

# UNITED IS A POOR MODEL FOR EMPLOYEE OWNERSHIP

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It would be easy to look at what's happening at United Airlines, now on the brink of bankruptcy, and conclude that the concept of employee ownership in America has fallen into a tailspin.

Eight years ago, after all, workers at United agreed to give up \$700 million in wage cuts and work-rule concessions. That, in turn, afforded them the chance to buy out many of the airline's executives and public shareholders and to form an employee stock ownership plan, or ESOP.

The idea at the time was that the employees would give up short-term benefits for long-term gains.

But for many reasons, the gains envisioned by the union leaders who led the ESOP drive -- a greater voice in parent company UAL Corp.'s policies and a direct stake in its future profitability -- have not materialized. After a burst of heightened productivity, enthusiasm for the ownership plan waned quickly in the mid-1990s as union members replaced their leaders and new managers took over for retiring executives.

UAL stock, which was selling at about \$30 a share when the ESOP went into effect and rose to more than \$100 a share in 1997, has nose-dived in the last year to its present price of about \$3. United's operations are plagued by costly inefficiencies, and if UAL files for bankruptcy protection in coming days, the stock in the ESOP will be virtually worthless. (The ESOP, which is administered by trustees, controls 55% of UAL's shares.)

So the question is: Was employee ownership simply a bad idea at United? Or is there a bigger lesson that workers at other companies -- especially those at the 11,000 firms in the U.S. that have ESOPs -- should take away from the airline's woes?

The answer is that, despite what is happening at United, ESOPs can be a real boon to companies and their workers. But ESOPs aren't a panacea, and they won't succeed in situations in which animosity between management and the rank and file is the rule.

Studies by the National Center for Employee Ownership in Oakland show that companies with ESOPs can grow 8% to 11% a year faster than they otherwise would be expected to grow -- but only when combined with a truly "participative management style."

At United, that notion never really took hold.

For a time, “the company appeared interested in valuing employees,” says Ira Levy, a United mechanic in Denver who serves as a district representative for the International Assn. of Machinists and Aerospace Workers.

But before long, top management “forgot all about the cooperation with employees.”

Standing in sharp contrast to United is Southwest Airlines Co., which is 12% owned by an employee profit-sharing plan and is famous for the way that everybody from the chairman on down gets along.

“Southwest started small and had a cooperative culture from the start,” says Michael E. Levine, a law professor at Yale University who served in executive positions with Continental Airlines Inc. and Northwest Airlines Corp. “Ownership reinforces that culture.”

But, Levine adds, simply giving employees ownership “doesn’t do much to change behavior in an adversarial culture” such as United’s.

United’s ownership plan was born in battle. The ESOP was instituted in large part to finance the buyout of UAL’s chief executive at the time, Stephen Wolf, who was threatening to break United into several regional airlines and to contract out maintenance to nonunion firms.

In the end, Wolf walked away with a package worth about \$30 million.

“The ESOP succeeded because it got rid of Wolf and saved our jobs,” says Frank Larkin, a spokesman for the machinists union.

But not for the long term. UAL has had to cut thousands of jobs through the years, and the company announced Tuesday that it plans to lay off 352 pilots in January and February.

The fatal flaw in United’s ESOP is that it was a distortion of the purpose of employee ownership plans.

“It was different from 99% of the plans because it was financed with wage concessions,” says John Menke, whose San Francisco law and investment firm counsels companies on employee ownership.

Menke was a student of the late Louis Kelso, a lawyer who conceived the idea of ESOPs in the 1950s. Kelso believed that the capitalist system would be stronger if all workers -- not just outside stockholders and senior managers -- could share in owning capital assets.

It was an idea rooted in history. The Knights of Labor, a 19th-century predecessor of the AFL-CIO, had company ownership as a goal. “They said if workers only bargain for wages they will limit their future,” notes Christopher Mackin, head of Ownership Associates, a Boston consulting firm specializing in ESOPs.

Kelso ultimately won the backing of Congress, which in 1974 passed a law making it possible for the owners of a business to sell it to a trust for the employees without incurring taxes on the proceeds.

Since then, many companies have pursued variations on the ESOP theme.

In 1978, after Ralph M. Parsons died, the Pasadena engineering company bearing his name set up a small ESOP to give employees a stake in the firm. Six years later, Parsons’ ESOP borrowed

money to buy up the remaining public stock in the firm, making it 100% employee owned.

“We wanted to align the interest of our engineers and skilled personnel with those of the company,” says Gary Stone, Parsons Corp. general counsel. And those employees have done well: The ESOP has handed out some \$500 million to Parsons retirees.

No doubt there are perils in employees’ putting their investments and retirement savings at risk in the same place as their jobs. But United’s failure shouldn’t scare off others. An ESOP forged in the right environment still can help employers and employees to soar.\*

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