



The ESOP Association

**Written Testimony of Daniel Goldstein
President and CEO of Folience**

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**U.S. House of Representatives Committee on Small Business, hearing on
“Challenges and Benefits of Employee-owned Small Businesses”**

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Thank you, Chairwoman Velazquez, Ranking Member Chabot, and members of the committee.

I'm Daniel Goldstein, CEO of Folience, a Cedar Rapids, Iowa-based company that has been in business since 1884, and 100 percent owned by our employees since 2012.

I also represent The ESOP Association, a non-profit whose purpose is to protect and grow employee stock ownership plans, or ESOPs.

A total of 6.6 percent of the U.S. workforce has ownership in an ESOP—*more than 10.6 million employees.*

In context, ESOP employees outnumber the workforce of the entire U.S. auto industry¹—by more than half a million.

We outnumber the combined workforce of the federal and state governments²—by three million.

ESOPs contribute substantially to our economy—and we believe they hold a solution for many of the intractable economic issues facing our nation.

As you know, one of the biggest challenges ahead is the looming retirement in the next 10 years of baby boomers who own nearly 2.5 million small businesses. Known as the “Silver Tsunami,” this will be the largest transfer of business ownership over the shortest period of time in our nation’s history. Even more concerning, is that the Wilmington Trust has estimated that nearly 60% of these businesses currently have no succession plan.³ These businesses, and their

¹ U.S. Auto Alliance, <https://autoalliance.org/economy/>

² <https://www.governing.com/gov-data/public-workforce-salaries/states-most-government-workers-public-employees-by-job-type.html>

³ <https://www.cnn.com/2019/12/10/as-baby-boomers-retire-main-street-could-face-a-tsunami-of-change.html>

nearly 25 million employees, face difficult futures if plans and supportive policies are not adopted.

I've seen what can happen if a succession plan is not made. And, from our own experiences at Folience, I can help demonstrate the role employee ownership can play in preventing catastrophe.

Let me tell the story of a typical small town.

Sumner, Iowa has a population of 1,961 and has one major private employer. Life Line Emergency Vehicles designs and builds ambulances and other emergency vehicles for first responders. It provides 180 good paying jobs.

In 2010 the founder and controlling owner passed away, leaving leadership of Life Line and its ownership to his 69-year-old widow who had not worked in the company.

When I met her in 2016, she was 75, CEO and President, and had no children or heirs prepared to take over the business. The business had to be sold.

Most in this situation face three choices: sell to a competitor, sell to private equity, or close and sell off the parts. This is very similar to the situation faced by those millions of businesses owned by retiring baby boomers.

Folience gave them another option—sell to their employees through an ESOP. Folience's ESOP purchased Life Line, and as those 180 employees vested in the ESOP through their work, they became owners of Life Line; they also became owners in every other business in the Folience portfolio.

Despite the many well-known benefits of employee owned businesses—benefits that include greater job security, better local economic stability, greater access to job training and development, higher pay, and more opportunities to accumulate retirement savings—those seeking to launch or expand their ESOPs face multiple, unnecessary obstacles.

As the leader of an employee owned business, I see three major obstacles to the expansion of employee ownership in our economy:

1. An absence of clear federal regulatory guidance, particularly on business valuations for purposes of securing an ESOP loan.
2. A shortage of lending capital for ESOP formation or acquisitions.
3. And, finally, education—there is low public and professional awareness about ESOPs.

Today I ask Congress to task federal agencies with solutions to address all three.

First, I submit that the biggest obstacle to the formation and expansion of ESOPs is the chilling effect of the U.S. Department of Labor's actions. DOL has perpetuated an absence of formal regulatory guidance, while simultaneously pursuing a litigious approach to oversight. The effect has been a deep chill on the market.

Every year, hundreds of business owners who want to learn about ESOPs attend educational events hosted by The ESOP Association. And once exposed to the lack of clear guidance, many turn away out of fear that some unknowable misstep will invite never-ending DOL scrutiny.

Those fears are not unfounded.

Today, more than 45 years after ESOPs were established with the passage of ERISA, the Department of Labor has *yet* to finish its rulemaking process. They started. They nearly finished in 1988. But they never issued final regulations.

Instead of issuing clear regulation, the Labor Department has practiced regulation by litigation, pursuing ESOP companies in a series of one-off cases that sometimes drag on for years, and often never reach a formal end or resolution. The result: ESOP companies have been left to interpret a patchwork of settlement agreements or decisions that sometimes were predicated on such unique circumstances they provided little or no generally applicable guidance at all.

Operating without clear guidance is a risk ESOP companies should not be forced to bear; it is a risk that adversely affects the entire industry offering legal, accounting, and other professional services and that are instrumental in helping companies form new ESOPs; it is a risk that negatively affects the wealth and security of the 10.6 million employee owners DOL has been tasked with protecting.

It is a risk our nation cannot afford if we hope to survive the gathering wave of the Silver Tsunami.

The direct cost to the ESOP community of the DOL's regulatory inaction has been enormous: Companies embroiled in Labor Department actions have been forced to scale back investments, acquisitions, and other wealth building efforts to pay for the legal and administrative costs of fighting these claims. Those who lost most were the employee owners who failed to realize the greatest gains possible from their shares of company stock.

Further, the Labor Department's success rate in these cases has been extremely low, leading one to question this investment of time and energy.

The indirect cost of the Labor Department's actions is even higher: By adding undue risk to the process of forming and running an ESOP, the agency is discouraging companies from becoming employee owned. This does not benefit employees, and it denies our economy of potential buyers of businesses at a time when we will need them most.

The Labor Department must stop its policy of regulation by litigation and instead provide the clear guidance necessary so that ESOP companies, boards, and trustees may operate their ESOP trusts in a manner consistent with clearly defined rules.

But here is the travesty: It is impossible to prove how many American workers have lost the opportunity to become employee owners as a result of this chilling effect. And, due to the rapidly escalating retirements of baby boomer business owners, there is urgency to reduce the chilling effect this lack of regulatory clarity is causing.

A solution can start very simply: Congress should require DOL to define what constitutes "adequate consideration" when an ESOP trustee values the price to be paid for shares of company stock.

Ambiguity regarding the term "adequate consideration" has been at the heart of many DOL actions, and it is our belief this ambiguity has depressed the legitimate efforts of businesses to launch ESOPs while complying with the law.

Congress has made clear, through legislation such as the Main Street Employee Ownership Act, that it wishes to encourage the formation of ESOPs. For that to happen, the

Labor Department must fulfill its mission and provide clear regulations that good corporate citizens can follow when selling their companies to their employees.

This one simple piece of guidance could be a game changer for new employee ownership.

Second, to start addressing lending shortages, the SBA must streamline lending for ESOPs, as outlined in the Main Street Employee Ownership Act. Unfortunately, in implementing the legislation, the SBA excluded ESOP loans from the Preferred Lending Program, instead continuing to require headquarters approval for all ESOP loans.

The Preferred Lending Program decentralizes loan decision making and results in faster loans, and it clearly was Congress' intent to make loans for ESOPs easier and faster.

We ask that the SBA be unambiguously directed to include ESOP loans in the Preferred Lending Program.

Third, the Main Street Employee Ownership Act tasked the SBA with promoting awareness of ESOPs and employee ownership. The ESOP Association knows that some on the front lines of the agency already take this task seriously, but they are too few and they lack adequate support, structure, and resourcing from senior management within the agency.

Business owners must know the ESOP option exists, and must be able to obtain useful, unbiased information. To that end, we ask that the SBA be directed to resource a specific, centralized office —such as the Office of Small Business Development Centers—with active public education and information efforts about ESOPs.

These three actions will provide a clearer path to launching and expanding ESOPs.

Thank you for the privilege of sharing my testimony today. I look forward to answering any questions you have.