite flexible, the degree of worker control is determined by the way it is employed. Olson, supra note 42, at 753.
99. Id.
100. Disclosure Document, supra note 2, at 80.
101. Id. at 81.
may vote in person or by proxy. However, only the "record" stockholder is entitled to vote.\textsuperscript{102} Since the "record" stockholder listed on the stock transfer books of Weirton is the ESOP Trustee, this Trustee is the sole holder of record and the only stockholder entitled to vote.\textsuperscript{103} Yet, the ESOP contains provisions that the participants can have "pass through" voting to direct the Trustee's vote on certain matters.\textsuperscript{104}

Weirton's By-Laws state that the general management of the corporation shall be vested in the Board of Directors.\textsuperscript{105} Unlike most enterprises, however, the Board includes Union representatives. This was done to ensure that the Union would have an adequate voice in this body.\textsuperscript{106} Therefore, the Board is comprised of not less than ten nor more than fourteen members, of which at least three directors are designated by the Union.\textsuperscript{107} For example, in a twelve member Board, the three Union members will be determined by the ESOP Election Committee, comprised of Weirton's independent directors. This committee will instruct the Trustee to cast all shares of the ESOP stock for the current Union president, two other Union designees, and the current Chief Executive Officer.\textsuperscript{108} The remaining votes will be cast for individuals who are neither nominated by nor requested by any labor organization or employee of Weirton.\textsuperscript{109} For at least the first five years of operation, the majority of these directors will be independent directors who are neither employees of Weirton nor affiliated with any labor organization.\textsuperscript{110} So long as Weirton

\textsuperscript{102} Weirton Steel Corporation By-Laws, (By-Laws) Acquisition of Assets of Weirton Steel Division and Establishment of Weirton Steel Corporation Employee Stock Ownership Plan, Sec. 10, 1 (January 11, 1984) [hereinafter By-Laws].

\textsuperscript{103} The Independent Trustee is selected by Weirton's Board. \textit{Id.}

\textsuperscript{104} \textit{Id.}

\textsuperscript{105} \textit{Id.}

\textsuperscript{106} In a similar situation concerning an ESOP formation at Pan Am, union leaders felt that "even one director, trusted and chosen by them for his competence, [could] serve the necessary function." Olson, \textit{supra} note 42, at 779.

\textsuperscript{107} By-Laws, \textit{supra} note 102, at 5.

\textsuperscript{108} Disclosure Document, \textit{supra} note 2, at 81.

\textsuperscript{109} \textit{Id.} In the alternative, a larger number is allowed for the union if the composition of the Board is increased to preserve adequate Union representation. \textit{Id.}

\textsuperscript{110} \textit{Id.} At the outset these directors included Eugene Keilin, Senior Vice President of Lazard Freres; Harvey Sperry, partner in Willkie Farr & Gallagher; Gordon Hurlbert, past President of a subsidiary of Westinghouse; Lawrence Issacs, Vice President and General Manager of the Aircraft Components Group of TRW; Richard Schubert, President of the American Red Cross; David L. Robertson, Counsel for the ISU; Irving Bluestone, Professor of Labor Studies at Wayne State
stock remains in the ESOP, these independent directors will be retained in office by the vote of the ESOP Trustee.\(^{111}\)

In addition to requirements for electing Board Members, voting procedures are divided into other categories. For the corporation’s routine matters, which require a favorable vote by only a majority of the shares actually voted, the rule of “majority of the quorum” is used.\(^{112}\) In this instance, the ESOP requests instruction from the ESOP participants under a one man/one vote rule. The ESOP Trustee then casts all shares in proportion to the results of that vote. For example, if 5,000 votes of 7,000 eligible votes are cast, the majority of the quorum requirement has been met. Furthermore, if the vote were three-to-two for affirmative action, the ESOP Trustee would cast a ballot for all shares held by the ESOP (both allocated and unallocated), voting sixty percent of the shares for and forty percent of the shares against the question.\(^{113}\)

On the other hand, if a matter is not routine and demands more than a majority of the quorum, the ESOP Trustee must request voting instructions based upon stock allocated to participants’ accounts, rather than the one man/one vote rule.\(^{114}\) In this case, the Trustee votes in accordance with the votes cast. Additionally, the ratio of affirmative and negative votes is calculated, thereby indicating the manner in which the Trustee votes those shares still remaining in the ESOP Suspense Account.\(^{115}\)

Conflicts of interests in collective bargaining situations which occur when employee-owners have union designates sitting on the Board of Directors are not, at present, an issue. The trend of the NLRB has been to use a “degree of control” test to determine whether or not the designate is to retain the NLRB of employee.\(^{116}\) Additionally,
the NLRB considers whether there is preferential treatment of employee stockholders conflicting with the interest of non-stockholding employees. However, in the Weirton case, where all stock is held by the ESOP, no conflict arises between employee and non-employee stockholders since only one category of owners exists. Significantly, a community of interest is retained where all employees are stockholders. Thus, the rule established in Everett Plywood and Door, Corp. applies.\textsuperscript{117} Everett stands for the proposition that the established rule for excluding employees who have an effective voice in management does not apply to 100\% employee-owned companies.\textsuperscript{118}

The National Labor Relations Board stated:

> The mere fact that an employee also has the privileges of a stockholder is not sufficient to debar him from availing himself, in his capacity as an employee, of the rights of employees to engage in concerted activities for the purposes of collective bargaining or other mutual aid or protection. . . . [S]tockholder employees not only have a proprietary interest in the employer-corporation, but also have an interest, at least as great, in their status as paid workers.\textsuperscript{119}

As far as the union's dual role as a bargaining agent and competitor, the NLRB and the courts have held that stock ownership "is legally distinguishable from stock ownership by the union or union pension fund."\textsuperscript{120} At Weirton, the individual union members who own stock are in no sense competing with their employer, thereby eliminating a conflict of interest. As employees, they depend upon the corporation for their livelihood; moreover, as stockholders, they have an interest in protecting both their savings and their pensions. Thus, the union is not sitting on both sides of the bargaining table anymore than the employer is sitting in the union meetings. "Nothing in labor law policy frowns upon such an arrangement so long as the conflicts of interest . . . are not present, and . . . the union's fiduciary and representational duties are not compromised."\textsuperscript{121}

\textsuperscript{117} Everett Plywood & Door Corp., 105 N.L.R.B. 17 (1953). Here all employees were stockholders, and had the right to appeal to but not overrule the board of directors on certain matters. The NLRB did exclude supervisors who were employees but allowed the production and maintenance employee-stockholders to remain within the unit. Olson, supra note 42.

\textsuperscript{118} Id.

\textsuperscript{119} Id.

\textsuperscript{120} Olson, supra note 42, at 790.

\textsuperscript{121} Id.
VIII. Conclusion

As the employees of Weirton discovered, an ESOP is no guaranteed panacea to a plant closing. Both management and union must work together to make Weirton successful. Yet, the example Weirton provides must not be ignored. First, the employees allowed adequate time to plan a successful takeover. Second, they employed experts to analyze potential profits and cost reductions. A third and crucial element was leadership. The JSC, although at times cumbersome, provided the necessary organizational structure. Utilizing the foresight to employ expert financial and legal assistance, they remained involved in the process itself. In fact, it was through their efforts that the employees backed the plan. A fourth element in the success was adequate financing. Here, the ESOP’s built-in tax breaks proved to be a boon. Finally, although disputes arose during negotiations, all parties shared a positive stake in the ESOP’s success.

The successful rebirth of the new Weirton is dependent upon the success of the ESOP. Undoubtedly, National’s announcement on March 2, 1982, was a potential death knoll which reverberated throughout both the plant and the community. Yet, through the creation of an employee stock ownership plan, a community and a company which sensed approaching death created a new company, a “New Beginning.” The preparation and implementation were slow and sometimes painful. Hopefully, the efforts will prove fruitful and develop into a vital and productive company.

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