Fifty Years of Utopia: A Half-Century After Louis Kelso’s The Capitalist Manifesto, a Look Back at the Weird History of the ESOP

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I. Introduction

Employee stock ownership plans are qualified retirement plans designed to invest in the stock of the companies that adopt them. The idea is that by participating in these plans, employees become, over time, owners of their own employers. Provisions to encourage the use of plans like this, known by their acronym “ESOPs,” are scattered throughout the Code and the Employee Retirement Income Security Act of 1974 (ERISA).1

One unusual thing about ESOPs is that they are almost entirely, from the original idea for the plans themselves to the array of enabling legislation, a product of the self-developed economic theories and vigorous lobbying of a single, now semi-obscure, private individual. In the middle of the last century, Louis O. Kelso, a lawyer in San Francisco, became convinced that (1) in general, the economic value of any given worker’s labor would be insufficient to support a living wage for that worker; (2) as a result, it was essential to encourage more widespread ownership of capital among laborers as a means of providing them with supplementary income; and (3) a good way to accomplish that goal was by encouraging investment by employee retirement plans in stock of the participants’ employers.2

Kelso publicly advanced these views just over 50 years ago, in 1958, in the book The Capitalist Manifesto, which he co-authored with Mortimer Adler.3 The title suggests the authors’ ambitions. Like Karl Marx, Louis Kelso believed he had stumbled upon a profound, previously unrecognized scientific truth that had the power to explain every economic problem and raise working people from poverty; the only difference was the prescription. “It’s one of the

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3Id.
In The Communist Manifesto, Marx had demanded an end to capitalism, whereas in The Capitalist Manifesto, Kelso demanded more of it.

Kelso quit his law job, formed a consulting firm, and from 1958 until his death devoted most of his time to promoting ESOPs. It was an uphill battle. In 1958—and now, and at all times in between—the reaction of mainstream economic academia to Kelso’s theories has been one of annoyed contempt. Kelso seems to have been one of those people, however, with a level of self-certainty that renders them impervious to rejection. He kept trying, and in 1973 he experienced the kind of breakthrough very few academic economists ever will: he convinced the Chairman of the Senate Finance Committee of the rightness—in fact, of the urgent importance—of his views. Such was the power at the time of the Senator, Russell Long of Louisiana, that the day after his meeting with Kelso, an ESOP provision had been inserted into legislation, the Railroad Reorganization Act, on the fast track to enactment.

That turned out to be just the beginning. From 1973 until his retirement from the Senate in 1986, by the estimate of one staff member, Senator Long arranged for the enactment of at least 25 separate pieces of legislation supportive of ESOPs. These included, crucially, revisions to ERISA itself that prevented that statute from, as it would have otherwise, rendering ESOPs illegal; they also included a number of distinct, cumulatively massive ESOP tax breaks. As best one can tell, all of these provisions were, for practical purposes, the legislative work of Russell Long alone. Few others in Congress, the White House, or the Treasury ever seemed too interested one way or the other.

Once Long retired, the flow of favorable legislation dried up. By then, though, the tax subsidies had led to adoption of thousands of ESOPs, by companies as large as Avis and Phillips Petroleum. Overall values are hard to assess, but they run into the hundreds of billions of dollars in terms of stock acquired over the years by ESOPs and at least tens of billions of dol-

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6 Corey Rosen et al., Equity: Why Employee Ownership is Good for Business 60–61 (2005).


8 See Rosen et al., supra note 6, at 61–62.

9 Nicholas V. Gianaris, Modern Capitalism 12 (1996).
And although many of the ESOP provisions have now been repealed, not all have, and of course, ESOPs themselves remain very much with us. Their existence is, in retrospect, actually difficult to understand. To the question, “Why does the United States have ESOPs?” it is not an exaggeration to say the answer is that a guy in California thought they were a good idea, and he personally persuaded a member of the Louisiana congressional delegation that he was right.

II. Labor and Capital

The dominant feature of Kelso’s worldview was what he came to call “binary economics,” the notion that labor and capital are the two and only two potential sources of personal wealth. For example, if a steam shovel is at work digging a foundation for a new building, the owner of the shovel is responsible for providing and entitled to get paid for the “capital” portion of the project, and the workers who operate the shovel, the “labor” portion. Kelso regarded the workers, who owned labor but no capital, as on a road to nowhere. Technology meant that things would get worse. As shovels, for example, became more efficient, fewer workers would be needed for foundation digging, and labor’s share in the production of wealth, relative to capital’s, would continue to shrink. It was thus imperative to get a portion of ownership of the shovel into the hands of the workers.

By his own account, these ideas first came to Kelso while he was a teenager growing up outside Denver during the Great Depression, when his father lost his job and his mother struggled to support the family on the income from a small grocery store. Kelso mused about the idle, desperate laborers visible everywhere, and the very troubling thought occurred to him that there was no necessary reason the economic value a given person could command, based on his or her capacity for work, would bear any relationship to that which he or she needed to live. Considering this further led him to binary econom-...
ics and the search for ways to give people a basis for economic participation other than the labor they could produce with their own hands.\textsuperscript{16}

Kelso continued to nurse his theories while serving on a Navy destroyer during World War II, eventually drafting a manuscript, which, however, he put aside after the war to focus on a legal career.\textsuperscript{17} Kelso got a chance to put his ideas into practical operation in 1956, when his San Francisco law firm was hired to assist the aging founder of a small regional newspaper publisher, Peninsula Newspapers, with succession planning, and Kelso persuaded the company to adopt an ESOP to buy the founder’s shares.\textsuperscript{18} Shortly thereafter, Kelso happened to mention his theories and manuscript to Mortimer Adler, a friend and client who was an academic philosopher and promoter of the then-popular “Great Books” approach to education. Adler became immediately convinced that Kelso was right, and he encouraged Kelso to try to have his manuscript published.\textsuperscript{19} Together they reworked the long-shelved draft for publication.\textsuperscript{20}

\section*{III. The Second Income}

In \textit{The Capitalist Manifesto}, Kelso contended, among other things, that capital was too highly concentrated in the hands of a few families.\textsuperscript{21} Because capital ownership offered the sole reliable means to support a person, all that prevented widespread indigence and starvation was the existence of artificial wealth-transfer mechanisms, including, most prominently, labor unions,\textsuperscript{22} but also a host of government policies such as the minimum wage, welfare, farm subsidies, and—apparently in Kelso’s opinion—most government jobs.\textsuperscript{23}

\begin{itemize}
\item \textsuperscript{16} See id. at 49.
\item \textsuperscript{17} Id. at 47.
\item \textsuperscript{18} See Daniel F. Cuff, \textit{Kelso Chairman Holds No Love for Wall Street}, N.Y. Times, Mar. 24, 1988, at D5.
\item \textsuperscript{19} ROSEN ET AL., supra note 6, at 47–48.
\item \textsuperscript{20} Id. at 48. Adler disclaimed in a preface any authorship of the book’s main ideas. See KELSO \& ADLER, supra note 2, at ix. Both Kelso and Adler seemed to have viewed Adler’s relationship to Kelso roughly as that of Friedrich Engels to Marx. Adler’s contributions appear to have been organizational and editorial, and also included the preface itself, in which he described the volume’s proposals (in, it bears mentioning again, 1958) as “a feasible way of accomplishing the capitalist revolution in the United States within the next fifty years.” See id. at xvii. On a more practical level, it is difficult to believe such a book could have been published without the credibility lent by Adler’s name. Adler was at the time a nationally famous author and academic authority, and Kelso an unknown attorney.
\item \textsuperscript{21} Id. at 69.
\item \textsuperscript{22} Id. at 105, 205, 259–64.
\item \textsuperscript{23} These wealth-transfer mechanisms were spelled out in more detail in a later work co-authored with Kelso’s second wife, Patricia Hetter. See LOUIS O. KELSO \& PATRICIA HETTER, TWO-FACTOR THEORY: THE ECONOMICS OF REALITY 19–23, 141–43 (1967) (originally published in hardcover under the better title \textit{How to Turn 80 Million Workers into Capitalists on Borrowed Money} (1967)). In this later book, Kelso estimated that “real” employment in 1967 in the United States—that which is economically sustainable in its own right, and not a mere artifice to shift wealth and keep laborers from starving—stood at only 50 million people, meaning the “real” unemployment rate was an astronomical 37.5%. See id. at 143.
\end{itemize}
Kelso had two problems with the situation, as he saw the situation. First, working people were deprived of security and dignity, being unable to support themselves absent contrived wealth transfers. Second, the contrived wealth-transfer mechanisms were themselves inefficient from a macroeconomic standpoint, as well as immoral. The Capitalist Manifesto argued that the only defensible economic systems were market-based ones in which participants were rewarded proportionate to their own contributions to wealth creation. But because capital had become the important source of wealth creation, that made it imperative for all people to be made owners of capital as well as labor.

So how to put stock in the hands of people who had no money to buy it? This question prompted another insight, one that led directly to so-called “leveraged ESOPs.” Workers should be given the opportunity to borrow the money to buy stock and then pay back the loan with the earnings on the stock. The idea was for workers to buy stock in just the same way business owners bought wealth-producing equipment or machinery. The owner of a steam shovel, for example, was likely to buy the shovel on credit, credit extended on the strength of the earnings the shovel itself was expected to generate.

In service of this idea, The Capitalist Manifesto proposed a series of things, first on the list of which was the “equity sharing plan” (the term “ESOP” did not appear in the book). Kelso came to call such plans “Second Income Plans,” because their goal was to provide employees with a second source of income derived from capital rather than labor. Kelso’s program also had other, more radical components. In order for the idea of paying off stock with its own earnings to work, corporations would have to distribute their income. Thus, Kelso proposed making it mandatory for every “mature” corporation to distribute all of its earnings, every year, in the form of dividends. And, to combat the troublesome national concentration of capital, Kelso proposed, as a deterrent, “precipitously” high top marginal income tax rates, as well as a restructuring of the estate tax so that estate tax rates would depend on the recipient’s wealth rather than the size of the estate.

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24 See Carlson, supra note 11, at 290–91.
25 See Kelso & Adler, supra note 2, at 71. The idea of distributing wealth according to need rather than according to who produced it, he said, would never work. See id. at iv. For example, the history of philanthropy, or lack of it, showed that in general people underestimate the needs of others for money relative to their own need for it. Fixation on ensuring distribution according to “need” was the fundamental flaw, as Kelso saw it, of previous economic theories from Marx to John Maynard Keynes. See id. at 60, 118, 237 n.9. Kelso’s theories had strong appeal for those who, around mid-century, were alarmed by the potential appeal of socialism and thus looking for an answering doctrine.
26 See Carlson, supra note 11, at 293–94.
27 See id. at 169, 190–92.
28 See Kelso & Hetter, supra note 23, at 43–63, 100.
29 See Kelso & Adler, supra note 2, at 191.
30 See id. at 169, 192–99, 220–23.
The Capitalist Manifesto brought a certain level of attention to Kelso and the idea of worker ownership. After its publication, Kelso commenced a prolific schedule of writing and speaking. Throughout the 1960s and into the 1970s, however, while many people seem to have found Kelso’s ideas intriguing, he made little practical headway. Some of his own clients adopted ESOPs, but Kelso was unable to convince legislators or policymakers of the merits of these plans (much less of his overall, comprehensive program for worker ownership of capital).

Then, in 1973, one of Kelso’s associates succeeded, after much strategizing, in arranging a meeting between Louis Kelso and U.S. Senator Russell Long.

IV. Making the Sale

Senator Long was the eldest son of Huey Long, who liked to have people call him the “Kingfish.” As governor of Louisiana and a U.S. Senator, Huey Long was, from the late 1920s until his assassination at the age of 42 by a constituent in 1935, the absolute political ruler of Louisiana. Huey had built his political career on a vehement populism that, while it endeared him to the rural poor of his state, angered and worried other politicians up to and including Franklin Roosevelt, whom Huey Long challenged from the left and who, in return, privately called Long “one of the two most dangerous men in [America]” (along with Douglas MacArthur). Huey Long’s favorite target was Standard Oil, which he nicknamed “the Octopus” and whose taxes he repeatedly attempted to raise. One of Huey Long’s biographers described him as “the Karl Marx for the hill-billies.”

Russell, the son, was different. He revered the memory of his father and retained a concern for working people as a general principle. Nonetheless, he regarded himself as fundamentally a conservative. Russell’s years in the Senate were spent protecting oil and gas companies from tax increases proposed by...
northeastern legislators.\textsuperscript{37} Russell Long came to Congress as a Democrat at a time when that was a prerequisite for public office in the South, but it seems likely that today he would be a Republican.\textsuperscript{38} In short, as the son and successor to one of the most famous left-wing populists in American history, but himself harboring a visceral suspicion of “liberal” wealth transfer schemes, Russell Long was what you might draw up if you wanted to create the perfect audience for someone who might be promoting the idea of the Second Income Plan.

Kelso and Long’s “historic meeting” (as it is remembered on the Kelso Institute website) occurred over dinner, in the Montpelier Room of the Madison Hotel in Washington, in the late evening of November 27, 1973.\textsuperscript{39} According to a Kelso disciple who was present, Kelso began the conversation by explaining, for the better part of an hour, his theories and how they offered hope for working people and the possibility of more widespread sharing in the benefits of the free market system.\textsuperscript{40} Kelso also told Long that his views had been rejected by essentially the whole of the economics establishment, including especially eminent critics Robert Samuelson and Milton Friedman.\textsuperscript{41} Long sat back and listened. As the evening wore on he began to engage with Kelso, and eventually appeared to arrive at a decision. As Kelso recounted five years later:

\begin{quote}
The senator was very patient, asked many questions,” Kelso recalls. “The waiters were standing around waiting for us to get out. It must have been around midnight. Then the senator said to me, ‘Are you saying that using financing techniques based on a two-factor (labor and things) economic theory can make have-nots out of the have-nots without taking it away from the haves?’ I said, ‘Senator, you put me to shame. I take three hours to explain something and you cover it in a sentence.’ ‘That’s the kind of populism I can buy,’ he said.\textsuperscript{42}
\end{quote}

V. ESOPs in Ascendance

Kelso’s conversion of Long elevated, at a stroke, the status of binary economics from the opinions of an ignored outsider to the source of impending federal law. There was no more influential tax lawmaker in the country at the time than Russell Long, regarded by his contemporaries as the most

\textsuperscript{37}Mann, supra note 35, at 325, 333, 344.
\textsuperscript{38}Russell spent his career fighting “liberals” and was one of Richard Nixon’s most prominent supporters and defenders, to the moment of Nixon’s resignation. See Mann, supra note 35, at 315.
\textsuperscript{41}Id.
\textsuperscript{42}Maxa, supra note 7.
adept and powerful legislative operator in the Senate. Almost immediately, Long secured inclusion, in the Railroad Reorganization Act, of a provision sponsoring a study of employee ownership of the new national rail system, Conrail. By the following August, ESOPs had been protected in the new Employee Retirement Income Security Act of 1974. The next year, the Tax Reduction Act of 1975 included a powerful incentive: a tax credit for company contributions of stock to a qualifying ESOP, known as a “TRASOP.” Eventually Long’s efforts resulted in a list of incentives that included, among other things, in addition to the tax credit: deferral of gains by a shareholder on sales of stock to an ESOP, deductibility of corporate dividends on ESOP-held shares, excludability from the income of a bank or other lender of 50% of the interest income generated by a loan to an ESOP, and a 50% exclusion from estate tax of gain on the sale by an estate of shares to an ESOP.

Although ESOP tax breaks faced criticism from liberal Democrats, the Kelso program was not partisan, exactly. Kelso managed, during his career, to attract at least the momentary interest of Republican leaders including Barry Goldwater, Richard Nixon, and Gerald Ford, and ESOPs won praise from Ronald Reagan. But Kelso bitterly opposed, for instance, Reagan’s economic policies. Kelso predicted that “Reagonomics” would, in fact, lead to such concentration of wealth that the country could expect “anarchy, violence in the streets.” In truth, Kelso was too contrarian to be located within

43 See Mann, supra note 35, at 328–37.
44 See Kurland, supra note 40.
45 Barring an exception, for example, ESOPs would violate ERISA section 404(a)(1)(C), which generally requires that benefit plan investments be diversified. See 29 U.S.C. § 1104(a)(1)(c) (2006). Thanks to Long, an exception was included in section 404(a)(2) for individual account plans (which ESOPs are) that hold “qualifying employer securities.” See 29 U.S.C. § 1104(a)(2) (2006).
49 See Rosen, supra note 6, at 51. Goldwater’s interest in ESOPs ended as soon as the subject was broached with his principal economic advisor, Milton Friedman. Id.
51 Rozek, supra note 4. Kelso regarded excessive concentration of wealth as a moral crime on a par with genocide. Id.

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conventional party politics. He seems to have been closer to an American tradition that includes, stylistically at least, Ross Perot, Ralph Nader, and Ron Paul.

To those whom he persuaded, however, Kelso was an economic prophet. Terms with religious connotations appear frequently in the ESOP literature. (In addition to “prophet,” you find “disciples,” and “followers,” and “gospel,” and “conversion,” and “crusade.”) One writer likened Senator Long to St. Paul, an analogy that appears to place Kelso himself in the role of . . . Jesus. To immerse oneself in ESOP history is sometimes to feel as though, for a moment, the nation’s tax laws had been turned over to be drafted by L. Ron Hubbard.

In any event, the special ESOP incentives that Long engineered eventually had their effect. By 1990, it was estimated that American companies had adopted more than 10,000 ESOPs, covering nearly ten million employees. While that was a lot of ESOPs, though, it was not remotely close to as many as Kelso and Long wanted. During the period before the special tax incentives almost no ESOPs had been formed, and even with the incentives it eventually became clear that only a minority of companies would adopt them; too few, certainly, to accomplish a national economic revolution. “This sometimes angered Long, and Kelso, for his part, went so far as to suggest legislation penalizing companies that failed to adopt ESOPs.

Reasons can be assembled, however, for the failure of ESOPs to catch on the way Kelso hoped. To take one supposed ancillary benefit of employee ownership, evidence suggests that a company’s adoption of an ESOP does not improve worker morale or productivity. ESOPs are sometimes adopted as a defensive measure against hostile takeovers, but that runs into questions of fiduciary conflict of interest. Leveraged ESOPs do not in any sense “convert” (as is often claimed) a nondeductible cost such as loan principal

52 See Carlson, supra note 11, at 289–90.
53 See id. at 289.
54 Rosen, supra note 6, at 64.
55 A Kelso follower estimated that as late as 1977, fewer than 500 ESOPs had been created, mostly at small, closely held companies that were clients of Kelso. See Speiser, supra note 48.
56 Carlson, supra note 11, at 311 n.61.
57 Id. at 305.
58 See Henry Hansmann, When Does Worker Ownership Work?, 99 Yale L.J. 1749, 1816 (1990); Ezra S. Field, Note, Money for Nothing and Leverage for Free, 97 Colum. L. Rev. 740, 752 & n.82 (1997). It must be pointed out that this conclusion has been vigorously disputed, particularly by organizations promoting the idea of employee ownership. See National Center for Employee Ownership, Employee Ownership and Corporate Performance, http://www. nceo.org/library/corpperf.html (last visited Jan. 27, 2009), for a survey of research that in various contexts supports a link between employee ownership and enhanced productivity.
repayment into a deductible expense.\textsuperscript{61} Worst of all, ESOPs unforgivably concentrate employees’ retirement funds in a single investment. What would be bad enough from the standpoint of simple portfolio and diversification theory—no investor is advised to put all his money in a single stock—is magnitudes worse if that single stock is that of the employees’ employer. In such a case, if something bad happens, the employees lose at the same time both their jobs and their retirement funds.\textsuperscript{62}

Kelso’s overall goal of broad capital ownership actually does seem to have been at least partly realized, and moreover, through the medium of employee retirement plans, but in an entirely different way than he envisioned. Defined contribution—particularly section 401(k)—plans are now the dominant retirement plan form in America, and they nearly universally permit the investment of employees’ accounts, at their election, in corporate stock: not necessarily of the employer but, almost always, among an array of diversified funds of stocks. Employee indirect ownership of capital has thus skyrock-

\textsuperscript{61}It has to be noted first that, partly because only a portion of Kelso’s program was adopted by Congress, “leveraged” ESOPs do not work exactly the way he first envisioned. Kelso originally contemplated that loans to purchase stock for workers would be largely repaid out of the dividends paid on the stock itself. Instead, in practice, leveraged ESOP loans are repaid with (deductible) contributions by the employer to the plan. In comparing a company’s raising of capital through this means with conventional financing (say, a bank loan), where principal repayments are nondeductible, two distinct possibilities must be accounted for. First, the ESOP could be an alternative to a different retirement plan (say, a 401(k) plan) that the employer would have (or had already) adopted in any event. That scenario does not involve a “conversion” of nondeductible conventional financing to deductible ESOP financing. Rather, it involves a forced capital investment in the employer by the employer’s plan, which would have existed and received deductible contributions anyway. The other possibility is that the employer might adopt a new plan, an ESOP, not in lieu of a different plan but solely for the purpose of financing. In this case the employer “repays” the principal twice: once through the dilution of its shares when new stock is first issued to the ESOP and again when the annual contributions are made to the plan to repay the loan. (Stated another way, with a conventional loan the employer’s per-share book value never decreases; the company receives cash and an offsetting liability when it gets the loan, and this is reversed as the principal is repaid. With an ESOP the corporation experiences a permanent reduction in per-share book value equal, in aggregate, to the loan’s principal amount; this amount is effectively transferred from the company to plan participants.) The deductibility of the contributions to the ESOP will always be outweighed economically by the fact of double payment. All this has been pointed out, in somewhat different terms, before. See Michael S. Knoll, Samuel Zell, the Chicago Tribune, and the Emergence of the S ESOP: Understanding the Tax Advantages and Disadvantages of S ESOPS 8–10 nn.49–56 (Univ. of Pa. Inst. for Law & Econ., Research Paper No. 08-14, 2008), available at http://ssrn.com/abstract=1143533.

\textsuperscript{62}Unfortunately, this has happened more than once. For example, United Airlines, majority-owned by an ESOP, declared bankruptcy in 2002, rendering employees’ accounts effectively valueless. See Rosen et al., supra note 6, at 69–70. Enron Corporation maintained an ESOP, as did Bear Stearns. See id. at 14–15.
eted. However, this development has itself not led, it seems, to dramatic enrichment of American workers. By contrast, the evidence appears to show that the switch to defined contribution plans (from the traditional defined benefit plans that were more common in Kelso’s day, and that in no way involve worker ownership of “capital,” in the sense he meant) has entailed a reduction in overall retirement wealth.

There is also the problem that *The Capitalist Manifesto’s* central premise seems to have been proven wrong over the last half-century. Technology has not destroyed the value of labor. Those without access to large amounts of (or any) capital continue to be able to earn a living by working. Though income disparity is great and has grown, workers in even the bottom quintiles of income are nonetheless better off in real terms than their counterparts, for example, of the 1970s, and this change has occurred despite the precipitous decline, during exactly the same time frame, of the organized labor movement, which Kelso saw as a crucial artificial crutch propping up the status quo.

It has to be noted that Kelso’s full binary economics program was never tried, only the ESOP part, and so we cannot say for sure what would have happened if it had been. Encouragement of ESOPs was all that was on legislative offer. Even Russell Long held insufficient influence to be able to slip into a tax bill, for example, a provision requiring corporations to distribute all of their earnings as dividends every year.

**VI. ESOPs in Eclipse**

In 1987, Long left office after 38 years in the U.S. Senate. The previous year, the remaining ESOP tax credit had been phased out of the Code. After

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63 This perspective on Kelso’s theories is not new. See Stephen J. Butler, *ESOP Fundamentals, BUYandHOLD, http://www.buyandhold.com/bh/en/retirement/retirement_perspectives/article_0077.html* (last visited Jan. 27, 2009). It has been further observed that widespread stock option grants, particularly to technology company employees, arguably usurped part of the role Kelso had envisioned for ESOPs. See *Rosen, supra* note 6, at 65–66.


66 See David S. Broder, *The Price of Labor’s Decline,* Wash. Post, Sept. 9, 2004, at A27. The crushing inequality of American income makes it hard not to sympathize with what Kelso was trying to do, even if one has trouble with leveraged ESOPs as the means to do it. And if the focus is restricted to certain economic sectors—one thinks in particular of agriculture—labor does seem to have been largely replaced by mechanization.

67 By that time Long was no longer Chairman of the Finance Committee, the Republicans having taken the Senate in 1980.

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1987, their benefactor gone, other special ESOP incentives continued to fall: in 1989 with the repeal of the estate tax deduction on sales to ESOPs, and in 1996 with the elimination of the 50% income exclusion for interest income on ESOP loans.68 Significant incentives nonetheless remain in place. Section 1042, for example, still allows a person selling stock to an ESOP, in certain circumstances, to defer gain on the sale, and section 404(k) still allows a corporation to deduct dividends paid on ESOP stock.69 New legislation facilitating ESOP ownership of S-corporations was enacted in 1997; this has led to a new cottage industry of tax planning (some of which was eventually deemed sufficiently abusive to warrant inclusion among Listed Transactions by the Service).70

Louis Kelso died in 1991, at the age of 77, in California, having spent much of the 1980s as a successful investment banker leading leveraged buyouts (some but not all of which were centered around ESOPs) through his firm, Kelso & Company.71 Russell Long died in 2003.

The nonprofit Kelso Institute continues today in apparently not-very-active operation. The Institute's web site features pictures of Kelso (sporting, iconoclastically, a bow-tie), a timeline highlighting the dates of various ESOP incentives' additions to the Code (but omitting, however, the dates of many of their later repeal), Kelso quotes (“I'm right and the whole world is wrong”), and a list of additional ESOP-like products invented by Kelso and his followers, including the MUCOP, CSOP, ICOP, RECOP, and COMCOP.72

A group of binary economics disciples also continues to operate under the auspices of an organization called the Center for Economic and Social Justice, which advocates a market-oriented “Third Way” and whose economists publish occasional articles in economic journals promoting Kelso's theories.73 As was Kelso, these economists seem to be ignored by the rest of their field. There are, in addition, two organizations that actively promote ESOPs: one, the National Center for Employee Ownership (NCEO), an informational

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69 See I.R.C. §§ 404(k), 1042(a)–(b).


clearinghouse addressing employee stock ownership by various means, and another, the ESOP Association, a trade organization that specifically focuses on (and aggressively lobbies for) ESOPs.74

Many of the incentives gone, the ESOP nowadays seems to figure less prominently as a device for general corporate finance or for takeover defense. ESOPs are nonetheless far from extinct; the NCEO estimates that 11,000 of them exist today,75 and some very big ones continue to be formed.76 ESOPs remain decidedly helpful, for example, in succession planning for small companies, just as in the time of Peninsula Newspapers. One of the remaining ESOP subsidies, section 1042, continues to offer the possibility of tax deferral in this situation.77 The problem of finding an appropriate successor for the aging founder of a business can be an important and vexing one for the parties involved. In such situations, the leveraged ESOP seems like a useful and, certainly as of 1958, legitimately innovative technique for the purpose of getting the company’s ownership into the hands of employees—something both they and the founder often strongly prefer to selling to an outsider. Still, it does not really feel like workers’ paradise.

74 The Ohio Employee Ownership Center, affiliated with Kent State University, also monitors and promotes employee ownership. See Ohio Employee Ownership Center, http://dept.kent.edu/oeoc/index.htm (last visited Jan. 27, 2009).


76 Sam Zell, for example, used an S-corporation ESOP in structuring last year’s acquisition of the Tribune Company. See Knoll, supra note 61, at 5–6.

77 I.R.C. § 1042.

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