

The Twisted Saga of Mercury Marine

Jack Norman
Karen Royster

Institute for Wisconsin's Future

October 2009



INSTITUTE FOR WISCONSIN'S FUTURE
policy research in the public interest

Executive Summary

Mercury Marine has been the most dramatic corporate story in Wisconsin in 2009. A struggling company put employees and residents in Fond du Lac, Wisconsin through weeks of anguish. Threatening to close the plant and transfer operations to Stillwater Oklahoma, the corporation pressured workers in Fond du Lac to accept large concessions and political leaders at the state and local level to offer the firm large incentive packages – the cost covered by taxpayers.

An analysis of the Mercury Marine situation shows that the key player was Illinois-based Brunswick Corporation which was facing a financial meltdown since CEO Dustan McCoy became head of the firm in 2005. There are many losers in the Brunswick/Mercury Marine tale. Over 5,300 workers lost jobs. Those remaining face reduced pay and benefits. Brunswick shareholders have suffered significant losses in their stock value. White-collar managers say they have been betrayed by the company. Communities in many states have watched their local economy hit by Brunswick factory closings. And as never before released data will show, taxpayers in Wisconsin as well have been ill-treated by the firm.

The only ones protected from loss have been the decision-makers at the very top of the Brunswick hierarchy. CEO McCoy collected over \$10 million between 2006 to 2008 and his five Board members who received an average of \$342,737 each during this same time period.

Even as the story was still playing out, some used the Mercury case as yet another excuse to call for cuts in Wisconsin taxes. High taxes, these critics contend, drive firms like Mercury to seek locations outside the state. The data will show, however, that Wisconsin taxes had nothing to do with Mercury/Brunswick's behavior.

The story of Mercury Marine is a sad documentary on how large corporations can reward executives for failure while dismantling the manufacturing structures that generate real value. Wisconsin's income tax didn't scare the company. Workers didn't drain the firm's cash. Rather, the company's senior executives and directors presided over an internal fiscal meltdown while collecting massive incomes. Employees, stockholders and taxpayers are paying the price for their mismanagement and their luxuries.

Introduction

The drama was perfect. A Wisconsin company struggling through the recession tries to survive by reducing labor costs, forced to relocate if local unions don't cooperate.

Mercury Marine rode the wave of publicity to win significant concessions from the International Association of Machinists Local 1947. Fond du Lac City and County contributed major incentives to keep the company's operations from closing. Fond du Lac County is giving a \$50 million, low-interest publicly financed loan to the firm. To pay for the loan, the Fond du Lac County Board imposed a countywide one-half percent sales tax. The Fond du Lac City Council approved a \$3 million package of incentives, also to be paid for by taxpayers. The State of Wisconsin is offering an additional incentive package that has not yet been publicly detailed.

There was collateral damage. Long-time workers must contend with withered income. Area residents and businesses pay a higher sales tax. The community of Stillwater, Oklahoma—the threatened alternate to Fond du Lac—was left high and dry.

There are many losers in the tale of Mercury Marine, as will be detailed below. Shareholders have suffered severely. White-collar managers say they have been betrayed by the company. Communities have taken big hits. And as never before released data will show, taxpayers as well have been ill-treated by the firm. The only ones protected from loss have been the decision-makers at the very top of the corporate hierarchy.

The main character

While Mercury Marine was the focus of media coverage, it is only a component of a larger entity, the Brunswick Corporation, which took over Mercury in 1961. Brunswick is a world leader in recreational equipment for boating, bowling, billiards and exercise, owning leading brands in each area.

Legally, Mercury Marine is not a subsidiary of Brunswick. It is referred to in Brunswick documents as a "group" (or sometimes as a "division" or "segment.") Since it is not a subsidiary, Mercury has no independent status, no board nor shareholders. It files no tax returns. It is integrated into Brunswick's overall corporate structure.

Decisions about Mercury Marine come from Brunswick headquarters in Lake Forest, Illinois, not from Fond du Lac. A serious look at the Mercury Marine situation requires a deeper examination of the Brunswick Corporation and its Lake Forest decision makers.

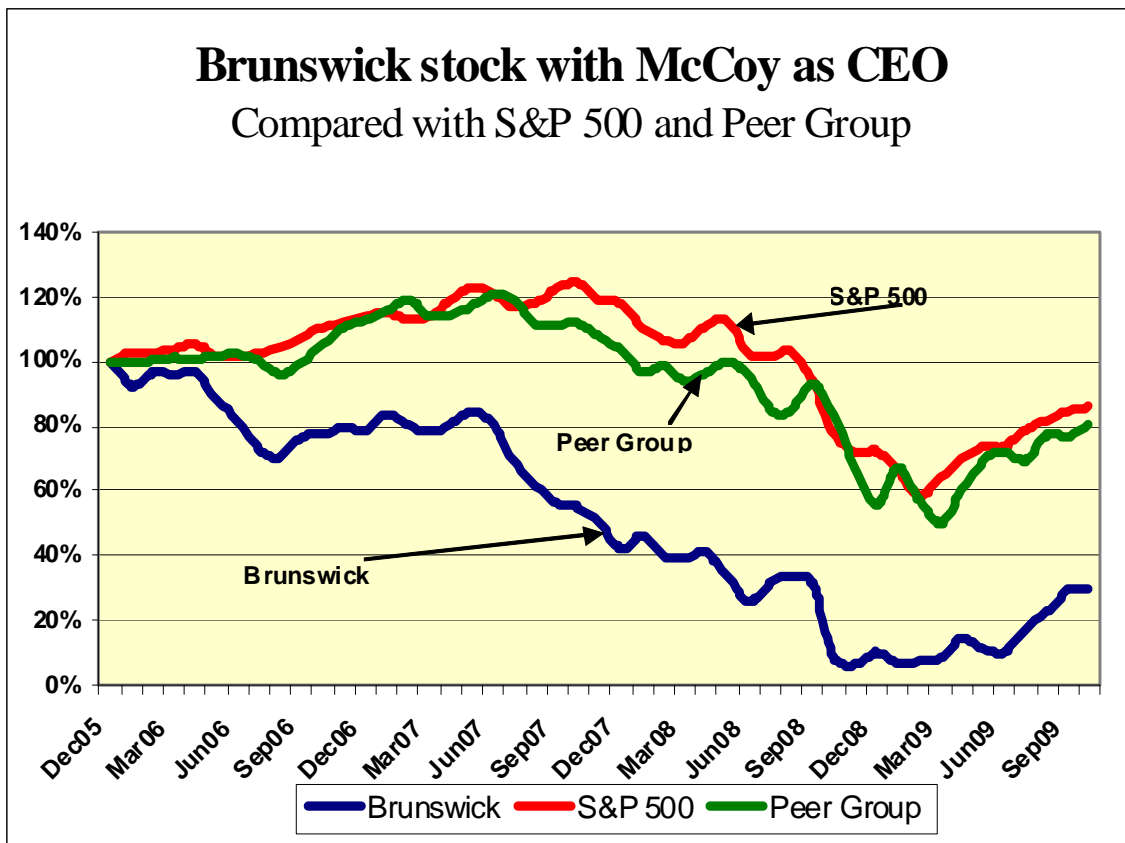
Summary of the plot

The Brunswick Corporation has been facing financial pressure—serious pressure. The Mercury Marine conflict appeared to place the responsibility for this squarely on the shoulders of employees, calling on them to accept cuts in wages and benefits to save the company. When the union voted against this, Mercury Marine said they'd close the Fond du Lac operation and move it to Stillwater, Oklahoma, where labor costs were "more competitive."¹

This threat created turmoil in Fond du Lac, as pressure built on members of Local 1947 to accept the proposed cuts and save the city's economy. Local leaders mobilized to provide large subsidies to Mercury Marine as an added inducement to remain in the area. In a serious recession, communities circle the wagon to protect local industry. The Brunswick strategy worked and Mercury Marine remains in Fond du Lac.

A closer look at Brunswick's financial problems – the losers

Brunswick Corporation has been heading for trouble for several years. The current leader of Brunswick is Dustan E. McCoy, appointed Chairman and Chief Executive on December 5, 2005. Since McCoy took over, the price of Brunswick stock has fallen 71%—far lower than the stock market as a whole. For comparison, the S&P 500 index, a standard measure of stock performance by larger firms which includes Brunswick, fell only 15% during the same period. A better comparison may be Brunswick's peer group of stocks—S&P's Consumer Discretionary group—which the company itself says it most closely resembles and which includes Brunswick. During McCoy's tenure, while Brunswick stock dropped 71%, the S&P Consumer Discretionary group fell only 17%.² [see chart]



Sources: Yahoo! Finance, Bloomberg.com

Shareholders are not the only Brunswick stakeholders to do poorly during McCoy's tenure as Chairman and CEO. In an October 2008 news release, McCoy announced that the firm was cutting its annual stock dividend by 92% and more than one-third of Brunswick's U.S. employees had lost their jobs. McCoy wrote: "In the past two years, we have closed 12 North American boat plants; continually reduced production rates throughout our marine businesses, including extended production furloughs; divested under-utilized assets; exited or divested certain businesses; and reduced headcount in our marine businesses and corporate staff in the United States during 2008 alone by some 5,300 positions, or 35 percent of that hourly and salaried work force."³ The downsizing has continued as Brunswick moves to close the Stillwater, Oklahoma operation. And McCoy's job-loss estimate of 5,300 did not include a reduction of over 2,000 Brunswick employees outside the U.S.⁴

Employees retained by Brunswick have also suffered. Management employees at Mercury Marine have filed a suit alleging that the company failed to abide by its promise to pay the managers 10% of money saved through aggressive cost-reduction measures.⁵ In addition, Mercury's Local 1947 employees were pressured to accept wage concessions including a pay freeze for current employees and a 30% cut for new hires and employees back from layoff.

Brunswick decisions have eroded the economic stability of many communities. In January 2009, Brunswick reported that it had "closed, mothballed, or sold" fifteen North American boat factories.⁶ These operations were located in states across the country – South Carolina, Oregon, Washington, Minnesota, North Carolina and Tennessee. The next will be in Oklahoma.

In short, Brunswick stakeholders have borne the consequences of corporate malfunction. Taxpayers are footing the bill for incentive packages; shareholders have seen most of their investment lost; both unionized employees and managers have lost jobs, income and bonuses; communities have seen factories shuttered.

Brunswick financial affairs—the winners

As the stock value fell, the factories closed and the workers faced unemployment, a small group at the top of the Brunswick pyramid was largely insulated from any damage.

McCoy has been Brunswick's Chairman and CEO since December 2005. Of the eight outside directors at the time McCoy was named to the company's top spot, six are still with the firm. Five remain on the board, chairing four of the board's five committees. Another board member at the time of McCoy's appointment, Peter B. Hamilton, is no longer a director but is the second most powerful Brunswick executive, as Senior Vice President and Chief Financial Officer.⁷

The five long-serving directors, including two with strong Wisconsin ties, are:

- Nolan D. Archibald, Chairman/CEO of Black & Decker and a Brunswick director since 1995;
- Jeffrey Bleustein, retired Chairman/CEO of Milwaukee-based Harley-Davidson and a director since 1997;
- Manuel A. Fernandez, Chairman of Sysco and a director since 1997;
- Graham H. Phillips, retired Chairman/CEO of Young & Rubicam Advertising and a director since 2002;
- And Ralph C. Stayer, Chairman/CEO of Sheboygan Falls-based Johnsonville Sausage and a director since 2002.

The overall income of these executives has not fallen during the company's hard times.

Chairman McCoy's base salary was \$906,000 in both 2007 and 2008, up from \$800,000 in 2006, his first full year. McCoy and other senior executives did take a 20% cut in their base salary for two months in 2008. His base salary remains at \$906,000 in 2009.

Members of the Brunswick Board of Directors who are not employees receive an annual base salary of \$100,000. From 2005 to the present, as the fiscal situation deteriorated, the annual fee was unchanged. Board members also receive additional fees for committee work, ranging from \$7,500 for some committee work up to \$20,000 for the chair of the Audit Committee. These fees have also remained the same.

Board members also receive free Brunswick products worth up to \$15,000 each year, plus additional compensation to pay taxes on those free products. They can choose freely from the company's boats and engines, bowling and billiards and exercise equipment. In each of 2006, 2007 and 2008, these five directors received an average of \$8,000 in free Brunswick products. In addition, directors lease Brunswick boats for free.

Based on details in the company's annual proxy statements, there appears to be only one part of the compensation package for board members that were eliminated in 2008, the year Brunswick lost \$788 million. That year, directors did not receive a "holiday gift" from the company, a gift that been valued at \$849 the year before.

Adding together base salary, committee fees, free products and other elements in the compensation package, the five long-standing directors averaged \$163,263 each for serving part-time on Brunswick's board in 2008. This is slightly below an average of \$168,121 apiece in 2007, and \$174,616 in 2006.

For senior executives, large corporations customarily augment base salaries by providing a variety of bonus and incentives that award cash, stock and stock options. For McCoy, the total value of these non-salary benefits is nearly triple the size of his basic salary. In the three full years since becoming Chairman and CEO, McCoy's total compensation was \$3,566,793 in 2006; \$3,398,800 in 2007; and \$3,137,801 in 2008. The three-year total was \$10,103,394.

But the company's recent poor performance has made it difficult to award executive bonuses which are tied to quantitative measures. The proxy statement sent to shareholders in March 2009 said that it had become too difficult "to provide appropriate incentives" for key employees. For example, it noted that its annual incentive plan "had not paid awards at the corporate level in two years."⁸

As a result, Brunswick modified its compensation scheme for top executives to make it easier to award bonuses. In addition, because of the absence of cash incentive bonuses in 2008 and other factors that limited compensation of top executives, Brunswick asked shareholders to approve "an increase in the number of shares available for awards." The approval was granted.

Brunswick employees who survived the various layoffs helped make this generosity possible. In a March 25, 2009 letter to shareholders, McCoy indicated there had been cuts, writing: "Our employees significantly contributed to our cash position through salary actions, periodic unpaid furloughs, and other measures which directly affected their pay and benefits."

Wisconsin's tax climate and Mercury Marine

In the midst of the Mercury Marine struggle between management and union members, some commentators seized the opportunity to blame Wisconsin taxes for Brunswick's threat to leave the state.

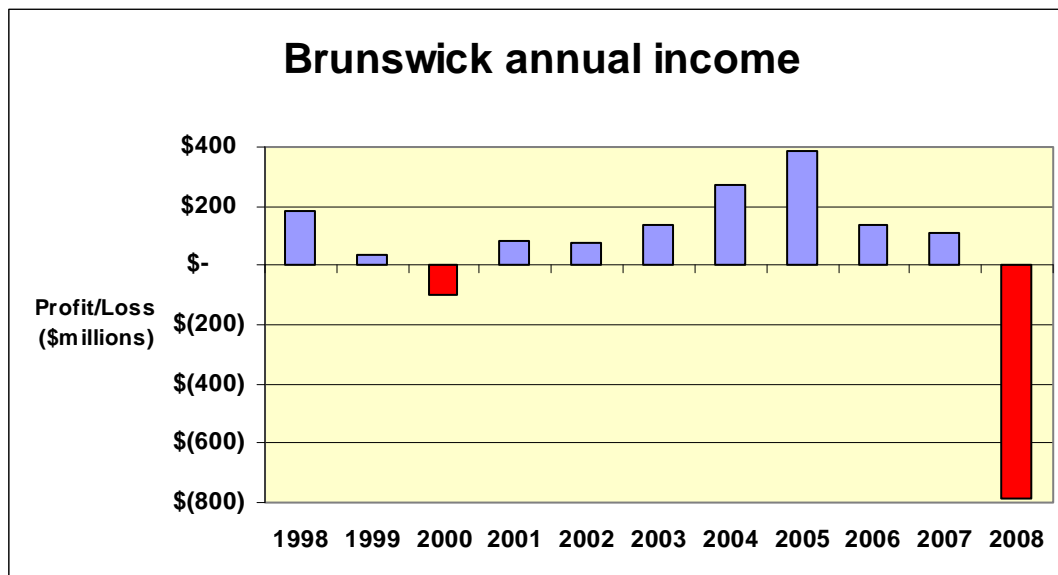
For example, State Rep. Bob Ziegelbauer cited Mercury Marine, among several other Wisconsin employers, as "examples of international manufacturers under stress." "The higher tax burden they now find in Wisconsin is a powerful incentive to look elsewhere when their business recovers with the economic cycle." Ziegelbauer is also Manitowoc County Executive.⁹

And Steve Prestgard, editor of *Marketplace Magazine*, wrote: "Well, like it or not, taxes do matter to businesses. The fact that a business even considers (Mercury Marine), let alone executes (Thomas Industries), a plan to move more than half of its total jobs out of Wisconsin to a state where much less than half of its workforce currently resides, indicates we are not as competitive a state as we should be."¹⁰

The facts of Brunswick's tax situation clearly show that Wisconsin revenue policies were irrelevant to the Mercury Marine showdown. Brunswick itself did not cite Wisconsin taxes as a factor in its maneuvers.

The Institute for Wisconsin's Future has obtained data from the Wisconsin Department of Revenue detailing the amount of state corporate income tax paid by Brunswick in each of eight consecutive years, from 2000 through 2007.¹¹ In each and every one of those years, Brunswick's Wisconsin income tax was \$0.00. Brunswick did not pay Wisconsin income tax through any of its subsidiaries; none of them filed a state tax return.

How did Brunswick manage to have zero state income tax liability? In 2000 Brunswick lost \$96 million, so there were no profits to tax. But Brunswick was profitable for each of the next seven years, 2001 through 2007, with profits ranging from \$78 million in 2002 to \$385 million in 2005.¹² [see chart] Its total profits in the seven years were \$1.1 billion.



The loss in 2000 could have been carried forward to offset some of that, but it still would have left more than one billion dollars in profit through 2007.

Wouldn't at least some of those billion dollars in profit be attributable to Wisconsin? Brunswick had major manufacturing operations in the state, along with healthy sales of its motors, boats, and equipment for bowling, billiards and fitness.

A company's public financial statements to the U.S. Securities and Exchange Commission and to its shareholders are different from its private statements to the federal Internal Revenue Service or state revenue departments. The privacy of tax returns makes it impossible to determine what legal and accounting techniques led to seven consecutive years of profit, but with absolutely zero profits that were taxable by Wisconsin.

Indeed, paying zero income tax is much more common among large companies than is paying something. Yearly data consistently show that among the large companies filing tax returns in Wisconsin, a majority pay zero tax.¹³ Numerous state tax credits and deductions, along with various transfers of assets from one part of a large company to another, are routinely used to legally avoid paying state income taxes. Blocking some of these maneuvers was the reason Wisconsin adopted 'combined reporting' in 2009. Combined reporting is a method of corporate tax filing, used in about half the states, that makes difficult for companies to wall off certain operations from the rest of a profitable corporation, in order to avoid tax liabilities.¹⁴

Wisconsin's adoption of combined reporting in early 2009 is not a problem for Brunswick. First, combined reporting is designed to bar companies from segregating the finances of a subsidiary from the rest of the corporate family. But Mercury Marine wasn't a separate subsidiary at all. It didn't file tax returns. Brunswick itself filed tax returns; it didn't need combined reporting for it to choose that approach to its Wisconsin taxes.

Second, it doesn't matter how Wisconsin taxes corporate profits, because Brunswick's losses were so large in 2008 and 2009 that it won't be paying income taxes of any kind for some years. In 2008, Brunswick broke its seven-year winning streak by losing \$788 million. In the first six months of 2009, Brunswick lost another \$348 million. Based on the company's performance and own statements, Wall Street analysts expect losses to continue apace through the second half of the year.¹⁵

Those losses will shelter over a billion dollars in profits, when Brunswick does return to profitability. This assures Brunswick of zero tax liability in Wisconsin for years to come, regardless of how Wisconsin assesses income tax.

Other state or local taxes were not factors either. Wisconsin's sales tax rate of 5% is barely higher than Oklahoma's 4.5%, and Oklahoma also has much larger local sales taxes than does Wisconsin.¹⁶ Nor did Brunswick object to Fond du Lac County raising the sales tax to pay for the firm's low-cost loan.

Further, Wisconsin exempts manufacturers from sales taxes on purchases of machinery and equipment, fuel and electricity. Its machinery, equipment and inventory are all exempt from property taxes as well, along with its computers.

The moral is clear: Wisconsin's tax climate was not a factor in Brunswick's threat to close Mercury Marine in Fond du Lac.

Conclusion

The Mercury Marine melodrama was portrayed as a simple story: Wisconsin manufacturing concern cutting costs to survive in bad economic times pitted against a recalcitrant union and punitive state tax laws. The community comes to the rescue, prevailing upon workers to accept the cuts while providing low-cost loans to the business. Nice fable. But truth gets bent beyond recognition.

Mercury Marine is actually a sad documentary on how large corporations can reward executives for failure while dismantling the manufacturing structures that generate real value. Wisconsin's income tax didn't scare Brunswick Corporation—they didn't have any state income to pay. Workers didn't drain Brunswick Corporation. Brunswick's most senior executives and directors presided over an internal fiscal meltdown. They collected and still collect massive incomes from this troubled corporation. Employees, stockholders and Wisconsin taxpayers are paying the price for their mismanagement and their luxuries.

Footnotes

¹ The phrase is from Mercury President Mark Schwabero. "Mercury President: Fond du Lac manufacturing hinges on Sunday's union vote," *International Boat Industry*, Aug. 21, 2009. Accessed at: www.ibinews.com/ibinews/newsdesk/20090721020611ibinews.html.

² Stock prices as of Oct. 9, 2009. Regarding its peer group of companies, Brunswick's annual 10-K filing with the U.S. Securities and Exchange Commission says: "The S&P 500 GICS Consumer Discretionary Index encompasses industries including automotive, household durable goods, textiles and apparel, and leisure equipment. Brunswick is included in this index and believes the other companies included in this index provide a representative sample of enterprises that are in primary lines of business that are similar to Brunswick." (p. 20) The 10-K was accessed at: www.ibinews.com/ibinews/newsdesk/20090721020611ibinews.html.

³ Brunswick release: *Brunswick Declares Common Stock Dividend*, Oct. 29, 2008. Accessed at: brunswick.com/news/newsstories/release/1/1219244.php.

⁴ Brunswick's 2009 10-K reports that total employees went from 27,050 on Dec. 31, 2007 to 19,760 on Dec. 31, 2008. (p. 9)

⁵ Kevin Murphy, "Suit says Merc failed to pay bonuses," *Fond du Lac Reporter*, Sept. 17, 2009. Accessed at: www.fdlreporter.com/apps/pbcs.dll/article?AID=/20090917/FON0101/909170413.

⁶ Brunswick release: *Brunswick to Mothball Riverview Boat Plant in Knoxville, Make Additional Reductions to Match Market Demand*, Jan. 6, 2009. Accessed at: brunswick.com/news/newsstories/marine/2/2009.php.

⁷ All information on Brunswick directors is from the company's annual Proxy statements to shareholders. Available online at: brunswick.com/investors/publications-and-filings/proxy-statements.php.

⁸ 2009 Proxy statement, p. 17.

⁹ Bob Ziegelbauer, "Business Cold," *Manitowoc Herald Times Reporter*, Sept. 21, 2009. Accessed at: www.htrnews.com/article/20090921/MAN06/909210464/1410/Ziegelbauer--Business-cold.

¹⁰ Steve Prestgard, "We're number 42!" *Marketplace magazine, Northeast Wisconsin's business magazine*. Accessed at: www.marketplacemagazine.com/blogs/blog2.php/2009/09/23/we-re-number-42.

¹¹ Income tax data are available from the Department of Revenue using a Form P-100. Details are available at: www.revenue.wi.gov/forms/misc/p-100f.pdf. There are significant restrictions on the use of the information obtained through this method. One restriction prohibits the public from disclosing the information, except while giving a public address, until the data are published in a newspaper. Information on Brunswick's state income taxes prior to 2000 has not been requested from the Department of Revenue.

¹² Annual profit figures are available from numerous sources, including the company's 10-K filings.

¹³ Institute for Wisconsin's Future, *Wisconsin's Revenue Gap: An analysis of corporate tax avoidance*, p. 9. Accessed at: www.wisconsinsfuture.org/publications_pdfs/tax/wi_revenue_gap_12_2007.pdf.

¹⁴ See Institute for Wisconsin's Future, *Combined Reporting: How Closing Corporate Loopholes Benefits Wisconsin*. Accessed at: www.wisconsinsfuture.org/publications.html.

¹⁵ See, for example, consensus of analyst estimates at *New York Times*. Accessed at: topics.nytimes.com/top/news/business/companies/brunswick_corporation/index.html.

¹⁶ "Sales taxes in the United States," in *Wikipedia*: "Oklahoma has a 4.5% sales tax rate. Cities have an additional sales tax which varies, but is generally 3-4% resulting in a total sales tax rate of 7.5% to 8.5%." Accessed at: en.wikipedia.org/wiki/Sales_taxes_in_the_United_States.