SCOMM

#32:5

MIKE GRAVEL
ALASKA

United States Senate

WASHINGTON, D.C 20510

May 24, 1979

The Honorable Mike Colletta
Box 3188
Anchorage, Alaska 99501

Dear Mike:

I certainly enjoyed the opportunity to work with you during this past legislative session on the Alaska General Stock Ownership Corporation bill. Peggy and your staff made me feel very much at home in Juneau and I hope that my contribution to the legislation was worthwhile.

I look forward to working with you again in the future and wish both you and Peggy an enjoyable summer.

With best regards,

Sincerely,

Jerry

Jerry Gauche
Legislative Aide

JG/ra

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TO REP. SAM COTTEN, CHAIRMAN, HOUSE RULES COMMITTEE
REP. RUSS MEEKINS, CHAIRMAN, HOUSE FINANCE COMMITTEE
REP. MIKE MILLER, CHAIRMAN, HOUSE STATE AFFAIRS COMMITTEE
REP. TERRY GARDINER, SPEAKER OF THE HOUSE
REP. JIM DUNCAN, CHAIRMAN, BUDGET AND AUDIT COMMITTEE

SENATOR MIKE COLLETTA, CHAIRMAN, SENATE RULES COMMITTEE
SENATOR BOB ~~MULCAHY~~, CHAIRMAN, SENATE STATE AFFAIRS COMMITTEE
SENATOR JOHN SACKETT, CHAIRMAN, SENATE FINANCE COMMITTEE
SENATOR BILL SUMNER, CHAIRMAN, SENATE RESOURCES COMMITTEE
SENATOR CLEM TILLION, PRESIDENT OF THE SENATE

THE BARTLETT CLUB IS IN UNANIMOUS SUPPORT OF SENATOR MIKE GRAVEL'S PLAN CREATING THE ALASKA GENERAL STOCK OWNERSHIP CORPORATION.

/S/ HOWARD BAKER, PRESIDENT, BARTLETT CLUB

EOM/

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 seeking state financial

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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.

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

Colletta

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

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 respc sibility 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, et 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 giants 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.

The 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 DI[illegible]RACY

That the existence of classification [illegible]irectors would limit the ability of minorities within the State [illegible]btain representation on the Board of Directors of AGSOC is, in [illegible]pinion, without foundation in fact. Board classification is de[illegible]able to promote stable policies in corporate matters. The possibil[illegible] of an entirely new Board being elected each year would be highl[illegible]undesirable. Board membership will be in a corporation charged [illegible]ith 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, suggestions 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

Colletta

MEMORANDUM

To: Gov. Jay Hammond

From: Jerry Gauche

Re: AGSOC Issues

Date: April 12, 1979

It may be helpful to comment on four issues which appear to have received considerable discussion within the administration regarding AGSOC. These comments are based on the most recent amendments by the House State Affairs Committee. The four issues are: (1) The distinctions between AGSOC and the permanent fund; (2) Financing for AGSOC; (3) Shareholder control; and, (4) Political impact.

Distinctions Between AGSOC and Permanent Fund

Resource Ownership vs. Capital Ownership

The permanent fund relys for its revenues on the resources owned jointly by Alaskans through their government. Development of those resources is controlled by private enterprise owned mostly by outsiders. AGSOC does not seek to distribute either the resources owned by Alaskans through their government or income from those

ASSETS. WHAT IT DOES SEEK TO DO IS TO GIVE ALASKANS A VEHICLE THROUGH WHICH THEY CAN PARTICIPATE IN THE DEVELOPMENT OF THEIR RESOURCES.

WHO PROFITS?

WHEN ALASKA RESOURCES ARE DEVELOPED BY OUTSIDERS THE OUTSIDERS PROFIT. ALASKA CAN SHARE IN ONLY A PART OF THE PROFITS FROM THAT DEVELOPMENT, THE PART WHICH CAN BE TAXED AWAY. HOWEVER THE STATE CANNOT TAX AWAY 100% OF THE PROFITS AND EXPECT FUTURE DEVELOPMENT BY OUTSIDERS. THE ENTIRE PROFITS FROM AGSOC PARTICIPATION IN DEVELOPMENT WILL REMAIN IN THE STATE BECAUSE THE SHAREHOLDERS OF AGSOC WILL BE ALASKANS.

TRUSTS VS. BUSINESS PARTICIPATION

THE PERMANENT FUND AND GOVERNMENT OWNED RESOURCES ARE VIEWED BY MANY AS A TRUST FUND FOR THE FUTURE, THE CORPUS OF WHICH SHOULD BE HELD INTACT AND INVESTED IN A CONSERVATIVE MANNER EITHER BY A BOARD OR INDIVIDUAL ALASKANS. AGSOC IS DESIGNED TO USE CREDIT IN ORDER TO GIVE ALASKANS ACCESS TO OWNERSHIP OF DEVELOPMENT CAPITAL IN THE STATE. THE PERMANENT FUND REPRESENTS ASSETS WHICH ALASKANS ALREADY OWN, AGSOC WILL BRING THEM OWNERSHIP OF NEW ASSETS. THE CONCEPT OF THE PERMANENT FUND AND AGSOC ARE NOT INHERENTLY COMPETATIVE, BUT COMPLIMENTARY. THE PERMANENT FUND QUESTION MAY BE SOLVED INDEPENDETLY OF AGSOC AND AGSOC CAN FUNCTION INDEPENDENTLY OF THE PERMANENT FUND.

State vs. Private Ownership

The permanent fund is a vehicle of the state and controlled by the elected officials of the state. It is a depository of state assets. The AGSOC is a private corporation controlled by its shareholders. Despite assertions otherwise, the fact that its shareholders are the residents of the state does not make it a political organization nor an arm of the state.

Financing of AGSOC

Legislative Review

No special legislation has been devised regarding state financial assistance for the AGSOC other than start-up costs. AGSOC is to be dealt with in the same manner as other private corpoations seeking state support. There is no mechanism whereby the state could be bound to financial support for AGSOC without legislative action. If state financial support is required for an investment AGSOC will be required to come before the legislature and the adminstration with a proposal which may or may not be approved by the legislature and signed by the Governor.

State Financing for Private Corporations

State involvement in financing private corporations is not new. But, present state support for private

CORPORATIONS BENEFITS ONLY THOSE PEOPLE IN ALASKA WHO HAVE ALREADY ACCUMULATED CAPITAL. THE STATE CURRENTLY HAS SOME $150 MILLION OF LOW INTEREST BUSINESS LOANS OUTSTANDING, BUT BECAUSE OF THE 75% LOAN LIMITS ONLY THOSE WITH EXISTING CAPITAL CAN QUALIFY. AGSOC BRINGS IN THE REST OF ALASKA IF THE LEGISLATURE AND THE GOVERNOR, AT THE REQUREST OF THE CORPORATION, SHOULD DETERMINE THAT STATE SUPPORT OF A PARTICULAR INVESTMENT BY THE AGSOC IS APPROPRIATE.

SHAREHOLDER CONTROL

THE HOUSE STATE AFFAIRS COMMITTEE IN DRAFTING A COMMITTEE SUBSTITUTE FOR THE AGSOC BILL HAS INCLUDED A NUMBER OF AMENDMENTS WHICH WILL MAKE THE BOARD OF DIRECTORS OF AGSOC MORE RESPONSIVE TO THE SHAREHOLDERS AND SHOULD ALAY FEARS THAT THE BOARD WILL BECOME AN INSULATED GROUP MORE POWERFUL THAN ANY OTHER IN THE STATE. THESE CHANGES INSURE THAT THE SHAREHOLDERS MAY PUT ISSUES AND BOARD CANDIDATES ON THE CORPORATION BALLOT, THAT THE INCUMBENT BOARD MAY NOT USE THE FUNDS OF THE CORPORATION TO MAINTAIN THEIR INCUMBANCY, AND THAT THE SHAREHOLDERS MAY, AT ANY TIME, REMOVE THE ENTIRE BOARD OR ANY MEMBER. IN ADDITION, THE COURTS ARE GIVEN JURISDICTION TO REMOVE A BOARD MEMBER JUDICIALLY AT SUIT OF THE SHAREHOLDERS OR THE ATTORNEY GENERAL.

Political Impact

Many inflamatory statements have been made about the potential political power of this corporation and its board members. Fundamental to the arguments over the question of AGSOC political influence is the question of whether or not the people of Alaska can be trusted to make proper decisions regarding their own future and the future of their state or whether, in order to protect them from making the wrong decisions, the government must be interposed between the people and the decisions.

AGSOC allows the people, through their corporation, to make decisions on economic development independently of the government and to receive the proceeds of such development without their first being filtered through the government. This does not, however, mean that government will be expected to abrogate its responsibilities with respect to proper regulation of business enterprises. Fear of possible misconduct by AGSOC is really fear that the people of Alaska will act irresponsibly if given the change to control their own destiny. I think that they have proven otherwise through their political decisions in the past.

Colletta

MEMORANDUM

TO: Rep. Jim Duncan

FROM: Jerry Gauche

RE: Policy & Legal Issues Surrounding AGSOC

DATE: April 4, 1979

Following is a discussion of some political and legal issues raised by a memorandum dated March 19, 1979 from Avrum Gross, Attorney General, to Frances Ulmer, Director, Division of Policy Development & Planning, regarding the Alaska General Stock Ownership Corporation legislation, SSHB 240.

I. TAXATION

The current sponsor substitute for HB 240 fulfills the requirements of Subchapter U of the Internal Revenue Code for tax qualification as a general stock ownership corporation and a corporation organized under its terms would be entitled to special tax treatment. The tax advantages available to GSOCs are presently available to all corporation with 15 or fewer shareholders. The Internal Revenue Code permits small business corporations to avoid corporate income taxes in much the same manner as a general stock ownership corporation. But, for the first time this concept of "integration" of the corporate and personal income tax has been extended to a large corporation through the GSOC.

A. State Income Tax.

Alaska law incorporates federal income tax changes unless the legislature acts. Tax benefits provided GSOCs could be denied to AGSOC by the Alaska legislature. However, for Alaska to take special steps to tax AGSOC as a typical corporation would reduce its ability to benefit its shareholders. In addition, the tax treatment provided GSOCs might well generate more income to the state per dollar of corporate earnings than the corporate income tax. In any event, no one has suggested that Alaska deny the tax benefits provided by federal law.

B. Other State Taxes.

AGSOC is subject to all state taxes including severance, property and, if certain investments are undertaken, the oil and gas corporate income tax. There has been no discussion of exempting AGSOC from these taxes and the Department of Revenue understandably opposes any exemption of AGSOC from the oil and gas corporate income tax. Such exemption could harm the state's case in litigation over that tax.

If AGSOC investments subject it to the oil and gas corporate income tax no special problems appear to be presented. The tax reaches income sheltered by multistate and multinational corporations through accellerated deductions, expenses, and shifting of income. AGSOC has no capacity to shift income out of Alaska nor the incentive to shelter income. The flow through of tax liability and high distribution requirements enable the AGSOC to function comfortably under the oil and gas corporate income tax if the tax should apply.

C. Potential Investments.

Several investments have been mentioned as possibilities for AGSOC. However, the concept of a general stock ownership corporation is to make investment decisions at the corporate level based on the good business judgement of professional managers following careful investigation of the alternatives. Selection of investments is designed to be made outside the political process. It is therefore impossible to suggest at this time which project or projects the AGSOC might find appropriate for investment. Because of this freedom of investment selection it would also be unwise to attempt to tailor the taxation of AGSOC through exemption from special taxes such as the oil and gas corporate income tax.

D. Policy Questions.

1. Pressure for Development.

Oil and gas development is one of many possible investments which may be explored by AGSOC. According to the Attorney General such an investment would encourage rapid exploitation of these resources because Alaskans would benefit directly. This suggests that if the people of Alaska benefit directly from development they will act irresponsibly with respect to Alaska's

resources. The status quo avoids any push for exploitation because Alaskans benefit only from taxes on the development earnings of outside corporations.

AGSOC provides an alternative to this status quo if one is willing to believe that Alaskans are capable of making proper decisions regarding their own economic destiny. For the first time, through AGSOC, development earnings will flow to Alaskans instead of the non-Alaskans who have, until now, controlled development in our state. Alaskans will continue to benefit from state ownership and control of the resources. In addition, they will have the opportunity to benefit from extraction and delivery as well.

There is no reason to believe that AGSOC will ravage Alaska in the name of ever higher profits. It is likely that the corporation will become a voice for more responsible development in Alaska. For the first time the people of the state will control a major corporation doing business in Alaska. AGSOC will be an exemplary corporate citizen because its activities will directly affect the quality of its shareholders' lives. Alaskans can be expected to demand responsible actions by the corporation. Unlike many developers here, if AGSOC dumps its garbage in Alaska it will be dumping it in the back yards of its shareholders.

2. State Revenues vs. AGSOC Income.

Will AGSOC become a lobbying force for lower state taxes? Every taxpayer in Alaska has some interest in lowering taxes. The real issue is whether AGSOC will change the balance between Alaskans' desire for more government services and lower taxes. Is there reason to believe that AGSOC shareholders will act differently with respect to taxes on AGSOC income than they do with respect to taxes on their other income?

The political and economic issues of state revenues versus disposable personal income are not new to Alaska or the nation. AGSOC does not significantly alter the trade off. The issue cannot be reduced to the simplistic choice between AGSOC dividends or social welfare programs. AGSOC will become only one relatively small component in the complex mix of taxes, government programs, and taxpayer perceptions. Increases in AGSOC dividends from lower taxes will not take food out of the mouths of the poor. AGSOC dividends may well benefit the poor as much, if not more than, the same amount of money doled out by the government as transfer payments.

In any event, there is no reason to presume that the AGSOC will lobby strongly for tax reduction. Alaskans already pay a significant share of their income in state taxes, but there has been no irresponsible drive to eliminate the personal income tax. Those same Alaskans will control the AGSOC. There is no reason to believe that the possibility of some additional dividend income will cause them to raid the state's treasury. The entire discussion of the trade off between state revenues and AGSOC income is mute if we assume that the people of Alaska and their elected representatives will continue to act responsibly in defining the relationship between state revenues and Alaskans' personal income.

II. "DEPOLITICIZING" AGSOC

"Depoliticize" is a polite word for the elimination of political rights. Proposals to limit the political and legal rights of AGSOC imply that Alaskans cannot be trusted to distinguish between their roles as citizens and shareholders. Therefore, the citizens must be protected from making unfortunate economic decisions by denying the political and legal rights of their corporation. Underlying is the implication that Alaskans should not have the power, independently of the state government, to determine their own economic future.

To suggest that AGSOC will become a "fourth branch of government" is an insult to the integrity of the governor, the legislature and the voters of the state. The proposed abrogation of political rights seems designed to protect the legislature from the influence of a corporation owned by its own people. It seems the legislature needs protection from AGSOC, a corporation owned by Alaskans, more than from other powerful corporate influences in the state.

Attempts to "depoliticize" AGSOC require limitations on the political rights of the corporation. This limits the ability of the corporation to protect the interests of its shareholders. Such limitations suggest that AGSOC shareholders are either less deserving of full political rights than the shareholders of other corporations or so powerful that they do not need the political protections afforded the shareholders of other corporations.

Government is one of the most significant forces affecting the conduct of modern corporate business. Taxes, licencing, and regulation of environmental pollution, securities transactions, transportation, health and safety and many other governmental activities affect the profitability and continued existence of the corporation. In order to protect itself and its shareholders from arbitrary or ill considered actions by the government the corporation must be able to exercise its political rights.

A. Specific Limitations.

Several specific limitations on the political and legal rights of the AGSOC are suggested. It is appropriate to question whether any of these limitations would be constitutional as applied only to AGSOC? These proposals may well be the start of an attempt to limit the political and legal rights of all corporations chartered or doing business in Alaska. If they are appropriate for AGSOC why not for other Alaska corporations as well?

The right to make political contributions is already limited to $1,000 per year per candidate. AS 15.13.070. The right to lobby is restricted by the existing disclosure provisions of Alaska law. The Attorney General suggests that AGSOC be denied the right to lobby, make political contributions, endorse candidates and reserve comment on state activities affecting the interests of its shareholders. In other words, if the state acts irresponsibly with respect to AGSOC the corporation cannot tell anyone or do anything to change the state's position. It must stand passively by while its shareholders suffer.

The justification for denying AGSOC political rights appears to be that it might have too much influence. Regarding the right to endorse candidates the Attorney General says, "[W]e have absolutedly no guarantees that management . . . will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic preferences implemented by vigorous participation in the political arena." We do not deny the political rights of other groups and corporations simply because they seek to implement their political and economic preferences, that is the essence of our system, why should we limit the AGSOC?

There are three points raised by the Attorney General which warrant consideration:

1. Block Voting.

Block voting of AGSOC stock by influential Alaska groups such as natives or labor unions is a possibility. To the extent that the corporation is made more responsive to its shareholders block voting is facilitated. However, we should ask why it is inappropriate for these important Alaskan groups to have an influence on AGSOC? Why is their influence within AGSOC more to be feared than their existing influence iwthin the economic or political arena?

2. Political Popularity.

The Attorney General points out that the governor could be in the "anomalous position of dealing with a more popular, albeit apolitical, leader representing" the AGSOC. This issue may present a political problem for the governor, but certainly is not grounds for denying the people of Alaska the benfits of a general stock ownership corporation.

3. The Springboard.

The suggestion is made that the AGSOC board members might use their positions as springboards to political office. It is not uncommon for individuals who have served in important posts within the state, both in government and the private sector, to subsequently run for political office. To protect against such an eventuality only in the case of the AGSOC would be to discriminate unfairly against that corporation. To deny the people an AGSOC because the directors might "utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office" seems narrow minded indeed.

B. Litigation with the State.

The Attorney General finds an "underlying irony" in the state litigating against the people of the state. This observation reflects again the confusion between the citizens of Alaska and the shareholders of AGSOC.

The Attorney General would not hesitate to sue a corporation owned by a few Alaskans. Why are these suits not a "waste of common resources" when, apparently, a suit against the AGSOC would be? The difference seems to be that damages from other corporations would burden only a few Alaskans while damages levied against AGSOC would cause many Alaskans to suffer.

An analysis of AGSOC legal rights must be founded on a proper understanding of the state's role as litigant. The state litigates for the purpose of enforcing reasonable rules established for the benefit of its citizens. If some of its citizens, acting through a corporation, violate its reasonable rules, the state should reprimand them. On the other hand, if the state's rules are unreasonable, the right to litigate protects the citizens. The state's relationship to AGSOC and its shareholders should be the same for purposes of litigation as its relationship to other corporations. It is proper for the state to litigate against even a majority of its citizens to enforce reasonable laws and regulations and it is reasonable for those citizens to defend in order to assure that their rights are not violated by the state.

The Attorney General offers two suggestions for resolving legal conflicts between the state and AGSOC. One suggestion is to throw any such dispute into the political arena where, if other Attorney General proposals are adopted, the AGSOC would have no access. This would politicize the AGSOC to the extreme and make of the legislature a court before which the issue would be tried without the proceedural protections of the law. Resolution of legal disputes would be based on political influence.

The suggestion to arbitrate conflicts approaches more closely existing law and would, hopefully, assure the parties' legal rights. However, arbitration can be nearly as costly and time consuming as a law suit. In the final analysis one must ask what is wrong with the existing system for settling legal conflicts between the state and corporations as applied to the AGSOC?

The existing system of laws was designed to protect the rights of the parties while arriving at a proper decision of the issues. It is sometimes costly, but we have yet to develop an alternative which arrives at

better decisions more expeditiously and at lower cost. We are willing to live with the existing system for most purposes and put some faith in its ability to reach the right decision. By denying AGSOC access to this system we deny its shareholders the protections of our legal system. To say that those shareholders can protect their rights through the political system is no answer. To reduce their access to the legal system is to deny them the protections of that system which we extend to all other Alaska corporation and to make of them second class legal citizens.

STATE of ALASKA

MEMORANDUM

TO: Frances Ulmer, Director
Division of Policy
Development & Planning

DATE: March 19, 1979

FILE NO:

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERAL

SUBJECT: Policy & Legal Issues Surrounding AGSOC Legislation (SSSB 170 and SSHB 240)

By: Joseph K. Donohue
Joseph K. Donohue
Assistant Attorney General

You have requested a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently before the legislature (SS for SB 170 and SS for HB 240). The following is an outline of those issues from the Department of Law's perspective:

I. TAXATION

The Revenue Act of 1978 added Subchapter U to the Internal Revenue Code 1954, 26 U.S.C. §1391 through §1397. This legislation provides for the creation of a general stock ownership corporation (GSOC) and it authorizes special tax treatment for those corporations which qualify. The federal legislation requires that all GSOCs be chartered by an act of the State Legislature or by a referendum and further requires that each state charter provide as follows:

1. That the charter provide for the issuance of only one class of stock;

2. That the charter provide for the issuance of shares only to eligible individuals; "eligible individuals" are further defined as those who are residents of the State as of the date specified in the State's enabling legislation and who continue to be residents of the State as of the date of the issuance of the shares;

3. That the charter provide for the issuance of at least one share of stock for each eligible individual;

4. That the charter provide that no share of stock shall be transferred by the shareholder other than by will or by intestate succession, until after five years from the date of issuance (except where the shareholder ceases to be a resident); that no share of stock be transferred to a person other than a resident; and that no share of stock be transferred to any individual who would as a result of the transaction acquire more than ten shares of the GSOC.

In addition, the GSOC may not acquire more than twenty percent of the shares of any other existing corporation; the GSOC may not acquire property through the right of eminent domain; the GSOC's charter must mandate that it qualify as a GSOC under the Internal Revenue Code; and finally, the GSOC must be chartered and organized between December 31, 1978, and before January 1, 1984.

Thus, AGSOC (Alaska GSOC) as set out by Louis Kelso's proposal in SSSB 170 would create a corporation whose shareholders consisted of every resident of the State of Alaska as of the time the State charter goes into effect who remain a resident until the date of the first issuance of the AGSOC shares. The AGSOC is treated as a private corporation and not as a governmental unit for purposes of the Internal Revenue Code, except that a qualifying AGSOC is not subject to federal corporate income taxes. Instead, AGSOC's "taxable income" which is calculated in accordance with the Internal Revenue Code (with minor exceptions not relevant here) would be attributed directly to the shareholders in proportion to the number of shares held and would be taxed as individual income to those shareholders. This dividend income does not qualify for the exclusion from gross income normally associated with the first $100.00 of dividend income. See 26 U.S.C. §116.

The AGSOC is required to distribute at least ninety percent of its "taxable income" for any tax year. 26 U.S.C. §1396(a). The failure of an electing AGSOC to make the required ninety percent distribution would subject it to a penalty of twenty percent of the excess amount required to be distributed over that amount actually distributed. The federal scheme is intended to give the AGSOC a significant competitive advantage since the corporation can operate free of corporate income taxes at the federal level. On the other hand, this ten percent maximum on retained earnings

may, indeed probably will, prohibit a corporation's expansion into major new investment areas on the basis of these earnings alone. New investment opportunities which arise in the future would require AGSOC to again obtain significant debt financing which may, in turn, require multiple state guarantees.

The first question which arises is whether or not the policy evidenced by the federal legislation (i.e., freedom from corporate income taxation) should be paralleled at the State level. The present SS for SB 170 would operate to exempt the AGSOC from the State's corporate income tax levied pursuant to AS 43.20. See AS 43.20.021, which incorporates by reference subchapter U of Chapter 1 of subtitle A of the Code. AS 43.20.021 provides for a delayed incorporation of tax exemptions. Those provisions of the Code adopted after 1975 "which change or modify exemptions from tax or credits against tax are not adopted by reference as a part of this chapter until the second January 1 following the effective date of the federal law". Here GSOC's exemption would go into effect at the State level on January 1, 1980. The AGSOC, however, would be subject to state severance taxes (AS 43.55), state oil and gas property taxes (AS 43.56), as well as the state's new oil and gas corporate income tax (AS 43.21.010) should the AGSOC invest in oil and gas production or pipeline transportation property. The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS.

AGSOC's investment in the oil and gas arena would present several important policy questions which should be analyzed prior to the Administration's endorsement of the present legislation. By purporting to give each resident of the State a direct interest in the development of the State's natural resources, it would become an independent voice for more rapid exploitation of those resources. Because the dividends to the residents would, as presently proposed, be directly affected by the nature and extent of the State oil and gas tax policy, it would likely become a lobbying force for lower State taxes. Obviously, lots of tradeoffs are involved, but the political and economic issue reduces itself to the following: Would it be better to expedite resource development and lower State taxes in such a case in order to allow AGSOC's shareholders to benefit directly (albeit by only a marginal increase in their dividend) and at the same time deprive the State treasury of potentially enormous revenues which could be devoted to various social welfare programs? These programs would ultimately return greater proportionate benefits to those in the lower income brackets in the State and possibly lesser benefits (than AGSOC) to those in the upper income brackets.

analyzed prior to the Administration's endorsement of the present legislation. By purporting to give each resident of the State a direct interest in the development of the State's natural resources, it would become an independent voice for more rapid exploitation of those resources. Because the dividends to the residents would, as presently proposed, be directly affected by the nature and extent of the State oil and gas tax policy, it would likely become a lobbying force for lower State taxes. Obviously, lots of tradeoffs are involved, but the political and economic issue reduces itself to the following: Would it be better to expedite resource development and lower State taxes in such a case in order to allow AGSOC's shareholders to benefit directly (albeit by only a marginal increase in their dividend) and at the same time deprive the State treasury of potentially enormous revenues which could be devoted to various social welfare programs? These programs would ultimately return greater proportionate benefits to those in the lower income brackets in the State and possibly lesser benefits (than AGSOC) to those in the upper income brackets.

Since this legislation is admittedly in an incipient stage, and since the various investment opportunities have not been publicly discussed in any detail, there has been little or no discussion of whether or not the AGSOC should be exempt from these various oil and gas taxes. The Department of Revenue has taken the position that it will oppose any attempt to render the AGSOC subject to special treatment under its present oil and gas corporate tax structure.

II. FINANCING

Senator Gravel and Louis Kelso have testified before a joint legislative committee and their representatives have stated to administration officials in a private meeting that there is some chance that AGSOC will be able to obtain financing on the private market without recourse to State guarantees or State credit. Obviously, this would be an infinitely preferable alaternative. In such a case, the investment itself, such as part of TAPS, becomes collateral for the loan made.

However, they have also indicated that there was a significant probability (about 75%) that AGSOC would have to return to the Administration and to the legislature, and ultimately to the people at the polls, for approval of a major extension of State credit or guarantees to secure loans of sufficient size to enable AGSOC to invest in TAPS, construct a gas line, etc.

SSSB 170 presently contains only one financing device--AS 10.50.100. The bill proposes the creation of a loan guarantee fund which will be a special fund segregated from all other funds of the State. It purports to be a trust fund for the uses and purposes of this section, but no uses and purposes are set forth in that section. As proponents of the measure have stated that the sole purpose is to guarantee loans for startup or organizational costs of the corporation, they have agreed to both clarify the uses to which the monies can be put and to a statement of a definite limit on the appropriations into the fund ($5,000,000.00). In addition, this section charges the Commissioner of Revenue with reviewing applications for loan guarantees (for the purpose of guarding against fraud and misrepresentation). It is suggested that the Commissioner of Revenue be given broader review powers such as the ability to disapprove a loan on the basis of its general inadvisability.

To accommodate these various concerns, the following substitute for AS 10.50.100 contained in SSSB 170 is submitted for consideration:

> A) There is a special fund of the State known as the Alaska General Stock Ownership Corporation Loan Guarantee Fund, which shall not exceed $5,000,000.00. and which shall be completely segregated from all other funds of the State. This fund is a trust for the uses and purposes of this section.
>
> B) The Commissioner of Revenue shall use the fund to guarantee loans solely for startup costs (and not to include major investment financing) made to the corporation by lenders other than the State. In guaranteeing loans, the Commissioner of Revenue shall review the loans for the purpose of ascertaining the general soundness of the proposed loan and for the purpose of guarding against fraud

and misrepresentation. The guarantee of a loan may not be for an amount in excess of the unobligated balance in the fund at the time the guarantee is made.

Whereas the above minor technical changes can clarify or limit the general purpose of the loan guarantee fund as originally proposed, the manner in which AGSOC would approach the State and apply for an appropriation or legislation which would enable them to utilize the public credit of the State of Alaska to guarantee a major investment in the future is not treated in this bill. Senator Gravel has testified that such an extension of public credit would be in accordance with the procedures which pertain to the issuance of general obligation bonds which require the ratification of the voters at the polls. Thus, Senator Gravel has argued that no major extension of public credit would occur without the ultimate participation of all the voters of the State who would, of course, include most of the AGSOC shareholders.

Senator Gravel is basing his procedural argument on Article IX, §8, State Constitution, which states:

> "No state debt shall be contracted unless authorized by law for Capital improvements and ratified by the majority of the qualified voters of the State who vote on the question."

Although the issue deserves further review by this department, it is suggested that this provision on its face does not apply to the type of guarantee contemplated by Senator Gravel and the proponents of the AGSOC, since the investment would not qualify as a capital improvement authorized by law under this section. See City of Juneau v. Hickson, 373 P2d 743 (Alaska 1962).

Rather, it would appear that Article IX, §6, applies in this context:

> "No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

Under this provision, all that would be required for an extension of credit to the AGSOC would be legislation appropriating a sufficient amount of money to guarantee AGSOC's commitment. Thus, it appears that something on the order of a loan guarantee fund on a vaster scale would in fact be required but such legislation would not be subject to voter ratification at a subsequent general election. Since Kelso's investment consultants have based their advice on the assumption that there could be a call on the general credit of the State without a significant appropriation to back up any guarantees, the ability of the State treasury to make such an appropriation and its fiscal impact on other State programs has never been carefully analyzed.

Thus, three questions need to be considered: (1) Whether there is any constitutional mechanism for extending the State's credit without the necessity of a large appropriation which may not be fiscally sound or economically feasible; if not, whether AGSOC's proponents who have assumed the availability of access to the State's credit have any alternative suggestions for the financing of the corporation which should be statutorily treated at this time; (2) Whether this statute should incorporate a statutory procedure or requirement for voter ratification of any major investment proposal, funded by direct appropriation into a guarantee loan fund; and (3) Whether a constitutional amendment would be required to allow the State to guarantee AGSOC's loans.

III. DEPOLITICIZING THE AGSOC

The proponents of the AGSOC have conceived of this entity as operating as a private corporation subject to the very few qualifications imposed on it by federal law. Thus, the corporation is subject to the standard provisions of the Alaska Business Corporation Act, AS 10.05, except where inconsistent with the state or federal enabling legislation. The proponents have argued that AGSOC stands the best chance of being a success, (i.e., operating at a profit which will be shared in by most Alaskan residents) if it is structured as a completely private corporation. However, 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.

No matter how the AGSOC is ultimately designed, it would be foolhardy to believe that this entity would not quickly become highly politicized and ultimately, if it is successful, become an extremely powerful political force in

the State. Assuming it is established as a private corporation, it would present the following issues:

A) AGSOC: A Fourth Branch of Government

A successful AGSOC, representing as it would the residents of the State of Alaska would in essence, become a fourth branch of government. It will be a fourth forum in which State environmental, social, economic and tax questions will be vigorously debated. The Governor's control over this corporation is limited to appointing the first board of directors. After that the corporation will, as presently designed, operate completely independent of any state agency, albeit it will be subject to all applicable state regulatory provisions. Given the composition of the corporation, it would become quickly susceptible to the pressures of any cohesive organized group of residents within the State, such as large labor unions, native corporations, etc. That is, any private organization containing a large number of resident votes could well form a block in the nature of a voters' trust, which could be used to gain control, or at least to form an influential minority on the board of directors.

The board, and indirectly management, would be subject to election by the same or a similar constituency as the Governor of the State. Thus, the chairman of the board could conceivably end up representing a larger number of Alaskan residents than the Governor of the State. The Governor would be put in the somewhat anomalous position of dealing with a more popular, albeit apolitical, leader representing the fourth estate, i.e., AGSOC.

Although one could argue that AGOSC violates the fundamental political theory of the State Constitution which established only three branches of government, this objection is more of a philosophical one than a legal one, and it is not anticipated that any such challenge could be successfully formulated and presented to the State courts. Finally, under this general category of concerns relating to its impact on the present institutional balance of power as contemplated by the State Constitution, it should be noted that

management of the corporation, members of the board of directors of the corporation, could, and very well might, utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office.

B) Specific Constraints: Lobbying and Political Contributions. Since AGSOC will purport to represent the people of the State of Alaska, it could be argued that since that function is also served by the Governor of the State and by the legislature in the political arena, AGSOC should be prohibited from participating in that same arena, or at least be made subject to stringent restrictions. It is suggested that AGSOC should be prohibited from lobbying, from making political contributions to candidates for State offices, and that strict proxy review mechanisms should be added to the bill to ensure that the board of directors act in a politically neutral fashion. For instance, AGSOC's board, in its annual report, would be allowed to analyze the impact of State taxes on its percapita dividends. However, the board would not be able to affirmatively encourage the shareholders to write their legislators and call for a lower rate of taxation. The shareholders would have to draw their own conclusions. Obviously, the shareholders would then be allowed to contact their legislators and express their opinion on the subject.

Furthermore, a AGSOC endorsement of a political candidate would obviously be a cherished one. Even though AGSOC's proponents at present claim that this corporation is merely another private corporate entity, we have absolutely no guarantees that management in future years will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic policy preferences implemented by vigorous participation in the political arena. AGSOC endorsements and political contributions might therefore best be prohibited.

C) Litigation With The State. AGSOC, just like any other major corporate entity, would become subject to various State regulatory laws, and the

possibility for confrontation is obvious. For instance, should AGSOC become the vehicle for financing the gas line, AGSOC would have a corporate interest in raising the tariff on the pipeline which would be assessed against the State, and the State as producer and shipper would have an interest in lowering the tariff in order to maximize State royalty and severance tax revenues to the treasury.

In addition, the proponents of AGSOC have stated on several occasions that in order for it to result in tangible benefits to the individual Alaskan shareholder, it must invest in vast development projects which will involve vast returns (hopefully). Thus, there is every likelihood that AGSOC would become a major force for concentration of economic power in the State and might ultimately develop or acquire monopoly control over one or more economic sectors. This, in turn, would present anti-trust problems, both under state and federal law, and the following scenarios are possible: 1) Since AGSOC is not a State agency, it would not enjoy the "state action" exemption from the federal anti-trust laws and it would likewise be subject to treble damage actions for any economic injuries arising out of violations of the Sherman or Clayton Anti-Trust Acts, 15 U.S.C., §1, et seq., and (2) The State could find itself litigating at great expense against AGSOC in order to require it to divest itself of various interests, or to require it to cease and desist from some specific anti-competitive practice.

The anti-trust example is one of many. It could occur in the environmental sector, the banking and securities area, the tax area, or in any other area of commercial endeavor. The State and AGSOC, if engaged in litigation with each other, would be drawing on resources which ultimately affect the same individuals, i.e., the taxpayers versus the shareholders. Should the State prevail and obtain a fine, such a fine would, itself, seem counterproductive.

Some suggestions for mitigating the underlying irony of the State litigating against the people of the State, i.e., AGSOC, and the potential for enormous waste of common resources which is inherent in any extensive litigation such as a protest of a pipeline tariff, might be as follows:

1) When a dispute arises between the State and AGSOC, the matter could be held in abeyance until the next legislature to allow the latter to determine by legislation the proper resolution of the matter; or the matter could be submitted to an arbitration panel established by statute.

2) Other means of controlling litigation between AGSOC and the State would be to create a disincentive to any litigation. One such disincentive would be a modification of the court rules relating to the award of costs and attorney's fees to provide that the State would always be entitled to receive its actual costs and attorney's fees incurred in the litigation of any action involving AGSOC. In addition, AGSOC's right to costs and attorney's fees would arise only in those cases where the court makes an express finding that the State's prosecution or defense was frivolous or lacking in good faith.

IV. CORPORATE DEMOCRACY

One of the most important policy questions which must be addressed in any analysis of AGSOC is whether or not resident shareholders' right to participate in and to influence corporate decision making is adequately protected or assured by the normal corporate procedures set forth in AS 10.05. The following is a list of specific issues which the administration and the legislature should address in its analysis of the AGSOC legislation:

1) Classified Directors. The present sponsor substitute provides for a board of directors consisting of nine members divided into three classes of three members each. Three directors will therefore be eligible for an election during any one year. See AS 10.50.030. A highly classified

board of directors such as this would limit the ability of minorities within the State to obtain representation on the board of directors. Every shareholder has one vote, and if all nine directors were elected at the same time, there is a greater opportunity for minorities such as native organizations, etc., to elect at least one board member. A highly classified board would tend to heavily favor urbanized Alaska.

2) Cumulative Voting. AS 10.05.162 presently provides that shareholders may, at an election for directors, cumulate their votes by giving one candidate as many votes as the number of directors to be elected, multiplied by the number of that shareholder's shares. However, a corporation may provide in its bylaws (modified by board of directors' resolutions) that shareholders cannct cumulate their votes but must vote shares held by them on an election-by-election basis. Cumulative voting is another device to help ensure minority representation on the board of directors. By leaving it optional, as stated in AS 10.05.162, the board of directors could amend the bylaws to prohibit cumulative voting. It is suggested that it might be desirable for the AGSOC legislation to expressly state that cumulative voting cannot be prohibited by shareholder or by director action.

3) Voting Trusts. In accordance with AS 10.05.171, voting trusts may be created by any number of shareholders who wish to confer upon a trustee the right to vote or otherwise represent the shareholders for a period not exceeding ten years. The existence or toleration of voting trusts within the AGSOC context is a question which should be carefully analyzed. At this point in time, it is suggested that their prohibition might be advisable or at least a limitation imposed on the number of years that they can remain in existence. For instance, AGSOC proponents indicate that the original AGSOC will be coming back to the legislature for each major investment proposal. Thus, within a ten-year period, two or three major investment schemes may have been considered and acted upon, and a ten-year voting trust would allow a trustee undue amount of influence over any of these decisions.

4) Amendment of The Articles of Incorporation. AS 10.05.276 presently provides that the board of directors shall adopt a resolution setting out a proposed amendment directing that it be submitted to a vote at the annual or special meeting of the shareholders. Thus, it appears that the initiative to amend the articles must come from the board, and it may be desirable to provide for an amendment which would allow the shareholders to propose amendments to the articles of incorporation that can be taken up and voted on at annual meetings.

5) Quorum of Shareholders. AS 10.05.153 presently provides that, unless otherwise provided in the articles of incorporation, the majority of the shares entitled to vote constitutes a quorum in a meeting of shareholders. (The section provides for a minimum of one-third of the shares.) The quorum requirement is something that the legislature may wish to mandate by statute. Here, of course, the higher the quorum requirement, the greater the difficulty the corporation will have in holding an annual meeting. However, a high quorum requirement would necessitate vigorous promotional and educational programs to ensure the presence of the quorum at each annual meeting and might indirectly spur thcorporation to greater efforts to include or request the participation of all shareholders of the State in corporate decision making.

6) Notice of Meetings of Shareholders. AS 10.05.138 presently provides that meetings of shareholders may be held at the place (either inside or outside the State) as may be provided in the bylaws. In addition, an annual meeting of the shareholders shall be held at the time provided in the bylaws. Special meetings of the shareholders may be called by the president, the board of directors, and holders of not less than one-tenth of all the shares entitled to vote at the meeting.

AS 10.05.141 in addition requires written or printed notice of all meetings, such notice shall be delivered not less than ten nor more than fifty days before the date of the meeting, either personally or by mail.

Obviously, together these rules operate to favor incumbent management. Annual meetings could

be rescheduled by a change in the bylaws which requires a vote of the board of directors. The board could, on short notice, i.e., as little as ten days, present the shareholders with any major issue it chose, such as the election of new directors or consideration of a major investment proposal.

The legislature might well wish to consider statutory safeguards which would ensure adequate notice of the time, place and purpose of any meeting which would preclude manipulation of the timing of any meeting to the advantage of the incumbents.

7) Bylaws. AS 10.05.135 presently provides that the board of directors shall have the power to alter, amend or repeal the bylaws unless it is reserved to the shareholders by the articles of incorporation. Again, it is suggested that the amendment of the bylaws might be a power which should be reserved to the shareholders in order to ensure adequate public review of any change in the management's approach to the conduct of the corporation's business.

8) Financing of Proxy Fights, Access to Voting Lists and Mailing Machinery. Several commentaries concerning modern corporate battles note the inherent advantage which incumbent management has through its control of the corporate machinery for sending out mailings, soliciting support, and arguing its cause before the shareholders. This is done at corporate expense, whereas opposing or dissenting shareholders frequently have to finance such efforts from private sources. Amendments might well be considered which would allow shareholders who can obtain a certain number of qualified signatures to utilize the corporation's mailing machinery at the corporation's expense. This procedure should be especially encouraged in the context of elections for the board of directors. Candidates who can either obtain a nomination by the board of directors or the support of a predetermined percentage of the shareholders should be entitled to publish information concerning themselves, their experience, their policy preferences and their criticisms of existing management at the corporation's expense.

V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

Two other constitutional issues should be mentioned briefly in this context. First, the federal legislation authorizing the creation of GSOC mandates that the shareholder group be made up of a closed class (i.e., those residents who satisfy the eligibility requirements imposed by state law as of the date of the state charter, and who remain residents as of the date of the issuance of the shares). Thus, future residents would be ineligible for one of the free shares of AGSOC. Under Kelso's present plan, AGSOC shareholders who leave the state and become nonresidents would be entitled to retain their dividends and voting rights in AGSOC. Persons leaving the state who wish to sell their shares could, of course, sell to new residents who wish to participate in the AGSOC. In addition, oldtime residents could acquire as many as ten shares in AGSOC through purchase or inheritance.

These two factors, when combined, could lead to the following scenario: The initial one hundred percent of the AGSOC shares could be concentrated in as few as ten percent of the original shareholders. Those shareholders, in turn, could become residents of other states, and thus it is theoretically possible that ten or twenty years from the original issuance, AGSOC shareholders could be composed of a select group of resident Alaskans and nonresident former Alaskans. Ironically, it may be at this very time that the state may be called upon to honor its guarantee, and thus the state's credit rating and ability to issue bonds at favorable interest rates would be adversely affected, and the people who would be called upon to bear the burden of AGSOC adventures would be the taxpaying class of Alaskans at that time. This potential for a sharp dichotomy between the shareholder class of AGSOC and the resident population of the state deserves closer analysis. Kelso's report contains no estimates of the transiency rates of the Alaskan population and no projections as to the future composition of its AGSOC.

The legal issue which overlaps this general policy question is whether or not the closed class nature of the AGSOC offends the equal protection provisions of the state or federal constitutions. Wilmer, Cutler & Pickering, in their memorandum of December 15, 1978, on the constitutional issues, felt that such a provision might be successfully

defended against a federal constitutional challenge. A closer question is presented under the state constitutional provision which has been interpreted somewhat more stringently than its federal counterpart. See Isakson v. Richey, 550 P2d 359 (Alaska 1976). Under this provision, a substantial question is raised as to whether or not the AGSOC arbitrarily discriminates against future residents of the state.

Secondly, a derivative issue is whether or not the use of the public credit for the direct benefit of a private corporation whose shareholders will, over time, form a distinct class within the state (possibly a minority class) qualifies under the "public purpose" requirement of Article IX, §6 of the Alaska State Constitution.

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

Hewitt Associates

100 Half Day Road
Lincolnshire, Illinois 60015
(312) 295-5000
Direct from Chicago: 273-5200;
from Milwaukee: 224-0202
Telex 28-3553

April 10, 1979

Ms. Debbie Smith
c/o Hon. Mike Colletta
Room 111 - Capitol
Juneau, AK

Dear Debbie:

Please pardon my unpardonable delay in getting these materials to you.

I enjoyed my all-too-brief stay in Juneau. And I particularly enjoyed our sojourn over the glacier - truly memorable.

I don't know that the attached testimony is terribly comprehensible without an accompanying explanation. Jerry Gauche could probably fill in any blanks.

I didn't really have a chance to meet many people. I missed speaking with the Senator, though I enjoyed a brief chat with Peggy. Please convey my best. My best also to Catherine (in Mike Miller's office) and to Christine as well.

Here's hoping I get asked back.

Yours truly,

HEWITT ASSOCIATES

Jeffrey R. Gates

JRG:cb
Enclosures

P.S. Enclosed also are some recent materials related to the TRASOP (tax credit ESOP).



AGSOC

THE FINANCIAL PLUMBING

Hearings before the

State Affairs Committee

March 20, 1979

Submitted by:

Jeffrey R. Gates
Hewitt Associates
Lincolnshire, Il.

THE AGSOC - AN OWNERSHIP STRATEGY

The American Dream - A Piece of the Action

Iron Law of Development - consume less, invest more
Catch-22 - Iron Law of Ownership

The Financial Plumbing of Stock Ownership (See Exhibit 1)

Captive Capital - Less than 10% of stock transfers are for directly fostering new capital formation.

New York Stock Exchange 1975 shareowner census:
(1) 5-year decline of 18.3%.
Quantitative vs. qualitative measure.
(2) Average age of typical shareholder increased five years over 5-year span.

Joint Economic Committee figures re stock ownership (1975):
(1) 0.5% own 50%.
(2) 1% claim 46% of dividends.
(3) Working non-professionals (76% of work force) own 19%.

(See Exhibit 2)

Debt:Equity ratio for U.S. manufacturers rose from 23% to 43% from 1964-1974.

Consumer Debt:
1960 - $56.1 billion
1976 - $217.8 billion

Comments from the Media - Why ESOPs are also called "Kelso Plans" (See Exhibit 3)

Historical Context

Industrial Homestead Act (See Exhibit 4)
Life, Liberty and ... (See Exhibit 5)

Contractual Context - Access to Ownership

The Evolving Social Contract

"A corporation is an artificial being, invisible, intangible, and existing only in the contemplation of the law. Being the mere creature of the law, it possesses only those properties which the charter of its creation confers on it, either expressly, or as incidental to its existence."

-John Marshall-

Market Context

Work Ethic - The Employment Act of 1946

"All we seek is an America where every person is given the chance to productively contribute to his country and where he can receive a fair and equitable share of the wealth that production creates."

-Coretta Scott King-

Industrial Context

Exchange Ethic

"Salary" vs. "Compensation"

Salary - salt; "not worth his salt", "In the sweat of thy face shalt thou eat bread."

Compensation - a balancing of accounts (See Exhibit 6)

Post-Industrial Context

Incomes policy designed as participation-in-production policy

The Affluent Society (1958) - "device for breaking the nexus between production and income security"

Breaking the nexus:

Federal Expenditures
- 1960 - $91.3 billion
- 1979 - $504 billion

Federal Budget
- 1960 - slight surplus
- 1978 - deficit of $61.7

Federal Transfer Payments
- 1960 - $20.6 billion
- 1979 - $198 billion

"There are no free lunches on welfare."

-Joseph Califano-
Secretary of HEW

"There is no more complete rejection of a person than to give them a job you know and they know is useless."

-F. Ray Marshall-
Secretary of Labor

A PIECE OF THE ACTION

VAN NOSTRAND REINHOLD

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FIGURE ONE

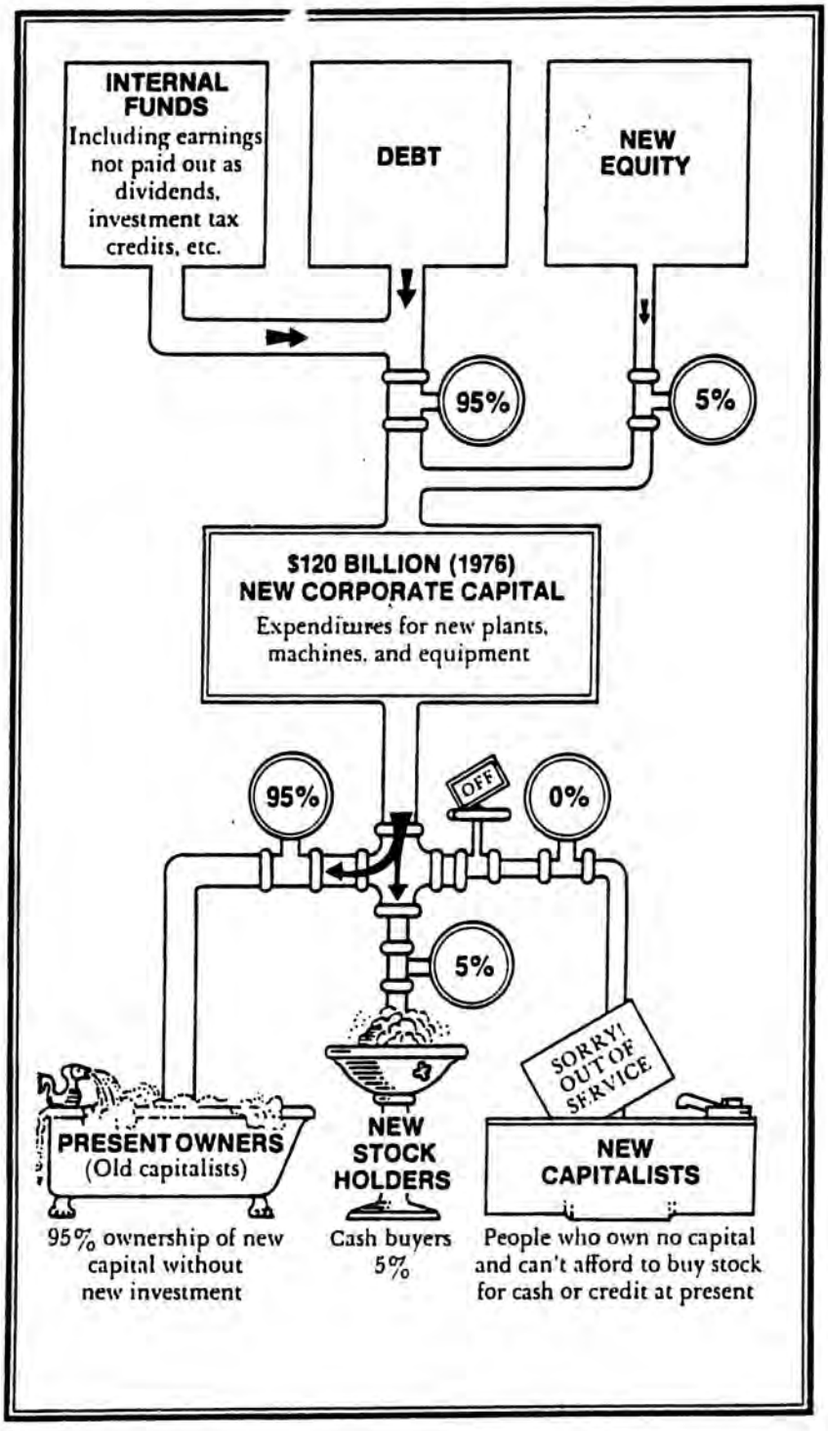
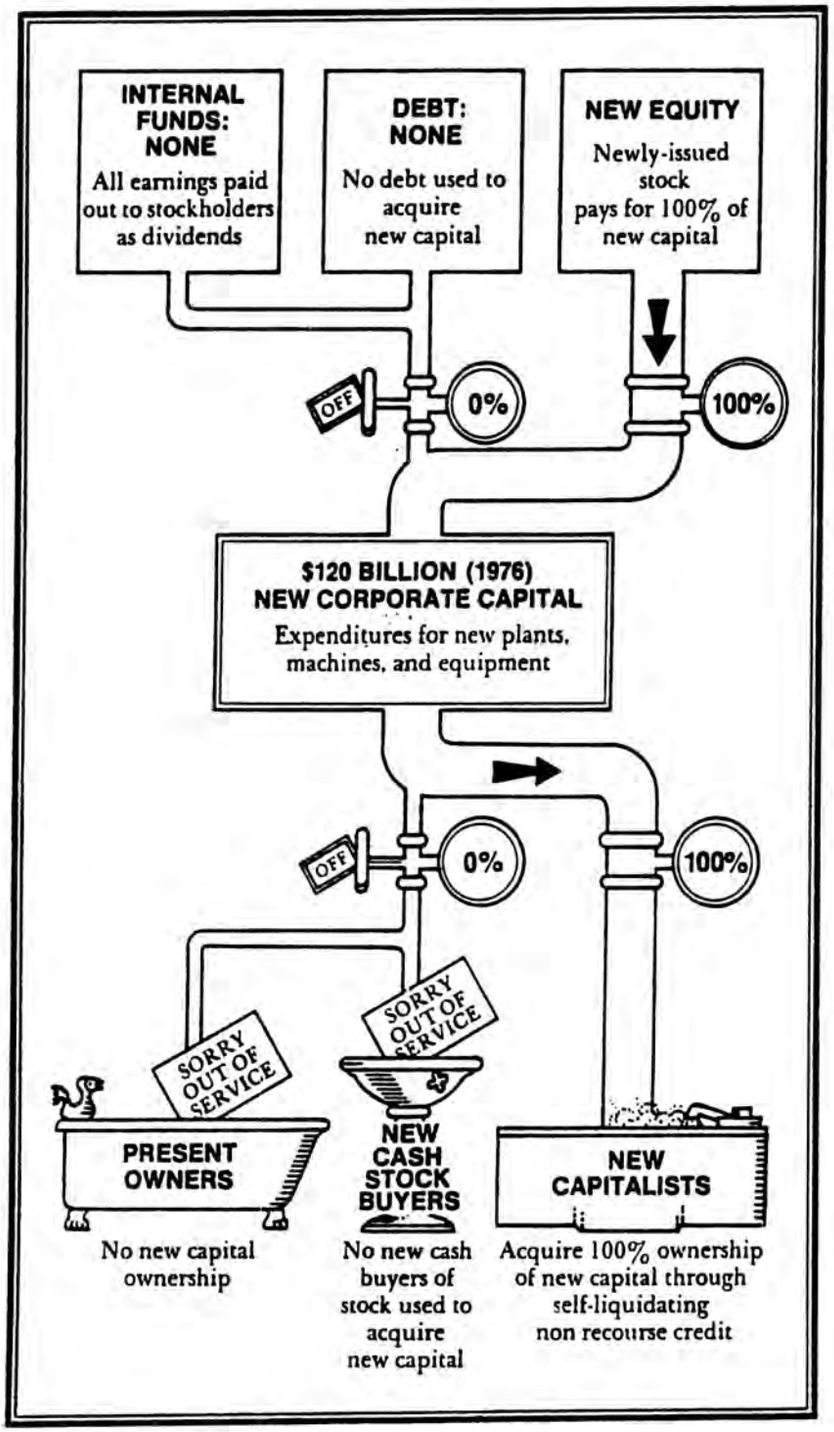


FIGURE TWO


INTERNAL FUNDS: NONE
All earnings paid out to stockholders as dividends
DEBT: NONE
No debt used to acquire new capital
NEW EQUITY
Newly-issued stock pays for 100% of new capital
OFF
0%
100%
$120 BILLION (1976) NEW CORPORATE CAPITAL
Expenditures for new plants, machines, and equipment
OFF
0%
100%
SORRY OUT OF SERVICE
SORRY OUT OF SERVICE
PRESENT OWNERS
NEW CASH STOCK BUYERS
NEW CAPITALISTS
No new capital ownership
No new cash buyers of stock used to acquire new capital
Acquire 100% ownership of new capital through self-liquidating non recourse credit

PERSONAL WEALTH: COMPOSI ON AND DISTRIBUTION

Personal wealth in the U.S. in 1972 totaled $4.3 trillion while net worth totaled $3.5 trillion. Evenly distributed, this would mean that the average sized family would have a financial net worth of $59,200. Less than one family in eight approached that figure in 1972:

TABLE 1.—PERSONAL WEALTH, 1972

Asset	All persons	Value (billions) held by the richest—		Share held by the richest—	
		1 percent	6 percent	1 percent	6 percent
	(1)	(2)	(3)	(4)	(5)
Real estate	$1,492.6	$225.0	$645	15.1	43.2
Corporate stock	870.9	491.7	629	56.5	72.2
Bonds	159.0	94.8	124	60.0	78.5
Cash	749.8	101.2	278	13.5	37.1
Debt instruments	77.5	40.8	475	52.7	40.5
Life insurance	143.0	10.0		7.0	
Trusts	99.4	89.4		89.9	
Miscellaneous	853.6	83.3		9.8	
Total assets	$4,344.4	$1,045.9	$2,152	24.1	49.5
Liabilities	808.5	131.0	300	16.2	37.1
Net worth	3,535.9	915.9	1,852	25.9	52.4
Number of persons (millions)	209.0	2.1	12.0		

Source: Cols. (1), (2), and (4): James D. Smith and Stephen D. Franklin, "The Distribution of Wealth Among Individuals and Families," 1975. Cols. (3) and (5): Internal Revenue Service, "Personal Wealth," 1976.

From: "Broadening the Ownership of New Capital: ESOPs and Other Alternatives," A staff study of the Joint Economic Committee (1976) p. 7.

This JEC report notes that "... the distribution of income has remained virtually unchanged since World War II: the top quintile of the population holds just over 40 percent of the income and the lowest quintile has 5 percent. Even these figures understate how rich the rich really are for the top quintile of families have almost 80 percent of total wealth. Clearly, income will not become more equally distributed in this country until the base of wealth holdings is broadened." Id.

Other studies document that wealth is even more concentrated than the JEC indicates:

Robert J. Lampman, National Bureau of Economic Research, The Share of Top Wealth-Holders in National Wealth, 1922-1956, (Princeton University Press, 1962).

Marshall E. Blume, Jean Crockett and Irwin Friend, "Stock Ownership in the United States: Characteristics and Trends," Survey of Current Business, November, 1974 at 16.

Expanded Ownership, (Sabre Foundation, 1971). This contains a survey of the studies on "The Distribution of Wealth in the Twentieth Century," by Prof. James D. Smith of Pennsylvania State Univ.

COMMENTS FROM THE MEDIA

WHY ESOPs ARE ALSO CALLED "KELSO PLANS"

Kelso and Adler's book could start a revolution.

Casper Weinberger
February, 1958

In those discussions there is as much of the wanderings of a madman as there is of cannibalism.

Pravda, March 25, 1959
in a review of The Capitalist Manifesto (1958) by Kelso & Adler

A crackpot theory. Instead of saying labor's exploited, as Marx did, Kelso says capital's exploited. It's worse than Marx. It's Marx stood on its head.

Milton Friedman
Time, Jan. 29, 1970

I think some economists such as Milton Friedman have given too short a shrift to the Kelso plan. It's an example of one means of acoomplishing a broadening of wealth ownership.... a quiet evolution in wealth ownership rather than the unquiet revolutions wealth owners have faced too often in the past.

Carl Madden, chief economist
U.S. Chamber of Commerce

A capitalist is someone who derives a substantial share of his income from his equity in producing companies. On this scale the figures are discouraging. Approximately ninety percent of the capital of this country is owned by five or less percent of the American people.

Louis Kelso of San Francisco, a lawyer-economist, has for years felt that he has a radical answer to the problem.

William F. Buckley
Feb. 24, 1970

There is a conspicuous void in the arguments and the programs of the counter-culture groups of this country, in that they have produced no well-formulated economic theories.

Unfortunately and ironically, Lou Kelso, who has some very imaginative economic proposals, has been offering them for many years to the establishment, the dinosaur culture.

So either Kelso is a lousy salesman or the dinosaurs are convinced their own designs will see them through.

The Whole Earth Catalog
Spring 1970

Louis O, Kelso, possibly the only genuine revolutionary in the United States.

Berkeley Daily Gazette
July 16, 1971

Kelso's formula sounds like Lydia Pinkham's Vegetable Compound. The whole theory sounds crazy. But, then, one may recall, they said all that of Copernicus too.

James J. Kilpatrick
Jan. 20, 1972

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.

Paul Samuelson
The San Juan Star
April 27, 1972

Like the emperor's clothes, it looks beautiful. But when you look closely, you find there's nothing there.

Sar Levitan, economist

Taxation has its limitations as a method of achieving better economic distribution since for this purpose it is essentially remedial. We must also take a positive approach by finding new ways to spread ownership of future capital growth more broadly in our society. This will be a fertile field for creative ideas and experimentation in the years ahead by both government and the private sector.

One such approach has been developed by Louis Kelso. Kelso makes a convincing argument that many of the deficiencies of our economic system could be alleviated if ways were found to broaden the ownership of the means of production.

John D. Rockefeller 3rd
The Second American Revolution (1973)

If a Little Capitalism Is Good, What's Wrong with a Lot?

Fred Harris, former Senator
A chapter title from
The New Populism (1973)

In America, the greatest, most famous capitalist country in the world, there are almost no capitalists. The largest majority, silent and noisy, are job serfs, wage villeins. dependent on salaries for all the money they'll ever see.

The great, lazy, anti-Calvinist, hedonistic Kelsonian truth is that you can't get rich through labor because it doesn't produce enough wealth.

Kelso's idea won't solve all our problems; it can't possibly work out as nicely as Kelso thinks, but it can move us from this barren repitition of fifty-year-old disputes. There is no salvation either outside the Church or on this earth, but Kelso does bring a new way of looking, and if that isn't salvation it's at least an intermediary grace.

Nicholas von Hoffman
Esquire December 1973

If a country in which only a few men and women are citizens is politically unjust, the remedy is not to abolish citizenship but to make all men and women citizens. If an industrialized country in which only a few own all the capital is economically unjust, the remedy is not to abolish private capital but to make it possible for all to become owners of some of it.

Winnett Boyd, president
Arthur D. Little, Canada

Over one hundred years ago Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already privately owned land. They did not take from those who owned to give to others who did not own. It set the pattern for the American capitalistic system. We need an Industrial Homestead Act.... it is time to formulate a plan to accelerate the economic growth and production at the same time we broaden the ownership of productive capital. The American dream has always been to have a piece of the action.

Ronald Reagan
July 20, 1974

The Kelso plan is a gentle, non-Robin Hoodish approach to the redistribution of wealth which his father Huey always preached.

Charles Bartlett
Arizona Republic, Mar. 24, 1975

Kelso: McLuhan of economics?

The Village Voice
April 28, 1975

One of the great things that ESOPs have going for them is that they are such a natural from a political viewpoint: Who in populist Washington, whether liberal or conservative, would knock the idea of spreading corporate ownership?

Forbes, May 1, 1975

Since the 1940s, a lawyer named Louis O. Kelso has haunted America's corporate corridors, spinning fables about the advantages of a fringe benefit known as an employee stock ownership plan - ESOP, for short.

Money, June 1975

The Kelso doctrine is the only economic doctrine introduced in generations that could become a plank in either tne Democratic of Republican platform.

Barron's, July 21, 1975

Bring on those tired, labor-plagued, competition-weary companies and ESOP will breathe new life into them. They will find ESOP better than Getitol. It will revitalize what is wrong with capitalism. It will increase productivity. It will improve labor relations. It will promote economic justice. It will save the economic system. It will make our form of government and our concept of freedom prevail over those who don't agree with us.

Senator Russell B. Long
Chairman, Senate Finance Committee
October 20, 1975

These plans (ESOPs) have been heralded as the basic solution for many of our economic ills. Specifically, one of our chief proponents who will be testifying today, has said the widespread adoption of ESOPs will accomplish the following objectives: the restoration and acceleration of economic growth to unprecedented levels; create legitimate full employment for two or three decades; and lay the foundation for arresting inflation.

I must confess that these are some claims. Certainly no one since I have been chairing this committee has come before us with any program that promises that much.

Senator Hubert H. Humphrey
Chairman, Joint Economic Committee
ESOP Hearings, Dec. 11, 1975

Louis O. Kelso is an economic seer whose time may have come.

Milton Moskowitz
San Francisco Chronicle
May 24, 1975

No one is putting in an ESOP just to be a nice guy.

Pension consultant quoted in
New York Times, Nov. 5, 1975

Like the case for acupuncture, it sounds bizarre, even alarming - but a suspicion remains that there may be something to it.

Fortune, March, 1976

Some brokers are saying that the ESOP trend may be exercising as much influence on the future as the computer.

San Francisco Business
January, 1976

Kelso's plan is so radical that it is difficult to take seriously.

Fortune, March, 1976

Paneceas often have a way of turning into Pandora's boxes.

Business Week editorial
Mar. 8, 1976

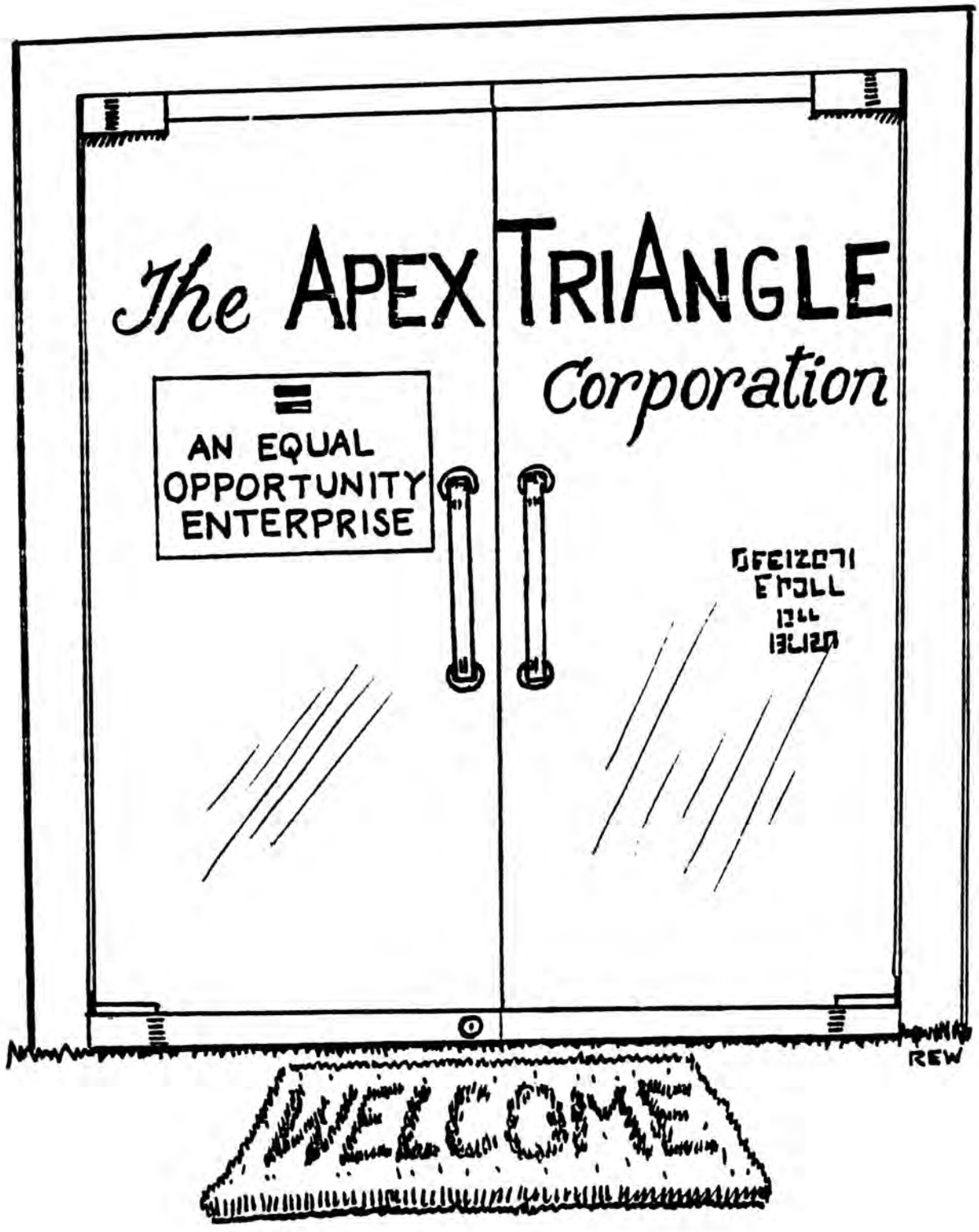
The conservative but populist chairman of the Senate Finance Committee has become an evangelical disciple of Louis O. Kelso, a San Francisco attorney who has long championed various forms of 'worker capitalism.'

The most powerful defense of ESOP comes from Long, who waxes as fervent on the subject as Kelso.

Time, Oct. 4, 1976

As one member of this committee, Mr. Kelso, let me express my appreciation to you for the tremendous contribution that you have made and the pioneering work that you have done in the interest of employee stock ownership. We are, in many respects, holding these hearings here because of the work you have done in the area.

Senator Russell B. Long
Chairman, Senate Committee
on Finance
July 19, 1978


The APEX TRIANGLE
Corporation
AN EQUAL
OPPORTUNITY
ENTERPRISE
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The Washington Post OUTLOOK Columnists / Editorials

SUNDAY, MARCH 11, 1979

A Radical Idea As Old As Lincoln

By William Greider

THE TIME has come, perhaps, to ask the question modern liberalism has always ducked. Who owns America? Why is the wealth of this fantastic, egalitarian nation distributed so unjustly? Why must capital and its attendant political power be concentrated in the hands of the few while the masses have only a mortgage and, if they are lucky, a modest pension?

The questions themselves sound vaguely Marxist, which is one reason why welfare state liberals have always ducked. Liberalism is defined and disciplined by its right wing adversaries, whose red-baiting effectively scares off new ideas, even new questions. I could make an argument that the long march of liberal solutions to social injustice -- tinkering with wage floors, moving cash from one group to another, propping up the poor and the weak, protecting the sick and the jobless from catastrophe — all these are evasions of the more fundamental questions about wealth and its gross maldistribution.

If liberal government could not do anything about the distribution of wealth, then it must concentrate on wages and particular benefits, propelling the welfare state deeper and deeper into private economic choices. Essentially, the federal government hands out coupons, little tickets that entitle qualified citizens to buy food at a supermarket, to occupy an apartment in a subsidized building, to buy medicine at the ghetto pharmacy, to pick up a little cash on the first of the month, to bill the Treasury for catastrophic illness.

No one who has talked to the recipients of these benefits or examined their actual condition can feel very satisfied with the results. Real pain and suffering, even hunger, truly are alleviated, but these people, still poor, have become prisoners of the government coupons.

The liberal imagination, knowing that real improvements in ordinary lives have flowed from the security programs, will insist on renewed dedication to the concept. If injustice persists, if some people still live in degradation while the rest of us live in royal luxury, then we must tinker with the coupons. Increase their cash value. Or invent new coupons for other items that these people cannot afford. Cars? Air conditioners? French bread?

Roughly speaking, this is the road American politics traveled to its present frustrations. The liberal mindset, honorable and well-intentioned, cannot confront the natural limits that always will stand in its way. One crucial boundary in the politics of redistributing cash is the private wage system. Nobody really believes Washington should give a nonworker coupons that are more generous than the wages earned by his neighbor, the worker.

The other limitation is less obvious but more harsh: As the welfare state created safety nets for the poor and the weak, other, stronger groups in society invented their own versions of coupons, serving their own needs, and sold them to the government. Price-support systems for farmers; tax loopholes and housing subsidies for the middle class; guaranteed markets for industrial sectors; guaranteed jobs for unions strong enough to demand them.

I could argue that, in the final balance, the welfare state cares best for the prosperous, not the poor. But the main point is that virtually everyone, every economic sector, now participates in the government transfer of cash from one pocket to another. Meanwhile, the fundamental injustice of concentrated wealth is not altered in the slightest.

♦

WHO OWNS America? I am pleased to report that this question will be raised next winter when all conventional politicians are campaigning in the New Hampshire presidential primary. Not by a bunch of parlor lefties. Not by desperate liberals searching for fuzzy new rhetoric. The question will be raised by a strange little group called the Ownership Campaign which, if one forced an ideological identity on this eclectic collection of individuals, probably would be called right-of-center.

The Ownership Campaign is an assortment of businessmen, government technocrats, old labor types, young idealists and blue-collar political neophytes. All of them came from different starting points to a shared conclusion: The welfare state fails ultimately to achieve justice; the government must intervene instead to create a broad distribution of capital wealth, stock ownership in the new productivity capacity of the future.

These inspired amateurs think this is the idea of the 1980s, since it did not become the idea of the 1970s. They see a way to renew industrial growth in America, to share the benefits of capitalism more equitably and to climb out of the cul-de-sac created by modern liberalism, the continuous elaboration of coupons. They believe labor should earn capital as well as wages. They believe citizens will never derive economic security, not to mention independence, as long as their well being depends on government decisions.

This is the voice of economic individualism — the old American dream of yeoman independence that was buried in the modern era of big government, big corporations. These people are taking the original impulses of the American experience and trying to graft them onto modern corporate capitalism. At the edges, there is a barbarous yelp of protest borrowed from Ayn Rand. The heart of the idea, including the approach to banking and credit, is as old as Jefferson and Jackson, more radical than any reform entertained by the New Deal.

To grasp the full historical flavor, forget about all of the modern subsidy programs created in the last 40 years. Think instead of the really radical coupons handed out by government in the 19th century — Lincoln's Homestead Act. Through the national government, vast wealth was distributed free to ordinary Americans, including new immigrants, regardless of birth or education or economic status. The wealth was land and it was given freely, with one crucial condition: The people had to make it productive.

The ownership guerrillas believe stock in new industrial capacity can be distributed similarly, setting interest rates for ventures that represent real growth — not the paper games of borrowing and buying. Unlike the Marxist systems of shared wealth, nothing would be taken from the rich. Nor would the new factory become a state-owned industry, as in Britain or France. Anyone who has ever tried to use a telephone in France knows the limits of state socialism.

♦

THOSE WHO find single issue politics nettlesome and disruptive



Greider is the editor of Outlook. His column appears weekly.

Exhibit 4

may be especially aggravated by the Ownership Campaign. It is raising money to enter not one, but two candidates in the 1980 New Hampshire primary — a Republican and a Democrat who will campaign jointly, share advertising costs and generally try to make the other conventional candidates take them seriously.

Neither major party has the intellectual vitality to take the plunge on this idea, though either could claim it as consistent with its past. The Ownership Campaign may end up looking silly, but can count itself successful if the horde of presidential candidates begins stealing their material.

Hold the smug laughter, for now. Some folks out there already understand this ownership pitch. When the farmers took their tractors to the Federal Reserve Board, demanding 3 percent interest rates, they were responding to the credit arguments of Norman Kurland, chairman of the Ownership Campaign. Kurland knows little about politics but he is one of those brilliantly obsessed figures one encounters in Washington, a person who cares more about ideas then making a living. Kurland has been pushing stock-ownership plans for more than a decade, undaunted by his limited success. He is the rarest combination — a creature who understands the banking laws yet continues to believe in the possibility of economic justice.

His political director is 25-year-old Luis Granados, a newly graduated lawyer from Takoma Park, who knows the operations of a political campaign from serving local candidates but who lacks the jaded amorality of experienced operatives. Granados learned economics from ordinary experience:

"I grew up middle class," he said. "I got a scholarship to a fancy prep school and I saw that end. Then I saw the other end, campaigning in poor neighborhoods. I just think the distribution of wealth is wrong. There's not sufficient difference in people to justify the differences in wealth."

This observation matches my own experiences as a reporter. Over the years, I have had many encounters with people on the bottom rung of our society — white mountaineers, black youths in the cities, migrant workers, poor people urban and rural. I always come away with a chilly feeling, a fresh recognition that most poor people could perform just as well as the rest of us, if they had gotten a few lucky rolls of the dice.

Others in the Ownership Campaign are not exactly bleeding hearts. They include Tim Maloney, a young new state legislator from Prince George's County; Anthony M. Carey, partner in a high-toned Baltimore law firm; Joe Rourke, a retired Massachusetts labor leader, and Wally Johnson, a former Republican mayor of Berkeley, Calif., who runs an aluminum scaffolding company called Up Right Inc.

Johnson is the only one with experience in a presidential primary. He received 35,000 votes in New Hampshire in 1976, running for vice president in the GOP primary on a single issue opposing congressional pay raises. This was 12,000 votes more than Jimmy Carter got in New Hampshire, but the press ignored Wally Johnson because he was not deemed to be serious.

♦

SERIOUS political people will be hostile to this idea. They will endorse the rhetoric of broadened ownership because it sounds like Mom and apple pie, but the major power centers of American politics feel threatened by the idea of actually distributing capital ownership to everyone.

Organized labor sees it as compromising the hard and clean lines of worker-management bargaining. Corporate management distrusts it as an ultimate threat to its own control of corporate behavior. Technocrats devoted to managing the welfare state do not wish for its demise. No-growth environmentalists do want a new industrial boom for this country. Status-conscious conservatives are offended by the egalitarian premise.

Listen carefully to their objections. These people have impressive arguments on why this scheme will not work or why it should not be tried. Listen, then ask yourself what these experts would have told Lincoln about his crazy plan for homesteading.

Ownership History

...That the inhabitants of the English colonies in North America, by the immutable laws of nature, the principles of the English constitution, and the several charters or compacts, have the following RIGHTS:

Resolved ... That they are entitled to life, liberty and property: and they have never ceded to any foreign power whatever, a right to dispose of either without their consent.

-Declaration and Resolves of the First Continental Congress-, October 14, 1774

"The control over a man's subsistence amounts to a control over his will."

-Alexander Hamilton-

...That all Men are by Nature equally free and independent, and have certain inherent Rights, of which, when they enter into a State of Society, they cannot by an Compact, deprive or divest their Posterity; namely, the Enjoyment of Life and Liberty, and the Means of acquiring and possessing Property, and pursuing and obtaining Happiness and Safety.

-Virginia Declaration of Rights- June 12, 1776

...We hold these truths to be self-evident; that all men are created equal; that they are endowed by their Creator, with certain inalienable rights; that among these are life, liberty, and the pursuit of happiness. That to secure these rights, governments are instituted among men, deriving their just powers from the consent of the governed;...

-Declaration of Independence- July 4th, 1776

All men are born free and equal, and have certain natural, essential, and unalienable rights; among which may be reckoned the right of enjoying and defending their lives and liberties; that of acquiring, possessing and protecting property; in fine, that of seeking and obtaining their safety and happiness.

- Massachusetts Declaration of Rights - October 25, 1780

Article V. No person shall ... be deprived of life, liberty, or property, without due process of law; nor shall property be taken for public use, without just compensation.

-Bill of Rights- December 15, 1791

Private property is a creature of society, and is subject to the calls of that society, whenever its necessities shall require it...

-Benjamin Franklin, 1783-

Law is a very good thing for men with property and a very bad thing for men without property.

-Rousseau, Social Contract-

The nations of our time can ot prevent the conditions of men from becoming equal; but it depends upon themselves whether the principle of equality is to lead them to servitude or freedom.

-de Tocqueville-
final comment in Democracy in America

Tenantry is unfavorable to freedom. It lays the foundation for separate orders in society, annihilates the love of country, and weakens the spirit of independence. The tenant has in fact no country, no hearth, no domestic altar, no household god. The freeholder, on the contrary, is the natural supporter of a free government, and it should be the policy of republics to multiply their freeholders, as it is the policy of monarchies to multiply tenants.

-Thomas Hart Benton-

Jefferson, though the secret vote was still unknown at the time had at least a foreboding of how dangerous it might be to allow the people to share a public power without providing them at the same time with more public space than the ballot box and with more opportunity to make their voices heard in public than on election day. What he perceived to be the mortal danger to the republic was that the Constitution had given all power to the citizens, without giving them the opportunity of being citizens and of acting as citizens.

-Hannah Arendt-
in On Revolution

...if you believe in democracy...distribute property as widely as possible.

-Aldous Huxley-

...In Harlem, for instance, all of the stores are owned by white people, all of the buildings are owned by white people. The black people are just there paying rent, buying the groceries; but they don't own the stores, clothing stores, food stores, any kind of stores; don't even own the homes they live in. They are all owned by outsiders, ... "When the thing is finally sparked, the white man is not there-he's gone. The merchant is not there, the landlord is not there, the one they consider to be the enemy isn't there. So, they knock at his property. This is what makes them knock down the store windows and set fire to things, and things of that sort.

-Malcom X-

Government has the responsibility to provide the climate in which Americans, all Americans, have an opportunity for good jobs; and not only for good jobs, but an opportunity if they have the ability and the desire, to be owners and managers, to have a piece of the action, because if they have a piece of the action, then they believe in the system rather than fighting against it.

-Richard Nixon-

Property performs the function of maintaining independence, dignity and pluralism in society by creating zones within which the majority has to yield to the owner. Whim, caprice, irrationality and 'antisocial' activities are given the protection of law; the owner may do what all or most of his neighbors decry. The Bill of Rights also serves this function, but while the Bill of Rights comes into play only at extraordinary moments of conflict or crisis, property affords day-to-day protection in the ordinary affairs of life. Indeed, in the final analysis the Bill of Rights depends upon the existence of private property.

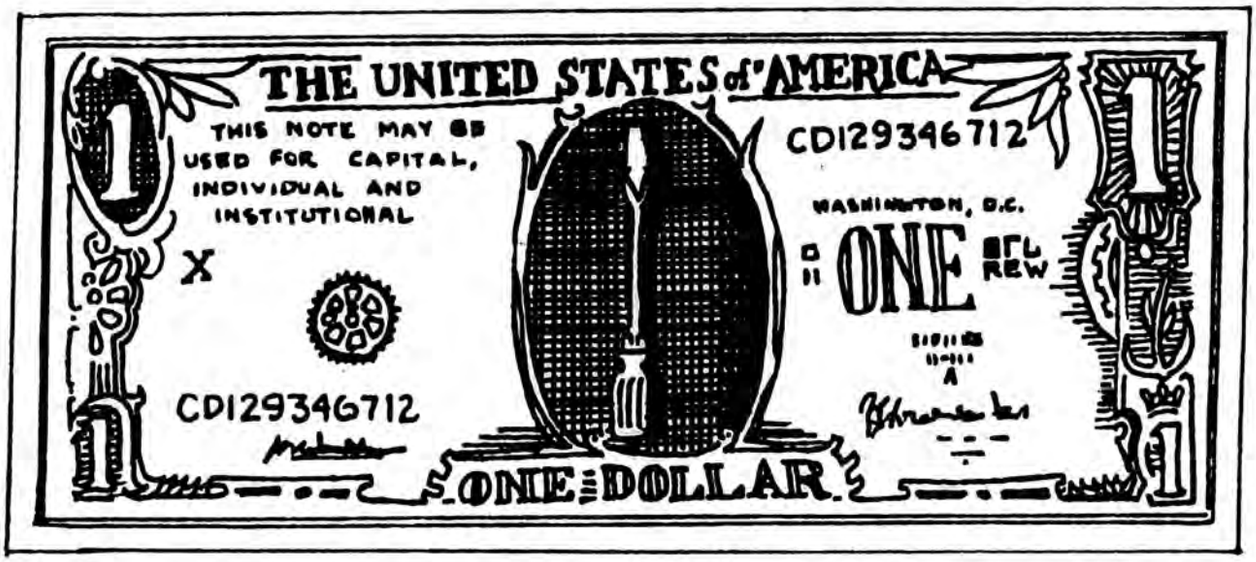
-Charles A. Reich-

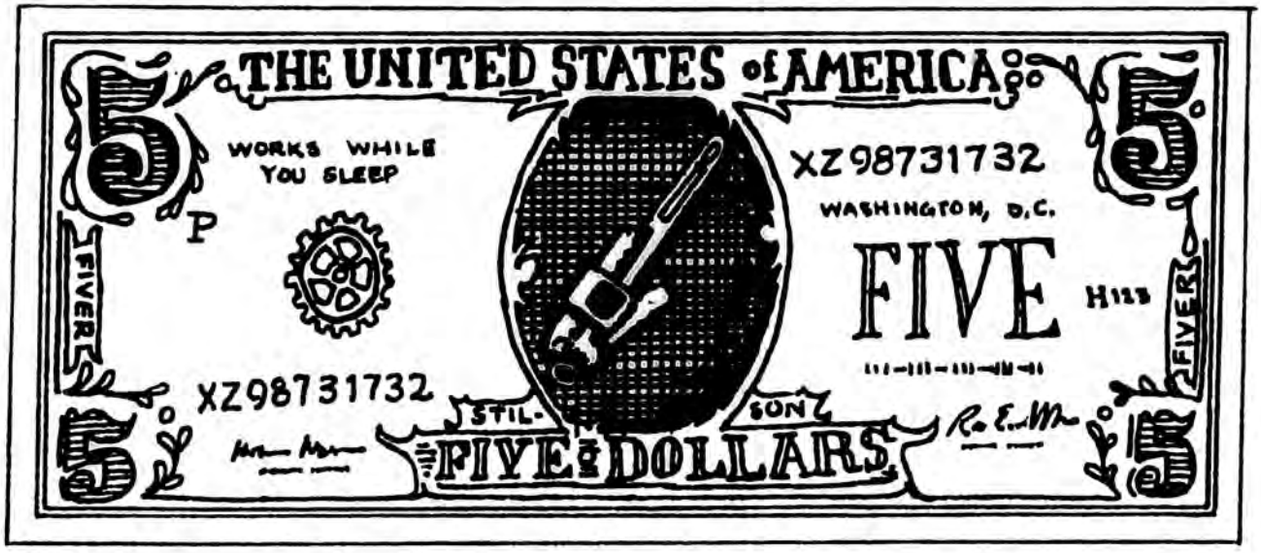
Profit sharing in the form of stock distributions to workers would help to democratize the ownership of America's vast corporate wealth which is today appallingly undemocratic and unhealthy.

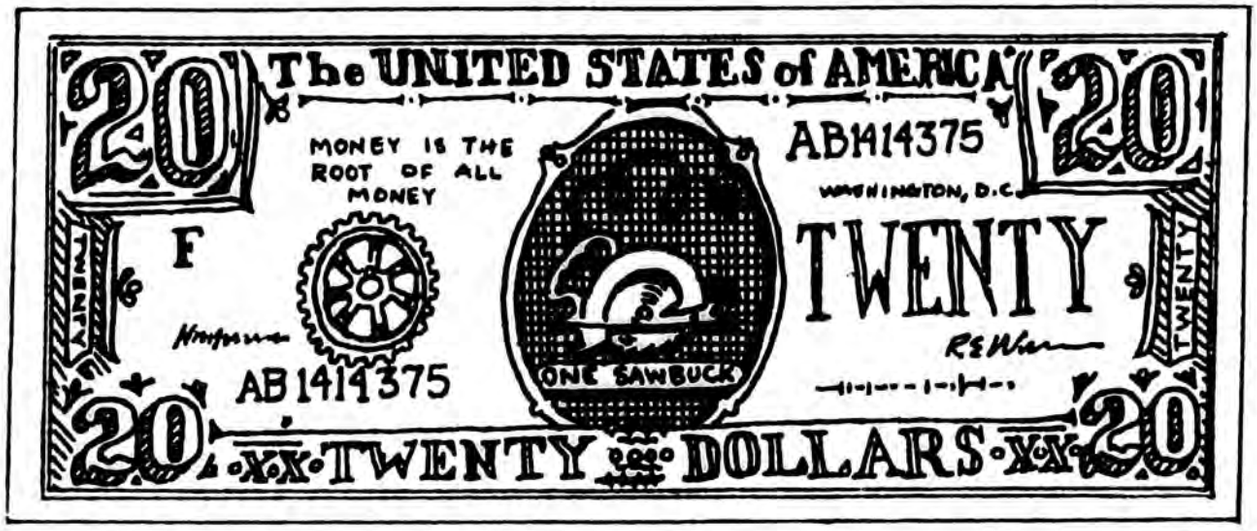
-Walter P. Reuther-
President, United Auto Workers

"...democracy is a method of finding proximate solutions for insoluble problems."

-Reinhold Niebuhr-


THE UNITED STATES of AMERICA
THIS NOTE MAY BE USED FOR CAPITAL, INDIVIDUAL AND INSTITUTIONAL
CD129346712
WASHINGTON, D.C.
ONE
CD129346712
ONE DOLLAR


THE UNITED STATES of AMERICA
WORKS WHILE YOU SLEEP
XZ98731732
WASHINGTON, D.C.
FIVE
XZ98731732
FIVE DOLLARS


The UNITED STATES of AMERICA
MONEY IS THE ROOT OF ALL MONEY
AB1414375
WASHINGTON, D.C.
TWENTY
AB1414375
ONE SAWBUCK
TWENTY DOLLARS

Share the Wealth

During three years in power, a socialist government succeeded in nationalizing or buying into a number of British Columbia's natural-resource companies. But in 1975, exasperated voters of Canada's third-largest province threw the socialist premier out and elected William R. Bennett, the millionaire son of a previous B.C. premier. A champion of free enterprise, Bennett, 46, has found a way to undo part of the socialists' work. Every one of the province's 2.4 million residents will be offered five shares of British Columbia Resources Investment Corp., a holding company set up by the government.

B.C. Resources owns 81 percent of Canadian Cellulose, a $153-million forest-products firm, and 10 percent of Westcoast Transmission Co. (1977 sales: $735 million), which operates a natural-gas pipeline. B.C. Resources also has two wholly owned forest-products companies, and valuable oil- and gas-exploration rights on some 2.3 million acres.

Under Bennett's plan, 80 percent of the stock—some 12 million shares—will be distributed to every man, woman, and child who has lived in the province in the last year and is a Canadian citizen. They will also be eligible to buy more stock—up to 5,000 shares—at a discount. Each share of B.C. Resources has a book value of $10, and the company will be listed on the Vancouver Stock Exchange. "We live in a rich province," says the premier. "Now my government wants to give the people the opportunity to share these riches."

SURVEY OF
TAX REDUCTION ACT ESOPS
HIGHLIGHTS REPORT

April 1979



Hewitt Associates

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SURVEY HIGHLIGHTS

During the months of January and February 1979, Hewitt Associates conducted its third annual TRASOP (Tax Reduction Act Employee Stock Ownership Plan) survey of the 1,000 largest industrial companies and the 50 largest commercial-banking, life-insurance, diversified-financial, retail, transportation, and utility companies as listed in the 1978 Fortune Directory.

Purpose of Survey

The primary purpose of the survey was to gather information on the prevalence of TRASOPs and to examine the important characteristics of plans that have been implemented.

Five hundred thirty-three companies participated in the survey. Participating companies span a wide cross section of business and industry and fall into the general groupings shown below:

Company Groupings	Number of Companies
Industrial Companies	
• Sales over $1 billion	154
• Sales of $500 million to $1 billion	59
• Sales under $500 million	185
All Industrial Companies	398
Non-Industrial Companies	
• Financial institutions	55
• Retail companies	20
• Transportation companies	21
• Utilities	35
All Non-Industrial Companies	131
Anonymous Responses	4
All Participants	533

TRASOP Prevalence

Survey participants were asked to indicate the current status of a TRASOP in their company. Of the 533 companies participating:

- One hundred sixty-two companies (30.4%) have implemented a TRASOP (plan has been formally adopted by the board of directors).
- Two companies (0.4%) are in the process of implementing a TRASOP (internal decision has been made to implement a TRASOP, but plan has not been formally adopted by board of directors).
- Forty-three companies (8.1%) do not presently have a TRASOP but are considering implementing such a plan.
- Three hundred twenty-six companies (61.1%) do not presently have a TRASOP and are not presently considering implementing such a plan.

Although last year's survey indicated significant corporate activity in the TRASOP area, this year's survey demonstrates only a slightly higher degree of prevalence. Below is a year-by-year breakdown of TRASOP prevalence.

	1979 Survey	1978 Survey	1977 Survey
Companies having implemented a TRASOP	30.4%	27.2%	9.4%
Companies in the process of implementing a TRASOP	0.4	1.5	3.3
Companies considering implementing a TRASOP	8.1	9.2	14.2
Companies not considering implementing a TRASOP	61.1	62.1	73.1
	100.0%	100.0%	100.0%

Utilities and certain other capital-intensive industries continue to be responsible for much of the activity that has occurred. For example, the survey companies which have implemented or are in the process of implementing a TRASOP include:

- 88.6% of the thirty-five utilities,
- 85.7% of the twenty-one companies in the petroleum refining industry,
- 69.2% of the thirteen companies in the mining and crude oil production industries, and
- 66.7% of the twenty-four companies in the paper, fiber, and wood products industries.

Among industrial companies, TRASOP prevalence appears to be influenced by company size as well as by industry. A breakdown of prevalence data into size groupings shows that the following companies have implemented or are in the process of implementing a TRASOP:

- 43.5% of companies with annual sales over $1 billion,
- 32.2% of companies with annual sales of $500 million to $1 billion, and
- 17.3% of companies with annual sales under $500 million.

It appears that the prevalence of TRASOPs has increased only slightly in all size categories over the past year.

	Of All Industrial Survey Companies in the Following Size Categories, % Which Have Implemented or Are in the Process of Implementing a TRASOP		
Sales	1979 Survey	1978 Survey	1977 Survey
$1 billion and over	43.5%	41.4%	21.7%
$500 million to $1 billion	32.2	24.6	16.3
Under $500 million	17.3	14.4	2.2

TRASOP Characteristics

The survey also examined TRASOP characteristics, focusing on the 162 plans of companies which have implemented a TRASOP. These plans reveal the following prevalences:

- 93.8% are separate plans (not attached to an existing company plan).

- 40.9% of the plans are extended to all or most employees (meeting age/service requirements) and 59.1% are extended to all or most salaried employees (or salaried and non-union hourly employees); however, several plans exclude officers, directors, or members of executive stock or incentive plans.

- 70.9% of the plans use the $100,000 individual annual maximum of covered compensation for allocation purposes; 29.1% use a limit of less than $100,000.

- Of the 129 plans responding to the issue, 71 plans (55.0%) anticipated a benefit for the average employee of less than $200 for the most recent year, 45 plans (34.9%) anticipated a benefit of from $200 to $500, and 13 plans (10.1%) anticipated a benefit of more than $500.

- 35.2% of the plans use some form of the maximum service requirement (up to three years) for participation. This is made possible by the fact that a TRASOP must provide for immediate vesting.

- 33.1% of the plans provide for the additional 1/2% tax credit available because of employee contributions.

- 62.1% of the plans make distributions only at termination of employment; 18.7% make rolling seven-year payouts; 16.2% give participants a choice between rolling seven-year payouts and distributions only at termination.



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TRASOPs—more attractive after the REVENUE ACT OF 1978

TRASOPs—more attractive after the REVENUE ACT OF 1978

Jeffery R. Gates
Consultant

Peter S. Egan
Consultant

Gail V. Kellogg
Consultant
Hewitt Associates

With the availability of generous tax credits for the funding of employee stock ownership plans, the prevalence of such plans is on the rise. Recently enacted legislation could make them even more popular.

Increasingly, the TRASOP acronym is becoming more familiar. No longer is the Tax Reduction Act Employee Stock Ownership Plan ("TRASOP") readily confused with the altogether different concept of the "leveraged ESOP." (See Financial Executive: "ESOPs: A Joint Piece of the Action," September 1975, and "ESOPs: Source of Funds and Their Effect on the Cost of Capital," July 1977.) With an eye on the ever-rising cost of employee benefits, financial managers have begun to view the tax credits available for funding of TRASOPs as a low cost means of satisfying employee pressure for "more" in the benefits area.

Indeed, a 1978 survey of Fortune-listed companies, conducted by Hewitt Associates, revealed that 152 of 530 survey participants (29%) currently have or were in the process of implementing such plans—up from only 13% of companies surveyed a year earlier. (See **Figure I,** p. 47) Further, 84% of surveyed major utilities are now TRASOP companies, as are 77% of the largest oil and coal companies, plus 63% of surveyed companies in the wood, paper, and fiber industries.

Much of the reason for the increased prevalence of TRASOPs can be traced to expanded tax legislation. Since adoption of the original enabling legislation in 1975, Congress has made the tax credit funding of TRASOPs progressively more attractive. The recently enacted Revenue Act of 1978 continues this trend—though not to the degree originally envisioned by certain members of Congress. (See inset on "What Might Have Been," p. 49)

Nonetheless, the decision facing financial managers on whether or not to implement a TRASOP is less than an easy one. TRASOPs are not without their pitfalls. The attractive tax benefit is often accompanied by complex financial, accounting and administrative considerations, as well as the difficulty of communicating the "ownership" feature of this new type of employee benefit.

EVOLUTION OF THE "TRASOP"

The TRASOP originated in the Tax Reduction Act of 1975. In its original form, a TRASOP provided an extra 1% investment credit (in addition to the standard 10% credit) to any corporation willing to place that amount in trust for employee investment in employer stock. Thus, with a $100 million capital budget, a company could claim a total investment credit of $11 million, provided $1 million was used to fund a TRASOP.

At first the TRASOP proved unpopular. For any but the most capital-intensive corporations, the extra credit was too small, generally resulting in only token benefits to a firm's employees, particularly when weighed against often substantial start-up and maintenance costs. Even the largest companies were concerned about the short (two-year) period for which the extra tax credit initially was available. In addition, some employers felt that if Congress eliminated the TRASOP's tax credit incentive, they might be forced to continue to fund the plan because of the Internal Revenue Service requirement for plan "permanence."

The Tax Reform Act of 1976

"Much of the reason for the increased prevalence of TRASOPs can be traced to expanded tax legislation. Since adoption of the original enabling legislation in 1975, Congress has made the tax credit funding of TRASOPs progressively more attractive. The recently enacted Revenue Act of 1978 continues this trend. . . ."

amended the 1975 Act by addressing these and other concerns. In fact, the 1976 modifications were specifically designed, as the Senate Finance Committee explained, "to overcome problems faced by companies wanting to establish employee stock ownership plans under that Act." In addition to extending the tax credit provision a full four years, the 1976 Act made it clear that a TRASOP adopted contingent upon the availability of the extra credit would, nevertheless, be considered a "permanent plan" for IRS tax qualification purposes.

The 1976 Act also permitted a sponsor to recover certain plan expenses. And, in a further attempt to enhance the TRASOP's financial attractiveness, the 1976 legislation offered an additional ½% investment credit — provided a company's employees made matching contributions to the plan.

With the 1976 changes, TRASOPs began to appear in many of the major capital intensive industries. In addition to the strong incidence of TRASOPs in the utility, fuel and paper industries, the 1978 survey also found strong TRASOP clusterings in such industries as transportation (36%), chemicals (33%), steel or metals and mining (30%), food processing and beverages (30%), and retail (26%).

Not surprisingly, TRASOP prevalence also appears to be a function of size. Of surveyed TRASOP companies, 41% have sales of over $1 billion. Another 26% are companies with annual sales between $500 million and $1 billion. Yet when annual revenue drops below $500 million, TRASOP prevalence falls to less than 15%. (See **Figure II**, p. 47)

NEW INCENTIVES: THE REVENUE ACT OF 1978

The Revenue Act of 1978 ("1978 Act") is the third piece of Congressional legislation in the past 3½ years to affect the TRASOP; however, the 1978 changes directly affecting the TRASOP itself are less dramatic than the amendments generally expanding the availability of the investment credit.

Previously, the investment tax credit was limited to certain depreciable capital expenditures (such as machinery and equipment). The 1978 Act extends the investment credit to expenses incurred in connection with the rehabilitation of industrial and commercial buildings that have been in use for more than 20 years. This should make the investment credit (and, thus the TRASOP) more attractive to established retailers and banks, companies which, previously, too often had far too few capital expenditures to make a TRASOP worthwhile.

The 1978 Act also increases the amount of tax liability that can be offset by the investment credit. Under prior law, the amount of investment credit that a taxpayer could apply against a tax liability in any one year could not exceed the first $25,000 of tax liability plus 50% of any excess. The 1978 Act raises to 90% the amount of tax liability that can annually be offset, phasing in the higher ceiling at the rate of 10% per year. Thus, the offset will reach 90% by 1982. This provision should make TRASOPs feasible for companies which previously had more credit carryovers than they could use prior to expiration.

The very fact that the TRASOPs incentives are now a part of the Internal Revenue Code may itself be a deciding factor for some financial executives worried about the temporary nature of the TRASOP. Previously, the relevant legal provisions appeared not in the Code, but in the amended language of the Tax Reduction Act of 1975 (scheduled to expire December 31, 1980). The new bill ensures that the tax credit funding of ESOPs will be available at least through 1983.

In addition to making the investment credit itself more attractive, the 1978 Act also makes a number of technical changes directly affecting the TRASOP.

Participation

A seemingly insignificant amendment may prove pivotal in determining a company's interest in adopting such a plan. In the past, a company was required to make allocations of stock to anyone who was a plan participant during the year. This often imposed a significant administrative burden, requiring that employers keep track of departing employees in order to deliver what were often minuscule distributions.

Under the new legislation, an employee need not be counted as a participant (and, thus, need not be entitled to an allocation) unless he or she is a participant at the close of the plan year. This greatly simplifies certain record-keeping aspects of the plan, permitting a firm to make allocations on the basis of a year-end census of the eligible employees.

Employee Matching

The 1978 Act made the employee matching feature a permanent part of the Code and simplified its administration. In 1976, the Senate had passed a provision allowing a TRASOP company to claim an additional 2% ESOP investment credit. The Conference Committee scaled that back to the existing extra 1% credit plus an additional ½% if employees made a matching contribution. This matching provision turned out not to be quite the enticement intended. It soon became clear that the administrative complexities of the contributory feature were more than most companies cared to handle.

For example, although no participant could be required to contribute, all participants in the plan had to be given the opportunity to contribute. Thus, many employers found themselves tracking employees who had been in the plan at some point during the year in order to provide them the chance to make a contribution for purposes of receiving a matching contribution of employer stock from their ex-employer. Also, the employees' pledge had to be made prior to the final date for filing of the corporation's income tax return, thereby often requiring, prior to filing, that a company give its employees several chances at making a pledge if the company wished to qualify for the entire extra one-half percent credit. Because of the restrictions, uncertainties and complexities of the matching provision, it came as no surprise to find that only 16.4% of TRASOPs surveyed in 1978 had chosen to include the contributory element.

Under the 1978 Act, an employee need not be counted as a plan participant (and, thus, eligible for matching) unless he or she is employed on the last day of the plan year. Also, the employer now need only make the company's matching contribution (and can only claim the extra credit) in the year in which employee matching contributions are actually made. Because employees may be provided 24 months in which to make their matching contribution, this change means that in a given year, a company may be able to claim a TRASOP investment credit in excess of 1½%.

Voting Stock

The 1978 Act also changes the TRASOP's unique pass-through voting provision by limiting the requirement to employers whose stock is publicly traded. In the case of closely held corporations, participants must be entitled to vote on any corporate issue which must be decided by more than a majority of common shareholders.

Although the costs involved in complying with the pass-through voting provision can be substantial, it appears that the tax credit ESOP companies are using the opportunity to communicate employer performance and, by so

Figure I. TRASOP PREVALENCE IN FORTUNE-LISTED COMPANIES

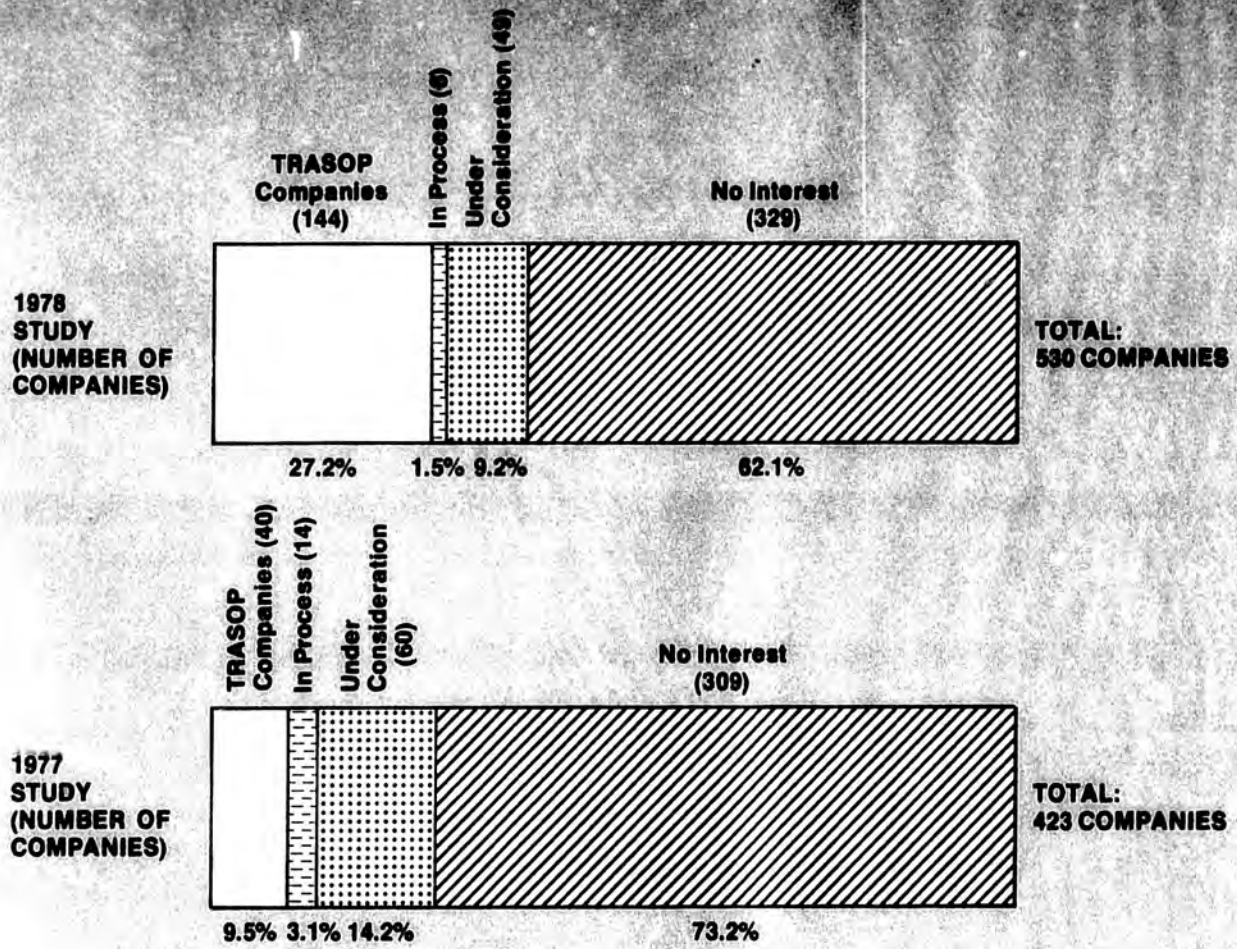
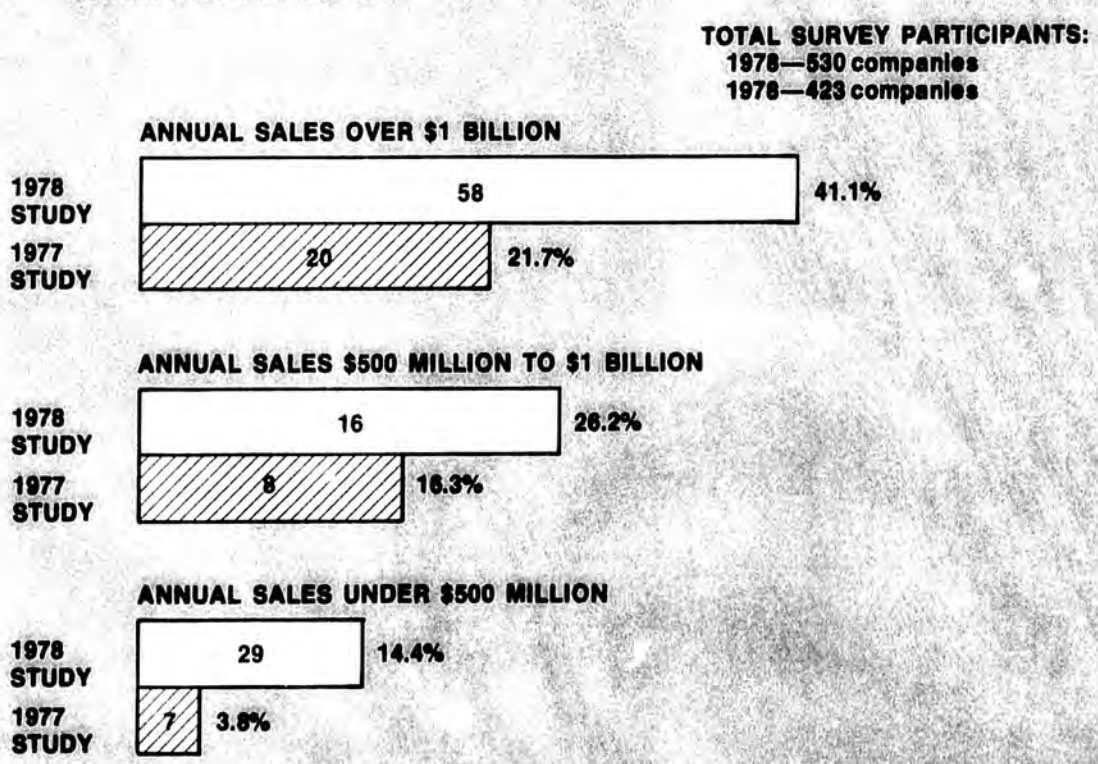


Figure II. TRASOP PREVALENCE BY COMPANY SIZE
(Industrial Companies Only)



doing, hopefully to motivate employees and increase employee identification with the company.

Anticipating that such employee stock ownership could become a motivational feature of a corporation's employee benefit program, the 1976 Tax Reform Act specifically authorizes TRASOPs to distribute dividends on such stock on a current basis.

Distribution Options

Although an employee's stock must be immediately vested, except in the case of separation from service, death or disability, the plan cannot provide for distribution of that stock before the end of the 84th month after the stock is actually allocated to an employee's account. Thus, a substantial number of plans provide for annual distributions beginning with the seventh year of the plan (what many are calling a "rolling seven" provision).

The 1978 Act made it easier for employees to "rollover" their stock into a tax-sheltered Individual Retirement Account ("IRA"). Federal law generally exempts an employee from taxation on such a distribution provided the actual assets received are rolled over within 60 days into an IRA. However, IRA trustees were often reluctant to accept employer securities, particularly in the case of closely held stock. And, if the employee sold his stock to the company or the plan, he thereby changed the nature of the assets and lost the rollover advantage. The new law permits an employee to sell employer securities received in a distribution and rollover the proceeds into his personal IRA.

In addition, subject to the participant's right to receive stock, the 1978 Act permits the plan to elect whether to distribute stock or cash (or some combination) from the TRASOP. Previously, TRASOPs were generally required to distribute employer stock. In the usual situation, the participant wished to immediately convert such stock to cash. The new law saves the employer from this administrative paperwork and expense by permitting a cash distribution unless the employee opts for stock.

Minimum Tax Relief

The 1978 Act also makes it clear that the claiming of the TRASOP tax credit is not intended to increase the minimum tax on tax preference items.

Tax preference items include the accelerated depreciation on certain real property, certain capital gains, and several other items listed in the tax code. In determining the amount subject to the 15% minimum tax, the corporation first totals all of its tax preference items. From that amount, it subtracts the amount by which its tax liability for the year exceeds certain listed tax credits. The new legislation provides that TRASOP contributions need not be included in the list of tax credit items reducing the corporation's tax liability (inasmuch as the reduction of tax liability is "offset" by such contributions).

Plan Costs

The 1978 Act continues a cost recovery provision first introduced in 1976 in response to complaints from companies regarding the high expense of such plans. In 1975, the original Tax Reduction Act version of TRASOPs prohibited a company from using any part of its contributions to defray the costs of implementing and administering the plan. The Tax Reform Act of 1976 addressed the problem by allowing a sponsoring firm to recover certain "start up" expenses from its initial contribution to the plan and, thereafter, to recover certain administrative expenses from dividends paid on stock held in the trust.

The law with the 1976 Act the 1978 Act permits a company to recover ten percent of the first $100,000 contributed to the plan

and five percent of any additional contributions. And to ease the financial burden of administration, a company may withhold up to ten percent of the first $100,000 of dividends paid on stock held by the plan plus five percent of any excess (subject to a $100,000 annual limit).

TRASOP: DO OR DO WITHOUT?

Total Compensation Objectives

Any corporation considering a TRASOP would do well to identify its long-term compensation philosophy. If capital accumulation is not a part of the company's employee benefit program, a TRASOP may be inappropriate. On the other hand, the ability to fund such a plan with tax credits may serve as the tax-funded foundation upon which such a program is built. For example, as a supplement to a profit-sharing plan, a TRASOP can provide a device for making annual contributions to employees' accounts even in unprofitable years.

However, if partial employee ownership does not fit well with either the management style or the overall compensation strategy, the available tax advantages should probably be foregone in favor of benefit plans making for a better marriage with management's objectives. Despite the obvious financial appeal of an employee benefit paid for with

What Might Have Been

When the new TRASOP-related legislation was first introduced by Senator Russell Long (and co-sponsored by Senators Roth, Anderson and Gravel), it contained a provision designed to make such plans attractive to labor-intensive firms. Titled the "Expanded Employee Stock Ownership Act of 1978," the bill would have offered the alternative of the greater of either (1) an additional investment credit (which was to have become a full two percent), or (2) a tax credit equal to one percent of the annual payroll of those participating in the plan. However, as the bill worked its way through the committee amendment process, the expanded tax credit provisions were withdrawn and the remaining TRASOP amendments were made a part of the President's tax package.

The proposed legislation would also have permitted a corporation to deduct the expense of dividends paid on stock in the plan provided such dividends were passed through to participants on a current basis. At the Senate Finance Committee hearings on the bill, however, the Treasury's tax policy staff suggested that the matter be withdrawn for future consideration in the larger context of integrating the personal and corporate income tax. Consequently, the dividend deductibility provision does not appear in the legislation as enacted.

When the bill reached the floor of the Senate, Senator Jacob Javits objected to the deletion of the payroll-based TRASOP, explaining that he "... would prefer using a wage base for such a credit rather than an investment base. The investment based credit discriminates in favor of workers in the utility, oil, communications, and other capital intensive industries. Such discriminations should be remedied." Similar sentiments have been expressed by other legislators. Thus, the prospects seem likely for the expanded use of tax credits to encourage employee ownership of corporate stock including, perhaps, a payroll-based TRASOP.

investment credits, the plan should be avoided by any company that cannot live with the idea of employee stock ownership.

Coverage

In determining which employees must be included in the plan to meet the nondiscrimination rules a sponsor must include all employees of a "controlled group." In the general case of a parent-subsidiary controlled group, this would mean all corporations linked in some manner by 80% ownership of the value (or the voting power) of all classes of stock.

In certain cases, a subsidiary or division may account for a significant percentage of a company's capital expenditures (for example, a financial institution with a leasing division generating substantial investment credits). In principle, the company could exclude the employees of this division and still take full advantage of the additional tax credit generated by that division's capital expenditures.

Thus, a plan could cover salaried personnel only, corporate headquarters employees, or those employed in a specific plant or location (assuming, of course, that plan coverage is otherwise nondiscriminatory). This approach has the effect of increasing the per participant benefit but may create employee relations problems internally. Alternatively, the investment credit of other related companies may be allocated among all employees of the controlled group. Or, the tax credits of related companies may be allocated solely to those employees of the divisions or subsidiaries having generated such credits. This feature provides a substantial amount of flexibility in TRASOP plan design.

Similarly, a TRASOP sponsor is given considerable latitude in the sources to which it looks for the purchase of employer securities. Because there is no requirement that new employer securities be transferred to the TRASOP, a company may choose to contribute treasury shares or, as seems to be more commonly the case, a company may use its TRASOP tax savings to acquire shares currently outstanding.

Regardless of the source to which the plan looks for its acquisition of employer stock, a financial manager should evaluate the TRASOP's long-term dilutionary effect on current shareholders. The seemingly insignificant TRASOP stockholdings in year one could become substantial. In practice, however, it seems likely that employees would elect cash instead of stock on termination. In turn, that stock may be reacquired on behalf of future participants so the problem of dilution may be a concern more theoretical than real. Also, in the case of closely-held companies, it appears likely that TRASOPS will be permitted to attach a right of first refusal to stock distributed from the plan.

Benefit Amounts

In many cases, the additional investment credit will not generate a large enough per employee benefit to make a TRASOP worthwhile. Although 10% of the companies in the 1978 TRASOP survey reported an average annual benefit of over $500, the great majority indicated that the average employee would receive less than $200 annually.

In designing who gets how much of the benefit, an employee's proportionate share can be no larger than the relative size of his or her paycheck. Thus, the $60,000 executive generally would get four times the amount credited to the account of the $15,000 employee. This requirement also means that a TRASOP can in no way be "integrated" with Social Security benefits.

However, individual annual compensation above $100,000 must be ignored for allocation purposes. Seventy percent of the participants in the 1978 survey

"The very fact that the TRASOP incentives are now a part of the Internal Revenue Code may itself be a deciding factor for some financial executives worried about the temporary nature of the TRASOP."

use this maximum salary ceiling. The remainder use limits less than the permissible maximum—with the result that more plan shares are thereby allocated to the lesser paid. Approximately 10% of surveyed TRASOP companies define covered compensation in such a way as to result in a per capita allocation.

Several companies approach this 'reverse discrimination' result be defining participation requirements so as to exclude the higher-paid. This is generally done by excluding from the plan those eligible for incentive plans or stock option plans, or by using a similar designation (e.g., excluding company officers or directors). Of course, reducing the number of participants raises the average benefit—a consideration for a sponsor's total compensation strategists.

Likewise, some control over who participates in the plan can be achieved through the setting of eligibility requirements. TRASOPs are required to provide for 100% immediate vesting (nonforleitability) of amounts allocated to participants' accounts. Because of this immediate vesting feature, such plans can utilize a provision of ERISA that permits the exclusion of employees until they reach age 25 and complete three consecutive years of service. When appropriate, such a feature can effectively exclude short-term employees from participation and may provide some incentive for employees to remain with the company.

Plan Adminstration

While the 1978 Act has somewhat simplified administration, employers still should pay careful attention to participant recordkeeping. TRASOPs require separate accounts for each participant—allocating shares and small amounts of cash, processing final distributions, and providing tax information on these distributions. In addition, allocations for each plan year generally are not made for 12 (and possible 24) months. As a result, TRASOP accounting introduces a unique requirement for delayed and overlapping recordkeeping. Plans with the employee matching feature and in-service distributions require even more sophisticated accounting systems.

LOOKING AHEAD

The recent enactment of the Revenue Act of 1978 represents the latest evolution of the TRASOP. The numerous technical amendments should prove to make such plans easier and less expensive to establish and administer.

Similarly, expansion of the investment credit to include rehabilitation expenses should serve to make the TRASOP attractive to some employers for whom the plan has previously proven infeasible. Likewise, the phased increase in the allowable amount of tax liability that can be offset may make such plans progressively more appealing to employers which have previously had more tax credits than they could use. From a long-range planning viewpoint, however, perhaps the most significant change is represented by the fact that the law governing such plans now actually appears in the tax code (with, at present, an expiration date of December 31, 1983).

TRASOPs seem to be here to stay. The investment credit funding of an employee benefit represents a unique blend of corporate financial strategy and employee benefits philosophy. Despite Congressional support for the concept of employee stock ownership, however, the TRASOP is not necessarily a desirable or a worthwhile addition to every corporation's employee benefit program. The decision is complex, calling for ongoing communication between a company's financial managers and those responsible for shaping total compensation objectives.□

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

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SCHOOL OF LAW — 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 CSOC. 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 CSOC, but to begin anew and design a fully developed Code to regulate the CSOC, 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. [redacted] In any event, it has been an experience beyond the [redacted] I thank you all.

Best personal regards,

Sincerely,

Daniel Wm. Fessler

Daniel Wm. Fessler
Professor of Law

DWF:bf

Enclosures

THE FOLLOWING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

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 <u>not</u> 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 <u>incorporators</u> (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 <u>bylaws</u>. 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.

//////

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 we 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 removal exceeds the number 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 to 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.

/ / / / /

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 __ 0 ____.
* The suggested provision on exhaustic 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 telephone 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 membership. 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 PRECEDING DOCUMENT(S) MAY NOT FILM
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Confidential

gsop

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.

While specific comment and recommendations on the bill must await additional analysis, I would like to raise a few preliminary points. There are a number of philosophical and technical difficulties with the sponsor substitute which we wish to take up with your committees at subsequent hearings. Also, the bill presently contains provisions for investment of both the Permanent Fund and the General Fund surplus in financial obligations of the AGSOC. As this corporation is intended to be as separate from state government as possible, I think it more appropriate to delete this link to public funds until the corporation has proven itself as a successful and profitable venture. Only after a track record has been established will we be in a position to judge the appropriateness of such investments for the Permanent Fund and the General Fund surplus.

A second 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

PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

GSOP

March 8, 1979

Ronald J. Trevithick
4847 Queens Court
Anchorage, Alaska 99504

Dear Ron,

Thank you for your letter and for the enclosure you sent from the February 26th issue of "Business Week." I read your opinions with interest and, for the most part, agree with them. I do receive the impression from your fourth point that you are under a misapprehension about the General Stock Ownership Plan.

The GSOP, as introduced in the United States Congress by Senator Mike Gravel, is a plan to develop a private corporation that has Alaskan residents as stockholders. This will allow Alaskans to reap the benefits of private investment in Alaska's resources. The only possible function of the Alaskan State Government would be to guarantee a loan from a private banking institution to the GSOC (General Stock Ownership Corporation.) At this time, discussion is under way to avoid even that limited involvement by Alaska's Government. This corporation is simply an attempt to pass the benefits from Alaska's resources back to the majority of the people of Alaska within the free enterprise system.

Thank you for your concern about this issue. If you have any other questions or comments, please feel free to contact me or my staff.

Best wishes,

Mike Colletta
Senate Majority Leader

MC/das

Township owned by citizens of C.

To form to create corporation
Legally formed.

Directors elected by stockholders
Duly charging of Coop
& Perhaps permanent assessment

3/5/79

2/27/79 - Awaiting Jerry to find permanent spot. Will discuss then

Debi

3-[illegible] - Pam Jerry copy of article.

Debi

Ronald J. Trevithick
4847 QUEENS COURT • ANCHORAGE, ALASKA 99504

February 21, 1979

The Honorable Mike Colletta
Alaska State Senate
Pouch V
Juneau, Alaska 99811

Dear Senator Colletta:

The enclosed article is illustrative of our state government's history and we are continuing on the road to disaster by considering any one of the following:

1. State government drilling for oil and gas
2. State government ownership of the current RCA facilities
3. State government participation in a natural gas pipeline
4. State government ownership in the existing oil pipeline

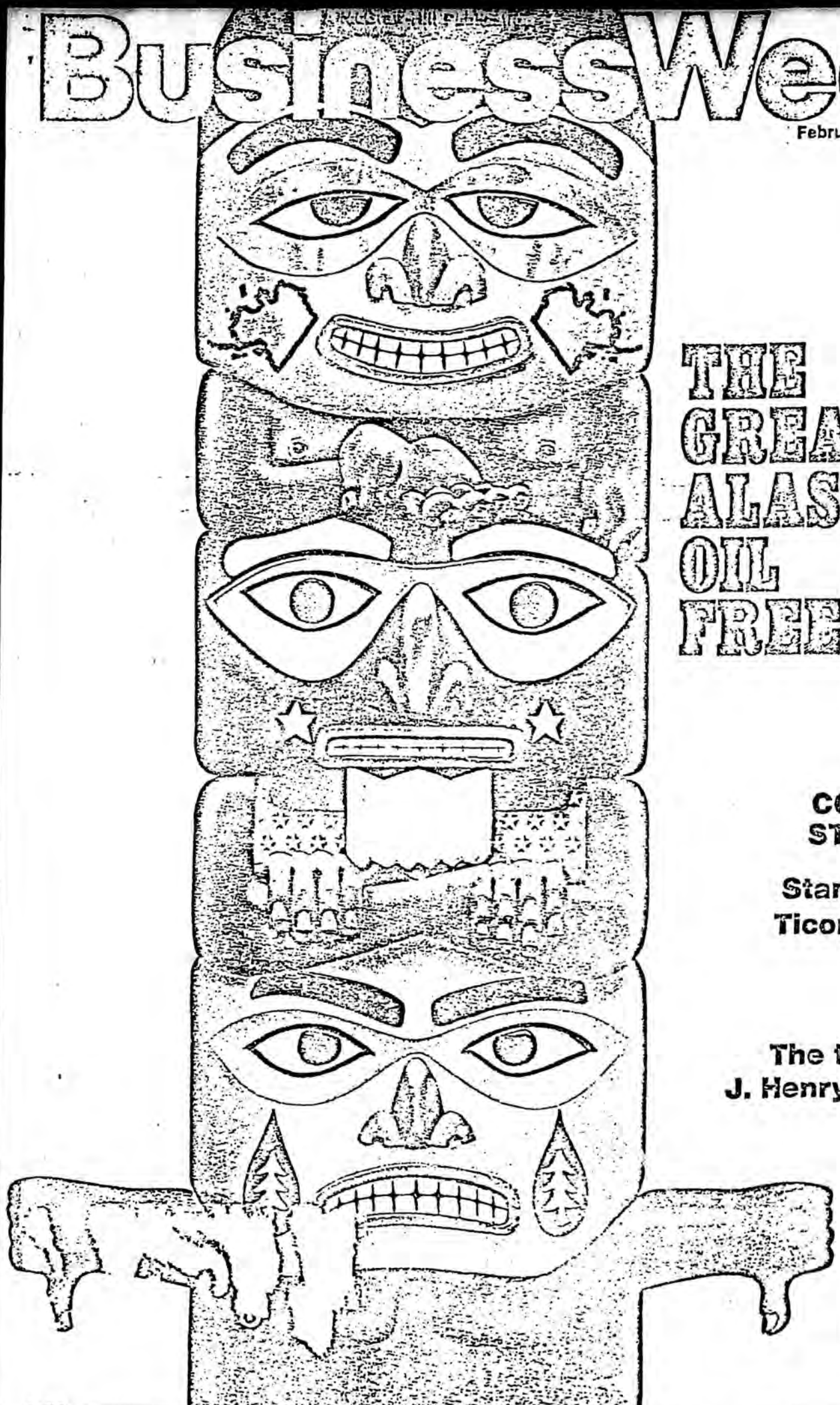
Respectfully submitted

Ronald J. Trevithick

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BusinessWeek

February 26, 1979 • $1.25



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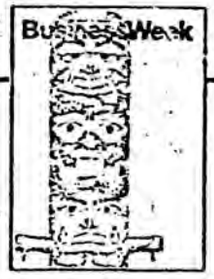
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Cover: Airbrush rendering by Stanislaw Fernandes of a totem pole symbolizes (from top) Alaska's big tax bite, Washington's lack of an effective oil policy, and the environmentalist opposition to further exploitation

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THE GREAT ALASKAN OIL FREEZE

Soaring costs, state taxes, environmental disputes have industry backing off

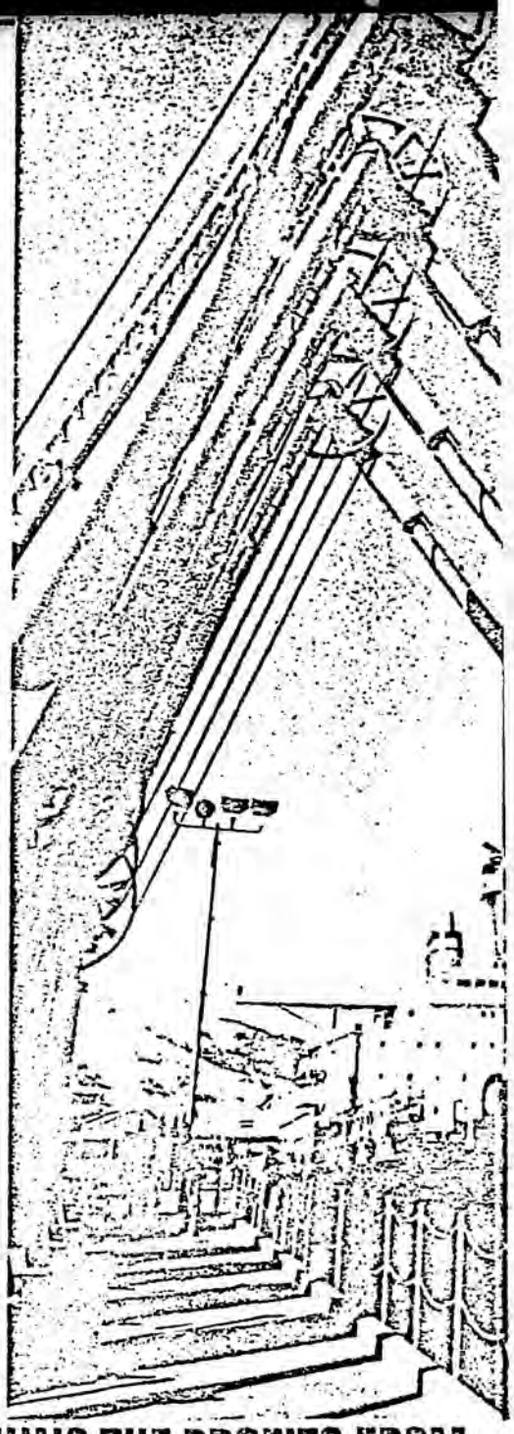
Pounded by high transportation and operating costs, environmental scrutiny, state taxes, and a lack of opportunity to explore, the oil industry is reluctantly turning away from Alaska. At the very moment when turbulence in Iran has cut worldwide oil supplies and altered oil distribution patterns, the industry is discovering that the nation's last great domestic oil frontier might simply be too expensive to exploit.

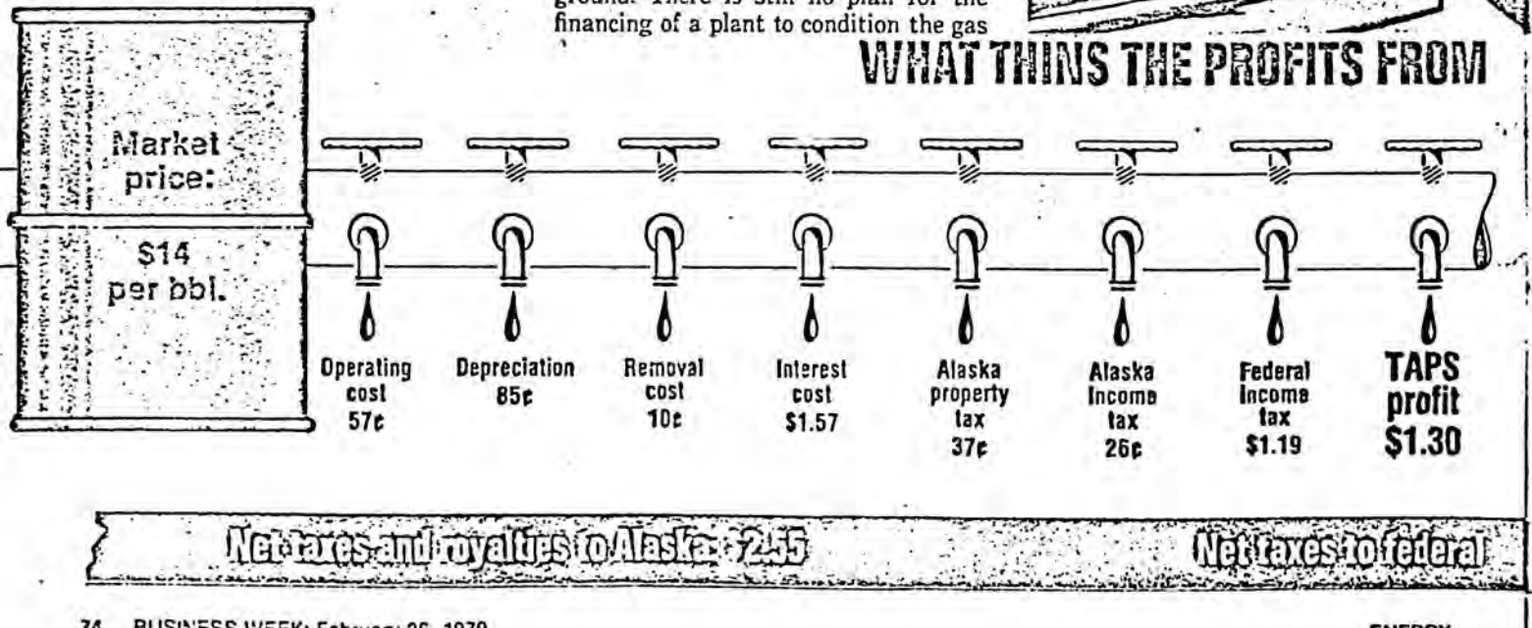
When Gulf Oil Corp. closed its Alaskan exploration office on Jan. 31, it became the 21st energy company to back away since 1971, according to the Alaska Oil & Gas Assn. The pace of that trend is speeding up. Exxon Corp., owner of 20.3% of the 9.4 billion bbl. of proved reserves at Prudhoe Bay, cut its exploration staff by more than one-quarter late last year. Shell Oil Co. says it cannot keep its offshore exploratory teams in readiness much longer without more activity. And Standard Oil Co. (Ohio), owner of 53% of the Prudhoe oil and a vast amount of Alaskan geological data, says it is thoroughly reevaluating its future in the state.

All of Alaska's oil has not yet been discovered, so the departure of exploration teams is a serious blow to the U. S. goal of energy independence. At stake are an estimated 30 billion bbl. of undiscovered Alaskan oil, the mean average of estimates made by the U. S. Geological Survey. These potential reserves are more than one-third of the nation's total. The agency also believes that Alaska holds 76 trillion cu. ft. of undiscovered natural gas, or 16% of the U. S. total.

For the last 10 years, the main focus of attention in Alaska has been Prudhoe, the nation's largest oil field by sevenfold. But while Prudhoe has now been smoothly pumping 1.2 million bbl. per day southward for more than four months, its profits have been disappointing. Part of the reason is that Prudhoe oil has glutted West Coast markets because of delays in building additional pipelines and the refusal of Congress to permit exports of Alaskan oil. After $14.3 billion of investment, the companies that own both the field and the Trans Alaska Pipeline System (TAPS) have earnings on the combined operation of only about $3 per bbl., compared with $3.50 or more in the North Sea. Currently, the annualized rate of profit on the full investment is a meager 9%. On a discounted cash flow basis, Sohio says its return on investment is five to nine percentage points lower than anticipated.

The 27 trillion cu. ft. of natural gas already found at Prudhoe remain in the ground. There is still no plan for the financing of a plant to condition the gas







George Hunton/Woodfin Camp

At Valdez, tankers pick up 1.2 million bbl. of oil a day from Prudhoe Bay.

Robert McAuley—BW

or of a pipeline to carry the gas to market. On Jan. 17, Senator Henry M. Jackson threatened his Energy & Natural Resources Committee that without some action soon, "we may find ourselves required to flare the gas or limit oil production." Exxon denies that possibility, and a 1972 state law prohibits gas from being flared. But even more crucial, the gas may prove too expensive to exploit.

A Robin Hood-like approach

The reasons for the Alaskan energy debacle are even more predominantly man-made than during the years when environmental disputes and red tape blocked construction of TAPS. Longstanding barriers to Alaskan oil development—a lack of available lease sites, inadequate nearby markets, and the scrutiny of the environmental movement—have been joined by new disincentives, among them a state political and business climate that oil companies now perceive as hostile. Sohio says it launched its reassessment after the Alaska legislature last June passed its 13th change in taxes on oil companies in the past 10 years.

The tack that Alaska is taking—a Robin Hood-like approach to rich oil companies in order to equalize the wealth—is being emulated by other mineral-rich states. Montana, Wyoming, and New Mexico all have increased levies on coal, uranium, or both.

Alaska's June measure—an income tax levied only on oil and gas companies—combines with other changes to raise overall oil taxes some 900% in the past decade. Alaska, whose rates before the Prudhoe discovery were the lowest of the major producing states, now imposes the highest burden. Sohio watched the June tax alone swallow up $60 million in 1978, increasing the company's state and federal taxes for all operations by 37% to $222 million.

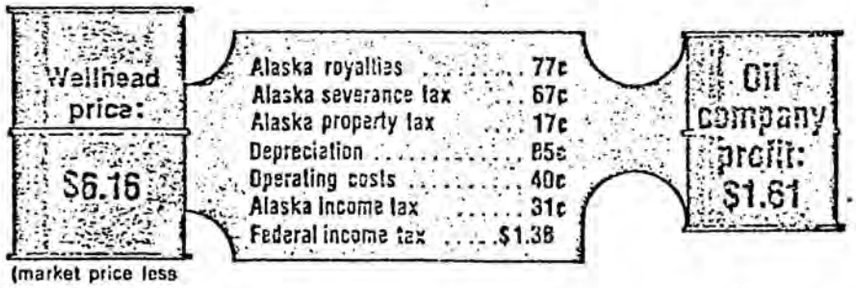
Embittered, Sohio Chairman Alton T. Whitehouse declares: "The Alaskans are raising moneys unrelated to their fiscal needs. These taxes are all designed to 'get their share' of Prudhoe Bay, whatever that means and notwithstanding the fact that leases were granted spelling out exactly what their share was. We haven't reached the point of saying the atmosphere in Alaska is so bad that under no circumstances will we put any money in there. But certainly we are headed in that direction."

Indeed, it appears that Alaskan government officials have learned to live not with the oil business but off it. Alaska derived 12% of its modest total revenues of $169 million from oil and gas in the pre-Prudhoe year of 1967, but this year the state will gather taxes and royalties from the industry totaling an estimated $790 million, or 58% of the state's total. If federal grants and other funds whose use is restricted were not counted, the oil and gas contribution to the state's income in 1979 would be 74%.

And that does not include the state's 1969 collection of Prudhoe lease payments of $906 million, which help maintain a general fund surplus of $761 million. Nor does it count about $75 million of oil and gas royalty money, which Alaska in 1979 will sock into its "permanent fund," a sort of endowment created in 1976 whose ultimate use is undetermined. Sohio estimates that this year it alone will provide some 27% of the state's total tax take, with legislators scrambling to use the oil money to build schools and roads in a vast undeveloped region (page 80). Whitehouse

ASKAN OIL





*Composite of West Coast and Gulf Coast destinations

Data: BW estimates



Where Alaska spends its oil money

Alaska holds some impressive records. It is the largest of the 50 states. It has the longest coastline, the highest mountains, and the richest mineral resources—and its spending record is equally formidable. State expenditures total roughly 20% of Alaskans' personal income—about 2½ times the per-capita average in the lower 48 states. This is a fairly recent phenomenon. General fund expenditures have jumped fivefold, from $692 per person in 1969 to $2,465 today. Part of that rise comes from providing the services needed to cope with population growth—from 290,000 to 410,000—during that period. But part comes from a staggering inflation rate. Indeed, the Alaska Revenue Dept. argues that real per-capita expenditures only doubled in the last decade.

Even if the Revenue Dept. is right, there is little doubt that Alaska's appetite for state funding was irreversibly whetted in 1969 when the lease sale at Prudhoe Bay brought in $906 million, half of which was transferred to state operations. This severed the previously close relationship between increases in the state's expenditures and increases in Alaskans' personal income. Since 1972 the state has attempted to restrain its spending spree, and, in fact, state spending has held at 20% of personal income. But it has shown no sign of sliding back to the 8% level prevalent during Alaska's early statehood.

"There's a popular misconception that we're rolling in wealth," says Alaska Governor Jay S. Hammond. In 1978, for example, individual income taxes declined $64.6 million from 1977, reflecting completion of oil pipeline construction and related activities. Some 40% of jobs in Alaska are supplied by government, including federal and military employment, and Anchorage banker Robert R. Richards says that this high level of public spending has helped avoid "a more severe post-pipeline downturn."

A tough place. This has been important for the state. With its harsh environment, double-digit unemployment, high costs, and tiny population, Alaska is a tough place to conduct business and government. Because so many of its villages are unincorporated and there is relatively little property to tax, the state pays most education costs. In 1978 these consumed $336 million, or nearly a third of all expenditures.

This year education costs will skyrocket as the result of the "Molly Hootch" case, a class action suit filed in 1972 by a teenager of that name living in Emmonak, near the lower Yukon River, charging that the state's 78,000 natives were not getting as good a secondary education as their white counterparts. An out-of-court settlement with the Education Dept. was reached in 1976. And last June, when the state adopted a new corporate income tax on the oil industry, an Education Dept. official says there was a "political rationale" for implementing the consent decree and allocating $110 million to construct approximately 100 high schools in bush communities where there are 11 or more students of high school age.

Between 2,500 and 2,800 high school students will be affected by this ultra-high-cost project, which amounts to $40,000 per student, not including future generations who will also benefit. One isolated high school in Teller, 90 mi. north of the Seward Peninsula, will cost nearly $250 per sq. ft. by the time it is finished this year, and it will serve just 15 to 20 students. Another, in Kipnuk, in western Alaska, will cost $2.2 million and be used by 50 to 60 students.

High costs, low volume. The cost of other public services is equally astronomical. Transportation costs, which totaled $242.5 million last year, including $121 million in federal grants for road construction, are the largest outlay after education. Even so, the state has fewer miles of road than Connecticut. Many states depend on fuel taxes to support highway construction, but even a respectable 8¢ per gal. tax in Alaska brings in less than half of the $39 million spent on highway maintenance. "The basic problem," says Robert B. Lind, director of Alaska's Budget & Management Div., "is high costs and low volume of traffic."

Federal grants accounted for more than half of state revenues right after statehood. Now the main revenue source is the oil industry. "The propensity of the state government, with its permanent staff of 11,500, is to ask, 'How much do we need?' and then to hit the oil companies to make up the difference between revenues and expenses," says Neil G. Bergt, president of Alaska International Industries Inc.

In at least one area, however, the state recently exhibited notable economic restraint. In 1976, Alaskan voters approved moving the state capital from isolated Juneau to a new town to be constructed near Anchorage. Last November, however, the electorate turned down a general obligation bond issue designed to finance 28% of the capital's relocation costs and required that voters approve all bondable costs (estimated at nearly $1 billion) before any further funds are spent on the relocation.

prompt Foothills to build the southern leg of the Alaskan line before the rest is completed, using the leg at first to ship gas from Alberta. However, Albertan gas, at $2.16 per Mcf, could also make Alaskan gas, at $6 per Mcf, so expensive that nobody will buy it for years. While most Canadian gas producers are convinced that Alberta holds up to 10 trillion cu. ft., some think the figure could be much higher. John A. Masters, president of Canadian Hunter Exploration Ltd., estimates that the Deep Basin region of Alberta, which runs northwest through the province into British Columbia, might alone contain up to 50 trillion cu. ft.

In the meantime, the oil company owners of the Prudhoe gas, perhaps the only companies whose assets could attract the private capital required for the line, refuse to participate. Already swamped with debt and high operating costs from its Alaskan ventures, Sohio says it will make no investment in the conditioning plant or pipeline. Says Exxon, the company with the greatest wherewithal: "Producers are prohibited by Congress from equity investment in the line. Although they may contribute funds or provide debt guarantees, producers, under these circumstances, could not exercise control over their investment. We do not believe we should commit shareholders' funds, or our financial support, therefore."

If, despite these difficulties, Prudhoe gas does make it to market, Alaskan taxes will come into play as they have with oil. The new income tax will apply to gas. And Alaska has raised its severance tax—the levy placed on resources removed from the ground—on gas from 1% in 1966 to 10% in 1977. A 1973 property tax of 2¢ per $1,000 of assessed value will also apply to the gas line and all production properties.

Neither the gas nor oil logistics and marketing problems are lost on Alaska's state government. Energy is far and away the state's largest industry. Yet 11.5% of the workers among Alaska's 410,000 residents are unemployed, and the state's 78,000 Indians and Eskimos remain largely tied to a subsistence lifestyle. State officials say they need the jobs and investment that oil and gas can provide. But they also need to modernize the state with the very tax revenues that are helping to discourage investment.

"There is not enough economic activity to support this state if all you do here is shoot game, catch fish, and cut down trees," says Thomas K. Williams, Alaska's petroleum revenue director. "But," he adds candidly, "there is no one else

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but the oil industry to hit for revenues. It's the only deep pocket in town."

Alaska Governor Jay S. Hammond, a moderate Republican who was reelected to a second term in November, concedes that the oil industry "has been taxed unfairly." But members of his administration point out that Alaskans should not be judged without also considering how oil has complicated their lives.

The state has been caught between the temptation to stimulate the oil industry and to sit on oil reserves until prices and royalties go higher. The decision so far, except at Prudhoe Bay, has been to hold back development. Resources Commissioner LeResche says the state is trying to prevent mistakes made when Alaska was plundered by successive waves of prospectors seeking furs, whales, and gold. Today, he says, government wants some control over what is essentially a seller's market.

"We still own most of the store, and our shelves are fully stocked with most of what the world wants," LeResche says. "We have a good nest egg [from Prudhoe Bay] to tide us over during periods of thoughtful positioning in the market. The days of the great Alaskan fire sales, loss leaders, and giveaways are over."

Consequently, there have been no major state lease sales to the oil and gas industry since Prudhoe. The state postponed one sale last October at Point Thompson, about 70 mi. east of Prudhoe. Federal lease sales have also been skimpy, making "lack of opportunity" a major reason for a slump in drilling. Only five wildcat wells were sunk in Alaska in 1978, says Roger Bexon, president of Sohio Natural Resources Co..

Expensive failures

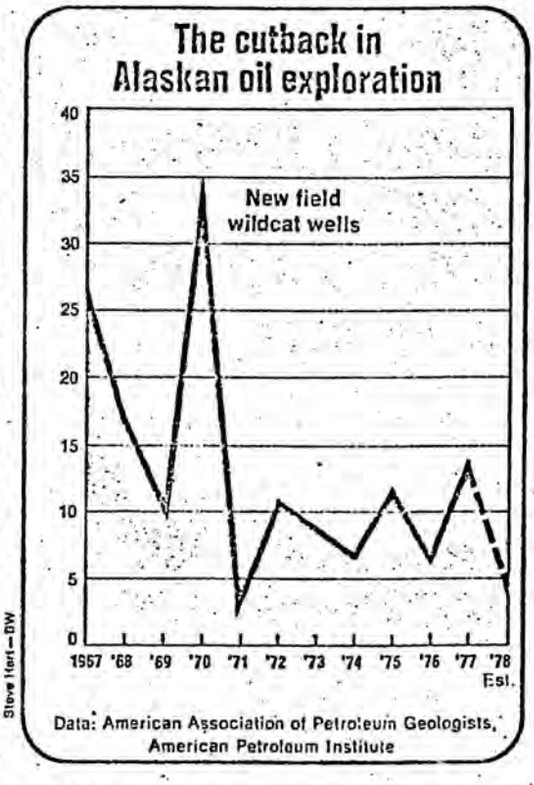
Perhaps even more depressing than the lack of leases have been the results at the sites that have been leased. These have led not to new Prudhoe Bays, but to expensive failures: In 1976, the Interior Dept. sold oil leases covering 400,000 acres in the Gulf of Alaska for more than $500 million. Purchasers, including Arco, Shell, Texaco, Exxon, and Gulf, drilled only dry holes at a total cost of nearly $1 billion. In October, 1977, the federal government also sold leases in the lower Cook Inlet. Marathon announced results of the first hole last Dec. 18: Dry, at a cost of $38.5 million for the lease alone.

In 1975 the federal government hired private contractors to start on an exploration project drilling on the 23 million-acre National Petroleum Reserve on the North Slope. Since then, contractors have drilled 14 dry holes. Originally targeted for 26 exploratory wells, the program will virtually be halted at a total 19 holes under President Carter's 1980 budget request. At that point, some $626 million will have been appropriated for what has been, so far, a total bust.

Just as Alaskan economics have been sobering in the offices of corporate treasurers, so have the exploratory failures brought a sense of reality to petroleum geologists. Says Sohio's Bexon, formerly managing director of worldwide exploration for BP: "At the time Prudhoe Bay was discovered, expectations ran riot. People thought there might be a dozen of these things lying around and all sorts of smaller ones. People have now come down to earth." But even more important, the real worry is that costs in Alaska could mean that quite substantial amounts of hydrocarbons will be uneconomic.

Alaska's exploratory opportunities have been further limited by Presidential action. In December, the Carter Administration put some 110 million acres of federally owned Alaskan lands under temporary wraps as wilderness areas and national monuments. Under subsequent legislation introduced this year by Representative Morris K. Udall (D-Ariz.), most of these lands would become permanently inaccessible for energy and mineral exploitation. That does not worry Congress. Because the oil industry focused most of its waning attention offshore, a congressional staffer close to the bill maintains that 90% of Alaska's best oil and gas lands remain outside the protected areas.

But Alaskans who are looking for more revenue are not all convinced. The 110 million acres comprise nearly one-third of the state. Alaska's Democratic Senator Mike Gravel, who threatened



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declared the new one "will write off Alaska as an oil province," if only because it will reduce access to resources. "If the lands bill passes, then Alaska's got no future," Gravel asserts.

Companies are mostly worried about the bill's effect on transportation of oil if it is found in the interior. Ronald E. Beck, manager of northwestern region exploration and production for Phillips, says the lands issue could become Alaskan oil's biggest problem. Edward B. Rasmuson, president of the National Bank of Alaska, says it is a "greater deterrent to oil development than the tax structure. If you were an oil or mining company, would you invest in Alaska not knowing where the corridors might be to get out what you find?"

Most Alaskan government officials see the lands bill as the ultimate encroachment on their authority to determine the state's economic goals. The role of economic guide and protector against absentee federal landlords and outside oil interests is taken seriously in Juneau. In fact, the state is examining a number of ways it might help shape Alaska's energy future by direct participation.

For example, state officials are doing more than just lobbying in Washington to change the law on oil exports. Natural Resources Commissioner LeResche, for one, has already conducted talks about swapping oil with Pemex, the state-controlled oil company in Mexico.

A controversial partnership

As an alternative use for Alaska's royalty oil, the state has given the impetus for Alaska to become a producer of petrochemicals. The state has committed 150,000 bbl. per day of its oil to a proposed $1.5 billion petrochemical complex at Valdez to be operated by Alaska Petrochemical Co. (Alpetco). Like the oil swap, however, this project is far from assured. Alpetco, a consortium composed of Alaska Interstate Co., of Houston, Seatrain Lines Inc., Barbour Oil Co., and six Alaska native regional corporations, has yet to obtain 160 federal, state, and local permits. More significantly, Alpetco needs to find markets, which for most petrochemical plants must be nearby to be economical.

Although exploitation of Alaska's energy resources is mired in delays and uncertainties, the state government is toying with a scheme to become directly involved with energy through a general stock ownership plan, a proposal permitted by a tax law change that Gravel pushed through Congress last year. It would establish each Alaskan citizen as a stockholder in a state-chartered corporation that, Gravel suggests, ought to get into the oil business. The first likely target: buying out BP's remaining 15.8% ownership of TAPS. In London, BP confirms that it has not only been approached by Alaskan officials about the purchase but would give it strong consideration. Alaska's legislature is currently considering the stock ownership plan and is awaiting results of a $205,000 study it has commissioned from San Francisco's Louis O. Kelso, the proponent of employee stock ownership plans. Unhappily, there are unanswered questions, such as who qualifies as a citizen and what influence the state would have on oil operations.

Many in the oil industry, of course, are less than thrilled about having a partner whose decisions would be made by the politicians in Juneau. Not only has the legislature frequently raised taxes, but it has also passed some 35 nontax regulations on oil and gas companies in the last 10 years. A new income tax will cost oil companies an estimated $166 million, compared with the state's former income tax provision, which collected $10 million. Richard B. Palmer, senior vice-president at Texaco Inc., says the company has long been concerned about marketing Alaskan oil "but now a more serious concern is state taxation."



Gravel: If the wilderness bill passes Congress, "then Alaska's got no future."

But for those companies sincere about leaving Alaska, Senator Stevens suggests an Alaskan-style Catch 22: "There are indications the industry may be reducing its efforts," he notes. "If that continues, and the Alaskan people get the feeling that Prudhoe Bay is the first and last major field, I think the attitude of the legislature and executive branch will change radically. The [remaining] oil companies will face a potential for increased taxation and state participation in their activities." ■

Killing the goose

At the very time that curtailment of Iranian oil production threatens the U. S. with a severe energy shortage, domestic oil companies are cooling on further exploitation of Alaskan fields, the largest oil and gas discovery this country has ever known (page 74). The responsibility for this nonsensical and destructive situation rests with state officials in Alaska, federal energy officials in Washington, and Congress. They should come to their senses immediately and start clearing away the mostly man-made obstacles that discourage further development of Alaskan oil and gas reserves.

The clearest reason why oil companies are pulling back on further Alaskan development is the state's grab-the-money-and-run tax policies. Over the past decade, state officials have steadily increased oil and gas taxes to the point where these revenues now pay most of the state's bills. Rising taxes and higher exploration costs have pushed down potential return on new investment to where oil companies are backing away from searching for new oil and gas.

Some of the state's behavior derives from federal policies, especially Congress' refusal to let Alaska export its oil to Japan and Mexico, a practice that would save substantial transportation costs and increase the state's royalty income.

None of this makes sense in the light of the U. S. goal of energy independence. Congress should authorize a swap plan under which Alaska could sell its oil to Japan and Mexico, and they, in turn, would arrange for oil shipments to U. S. users from Middle Eastern and Mexican sources.

Alaskan officials, for their part, should stop treating the oil companies as the answer to all state financial needs, present and future. Sticking it to them now may look politically appealing, but in the long run it could mean less income for Alaska and less vitally needed oil for the rest of the country.

Federal officials, too, have thrown up bureaucratic barriers, including obstacles to new pipeline construction. They should come down. Unless Alaskan and federal officials, as well as congressmen, show more commitment to full development of the state's reserves, Prudhoe Bay—and not some field that remains to be discovered—may be our last great oil bonanza.

A shortsighted decision

The U. S. aluminum industry is taking a very short-run view, with consequent serious risks to itself and to the country, by refusing to expand its domestic ingot-making capacity to keep pace with anticipated demand (page 109). Industry leaders have what they see as solid business reasons for their decision, but they—and the country—may find too late that the risks were not worth taking. The industry has time now to reconsider its decision, and for its own sake and the sake of the economy, it should change its mind.

The consequences of holding back on investing in additional capacity are sobering. Holding back would be inflationary. Aluminum users would face numerous hardships. As users step up their imports, it would exacerbate the balance-of-payments deficit. National defense could also be threatened.

The aluminum companies defend their decision by pointing to the surpluses of the metal that built up in the early 1970s, when they expanded for a demand that did not grow as much as expected. To make matters worse, mandatory controls then went into place, catching the producers with prices down and costs rising sharply. And the companies are reluctant to invest in new plants at this time without reasonably assured sources of power, especially the relatively cheap hydroelectric power of the Pacific Northwest.

But successful industries were not built by avoiding all risks. If U. S. producers allow demand to outstrip supply, there is likely to be a rerun of the scenario in steel over the past 12 years, with domestic producers—their reputations maimed by steady price increases—pleading with the government to ban lower-priced imports. But if aluminum producers fail to expand now, they will have no claim on protection later.

Fitting Amtrak to size

Transportation Secretary Brock Adams is making another effort to reorganize Amtrak's 27,700-mi. system by eliminating 12,000 mi. of passenger train service. If Congress blocks this attempt, as it has earlier ones, Adams admits it could be his last, and that could mean the end of all rail passenger service. This time, though, Adams is making it easy for Congress to approve necessary cutbacks, and congressmen should go along with his recommendations.

In its present size, Amtrak will cost taxpayers $6 billion over the next five years, and much of this money goes to subsidize trains that practically nobody is interested in riding. But past efforts to trim back the system to include only service that passengers are using have always run into opposition from congressmen more concerned with keeping their districts on the railroad map than with helping create an economically viable system.

Transportation is calling for eliminating all trains that now operate for essentially political reasons—including, for example, three trains that run through West Virginia, the home state of several powerful politicians. Adams' hope is that if he takes trains away from everybody, nobody can claim he was discriminated against. Further, Transportation's plan will become law around May 15 unless Congress acts to kill it. Again, this makes it easier for senators and representatives from affected districts to let the cuts take place.

Transportation says the smaller system will potentially serve 90% of the people now riding Amtrak. It will still cost $4.5 billion over the next five years, and taxpayers will still be paying 53% of its operating expenses, but this is some improvement over the 65% they now pay. Most important, the trains left running will be in places where people want to ride them.

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PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

March 5, 1979

To: All Members of the Press

From: Senator Mike Colletta

Attached for your information is a summary of the Alaska General Stock Ownership Corporation legislation. As you know, a Sponsor Substitute has been introduced for SB 170.

March 5, 1979

To: Representative Jim Duncan

From: Senator Mike Colletta

Per our discussion, attached herewith is a copy of the General Stock Ownership Corporation bill summary.

I have distributed a copy of the summary to all Senators and to the Press.

March 5, 1979

To: All Senators

From: Senator Mike Colletta

Attached for your information is a summary of the Alaska General Stock Ownership Corporation legislation. As you know, a Sponsor Substitute has been introduced for SB 170.

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.

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.

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.

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.

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gsp

Alaska State Legislature

SENATOR MIKE COLLETTA

SENATE FLOOR LEADER

Senate

February 23, 1979

The Honorable Mike Gravel
United States Senate
3121 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Gravel,

Please find enclosed copies of the following reports:

Design of an Alaskan General Stock Ownership Plan, Volumes I and II; by Kelso and Company, Inc.

Alaska Gas Pipeline Perspectives: History, Current Perceptions and Potential Federal Influence related to State Financial Participation; by Birch, Horton, Bittner and Monroe.

I hope you will find them very helpful. Although I will not be able to come to Washington next week with many of the other Alskan legislators, I do look forward to seeing you at some time in the future.

Best personal regards,

Mike Colletta
Senate Majority Leader

MC/das

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MEMO TO FILE February 21, 1979

FROM: Marcie

RE: Kelso Study and SB 170

Original report, Volume one has gone to the printers and should be ready by Friday. It will include a cover letter signed by Sen. Colletta and Rep. Duncan, Project Directors.

The original and 100 copies are to be sent to Kelso in SF along with billing. 200 copies were made for leg. and resource.

Volume II will not be printed but will be available in Leg. Finance Office.

The final copy of volume one completed on Friday, February 16 made only one change from the draft in the portion that was to introduced as a bill. Added language "eligable individual" in the section that defines resident.

Norma Johnson from Kelso's SF office said she had spoken with Jerry Gosche from Gravel's office. Jerry will be in Juneau starting on Monday to work on a redraft what Legislative Affairs came up with.

Kelso's office is not redrafting the bill.

MEMORANDUM

February 21, 1979

TO: SAM
PRINT SHOP

FROM: SENATOR MIKE COLLETTA

PLEASE PRINT 100 COPIES OF THE ATTACHED KELSO REPORT: "DESIGN OF AN ALASKAN GENERAL STOCK OWNERSHIP PLAN, VOLUME 1" AND SEND BILLING FOR PRINTING TO:

LOUIS KELSO
KELSO & COMPANY
111 PINE STREET
SAN FRANCISCO, CALIFORNIA 94111

SEND THE 100 COPIES VIA IAR FREIGHT COLLECT TO MR KELSO AT THE ABOVE ADDRESS.

YOUR ASSISTANCE IN THIS MATTER IS APPRECIATED.

PLEASE RETURN ORIGINAL MASTER TO MY OFFICE, ROOM 107, CAPITOL BUILDING, ATTENTION: MARCIE.

REQUEST FOR DUPLICATING

LA-A 1 Date Submitted: _____ Acct. No.: _____

Date Required: _____

Department: _____ Division: Legislative Budget & Audit

Contact Person: Milt Barker (3700) or Senator Colletta (3769) Phone No.: _____

WORK DESCRIPTION: Off Set Print

KELSO REPORT: DESIGN OF AN ALASKAN GENERAL STOCK OWNERSHIP PLAN

VOLUME 1

* *

No. of Masters: 134 No. of Copies: _____

Original size: 8½x11 /X/ 8½x13 / / / / Other: _____

Finished size: 8½x11 /X/ 8½x13 / / / / Other: _____

Color and Type of Paper: /X/ 20# White / / Other: _____

* *

Printing: One Side / / Collate / / Drill / /

Book / / Staple / / Pad / /

Journal / / Fold / / Trim / /

Tumble / /

* *

Special Instructions: _____

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Time In: _____

Time Out: _____

SIGNED _____

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

February 16, 1979

Ms. Marcie Sharrock
c/o Senator Mike Colletta
Pouch V
Juneau, Alaska 99811

Dear Marcie:

Enclosed is the original copy of Volume I of the Design of an Alaskan General Stock Ownership Plan which we are sending for use in printing. As we mentioned, we would like to have the original returned to us if possible.

Thanks for your help.

Sincerely,

Norma R. Johnson

NRJ:ch
Encl.

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7454

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

February 12, 1979

Senator Mike Colletta
c/o Office of the
Hon. Jay Hammond
State Capitol Building
Juneau, Alaska

Dear Senator Colletta:

Attached is our proposed draft of the AGSOC bill prior to receiving the comments of Mr. Ken Rosenstein. Perhaps your secretary would duplicate copies to Mr. Rosenstein and for Senator Gravel, who is due in Juneau Tuesday.

Our basic report and appendix will be sent via Alaska Airlines Flight No. 69 arriving in Juneau at 8:15 p.m. Tuesday, February 15th.

Sincerely,

Louis O. Kelso

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 (415) 788-7454

A BILL

FOR AN ACT ENTITLED "AN ACT ESTABLISHING ALASKA GENERAL STOCK OWNERSHIP CORPORATION; AMENDING CERTAIN ALASKA STATUTES; AND PROVIDING FOR AN EFFECTIVE DATE."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

Section 1. ALASKA GENERAL STOCK OWNERSHIP CORPORATION ORGANIZATION. The Governor of the State of Alaska be, and hereby is, authorized and directed to cause the incorporation of Alaska General Stock Ownership Corporation (AGSOC), by the filing of appropriate Articles of Incorporation with the Division of Banking and Securities of the Department of Commerce and to appoint as incorporators and as the first Board of Directors of AGSOC nine (9) individuals, at least five (5) of whom are residents of Alaska.

Section 2. GENERAL STOCK OWNERSHIP CORPORATION UNDER INTERNAL REVENUE CODE. AGSOC shall be organized as a General Stock Ownership Corporation under Title VI of the Internal Revenue Code of 1954, as amended, and under this Act.

Section 3. ORGANIZED AS A DOMESTIC CORPORATION. AGSOC shall be a domestic corporation for profit under the laws of the State of Alaska, and shall not be an agency or political subdivision of the State of Alaska for any purpose.

Section 4. INITIAL BOARD OF DIRECTORS.

(a) The initial Board of Directors of AGSOC (hereinafter referred to as the "Board") shall consist of nine (9) members, at least five (5) of whom shall at all times during their terms as members of the Board be residents of the State of Alaska.

(b) Members of the initial Board shall be divided into three (3) classes, each class consisting of three (3) individuals, designated as Class One directors, each with a term of one (1) year and until their successors are elected and qualified; Class Two directors, each with a term of two (2) years and until their successors are elected and qualified; and Class Three directors, each with a term of three (3) years and until their successors are elected and qualified.

Section 5. ISSUE AND TRANSFER OF STOCK. Alaska General Stock Ownership Corporation is hereby authorized and directed:

(a) to issue only one (1) class of stock;

(b) to issue shares only to residents (eligible individuals) of Alaska as defined herein;

(c) to initially issue at least one (1) share of its stock to each resident of Alaska, unless such resident elects within one (1) year after the date of such issuance not to receive such shares;

(d) to provide that no share of stock shall be sold, pledged, assigned, mortgaged, subjected to encumbrance, voluntarily or involuntarily, or otherwise transferred --

(i) by a shareholder other than by will or the applicable laws of descent and distribution until after the expiration of five (5) years from the date such stock is issued by AGSOC except in the event the shareholder ceases to be a resident of the State of Alaska and thereupon elects to make such transfer;

(ii) to any person other than an individual who is at the time of such transfer an individual resident of Alaska as defined herein;

(iii) to any individual who, after the transfer, would own more than ten (10) shares of the stock of AGSOC;

(iv) by any shareholder until such shareholder shall reach the age of majority, as defined by Alaska law;

(e) to perform all acts and conform to all legal requirements to qualify and thereafter to continue to qualify as a General Stock Ownership Corporation under the Internal Revenue Code of 1954, as amended, and under this Act, unless the Board, with the consent of the Secretary in accordance with applicable provisions of the Internal Revenue Code and regulations thereunder, shall elect to terminate such qualification; and

(f) not to invest in or acquire any interest in properties acquired by it or for its benefit through exercise of the right of eminent domain.

Section 6. RIGHT OF FIRST REFUSAL TO PURCHASE OWN STOCK. AGSOC shall have a right of first refusal to purchase any shares of stock of AGSOC offered to be transferred by the holder thereof. Such shares may be held by AGSOC in the general escrow or trust account of its trust or escrow division, in which event such stock shall continue its status as issued and outstanding stock of AGSOC for all purposes, except that such shares, while so held, shall not be voted nor shall they be entitled to dividends declared on shares of AGSOC stock. The Board of Directors by resolution shall have the power to cancel such reacquired shares and such shares shall thereupon return to the status of authorized and unissued shares.

Section 7. ESCROW OF STOCK BY AGSOC. AGSOC shall have the power to make and enforce reasonable rules and regulations with respect to the establishing of escrow accounts either within its own trust and escrow department or otherwise for each stockholder of the corporation; for releasing shares of stock to the owner or buyer thereof subject to the continuing restrictions set forth in this Act at the expiration of the period of five (5) years following date of issue thereof, or the date upon which the shareholder shall reach the age of majority, as defined by Alaska law, or the date when the shareholder shall have complied with all reasonable rules and regulations of AGSOC pertaining to the release of such shares from escrow, whichever

of said events shall be the last to occur, except in the event of death of the shareholder or upon the shareholder ceasing to be a resident of the State of Alaska and thereupon electing to transfer such shares to an eligible transferee; for the operation of its trust and escrow division; for the transfer and recording of transfers of its stock if it determines to act as its own transfer agent; for the operation of its trust and escrow division if it determines to establish a trust and escrow division, and with respect to the issue, transfer, repurchase and other handling or dealing with its stock as its Board of Directors may adopt and promulgate. All such rules and regulations shall be published to the stockholders of AGSOC and shall be available in suitable form to any stockholder at any time upon request during regular business hours.

Section 8. DEFINITION OF RESIDENT.

(a) For purposes of original issue of shares of AGSOC stock under this Act, the terms "resident", "eligible resident", or "qualified individual" shall have the same and identical meaning, and shall mean an individual, born prior to 12:00 o'clock midnight on January 1, 1979, regardless of age, who as of 12:00 o'clock midnight on January 1, 1979, was a resident of and was domiciled in the State of Alaska and who remains a resident of Alaska through the date determined by the Board of Directors of AGSOC and publicly announced as such, to be the date the shares of stock of AGSOC are initially issued.

(b) For purposes of transfer of AGSOC shares subsequent to

initial issuance, "resident" shall mean an individual, regardless of age, who is a resident and is domiciled in the State of Alaska on the date such transfer is made effective.

Section 9. IDENTIFICATION OF RESIDENTS OF ALASKA ELIGIBLE TO BECOME AGSOC SHAREHOLDERS.

(a) Prior to issuing any shares of stock, AGSOC shall take all reasonable measures, by public advertising, radio and television broadcasting, and otherwise, to make known to all residents of the State of Alaska its intention to issue stock to each person eligible to become a shareholder and to similarly notify all Alaska residents of the eligibility requirements to become a registered shareholder of AGSOC. Such efforts shall be made from time to time and shall continue for a period of at least ninety (90) days prior to the date for issuance of stock of AGSOC, and shall be made at least once each month over the next eleven (11) months, and as frequently thereafter as the Board of Directors of AGSOC may deem appropriate. The procedural details pertaining to the identification of such persons as shareholders, either in person, or if they are minors represented by a parental or legal guardian, or if they be incompetent persons by a legal guardian, shall be fully provided to each person making inquiry at a properly designated office by a representative of AGSOC.

(b) The duty and responsibility, however, of each qualified resident to make application for registration as a shareholder of AGSOC shall rest solely and exclusively upon such

qualified resident and upon the parental and legal guardians of qualified residents, and AGSOC shall not be liable for any loss, loss of income, disadvantage or inconvenience resulting directly or indirectly from the failure of such qualified resident to make such timely application except as herein specifically provided.

(c) AGSOC shall have no obligation to reimburse any eligible individual who may incur income tax liability as the result of failure to make timely application for registration as a shareholder of AGSOC, nor shall AGSOC be liable for reimbursing previously declared or paid dividends to which an applicant for registration as a shareholder would have been entitled had timely application therefor been made. Subject to these limitations, however, an eligible resident who would have been entitled to the issuance of a share or shares of stock of AGSOC, had application been made prior to the time of such issuance, or a transferee by will, or by the laws of descent and distribution, or other legal transferee, and had such qualification continued through the date of such issuance, may at any time thereafter make such application and receive the stock (or escrow certificate representing such stock) to which he shall thus be established as being entitled.

Section 10. CIVIL AND CRIMINAL PENALTIES FOR MISREPRESENTATION OF FACTS DETERMINING ELIGIBILITY TO BECOME AGSOC SHAREHOLDER.

(a) Any individual who shall have received stock upon orig-

inal issue by AGSOC through fraudulent or misleading representations shall, upon demand therefor in writing being made by or on behalf of AGSOC, return all certificates or other evidence of the ownership of such shares and the full amount of dividends, whether in cash, in stock or otherwise, received thereon, together with interest at the rate of eight percent (8%) per annum from the date that such dividend or dividends were received to the date of such repayment. In the event of failure of such illegal holder of shares of AGSOC to make such restitution in full, AGSOC shall be entitled by civil action in any Superior Court in the State of Alaska to enforce such recovery, together with payment of all legal fees and court costs incurred by AGSOC in effecting such recovery.

(b) Any person who shall obtain for himself or for a person as to whom he is or has represented that he is a parental or legal guardian the issuance of shares of AGSOC through fraud, misrepresentation or by any deceitful or illegal means, shall be guilty of a Class C felony.

Section 11. SPECIAL SESSION TO APPROVE FINANCING. It is the intent of the legislature that at such time as AGSOC comes forward with a request for project financing that the Governor shall call a special session of the legislature to consider such request. However, no special session need be called if the legislature is scheduled to meet within sixty (60) days of the date of such request. In the event the legislature shall determine that financing or the guaranty of financing for an AGSOC project is necessary or desirable, the legislature shall at the

earliest convenient time call a special election (unless an election is scheduled to be held within sixty (60) days) for voting on the approval of the extension of credit to AGSOC by the State of Alaska, or the guarantying by the State of Alaska or by any agency or instrumentality thereof of the credit of AGSOC.

Section 12. TRUST ACCOUNT WITH DEPARTMENT OF REVENUE. There is hereby established a trust account within the Department of Revenue which account shall be used solely and exclusively for purposes of guarantying loans, public or private, to AGSOC for the accomplishment of its purposes.

Section 13. The following amendments shall be and hereby are made to the Alaska Statutes:

(a) Title 10, Section 10.05.012, is hereby amended by inserting prior to the first word in the second sentence thereof the words: "Except with respect to General Stock Ownership Corporations,".

(b) The last sentence of Title 10, Section 10.05.186, is hereby amended to read: "Except with respect to General Stock Ownership Corporations, no classification of directors is effective prior to the first annual meeting of shareholders."

(c) Title 10, Section 10.05.204, is hereby amended by adding a new Subsection (7) at the end thereof as follows:

"(7) Notwithstanding the foregoing or any other pro-

visions of Title 10 of the Alaska Statutes, dividends may be declared and paid by a General Stock Ownership Corporation, organized under AS _____, at any time and from any source to the extent deemed by the Board of Directors thereof necessary to comply with the distribution requirements of the laws of Alaska and of the United States, except that no dividend shall be declared when such General Stock Ownership Corporation is insolvent or which would cause it to become insolvent."

(d) Title 45 is hereby amended by adding a new Section 45.55.141 thereto to read:

"Section 45.55.141. The stock of a General Stock Ownership Corporation organized under the Alaska General Stock Ownership Corporation Act (AS ____.____) is not a security and the issue or sale of stock under that Act shall not be construed as a sale of a security for purposes of this chapter."

Section 14. AGSOC SHALL BE EXEMPT FROM PROVISIONS OF TITLE 6, CHAPTER 25, OF ALASKA STATUTES. AGSOC shall be authorized to engage in trust and escrow activities with respect only to matters involving its own stock and to such extent AGSOC shall be exempt from compliance with the provisions of Title 6, Chapter 25, of Alaska Statutes.

PLEASE NOTE: THE PRECEDING PAGES WERE TREATED AS A UNIT IN THE ORIGINAL DOCUMENT.

gsop

Alaska State Legislature

SENATOR MIKE COLLETTA

SENATE FLOOR LEADER

Senate

February 19, 1979

The Honorable Mike Gravel
United States Senator
3121 Dirksen Senate Office Building
Washington, DC 20510

Senator Gravel,

Please find enclosed some material that may be of interest to you. I have not yet had the opportunity to speak with Mr. Lopp, but look forward to doing so in the near future.

Respectfully yours,

Mike Colletta

Mike Colletta
Senate Majority Leader

MC/das

P.O. BOX 3188, ANCHORAGE 99501 • POUCH V JUNEAU 99811

Sen. Colletta

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K–STATE CAPITOL
JUNEAU, ALASKA 99811

February 9, 1979

file GSOC

Norma R. Johnson
Assistant General Counsel
Kelso & Company, Inc.
Investment Bankers
111 Pine Street
San Francisco, California 94111

Dear Norma:

Enclosed are final copies of the Department of Law's preliminary analysis of the legal questions raised by the GSOC which you directed to us. These are not official opinions from our office, (formal or informal) but merely reflect the results of our research to assist you in drafting GSOC legislation. Please feel free to contact me when more specific questions arise.

Sincerely,

AVRUM M. GROSS
ATTORNEY GENERAL

By: Teo Spengler
Teo Spengler
Assistant Attorney General

TS:vr

Enclosures

cc: Milt Barker
Legislative Finance

03-C5LH

I.

CAN AN EXISTING ACT AUTHORIZE THE GOVERNOR TO APPOINT A SPECIFIED NUMBER OF INCORPORATORS (WHO WILL ALSO SERVE AS FIRST BOARD) TO INCORPORATE A GSOC IN CONFORMITY WITH FEDERAL LAW AND THE ALASKA CORPORATIONS CODE, AS AMENDED, AND OTHER GENERAL LAWS?

As a qualified opinion, I believe that this is possible. However, a negative response could be forthcoming, depending upon the details that evolve as the concept takes form.

*

What appears certain is that the concept of a GSOC, as set forth in federal law, is not offensive to Alaska law. It is well understood that the public policy of a state is expressed by acts of the legislature. A statutory expression of public policy will be upheld if subjected to judicial scrutiny so long as the law does not contravene a specific federal or state constitution prohibition, or a valid pre-emptive federal law. I do not believe that the concept contravenes any of these.

However, a GSOC is a new legal creature. Until a more detailed framework is developed an opinion regarding the legality of its corporate attributes will be a qualified one. Examples are difficult to come by for, though termed a domestic corporation, it has some attributes of a domestic corporation, some of a political subdivision and is also somewhat similar to an Alasan authority (i.e., Alaska Medical Authority). A balanced hybrid should be viable and legal. The most sensitive aspect of the three-prongs that influence it, from a legal view, it is the political subdivision aspect.

Were the concept fleshed out by a detailed statutory "charter", it would, in my estimation, have the best foundation

to withstand judicial challenge to its existence and actions. A circulating document entitled "Proposed Alaska State Legislation" (Proposed Act) is an example of the form of legislation I believe to be most vulnerable to attack. Its eight pages (including two pages of WHEREAS) lack corporate management mechanisms reflecting fiduciary responsibility that have long been required of private corporations. Though the WHEREAS recitals declare shareholder participation to be an integral aspect of the concept, the Proposed Act reflects a corporate form that basically insulates incumbent management from shareholder influence (i.e. classified board and no cumulative voting rights). An enormous amount of discretion is left to the incorporators/initial board - so much that it appears unnecessarily open to abuse or the appearance of it. For example, as I read the Proposed Act, it seems as if the Governor has authority to appoint the incorporators/initial board [See § 2(b)]. This should be explicitly stated, not buried in a sentence specifying what "may" occur if the Governor fails to appoint all nine members.

The ratio 1 for leaving it within the appointed board's discretion whether or not to fill remaining seats is questionable. Since transferability is restricted, restrictive legend language should be required by the act. Repurchase procedures also need to be addressed. The unrestricted dividend distribution section seems inconsistent with a basic corporate principle, in that it gives the board discretion to bankrupt the GSOC. If administrative or legislative exemptions from federal securities regulation is achieved and the state is prohibited from regulating pursuant to § 8(g) the courts may view it as in opposition to the legislature's statement of public policy or, as a misuse of the ta[illegible]'s money. Unless some of these matters are addressed and the alternatives explored, we could expect a lawsuit before one dollar was withdrawn from the general fund to cover a guarantee start-up costs or before the implementation of a loan guarantee package.

The concept should be developed within a much more detailed framewrok (i.e. Native Claims Settlement Act). A GSOC could become the most powerful corporation in the state. As such, I believe it very important to statutorily specify management controls (there is no mention of proxies, for instance), auditing procedures and reporting requirement to name but a few. In brief, this legislation needs serious revision.

II

WHAT STEPS WOULD BE NECESSARY TO SYNCHRONIZE OPERATIONS WITH ALASKA BLUE SKY LAWS?

a) DOES THE COMMISSIONER OF CORPORATIONS ADMINISTER BLUE SKY LAWS?

b) COULD WE GET PUBLISHED REGULATIONS? NOTE: WE ANTICIPATE EXEMPTION FROM FEDERAL 1933 ACT, BUT WILL CONFER WITH SEC REGARDING CONFORMITY TO 1934 ACT.

The Commissioner of Commerce and Economic Development has authority to administer the Blue Sky laws and has delegated this authority to the Director of Banking, Securities and Corporations. Copies of published regulations are available from the division. The synchronization portion of the question is impossible to answer until policy decisions regarding the corporate form and the statutory treatment of shares is first determined.

III

COULD IT BY THE ENABLING ACT BE AUTHORIZED TO ESTABLISH A TRUST DEPARTMENT TO ESTABLISH ESCROWS FOR AGSOC-1 STOCK-HOLDERS, HANDLE STOCK TRANSFER FUNCTIONS, ACQUIRE COMPANY STOCK UNDER RIGHTS OF FIRST REFUSAL OR OTHERWISE AND RESELL SUCH STOCK TO QUALIFIED BUYERS?

It is entended that all shares of AGSOC-1 would be

held in excrow by the trust department of the corporation during the initial five-year inalienability period. Escrow would continue during the minority of any shareholder.

*

Since the legislature can give a statute almost any form, an "enabling" act could probably authorize everything suggested in the question. However, all the named functions should be explicity referenced in the act and not left to the discretion of the board. The situation would be ripe for confusion and a deadlocked board at best and fraud and mismanagement at worst.

It is questionable whether the state would be found to be acting in the public interest if it were to guarantee a multimillion dollar loan for a corporation whose board of directors 1) was not subject to any conflict of interest restrictions, 2) was permitted to issue dividends when the GSOC was insolvent or would become insolvent, 3) authorized brokerage functions without being subject to regulations, etc. If the GSOC were to undertake all named functions, there would be no effective external or cross-controls over management and management's internal controls; all controls would be internalized. If the goals encompass accuracy of GSOC and shareholder records, integrity of GSOC and shareholder records and the prevention of defalcations and fraud, the GSOC should not be permitted all the named functions without strict regulatory control. Indeed, it is questionable whether it should be permitted to perform the interlocking functions at all.

IV

CAN WE PROTECT STOCK WHILE IN ESCROW FROM BEING SUBJECTED TO CLAIMS OF CREDITORS, LIENS, CONTRACTUAL PURCHASE RIGHTS,

ETC. -- IN SHORT, TIGHT "SPENDTHRIFT" PROVISIONS. WILL THIS PRESENT PROBLEMS UNDER ALASKA LAW? COULD ENABLING LEGISLATION GIVE EFFECTIVE SPENDTHRIFT PROTECTION DURING INITIAL FIVE-YEAR NON-TRANSFERABILITY PERIOD?

There is insufficient information on which to respond.

*

The traditional purpose of spendthrift trusts was to protect the ward/beneficiary against the beneficiary's own wasteful habits or inclinations which exposed the beneficiary and the beneficiary's family to unnecessary want or caused any public authority to be charged for any support expenese for the beneficiary and/or family. The traditional purpose would have to be retailored to accommodate a GSOC. For instance, ordinarily, a beneficiary's interest in a spendthrift trust cannot be reached by garnsihment unless the statute prescribes otherwise. Soem courts base their decision on whether the beneficiary's interest is contingent or on whether the trustee or beneficiary has discretionary powers. Each of the named areas in the question is subject to a large body of law with statutory and judicial exceptions that must be responded to for a "tight" statute to giving protections similar to those of spendthrift trusts, if desired.

The beneficiary could have a right of action against a trustee if legal title to the corpus (shares) would be in the trustee (with appurtenant right to vote the shares) and equitable title in the beneficiary (income/ dividends on the shares). It is unclear whether dividends would accrue or be distributed.

If the stock is to be a "gift", the doner may attach almost any limitations on its acceptance. However,

there was no mention of "gift" in the Proposed Act or the list of questions with attachments. Tax consequences may be substantial using the "gift" approach and securities problems won't be avoided by naming the transaction a gift.

V

CAN AGSOC-I ENGAGE IN A TRUST AND ESCROW BUSINESS WITH RESPECT TO ITS OWN STOCK?

No.

*

AS 06.25 governs the formation and on-going activities of trust companies which are corporations incorporated for the sole purpose of performing trust functions.

The GSOC Act could be drafted to adopt pertinent provisions of AS 06.25 and exempt specific inconsistent sections though at this point I do not recommend that approach.

gsop

2/5/79. Cathy called
She has spoken with
[illegible]

Send copy of this to
Sen. Gravel & L. Kelso
(MW)
copies sent
2/19/79

Catherine A. Chandler
Attorney at Law
601 West 5th Ave., Suite 320
Anchorage, Alaska 99501

February 2, 1979

Senator Mike Colletta
Senate Majority Leader

Senator Bill Sumner
Chairman, Senate Resources Committee

Pouch V
State Capitol
Mail Stop #3100
Juneau, Alaska 99811

Gentlemen:

First let me thank you for the time you both spent with me yesterday. I found the conversation most enlightening and I intend to follow through on it immediately.

Enclosed are two articles on Jim Lopp, Executive Vice President and Director of E. F. Hutton, who has been following the GSOP proposal. You may recall hearing testimony from him last year. I'm certain it would be of mutual benefit for you to meet with him, and I would be happy to arrange such a meeting. Jim Lopp is an extremely creative financial advisor as you will see in the articles.

Hope to see you again in the near future.

Best regards,

Cathy

Catherine A. Chandler, Attorney
Alaska Petrochemical Company

Enclosures

CAC:srb

Jim Lopp's innovative bonds

If he were prone to paranoia—which the very self-assured W. James Lopp II, executive vice-president and director of E. F. Hutton & Co., is not—he might think the Treasury Dept. had it in for him. Treasury's November, 1977, cancellation of a financing strategy first tried by Lopp last spring was upheld by Congress last month. Lopp's plan involved advanced refunding of tax-exempt industrial revenue bonds. Treasury also wants to restrict severely tax-exempt pollution control bonds, a concept Lopp pioneered. And it is looking askance at the 39-year-old banker's latest brainchild: tax-exempt, residential-mortgage revenue bonds, which Lopp sees as akin to motherhood. "I don't think Congress and the people would stand for laws against homeownership," he says.

Treasury dislikes the private use of tax-exempt funds. Pollution control bonds, it argues, subsidize companies to do something they should be doing anyway. In Lopp's mortgage bond scheme, used to date by officials in Chicago, Denver, and Pueblo, Colo., a city raises tax-exempt funds that are lent out for low-rate mortgages to middle-income home buyers. This type of financing, says Donald C. Lubick, Assistant Treasury Secretary for tax policy, "undermines the ability of state and local governments to issue bonds for legitimate municipal projects. And it raises interest costs for all issuers of municipal bonds."

Lopp's housing bonds also could play hob with the Federal Reserve Board's attempts to slow the vigorous pace of housing starts by weakening its efforts to reduce the pool of mortgage funds through higher interest rates.

Creative financier. Such turmoil helps explain why the strapping (6 ft.-4 in., 205-lb.) banker with the dazzling smile and infectious enthusiasm is viewed by his critics as opportunistic and irresponsible. But Lopp also is possibly the most creative figure in public finance. "The best thing about Jim Lopp," says a competitor, after claiming he acts "more like a promoter than an investment banker," is that he "keeps the fees up. He sells his ideas, not cheaper service."

Lopp's ideas, and his ability to sell them, helped catapult Blyth Eastman Dillon & Co., where he was a senior vice-president and director, from an also-ran to the upper echelons of municipal underwriting. And Hutton has risen to No. 7 in the field from no ranking at all in 1975, when Lopp and two cohorts from Blyth joined the firm.

Stephen Castagneto



Hutton's Lopp: His latest brainchild has Treasury upset.

The key to Lopp's success is his fertile imagination. "I'm not a technician," he admits. "I thrive on the new idea—conceiving it, structuring it, selling it."

Also instrumental are Lopp's associates, Richard S. Locke and Scott Pierce, both formerly with Blyth and now executives at Hutton. They process and syndicate the business that Lopp, and frequently Locke, bring in. Lopp also relies heavily on the Omaha law firm of Kutak Rock & Huie, specialists in tax-exempt financing.

Shift to underwriting. Aside from dabbling in magic as a hobby, Lopp's background did little to prepare him for public finance. He attended three other colleges before earning a degree in marketing from the University of Mis-

souri. Plans to join his father's pharmaceuticals company went up in smoke with the fire that put the elder Lopp out of business.

Lopp set out to be a stockbroker. After 18 months in the back office of a regional brokerage in Kansas City, Mo., he was made a bond salesman. He moved to New York in 1962 to earn an MBA from Columbia University and work part-time for a now-defunct bond house. After three months at the London School of Economics, he joined Eastman Dillon Union Securities (today Blyth Eastman Dillon) as a municipal bond salesman. "He didn't like selling bonds, and he wasn't very good at it," recalls Locke, whom Lopp says saved his job when he asked for Lopp for his nascent municipal bond underwriting department.

Eschewing the bond fraternity, Lopp joined the Chamber of Commerce. "During lunch I'd hustle uptown, sit next to important people, and pick their brains." He formed his own company to ferret out deals. "I used to write all over the place," he recalls. One possible venture—a one-piece molded golf ball—fell apart when a prototype being tested by columnist and TV emcee Ed Sullivan exploded. A meatpacking plant in northern Nigeria never came off either, but that contact led Lopp to pollution control and to Omaha lawyer Robert J. Kutak.

Airborne life. In 1968, Congress put a $5 million cap on tax-exempt industrial revenue bonds but left a few exceptions—notably pollution control; wharves and airports; and single-family dwelling units. Impervious to the controversial nature of those exceptions, Lopp says he has tried to make a living off them, "and I've done pretty well."

Lopp did the first tax-exempt pollution control financing under the new federal rules in 1971 with an Allegheny County (Pa.) issue for U. S. Steel Corp. Since some 35 states lacked local authorization, he spent years pushing for enabling legislation.

He became almost permanently airborne. "For four years I just rode the airlines. Others would stay with a deal and do it. But I'd bring in [Kutak's] law firm to do the documents and go and get the next deal." Lopp still is on the road at least three weeks a month.

Refunding scheme. Lopp's creative juices seem to be as supercharged as his energy level. He is forever stuffing his attaché case with clippings that suggest financing opportunities.

In 1973 he began work on a tax-exempt financing for the port facilities at Valdez, the southern terminal of the Alaska pipeline, using the 1968 wharf exemption. In the early 1970s he also began developing municipal bond insurance for unrated issuers. "We were turned down by every major insurance company for five years running," he says. Finally, four insurers, led by Aetna Life & Casualty Co., joined in the Municipal Bond Insurers Assn. The MBIA has insured some 660 issues with par value of $3.3 billion, yielding over $50 million in premiums. "It's not huge," says one competitor, "but it certainly has been good for certain issuers."

The MBIA also has been good for Lopp, who owns about 18% of Municipal Issuers Service Corp., the managing agent for the insurers. An affiliated company formed in 1976 to guarantee other financial instruments also is a tidy, though smaller, profit maker.

In 1975, Lopp decided to try advance refunding of the outlawed industrial revenue bonds and went to the IRS for a ruling. It was approved for a Crossett (Ark.) issue for Georgia-Pacific Corp. made in May, 1977. When the IRS not only outlawed the ploy but also canceled any deals already in the works, Lopp was outraged. Rather than walk away licking his wounds, the tenacious banker decided to fight, and, despite his loss on this issue, he does not regret it.

Now Lopp is running hard with the mortgage bonds, which will need much state enabling legislation. "Organizing this effort has been a bear cat," he says, "but I learned from the pollution experience how to do it."

Lopp's imaginative approach to public finance is not without critics

Ready for new ideas. He also has moved into traditional corporate finance activities, with less satisfactory results. And he has been spending about 25% of his time trying to develop international business. "I've been cutting back on it recently," he says. "I can't move in and out that easily."

When Lopp moved to Hutton, says Hutton Chairman Robert M. Fomon, "he told me he wanted to build a department with Dick and Scottie, and he was confident he could do it in three years. After that, he'd take another look."

Lopp is taking that look now. "I've accomplished the goals I've set for myself. Doing it over and over again just isn't exciting." The extensive travel is particularly taxing. "On Friday night those bags are a lot heavier than on Monday morning," he says.

But whether Lopp really could pull back is debatable. More likely is a shift in emphasis. "To keep my vitality," he says, "I've got to come up with new ideas, and I think they may be in Europe. I also could be interested in political office—appointed, not elected." Says Kutak: "Jim's the kind of guy a President needs as Treasury Secretary or negotiating in Geneva. Sadat and Begin would have gotten together a lot sooner if Jim had been around." ■

Growing Up at Kutak Rock & Huie

The Omaha law firm is making a national impact wit

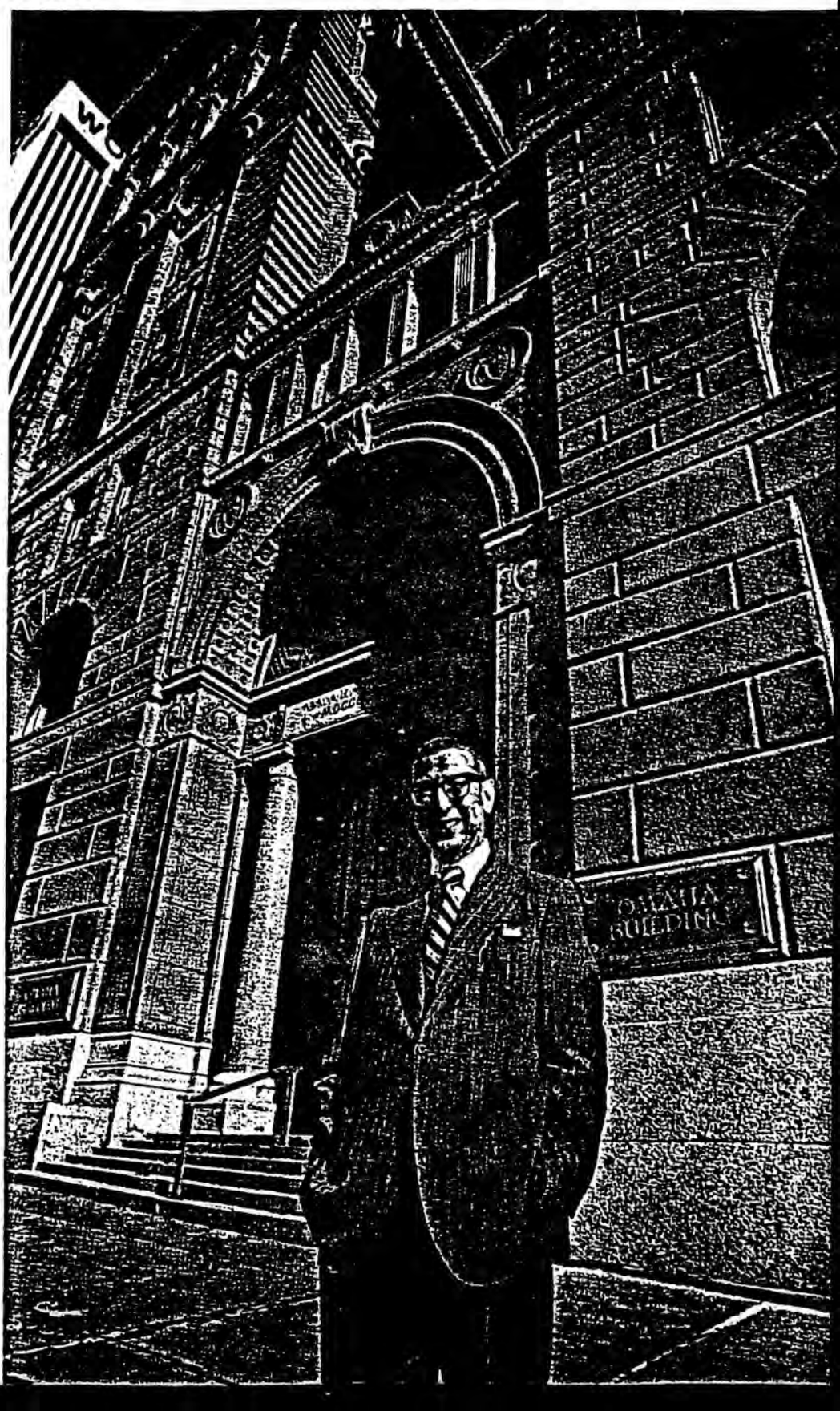
by WALTER KIECHEL III

Kutak Rock & Huie—which could well be the fastest-growing large law firm in the country—did not spring from the canyons of Wall Street, or amid Houston's skyscrapers, or out of the fertile legal soil of Washington, D.C. It started in, of all places, Omaha. Though it has been moving into new cities in the last two years, its largest office is still out in Nebraska, in an unconventional building that hints at the iconoclastic nature of the firm itself.

Working with a solidly serious McKim, Mead & White structure, the partnership enlivened a five-story atrium with a spiral staircase and added other unlawyerly features—like a racquetball court. From this salubrious home base, partners and associates travel across the U.S., often with investment-banker clients, arranging tax-exempt financings. The firm's expertise in this kind of deal helped to catapult it from an unremarkable beginning, with three lawyers in 1965, to its current impressive size. Now, with 148 attorneys, it ranks as one of the forty or fifty largest law firms in the U.S.

Lawyers familiar with the Kutak Rock phenomenon wonder whether the firm is an upstart with a lot to learn, or an innovative enterprise with lessons for the profession at large. Certainly, a lot of young lawyers have been attracted by its unique management style. The partners of Kutak Rock & Huie (the tough names are pronounced *cuetack* and *huey*) pride themselves on having what, in design at least, may be the most democratically managed large legal firm anywhere. Egalitarianism rules, and some of the traditional incentives that spur ambitious lawyers elsewhere are strangely absent. Kutak Rock's avowed policy is to make *every* associate a partner after four and a half years, and attorneys at the firm downplay the distinction between the ranks. Top partners take

Research associate: Jo Thomson



a management style that flouts all the rules.

a smaller share of the profits than they might receive elsewhere so that junior attorneys can be well compensated. Younger lawyers, the firm believes, shouldn't be "exploited."

Acting according to this wisdom, all but one of the fifteen or so top partners at Kutak Rock—known as "1,000 point" partners—took down an identical $80,000 last year. Senior partners at other firms, even in Omaha, can make more, because their compensation is often tied to the amount of work they do or the business they bring in. But not at Kutak Rock, where junior partners advance in lockstep with their "class"—by fifty-point annual increments from a 400-point, $40,000 base. Associates, in turn, are commonly paid better than any of their local contemporaries.

These policies are backed by written articles of faith. A firm charter, agreed upon in 1977, provides that "Relationships among all lawyers, all associated professionals and all support staff will be based upon mutual respect, fairness, selflessness and generosity." By the terms of the charter, all lawyers—partners and associates alike—have one vote apiece when it's time to elect the firm's management.

The man elected last December as the first national chairman was, to absolutely no one's surprise, Robert J. Kutak. If Kutak Rock sometimes seems less a law firm than a jihad against traditional ways of practicing law, then Bob Kutak is its prophet. Bespectacled, crew-cut, a bachelor at age forty-six, he talks the faith constantly.

Kutak lives in a modest apartment, brimful with books and the modern paintings he avidly collects, but he has dreams of grandeur for his firm. He sees it growing to perhaps 400 lawyers in 1983, 175 of them in Omaha—roughly twice the present Nebraska contingent. In his vision, Kutak Rock will enter one new city a year over the next five years. Since 1977, it has merged with, or started up, offices in Atlanta, Denver, and Washington; Minneapolis is already scheduled for next year. By the late 1980's, Kutak expects to have perhaps seventeen offices nationwide.

All this can be wrought, Kutak thinks, without sacrificing the firm's egalitarian character—about which he feels strongly—and without exacting too high a toll from its lawyers. The charter states loftily, "The firm has a commitment to allow and encourage each individual within it to be a whole person." As Kutak sees it, "The greatest problem at many firms is greed." And he professes to have found a way around that. "A law firm should provide an adequate living, but, more than that, it should provide an adequate life. That's where our equity goes—into the professional and social environment."

To enhance the professional environment, Kutak and his colleagues have set up an unusual Department of Research and Education, which he hopes may someday become a "law school within a law firm." The "faculty" now consists chiefly of the former dean of a local law school and occasional visiting professors who write, practice law, or teach Kutak Rock lawyers on the firm's premises.

A fateful wave from the window

Apparently the money is there to support such scholarly efforts, as well as the racquetball court and the other amenities available to all the firm's lawyers. Last year, according to Kutak, the four offices of Kutak Rock & Huie had gross billings of almost $9 million. This year the firm expects to do $11 million to $12 million worth of business.

When Kutak set up the partnership with Harold L. Rock and William G. Campbell in 1965, they began without a single client. The rapid growth of the practice attests to an attribute that doesn't get much play in the charter: these are aggressive lawyers. Just how aggressive is well illustrated by the history of the firm's tax-exempt financing business and, in particular, Kutak Rock's relationship with one individual very active in this area, W. James Lopp II.

Tax-exempt financing today represents somewhere around 35 to 40 percent of the firm's billings. E.F. Hutton, the investment-banking firm with which Lopp is now associated, alone accounts for perhaps a quarter of that.

It wasn't always so. In 1966, Jim Lopp was, by his own description, a singularly unsuccessful twenty-seven-year-old bond salesman at Eastman Dillon. But he was an energetic deal-seeker. When one of the clients he had been nurturing came up with the idea of selling waste-treatment equipment for the Omaha stockyards, the young salesman flew to Nebraska.

There, in the course of a day's negotiations about financing the sale, he met, but barely noticed, a local lawyer who was also involved in the talks—Bob Kutak. That night, alone in Omaha, Lopp was walking the streets when he chanced past the window of a downtown restaurant. Bob Kutak, who was sitting in the place having dinner, waved Lopp in. Then, and later on in the lawyer's apartment, the two men talked about the treatment-plant deal—and about deals in general.

Soon Kutak and his two partners were working with Lopp "seven days a week, sixteen hours a day," as Lopp tells it. "I didn't have enough seniority to pay the guy," Lopp said recently, referring to Kutak. "I told him, 'You've got to believe in what we're doing.' In the first year they were in practice, they supported me." In fact, the firm provided, on a contingency-fee basis, the legal documentation Lopp needed to pull off the deal. When the financing went through, more than a year later, Kutak Rock received $75,000 from the proceeds of the bond offering.

Around the time that work ended, in the late Sixties, the environmental movement was in full swing. "I said to Bob, 'This pollution thing is going to be nationwide,'" recounts Lopp. "Why don't you and I go all over the country on these deals?" Lopp was talking about tax-exempt pollution-control financings, a specialized form of industrial-revenue bond. They are issued by

Chairman Robert J. Kutak founded the firm in this landmark Omaha building in 1965. He and two partners then occupied cramped offices on part of one floor. Today, Kutak Rock holds a fifty-year lease on the building. Its $4.2-million renovation has made the interior an eye-stopping symbol of the law firm's success.

Lawyers in Kutak Rock's Omaha office crowd a staircase spiraling downward through the building's five-story skylit atrium. Those with inner offices can open their windows to take in the occasional concert presented on the atrium's greenery-decked floor.

units of local government, typically municipalities, which can raise money relatively cheaply because the interest they pay is exempt from federal income taxes. The proceeds of the bond issues are used to buy pollution-control equipment for corporate plants operating locally. The corporations, in turn, funnel to the municipality the funds needed to pay principal and interest on the bonds.

Lopp began to ferret out clients aggressively. Kutak's lawyers helped him with the legal intricacies, working up documents tailor-made to the needs of each prospect. Lopp would fly to Michigan one day and Montana the next, making his pitch. Every morning when the peripatetic investment banker arrived at a new airport, he would find either a Kutak Rock attorney or the appropriate packet of documents awaiting him. With practice, the law firm got the cost to its investment-banking client down to $5,000 a packet.

The law firm burgeoned, and Lopp constantly tested its mettle. Just before New Year's Day of 1974, he set out to investigate a deal that was to put a crimp in the holiday plans of some Kutak Rock lawyers. As Lopp tells it, he was feeling a little under the weather after an office party, and was looking for something to keep him busy over the holidays. He got an idea, called Kutak, and the two men flew off to Anchorage, Alaska, the day after Christmas. Their purpose was to win for Lopp's firm—by then renamed Blyth Eastman Dillon—a share of the tax-exempt financing of pollution-control and port facilities for the city of Valdez, the southern terminus of the trans-Alaska pipeline. After looking over the situation, Kutak returned to Omaha on December 29 and "cranked up"—to use Lopp's phrase—about ten of his lawyers. Working through the holiday, they turned out two thick volumes on the proposed deal, which Lopp and Kutak used in making presentations to all the major oil companies at work on the pipeline project. In all, the lawyers produced some 28,000 pages of photocopy. Eventually, this frenetic effort culminated in some profitable business with Atlantic Richfield.

Lopp and Kutak Rock have since moved on to other types of tax-exempt financing. Beginning in the mid-Seventies, they teamed up to push refundings—sales of new tax-exempts, the proceeds of which are eventually used to retire bonds issued earlier, usually at higher rates. In the past two years, Lopp and the firm have together pioneered an innovative form of housing finance. In something of an end run around traditional state housing authorities, a city issues tax-exempt securities, and passes the money to local savings-and-loans. For a fee, the s. and l.'s put the proceeds out as mortgages to individual home buyers, carrying rates a point or two below the market rate in the community. But the rates are high enough to cover the costs of servicing the low-interest tax-exempts.

"I couldn't have a closer friend"

Both the law firm and the investment banker clearly have come out ahead on the deals. Today Lopp is an executive vice president and director of E.F. Hutton, which lured him away from Blyth Eastman Dillon in 1975. Together with Richard Locke, his former boss at Blyth, Lopp presides over a tax-exempt department that has risen from nowhere to seventh place in recent rankings of the number of issues managed by the big Wall Street houses. Says Lopp of Bob Kutak, "I couldn't have a closer friend. I spend more time with Kutak than I do with my own wife."

While the friendship was developing, so was Kutak Rock's reputation as experienced counsel in tax-exempt financing. Along the way, the firm picked up some other impressive clients among the large investment-banking firms, e.g., Lehman Brothers Kuhn Loeb and Paine, Webber, Jackson & Curtis. It still does business with Lopp's former firm and, of course, E.F. Hutton is by far its biggest client in this area. The big Wall Street firms account for about a third of the tax-exempt work. Another third is done for regional investment-banking houses—for example, Piper, Jaffray & Hopwood in Minneapolis, and Boettcher & Co. and Bosworth Sullivan in Denver. The remaining third is billed to

continued

Photographs by Bill Ray

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A racquetball court is only one of the amenities available in the lawyers' club on the top floor of the Kutak Rock building in Omaha. Other features include a large dining-and-meeting room, a kitchen, locker rooms, a bar, and a leather-chaired lounge.

smaller local firms in cities around the country. Service offered these clients includes the use of Kutak Rock's proprietary computer programs, which are used to make the complicated calculations needed to structure a refunding or housing deal.

Aside from tax-exempt financing, the practice of Kutak Rock's four offices remains largely local. Clients, with one or two exceptions, tend to be of middling to small size. In Omaha, the partnership represents J.L. Brandeis & Sons department stores and Father Flanagan's Boys Town, both traditional clients of a local firm with which Kutak Rock merged. The Washington office does legislative and lobbying work for Citibank, a relationship that again results from merger with an existing firm. The Atlanta office has as its principal client MARTA, the city's rapid-transit system, worth about $900,000 a year in legal fees. The lawyers in Atlanta also do work for Standard Federal Savings & Loan Association, some local businesses of the auto-dealership category, and a wide range of litigation clients. Kutak Rock's southern trial attorneys are, for example, currently handling Mrs. Herman Talmadge's divorce from the Senator.

The law firm does not, however, serve as principal outside counsel to any company on the FORTUNE lists of the largest industrial corporations. Some lawyers believe that without such clients, no legal partnership can claim to be a "national firm," which is what Kutak Rock aspires to be. Kutak himself has a loftier-sounding notion of why the firm is seeking what he calls a "national presence." The idea, he says, is not to get clients, but to "better serve each other as lawyers." He envisions that each city will have a specialty, with its expertise available to all the other offices. "Atlanta," he says, "will have expertise in mass-transit law, and Denver in the natural-resources area." Thus an Atlanta client could draw upon tax advice from Washington, consult with agribusiness attorneys from Minneapolis, or have tax-exempt securities work done out of Omaha.

Talent will bring in the business

To build this synergistic empire, Kutak Rock began expanding geographically in 1977 by co[illegible]zation and merger. At the beginning [illegible] the year, the firm—then about sixty attorneys—opened a two-man Denver office with a lawyer dispatched from Omaha and a local Colorado attorney. Continued migration from the mother church swelled the ranks, as did local accessions. The Denver offshoot combined this year with the four-man firm of Moran, Reidy & Voorhees, specialists in oil-and-gas law since 1945. Today, the Denver office has sixteen lawyers.

The Washington office was also opened last year, as a joint venture with Huie Sterne Brown & Ide in Atlanta. Later, a merger with the banking-law partnership of Yingling & Shay added four lawyers, and the Washington office is now up to twelve. Moreover, the Potomac relationship of the Omaha and Atlanta firms blossomed into marriage. Their merger last January added about thirty-five Atlanta lawyers and gave the firm its current name.

By the terms of the merger, Stell Huie is the only "1,000-point" partner whose draw exceeds $80,000. His firm had billings last year of $2.7 million, which Kutak includes in his $9-million total for 1977.

continued

Bob Kutak operates on the unusual principle that it pays to hire good lawyers and set up new offices even before there are clients to foot the bill. The talent, he believes, will bring in the business. But doing things this way can put a drain on profits. The new Denver office, in fact, has only recently become profitable.

There is also a question about how much expansion any law firm can easily digest. While lawyers in the new offices are hustling for clients, they may have difficulty developing the specialties Kutak talks about—and will find it hard to enjoy the professional amenities offered by the Department of Research and Education. It also takes time to develop an interchange between offices. Lawyers in Atlanta and Washington barely know most of their partners and associates in Omaha.

Communication problems can lead to conflict-of-interest questions. For example, the Denver office might unknowingly take on a client with interests clearly adverse to those of a client in Atlanta. Kutak Rock's solution is a centralized computer listing of all clients. Like the bills sent out by the firm, all requests for representation go through Omaha.

The plant that flopped

Kutak Rock hasn't come this far without stirring up controversy. Some critics charge that it is *too* aggressive. In Omaha, for example, there is still carping about the 1966 deal that brought Bob Kutak together with Lopp.

Lopp's client in the Nebraska deal was Fred S. Carver, Inc., a New Jersey company with a process it thought could turn fat and other kinds of packinghouse waste —known as paunch manure—into salable byproducts. Lopp and Carver had hopes that Omaha would sell revenue bonds to finance a plant that would use the process on wastes from the South Omaha stockyards. It was a tempting proposition because pollution in the Missouri River had become so troublesome that environmental authorities had threatened to close down the local meatpackers.

Bob Kutak was involved, at different

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times, with various parties to the deal —Lopp, Carver, the city of Omaha, and the Omaha Pollution Control Corporation (O.P.C.C.). Initially Kutak reviewed papers drawn up by Carver to incorporate the O.P.C.C. He then served as counsel to the new corporation, which was to oversee construction and operation of the pretreatment plant by a Carver subsidiary. Some people found themselves wondering just whose interests Kutak was serving.

But one thing was clear. Kutak was vociferously in favor of the project—even though Carver had never built a plant of this kind and the meatpackers were showing signs that they might abandon South Omaha anyway.

The plant turned out to be a flop. It performed the pretreatment function, but was never able to turn out the byproducts that were to make the Carver subsidiary profitable. Consequently, the subsidiary defaulted on its payments to the city. A bit imprecisely, Omaha wags spoke of the "$11-million toilet that wouldn't flush." The city and the O.P.C.C. sued Carver and its subsidiary to recover the money. Kutak Rock managed the trial work for the plaintiffs. The case still stands as the largest litigation ever handled by the Omaha office. Eventually, it won a $5.3-million judgment, but only against the subsidiary.

Since the subsidiary was bankrupt by that time, however, no money could be recovered. For its work, Kutak Rock collected $178,000 in legal fees from the O.P.C.C. over seven years. But it did not bill the city for what Kutak claimed was an additional $180,000 worth of trial work—perhaps out of some embarrassment over his role in bringing the project into being.

The Hruska connection

Kutak Rock & Huie has also been accused of trading too heavily on its political connections to get work on a number of Nebraska projects that have involved substantial federal funding. The talk derives in part from the presence in the firm of retired Senator Roman Hruska. Since 1976, Hruska has been with the firm in the status lawyers call "of counsel," meaning

continued



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"Some of my colleagues here have already been offered $150,000."

he is not a partner but acts as a sort of elder statesman. The firm's ties to Hruska go back a long way. Kutak's father was a friend of the former Senator, and it was a job in Hruska's law firm that brought young Kutak to Omaha in the first place. Later, during the early Sixties, he served as Hruska's administrative assistant on Capitol Hill. About half a dozen lawyers in the firm worked for the Senator at some point, which suggests that the "Hruska connection" may have been a recruiting tool for Kutak Rock. While lawyers in the firm claim that the Hruska tie has never brought in as much business as some in the Omaha bar darkly hint, it clearly hasn't hurt the practice either.

The "graybeards" learned by doing

The academic credentials of the lawyers the firm has attracted might not impress the snootiest Wall Street lawyer. Twenty-one are graduates of Creighton University Law School in Omaha, fifteen are from the University of Nebraska, and seven are from the University of Georgia. This compares with twelve from Harvard, one from Yale, two from Columbia, and six from the University of Michigan.

The lawyers are comparatively young. In the Omaha office the average age of the partners is thirty-six; in Atlanta, forty-one. Most of the firm's "graybeards" started at Kutak Rock only six or seven years ago, when there were almost no senior attorneys around to teach them. They "learned by doing" municipal bond work and mass-transit law, and missed the apprenticeship experience that more established law firms consider so important in the development of young lawyers. The firm is proud of the lawyers it has attracted from high government positions, but even some of these do not have that much experience in their specialties. For example, the head of the firm's natural-resources department served for two years as assistant attorney general for the Justice Department's Land and Natural Resources Division, but before that had no experience in environmental law.

Kutak Rock's clients don't seem to mind that its young lawyers are thrown into the courtroom, or onto deals, more quickly than some other firms would permit. After all, Wall Street investment bankers can choose their lawyers from among the best. Other practitioners who have worked with the law firm, particularly in the tax-exempt financing area, express admiration in the genteel tones reserved for fellow lawyers. A partner at one Wall Street firm describes Kutak Rock's lawyers as "very professional, a good outfit." He adds, "It's incredible what they've done in the last five years."

This "good outfit" has built its practice on a client base that now has one or two soft spots. The day is gone when Kutak Rock would be crippled if, in a phrase common at the firm, "Bob Kutak's airplane fell from the sky"—or Jim Lopp's. But the percentage of billings accounted for by E.F. Hutton can be considered somewhat troublesome. By specializing in certain fairly restricted areas of tax-exempt financing, the law firm also makes itself vulnerable to changes in Treasury regulations that can, in effect, wipe out a particular type of deal. Two such rulings since last November have already affected its practice in refundings. Outside the tax-exempt area, probably the biggest question mark for Kutak Rock is MARTA. Atlanta's flagship client is making noises about expanding its in-house legal department, a move that could drastically reduce the firm's fees.

Even if the client base remains solid, down the road Kutak Rock faces a challenge born of what may be a contradiction in its goals. Can the partnership maintain its egalitarian philosophy while growing the way it hopes to do?

Larger and larger classes of junior partners will be reaching 1,000-point status every year. At some point, unless the total pie grows very fast, the group at the top may find its dollar draw shrinking. Will a recognized tax-exempt securities expert stay with the firm when he could be making much more elsewhere? Kutak's response is simply to smile and note, "Some of my colleagues here have already been offered $150,000." Apparently, for the time being at least, everyone is quite content in Omaha. F

United States Senate

WASHINGTON, D.C. 20510

December 12, 1978

Honorable Mike Colletta
State Senator
P. O. Box 3188
Anchorage, Alaska 99501

Dear Mike:

It was a pleasure to work with you during the Interim Committee meeting in San Francisco. I have been looking forward to meeting you for some time and was happy to have the opportunity to join in your discussions.

The General Stock Ownership Plan Proposal presents great challenges and I look forward to working with you in the future on this project. If I can be of any help in your efforts to further clarify the issues or resolve questions regarding the GSOP legislation please feel free to call me at Senator Gravel's Washington Office.

Sincerely,

Jerry

Jerry Gauche
Legislative Aide

MG/jg

MIKE GRAVEL
ALASKA

United States Senate

WASHINGTON, D.C 20510

October 26, 1978

Debi Smith, Secretary
Budget and Audit Committee
Alaska State Senate
Pouch W
Juneau, Alaska 99811

Dear Debi:

I am pleased to inform you that the Federal legislation required for the formation of the first General Stock Ownership Plan was included in the final version of the tax bill (H.R. 13511) which cleared the Congress last week.

I have taken the liberty of enclosing a number of items which may be of interest to you. These materials regarding the recently passed GSOP legislation include:

1. Washington Post front page article of Sunday, October 22, 1978

2. Finance Committee report on GSOPs

3. Floor statement fron the Congressional Record of Saturday, October 14, 1978

4. Title VI of H.R. 13511, the GSOP legislation

I hope that you will take the time to review these items. The Kelso firm is hard at work preparing its recommendations to the State and I expect to see this project move ahead quickly.

Thank you for your interest in this subject; and if you have any questions regarding the recently passed legislation, please feel free to contact me.

Sincerely,

Mike

Mike Gravel

MG/jg

Enclosures

STATE OF ALASKA

THE LEGISLATURE
BUDGET AND AUDIT COMMITTEE

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

October 3, 1978

M E M O R A N D U M

TO: The Honorable Mike Colletta
The Honorable Jim Duncan
GSOP Study Directors

FROM: Milt Barker MB
Legislative Finance Division

SUBJECT: Congressional GSOP Actions

Attached is an excerpt from the Congressional Record in which Senator Gravel describes the genesis and rationale of a General Stock Ownership Plan (GSOP) and which contains the provisions of S.3223 which would authorize the establishment of GSOP's. Also attached are a press release and committee report which describe an amendment to H.R. 13511 which would also authorize GSOP's and which was adopted by the Senate Finance Committee in reporting the bill out. The amendment would yet have to pass the hurdles of Senate floor action, approval by conference committee, approval of the conference committee report by both houses, and receive the President's signature.

The language of the amendment is not yet available. However, examining the committee report and press release reveals several significant differences from S.3223. The amendment allows for the chartering of a GSOP only by a state whereas S.3223 would permit political subdivisions of a state to do so. There is no provision in the amendment for a GSOP to use tax-exempt financing as there was in S.3223. Finally, the amendment would not permit another corporation to take a tax deduction for dividends paid to a GSOP as S.3223 would. In fact, the amendment specifically provides that a GSOP may not be affiliated with any other corporation.

Under the amendment, the GSOP would be a tax-exempt corporation with direct investments in various projects. Shareholders are taxed as in subchapter "S" corporations on a pro-rata share of the corporation's income.

Under S.3223, the GSOP would be a trust which could hold stock in various corporations which would be afforded the tax-exemption of their net income to the extent their dividends were paid to a GSOP trust. Trust participants would only be taxed based on actual distributions received.

MBB:pw
Attachments

cc: Steve Cowper
Budget & Audit Committee Members
Terry Gardiner

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 95th CONGRESS, SECOND SESSION

Vol. 124 WASHINGTON, THURSDAY, JUNE 22, 1978 No. 96

Senate

GENERAL STOCK OWNERSHIP PLANS

Mr. GRAVEL. Mr. President, the United States is the world's wealthiest Nation. Our net national worth has tripled since 1925 and now stands at over $6 trillion. This growth has been dramatic, but we should be concerned that a quarter of this growth, nearly $1 trillion of capital expansion, is owned by 1 percent of the population. This is the same 1 percent of our population which controlled 25 percent of our national wealth in 1925 and which today owns over half of all privately held corporate stock and more than 60 percent of all bonds.

Concentrations of wealth are not bad per se, but do create serious problems when many Americans find their labor income insufficient and must rely on Government subsidies for survival. In such a situation it is incumbent upon policymakers to review and correct structural defects which prevent the great majority of citizens from sharing in the Nation's growth.

There is continuing concern over the concentration of wealth in our economy. The Joint Economic Committee has recommended that the broadening of capital ownership be adopted as a national goal. Secretary of the Treasury Blumenthal and other Treasury officials have expressed concern over this concentration as well. But, in spite of this "gnashing of teeth" over the issue, little of substance has been accomplished. The great bulk of our national wealth is still controlled by a very few.

One of our greatest legislative failures is that we have not significantly broadened the ownership of American wealth during the past 50 years. In spite of all our income transfer programs and massive Federal deficits 25 percent of our wealth is still owned by 1 percent of the people. It would be a tragedy indeed if, through our own negligence, the future expansion of our capital stock is similarly concentrated. If it can be said in the year 2000 that 1 percent of our population controls 25 percent of our wealth it will be a great American tragedy and it will be our fault. The failure to insure broader participation in the economy will be laid at our doorstep and the epitaph of the capitalist system may well read, "In failing the people they themselves were doomed to failure."

IT TAKES MONEY TO MAKE MONEY

The old addage, "It takes money to make money," holds more than a grain of truth. To a great extent new wealth is a function of existing wealth. Wealth is generated either through credit or saving. Savings are invested to create new capital while debt may be used in the same way with the earnings of the investment amortizing the loan.

The poor and middle classes are precluded from accumulating wealth through either of these means. Because of our failure to provide access for the less affluent in our society to either existing wealth or debt for the generation of new wealth they are locked into their present status. The great bulk of our citizens cannot save enough from their incomes to generate capital wealth, they must consume what they earn. Neither can they finance new wealth through credit because that requires a guarantee for repayment. The lender needs assurances of repayment if the investment fails to throw off sufficient income to amortize the debt. Existing wealth performs this function for the rich, but the poor have no guarantee to support debt financed access to new wealth. The key to new wealth for the vast majority of Americans is the capacity to guarantee debt. I have structured a program which allows the citizens of a State, acting through their State government, to avail themselves of the guarantee power of the State itself to provide access to new wealth.

I want to emphasize at the beginning that this plan is not one designed to transfer the ownership of existing wealth. I do not propose to play Robin Hood, taking from the rich and giving to the poor. I do propose that more Americans be allowed access to the new wealth required by the future expansion of our economy. I am offering a vehicle through which we can involve all our citizens in the process of generating new productive capacity. By bringing more people into the capital formation process we also allow more people to share in the fruits of that capital, increased income.

ESOP'S: A FIRST STEP

Employee stock ownership plans were developed more than 20 years ago under the pension provisions of the Internal Revenue Code. They have recently received congressional attention and sup-

port beginning with the Pension Reform Act in 1974. In addition to its pension potential, the ESOP also provides a means for the diffusion of capital ownership. Through an ESOP employees can use the corporation's credit to guarantee their leveraged purchase of the company for which they work.

Under an ESOP the employer company establishes a tax exempt pension trust with its employees as beneficiaries. A loan to the trust is guaranteed by the company. The loan proceeds are used to purchase employer stock on behalf of the employees. The debt is repaid by the trust out of pension contributions made to the trust by the employer corporation. The employee receives the stock held for him by the trust either when he retires or terminates his employment.

The ESOP is a very important and useful device for spreading capital ownership, but its scope is severely limited. ESOP's are not available to those Americans who are not employed by corporations sponsoring such plans. Although some 10 million employees are covered by these plans we have neglected the welfare of hundred of millions of Americans. I would like to propose a program offering some opportunity for other Americans to share in our capital growth. My program is a parallel to the ESOP which would be available to all Americans.

THE GENERAL STOCK OWNERSHIP PLAN

Today I urge the adoption of legislation to enable the adoption by States of general stock ownership plans. This proposal finds its origins in the ESOP. It is designed to parallel the tax treatment of ESOP's while expanding the category of eligible individuals beyond the employees of a single company. As with the ESOP the key feature of the GSOP is a tax-exempt trust. However, the GSOP trust is sponsored by a State government with eligibility open to all residents of the State. Payments to the trust are deductible to corporations and tax free to the trust. The trust is required to distribute all its income annually either in repayment of debt or as dividends to the trust participants, the citizens of the State.

Before discussing the operation of GSOP's I should emphasize that the GSOP is not a vehicle for State ownership. In fact, the concept is offered as an alternative to State ownership. In Alaska we have been discussing the possibility of an Alaska State equity interest in the proposed gas pipeline. While such an investment is an exciting opportunity I am concerned about State ownership of private business. Under existing law it would be possible for the State government to make such an investment and pass the profits through to its citizens either in services or tax reductions.

However, I think it is important that ownership in such investments be held by the people directly rather than through the State government. Direct ownership puts spending decisions in the hands of the consumers. State ownership tends to concentrate both economic and political power in the same hands, an unhealthy combination. In addition bureaucratic spending decisions are not always consistent with the needs or desires of the people. Therefore, I think the people of the State should hold direct ownership of any equity interest the State chooses to make in private business. The GSOP can accomplish this goal by using the credit of the State to acquire interests on behalf of the State's citizens.

THE GSOP AT WORK

The GSOP provides an additional and expanded vehicle for capital diffusion. It creates a means for the transfer of what would otherwise be government-owned interests directly to the people. It can be used for the ownership of any revenue producing government project from a sports complex to a power plan. The GSOP puts the profits of operating these essentially private sector enterprises back into the hands of the people where they belong.

To form a GSOP the sponsoring government forms a GSOP trust and appoints trustees. Based on revenue and financial projections, and perhaps a guarantee by the sponsoring State government, the trust borrows money in the private market to make investments. In order to provide for allocation of ownership interests within the trust investment is limited to corporate stock. If the target project is one which is to be initiated by the GSOP a corporation is formed to hold the assets themselves.

Within the GSOP trust the newly acquired stock is allocated one share each to persons who have resided in the State for at least a year who choose to participate. All residents are eligible regardless of age and new residents may apply for participation once they have fulfilled the 1 year requirement. The stock of the corporation allocated to the trust participants is voted by them so that control of the investment is in the hands of the citizens and not the sponsoring State government.

The loan to the trust used to finance the purchase of stock must be repaid through the use of the investment proceeds. The corporation makes payments to the trust for this purpose which are deductible to the corporation up to its full taxable income. The trust, however, cannot accumulate income and must distribute out what it receives from the corporation either as loan payments, operating expenses or dividends to the participants. Cash dividends to participants are treated as dividends on corporate stock and taxed accordingly. Since this dividend amount is deductible to the corporation when paid to the trust we have effectively eliminated the double tax on corporate earnings.

The GSOP trust is designed not only to provide income for the participants, but to provide actual capital ownership

as well. Without access to the GSOP stock the participant would be like the spendthrift nephew whose uncle provides a trust from which he can only receive the income. Despite his extreme need he cannot sell off the trust assets to pay his gambling debts and avoid the malice of his creditors. I believe that there are a minimum of never-do-well nephews in our society and that most Americans are capable of making their own spending and capital allocation decisions.

Without providing for direct ownership of the stock a plan such as the one I propose would be unduly paternalistic. Therefore, the GSOP trust must, upon request, distribute the stock held for a participant to him after 5 years of participation. Distribution of the stock to the participant will not preclude continuing integration of the corporate tax so long as the corporation continues to make its dividend payments through the trust. The stock is not taxed upon distribution to the participant, but if the participant sells the stock the proceeds are taxed as ordinary income. In addition to the tax consequences upon a sale of the GSOP stock no person may own more than 10 shares of any corporation's GSOP stock.

WHAT CAN A GSOP MEAN

In working with the GSOP concept I became curious as to what such a program might mean to individuals participating in the program. Using Alaska as an example I turned to our oil pipeline since State participation was being sought in the comparable gas pipeline. British Petroleum owns a 15.85-percent interest in the oil pipeline and their revenue and cost figures are available through testimony before the Federal Energy Regulatory Commission. Assuming a purchase price of $1.5 million with 100-percent financing through tax-exempt bonds over 20 years at 5.5 percent interest this asset could produce $500 annually in 1978 dollars for every citizen of the State of Alaska and more than $800 annually after the debt is retired; $2,000 per year for a family of four is a substantial amount for citizens in parts of Alaska where median income is less than $3,000 per year.

I am not suggesting that GSOP's are appropriate for all State owned and operated activities or that they constitute the whole solution to the problem of capital concentration. However, they can and will provide an additional tool available to assist the broad mass of Americans to participate in capital ownership. Mr. President, I would ask unanimous consent that my bill be reprinted in the RECORD.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S. 3223

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled.

SECTION 1. GENERAL STOCK OWNERSHIP TRUSTS.

Subsection (c) of section 501 of the Internal Revenue Code of 1954 (relating to list of exempt organizations) is amended by adding at the end thereof the following new paragraph:

"(22) A general stock ownership trust which is established in writing by the United States or the government of a State or a political subdivision of a State exclusively for the purpose of broadening stock ownership and integrating the corporate income tax by purchasing, receiving, holding, pledging, and distributing securities (within the meaning of section 251(b)) of one or more corporations, and which is empowered to receive, hold, and distribute amounts paid to the trust by corporations whose securities are held by the trust (or trust participants) and incur, amortize, and guarantee indebtedness in furtherance of the trust purposes, but only if the trust—

"(A) provides for participation by all residents of the sponsoring jurisdiction as of the date each such resident completes at least 12 consecutive months of residency within the jurisdiction,

"(B) provides for the allocation of one share of each issue of securities held by the trust to the account of each participant (within the meaning of section 251(b)) as of the last day of the trust year in which the individual initially becomes a participant in the trust in a manner which does not discriminate among such participants on the basis of race, sex, age, income, or ownership of property,

"(C) provides that each participant has a nonforfeitable right to any stock allocated to his account but that no stock allocated to a participant's account may be distributed to the participant from that account before the last day of the trust year next following the trust year of the participant's death or, if earlier, the last day of the trust year next following the later of—

"(i) the participant's completion of 5 years of participation in the trust, or

"(ii) the participant's attainment of 18 years of age,

"(D) provides that all amounts received by the trust will be distributed not later than the due date for the filing of the trust's information return under section 6033 for the trust year in which such amounts are received,

"(F) provides that no person may purchase or otherwise acquire except by gift or devise from any participant directly or indirectly more than ten shares of any security held by or upon which dividends are distributed through the trust, and

"(G) meets such other requirements as the Secretary may be regulation prescribe.".

SEC. 2. INCOME TAX TREATMENT OF DISTRIBUTIONS FROM GENERAL STOCK OWNERSHIP TRUSTS.

Securities (as defined in section 251 (b) of the Internal Revenue Code of 1954) transferred to a participant or to the account of a participant in a trust described in section 501 (c) (22) of the Internal Revenue Code of 1954 shall not be considered income of the participant under the Internal Revenue Code of 1954 until such time as the participant sells or exchanges such a security. Amounts paid by the trust in connection with securities held by the trust in the account of a participant shall not be considered income of the participant under the Internal Revenue Code of 1954 until actually received by the participant and, at such time, shall be

treated, for purposes of such Code, as dividends.

SEC. 3. CORPORATE DEDUCTION FOR AMOUNTS PAID TO GENERAL STOCK OWNERSHIP TRUSTS.

(a) In General.—Part VIII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to special deductions for corporations) is amended by adding at the end thereof the following new section:

"SEC. 251. AMOUNTS PAID TO A GENERAL STOCK OWNERSHIP TRUST.

"(a) GENERAL RULE.—In the case of a corporation there shall be allowed as a deduction an amount equal to the amount paid for the taxable year by such corporation to a trust described in section 501 (c) (22), not in excess of the amount determined by multiplying the corporation's net taxable income (determined without regard to any deduction allowable under this section) by a fraction, the numerator of which is the total number of shares of the corporation's securities held by the trust (including shares held by participants in the trust which were acquired, other than by purchase, from the trust) and the denominator of which is the total number of shares of the corporation's securities outstanding. Amounts paid to the trust not later than the date established by law for filing the corporation's return of tax for a taxable year, including any extension thereof, shall be treated as paid for that taxable year.

"(b) DEFINITIONS.—For purposes of this section and sections 4975(c)(4) and 501(c)(22)—

"(1) Distributed.—The term 'distributed' means actually paid to the participants of the trust, paid as ordinary and necessary expenses of trust operation, or paid in retirement of debt principal and interest incurred in furtherance of the trust's purposes.

"(2) Participant.—The term 'participant' means any individual for whom an account is maintained under a trust described in section 501(c)(22), for whose benefit allocations are made under the trust, and to whom benefits are distributed from the trust, and any individual who succeeds to the interest of a participant in a transaction in which gain is not recognized.

"(3) Securities.—The term 'securities' means common stock issued by a corporation with voting power and dividend rights no less favorable than the voting power and dividend rights of other common stock issued by the corporation.".

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 251. Amounts paid to a general stock ownership trust.".

SEC. 4. FAILURE TO DISTRIBUTE.

Section 4975(c) of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amended by adding at the end thereof the following new paragraph:

"(4) Special rule for general stock ownerships trusts.—It shall be a prohibited transaction within the meaning of this section for a trust described in section 501(c)(22) to fail to distribute all amounts transferred to it as required by section 501(c)(22)(E).".

SEC. 5. EXEMPTION OF GENERAL STOCK OWNERSHIP TRUSTS FROM TAX ON UNRELATED BUSINESS INCOME.

Section 511(a)(2) of the Internal Revenue Code of 1954 (relating to organizations subject to tax) is amended by inserting "or in section 501(c)(22)" after "section 501(c)(1)".

SEC. 6. ELIGIBILITY FOR INDUSTRIAL DEVELOPMENT BONDS.

Section 103(b)(3) of the Internal Revenue Code of 1954 (relating to exempt persons) is amended by adding at the end thereof the following new subparagraph:

"(C) an organization described in section 501(c)(21).".

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act, and the provisions of section 2 of this Act, shall apply with respect to taxable years beginning after December 31, 1976.

PRESS RELEASE

FOR IMMEDIATE RELEASE
September 21, 1978
P.R. #74

UNITED STATES SENATE
COMMITTEE ON FINANCE
2227 Dirksen Senate Office Bldg.

FINANCE COMMITTEE ACTS ON CAPITAL GAINS, OTHER PROVISIONS IN TAX CUT BILL (H.R. 13511)

General Stock Ownership Plans

Under present law, income of a corporation, less allowable deductions and exclusions, is generally taxable to the corporation and, if distributed to shareholders as dividends, is taxable to the shareholders in the year in which it is received.

It is possible to establish a special "subchapter S" corporation which is subject to different tax treatment. Where an eligible corporation elects under the subchapter S provisions of the Internal Revenue Code, the income or loss (except for certain capital gains) is not taxed to the corporation, but each shareholder reports a share of the corporation's income or loss each year in proportion to his share of the corporation's total stock outstanding. However, treatment as a subchapter S corporation is restricted to situations in which there are a limited number of shareholders.

The Committee agreed to provide special income tax treatment to certain State-chartered corporations established within a five-year period. These corporations would be exempt from Federal income taxation. Shareholders of these corporations would be taxed currently on their pro rata share of the corporation's taxable income (computed with receipts and deductions netted at the corporate level) in a manner similar to that available to subchapter S corporations under current law. However, unlike a subchapter S corporation, there would be no numerical limitation on the number of shareholders in these State-chartered corporations. Also, losses incurred by these corporations would not flow through to shareholders; instead they could be used by the corporations as net operating loss carryforwards against future income.

At least 90 percent of the income of these corporations which is not used to pay corporate operating expenses would be required to be distributed to the shareholders each year. However, these distributions would not be eligible for any exclusion for dividends received and would not constitute earned income for purposes of the maximum tax on earned income.

All residents of a State which charters such a corporation are eligible to become shareholders in the corporation and would be allocated a stock interest in the corporation. No shareholder who is allocated stock in such a corporation may sell or otherwise dispose of this stock for five years after receiving it. Any one individual may not purchase or otherwise acquire more than 10 shares of stock in any one such corporation. Only citizens within the State which charters such a corporation may acquire these shares of stock, whether they are obtained from the corporation or a shareholder.

Any State which charters such a corporation must report to the Congress each year during which the corporation is in existence and must file a final report to the Congress at the end of five years.

THE FOLLOWING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

J. General Stock Ownership Corporations

(Sec. 201 of the bill)

Present law

Under present law, there are no special provisions relating to the establishment of a private corporation for the benefit of the residents of a State.

Reasons for change

The committee believes that many citizens should have a greater ownership stake in the private enterprise system, and that this would lead to better understanding of the system and would encourage individuals to invest in other business enterprises. Also, in the case of individuals now receiving various forms of transfer payments from Federal, State, or local governments, the receipt of dividend income from a General Stock Ownership Corporation (GSOC) would, to some extent, reduce the need for such payments. The committee believes that an experimental program permitting States to form such private corporations for the benefit of their citizens may enable the Congress to study a method of replacing transfer payments with dividend income.

Explanation of provisions

General.—Under the committee bill, a State would be authorized to establish a GSOC for the benefit of its citizens. It is anticipated that the GSOC would be authorized to borrow money to acquire business enterprises. The cash flow from the operation of the business would be used to pay the loan, and the corporate revenues would be distributed to the GSOC shareholders (i.e., the citizens of the State).

Definition of GSOC.—The bill provides that a corporation must meet certain statutory tests in order to be treated as a GSOC. First, the corporation must be chartered by an official act of the State legislature or by a State-wide referendum. Second, the GSOC's corporate charter must provide for the issuance of all authorized shares to eligible individuals provided that at least one share is issued to each eligible individual, and such eligible individual does not elect within one year after the date of issuance not to receive such share, and provides for certain restrictions on the transferability of the shares. The transfer restriction must provide that the shares cannot be transferred until the earliest to occur of (1) the expiration of 5 years from issuance,

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This rule applies to an election made under either subdivision (i) or (ii) of Treasury Regulations § 1.761-2(b) (2), relating to the method of electing not to be treated as a partnership.

(2) death or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, an individual may not acquire more than 9 shares by purchase. Third, the charter must provide that the GSOC is empowered to invest in properties (not including properties acquired by it or for its benefit through the right of eminent domain). Fourth, the GSOC may not be affiliated with any other corporation. Fifth, the GSOC must be organized after December 31, 1979, and before January 1, 1984. An eligible individual is any individual who is a resident of the chartering State as of the date specified in the corporate charter. A State may define a resident for purposes of its GSOC so long as such definition is consistent with constitutional principles.

Election.—A GSOC must make an election to obtain the special statutory treatment provided for by the amendment. The election is effective for the taxable year for which it is made on a timely filed tax return. The manner in which the election is to be made would be determined by regulations. The election once made is irrevocable unless terminated with the consent of the Secretary of the Treasury.

Effect of election.—The effect of the election would be to exempt the corporation from Federal income taxation. Instead, the shareholders of the GSOC would report their proportionate part of the GSOC's taxable income on their Federal individual income tax returns.

Treated as a private corporation.—A GSOC would be treated as a private corporation.

Computation of GSOC income.—The GSOC would compute its taxable income in the same manner as a regular corporation with certain modifications. The GSOC would not be eligible for a dividends received deduction nor any tax credits.

Net operating loss deduction.—The shareholders of a GSOC would not be eligible to report any portion of a GSOC net operating loss on their individual income tax return. Instead, the GSOC would be entitled to a 10-year carryover of any net operating losses.

Investment tax credit and recapture of investment tax credit.—Under the bill, shareholders of the GSOC would be entitled to their pro-rata share of the GSOC's investment tax credit. The shareholders would also be personally responsible for any recapture of such investment tax credit. Neither the corporation nor its shareholders would be entitled to the foreign tax credit.

Taxation of shareholders.—Under the bill, each shareholder would include in his gross income his daily prorated portion of the GSOC's taxable income. Such income would be included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. The income in the hands of the shareholder would be treated as ordinary income and would not be eligible for either the partial dividend exclusion (sec. 116) or the maximum tax on earned income.

Shareholders would increase the tax basis of shares of stock in the GSOC to the extent they reported income from the GSOC. Distributions from the GSOC out of such previously taxed income would decrease the tax basis of such shares.

Taxation of GSOC distributions.—Under the bill, distributions from a GSOC's taxable income previously taxed to a shareholder would

be treated as a tax-free distribution. Any distribution in excess of such previously taxed income would be taxed in the same manner as a distribution from a regular corporation (sec. 59 (c)).

Audit adjustments and amended tax returns.—Any audit adjustment resulting from an Internal Revenue Service determination would be reflected in the GSOC's taxable year in which such adjustment is made (and not the taxable year to which it relates). The amount of such adjustment would be subject to an interest charge in an amount computed as though the income had been taxed to a nonelecting corporation.

Reporting requirements.—Under the bill, a GSOC would be required to file a Federal income tax return and a computer-coded data entering information reported to each of its shareholders. The corporate tax return would be required to meet the same filing requirements as a regular corporation. In addition, a GSOC would be required to file each shareholder a Form 1099. The Form 1099 would report (1) the shareholder's pro rata income for the taxable year, (2) tax-free distributions for the year, (3) the tax treatment of other distributions, and (4) the amount of any investment tax credit and recapture thereof for such year, and (5) any amounts withheld for Federal income tax purposes.

Distribution requirements.—A GSOC would be required to distribute 90 percent of its taxable income to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 50 percent of the deficiency (i.e., the difference between the required distribution and the actual distribution) would be imposed on the GSOC. The amount of such tax would be allowed as a deduction to the GSOC for the year in which it is paid.

Withholding requirements.—The bill requires the GSOC to withhold an amount equal to 20 percent of every distribution made to its shareholders. The amount of such withholding would be allowed as a refundable credit to the shareholder. The Treasury would be authorized to issue regulations providing a certification procedure for individuals who are nontaxpayers under which they may be exempted from the withholding requirement.

Studies.—It is expected that a study would be made of the effect GSOC's have on competition with regular private corporations. It is also anticipated that a study would be made of the GSOC as a form of full corporate integration.

Taxable year end of GSOC.—The bill requires a GSOC to adopt a taxable year end of October 31. It is anticipated that most GSOC's would elect an October 31 year end. This would enable them to close their books and meet their shareholder reporting requirements by January 31 of the next succeeding year.

Effective date

The provision applies to corporations chartered and organized after December 31, 1978.

Revenue effect

The revenue cost of the proposal is expected to be negligible during the next five years. However, the long-run cost could be substantial.

THE PRECEDING DOCUMENT(S) MAY NOT FILM
LEGIBLY BECAUSE OF POOR QUALITY OF THE
ORIGINAL.

Synopsis of the letter from Louis O. Kelso
to Senator Mike Colletta and Representative Jim Duncan
dated September 26, 1978

Note: All conclusions of the letter seem to be based on the assumption that the tax environment will remain stable or will in fact, become more favorable in GSOP's.

1. It will be difficult to develop a GSOP emphasizing individual choice.

2. A GSOP can, under the proper federal regulations, allow the development of capital ownership by persons who can not develop this capital ownership under any other system given today's economic environment. The reasons for this phenomenon are as follows:

a. The GSOP operates on pre-tax dollars.

b. Presently under a GSOP a person is not taxed on the money financed to purchase the stock, nor is he or she taxed on the stock itself. If Federal and State tax laws are ultimately developed according to Kelso's recommendations; the GSOP will be taxed either at a regular income tax rate or at a capital gains tax rate when the stock is sold. According to two-factor theory there should be no tax on the stock at all. In a nut-shell, two-factor theory can be defined as allowing a person, on the basis of his or her good credit, to acquire stock; the person would then pay the purchase price of the stock off with the profits, or dividends of the stock. (*) p 3

c. The theory of two-factor economics is based upon the following premise:

In the technological life style of today a person needs the "power of labor" AND the "power of capital" to acquire the productive power necessary to live. (#) p3 The "power of labor" is acquired at birth since slavery is outlawed in the United States. The "power of capital" can not be acquired by more than a few under the present system. Due to the nature of our technological society the value of the "power of labor" is decreasing as compared with the value of the "power of capital." Therefore, a new system must be implemented to preserve the integrity of the US Constitution. A tenet of the new system, as proposed in two-factor economics, is the tax treatment of a GSOP. Since the stock is not earning income until the dividends have paid the purchase price, the stock should not be taxed until the consumer is in fact earning an income from his or her stock.

d. It is imperative that a proper tax and legal environment be maintained to assure the success of GSOP's. At the present time it will involve structuring or restructuring federal and state laws.

e. The most comprehensive plan developed to broaden the captial base is called the "Financed General Capital Ownership Plan" (FINGCOP) which is closely related to a GSOP.

f. The concept of a FINGCOP must be federally implemented to be effective. Following are some of the concepts which would have to be legislated or guarenteed to assure the FINGCOP's success.

1. Corporation's would have to guarentee that all profits, after debt service, depreciation and operating reserves, would be periodically declared as dividends rather than reinvested. Corporation's would have to have a guarentee of an assured source of similar financing by their lending institution and by the Federal Reserve Board of Governors as long as future capital requests are feasible and reasonable.

2. Individuals buying stock should not have to pay corporate income taxes on their purchase. Eventually all corporate income taxes should be eliminated leaving only individual income taxes.

3. Dividends applied to the purchase of the stock should not be taxed. Dividends received after the purchase price has been paid should be taxed only at the individual income tax rate. This tax should not be applied until the stock is sold, and only if it is not reinvested within 60 days in "income-yielding productive capital."

4. An insurance corporation (Suggested title: Capital Diffusion Insurance Corporation [CDIC]) must be formed to facilitate the confidence of the lending institutions. It would be comparable to the FHA insurance program; but the premiums should be cheaper. It could be done by either a public agency or private enterprise or by both.

5. The money for the purchase of the stock will be provided through lending institutions directly from the Federal Reserve Bank. The price of that money shall not exceed the administrative and policing costs of the FRB and the lending institution (estimated 3%). The loans would be made directly into escrows and the lending institution would provide counseling for the borrower. The loan could be refused by the lending institution if it found the diversification of the borrower's portfolio too narrow. Loan limits would be set by law, as would eligibility requirements.

g. It will be difficult to develop a GSOP emphasizing individual choice because of the present tight money situation (high interest rates), low potential dividends by corporations, and the present tax policies at the federal level. This situation is such that the stock purchaser could never pay off the loan. (Shades of 1929 stock market crash??)

Melso stated that he will do his best to incorporate freedom of choice into the design study.

Enclosed in the correspondence from Louis O. Kelso was a letter from Louis O. Kelso, Inc. to President Gerald Ford concerning the present Keynesian Economic theory VS the concept outlined above. It also included a letter concerning Ford's summit conference on inflation and Kelso's proposal as given at that summit conference.

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* It sounds like the GSOP does to "capital" what the voluntary indentured servant did to "labor."

The Right to Life is guarenteed under the Constitution. The two-factor theory has defined "life" as living within a "reasonable life-style that suits him (any American citizen)."

KELSO & CO.
INCORPORATED

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7454

LOUIS O. KELSO
PRESIDENT

September 26, 1978

The Honorable Mike Colletta
Alaskan State Senator

Dear Senator:

As requested by Milt Barker, we are sending under separate cover two copies of each of our books. While all of them are in print, except TWO-FACTOR THEORY: THE ECONOMICS OF REALITY, we hope to get that back in print soon. However, our own supply of them is quite limited.

Also enclosed is a copy of a short bibliography showing where the books (except TWO-FACTOR THEORY) can now be ordered. We would recommend that your Committee order as many sets as it might desire of the Congressional testimony referred to in the bibliography, since it is quite comprehensive.

Best regards,

Sincerely,

Louis O. Kelso

LOK:ch

Our work on the tying and sequencing is taking longer than we estimated, but it should be completed by next week end.

LOK

31-01:LH

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

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.

(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 terminate on February 1, 1979 unless extended or terminated by written agreement.

CLAUSE III - PRJECT DIRECTOR

The Project Director shall be Sen. Mike Colletta & Rep. Jim Duncan, 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 - $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. 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.

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.

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

Louis O. Kelso
President & Chief
Executive Officer

September 1, 1978
Date

THE STATE OF ALASKA

Mike Colletta 25 Aug 78

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

John C. Sackett

Sen. John Sackett — Date
Chairman, Senate
Finance Committee

20 Sept 1978

Rep. Steve Cowper — Date
Chairman, House
Finance Committee

Jim Duncan 1 Sept 78

Rep. Jim Duncan — Date
Vice-Chairman, Legislative
Budget & Audit 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 SUCH 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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

June 5, 1978

The Hon. Mike Gravel
United States Senator
4107 Dirksen Senate Office Building
Washington, D.C. 20510

Attention: Mr. Jerry Gauche

Dear Jerry:

With your note of May 24, 1978, you enclose "the latest GSOP draft" and comment that "we are getting closer." I have strained every brain cell I have and reflected on every relevant bit of experience that I have, and yet I cannot avoid my response springing up from your comment — "Perhaps, but to what?"

My deep regard for you and for Senator Gravel, for your courageous and forthright concerns to work out solutions to the major world problem of the day — workable methods of wealth generation and income distribution that are consistent with political democracy and a free-market, private property economy, and my own life-long dedication to these goals, compel me to say that I do not think the concept of a GSOP that you are working with is sound, that therefore it will be successfully attacked from many quarters, and that if it were enacted into legislation, I think it would create confusion from a source where a reputation for sound thinking is being built. If my analysis is in error, please show me where the error lies. My following comments spring only from a sense of duty, and not at all from a desire to second guess.

Here is the problem as I see it.

Assuming that the theoretically distinct legal and business institutions (I will call them "tools") for financing business on the one hand, and for making the poor rich (to the maximum extent practical in each instance) that have been developed to date are:

1) The ESOP,
2) The CSOP,
3) The GSOP,

let us examine the similarities and distinguishing characteristics of each:

Similarities and Differences:

a) Each is a financing device. Each would function to serve the general goals of accelerating economic growth and broadening legitimate acquisition of capital ownership without any added advantages arising out of changes in the income tax laws. Indeed, each would function best if there were no corporate income tax laws at all. (See Exhibit A attached.) But time of transition in the establishing and implementing of a new economic policy built on Two-Factor Economics is critical. The signs of impending economic collapse are alarming. And there are corporate and personal income tax laws. To the extent that changes in the tax laws can accelerate the goals of a Two-Factor policy, for the benefit of people, business and government, then it makes sense to speed the process with tax reforms. But it is basic to recognize that each of the three methods is a financing method, not a method of taxation or a method of paying compensation.

b) Each of these three methods applies primarily to a category of circumstances. The ESOP, while financing a wide variety of transactions for corporate businesses, is particularly suited to enabling employees to acquire economic independence over a reasonable working lifetime. If given further legislative encouragement by measures such as H.R. 462 which was introduced but not acted upon in the 94th Congress, the adoptions of ESOPs would be speeded up enormously, the welfare burdens of the future and thus the costs of government and the burdens of taxpayers, would be shrunken rapidly, and the personel tax base would be immeasurably enlarged.

c) The CSOP selects consumers as those to have capital ownership built into them, while being capable of meeting all financing needs of the future of certain kinds of businesses. It is suitable only to relatively large, capital intensive businesses where experience has shown long-sustained patronage or seller-customer relations to be the norm. It is particularly applicable to regulated public utilities; to banks, to savings banks; to savings and loan associations, and to various other enterprises. Investment is required in proportion to patronage, and thus the resulting capital ownership created by CSOPs is proportioned to patronage. Corporate customers of a CSOP might easily be required to pass through their shares to their stockholders to prevent the use of the method to concentrate wealth ownership. The only

CSOP established to date (1958-65) but an enormously successful one, is Valley Nitrogen Producers, one of the largest agricultural chemical producers in California, and a tremendous success.

d) CSOPs, used in conjunction with ESOPs, are ideal for financing the conversion of mutual companies of all sorts -- savings and loan associations, savings banks, insurance companies, commercial banks, etc. All these face gaping financing deficiencies in the near and distant future. All of these, except perhaps converted mutual insurance companies, should be owned by individual stockholders within the communities in which they operate. All should have broad constituencies. ESOP conversion, with, say, an arbitrary allocation of 25% to 35% of the stock to the employees through their ESOP and the remainder of their stock becoming owned by their customers, with eligibility of the loan financing paper to Federal Reserve discounting at the pure administrative cost to the Federal Reserve System, would put us into a 10-15% economic growth pattern, while building matching consumer power in the public utility field and in the savings and loan and banking fields. The present need for this low-cost financing in these two fields is recognized by experts in these industries today.

e) The unique characteristic of the GSOP (which Mortimer Adler and I at first called the Financed Capital Ownership Plan in THE NEW CAPITALISTS (1961) and in my testimony before the Heineman Commission in May, 1969) is that its stockholder constituency is selected politically because no other method seems appropriate. For that reason we have urged their use (in Puerto Rico and in Alaska) only when no other method seems to solve the problem.

f) The economies of Puerto Rico and Alaska are unique, and each has economic challenges and circumstances not found in the other 49 states in general. In the case of Puerto Rico, it has its own separate tax system. It had (and still has) a higher percentage of unemployment, and government employment than any state. In the case of Alaska, it has a high level of wealth in relation to its population size and only a GSOP would do the job. Absent these unusual circumstances, the GSOP is by its nature a nationwide plan. Its appropriate constituencies would be the elderly poor, the social security recipients as a way of phasing out their social security, enlarging their income and making them economically independent, government employees, the welfare-dependent, the chronically unemployed; in every case a nationwide constituency, selected by Congress.

g) The GSOP is a method almost useless without its contemplated direct link to the monetary system. It is, at heart, a method of changing from the monetization of welfare, as we are doing today, with the inevitable vaporization of the value of our monetary unit, to

monetizing self-liquidating productive capital. It is a method of converting inflation into deflation, with uniformly beneficial side effects. It has with the rarest of exceptions no application to a political entity smaller than a sovereign nation having its own monetary system. It is basically national in character, not suited for states, counties, cities, in each of which it could begin to function as a governmental encroachment on private enterprise.

h) There have been good reasons for not "pushing" the GSOP in the U.S. economy as a whole, until a high growth level has been achieved through ESOPs and CSOPs and until a substantial part of the goal of general affluence has been achieved, apart from the unique characteristics of the economies of Alaska and Puerto Rico. The building of a national capital structure large enough to produce a high general standard of living will require maximum motivation of all potential members of the labor force to enter it and get the job done. My estimate is an economy with a capital structure in excess of seven times the capacity of the present one, on a per-capita basis.

i) One could easily differ with this reasoning and argue that the GSOP is imperative now in order to build capital ownership into government workers, the elderly, the unemployable, etc. If so, then it must be approached as a national program, not one that can be adopted by states, counties, cities or towns. It must broadly meet the financing requirements of business, and the legislative measures that accompany it must powerfully encourage equity financing and discourage debt financing, the availability of GSOP financing must be so clearly reliable that, again by legislative or tax measures, the high-payout of the yield on equity (restoration of private property in capital, the ownership of which is represented by corporate stock) can be required or motivated. The entire relationship of the process for qualification of the stocks of business corporations for ESOP financing and the registration of securities for SEC purposes must be integrated and simplified. The trusts (escrows) established to receive loan financing from banks, with CDIC insurance, must be of such nature as to promote long-term investment, not short-term (5 year) speculation, and finally a financing transaction that simply puts the average man in a position to buy capital with credit and to pay for it out of what it produces, must not be misinterpreted as an income or compensation transaction in the one-factor sense of the word and taxed as income. It is not income, and to so treat it would be to take two centuries to do what can be accomplished in 25 years.

Politically, Jerry, I think the CSOP is the thing to offer all 50 states in return for their support to Federal Reserve discount rights for the Alaskan GSOP within four or five years when it will be needed. The steps could be initiated now if desired; the sooner, the better. I do not think the Senate and House Banking Committees are

going to be the obstacles you visualize because they know they are facing otherwise unsolveable problems.

But if you and the Senator think otherwise, I am ready to help. We are talking about either a new administrative agency or a new division in the Department of Commerce, and a whole new set of laws and amendments to existing securities laws, tax laws, welfare laws, social security laws, etc.

I sincerely believe the present approach would produce nothing but confusion.

Please tell me what you think.

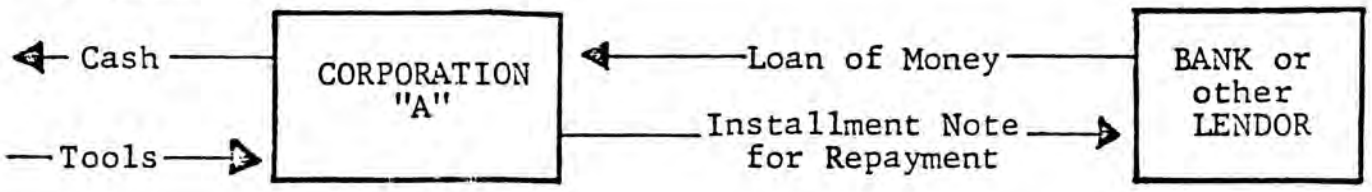
Warm regards to you and the Senator,

Louis O. Kelso

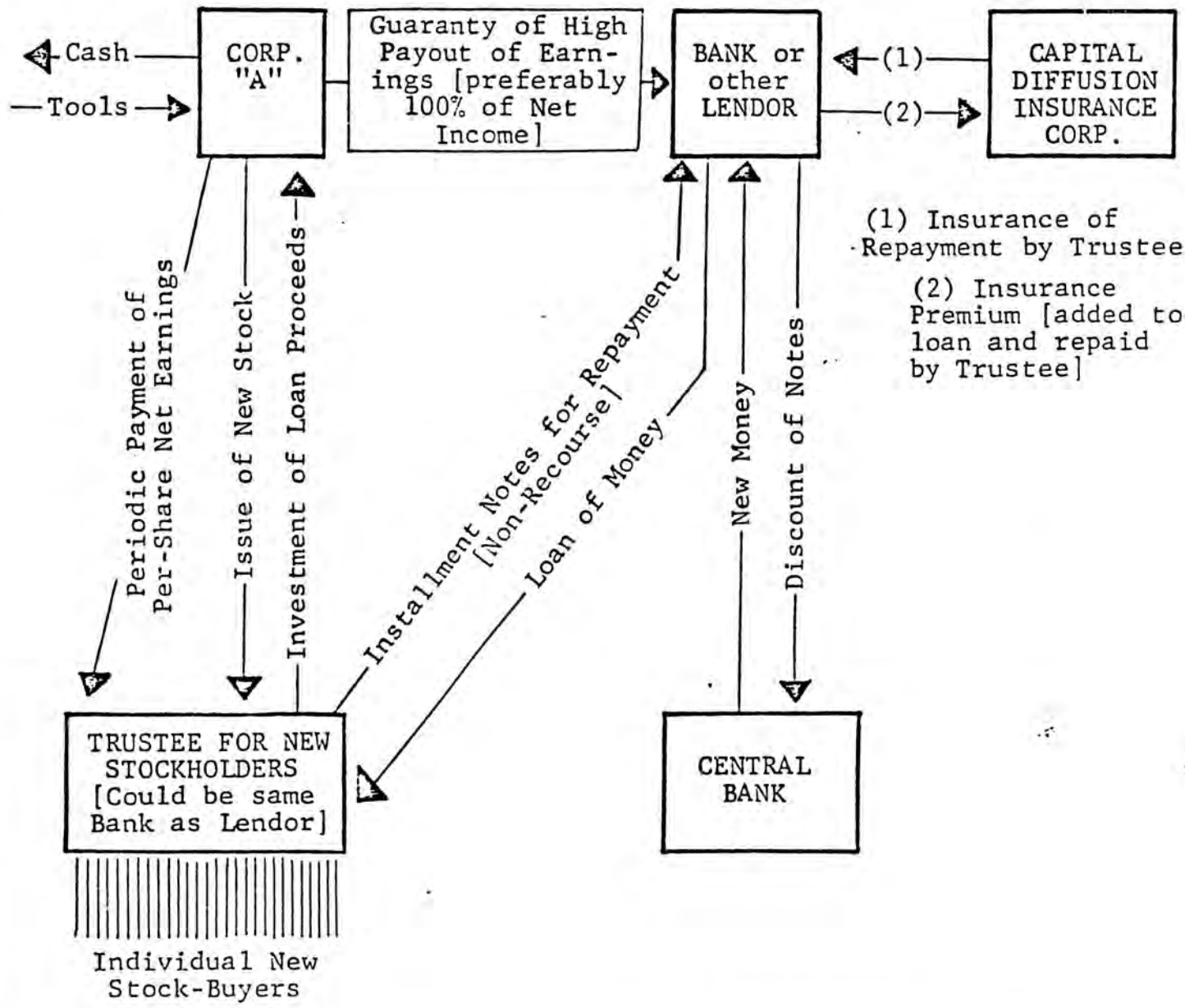
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COMPARISON OF THE CONCENTRATING EFFECT OF CONVENTIONAL CORPORATE FINANCE
WITH
THE EMPLOYEE STOCK OWNERSHIP PLAN (ESOP) TECHNIQUE OF
SIMULTANEOUSLY FINANCING NEW CAPITAL FORMATION
AND CREATING NEW CAPITAL OWNERS
WITHOUT IMPAIRING THEIR SAVINGS OR INCOMES FROM OTHER SOURCES*

I. THE CONVENTIONAL METHOD:



II. THE FINANCED CAPITALIST or
THE ESOP ALTERNATIVE:



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* Copyright Kelso & Co., Incorporated 1978

EXPLANATION of CHART 10:

1. Method I above illustrates the economic effect of financing new corporate capital formation either through retained earnings or through borrowings repaid from retained earnings. In either case, when the loan is repaid, the productive power of a stationary body of stockholders is increased by the newly formed capital. No new shareholders are created.

2. Method II illustrates how, if corporate income taxes are eliminated, and corporate net earnings are fully paid out currently, so that the full income-producing power of real (i.e., physical) capital is made available to new stock purchasers, they can pay for their stock from the income produced by the underlying tools and assets, without diminishing their savings or reducing their consumption. The managements of large and stable corporations know that newly formed capital is self-financing, since a new expansion normally will not be undertaken unless it will quickly pay for itself -- usually in 3 to 5 years. But the conventional method of finance [Method I] makes this self-financeability available only to existing stockholders. Method II enables new stockholders to utilize it as well. By making the self-financeability of newly formed capital in well-managed businesses available to the propertyless majority, as well as to the capital-owning minority, Method II enables the many to raise their power to engage in production through capital ownership and thus to raise their consumer income. Thus, Method II is a method of building consumer power (i.e., markets) along with new productive power. To eliminate doubts of the bank or other lendor, a loan insurance plan is proposed, similar to the Federal Housing Insurance Corporation home mortgage plan in the U.S. and other similar national housing mortgage insurance plans.

3. Finally, since a new valid corporate strategy that increases production and sales, and also raises the power of financially under-powered workers and the unemployed to consume by making them owners of productive capital, should increase national growth rates in most industrial economies by 3 or 4 times previous rates [even more for developing economies], it must be assumed that all available accumulations of financial savings would be exhausted at an early date. The financed-capitalist paper must then be made discountable at a nominal rate with the central bank. This, in effect, finances new capital formation out of pure credit and monetizes newly formed capital in central bank-approved, well-managed corporations, where newly formed capital only comes into existence if it will, in the judgment of corporate management, pay for itself quickly; and then continue to produce goods or services indefinitely thereafter, its productiveness constantly restored through depreciation policies which set aside sufficient funds for that purpose before net income is computed. Because newly formed capital will continue to throw off goods and services indefinitely after the credit (loan and interest) has been repaid, this technique has the virtue, if properly used, of making continuously and simultaneously possible:

(a) Expansion of production of goods and services with rising worker incomes and without increases in

unit costs, free of any limitations imposed by unavailability of accumulated financial savings. Thus, this technique can free an economy without savings accumulations from dependence on foreign investors.

(b) Progressive deflation with expanding opportunities of the non-capital-owning majority to acquire rising incomes through capital ownership. This proposal is the exact reverse of the inflationary process of one-factor economic systems under which labor demands progressively more pay for less work, packing the wage bill with welfare and using the price system to tax the public. As labor discovers it <u>is</u> the public, it must again and again repeat the inflationary process.

4. For further discussion, see:

SUGGESTED READING ON TWO-FACTOR ECONOMICS

<u>Books</u>

THE CAPITALIST MANIFESTO by Louis O. Kelso and Mortimer J. Adler (Random House, New York, 1958; Greenwood Press, Westport, Connecticut, 1975)

THE NEW CAPITALISTS by Louis O. Kelso and Mortimer J. Adler (Random House, New York, 1961; Greenwood Press, Westport, Connecticut, 1975)

TWO-FACTOR THEORY: THE ECONOMICS OF REALITY by Louis O. Kelso and Patricia Hetter (Random House, New York, 1967; Paperback Edition, Vintage Press, 1968; available at all B. Dalton Bookstores)

<u>Testimony</u>

Testimony by Louis O. Kelso before the Joint Economic Committee, U.S. Congress, December 11-12, 1975, on "Employee Stock Ownership Plan Financing and Other Financing Concepts Based on Two-Factor Economics"

Testimony by Louis O. Kelso, Norman G. Kurland and Patricia Hetter before the Senate Finance Committee, U.S. Congress, March 31, 1976, on "Major Tax Revisions and Extension of Expiring Tax Cut Provisions"

<u>Reports and Publications</u>

"ESOPS: An Analytical Report" prepared for the Profit Sharing Council of America, Chicago, Illinois, by Hewitt Associates, Deerfield, Illinois

"Employee Stock Ownership Plans" prepared by The Committee of Publicly Owned Companies, New York, New York

"Uprooting World Poverty: A Job for Business" from the Fall 1964 issue of BUSINESS HORIZONS, Indiana University, Graduate School of Business.

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By_____
Louis O. Kelso, President
and Chief Executive Officer

United States of America

Congressional Record

PROCEEDINGS AND DEBATES OF THE 95th CONGRESS, SECOND SESSION

Vol. 124 WASHINGTON, THURSDAY, JUNE 22, 1978 No. 96

Senate

GENERAL STOCK OWNERSHIP PLANS

Mr. GRAVEL. Mr. President, the United States is the world's wealthiest Nation. Our net national worth has tripled since 1925 and now stands at over $6 trillion. This growth has been dramatic, but we should be concerned that a quarter of this growth, nearly $1 trillion of capital expansion, is owned by 1 percent of the population. This is the same 1 percent of our population which controlled 25 percent of our national wealth in 1925 and which today owns over half of all privately held corporate stock and more than 60 percent of all bonds.

Concentrations of wealth are not bad per se, but do create serious problems when many Americans find their labor income insufficient and must rely on Government subsidies for survival. In such a situation it is incumbent upon policymakers to review and correct structural defects which prevent the great majority of citizens from sharing in the Nation's growth.

There is continuing concern over the concentration of wealth in our economy. The Joint Economic Committee has recommended that the broadening of capital ownership be adopted as a national goal. Secretary of the Treasury Blumenthal and other Treasury officials have expressed concern over this concentration as well. But, in spite of this "gnashing of teeth" over the issue, little of substance has been accomplished. The great bulk of our national wealth is still controlled by a very few.

One of our greatest legislative failures is that we have not significantly broadened the ownership of American wealth during the past 50 years. In spite of all our income transfer programs and massive Federal deficits 25 percent of our wealth is still owned by 1 percent of the people. It would be a tragedy indeed if, through our own negligence, the future expansion of our capital stock is similarily concentrated. If it can be said in the year 2000 that 1 percent of our population controls 25 percent of our wealth it will be a great American tragedy and it will be our fault. The failure to insure broader participation in the economy will be laid at our doorstep and the epitaph of the capitalist system may well read, "In failing the people they themselves were doomed to failure."

IT TAKES MONEY TO MAKE MONEY

The old addage, "It takes money to make money," holds more than a grain of truth. To a great extent new wealth is a function of existing wealth. Wealth is generated either through credit or saving. Savings are invested to create new capital while debt may be used in the same way with the earnings of the investment amortizing the loan.

The poor and middle classes are precluded from accumulating wealth through either of these means. Because of our failure to provide access for the less affluent in our society to either existing wealth or debt for the generation of new wealth they are locked into their present status. The great bulk of our citizens cannot save enough from their incomes to generate capital wealth, they must consume what they earn. Neither can they finance new wealth through credit because that requires a guarantee for repayment. The lender needs assurances of repayment if the investment fails to throw off sufficient income to amortize the debt. Existing wealth performs this function for the rich, but the poor have no guarantee to support debt financed access to new wealth. The key to new wealth for the vast majority of Americans is the capacity to guarantee debt. I have structured a program which allows the citizens of a State, acting through their State government, to avail themselves of the guarantee power of the State itself to provide access to new wealth.

I want to emphasize at the beginning that this plan is not one designed to transfer the ownership of existing wealth. I do not propose to play Robin Hood, taking from the rich and giving to the poor. I do propose that more Americans be allowed access to the new wealth required by the future expansion of our economy. I am offering a vehicle through which we can involve all our citizens in the process of generating new productive capacity. By bringing more people into the capital formation process we also allow more people to share in the fruits of that capital, increased income.

ESOP'S: A FIRST STEP

Employee stock ownership plans were developed more than 20 years ago under the pension provisions of the Internal Revenue Code. They have recently received congressional attention and sup-

port beginning with the Pension Reform Act in 1974. In addition to its pension potential, the ESOP also provides a means for the diffusion of capital ownership. Through an ESOP employees can use the corporation's credit to guarantee their leveraged purchase of the company for which they work.

Under an ESOP the employer company establishes a tax exempt pension trust with its employees as beneficiaries. A loan to the trust is guaranteed by the company. The loan proceeds are used to purchase employer stock on behalf of the employees. The debt is repaid by the trust out of pension contributions made to the trust by the employer corporation. The employee receives the stock held for him by the trust either when he retires or terminates his employment.

The ESOP is a very important and useful device for spreading capital ownership, but its scope is severely limited. ESOP's are not available to those Americans who are not employed by corporations sponsoring such plans. Although some 10 million employees are covered by these plans we have neglected the welfare of hundred of millions of Americans. I would like to propose a program offering some opportunity for other Americans to share in our capital growth. My program is a parallel to the ESOP which would be available to all Americans.

THE GENERAL STOCK OWNERSHIP PLAN

Today I urge the adoption of legislation to enable the adoption by States of general stock ownership plans. This proposal finds its origins in the ESOP. It is designed to parallel the tax treatment of ESOP's while expanding the category of eligible individuals beyond the employees of a single company. As with the ESOP the key feature of the GSOP is a tax-exempt trust. However, the GSOP trust is sponsored by a State government with eligibility open to all residents of the State. Payments to the trust are deductible to corporations and tax free to the trust. The trust is required to distribute all its income annually either in repayment of debt or as dividends to the trust participants. the citizens of the State.

Before discussing the operation of GSOP's I should emphasize that the GSOP is not a vehicle for State ownership. In fact, the concept is offered as an alternative to State ownership. In Alaska we have been discussing the possibility of an Alaska State equity interest in the proposed gas pipeline. While such an investment is an exciting opportunity I am concerned about State ownership of private business. Under existing law it would be possible for the State government to make such an investment and pass the profits through to its citizens either in services or tax reductions.

However, I think it is important that ownership in such investments be held by the people directly rather than through the State government. Direct ownership puts spending decisions in the hands of the consumers. State ownership tends to concentrate both economic and political power in the same hands, an unhealthy combination. In addition bureaucratic spending decisions are not always consistent with the needs or desires of the people. Therefore, I think the people of the State should hold direct ownership of any equity interest the State chooses to make in private business. The GSOP can accomplish this goal by using the credit of the State to acquire interests on behalf of the State's citizens.

THE GSOP AT WORK

The GSOP provides an additional and expanded vehicle for capital diffusion. It creates a means for the transfer of what would otherwise be government-owned interests directly to the people. It can be used for the ownership of any revenue producing government project from a sports complex to a power plan. The GSOP puts the profits of operating these essentially private sector enterprises back into the hands of the people where they belong.

To form a GSOP the sponsoring government forms a GSOP trust and appoints trustees. Based on revenue and financial projections, and perhaps a guarantee by the sponsoring State government, the trust borrows money in the private market to make investments. In order to provide for allocation of ownership interests within the trust investment is limited to corporate stock. If the target project is one which is to be initiated by the GSOP a corporation is formed to hold the assets themselves.

Within the GSOP trust the newly acquired stock is allocated one share each to persons who have resided in the State for at least a year who choose to participate. All residents are eligible regardless of age and new residents may apply for participation once they have fulfilled the 1 year requirement. The stock of the corporation allocated to the trust participants is voted by them so that control of the investment is in the hands of the citizens and not the sponsoring State government.

The loan to the trust used to finance the purchase of stock must be repaid through the use of the investment proceeds. The corporation makes payments to the trust for this purpose which are deductible to the corporation up to its full taxable income. The trust, however, cannot accumulate income and must distribute out what it receives from the corporation either as loan payments, operating expenses or dividends to the participants. Cash dividends to participants are treated as dividends on corporate stock and taxed accordingly. Since this dividend amount is deductible to the corporation when paid to the trust we have effectively eliminated the double tax on corporate earnings.

The GSOP trust is designed not only to provide income for the participants, but to provide actual capital ownership

as well. Without access to the GSOP stock the participant would be like the spendthrift nephew whose uncle provides a trust from which he can only receive the income. Despite his extreme need he cannot sell off the trust assets to pay his gambling debts and avoid the malice of his creditors. I believe that there are a minimum of never-do-well nephews in our society and that most Americans are capable of making their own spending and capital allocation decisions.

Without providing for direct ownership of the stock a plan such as the one I propose would be unduly paternalistic. Therefore, the GSOP trust must, upon request, distribute the stock held for a participant to him after 5 years of participation. Distribution of the stock to the participant will not preclude continuing integration of the corporate tax so long as the corporation continues to make its dividend payments through the trust. The stock is not taxed upon distribution to the participant, but if the participant sells the stock the proceeds are taxed as ordinary income. In addition to the tax consequences upon a sale of the GSOP stock no person may own more than 10 shares of any corporation's GSOP stock.

WHAT CAN A GSOP MEAN

In working with the GSOP concept I became curious as to what such a program might mean to individuals participating in the program. Using Alaska as an example I turned to our oil pipeline since State participation was being sought in the comparable gas pipeline. British Petroleum owns a 15.85-percent interest in the oil pipeline and their revenue and cost figures are available through testimony before the Federal Energy Regulatory Commission. Assuming a purchase price of $1.5 million with 100-percent financing through tax-exempt bonds over 20 years at 5.5 percent interest this asset could produce $500 annually in 1978 dollars for every citizen of the State of Alaska and more than $800 annually after the debt is retired; $2,000 per year for a family of four is a substantial amount for citizens in parts of Alaska where median income is less than $3,000 per year.

I am not suggesting that GSOP's are appropriate for all State owned and operated activities or that they constitute the whole solution to the problem of capital concentration. However, they can and will provide an additional tool available to assist the broad mass of Americans to participate in capital ownership. Mr. President, I would ask unanimous consent that my bill be reprinted in the RECORD.

There being no objection, the bill was ordered to be printed in the RECORD, as follows:

S. 3223

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. GENERAL STOCK OWNERSHIP TRUSTS.

Subsection (c) of section 501 of the Internal Revenue Code of 1954 (relating to list of exempt organizations) is amended by adding at the end thereof the following new paragraph:

"(22) A general stock ownership trust which is established in writing by the United States or the government of a State or a political subdivision of a State exclusively for the purpose of broadening stock ownership and integrating the corporate income tax by purchasing, receiving, holding, pledging, and distributing securities (within the meaning of section 251(b)) of one or more corporations, and which is empowered to receive, hold, and distribute amounts paid to the trust by corporations whose securities are held by the trust (or trust participants) and incur, amortize, and guarantee indebtedness in furtherance of the trust purposes, but only if the trust—

"(A) provides for participation by all residents of the sponsoring jurisdiction as of the date each such resident completes at least 12 consecutive months of residency within the jurisdiction,

"(B) provides for the allocation of one share of each issue of securities held by the trust to the account of each participant (within the meaning of section 251(b)) as of the last day of the trust year in which the individual initially becomes a participant in the trust in a manner which does not discriminate among such participants on the basis of race, sex, age, income, or ownership of property,

"(C) provides that each participant has a nonforfeitable right to any stock allocated to his account, but that no stock allocated to a participant's account may be distributed to the participant from that account before the last day of the trust year next following the trust year of the participant's death or, if earlier, the last day of the trust year next following the later of—

"(i) the participant's completion of 5 years of participation in the trust, or

"(ii) the participant's attainment of 18 years of age,

"(D) provides that all amounts received by the trust will be distributed not later than the due date for the filing of the trust's information return under section 6033 for the trust year in which such amounts are received,

"(F) provides that no person may purchase or otherwise acquire except by gift or devise from any participant directly or indirectly more than ten shares of any security held by or upon which dividends are distributed through the trust, and

"(G) meets such other requirements as the Secretary may be regulation prescribe.".

SEC. 2. INCOME TAX TREATMENT OF DISTRIBUTIONS FROM GENERAL STOCK OWNERSHIP TRUSTS.

Securities (as defined in section 251 (b) of the Internal Revenue Code of 1954) transferred to a participant or to the account of a participant in a trust described in section 501 (c) (22) of the Internal Revenue Code of 1954 shall not be considered income of the participant under the Internal Revenue Code of 1954 until such time as the participant sells or exchanges such a security. Amounts paid by the trust in connection with securities held by the trust in the account of a participant shall not be considered income of the participant under the Internal Revenue Code of 1954 until actually received by the participant and, at such time, shall be

treated, for purposes of such Code, as dividends.

SEC. 3. CORPORATE DEDUCTION FOR AMOUNTS PAID TO GENERAL STOCK OWNERSHIP TRUSTS.

(a) In General.—Part VIII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to special deductions for corporations) is amended by adding at the end thereof the following new section:

"SEC. 251. AMOUNTS PAID TO A GENERAL STOCK OWNERSHIP TRUST.

"(a) GENERAL RULE.—In the case of a corporation there shall be allowed as a deduction an amount equal to the amount paid for the taxable year by such corporation to a trust described in section 501 (c) (22), not in excess of the amount determined by multiplying the corporation's net taxable income (determined without regard to any deduction allowable under this section) by a fraction, the numerator of which is the total number of shares of the corporation's securities held by the trust (including shares held by participants in the trust which were acquired, other than by purchase, from the trust) and the denominator of which is the total number of shares of the corporation's securities outstanding. Amounts paid to the trust not later than the date established by law for filing the corporation's return of tax for a taxable year, including any extension thereof, shall be treated as paid for that taxable year.

"(b) DEFINITIONS.—For purposes of this section and sections 4975(c)(4) and 501(c)(22)—

"(1) Distributed.—The term 'distributed' means actually paid to the participants of the trust, paid as ordinary and necessary expenses of trust operation, or paid in retirement of debt principal and interest incurred in furtherance of the trust's purposes.

"(2) Participant.—The term 'participant' means any individual for whom an account is maintained under a trust described in section 501(c)(22), for whose benefit allocations are made under the trust, and to whom benefits are distributed from the trust, and any individual who succeeds to the interest of a participant in a transaction in which gain is not recognized.

"(3) Securities.—The term 'securities' means common stock issued by a corporation with voting power and dividend rights no less favorable than the voting power and dividend rights of other common stock issued by the corporation.".

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 251. Amounts paid to a general stock ownership trust.".

SEC. 4. FAILURE TO DISTRIBUTE.

Section 4975(c) of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amended by adding at the end thereof the following new paragraph:

"(4) Special rule for general stock ownerships trusts.—It shall be a prohibited transaction within the meaning of this section for a trust described in section 501(c)(22) to fail to distribute all amounts transferred to it as required by section 501(c)(22)(E).".

SEC. 5. EXEMPTION OF GENERAL STOCK OWNERSHIP TRUSTS FROM TAX ON UNRELATED BUSINESS INCOME.

Section 511(a)(2) of the Internal Revenue Code of 1954 (relating to organizations subject to tax) is amended by inserting "or in section 501(c)(22)" after "section 501(c)(1)".

SEC. 6. ELIGIBILITY FOR INDUSTRIAL DEVELOPMENT BONDS.

Section 103(b)(3) of the Internal Revenue Code of 1954 (relating to exempt persons) is amended by adding at the end thereof the following new subparagraph:

"(C) an organization described in section 501(c)(21).".

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act, and the provisions of section 2 of this Act, shall apply with respect to taxable years beginning after December 31, 1978.

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as well. Without access to the GSOP stock the participant would be like the spendthrift nephew whose uncle provides a trust from which he can only receive the income. Despite his extreme need he cannot sell off the trust assets to pay his gambling debts and avoid the malice of his creditors. I believe that there are a minimum of never-do-well nephews in our society and that most Americans are capable of making their own spending and capital allocation decisions.

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S. 3223

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

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"(A) provides for participation by all residents of the sponsoring jurisdiction as of the date each such resident completes at least 12 consecutive months of residency within the jurisdiction,

"(B) provides for the allocation of one share of each issue of securities held by the trust to the account of each participant (within the meaning of section 251(b)) as of the last day of the trust year in which the individual initially becomes a participant in the trust in a manner which does not discriminate among such participants on the basis of race, sex, age, income, or ownership of property,

"(C) provides that each participant has a nonforfeitable right to any stock allocated to his account, but that no stock allocated to a participant's account may be distributed to the participant from that account before the last day of the trust year next following the trust year of the participant's death or, if earlier, the last day of the trust year next following the later of—

"(i) the participant's completion of 5 years of participation in the trust, or

"(ii) the participant's attainment of 18 years of age,

"(D) provides that all amounts received by the trust will be distributed not later than the due date for the filing of the trust's information return under section 6033 for the trust year in which such amounts are received,

"(F) provides that no person may purchase or otherwise acquire except by gift or devise from any participant directly or indirectly more than ten shares of any security held by or upon which dividends are distributed through the trust, and

"(G) meets such other requirements as the Secretary may be regulation prescribe.".

SEC. 2. INCOME TAX TREATMENT OF DISTRIBUTIONS FROM GENERAL STOCK OWNERSHIP TRUSTS.

Securities (as defined in section 251 (b) of the Internal Revenue Code of 1954) transferred to a participant or to the account of a participant in a trust described in section 501 (c) (22) of the Internal Revenue Code of 1954 shall not be considered income of the participant under the Internal Revenue Code of 1954 until such time as the participant sells or exchanges such a security. Amounts paid by the trust in connection with securities held by the trust in the account of a participant shall not be considered income of the participant under the Internal Revenue Code of 1954 until actually received by the participant and, at such time, shall be

treated, for purposes of such Code, as dividends.

SEC. 3. CORPORATE DEDUCTION FOR AMOUNTS PAID TO GENERAL STOCK OWNERSHIP TRUSTS.

(a) In General.—Part VIII of subchapter B of chapter 1 of the Internal Revenue Code of 1954 (relating to special deductions for corporations) is amended by adding at the end thereof the following new section:

"SEC. 251. AMOUNTS PAID TO A GENERAL STOCK OWNERSHIP TRUST.

"(a) GENERAL RULE.—In the case of a corporation there shall be allowed as a deduction an amount equal to the amount paid for the taxable year by such corporation to a trust described in section 501 (c) (22), not in excess of the amount determined by multiplying the corporation's net taxable income (determined without regard to any deduction allowable under this section) by a fraction, the numerator of which is the total number of shares of the corporation's securities held by the trust (including shares held by participants in the trust which were acquired, other than by purchase, from the trust) and the denominator of which is the total number of shares of the corporation's securities outstanding. Amounts paid to the trust not later than the date established by law for filing the corporation's return of tax for a taxable year, including any extension thereof, shall be treated as paid for that taxable year.

"(b) DEFINITIONS.—For purposes of this section and sections 4975(c)(4) and 501(c)(22)—

"(1) Distributed.—The term 'distributed' means actually paid to the participants of the trust, paid as ordinary and necessary expenses of trust operation, or paid in retirement of debt principal and interest incurred in furtherance of the trust's purposes.

"(2) Participant.—The term 'participant' means any individual for whom an account is maintained under a trust described in section 501(c)(22), for whose benefit allocations are made under the trust, and to whom benefits are distributed from the trust, and any individual who succeeds to the interest of a participant in a transaction in which gain is not recognized.

"(3) Securities.—The term 'securities' means common stock issued by a corporation with voting power and dividend rights no less favorable than the voting power and dividend rights of other common stock issued by the corporation.".

(b) CLERICAL AMENDMENT.—The table of sections for such part is amended by adding at the end thereof the following new item:

"Sec. 251. Amounts paid to a general stock ownership trust.".

SEC. 4. FAILURE TO DISTRIBUTE.

Section 4975(c) of the Internal Revenue Code of 1954 (relating to prohibited transactions) is amended by adding at the end thereof the following new paragraph:

"(4) Special rule for general stock ownerships trusts.—It shall be a prohibited transaction within the meaning of this section for a trust described in section 501(c)(22) to fail to distribute all amounts transferred to it as required by section 501(c)(22)(E).".

SEC. 5. EXEMPTION OF GENERAL STOCK OWNERSHIP TRUSTS FROM TAX ON UNRELATED BUSINESS INCOME.

Section 511(a)(2) of the Internal Revenue Code of 1954 (relating to organizations subject to tax) is amended by inserting "or in section 501(c)(22)" after "section 501(c)(1)".

SEC. 6. ELIGIBILITY FOR INDUSTRIAL DEVELOPMENT BONDS.

Section 103(b)(3) of the Internal Revenue Code of 1954 (relating to exempt persons) is amended by adding at the end thereof the following new subparagraph:

"(C) an organization described in section 501(c)(21).".

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act, and the provisions of section 2 of this Act, shall apply with respect to taxable years beginning after December 31, 1978.

MAILING LIST FOR
KELSO AND COMPANY

RE: GSOP Study

Sen. Mike Colletta, Chairman
Budget and Audit Committee
PO Box 3188
Anchorage, AK 99501

Rep. Jim Duncan, Vice-Chairman
Budget and Audit Committee
RR 4 Box 4316
Juneau, AK 99803

Sen. Frank R. Ferguson
Budget and Audit Committee
PO Box 131
Kotzebue, AK 99752

Rep. Sam Cotten
Budget and Audit Committee
Box 296
Eagle River, AK 99577

Sen. John C. Sackett
Budget and Audit Committee
1547 LaTouche
Anchorage, AK 99501

Rep. Bill Miles
Budget and Audit Committee
PO Box 4-2038
Anchorage, AK 99509

Sen. Clem Tillion
Budget and Audit Committee
PO Box 373
Homer, AK 99603

Rep. Leo P. Schaeffer, Jr.
Budget and Audit Committee
General Delivery
Kobuk, AK 99751

Sen. Edward C. Willis
Budget and Audit Committee
Box 402
Eagle River, AK 99577

Rep. Rick Urion
Budget and Audit Committee
PO Box 868
Juneau, AK 99802

Sen. George Hohman
Pouch V
Juneau, AK 99811

Rep. C. V. "Chat" Catterton
2308 Boniface Pkwy
Anchorage, AK 99504

Senator Ted Stevens
United States Senate
260 Russell Building
Washington, DC 20510

Senator Mike Gravel
United States Senate
3121 Dirksen Senate Office Building
Washington, DC 20510

Sterling Gallagher, Commissioner
Department of Revenue
Pouch S
Juneau, AK 99811

Jay Hogan, Director
Legislative Finance
Pouch WF
Juneau, AK 99811

Tyler Jones, Alaska Coordinator
Office of Senator Gravel
Federal Building
PO Box 2283
Anchorage, AK 99510

Milt Barker, Fiscal Analyst
Legislative Finance
Pouch WF
Juneau, AK 99811

Debi Smith, Secretary
Budget and Audit Committee
Pouch W
Juneau, AK 99811

AGSOC EDUCATIONAL COMMITTEE
P.O. Box 3160
Anchorage, Alaska 99510

MAY 3 1980

April 25, 1980

Avrum M. Gross,
Attorney General
State of Alaska
Pouch K
Juneau, Alaska 99811

Dear Mr. Attorney General:

On behalf of the AGSOC Educational Committee I would like to request that I be notified in the event that the Attorney General's office is requested to consider or on its own motion considers whether the Alaska General Stock Ownership Corporation's initiative should remain on the November 1980 general election ballot. As you can imagine, any determination regarding the initiative is of great concern to the Committee and we appreciate your assistance in this matter.

With best regards.

Sincerely,

Mike Gravel

MG:jg
cc: B. Fahrenkamp
M. Colletta

A copy of our report is filed and available for inspection with the
Alaska Public Offices Commission, Anchorage, Alaska 99501