HB

240

#1

(7)

COMMITTEE REPORT

HOUSE

FURTHER: FINANCE

March 6, 1979 Date: 3-7-80

Mr. Speaker:

The Committee on STATE AFFAIRS has had SSHB 240

"An Act creating the Alaska General Stock Ownership Corporation; eff. date."

under consideration and (a majority of the committee) (the committee) reports it back with the following recommendations:

[ ] do pass [ ] do not pass

[ ] do pass with attached amendments(s)

[X] replace with CS for STHB 240 [ ] same title [ ] new title

and ~~recommends~~ [illegible]

[ ] AND attaches a "Letter of Intent" [ ] New Fiscal Note

[ ] reports it back without recommendation

[ ] referred to the ______ Committee

MEMBERS SIGNING DO PASS	MEMBERS HAVING OTHER RECOMMENDATIONS:
Terry Gardiner, Not Pass	[illegible] no rec
[illegible signature]	[illegible signature] no rec
[illegible signature], Do Not Pass	Tony [illegible] No Rec
	[illegible signature] " "

[illegible signature]
CHAIRMAN

H 60 (Rev. 12/78)

Kelsoism, GSOC, and AGSOC

Prepared for
The House Finance Committee
ALASKA STATE LEGISLATURE

by

Robert E. Smith
Professor of Economics
and
Business Administration
University of Oregon

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Executive Summary

This report is divided into three parts: the Kelso framework; the GSOC; and the AGSOC.

The Kelso Framework. Central to the analysis of capitalism by Kelso and his associates is the alleged existence of a massive maldistribution of income: capital accounts for 90 percent of the economy's output but gets only 30 percent of that as income while labor produces only 10 percent and gets 70 percent. There is also said to be a maldistribution of wealth; 10 percent of the households own all of the capital assets. They argue that these two maldistributions are inherently contradictory and, unless corrected, Mixed Capitalism (i.e., the type of capitalism that exists in the U.S. today) will collapse into State Capitalism (i.e., the type of capitalism that exists in Russia today).

To prevent these developments, Kelso and his associates advocate a capitalist revolution--the creation of Universal Capitalism by the adoption of a gigantic capital diffusion program that would make new capitalists of the 90 percent of households that now own no capital. This revolution would require that corporations no longer retain earnings for purposes of internal financing, thereby compelling them to pass profits through to stockholders as dividends; would eliminate collective bargaining by unions; and would abandon the full employment and welfare transfer policies of the federal government. The magnitude of these changes would be huge; these changes, designed

to reduce the alleged maldistribution of income, would require that wages decrease by 85 percent and that the returns to capital increase by 600 percent. Similarly, the rate at which the economy would have to grow in order to effect this transfer would also be very large, given historic comparisons; they would have to be "several" times four percent.

We suggest that, even if this analysis by Kelso and his associates were correct, it is doubtful that such a program of action is feasible. If the economy were to expand to the extent and as rapidly as projected, we would expect inflation to be a major problem and that the levels of concentration and centralization in the economy would increase significantly from their present levels. More important, however, is the high probability that present economic/physical constraints on resources, especially energy, would not allow the necessary rapid rates of growth. The scope and speed of the proposed reform are beyond current economic/physical resource capabilities.

More determinative of the relevance of the Kelso framework, however, is the fact that the alleged massive distribution of income does not exist. Kelso and his associates provide no quantitative support for the existence of the 90-10/30-70 breakdown. It appears to be the result primarily of casual observation. Their version of such an income maldistribution has no known support among professional economists. It is argued below that, in alleging the existence of such a maldistribution, Kelso and his associates made a basic theoretical error. They overlooked the fact that entry and the competitive market dis-

tribute the results of particular productivity improvements, whether made by capital or labor, primarily to consumers in the form of lower prices rather than to capitalists and labor in the form of persistently higher profits or wages. Given this historic process, there is no justification for allocating exclusively to capital a persistent and high rate of return for having initiated a productivity improvement.

Although a capital diffusion plan is central to the analysis of capitalism made by Kelso and his associates, the invalidity of that analysis does not necessarily make capital diffusion also invalid. Such programs should be considered on their own terms and rated up or down on the basis of their own merits. This is true of both GSOC and AGSOC.

GSOC. The most important feature of the federal law that created the opportunity for states to create GSOCs was the refusal by Congress to grant two very significant tax exemptions that were initially sought. The failure to obtain these exemptions had three effects. First, the probability of a negative cash flow during the first years of a GSOC was increased. Second, this adverse effect on cash flow will increase the probable need and duration to finance losses during the early years of a GSOC. And, third, the possibility is increased that during these initial years a GSOC will not be able to pay dividends to its stockholders but will pass through to them a tax liability. During these years, the stockholders would be net losers.

AGSOC. We analyzed three administrative and organizational

features of AGSOC, as currently proposed: the guarantee issue, the issue of the investment decision-making process, and the holding v. operating company issue.

In connection with the guarantee issue, we concluded that a loan guarantee fund would undoubtedly be required by private creditors of an AGSOC. The key to long term legislative control over an AGSOC lies in the enabling and appropriation acts with respect to successive loan guarantee funds. But the significance of the fund goes further: it can affect the nature of the investment decision-making process.

Five parties will be involved in the investment decision-making process: the seller of the asset, creditors, AGSOC management, AGSOC's Board of Directors, and the Legislature. Given the elective nature of both the Board and the Legislature, it is hard to escape the conclusion that the investment decision-making process will be subject to appreciable political influence. This means that Alaska will have to rely heavily on creditors to sift the good risks from the bad risks. In projects of the magnitude presently contemplated, it is doubtful wisdom for debtors to depend so heavily on creditors. Such dependence will, at best, come at a price.

The general principle with respect to investment is that, if markets work efficiently and if the buyer functions only as a non-speculative and non-operating investor, the price paid (i.e., the amount borrowed) plus interest paid on the debt will just equal the income generated by the asset over its life. This principle applies to assets with either a finite or perpetual life.

Given the above principle, how can a buyer borrow, invest, pay back the loan, and still make money? A buyer can, for example, make money if he has better information than the seller, is a better negotiator than the seller, is both more risk prone and lucky, or is able to increase the annual income generated by the asset. Income can be increased (1) if the buyer were to become an operator as well as an investor and if he is more efficient as an operator than the seller or (2) if the buyer got a tax break not previously available to the seller. This analysis suggests that, failing to get their desired tax breaks, AGSOC proponents will begin to promote AGSOC as an operating company rather than as a holding company. AGSOC as an operating company, however, would break the Kelso conception as to the nature of investment in capital diffusion programs. The expected result of such a change in function would be to increase significantly both the risk characteristics and the degree of uncertainty associated with the AGSOC. There would undoubtedly be an adverse effect both on the ability to secure 100 percent debt financing and on the probability of a reasonable pay-out period.

Kelsoism, GSOC, and AGSOC

Introduction

The proposed Alaska General Stock Ownership Corporation (hereafter AGSOC) came to Alaska in three steps. The first step was the writings of Louis D. Kelso and his associates[1] in which they set forth a program of capital diffusion. The second step was the inclusion by Congress in the Revenue Act of 1978 of the General Stock Ownership Corporation (hereafter GSOC) provisions in which Senator Gravel played a major role. The final step was the introduction in the Alaskan Legislature of a bill proposing to create an AGSOC.

The present report follows this development. The first section is an economic analysis of the writings of Kelso and his associates. The second section discusses major characteristics of a GSOC with special reference to tax considerations. The third section analyzes important issues raised by the AGSOC proposal itself. The preceding executive summary will function as a conclusion.

The Kelso Framework

Kelso and his associates identified four types of capitalism. Primitive Capitalism was the "form of capitalism which existed in Great Britain during the nineteenth century and which persisted

[1] These abbreviations will be used to identify the following three books. CM will identify The Capitalist Manifesto by Louis O. Kelso and Mortimer J. Adler (Random House, New York) 1958; TFT for Two Factor Theory: The Economic of Reality by Louis O. Kelso and Patricia Hetter (Vintage Books, New York) 1967; and PA for A Piece of the Action by Stuart M. Speiser (Van Nostrand Reinhold Company, New York) 1977.

in a waning state until the end of the First World War" (CM, p. 104). State Capitalism is the "form of capitalism that exists in Soviet Russia today" (CM, p. 105). Mixed Capitalism is the "form of capitalism which exists in the United States and Great Britain today and which has been developing since the end of the First World War and the rise of labor unions to power with the help of the countervailing power of government" (CM, p. 105). Finally, Universal Capitalism or Capitalism "with a capital 'C'" is the "form of capitalism which will exist, probably in the United States first, after the capitalist revolution has brought into being the first justly organized capitalist economy" (CM, p. 107). Universal Capitalism is advocated by Kelso and his associates.

In brief, Kelso argues that Mixed Capitalism is doomed because of internal contradictions and will be replaced by State Capitalism unless the transition is made to Universal Capitalism. Universal Capitalism will be the product of installing capital diffusion policies--accompanied by other key changes in corporate conduct, labor unions, and government economic policies--on a sufficiently grand scale to give all citizens a second income that is derived from their ownership of capital and not from their labor. This section will briefly sketch out his argument with emphasis on the key role of his capital diffusion program. The General Stock Ownership Corporation (hereafter GSOC) and the Alaska General Stock Ownership Corporation (hereafter AGSOC) are directly derived from this capital diffusion program although, as will be duly noted, they differ importantly from the diffusion

institutions described in the writings of Kelso and his associates. As they see it, the game is big and the stakes are obviously high.

Mixed Capitalism and its Fatal Flaw. It is the position of Kelso and his associates that Mixed Capitalism contains a fatal flaw or internal inconsistency that, unless eliminated, will cause the collapse of Mixed Capitalism into State Capitalism. This fatal flaw consists of a massive maldistribution of wealth and of income.[2]

Maldistribution of wealth. According to Kelso and his associates "2.3% of America's households own about 80% of the economy's productive capital, and an additional 5 to 8% own the rest" (TFT, p. 40). In short, 7 to 10% of U.S. households own all productive assets. This massive maldistribution is said to be the result of the two conventional methods by which new productive capital is financed (TFT, p. 40, p. 79). The first method is the internal corporate financing of new investments by the use of retained corporate earnings. The second method is the insistence by creditors that debtors provide collateral that consists of existing capital owned by the debtors. The use of these two conventional financial processes assures that those who get more will be those who already have. In short, the rich get richer. Increasing centralization of capital is the result.

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[2] To this reader, Kelso and his associates use the concepts of wealth and income in an ambiguous manner. In that which follows, wealth is used as a stock concept and income as a flow concept. For an example of the ambiguity, see CM, p. 129.

This maldistribution is said to cause a shortage of purchasing power; "a few families have purchasing power in excess of their consumption needs, and the great majority have needs in excess of their purchasing power" (TFT, p. 40). According to Kelso and his associates, it is this excessive concentration in the ownership of capital and the resulting shortage of purchasing power "that is the basic cause of the economic dislocations or periodic 'depressions' in an industrial economy based on private property in capital and labor" (CM, p. 151). This condition is aggravated by the maldistribution of income.

The Maldistribution of Income. According to Kelso and associates, over "70 percent of the wealth produced (read "income") is distributed to labor, but over 90 percent of that wealth (again read "income") is produced, not by labor, but by capital instruments" (CM, p. 129). In other words it is alleged that, while capital accounts for 90 percent of output, the owners get only 30 percent of that income. Labor, on the other hand, produces only 10 percent but gets 70 percent of the output. In Mixed Capitalism, labor exploits capital! The massive maldistribution of income claimed by Kelso and his associates is advantageous to labor and disadvantageous to capital. No wonder that Milton Friedman, bel Laureate in Economics, said of this theory: "It's Marx stood on its head" (PA, p. 124).[3]

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[3] More generally, Professor Friedman characterized the "two factor theory" of Kelso and his associates as "a crackpot theory" (PA, p. 124).

This alleged maldistribution of income (we shall assume for the time being that such a maldistribution of income exists. I personally do not believe that this type of a maldistribution of income exists.) is said to be the result of a conflict between a capitalistic mode of production and a laboristic mode of distribution (CM, p. 129). The capitalistic mode of production refers to the increasing use of capital and associated labor-saving improvements in technology to produce an ever increasing supply of goods while decreasing the demand for labor. The laboristic mode of distribution distributes the national income through wages paid in the process of employment. "The laboristic distribution which organized labor, with the help of government, has managed to effect has been achieved by the exercise of political and economic power, not by bargaining" (CM, p. 125). This laboristic mode has been supplemented by a "needistic" distribution based on welfare programs that transfer income from one group to another

The simultaneous use of capitalistic and laboristic modes increases the supply of goods to be distributed, thereby increasing the pressure on the distribution system, while decreasing the demand for labor, thereby decreasing employment and further eroding the basis of distribution. A gap is said to develop between society's ability to produce goods and its ability to distribute goods. As a consequence the government comes under increasing pressure to increase employment or to develop welfare-like transfer systems in order to generate sufficient purchasing power to move all that can be produced. The result has been

the expeditous adoption of a full employment policy and the development of a welfare system based on income transfers from the rich to the needy. These "laboristic" and "needistic" programs are at the heart of the policies of Mixed Capitalism.

The full employment policy, drafted as a partial solution to the conflict between the capitalistic mode of production and the laboristic mode of distribution, requires that the economy be continually stimulated. This stimulation leads to persistent inflation which, according to Kelso, is Mixed Capitalism's "insoluble problem" (CM, p. 129). "Inflation is a natural and necessary process in an economy that is capitalist in its mode of production and laboristic in its form of distribution" (CM, p. 129).

In addition, Kelso sees a potential conflict between the maldistribution of wealth and income: the "effective and highly concentrated ownership of capital in about 5 percent of the households of our economy is incompatible with the production of some 90 percent of the wealth (read income) by capital instruments" (CM, p. 136). As capital continues to produce more, the increasing concentration of capital decreases the ability of capital ownership to serve as a basis for distributing income, thereby creating increasing pressures to use labor and employment as the basis for distribution. Kelso and Adler reached this pessimistic conclusion:

> If mixed capitalism cannot check the inflationary process of the last thirty years, if it cannot resolve the conflict between its policy of full employment and the technological advances that lie ahead, if by the very nature of the elements in the mixture the laboristic

> aspect of the distribution tends to expand and the capitalistic aspect to contract..., then, perhaps, mixed capitalism...contains the seeds of its own destruction. (CM, p. 129)

The Kelso Program of Reform. The principal goal of the reform program of Kelso and his associates is to create Universal Capitalism whose essential characteristic is to make effective capitalists of those 90 percent of the households who own no capital. This transformation will provide the basis for a distribution system that is based predominately on capital ownership rather than on labor. This capitalistic mode of distribution will be able to absorb the output of the capitalistic mode of production. The gap that breeds inflation will allegedly be closed. And, according to the theory, this capitalist revoluation will correct the fatal maldistribution both of wealth and of income.

More particularly, the capitalist revolution consists of four steps. First, corporations will no longer be able to finance expansion internally from retained earnings; profits are to be paid to stockholders as dividends. This change will prevent further concentration of wealth and facilitate the creation of the New Capitalists by accelerating the repayment of funds borrowed to finance the purchase of their equity positions. Second, markets must be freed from the collective or "coercive" (TFT, p. 76) bargaining imposed by unions that has distorted the distribution of income to the advantage of labor. Collective bargaining

> introduces into the economy a governmental enfranchisement of unions to levy taxes upon employers, stockholders, and upon the economy as a whole. It sanctions a form of monopoly

> and conspiracy made effective by organized force which dwarfs any industrial monopoly ever contrived. It eliminates from the major area of the economy the use of objective, impartial, and free competition as a just determinant of economic values. (CM, p. 187)

A measure of the extent of the distortion Kelso and Adler attribute to labor unions is indicated by this passage.

> If a competitive evaluation of the contribution of labor were then to set wages at a level which labor could justly claim as a return for its services, labor's standard of living might dwindle to bare subsistence or even fall below it. (CM, p. 61)

Under Kelso's program unions would indeed be transformed; they would cease being an organization that exploited capitalists and become an institution whose function would be to protect the small and medium sized capitalists from all challenges. Under Universal Capitalism,

> ...the labor union will obviously not be needed as an instrument of power to effect a laboristic distribution of wealth (read income)....But to say that the union will not be needed to perform this function in a justly organized economy, with diffused ownership of capital and a capitalistic distribution of wealth (read income), is not to say that there will be no socially useful service for it to undertake. Voluntary associations of capitalist workers, operating through democratic processes of self-government, may serve their own members and the whole society by functioning as agencies for the economic education of the newly made capitalists, and as instruments for the protection of their property rights. (CM, p. 157)

Kelso recognizes that the reform of corporations and unions would be both necessary and difficult.

> The giant corporations which exist and the giant labor union which has just come into existence represent enormous concentrations of power which have not as yet been made fully responsible for the use they make of their power. The most difficult task that government faces, in effecting the transition from our present mixed capitalism, is to tame and harness

> the power of these creatures of capitalism and, by making them responsible in the discharge of the limited functions they should perform, make them serve (Universal) Capitalism, or at least prevent them from despoiling either. (CM, pp. 156-157)

The third step is to create the class of New Capitalists who presently own no capital. This will be a massive undertaking because sufficient new capital must be created to give those 90 percent of households that own no capital a grubstake that will provide with them an important second income based on capital ownership. Some idea as to the magnitude of the change required can be obtained from the following considerations. Under Mixed Capitalism labor is the source of 70 percent of household income. Under Universal Capitalism and after correction of the maldistribution of income, labor would be the source of only 10 percent of that income--as determined by labor's 10 percent productivity. Capital ownership would have to become the source of that 60 percent difference. In short, during the transition from Mixed Capitalism to Universal Capitalism, wages would have to decrease 85 percent (6/7s) and the return to capital would have to increase 600 percent, assuming no increase in the standard of living.

This mammoth restructuring of both the production and distribution systems would apparently be accomplished by allowing these households to borrow from banks and to purchase stock in a limited set of well established, blue chip corporations; the investments of the New Capitalists are not to be in venture capital. The purchased securities would be held in escrow until they had been paid for by dividends received. The New Capitalists

would then receive their stock. Three programs would expedite this process. First, the corporations could retain no earnings; this would maximize the dividends to accelerate paying off the loan. Second, tax exemptions would further maximize the flow of earnings to repay the loan. Third, a Capital Diffusion Insurance Corporation would be created in order to encourage banks and other institutional creditors to engage in 100 percent financing by protecting them against losses. This last proposal would, in effect, base creditor protection on the collective credit worthiness of non-capitalist households rather than on assets owned by est blished capitalists.

Finally, the U.S. economy would have to grow at a much more rapid rate than it has in the past if the New Capitalists are to acquire a capital base sufficient to make a difference; the New Capitalists are not to be created at any significant expense to existing capitalists. The New Capitalists and their "Second Income" are to be created out of growth. For example, in the United States and Canada a growth rate will be required that is "several times the three and a half to four percent that is currently achieved in the U.S. and in most Western economies." (TFT, p. 9) The situation would be even more striking in less industrialized economies; their productive capacity "may have to be expanded fifteen, twenty or more times in order to build second economies capable of producing general affluence." (TFT, p. 47) It is evident that the arrival of Universal Capitalism will be heavily dependent upon realizing sustained rates of growth significantly greater than the world has as yet experienced in a sustained and general fashion.

Is the Kelso Program Workable? Let us assume for the sake of argument that the diagnosis of Kelso and his associates is correct and that their proposed remedies could solve the problems. Is the plan workable?

To answer this question, two economic features of the plan should be recalled. First, the plan envisions a huge increase in capital formation in order to create the capital base for an adequate second income for 90 percent of U.S. households. Second, in order to realize this great expansion within a reasonable period of time, the economy must grow at an unprecendentedly rapid, sustained rate of growth.

If we assume for the moment that such rates of growth are within our physical capabilities, we must examine the effects of such large and rapid rates of growth on the national economy. At least two consequences can be predicted with reasonable assurance: the program would be inflationary and would lead to an increase in both industrial centralization and concentration.

Kelso and Hetter have argued that his capital diffusion plan would be "deflationary" (TFT, p. 97) on the grounds that the new capital formation would lead to a larger supply of goods. They acknowledge, however, that the debt financing aspect of the program would increase significantly the supply of money. This would, of course, be inflationary unless the supply of goods could be increased simultaneously and commensurately. The increase in the money supply and hence demand would begin immediately with the start of the plan. The increase in the supply of goods would come more slowly and later. Because of

this lag, inflationary pressures would develop. History does not support Kelso's implicit assumption as to the almost spontaneous responses of supply to a sharp and sustained increase in demand. We could expect significant lead times, lags, and bottlenecks. The inflationary potential of the Kelso plan was recognized by a 1976 staff report of the Joint Econmic Committee of the U.S. Congress.[4]

The Kelso program would funnel much of this new capital expansion into established, well-managed firms (TFT, p. 97). This would increase their size relative not only to the economy as a whole but also to other less favored firms with which they compete in relevant markets. The first type of increase we customarily call centralization and the second type concentration. Because of this preference for blue chip firms, we can expect the capital diffusion plan of Kelso to increase both centralization and concentration.

A more important difficulty, however, than the likely inflationary and centralization tendencies of the Kelso program, is the great likelihood that the projected rates of growth are beyond our present economic/physical capabilities. It is increasingly apparent that we are entering a mandatory slow growth period, constrained by energy and raw material supplies. Growth targets have been reduced by both developed and developing countries. What might have been a potentially viable policy in the

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[4] See PA, p. 254-6 for a discussion of that report. The report did support, in general, efforts to diffuse capital ownership.

60's appears no longer to be viable, given the magnitude of the proposed change.

Implementation of the plan would also undoubtedly pose political problems. Two major economic inscitutions, both with political clout, would have to undergo basic changes. Management would lose the flexibility associated with internal financing. The impact on labor unions would be even more far-reaching. Not only are unions accused of exploiting capitalists (albeit apparently of willing capitalists) but the plan would dismantle collective bargaining as we know it. The new unions would function as the protectors of the interests of small capitalists.

Political problems could also be associated with the need for wages to fall some 85 percent during the transition to Universal Capitalism as the income to households from capital ownership rose 600 percent. Upheavals of this magnitude boggle the mind and challenge credibility, especially when the whole conception is based on an alleged massive maldistribution of income that does not exist.

Is There Really a Basic Maldistribution of Income? From the standpoint of a professional economist the most suspect aspect of the analysis by Kelso and his associates is their contention that, although labor gets about 70 percent of the economy's income and capital gets 30 percent, capital should get 90 percent and labor only 10 percent based on their comparative productivities. This contention was rather summarily dismissed by Professor Paul Samuelson, a Nobel Laureate in Economics, in a brief

report that he prepared on Kelso's ideas for the Puerto Rican government.

> Kelsoism is not accepted by modern scientific economics as a valid and fruitful analysis of the distribution of income, but rather it is regarded as an amateurish and cranky fad....Its central tenet (the 90-10/30-70 gap) is contradicted by the findings of economic empirical science: according to statistical study of macro-economic trends, by such distinguished scholars as Professor Simon Kuznets of Harvard (Nobel Laureate in 1971), Senator and Professor Paul H. Douglas (award winner for his Cobb-Douglas statistical measurement of the aggregate production function), MIT Professor Robert M. Solow, and numerous researchers at the National Bureau of Economic Research under the direction of Arthur M. Burns, chairman of the Board of Governors of the Federal Reserve System, economic adviser to Presidents Eisenhower and Nixon, the contribution of labor to the totality of GNP is in the neighborhood of 75 percent, with only 25 percent attributable to land, machinery and other property.
>
> ...this 75-25 percent breakdown is diametrically opposite to the Kelso presuppositions, which are purely speculative and not based on econometric analysis of the observed statistics of nations at different stages of development. (PA, p. 112)

According to Samuelson, the principal determinants of the distribution of income between capital and labor are changes in the relative supplies of labor and capital, changes in technology, trade union pressure, antitrust policies, and welfare transfers.[5] The process, however, is dominated by the first two determinants. The two have combined to stabilize the 75-25 (similar to Kelso's 70-30) distribution of income.

Professor Samuelson's comments do not quite get to Kelso's concern. I do not believe that Kelso's problem is that the 70-30 (or 75-25) breakdown fails to measure what capital and labor get.

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[5] Paul Samuelson, Economics (McGraw-Hill, New York) 1973, 9th edition, pp. 741-748).

His concern is that the distribution should reflect the relative contributions of capital and labor to national output. If capital produces 90 percent, it should get 90 percent. If labor produces only 10 percent, it should get only 10 percent. It is for these reasons that he contends "there is no longer any basis for believing that the available statistics give us an accurate picture of the relative economic productivity of capital and labor" (CM, pp. 260-261).

The real issue is the relative productivities of capital and labor. Kelso and his associates offer no empirical support for this important quantitative aspect of their analysis. It seems to be based on nothing more than casual observation. I believe that Kelso and his associates have made a fundamental theoretical error. The central question is simply stated: How is the productivity dividend to be distributed? Kelso's answer is straightforward: Capital, not labor, is responsible for the increased productivity; therefore, it is only just that capital should get it all. But, in a market system (and recall that Kelso is a strong believer in a market system) there are three claimants to a productivity increase: capital, labor, and the consumer. Kelso overlooks the critical role of the consumer. In a market economy, the initial, high return to capital for innovation is eventually eroded and prices fall a entry of new capacity, attracted by the profits, increases industry supply. New products have such a life cycle. The price experience of small hand-held calculators over the last five years is a good example. In short, the principal beneficiary of increases

in productivity in a market economy is the consumer and not the capitalist. The consumer benefits from the lower prices made possible by technological gains and enforced by a competitive market. It is the consumer, not capital or labor as factors, who is the principal beneficiary of productivity improvements. If the above analysis is accepted, there is no reason to accept Kelso's 90-10 breakdown or, more importantly, his claim of a massive maldistribution of income that is alleged to be a fatal flaw of Mixed Capitalism.

Does Capital Diffusion Make Sense Outside the Kelso Framework?

According to Kelso and his associates, the two fatal flaws of Mixed Capitalism were the maldistributions of wealth and income. Of these two, the maldistribution of income was both the more controversial and the more important. In my opinion, the maldistribution of income as described by Kelso, does not exist. It is not a fact. Is there, however, a maldistribution of wealth? In this instance, the facts are less controversial and reasonable people can disagree as to the desirability of the existing distribution of wealth. For those who would prefer a more even distribution of wealth, a capital diffusion program is one way to achieve it.

In 1976, for example, the Joint Economic Committee of the U.S. Congress stated in its Joint Economic Report:

> To begin to diffuse the ownership of capital and to provide an opportunity for citizens of moderate incomes to become owners of capital rather than relying solely on their labor as a source of income and security, the Committee recommends the adoption of a national policy to foster the goal of broadened ownership. (PA, p. 25?)

In sum, a policy of capital diffusion should be evaluated outside the Kelso framework and its dire predictions of the collapse of Mixed Capitalism. Such a policy should be allowed to stand on its own feet and be voted up or down on its own merits. In this conclusion, I agree with Stuart Speiser, an admirer of Kelso, when he wrote concerning Kelso's two factor theory--the theory that is based on the existence of the massive maldistribution of income--that it is "an irrelevant issue that would be ruled out of the case if Kelso were trying it in court" (PA, p. 95) and "a millstone around Kelso's neck" (PA, p. 122). In addition, Speiser believes that this theory "has absolutely nothing to do with capital diffusion or universal capitalism" (PA, p. 95). I would, however, go one step further and argue that capital diffusion policies should be evaluated on their own terms and not even as a part of that broader program, Universal Capitalism. It is in this limited context that we proceed to an analysis of GSOC and AGSOC.

The General Stock Ownership Corporation

The General Stock Ownership Corporation (hereafter GSOC) plan, as initially conceived, had at its heart two elements: finance by borrowing and significant tax exemptions to facilitate that debt financing. Debt financing was at the ideological core of the Kelso program: individuals were to utilize their collective credit worthiness to finance their increased participation in the capitalist system. This was to be a "boot strap" operation--a painless way for all to become capitalists and ac-

quire a significant second income. Although we shall concentrate in this section on the tax exemptions, it is important to stress that their importance derives from the key role of debt financing.

The GSOC plan, as initially proposed in the U.S. Senate, sought two major tax exemptions. First, the corporation in which a GSOC acquired stock was to be allowed to deduct as an expense dividends paid to GSOC. This would approximately double the revenue to GSOC relative to other stockholders. Second, the bill proposed that GSOC be given tax-exempt debt financing. Not only would GSOC have been able to deduct the interest payments on its debt but it would also be able to deduct its payments against the principle. In other words, the principle debt was not to be paid out of taxable income as it normally is, for example, in a home mortgage; the mortgage payment would itself be tax deductible. This was a critical exemption and would have significantly facilitated debt financing.

In the final bill, Congress gave GSOC neither of these important exemptions. Instead GSOC was allowed to integrate its tax liability with its stockholders; the corporation was allowed to escape double or triple taxation by passing its income tax liability through to the stockholders. This is the same type of tax advantage that is routinely exercised by small business.

The refusal of Congress to grant the previous two major tax exemptions has three consequences with respect to the operation of a GSOC. First, by reducing the after tax income of the GSOC

Congress's refusal increased the probability and duration of a negative cash flow during the first years of the GSOC. Second, this adverse effect on the cash flow will increase the probable need and duration to finance losses during the initial period of a GSOC. In particular, it complicates attempts by a state legislature to guarantee the debt of the GSOC to its creditors either by a guaranteed loan or a loan guarantee fund.

The third consequence of Congress's refusal to grant the tax exemptions initially sought by the GSOC proponents is the taxable income issue. It will be recalled that under the only tax exemption granted--the tax integration exemption--GSOC's taxable income flows through to its stockholders. This tax liability flows through whether the stockholders receive any dividends or not. The source of the problem is twofold. First, although it is not inevitable, it is probable that a GSOC will initially generate a negative cash flow. It, therefore, will be unable to pay dividends because its expenses, including interest and payments against principle, will exceed its revenues. Second, despite the negative cash flow and consequent inability to pay dividends, the GSOC can generate a taxable income which passes through to the stockholders as a tax liability. This is a result of the fact that a payment against principle is included in taxable income because it is not deductible, thereby increasing taxable income, but is excluded from cash flow because it is paid to the creditors, thereby decreasing the cash flow. In sum, in the first years of a GSOC it is very probable that its stockholders will get no dividends but will receive an ad-

ditional tax liability. The cost to particular stockholders will depend on their tax status. In passing, we might note that at a hearing of the Alaskan House Finance Committee on November 2, 1979, Senator Gravel acknowledged the probability that the plan "can wind up having to saddle the people with a tax liability."

In conclusion, the proponents of the original GSOC went to Congress and asked for a silk purse. Instead, Congress gave them a sow's ear. And it is well understood that you cannot make a silk purse out of a sow's ear. Congress, however, could be asked once again for the silk purse--i.e., for the two major tax exemptions--in order to minimize the taxable income problem and to increase the financial viability of the GSOCs. Such action by Congress would create a new set of problems--equity problems associated with transfers from one set of taxpayers to another set.

It is convenient to distinguish between two types of tax subsidies: direct subsidies and indirect subsidies or tax expenditures. A direct subsidy involves taxing A to pay B; it is a direct transfer from A to B. A tax expenditure involves a more complex subsidy. One set of citizens (A) gets a tax break. Government revenue is reduced by this amount; consequently, in order to compensate for the revenue loss, B's taxes must be increased or C's benefits must be reduced. A transfer is involved: A benefits at the expense of B or C. Peter is robbed to pay Paul.

It is correct to note that these "silk purse" exemptions would not make a GSOC a Robin Hood. Robin Hood took from the rich to give to the poor. Such a GSOC would instead take from all (rich and poor) to give to some (rich and poor). Congress recognized that these "silk purse" exemptions were a potential threat to the corporate tax base at the national level. This erosion would increase as the use of GSOCs expanded. This is why Congress rejected these exemptions and will undoubtedly continue to reject them. Consequently, the future viability of GSOCs in general and of AGSOC in particular must be assessed on the basis of the very limited tax exemption given in the 1978 law.

AGSOC: Some Administrative and Organizational Features

We shall consider three important issues raised by the administrative and organizational features of the proposed Alaska GSOC (hereafter AGSOC): the guarantee issue; the issue of the investment decision-making process; and the holding v. operating company issue.[6]

The Guarantee Issue. An AGSOC will be limited to financing its investments by borrowing. There will be no initial payments for stock. There can be no relatively significant retained earnings by which an AGSOC could finance its own expansion. An AGSOC could borrow directly from the State of Alaska or from

[6] Other important issues include the constitutional issue and the issue of stockholder control. These will not be discussed in this report; they have been the subject of other reports.

the private sector. I shall limit this discussion to efforts to borrow from the private sector.

In borrowing from the private sector (e.g., banks and insurance companies), an AGSOC would have three possible options: borrowing with no guarantee or collateral to protect the creditor; borrowing with creditor protection provided by a guaranteed loan; and borrowing with protection provided by a loan guarantee fund.

1. Borrowing Without Creditor Protection. It is very doubtful that this is a realistic option for at least four reasons. First, there is the need for 100 percent debt financing. As a result, there would be no margin for error; the creditor would be fully exposed. The creditors would not even have the minimal protection provided by an equity contribution to the original investment.

Second, the very large sums of money that are involved in proposed investments can be expected to assume that creditors will seek some type of protection. It is one thing to lend $1,000,000. It is quite a different order of magnitude to lend $500,000,000 or $1,000,000,000. Third, the probability of an initial negative cash flow which must be covered by borrowing raises further difficulties when financing must be 100 percent by debt. Losses are not assets that could conceivably protect the creditors.

Finally, Mr. Kelso and his associates have recognized the historical need for creditor protection. In conventional finance, based on the assets of individual debtors, "existing financial

or tangible capital is put at risk to insure against the possibility that newly formed capital either may not pay for itself within a reasonable time, or that if it does so, the wealth it produces may not be used to make that disbursement" (TFT, p. 93). They would substitute for that individual credit worthiness either the collective credit worthiness of all within a given jurisdiction or some insurance scheme. For example, a Capital Diffusion Insurance Corporation (CDIC), modelled after the Federal Housing Authority Insurance Plan, was suggested (CM, p. 241) in order to insure institutional creditors against losses in the realization of any capital diffusion plans. In brief, AGSOC will almost certainly have to offer its creditors some type of a guarantee against losses.

2. Borrowing With a Guaranteed Loan. It is quite certain that the Alaskan Legislature cannot constitutionally guarantee a loan to an AGSOC. Such a guarantee does not involve a capital improvement. The Alaskan Legislature can, however, protect AGSOC's creditors, if it so desires, by the creation of a guarantee loan fund.

3. Borrowing with a Loan Guarantee Fund. The creation of a loan guarantee fund would involve two legislative acts: an enabling act and an appropriation act. The enabling act is necessary to create the loan guarantee fund. Conditions that determine the reach and functions of the fund are in control of the Legislature. This would be an important statute. The appropriation act would provide the money required by the fund. The amount of the appropriation would depend on negotiations between AGSOC and the seller of the assets being acquired (this

determines the amount of money AGSOC would have to borrow and between AGSOC and its creditors. The Legislature would be asked to appropriate the amount of money that AGSOC and its creditors negotiated as sufficient to protect the creditors, given the size of the loan. This could be 50 percent or more. The appropriate money would, in effect, sit there; it could be put to no other use. This use of state money would be at the expense of other uses. There would be no free lunch.

Neither the enabling act nor the appropriation act appear to present any constitutional issue. An adequate "public purpose" can almost certainly be found.

The proposed AGSOC bill includes a start-up loan guarantee fund for which it appropriates $5,000,000. This fund is for the limited purpose of enabling the AGSOC, when created, to be able to borrow enough to cover its organizational, start-up costs. The bill, however, makes no provision for a loan guarantee fund designed to cover investments made by the AGSOC.

It has been stated that the bill does not provide for an investment loan guarantee fund in order to maximize the flexibility and discretion of AGSOC's board of directors. Others have suggested that it might well be a political maneuver--a two stage strategy. Initial silence with respect to the loan guarantee fund should increase the probability of passing the AGSOC bill because the issue of financial consequences would be minimzied. Then, once the AGSOC bill is passed, it would be easier to pass the necessary enabling and appropriation acts on the grounds that, without them, there can be no AGSOC.

The key to long term legislative control over an AGSOC, whether created by a legislative act or by referendum, lies in the enabling and appropriation acts in connection with successive loan guarantee funds. But the significance of the fund goes further: it can affect the nature of the investment decision-making process.

The Investment Decision-making Process. The declared goals of AGSOC's investment decision-making process are that it be professional and free of political considerations. The nature of AGSOC's investment decision-making process raises important issues that might well have an adverse effect upon the realization of these goals. It is apparent that five parties will be involved in this process: the seller of the asset, the creditors, AGSOC's management team, AGSOC's Board of Directors, and the Legislature. The anticipated role of each will be briefly discussed.

1. The Seller of the Asset. The purchase price of the asset will be negotiated by the seller of the asset and AGSOC's management. Because of the nature of the decision-making process, however, participation in one form or another along the way can be expected from the creditors, AGSOC's Board of Directors, and the Legislature. The result of the negotiation between the seller and management will reflect their relative positions with respect to information, risk preferences, and negotiating skills and power. As pointed out in the last part of this section, these differences are key to determining the price and resulting profitability of the transaction.

2. Role of Creditors. Creditors hold a veto power. With 100 percent debt financing, nothing happens without their approval. Their interest in the extent of a loan guarantee fund will depend upon the degree of risk involved in the investment. It is clear that Mr. Kelso and his associates prefer relatively low risk, blue chip type of investments. Speiser, for example, says that "Kelso thinks that venture capital (capital for starting new enterprises) is a game to be played by the very wealthy" (PA, p. 80). The proponents of AGSOC appear to be somewhat ambiguous as to whether AGSOC should be used to promote development and new ventures or should be limited to taking over a part of a major, successful enterprise. Whichever is the case, it is certain that the creditor will relate the risk to the amount of money demanded in the loan guarantee fund.

3. Role of AGSOC's Management. Management is to make the initial investment decision for AGSOC. This will be presumably a professional decision, i.e., based on the intrinsic merits of the case. But their decision must be approved by the Board of Directors. Given the probable political nature of the Board as described in the following section, it is quite certain that management will have to exist and survive in a political environment.

4. Role of the Board of Directors. The role of the Board is critical in the investment decision-making process. The Board's approval is necessary before any project can begin. At this point we can expect political considerations to be injected directly into the process because the Board is quite

explicitly designed to be a political institution. Directors run in a statewide election; the usual proxy system is prohibited. The electorate is broader than the usual electorate because stockholders (and, therefore, voters) will include those younger than the normal voter. In addition, after a phase-in period each Director will serve a limited term of two years. There will be an election every year at which one half of the Board must stand. Given such short terms and annual elections, a Director will always be running for office. In addition, the candidate nominated by the Board can be challenged by nominees put forward by groups of stockholders. Under these circumstances it is hard to escape the conclusion that the Board will be a political institution and that the investment decision-making process will be significantly influenced by political considerations.

It is legitimate to ask what, in this context, is meant by the term "political." Without impugning the motives of anyone, in this context political means that the decision-making process is subject to a perverse incentive system; Directors will be unable to make decisions that are unpopular with this diversely structured electorate whose decisions will almost certainly not be professional in nature.

5. Role of the Legislature. The Legislature becomes involved in the investment decision-making process because of the almost inevitable need for a loan guarantee fund and the consequent need for passage of the enabling and appropriation acts. It is here that the Legislature takes over the investment decision-

making process; its political decision-making process will be able to dominate the investment decision-making process at this point. The Legislature is the final hurdle.

While one enabling act may be able to serve more than one project, it is more than likely that each project will require its own appropriation act. This is likely because each project can be expected to differ as to risks and the identity of creditors and, therefore, as to the magnitude of the loan guarantee fund. By the very nature of the AGSOC arrangements, the Legislature will be involved in the investment decision-making process and will be held accountable at the polls.

In sum, Alaskan participation in the investment decision-making process will be influenced by two political institutions (the Legislature and the Board of Directors) which may or may not be able to work together in harmony with one another[7] and a third group (AGSOC management) which, through ostensibly professional, must function and survive in a political environment. These considerations mean that Alaska would probably have to depend heavily on creditors to sift the good risks from the bad risks. In projects of the magnitude presently contemplated, it is doubtful wisdom for debtors to depend so heavily upon creditors. Such dependence will, at best, come at a price.

6. Is an AGSOC-type Investment Possible? The non-speculative and non-operating investment in an income-producing asset creates

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[7] For example, they differ (1) as to the nature and extent of their electorates, (2) as to the roles of the traditional political parties, and (3) as to the range of issues that they must consider and the consequent focus of their energies.

some interesting questions as to the nature of the profitability of the investment. Two examples will be used to illustrate the nature of the problems involved. The first example involves the purchase of an asset with a limited life; the second is a perpetual asset.

Asset with a Finite Life. Assume an asset with a five year life that produces an annual after-tax income of $100. Further assume that the buyer and seller have the same information, the same risk preference, and are subject to the same discount rate of five percent. Under these conditions, what is the maximum price that the buyer should pay and what is the minimum price that the seller should accept? Both prices should depend upon the calculations by the buyer and seller of the discounted present value of that future flow of income. Based on calculations given in an Appendix to this report, the maximum price of the buyer and the minimum price of the seller are both $432 (rounded off). A deal is possible.

If the buyer bought the asset for $432, how would he fare after five years? The buyer would have received an income of $500 over the life of the asset. Over the five years, however, he would have paid back $432 to his creditor, returning the principle borrowed plus a total interest payment of $68 (rounded off). In short, the buyer would have paid out $500 for the $500 that he received. His cash outflow equals his cash inflow. He started with nothing and wound up with nothing. The general rule is that, if markets work efficiently and if the buyer functions only as a non-speculative investor, the price paid

(i.e., the amount borrowed) plus the interest paid on the debt will just equal the income generated by the asset over its life. This principle also holds in the case of an asset with perpetual life.

Asset with Perpetual Life. Assume an asset with a perpetual life that generates an annual after-tax income of $100. Further assume that the buyer and seller have the same information, the same risk preference, and are subject to the same discount rate of five percent. Under these conditions, the maximum price that the buyer will pay and the minimum price that the seller will accept is $2,000 (÷ .05). Assume that the buyer borrows $2,000 for ten years to buy the perpetual asset. At the end of the ten years, the buyer will own the asset and its future stream of income. He will, however, have received only $1,000 in income while he will have repaid the $2,000 that he borrowed plus ten years of interest. In short, after ten years he will own the perpetual asset but he will have paid out much more than he received during that time. After ten years the asset should begin to pay back his arrears. Theoretically, however, over time, this transaction should also wash, i.e., the cash inflow should equal cash outflow.

If the general principle holds that repayment of principle plus the interest paid equals the income generated by the asset over its life, how can a buyer borrow, invest, pay back, and still make money? It can be done but under a different set of circumstances than those that govern the general principle. A buyer, for example, can make money if he has better information

than the seller, is a better negotiator than the seller, is both more risk prone and lucky, or is able by one way or another to increase the annual income generated by the asset. Income can be increased in the following two ways. If the buyer is an operator as well as an investor and if he is more efficient than the seller, income will increase because of the more efficient operation. Second, income will increase if the buyer gets an income tax break that was not available to the seller. It should also be noted, however, that the buyer can lose if it turns out that the seller had better information, that the buyer encountered bad luck, or that income fell because, for example, the buyer was a less efficient operator.

The above analysis is relevant to the proposed AGSOC program in at least two ways. First, it demonstrates the critical role in the viability of an AGSOC of the two "silk purse" tax exemptions that were initially sought and finally refused. And, second, it suggests that AGSOC proponents will begin to promote AGSOC as an operating company rather than as a holding company. As an operating company, an AGSOC would apparently gain a tax advantage through its tax integration feature and might be able to increase income if it proved to be more efficient as an operator than the seller. But AGSOC as an operating company would break with the Kelso tradition as to the nature of investment in his capital diffusion program.

The Holding v. Operating Company Issue. The federal enabling statute simply empowers a GSOC "to invest in properties." It is assumed that this empowers the GSOC not only to purchase

and hold securities in other corporations (the holding company issue) but also to purchase assets and operate a business in its own name (the operating company issue). As a holding company, the federal law limits a GSOC's holding to 20 percent of the stock of any corporation. As an operating company, however, a GSOC can apparently own 100 percent of the assets of a business operated under its own corporate name.

In the Kelso scheme of things, the 90 percent of households were to be allowed to invest only in a limited group of corporations. This group was more broadly conceived in CM than in the later TFT and PA. In CM individual households were to purchase directly the stock in existing corporations so as to realize a "balance between securities of well-seasoned corporations and those of still somewhat speculative businesses;" investment in the securities of "brand new and completely unseasoned enterprises" as well as those of "unseasoned and speculative" (CM, p. 241) firms was to be denied. Concern over the need to reduce the level of concentration, however, induced Kelso and Adler to suggest that the program "should direct a predominant share of new capital formation into new enterprises owned by new capitalists" (CM, p. 215). In later writings investment recommendations became more cautious.

In TFT Kelso and Hetter wrote of investment only in terms of "well-managed" firms (TFT, p. 61 and P. 97). Speiser in his PA is more descriptive. According to him, Kelso advocated investment only in the "big winners," the "profitable giants" (PA, p. 56), the "major successful businesses" (PA, p. 54), and

and the "largest and most successful" corporations (PA, p. 80). Investment was to be discouraged in "new start-up ventures" (PA, p. 56) and in "venture capital (because that) is a game to be played by the very wealthy" (PA, p. 80).

In sum, investment by households was to be done either directly or through a special mutual fund arrangement in major, well-managed corporations. Investment in speculative or start-up ventures was to be discouraged. In no event and at no place did Kelso and his associates in the three books covered in this report recommend a comprehensive capital diffusion program that would involve creation of and investment by non-capitalists in a special corporation that would both acquire productive assets and manage the operation.

As we noted in the previous section, AGSOC proponents may well come under increasing pressure to transform an AGSOC from a holding company into an operating company. Such a development would certainly break with Kelso's previous reasoned conceptions of the nature of investment by non-capitalist households in the corporate economy. The expected result of this development would be significantly to increase both the risk characteristics and the degree of uncertainty associated with the AGSOC. There would probably be adverse effects on the ability to secure 100 percent debt financing and on the probability of a reasonable pay-out period.

Appendix

The discounted present value of a future income stream is calculated by this formula:

$$\frac{Y_1}{2+i} + \frac{Y_2}{(2+i)^2} + \frac{Y_3}{(2+i)^3} \cdot \quad + \frac{Y_n}{(2+i)^n} \quad \text{where}$$

Y is the annual income for that year, i is the discount rate, and n is number of the years in the asset's life. If we assume Y to be $100, i to be 5 percent, and the life of the asset to be five years, the result of the calculations would be:

$$\frac{\$100}{1.05} + \frac{\$100}{1.1} + \frac{\$100}{1.16} + \frac{\$100}{1.22} + \frac{\$100}{1.28} =$$

$$\$95.24 + \$90.90 + \$86.21 + \$81.97 + \$78.13 = \$432.45$$

The buyer should, therefore, be willing to pay $432 for the asset or less. Using the same calculations, the similarly situated seller would accept no less than $432.

If the buyer borrowed $432 for five years at five percent to buy the asset, his situation at the end of five years would be:

1. He would have received $500 in income over the five year period.
2. He would have paid back the $432 he borrowed plus $68 in interest payments on the declining balance to the creditor--a total of $500.

In short, his cash inflow would equal his cash outflow for the five year period.

STATE OF ALASKA
THE LEGISLATURE

POUCH V STATE CAPITOL
JUNEAU ALASKA 99811
907 465 3800

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M

March 10, 1980

SUBJECT: Final draft of CS for House Bill 240

TO: Representative Mike Miller

FROM: Tamara Brandt Cook
Legislative Counsel

Enclosed please find the final draft you requested of CSHB 240. I noted that sec. 10.50.295(b) relating to shareholder removal of directors is ambiguous and would suggest that this section be redrafted for the sake of clarity. It now reads:

> "An individual director may be removed if the majority of votes cast for his removal exceeds the number of votes he received at the last preceding election . . ." (Emphasis added)

This is capable of being interpreted to mean that a director may not be removed unless the number of votes over 50 percent of the votes cast (a majority) is greater than the number of votes he received when elected. On the other hand, it could simply mean that only a majority of votes is required if the number exceeds the number of votes which the director initially received.

TBC:jdn

Enclosure

WORKING PAPER ON

DIVIDEND DISPERSAL PROGRAMS

By Governor Jay S. Hammond

There is increasing interest in providing Alaskans with a "piece of the action" through some method of distributing "dividends."

I am encouraged by this for I believe it appropriate that all Alaskans receive some direct benefits from their resource wealth rather than simply receiving whatever more government we politicians think they should have.

-- ALASKA INC.

Some few years ago, I proposed a means by which a portion of income earned from investments of the public's resource wealth would be distributed in direct dividends to all "shareholders". This proposal became known as Alaska, Inc. I introduced a modified form of Alaska, Inc. again this year, as has Senator Sumner.

-- AGSOC

Another means of granting Alaskans a "piece of the action" has been proposed by Senator Gravel. This is known as "Alaskan General Stock Ownership Corporation" or AGSOC. Unlike Alaska, Inc. which disperses a portion of earnings from investments of citizen-owned resource wealth, an AGSOC would permit citizens to own shares of development programs which might relate - but not necessarily exclusively - to the manner in which that resource wealth was transported, refined or manufactured. The necessary capital to acquire ownership in such endeavor could come either from the sale of tax free revenue bonds, private financing or State guaranteed funds.

-- MUTUALLY EXCLUSIVE OR COMPATIBLE?

While the intent of both programs is similar, there are important distinctions. Moreover, while they are by no means mutually exclusive, I am increasingly convinced that insofar as the State's long term best interest is concerned, an AGSOC can best work only if an Alaska, Inc. program is first put into place and, as well, certain amendments are made to both bills now before us.

In order to discuss my reasons for so concluding, it is necessary first to explain how, ideally, I believe an Alaska, Inc. program should work.

-- MECHANICS OF ALASKA, INC

Each Alaskan would receive, annually, one share of 1/2 the earnings of Permanent Fund investments for every year they have resided in "an area where cost of living was recognized by the Federal government as warranting a 25 percent cost of living pay differential for its employees." While nothing is said about residency versus nonresidency, all Alaskans, of course, would qualify. Those with longer tenure would accrue more shares. Shares would not be transferable. However, new Alaskans, upon qualification, would as well receive shares.

Application for annual dividends could be made upon filing an income tax form attesting to ones having resided during most of the previous year in such a high C.O.L. area. Thus, persons who leave the state would no longer qualify after one year.

In a bill I presented to the Legislature this year, House Bill 99, such "dividends" would come only in the form of tax credits. Moreover, no one would qualify for more than one share for each year during which the applicant had paid State income taxes up to a total of five shares. This five-year limitation was proposed since Department of Revenue tax records are held for only five or six years.

While this approach was taken to curry support from those who wanted tax relief as well as for administrative convenience in checking an applicant's eligibility, it raises serious questions.

For example, all citizens, whether they're taxpayers or not, are impacted by Alaska's high cost of living. Moreover, if you truly believe, as I do, that Alaskans collectively own such resource wealth as their royalty oil, how can we justify dispersing income investments of collectively owned Alaskan wealth selectively to only those who make enough money to have to pay taxes? Accordingly, I would prefer that dividends go to all otherwise qualified citizens either in the form of tax credits or as a negative income tax return.

Additionally, since the rationale for dispersing dividends is based on the belief that with all their energy wealth Alaskans should receive at least some direct relief from the exceptionally high price they've had to pay for energy, then there is little rationale to compensate them for but 5 years of such impact. Compensation should be for each year so impacted.

Though determining the number of years for which each applicant is qualified may seem difficult, it is less difficult than obtaining similar data required for proof of eligibility for receipt of the longevity bonus, guide licenses, limited entry permits, or entry into a pioneer home.

To minimize administrative costs and the likelihood of perjury, we could require an affidavit from the applicant with two other "shareholders" as witnesses. If all parties were to lose eligibility should they perjure themselves, it is unlikely many would falsify claims. In those cases where no witnesses will come forward, shares could be confined to the number of years the applicant can provide documentation to prove his case, i.e., tax records, etc.

The conclusion that an Alaska, Inc. type program should be established before an AGSOC proposal was reached primarily because of the potentials of an AGSOC to place the shareholders' interests precisely at odds with State interests. For example, one AGSOC proposal involves partial purchase of the trans-Alaska oil pipeline. Should all shareholders then get dividends based on the profitability of that purchase, it is to the shareholders' benefit to get the highest possible price - i.e. tariff - for transporting oil. However, the State treasury, including the Permanent Fund, gets more money the lower the tariff. Thus, the AGSOC's interest would be precisely opposite those of the State in regard to the level of tariff. On the other hand, in the case of an Alaska, Inc. type distribution of Permanent Fund earnings, the interests of the State and the shareholders would be precisely the same.

Similarly, if an AGSOC were to invest in a petrochemical plant, its shareholders would benefit if we sold that plant our royalty oil at a cut rate. This too would be a loss to the State's Permanent Fund and to those who did not hold shares of that AGSOC.

Only by passing an Alaska, Inc. type program first could we likely establish conditions where the State and all Alaskans' interests were compatible insofar as maximizing the return from the citizens' resource wealth. Once in place, such programs reduce the likelihood of conflicting AGSOC proposals being undertaken.

In its present form, proposed AGSOC legislation has other problems:

1. Since only one share of stock goes to each person here in Alaska at the time each AGSOC is formed, ultimately there would be two types of Alaskans: those who were shareholders, and those who were not.

Remedy:
One way to remedy this is to amend the bill to provide one share of stock for each year the shareholder has resided in a locale where the government recognizes cost of living impact sufficient to warrant their payment of a 25 percent cost of living differential to government workers. Then all Alaskans would be shareholders.

2. AGSOC shares would be transferable, permittting money to leave Alaska. This should be amended since the prime objective and rationale is to insure that Alaskans get a "piece of the action" to compensate them, in part, for the exceptionally high cost of living impact here in Alaska. Accordingly, persons who have moved to Hawaii or California have no justification for receiving such cost of living offset.

Remedy:
A remedy would be to require that persons make application for their annual dividends on an Alaskan income tax filing form attesting to their having resided during most of the previous year in an area of qualifying high cost of living differential.

3. Another problem is, what if the AGSOC loses money? Who then pays off the bonds or other debt obligations? I am opposed to State guarantees. Would the AGSOC shareholders then become liable?

Remedy:
To offset this concern, were the Alaska, Inc. concept in place first, guarantees or collateral could be an AGSOC shareholder's prospective Alaska, Inc. dividends. Far better to use the AGSOC shareholder's prospective Alaska, Inc. dividends as such than use, as guarantees, Permanent Fund principle or general fund monies which belong to all Alaskans, not just AGSOC shareholders.

4. Under an AGSOC proposal some shareholders may be unwilling participants in programs to which they are philosophically or otherwise ill disposed.

Remedy:
If one is already a shareholder in an Alaska, Inc. program, they should be able to elect whether or not they wish to become an AGSOC shareholder. By so doing, they would not be compelled to participate in some development program they may not favor in order to get any "piece of the action" whatsoever.

Another reason why the Alaska, Inc. program should go in place first is because it would motivate placement of more oil wealth behind the Permanent Fund "rope" where it could not be used for more government or as guarantees for some shakey AGSOC proposal. Since Alaska, Inc. shareholder "dividends" are directly dependent upon the amounts of money placed in the Permanent Fund, there would be a countering pressure to those political pressures which create bigger government.

Because the Alaska, Inc. approach would provide "dividends" from an "enterprise" already returning revenues which belong to all Alaskans, the charge of "improper involvement of government into private sector affairs" is absent. Of course, since AGSOC's are not truly government functions the traditional "undue involvement" charge does not really wash. However, because of the potential impact on government funds to bail out ailing AGSOCs, a reverse concern may be valid: "undue involvement by the private sector in the affairs of government."

Other advantages recommending prior implementation of Alaska, Inc. are its comparative simplicity and the fact that unlike the speculative nature of any AGSOC, we would be betting on a "sure thing." For example, we know that we have a fully capitalized, debt free enterprise in the Permanent Fund which can immediately start paying "dividends". No loans must be made; bonds sold; speculation engaged in. We are already functioning "in the black." Surely if we're going to condition the public to feel comfortable with any "dividend distribution' system at all, we should start with a simplistic "sure" winner.

A major benefit of increasing contributions to the Permanent Fund is that the other half of the resultant increased recurring income from Permanent Fund investments would flow into the General Fund where it could supplant these non-recurring oil wealth dollars now improperly funding our day to day government operations. Such reduction of our dangerous dependence upon principle dollars for funding operations - which should be funded with income dollars - is imperative.

If the AGSOC program goes on the line first, the chances of finding surplus State dollars to place into the Permanent Fund would likely diminish.

Thus, while I favor both the Alaska, Inc. and AGSOC concepts for insuring all citizens a "piece of the action," I believe it imperative that the Alaska, Inc. program be placed on line before an AGSOC be established. Meanwhile, I would like the enabling AGSOC legislation amended to deal with those problems I've previously outlined.

MIKE GRAVEL
ALASKA

United States Senate

April 26, 1979

Dear Friends:

Governor Hammond in his "Working Paper on Dividend Dispersal Programs" criticises the House State Affairs Committee AGSOC bill. He assures me that his comments were not intended to give the impression that he would veto the AGSOC bill, but were offered as an aid in moving the bill forward. However, the Governor has made some assertions which are wrong and need to be corrected.

The Governor implies that AGSOC, like Alaska Inc., is merely a means of distributing "dividends" to Alaskans. AGSOC is not a scheme for distributing state assets to Alaskans, but a vehicle through which Alaskans can acquire new wealth independently of government. AGSOC is a vehicle for new capital ownership by the citizens of Alaska, not a scheme to distribute something they already own.

The Governor maintains that AGSOC would place the interests of the shareholders at odds with the interests of the state. The interests of the state are not independent of the interests of its people. The shareholders of AGSOC will be the people of Alaska. It is my conviction that people will be better citizens if they have a real economic interest in private enterprise and that they will act in their own best interests as economic shareholders and political citizens.

The Governor criticises AGSOC because it will create two types of citizens, shareholders and non-shareholders, and proposes as a remedy a scheme which creates many classes of citizens shareholders based on length of residency in Alaska. The Governor misses the point of AGSOC. The rational for AGSOC is not to "compensate" anyone for living in Alaska, but to provide a means other than the taxing power of the state for Alaskans to participate in the economic development of their state.

The House State Affairs Committee AGSOC bill prohibits ownership of AGSOC shares by outsiders. When a shareholder leaves the state he is required to sell his stock either to the corporation or another Alaskan.

The House Committee carefully considered the question of state financial assistance to AGSOC and made it clear that AGSOC was to be treated no differently than any other private corporation seeking state financial assistance. If, after full legislative action, the state decides to assist in AGSOC financing it will be doing no more than what it has already done for those Alaskans holding more than $150 million in state low interest business loans.

The corporate doctrine of limited liability protects the shareholders of AGSOC from any liability for the debts of the corporation.

There is no requirement that an Alaskans become a shareholder of AGSOC. He may reject the stock offered to him at any time within one year of its issue. If he becomes a shareholder and does not want the corporation involved in a particular investment he may put the question to a vote of the shareholders.

Best regards,

Mike Gravel

HB 240

February 23, 1979

Honorable James Duncan
State Representative
Pouch V
Juneau, Alaska 99811

Dear Jim:

I would like to take this opportunity to express my opposition to your General Stock Ownership Plan (G.S.O.P.) bill.

I feel the State's royalty and/or permanent fund income would be more equitably used as a vehicle to reduce income taxes and increase revenue sharing. This would result in a distribution which relates in some manner to the widely varying burdens carried by different people by present income and property tax schedules.

I likewise find the $100/200/300 tax credit bill passed last year distasteful. The person who pays, say, $10,000 a year in State income tax realizes no more benefit than the person who previously paid only $300 and only an insignificant benefit in comparison to the person who draws welfare and pays no taxes.

A program for an across the board percentage temporary tax credit or permanent tax reduction would be more equitable. A scaled credit with a smaller percentage applying to higher tax brackets would be less preferable than a flat credit but would still be preferable to last year's credit or the proposed G.S.O.P., which are both nothing more than thinly-veiled welfare programs.

Sincerely,

Roger R. Shattuck

RRS/ce
cc: Honorable Mike Miller
Honorable Bill Ray

Shattuck + Grummett close
Insurance Comp
301 Seward St
Juneau 99801

ALASKA

GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

Federal law requies state authorization of general stock ownership corporations receiving special tax treatment under Subchapter "U" of the Internal Revenue Code. The bill creates the Alaska General Stock Ownership Corporation (AGSOC). This corporation is a completely private for profit corporation which will operate under the Alaska Business Corporations Act to the extent consistant with the AGSOC act. The shares of the AGSOC will be owned and voted by the citizens of Alaska with each resident holding a share of stock.

The bill directs the Governor to appoint incorporators to form the AGSOC and sets forth the following:

1) Board membership limitations assuring Alaskan control;
2) Federal requirements for corporate articles;
3) Stock distribution to all Alaska residents;
4) Penalties for fraudulent acquisition of AGSOC stock;
5) One year statute of limitations on AGSOC challenges;
6) Financing for AGSOC startup costs; and,
7) Technical amendments required to Alaska statutes.

The corporation is designed to have as its shareholders existing Alaskan residents. Stock will be distributed to eligible individuals without cost. Investments by the AGSOC will be made through the use of borrowed funds and the earnings from those investments used to retire the loan and distribute dividends to the shareholders. Except for minor exemptions the AGSOC will be subject to the same rules as all other Alaska corporations.

DETAILED EXPLANATION

The bill creates a new Chapter 50, entitled "Alaska General Stock Ownership Corporation", within Title 10, the Corporations and Associations title, of Alaska Statutes. The act contains nine sections which may be summaried as follows:

Section 1 sets forth those areas where the AGSOC differs from a typical Alaska business corporation organized under Chapter 5 of Title 10. To the extent that these provisions do not conflict with the provisions of Chapter 5, the Alaska Business Corporations Act, Chapter 5 will apply;

Section 2 includes the corporation among those organizations eligible to receive secured loans from the Permanent Fund;

Section 3 allows the investment of surplus state funds in bonds of the AGSOC;

Section 4 exempts the AGSOC from registration under the Alaska securities laws while providing protection from fraud;

Section 5 creates a one year statute of limitations on suits brought to challenge legality of the AGSOC;

Section 6 makes the provisions regarding eligibility for stock ownership "nonseverable" in order to assure that if this fundamental section is found unconstitutional the entire law will be voided;

Section 7 makes fraud or misrepresentation in obtaining or selling shares of the AGSOC a Class C felony; and,

Sections 8 and 9 provide effective dates immediately following the Governor's signature for most of the legislation.

ANALYSIS: SECTION 1

Section 1 of the bill constitutes the primary legislative section. It creates a new chapter, Chapter 50, of the Alaska Statutes, Title 10, setting forth technical requirements for the Alaska General Stock Ownership Corporation. The Chapter is divided into nine sections dealing with creation of the AGSOC, federally required charter limitations, board of directors, notification of shareholders' eligibility, limitations on corporate liability, restrictions on application for shares, fraud penalties, corporate dividends and definitions. A section by section analysis of Chapter 50 follows.

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

This section directs the Governor to appoint nine people as the incorporators and initial board members of the Alaska General Stock Ownership Corporation. These nine people, a majority of whom must be Alaskans, will adopt corporate articles and bylaws and file with the state to create the corporation as required under the Alaska Business Corporations Act. The bill allows the appointment of some non-Alaskan directors to provide flexibility in obtaining special expertise.

The status of the general stock ownership corporation is made clear by this section. AGSOC is not and may not be considered to be an agency, instrumentality or political subdivision of the State of Alaska. This parallels the federal statute which provides that a GSOC shall be treated as a private corporation and not as a governmental unit. The section also clarifys AGSOC status in relation to other statutes by requiring that it comply with the provisions of Subchapter U of the Internal Revenue Code and the Alaska Business Corporations Act. To the extent that the AGSOC authorizing legislation is not inconsistant with Chapter 5 of Alaska Statutes Title 10, AGSOC will be subject to all the rules applicable to any other Alaska business corporation.

50.020. ARTICLES OF INCORPORATION.

Federal law requires certain charter provisions for general stock ownership corporations and these are set out as requirements for the articles of incorporation of the Alaska General Stock Ownership Corporation. Each of the subsections in .020 set forth a different requirement which must be included in the AGSOC articles.

Subsection 1 provides that the AGSOC may issue only one class of stock which impliedly must be voting common stock.

Subsection 2 provides that stock may be issued only to a certain class of individuals. The group to whom stock may be issued, a closed class of original issue shareholders, are those people who fulfill two tests:

a) They were residents of Alaska, as defined by the definition Section .900, as of the effective date of the legislation which, under Section 8 of the bill, will be the day following the Governor's signing; and,
b) They remain residents of Alaska until the shares are issued.

50.900 defines resident as a person who lives in Alaska and intends to remain here permanently. The definition allows for temporary travel or employment outside without loss of residency. If a dispute arises over residency all of the facts and circumstances indicative of permanent residency must be considered.

Subsection 3 provides that at least one share of stock must be issued to each eligible resident unless that person elects within one year not to receive the stock. The legislation contemplates issuance of shares to eligible individuals free of charge with corporate investments financed entirely with borrowed funds. The one year period allows shareholders who do not wish to receive stock for whatever reason to reject their share, but this election not to receive stock is irrevocable and once made may not be changed.

Subsection 4 provides for limitations on the transferrability of the stock so that shares may not be sold or used as security for a loan during the first five years unless the shareholder dies or moves out of the state. Shares may only be transferred to another Alaska resident and then only if that person would not own more than ten shares of AGSOC stock after the transfer. Corporations and other artificial persons may not be shareholders. Finally, in order to protect minors, shares may not be transferred until the shareholder reaches 18.

Subsection 5 provides that the corporation shall qualify as a general stock ownership corporation subject to the special tax provisions of Subchapter U of the Internal Revenue Code.

Subsection 6 provides for a limitation on investments which the corporation may purchase. The corporation may not invest in assets acquired by it or for its benefit through the power of eminent domain. This is not to imply that the AGSOC has the power of condemnation since that power may be exercised only by the government. The limitation is designed to prevent the AGSOC from acting in collusion with an agency or local government to acquire a going business from an unwilling seller. It is not intended to prevent the purchase at arm's lenght of a business where a portion of the seller's assets may have been acquired by condemnation. The AGSOC would not be prevented from investing in a project where some minor portion of the assets must be acquired through eminent domain is the State or local government determines that the exercise of its condemnation power is appropriate. Such a situation might occur should the AGSOC become involved in the construction of a major pipeline.

Subsection 7 provides the AGSOC with a right of first option to purchase, at a price not less than book value, any stock offered for sale during the first five years of the corporation. The terms and conditions for exercise of this right will be set forth in detail in the corporate bylaws and a notice of the restriction will appear on the stock certificates or receipts.

The five year period for the right of first option parallels the time during which shareholders are prohibited from selling their stock. Only a limited number of shares will become available for sale during this period of time and it is unlikely that an organized market for AGSOC stock will develop during this period. Discretion is left with the corporation to pay prices higher than book value for the stock, but it is likely that the directors will determine that book value is the appropriate price.

Since shareholders who become non-residents during the five year period of transfer restrictions may be able to sell their stock at a high price in an uncontrolled market emigration might be encouraged. The option by the corporation provides a controlled market during the transfer restriction period and allows time to structure the full public market which will develop after the transfer restrictions lapse.

50.030. BOARD OF DIRECTORS.

This section sets out the provisions for AGSOC directors which differ from those applicable under Alaska Statutes Title 10, Chapter 5. The nine incorporators serve as the original board of directors and are divided into three groups in accordance with AS 10.05.186, except that only one-third of the directors will stand for election at the first annual meeting, one-third at the second annual meeting and one-third that the third annual meeting. Thereafter each director will serve for a term of three years as provided in AS 10..5.186. None of the other provisions of the Alaska Business Corporations Act regarding directors are changed and the normal rules of Chapter 5 apply to the AGSOC.

SHAREHOLDER.

This section provides a civil right of action against individuals who obtain stock through fraud or misrepresentation and who sell stock on the same basis. It allows the stock to be voided, dividends to be recovered with interest and costs of the suit to be paid by the defendant.

50.080. DIVIDENDS OF THE CORPORATION.

Under the rules of the Alaska Business Corporations Act a corporation may pay dividends only out of earned surplus, the retained earnings of the corporation. Since the AGSOC is required by federal law to distribute 90% of its taxable income to its shareholders on an annual basis is may be necessary to distribute a dividend in excess of earned surplus. Such a situation can arise because accounting for tax purposes and for purposes of the corporation's books may not and are not required to be the same. For this reason an exception to the general rule of Chapter 5, Title 10, is required allowing the AGSOC to distribute dividends as required to meet the terms of Internal Revenue Code Subchapter U except where such distribution would cause the corporation to become bankrupt or when the corporation is already bankrupt. Bankruptcy in this situation means when the corporation is unable to meet its current obligations.

50.090. EXEMPTION FROM AS 10.05

This section exempts the AGSOC from the provisions of the Alaska Business Corporations Act which requires $1,000 of paid in capital before operation of the corporation commences.

50.100. LOAN GUARANTEE FUND.

This section establishes a fund within the Department of Revenue which is to be used to guarantee loans to the AGSOC by private lenders. This fund is intended to provide security for private credit to be used by the AGSOC for its startup expenses such as the costs of stock issue and the investigation of potential investments.

50.900. DEFINITIONS.

This section defines the terms used in Chapter 50. Especially important is the definition of resident since that definition will determine who is eligible to receive AGSOC stock without charge.

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

Since stock is to be distributed free of charge all Alaska residents must be notified of its availability. This section sets out the minimum notice requirements of weekly broadcast and publication for at least three months before stock distribution and monthly broadcast and publication for eleven months after distribution. These are minimum requirements only and the board of directors may determine that the corporation should take other steps to identify and notify potential shareholders. The AGSOC might want to compile mailing lists from various sources to develop a list of potential shareholders while in the bush it might be appropriate for it to hire census personel to locate and identify eligible Alaskans.

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

This section makes it clear that although the AGSOC is required to take reasonable steps to notify potential shareholders of their right to stock the burden of applying for stock lies with the resident and the corporation is not liable for failure to notify or issue stock to a potential shareholder. If a resident makes application for stock after the distribution of one or more dividends he looses his right to those dividends and is entitled to receive only those dividends declared and paid after the date upon which his stock was issued to him.

50.060. LATE APPLICATION FOR SHARES.

The legislation provides that stock is to be issued to all qualifying residents and the corporation directed to use reasonable efforts to identify potential shareholders. The burden of application is upon the resident. Those residents who are identified or who identify themselves will have one year in which to elect not to receive stock. To protect against those eligible residents who are not identified and fail to identify themselves hoping to see how the corporation fares before applying for their stock, a final cutoff date is provided after which distributions of stock will be made only upon payment to the corporation of book value.

JAY S. HAMMOND
GOVERNOR

STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 12, 1979

The Honorable Mike Miller
Chairman
House State Affairs Committee

The Honorable Brad Bradley
Chairman, Senate Commerce Committee
Alaska State Legislature
Juneau, Alaska 99811

Dear Sirs:

Thank you for this opportunity to offer my views on SB 170/HB 240, the enabling legislation for an Alaska General Stock Ownership Corporation (AGSOC). As you know, I have been an advocate of a similar idea, Alaska, Inc., which was designed to distribute a portion of the income produced from Permanent Fund to Alaskans. This idea has been incorporated into my proposal for the Permanent Fund through the distribution of one-half of the earnings of the Permanent Fund to Alaskan residents in the form of tax credits.

As I understand it, the AGSOC concept proposes a completely private corporation, the shareholders of which would be Alaska residents who elect to receive a share. Like Alaska, Inc., the earnings of the AGSOC would also be distributed to residents as dividends on their shares. I would like to express my support of the AGSOC idea in concept. AGSOC would represent a unique experiment to provide an opportunity for the broad participation of Alaska residents in the financing of resource development projects in the state. I would encourage you to undertake as much investigation and public discussion as possible in order to familiarize all Alaskans with this idea and to insure that a wise and informed decision will be made. While I wish to reserve judgement on the specific details of this idea pending additional review, I do hope to work closely with your committee and other committees as the bills proceed through the legislative process.

To facilitate this cooperation, I have requested the Division of Policy Development and Planning to coordinate the Administration's review of this legislation, and to work closely with the Departments of Law, Revenue, Commerce and Economic Development, and with Sterling Gallagher, who is on contract with my office on this issue.

Specific comment and recommendations on the bill must await additional analysis. However, there appears to be a number of philosophical and technical difficulties with the sponsor substitute which we wish to take up with your committees at subsequent hearings.

One fundamental issue which I would like to raise at this point is the question concerning the applicability of the normal procedures for corporate governance (annual shareholder meetings, voting by proxy, etc.) to this unique corporate creature which will make shareholders voice their concerns and influence or veto management decisions. I hope that this experiment in economic democracy might be linked to an experiment in corporate democracy which might involve the creation of mechanisms specifically tailored to insure adequate shareholder representation and participation in major management decisions.

There are many details about the bill which require closer scrutiny, such as the amount of state assistance which will be required and the investment opportunities available. My Administration intends to work closely with you on this issue to analyze these and other questions. We look forward to an open dialogue to resolve any uncertainties and to talk with Alaskans about this exciting opportunity for our future.

Sincerely,

Jay S. Hammond
Governor

ALASKA STATE LEGISLATURE

Legislative Affairs Agency

Pouch Y - State Capitol
Juneau, Alaska 99811

REGIONAL INFORMATION OFFICE
1024 West 6th Avenue
Anchorage, Alaska
99501
(907) 278-3668

Enclosed for your information and files are materials relating to the teleconference on HB 240, Alaska General Stock Ownership Corporation held March 12, 1979, including a copy of the witness and observer list.

Judy Hopkins
Anchorage Moderator

LAA 11
(Rev. 4-29-77 K)

Alaska State Legislature

TELECONFERENCE HEARINGS

SUBJECT: HB 240 - Alaska General Stock Ownership Corporation (Duncan et al)

COMMITTEE: House State Affairs (MILLER, Fuller, Gardiner, Parker, Eliason, Martin, Metcalfe)

DATE: Monday, March 12, 1979

TIME: 5:30 p.m. A.S.T.

SITES PARTICIPATING: Gravel, Anchorage, Fairbanks and other interested sites

CONFERENCE MODE: audio

LOCATION: LIO

MODERATOR: Hopkins

UAA ADVISED, CONFIRMED na
Extra bills ordered
Register prepared 3/5/79

NOTES:

Summary Coming.

✓ UAA 263-1756
○ ACC 263-1536
✓ APU 276-8181
✓ ISER 278-4621

Briefing teleconference - hearings later on.

start - 5:30
end - 8 pm

PUBLICITY:

INVITATIONAL

	Date	Quantity
PSAs	3/6/79	26
Audio PSAs		
Video PSAs		
News releases	3/8/79	30
Direct mail		
Phone contacts	3/12/79	8 4
Other:		
Posted at LIO	3/5/79	

Copies to LTN Juneau 3/13
Copies to committee 3/13
~~Copies to sponsor~~

NUMBER IN ATTENDANCE 4
NUMBER TESTIFYING 0

61-08

Today in Anchorage

Public input on House Bill 240, creating the Alaska General Stock Ownership Corp., is invited by the House State Affairs Committee in an audio teleconference beginning at 5:15 p.m. at the Legislative Information Office, 1024 W. Sixth Ave. Area residents interested in testifying should register in advance by calling 279-3668. Observers are welcome.

Alaska State Legislature

TELECONFERENCE HEARINGS

March 8, 1979

Contact: Representative Mike Miller
465-4964 Juneau or Judy Hopkins
278-3668

FOR IMMEDIATE RELEASE

ALASKA GENERAL STOCK OWNERSHIP PLAN AIRED

Legislation creating the Alaska General Stock Ownership Corporation will be considered in an audio teleconference hearing beginning at 5:30 p.m. Monday, March 12 at the Legislative Information Office, 1024 West Sixth Avenue. Participants will include Senator Mike Gravel and residents of Anchorage and Fairbanks interested in commenting on the proposal before the House State Affairs Committee, chaired by Representative Mike Miller of Juneau.

House Bill 240, sponsored by Representative Jim Duncan and eight of his House colleagues, creates the Alaska General Stock Ownership Corporation as a completely private for profit corporation which will operate under the Alaska Business Corporations Act to the extent consistent with the AGSOC act. The shares of the AGSOC will be owned and voted by the citizens of Alaska with each resident holding a share of stock.

The bill directs the Governor to appoint incorporators to form the AGSOC and provides for board membership limitations assuring Alaskan control,

(MORE)

MORE ON STOCK OWNERSHIP PLAN

stock distribution to all Alaska residents, penalties for fraudulent acquisition of AGSOC stock, and financing for AGSOC startup costs.

The corporation is designed to have as its shareholders existing Alaska residents. Stock will be distributed to eligible individuals without cost. Investments by the AGSOC will be made through the use of borrowed funds and the earnings from those investments used to retire the loan and distribute dividends to the shareholders. Except for minor exemptions, the AGSOC will be subject to the same rules as all other Alaska corporations.

Federal law requires state authorization of general stock ownership corporations receiving special tax treatment under Subchapter "U" of the Internal Revenue Code.

###

Alaska State Legislature

TELECONFERENCE HEARINGS

March 6, 1979

Contact: Judy Hopkins 278-3668

PUBLIC SERVICE ANNOUNCEMENT

(Run through 3 p.m. 3/12/79)

PUBLIC INPUT ON HOUSE BILL 240, CREATING THE ALASKA GENERAL STOCK OWNERSHIP CORPORATION, IS INVITED BY THE HOUSE STATE AFFAIRS COMMITTEE IN AN AUDIO TELECONFERENCE STARTING AT 5:15 p.m. MONDAY, MARCH 12, AT THE LEGISLATIVE INFORMATION OFFICE, 1024 WEST SIXTH AVENUE.

AREA RESIDENTS INTERESTED IN TESTIFYING SHOULD REGISTER IN ADVANCE BY CALLING 278-3668. OBSERVERS ARE WELCOME.

###

Legislative Affairs Agency
Legislative Teleconferencing Network
State Capitol . Pouch Y . Juneau . 99811

Phone: 465-4980

PLEASE PRINT

Name: Douglas B. Terhune — Here to TESTIFY: ____

Representing: Self

Mailing Address: 2711 W. 84th Ave Zip 99502 — Here to OBSERVE: ✓

Phone: 243-7189

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

Douglas B. Terhune
(signature)

Have you participated in other legislative teleconferences? YES How many? 6-8

Would you have participated in this hearing if the network were not available?

PLEASE PRINT

Name: Amy E Quesnel — Here to TESTIFY: ____

Representing: Senator Frank

Mailing Address: P.O. Box 2283 Anchorage Zip 99510 — Here to OBSERVE: ✓

Phone: 277-4591

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

Amy E Quesnel
(signature)

Have you participated in other legislative teleconferences? ____ How many? ____

Would you have participated in this hearing if the network were not available? ____

How did you learn about this hearing?

If yes, did you use the network:
___ instead of travel
___ instead of phone conversations
___ instead of mailed testimony

PLEASE PRINT

(Fred)

Name: Fred B. Morgan — Here to TESTIFY: (Yes)

Representing: Self

Mailing Address: Box 2328; Anchorage, Zip 99510 — Here to OBSERVE: ____

Phone: ____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio, or television stations. Please indicate your consent by signing below:

Fred B. Morgan
(signature)

Have you participated in other legislative teleconferences? ✓ How many? 3 or 4

Would you have participated in this hearing if the network were not available? No

How did you learn about this hearing? Anch. Daily News (2-day in Anch. only)

If yes, did you use the network:
___ instead of travel
___ instead of phone conversations
___ instead of mailed testimony

Date: 3/12/79 Subject: HB 240 - GSOC Location: Anchorage

PLEASE PRINT

Name Jerry McCutcheon — Here to TESTIFY ____

Representing _____

Mailing Address _____ Zip _____ — Here to OBSERVE ____

Phone _____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

_____
(signature)

Have you participated in other legislative teleconferences? ____ How many? _____

How did you learn about this hearing?

_____

Would you have participated in this hearing if the network were not available? _____

If yes, did you use the network:
___ instead of travel
___ instead of phone conversations
___ instead of mailed testimony

Date: 3/12/79 Subject: HB 240 - GSOC Location: Anchorage

EOM

LA21 1930 15.24 JA01 0043 15.24 03/16/79

FROM: FAIRBANKS LEGISLATIVE INFORMATION OFFCE

TO: REP. MILLER, HOUSE STATE AFFAIRS CHAIRMAN
CC: CLAUDIA COYNER, TELECONFERENCE NETWORK REP.

FOLLOWING IS LIST OF OBSERVERS ON MARCH 12 AT HOUSE STATE AFFAIRS COMMITTEE TELECONFERENCE ON HB 240 FOR INCORPORATION IN YOUR COMMITTEE'S RECORDS.

1. JENNIFER JOHNSTON, BETTYE FAHRENKAMPE, 221 KODY DR., FBKS 99701 452-8097
2. ROBERT DEMPSEY, ECON, DEVELOPMENT COMM., CHAMBER OF COMMERCE, 11 WOLF RUN, FBKS 99701 479-5154
3. ROSE C. HOUGH, SEN. MIKE GRAVEL AND DEMOCRATIC CENTRAL DIST. COMMITTEE, 4050 EVERGREEN AVE, FBKS 99701 452-6227
4. EDITH RISSELL, SENATR MIKE GRAVEL, BOX 7, 101 12TH AVE., FBKS 99707 452-6227
5. ALLAN R. JOHNSTON, SELF, 221 KODY DR., FB S 77701 452-8094
6. MONTE SHADE, SELF, P.O. BOX 1271, FBKS 99707 452-8352
7. TERRY PALCZER, SELF, SR BOX 10671, FBKS 99701 479-6344
8. SHERRY MODROW, SELF, BOX 2847, FBKS 99707 456-2037

/NS/ EOM

ALASKA STATE LEGISLATURE

Legislative Affairs Agency

Pouch Y - State Capitol
Juneau, Alaska 99811

REGIONAL INFORMATION OFFICE
1024 West 6th Avenue
Anchorage, Alaska
99501
(907) 278-3668

Enclosed for your information and files are materials relating to the teleconference on HB 240 - AGSOC held March 14, 1979, including a copy of the witness and observer list.

Judy Hopkins
Anchorage Moderator

LAA 11
(Rev. 4-29-77 K)

Alaska State Legislature

TELECONFERENCE HEARINGS

SUBJECT: HB 240 - Alaska General Stock Ownership Corporation (Duncan et al)

COMMITTEE: House State Affairs (Miller)

DATE: Wednesday, March 14, 1979

TIME: 5:30 - 7 p.m. A.S.T.

SITES PARTICIPATING:

CONFERENCE MODE: audio

LOCATION: LIO

MODERATOR: Hopkins

UAA ADVISED, CONFIRMED na
Extra bills ordered x
Register prepared x

NOTES:

Gravel will be on hand in Washington

PUBLICITY:

INVITATIONAL

	Date	Quantity
PSAs		
Audio PSAs		
Video PSAs		
News releases		
Direct mail		
Phone contacts		
Other:		
Posted at LIO	3/13	

Bob Richards (Mary Lou Couch) 276-3110
✓ Simpson 276-7133 out of town
✓ Zink 279-2522
✓ Hancock - 263-1810 out of town
Orgt - 272-3508

Copies to LTN Juneau 3/15
Copies to committee 3/15
Copies to sponsor

NUMBER IN ATTENDANCE 1
NUMBER TESTIFYING 1

1-30-79

Name Jerry McCutcheon (T) Here to TESTIFY ✓

Representing _____

Mailing Address _____ Zip _____ Here to OBSERVE _____

Phone _____

BROADCAST CONSENT: This proceeding may be broadcast live or recorded for later broadcast by radio or television stations. Please indicate your consent by signing below:

_____
(signature)

Have you participated in other legislative teleconferences? _____ How many? _____

How did you learn about this hearing?

_____

Would you have participated in this hearing if the network were not available? _____

If yes, did you use the network:
___ instead of travel
___ instead of phone conversations
___ instead of mailed testimony

Date: 3/14/79 Subject: HB 240 - AGSOC Location: Anchorage

LA21 2527 18.17 03/16/79 JA01 0013 08.36 03/17/79

FROM: FAIRBANKS LEGISLATIVE INFORMATION OFFICE

TO: SEN. MULCAHY, SENATE STATE AFFAIRS COMMITTEE CHAIRMAN
REP. MILLER, HOUSE STATE AFFAIRS CHAIRMAN
CC: CLAUDIA COYNER, TELECONFERENCE NETWORK REP.

FOLLOWING IS LIST OF WITNESSES ON MARCH 14 AT SENATE & HOUSE STATE AFFAIRS COMMITTEE TELECONFERENCE ON SB 170 & HB 240 FOR INCORPORATION IN YOUR COMMITTEES' RECORDS.

1. DONALD D. THOMAS, SELF, 3070 TOTEM DR., FBKS 99701 479-2004
2. BOB DEMPSEY, SELF, 11 WOLF RUN, FBKS 99701 479-5154
3. FRANK P. LEE, SELF, P.O. BOX 80565, FBKS 99701 456-8671
4. ALLAN R. JOHNSTON, SELF, 221 KODY DRIVE, FBKS 452-8094
5. MONTE S. SHADE, SELF, P.O. BOX 1271, FBKS 99707 452-8352
(OBSERVE ONLY)

/NS/ EOM

PERSONAL MESSAGE FORM

DATE March 13, 1979

NAME Vander Pearson

REPRESENTING The Greater Fairbanks Black Caucus

ADDRESS 1028½ 23rd Ave.

Fairbanks, Alaska 99701

PHONE NUMBER 479-6514

TO House State Affairs Committee

RE House Bill 240

MESSAGE I support House Bill 240 and would like to see this bill become law. As I understand H.B. 240, it would create a General Stock Ownership Corporation that would finance the Alaska Gasline. With this approach, every Alaskan will have an opportunity to participate in the growth and development of Alaska.

Vander Pearson
Signature

CAN BE CONTACTED AT FOLLOWING TIMES 4:30 - 8:00 P.M. Week days

ADDRESS AND PHONE NUMBER (If different from the above)

4705 Palo Verde, Univ. West

Fairbanks, Alaska 99701 479-6514

Senator Gravel finally got his Government Stock Ownership scheme into law, but who, all things considered, wants it?

A bad idea whose time, alas, came

Senator Gravel of Alaska
A curious way to build a constituency for capitalism.

By Fern Schumer

IN THE WANING HOURS of the 95th Congress a new economic animal was born—the Government Stock Ownership Corp. The GSOC (pronounce it "Gee, Sock") owes its life to Senator Mike Gravel of Alaska, who, in the rush toward adjournment, tucked the idea into the big tax-cut bill. It is an odd beast, a sort of state-chartered mutual fund. A state could use its credit to borrow right and left for the GSOC so that the corporation could invest in stock. It would distribute each year at least 90% of the profits to its shareholders, who, in turn, would be credited with the income for federal tax purposes. (Shareholders would not be able to use GSOCs as tax shelters, however, because they would not be allowed to flow through any losses.)

In theory, any state can now set up a GSOC. One can almost hear the bond salesmen and underwriters of the world bracing to handle a flood of new state-guaranteed issues. But, in fact, few are likely to, and only Alaska, with its huge

Not the least peculiar thing about the GSOC concept is that it all but totally separates risk from reward. If the Alaska legislature runs with the idea, each of Alaska's 405,000 residents would receive a free share of stock and its dividends. But the corporation's only real asset in the beginning would be the state's ability to guarantee huge loans, the proceeds of which would be invested by the corporation. As in any state, however, a lot of Alaskans don't pay taxes. Furthermore, Alaska is unique in that it has a native group of people who live off the land and have no cash income. Is it fair that only taxpayers absorb the risk of GSOC, while an initial group of Alaska residents reaps the benefits?

After the stock has been distributed, of course, there will also be an ever-growing divergence between the stockholders, on the one hand, and taxpayers and citizens on the other. As people move to the state, they may not be eligible for a share of stock. At the same time, citizens who lived in Alaska and have since moved may still own stock.

other stockholders. For instance, GSOC proponents are talking about investments on the scale of $1.5 billion. With that money the corporation might buy BP's 16% share of the oil pipeline. (BP is rumored to be eager to get its money out to help cover mounting exploration costs in the North Sea and elsewhere.) In that case, the state would be guaranteeing a $1.5 billion loan—its total indebtedness now is only $694 million, with guarantees in various forms for about another $400 million. The state's credit rating would clearly be affected. If it needs to borrow more money, say, for a public works project, interest rates would be higher. Who would pay these higher rates? The taxpayer, of course. The stockholders who *are* taxpayers would have a direct, obvious stake in the corporation's profits and a less obvious interest in holding down taxes.

"Not the least peculiar thing about GSOC is that it all but totally separates risk from reward. Is it fair that only taxpayers absorb the risk while an initial group of Alaska residents reaps the benefits?"

Gravel, nevertheless, is pushing GSOC as a way "to build a constituency for capitalism." He got the idea from the theories of economist Louis Kelso, godfather of the employee stock ownership plans in effect at a good many U.S. companies. Alaska shows at least tentative interest in pushing the idea. The state has given Kelso a $180,000 contract to draw up a GSOC blueprint and is spending an additional $60,000 on other related consulting work. Kelso's blueprint is due next February, and the legislature is expected to tackle it shortly after that.

Gravel's staff has looked with particular longing at BP's 16% share of the Alaska oil pipeline. That would produce revenues of $406 million a year, they reckon. After operating costs and annual debt payments, about $158 million would be left to distribute to shareholders. Thus each of Alaska's citizen-shareholders would get a dividend check for $390 a year. BP projects its revenues will be $372 million this year and $437 million next year if the pipeline runs at capacity.

GSOC, in a way, is another offspring of Proposition 13. "People recognize that once the money flows into the state treasury, it's harder to get it back into the hands of the people," says Milt Barker, a fiscal expert for the state legislature. GSOC may be perceived as one way to filter the money into the people's hands. But the Alaska legislature had better take a hard look at Kelso's blueprint and add

Rule 23.1 Derivative Actions by Shareholders.

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the aprpoval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs. (Added by Supreme Court Order 258 effective November 15, 1976)

MEMORANDUM

TO: Representative Jim Duncan, Chairman
Budget and Audit Committee
Alaska State Legislature

FROM: Arlon R. Tussing

RE: Questions about an Alaska General Stock Ownership Corporation (GSOC)

I am submitting these preliminary comments at the request of Mr. Milt Barker of the Division of Legislative Finance. They are based upon my review of the following materials:

1. Louis O. Kelso, et al, Design of an Alaskan General Stock Ownership Plan, Volume I. (February 15, 1979);

2. Kelso & Co., (untitled) documents on British Petroleum's interest in TAPS (December 7, 1978);

3. Alaska House of Representatives, Sponsor Substitute for House Bill No. 240 (March 6, 1979);

4. Wilmer, Cutler & Pickering, Federal Constitutional Issues Presented by Alaska's GSOC (December 15, 1978);

5. Senator Mike Gravel, various speeches, Congressional Record citations on GSOCs (1978 & 1979).

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I regret that I was not able to present these comments in person to the House State Affairs Committee on March 20, 1979, but I hope that they will be of use to you. Please let me know if you have any further questions.

QUESTIONS ABOUT AN ALASKA GENERAL STOCK OWNERSHIP CORPORATION

1. GSOCs in General. Louis Kelso's concept of the General Stock Ownership Corporation (GSOC) has much in common with socialist and welfare state programs for redistributing wealth.* Instead of directly expropriating or taxing away property for redistribution, however, Kelso's approach would use the government's credit to finance specially created corporations, whose shares would be dealt out to eligible citizens. The individual shareholder in GSOC thus could regard any dividends he received as earnings from his ownership of private capital rather than as a government handout.

Like confiscation or condemnation, GSOCs would create no new wealth for society. The money used to create the GSOC would have to be bid away from private investors who did not have the same access to the government's power to tax (or, in the case of a federally-sponsored GSOC, to print money) in order to make good on their obligations. Because

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* Kelso's accusations against present-day capitalism could well have come from a handbook of revolutionary Marxism. His program, it appears, is a remedy for "endemic poverty . . . misuse of technology, resource waste, despoilation of the environment, declining personal freedom, increasing lawlessness and civil disorder, the waning of liberal education, the civil rights impasse, the youth revolt, urban concentration, rising public and private debt, public loss of confidence in leadership and the seemingly irreversible advance toward a totalitarian society." [Kelso, et al, p. 16].

the "losers" would be widely scattered and impossible to identify individually, however, we could expect this kind of property redistribution to be less painful and less socially disruptive than more traditional socialist schemes.

There is nothing novel or radical in this aspect of the GSOC. Private individuals and corporations already benefit from a wide variety of federal and state loan and guarantee programs: each of them reallocates resources and redistributes wealth as surely (if not as visibly) as would taxation or government ownership of industry. GSOCs would no more revolutionize or redeem the capitalist system than do the existing programs of government credit for housing, agriculture, shipbuilding, rural electrification or education. The value of the GSOC concept to Alaska must be judged not by the sweeping claims of its inventors, but rather by whether specific proposals are properly tailored to the state's specific problems.

2. GSOCs in Alaska. The GSOC concept (like that of "Alaska, Inc.") appeals to legislators and other Alaskans because it may be a Constitutional way to use the state's petroleum revenue to increase the wealth of present resident Alaskans without permanently swelling the size of state government or attracting a host of immigrants to share in the windfall. In my opinion, something like a GSOC as contemplated in H.B. 270 may indeed be the best way to give

Alaskans a personal stake in the state's natural resource income. But the GSOC concept is still a very rough one, and there are a number of reservations and cautions even apart from technical le al issues, that I would like to raise here. As the Legislature deliberates further on the GSOC concept, I would expect to raise other problems and perhaps to offer some suggestions for improving the pending legislation.

3. Widely distributed ownership vs. broad-based control. GSOCs may very well be a means of widening ownership in Alaska industry, but widely distributed ownership is not the same thing as broadly-based control. It is a truism that corporations with widely dispersed share ownership are the easiest for small groups of insiders to control. They are practically immune both to stockholder revolts and to hostile takeover attempts (which are often the only way in which an ineffective management can be replaced).

Small shareholders normally do not take an interest in corporate affairs, and it is usually not worth their time to do so. Most shareholders express any dissatisfaction with management by selling their stock, not by becoming active in corporate politics. Otherwise, they routinely give their pr ies to management, or simply decline to vote at the annual meeting. This experience in ordinary business corporations is duplicated in "non-profit" economic enterprises

with widely spread ownership, such as cooperatives, credit unions, savings and loan associations, and mutual insurance companies.

By limiting any person's interest to ten shares of GSOC stock, the proposed legislation assures that shareholders generally will not have a large enough stake to warrant their taking an active part in the corporation's affairs on the basis of economic self-interest. This limitation on individual share ownership, the absence of cumulative voting and the staggered terms of office for directors, almost guarantee a self-perpetuating management.

In this setting, the alternative of vigorous controversy among the shareholders is hardly more attractive, however. Any activists, apart from the insider group itself, are likely to be more concerned with personalities and politics then with prudent business management. Alaska can already offer a few prominent examples of broadly-based corporations with such a malady.

4. Motivations of the Directors. Since the officers and directors of a GSOC will not be selected on the basis of a substantial ownership position, and may not obtain such a position, the legislature should consider in advance just what kind of people will constitute this self-perpetuating insider group, and what their motivations are likely to be. Such a group is more likely to be moved by considerations

other than profitability than a board and management representing large shareholders, for example:

Their outside business interests;

Officers' salaries, directors' fees, and other perquisites;

Size and prestige of the organization;

Their social and business philosophies, ideals and ideologies; and

The approval of other businessmen, the media, or the community at large.

These are on the whole the considerations that motivate the boards of many "charitable" enterprises: "non-profit" hospitals, for example, are notorious for bad management, inefficiency, and petty corruption. None of the foregoing motives is necessarily reprehensible, and they are not always at odds with the interest of the shareholders in maximizing profits or capital gains. But as a small shareholder I would prefer to have a few large shareholders on the board looking at the bottom line, and, in their own self-interest looking askance at inefficiency, empire-building or gold-

plating.

5. Vulnerability to speculative promotions. Alaska is a fertile field for promotional schemes, and GSOCs may be just made to order for them. The big private gains in industrial development projects are not made on the operating profits of ownership (Kelso's theories notwithstanding), but from promotional and organizational expenses: land speculation and sales; engineering, consulting, legal and underwriting fees; and the purchase and sale of corporate assets --- all of which can be capitalized into a GSOC's initial "investment."

The Board of Directors of GSOCs will almost inevitably be made up of people who make their living, or at least many of whose friends make their living, by such pursuits. Those who were strangers to that way of life when they were appointed or elected as Directors would not remain so for long. It is likely that an Alaska GSOC of the kind presently contemplated would be tempted to invest in projects that sophisticated profit-motivated capitalists would shun, and for which the legislature would not have been willing to appropriate public funds.

6. State Loan Guarantees. One seeming advantage of the GSOC concept is that the state money backing GSOC credit would bring a double return to Alaska --- once from the investment earnings the government earns on money in the

guarantee fund, and once again from the citizens' GSOC dividends. But state funds needed to back GSOC debt would be considerable (in the case of the proposed BP Pipeline purchase, over $1 billion), they would be immobilized for any other purpose, and they would truly be at risk --- particularly if GSOCs were capitalized with 100 percent debt, as seems to be necessary if the corporations are to be created without an appropriation of equity capital from the general fund.

The proposed legislation is not clear who is to propose and approve state loan guarantees for the purchase of GSOC assets. There seems to be a Constitutional question whether such a guarantee could be authorized by the Legislature, or even by a popular referendum, but that is an issue outside my area of competence.

7. Investment in TAPS. A share in TAPS is one of the worst investments an Alaska GSOC could possibly make. If something went wrong at the Prudhoe Bay field, with the pipeline or terminal, or in the world petroleum market --- the state could simultaneously be faced with (1) a drastic decline in the oil revenues that support state government and underpin the Alaska economy, (2) an obligation to make good on defaulted pipeline bonds (either out of a guarantee fund or out of reduced general fund revenues), and (3) loss of the value of GSOC stock in the hands of individual Alaskans.

The fact that such a scenario is even imaginable makes it very unlikely that the present holders of pipeline bonds would agree to their assumption by an Alaska GSOC, or that they take any state loan guarantee seriously. As some big lenders have stated about state backing for gas pipeline debt, they would justifiably expect Alaska to try to recover any loss by means of higher taxes on oil and gas production, thereby further undermining the soundness of the lenders' other loans to th owners of TAPS. The same considerations apply, with only slightly less force, to GSOC investments in other facilities for transporting North Slope hydrocarbons.

If the Legislature were to authorize creation of a GSOC, however, there will surely be a clamor (which may well become irresistible) for it to finance or buy into the Alaska Highway gas pipeline, a North Slope gas conditioning plant, the Alpetco refinery, a Fairbanks petrochemical plant, or a natural gas liquids pipeline on terms that no rational private investor would accept. This is my own main concern about GSOCs today. But, for some Alaskans, it may well be a point in their favor.

Alaska State Legislature

House of Representatives

Ray Metcalfe
Pouch V
State Capitol
Juneau, Alaska 99811

April 6, 1979

The Honorable Avrum M. Gross
Pouch K
Juneau, Alaska 99811

Dear Mr. Gross:

Thank yc for you. timely response to my earlier proposal.

I have reviewed the problems that you have outlined with the original draft of my proposal Attached hereto is a redraft of that same proposal bearing two minor changes. The changes therein are for the purpose of addressing each of those problems that you found with my proposal. As you had indicated in your letter to me in the third paragraph of the first page, for a committee of the Legislature to negotiate agreements with the Matanuska/Susitna Borough is not a legislative function, is outside the purview of the Legislature and is a responsibility of the executive branch. Therefore, I have revised paragraph four of the first page of my proposal, to bring the recommended duties of the proposed committee within a proper legislative function.

In the fourth paragraph of your response to my proposal, you have indicated a potential conflict with A.S. 44.06.160. and A.S. 44.06.200-A.S. 44.06.260.. Therefore in paragraph three of my pro,osed method of moving the capital, I have added one more subparagrph of paragraph three which you will note as Item (d). Item (d) calls for the repeal of those statutes for the purpose of eliminating the potential conflict of the law.

It would appear from your response to my original proposal, that such action of repealing the above mentioned statutes would alleviate any potential conflict between the FRANK Initiative and this proposal. In addition to the removal of the conflict of the FRANK Initiative and the above mentioned statutes, you might also notice that the proposal goes one step further in removing any requirement to build a city as outlined by the commission's existing plan, On the first

page, paragraph three, item (c) requires that the Legislature must find the proposed capital improvements to be sufficient to accomodate the Governor's Office, the Legislature, the Legislative staff, and any other state personnel that the Legislature feels must be near or within the new capitol building.

Considering that this subject is coming before the State Affairs Committee meeting on Friday, April 6th, being the day of delivery of this letter, it would be most sincerely appreciated if your office could expeditiously review the minor changes in my proposal, in order to allow this matter to be discussed in the State Affairs Committee meeting beginning at 1:15 p.m. on the 6th.

Sincerely,

Ray Metcalfe
Representative

RM/ddp

1) A capital move proposal offered by Rep. Ray Metcalfe for the purpose of attempting to find an economically sound method of moving the capital that will hopefully,

A) Meet with the scrutiny of the Attorney General's office,

B) Satisfy the provisions of the 1978 FRANK Initiative,

C) Satisfy the 1974 mandate to move the capital,

D) Meet with the satisfaction of the people of the Matanuska/Susitna Borough.

2) This proposal is for the purpose of outlining a step-by-step method of moving the capital to Willow, Alaska, via an avenue that, if agreed to and pursued, will not encounter any insurmountable obstacles that might otherwise prevent the concept expressed herein, from being fully implemented.

3) This outline will be subject to the passage of the following legislation:

A) Enabling legislation to allow the Matanuska/Susitna Borough unlimited selection rights to those lands currently reserved for the development of a new capital city.

B) The passage of a concurrent resolution requesting the state to enter into negotiations with the Matanuska/Susitna Borough for the purpose of moving the capital.

C) An eventual approval by the Legislature of all plans, all negotiated agreements, and a decision by the Legislature that the State of Alaska finds the proposed capital improvements to be of sufficient magnitude to accomodate the Governor's office, the Legislature, the Legislative staff, and any other state personnel that the Legislature feels must be near or within the new capital building.

D) Legislation repealing Alaska State Statute, A.S. 44.06.160. and A.S. 44.06.200 - A.S. 44.06.260.

4) Immediately following the passage of legislation as outlined in item (D) above, the Legislature shall appoint a Capital Move Steering Committee. It shall be the responsibility of the Capital Move Steering Committee, to advise the Matanuska/Susitna Borough as to what that committee feels the Legislature as a whole will consider to be necessary for the completion of the project as outlined herein.

5) To the extent the Attorney General finds necessary, for the purpose of meeting the requirements of the FRANK Initiative, the Matanuska/Susitna Borough shall agree to pay for all salary, per diem and travel of those involved in the negotiations to be conducted between the State of Alaska and the Matanuska/Susitna Borough.

6) The Matanuska-Susitna Borough shall, in cooperation with the committee of the Legislature, prepare a basic site plan which shall consist of

A) All future major thoroughfares throughout the capital city,

B) All major corridors for future utility trunk line development,

C) All sites for major public facilities of the future,

D) Planting and zoning of major tracks of land to be made available to private industry for further subdivision and development of business, industrial and residential facilities, and

E) To the extent the committee and Borough find necessary, prepare a planned unit zoning plan for business and other industry immediately surrounding that site which is selected for the development of the new capital building.

7) In addition to the general site plan, the Matanuska-Susitna Borough shall, in consultation with the committee, develop detailed plans for a building that the committee determines to be of sufficient size to accomodate the Governor's office, the Legislature, and all state personnel determined by the committee to be necessary for the first meeting of the Legislature. Additionally, the Borough, in consultation with the committee, shall also determine what other facilities will be required in terms of capital improvements through the year 1992, as well as determine within what time frame the additional state facilities shall be constructed.

8) As a part of those negotiations,

A) The state shall agree to provide all rights-of-way to the Borough for construction of necessary access roads and other infrastructure items to be built by the Borough and others as described herein.

B) The Borough shall agree to construct all state facilities and other necessary infrastructure within a time fram to be outlined in those negotiations, and hand over to the State of Alaska in fee simple title, and with no incumberments, all those state facilities determined to be needed through the year 1992.

C) The State shall agree to occupy each facility constructed immediately following completion of said facility.

D) Upon completion of each facility the Matanuska-Susitna Borough shall be required to pay all costs involved in the moving of personnel, records and equipment from the capital city of Juneau to the new capital city of Willow.

9) Should the costs of maintenance and operation be determined by the Attorney General to be a cost that cannot be paid by the State of Alaska through the year 1992, because of the provisions of the FRANK Initiative, the Borough shall assume those responsibilities, unless or until, the Borough has secured a decision by a court of the State of Alaska determining such cost to be costs which the State would not be precluded from paying because of the provisions of the FRANK Initiative.

10) The entire agreement negotiated between the Matanuska-Susitna Borough and the committee of the Legislature shall be subject to the passage of legislation allowing the Matanuska-Susitna Borough unlimited rights to select lands from within the 64,000 acre proposed capital site, that in the Borough's opinion, will be necessary for the purpose of securing as well as paying for

A) All bonded indebtedness incurred by the Matanuska-Susitna Borough as a result of the capital city development,

B) All debts incurred from private financial sources as a result of the development of the new capital city,

C) All costs otherwise incurred by the Matanuska-Susitna Borough as a result of the development of the new capital city

D) Sufficient cash to equal a reasonable return for the risk the Matanuska-Susitna Borough has taken, which shall equal not more than 18% of all combined total costs and indebtedness incurred by the Matanuska-Susitna Borough.

11) All revenues produced from the sale of lands from the Matanuska-Susitna Borough to private industries shall be applied to the existing bonded indebtedness that has resulted from the construction of a new capital in Willow, or shall be escrowed for the payment of future bonds or bond payments that are anticipated to be incurred by the Matanuska-Susitna Borough as a result of the capital city development.

12) Once sufficient cash revenues have been generated by the Matanuska-Susitna Borough from the sale of lands, to cover all the costs and profits as outlined herein, the unlimited selection rights of the Borough shall cease, and all land that has not yet been sold by the Borough shall be returned to the State of Alaska.

13) In summary, it is to be understood that within this proposal it is understood that the Matanuska-Susitna Borough shall be required to pay for any and all costs of the capital move that are determined by the Attorney General to be a cost that the State is precluded from paying throughout the year 1992 as a result of the FRANK Initiative, as well as assume full responsibility for all bonded indebtedness incurred for capital improvements through that same period of time.

14) All costs shall be outlined in detail prior to any final agreement between the State of Alaska and the Matanuska-Susitna Borough. Should there be any dispute between the Attorney General's office and the Matanuska-Susitna Borough with regard to what costs the State is precluded from paying as a result of the provisions of the FRANK initiative, or for any other reason, the Matanuska-Susitna Borough shall pursue an expeditious settlement of the disputed matter via a decision of the courts of the State of Alaska.

15) Once final agreement is reached between the Matanuska-Susitna Borough and the committee of the Legislature, that agreement shall be submitted to the Legislature for its final approval, and the move shall be completed as expeditiously as possible thereafter.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

POUCH Y STATE CAPITOL
JUNEAU ALASKA 99811
907-465-3800

M E M O R A N D U M March 9, 1979

SUBJECT: Capital Move Concept
(Work Order No. 6821)

TO: Representative Mike Miller

FROM: Kenneth E. Vassar
Legislative Counsel

You have requested a legal opinion relating to the "Capital Move Concept" outlined in the rough draft of an agreement between the Matanuska-Susitna Borough and the state which you have furnished us. At the outset, I think it is appropriate to discuss the FRANK initiative and the effect of any attempt to avoid it.

I would have to approach any plan which would attempt to provide for the relocation of the capital without the expenditure of state money with a skeptical attitude as to its viability in the courts. Such a plan must avoid any expenditure of state money for the physical relocation of the present functions of state government and must also avoid incurring any obligation on the part of the state to pay any state money at any time in the future for such physical relocation. Even assuming that such a plan does exist, any prognosis as to the viability of the plan comes with a very large caveat, which will be explained in the following paragraph.

In the ordinary review of statutes, a court will apply the law in accordance with the literal meaning of the words used in the statutes unless there is some ambiguity which requires it to go behind the words of the statutes and look at the legislative intent. The phrase "State money may be expended," as it is used in the FRANK initiative, appears to be unambiguous, and so it would be fair to assume that a court would apply the law strictly in accordance with the language in the initiative under normal circumstances. Thus, a plan which does not involve the expenditure of any state money, now or in the future, for the physical relocation of the

present functions of the state government might be expected to survive a FRANK initiative attack. However, the magnitude of the issue and the fact that this is an initiative rather than a legislative enactment would take the interpretation of this language far from normal circumstances, and a court might go beyond the literal interpretation of the words used in the initiative and examine the purpose behind the words.

If this were the case, the court would surely give some weight to the "Purposes" section of the initiative. That section includes the following language:

> It is the purpose of this act to insure that the people of Alaska will have the opportunity to make an intelligent and objective decision on relocating the capital with all pertinent data available to them concerning the costs to the State. . . .

Since it would be only of relatively mild interest to the people to know the costs of the move after the move had begun, and since it would leave little room for decision making by the people at that point, I would assume that a court would view this purpose as applying before any move began. It would follow that a court could interpret the language of the initiative to actually mean that no movement of the present functions of state government may begin before the required bond issue election.

Turning now to the "Capital Move Concept," I would like to begin with a summary of my perception of the plan. Since the concept does not appear to present all the details of the plan, this summary and the following analysis may include some assumptions on my part relating to those details. Under the plan the borough would select from, or trade borough land for, a minimum of 6,240 acres of state land at the relocation site. The existing provisions of law relating to borough selections and exchanges of land are found in AS 29.18.205 and 29.18.209. In return, for the selection or trade, the borough would prepare a basic site plan for the capital city and finance and construct a building for use as a part of the total state office complex. When the building is completed, it would be turned over to the state for occupancy, and the borough would be allowed to charge rent on the building in an amount sufficient to cover debt service on a portion of the bonds issued by the borough for

the project. The state would provide rights of way to the borough for the construction and would establish an appropriate body to consult with the borough. The borough would return title to lands it receives under the agreement to the state if (1) the borough is repaid for all its expenditures; (2) any bonds issued by the borough are retired or assumed by the state; and (3) the borough regains entitlement to selection of an equal amount of land.

Before getting into an analysis of the concept in relation to the FRANK initiative, I have some comments about the selection and transfer of land under AS 29.18.205. That law allows boroughs to select vacant, unappropriated and unreserved state land within their boundaries. Under the terms of the 1974 initiative (AS 44.06.130), the land from which selections would be made under the concept submitted is classified as reserved use lands. Therefore, it is ineligible for selection under AS 29.18.205 absent some legislative action. It appears, however, that the land would be eligible for a land exchange under the authority of AS 29.-18.209. The exchange would have to be for land owned by the borough of equal value to the state land. The determination of equal value would be incumbent upon the director of the division of lands and the commissioner of natural resources.

The following paragraphs relate to the "Capital Move Concept" on a paragraph-by-paragraph basis with specific attention to the relationship of the concept to the FRANK initiative.

1. As noted before, this paragraph will require a land exchange rather than a municipal selection. In order to fulfill his statutory duties (which cannot be contracted away), the director will be required to determine whether there is a public interest to support the exchange and whether the land offered by the borough is of approximately equal value to the land offered by the state (including the non-monetary value of public benefits). In addition, the director must give notice of the exchange to the governing body of the borough under AS 38.05.305 and to the public under AS 38.-05.345. Finally, while AS 29.18 requires a survey to be conducted or paid for by the municipality for municipal selections under that chapter, it does not expressly require the municipality to survey or pay for the cost of a survey of land proposed to be exchanged.

The director's duties, particularly those relating to the giving of notice, appear to require the expenditure of some state money. Thus, the FRANK initiative prohibition could apply to this section. In the absence of statutory requirements relating to surveys, the state may be required to pay for the survey of the land subject to the exchange; this would be prohibited by the FRANK initiative.

2. Since this paragraph relates solely to planning by the borough, there would appear to be no FRANK initiative questions.

3. Since this paragraph relates solely to financing and construction of a building by the borough, there would appear to be no FRANK initiative questions.

4. This paragraph requires the state to provide rights of way to the borough for construction of necessary access roads and other infrastructure items to be built by the borough. This is a power granted to the director under AS 38.05.350. If the application is made in accordance with regulations promulgated under AS 38.05.330, it appears that there would be no required expenditure of money for the granting of the rights of way.

5. Under this paragraph, the state would be required to establish an appropriate body to consult with and coordinate the work of the borough to ensure compliance with the agreed plans. I am not sure how this body would be established; however, it appears that its duties would require travel and per diem allowances and possibly salaries. These obviously will require the expenditure of state money. Again, the FRANK initiative may prohibit this expenditure.

6. After the completion of the building, the borough will turn it over to the state to permit meetings of the legislature in the building. The borough, six months after completion of the building, will charge the state rent based upon the proportionate amount of revenue raised by the sale of bonds for the construction of the building.

There are two questions with regard to this paragraph. First, the obligation to pay rent would require an expenditure of state money. The obligation to maintain and operate a municipal building leased to the state for state purposes would

also require an expenditure of state money. Either of these expenditures could be violative of the FRANK initiative. The ultimate question would be whether they are expenditures for the physical relocation of the present functions of state government or whether they are expenditures for some other purpose. This could be the ambiguity that would justify a court's decision to look at the purpose of the initiative rather than relying on a literal interpretation of the words used in the initiative.

The second question also relates to the FRANK initiative. It seems that tying rental payments to an amount sufficient to cover debt service on a portion of the bonds equal to the ratio of borough expenditures on the building to total borough expenditures raises a strong argument that the borough is acting as a "straw man" for the purpose of the bond issuance. It could be argued that there is very little difference between the state issuing the bonds itself and the state contracting to pay the debt service on the bonds used to construct the building. A court, even if it found the payment of rent permissible under the FRANK initiative, could determine that tying the rent to payment of the bonds is impermissible.

7. This paragraph provides that, if the borough is repaid for its expenditures and if the bonds issued by the borough are retired, the borough will return the land it receives under the agreement to the state.

In order to accomplish this, the state could assume or pay off any amounts outstanding on the bond issuance; and I assume it would be the state that would reimburse the borough for its expenditures. Of course, none of this can happen until the FRANK initiative requirements are satisfied, amended or repealed.

8. This paragraph appears to have no FRANK initiative repercussions.

In conclusion, it would appear that, if I have understood the plan you have presented to us correctly, the plan could not be implemented without violating the provisions of the FRANK initiative.

KEV:jdn

CAPITAL MOVE CONCEPT

The objective of this concept is to provide a reasonable alternative plan for fulfilling the mandate of the people of Alaska to commence relocation of the capital to Willow by October 1, 1980.

1. Once the concept outlined herein is agreed upon, the Matanuska-Susitna Borough will be entitled to receive under Borough selection (or trade) a minimum of ,240 net acres within the Willow capital site area. Those 6,240 acres will be net of the areas designated in the site plan for state facilities, for streets, access roads and other infrastructure and for public use items. In return, the Borough agrees to carry out the undertakings outlined below.

2. The Borough, in consultation with the state, will prepare a basic site plan for the capital city. This plan will show the location of the state office complex, and the siting of infrastructure items to be built by the Borough hereunder. The Borough, with appropriate state input, will also prepare detailed plans for all the facilities it is to construct, including provision for their future expansion.

3. In accordance with the detailed plans, the Borough will finance and construct a building of not less than 75,000 square feet suitable for use as a part of the total state office complex, to be completed by January 1, 1981.

4. The state will provide rights of way to the Borough for construction of necessary access roads and other infrastructure items to be built by the Borough or by others hereunder.

5. The state will establish an appropriate body to consult with and coordinate the work of the Borough to ensure compliance with the agreed plans.

6. When the building referred to in paragraph 3 is completed, it will be turned over to the state for occupancy, to permit meetings of the legislature to be held at the site no later than 1981. Costs of maintenance, operation and desired alterations, if any, of this building and attendant infrastructure will be defrayed by the state commencing with the date of availability for occupancy. If revenue or other bonds to finance construction hereunder by the Borough remain outstanding, the Borough shall be entitled, commencing six months after the date of availability for occupancy, to receive rental payments for the structure not to exceed an amount sufficient to cover debt service on a portion of the bonds equal to the ratio which total expenditures by the Borough on account of the building and attendant infrastructure bears to total expenditures by the Borough under this agreement.

7. The Borough will return to the state title to lands transferred to it by the state hereunder and which have not previously been disposed of by the Borough or designated for

public (other than state) use, provided the following shall have occurred:

(a) The Borough shall have been repaid for the total amount of its expenditures.

(b) The revenue or other bonds (if any) issued for carrying out this agreement have been retired. (To accomplish this, the state may, at its option, at any time assume or pay off any amounts outstanding.)

(c) The Borough shall have regained entitlement to selection of lands equal to the number of acres originally selected or traded under this agreement.

8. Implementation of this concept is subject to obtaining any necessary approvals by appropriate authorities, together with confirmation of the powers of the parties hereto to carry out the obligations outlined.

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DAVIS, CALIFORNIA 95616

April 4, 1979

The Honorable Mike Miller
Chairman
State Affairs Committee
Alaska State House of Representatives
Pouch "V" State Capitol Building
Juneau, Alaska 99811

Dear Chairman Miller:

I am enclosing the promised specific, suggested amendments to SSHB 240 which are addressed to the questions of accountability of the Board, the rights of shareholders, and procedures for Board and Board Committee meetings. In each instance I have attempted to describe the content of the proposed amendment and to offer an explanation of why I hold the view that such an amendment would be desirable. I have then attempted to break the amendment down into its component ideas and to give the Committee an opportunity to vote them up or down. My further function in this regard is then to draft statutory language which carries into effect the decisions of your Committee.

A number of critical questions concerning SSHB 240 are <u>not</u> addressed in this transmission. We have yet to discuss the regulation of proxies, their content and the vexing issue of how they will be financed. If the legislature desires to influence these thorny problems, now is the only opportunity. Another unfinished item is the future political activities of the GSOC. We can anticipate substantial first amendment problems if we embark on a project to muzzle the directors in their individual capacities. If the directors can speak to the public, the limitation on the "corporation's political activities" is, at best, theoretical. Working on this problem should present quite a challenge!

Finally, there are the proposals I advanced on the first evening of my testimony regarding criminal liability of directors in certain instances. I will work on these in the course of the next week.

If I may offer a suggestion: As I spend more and more time with SSHB 240 and the Alaska Business Corporations Act the more I become convinced that the better course is not to amend the existing corporations code to make room for the GSOC, but to begin anew and design a fully developed Code to regulate the GSOC, a set of laws designed with the special attributes of a general stock ownership corporation in mind and not as an afterthought. This project sounds bigger than it will turn out to be. I sincerely believe that working with your staff people it could be accomplished in a matter of weeks, although I would prefer to have the summer months to fine-tune the statute but, in the final analysis, having come this far with you, I am the servant of the Committee.

I hope that this material proves of use to the Committee. When you have reached your decisions simply mail them back to me and I will sit down and draft the content of suggested legislation.

The Honorable Mike Miller
Chairman
State Affairs Committee

April 4, 1979

May I take this opportunity to thank you, the other members of the Committee, the various nonmembers who sat in on our discussions and the staff people for a splendid experience. People here have remarked that they have never seen me so energetic. One student commented that I seem to be following the "North Star." In any event, it has been an experience beyond the imagination of the scriptwriters for the "Paper Chase." I thank you all.

Best personal regards,

Sincerely,

Daniel Wm. Fessler

Daniel Wm. Fessler
Professor of Law

DWF:hf

Enclosures

TO: THE STATE AFFAIRS COMMITTEE OF THE ALASKA HOUSE OF REPRESENTATIVES

FROM: Professor Daniel Wm. Fessler, King Hall, the Law School of the University of California at Davis

SUBJECT: Suggested Amendments to Sponsor Substitute for House Bill 240: "An Act Creating the Alaska General Stock Ownership Corporation; and providing for an effective date."

DATE: April 4, 1979

Preliminary statement: At the conclusion of my appearance before the Committee last week I agreed with the members to prepare a series of written proposals for your consideration. Depending upon the sentiment of this body I will be directed in the drafting of amendments to the Sponsor's Substitute for House Bill No. 240. As will quickly become evident, it is time for the Committee to make some basic choices concerning the nature of the General Stock Ownership Corporation which it may wish to pass to the floor for consideration in the whole House. The suggestions which follow represent nothing beyond the scope of our discussion last week unless specifically indicated as "NEW." In each instance I will set forth the proposal and a brief statement illustrating specifically what it is that I am suggesting be accomplished if you elect to follow my recommendation.

I. SUGGESTIONS DESIGNED TO MAKE THE BOARD OF DIRECTORS MORE RESPONSIVE TO THE DESIRES OF SHAREHOLDERS OF THE GENERAL STOCK OWNERSHIP CORPORATION:

My perception of the need for revision: The pending proposal is that the legislature create the AGSOC as a "private" corporation essentially regulated under the terms of Chapter 05 of the Alaska Statutes (The Alaska Business Corporation Act). As I indicated in my testimony, this general statute is a bare bones version of the "Model Act" which is, in turn, fashioned after the

Illinois Business Corporation Act. Its essential feature is to give a corporation a license to create a very strong board of directors, a board which is effectively insulated from shareholder pressure during its tenure in office.

This is a crucial assertion. Once this corporation is created and deemed "private" the legislature will part with its major chance to have an effective voice in the behavior of such an instrumentality. If the GSOC is a successful economic venture the power of that unchecked body will rise dramatically and its ability to pursue conduct which subsequent legislatures may deplore is a real danger which ought to concern this present body.

Why is the board of directors of a corporation organized under a statutory framework such as the Model Act virtually unchecked in these circumstances? To begin our assessment we should think in terms of the content of three documents: the statutory framework, the articles of incorporation, and the bylaws. It is no accident that the Kelso Report presents this legislature with a package containing a recommended content for each of these essential documents. Here is a point the Kelso Report does not stress: the legislature has control only over the statutory framework (the enabling legislation now before the Committee). Once the GSOP is formed by this legislation, the incorporators (See, Sec. 10.50.010(a), p. 1 SSHB 240) will adopt the articles of incorporation and it will then be beyond the powers of this or subsequent legislatures to interfere with the content of that fundamental document. Once the incorporators have elected themselves as the initial board of directors (See, Sec. 10.50 030(b), p. 3 SSHB 240), they will act in that capacity to adopt the content of the bylaws. Again, it will be too late for the legislature to exert its will. Thus unless changes are made you will have surrendered to these nine appointed individuals sole determination over the content of the documents which will become the framework in which the corporation will actually be structured and function. Your only chance for effective influence

is with respect to the content of the statute. If you adopt the current content of House Bill 240, you will hand these appointed individuals (only a majority of whom need be Alaskans) a blank check to narrow their accountability to all of the citizens of this state in their capacities as shareholders in the GSOC. The express terms of SSHB 240 already give to this Board the strong power position of "classification" meaning that the directors will serve three year terms with the nine members segregated into three classes so that only one third of the membership is up for election by the shareholders at each annual meeting. (See, 10.50.030(a)(b), pp. 2-3 SSHB 240). There is a pragmatic advantage in this proposed classification in that insures to the incumbent board the continuity inherent in the fact that a working majority of the Board will not be facing election. There is also a grave danger. Such a Board could ignore the wishes of a majority of the shareholders and yet maintain effective control and management over the corporation for two years. The people in their role as shareholders would be powerless. This body in its role as representative of the people would be equally powerless. True, it could deny the GSOC cooperation to the extent that it was requesting the legislature to call for an election to authorize a state guarantee of GSOC debt instruments (although see the Memorandum of Attorney General Gross under date of March 20, 1979, raising a question as to whether recourse to the people would actually be required). Yet this is a very indirect way of attempting to discipline the Board or correct the excesses of that body as viewed from the perspective of the legislature. I do not wish to belabor the point: if the members of this House feel that a different distribution of power as between the shareholders and the board, and as between the GSOC and the government of Alaska is desired . . . now is the time to act and the content of the enabling legislation is the proper forum for that action.

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PROPOSALS DESIGNED TO INCREASE THE ACCOUNTABILITY OF INDIVIDUAL DIRECTORS AND THE BOARD AS AN ENTITY:

PROPOSAL NUMBER ONE: THAT DIRECTORS BE SUBJECT TO REMOVAL BY ORDER OF A SUPERIOR COURT UPON SUIT BY 100 OR MORE SHAREHOLDERS OF THE GENERAL STOCK OWNERSHIP CORPORATION.

I propose that the enabling legislation be amended to provide that a superior court may, at the suit of 100 shareholders or more or upon petition of the attorney general, remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation and may bar from reelection any director so removed for a period prescribed by the court. In any such proceeding the corporation should be made a party to the action.

Explanation: This proposal is based upon Section 304 of the 1977 California Act with two important modifications: first, I propose that you alter the "standing requirement" from California's [". . . shareholders holding at least 10 percent of the number of outstanding shares. . . ."] to one hundred shareholders. To follow the California percentage would be most unreal given the total diffusion of shareholdings in the GSOC (one share per resident). It would require a petition of 40,000 Alaskans or more! In any other private corporation it is perfectly possible for a single shareholder to own 10% or more of the outstanding shares and thus have standing under the California Act. Requiring one hundred Alaskans to join in this suit should ensure that a single angry shareholder could not inaugurate a vexatious complaint. The second modification is to specially grant to the Attorney General standing

to initiate this removal litigation. I do this because while the attorney general may well have personal standing as a resident of Alaska to join in such a suit we must recognize that litigation may be costly and that frequently only the office of the attorney general may have the human and financial resources to prosecute a removal suit upon which may depend the welfare of the corporation (and with that, welfare and interests of Alaskans).

Now it must be immediately evident that this type of removal can only be for the most gross violations of the fiduciary responsibilities assumed by a director and that the statute only grants standing to potential litigants and subject matter jurisdiction to the superior courts. Naturally, the plaintiffs would have to prove the allegations of their complaint by a preponderance of the evidence before the superior court would be warranted in exercising the power vested in it by this statute. I should add that it is quite possible that if the legislature does not act to provide for removal of directors in circumstances such as are covered by this proposal, a superior court might entertain such suits on a theory that such a grave matter is within the court's inherent jurisdiction. There is precedent. See, California Fruit Growers' Assn. v. Superior Court, 8 Cal.App. 711, 97 Pac. 769 (1908). In my opinion, this is not a desirable alternative because the legislature would be without control over the vital questions of who had standing to initiate the litigation and what would be deemed sufficient grounds for this grave remedy.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of having directors subject to removal by order of a superior court? YES ____ NO ____. If "yes," is the Committee in favor of the proposed formula

granting standing only to one hundred or more shareholders? YES ____ NO ____. Does the Committee favor granting standing to the Attorney General of Alaska to initiate a removal suit? YES ____ NO ____.

PROPOSAL NUMBER TWO: THAT ANY DIRECTOR OR THE ENTIRE BOARD MAY BE REMOVED BY THE SHAREHOLDERS WITHOUT CAUSE.

I propose that at any annual meeting or a special meeting properly noticed for the purpose at which a quorum is present, a majority of the shares voting in person or by proxy may remove the entire board and elect replacement directors. I further propose that the shareholders have power to remove less than the entire board provided there are appropriate safeguards to minimize the chance that an angry faction of shareholders could oust a single director.

Explanation: Both California and Delaware have found it expedient to pass recent legislation enabling shareholders who have lost confidence in the Board of Directors to remove either the entire Board or individual members at a meeting especially called and noticed to entertain such a motion, and that such removal may be for any cause deemed sufficient by a majority of the shares. In both California and Delaware, the statutes grant the right of removal to an absolute majority of the shares (50% plus 1 share). Again, we must recognize that there may be individuals or institutional shareholders who, though a handful in number, would command an absolute majority of the outstanding shares. Such a potential coalition of large shareholders is a strong check upon the Board of Directors. Unfortunately, there will be no such potential shareholder

coalition in the GSOC. We must deal with the fundamental characteristic of a corporate entity, the shares of which are held in lots of one . . . and by more than 400,000 individuals.

The Kelso Report recognizes the problem of human inertia inherent in such diffuse shareholdings when it proposes to set a quorum for shareholder attendance at annual and special meetings at one third of the shares voting either in person or by proxy (an absentee ballot). At any meeting at which such a quorum is ascertained to be present, a vote of a majority of that quorum is sufficient to elect directors. Simple arithmetic will reveal that a simple majority of one-third is one-sixth of the shares plus one. Such a scheme is permitted by Sec. 10.05.153 of the Alaska Business Corporation Act if the articles of incorporation are so drafted. I favor this aspect of the proposed articles contained in the Kelso Report because I fear that setting a higher quorum requirement might preclude the shareholders from effectively meeting. How then does this guide us as to the machinery for removal of directors by shareholder vote? I propose that the entire board might be removed for any reason either at an annual or special meeting of shareholders for which notice of such a proposal had been given (as provided in Sec. 10.05.141) upon the vote of a majority of a quorum of the shares present in person or by proxy.

If the shareholders desire to remove less than the entire board, we have a different problem. Here is a danger that a special interest group or other faction might attempt to gang up on a single director for his or her policies and seek to accomplish this at a special meeting which may well be attended by fewer shares than were present at the annual meeting which elected the targeted director. We can guard against this possibility by drafting the statute to provide that in the event that there is an attempt to remove less than the entire board, the resolution shall fail

unless the number of shares cast for rem[illegible] exceeds the numbe[illegible] of shares which originally elected the director. Thus if he was elected by a majority of 261,000 shares at an annual meeting, a special meeting noticed to entertain a removal resolution would not accomplish that objective unless 261,001 shares voted "yes" (in person or by proxy) on that question. If the director was appointed (as in the case of the initial Board), or elected by the Board to fill a vacancy arising by death, incapacity, or resignation mid-term, I would propose that a simple majority of a quorum would be sufficient to remove that director.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of having directors susceptible of removal by vote of the shareholders? YES ____ NO ____. If so, is the Committee content with the suggested formula for that removal? YES ____ NO ____.

PROPOSAL NUMBER THREE: THAT THE ENABLING ACT REGULATE THE STANDING OF SHAREHOLDERS TO INAUGURATE ACTIONS AGAINST DIRECTORS OR OFFICERS BROUGHT FOR THE BENEFIT OF THE CORPORATION (SHAREHOLDER'S DERIVATIVE ACTIONS).

I propose that the enabling act be amended to regulate the standing of shareholders to inaugurate actions seeking declaratory relief or money damages as against officers and directors of the GSOC for the benefit of the corporation (shareholder's derivative actions); lodge discretion in the superior court respecting whether and in what amount a security bond for expenses of litigation should be required of such a plaintiff; preclude non-judicially approved out-of-court settlements of such actions; and, provide for an accounting to the corporation of any proceeds received by the litigating

shareholder(s) whether by judgment, settlement, or compromise.

Explanation: One of the most important developments in the past half century in seeking to hold directors and officers accountable for harm they bring upon the corporation is the concept of the shareholders' action or derivative suit. If you adopt the hypothesis that the Board or certain of its members is guilty of action or inaction which has brought great harm to the GSOC and which violates the duties of care or loyalty to the corporation, it is unrealistic to assume that those very directors will authorize or encourage corporate counsel to bring an action naming them as defendants! For this reason it is necessary to give individual shareholders the right to bring the litigation in the name of the corporation. Any recovery of money damages goes to the corporate treasury, not to the litigating shareholder (save for reimbursing him/her for the costs of the litigation).

Nearly every jurisdiction permits such actions and most regulate the conduct of such litigation by statute. Alaska is one of the few jurisdictions which permits but does not regulate by statute. Fortunately, the Supreme Court has acted to fill this void by providing in Rule 23.1 of the Civil Rules certain regulations for derivative actions by shareholders. (Added by Supreme Court Order 258, November 16, 1976.) The Alaska rule is predicated upon and nearly identical to Rule 23.1 of the Federal Rules of Civil Procedure. In my opinion, it does not go far enough in policing derivative actions by shareholders in the context of the General Stock Ownership Corporation.

The matters which should be covered by statute include:

* Who among the shareholders may bring such an action?

I suggest that standing be limited to a shareholder who held his or her share at the time of the transaction of which complaint is made

else an unscrupulous shareholder might merely "buy a lawsuit." And standing should be limited to a shareholder or shareholders with sufficient resources to be able to vigorously prosecute the action since a judgment will bind all of the other shareholders by its result.

* Should the shareholder be required to exhaust intra-corporate remedies (e.g., make a demand upon the Board that it bring the action) as a precondition to commencing the action?

Modern statutes do not require the shareholder to make demands upon the Board if that would be a futile act (e.g., if the directors are named as the defendants it is unlikely that they would respond to the demand by directing suit against themselves). Thus I would propose that the shareholder be required to make demand upon the Board for corrective action or to allege in his complaint before the superior court the reasons why he deems such a demand to be a futile gesture.

* Should the shareholder be required to post a bond as a precondition to maintaining any derivative action?

Defending a derivative action is time consuming and expensive and there is always a danger that a shareholder will bring an ill-founded or vexatious action simply to harass management or in the hope that he will be "bought off" with an out-of-court settlement. To minimize the instance of such "strike suits," many states in the 1940's adopted the practice of requiring a litigating shareholder to post a bond as a precondition to maintaining the action, a bond which would hold the defendants harmless against their costs of litigation (including attorney's fees) in the event the shareholder should fail to prevail. There is no current Alaska law on this point. Rule 23.1 is silent. My suggestion is that the Committee borrow the best

features of modern California and New York statutes on striking a balance on this vital question. Section 800 of the California Act leaves the trial court with substantial discretion to entertain a timely motion from defendants for the posting of such security. Thus the court could consider the nature of the plaintiff's allegations and project the likelihood of success. It would then exercise sound discretion in requiring that a bond be posted or in denying the request of the defendants. If a bond is required the court has further discretion to determine the amount of the bond. California presently limits the bond to a sum not more than $50,000. This ceiling is viewed as posing some protection against a judge who would simply price the plaintiff out of court with a bond requirement substantially beyond reasonable means. Again, the California Act provides that the amount of the bond may be raised or lowered (subject to the $50,000 ceiling) at any time during the course of the litigation upon the motion of either party or upon the court's own initiative as it seems the interests of fairness so require.

* Should the shareholder who has commenced a derivative action be allowed to compromise or "settle out of court"?

No, not in my opinion. This is very dangerous and tolerates "strike suits"--actions commenced with no solid ground but with the hope that management will tire of the time and expense of defending the litigation and "buy plaintiff off." New York is far ahead of other jurisdictions in warding off this danger. No action in the nature of a derivative suit may be settled or compromised without the approval of the court in which it was commenced and without notice to the other shareholders. This last feature is essential to protect the interests of both the court and the other shareholders. The court is protected

for a judicially approved settlement precludes any shareholder from attempting to relitigate the same questions. The notice requirement permits other shareholders to come forward and object either to the terms of the proposed settlement or to offer to take up the suit and carry it forward in the event of an afterarising unwillingness of the original litigant.

* Should the litigating shareholder in all circumstances be forced to account to the corporation for any proceeds realized from such an action?

Yes. In all jurisdictions this is mandatory if the court returns a judgment against the defendant officers or directors. All proceeds of the judgment are paid into the corporate treasury on the theory that the action has vindicated harm done to the corporation and not the litigating shareholder. The shareholder receives an allowance from these funds sufficient to cover the costs of the litigation. But what if the resolution is by way of an informal settlement? This is the dark side of this type of litigation. Frequently shareholders are offered a tidy sum (e.g., $20,000) if they will dismiss their suit. They keep the money and none of the other shareholders are the wiser. New York simply prevents this. There can be no informal settlement. Any dismissal predicated upon a compromise must be presented to the court, its terms noticed to the other shareholders, and any proceeds paid into the corporate treasury.

If all of these features are incorporated into the enabling act, I am of the view that Alaska will have the best of all possible positions with the virtue of derivative actions and none of the vices inherent in strike litigation.

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DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of permitting derivative actions by shareholders in the General Stock Ownership Corporation? YES ____ NO ____. If "yes," does the Committee favor regulating the derivative action by special provisions in the enabling act? YES ____ NO ____. If "yes," does the Committee favor:

* The suggested standing rules? YES ____ NO ____.
* The suggested provision on exhaustion of intra corporate remedies? YES ____ NO ____.
* The suggested provision on the posting of a security bond for the defendants' costs of litigation? YES ____ NO ____.
* The suggestion that there be no compromise or dismissal of such an action without court approval? YES ____ NO ____.
* The suggested provision that the litigating shareholder in all circumstances be forced to account to the corporation for any proceeds realized from such a derivative action? YES ____ NO ____.

II. PROPOSALS DESIGNED TO INCREASE THE INFORMATION AVAILABLE TO AND THE POTENTIAL ROLE OF SHAREHOLDERS IN THE GENERAL STOCK OWNERSHIP CORPORATION.

PROPOSAL NUMBER FOUR: THAT THE ENABLING ACT BE AMENDED TO PROVIDE LIABILITY FOR AN OFFICER OR AGENT WHO WRONGFULLY REFUSES TO ALLOW A SHAREHOLDER, OR A SHAREHOLDER'S AGENT OR ATTORNEY, TO EXAMINE AND MAKE EXTRACTS FROM CORPORATE BOOKS AND RECORDS.

I propose that an officer or agent who refuses to allow a shareholder or the agent or attorney of a shareholder to examine and make extracts from corporate books and records

of account, minutes, and record of shareholders, for a proper purpose be made liable to the aggrieved shareholder for the penal sum of $1,000 in addition to other damages or remedy given such shareholder by law.

Explanation: Currently Sec. 10.05.240 of the Alaska Business Corporations Act confers upon shareholders a right to examine books and records. Section 10.05.243 provides a penalty for any officer or agent of the corporation who refuses to permit this inspection. Unfortunately, the penalty there provided (10% of the value of the shares owned by the aggrieved shareholder), is not much of a sanction in the context of the GSOC. In other contexts it may be very effective for it is obvious that the larger the number of shares owned by the aggrieved shareholder the more substantial are the consequences of denying the right of inspection. But a shareholder in the GSOC can never own more than 10 shares. Thus I propose to follow the current content of Alaska law in all particulars save for suggesting that a flat penal sum of $1,000 be established as the sanction.

The effective use of any of the shareholder checks upon management which are set forth in Suggestions One, Two and Three depend upon an effective ability to gain information as to the conduct of corporate affairs by the officers and the Board. Thus an effective right of inspection is essential. Indeed, the Committee might desire to see the penal sum imposed for each day there is a wrongful denial of the statutory right of inspection conferred by Sec. 10.05. 240.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of a statutory right of shareholders in the General Stock Ownership Corporation to inspect corporate books and records? YES ____ NO ____. Should this sum be levied: (a) per

refusal _____; or, for each day of a refusal _____?

PROPOSAL NUMBER FIVE: THAT THE SHAREHOLDERS BE GIVEN THE POWER TO INITIATE AMENDMENTS TO THE BYLAWS.

The current statutes in Alaska provide that the articles may restrict the power to adopt, amend, and repeal bylaws to the Board of Directors. The Kelso Report recommends articles which do so restrict the power to the Board and it is likely that this is what a Board would do. I propose that the enabling act be amended to reserve a power of adoption, amendment or repeal of the bylaws to the vote or written assent of shareholders entitled to exercise a majority of the voting power of the GSOC. I would also propose that the act permit the Board to enjoy this power save for the fact that the Board could not, on its own motion, repeal or amend a bylaw which had been adopted by vote of the shareholders.

Explanation: As was dramatically illustrated by the content of the Kelso Report, the document which is most likely to contain the crucial provisions which govern the structure and operation of the General Stock Ownership Corporation is the bylaws. A significant feature in what is, in my opinion, the excessive grant of power to the Board in SSHB 240 is the potential for vesting this power exclusively in the Board. The balance can be redressed by simply amending the enabling act to provide for a sharing of this power in the case of a General Stock Ownership Corporation.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of permitting the shareholders to adopt, amend or repeal bylaws in the General Stock Ownership Corporation? YES ____ NO ____. If "yes," does the Committee favor the

suggestion that this power be vested by statute in both the shareholders and the Board? YES ____ NO ____.

III. PROPOSALS DESIGNED TO IMPROVE THE QUALITY OF BOARD DECISION MAKING.

PROPOSAL SIX: THAT THE BOARD BE ENABLED TO TRANSACT BUSINESS BY USE OF A CONFERENCE TELEPHONE OR SIMILAR COMMUNICATIONS EQUIPMENT.

Given the significant distances as barriers to travel within the State of Alaska plus the strong likelihood that a minority of the directors will be non-Alaskans, I propose that the enabling act be amended to authorize the board to transact business by use of a conference tele[illegible] or similar communications equipment so long as all members participating in such a meeting can hear one another.

Explanation: One of the difficulties inherent in a body of nine members is to physically gather them in the same place at the same time for the transaction of Board business. In large corporate entities this is frequently difficult. The result has been a tendency to permit the Board to divide itself into smaller working committees or an "executive committee" to which is delegated most of the Board's function and authority. There is a price paid for such a solution. Decisions are made without the participation of the full m[illegible]bership. Yet a non-classical solution is at hand, and from my personal observation, a very familiar aspect of life in Alaska--the use of modern communications equipment to hold board meetings notwithstanding the fact that the members are not in the same place at the same time. Both California and Delaware now permit this and the reported experience is very satisfactory. I would suggest that such a provision be made a permanent amendment to Sec. 10.05.198 for all corporations formed in Alaska. It certainly merits adoption in the special case of the GSOC.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of permitting the directors to hold meetings via the use of conference telephones or similar communications equipment with participation in such a meeting constituting presence in person? YES ____ NO ____.

PROPOSAL NUMBER SEVEN: THAT REGARDLESS OF COMMITTEE ASSIGNMENTS EVERY DIRECTOR HAVE A RIGHT TO ATTEND THE MEETINGS OF ANY COMMITTEE AND BE PRIVY TO ALL BOOKS AND RECORDS.

Current Alaska law permits the Board to divide itself into committees including an executive committee and to delegate board functions and authority. I have no quarrel with this concept but do suggest that the enabling act be amended to make it clear that regardless of committee assignments any director shall have the right to attend (but not participate in) any meeting of any committee and to have access to books and records pertaining to the activities or responsibilities of such committees as may, from time to time, be created.

Explanation: Again we illustrate what one jurist has termed the "law of laws" . . . that every advantage is purchased at a price. The desire to streamline and specialize the functions of directors is understandable but the price is the exclusion of those directors who are not appointed to key committees. Sometimes this problem assumes serious dimension as those directors who are perceived by the majority as raising vexing questions and airing dissenting views are simply shunted aside by exclusion from committee assignments. The legislature can go some distance toward minimizing this harm by providing by statute a right of each director to attend the meeting of any committee and to have access to books and records.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of granting directors a statutory right to attend the meetings of any Board committee and to have access to minutes and records? YES ____ NO ____.

END OF THIS TRANSMISSION -- SEPARATE LETTER BEING TRANSMITTED NEXT.

* * *

The danger in this lack of understanding of the corporation by most Natives is that the Native community in Alaska is becoming corporatized. As with most economically disadvantaged minorities, the Native leadership pool is limited. And the action has switched from the political to the economic front. Former political leaders, many of whom were instrumental in getting the Claims Act passed, were naturally attracted by the economic clout of the corporations —as well as the $40,000 to $50,000 salaries many top officers are paid. Because of their former political status and because of the corporations' overwhelming importance to the Native community, the firms' officers are frequently still looked upon by their shareholders as broad-based community leaders, even though their perspectives and interests have narrowed somewhat.

With a few exceptions, the Native firms are corporations just like IBM and AT&T. And, while most of the corporate leaders say they realize that part of their mission is to help preserve the traditional Native life-styles, the ultimate success of a corporation is, as Koniag's Karl Armstrong noted, determined by that one quantifiable measure—profits and losses. And as corporations were designed more for stability than for democracy, they were also designed more to protect proprietary interests than to require disclosure and openness. It is not surprising that some of the Native corporations decline to disclose the salaries of officers, for example, or that some are reluctant to discuss negotiations with oil companies, even with their own shareholders.

Given the limitations and potential pitfalls involved in the modern corporate structure, it is somewhat surprising that, during the years of debate preceding the Alaska Native Claims Settlement Act, the focus was almost solely on the corporation as the vehicle for a settlement. Remarkably, the pre-settlement debate gave no serious consideration to developing a more democratic entity that would more nearly meet the economic and cultural needs of the Native peoples. As established, the Native corporations leave important decision-making power in the hands of a few corporate leaders. The individual shareholder's sole check on the corporation is a limited one: he or she can cast a vote at the annual stockholders' meeting for members of the board of directors. As the book *Alaska Native Land Claims*, the Alaska Native Foundation's detailed analysis of the Claims Act, puts it:

> Although a corporation's stockholders are its owners, the role of stockholders in the life of a typical corporation is a very limited one. . . . What the corporation sets out to do, and how effectively it accomplishes it, is dependent upon the qualities of judgment brought to the enterprise by corporate leaders.

Although directors are elected on the basis of one person, one vote, it is difficult for stockholders in most of the Native corporations to mount effective challenges to the group in power. This is due partly to a lack of political sophistication; partly to geographical factors which make it difficult for dissidents to get together to organize their opposition; and largely to the power of corporate incumbents to use the proxy.

The level of democracy in the corporations could be improved considerably, however, if the Native firms were organized in a different corporate form—along the lines of cooperatives. Such changes could be achieved through revisions in corporate bylaws rather than through amendments to the Native Claims Act. A key to the cooperative structure is maximum decision-making power by the stockholders, rather than by a few directors and corporate managers. Because the regional corporations all have more than 1,000 stockholders, it probably would be unwieldy for them to call full meetings every time there is a policy, or major investment, decision to be made. Instead, a representative assembly of, say, 100, could be established this would not only democratize the corporate decision-making process, but also would involve more deeply a greater number of individual stockholders, thereby reinforcing the feeling that the corporation is really theirs. Art Danforth, secretary-treasurer of the Cooperative League of the United States, told us that cooperatives at their best "can be kind of like New England town meetings," in that they involve the nearest thing possible to direct democracy under the corporate structure. In a situation where the corporate structure is an unfamiliar one, such as is the case with many Alaska Natives, and where there are even language barriers, the cooperative system would be far preferable, because important decisions affecting the future of the culture would be made by a representative group of Natives rather than just by a small number of corporate managers.

During the battle leading up to passage of the Claims Act, the Native lobbyists stressed the need for a settlement that would enable the Native cultures to survive and would also allow the Natives to

prosper financially. A per capita disbursement wouldn't have made a lot of sense, since the Natives treat land used to sustain their subsistence way of life as community property. Certainly, the paternalistic Indian policies of the past—a federal agency protecting the interests of its wards—have been discredited.

But there *are* problems with the Claims Act. Some Native leaders told us that one troubling aspect of the act is that Natives born after 1971 cannot obtain stock in any of the corporations except through inheritance. Even more worrisome is the provision that allows Natives to sell their stock after 1991, which raises the specter of eventual non-Native control. For example, in the case of Doyon, the largest of the regions,[17] the value of its land alone could make a stockholder's 100 shares worth more than $130,000 in 1992. With such value, many individual stockholders may be tempted to sell. Finally, there is an obvious built-in conflict between the goals of protecting a way of life and making profits. And some Natives have expressed the worry that the end result of corporatizing Alaska's Native people could be the same thing that happened when the Menominee Indians of the Midwest had their tribal status terminated and had land from their former reservation in the Menominee Forest turned over to them and corporatized. As the Native American Rights Fund described the aftermath of the Menominee Termination Act signed into law on June 17, 1954:

> The tribal assets were turned over to a new corporation, Menominee Enterprises, Inc. (MEI), and suddenly Menominee survival was based on knowledge of a complicated corporate style of living including: par value stocks, voting trusts, income bonds and shareholders' rights. . . .
>
> The effects of termination and corporate-style management of Menominee assets pitted brother against brother and parents against their children. It increased the poverty of most individual Menominees, created political turmoil, and brought on economic chaos. . . .

[17] The approximate amount of land due to each of the regions (including villages within the regions) under the Alaska Native Claims Settlement Act is: Doyon, 12 million acres; Calista, 6.2 million; Arctic Slope, 5.1 million; Bristol Bay, 2.9 million; NANA, 2.2 million; Cook Inlet, 1.2 million; Ahtna, 1.7 million; Aleut, 1.3 million; Koniag, 1 million; Chugach, 920,000; Bering Straits, 2.1 million; Sealaska, 200,000.

The approximate amount of federal and mineral royalty money that will go to each region under the Claims Act is: Sealaska, $200 million; Calista, $165 million; Doyon, $115 million; Bering Straits, $85 million; Cook Inlet, $75 million; Bristol Bay, $65 million; NANA, $60 million; Arctic Slope, $48 million; Aleut, $40 million; Koniag, $40 million; Chugach, $15 million; Ahtna, $12 million.

MEI, as well as individual Menominees, were forced to sell corporate shares and land in order to pay county and state taxes. As a result, acres and acres of the heartland of the magnificent Menominee forest were sold to non-Indians and Menominee reservation lands fell into the hands of non-Indian developers who destroyed religious sites and the cultural character of the community.

The report went on to note that unlike the Alaskan Natives, the Menominees did not have actual control of the corporation; this instead was handled by "non-Indian businessmen and so-called experts . . . to insure its success." Also, the Menominees faced immediate taxation of their lands, while the Alaska Native corporations have no such problem on undeveloped lands until 1992. Eventually, the Menominees asked restoration of their tribal status so that they could hold on to some of their financial assets, land, and tribal culture.[18]

Although there are differences in the Menominee and Alaska settlements, there are enough similarities to make the future uncertain for some of the corporations and the Native cultures. Yet, despite all the legal snafus and internal conflicts within the corporations, there still is no question that the Land Claims Act has given the Alaska Natives more political and economic clout than any minority group in the U.S. has ever commanded in one state. An orientation speech that was given by management for workers on the trans-Alaska oil pipeline illustrates this:

> Now, then, you may come upon a small Indian village of twelve or fifteen families somewhere up along the Yukon. You are to treat these people with respect. When you see them you may wonder why you are to treat them with respect. Well, we can give you three very good reasons. First, because they are people. Second, because they were here first and they owned the land before we did. Third, because their Native Land Claims corporations have got the money to hire the best legal talent in the United States.

There is an old Native saying that, "The way to beat the white man is with the white man's tools." As NANA's Hensley put it: "Anything that came along that helped us survive, we took ahold of it." The corporation, he told us, is just another of the white man's

[18] In the event the Alaska Native corporations ran into financial difficulty, what would the federal government's responsibility be, if any? Law professor Monroe E. Price, of the University of California, Los Angeles, noted that the situation is unclear. "No one knows what continues to be the relationship between the Alaska Native and the United States after the implementation of the Alaska Native Claims Settlement Act."

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

March 30, 1979

Frances A. Ulmer
Director
Division of Policy Development
and Planning
Pouch AD
Juneau, Alaska 99811

Dear Fran:

We want to correct a statement made recently to you in a memorandum from Avrom M. Gross, Attorney General, by Joseph K. Donohue, Assistant Attorney General. The date of the memorandum is March 19, 1979, and the subject is "Policy and Legal Issues Surrounding AGSOC Legislation". On Page Three, at the end of the first paragraph, there is the following statement:

> "The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS."

This statement is not accurate.

Our contract with the Alaskan Legislature specifically prohibited investigation into potential investments. See Page Two of the attached proposal which became part of the final contract.

Subsequently, Amendment I to the contract provided for:

> "(F) The contractor shall provide an analysis demonstrating how a direct investment in a pipeline would be made by an Alaskan General Stock Ownership Corporation."

We are quite sure that our oral testimony before various legislative committees has never indicated a recommendation for purchase of BP's interest in TAPS or any other investment opportunity.

In commenting on the urgency, as we see it, of getting the legislation enacted in the present legislative year, we have noted only that rapidly shifting world politics could affect the availability of an investment like the BP interest in TAPS, should the Board of AGSOC and the legislature conclude that particular acquisition to be of interest. That comment was not intended to be a recommendation, nor were recommendations requested of us.

We have not yet seen the text of the memorandum by Mr. Donohue, and we may well have other comments when we do.

We hope that this will help to clarify our interest.

With best regards,

Sincerely,

Louis O. Kelso

John A. Miskimen

LOK/JAM:ch
Encls.

CONTRACT BETWEEN

STATE OF ALASKA
LEGISLATIVE FINANCE DIVISION

AND

KELSO & CO., INCORPORATED
111 Pine Street
San Francisco, California 94111

The parties to this agreement are (1) the LEGISLATIVE FINANCE DIVISION, hereinafter referred to as the "State", and (2) KELSO & CO., INCORPORATED, hereinafter referred to as the "Contractor".

THE PURPOSE OF THIS AGREEMENT is to provide the consulting services described herein to the Alaska State Legislature.

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I - STATEMENT OF WORK

(A) The Contractor shall provide a design study for a General Stock Ownership Plan in the manner described in the Contractor's proposal to the State of Alaska, dated July 10, 1978, as amended by the deletions indicated on the attached copy of said proposal.

(B) The Contractor shall provide draft proposals of the State and Federal legislation necessary to implement the General Stock Ownership Plan developed in the design study.

(C) The Contractor shall provide an analysis of the possible adverse effect upon the flow of Federal aid due to the successful establishment of an Alaskan General Ownership Plan and recommendations for dealing with this potential problem.

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7484

(D) The Contractor may purchase the services and provide for the expenses of other consultants or professionals selected with the written approval of the Project Director.

(E) In the event of any conflict between the amended proposal and this agreement, this agreement shall govern.

CLAUSE II - PERIOD AND DATES OF PERFORMANCE

(A) The Contractor shall submit the study and proposed legislation on or before February 1, 1979. The report shall be submitted in duplicate in a form suitable for offset printing to the Project Director.

(B) The period of this contract shall begin on the date it is executed by all parties and terminated on February 1, 1979 unless extended or terminated by written agreement.

CLAUSE III - PROJECT DIRECTOR

The Project Director shall be _____ c/o Legislative Finance Division, Pouch WF, Juneau, Alaska 99811.

CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT

(A) Contractor's total compensation, including all expenses for the work described in Clause I, shall be $180,000, and shall be payable to the Contractor as follows:

(1) On the date this contract is executed, August 25, 1978: - $30,000.

(2) The payment of the balance in monthly installments of $30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.

(3) Out-of-pocket expenditures approved in advance by the State of Alaska will be billed monthly and due within 15 days of billing therefor by Kelso & Co.

CLAUSE V - PROGRESS REPORTS

The Contractor shall keep the Project Director informed as to the progress of the work performed under this agreement.

CLAUSE VI - RECORDS, DOCUMENTS, AUDIT

All documents, reports and writings produced in the course of the work performed under this contract are, upon delivery to the Agency or at the termination of this agreement, whichever occurs first, the property of the Agency.

CLAUSE VII - ALL WRITINGS CONTAINED HEREIN

This agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this agreement shall be deemed to exist or to bind either of the parties to this agreement. Contractor understands that State shall have an unlimited license, without further compensation, to reproduce and use all materials containing any claims of copyright by Contractor.

IN WITNESS WHEREOF, the parties have executed this agreement on the dates indicated below.

KELSO & CO., INCORPORATED
111 Pine Street
San Francisco, CA 94111

Louis O. Kelso _____ _____
President & Chief
Executive Officer

_____
Date

THE STATE OF ALASKA

Sen. Mike Colletta _____ Date
Chairman, Legislative
Budget & Audit Committee

Sen. John Sackett _____ Date
Chairman, Senate
Finance Committee

Rep. Steve Cowper _____ Date
Chairman, House
Finance Committee

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

PROPOSAL TO THE STATE OF ALASKA TO PROVIDE A DESIGN STUDY FOR A GENERAL STOCK OWNERSHIP PLAN FOR USE IN FINANCING THE ACQUISITION AND/OR DEVELOPMENT OF SELECTED ENTERPRISES INVOLVED IN THE DEVELOPMENT OR EXPLOITATION OF THE RESOURCES OF THE STATE OF ALASKA IN SU H MANNER AS TO MINIMIZE THE COSTS THEREOF AND TO BUILD THE OWNERSHIP OF SUCH ENTERPRISE, OR SIGNIFICANT INTERESTS THEREIN, INTO EVERY ALASKAN CITIZEN

July 10, 1978

INTRODUCTION

This proposal is a revision of our proposal of May 10, 1978 to the State of Alaska, forwarded in its original form under a cover letter addressed to The Hon. Steve Cowper, Chairman of the House Finance Committee of the State of Alaska. By this reference, our cover letter to Mr. Cowper of May 10, 1978, our proposal included therein and its enclosures (collectively referred to herein as the "May 10, 1978 Proposal") are incorporated herein for background purposes only, and without any intent thereby to enlarge the scope or proposed compensation contemplated by this proposal.

After conferences between representatives of the State of Alaska and officers of our firm, it has been concluded that the initial step in the overall project contemplated by the May 10, 1978 proposal should be the development of the economic and financial design characteristics, together with an analysis of the legislative, legal and economic requirements for enabling the State of Alaska and its citizens to take advantage of the resulting device, which we refer to in our proposal of May 10, 1978, and refer to in this proposal as "Alaska General Stock Ownership Corporation", or "AGSOC" for short. We understand that the State of Alaska will be under no obligation to implement the plan thus developed, or any variation of it that may, in the future, recommend itself.

The thrust of the work proposed to be undertaken pursuant hereto is the development of the design characteristics of an institution capable of being used by the State of Alaska to build into its citizens individually the equity ownership of some predetermined portion of the capital facilities developed or constructed from time to time to exploit and to realize the economic value of the resources of the State of Alaska. In this initial phase, we are not to concern ourselves with particular potential investments nor with specific activities designed to educate or test the opinion of particular groups of people on any of the aspects of the design which it is the purpose of our study to develop and recommend to the State of Alaska. The focus is to be upon design, and upon the identification and solution of legislative (state and federal), legal, accounting, tax, business, economic and finance problems foreseeably incidental to the implementation of the design so to be recommended.

In our work, we are to make the fullest feasible use of the facilities and talents that may be available to us through the Legislative Research Division and its staff of technicians, presently under the directorship of Mr. Greg Erickson.

PROPOSED FEE FOR OUR SERVICES IN THE ACCOMPLISHMENT OF THIS PROPOSAL

We propose as a fee for our services in developing and perfecting the design of an Alaskan General Stock Ownership Corporation, the sum of $180,000. This sum would cover not only our services and all of our out-of-pocket expenditures, but the services and expenses of consultants, selected with advance approval by the State's representatives, to participate in the project.

We propose that the fee would be payable as follows:

1. An initial retainer of $30,000 upon the execution on behalf of the State of Alaska of this proposal memorandum, thus establishing an agreement between our firm and the State of Alaska.

2. The payment of the balance in monthly installments of $30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.

An increase in a particular monthly fee (thus shortening the overall payment period) will be considered by the State of Alaska in the event approved out-of-pocket expenditures, combined with compensation for the ongoing efforts of our firm, for a particular month are materially higher than the average contemplated over the performance period.

COMPLETION OF THE DESIGN STUDY

Completion of our design study contemplated by this proposal and the delivery of a final report embodying the results thereof and our recommendations thereon to you will be made on or before February 1, 1979, assuming this proposal or any variation of it that we may negotiate is accepted by August 1, 1978. Otherwise, our completed report and recommendations would be delivered to you on or before 180 days from the date of acceptance of this proposal or of some variation of it.

Specialized consultants and subcontractors employed with the approval of whomever the State of Alaska may designate as the proper person or agency to supervise the project, would be paid by us from monies received from the State of Alaska hereunder. We anticipate that these consultants would include persons or organizations having the highest qualifications in their fields, and that, among others, these would include legal counsel skilled in the interpretation of the Alaskan and U. S. Constitutions, municipal bond counsel (who in this case would be entering a new field of counseling with respect to the use of a State agency to facilitate the distribution of stock representing private capital), State tax counsel, Federal tax counsel, accountants and lawyers skilled in the particular disciplines pertaining to problems developed by the design analysis (some of which may well be available within the State government), and other specialized talents. We assume that in every case, where the necessary talents can be found within the State government, that these would be used to minimize costs.

LEGAL PROBLEMS

A number of critical legal problems will require at least preliminary examination by the most highly qualified available experts. These will include the design characteristics of AGSOC as an agency of the State of Alaska, though intended for use to build the private and individual

ownership of productive capital into every Alaskan citizen. While the Legislature of the State can, and doubtless will for reasons of efficiency, confer exemption from State corporate income taxes and all State property and excise taxes upon AGSOC, and exemption from income taxes upon stockholders on account of dividends used to pay for stock subscribed to, careful attention in the legal and financial design of AGSOC and its relationship to its stockholders and stock subscribers will be required in order to bring such dividends within the mantle of protection of the State itself from federally imposed taxes. The theory behind the preliminary plan itself is the universally accepted financing strategy of business corporations that a sound and feasible investment is one that will pay for itself within a reasonable period of time and then, protected by good management, a sound research and development program to keep its products and services relevant to the available markets, and depreciation adequate to restore its capital instruments as they wear out, the investments will go on throwing off income virtually indefinitely. Obviously, however, capital will pay for itself much more efficiently if the buyer of capital receives the entire yield, after depreciation and operating reserves (including liquidity reserves, if necessary), than if a governmental body or bodies carve out, through corporate or personal income taxation or otherwise, income that could be used to enable the stock subscriber to pay for his stock. While it is both fair and equitable that Alaskan citizens who receive income from AGSOC stock that has already paid its acquisition costs should be taxed upon dividends they receive as spendable income, it is both rational and desirable that the rate of amortization of their non-recourse stock subscriptions not be delayed or retarded either by State or Federal income taxation. Opinions of qualified legal counsel on any relevant aspect of the Constitution of the State of Alaska or the U. S. Constitution, so far as such provisions may affect the legal or financial design of AGSOC would be obtained. Similarly, opinions of qualified tax experts on the steps needed to create a temporary immunity from Federal personal income taxation on dividends declared by AGSOC but applied by it to the payment of the subscription price on each subscriber's stock will be obtained.

It seems at the outset reasonably clear that at the most, exemption from Federal personal income taxation on dividends declared by AGSOC on its stock can be achieved only so long as neither the stock nor the dividend income itself is available for personal disposition by the subscriber or stockholder. Beyond that point, Federal legislation will be required, but it is submitted, an excellent foundation has been made for such Federal exemption. It is necessary to effectively broaden the capital ownership base of the American economy, and the Joint Economic Committee

has already officially recommended, in its 1976 Annual Report to Congress, that the rate of new capital formation be accelerated and that the base of ownership be broadened. It should be pointed out that the availability or non-availability of the Federal personal income tax exemption would not necessarily affect the feasibility of the plan itself, but rather, the length of time required for each stockholder's stock to pay its purchase price out of its dividends.

MEANS OF IMPROVING THE PROBABILITY OF FAVORABLE FEDERAL PERSONAL INCOME TAX EXEMPTION ON DIVIDENDS USED TO PAY THE PURCHASE PRICE OF STOCK

The likelihood of obtaining Federal legislation within a period of four or five years, at most, during which, it is our preliminary opinion, such exemption can be achieved through the design of AGSOC as an agency of the State of Alaska, will be significantly increased if circumstances are such that similar legislation would be needed by and beneficial to the citizens of the other 49 states. Ideally, this requisite would be accomplished by the enactment by Congress of S.3223, introduced into the 95th Congress, Second Session, by the Hon. Mike Gravel, United States Senator from Alaska, on June 22, 1978 (see Congressional Record, volume 124, number 96).

SPECIFIC ADDITIONAL FEATURES TO BE ANALYZED IN THE DESIGN STUDY, WITH RECOMMENDATIONS THEREON IN THE FINAL REPORT

The definitive structure of AGSOC and the design of its trust division, within which the escrow accounts of all subscribers to its stock would be established, should be planned and analyzed. On the assumption that the General Stock Ownership Plan Trust of AGSOC would function as the exclusive, or perhaps primary market for the stock of AGSOC as it may be transferred because of the succession of generations, or for whatever reasons, then careful consultation with the best available expert on stockholder relations would be held in order to foresee and, so far as possible, to avoid functional problems. Advice of counsel on the implications of Alaskan inheritance laws and inheritance tax laws would be sought.

All steps necessary to acquaint the blue sky commission of the State of Alaska with the details of operation of AGSOC and to arrange in advance for compliance with the applicable requirements of that agency should be made.

The Securities and Exchange Commission would be brought into consultation to acquaint all interested divisions fully with the nature of AGSOC and its proposed operations to obtain, so far as possible, understandings as to the applicability of the securities laws under its jurisdiction to the activities of AGSOC and its stockholders. While there is not much precedent for ascertaining in advance the questions which may arise, the general interest of the Securities and Exchange Commission in investors, as distinguished from speculators, and its interest in broad-based capital ownership, provide assurances that these problems will be satisfactorily solved.

The full details of the GSOP itself must be delineated. These would include the drafting of a body of regulations acceptable to the representatives of the State with respect to the definition of "eligible citizens" under varying circumstances of residence, time of birth, change of residence, period of years of eligibility to bring about full vesting, the conditions of forfeiture of vested interests, the provisions for transfer of ownership through sale, gift, descent and distribution, or otherwise, must be included in such regulations, and their legal soundness tested from every standpoint. The question of whether such stock, until released from the GSOP trust, would be subject to "spend-thrift" restrictions must also be covered by regulations. Rights of first refusal, or provisions for calls or puts with respect to the stock by the GSOP trust under various circumstances, should be considered, and the resulting decisions embodied in regulations duly adopted by the Board of Directors of AGSOC.

The design study would include an analysis of any special rights or privileges that may be necessary or appropriate between AGSOC and the native tribes or their corporations.

We will, of course, be pleased to respond to any and all questions. If you decide to proceed with the Economic Design Study as outlined in this proposal, please provide authorization for Kelso & Co., Incorporated's services by execution of the acceptance hereof through signature by officers authorized to obligate the State hereunder and returning a copy of this memorandum to us with a check payable to our firm as our retainer hereunder for the sum of $30,000.

KELSO & CO., INCORPORATED

By_____
Louis O. Kelso, President and
Chief Executive Officer

LOK:ma

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

FINANCE DIVISION
POUCH WF–STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3795

AMENDMENT I

to the

CONTRACT BETWEEN

STATE OF ALASKA
LEGISLATIVE FINANCE DIVISION

AND

KELSO & CO., INCORPORATED

The Legislative Finance Division and Kelso & Co., Incorporated hereby amend the contract to which they are parties as follows:

1. CLAUSE I - STATEMENT OF WORK is amended by adding the following paragraph:

> "(F) The contractor shall provide an analysis demonstrating how a direct investment in a pipeline would be made by an Alaskan General Stock Ownership Corporation."

2. CLAUSE II - PERIOD AND DATES OF PERFORMANCE is amended by:

(a) deleting "February 1, 1979"; and

(b) inserting "February 15, 1979" in both paragraphs (A) and (B)..

3. CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT is amended by:

(a) deleting "$180,000" and inserting "205,000"; and

(b) adding the following sentence to subparagraph (1):

"On the date that Amendment I is executed - $25,000."

IN WITNESS WHEREOF, the parties have executed this amendment on the dates indicated below.

KELSO & CO., INCORPORATED
111 Pine Street
San Francisco, CA 94111

Louis O. Kelso

Louis O. Kelso
President & Chief Executive Officer

January 15, 1979
Date

STATE OF ALASKA

Senator Mike Colletta
Project Director

Date

Rep. Jim Duncan
Project Director

1/12/79
Date

AGSOC Plan Overhaul Advised

By NANCY HARRIS
Empire Staff Reporter

The House State Affairs Committee, wary of the power which might be vested in the board of directors of the proposed Alaska General Stock Ownership Corp. (AGSOC), has agreed that a new set of laws should be drafted to govern the corporation.

The committee is responding to a warning from a University of California law professor that the Alaska Business Corporations Act is not designed to control a corporation such as AGSOC and that its board members could become the nine most powerful persons in Alaska.

Professor Daniel Fessler last week sent the committee proposed amendments to legislation setting up AGSOC which he says are designed to make the board of directors more responsive to corporation shareholders.

In addition, the panel agreed that a new chapter under Alaska's corporations laws should be drafted to deal specifically with general stock ownership plans.

The committee has held a series of hearings on the AGSOC proposal since early March, but just last week started addressing specific changes in the legislation. Identical bills introduced in the House and Senate (HB240 and SB170) were drafted from a plan produced for the Legislature by Louis Kelso, an economist who fathered the idea of general stock ownership plans.

The measures, as introduced, only set up the framework for the corporation, which would be a private business in which all Alaskan residents would be shareholders.

Under the AGSOC proposal, the state would loan the corporation several million dollars to finance start-up costs. The initial board of directors would be appointed by the governor and would adopt articles of incorporation and bylaws.

Fessler cautioned the committee that once the corporation was launched, the legislature would have no further say in how it is run and that AGSOC's citizen shareholders would have little power to affect corporate decision-making.

The committee decided to build restrictions on the AGSOC board into the enabling legislation, while at the same time working to keep it an entirely private corporation.

Amendments tentatively agreed to by the committee include:

—Giving shareholders power to initiate amendments to the corporation's bylaws. Under current law, a corporation can restrict

Continued on Page 2

AGSOC...

Continued from Page 1

that power to its board of directors. Fessler said the AGSOC board would be likely to adopt that restriction, but that could be prevented by giving the power to shareholders, also, in the enabling legislation.

—Requiring legislative approval of the articles of incorporation and bylaws adopted by the first board.

—Restricting AGSOC's ability to lobby and campaign. Representatives of the administration, and others, have expressed fear that AGSOC could create a powerful lobby by the citizen shareholders to repeal taxes and restrictions on industries the corporation invested in.

—Limiting the initial loan guarantee fund to strictly "start up" expenses not to exceed $5 million. The legislation currently does not spell out what the initial appropriation would be used for. Some lawmakers are concerned that the corporation would have to keep coming back to the state for more money and that there were no safeguards to prevent a drain on the state's treasury.

—Requiring a voter referendum for later appropriations and loan guarantees.

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS
GREENSBORO, N.C. SAN FRANCISCO

April 10, 1979

The Honorable Mike Miller
Chairman, State Affairs Committee
Alaska State House of Representatives
Pouch V
State Capitol Bldg.
Juneau, Alaska 99811

Dear Representative Miller:

We are writing you to comment upon the principal items covered by the memorandum from The Honorable Avrum M. Gross, Attorney General (by Mr. Joseph K. Donohue, Assistant Attorney General), to The Honorable Frances Ulmer, Director of the Division of Policy Development & Planning, under date of March 19, 1979. We understand this memorandum has been considered by both State Senate and State Assembly Committees, but is presently before the State Affairs Committee. The subject of the memorandum is "Policy & Legal Issues Surrounding AGSOC Legislation (SSSB 170 and SSHB 240)". The memorandum states that it is in response to a request from The Honorable Frances Ulmer for a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently pending before the legislature.

The memorandum itself, the care and astuteness used in its preparation, and the wisdom of Miss Ulmer in requesting it, all attest the high degree of responsibility and thoroughness with which the legislature is studying the AGSOC legislation. We hope that our comments on certain of the provisions of the memorandum will prove of use to your Committee, and to others to whom you may wish to distribute copies.

For simplicity of reference, we will initiate each of our comments with a reference to the paragraph or paragraphs and to the page number in the memorandum of March 19th or 20th (March 20th being the date used on its separate pages). We will also number our paragraphs for easy reference in case you wish to ask questions or comment on this letter.

1. THE FIRST FULL PARAGRAPH ON PAGE 3

The question of whether the State should follow the policy of the federal legislation and exempt AGSOC from State corporate income tax and from certain other State level taxes which might otherwise be imposed on the corporation are, of course, precisely the kinds of questions that only the legislature can answer. There is one erroneous statement at the end of the paragraph, however, and that is that

our firm, as investment bankers, is presently recommending "the new AGSOC purchase BP's share of TAPS." We, in our instructions from the legislature, were expressly requested to avoid recommendations as to AGSOC's investments, although, basically to illustrate feasibility, we believe, we were asked to do a feasibility study of that particular purchase.

In general, it will be obvious to your Committee that the taxes imposed on AGSOC at the corporate level would simply slowdown the rate at which AGSOC could amortize its debt incurred in acquiring productive investments from time to time, and thus slowdown the rate at which AGSOC is effective in building capital ownership into each Alaskan resident.

2. THE LAST FULL PARAGRAPH ON PAGE 3

In the last paragraph at the bottom of Page 3 (erroneously reproduced in our copy at the top of Page 4), it is postulated that by purporting to give each resident of the State a direct interest in the development of the State's natural resources, AGSOC would become an independent voice for more rapid exploitation of those resources, and that because the AGSOC is required to pay out substantially all of its net income to residents of the State, it "would likely" become a lobbying force for lower State taxes. We do not believe that these conclusions are by any means obvious or sound. It apparently has been overlooked that while AGSOC, as a corporation in which every resident owns an interest, is intended to build capital ownership in each such resident each resident also has other and independent interests. He has an interest in the overall tax impact on him. Thus if reducing the taxes on AGSOC raised his personal income tax, or his property tax, he would certainly take both into consideration and either of these events would undoubtedly have a far greater individual effect than lowering State taxes of the corporation of which he is a shareholder. It is inconceivable that AGSOC would become a lobbying force contrary to other basic interests of the residents of Alaska, simply because its stockholders would have ultimate control over AGSOC.

To be sure, as independent and privately owned capital is built into Alaskan residents, there will be less need for welfare and redistribution of income within the State of Alaska. The very theory upon which AGSOC is structured asserts that by enabling each resident to become, to whatever degree possible, economically autonomous and independent, such resident will be freed from the indignity of seeking welfare and other taxpayers will be freed from the unpleasant task of being forced to support strangers through taxation used for welfare purposes. These are "trade-offs" of a political and economic nature, but the underlying theory of AGSOC is that economic self-sufficiency through the ownership of income producing capital is preferable to welfare for some and redistributive taxes for others. We believe that this point should be clearly and thoroughly debated by the legislature and the question of whether the legislature prefers the prin-

ciple of capitalism or the principle of socialism should be determined.

3. THE SEVERAL PARAGRAPHS BEGINNING AT THE BOTTOM OF PAGE 4 UNDER SECTION II. FINANCING

It is represented in the memorandum that Louis Kelso testified before the Joint Committee and has stated to various Administration officials that AGSOC will be able to obtain financing on the private market without recourse to State guarantees or State credit. This is not, we believe, an accurate summary of my personal testimony and statements to various Committees and to various individuals in the legislature.

I have pointed out that in addition to start-up funding in order to make AGSOC an operating reality, it should then seek the best sources of funding available. Some investments, it is possible, can be acquired through collateral financing, or other conventional types of corporate finance. On the other hand, some investments may require support by the State or by some appropriate or appropriately created State agency. The important point to be focused upon in this area is that conventional corporate and business finance tends specifically to make the rich richer and to fail to make the poor richer. We do not see how it can be considered objectionable for the people of the State to use their collective power to assist the individual residents -- all residents at the outset and new residents as these grow in significant numbers -- by amendments to the State and federal legislation, or by the Alaskan State Legislature's specifically incorporating future AGSOCs -- AGSOC-I, AGSOC-II, etc.

The points made in the remainder of Section II should, of course, be considered by the legislature in the light of the existing Constitutional provisions and the existing State mechinery for backing up an enterprise -- AGSOC -- that is a private corporation but whose activities will address themselves to the solution of a public problem. AGSOC is a device to carry into practice preventative economic measures to avoid future poverty and to improve future affluence for Alaskan residents as a whole. We submit that these are noble public purposes and that in considering the use of the power of the State to support investments made by AGSOC, all of the income of which is commanded to be distributed to the stockholders of AGSOC, the legislature should not impose administrative barriers that would prevent AGSOC from competing effectively with giant corporations for investments. Investments of AGSOC will benefit all the residents of Alaska whereas investments of the traditional giant corporations primarily benefit the pinnacle wealth owners, a few of whom may be Alaskan residents, but most of whom will be non-residents and perhaps even non-U.S. citizens.

For our part, it would seem that the wisdom of the legislature in appropriating particular funds that can be used as guaranty funds is adequate assurance of careful review by the legislature on behalf of the people as a whole.

4. SECTION III. DEPOLITICIZING THE AGSOC BEGINNING ON PAGE 7

In general, it appears to us that the discussion here is made-up not of legal analysis primiarly, but rather of political concerns.

In the first paragraph under this item is the statement that "it should be noted that there is nothing in the federal legislation which would preclude the AGSOC's establishment as a state agency or public corporation." We believe this is a misinterpretation of the federal law, which requires that a General Stock Ownership Plan be a private corporation even though its shareholders must include, at the outset, all residents of the State as of a date selected by the legislature and as of the date of the issuance of its stock.

We disagree with the unwarranted conclusion drawn in the paragraphs at the bottom of Page 7 and on Page 8, at seq. that, if successful, AGSOC would quickly become highly politicized and an extremely powerful force -- in fact a Fourth Branch of Government. If AGSOC were permitted to accumulate its net income and thus develop a vast reservoir of funds which it could spend as its Board of Directors saw fit, then these comments might be justified. But that is precisely what AGSOC is designed to avoid. Its income is promptly translated into the income of its broad base of stockholders. It is not designed to be a powerful entity for anyone except the people of the State as a whole. As the shareholders gain power, their power to control AGSOC, through election of directors and through the power, under general law, to initiate a suit to have questioned in court a misuse of funds by AGSOC, is, it would seem to us, an ironclad guaranty that AGSOC would never become a branch of government in any form.

Because of its very size, and its potential economic importance to the enormously broad base of Alaska residents, we do not believe the speculation that ultimately one-tenth of the residents could wind-up owning all of AGSOC. One very simple reason for this belief is that if the residents do not tenaciously hold on to their AGSOC stock, the legislature is free to incorporate successive new AGSOCs and to add assurances that they do keep their individual economic power and independence.

Thus we regard it as simply improbable and unfounded speculation that any "power blocks" of residents could be established or that, if established, they could not be controlled quite easily by stockholders' derivative litigation.

With the absolute necessity that for many if not most of its investments AGSOC will look to the economic power of the State, as determined by the legislature, to give it access to federal or private credit, we think that there is no basis for imagining that AGSOC could develop a constitutency over which it has no control whatsoever. We also believe that since AGSOC must pay its income to its stockholders, and has no duty except to develop and produce wealth and to distribute

it to those citizens, that the Board of Directors or the management of AGSOC could not become a political center or political leader of any kind whatsoever.

The last paragraph on Page 8 speculates that "Although one could argue that AGSOC violates the fundamental political theory of the State Constitution which established only three branches of government****". As noted above, AGSOC is not, and could never be under the proposed legislation, a branch of government of any kind whatsoever. It is an instrumentality created by the State, just as the State creates the laws under which business corporations in general can be established, but upon which the governments, State and Federal, have imposed limitations to assure that it will work for all residents -- all stockholders -- rather than for one, or a few, as present corporate grants do. Having made a false assumption that AGSOC could be a "Fourth Branch of Government", it is natural to speculate on all the dangers that would flow from this impossible situation. The recommendation for bureaucratic regulation appears to us to be totally unwarranted and would impede the potential efficiency of AGSOC to improve the economic status -- legitimately -- of all residents of Alaska. There is no virtue in bureaucratic regulation as such. The stockholders would annually vote on directors and upon all issues put to them by the Board or by stockholder initiative. A broader and more diversified base for AGSOC could hardly be conceived. The power of AGSOC is in its stockholders, not in its Board of Directors or its management.

Sight seems to have been lost of the fact that AGSOC is meticulously designed as the new method of financing economic growth and development for the purposes of attacking the cause rather than merely the effects of poverty. This is precisely what it is designed to do and precisely what it must do under its structural regulations. That is its purpose. Since AGSOC must pay out substantially all of its earnings to its shareholders, its sole function is to connect each resident with capital ownership and income. Could a more desirable goal be conceived?

5. BEGINNING AT THE BOTTOM OF PAGE 8 AND CONTINUING ONTO PAGE 9 OF THE MEMORANDUM

The problem is raised that members of the Board of Directors of AGSOC could use their position as a forum for criticizing the Administration's economic policies and ultimately as a launching pad for State elective office.

This is not a very real concern because the only official obligation of the members of the Board of Directors of AGSOC is to develop and produce Alaskan wealth for ownership by every Alaskan resident. When members of the Board of Directors periodically run for election as such, if they are incumbents, they do so on their performance record, as does any elected official, public or private.

The freedom of particular directors and/or officers of AGSOC to criticize the State's economic policies is nothing but the Constitutional right of all U.S. citizens to free speech. Precisely the reverse exists as well. The Governor, or any Committee of the legislature, is free to criticize the investments of AGSOC. It would appear to us that the absolute dependence from time to time of AGSOC upon specific legislative provision of economic support for its investments assures that any free speech that passes between the Board of Directors of AGSOC and any branch of the State Government will be tempered with these realities in mind.

Any activity within or without the State of Alaska could theoretically be a "launching pad" for public office. But AGSOC as an entity that makes every resident more affluent will increase the possible opportunities of every resident to run for State office, and to participate in local State and community affairs. This is a more democratic basis for the State than where only a few people can afford to run for office. Does Alaska want more or less democracy?

In the first full paragraph on Page 9 of the memorandum, it is suggested that AGSOC be prohibited from lobbying and from making political contributions to candidates for State offices. We would think it entirely proper that AGSOC be prevented from making political contributions out of its funds to candidates for State office. Indeed, since it must periodically come under the scrutiny of the entire legislature and the Governor, we find it difficult to imagine that such prohibition would not be voluntarily imposed upon itself. But nothing would be lost by including such limitations in the legislation.

However, we have grave reservations about "strict proxy review mechanisms" that would cause the directors to act in "a politically neutral fashion". AGSOC is not designed to act in a politically biased fashion, nor does its design so permit. It has one function: to make each resident wealthier and to deliver that wealth to him periodically and dependably. Nothing more. What the residents of Alaska do with their wealth would seem to us to be their business.

On general legal principles, it would appear to us that any stockholder of AGSOC could institute legal action to restrain AGSOC's Board from using the potential income belonging to the residents as stockholders for the benefit -- any benefit -- of the Board of Directors.

Only totalitarian states adopt edicts to shield bureaucrats from speaking freely, but AGSOC's single purpose assures the ease of its stockholders in holding it to the performance of its sole purpose.

6. CAN AGSOC BECOME A CENTER OF CONCENTRATED ECONOMIC POWER?

This question is raised at the bottom of Page 9 and on Page 10 of the memorandum. We believe that this is random and unrealistic

speculation.

It is quite true that because of the vastness of its stockholder constituency, AGSOC should seek to invest in massive and highly productive economic developments and activities. But it is not true that this can lead to its becoming a "major force for concentration of economic power in the State***". The design of AGSOC specifically makes this impossible for the very simple reason that it is required to pay out all of its income to its shareholders. That its shareholders will become more affluent, less dependent on redistribution of wealth, less dependent on welfare, and more powerful, is elementary. But this is the same as saying that its shareholders are the ones who have the power to scrutinize, correct, and contain any potential concentration of economic power in AGSOC.

Th same is true of the risk that AGSOC may violate the Federal anti-trust laws. We have seen no lack of ability on the part of the Federal Anti-Trust Division to watch over this area of business activity. The periodic supervision by the legislature at the time it grants added support for any further investment by AGSOC assures that the State legislature itself can consider the question of whether any anti-trust monopoly action is involved. Certainly the absolute inability of AGSOC to accumulate internal funds defeats its power of ever exercising the main means by which business corporations violate anti-trust laws, namely by withholding the "wages of capital" from the owners of capital (the stockholders) and accumulating those funds to buy monopolistic power. Again, AGSOC is designed to make this impossible. We cannot conceive of the slightest need for any added limitations in this area.

We submit that the last sentence in the last paragraph on Page 10 of the memorandum, in itself, recognizes the improbability of the speculation involved in the preceding paragraphs. The fact that the stockholders of AGSOC and the people of the State are, and at all times will be identical, merely shows that AGSOC is, by its design, constrained through its broad ownership, and through the right of the legislature to launch any number of additional AGSOCs and to dry up its source of funding, designed to avoid any of the conflicts thus imagined.

Since the type of conflicts imagined in Pages 9 and 10 of the memorandum are unrealistic and cannot occur, the remedies proposed on Page 11 for this non-existent danger would seem to be entirely unnecessary. AGSOC's designed trust obligation -- to develop and produce wealth for all Alaskans -- assures that any wasteful or improper use of its resources could be enjoined by any of its stockholders under general principles of corporate law. The imagined problems simply do not and cannot exist, and if they did, they could be quickly restrained under these generally applicable legal principles.

7. PAGE 11, SECTION IV. CORPORATE DEMOCRACY

That the existence of classification of directors would limit the ability of minorities within the State to obtain representation on the Board of Directors of AGSOC is, in our opinion, without foundation in fact. Board classification is desirable to promote stable policies in corporate matters. The possibility of an entirely new Board being elected each year would be highly undesirable. Board membership will be in a corporation charged with a trust to represent all the people of the State of Alaska.

On the question of cumulative voting, we do not see, in a corporation with a stockholder base as vast as that proposed for AGSOC, that there would be any advantage in insuring cumulative voting. On the other hand, we see no disadvantage in assuring that cumulative voting must exist.

On the question of limiting the duration of any voting trusts, made in the paragraph at the bottom of Page 12, it would appear to us that this suggestion is a good one.

Similarly, providing for shareholders to initiate amendments to the Articles of Incorporation would be desirable where a substantial shareholder initiative, say 10%, or even 5%, of the registered shareholders' signatures would be required. It would not be desirable to permit a tiny handful of stockholders to upset the efficiency of the corporation in making its day-to-day decisions.

8. DESIRABILITY OF A HIGH FORUM REQUIREMENT

This would seem to us to simply impose clumsy procedures on the State's prime weapon in building preventative economic power into its citizens, i.e., measures to prevent future poverty from arising. AGSOC will be under a constant obligation to educate its stockholder constituency about the economics of capitalism and will, of necessity, become a source of economic education because it will enable, for the first time in history, every Alaskan to become a capital owner. To go further than this would seem to be probably wasteful in terms of paperwork and a pointless waste of time.

9. LESIGLATION ASSURING ADEQUATE NOTICE OF MEETINGS

In the second paragraph on Page 14 of the memorandum, suggestion with respect to this are made. We would think this entirely proper if the restriction does not obstruct reasonably efficient governance of the corporation.

10. THE CORPORATE BY-LAWS

The memorandum suggests that the power to amend the By-Laws should be reserved to the shareholders "in order to ensure adequate public review." We believe that such a provision would be too expen-

sive and too restrictive in terms of efficient governance of the corporation, and excessively wasteful of time.

11. AGSOC'S FINANCING OF PROXY FIGHTS, ACCESS TO VOTING LISTS AND VOTING MACHINERY

We believe that the suggestion made in Paragraph 8 on Page 14 would be salutary if the signatures of 10% or more of shareholders were required. Otherwise, the corporation could waste time dealing with mere adventurers.

12. SECTION V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

In this matter, covered on Pages 15 and 16 of the memorandum, we believe that the first paragraph on Page 15 is in error in stating that federal legislation mandates that the shareholder group in AGSOC be made up of a "closed class" in any realistic sense, for the simple reason that it imposes no limitation upon the number of AGSOCs which the Alaskan Legislature could authorize. Thus a longtime resident might well wind-up holding shares in ten or fifteen different AGSOCs, while those who depart the State would only own shares in those AGSOCs whose stock ownership qualifications they had previously met.

The "scenario" imagined by the author of the memorandum in the second paragraph on Page 15 is simply unrealistic. The preventative economic measures involved in establishing AGSOC that strike at the cause of poverty rather than merely at the effects of poverty hold more promise for eliminating poverty than all past measures, State and Federal, dealing with this subject, for those measures merely apply band-aids to the effects of poverty.

The problems imagined here are under year-to-year control by the legislature since AGSOC must be created by a separate act of the legislature. Other AGSOCs can be created at will by the legislature. Changes in the law concerning transferability of its stock can be made by the legislature if experience proves that such changes are warranted. It is contemplated that the full thrust of AGSOC's educational stockholder relations program will induce most stockholders to hold onto their shares as their dearest economic possessions.

We hope that the foregoing comments will be of use to your Committee in its deliberations. We would be pleased to respond to any requests for elaboration or to any questions.

Sincerely,

KELSO & CO., INCORPORATED

By _____
Louis O. Kelso

By _____
John A. Miskimen

LOK/JAM:ch

cc: The Honorable John G. Fuller,
Vice Chairman, State Affairs Committee
The Honorable Terry Gardiner,
State Affairs Committee
The Honorable Bill Parker
State Affairs Committee
The Honorable Terry Martin,
State Affairs Committee
The Honorable Ray H. Metcalfe,
State Affairs Committee
The Honorable Richard Eliason,
State Affairs Committee
Frances Ulmer, Director, Division
of Policy Development & Planning

STATE OF ALASKA

JAY S. HAMMOND
GOVERNOR

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

POUCH AD-JUNEAU 99811
PHONE 465-3577

April 19, 1979

The Honorable Mike Miller
Chairman
House State Affairs Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mike:

Attached is a briefing memo prepared for the Governor's conference call with Senator Gravel last Friday. We offer it to your committee as a source of ideas for additional amendments to HB 240. In particular, the items on pages two through four include a number of points raised by Professor Fessler and others which have not yet been incorporated into the committee substitute. The most important of these are circled. If your committee decides to pursue any of these items, Administration staff will be available to provide assitance upon your request. One point not discussed in the memo which should be mentioned is the level of state financial assistance to AGSOC. The Governor recommended and and Senator Gravel agreed that the AGSOC should not be allowed to request or receive any state financial assistance (by appropriation, guarantee, or any other method).

While the Governor has not yet resolved all of the "First Level" questions for himself, he wants to share the ideas in this memo with your committee and to provide staff assistance, so that the best possible AGSOC bill might be developed.

Sincerely,

Fran Ulmer
Director

Enclosures

STATE of ALASKA

MEMORANDUM

DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: Governor Jay S. Hammond

DATE: April 12, 1979

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: AGSOC

The following questions still remain concerning SB 170/HB 240, the Alaska General Stock Ownership Corporation bill. There are really two levels of questions. The first are the more basic philosophical questions which defy technical resolution. They must be answered intuitively. The second level involve more tangible questions which can, to a greater or lesser degree, be resolved via amendment to the bill. However, consideration of second level questions assumes that the first level questions are resolved in favor of the basic AGSOC concept and a decision is made to develop the best possible bill.

First Level

1. What are the basic goals of AGSOC? Is AGSOC the best mechanism for achieving those goals?

   Basic goals: to provide broad capital ownership by Alaskans of either existing assets or new assets involved in resource development

   to provide dividends to supplement personal income.

2. Is there any way to avoid or resolve the basic conflict of interest between residents as taxpayers and citizens, and residents as shareholders?

   Examples; purchase of oil line share - tarrif question

   development of petrochemicals - royalty prices

   construction of gasline - oil recovery

   virtually any business - any regulation.

3. With respect to the above questions, can we expect AGSOC to become an important political force? Is it appropriate or possible (first amendment rights question) to prevent this?

4. Even with the amendments contemplated by either the House State Affairs Committee or the Administration regarding corporate governance, how likely is democratic control of AGSOC?

5. What is the likely extent of state subsidies to AGSOC? What will be the impact on the state's credit rating from passage of the bill? From actual extension of state financial aid?

Should procedures and/or conditions for extending such aid be included in the bill?

NOTE: The House State Affairs Committee has requested drafting of amendments to provide for a referendum for any state financial assistance to AGSOC. No legislative approval would be required for AGSOC investment not requiring state financial assistance.

6. Is it possible to resolve/avoid the "closed class" problem created by "old" residents being shareholders while "new" residents are not?

7. How will the Governor make decisions as to who shall constitute the first Board of Directors?

8. Does the Alaskan public want an AGSOC?

Second Level

1. What should be the procedures for electing the Board of Directors?

2. Should the state allow the federal corporate income tax exemption to pass through to state corporate income taxes?

NOTE: The House State Affairs Committee has agreed to pass through the tax exemption.

3. Should there be one AGSOC per investment or project, or should there be only one AGSOC which could invest in a variety of projects?

NOTE: Senator Colletta supports the former approach; House leaders support the latter.

4. Should people who leave the state be able to take their shares with them?

NOTE: The House State Affairs Committee has decided to mandate that people who cease to be residents transfer their shares either to a resident or to the corporation.

5. Is AS 10.05 of the Alaska Business Corporation Act the appropriate "regulatory umbrella" for AGSOC, or do we need a new chapter specifically designed for AGSOC?

NOTE: The House State Affairs Committee has requested drafting of a new "GSOC" chapter.

6. Should there be a limitation on, or incentives against, litigation between AGSOC and the state (because the same people bear the costs)?

Does AGSOC possess unfair competitive advantages which could lead to anti-trust problems?

7. What are the implications for AGSOC of SEC regulations?

8. What other changes to the bill, Articles of Incorporation, or Bylaws are desired by the Governor or the legislature?

House State Affairs Committee (tentative) desired amendments:

- Chairman of the Board must be Alaska resident.

- Nine member board, seven residents, two outsiders.

- No classified board; all directors elected every two years (mechanics, i.e., proxy issues, undecided).

- Directors removable by shareholders without cause.

- Statutory provision for derivative suits.

- Require legislative approval by resolution of articles and bylaws.

- Give shareholder the ability to amend bylaws.

- Allow board business to be conducted via telecommunications.

- Every director has right to attend all board committee meetings.

- Liability for officers' refusal to allow shareholder access to corporation books and records.

- Loan guarantee fund limited to start-up costs not to exceed $5 million.

- Delete Sections 2 and 3 regarding investments of GF surplus or permanent fund in AGSOC securities. Consider amendment to AS 37.10.070 to prohibit use of subsection 6 for investment of GF surplus in AGSOC. Also delete Sec. 4 which would exempt AGSOC securities from registration under the Alaska Securities Act of 1959 and from filing of sales and advertising literature.

- Prohibit officers and employees of corporation from serving on board.

Administration working Group desired actions or amendments:

- Statutory reservation by the legislature of the right to amend the statute - impairment of contracts issue.

- Development of election procedures for the Board, including financing of proxy fights, access to voting lists and mailing machinery, and consideration of a regionalized board.

- Solution of "single class of stock" issue created by the voting rights of shares held by minors.

- Assessment of the definition of "resident" provided in the bill.

- Assessment of potential for tax liability on initial issue or otherwise to be greater than dividend.

- Criminal liability of directors in certain instances.

- Provision for cumulative voting.

- Limitation on voting trusts.

- Requirement that feasibility analysis and other information be provided to the Governor and the legislature in sufficient time before a decision is necessary on financial or other state aid.

- Details of shareholder meetings, i.e., notice, location, quorum.

- Limitation on assignement of dividend rights.

- Limitation on ability of corporation to acquire Treasury shares.

- Shareholders' ability to amend the number and terms of office of the Board of Directors.

- Directors subject to removal by Superior Court at suit of 100 or more shareholders or Attorney General for fraudulent or dishonest acts or gross abuse.

- Limitation of ownership to one share.

MEMORANDUM

To: MG

From: Jerry Gauche

Re: Markup Issues for State Affairs

Date: 4/23/79

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1. Question of whether petition signed by 100 shareholders is too open to abuse and whether the number of signatures required for shareholder nominations or ballot issues should be some higher number like 500 or 1,000.

2. Directors should be able to suggest changes in bylaws to be voted on by the shareholders even though the shareholders prposed the bylaw. Currently the bill, at page 18, line 2, restricts the board from making such proposals for one year after the meeting at which a shareholder bylaw was proposed.

3. Could allow more outside directors and still assure Alaskan control by providing that a quorum of the board may not be constituted without a majority of Alaskan directors (instead of the current treatment of requiring that only 1/4 of the board be from outside). Bill at page 18 line 12.

4. Add clause which insures that legislative disapproval

IF ARTICLES OR BYLAWS AND ANY LEGISLATIVE CHANGES TO THE GSOC CHAPTER WILL NOT AFFECT FINANCIAL COMMITMENTS OF THE CORPORATION. BILL SECTIONS 330 (PAGE 32) AND 635 (PAGE 57).

5. SUGGEST THAT TO LIMIT SHARE OWNERSHIP TO ALASKANS PROVIDE DURING FIRST YEAR ANYONE CAN GET SHARES FREE OF CHARGE, AFTER FIRST YEAR AND UP TO YEAR SIX MUST PAY BOOK VALUE. BILL SECTION 7, PAGE 60/61.

6. NEW PROVISIONS ON APPOINTMENT OF INCORPORATORS.

7. DISCUSS REMOVING THE LOBBIEST SECTION FROM THE COMMITTEE AMENDMENT REGARDING POLITICAL ACTIVITIES.

James Allen were able to create and fund the Economic and Development Corporation, a separate Swiss company, and pay $750,000 to Dr. Hubert Weisbrod, a Swiss attorney, to stimulate West German jet sales without the knowledge of the board or, apparently, other senior executives

At 3M, chairman Bert Cross and finances vice president Irwin Hansen ordered the company insurance department to pay out $500,000 for imaginary insurance and the bookkeeper to fraudulently record the payments as a "necessary and proper" business expense for tax purposes. Although the transactions lacked required documentation, they were approved by both departments and later "verified" by Haskins and Sells, the outside auditor.

Ashland Oil Corporation's chief executive officer, Orwin E. Atkins, involved at least eight executives in illegally generating and distributing $801,165 in domestic political contributions, also without question. Not only was the board not informed until the Special Prosecutor's Office and Internal Revenue Service compelled Atkins to dribble out details of the misappropriation of funds, but Ernst and Ernst, Ashland's accountants, did not effectively investigate any of half a dozen separate accounts it discovered that suggested Ashland's illegal course of action.

The Legal Basis of Management Power

The legal basis for such a consolidation of power in the hands of the corporation's chief executive is the proxy election. Annually the shareholders of each publicly held corporation are given the opportunity of either attending a meeting to nominate and elect directors or returning proxy cards to management or its challengers signing over their right to vote. Few shareholders personally attend meetings. Sylvan Silver, a Reuters correspondent who covers over 100 Wilmington annual meetings each year, described representative 1974 meetings in an interview: At Cities Service Company, the 77th largest industrial corporation with some 135,000 shareholders, 25 shareholders actually attended the meeting; El Paso Natural Gas with 125,000 shareholders had 50 shareholders; at Coca Cola, the 69th largest corporation with 70,000 shareholders, 25 shareholders

Source: Taming the Giant Corporation
Nader, Green, and Seligman

attended the annual meeting; at Bristol Meyers with 60,000 shareholders a like 25 shareholders appeared. Even "Campaign GM," the most publicized shareholder challenge of the past two decades, attracted no more than 3,000 of General Motors' 1,400,000 shareholders, or roughly two-tenths of one percent.

Thus, corporate directors are almost invariably chosen by written proxies. Yet management so totally dominates the proxy machinery that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot"—that is, a ballot which lists only one slate of candidates. Although federal and state laws require the annual performance of an elaborate series of rituals pretending there is "corporate democracy," in 1973, 99.7 percent of the directorial elections in our largest corporations were uncontested.

Of the 6,744 corporations required to file data with the Securities and Exchange Commission, incumbent management retained control in at least 6,734 companies, or 99.9 percent. In the 500 largest industrial corporations—corporations which account for some 66 percent of the sales of all industrial corporations in the United States—no incumbent management was even challenged in 1973. One-sided as these results are, they are entirely typical for the largest business corporations. During the 18 years for which data are available, 1956–73, management has won 99.9 percent of all proxy solicitations in 10 out of 18 years.

THE BEST DEMOCRACY MONEY CAN BUY

The key to management's hegemony is money. Effectively, only incumbent management can nominate directors—because it has a nearly unlimited power to use corporate funds to win board elections while opponents must prepare separate proxies and campaign literature entirely at their own expense.

There is first management's power to print and post written communications to shareholders. In a typical proxy contest, management will "follow up" its initial proxy solicitation with a bombardment of five to ten subsequent mailings. As attorneys Edward Aranow and Herb Einhorn explain in their treatise, *Proxy Contests for Corporate Control:*

Perhaps the most important aspect of the follow-up letter is its role in the all-important efforts of a soliciting group to secure the *latest-dated* proxy from a stockholder. It is characteristic of every proxy contest that a large number of stockholders will sign and return proxies to one faction and then change their minds and want to have their stock used for the opposing faction.

The techniques of the Northern States Power Company in 1973 are illustrative. At that time, Northern States Power Company voluntarily employed cumulative voting, which meant that only 7.2 percent of outstanding shares was necessary to elect one director to Northern's 14-person board. Troubled by Northern's record on environmental and consumer issues, a broadly based coalition of public interest groups called the Citizens' Advocate for Public Utility Responsibility (CAPUR) nominated Ms. Aloha Snaby, a former Minnesota state legislator, to run for director. These groups then successfully solicited the votes of over 14 percent of all shareholders, or more than twice the votes necessary to elect her to the board.

Northern States then bought back the election. By soliciting proxies a second, and then a third time, the Power Company was able to persuade (or confuse) the shareholders of 71 percent of the 2.8 million shares cast for Ms. Snaby to change their votes.

Larger, more experienced corporations are usually less heavy-handed. Typically, they will begin a proxy campaign with a series of "build-up" letters preliminary to the first proxy solicitation. In Campaign GM, General Motors elevated this strategy to a new plateau by encasing the Project on Corporate Responsibility's single 100-word proxy solicitation within a 21-page booklet specifically rebutting each of the Project's charges. The Project, of course, could never afford to respond to GM's campaign. The postage costs of soliciting GM's 1,400,000 shareholders alone would have exceeded $100,000. The cost of printing a document comparable to GM's 21-page booklet, mailing it out, accompanied by a proxy statement, a proxy card, and a stamped return envelope to each shareholder might have run as high as $500,000.

Nor is it likely that the Project or any other outside shareholder could match GM's ability to hire "professional" proxy solicitors such as Georgeson & Company, which can deploy up to 100 solicitors throughout the country to personally contact shareholders, give them a campaign speech, and urge them to return their proxies. By daily tabulation of returned proxies, professional solicitors are able to identify on a day-by-day basis the largest blocks of stock outstanding which have yet to return a favorable vote.

Management's "army" in a proxy contest will also include attorneys to prepare necessary documents for the SEC and distract the opposition with costly litigation; accountants and statisticians to prepare the most self-serving financial analysis allowable; and public relations advisors to prepare advertisements for trade journals and the financial section of major newspapers. In the past 25 years there have been no more than a dozen instances in which insurgents have been able to match management expenses in a major proxy fight. Over the past decade, only the MGM proxy contest of 1967 has seen insurgents match management expenses in a large corporation's proxy contest for control.

A second advantage—and one that no outsider can match—is management's ability to use corporate personnel on its own behalf. Clerical help and clerical facilities including printing presses, photocopying machines, and addressing machines are invariably employed. Salespersons skilled in talking to customers are frequently assigned to the telephones to answer inquiries and to supplement the professional proxy solicitors by making direct calls to shareholders. Moreover, senior executives can be assigned to telephone particularly important shareholders who may be impressed by the personal call of a top executive.

State corporations law has done nothing to correct this inequality of corporate resources. Although leading cases in Delaware and New York have engaged in much gnashing of teeth about limiting management expenditures to: (a) proxy contests involving a "policy" issue, (b) expenditures necessary to inform shareholders about the "policy" issue, and/or (c) "reasonable" expenses—no decision since 1907 in either jurisdiction has denied management the power to expend corporate funds or use corporate personnel exactly as management chooses. Even such seemingly "unreasonable"

expenditures as public relations counsel, "entertainments," chartered airlines, limousines, and the indirect cost to the corporation of using officers and employees on behalf of an incumbent director slate have survived judicial scrutiny. By contrast, state courts have firmly established the rule that insurgents, unlike management, are not entitled to reimbursement of any campaign expenses as a matter of right. Challengers must defray all their own expenses, with the single slim hope of later being reimbursed *if* they are successful and the stockholders approve.

MANAGEMENT CONTROL OF INFORMATION

Management's grip on corporate power is tightened by its authority to print and distribute annual, quarterly, and other reports to shareholders. Besides the formal proxy statement, these reports usually embody the only detailed information shareholders receive about their corporation.

Neither state nor federal law places any meaningful restrictions on the amount of money management may spend reporting to shareholders. SEC Proxy Rules *do* require certification of financial statements. The report, however, "may be in any form deemed suitable by the management" and is not subject to the same standards of truthfulness that the text of a proxy solicitation is subjected to. Consequently, though every word of an insurgent shareholder's communications with other shareholders may be challenged if it is arguably "false or misleading," most management reports are subject to no textual regulation whatever.

Unfortunately, management reports are frequently "false and misleading." They are often written in an upbeat public relations jargon which emphasizes "positive" aspects of the past business year while rationalizing or ignoring management mistakes, financial losses, corporate or executive criminal violations, or civil actions successfully prosecuted against the corporation. Frequently, as much as half of the text of an annual report is represented by oversized charts, colored illustrations, and kindred public relations gimmickry.

There is often little difference between the text of a failing corporation's annual report and a healthy corporation's report. For example, although subsequent congressional testimony made clear that Lockheed would have gone bankrupt unless it received an emergency loan guarantee from the federal government, Lockheed's 1969 annual report managed to ignore the prominent debate in Congress over whether the federal government should "bail out" the firm. Instead shareholders read the following:

> It is disappointing to have to record a net loss for the year. Yet setbacks like this are singularly possible in an industry so dependent upon government policy and the ebb and flow of domestic and international developments.
>
> We have experienced them before and in each case have emerged stronger than ever. We are confident this will be so again. We say this not out of easy optimism but from the knowledge that we have many broadly based defense and commercial programs with high business potential and that we are expending much technical effort to meet the nation's future needs.

The report then spent six pages suggesting that Lockheed's financial difficulties were primarily the result of contractual misunderstandings with the federal government. It strongly suggested that the federal government would compromise in these disputes. It was only *after* the Senate voted an Emergency Loan Guarantee by the razor-thin margin of 49–48 in August 1971 that Lockheed reported to its shareholders that without this congressional subsidy the corporation would have collapsed.

A similar lack of veracity appeared in the 1973 Annual Report of the Franklin New York Corporation, whose principal subsidiary was the Franklin National Bank, the largest state bank ever to fail in the United States. Just a few months before the Comptroller declared the Franklin National Bank insolvent, the corporation's management reported to its shareholders that "In 1973 Franklin crossed an important threshold so that it is now in a position to move forward in establishing itself as a major worldwide financial institution and a leading money center banking operation." Nowhere in the report was any mention made of the foreign currency speculation or improvident real estate loans which four months later caused the bank's demise. This was a serious omission, for the preponderance of financial loss caused by Franklin's collapse was

absorbed by the shareholder-readers of this report, not the management or the public relations firm which wrote it. These shareholder-readers were given absolutely no warning of what was coming, no opportunity to exert their prerogative to change management or to vote a more timely dissolution.

Nor can insurgent shareholders obtain much additional information from their own corporation when they prepare for a proxy challenge. They lack the legal tools to gain access to live interviews with corporate executives, board meetings, or memoranda which could document internal debate, management error, derogations of law, sloppy execution of policy, or even the content of management's policy formulations.

All of which is a bizarre commentary on the Securities and Exchange Commission. The federal security laws emphasize disclosure. The Commission has claimed that its Proxy Rules "represent an effective contribution to corporate democracy" because disclosure enables individual investors to exercise some measure of control over the management of their corporation. Although the Securities and Exchange Act of 1934 authorizes the SEC to require annual and quarterly reports, including the authority to prescribe "the items or details to be shown in the balance sheet and the earnings statement . . . ," shareholders can not compel their corporation to give a product line or division accounting so as to uncover unprofitable operations. Specific management mistakes may thus be submerged in consolidated financial reports. Shareholders may wish to know whether executives are using expense accounts improperly or are being indemnified for certain civil or criminal liabilities. They cannot find out. They may wish to read minutes of the meetings of corporate directors—whom they elect—or reports of decisions by executives respecting corporate property—which shareholders own. Under federal securities laws, they have no legal rights to do so.

Under state statutory law, shareholders theoretically have broad rights to examine corporate records. State statutes typically authorize inspection of shareholder lists—without which a shareholder could not even begin a proxy solicitation—and "other books and records." But this access is circumscribed by legal requirements of "good faith," "proper purpose," and minimum share ownership, as well as ample opportunities for management to delay compliance with legitimate shareholder demands by forcing expensive court tests.

Almost invariably shareholders prevail in court battles to secure a shareholder list, for, as a leading Pennsylvania decision put it, ". . . the right to examine the stockholders' list is a basic privilege of every stockholder of a corporation and should be given the widest recognition as fundamental to corporate democracy." But the courts are reluctant to enforce shareholder demands for other information. Doctrinally, this has been rationalized as deterring excessive "stockholder agitation." The Supreme Court of Minnesota rather melodramatically explained why in the leading case of *State Ex rel. Pillsbury v. Honeywell:*

> In terms of the corporate norm, inspection is merely the act of the concerned owner checking on what is in part his property. In the context of the large firm, inspection can be more akin to a weapon in corporate warfare. The effectiveness of the weapon is considerable: "considering the huge size of many modern corporations and the necessarily complicated nature of their bookkeeping, it is plain that to permit thousands of shareholders to roam at will through their records will render impossible not only any attempt to keep their records efficiently, but the proper carrying on of their business." . . . Because the power to inspect may be the power to destroy, it is important that only those with a bona fide interest in the corporation enjoy the power. . . .

Alarming as the specter of "thousands of shareholders roaming at will" through once efficient corporations may be, it can only be conjured up by courts so cunning as to overlook their inherent judicial power to restrict any shareholder access to corporate data to reasonable numbers of shareholders at reasonable times and reasonable places. Yet phantom or not, this rationale has been employed in recent decisions to deny one A&P shareholder access to the minutes of board meetings and information relevant to store closings; to deny Ralston Purina shareholders access to monthly profit analyses employed by management; and to deny shareholders of Gulf Sulphur Corporation information concerning a firm with which Gulf proposed to merge.

MANAGEMENT CONTROL OF THE LAW

Management power is further entrenched by three significant legal advantages.

First, in approximately 90 percent of all large industrial corporations, cumulative voting is not required. In these corporations, a minority of shareholders—even a minority as substantial as 49.9 percent—may be precluded from electing even one director to the board.

Under cumulative voting, each shareholder is entitled to votes equal to the number of his or her shares multiplied by the number of directors to be elected. The shareholder may cast all his or her votes for a single candidate or distribute them among two or more candidates as he or she sees fit. Cumulative voting, therefore, helps to protect the *financial* interest of minority shareholders by assuring them voice on the board of directors. And it protects the *political* interest of minority shareholders. For without cumulative voting, the tendency of large industrial corporations to perpetuate one-party rule is powerfully enhanced. As Professor Charles M. Williams demonstrated after analyzing proxy contests for the years 1943–1948, corporations with cumulative voting were more than twice as likely to have proxy contests as those without.

Because of these benefits, cumulative voting has enjoyed considerable popularity. From 1870, when Illinois became the first state to require cumulative voting, until 1955, 23 states had established absolute requirements for cumulative voting. Additionally, federal law requires cumulative voting for over 5,000 banks subject to the Federal Banking Act of 1933 (although the intent of this law has often been frustrated by bank holding company structures); and the Securities and Exchange Commission has consistently required cumulative voting for corporations subject to the Public Utility Holding Act of 1935 and corporations undergoing reorganization under Chapter X of the Bankruptcy Act. As an attorney snapped in 1950 in frustration at Wisconsin's refusal to enact cumulative voting, "Cumulative voting is so obviously in accord with our basic political philosophy of group representation and the party system that it is difficult to understand the legislature's repeated rejection of it, except in terms of a response to the pressure of corporate management's interest."

Unfortunately, "the pressure of corporate management's interest" often does prevail in state corporation law. Between 1955 and 1972, five states dropped mandatory cumulative voting. In 1973, Michigan changed from mandatory to permissive cumulative voting; in 1974 both California and Ohio considered—but did not enact—similar legislation. Today, in Delaware, as well as 32 other states, cumulative voting is not required. True, in most of these states, cumulative voting is permitted. In practice, however, permissive cumulative voting offers little but an illusory right. Studies by Professor Williams in 1951 and the Conference Board in 1973 indicate that only about 15 percent of the corporations in states with permissive cumulative voting have provided for this right.

And even in those few corporations which voluntarily institute cumulative voting, most states provide ample devices to subvert it. Although cumulative voting aims to prevent a simple majority from maintaining absolute corporate control, Delaware permits a simple majority to amend the corporate charter to repeal cumulative voting. And Delaware and some 42 other jurisdictions allow the "classification" of the board of directors. This device reduces to one third or one half the number of directors required to stand for election anually and thus increases the minimum vote necessary to elect a director.

Management's second legal edge is its power to issue nonvoting stock or classes of stock with unequal voting rights. For example, prior to December 1, 1955, there were three classes of stock in Ford Motor Company: common, Class A, and Class B. Only the Class B shares (4.94 percent of total equity), all of which were owned by Ford family interests, were entitled to vote.

Only Illinois and a few other states forbid the issuance of classes or series of stock without voting rights. But the refusal of both the New York Stock Exchange and the American Stock Exchange to list corporations with nonvoting stock has substantially reduced the number of corporations which may totally eviscerate shareholder suffrage, although neither exchange actively enforces equal voting rights.

The third statutory device for impairing shareholder suffrage

rights is a provision common to the law of Delaware and apparently every other jurisdiction requiring the submission of proxy materials only to *shareholders of record*. This innocent sounding requirement effectively disenfranchises approximately 50 percent of the beneficial owners of corporate stock in the largest industrial corporations. For approximately 50 percent of the stock in the 1,800 companies traded on the New York Stock Exchange is held by mutual funds, life insurance or property and casualty insurance companies, private pension funds (usually administered through commercial bank trust departments), state and local pension funds, foundations, university endowment funds or other institutional investors. The result is a mockery of shareholder democracy: *Approximately 50 percent of the votes in our largest industrial corporations are cast by financial intermediaries—not the real owners.*

These institutional shareholders provide virtually no check to corporate management. Most financial institutions, according to the SEC's 1971 *Institutional Investor Study*, follow what is known as "The Wall Street Rule": An investment in a business corporation is considered an investment in that corporation's management; if the financial institution ceases to like what management is doing, the institution sells the stock. By examining the voting practices of 215 large institutions between January 1, 1967 and September 30, 1969, the SEC determined that approximately 30 percent of these institutions *always* voted for management (in elections other than votes for directors). For the remaining institutions, both voting against management and abstention were found "to be a relatively infrequent phenomenon." For example, in only 26 instances did any of the 215 institutions vote against an acquisition favored by management, "a miniscule fraction of such transactions."

The SEC conducted its study before the proliferation of shareholder proposals directed at social issues and precipitated by Campaign GM. In the past five years, some financial institutions have established formal procedures to consider shareholder public policy or ethical proposals. According to newsletters published by the Council on Economic Priorities and the Investor Responsibility Research Center, a small number of church-related funds, foundations, and universities have supported shareholder proposals respecting disclosure of political contributions; withdrawal from South Africa, Rhodesia, or Namibia; opposition to military production; or review of corporate safety, environment, occupational discrimination, or community programs. Since most institutional shares are voted by banks, insurance companies, and mutual funds, and these financial institutions have shown only a negligibly greater willingness to oppose management, the overall pattern of institutional voting has changed little in the past five years.

MANAGEMENT CONTROL OF OTHER FUNDAMENTAL DECISION-MAKING

Historically, shareholders controlled the business corporation not only through the election of directors but also through shareholders' power to initiate and vote upon all fundamental changes in the character of the corporation. Management's ability to initiate change was carefully circumscribed by requiring two-thirds or three-fourths affirmative votes for charter amendments, bylaw changes, mergers, sales of assets, stock issuance, recapitalization, or dissolution and was further limited by shareholder appraisal and preemptive rights.

Under Delaware's General Corporation Law, shareholders have lost nearly all power to initiate corporate change. Only the board of directors may propose charter amendments, a merger, or a sale of assets. The SEC Proxy Rules complement Delaware's corporation law by denying shareholders opportunity to communicate opposition to management proposals or to suggest modifications in management's formal proxy proposals.

This rout has been substantially replicated in all other leading chartering states. Indeed, the trend of recent revisions to state corporation law has been to attempt to deny the shareholder any vote at all! Modern corporate draftsmen invariably write short, purely formal certificates of incorporation and then place most of a corporation's actual governing rules in its bylaws, which the certificate establishes can be revised by the corporation's directors without any shareholder vote. For example, when ITT reincorporated in Delaware in 1967, it did so by creating a Delaware corporation called the "DeLitt Corporation" and by then merging ITT, previously a Maryland corporation, into DeLitt. The certificate of incorporation of DeLitt was only 1½ pages long. It reads in toto:

CERTIFICATE OF INCORPORATION
OF
DELITT CORPORATION

Article 1

The name of the corporation is Delitt Corporation (hereinafter called the "Corporation"). The name and mailing address of its incorporators are as follows:

NAME	MAILING ADDRESS
John J. Navin	320 Park Avenue, New York, N.Y. 10022
William J. Donovan	320 Park Avenue, New York, N.Y. 10022
DeForest Billyou	320 Park Avenue, New York, N.Y. 10022

Article 2

The address of the registered office of the Corporation in the State of Delaware is No. 100 West Tenth Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.

Article 3

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

Article 4

The total number of shares of stock which the Corporation has authority to issue is 100 shares of capital stock of the par value of $100 per share.

Article 5

Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action by any provision of the General Corporation Law of Delaware, the meeting and vote of stockholders may be dispensed with if the holders of stock having not less than the minimum percentage of the vote required by statute for the proposed corporate action shall consent in writing to such corporate action being taken, provided that prompt notice must be given to all stockholders of the taking of such corporate action without a meeting and by less than unanimous written consent.

Article 6

In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized:

(a) To make, alter, amend or repeal the By-Laws of the Corporation.

(b) To direct and determine the use and disposition of any annual net profits or net assets in excess of capital; to set apart out of any of the funds of the Corporation available for dividends a reserve or reserves for any proper purpose; and to abolish any such reserve in the manner in which it was created.

(c) To establish bonus, profit-sharing, stock option, retirement or other types of incentive or compensation plans for the employees (including officers and directors) of the Corporation and to fix the amount of the profits to be distributed or shared and to determine the persons to participate in any such plans and the amounts of their respective participations.

(d) From time to time to determine whether and to what extent, and at what time and places and under what conditions and regulations, the accounts and books of the Corporation (other than the stock ledger), or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the Corporation, except as conferred by statute or authorized by the Board of Directors or by a resolution of the stockholders.

(e) To authorize, and cause to be executed, mortgages and liens upon the real and personal property of the Corporation.

Article 7

The corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.

The key sentence is contained in Article 6: "In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized: (a) To make, alter, amend or repeal the By-Laws of the corporation. . . ." What ITT tried to do, as so many other giant Delaware corporations have tried to do, was to totally shut shareholders out of the governing process except in those rare instances in which the Delaware General Corporation Law explicitly requires a shareholder vote—which is not very often.

True, technically, section 251(c) grants shareholders a vote on management merger proposals. But this, in fact, is a mere snare

for the dim-witted. Only a small minority of corporate [illegible] actually trigger this shareholder vote. The overwhelming majority employ one of three conventional loopholes (discussed in the Source[illegible]

Similarly, section 271 limits shareholder suffrage in a sale, lease, or exchange of assets to transactions involving "all or substantially all" of a corporation's property and assets. Since most large industrial corporations are highly diversified, this provision effectively insures their shareholders will never vote. For example, General Motors could sell an automobile division such as Pontiac or Cadillac and not require a vote. It could liquidate hundred-million-dollar plants which manufacture refrigerators, diesel engines, and trucks or auction off all of its Detroit real estate and relocate in the Peoples Republic of China, and shareholders would have no choice in the matter. Only if GM sold *all* assets used to manufacture "automotive products" (about 75 percent of the corporation) would a sale of assets require a shareholder vote.

Moreover, section 271 is the only Delaware statute concerning corporate divisions. A Delaware corporation may create and fund new subsidiary corporations, regardless of size; liquidate these subsidiaries or comparable divisions and distribute assets to shareholders; or spin-off new corporations altogether without any shareholder vote. As business corporations have evolved these new forms, Delaware and other principal chartering states have deliberately not kept pace. Corporate executives have not hesitated to take advantage of this laxity. In the past three years many Delaware corporations have "gone private" and bought up minority shareholdings at bargain prices during a depressed stock market. This will allow favored shareholders or the firm itself to reap the profits when the company's stock price rises. Other senior managements have used the merger provisions to prevent take-over bids—which can benefit all shareholders—by requiring super-majorities, such as 75 or 90 percent, to consent to any consolidation or sale of the companies assets.

Whither/Wither the Board of Directors?

But does not the board of directors with its sweeping statutory mandate "to manage the business and affairs of every corporation"

provide an internal check on the power of corporate executives? No. Long ago the grandiloquent words of the statutes ceased to have any operative meaning. "Directors," William O. Douglas complained in 1934, "do not direct." "[T]here is one thing all boards have in common, regardless of their legal position," Peter Drucker has written. "*They do not function.*" In Robert Townsend's tart analysis, "[M]ost big companies have turned their boards of directors into nonboards. . . . In the years that I've spent on various boards I've never head a single suggestion from a director (made as a director *at* a board meeting) that produced any result at all."

Recently these views were corroborated by Professor Myles Mace of the Harvard Business School, the nation's leading authority on the performance of boards of directors. In *Directors—Myth and Reality*, Mace summarized the results of hundreds of interviews with corporate officers and directors.

Directors do not establish the basic objectives, corporate strategies or broad policies of large and medium-sized corporations, Mace found. Management creates the policies. The board has a right of veto but rarely exercises it. As one executive said, "Nine hundred and ninety-nine times out of a thousand, the board goes along with management. . . ." Or another, "I can't think of a single time when the board has failed to support a proposed policy of management or failed to endorse the recommendation of management."

The board does not select the president or other chief executive officers. "What is perhaps the most common definition of a function of the board of directors—namely, to select the president—was found to be the greatest myth," reported Mace. "The board of directors in most companies, except in a crisis, does not select the president. The president usually chooses the man who succeeds him to that position, and the board complies with the legal amenities in endorsing and voting his election." A corporate president agreed: "The former company president tapped me to be president, and I assure you that I will select my successor when the time comes." Even seeming exceptions such as RCA's 1975 ouster of Robert Sarnoff frequently turn out to be at the instigation of senior operating executives rather than an aroused board.

The board's role as disciplinarian of the corporation is more apparent than real. As the business-supported Conference Board conceded, "One of the most glaring deficiencies attributed to the corporate board . . . is its failure to monitor and evaluate the performance of the chief executive in a concrete way." To cite a specific example, decisions on executive compensation are made by the president—with perfunctory board approval in most situations. In the vast majority of corporations, Professor Mace found, the compensation committee, and the board which approves the recommendations of the compensation committee, "are not decision-making bodies."

Directors do not even ask discerning questions. It is considered "discourteous," a breach of "corporate manners" for directors to "challenge" the president or other corporate officers. This can be a very expensive form of decorum, as the Penn Central's shareholders painfully discovered. At the time of its collapse in June 1970, Penn Central was the largest railroad in the country and the sixth largest industrial corporation overall. Within a two-year period, shareholders witnessed the decline of their shares from $86.50 to $2.75.

Why? "The board was definitely responsible for the trouble," recounted outside director E. Clayton Gengras. "They took their fees and they didn't do anything. Over a period of years, people just sat there. That poor man from the University of Pennsylvania [University President Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out." As the Penn Central rushed towards its monumental crack-up, the board routinely approved every proposal forwarded by management. Although Penn Central was desperate for capital, the directors paid out nearly $100 million in dividends. The board never saw a capital expenditures budget. It never understood the inaccuracies published in Penn Central's annual reports. Just six hours before the corporation filed its bankruptcy petition, the board routinely approved new contracts for eight corporate executives, apparently unaware even then of the dimensions of the Penn Central's crisis. "All of this raises the serious question as to whether giant corporations affecting the everyday lives of our population . . . should continue to be governed in the traditional fash-

ion or whether a new system of corporate directorships should be devised," concluded the House Banking and Currency Committee.

Yet boards will continue to be dysfunctional as long as they remain the creature of the corporate chief executive. For it is the chief executive who, like the family owner-manager in a small corporation, selects new members of the board. And it is the chief executive who de-selects existing board members when nominations for the board are necessary for annual shareholders' meetings.

Our own survey of the boards of the 200 largest industrial corporations found that the average board had a total of 14.49 directors, including 7.93 "outsiders" (that is, directors who were not employees of the corporation) and 6.56 insiders (or employee directors). Some 69 percent of the outside directors were fellow corporate executives; 6 percent were investment bankers; 7 percent were lawyers. Only 2 percent were women; a lesser percentage were black. Hence over 90 percent of the directors of our largest corporations either worked for the corporate chief executive or were fellow corporate executives, corporate bankers, or corporate lawyers.

Most "outside" directors appear to be chosen because of their status. "Presidents and chairmen of large and respected companies," one corporate president observed, "enjoy the prestige of serving on similar large and respected company boards. They are identified with their peers. They find the experience socially satisfying. Outside directorships provide a few more lines in their *Who's Who*, and it is a little bit like being knighted to say 'I'm a director of General Motors, or General Electric, or AT&T.'" Frequently, the chief executive chooses his friends, or individuals known to be "sympathetic" or "congenial," to be directors. "You certainly don't want anyone on your board who even slightly might be a challenge on a question of your tenure, so you pick personal friends with prestige titles and names," a corporate president explained. Another executive agreed: "What would you do if you were president? You control the company and you control the board. You want to perpetuate this control. . . . You sure as hell are not going to ask Ralph Nader. . . ."

At its worst, the outside director system degenerates into a private club, as the president of a west coast company explained:

You've got to remember that the outside directors of large national and regional companies are members of a sort of club. To be considered for admission you must have the title as president or chairman of a respectable and respected organization. This is what some young people call the Establishment. But these are the people you do business with, travel around with, serve on community projects with—and it has to be a group the members of which get along together. Regionally each area has its elite. Sometimes many will in fact be members of the same golf or social club. Here in Los Angeles you will find a great number of directors with membership in the Los Angeles Country Club; in Cleveland the same is true of the Union Club—each city has its hard core members of the club group.

Exceptions to this pattern become news events. In reporting on General Motors' 1971 annual shareholders' meeting, the *Wall Street Journal* noted that, "The meeting's dramatic highlight was an impassioned and unprecedented speech by the Rev. Leon Sullivan, GM's recently appointed Negro director, supporting the Episcopal Church's efforts to get the company out of South Africa. It was the first time that a GM director had ever spoken against management at an annual meeting." Now Rev. Sullivan is an unusual outside director, being General Motors' first black director and only "public interest" director. But what makes Leon Sullivan most extraordinary is that he was the first director in *any* major American corporation to come out publicly against his own corporation when its operations tended to support apartheid.

Yet as lethargic as outside directors usually are, employee directors tend to be even less effective. The typical vice president/inside-director is in a very precarious position at a board meeting. Unwilling to say anything in disagreement with his boss, he usually sits quietly and waits until he is called upon to speak. Disagreements with other corporate executives are invariably resolved out of the board room. The effect is to present outsiders with a "united front": to make the corporate chief executive's decisions seem inevitable.

So staffed, board meetings in most large industrial corporations have become formalized into a monthly or bimonthly ritual, usually lasting about one to three hours. Much of this time is consumed by perhaps a 30-minute to an hour review of operations for the last period (month or quarter) by the president or vice president of finance. This is followed by board approvals of capital appropriations and of the actions of the executive committee taken since the last meeting. The meeting often concludes after senior executives have described a new research development or a major operations program. Usually the entire meeting—which is closed to shareholders—is choreographed by the corporate chief executive. He chooses which officers shall speak. He writes the agenda. When he wants to be asked about a particular issue, he plants the relevant question.

The impossibility of so infrequent or so circumscribed meetings of the board enabling directors to effectively "manage" their corporation was sardonically illustrated by the congressional testimony of H. O. Havemeyer, a corporate chieftain of an earlier day:

Q. As a member of that board, what else have you done?
A. *Oh, I have convened and talked.*
Q. You have convened and talked?
A. *And adjourned.*
Q. Well, you have convened and talked?
A. *And adjourned.*
Q. Well, what have you talked about?
A. *Statistics.*

This testimony was given in 1887 when outside directors were typically the "tools" or "dummies" of the controlling corporate president or bank. A popular gag on Wall Street was that the role of an outside director was to receive his five-dollar gold piece at the start of each meeting and then obediently fall asleep. Directorial lassitude is not so obvious today. Yet considering that the size and complexity of corporate enterprise has significantly increased since 1887 while the frequency and length of directors' meetings has not, it is a fair assumption that the outsiders who obediently nod through ceremonial board meetings today are little better informed than their brethren who slept before them.

Certainly directors' sources of information remain as much subject to management control today as they did 90 years ago. After resigning from TWA's board, former United States Supreme Court Justice Arthur Goldberg had this complaint: "What the typical board of directors gets is a recommendation which seems mono-

lithic. . . . It's not like a court, where a judge can order a brief from both sides." Recently the *quantity* of preparatory information available to outside directors has significantly increased. Yet the thickened reports and whirlwind plant tours are still only what the corporate chief executive wants outsiders to see. "In many corporations," found Professor Melvin Eisenberg, "the executives go so far as to wholly deny the board—supposedly entrusted with supreme power over the corporation—access to certain categories of information." For instance, a 1971 survey found that only 17 percent of 474 industrial firms sent manufacturing data to directors prior to board meetings, only 21 percent sent marketing data, and 11 percent sent no data at all.

And outside directors have little personal incentive to doubt management. A 1973 survey of 378 manufacturing corporations with assets of $50 million or more showed that outside directors received median annual fees of approximately $5,000, while inside directors generally are not paid at all. On top of the $100,000+ incomes typically earned by outside directors, who are corporate chief executives or vice presidents, leading investment bankers, or law firm partners, such annual retainers or meeting fees seem like peanuts. The result is counterproductive. Outside directors rationalize not doing very much by the fact they are not paid very much.

How, then, can one reconcile the grand imperative, "The business and affairs of every corporation . . . shall be managed by or under the direction of . . . a board of directors" with the reality of this "non decision-making body"? The fashionable response is that the board is a legal fiction. Management control has overwhelmed the rule of law.

This widely held view is only half right. Management has deposed the board of directors—but it has done so under color of law. No rule within the modern corporation statutes prohibits management from nominating and serving as directors. Corporation law has abrogated directional independence by omission. Moreover, even if the statutes provided structural safeguards to maintain the independence of the board, these could not undo the effect of two provisions found in most state corporation laws.

The first provision is exemplified by a Delaware Corporation Law section which provides that a director shall "be fully protected in relying in good faith upon . . . reports made to the corporation by any of its officers." The meaning of this provision is very simple. Directors have no duty to know. "Unless something occurs to put them on suspicion that something is wrong, directors are entitled to rely on the honesty and integrity of [management]," held the leading case of *Graham v. Allis-Chalmers Manufacturing Company*. Directors are not required to "put into effect a system of watchfulness." They need not anticipate problems nor verify the accuracy of reports upon which they rely.

A second provision of the Delaware General Corporation Law accomplishes the same result by allowing the board to *formally* delegate responsibility for most corporate business to a committee dominated by inside directors. Our survey of the 200 largest industrial corporations indicates that approximately two-thirds of the corporations had withdrawn directorial powers from the full board—typically a majority of whose members were outsiders—to an executive committee at least half of whose members were insiders.

A much smaller number of corporations accomplish a comparable result by delegating authority to an insider-dominated finance committee. In our survey of the 200 largest industrial corporations, we found that 16 corporations had delegated authority to a finance committee, half or more of whose members were insiders.

Examples of the delegation of the board's authority to either an insider-dominated executive or finance committee have been well described by attorney John A. McMullen:

> At IBM—four directors, all top level officers of the corporation, control the all-important executive and finance committees; in addition, three of them are members of the powerful Corporate Office. At GM, four or five men, all inside directors of the company, dominate the executive and finance committees of the board as well as the administration committee comprised of key officers and directors. . . . DuPont's executive committee consists of the company's chairman of the board, president, and six senior vice presidents. Each of these men is entirely relieved of day-to-day functional responsibilities; each operates jointly with his fellow committee

members to set overall corporate policy, and acts only as an advisor to the operating department from which he originally derived his skills, training, and experience.

Yet, whether or not the board formally resolves to delegate operational authority to an executive committee between board meetings, the actuality is that employee directors or other senior executives invariably exercise the powers of initiation. It does not matter whether key corporate decisions are initiated by a single corporate autocrat or a board committee or a committee operating out of the office of the president. Senior executives call the shots. This is what Berle and Means meant by their insightful descriptions of "management control." This is why state corporation law is moribund. Not only is it written by corporate management's representatives, it is also hopelessly inaccurate. In appreciating the law of corporate governance, one rule above all others must be followed: *Concentrate on the omissions.* Where state law does not require directors to be, corporate executives inevitably are.

The Limitations of Shareholder Litigation

STATE LAW: THE NON-DUTY OF CARE

The erosion of shareholder authority within the corporation would be less serious if shareholders were able to oppose the abuses of corporate management in court. In theory, civil litigation remains the shareholder's ultimate check. The problem is that, except for certain limited claims under the federal securities laws, it rarely works. Long ago judicial doctrines reduced the state shareholder action to a trivial value.

Earliest was the judicial rejection of the principle of *ultra vires* action. In its classical form, the doctrine of *ultra vires* envisioned the corporate charter as a contract between the state, corporate management, and the shareholders. Corporations were prohibited from performing certain acts, not because they were illegal but because neither the state nor the shareholders had agreed to them. Shareholders could enjoin corporate officers and directors from engaging in actions "beyond their powers." Accordingly, in a leading 1867 case, a single shareholder blocked a railroad from extending its railway to a more distant point than that specified in the charter because that was not the enterprise he had bargained for.

With the rise of the corporate enabling acts, the principle of *ultra vires* declined. Shareholder limitations were overridden through court discoveries of "implied" or "auxiliary" powers. In the 1896 case of *Jacksonville M. P. Ry. & Nav. Co. v. Hopper*, for example, the United States Supreme Court held that the Florida railway company might engage in leasing and running a resort hotel, on the curious logic that "to maintain cheap hotels or eating houses . . . would not be so plainly an act outside the powers of a railway company as to compel a court to sustain the defense of ultra vires. . . ." By 1931, *Fletcher's Cyclopedia of Corporations* could proclaim, "the theory that a corporation can do no acts beyond its authority [has been] discarded by a majority of the courts in the country."

Paralleling the decline of *ultra vires* has been the universal refusal of state courts to hold corporate directors or officers liable for negligence. Because they are vested with great power over other people's property, the law has always nominally required, in the language of the present New York statute, that "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care and skill which ordinarily prudent men would exercise under similar circumstances in like positions."

In practice, the typical judicial or statutory formulation of the duty of care is too vague to require much of anything. As Yale Law School's Professor Joseph Bishop concluded after an extensive review of the case law:

> The search for cases in which directors of industrial corporations have been held liable . . . for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack. Few are the cases in which the stockholders do not allege conflict of interest, still fewer those among them which achieve even such partial success as denial of the defendant's motion to dismiss the complaint.

In all, Professor Bishop was able to find only four recent cases in which a state court held that a shareholder had alleged a good cause of action for negligence uncomplicated by self-dealing. In only one

of these cases did a state court rule on the merits that a corporate officer was liable for negligence. And in that case, the word "negligence" had been used as a euphemism for dishonesty.

This result is primarily the fault of statutory draftsmen. They have refused to identify *how* a corporate officer meets his duty of care. They have never identified what specific actions he must perform; what specific responsibilities are his. In the absence of a clear standard from the legislature, state courts have refused to guess.

At most, state courts will hold corporate directors or executives liable for conduct involving obvious self-enrichment such as fraud, misapplication of funds, diversion of corporate business opportunities, or causing the corporation to make excessive payment for the purchase of their property. Yet even in these types of cases, where the actions of corporate officers amount to simple and obvious theft, the procedural rules of state corporation law have been skewed to discourage shareholder suits.

The most onerous bars to shareholder litigation are the so-called "security for expenses" provisions enacted by New York, New Jersey, Pennsylvania, Michigan, California, and 13 other states. These provisions require a complaining shareholder owning less than a stated amount of stock—typically 5 percent of the stock or shares worth less than $50,000—to "give security for the reasonable expenses, including attorney's fees, which may be incurred" by both the corporation and the parties defendant in a shareholder action. Since the cost of defendants' legal fees may amount to hundreds of thousands of dollars, the security for expense provision, when enforced, presents a formidable barrier to shareholder action.

The rules respecting attorneys' fees pose a second procedural pitfall for shareholder actions. Nearly every jurisdiction provides that only shareholders whose suits are successful may be reimbursed by the corporation for attorneys' fees. This rule seeks to discourage attorneys from bringing nonmeritorious suits. Several states, however, further provide that attorneys' fees may be awarded only if a substantial monetary benefit is conferred upon the corporation. As a practical matter, this standard precludes shareholder litigation in all cases except those of overreaching where a monetary benefit—the amount taken—is readily apparent. In all other cases it is normally cheaper to sell the stock than to compel the corporation to obey the law.

FEDERAL SECURITIES LAW: "TAKING OVER THE UNIVERSE GRADUALLY"?

To some extent, federal securities law—and federal court decisions—have compensated for the atrophy of state shareholder protection.

In 1968, the influential Second Circuit Court of Appeals handed down its celebrated *S.E.C. v. Texas Gulf Sulphur* decision which revolutionized the case law interpreting Rule 10b-5 under the 1934 Securities and Exchange Act. Rule 10b-5 provides that it is unlawful for any person to employ a fraudulent scheme, to make any untrue statement, or to fail to state a pertinent fact when purchasing or selling a security. *Texas Gulf* substantially broadened this antifraud rule by holding that corporate directors, officers, and employees violated 10b-5 when they purchased company stock knowing of a huge mineral strike before this fact was generally known or communicated to the public.

A federal district court, also in 1968, ruled in *Escott v. Bar Chris*—a decision some commentators initially believed would have even greater effect on directorial behavior than *Texas Gulf*. In *Bar Chris* security holders asserted that a bowling alley construction company that had sold them convertible debentures had filed a registration statement prior to the sale of the bonds which contained false statements and omissions. After concluding that the registration statement did, indeed, contain numerous inaccuracies, the district court stunned Wall Street by holding all nine directors who signed the prospectus—including two new to the board—liable. In summing up their liability, the court seemed to move far toward creating a federal duty of care, at least with respect to registration statements:

> Section 11 imposes liability in the first instance upon a director, no matter how new he is. He is presumed to know his responsibility when he becomes a director. He can escape liability only by using that reasonable care to investigate the facts which a prudent man would employ in the management of his own property. In my opinion, a prudent man would not act in an important matter without any knowledge of the relevant facts, in sole

reliance upon representations of persons who are comparative strangers and upon general information which does not purport to cover the particular case. To say that such minimal conduct measures up to the statutory standard would, to all intents and purposes, absolve new directors from responsibility merely because they are new. This is not a sensible construction of section 11, when one bears in mind its fundamental purpose of requiring full and truthful disclosure for the protection of investors.

The cumulative result of these and other federal securities law decisions led the *Wall Street Journal* to exclaim in early 1973, "[D]irectors of corporations now face more perils than Pauline ever did!" In a similar vein, Harvard Law School's securities expert, Professor Louis Loss, observed in 1969 that "the great Rule 10b-5," which had emerged as the principal basis of liability under the federal securities laws, "seems to be taking over the universe gradually."

In retrospect, both views seem overstated. The basic reason the securities laws will neither "take over the universe" nor seriously "imperil outside directors" is that they are restricted to a discrete set of securities transactions. Although present securities laws do require corporate officers to file with the SEC accurate periodic financial reports and securities registration statements, not make false and misleading statements in proxies, nor defraud outsiders in connection with their own securities purchases or sales, the securities laws do not, emphasized the Supreme Court in 1971, reach transactions which otherwise involve "internal corporate mismanagement."

And in late 1973, the Second Circuit Court of Appeals held in *Lanza v. Drexel* that only corporate officers who recklessly or deliberately defrauded shareholders could be held liable for money damages under Rule 10b-5. In refusing to follow the reasoning of the district court in the *Escott v. Bar Chris* case, the appeals court made plain that an outside director who was "merely negligent" in his participation in a fraudulent securities transaction had little to fear.

The consequence of *Lanza* and similar recent decisions has been to leave federal securities law in a crazy quilt pattern. The federal securities laws, for example, will not reach a deliberate though not self-enriching decision of corporate executives to engage in an unprofitable line of business unless there has been an accompanying failure of disclosure. Nor will they reach decisions which *do* enrich corporate officers unless they involve security transactions. Liability seems so haphazard and fortuitous that former SEC Chairman William Cary was moved to complain:

> There is no justification for a *federal* law disciplining or holding a tippee liable for misusing inside information concerning management decisions but not monitoring the misconduct of management itself. . . . It is absurd that a corporate transaction, clearly unfair though perhaps not fraudulent, should be subject to attack in the federal courts only upon the ground that it has not been disclosed to shareholders rather than because of its inherent inequity.

NULLIFY THE JUDGMENT: INDEMNIFICATION INSURANCE

Not only is it difficult for shareholders to successfully sue their companies, but even successful judgments often can be nullified. Seventeen states today permit corporations to purchase indemnification insurance for their directors and officers against, in the words of a typical policy, any "wrongful act [committed] . . . in their capacities as directors or officers." A 1974 survey of the Fortune 500 list found that 80 percent of these companies carried indemnification insurance. A similar sample of corporations listed on the New York Stock Exchange found that 76.1 percent carried such insurance. Since indemnification insurance was virtually unknown as recently as a dozen years ago, and most insurance policies were purchased within the past five to seven years, it is a fair assumption that nearly every large industrial corporation permitted by state law will carry indemnification insurance within a short time.*

* One reason for the enormous leap in the number of corporations carrying indemnification insurance has been the scare tactics employed by the insurance companies. The general tenor of their approach is illustrated by an advertisement on page six of the *Wall Street Journal*, March 21, 1968, featuring a composite photograph of a board of directors presided over by a stuffed duck and the explanatory text, "As a corporate officer or director, you may be a sitting duck for a shareholder or third party liability suit." A similar ad appears on page nine of the same issue wherein a sullen looking stockholder announces that he "might just sue every company director reading this newspaper," and reminds the presumably panicking directors that he is just one of "24 million potential enemies."

There is, to be sure, a persuasive case for indemnifying corporate directors against the costs of nonmeritorious legal claims. If innocent directors had to settle such suits because they lacked the resources to hire competent attorneys, responsible men and women would be discouraged from becoming directors. But current indemnity statutes are not limited to the purpose of protecting innocent officers from the costs of nonmeritorious suits. They also protect guilty officers from accountability for their wrongs and reduce incentives for lawful conduct.

Delaware's statute exemplifies this overbreadth. It allows a corporation

> to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against any such liability under the provisions of this section.

As written, this provision permits the corporation to insulate its officers from *all* potential liabilities. Officers may be insured against any negligence, self-dealing, looting the corporation or embezzlement, all conflicts of interest, and deliberate statutory violations. They may be reimbursed for violations of federal safety, civil rights, environmental, tax, or antitrust laws. They may even be insured against the same judgments in derivative actions that an earlier provision of the same statute provided a corporation could not indemnify directly.

Delaware defends such insurance as a form of compensation, arguing that the corporation could make a larger compensation arrangement with the executive and let him pay for the insurance himself. But the question is not how much officers' compensation should be, but rather whether wrongful acts *should* be indemnified at all. Why should an executive of a drug company be indemnified for the costs of a criminal fine if he is convicted of allowing a harmful drug to injure several thousand people when the same act as a private individual would send him to jail? An untenable double standard has been created. The more powerful an executive becomes, the less likely he is to pay for an abuse of power.

Conflicts of Interests

In almost every primary economic relation of the industrial corporation—to competing corporations, to banks, to suppliers, to distributors, to investors—the law now permits (in many instances, encourages) the most blatant division of loyalties.

Most threatening is the anticompetitive practice of *interlocking directorates*. A philosophic cornerstone of American business is that vigorous competition will enable firms to have comparable access to capital, supplies, distributors, and markets, and thus an equal chance to succeed or fail on the merits. But if competing corporations place directors on each other's boards, there is opportunity to conspire on price or territory. If corporate officers sit on the boards of their banks or suppliers or distributors, there arises the obvious temptation to obtain preferential treatment based on favor and friendship. Then the race is not to the swift, but to the well-connected. Louis Brandeis saw the problem early in this century:

> The practice of interlocking directorates is the root of many evils. It offends laws human and divine. Applied to rival corporations, it tends to the suppression of competition and to violation of the Sherman law. Applied to corporations which deal with each other, it tends to disloyalty and to violation of the fundamental law that no man can serve two masters. In either event it leads to inefficiency; for it removes incentive and destroys soundness of judgment. It is undemocratic, for it rejects the platform: "A fair field and no favors"—substituting the pull of privilege for the push of manhood.

With Brandeis as a major proponent, Congress in 1914 enacted the Clayton Act, section 8 of which expressly forbids any person from serving on the boards of two or more competing corporations. Until recently, however, section 8 had not been enforced. Through 1952, some 38 years after the enactment of the Clayton Act, the Department of Justice had not litigated a single case to a decision by a court. Through December 1975, the Department had instituted a total of 15 cases. The Federal Trade Commission, which has concurrent enforcement responsibilities, had filed only 13 complaints under section 8 of the Clayton Act through January 1965. Only one of these complaints resulted in a cease and desist order; the remainder were dismissed when the directors involved discon-

tinued the prohibited relationship. As Chairman Emanuel Celler's House Antitrust Subcommittee concluded in 1965 after a lengthy study of interlocks among competitors: enforcement had been neither "prompt nor vigorous."*

Shortly after Celler's study was released, economist Peter Dooley calculated that there were a total of 4,007 directorships held by the directors of the 200 largest nonfinancial corporations and the 50 largest financial corporations. "While most of these directors sat on a single board, 562 sat on two or more boards: Five men held six directorships each. In all, 1,404 directorships were held by multiple directors." Two hundred and thirty-three of the 250 corporations had at least one director who sat on the board of at least one other of the largest corporations. Most significantly, fully 297 interlocks involved companies which were competitors. "While illegal under the Clayton Act," observed Professor Dooley, "the law has not been effectively enforced, so that the institution of interlocking directorates continues to provide a vehicle for restricting competition. . . ."

Our own more recent survey of the boards of directors of the 50 largest industrial corporations identified eight apparent instances of illegal interlocks. John T. Connor, for example, is both a director of General Motors and Chairman of Allied Chemical, though Allied Chemical produces seat belts, shoulder harnesses, and airbags, all of which GM either presently manufactures or potentially could. Dean McGee is a director of General Electric and Chairman of Kerr-McGee, though both sell nuclear fuels. Henry S. Wingate is a director of both U.S. Steel and International Nickel Company of Canada, both of which mine nickel, iron ore, and other competing metals.

Even beyond inadequate enforcement of its provisions, section 8 only forbids interlocks among competitive corporations. Interlocks among corporations which provide services, supplies, funding, or distribution for each other equally violate the fundamental law that no man can serve two masters. They are also far more numerous. In 1974, the Center for Science in the Public Interest analyzed interlocking directorates and advisory committee connections of the eighteen largest United States oil corporations. They found 460 interlocking connections in all, including 132 interlocks with banks, 31 interlocks with insurance companies, 12 interlocks with utilities, 15 interlocks with transportation corporations, and 224 interlocks with manufacturing and distribution corporations. Oil company ties with banks (which supply capital), insurance companies (which provide an underwriting service), distribution companies (which distribute oil company products), and utilities, transportation, and manufacturing corporations (which purchase oil products) inevitably diminish the arm's length atmosphere in which effective competition thrives.

Such clubbishness, however, is typical of this nation's largest corporations. Our survey of the 50 largest industrial corporations and 10 largest commercial banks found that the 50 largest industrialists had 54 interlocks with the 10 leading commercial banks and 24 interlocks among themselves. Our survey also established that it has become a common practice for the leading commercial banks to bring together competitors on their boards of directors. For example, on its board Chase Manhattan unites directors from competing companies in four industries: industrial chemicals (Allied Chemical, Celanese, and Commercial Solvents Corporation); drugs (Pfizer and Squibb); paper goods (Celanese and International Paper); and oil (Exxon, Royal Dutch Petroleum, and Standard Oil of Indiana). Continental Illinois brings together leading agricultural equipment producers Caterpillar Tractor and International Harvester; food producers Esmark and Krafteo; and railroads Chicago-Milwaukee and Illinois Central.

When interlocks are viewed on a city-by-city basis, it becomes clear that there are substantial social costs as well—as in the case of Minneapolis-St. Paul. In January 1971, Richard Gibson, a methodical staff reporter for the *Minneapolis Star*, described the social structure of a major industrial city by examining the boards of the 20 or so leading Twin City industrial corporations and eight leading banks. What he found was a tight little net or what he

* In the past three years the Federal Trade Commission has begun to enforce the Act, bringing three major actions, the most important of which required seven directors common to the boards of 12 competing oil and gas corporations to resign. More recently the Justice Department awoke from its long slumber and brought an action in 1975 against the Bank of America holding company and certain insurance companies which allegedly competed in providing designated services.

called swapping: Burlington Northern placed its executive on the board of General Mills, and General Mills reciprocated by placing an executive on the board of Burlington Northern. Honeywell, Pillsbury, 3M, and Dayton Hudson just placed executives everywhere, as did the leading banks.

But Gibson went beyond the statistics and examined the personalities involved. He found that the boards of the 30 leading corporations in a major metropolitan area of some two million people were dominated by 19 men. Eight served on three or more boards: five men served on four boards; six served on five boards or mor Crucially, these were the men that served as chairman or led the key committees. All but one of these men, Professor Walter Heller, was a corporate executive. Fourteen of the 19 were corporate chief executives. Examined in social terms, the economy of Minneapolis looks like an oligarchy.

Certainly no one would argue that all interlocks, whether among competitors, in financing, supply, or distribution relations, direct or indirect, lead to collusive behavior. But it is unnecessary that any interlock occur. There are sufficient directors available so that each board may be staffed by disinterested persons. The costs of interlocks—favoritism, joint price or output actions, discouragement of entrepreneurs—must be weighed against what are at best negligible advantages.

Conflict of interests can also occur when large industrial corporations invite their investment banker or outside counsel to serve on their boards. For the investment banker, especially, this creates a stark division of loyalty. In addition to underwriting security offerings and relat l corporate financial services, he typically does investment counseling, employs brokers, and administers mutual funds. He is just as likely to perceive his primary obligation to run to his investment clients as to the shareholders of the corporation he directs. As one top executive explained, "As soon as you have an investment banker [on the board], you put yourself in a position where one group of shareholders might be favored at the expense of other shareholders."

A worse situation occurs when the investment banker is favored at the expense of *all* shareholders. J. M. Juran and J. Louden, authors of the American Management Association's study, *The Corporate Director*, cited instances where investment bankers have been guilty of guiding the company into a poor acquisition to create a need for selling securities. Investment banker-directors have insisted on being involved—for a fee—when the corporation seeks to borrow money from an insurance company or other lender. And when a corporation has an investment banker on its board, it becomes very difficult to transact business with other investment bankers. "Having a senior partner of an investment banking firm on our board is notice to the world that we are his captive client," said one corporate president. "Of course this is the main reason investment bankers want to be on so many boards. They think of board membership as a very good way of assuring that the business of the company goes only to them. It's a sort of Operation Stakeout. It tags the company as belonging to one particular firm."

A similar division of loyalties occurs when corporate counsel serves on the board. Attorneys have a financial interest to increase the corporation's law bills, rather than economize for its shareholders. This inability of lawyer-directors to give disinterested counsel has led some law firms to discourage partners from serving on clients' boards. For example, New York City's Debevoise, Plimpton, Lyons and Gates will not permit a partner to go on a board without the approval of the firm as a whole. Skadden, Arps, Slate, Meagher and Flom, also of New York, flatly prohibits partners from becoming directors "except in extenuating cases." Nonetheless, an exhaustive 1971–72 study of some 12,000 companies, which filed information statements with the SEC, found that approximately one in six employs an attorney from the company's outside counsel as a director.

Aggravating the costs to shareholders of these structural conflicts of interest is the tolerance by modern corporate law of self-enriching executive conduct. As early as an 1846 Supreme Court opinion, the rule was well established that any contract between an interested director and his corporation was voidable at the mere insistence of the corporation or any of its shareholders regardless of the fairness or unfairness of the transaction. Professor Harold Marsh explained why:

Under this rule it mattered not the slightest that there was a majority of so-called disinterested directors who approved the contract. The courts stated that the corporation was entitled to the unprejudiced judgment and advice of all of its directors and therefore it did no good to say that the interested director did not participate in the making of the contract on behalf of the corporation. . . .

By 1880, this principle "appeared to be impregnable. . . . It was stated in ringing terms by virtually every decided case, with arguments which seemed irrefutable, and it was sanctioned by age." One scholar termed this the "fundamental law of morals and of human nature" and identified its Biblical origin: "No man can serve two masters." "Fraud is too cunning and evasive," reasoned a New Jersey court, "for courts to establish a rule that invites its presence."

Today this principle is dead. The Delaware General Corporation Law not only tolerates interested conduct by corporate officers and directors; it has made self-dealing the norm.

Under current Delaware law, the chief executive of a corporation and other senior corporate executives may serve on the board of directors or compensation committee which: (1) sets executive salaries; (2) sells or purchases property from corporate executives; (3) loans money—on a secured or unsecured basis; with or without interest—to corporate executives; and (4) establishes pension plans, profit sharing plans, stock bonuses, retirement, benefit, incentive, and compensation plans (including "phantom stock"—a risk-free, cost-free stock option plan), trusts; health insurance; or deferred income plans for such corporate officers or their dependents.

Not only may corporate officers engage in such self-dealing but shareholders under Delaware law are nearly powerless to minimize the amount of corporate largess top executives pay themselves. Any contract or transaction between the corporation and an interested executive is permissible as long as it is "fair." But, in Delaware, fairness is presumed. Professor Ernest Folk, the leading commentator of Delaware's General Corporation Law, explains that "Given Delaware's presumption of sound business judgment with respect to board decisions, the courts will try to determine whether the decision can be attributed to any rational business purpose, and if so, there will be no judicial preemption of the decision."

There seem to be few practical limits to this doctrine. For example, if a corporate chief executive were so graceless as to embezzle $500,000, there is little question that even in Delaware he would be required to return the money and would be subject to criminal prosecution. Yet if that same corporate executive raised his salary $500,000 and received the approval of a board of directors he selected, there is equally little question that a Delaware court would term this "fair"—so long as the chief executive could point to similar salary increases in his industry or received the $500,000 through an "incentive bonus" or profit participation plan.

In the absence of judicial limitations, excessive remuneration has become the norm. In 1974 the executive compensation (salary, bonus, deferred income, and directors' fees) of the highest paid executive at the 50 largest industrial corporations was approximately $400,000—or about as much in one year as many of their employees earn in a lifetime and two and one-half times the average executive compensation of $145,000 earned by the highest paid executive at the 50 largest industrial corporations in 1963.

Contrary to the conventional wisdom, top executive salaries do not generally decrease in response to a decline in corporate sales or profits. In the recessionary years 1970–1973, Professor Wilbur Lewellen, a leading authority on executive compensation, found that the "mean" salary for the top executive at 50 large manufacturing corporations increased steadily from $251,867 in 1970, to $287,759 in 1971, $323,802 in 1972, and $389,277 in 1973.

But salary, bonus, and deferred income are only the most obvious benefits appropriated by corporate chieftains. Equally important is ownership income. Nearly every large industrial corporation offers its top executives stock options. These options allow executives to buy shares of stock in their corporation at a fixed price at any time or at specified times—often with the help of company-secured low interest loans or interest-free loans—and subsequently sell them.

From the shareholder's point of view, the result is a classic case of "heads we lose, tails you win." Over time, executives are

able to build up a substantial fortune in corporate stock without personal risk. The more they do so, the more they dilute the value of other stockholders' shares.

We examined the stock holdings of the highest paid executives at the 50 largest industrial corporations to get some indication of the extent of executive stock holdings. From the start, we eliminated from consideration the seven highest paid chief executives whose stock holdings were either largely inherited or largely "founder's shares": Henry Ford II (Ford Motors), Robert Sarnoff (RCA), Brooks McCormick (International Harvester), Willard Rockwell (Rockwell International), Armand Hammer (Occidental Petroleum), Sanford McDonnell (McDonnell Douglas) and J. P. Grace (W. P. Grace). The 43 remaining chief executives were "employee" executives. Yet each owned an average of $1,566,009 of his corporation's stock, according to the most recent proxy statements filed with the SEC and the closing stock prices of October 1, 1975.*

This crude figure illustrates three points. First, primarily at shareholder expense, the top executives of our largest corporations can and often do, build up million-dollar fortunes in corporate stock on top of their substantial cash and deferred compensation. Second, the income of top executives is significantly increased each year by dividends from their corporate stock. Using our 43 top executives again as an example again, each received an average of $60,382 in dividend income in 1974 above and beyond a $400,000 salary. Third, each top executive will further be enriched by increases in the price of the stock. Professor Lewellen has determined that a similar list of chief executives at the fifty largest industrial corporations (after deleting "extreme values" such as inherited or founder's stockholdings) averaged $220,087 per year in capital gains income for the four years 1960–63.

* This figure is admittedly a very crude approximation of ownership income. On the one hand, it does not distinguish the shares the executives purchase with their own money from those the company gave them through stock options, stock bonuses, or loan arrangements. On the other hand, it understates the amount of ownership income of these executives by making no allowance for the fact that corporate chief executives frequently sell stock they own in their own corporation and put their money in other investments.

Additionally, pension or retirement benefits have swollen. McKinsey and Company's 1975 Executive Compensation Survey found that all but one of 577 major U.S. corporations studied had a pension or profit-sharing retirement plan to pay former executives a fixed income each year after they retire. Almost half of the companies provide either a thrift or savings plan or a profit-sharing plan in addition to the pension plan. Our own survey found that the 21 chief executives of the 50 largest corporations who disclosed their estimated annual retirement benefits anticipated an income of $133,970 per year after they retire. And corporate executives also enjoy other benefits such as life and medical insurance; free medical service; educational grants for their children; indemnification insurance; company apartments; country club membership; luncheon or dinner club membership; chauffeur-driven cars; free legal and tax counseling; personal financial counseling; expense accounts; and other amenities. This myriad of stock bonus, insurance, and benefit programs increases the income of corporate chiefs by approximately 50–75 percent above their $400,000 direct remuneration to an actual income of approximately $600,000 to $700,000 per year.

Yet if excessive remuneration were a conflict of interest confined to the corporate chief executive, it would seem small once it was divided by the total number of shares in most large industrial corporations. What makes the executive compensation conflict truly expensive is that the corporate chief executive not only sets his own salary but also determines the remuneration of other executives all the way down the line. It is clearly in the corporate chief executive's personal interest to seek the greatest possible rewards for his subordinates as well as himself. For a corporate chief who can "deliver" high salaries increases the personal loyalty of his subordinates. And the higher his subordinates' income, the higher the chief executive's income must be.

A good illustration of this is General Electric, where in 1974 Reginald Jones, the chairman, received a compensation of $501,200. Walter Dance, Jack Parker, and Herman Weiss, the next three highest paid executives, received $400,750; $400,500; and $400,000, respectively. The next 107 highest paid officers averaged direct compensation of $121,240. Aggregate figures for "executive groups" at the other 50 largest industrial corporations were approx-

imately the same. In the average corporation, the 31 or so officers ranked immediately below the five highest paid executives received an average of $99,256 in direct remuneration, which would equal approximately $150,000 imputing the present value of stock bonus programs, retirement benefits, insurance, and other perquisites.

A compensation system is obviously askew when a private business corporation must pay a chief executive compensation and benefits of over $600,000 when this is 15 times the $40,000 or so the United States government must pay its highest ranking general, regulator, or Senator. Or when it must pay its next 20–100 senior executives an average of $150,000 each when the federal government expends a maximum of $38,000 per year to hire its highest ranking civil servants, and California, this nation's largest state, pays its governor $49,000.

This is not to deny that the entrepreneur or corporate founder who, at substantial risk, introduces a new or better good or service should not be given a substantial incentive to make an unusual personal contribution to society. But we are concerned here with the administrators of large industrial corporations who, at minimal personal risk, serve as the bureaucrats of private industry. These individuals receive their staggeringly large salaries and stock options by rising through executive ranks—in exactly the same way that government civil servants rise through civil service ranks—and by then exploiting the laxity of state corporate laws that their predecessors helped write.

Remedies

REVAMPING THE BOARD

The modern corporation is akin to a political state in which all powers are held by a single clique. The senior executives of a large firm are essentially not accountable to any other officials within the firm. These are precisely the circumstances that, in a democratic political state, require a separation of powers into different branches of authority. As James Madison explained in the *Federalist No. 47*:

> The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny. Were the federal constitution, therefore, really chargeable with this accumulation of power, or with a mixture of powers, having a dangerous tendency to such an accumulation, no further arguments would be necessary to inspire a universal reprobation of the system.

A similar concern over the unaccountability of business executives historically led to the elevation of a board of directors to review and check the actions of operating management. As a practical matter, if corporate governance is to be reformed, it must begin by returning the board to this historical role. The board should serve as an internal auditor of the corporation, responsible for constraining executive management from violations of law and breach of trust. Like a rival branch of government, the board's function must be defined as separate from operating management. Rather than pretending directors can "manage" the corporation, the board's role as disciplinarian should be clearly described. Specifically, the board of directors should:

- establish and monitor procedures that assure that operating executives are informed of and obey applicable federal, state, and local laws;
- approve or veto all important executive management business proposals such as corporate by-laws, mergers, or dividend decisions;
- hire and dismiss the chief executive officer and be able to disapprove the hiring and firing of the principal executives of the corporation; and
- report to the public and the shareholders how well the corporation has obeyed the law and protected the shareholders' investment.

It is not enough, however, to specify what the board should do. State corporations statutes have long provided that "the business and affairs of a corporation shall be managed by a board of directors," yet it has been over a century since the boards of the largest corporations have actually performed this role. To reform the corporation, a federal chartering law must also specify the manner in which the board performs its primary duties.

First, to insure that the corporation obeys federal and state laws, the board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created. Similar mechanisms can insure that corporate "whistle blowers" and nonemployee sources may communicate to the board—in private and without fear of retaliation—knowledge of violations of law.

Second, the board should actively review important executive business proposals to determine their full compliance with law, to preclude conflicts of interest, and to assure that executive decisions are rational and informed of all foreseeable risks and costs. But even though the board's responsibility here is limited to approval or veto of executive initiatives, it should proceed in as well-informed a manner as practicable. To demonstrate rational business judgment, the directorate should require management "to prove its case." It should review the studies upon which management relied to make a decision, require management to justify its decision in terms of costs or rebutting dissenting views, and, when necessary, request that outside experts provide an independent business analysis.

Only with respect to two types of business decisions should the board exceed this limited review role. The determination of salary, expense, and benefit schedules inherently possesses such obvious conflicts of interest for executives that only the board should make these decisions. And since the relocation of principal manufacturing facilities tends to have a greater effect on local communities than any other type of business decision, the board should require management to prepare a "community impact statement." This public report would be similar to the environmental impact statements presently required by the National Environmental Policy Act. It would require the corporation to state the purpose of a relocation decision; to compare feasible alternative means; to quantify the costs to the local community; and to consider methods to mitigate these costs. Although it would not prevent a corporation from making a profit-maximizing decision, it would require the corporation to minimize the costs of relocation decisions to local communities.

To accomplish this restructuring of the board requires the institutionalization of a new profession: the full-time "professional" director. Corporate scholar frequently identify William O. Douglas' 1940 proposal for "salaried, professional experts [who] would bring a new responsibility and authority to directorates and a new safety to stockholders" as the origin of the professional director idea. More recently, corporations including Westinghouse and Texas Instruments have established slots on their boards to be filled by full-time directors. Individuals such as Harvard Business School's Myles Mace and former Federal Reserve Board chairman William McChesney Martin consider their own thoroughgoing approach to boardroom responsibilities to be that of a "professional" director.

To succeed, professional directors must put in the substantial time necessary to get the job done. One cannot monitor the performance of Chrysler's or Gulf's management at a once-a-month meeting; those firms' activities are too sweeping and complicated for such ritual oversight. The obvious minimum here is an adequate salary to attract competent persons to work as full-time directors and to maintain the independence of the board from executive management.

The board must also be sufficiently staffed. A few board members alone cannot oversee the activities of thousands of executives. To be able to appraise operating management, the board needs a trim group of attorneys, economists, and labor and consumer advisors who can analyze complex business proposals, investigate complaints, spot-check accountability, and frame pertinent inquiries.

The board also needs timely access to relevant corporate data. To insure this, the board should be empowered to nominate the corporate financial auditor, select the corporation's counsel, compel the forwarding and preservation of corporate records, require all corporate executives or representatives to answer fully all board questions respecting corporate operations, and dismiss any executive or representative who fails to do so.

This proposed redesign for corporate democracy attempts to make executive management accountable to the law and shareholders without diminishing its operating efficiency. Like a judi-

ciary within the corporation, the board has ultimate powers to judge and sanction. Like a legislature, it oversees executive activity. Yet executive management substantially retains its powers to initiate and administer business operations. The chief executive officer retains control over the organization of the executive hierarchy and the allocation of the corporate budget. The directors are given ultimate control over a narrow jurisdiction: Does the corporation obey the law, avoid exploiting consumers or communities, and protect the shareholders' investment? The executive contingent retains general authority for all corporate operations.

No doubt there will be objections that this structure is too expensive or that it will disturb the "harmony" of executive management. But it is unclear that there would be any increased cost in adopting an effective board. The true cost to the corporation could only be determined by comparing the expense of a fully paid and staffed board with the savings resulting from the elimination of conflicts of interest and corporate waste. In addition, if this should result in a slightly increased corporate expense, the appropriateness must be assessed within a broader social context: should federal and state governments or the corporations themselves bear the primary expense of keeping corporations honest? In our view, this cost should be placed on the corporations as far as reasonably possible.

It is true that an effective board will reduce the "harmony" of executive management in the sense that the power of the chief executive or senior executives will be subject to knowledgeable review. But a board which monitors rather than rubber-stamps management is exactly what is necessary to diminish the unfettered authority of the corporate chief executive or ruling clique. The autocratic power these individuals presently possess has proven unacceptably dangerous: it has led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment. Under normal circumstances there should be a healthy friction between operating executives and the board to assure that the wisest possible use is made of corporate resources. When corporate executives are breaking the law, there should be no "harmony" whatsoever.

ELECTION OF THE BOARD

Restructuring the board is hardly likely to succeed if boards remain as homogeneously white, male, and narrowly oriented as they are today. Dissatisfaction with current selection of directors is so intense that analysts of corporate governance, including Harvard Law School's Abram Chayes, Yale political scientist Robert Dahl, and University of Southern California Law School Professor Christopher Stone, have each separately urged that the starting point of corporate reform should be to change the way in which the board is elected.

Professor Chayes, echoing John Locke's principle that no authority is legitimate except that granted "the consent of the governed," argues that employees and other groups substantially affected by corporate operations should have a say in its governance:

> Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporations whose consent must be sought. . . . Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in [corporate decision making]. They are no more affected than nonshareholding neighbors by these decisions. . . .
>
> A more spacious conception of 'membership,' and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its power in a sufficiently specialized way. Their rightful share in decisions and the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.

Professor Dahl holds a similar view: "[W]hy should people who own shares be given the privileges of citizenship in the government of the firm when citizenship is denied to other people who also make vital contributions to the firm?" he asks rhetorically. "The people I have in mind are, of course, employees and customers, without whom the firm could not exist, and the general

public, without whose support for (or acquiescence in) the myriad protections and services of the state the firm would instantly disappear. . . ." Yet Dahl finds proposals for interest group representation less desirable than those for worker self-management. He also suggests consideration of codetermination statutes such as those enacted by West Germany and ten other European and South American countries under which shareholders and employees separately elect designated portions of the board.

From a different perspective, Professor Stone has recommended that a federal agency appoint "general public directors" to serve on the boards of all the largest industrial and financial firms. In certain extreme cases such as where a corporation repeatedly violates the law, Stone recommends that the federal courts appoint "special public directors" to prevent further delinquency.

There are substantial problems with each of these proposals. It seems impossible to design a general "interest group" formula which will assure that all affected constituencies of large industrial corporations will be represented and that all constituencies will be given appropriate weight. Even if such a formula could be designed, however, there is the danger that consumer or community or minority or franchisee representatives would become only special pleaders for their constituents and otherwise lack the loyalty or interest to direct generally. This defect has emerged in West Germany under codetermination. Labor representatives apparently are indifferent to most problems of corporate management that do not directly affect labor. They seem as deferential to operating executive management as present American directors are. Alternatively, federally appointed public directors might be frozen out of critical decision-making by a majority of "privately" elected directors, or the appointing agency itself might be biased.

Nonetheless, the essence of the Chayes-Dahl-Stone argument is well taken. The boards of directors of most major corporations are, as CBS's Dan Rather criticized the original Nixon cabinet, too much like "twelve grey-haired guys named George." The quiescence of the board has resulted in important public and, for that matter, shareholder concerns being ignored.

An important answer is structural. The homogeneity of the board can only be ended by giving to each director, in addition to a general duty to see that the corporation is profitably administered, a separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board. There might be nine corporate directors, each of whom is elected to a board position with one of the following oversight responsibilities:

1. Employee welfare
2. Consumer protection
3. Environmental protection and community relations
4. Shareholder rights
5. Compliance with law
6. Finances
7. Purchasing and marketing
8. Management efficiency
9. Planning and research

By requiring each director to balance responsibility for representing a particular social concern against responsibility for the overall health of the enterprise, the problem of isolated "public" directors would be avoided. No individual director is likely to be "frozen out" of collegial decision-making because all directors would be of the same character. Each director would spend the greater part of his or her time developing expertise in a different area; each director would have a motivation to insist that a different aspect of a business decision be considered. Yet each would simultaneously be responsible for participating in all board decisions, as directors now are. So the specialized area of each director would supplement but not supplant the director's general duties.

Although not a symmetrical analogy, the most successful precedent for dividing the representative responsibilities and constituencies is, of course, the Constitution of the United States. There, too, a basic question was one of motivation: How to design a political administration which would retain an equal respect for the rights of all of its citizens. Only by arranging "ambition . . . to counteract ambition" did the Federalists believe such respect would endure. By granting the President, the two houses of Congress, and the judiciary different geographic constituencies, different

terms, and different duties, the various factions of the nation's citizens were most likely to be insured some representation within the government. "Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself," explained Madison in *Federalist No. 51*.

In recent years, some business corporations have also perceived the advantages of creating constitutent voices within the structure of the firm. Reverend Leon Sullivan, the only black director on General Motors' board, has made plain that he considers it his special responsibility to advance the interests of GM's black employees and dealers. His representation, among other things, has led to an increase in the number of blacks being trained to be GM executives. Gillette's Vice President for Product Integrity, Robert Giovacchini, is said to perform a similar role. Although not a member of the board, Mr. Giovacchini has been given the authority to recall any Gillette product, quash any advertising claim, or order any packaging change he feels is necessary to protect the company's consumers.

Only by institutionalizing the duties and power that individuals like Reverend Sullivan and Robert Giovacchini hold can responsible corporate government be brought to each large firm.

For in most giant corporations, no specific executive official or board member is responsible for protecting the interests of employees, consumers, the environment, or local communities. No one outside of senior management reviews the most important business decisions to assure their compliance with law, financial integrity, efficiency or long-term corporate goals. Because these concerns become everybody's general interest, they become nobody's particular interest—and often go unattended.

To maintain the independence of the board from the operating management it reviews also requires that each federally chartered corporation shall be directed by a purely "outside" board. No executive, attorney, representative, or agent of a corporation should be allowed to serve simultaneously as a director of the same corporation. Directorial and executive loyalty should be furthered by an absolute prohibition of interlocks. No director, executive, general counsel, or company agent should be allowed to serve more than one corporation subject to the Federal Corporate Chartering Act.

Several objections may be raised. First, how can we be sure that completely outside boards will be competent? As elaborated subsequently, corporate campaign rules will be redesigned to emphasize qualifications. This will allow shareholder voters to make rational decisions based on information clearly presented to them. It is also a fair assumption that shareholders, given an actual choice and role in corporate governance, will want to elect the men and women most likely to safeguard their investments.

A second objection is that once all interlocks are proscribed and a full-time outside board required, there will not be enough qualified directors to staff all major firms. This complaint springs from that corporate mentality which, accustomed to 60-year-old white male bankers and businessmen as directors, makes the norm a virtue. In fact, if we loosen the reins on our imagination, America has a large, rich, and diverse pool of possible directorial talent from academics and public administrators and community leaders to corporate and public interest lawyers.

But directors should be limited to four two-year terms so that boards do not become stale. And no director should be allowed to serve on more than one board at any one time. Although simultaneous service on two or three boards might allow key directors to "pollinize" directorates by comparing their different experiences, this would reduce their loyalty to any one board, jeopardize their ability to fully perform their new directorial responsibilities, and undermine the goal of opening up major boardrooms to as varied a new membership as is reasonable.

The shareholder electoral process should be made more democratic as well. Any shareholder or allied shareholder group which owns 1 percent of the common voting stock in the corporation or comprises 100 or more individuals and does not include a present executive of the corporation, nor act for a present executive, may nominate up to three persons to serve as directors. This will exclude executive management from the nomination process. It also increases the likelihood of a diverse board by preventing any one or

two sources from proposing all nominees. To prevent frivolous use of the nominating power this proposal establishes a minimum shareownership condition.

Six weeks prior to the shareholders' meeting to elect directors, each shareholder should receive a ballot and a written statement on which each candidate for the board sets forth his or her qualifications to hold office and purposes for seeking office. All campaign costs would be borne by the corporation. These strict campaign and funding rules will assure that all nominees will have an equal opportunity to be judged by the shareholders. By preventing directorates from being bought, these provisions will require board elections to be conducted solely on the merit of the candidates.

Only the actual or "beneficial" owners of stock should be eligible to vote. Financial intermediaries shall be required to "pass through" voting rights in approximately the same manner that present New York and American Stock Exchange rules require broker-dealers to "pass through" proxies and corporate reports to shareholders owning stock in street name accounts. Already a number of major firms, including Sears, Roebuck, General Motors, McDonnell Douglas, and United States Steel, "pass through" voting rights to hundreds of thousands of employees holding stock in joint pension funds.

Finally, additional provisions will require cumulative voting and forbid "staggered" board elections. Thus any shareholder faction capable of jointly voting approximately 10 percent of the total number of shares cast may elect a director.

A NEW ROLE FOR SHAREHOLDERS

The difficulty with this proposal is the one that troubled Juvenal two millennia ago: *Quis custodiet ipsos custodes*, or, Who shall watch the watchmen? Without a full-time body to discipline the board, it would be so easy for the board of directors and executive management to become friends. Active vigilance could become routinized into an uncritical partnership. The same board theoretically elected to protect shareholder equity and internalize law might instead become management's lobbyist.

Relying on shareholders to discipline directors may strike many as a dubious approach. Historically, the record of share-

holder participation in corporate governance has been an abysmal one. The monumental indifference of most shareholders is worse than that of sheep; sheep at least have some sense of what manner of ram they follow. But taken together, the earlier proposals—an outside, full-time board, nominated by rival shareholder groups and voted on by beneficial owners—will increase involvement by shareholders. And cumulative voting insures that an aroused minority of shareholders—even one as small as 9 or 10 percent of all shareholders—shall have the opportunity to elect at least one member of the board.

But that alone is hardly sufficient. At a corporation the size of General Motors an aggregation of 10 percent of all voting stock might require the allied action of over 200,000 invididuals—which probably could occur no more than once in a generation. To keep directors responsive to law and legitimate public concerns requires surer and more immediate mechanisms. In a word, it requires arming the victims of corporate abuses with the powers to swiftly respond to them. For only those employees, consumers, racial or sex minorities, and local communities harmed by corporate depradations can be depended upon to speedily complain. By allowing any victim to become a shareholder and by permitting any shareholder to have an effective voice, there will be the greatest likelihood of continuing scrutiny of the corporation's directorate. Shareholder involvement can be further enhanced by the disclosures discussed in the next chapter, by the opportunity to attend periodically scheduled directors' meetings to ask questions or present grievances, and by reform of the shareholder derivative action so that any investor who identifies a corporate violation of law may bring lawsuit without risk of financial loss.

For the purpose of motivating the board to perform its intended role, however, it is appropriate to inject shareholders further into corporate governance wherever they have a financial or other incentive to perform effectively.

Six weeks before a vote on any fundamental transaction—which can be defined as executive proposals involving the purchase, sale, lease, merger, consolidation, financing, refinancing, dissolution, or liquidation of assets equal to, say, 10 percent of the corporation's total assets or over $100 million, or the authorization

of corporate securities in any amount—the board should forward a written statement to the shareholders explaining the transaction, the vote by which the transaction was approved by the board, the reasons why members of the board approved the transaction, the reasons why other members opposed it, and the foreseeable costs and risks of implementing the proposal. This provision would provide for shareholder votes on all business decisions above a certain minimum size, however named. By requiring directors to publicly elaborate their reasoning—reasoning which may be judged not only during this vote but also during subsequent board elections or mismanagement suits—there would be a powerful incentive for directors to police themselves.

A complementary provision should allow any shareholder or allied shareholder group holding stock equal to a minimum of one percent of all outstanding stock to simultaneously publish a dissenting view or, at any time, to propose amendments to the corporate charter or bylaws.

AFFECTED COMMUNITIES

Shareholders are not the only ones with an incentive to review decisions of corporate management; nor, as Professors Chayes and Dahl argue, are shareholders the only persons who should be accorded corporate voting rights. The increasing use by American corporations of technologies and materials that pose direct and serious threats to the health of communities surrounding their plants requires the creation of a new form of corporate voting right. When a federally chartered corporation engages, for example, in production or distribution of nuclear fuels or the emission of toxic air, water, or solid waste pollutants, citizens whose health is endangered should not be left, at best, with receiving money damages after a time-consuming trial to compensate them for damaged property, impaired health, or even death.

Instead, upon finding of a public health hazard by three members of the board of directors or 3 percent of the shareholders, a corporate referendum should be held in the political jurisdiction affected by the health hazard. The referendum would be called by the unit triggering it—either the three board members or a designate of the shareholders. The affected citizens by majority vote will then decide whether the hazardous practice shall be allowed to continue. This form of direct democracy has obvious parallels to the initiative and referendum procedures familiar to many states—except that the election will be paid for by a business corporation and will not necessarily occur at a regular election.

What would happen to the local community if it voted to close a dangerous plant? Three answers seem reasonable. First, the board of directors should have the opportunity to modify the local plant to reduce the health hazard. If the board chooses to do so, it should be allowed to submit its modification plan as a subsequent referendum for community approval. Second, if the corporation chooses to leave after the vote, it should be required to immediately repay the local community for all damages to its health and property by the outlawed activity. This valuation proceeding should occur in federal district court. If the corporation chooses to leave before the referendum vote, it should additionally be required to pay its local employees salaries for a reasonable interim period. Third, the referendum voting procedure should be flexible. Local communities should be given the opportunity to vote upon an initiative calling for the corporation to remedy a specific health hazard by a designated date as an alternative to one calling for immediate closing of a plant. Similarly, the board should be given the opportunity to submit a plan of modification simultaneously with the initial referendum vote.

This type of election procedure is necessary to give enduring meaning to the democratic concept of "consent of the governed." To be sure, this proposal goes beyond the traditional assumption that the only affected or relevant constituents of the corporation are the shareholders. But no longer can we accept the Faustian bargain that the continued toleration of corporate destruction of local health and property is the cost to the public of doing business. In an equitable system of governance, the perpetrators should answer to their victims.

WORKING PAPER ON

DIVIDEND DISPERSAL PROGRAMS

By Governor Jay S. Hammond

There is increasing interest in providing Alaskans with a "piece of the action" through some method of distributing "dividends."

I am encouraged by this for I believe it appropriate that all Alaskans receive some direct benefits from their resource wealth rather than simply receiving whatever more government we politicians think they should have.

-- ALASKA INC.

Some few years ago, I proposed a means by which a portion of income earned from investments of the public's resource wealth would be distributed in direct dividends to all "shareholders". This proposal became known as Alaska, Inc. I introduced a modified form of Alaska, Inc. again this year, as has Senator Sumner.

-- AGSOC

Another means of granting Alaskans a "piece of the action" has been proposed by Senator Gravel. This is known as "Alaskan General Stock Ownership Corporation" or AGSOC. Unlike Alaska, Inc. which disperses a portion of earnings from investments of citizen-owned resource wealth, an AGSOC would permit citizens to own shares of development programs which might relate - but not necessarily exclusively - to the manner in which that resource wealth was transported, refined or manufactured. The necessary capital to acquire ownership in such endeavor could come either from the sale of tax free revenue bonds, private financing or State guaranteed funds.

-- MUTUALLY EXCLUSIVE OR COMPATIBLE?

While the intent of both programs is similar, there are important distinctions. Moreover, while they are by no means mutually exclusive, I am increasingly convinced that insofar as the State's long term best interest is concerned, an AGSOC can best work only if an Alaska, Inc. program is first put into place and, as well, certain amendments are made to both bills now before us.

In order to discuss my reasons for so concluding, it is necessary first to explain how, ideally, I believe an Alaska, Inc. program should work.

-- MECHANICS OF ALASKA, INC

Each Alaskan would receive, annually, one share of 1/2 the earnings of Permanent Fund investments for every year they have resided in "an area where cost of living was recognized by the Federal government as warranting a 25 percent cost of living pay differential for its employees." While nothing is said about residency versus nonresidency, all Alaskans, of course, would qualify. Those with longer tenure would accrue more shares. Shares would not be transferable. However, new Alaskans, upon qualification, would as well receive shares.

Application for annual dividends could be made upon filing an income tax form attesting to ones having resided during most of the previous year in such a high C.O.L. area. Thus, persons who leave the state would no longer qualify after one year.

In a bill I presented to the Legislature this year, House Bill 99, such "dividends" would come only in the form of tax credits. Moreover, no one would qualify for more than one share for each year during which the applicant had paid State income taxes up to a total of five shares. This five-year limitation was proposed since Department of Revenue tax records are held for only five or six years.

While this approach was taken to curry support from those who wanted tax relief as well as for administrative convenience in checking an applicant's eligibility, it raises serious questions.

For example, all citizens, whether they're taxpayers or not, are impacted by Alaska's high cost of living. Moreover, if you truly believe, as I do, that Alaskans collectively own such resource wealth as their royalty oil, how can we justify dispersing income investments of collectively owned Alaskan wealth selectively to only those who make enough money to have to pay taxes? Accordingly, I would prefer that dividends go to all otherwise qualified citizens either in the form of tax credits or as a negative income tax return.

Additionally, since the rationale for dispersing dividends is based on the belief that with all their energy wealth Alaskans should receive at least some direct relief from the exceptionally high price they've had to pay for energy, then there is little rationale to compensate them for but 5 years of such impact. Compensation should be for each year so impacted.

Though determining the number of years for which each applicant is qualified may seem difficult, it is less difficult than obtaining similar data required for proof of eligibility for receipt of the longevity bonus, guide licenses, limited entry permits, or entry into a pioneer home.

To minimize administrative costs and the likelihood of perjury, we could require an affidavit from the applicant with two other "shareholders" as witnesses. If all parties were to lose eligibility should they perjure themselves, it is unlikely many would falsify claims. In those cases where no witnesses will come forward, shares could be confined to the number of years the applicant can provide documentation to prove his case, i.e., tax records, etc.

The conclusion that an Alaska, Inc. type program should be established before an AGSOC proposal was reached primarily because of the potentials of an AGSOC to place the shareholders' interests precisely at odds with State interests. For example, one AGSOC proposal involves partial purchase of the trans-Alaska oil pipeline. Should all shareholders then get dividends based on the profitability of that purchase, it is to the shareholders' benefit to get the highest possible price - i.e. tariff - for transporting oil. However, the State treasury, including the Permanent Fund, gets more money the lower the tariff. Thus, the AGSOC's interest would be precisely opposite those of the State in regard to the level of tariff. On the other hand, in the case of an Alaska, Inc. type distribution of Permanent Fund earnings, the interests of the State and the shareholders would be precisely the same.

Similarly, if an AGSOC were to invest in a petrochemical plant, its shareholders would benefit if we sold that plant our royalty oil at a cut rate. This too would be a loss to the State's Permanent Fund and to those who did not hold shares of that AGSOC.

Only by passing an Alaska, Inc. type program first could we likely establish conditions where the State and all Alaskans' interests were compatible insofar as maximizing the return from the citizens' resource wealth. Once in place, such programs reduce the likelihood of conflicting AGSOC proposals being undertaken.

In its present form, proposed AGSOC legislation has other problems:

1. Since only one share of stock goes to each person here in Alaska at the time each AGSOC is formed, ultimately there would be two types of Alaskans: those who were shareholders, and those who were not.

Remedy:
One way to remedy this is to amend the bill to provide one share of stock for each year the shareholder has resided in a locale where the government recognizes cost of living impact sufficient to warrant their payment of a 25 percent cost of living differential to government workers. Then all Alaskans would be shareholders.

2. AGSOC shares would be transferable, permitting money to leave Alaska. This should be amended since the prime objective and rationale is to insure that Alaskans get a "piece of the action" to compensate them, in part, for the exceptionally high cost of living impact here in Alaska. Accordingly, persons who have moved to Hawaii or California have no justification for receiving such cost of living offset.

Remedy:
A remedy would be to require that persons make application for their annual dividends on an Alaskan income tax filing form attesting to their having resided during most of the previous year in an area of qualifying high cost of living differential.

3. Another problem is, what if the AGSOC loses money? Who then pays off the bonds or other debt obligations? I am opposed to State guarantees. Would the AGSOC shareholders then become liable?

Remedy:
To offset this concern, were the Alaska, Inc. concept in place first, guarantees or collateral could be an AGSOC shareholder's prospective Alaska, Inc. dividends. Far better to use the AGSOC shareholder's prospective Alaska, Inc. dividends as such than use, as guarantees, Permanent Fund principle or general fund monies which belong to all Alaskans, not just AGSOC shareholders.

4. Under an AGSOC proposal some shareholders may be unwilling participants in programs to which they are philosophically or otherwise ill disposed.

Remedy:
If one is already a shareholder in an Alaska, Inc. program, they should be able to elect whether or not they wish to become an AGSOC shareholder. By so doing, they would not be compelled to participate in some development program they may not favor in order to get any "piece of the action" whatsoever.

Another reason why the Alaska, Inc. program should go in place first is because it would motivate placement of more oil wealth behind the Permanent Fund "rope" where it could not be used for more government or as guarantees for some shakey AGSOC proposal. Since Alaska, Inc. shareholder "dividends" are directly dependent upon the amounts of money placed in the Permanent Fund, there would be a countering pressure to those political pressures which create bigger government.

Because the Alaska, Inc. approach would provide "dividends" from an "enterprise" already returning revenues which belong to all Alaskans, the charge of "improper involvement of government into private sector affairs" is absent. Of course, since AGSOC's are not truly government functions the traditional "undue involvement" charge does not really wash. However, because of the potential impact on government funds to bail out ailing AGSOCs, a reverse concern may be valid: "undue involvement by the private sector in the affairs of government."

Other advantages recommending prior implementation of Alaska, Inc. are its comparative simplicity and the fact that unlike the speculative nature of any AGSOC, we would be betting on a "sure thing." For example, we know that we have a fully capitalized, debt free enterprise in the Permanent Fund which can immediately start paying "dividends". No loans must be made; bonds sold; speculation engaged in. We are already functioning "in the black." Surely if we're going to condition the public to feel comfortable with any "dividend distribution' system at all, we should start with a simplistic "sure" winner.

A major benefit of increasing contributions to the Permanent Fund is that the other half of the resultant increased recurring income from Permanent Fund investments would flow into the General Fund where it could supplant these non-recurring oil wealth dollars now improperly funding our day to day government operations. Such reduction of our dangerous dependence upon principle dollars for funding operations - which should be funded with income dollars - is imperative.

If the AGSOC program goes on the line first, the chances of finding surplus State dollars to place into the Permanent Fund would likely diminish.

Thus, while I favor both the Alaska, Inc. and AGSOC concepts for insuring all citizens a "piece of the action," I believe it imperative that the Alaska, Inc. program be placed on line before an AGSOC be established. Meanwhile, I would like the enabling AGSOC legislation amended to deal with those problems I've previously outlined.

Buy In-State, Adviser Tells AGSOC Backers

By LAURA ZAHN
Empire Staff Reporter

An investment banker hired by the Legislature says a proposed resident owned general stock ownership corporation, AGSOC, should only invest in projects within the state, not operate them.

John A. Miskimen, senior vice president of Kelso and Co. of San Francisco, Calif. concluded a 10-day visit to Fairbanks, Anchorage and Juneau today, after talking with business, governmental and Native leaders in those cities. Miskimen has been hired to study the economy of the state and investment possibilities for the Alaska General Stock Ownership Corp., (AGSOC), proposed by U.S. Sen. Mike Gravel and Kelso and Co.

Under the proposed plan, residents would receive one share of stock and control the corporation's investment decisions. The state would back the corporation with a $5 million loan guarantee, but it would make no investment in the corporation, according to Dale Staley, legislative aide to Juneau Rep. J n Duncan.

Staley and another Duncan aide, Commissioner of Commerce and Economic Development Charles Webber, Juneau Mayor Bill Overstreet and other local business and government leaders heard Miskimen say this morning that "public opinion on this issue has not jelled one way or another."

Miskimen recommended that AGSOC "get involved in a situation where the supplier needs capital to get off the ground," but stay away from being an operating company.

"There's no reason to get involved where there's already plenty of investment capital," he said. The corporation could remain small, with about 25 employees, for instance, and manage to return 90 percent of its profits to shareholders. Under federal laws it would have to make that size return to be within IRS codes.

Good investment possibilities include becoming involved in leasing equipment to companies operating in Alaska.

Also AGSOC should consider building a large generating facility at the mouth of a Fairbanks coal mine, and selling the electricity to Fairbanks. "The mining company does not seem to be able to make the investment to put together a generator of that size," Miskimen said.

Another good investment would be to buy British Petroleum's Inc., 15 percent share of the Trans-Alaska oil pipeline for about $1.3 billion. That investment alone would bring about $200 a year in dividends to Alaskans owning one share of AGSOC, he said.

Possible drawbacks of the BP investment would be the large expenditure required, and the fact that the already established pipeline would not add jobs to the economy.

If the organizers are careful about the initial loan guarantee and its terms with the state, "10 years from now, you won't recognize AGSOC from XYZ corporation...except that it's owned by Alaskans," he said.

An amendment may be necessary to insure that the Board of Directors, at first appointed but then elected by stockholders, are not from one area of the state, Miskimen said.

AGSOC will have to "diversify the investments across the state," so that in 10 years there will be investments in each part of Alaska, he said.

The original board under the proposal would be appointed by the house speaker, senate president and governor, who are presently from Southeast and Southcentral.

"The management is all-important—whoever selects the board is going to be under public scrutiny, which (should) tend to create a higher quality board," Miskimen said.

Large blocks of stock ownership would not be possible because no corporations can buy it, it can only be transferred when someone dies or leaves the state, and no individual can own more than 10 shares, he said.

Although "you can't regulate people against cheating," Miskimen said he thinks penalties for cheating are "fairly substantial" to deter residents from doing so.

He recommended subsequent issues of stock or provisions for new residents or new births so that "two classes of residents" don't result.

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Labor Department Mov

By Empire Staff

Attorney General Avrum Gr this week issued an opinion discounting the objections of some Southcentral Alaska lawmakers with plans for the Department of Labor to move into a new building in Juneau.

Ten Anchorage-area lawmakers, plus Matanuska-Susitna Borough Mayor Ron Larson, last week wrote Gov. Jay Hammond charging that state plans to lease a new facility for the Labor Department violates the wording of the FRANK initiative passed by

capital site to another capital site, and that it has no relevance on moving from one building to another within the same capital site," he said.

The federal government, which picks up the bulk of Department of Labor's cost for rental of office space, late this summer said it would stop paying rent for the department's main offices, currently at Fourth and Harris streets in the downtown area. The government said the two-story building violates its rules for access for the handicapped.

ing sought for the project.

Anchorage lawmakers l however, wrote Hammond FRANK initiative, which requ approve the full bondable cost move before it can start also for relocation of a central facility in Juneau. Gross dispu

"Carried to the extreme, o have to get a renewal of the costs of moving people from