

HB

537

THE FOLLOWING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.



Ombudsman

Frank Flavin

OCT 10 1977

September 30, 1977

Mr. B. B. Allen
Commissioner
Department of Administration
Pouch C
Juneau, Alaska 99811

① 1st Jan - transfers
of
② enrollment 2 months
of 1st
(equitable)
③ Hartford court
④ I.R.S. questions big question
⑤ No reply from
J.B. Allen

State of Alaska
360 "K" Street, Room 246
Anchorage, Alaska 99501
(907) 226-4011



RE: 77-1586 (Pending)
Preliminary Report

Dear Commissioner Allen:

Please be advised that the above-cited complaint has been investigated by the Office of the Ombudsman. In pursuing information relevant to this complaint, several other problems have come to light prompting us to expand this investigation into a special Ombudsman investigation (pursuant to AS 24.55.120) spanning the last four months.

The original complaint alleged that the changes brought about in the State Employees' Deferred Compensation Program were unsupported by fact or logic, were contrary to legislative intent, and represent a breach of good faith on the part of the State. For clarity, we have separated the issues in the discussion which follows.

Pursuant to AS 24.55.150, the Ombudsman may investigate an administrative act of an agency which the Ombudsman has reason to believe might be:

- (1) contrary to law
- (2) unreasonable, unfair, oppressive, arbitrary, capricious, an abuse of discretion, or unnecessarily discriminatory, even though in accordance with the law
- (3) based on a mistake of fact
- (4) based on improper or irrelevant grounds
- (5) unsupported by an adequate statement of reasons
- (6) performed in an inefficient or discourteous manner
- (7) or otherwise erroneous

Because of the complexity of this subject which involves financial investment of public monies, and the fact

Copy to State...

that time has been a major factor in this issue, we have not pursued the merits of one deferred compensation investment vehicle versus another. However, we support the contention that the questions raised by the complainant in this matter are significant and do require appropriate review. Our recommendations address this need.

As Mr. Gates indicated in his September 12 letter to my Assistant, Don Fisher, the background of this matter must be examined in order to understand the recent action involving the Deferred Compensation Program. It is our understanding that the deferred compensation fund is viewed by your department as state monies whose management comes under the general authority of AS 35, Public Finance, and is subject therefore to the requirements set forth in that chapter.

Our investigation revealed several major discrepancies in the State's management of the Deferred Compensation Program. These discrepancies centered around the failure of the State to responsibly monitor and supervise the professional actions and attitude of the State consultant, Mr. Robert Irwin of the William Mercer Company. In his capacity as the State's consultant, Mr. Irwin allegedly threatened Hartford associates several times, in front of witness in September, 1976, to use his influence to remove the Hartford Company from the Deferred Compensation Program. The fact that personal problems existed between the Hartford people and the consultant were communicated to then Director of Retirement, Mr. Robert Gates, in a February 16, 1977, luncheon meeting with Mr. Ron Robinson of Hartford at the Jun. au Hilton Hotel. Further concern was expressed about Mr. Irwin's conduct in a letter dated May 27, 1977, to Mr. Irwin from Michael E. Greene, Assistant Vice President and Director of Sales for Hartford. You responded to Mr. Greene's letter on June 2, 1977. Both letters are attached as Exhibit 1 to this report.

In his September 12, 1977, letter to Mr. Fisher, Mr. Gates stated that "the Hartford was advised on May 11, 1977, that we were not satisfied with the proposal which had been presented up until that date..." In conversation with Mr. Fisher, Mr. Gates further advised that on the State's authority bid questionnaires were solicited by the consultant, Robert Irwin, and that the bid period was June 15 through July 15, 1977. He also indicated that Mr. Irwin had opened the bids on

behalf of the State on July 15, in his Seattle office. Mr. Irwin's consultant's report was not dated, but Mr. Gates stated it was received by the State on August 15, 1977.

The record of dates as restated above indicates that the bid process was perceived as a necessary procedure in conducting this transaction of public finance. However, at least two items of record were retracted from the Equitable's original bid on August 3, 1977. These changes were agreed upon approximately nineteen days after the bidding period had closed. Exhibit 2 is a copy of a letter dated August 3, 1977, from Paul J. Dolinoy, Pension Consultant with The Equitable, to Mr. Robert F. Irwin. In his letter Mr. Dolinoy states in part, "You expressed concern about the penalty (3%) that would be levied in the event that a unilateral withdrawal of the fund was made by the State of Alaska prior to the end of the guarantee period. Your concerns were communicated to Equitable's home office in New York with the hope that an arrangement could be worked out where there would be "no penalty" after the market value adjustment was determined. We are pleased to inform you that the "penalty" provision of the market value adjustment will be eliminated..."

A second change was made in the Equitable bid on August 3, 1977, in another letter from Paul J. Dolinoy to Robert Irwin. In part it said, "We have re-evaluated the guaranteed expenses for the above group's Deferred Compensation Program and we are pleased to advise you that we were able to decrease our expense formula to .25% from the previously quoted .30%." A copy of this letter is attached as Exhibit 3.

Impact:

Alaska Statute 37.05.230, embellished by the 1959 Attorney General's Opinion No. 27, set the tone and has direct application in the matter at hand. "The purpose of this chapter was not only to protect the State and the public purse from uneconomic contracts let by use of failure to request competitive bids and because of possible favoritism, but was also to insure that contractors would be insured a certain amount of "fair play" in dealing with the State government and in competing with one another for State contracts." In allowing a consultant for the State to act exclusively unsupervised and in private in a distant city (Seattle) on a sealed public bid, and with the prior knowledge that his professional perspective had been seriously questioned, has cast a cloud over the entire process. In effect, the bids were not opened in public. The State failed to ensure that an employee of the State was present at the opening

on July 15, 1977 to ensure that AS 37.05.230 and 37.05.240 were adhered to. In addition, major changes to the plan were negotiated by the consultant with his choice of program carriers after the bids were opened. This violates the intent of the bidding process and undermines the spirit of "fair play" which is insured by AS 37.

Findings

I find; that the State failed to follow the bidding requirements as set forth as AS 37.05.250, in that the Retirement and Benefits Division delegated the duties and legal obligations of soliciting and opening bids to Mr. Robert Irwin, an unauthorized individual not in the employment of the State; and that the State authorized Mr. Robert Irwin to open bids in his Seattle office, not in public as prescribed in AS 37.05.230(2); and that through the State's acquiescence, Mr. Irwin negotiated significant changes in the Equitable carrier's original bid after the July 15 closing date in violation of the spirit and intent of AS 37.05.230; and that AS 37.05.240 requiring specific organization of bidding documents was not adhered to.

The statute states: "All bids with the names of the bidders and the amounts of the bids, together with all documents pertaining to the award of a contract, shall be made a part of a file or record and retained by the department . . . and these files or records are open to public inspection at all reasonable times."

It was our finding that no such coordination of bids and documents existed in the State files and were therefore not readily available to the public upon request. It was our understanding that most records pertaining to the bids were in Mr. Irwin's custody.

In view of the secretive manner in which this initial changeover of the Deferred Compensation Program was done and due to the peculiarities of this system, it is recommended that:

1. The State immediately stop further action in pursuing the new contract with Equitable and T. Rowe Price until the following step has been accomplished and the collective decision has been reached by those involved:
2. In light of the reported conflicts of the present consultant cited above, Commissioner of Administration establish a committee of five impartial persons, two of whom would meet with approval of the executive branch and three of whom would meet with the approval of APEA, Local 71, and IBU, whose members comprise in excess of 85% of the total plan participants.

RE-INSURED

September 30, 1977

Because of the constraints of time we have not outlined how the above committee should operate; however, we will detail these procedures at a later time. In addition, because of the limited time involved, we have not put forth our concerns about the lack of participant input into the management decisions of this program.

The above recommendations have taken into account the fact that the 1978 open enrollment period is to begin October 1, 1977. We see no reason why the present carrier cannot continue to enroll new participants and make necessary adjustments for current members regardless of the outcome of this matter. On the other hand, if this is perceived as a problem, the review process could be expedited and would merely result in a shortening of the open enrollment period this year.

Since this represents the formal report with recommendations from this office, may we please be advised of the disposition your agency gives to each recommendation in accordance with 21 AAC 05.080.

We will appreciate your careful consideration of these recommendations.

Sincerely,

Frank Flavin
Frank Flavin *by DF*
Ombudsman

FF/DF/lh

cc: Don Fisher, Ombudsman Assistant
Governor Hammond, State of Alaska

1,100 state workers involved:

Tax shelter faces a challenge

by Howard Weaver

Anchorage

Debate surrounding planned changes in the deferred compensation plan for state employes has many of the 1,100 participants worrying about the tax-exempt status of almost \$10 million of their money.

The deferred compensation plan (DCP), through which workers reduce their tax burden by electing to postpone receipt of some wages, has been called to question because the IRS was not notified of a planned change in administration. State officials say there are "absolutely confident" that the contemplated change of investment managers is not a substantive modification and so does not require the IRS okay.

But if they're wrong, the plan—designed as a tax shelter—could become a massive tax liability for most participants. Should the plan be disallowed, participants face the prospect of having their money returned in one lump sum—all of it then taxable at high rates.

"There is no problem and has never been a problem. Everyone (in state government) is very confident there is no problem," said Paul Arnoldt, who as director of the Division of Retirement and Benefits heads the program.

Critics are not that sure. Senior officials of Hartford Insurance Co.—which stands to lose the contract to manage the fund—say the proposed transfer of carriers and investment plans likely are substantive amendments. That would require approval which the IRS says it just won't give, they say.

Meanwhile, the procedure used to award the investment contract is under investigation by the state Ombudsman's Office. Results of his preliminary examination say the manner in which that contract was changed "violates the intent of the bidding

It's called 'deferred compensation,' and it's turned into what one state official calls 'a game of politics.'

He also said changes made after the selection process closed were "improvements to an already superior product." Had the consultant not accepted them, he said, the state would have received a program less suitable than it ultimately got.

The uncertainty about IRS approval, however, could make moot the question of who manages the investments. In the worst case, tax agents could simply disqualify the plan, mandating return of deferred wages. That would leave participants holding the bag for taxes perhaps greater than they would have paid had they not deferred income. The returned funds would be counted taxable income; they are exempt only while in the DCP system. Since the money would come all in one tax year, participants likely would find themselves in a higher bracket than if they had not deferred income over a period of years.

The plan has proved extremely attractive to many state workers—especially those in the upper range of the salary schedule. Some state employes have deferred more than \$2,000 monthly, and total investments run to more than \$30,000 for some individuals.

One state employe, at least, has written to Allen raising concerns over the IRS status of the system and asked the state to guarantee he will not suffer by participating in the plan. He said representatives of Rowe Price and Equitable were "unable to answer the questions" he raised.

In a recent letter to Allen, the employe said the uncertainty "leaves me totally con-

U.S. Internal Revenue Service approval for its deferred compensation plan.

"Therefore, before I made my decision on what amount of my income, if any, to defer during . . . 1978, I am formally requesting that you . . . certify to me that I shall incur no federal or state tax liability on any income so deferred as long as I am enrolled in the State deferred compensation plan.

"In effect, I am asking that you agree to hold me harmless should the Internal Revenue Service eventually decide that as of January 1, 1978, the State of Alaska did not have a valid ruling on the plan," the letter said.

At issue is what the IRS calls a "private taxpayer letter," by which the tax service authorizes tax-exemption plans such as the Alaska DCP. The State obtained approval for its plan in 1974—but, as is often the case with the IRS, there's a catch.

After approving the DCP as passed by the legislature and amended, the IRS cautioned ". . . that if the Plan is amended or modified . . . this ruling may no longer apply."

To compound that threat, the IRS recently issued a bulletin saying it does not intend to issue any new approvals or to approve newly amended plans pending a review of the deferred income, tax shelter schemes. If plans to change carriers for the plan and related changes in it are deemed substantive—therefore requiring IRS approval—the State could find itself without a valid DCP.

But while the state is most unlikely to

officials say they are confident the change in management does not require IRS approval and the DCP will remain a solid tax shelter.

Asst. Atty. Gen. Tom Koester, who is preparing a formal opinion at Arnoldt's request, says he sees "no spectre of adverse tax consequences" for DCP participants.

"I don't believe IRS approval is jeopardized by a change in carriers. We're not changing the terms of the plan document approved by the IRS (in 1974)," he said.

Robert R. Baird, vice president of Hartford, sees it differently. In a recent letter, he wrote, ". . . it is difficult to think of any amendment which is meaningful as far as the operation of the plan is concerned which would not also be considered substantive by the IRS."

Later, Philadelphia lawyer Daniel S. Knight prepared an opinion at Baird's request and came to similar conclusions.

Since the state plan authorized by the IRS specifies that DCP payments will "equal the amount which would have been payable under a variable annuity contract" and the proposed new managers don't offer variable annuities, the plan likely would need amendment, Knight said.

". . . At a bare minimum, the State of Alaska would be most imprudent if it did not call these changes to the attention of the (Internal Revenue) Service," he wrote.

The state hasn't done that, and doesn't intend to, according to Arnoldt. "It's been our feeling right along that we're not changing the plan. There's been no change, so why ask for approval? There is absolutely no need or justification," he said.

The only problem, he says, has come from rumors spread by "self-serving interests"—a clear reference to Hartford agents—who may well lose their status as providers of the DCP service. Arnoldt laid responsibility for the disquiet on "people looking more from their interested perspective than the interest of participants."

say the manner in which that contract was changed "violates the intent of the bidding process and undermines the spirit of 'fair play' . . ."

That change, resulting from a selection process concluded in August, would transfer management of the DCP from Hartford to a team of Equitable Insurance and the T. Rowe Price Co. The contract can be a lucrative one, and the competition, although publicly quiet, has been intense.

Ombudsman Frank Flavin recommended in a Sept. 30 letter to Commissioner of Administration B.B. Allen that the state "immediately stop further action in pursuing the new contract" until a special five-member panel is appointed to review the process.

Flavin's investigation dealt not with the question of IRS approval but the manner in which new management contractors were awarded the DCP account. His letter outlined findings of an Ombudsman investigation:

" . . . The State failed to follow the bidding requirements (of state law) in that the Retirement and Benefits Division delegated the duties and legal obligations of soliciting and opening bids to Mr. Robert Irwin, an unauthorized individual not in the employment of the state; and the State authorized Mr. Irwin to open bids in his Seattle office, not in public as prescribed (by law); and through the State's acquiescence Mr. Irwin negotiated significant changes in the Equitable carrier's original bid after the . . . closing date in violation of the spirit and intent of (legal bid procedures); and (laws) requiring specific organization of bidding documents were not adhered to . . ."

Arnoldt said Tuesday the DCP "really defies the bid process," and that Irwin's solicitations were handled in the manner of professional services not subject to competitive bidding by specifications.

"I am totally convinced the people involved with the bid process maintained a professional approach. They acted as honestly and with as good faith as anybody," Arnoldt said. He expressed "utmost faith and confidence" in Irwin, the Seattle-based consultant to the DCP.

In a recent letter to Allen, the employe said the uncertainty "leaves me totally confused as to whether the State has a valid

valid DCP.

But while the state is most unlikely to agree to hold anybody harmless for taxes,

'The state failed to follow the bidding requirements,' an Ombudsman's investigation found. 'The state delegated the duties and legal obligations of opening bids to . . . an unauthorized individual not in the employment of the state; and the state authorized (him) to open the bids in his Seattle office, not in public as prescribed (by law) . . .'

looking more from their interested perspective than the interest of participants.

"I think we've gone through the big hump now," he said. "A lot of people with concerns are now satisfied."

A number of others, however, may not be. There has been talk of filing a lawsuit to stop transfer of the management contract until the IRS question is finally determined. A kind of network has emerged among opponents of the change, and word of developments is passed continually along it.

"The former carrier has generated some interest with unsubstantiated claims. We recognized there would be some pressure brought. That's politics, that's the name of the game," Arnoldt said.

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**NOTICE OF ADOPTION
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See Legal Notice Page 18

Lawsuit ready in IRS flap

Juneau

A high-ranking Legislative Affairs official says he plans to sue the state over proposed changes in the state's deferred compensation plan for state employees.

Myrt Charney, director of administrative services for the Legislative Affairs Agency, told the *Advocate* he and a few other employees have instructed their lawyers to file a class action suit on behalf of the 1,100 employees participating in the plan.

Under the deferred compensation plan (DCP) workers reduce their tax burden by delaying receipt of a portion of their wages. Since the plan went into effect in October, 1974, almost \$10 million has been invested in the fund. The money is returned with interest to participants or their beneficiaries upon retirement, termination, disability or death.

The DCP has come into question recently because the IRS was not notified of a planned change in administrators (*Advocate*, Nov. 10-16). State officials say the decision to change from Hartford Insurance Co. to a team of Equitable Insurance and the T. Rowe Price Co. does not require IRS approval.

But top Hartford officials say the proposed transfer is a substantial amendment requiring IRS approval.

Because state officials are convinced the change is not a major modification and therefore does not require IRS okay, state officials say they do not plan to notify the IRS.

But if it is determined that IRS approval is necessary and it is not given, the plan could be disqualified, mandating return of the wages. Participants then would face the prospect of having their money returned in one lump sum — much of it then taxable at high rates.

Charney said he expects the suit to be filed within the next two weeks. He said it will seek an injunction preventing the state from transferring administration of the plan until an IRS ruling has been issued.

If the IRS approves the transfer, the suit will be dropped, Charney said.

The new carrier currently is scheduled to take over Jan. 1.

Commissioner of Administration Bill Allen said he is confident the change does not require IRS approval. He said the allegations that the change is a substantial modification have come primarily from Hartford.

"Hartford is putting pressure on our office to find fault with our decision," Allen said. "We asked Hartford to consider re-negotiating this three times but they didn't come up with the best plan."

According to state officials, the Equitable plan would result in higher guaranteed interest and annuity rates and lower operating expenses. Under the new plan, an employee who invested \$5,000 a year for 10 years would be guaranteed a return of \$74,203 compared to \$63,350 under the Hartford plan, state officials said.

The current deferred compensation plan has proved extremely attractive to many state workers.

—Jean Kizer



The Alaskaland auditorium (shown above) was filled to the brim with bidders and bystanders last weekend for the first gold auction in Alaska.

Action turned from the man (at right) weighing his nugget to the fellow (at left) displaying one of the larger pieces of some 9,000 ounces available for auction. (Photos by Rodger Painter).



Auction attracts bids; 'have a little larceny'

checkbooks walked away with the fattest pokes.

Prices generally were above smelter prices offered to small miners, but below the current world gold market price of \$161.15 per ounce.

The audience and promoters were equally given at the auctioning process, which appeared to stifle spirited bidding. Most of the miners offered their winning bidders were allowed to purchase as little as one ounce, and the remaining gold from that consignment is offered to anyone else interested — at the same price.

But, some of the larger nuggets, ranging in size up to 62 ounces, attract competitive bidding.

Auctioneer Joe Kasler of Skagway

\$900 an ounce, and many of the vials of smaller nuggets went at \$220 an ounce or more.

The two-day auction had somewhat of a carnival atmosphere and many came to observe without making a bid.

No official estimate of the total sales was available immediately, but it appeared to be well below the 10,000 ounces estimated by some.

International Gold Corp. of Santa Ana, Calif., bid \$115,000 for the 62-ounce nugget, well below the minimum asking price of \$180,000. The nugget was found in the McGrath area by Miner Warren Magnusson in 1959.

The largest nugget sold weighed 18.9 oz. and drew a bid of \$15,000.

Miners and sponsors of the auc-

DEFERRED COMPENSATION

November 30, 1977

The Deferred Compensation Plan for the employees of the State of Alaska is designed as a convenient and economical method of increasing their financial independence during retirement years. The primary purpose of this plan is to allow individuals to defer receiving a portion of their current salary and have it accumulate on a pre-tax basis until some future date when they will then be in a position to receive an annuity to supplement other types of income. All regular full-time and permanent part-time State employees who have completed six consecutive months of employment may voluntarily elect to place a portion of their salary into this Internal Revenue Service approved tax sheltered plan. The plan allows the participant to defer receiving a portion of their current salary and postpone payment of both State and Federal income taxes on such deferred amounts plus any interest or investment income until the time those monies are paid out under one of the various provisions.

The plan was established in 1974 following enactment of Ch. 40, SLA 1973 which granted the authority for offering a deferred compensation plan to State employees. The plan is administered by the Division of Retirement and Benefits, Department of Administration. From the inception of the program it has been the goal of the Department of Administration to provide an administratively feasible plan which has great flexibility and the best possible guarantees

for the participating employees. The consulting firm of William M. Mercer, Inc. was retained to assist the State in the initial selection of an insurance carrier to handle the plan, and after an extensive review of the proposals submitted it was concluded that the Hartford Variable Annuity Life Insurance Company could best provide what was felt to be the most desirable overall program. The program was implemented in October 1974, and since that time approximately 1,100 eligible employees have enrolled in the plan and are deferring nearly \$400,000 a month. The open enrolled period for this program is held during October and November of each year.

The administration and the investment options of the plan are periodically reviewed to insure that the employees of the State are participating in the best overall deferred compensation program at the lowest possible cost. Over the past several years an increasing number of financial institutions have started to offer products to fund deferred compensation plans. In March 1977, the Department of Administration directed its consultant to conduct a market survey to determine the availability of products suitable for funding the deferred compensation plan. The findings of this survey indicated that there were a number of competitive products to the existing State plan being offered. Based on this information the State solicited proposals from various financial in-

stitutions. After a detailed review of the various proposals submitted it was concluded that the current insurance company no longer offered the best overall program and that a change in the funding vehicle for the deferred compensation plan was warranted. The combined proposals submitted by two other financial institutions were deemed to be the most attractive funding vehicles offered from the individual participant's standpoint. The most significant advantage of the new program is that the accumulation of funds based on contractual interest guarantees is substantially greater than the present plan. For example, based on contract guarantees only, a participant who is deferring \$5,000 annually in a fixed income account over a 10 year period would have an accumulated account value under the new plan of approximately \$13,000 more than the present plan. Another major advantage of the new program is that the annuity rates are substantially greater than those guaranteed by any of the other proposals which were received.

The improvements in the deferred compensation plan will become effective January 1, 1978.

ALASKA PUBLIC EMPLOYEES ASSOCIATION

State Headquarters: 130 Seward Street, Suite 508, Juneau, Alaska 99801 • Tel: (907) 586-2334

December 1, 1977

Re: Status Report on the
Alaska Deferred
Compensation Plan

John Pugh, President and
Members of the Executive Committee:

I have been asked by the Executive Director to provide you with an update as to the present status of the dispute over the Alaska Deferred Compensation Plan. As you know, the Deferred Compensation Plan, approved by the Internal Revenue Service, permits state employees to postpone receiving part of their salary and defer payment of both Federal and State income taxes on the amount deferred until time of payout.

Briefly stated the background of this problem is outlined as follows:

1. The State of Alaska adopted a Deferred Compensation Plan on May 31, 1974. Although the State is not required to fund the Plan with an insurance carrier, it has done so and originally selected Hartford Variable Annuity Life Insurance Company ("Hartford") as the funding medium.

2. The only documents submitted to the IRS in connection with the ruling request were the Plan document, a transmittal letter from Mr. Joseph R. Henrie, Commissioner of the Alaska Department of Administration and a letter dated June 4, 1974 submitted by Mr. Robert Gates on behalf of the Department of Administration. Mr. Gates' letter of June 4 was merely a transmittal letter forwarding the Plan document as amended in response to an IRS letter dated May 28, 1974.

3. The State of Alaska decided to change the carrier under the Plan from Hartford to the Equitable Life Assurance Society of America ("Equitable") and T. Rowe Price ("Price"), a no-load mutual fund.

The foregoing has resulted in a dispute that has two primary issues:

1. First, were the bidding procedures followed by the Department of Administration for the change in carriers contrary to legislative intent and/or a breach of good faith on the part of the State?

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12/1/77

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2. Secondly, does the change in carriers by the State of Alaska render the favorable IRS Ruling of 1974 inapplicable to the State's Deferred Compensation Plan?

Turning to the first issue, this problem was originally raised in a complaint filed with the Office of the Ombudsman. The Ombudsman found, in part, as follows:

"I find; that the State failed to follow the bidding requirements as set forth as AS 37.05.250, in that the Retirement and Benefits Division delegated the duties and legal obligations of soliciting and opening bids to Mr. Robert Irwin, an unauthorized individual not in the employment of the State; and that the State authorized Mr. Robert Irwin to open bids in his Seattle office, not in public as prescribed in AS 37.05.230(2); and that through the State's acquiescence, Mr. Irwin negotiated significant changes in the Equitable carrier's original bid after the July 15 closing date in violation of the spirit and intent of AS 37.05.230; and that AS 37.05.240 requiring specific organization of bidding documents was not adhered to."

The State's reply has consistently been that changing of carriers for handling of the Deferred Compensation Plan is outside of and not regulated by the Statutes and Administrative Regulation and that Irwin's solicitations to Equitable and Pricewere handled in the way professional services are handled and were not subject to competitive bidding by specifications.

After conversations with Bob Gates, Deputy Commissioner of Administration, and the Ombudsman's office, it appears that the resolution of this first issue is in limbo; no one is doing anything. Hartford Insurance has not retained attorneys to enjoin the State from proceeding further and the Department of Administration has not even replied in writing to the Ombudsman complaint dated September 30, 1976. (In fact, in a conversation with Paul Arnoldt, Director of Benefits and Retirement on November 28, 1977, he told me the Ombudsman was now fully satisfied.)

A.P.E.A. does have interest in seeing that State Statutes and Regulations are followed; however, we are not a watchdog for all violations by the three branches of government. Our primary concern is "does what the State is doing adversely affect the employees we represent." For this reason the second question is of more immediate concern to our membership.

Moving to the second issue, if the change in carriers were to disqualify the Plan from the coverage of the 1974 IRS Ruling, it would leave participating State employees with the obligation to pay taxes probably greater than they

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12/1/77
Page 3

would have paid had they not deferred income. The returned deferred funds would all come to the employee in one tax year leaving most state employees in a higher tax bracket. This is for the reason that the IRS in 1974 warned the State of Alaska..."that if the Plan is amended or modified...this ruling may no longer apply."

Hartford and their attorneys claim that the change in carriers is an amendment of the Plan which would affect the deferred tax status of the Plan. However, I have talked to Paul Arnoldt, Director of Benefits and Retirement; to Bob Gates, Deputy Commissioner of Administration; and Assistant Attorney General Tom Koester (in a verbal preliminary opinion) and they all believe that IRS approval is not jeopardized by a change in carriers. I also talked to a tax attorney in town who also leans toward the position that the change of carriers standing alone does not jeopardize the IRS Ruling.

For approximately 10 days I have been awaiting an Attorney General's opinion on this change of carriers issue and it will apparently not be forthcoming. The last information I have is that the Attorney General will now seek an opinion from the IRS on whether the change of carriers affects the deferred status of the Plan. This request of the IRS follows on the heels of a similar request to the IRS by Jay Hogan of Legislative Finance. In conversations with Mr. Hogan he stated to me that he was told by the IRS that he could expect a reply by December 15th. I have serious doubts that such a reply will be given by the IRS prior to January 1, 1978.

Attached for your review is a number of opinions on the deferred compensation issue. Of particular interest is an article in the Alaska Advocate dated November 24-30th stating that Myrt Charney, Director of Administrative Service for Legislative Affairs and other state employees intend to file a class action suit for injunctive relief on behalf of all state employees seeking to prevent the State from transferring administration of the Plan until an IRS Ruling has been issued.

In the next day or two Bart Rozell and myself will seek a meeting with Commissioner Allen. Thereafter, Bart Rozell and I will weigh all information available and present you with our recommended course of action. It may well be that the best course of action is for A.P.E.A. to join in such a suit for injunctive relief if the State will not voluntarily hold up the change of carriers until after the reply from the IRS.

Very truly yours,



Patrick E. Murphy

General Counsel

Alaska Public Employees Association

PEM/bg

Attachments



ALASKA PUBLIC EMPLOYEES ASSOCIATION

State Headquarters: 130 Seward Street, Suite 508, Juneau, Alaska 99801 • Tel: (907) 586-2334

DECEMBER 19, 1977
RELEASE: IMMEDIATELY
CONTACT: MICHAEL WILLIAMS
(907) 586-2334

APEA FILES SUIT AGAINST THE STATE OF ALASKA

JUNEAU, ALASKA -- THE EXECUTIVE DIRECTOR OF THE ALASKA PUBLIC EMPLOYEES ASSOCIATION, RUSSELL D. MOLT, ANNOUNCED TODAY THAT A SUIT FOR INJUNCTIVE RELIEF HAS BEEN FILED IN JUNEAU SUPERIOR COURT BY APEA AND CERTAIN OTHER PARTIES, INCLUDING STAFF MEMBERS OF THE LEGISLATIVE AFFAIRS AGENCY, AGAINST THE STATE OF ALASKA IN REFERENCE TO THE CHANGE OF CARRIERS FOR THE STATE'S DEFERRED COMPENSATION PROGRAM.

"APEA HAS A VITAL INTEREST IN QUESTIONS AND CONTROVERSIES ARISING FROM THE CHANGE OF CARRIERS IN THAT APPROXIMATELY 800 OF THE 1100 PARTICIPATING MEMBERS ARE ALSO MEMBERS OF APEA. CONSIDERING THE NUMBER OF APEA STATE EMPLOYEES DEFERRING PORTIONS OF THEIR INCOME, UNDER THIS PROGRAM, IT SEEMS ONLY REASONABLE TO DO WHATEVER IS NECESSARY TO SET OUT THE FACTS CONCERNING THE DEFERRED COMPENSATION PROGRAM AS IT NOW EXISTS," STATED MOLT.

OUTLINING SOME OF THE MAJOR CONCERNS WHICH RESULTED IN THIS SUIT, MR. MOLT SAID,

- MORE -

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FAIRBANKS, ALASKA 99701
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APEA SUES STATE

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"FIRST, TO THE BEST OF APEA'S KNOWLEDGE, NO DETAILED STATEMENT COMPARING THE DIFFERENCES BETWEEN THE OLD (HARTFORD) AND THE NEW (EQUITABLE) INVESTMENT PROGRAM EXISTS. WITHOUT SUCH A COMPARISON, IT IS DIFFICULT IF NOT IMPOSSIBLE TO SAY WHAT THE PARTICIPATING EMPLOYEES HAVE GAINED...VERSUS WHAT THEY HAVE LOST. "

"SECONDLY, THERE IS SERIOUS QUESTION" CONCERNING THE BIDDING PROCESS THE STATE FOLLOWED, AS BROUGHT OUT BY THE STATE'S OMBUDSMAN, FRANK FLAVIN."

"THIRDLY, THE REAL VALUE OF THE STATE'S DEFERRED COMPENSATION PROGRAM HINGES ON A WRITTEN RULING FROM THE U.S. INTERNAL REVENUE SERVICE DATED JULY 25, 1974, WHICH GIVES THE PROGRAM A TAX DEFERRED STATUS. HOWEVER, THE I.R.S. HAS SUSPENDED THE ISSUANCE OF TAX RULINGS ON DEFERRED COMPENSATION PLANS UNTIL FURTHER NOTICE, SO THERE IS NO WAY ONE COULD SAY THAT THE NEW PROGRAM WOULD BE TAX DEFERRED."

"FOURTHLY, THE BUDGET UNDER WHICH THE NEW PROGRAM WOULD BE ADMINISTERED HAD NEITHER BEEN PRESENTED TO THE LEGISLATURE, NOR OBVIOUSLY RECEIVED THEIR APPROVAL. THE NEW PROGRAM ENVISIONS STATE PERSONNEL AND FACILITIES PERFORMING MANY OF THE FUNCTIONS PREVIOUSLY PROVIDED BY THE CARRIER AND THUS REQUIRING A COMMITMENT OF STATE FUNDS."

- MORE -

APEA SUES STATE

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"LASTLY, THE "PUBLIC FORUM" INVOLVED IN THIS DECISION-MAKING PROCESS CONSISTED APPARENTLY OF OFFICIALS OF THE DEPARTMENT OF ADMINISTRATION, THE STATE'S INSURANCE CONSULTANT, AND A HANDFUL OF PERSONS SELECTED BY THE GOVERNOR'S OFFICE TO REVIEW THE DECISION TO CHANGE CARRIERS/PROGRAMS. HOWEVER, IT APPEARS THAT THE LATTER WERE NOT AWARE THEY WERE "APPROVING" THE PROGRAM CHANGE OR THAT THE DECISION TO CHANGE THE PROGRAM HAD ALREADY BEEN MADE. NO PERSONS REPRESENTING EMPLOYEE ASSOCIATIONS, WITH THE EXCEPTION OF THE CONFIDENTIAL BARGAINING UNIT, NO LEGISLATORS, NO LEGISLATORS STAFF AND NO MEMBER OF THE GENERAL PUBLIC APPEAR TO HAVE BEEN INVOLVED IN ANY WAY DURING THE DECISION MAKING PROCESS."

THE ALASKA PUBLIC EMPLOYEES ASSOCIATION AND THE STATE OF ALASKA HAVE BEEN IN NEGOTIATIONS OVER THE DEFERRED COMPENSATION PROGRAM FOR THE PAST THREE (3) MONTHS, TRYING TO RESOLVE THE DIFFERENCES WITHOUT HAVING TO RESORT TO LITIGATION. HOWEVER, THERE IS NO OTHER RECOURSE LEFT OPEN TO APEA TO PROTECT THE VITAL INTEREST OF THE 1100 PUBLIC EMPLOYEES.



ALASKA PUBLIC EMPLOYEES ASSOCIATION

State Headquarters: 130 Seward Street, Suite 508, Juneau, Alaska 99801 • Tel: (907) 586-2334

DECEMBER 20, 1977
RELEASE: IMMEDIATELY
CONTACT: MICHAEL WILLIAMS

*** BULLETIN ***

JUNEAU, ALASKA -- SINCE THE FILING OF THE SUIT BY THE ALASKA PUBLIC EMPLOYEES ASSOCIATION, IN JUNEAU SUPERIOR COURT THIS MORNING AT 11:00 AM, BOTH THE STATE OF ALASKA AND APEA'S ATTORNEYS HAVE RE-ENTERED INTO NEGOTIATIONS OVER THE DEFERRED COMPENSATION PROGRAM.

"IT IS APEA'S HOPE, AND BELIEF, THAT THE PROBLEMS OVER THE DEFERRED COMPENSATION PROGRAM CAN BE JOINTLY RESOLVED WITHOUT HAVING TO PURSUE FURTHER LITIGATION," STATED RUSSELL D. MOLT, EXECUTIVE DIRECTOR OF THE ALASKA PUBLIC EMPLOYEES ASSOCIATION.

- 30 -

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ALASKA PUBLIC EMPLOYEES ASSOCIATION

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PRESS RELEASE

DECEMBER 28, 1977
RELEASE: IMMEDIATELY
CONTACT: MICHAEL WILLIAMS

AGREEMENT MADE

JUNEAU, ALASKA -- THE EXECUTIVE DIRECTOR OF THE ALASKA PUBLIC EMPLOYEES ASSOCIATION, RUSSELL D. MOLT, ANNOUNCED TODAY THAT AN AGREEMENT HAS BEEN REACHED BETWEEN THE STATE OF ALASKA AND APEA OVER THE CHANGE OF CARRIERS FOR THE STATE'S DEFERRED COMPENSATION PROGRAM.

"AFTER FILING A SUIT DECEMBER 20, 1977, AGAINST THE STATE OF ALASKA, IN JUNEAU SUPERIOR COURT, FOR INJUNCTIVE RELIEF IN THE MATTER OF CHANGE OF CARRIERS IN THE DEFERRED COMPENSATION PROGRAM, ATTORNEYS FOR APEA AND THE STATE OF ALASKA RE-ENTERED INTO NEGOTIATIONS. AS A RESULT OF THOSE NEGOTIATIONS, THE STATE HAS POSTPONED CHANGING CARRIERS FOR THE DEFERRED COMPENSATION PROGRAM FOR AT LEAST ONE YEAR. BOTH PARTIES AGREED THAT THE QUESTION OF THE POSSIBLE LOSS OF THE TAX DEFERRED STATUS OF THE PROGRAM WAS SO VITAL A QUESTION, THAT NO CHANGE COULD TAKE PLACE AT THIS TIME," MOLT STATED.

MOST OF THE CONCERNS WHICH HAD LEAD APEA TO FILE THE SUIT, ON BEHALF OF THE STATE EMPLOYEES, HAVE BEEN RESOLVED. AND AT PRESENT, APEA'S ATTORNEYS ARE LOOKING INTO THE POSSIBLE DISMISSAL OF THE LAW SUIT AGAINST THE STATE OF ALASKA.

- 30 -

THE PRECEDING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

THE FOLLOWING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

August 18, 1977

Mr. Robert Irwin, CLU
Assistant Vice President
Wm. M. Mercer, Inc.
Norton Building
Seattle, Wash. 98104

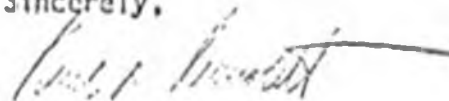
Dear Bob:

I would like to express our appreciation for your consultants report on the State of Alaska's Deferred Compensation Plan. Your report has been reviewed with Commissioner Allen and Deputy Commissioner Gates, and we concur with your recommendations regarding the change in carriers for the State's plan.

By way of this letter you are authorized to notify The Hartford effective January 1978 they will no longer be the State's carrier for the Deferred Compensation Plan. You should also advise the Equitable Life Insurance Company and T. Rowe Price that they have been selected as carriers for the fixed and equity portions of the plan respectively.

If you have any questions regarding this direction, please do not hesitate to contact me.

Sincerely,



Paul B. Arnoldt
Deputy Director

PBA/jb
cc: Commissioner Allen
Deputy Commissioner Gates

EXHIBIT E

1 IN THE SUPERIOR COURT FOR THE STATE OF ALASKA

2 FIRST JUDICIAL DISTRICT AT JUNEAU

3 MYRTON R. CHARNEY, and)
4 ALASKA PUBLIC EMPLOYEES)
5 ASSOCIATION, an Alaska non-)
6 profit corporation,)

7 Plaintiffs,)

8 vs.)

9 STATE OF ALASKA, DEPARTMENT)
10 OF ADMINISTRATION; and)
11 HARTFORD VARIABLE ANNUITY)
12 LIFE INSURANCE COMPANY,)
13 a Connecticut corporation,)

14 Defendants.)

15 C. A. NO. 77-

16 MOTION FOR TEMPORARY RESTRAINING ORDER
17 AND PRELIMINARY INJUNCTION

18 The plaintiffs, pursuant to Alaska Civil Rule 65,
19 move the Court for entry of a temporary restraining order
20 and preliminary injunction against the above-named defendants,
21 as follows:

22 1. That defendant, State of Alaska, Department of
23 Administration, altogether cease and desist from undertaking
24 any further action implementing a change in carriers of the
25 Public Employees' Deferred Compensation Plan from the Hartford
26 Variable Annuity Life Insurance Company to the Equitable
27 Insurance Company and T. Rowe Price New Era Fund, Inc., a no
28 load mutual fund, pendente lite.

29 2. That the defendant, Hartford Variable Annuity
30 Life Insurance Company, altogether cease and desist from
31 transferring the funds of the Alaska Public Employees'
32 Deferred Compensation Program from themselves to Equitable
33 Insurance Company and T. Rowe Price New Era Fund, Inc., a no
34 load mutual fund, pendente lite.

35 / / / / /

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907-588-3330

4

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3. That the aforementioned directive be binding upon the agents, successors, assigns, servants, employees, consultants, and those in active concert with defendants.

As grounds for this motion, the plaintiff respectfully refers the Court to the Complaint on file herein and plaintiffs' affidavits in support hereof, and the Affidavit of Genie Chance.

DATED this 20 day of December, 1977, at Juneau, Alaska.

MYRTON R. CHARNEY,
Plaintiff,

Gail Roy Fraties
Fraties & Petersen
Anchorage, Alaska
Attorney for Myrton R. Charney

By James F. Petersen
James F. Petersen
Juneau, Alaska

ALASKA PUBLIC EMPLOYEES ASSOCIATION,
an Alaska non-profit corporation

Faulkner, Banfield, Doogan & Holmes,
Attorneys for Alaska Public Employees
Association,

By William B. Rozell
William B. Rozell
For the Firm

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IN THE SUPERIOR COURT FOR THE STATE OF ALASKA
FIRST JUDICIAL DISTRICT AT JUNEAU

MYRTON R. CHARNEY, and)
ALASKA PUBLIC EMPLOYEES)
ASSOCIATION, an Alaska non-)
profit corporation,)
)
Plaintiffs,)
)
vs.)
)
STATE OF ALASKA, DEPARTMENT)
OF ADMINISTRATION; and)
HARTFORD VARIABLE ANNUITY)
LIFE INSURANCE COMPANY,)
a Connecticut corporation,)
)
Defendants.)

C. A. NO. 77-

COMPLAINT

1. Plaintiff, Myrton R. Charney, is an adult resident of the City and Borough of Juneau, Alaska, and is employed by the State of Alaska, Legislative Affairs Agency, as Director of the Division of Administrative Services and a participant in the Public Employees' Deferred Compensation Program, and is bringing this action on behalf of himself and all similarly situated persons who are employees of the State of Alaska and participants in the Public Employees' Deferred Compensation Program.

2. Plaintiff, Alaska Public Employees' Association, is a non-profit corporation, incorporated under the laws of the State of Alaska. There are presently approximately 1,100 participants in the State of Alaska Public Employees' Deferred Compensation Program as authorized by Chapter 45 of Title 39 of the Alaska Statutes (see Exhibit G to this Complaint), and approximately 900 of these are members of plaintiff, Alaska Public Employees' Association.

/// ///
/// ///

1 3. The defendant, State of Alaska, Department of
2 Administration, is the designated administrator of the
3 Public Employees' Deferred Compensation Program.

4 4. The Hartford Variable Annuity Life Insurance
5 Company, a Connecticut corporation, is the designated carrier
6 of the Public Employees' Deferred Compensation Program as
7 the same now exists.

8 5. In 1974 the Department of Administration con-
9 tracted with Hartford Variable Annuity Life Insurance Company
10 to be the exclusive carrier for the State of Alaska Public
11 Employees' Deferred Compensation Program, and the plan
12 adopted pursuant thereto is attached as Exhibit A to this
13 Complaint.

14 6. The Public Employees' Deferred Compensation
15 Plan was submitted to the U.S. Internal Revenue Service and
16 received approval through a private letter ruling of July 25,
17 1974 (see Exhibit B to this Complaint), and this private
18 letter ruling approving the plan also provided that if the
19 plan were modified or amended the ruling may no longer be
20 applicable.

21 7. On September 7, 1977, the U.S. Internal Revenue
22 Service issued Directive IR(1881) (attached as Exhibit C to
23 this Complaint) which has suspended all rulings dealing with
24 the income tax treatment of deferred compensation plans,
25 such as the State of Alaska Deferred Compensation Plan
26 previously approved.

27 8. The Department of Administration is presently
28 in the process of changing the carrier from Hartford Variable
29 Annuity Life Insurance Company to Equitable Insurance Company
30 and the T. Rowe Price New Era Fund, Inc., a no load mutual
31 fund, and also has undertaken steps which will modify and
32 / / / / /

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1 amend the plan approved by the Internal Revenue Service in
2 July of 1974.

3 9. This proposed modification and amendments may
4 cause the plaintiffs, Myrton R. Charney, and the members of
5 the Alaska Public Employees' Association who are partici-
6 pants in the State of Alaska Deferred Compensation Program,
7 irreparable harm and injury by jeopardizing the funds which
8 they are counting on for retirement income and may cause
9 them and others serious income tax problems for the reasons
10 outlined and set forth in the affidavit of plaintiff, Myrton R.
11 Charney, and the affidavit of the Executive Director of the
12 plaintiff, Alaska Public Employees' Association.

13 10. The existing plan (see Exhibit A) which has
14 received the private letter ruling from the Internal Revenue
15 Service (Exhibit B), specifically states in Section 602
16 that:

17 ". . . Deferred Compensation payments and
18 the death benefits (if paid in other than
19 a lump-sum) will be in an amount equal
20 to the amount which would have been pay-
21 able under a variable annuity contract,
22 had such a contract been purchased from
the carrier at the time of the initial
participation in the plan and with the
annual premium equal to the annual amount
of compensation that had been deferred".

23 Under the proposed new plan (see Exhibit D attached hereto)
24 variable annuity contracts are not included in the products
25 offered by either of the companies and death benefits are
26 likewise not included.

27 11. The proposed new plan (Exhibit D) may violate
28 state law by investing in mutual funds, and under the pro-
29 visions of Chapter 45 of Title 39 of the Alaska Statutes
30 mutual funds are not an authorized investment vehicle for
31 deferred compensation programs in the State of Alaska; and
32 further, the plan document (Exhibit A), which was approved

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1 by Internal Revenue Service in July of 1974, particularly
2 states in Section 14: "This agreement shall be construed
3 under the law of the State of Alaska." The language of the
4 statutes themselves (AS 39.45.010 through .050) specifically
5 does not include an investment vehicle of mutual funds and
6 as such the use or the threatened use of that investment
7 vehicle by the Department of Administration may be in
8 violation of said statutes and the legislative intent of
9 those statutes (see the Affidavit of Genie Chance attached
10 hereto as Exhibit H).

11 12. The defendant, the Department of Administration,
12 by letter dated August 18, 1977, (see Exhibit E attached
13 hereto) authorized their consultant, Robert Irwin, to notify
14 Hartford Variable Annuity Life Insurance Company to transfer
15 all deferred compensation funds to Equitable Life Insurance
16 Company and T. Rowe Price New Era Fund, Inc., on or about
17 January 1, 1978. The consultant, Robert Irwin, did this by
18 letter dated August 19, 1977, (see Exhibit F) and unless the
19 defendants are enjoined the funds of the Public Employees'
20 Deferred Compensation Program deposited with the Hartford
21 Variable Annuity Life Insurance Company will be transferred
22 which, as stated above, may seriously jeopardize and may
23 subject said funds to immediate taxation by the individual
24 participants, as outlined above.

25 WHEREFORE, plaintiffs demand relief as follows:

26 1. That the defendant, Hartford Variable Annuity
27 Life Insurance Company be enjoined from transferring the
28 funds which it now holds as the carrier of the Public Employees'
29 Deferred Compensation Program under the Deferred Compensa-
30 tion Plan as approved by the Internal Revenue Service in
31 July of 1974, until the Internal Revenue Service or a court
32 / / / / /

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907 586 2112

1 o. competent jurisdiction approve any change in the Deferred
2 Compensation Plan and a transfer of funds thereto.

3 2. That the defendant, the State of Alaska,
4 Department of Administration, be enjoined from carrying out
5 its proposed new plan with the Equitable Life Insurance
6 Company and T. Rowe Price New Era Fund, Inc., and from
7 further accepting the offer of Equitable Life Insurance
8 Company and T. Rowe Price New Era Fund, Inc., as being the
9 substituted or new carrier of Public Employees' Deferred
10 Compensation funds.

11 3. That the Court grant such other and further
12 relief as may be necessary and requisite in the premises.

13 4. That plaintiffs be awarded their costs and
14 attorneys' fees in prosecuting this action.

15 DATED at Juneau, Alaska, this 20th day of December,
16 1977.

17
18 MYRTON R. CHARNEY,
19 Plaintiff,

20 Gail Roy Fraties
21 Fraties & Petersen
22 Anchorage, Alaska
23 Attorney for Myrton R. Charney

24 By James F. Petersen
25 James F. Petersen,
26 Juneau, Alaska

27 ALASKA PUBLIC EMPLOYEES ASSOCIATION,
28 an Alaska non-profit corporation

29 Faulkner, Banfield, Doogan & Holmes,
30 Attorneys for Alaska Public Employees
31 Association,

32 By William B. Rozell
William B. Rozell
For the Firm

IN THE SUPERIOR COURT OF THE STATE OF ALASKA
FIRST JUDICIAL DISTRICT AT JUNEAU

MYRTON R. CHARNEY, and)
ALASKA PUBLIC EMPLOYEES)
ASSOCIATION, an Alaska non-)
profit corporation,)

Plaintiffs,)

vs.)

STATE OF ALASKA, DEPARTMENT)
OF ADMINISTRATION; and)
HARTFORD VARIABLE ANNUITY)
LIFE INSURANCE COMPANY,)
a Connecticut corporation,)

Defendants.)

C. A. No. 77-1169)

ENTRY OF APPEARANCE

COMES NOW Robertson, Monagle, Eastaugh & Bradley,
Box 1211, Juneau, Alaska, 99802, by and through W. G. Ruddy,
entering its appearance on behalf of defendant, Hartford
Variable Annuity Life Insurance Company, in the above-
captioned court and cause.

DATED this 20 day of December, 1977, at Juneau,
Alaska.

ROBERTSON, MONAGLE, EASTAUGH & BRADLEY

By

W. G. Ruddy
W. G. Ruddy
Of Attorneys for Defendant,
Hartford Variable Annuity Life
Insurance Company

ROBERTSON, MONAGLE, EASTAUGH & BRADLEY
A PROFESSIONAL CORPORATION
100 N. B. A. BLDG. PHONE 588-3340
P.O. BOX 1211, JUNEAU, ALASKA 99802

Service and receipt of copy
acknowledged this 20th
of Dec 1977.

James G. Petersen / sam
Attorney for

Service and receipt of copy
acknowledged this 20th
of December, 1977

H. J. R. W.

Attorney for

1 which has suspended all rulings dealing with the income tax
2 treatment of plans such as the State of Alaska Deferred Compen-
3 sation Plan previously approved.

4 8. The Department of Administration is presently in the
5 process of changing the carrier from Hartford Variable Annuity
6 Life Insurance Company to Equitable Insurance Company and the
7 T. Rowe Price New Era Fund, Inc., a no load mutual fund.

8 9. This proposed change will cause the members of the
9 Alaska Public Employees Association who are participants in the
10 State of Alaska Deferred Compensation Program irreparable harm
11 and injury by jeopardizing the funds they are counting on for
12 retirement income, and may further cause them and others serious
13 income tax problems.

14 10. APEA first became aware that the Department of Ad-
15 ministration proposed to make changes in the Deferred Compen-
16 sation Plan in September of this year; up until that time the De-
17 partment of Administration had acted on its own without consulta-
18 tion and without informing participants of the plan, their bar-
19 gaining representatives, the legislature or other interested par-
20 ties about the proposed changes. Since that time APEA has worked
21 together with representatives of other bargaining units, the
22 Office of the Ombudsman, and representatives of the legislature
23 in attempting to ascertain why the proposed changes were being
24 made, the manner in which the decision was reached to make the
25 proposed changes, the merits of the proposed changes and whether
26 the tax exempt status of the plan would be jeopardized by the
27 proposed changes.

28 11. On October 4, 1977, at the request of APEA, a meet-
29 ing was held in the Governor's conference room among representa-
30 tives of the Department of Administration, the Office of the
31 Attorney General, the State's financial advisor, Mr. Robert
32 Irwin of William M. Mercer, Inc., representatives of Hartford,

1 members of the legislature, representatives from Legislative
2 Affairs, the Assistant Ombudsman, representatives from several
3 employee bargaining units and other interested persons to discuss
4 the changes proposed by the Department of Administration in the
5 Deferred Compensation Plan. It became apparent to everyone pre-
6 sent at that meeting, including representatives of the Admini-
7 stration, that many serious questions remained unanswered about
8 the proposed changes. Of particular concern was the fact that a
9 detailed comparison of the merits of the proposed new plan with
10 the existing Hartford plan was not available, that no formal bid-
11 ding procedure had been followed in soliciting proposals for
12 changes in the plan, that no company except T. Rowe Price was
13 ever requested to submit a proposal on the so-called equity side
14 to complement the proposal of Equitable which was limited to par-
15 ticipation on the fixed or guaranteed side, and that the State's
16 financial advisor, Mr. Irwin, had never considered or received
17 any legal advice about the possible effects of any change in the
18 plan on the tax exempt status of the State's Deferred Compensa-
19 tion Plan.

20 12. Since that time APEA has received a continuing flow
21 of concerned inquiries, complaints and demands for action from
22 participants in the plan seeking to protect their investments in
23 the plan. The Executive Committee of APEA, which is the decision
24 making body of APEA and whose members are all State employees,
25 has directed me to file this action.

26 13. In the more than two months since the date of that
27 meeting APEA has met and corresponded with representatives of the
28 State Administration on numerous occasions in an effort to coop-
29 erate with the State in gathering the information necessary in
30 order to determine whether a change in the proposed Deferred Com-
31 pensation Plan should be made. During that period of time con-
32 flicting legal opinions have been obtained about the effect of

1 the proposed change in the Deferred Compensation Plan upon the
2 tax status of the plan from law firms representing William M.
3 Mercer, Inc., the State's financial advisor, and Hartford Variable
4 Annuity, the carrier presently managing the State's Deferred Com-
5 pensation Plan. Both the Legislative Affairs Agency and the
6 Office of the Attorney General have sought advice and information
7 directly from the Internal Revenue Service concerning the effect
8 of the proposed changes on the tax status of the Deferred Compen-
9 sation Plan. The Internal Revenue Service has expressly declined
10 to issue any opinion that the proposed change will not jeopardize
11 the present tax exempt status of the State's Deferred Compensa-
12 tion Plan.

13 14. On or about December 12 and 13, 1977, the Deputy
14 Commissioner of Administration, Robert Gates, and Assistant
15 Attorney General Thomas Koester met with representatives of the
16 Internal Revenue Service in Washington, D.C., in an effort to
17 obtain a statement or commitment from the IRS that the proposed
18 changes would not jeopardize the tax status of the plan. The IRS
19 expressly refused to make or give any such statement or commit-
20 ment.

21 15. Following that meeting the State represented to APEA
22 that it would not implement the proposed changes because it was
23 not willing to jeopardize the tax status of the plan. However,
24 the State has failed and refused to follow through on its stated
25 intentions even though only seven working days remain in 1977 and
26 before the scheduled date for changing the plan.

27 16. The approximately 1,100 State employees participating
28 in the Deferred Compensation Plan will suffer irreparable harm if
29 a change is made in the plan which jeopardizes its tax exempt
30 status. There is no evidence that employee participants in the
31 Deferred Compensation Plan will achieve any substantial advantages
32 from the proposed changes in the plan and there is a serious

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JUNEAU, ALASKA 99801

1 question whether the proposed changes result in any increased
2 benefits at all to the participants therein. On the other hand,
3 there is a real and substantial risk that by making a change at
4 this time in the carrier for the plan, and the necessary related
5 changes in the plan itself, that the tax exempt status of the
6 plan will be lost and that the employees who have invested sums in
7 the plan will suffer serious adverse tax consequences. There is
8 substantial doubt whether these employees could ever recover
9 their losses in a claim for damages against the State. Accord-
10 ingly, since there is no risk and no significant loss in benefits
11 by not making a change in carriers at this time, and since a
12 change in carriers and the related changes in the Deferred Com-
13 pensation Plan could jeopardize the tax status of the entire
14 State's Deferred Compensation Plan, no change in carriers should
15 be made at this time.

16 Further affiant sayeth not.

17 *Russell D. Molt*

18 _____
Russell D. Molt

19
20
21 SUBSCRIBED AND SWORN to before me this 20 day of
22 December, 1977.

23
24 *Shilo R. Enger*

25 Notary Public for Alaska

My commission expires: 9-13-81

1 7. When I received the language for the bill I was
2 disturbed by what I thought could be interpreted as "per-
3 missive" language rather than restrictive language concern-
4 ing the investment vehicles. The language read as follows:

5 "The administrator of the state or political
6 subdivision deferred compensation program is
7 authorized, subject to contracts with indivi-
8 dual employees, to invest the funds held under
9 a deferred compensation program in fixed and
10 variable life insurance and annuity contracts."

11 I wanted to change the language from "is authorized" to
12 "shall invest" to ensure that only the investment vehicles
13 in the statute could be used. However, I was advised by
14 the Aetna man in Seattle that the Internal Revenue Service
15 insisted on "is authorized" because, in their interpretation,
16 that is the language which gives authority.

17 8. I don't remember which attorney in Legislative
18 Affairs Agency I was working with on this bill, but I do
19 remember that we came up with the idea of using both
20 phrases. The attorney said he didn't remember seeing a
21 statute with two authorization sections before, but he saw
22 no reason why we could not do it. So the restrictive language
23 was titled "Authority" and the Internal Revenue Service
24 language was entitled "Investment Authority".

25 9. As I explained the bill to the other legislators,
26 many of them expressed reservations about investing employees'
27 funds in mutual funds. I explained that mutual funds and
28 other investments were excluded on purpose and investment
29 could be made only in fixed and variable life insurance and
30 annuity contracts and that was the reason for the restrictive
31 language of the general authorization section.

32 10. While the bill was in the legislative process, I
received several calls from persons representing mutual
funds and savings and loan associations. They explained

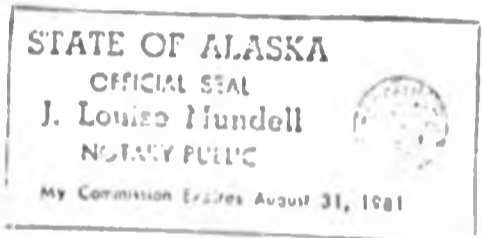
1 their desire to have me amend their entities into the bill
2 as authorized investment vehicles.

3 11. But the bill was enacted into law with only one
4 amendment. That was an amendment made in the Senate which
5 changed the phrase "employee's income" to "employee's
6 salary or wages".

7 Further affiant sayeth not.

8
9 Genie Chance
10 GENIE CHANCE

11 SUBSCRIBED AND SWORN to before me this 17th day of
12 December 1977.



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11/17/77
Notary Public in and for Alaska
My commission expires: 11/17/77

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1 issued IR-1881 (attached as Exhibit C to the Complaint) which
2 has suspended all rulings dealing with the income tax treatment
3 of plans such as the State of Alaska Employees Deferred Compen-
4 sation Plan previously approved.

5 8. The Department of Administration is presently in the
6 process of changing the carrier from Hartford Variable Annuity
7 Life Insurance Company to Equitable Insurance Company and
8 T. Rowe Price, a no load mutual fund, and also modifies and
9 amends the approved plan.

10 9. This proposed change will cause me and others similiar-
11 ly situated irreparable harm and injury, by jeopardizing the
12 funds I am counting on for retirement income and may further
13 cause me and others serious income tax problems, for the follow-
14 ing reasons:

15 a. The Plan document (Exhibit A) which received the
16 private letter of ruling from Internal Revenue Service (Exhibit
17 B), specifies in Section 6.02 that "Deferred Compensation
18 Payments and the Death Benefits (if paid in other than a lump-
19 sum) will be in an amount equal to the amount which would have
20 been payable under a variable annuity contract had such a
21 contract been purchased from the carrier at the time of the
22 initial participation in the Plan and with the annual premium
23 equal to the annual amount of compensation that had been deferred.
24 Under the proposed plan (Exhibit D), it is my understanding that
25 variable annuity contracts are not included in the products
26 offered by either of the companies and death benefits are not
27 included.

28 b. The proposed new plan would violate state law by
29 investing in mutual funds, and the plan document (Exhibit A)
30 approved by Internal Revenue Service states in Section 14:
31 "This Agreement shall be construed under the law of the State of
32 Alaska."

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1 c. The proposed new plan would further violate the
2 written agreement entered into by me and other state employees
3 and the State of Alaska. I read the Plan document and the
4 prospectus presented to me by the registered representative of
5 Hartford Variable Insurance Company, and entered into an agree-
6 ment with the State to defer a portion of my income with the
7 understanding that I would have the pay-out benefits of a
8 variable annuity contract and death benefits, and with the
9 additional understanding that the funds I allocated into the
10 separate account would be invested by the company whose portfolio
11 of investments I had read in the prospectus and approved. Under
12 the new plan, those funds would be unilaterally removed by the
13 State from the portfolio I approved and put into another
14 portfolio.

15 d. The proposed new plan places all participants in
16 the Deferred Compensation Program in jeopardy by not seeking and
17 obtaining approval of the Internal Revenue Service to the
18 modifications and amendments of the existing plan.

19 e. The proposed new plan violates the terms of the
20 contracts entered into with current participants by withdrawing
21 the options of variable annuities and death benefits in the
22 equity option.

23 f. The proposed new plan is misleading participants
24 and prospective participants by leading them to believe the new
25 products offer guaranteed interest and expense factors said
26 interest is guaranteed for only 10 years and annuity rates are
27 guaranteed for only 5 years, whereas the existing plan has
28 lifetime guarantees. Further, the State's 13 administrative
29 expenses are not guaranteed. All of these appear to constitute
30 substantial modification requiring IRS approval, which by their
31 present directives they are refusing to issue (Exhibit C).

32 Further affiant sayeth not.

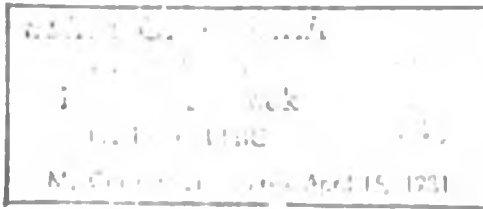
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Myrton R. Charney
MYRTON R. CHARNEY

SUBSCRIBED and SWORN to before me this 16 day of December, 1977.

SEAL

James F. Petersen
Notary Public for Alaska
My Commission Expires: 4-15-81



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