MINUTES

MONTANA SENATE
51st LEGISLATURE - REGULAR SESSION

COMMITTEE ON BUSINESS AND INDUSTRY

Call to Order: By Chairman Gene Thayer, on January 30, 1989, at 10:00 a.m.

ROLL CALL

Members Present: Chairman Thayer, Vice Chairman Meyer, Senator Noble, Senator Williams, Senator Hager, Senator McLane, Senator Weeding, Senator Lynch.

Members Excused: Senator Boylan

Members Absent: None

Staff Present: Mary McCue, Legislative Council

Announcements/Discussion: Chairman Thayer stated the committee must vote on a letter of intent for SB 115. Senator Lynch moved the statement of intent on SB 115. Senator Hager seconded, and the motion carried unanimously.

HEARING ON SENATE BILL 215 AND 246

<u>Presentation and Opening Statement by Sponsor:</u> Senator Halligan, Senate District 29, asked that SB 215, and SB 246 be considered together in a package, because the arguments and discussions would pertain to both. He would present them separately, but both could be testified to together.

Chairman Thayer stated, with no objection from the committee they would hear the bills as a package. The committee consented.
Senator Halligan entered a summary, from the Department of Commerce. He said SB 215 was a key piece of legislation, as well as SB 246, in economic development. He said they were trying to move Montana into the twenty-first century, by promoting employee ownership as well as stock options. He then went through the summary presented to the committee. (See Exhibit #1)

List of Testifying Proponents and What Group They Represent:

Bob Hefner - Department of Commerce
Kathy Irigoin - State Auditor's Office

List of Testifying Opponents and What Group They Represent:

None

Testimony:

Bob Hefner said he would like to point out and emphasize, that both bills were administration bills, and were part of the Governor's package, and were part of our previous Governor's package. They were bills that would cost very little, and made good sense.

The bills declared a policy of support for employee incentive, participation, and stock ownership plans; different ways of turning employees into business people. The states existing business programs were to be extended to employee owned companies. It further directed the Department of Commerce to gather, and make available information about incentive plans, to present seminars, to provide training, and to report to legislation on these subjects. It also set up a clear legal framework for industrial cooperatives. He said that under employee owned business, over a ten year period, the employee owner could build equity about three times as fast as just working. He cited employee ownership as broadening capital reinvestment, and keeping business in the state. (See Exhibit #4 & 5)

He stated that since the committee only had two bills to hear, he would take them through the bills step by step, explaining to them as they went.

Kathy Irigoin said she was present mainly to answer questions, but had a question. She asked if all of the subsections in SB 215, relating to employee cooperative corporations, would be void if SB 246 did not pass? She said she had a proposed amendment to make the changes they felt necessary. (See Exhibit #2, & #3)

Questions From Committee Members: Senator McLane asked, "If SB 215, and SB 246 were in the statutes now, would the people operating the aluminum plant in Columbia Falls be getting more help than they are now? What is the difference that this legislation would make?"

Mr. Hefner said, "The plant at Columbia Falls was a management buy out, a small group of managers who operate the plant. It was not an employee ownership where all the employees bought the stock. They reward their employees, on the basis of the plant's performance, at the end of the year. Their structure is somewhat different than what is being discussed here, and I think an ESOP might help them more. I'm not aware of an employee owned and operated ESOP corporation in Montana."

Senator McLane asked, "If the employees want to buy the company, do they go to the bank and borrow the money?"

Mr. Hefner replied, "An ESOP is a wonderful borrowing mechanism. It can allow refinancing and recapitalization of major investments. If all the outstanding stock were put into an ESOP plan, the ESOP could in turn borrow the full value of the stock through a bank. The loan is then paid off through contributions to the pension plan through the years, with considerable tax savings."

Senator Williams asked if the state would share in the cooperatives?

Hefner said, "The state sets guidelines and framework, but doesn't share ownership."

Senator Williams "Who might be ready to utilize this program? What can be expected to come out of your report in a couple of years? Mr. Hefner said, "The Champion Company is a real prospect.....The cooperative corporations law gives a ready made structure, and would save time and money in forming a corporation. More than the Champion Company, there are thousands of small businesses in the state of Montana who aren't aware of the E.S.O.P. structure, and what they could gain from it."

Senator Williams asked, "If the mechanics of SB 246 were set up to address the unclaimed dividends, or capital credits?" Mr. Hefner said "The legislation sets up a system specifically designed for that, called internal capital account. At the end of the year, any money left over can be distributed to the employee-owners."

Senator Weeding asked, "When the employee-owned cooperative is purchased, every owner starts with the same amount of equity and equal voting powers. As the plan expands, the higher paid employees gather equity in the company faster than the lower paid employees. Does the voting power, forever, stay equal?"

Mr.Hefner said, "Yes, they all pay a membership fee to begin with, approximately one years wages. That is just a fee, they are not buying stock. Their share of profits is the same percentage of total profits as their share of earnings is of total earnings. The incentive is there to encourage long productive hours. Their earnings are greater, and so is their share of profits, but their votes remain equal.

Senator Hager asked, "Are the taxes distributed to the members on the same percentage?" Mr. Hefner said, "The property taxes were paid by the company. Personal taxes are paid individually."

Senator Hager asked, "Does the company keep the money and pay it out, as the earnings grow."

Hefner said, "If the corporation provides for that, retained earnings are retained, and the company issues capital shares. The money would be used for company growth."

Senator Hager said, "Then the company really is distributing taxes to its' members, but they are receiving no actual cash to pay them." I am aware of a similar situation of employee ownership, and to receive their earnings they have to buy the company. "I wonder if this cooperative could work the same way."

Hefner said, "Possibly, it could, but they do have an equal vote, and should be able to control those situations."

Senator Hager asked, "Are the company losses distributed also?"

Mr. Hefner said, "They are exactly the same as profits."

Chairman Thayer said, "It has been stated, the cost to the Chamber would be nearly nothing. There obviously will be a cost to have people out assisting, or will existing staff handle it? I notice we don't have a fiscal note with the bill."

Hefner said "Small Business gives assistance to the Division. Our responsibility is to help with economic development, so administration will decide what our focus will be. I think it would be normal business assistance, and as for technical assistance, we would send the information so there would be no direct cost."

Chairman Thayer asked, "What is the purpose of this bill, or both of these bills? People can already form employee-owned stock companies under present law."

Senator Halligan said, "The legislation provides a framework, offers technical assistance, and saves thousands of dollars for the companies through their organizing process."

Chairman Thayer asked, "Does the program just apply to employee-owned ESOP's, or does also apply to ESOP plans where the employer owns the majority?"

Mr. Hefner said, "It would apply to both."

Chairman Thayer asked, Why is the structure for co-ops needed? Co-ops are already employee owned organizations now. What is the distinctive difference?"

Mr. Hefner said, "The employees of existing co-ops are not members, the people who purchase their products are. The benefits are distributed to the customers, not to the employees. The industrial cooperative distributes the benefits to its employees."

Chairman Thayer said, "I can see that distinction, but if the benefits go to the employees, where do the patrons fit into the structure? Cooperatives are also for the benefit of the patrons, are they not?"

Mr. Hefner said, "The benefit to the patrons is in the products being offered at a more reasonable price, through the efficiency of the organization."

Chairman Thayer asked, "Why call it a cooperative then? They can already organize cooperatives if they want one?"

Mary McCue said, "SB 215 has the provisions directing the Chamber of Commerce to supply the service. If you look at the definition of an employee-owned enterprise, it is the entity in SB 246, where the structure was set up."

Hefner said, "SB 215 gives direction to all forms of employment incentive plans, it doesn't try to set forth a statute toward the declaration of a business form."

Senator Meyer stated, "SB 215 promotes the idea, and SB 246 allows the mechanism to accomplish it."

Senator Halligan said, "The existing law allows cooperative associations, SB 246 would allow cooperative corporations."

Chairman Thayer said, "I still feel the word `cooperative' is incorrect in the manner it is being used. If it said, the creation of an employee stock option corporation, it would track. I don't think you can have a cooperative, in the sense of a cooperative that dove-tails in with an ESOP."

Hefner said, "The reason `cooperative' was used because `one member, one vote' is used to define a cooperative. The structure would not be an ESOP, because the stock was already distributed to the members."

Senator Lynch asked, "What about the effective date of July 1. What was the reason for that?"

Senator Halligan said "I think it was to fit the fiscal year of local government, but I have no objection to changing it to October."

Senator Noble stated, "I think the tax structure of a cooperative gives them an unfair advantages over their competition. I'm wondering if this legislation would encourage unfair competition to other type of corporations?"

Mr. Hefner said, "It certainly would be competitive, but the structure is available to everyone. The tax benefit is the same as Sub Chapter 5 Corporations, although the internal structures differ."

Closing by Sponsor: Senator Halligan said, Private business has to be able to survive on its own. If conditions were such that the employee-ownership became necessary, the laws should be in the statutes. It is a business aid that could be capitalized upon in the state of Montana. The banks are shutting down businesses which possibly could re-group under this form of corporation, and keep more businesses in business in our state.

DISPOSITION OF SB 215 AND 246

Executive Action will be taken at a later date.

DIPOSITION OF HOUSE BILL 150

<u>Discussion:</u> Chairman Thayer said, Mr. Gene Phillips of the Recreational Vehicle Association, would like an opportunity to address the committee in opposition to HB 150. The committee gave their consent.

Gene Phillips said, I am representing the Recreational Vehicle Industrial Association, which are the manufacturing companies that manufacture RVs....and other pieces of equipment like that.....The RV dealers are a little different than the other entities your are talking about, in the way that they operate. They have two trade shows, nation-wide, each year. They display their various wares from those two hundred and some manufacturers, most of which are small business organizations. At that time, they line up dealers to handle their product. The dealers, apparently of to these trade shows, for the purpose of lining up a good mix of the different things they want.....So they add and drop franchises on a regular basis....They also indicate to me that the Rv components, there is no necessity for a large parts inventory...."

Mr. Phillips said, "Most states do not have a requirement like that. There are some states that do require a buy back of the current year inventory, by the manufacturer, if the manufacturer terminates the dealership."

Mary McCue said, We talked about the effective date, and I don't think we really need it to be immediately effective. Do you remember what Representative Johnson's felling were?"

Senator Lynch said "His fear was that it might, in fact, by putting a later effective date, result in a great many people being terminated. Virtually, any company....could eliminate all franchises.....everybody who presently has one would be stuck with their present inventory."

Mary McCue said, "That's right, you may want to leave that on there. I think those bill should have a savings clause on it. I think there are impairment of contracts issues that are resent. If you had a savings clause, that would say this doesn't affect rights and duties that have matured, or proceedings that are already begun before the effective date."

Senator Lynch said, "It seems to me, if I read the title correctly, that would be beyond the scope of the title because we are simply adding additional categories to a present law. By amending this from three years to one year, you would be affecting those already covered . In fact, you would change the bill considerably from what the intent was." Mary McCue said, I think that's right, as to these other people who are presently covered, that is a substantive change in their rights."

Chairman Thayer asked, "If the committee thought it a good idea to make it a one year buy back instead of three, just for these only, could you do that?"

Mary McCue said it could be limited to the people listed within the bill as long as the existing law was not altered without notification of those people who would be affected.

Senator Noble said he thought it was important that businesses use discretion when purchasing products. He said he felt a three year guaranteed buy back upon leaving the franchise would cover a dealer who did not do any planning and he could send anything back that he did not sell. He thought the concerns of boat manufacturers should be studied further, some of the concerns probably should be looked at also.

Chairman Thayer expressed concern of allowing dealers to initiate the buy back. He thought maybe there were some unfair situations occurring, but did not want to send bad signals to the business climate within the state. Possibly, he said, it should be limited to the manufacturers initiation.

Chairman Thayer suggested the bill be held for further study, and to allow Mary time to incorporate the suggested changes.

ADJOURNMENT

Adjournment At:

SENATOR GENE THAYER, Chairman

GT/CT

ROLL CALL

BUSINESS & INDUSTRY COMMITTEE

DATE 1/30/89

51st LEGISLATIVE SESSION 1989

NAME	PRESENT	ABSENT	EXCUSED
SENATOR DARRYL MEYER	✓		
SENATOR PAUL BOYLAN			✓
SENATOR JERRY NOBLE	✓		
SENATOR BOB WILLIAMS	✓		
SENATOR TOM HAGER	✓		
SENATOR HARRY MC LANE	✓		
SENATOR CECIL WEEDING	✓		
SENATOR JOHN"J.D."LYNCH	✓		
SENATOR GENE THAYER	✓		

Each day attach to minutes.

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 1
DATE 1-30-89
BILL NO. SB 215 - 246

Employee Ownership Opportunity Act

Senate Bill 215

and

Cooperative Corporations Act

Senate Bill 246

Senator Mike Halligan
Sponsor

Summary of the Legislation

ACTION: Promotes and facilitates employee incentive plans, participatory management, employee stock ownership, and industrial cooperatives.

MEANS:
- Declares a policy of support.
- Directs the Department of Commerce to provide information, training and technical assistance.
- Exempts Employee Stock Ownership Plans (ESOPs) and cooperative corporation membership shares from state securities registration.
- Specifies a clear legal framework for organizing cooperative corporations.

PURPOSE:
- Increase industrial efficiency.
- Stabilize employment.
- Anchor capital in the community.
- Develop human resources: turn employees into business people.

COST: Information, training and technical assistance can be provided within existing programs. Exemption of ESOPs from securities registration, and enactment of cooperative corporation law will have no fiscal impact.

No appropriation is required or requested.

Ex # 1
1/30/89

Employee Ownership Opportunity Act

Senate Bill 215

and

Cooperative Corporations Act

Senate Bill 246

Senator Mike Halligan
Sponsor

Description

The Employee Ownership Opportunity Act essentially does three things: (1) declares an affirmative policy of support for employee incentive plans, participatory management and employee ownership, extending state business assistance programs to such companies; (2) simplifies the process of setting up employee owned companies by exempting ESOP securities and coop membership shares from state securities registration (federal law already provides for intense scrutiny of ESOPs); (3) directs the Department of Commerce to create and maintain a pool of information about incentive plans, participatory management and employee ownership; directs the Department to present seminars and provide management training in these subjects; and directs the Department to report to the legislature on accomplishing these objectives. The Cooperative Corporations Act specifies a clear legal framework for organizing industrial cooperatives, wherein the employees (rather than customers or clients) are the members and stockholders of the corporation.

Questions and Answers:

Ex. #1
1/30/89

Does this legislation force the creation of employee-owned firms?

Absolutely not. The bill simply encourages employees, owners and managers to examine several options through which they may or may not choose to implement employee participation, incentive or ownership plans. ESOP's offer several advantages to owners, including reduced-rate financing, improved employee productivity and the possibility of tax-free sale of the business to employees upon retirement.

Does a company have to be on the verge of bankruptcy in order to allow an employee buy-out?

No. In fact, most employee participation plans are initiated with solvent, profitable businesses. Buyouts, while not precluded in bankruptcy situations, usually occur in healthy businesses. Across the United States, over 8,000 companies, employing about 8,000,000 workers, have some form of employee ownership plan.

Does this legislation promote a socialistic approach to business problems?

Individual share ownership and participation in decision-making are expressions of both democratic and capitalistic ideals. Government does not participate in any part of the actual decision-making process, and individual rights and incentives are under the control of managers and employees, who design the type of participation they think best.

Has this type of legislation worked elsewhere?

Yes. The National Center for Employee Ownership in

Ex. #1
1/30/89

Washington, D.C. tells us that more than 17 states have similar legislation. Among the leaders in the field are; Massachusetts, Washington, Oregon, Illinois, Wisconsin, Iowa and California. In every case, employee ownership, when coupled with intelligent and professional management, has made improvements in profitability and productivity. In addition, many states have corporate laws which allow such employee participation and ownership, but which are not recognized as "special legislation" to that effect.

<u>What examples can you give me that prove the efficiency of such businesses?</u>

(1) The most exciting example from worldwide commerce is the Mondragon Cooperative Complex in Mondragon, Spain. It began in 1953, in a small town of about 14,000 people. After more than 35 years, Mondragon has grown to a network of 110 cooperative factories and supportive businesses that employ 20,000 people and annually do one billion dollars business worldwide.

(2) Studies by the National Center for Employee Ownership, and by the U.S. General Accounting Office, demonstrate that employee stock ownership, when combined with participation in management, yields efficiency gains in every kind of industry.

(3) Examples in the United States include more than a dozen lumber mills and plywood plants in Washington and Oregon, ESOP's like the Columbia Falls Aluminum Plant, and participatory management companies such as Montana Rail Link and Montana Mineral Resources--all of which represent businesses of widely

Ex. #1
1/30/89

varied types with different types of employee participation and management.

<u>Why can't businesses set up employee participation plans without this bill? (and) Why can't employees start up cooperatives without this legislation?</u>

They can, but this bill makes it much easier, and it provides both law and structure, as well as an information network to assist. Montana cannot afford to lose more jobs; this bill simply gives government and the public more ways to save businesses, and to improve productivity and profits.

<u>Why the provision for "one employee, one vote?"</u>

Nothing in Senate Bill 215 or Senate Bill 246 imposes that type of a structure, but if a one-to-one voting structure is chosen, each employee, whether labor or management, will have an equal voice in decisions affecting his or her life. A decision to relocate a factory, for instance, might be a good idea for a few people, but very bad for the majority. With a one-to-one voting structure, no one could force the majority to move if they didn't want to.

<u>What specific need does Senate Bill 246 address?</u>

S.B. 246 creates the necessary legal framework for employee-owned, or cooperative corporations, and completes the work done by S.B. 215. Current Montana law provides only a framework for farming and credit cooperatives and cooperative

Ex. #1
1/30/89

associations, wherein the owner-members are those who receive the services, rather than the employees of the business.

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 2
DATE 1-30-89
BILL NO. SB215-246

Kathy M. Irigoin
State Auditor's Office
444-5236

AMENDMENT TO SENATE BILL 215

1. Page 4, line 17 through line 22, page 10.
Strike: section 7 in its entirety
Insert: "Section 7. Section 30-10-105, MCA, is amended to read:

"**30-10-105. Exempt transactions.** Except as in this section expressly provided, 30-10-201 through 30-10-207 shall not apply to any of the following transactions:

(1) any nonissuer isolated transaction, whether effected through a broker-dealer or not. A transaction is presumed to be isolated if it is one of not more than three transactions during the prior 12-month period.

(2) (a) any nonissuer distribution of an outstanding security by a broker-dealer registered pursuant to 30-10-201 if:

(i) quotations for the securities to be offered or sold (or the securities issuable upon exercise of any warrant or right to purchase or subscribe to such securities) are reported by the automated quotations system operated by the national association of securities dealers, inc., (NASDAQ) or by any other quotation system approved by the commissioner by rule; or

(ii) the security has a fixed maturity or a fixed interest or dividend provision and there has been no default during the current fiscal year or within the 3 preceding fiscal years, or during the existence of the issuer and any predecessors if less than 3 years, in the payment of principal, interest, or dividends on the security.

(b) The commissioner may by order deny or revoke the exemption specified in subsection (2)(a) with respect to a specific security. Upon the entry of such an order, the commissioner shall promptly notify all registered broker-dealers that it has been entered and of the reasons therefor and that within 15 days of the receipt of a written request the matter will be set down for hearing. If no hearing is requested and none is ordered by the commissioner, the order will remain in effect until it is modified or vacated by the commissioner. If a hearing is requested or ordered, the commissioner, after notice of and opportunity for hearing to all interested persons, may modify or vacate the order or extend it until final determination. No order under this subsection may operate retroactively. No person may be considered to have violated parts 1 through 3 of this chapter by reason of any offer or sale effected after the entry of an order under this subsection if he sustains the burden of proof that he did not know and in the exercise of reasonable care could not have known of the order.

(3) any nonissuer transaction effected by or through a registered broker-dealer pursuant to an unsolicited order or offer to buy, but the commissioner may require that the customer acknowledge upon a specified form that the sale was unsolicited and that a signed copy of each form be preserved by the broker-dealer for a specified period;

(4) any transaction between the issuer or other person on whose behalf the offering is made and an underwriter or among underwriters;

(5) any transaction by an executor, administrator, sheriff, marshal, receiver, trustee in bankruptcy, guardian, or conservator in the performance of his official duties as such;

Ex. #2
1/30/89

(6) any transaction executed by a bona fide pledgee without any purpose of evading parts 1 through 3 of this chapter;

(7) any offer or sale to a bank, savings institution, trust company, insurance company, investment company as defined in the Investment Company Act of 1940, pension or profit-sharing trust, or other financial institution or institutional buyer, or to a broker-dealer, whether the purchaser is acting for itself or in some fiduciary capacity;

(8) (a) any transaction pursuant to an offer made in this state directed by the offeror to not more than 10 persons (other than those designated in subsection (7)) during any period of 12 consecutive months, if:

(i) the seller reasonably believes that all the buyers are purchasing for investment; and

(ii) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective buyer; provided, however, that a commission may be paid to a registered broker-dealer if the securities involved are registered with the United States securities and exchange commission under the federal Securities Act of 1933, as amended.

(b) For the purpose of the exemption provided for in subsection (8)(a), an offer to sell is made in this state, whether or not the offeror or any of the offerees is then present in this state, if the offer either originates from this state or is directed by the offeror to this state and received at the place to which it is directed (or at any post office in this state in the case of a mailed offer).

(9) any offer or sale of a preorganization certificate or subscription if:

(a) no commission or other remuneration is paid or given directly or indirectly for soliciting any prospective subscriber;

(b) the number of subscribers does not exceed 10; and

(c) no payment is made by any subscriber;

(10) any transaction pursuant to an offer to existing security holders of the issuer, including persons who at the time of the transaction are holders of convertible securities, nontransferable warrants, or transferable warrants exercisable within not more than 90 days of their issuance, if:

(a) no commission or other remuneration (other than a standby commission) is paid or given directly or indirectly for soliciting any security holder in this state; or

(b) the issuer first files a notice specifying the terms of the offer and the commissioner does not by order disallow either (a) or (b) of this subsection;

(11) any offer (but not a sale) of a security for which registration statements have been filed under both parts 1 through 3 of this chapter and the Securities Act of 1933 if no stop, refusal, denial, suspension, or revocation order is in effect and no public proceeding or examination looking toward such an order is pending under either law;

(12) any offer (but not a sale) of a security for which a registration statement has been filed under parts 1 through 3 of this chapter and the commissioner in his discretion does not disallow the offer in writing within 10 days of such filing;

(13) the issuance of any stock dividend, whether the corporation distributing the dividend is the issuer of the stock or not, if nothing of value is given by stockholders for the distribution other than the surrender of a right to a cash dividend where the stockholder can elect to take a dividend in cash or stock;

(14) any transaction incident to a right of conversion or a statutory or judicially approved reclassification, recapitalization, reorganization, quasi-reorganization, stock split, reverse stock split, merger, consolidation, or sale of assets;

(15) any transaction in compliance with such rules as the commissioner in his discretion may adopt to serve the purposes of 30-10-102. The commissioner may in his discretion require that 30-10-201 through 30-10-207 apply to any or all transactional exemptions adopted by rule.

Ex. #2
1/30/89

(16) any transaction by a certified Montana capital company as defined in 90-8-104, provided that such company first files all disclosure documents, along with a consent to service of process, with the commissioner. The commissioner may not charge a fee for the filing.

(17) the sale of a commodity investment contract traded on a commodities exchange recognized by the commissioner at the time of sale;

(18) transaction within the exclusive jurisdiction of the commodity futures trading commission as granted under the Commodity Exchange Act;

(19) a transaction that:

(a) involves the purchase of one or more precious metals; and

(b) requires, and under which the purchaser receives within 7 calendar days after payment in good funds of any portion of the purchase price, physical delivery of the quantity of the precious metals purchased. For the purposes of this subsection, physical delivery is considered to have occurred if, within the 7-day period, the quantity of precious metals, whether in specifically segregated or fungible bulk, purchased by such payment is delivered into the possession of a depository (other than the seller) that:

(i) (A) is a financial institution (meaning a bank, savings institution, or trust company organized under or supervised pursuant to the laws of the United States or of this state);

(B) is a depository the warehouse receipts of which are recognized for delivery purposes for any commodity on a contract market designated by the commodity futures trading commission; or

(C) is a storage facility licensed by the United States or any agency of the United States; and

(ii) issues, and the purchaser receives, a certificate, document of title, confirmation, or other instrument evidencing that such quantity of precious metals has been delivered to the depository and is being and will continue to be held on the purchaser's behalf, free and clear of all liens and encumbrances other than:

(A) liens of the purchaser;

(B) tax liens;

(C) liens agreed to by the purchaser; or

(D) liens of the depository for fees and expenses that previously have been disclosed to the purchaser.

(20) a transaction involving a commodity investment contract solely between persons engaged in producing, processing, using commercially, or handling as merchants each commodity subject to the contract or any byproduct of the commodity~~.~~;

(21) any offer or sale of a security to an employee of the issuer, pursuant to an employee stock ownership plan qualified under section 401 of the Internal Revenue Code of 1986; and

(22) any offer or sale of a membership share issued by an employee cooperative corporation organized under the provisions of [Bill No. (LC 1149)]."

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 3
DATE 1/30/89
BILL NO. SB215-246

(This sheet to be used by those testifying on a bill.)

NAME: Kathy Irigoin DATE: 1/30/89

ADDRESS: P.O. Box 4009 Helena 59604

PHONE: 444-2040

REPRESENTING WHOM? State Auditor's Office

APPEARING ON WHICH PROPOSAL: SB 215

DO YOU: SUPPORT? ______ AMEND? X SB215 OPPOSE? ______

COMMENT: If want exemption from broker-dealer and salesman registration requirement (30-10-201, MCA), then should amend, in section 7, 30-10-105, MCA, not 30-10-104, MCA. Also, in coordination instruction, shouldn't all of the subsection, in SB 215 relating to employee cooperative corporations be void if SB 246 (LC 1149) does not pass?

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

SENATE BUSINESS & INDUSTRY
EXHIBIT NO. 4
DATE 1-30-89
BILL NO. SB 215 : 246

HOW THE WORKERS RUN AVIS BETTER

Employee ownership is the best thing to happen to the No. 2 car renter in a long time. For a lot of companies it could be the key to better performance in the Nineties. ■ *by David Kirkpatrick*

A YEAR HAS PASSED since the employees bought Avis, and when Chairman Joe Vittoria isn't out pumping the troops for ideas to help improve customer service he is often fielding inquisitive calls from executives of major corporations. With 12,500 employees, Avis is the best-known company in America fully owned by an employee stock ownership plan, or ESOP. Vittoria, 53, says Avis's success with the plan has executives from "much bigger" corporations thinking seriously about creating one themselves.

It's easy to see why. As America moves toward a more service-oriented and highly leveraged economy, ESOPs seem made to order. Employee ownership has proven particularly effective in motivating workers to provide extra effort in customer service. Provisions in the tax code render debt a lighter burden on ESOP-owned companies than on conventional competitors (see box). ESOPs have been around a long time, and most own only a small percentage of a company's stock. But 1,500 companies, with 1.5 million employees, were majority-owned by ESOPs at the end of last year, and the number is growing.

Those curious corporate callers hear nothing but encouraging words from an enthusiastic Vittoria. "Believe me, the ESOP works, and it works very well," he exults, sitting in his large but spartan office at headquarters near New York's Kennedy Airport. In typically frugal Avis style, the room appears not to have been redecorated since Avis moved in 21 years ago. The tall, folksy CEO proudly reports that operating profit for the first six months of 1988 rose 35% over the same period in 1987, when Avis was owned by Wesray Capital, an investment firm that purchased it in 1986. (Operating earnings for 1987 totaled $177 million on revenues of $971 million.) By year-end Avis will have repaid about $90

REPORTER ASSOCIATE *Susan Kuhn*

Chief Joe Vittoria gets out often to talk with fellow owners like bus driver Marcos Santiago.

million of the $650 million the ESOP buyout added to the company's debt obligation—more than double the projected repayment.

"Right now Avis is on a roll," says Charles Finnie, an analyst at the Baltimore brokerage Alex. Brown & Sons, who is widely considered the country's most knowledgeable observer of the rental-car industry. "The ESOP has really improved their morale and productivity and service." Avis's share of the brutally competitive airport market, where 70% of all car rentals take place, is up a point to about 27%, and all internal measures of service quality are setting records. On-time arrivals of airport buses have risen from 93% to 96%, for example. Service-related customer complaints were rising at the time of the employee buyout but have subsequently dropped 35%, from 1,918 in the 12 months ended in August 1987 to 1,238 a year later.

The lesson from Avis is not that an ESOP is a quick fix. Says Vittoria: "Just

Ex #4
11/30/87

creating an ESOP isn't going to make you a better company. It's how you involve the employees, it's how you maintain a dialogue, listen to their input, and use it." Since the buyout, Avis has organized employee participation groups as a conduit for ideas, and everything from billing to bathrooms to baby seats is changing as a result. Corey Rosen, executive director of the National Center for Employee Ownership, a nonprofit research group in Oakland, California, applauds Avis's effort to increase employee involvement. But he is frustrated that it is still unusual. Most ESOP executives mistakenly believe employee ownership alone will boost productivity, and shun participative programs.

The center's research has found that if an ESOP-owned company allows workers to participate in decisions about their jobs, it will grow an average of 11% faster than if it doesn't. Says Rosen: "An employee comes to work and is motivated as an owner, but that motivation is useless unless there's a structure to use the ideas, experience, and knowledge he or she has. And Avis has taken all this to heart." Rosen believes employee involvement programs can be helpful in any company but are more likely to succeed with employee ownership.

Wesray Capital and senior Avis managers had bought the company, then part of Beatrice Cos., from Kohlberg Kravis Roberts & Co., the leveraged-buyout firm that controlled Beatrice. Led by Wesray Chairman Ray Chambers, the group paid $1.6 billion in July 1986 and after selling off some assets sold Avis to the ESOP for a stunning $740 million profit just over a year later. (Former Treasury Secretary William E. Simon, the WES of Wesray, withdrew from active involvement before the Avis purchase.)

IN THIS TYPE of leveraged deal, an ESOP borrows the money to buy the company, or part of it, in the name of the employees. A trustee holds the shares and is mandated to represent the interests of the eventual shareholders. As the company pays off the debt, shares are allocated to employees in proportion to their pay. Managers receive shares in the same proportion as car cleaners, but federal law restricts anyone from receiving an allocation of more than $30,000 of ESOP stock in any given year. By the end of this year, employees at Avis will own about ten shares per $1,000 of annual compensation.

Vittoria predicts that within 15 to 18 years all 24 million shares will be held by employees, who must remain at least five years for their shares to be vested. An outside appraiser appointed by the trustee values the shares annually. The current value is $5.22, which will certainly rise this year to reflect the company's impressive performance. Even after shares are awarded to an employee, the trustee holds them. When a vested employee leaves the company for any reason, the trust buys out the shares at the most recently assessed price (with the full value of the payout as taxable income to the employee).

"We're going to give a lot of people an opportunity to build a nest egg here that they would never have been able to build in their lives," says Vittoria. That's just what Louis Kelso had in mind. As the inventor of the ESOP and its indefatigable advocate, he passionately believes that capitalism will not survive unless capital ownership is more evenly distributed across the economy. He declares: "For employees of service enterprises not to have a piece of the action is almost another form of slavery."

Kelso, 74, finds it inexcusable that all leveraged buyouts don't have at least an ESOP component. He says that the first ESOP buyout he orchestrated—at Palo Alto's Peninsula Newspapers in 1956—was the first LBO. He also claims that in about 1964 he introduced LBOs to George Roberts, who was courting the niece of one of Kelso's law partners, and to Roberts's friend Jerome Kohlberg. "I taught them the art of the leveraged buyout. Now they're just using it for the wrong purpose—to make themselves and a few people richer," laments Kelso. Kohlberg and Roberts have no comment.

DESPITE Avis's success at rousing employees with the plan, they would never have become owners were it not for the generous tax benefits Kelso has won for ESOPs over the years. In the early Seventies he convinced Russell Long, then the potent chairman of the Senate Finance Committee, that employee ownership was good for the economy. Long helped write a succession of bills that aided ESOPs. Lenders to an ESOP pay taxes on only half the interest they receive and can thus charge lower rates. Avis routinely carries a huge debt in connection with its fleet of vehicles—about $1 billion at the time of the deal. The management figured a way to include that sum in the tax-favored ESOP debt. Result: The company significantly lowered its cost of doing business.

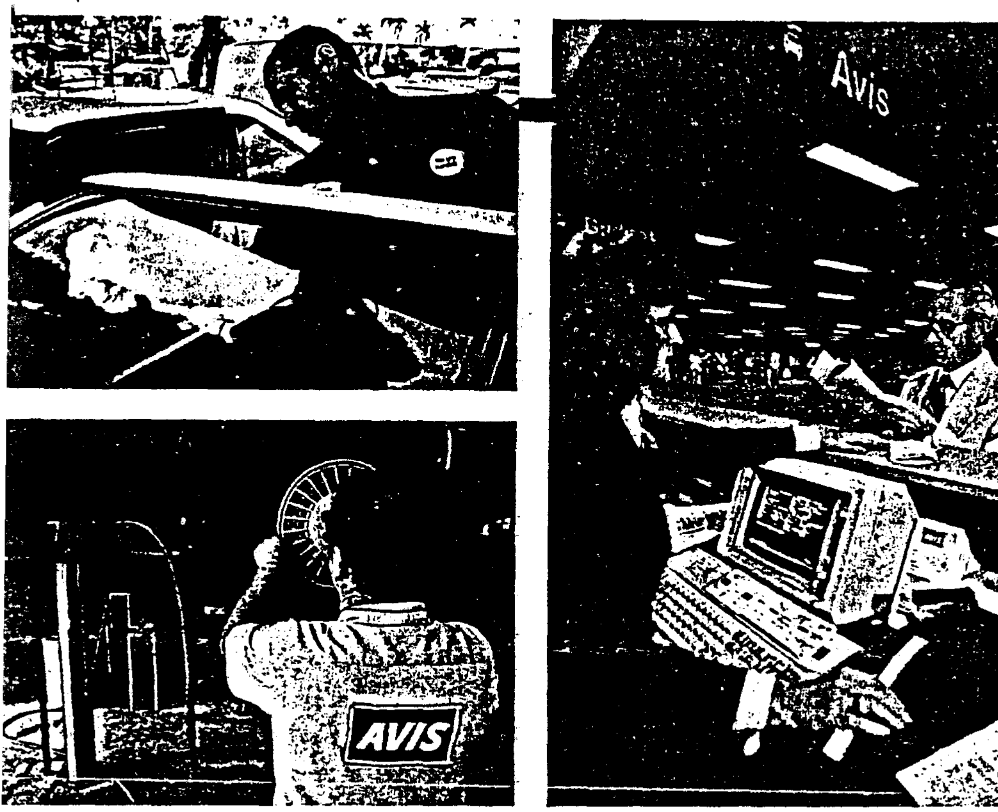
Another major concern for Vittoria was to get Avis off what he and everyone else there call its "merry-go-round" of owners.

THE TEN LARGEST ESOP-OWNED COMPANIES

COMPANY	BUSINESS	% ESOP-OWNED	ESOP BEGUN	EMPLOYEES
HealthTrust Nashville	Hospital management	100%	1987	23,000
Avis Garden City, N.Y.	Car rental	100%	1987	12,500
EPIC Healthcare Group Dallas	Hospital management	100%	1988	10,000
Amsted Industries Chicago	Diversified manufacturing	100%	1986	8,300
Avondale Industries New Orleans	Shipbuilding	60%	1985	8,000
Parsons Pasadena, Calif.	Engineering & construction	100%	1974	8,000
Weirton Steel Weirton, W.Va.	Steel manufacturing	100%	1984	8,000
Dan River Danville, Va.	Textiles	100%	1983	7,000
Austin Engineering Austin, Texas	Construction	60%	1987	6,500
Wyatt Cafeterias Dallas	Cafeterias	100%	1988	6,500

SOURCE: NATIONAL CENTER FOR EMPLOYEE OWNERSHIP

Ex. 4
1/30/89



OWNERS AT WORK IN FORT LAUDERDALE

Whether they fix cars, clean them, or serve travelers at the airport, Avis employees really do seem to try harder now that they own the place. Customers have noticed the difference.

ten since it was founded in 1946 and five (Norton Simon, Esmark, Beatrice, KKR, and Wesray) in the five years before the employee buyout. Vittoria, who had been CEO of Hertz, arrived at Avis in 1982. Managing for a different owner each year had been enormously frustrating. One solution would have been taking the company public, but Vittoria worried that public ownership could have left the company vulnerable to another takeover. The first time he ever heard the term ESOP was in a meeting with Wesray investors. Other Avis executives remembered considering an ESOP back in 1977, before Norton Simon bought the company. Once it became clear that the fleet debt would qualify for the ESOP tax advantages, Wesray's partners at Avis began pushing for employee ownership.

AVIS ALREADY had a fine reputation for service, and its share of the crucial on-airport market was edging up, while Hertz's dropped from 37% to 32% between 1982 and 1987, according to Finnie of Alex. Brown. He adds that Avis also had the best operating margins among the largest rental companies. Since all of Avis's major competitors have changed hands recently and as a result increased their debt loads, that extra ESOP debt was not much of a competitive disadvantage.

The biggest surprise about employee ownership at Avis is how effective it has proven as a marketing tool. Even before the deal was complete, James Collins, Avis's vice president for sales and marketing, suggested to ad agency Backer Spielvogel Bates that the ESOP might be a good advertising hook. Backer's staff was skeptical. But when the agency commissioned a study of 1,000 typical car-rental customers it found an astonishing 77% believed that employee ownership would mean better service. Says Collins: "The number knocked our socks off."

"Employee ownership translates into an amazing halo," says Randy Hackett, Avis's account manager at Backer. The agency produced a series of television commercials and print ads showing eager workers and announcing, "Avis is the only major rent-a-car company owned by its corporate employees." A new version of the company's famous tag line announces, "We're trying harder than ever." Independent tests found the copy more effective at swaying consumers than any Avis ad Backer had ever produced. Follow-up studies conducted after the commercials began airing this spring showed a dramatic increase in favorable perceptions of Avis. Even Craig Koch, president of Hertz's North American division, a man singularly unimpressed by the new Avis, concedes, "The only advantage I see to the ESOP is that it gives them a good advertising campaign. It's something consumers will listen to."

SOME LARGE corporate customers are listening. Says Robert W. Anderson, director of corporate travel for Unisys, which splits its $15 million in annual car rentals between Avis and Hertz: "Employee ownership has got to be a winner. Avis is absolutely superior in customer service, though they were pretty good to begin with." When Westinghouse named Avis its primary car-rental supplier in April, every Avis employee in Pittsburgh, where Westinghouse is based, signed a letter to travel managers there pledging to provide the best possible service. "We were really impressed," says Betty Lou Luketich, manager of business travel. "When employees own a company there is a definite difference in their attitude. Our travelers say they have noticed."

Avis employees show a palpable enthusiasm for the changes that have come since the ESOP. Fears of pay cuts and layoffs have proven groundless, and managers no longer

HOW THE TAX CODE ENCOURAGES ESOPs

- **When an ESOP borrows to buy stock, not only are the interest payments tax deductible—so are repayments of principal.**
- **A commercial lender may exclude from taxable income 50% of the interest earned from loans to an ESOP. Most lenders pass part of this saving on to the ESOP.**
- **Dividends paid on stock that is held by an ESOP can be deducted from corporate taxable income.**
- **Owners of privately held corporations who sell their shares to an ESOP can defer the capital gains tax if they reinvest the gains in the stock of a U.S. corporation within a year.**

Ex. #4
1/30/89

worry that the new owners beneath them might prove unruly and unmanageable. Though employees still hold little stock, most are impressed with the company's more open management style. Many refer with satisfaction to the advertising campaign, and a striking number tell inquiring visitors, "We're trying harder than ever."

"We feel we have closer contact with management," says Roberta Beckelman, a telecommunications specialist at Avis's Worldwide Reservations Center in Tulsa. "We're ready to voice our opinions, and we know we will be heard if we do." John Sellers, director of reservations at the Tulsa center, concurs. "In the past, people felt management couldn't really listen to their ideas because we weren't in control of our own destiny," he says. It's easier to manage now: "We've seen a reduction of lost time, and we've actually had employees coming to us asking us to tighten some of our performance standards. That would never have happened prior to the ESOP."

Even employees with gripes give the company a break. Mike Trissel, an Avis bus driver at Fort Lauderdale International Airport, is unhappy that the company insisted on bonuses rather than wage increases in recent local union negotiations. "I feel we should have at least gotten a cost-of-living raise," he says, "but I can see they have a large debt now, and they want to pay it off as soon as they can." And Trissel adds: "Everything else here is 100% positive."

Though some ESOPs exclude union members, Avis decided to make its 2,800 unionized employees owners too. "We wanted to have everybody on the same team and not create two classes of people," says human resources vice president Donald Korn. Negotiations have been a bit more cordial since the buyout. Union officials seem generally pleased with the plan, since it required no explicit concessions on their part, but several worry that Avis, like many ESOP-owned companies, may eventually try to substitute the ESOP for pension benefits. Avis says it retains the option to change pensions. The union officials say they would fight to prevent that.

BA KAMP—BLACK STAR

Employees meet regularly (above, in Fort Lauderdale) to make worker ownership work.

Employee participation groups comprising representatives from each job category now meet at least monthly at each of Avis's company-owned locations in the U.S. (employees at the many smaller franchise locations are not included in the ESOP). Scores of valuable ideas have surfaced. A sales staffer suggested that the Avis sales force could use an internal charge card instead of American Express when renting Avis cars on the road. The switch saved the transaction fee paid to American Express as well as the concession fee Avis pays to the airport for every paid rental. Says field operations vice president Robert Salerno: "That's maybe another $30,000 or $40,000 that just went to the bottom line."

Employees don't just make suggestions—they follow up. Says Avis Fort Lauderdale district manager Dan Falvey: "In many cases people will go out on their own time and get prices on materials for some idea they've had and come back to the committee and say, 'Hey, should we do it?' And we make the decision as a group. We're not sitting there as managers and employees. We're sitting there as a group of employees in Fort Lauderdale, asking how can we provide better service." They must be coming up with good answers. Since the ESOP purchase Avis has beaten Hertz in Fort Lauderdale market share for the first time ever.

Falvey has to watch himself, though: "If I as the district manager decide to get a new carpet for the office, employees will now come up to me and say, 'Wait a minute, how much is this costing us?' They're half kidding, but the whole message of the ESOP is that you are an owner. We pay off the debt—we own a piece of this company."

Operations chief Salerno says the manager's role is changing. "This whole participation process has put a lot of burden on management to get the people involved and interact with them," he says. "So we're starting a new program for managers on how to deal with people. It takes a lot of work and pressure to instill this thing in the whole company. We don't want people to think it's today's fad and in a month it'll be gone."

VITTORIA, Salerno, and others criss-crossed the country after the ESOP buyout, meeting face-to-face with about 7,000 employees. Top executives still meet regularly with representatives of the participation groups and circulate among employees at all levels. Vittoria says he has respected the knowledge of front-line employees ever since he started in the business in 1960, as a rental agent for Hertz in New York City. "I've always been a believer in visible management, but now I'm doing it more because it has greater value," he says. "This is not the time for management to start taking vacations. I've worked harder since this ESOP was formed than I have in many years." So have a lot of other Avis employees, it appears. They may not have imagined that this would be part of becoming capitalists, but the results are hard to argue with. ■

SENATE BUS...

EXHIBIT NO. #5

(This sheet to be used by those testifying on a bill.)

DATE 1/30/89

BILL NO. SB 215 + 246

NAME: Bob Heffner + Bill Pedersen DATE: 1-30-89

ADDRESS: Dept. of Commerce

PHONE: 444-3923

REPRESENTING WHOM? Small Bus. Devel. Center

APPEARING ON WHICH PROPOSAL: SB 215 SB 246

DO YOU: SUPPORT? ✓ AMEND? ______ OPPOSE? ______

COMMENT:

PLEASE LEAVE ANY PREPARED STATEMENTS WITH THE COMMITTEE SECRETARY.

DATE 1/30/89

COMMITTEE ON Business & Industry

VISITORS' REGISTER

NAME	REPRESENTING	BILL #	Check One Support	Oppose
Don Ingels	Mt Chamber of Commerce	215/246		

(Please leave prepared statement with Secretary)