Early Days of Bay Area Construction
and
ESOPs (Employment Stock Ownership Plans)
February 2017

We recently attended a Sliver meeting held at McCutcheon Construction in Berkeley. The host was Michael McCutcheon, of McCutcheon Construction. The topic was the ESOP, which stands for Employment Stock Ownership Plan.

A Bit of Local History; What is a Sliver Group? The National Association of the Remodeling Industry (NARI) has been around in its present form since 1983. But prior to NARI becoming the big player of construction associations it is now, there was the Splinter Group

Cute name aside, this was a similar but mostly East Bay group of general contractors. Meetings were generally held in Berkeley. It was less structured than present NARI chapters - in hindsight it had something of a counter-culture flavor to it. But the Splinter protocols were similar to NARI's – there would be evening meetings with presenters and food and drink.

Within the Splinter Group there were smaller groups called Slivers (an even cuter name). These smaller Slivers were of like-minded and similarly situated contractors. At one point in the 1990's, there were probably six of these Sliver groups. And at these Sliver meetings some real business was often transacted. Useful business information was exchanged (names of bad clients, good insurers), and job referrals made.

In 1991, the country was in the middle of a recession. In October 1991, the East Bay Hills Fire occurred; lives were lost and thousands of dwellings were burned. While this was a truly dreadful event, it was also a godsend for local contractors who in some cases were close to going out of business. Attendance at the Splinter meetings went from 30-40 to over a 100. It was a mob scene.

The days of our youth were the days of our glory. But like people, institutions have life spans. Unhappily, and in spite of valiant efforts by Michael McCutcheon, Steve Nicholls of Mueller Nicholls and others, interest in the Splinter Group waned and it ceased meeting in 2015. But some of the smaller Slivers continue to meet.

ESOPs. But I digress. While ESOPs can be problematic – expensive, complicated – when they work, they work well.

An **Employee Stock Ownership Plan** (**ESOP**) is an employee-owner program that provides a company's employees with an ownership interest in the company. It is in some ways similar to a profit sharing plan.

Companies provide their employees with stock ownership, usually at no upfront cost to the employees. ESOP shares, however, become part of employees' remuneration for work performed. The shares may be held in an ESOP trust until the employee retires or leaves the company. The shares are then either bought back by the company for redistribution or voided. Oftentimes, employees can roll over their distributions to an IRA or other retirement plan, which avoids income tax at the time of distribution.

The positives are several. ESOPs are most commonly used to provide a market for the shares of departing owners of successful companies; to motivate and reward employees; and to take advantage of incentives to borrow money for acquiring new assets in pretax dollars. In most cases, ESOPs are a contribution to the employees - not a purchase.

There are also limitations and downsides. ESOPs can be used in S corporations, but do not qualify for the rollover treatment and have lower contribution limits. Private companies must repurchase shares when an employee leaves, and this can be a big expense. The cost of setting up an ESOP is also substantial – around $40,000 for a basic plan in small company and increasing from there. Finally, it has been shown that ESOPs will improve corporate performance, but only if combined with opportunities for employees to participate in decisions affecting their work.

So now you know something about ESOPs.

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