

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

897 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

- Section 7: This section authorizes the governor to appoint nine persons to act as incorporators and the initial board of directors of the Alaska General Stock Ownership Corporation. This is the section which actually provides for the creation of a GSOC in Alaska. The section restricts share ownership of this corporation to Alaska residents and requires that shares be sold when a shareholder leaves the state or dies leaving his stock to an outsider. It also creates a special fund, not to exceed five million dollars, in the Dept. of Revenue to be used in guaranteeing private loans for the corporation's startup expenses.
- Section 8: Section 1 of the bill amends Rule 23.1 of the Rules of Civil Procedure, dealing with derivative suits by shareholders of a general stock ownership corporation. Because it is amending a rule of the courts this provision must be approved by a 2/3 vote of each house. To allow separation of the vote section 8 amends the court rule.
- Section 9: This section provides for an immediate effective date for the Committee bill.
- Section 10: This section provides for a January 1, 1980 effective date for sections 4-6 which amend the criminal sanctions in the bill to parallel the treatment provided in the new criminal code which also becomes effective January 1, 1980.

SECTION BY SECTION ANALYSIS

This analysis of House State Affairs Committee action on the Alaska General Stock Ownership Corporation legislation describes the provisions of Section 1 of the Committee draft as of April 19, 1979. Since many of the provisions of the draft are carried over wholly or in part from the Alaska Business Corporations Act (ABCA) there is included at the end of each section description a reference to the corresponding section of the ABCA, if any.

ARTICLE 1. SUBSTANTIVE PROVISIONS.

- .005. PURPOSES. This section makes it clear that, unless the enabling legislation for a GSOC provides otherwise, the corporation may engage in any legal business. (ABCA 10.05.003).
- .010. GENERAL STOCK OWNERSHIP CORPORATIONS. This section makes it clear that corporation organized under chapter 50, Title 10, are general stock ownership corporations subject to Internal Revenue Code Subchapter "U" and are not agencies of the state for any purpose.
- .015. GENERAL POWER. This section grants to GSOCs the powers of normal corporations to conduct business. Two changes have been made in adapting the ABCA provisions to GSOCs.
 - 1) There is a limitations in (4) preventing a GSOC from investing in property "acquired by it, or for its benefit, through the right of eminent domain" This limitation prevents GSOCs from acting in collusion with an agency or local government to acquire a going business from an unwilling seller. GSOCs are not prevented from investing in projects where some minor portion of the project is acquired through condemnation if the local government determines that the exercise of its condemnation power is appropriate.
 - 2) The power to establish stock bonus plans is deleted from subsection (15) because of the special nature of GSOCs and the limitations on share ownership would make it difficult for a GSOC to adopt a qualified stock bonus plan for its employees. If the GSOC desires to have its employees benefit from growth in the value of GSOC stock the corporation could adopt a funded "phantom stock" program. (ABCA 10.05.009).

- .020. INDEMNIFICATION OF OFFICERS, DIRECTORS, EMPLOYEES AND AGENTS; INSURANCE. This section is carried over unchanged from the ABCA and allows the corporation to indemnify its directors or employees for expenses and fines incurred as a result of their actions on behalf of the corporation if they acted in good faith. Indemnification is disallowed in derivative suits where the defendant is guilty of negligence or misconduct in his duties unless the court determines the indemnification is proper. The corporation may purchase insurance on behalf of its directors and employees for claims against them arising out of their corporate positions. (ABCA 10.05.010).
- .030. DEFENSE OF ULTRA VIRES. Meaning "beyond the power" an ultra vires act is one which the corporation did not have authority to perform. This section, carried over from the ABCA, provides that this lack of corporate power can be asserted by a shareholder, the corporation, or the attorney general. It may not, however, be asserted by another party to a transaction with the corporation as grounds for failing to perform. (ABCA 10.05.018).
- .035. CORPORATE NAME. This section requires that a GSOC include in its corporate name the words "general stock ownership corporation" or an abbreviation thereof. In addition, the name may not be misleading or deceptively similar to the name of another corporation doing business in Alaska. (ABCA 10.05.021).
- .040. RESERVATION OF CORPORATE NAME. This section allows a person or corporation to reserve a specific name for a general stock ownership corporation for a period of two years with a renewal period of one year. Reservation of a name might be used where an individual seeks to establish a GSOCs by initiative petition or where an existing GSOC seeks to change its name upon the approval of its shareholders. The name may be reserved by this section during the period in which the necessary activities are undertaken to make the name effective. (ABCA 10.05.024, .027, and .033).
- .045. FOREIGN GENERAL STOCK OWNERSHIP CORPORATIONS. General stock ownership corporations chartered in another state and doing business in Alaska are subject to the rules of the Alaska Business Corporations Act (AS 10.05).
- .050. REGISTERED OFFICE AND REGISTERED AGENT. The registered agent is the agent for the corporation upon whom legal papers may be served. This provision requires that the corporation maintain a registered office and agent within the state. (AS 10.05.045)

- .055. FILING LIST OF REGISTERED CORPORATIONS WITH SUPERIOR COURT.
- .060. CHANGE OF REGISTERED OFFICE OR AGENT.
- .065. REGISTRATION OF REGISTERED AGENT.

These three sections set out the rules for registration of the registered agent with the Commissioner of Commerce, the listing of registered agents and offices with the superior courts throughout the state, and the method by which a registered agent may change the registered office or resign his position. These provisions are carried over intact from AS 10.05.048, .051, and .054 respectively.

- .070. SERVICE OF PROCESS ON CORPORATION. In addition to designating the registered agent as agent for service of legal papers on the corporation this section allows the Commissioner of Commerce to be served on behalf of the corporation when the registered agent cannot be found. (AS 10.05.057).

- .075. CREATION AND ISSUANCE OF SHARES. This section allows the corporation to create and issue shares of no par value stock. The total number of shares available for issue must be stated in the articles of incorporation. GSOCs are prohibited from issuing "par value" stock since that concept, developed for the protection of shareholders, has no application in a corporation such as the GSOC where shares are to be distributed initially without payment by the shareholders.

- .080. CONSIDERATION FOR SHARES. The federal GSOC legislation requires that a GSOC have a charter providing for the issuance of "at least one share (of stock) to each eligible individual." In order to fulfill this requirement it appears that the first share of GSOC stock must be issued without charge to the shareholders. However, there does not appear to be any restriction in the federal legislation upon subsequent sales of stock by GSOCs except for the general limitations upon share ownership. In keeping with the Committee's desire for a generally applicable GSOC chapter provision is made for the subsequent sale of stock by GSOCs. Thus, this section allows the GSOC to issue shares without consideration or for a payment fixed in advance by a vote of the shareholders.

Sales of corporation stock by the corporation may not be made at a price in excess of book value if the shares sold are treasury shares, that is shares which have been issued and repurchased by the corporation. (AS 10.05.096).

- .085. PAYMENT FOR SHARES. Payment for shares may be made in cash, other property or services, but not in notes or future services. (AS 10.05.099).
- .090. JUDGMENT OF BOARD OR SHAREHOLDER AS TO VALUE OF CONSIDERATION CONCLUSIVE. This section allows the directors or the shareholders to conclusively determine the value of payment for shares in the absence of fraud. (AS 10.05.102).

- .095. EXPENSES OF ORGANIZATION, REORGANIZATION AND FINANCING. In sales of stock by a corporation shares entitled to the full protections of limited liability must be fully paid and nonassessable. This means that the full sales price for the stock has been received by the corporation. However, if the stock is sold through an underwriter the fees will come out of the sales proceeds before they are paid to the corporation. Likewise, the organizational expenses of the corporation may be paid out of stock sales before the proceeds are remitted to the corporation. This section clarifies that in such cases the shares are deemed to be fully paid. (AS 10.05.111).
- .100. CERTIFICATES REPRESENTING SHARES. This provision sets out the requirements as to form of stock certificates which must be signed by the corporate officers. (AS 10.05.114)
- .105. INFORMATION REQUIRED TO BE STATED ON CERTIFICATE. The stock certificates or other evidences of ownership must include information regarding the person to whom they are issued, that they are no par value shares, and that the corporation is organized in Alaska. (AS 10.05.117).
- .110. FULL PAYMENT REQUIRED FOR CERTIFICATE. If payment is required for shares they may not be issued until full payment is received. (AS 10.05.120).
- .115. ISSUANCE OF FRACTIONAL SHARES. GSOCs may issue fractional shares of stock and these fractional shares hold dividend, voting and distribution rights equal to their fractional interest. It may be necessary for a GSOC to issue fractional shares in the situation where a shareholder leaves his stock to his heirs and there is more than one child beneficiary. (AS 10.05.123).
- .120. LIABILITY OF SUBSCRIBERS AND SHAREHOLDERS. This section, adopted directly from ABCA, limits the liability of shareholders and those who have agreed to purchase share to the amount which they agreed to pay to the corporation for the shares. Subsequent holders of the stock are protected if they received the stock in good faith. (AS 10.05.126).
- .125. BYLAWS. The board of directors adopts the initial bylaws of a GSOC subject to review and rejection by the legislature under section 330 of the draft bill. Subsequent bylaws may be adopted, amended or repealed only by a vote of the shareholders.
- .130. MEETINGS OF SHAREHOLDERS. The time and location of the annual shareholders meeting is to be established in the bylaws. The specific place for the meeting may be set by the board. Special meetings of the shareholders may be called by the president of the corporation, the board or the holders of at least 500 shares. Shareholder meetings may be teleconferenced. (AS 10.05.138).

- .135. NOTICE OF SHAREHOLDER'S MEETINGS. This section requires written notice of shareholder's meetings mailed to shareholders not less than 60 days before the meeting. In addition, notice of shareholders' rights to add ballot issues or nominate directors must be made by publication at least once a week for four weeks beginning at least 150 days before the meeting. (AS 10.05.141).
- .140. CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE. To determine the shareholders of the corporation for purposes of a dividend distribution or voting rights the transfer books of the corporation may be closed prior to the date of the proposed activity or a "record date" may be established and the shareholders determined as of that date. Time limits are provided beyond which the transfer books may not be closed in order to protect shareholder voting rights and to allow interested parties to inspect the share records of the corporation prior to shareholders' meetings. (AS 10.05.144).
- .145. VOTING LIST. The responsible officer of the corporation must make available at the registered office of the corporation beginning at least 60 days before any shareholders' meeting a list of the shareholders eligible to vote at the meeting and access to this list must be provided to all shareholders. (AS 10.05.147).
- .150. QUORUM OF SHAREHOLDERS. 1/3 of the shares constitute a quorum for action by the shareholders and a majority vote of a quorum is sufficient to bind the shareholders in most cases. (AS 10.05.153).
- .155. PROXY VOTING PROHIBITED. Because of the ballot mechanism whereby each shareholder is allowed to vote in person through his ballot proxies are unnecessary in general stock ownership corporations and are therefore prohibited.
- .160. VOTING FOR DIRECTORS. Each shareholder may vote his shares for directors but cumulative voting is prohibited. This means that each share can cast only one vote for director in any contested election for a directorship position.
- .165. VOTING OF SHARES IN THE NAME OF ANOTHER.
- .170. VOTING OF PLEDGED SHARES. These sections allow shares held by an administrator, executor or guardian to be voted by him without a transfer of the shares into his name. Shares held by a pledgee may be voted by the pledgor until transferred into the pledgee's name. (AS 10.05.165 and . 168).

- .175. CORPORATION BALLOT. Voting at meetings of shareholders will be by ballot rather than through the normal corporate vehicle of proxies. The ballot will be prepared by the corporation subject to review for fairness by the Commissioner of Commerce. It will be mailed to each shareholder with the notice of the shareholders' meeting and voted by mailing it back to the corporation before the date of the meeting.

Shareholders may, by petition of 100 or more, nominate directors and place issues on the corporate ballot. In addition, the directors may place issues and candidates on the ballot by a majority vote. Shareholder information on board candidates and ballot issues is to be provided to the shareholders by the corporation and these materials will be filed with the Commissioner of Commerce and subject to the regulations and criminal penalties applicable thereto.

The directors may not propose to amend any proposal sponsored and approved by the shareholders within one year of the meeting at which the proposal was approved.

- .180. BOARD OF DIRECTORS. The board of directors is charged with management responsibility for the corporation and their compensation is to be fixed in the bylaws. At least 3/4 of the board must be residents of Alaska insuring that outside directors may never constitute a quorum of directors except when meeting to fill vacancies in directors seats until the next annual meeting of shareholders. (AS 10.05.174).

- .185. NUMBER OF DIRECTORS. The minimum number of directors is three and the number is to be fixed in the bylaws except that the original number is fixed by the enabling legislation. If the bylaws are silent the number fixed in the enabling legislation is the proper number. The number of directors can be changed through a bylaw amendment.

The board members serve for two year terms and they are to be divided into classes with only half the board standing for election at any one annual meeting. This staggering of the board members' terms provides for some continuity of management on the board of directors. (AS 10.05.177).

- .190. ELECTION OF DIRECTORS. Directors are to be elected at the annual meetings and each director hold office until his successor is elected and qualified. This prevents gaps in board membership except upon death or incompetance of a board member. (AS 10.05.183).

- .195. VACANCIES. Vacancies in the board caused by death, resignation or incompetance may be filled by a majority vote of the remaining directors. Directors elected by the board to fill a vacancy must stand for election by the shareholders at the next shareholders' meeting and are elected to fill the remaining portion of the directors position originally filled by vote of the board. No vacancy may continue for more than 6 months or until the next shareholders' meeting. (AS 10.05.189).

- .200. QUORUM OF DIRECTORS. A majority of the total number of directors fixed in the bylaws, articles or enabling legislation constitutes a quorum and action may be taken by a majority vote of a quorum. By allowing only $\frac{1}{4}$ of the board to be outsiders Alaskan control of the board is assured. One-quarter of the board can never constitute a majority of a quorum except in the event of a vacancy in which case the board must act to fill the vacancy. (AS 10.05.192).
- .205. PLACE AND NOTICE OF DIRECTORS' MEETINGS. Directors meetings may be held only in Alaska and regular meetings of the board may be held without notice. Special board meetings require notice specifying the purpose of the meeting. (AS 10.05.198).
- .210. PARTICIPATION BY TELEPHONE. Directors may participate in directors meetings by telephone if all the participants may hear and be heard by each other. (AS 10.05.199).
- .215. DISTRIBUTIONS. Some restrictions on corporate distributions are necessary because the limited liability feature of corporations prohibits creditors from levying against shareholders if the corporation distributes its way to insolvency. The traditional restraints which have been used to protect creditors of corporations are the devices of stated capital, capital surplus, earned surplus and retained earnings. Through these devices corporations are required to keep at least something in the till for creditors.

However, the traditional restraints never ensured that cash would be on hand for creditors and they have been eroded by numerous exceptions allowing the corporation to disgorge capital surplus and create surplus by reduction of capital. As a result corporations have been able to make distributions beyond the point where liabilities to third parties were protected.

Under the ABCA dividends may generally be declared only out of earned surplus. (AS 10.05.204). There are several exceptions to this rule. Dividends may be paid in cash out of depletion reserves by natural resource companies and in stock out of capital surplus. (AS 10.05.204). However, a dividend may not be declared if the corporation would thereby be rendered insolvent. (AS 10.05.201). These restrictions provide some protection to creditors in that at least 75% of the amount received for shares must be allocated to stated capital, but the remaining 25% may be allocated to capital surplus available for distribution under certain circumstances.

Similarly, the ABCA provides that a corporation may acquire shares issued by it only from earned surplus except in special situations. (AS 10.05.012). This distinction between the sources from which shares may be purchased and those from which dividends may be paid does not make much sense since a purchase of shares on a pro rata basis has the same effect as a dividend with regard to the protection of creditors.

To protect the creditors and shareholders of general stock ownership corporations and to rationalize restrictions upon the payment of dividends and repurchase of shares, this section provides restrictions on shareholder distributions based upon the current financial condition of the corporation. This section, adapted from a 1977 California amendment to the California Corporations Code, eliminates the concepts of stated capital and capital surplus in favor of a simple balance sheet test.

Under this section the corporation may always make the distribution required by subchapter "U" of the Internal Revenue Code. Thus, the corporation may always distribute to its shareholders an amount equal to 90% of its taxable income.

For distributions in excess of 90% of taxable income the corporation must fulfill either of two tests:

- 1) The corporation may make a distribution out of retained earnings.
- 2) If there are no retained earnings the corporation may make a distribution only if it meets a two pronged test:
 - a) The assets of the corporation, after the distribution are at least equal to $1\frac{1}{4}$ times its liabilities, AND
 - b) The current assets, after the distribution, are at least equal to the current liabilities (a "liquidity test").

If the average pretax income plus interest expense for the two preceeding fiscal years is not at least equal to the average interest expense for those years the current assets must be at least $1\frac{1}{4}$ times current liabilities.

If the corporation does not classify its assets into current and fixed in accordance with generally accepted accounting principles the current assets or liquidity test does not apply.

- .220. DISTRIBUTIONS IN PARTIAL LIQUIDATION. Distributions in partial liquidation are special distributions which reduce the capital value of the corporation. They are distributions out of capital rather than earnings. These distributions may be made only upon a 2/3 vote of the shareholders and must be identified as distributions in partial liquidation. (AS 10.05.207).
- .225. CERTAIN LOANS PROHIBITED. Loans by the corporation to its officers or directors are prohibited. (AS 10.05.213).

- .230. **LIABILITY OF DIRECTORS IN CERTAIN CASES.** This section carried over from ABCA makes directors personally liable for distributions and stock purchases by the corporation in violation of the distribution limitations. (AS 10.05.216).
- .235. **EFFECT OF GOOD FAITH RELIANCE ON FINANCIAL STATEMENTS OR BOOK VALUE.** Directors are not liable under the preceeding section if they relied upon financial statements of the corporation represented to him to be correct. (AS 10.05.219).
- .240. **PRESUMPTION OF CONSENT OF DIRECTOR AND FILING OF DISSENT.** A director present at a meeting is presumed to consent to the action taken by the board at such a meeting unless he files a dissent in accordance with this section. (AS 10.05.222).
- .245. **DIRECTOR'S RIGHT TO CONTRIBUTION.** A director sued for violation of the distribution rules is entitled to contribution (a sharing of the damages) from all directors assenting to or voting for the action. (AS 10.05.225).
- .250. **OFFICERS.** Officers of the corporation are elected by the board of directors and serve at their pleasure. (AS 10.05.228).
- .255. **DUTIES OF OFFICERS.** The board and the bylaws establish the duties of the corporate officers. (AS 10.05.231)
- .260. **REMOVAL OF OFFICERS.** Officers may be removed by the board but removal does not prejudice contract rights. (AS 10.05.234).
- .265. **BOOKS AND RECORDS.** GSOCs are required to keep complete books and records and make them available for inspection by shareholders and the Dept. of Commerce at the principal place of corporate business or the registered office. (AS 10.05.237).
- .270. **SHAREHOLDER'S RIGHT TO EXAMINE BOOKS AND RECORDS.** Shareholders have the right to examine books of the corporation at a reasonable time upon written demand. Access to the books of the corporation can be denied if sought for an "improper" purpose. The proper purpose restriction is a carryover from common law where the restriction insured that the examination was for an honest purpose and not to gratify curiosity or for speculative or vexatious purposes. It was designed to make certain that the purpose of the shareholder desiring to make examinations must be germane to his interests as a shareholder, that it was proper and lawful in character, and that it was not inimical to the interests of the corporation.

To clarify the applicability of this common law doctrine a number of states, including Alaska, have adopted into their corporation codes an inspection of records provision requiring the proper purpose. Under these provisions the shareholder is presumed to have the right of inspection and the lack of a proper purpose can only be asserted as a defense to a claim of wrongful denial of inspection. There is no comprehensive definition of what constitutes a proper purpose since there are innumerable valid reasons for a shareholder to inspect the books of his corporation. However, case law has indicated many such purposes a partial list of which would include:

- 1) To ascertain the value of a shareholder's stock.
- 2) To acquire knowledge to enable him to vote understandingly at a shareholder's meeting.
- 3) To investigate into consideration actually paid for stock and the failure to distribute dividends.
- 4) To investigate irregularities resulting in secret profits to officers of the corporation.
- 5) To determine correctness of financial statements and the existence of collateral for notes.
- 6) To determine whether a shareholder is being discriminated against in relation to his shares. (AS 10.05.237).

.275. LIABILITY FOR REFUSAL OF EXAMINATION. Any agent of the corporation wrongfully refusing shareholder access to the books and records of the corporation is subject to a fine of \$1,000 per day for each day of wrongful refusal. (AS 10.05.243).

.280. COURT MAY COMPEL INSPECTION. Courts have the power to compel inspection of the corporations books. (AS 10.05.249).

.285. SHAREHOLDERS' RIGHT TO FINANCIAL STATEMENT. The corporation must provide the shareholders with a financial statement upon request. (AS 10.05.249).

.290. REMOVAL OF DIRECTORS BY SUPERIOR COURT. This new provision allows a court, upon the suit of the attorney general or 100 shareholders 18 or older, to remove a director for fraudulent or dishonest acts or gross abuse of authority and bar such director from reelection.

This provision is not a simple removal clause, but gives standing to the shareholders and the attorney general to ask a court to remove a director for specific reasons. In order to have the court remove the director the shareholders or the attorney general bringing suit must still prove the director guilty of the offenses charged.

.295. SHAREHOLDER REMOVAL OF DIRECTORS. This section allows the shareholders to remove the entire board by a majority vote or any single director by a vote at least as large as that which elected him at his last election.

- .300. SHAREHOLDERS' DERIVATIVE ACTION. This section allows shareholders to file an action on behalf of the corporation if those responsible inside the corporation fail to do so. Alaska Supreme Court Rule 23.1 provides for such an action, but does not specify the treatment of security for expenses or accounting of settlements. Because this section would amend a rule of court a 2/3 vote is required for passage and the provision is set forth separately in Section 8 of the bill.

This section allows the courts discretion to require security for expenses incurred in the prosecution of the derivative action. It requires court approval of any out of court settlement to insure that those prosecuting the suit may not simply be bought off. The proceeds of any successful action or settlement of a derivative suit must be accounted for to the court and the court is then authorized to award reasonable expenses to the parties.

- .305. FRAUDULENT TRANSFERS OF SHARES. Transferring or obtaining shares of the corporation by fraud is a felony.

ARTICLE 2. FORMATION OF CORPORATIONS.

- .310. INCORPORATORS. Incorporators are those persons who file the articles of incorporation to begin the corporation's existence. This must be done by at least three people over the age of 19. (AS 10.05.252).
- .315. ARTICLES OF INCORPORATION. This section sets out the minimum requirements of the articles of incorporation for general stock ownership corporations. The article provisions required by subchapter "U" of the Internal Revenue Code are included in this section as requirements for GSOCs organized in Alaska. Other provisions are carried over from ABCA. (AS 10.05.255).
- .320. FILING OF ARTICLES OF INCORPORATION. Articles of incorporation are to be filed with the Commissioner of Commerce who shall certify the filing and return one original of the articles to the corporation. (AS 10.05.258).
- .325. EFFECT OF ISSUANCE OF CERTIFICATE OF INCORPORATION. Upon issuance of the certificate the corporate life begins. (AS 10.05.261).
- .330. ARTICLES OF INCORPORATION AND INITIAL BYLAWS. This section provides for legislative review of the articles and initial bylaws. They must be submitted to the next session of the legislature and, if not disapproved within 60 days by concurrent resolution they are approved. Legislative disapproval may be overridden by a vote of the shareholders.

- .335. ORGANIZATION MEETING OF DIRECTORS. The incorporators shall call an organizational meeting of directors in the state for the purpose of adopting bylaws, electing officers and conducting other business necessary to the organization of the corporation. (AS 10.05.267).
- .340. NOTIFICATION OF ELIGIBLE SHAREHOLDERS. Since stock is to be distributed free of charge initially 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 month 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.
- .345. CORPORATION NOT LIABLE TO SHAREHOLDERS. Although GSOCs are 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 loses 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.
- .350. LATE APPLICATION FOR SHARES. Any individual who is eligible to receive an initial distribution of shares but who fails to apply for an issuance of stock may be issued a share at any time within one year of the original issue of stock upon application and payment of book value therefor. The one year period coincides with the period during which a shareholder may elect not to receive his stock and have his share cancelled. This cut off period protects the corporation and the other shareholders from those eligible residents who are not identified and who fail to identify themselves hoping to see how the corporation fares before applying for their stock.
- .355. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER. The superior court is given jurisdiction to void stock issued to an ineligible individual who obtained his shares by fraud and allows the corporation to recover any distributions paid to such a shareholder.

ARTICLE 3. AMENDMENT.

- .360. RIGHT TO AMEND ARTICLES OF INCORPORATION. The articles of the corporation may be amended to include any legal provision. (AS 10.05.270).

- .365. PURPOSES FOR WHICH ARTICLES MAY BE AMENDED. This section lists some, but not all, of the legal purposes for which the articles may be amended. (AS 10.05.273).
- .370. PROCEDURE TO AMEND ARTICLES OF INCORPORATION. The board of directors or the shareholders can propose amendments to the articles of incorporation, but the articles may only be amended upon a 2/3 majority vote of a quorum of shareholders.
- .375. ARTICLES OF AMENDMENT.
- .380. FILING OF ARTICLES OF AMENDMENT.
- .385. EFFECT OF CERTIFICATE OF AMENDMENT.
These three sections provide that an amendment approved by the shareholders to the articles of incorporation must be filed with the Commissioner of Commerce in the same manner as the original articles of incorporation and once certified by the Commissioner the amendment becomes effective. These sections are adopted directly from AS 10.05.285, .288, and .291 respectively.
- .390. RESTATED ARTICLES OF INCORPORATION.
- .395. EXECUTION OF RESTATED ARTICLES OF INCORPORATION.
- .400. CONTENTS OF RESTATED ARTICLES OF INCORPORATION.
- .405. FILING OF RESTATED ARTICLES OF INCORPORATION.
- .410. EFFECT OF ISSUANCE OF RESTATED CERTIFICATE OF INCORPORATION.
These five sections deal with restated articles of incorporation. Restated articles of incorporation for purposes of GSOCs are simply a consolidation and updating of the articles of incorporation with current amendments. This allows the corporation to have on file with the Commissioner a current copy of the articles of incorporation incorporating all amendments. The provisions are adopted essentially from ABCA except that GSOCs are not allowed to amend the articles of incorporation through filing restated articles and for that reason are allowed to file restated articles upon motion of the board of directors. (AS 10.05.294, .297, .300, .303, and .306 respectively).

ARTICLE 4. SALE OF ASSETS.

- .415. SALE OR MORTGAGE OF ASSETS IN REGULAR COURSE OF BUSINESS.
The board of directors may sell or dispose of all the assets of the corporation if it is in the ordinary course of the corporation's business. (AS 10.05.435).
- .420. SALE OR MORTGAGE OF ASSETS OTHER THAN IN REGULAR COURSE OF BUSINESS. Sale of all the assets of the corporation other than in the ordinary course of business requires a vote of the shareholders. (AS 10.05.438).

- .425. APPROVAL OF PLAN BY SHAREHOLDERS. A 2/3 vote of the shareholders is required to approve a sale of all the assets of the corporation outside the ordinary course of business. (AS 10.05. 441).
- .430. ABANDONMENT OF PLAN BY BOARD OF DIRECTORS. Even though a vote of the shareholders is required to approve a sale of all the assets the sale may be abandon by the board since such sales are unusual and may require quick decisions which cannot be effectively put to the shareholders. If the shareholders are unhappy about the abandonment they have the power to remove the board and it is to be expected that the board would not abandon such a sale without good cause. (AS 10.05.444).
- .435. RIGHTS OF DISSENTING SHAREHOLDERS UPON SALE OR EXCHANGE OF ASSETS.
- .440. NOTICE TO DISSENTING SHAREHOLDER.
- .445. PAYMENT TO DISSENTING SHAREHOLDER AFTER AGREEMENT ON VALUE OF SHARES.
- .450. ACTION BY DISSENTING SHAREHOLDER TO COMPEL PAYMENT UPON FAILURE TO AGREE ON VALUE.
- .455. EFFECT OF ABANDONMENT OR REVOCATION OF SALE OR EXCHANGE ON SHAREHOLDER'S RIGHTS.
- .460. STATUS OF SHARES ACQUIRED FROM DISSENTING SHAREHOLDER. These section deal with the shareholder who does not wish to be a part of the sale of substantially all the assets of the corporation in spite of the 2/3 majority vote of the shareholders. Such a shareholder can dissent from the sale and have the corporation purchase his shares. There are notice provisions and opportunity for the shareholder and the corporation to agree upon a purchase price for the shares. If the shareholder and the corporation cannot agree upon a price the matter can be decided by a court. If the sale is abandoned the dissenting shareholder loses his right to receive payment from the corporation for his share and he remains a shareholder. Shares acquired from a dissenting shareholder become treasury shares.

ARTICLE 5. DISSOLUTION.

GSOCs may be dissolved voluntarily by a 2/3 vote of a quorum of shareholders (.470) or by the Commissioner of Commerce (.525).

In a voluntary dissolution the question may be put to the shareholders upon action of the board or a petition of 100 shareholders (.470). Upon affirmative vote of the shareholders a statement of intent to dissolve signed by corporate officers (.475) is filed with the Commissioner of Commerce (.480). When the statement is officially filed by the Commissioner the corporation must cease doing business and wind up its operations (.465). However, the corporate existence continues while the corporation notifies creditors,

collects and liquidates assets and pays off its obligations (.485)(.490). When the business of the corporation has been wound up articles of dissolution (.510) are filed with the Commissioner (.515) and when certified the corporate existence ceases (.520). Voluntary dissolutions may be revoked at any time by a 2/3 vote of the shareholders (.495) in which case the corporation files a statement of revocation (.500) and the dissolution process is terminated (.505).

A GSOC may be dissolved involuntarily by the Commissioner of Commerce with 60 days notice for failure to file reports or pay fees, failure to maintain a registered agent or office or change either without notice, and unfilled board vacancies continuing beyond the allowable time (.525). A corporation can be reinstated within two years upon remedy of the violation.

The superior court may dissolve a GSOC (.53) and has jurisdiction to liquidate the corporation's assets (.535). The Attorney General may bring suit to dissolve the corporation where there was fraudulent incorporation or continual abuse of corporate authority (.525).

In addition a suit for liquidation of the corporations assets may be brought by:

- 1) A shareholder where the board is deadlocked; the board is action in an illegal, oppressive, or fraudulent manner; the shareholders are deadlocked for two annual meetings; or, the corporation's assets are being misapplied (.540).
- 2) A creditor when the creditor's claim is unsatisfied and the corporation is insolvent (.545).
- 3) The corporation upon request to have a voluntary dissolution continued under court supervision(.550).
- 4) The Attorney General in conjunction with a suit for dissolution (.555).

The shareholders need not be a party to the action for liquidation (.560). The court has authority to appoint a qualified receiver (.600) for the corporation with power defined by the court (.580) to collect and sell its assets (.565)(.570). Proceeds are to be used to pay expenses allowed by the court (.585) and debts of the corporation with the remainder distributed to the shareholders (.575).

The receiver may sue and be sued (.590) and all claims against the corporation must be filed in a timely manner with the court or the receiver (.605). Liquidation may be terminated by the court (.610) but upon completion the court must enter a decree of dissolution (.615).

The article on dissolution is carried over substantially intact from ABCA (AS 10.05.465 - .594).

ARTICLE 6. GENERAL PROVISIONS.

- .620. AS 10.05 INCORPORATED BY REFERENCE. In order to reduce duplication this section incorporates by reference Sections .699 through .819 of ABCA (AS 10.05.699 - .819). These sections deal with requirements for annual reports to be filed with the Commissioner of Commerce, filing fees and charges, procedural provisions and forms, and powers of the Commissioner of Commerce.
- .625. FALSE STATEMENTS AFFECTING VALUE OF SHARES. An agent of a corporation who makes fraudulent statements regarding the value of shares is guilty of a misdemeanor.
- .630. DIRECTOR MAKING UNLAWFUL DIVIDEND OR DISTRIBUTION OF ASSETS. A director who concurs in a distribution designed to deceive creditors or shareholders is guilty of a misdemeanor.
- .635. RESERVATION OF POWER. Amendments to this chapter apply to all existing and future corporations organized under it.
- .640. DEFINITIONS. Many of the definitions in this section are carried over from ABCA and may also be found in AS 10.05.825. However, there are two significant new definitions:

Certificate as used in the context of "stock certificate" may mean something other than the actual certificate such as a receipt evidencing ownership. This definition has been broadened in order to allow for the possibility that the stock certificates themselves may never be issued, but that the stock records may be kept by the corporation itself as the evidence of ownership in a particular shareholder which ownership would be represented in the hands of the shareholder by a receipt. Such a receipt would be required to carry all the same information as is required on the certificate itself.

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

DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: [

DATE: April 12, 1979

Governor Jay S. Hammond

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: AGSOC

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

First Level

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

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

to provide dividends to supplement personal income.

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

Examples; purchase of oil line share - tariff question

development of petrochemicals - royalty prices

construction of gasline - oil recovery

virtually any business - any regulation.

3. With respect to the above questions, can we expect AGSOC to become an important political force? Is it appropriate or possible (first amendment rights question) to prevent this?
4. Even with the amendments contemplated by either the House State Affairs Committee or the Administration regarding corporate governance, how likely is democratic control of AGSOC?
5. What is the likely extent of state subsidies to AGSOC? What will be the impact on the state's credit rating from passage of the bill? From actual extension of state financial aid?

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

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

6. Is it possible to resolve/avoid the "closed class" problem created by "old" residents being shareholders while "new" residents are not?
7. How will the Governor make decisions as to who shall constitute the first Board of Directors?
8. Does the Alaskan public want an AGSOC?

Second Level

1. What should be the procedures for electing the Board of Directors?
2. Should the state allow the federal corporate income tax exemption to pass through to state corporate income taxes?

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

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

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

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

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

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

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

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

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

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

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

House State Affairs Committee (tentative) desired amendments:

- (-) Chairman of the Board must be Alaska resident.
- Nine member board, seven residents, two outsiders.
- No classified board; all directors elected every two years (mechanics, i.e., proxy issues, undecided).
- Directors removable by shareholders without cause.
- Statutory provision for derivative suits.
- Require legislative approval by resolution of articles and bylaws.
- Give shareholder the ability to amend bylaws.
- Allow board business to be conducted via telecommunications.
- Every director has right to attend all board committee meetings.
- Liability for officers' refusal to allow shareholder access to corporation books and records.
- Loan guarantee fund limited to start-up costs not to exceed \$5 million.
- Delete Sections 2 and 3 regarding investments of GF surplus or permanent fund in AGSOC securities. Consider amendment to AS 37.10.070 to prohibit use of subsection 6 for investment of GF surplus in AGSOC. Also delete Sec. 4 which would exempt AGSOC securities from registration under the Alaska Securities Act of 1959 and from filing of sale and advertising literature.
- (-) Prohibit officers and employees of corporation from serving on board.

Administration working Group desired actions or amendments:

- (-) Statutory reservation by the legislature of the right to amend the statute - impairment of contracts issue.
- Development of election procedures for the Board, including financing of proxy fights, access to voting lists and mailing machinery, and consideration of a regionalized board.
- Solution of "single class of stock" issue created by the voting rights of shares held by minors.

- Assessment of the definition of "resident" provided in the bill.
- ① - Assessment of potential for tax liability on initial issue or otherwise to be greater than dividend.
- Criminal liability of directors in certain instances.
- ① - Provision for cumulative voting.
- ① - Limitation on voting trusts.
- ① - Requirement that feasibility analysis and other information be provided to the Governor and the legislature in sufficient time before a decision is necessary on financial or other state aid.
- Details of shareholder meetings, i.e., notice, location, quorum.
- ① - Limitation on assignment of dividend rights.
- ① - Limitation on ability of corporation to acquire Treasury shares.
- Shareholders' ability to amend the number and terms of office of the Board of Directors.
- Directors subject to removal by Superior Court at suit of 100 or more shareholders or Attorney General for fraudulent or dishonest acts or gross abuse.
- ① - Limitation of ownership to one share.

MEMORANDUM

To: MG
From: JERRY GAUCHE
Re: MARKU, ISSUES FOR STATE AFFAIRS
Date: 4/23/79

1. QUESTION OF WHETHER PETITION SIGNED BY 100 SHAREHOLDERS IS TOO OPEN TO ABUSE AND WHETHER THE NUMBER OF SIGNATURES REQUIRED FOR SHAREHOLDER NOMINATIONS OR BALLOT ISSUES SHOULD BE SOME HIGHER NUMBER LIKE 500 OR 1,000.
2. DIRECTORS SHOULD BE ABLE TO SUGGEST CHANGES IN BYLAWS TO BE VOTED ON BY THE SHAREHOLDERS EVEN THOUGH THE SHAREHOLDERS PROPOSED THE BYLAW. CURRENTLY THE BILL, AT PAGE 18, LINE 2, RESTRICTS THE BOARD FROM MAKING SUCH PROPOSALS FOR ONE YEAR AFTER THE MEETING AT WHICH A SHAREHOLDER BYLAW WAS PROPOSED.
3. COULD ALLOW MORE OUTSIDE DIRECTORS AND STILL ASSURE ALASKAN CONTROL BY PROVIDING THAT A QUORUM OF THE BOARD MAY NOT BE CONSTITUTED WITHOUT A MAJORITY OF ALASKAN DIRECTORS (INSTEAD OF THE CURRENT TREATMENT OF REQUIRING THAT ONLY 1/4 OF THE BOARD BE FROM OUTSIDE). BILL AT PAGE 18 LINE 12.
4. ADD CLAUSE WHICH INSURES THAT LEGISLATIVE DISAPPROVAL

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

5. SUGGEST THAT TO LIMIT SHARE OWNERSHIP TO ALASKANS PROVIDE DURING FIRST YEAR ANYONE CAN GET SHARES FREE OF CHARGE, AFTER FIRST YEAR AND UP TO YEAR SIX MUST PAY BOOK VALUE. BILL SECTION 7, PAGE 60/61.
6. NEW PROVISIONS ON APPOINTMENT OF INCORPORATORS.
7. DISCUSS REMOVING THE LOBBYING SECTION FROM THE COMMITTEE AMENDMENT REGARDING POLITICAL ACTIVITIES.

STATE OF ALASKA THE LEGISLATURE

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

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

June 18, 1979

SUBJECT: Meeting with Professor Fessler

TO: Representative Jim Duncan, Chairman
Legislative Budget and Audit Committee

Representative Mike Miller, Chairman
State Affairs Committee

FROM: Kenneth M. Rosenstein *KMR*
Legislative Counsel

The meeting took place at the San Francisco airport on June 13, 1979. In attendance were: Professor Daniel Fessler, Representative Jim Duncan, Representative Mike Miller, Milt Barker and Ken Rosenstein.

The meeting began with Professor Fessler responding to Mr. Kelso's Comments on the bill (CSSSSB 170):

(1) Although the bill is fairly clear and unambiguous, Professor Fessler recommended the inclusion of a preemption provision suggested by Mr. Kelso in order that the issue be free from doubt.

(2) Regarding the problem with AS 10.50.215(b), Professor Fessler stated that treasury shares are not considered assets under prevailing accounting principles and that, therefore, they would not even be considered under §215.

(3) Since a director is personally liable only for conscious "misfeasance in office," Professor Fessler felt that few qualified candidates for the board of directors would be dissuaded from serving on the board.

Professor Fessler had the following additional comments:

(1) The initial distribution scheme under which late applicants for shares would be required to pay book value for them may create a second class of shares. He suggests

seeking an opinion from the IRS and the SEC that such an interpretation would not be given.

(2) The limitation on the consideration paid for treasury shares in AS 10.50.080(b) is book value. This is a new standard. AS 10.05.096(c) permits the board of directors to fix the consideration for treasury shares.

(3) AS 10.50.105 should require that the transfer restrictions applicable to the shares should appear on the shares. This would protect potentially unlawful transferees.

(4) Shares owned in excess of the maximum permitted by federal law (10) should be subject to forfeiture.

(5) Directors should be prohibited from altering or repealing a by-law proposed by the shareholders. Professor Fessler did not give much weight to the argument that the board should have the power to change such by-laws in the name of business efficacy.

(6) The provisions relating to notice of shareholders' meetings need to be clarified as they relate to special meetings. There are conceivable situations where it would take almost 300 days between the call of the meeting and the meeting.

(7) AS 10.50.175(d) relating to information appearing on the ballot is too broad and without adequate control.

(8) The penalty contained in AS 10.50.275 should be assessed for each day that the wrongful refusal of inspection continues.

(9) The removal of a director by the shareholders should occur when a majority of the votes for removal exceed the number of votes that elected the director. Otherwise, a director could be removed by minority action.

(10) The prohibited political activities should be expressly declared as ultra vires.

(11) The intent of the requirement of legislative approval of the initial articles and by-laws is easily avoided.

Page 3
June 18, 1979

(12) Under AS 10.50.475 it would be easier to dissolve the corporation than to amend the articles or rescind a proposed dissolution.

KMR:jdn

cc: Milt Barker
Jerry Gauche

STATE OF ALASKA THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

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

MEMORANDUM

June 18, 1979

SUBJECT: Meeting with Kelso & Co., Inc.

TO: Representative Jim Duncan, Chairman
Legislative Budget and Audit Committee

Representative Mike Miller, Chairman
State Affairs Committee

FROM: Kenneth M. Rosenstein *KMR*
Legislative Counsel

The meeting took place at Kelso's office in San Francisco on June 11, 1979. In attendance were: Louise Kelso, John Miskimmen, and Norma Johnson of Kelso & Co., Inc.; Representative Jim Duncan, Representative Mike Miller, Milt Barker and Ken Rosenstein.

Mr. Kelso began the meeting by stating that he had not yet had an opportunity to analyze the bill (CSSSSB 170) in detail, but had several comments and suggestions for changes:

(1) A provision should be included that makes clear that the Alaska Business Corporation Act (AS 10.05) is preempted by AS 10.50 insofar as it relates to general stock ownership corporations.

(2) Ownership of GSOC stock should be permitted by Alaska residents retiring to locations outside the state.

(3) Potential candidates for the board of directors may be eliminated due to the personal liability imposed on directors for certain acts and the risk of removal.

(4) Serious management problems could arise as a result of the prohibition on directors serving as officers. The suggestion was to add two directorships which would be filled by the president and highest financial officer of the GSOC.

(5) There was a problem perceived in AS 10.50.215(b) which was viewed as creating problems with the valuation of treasury shares. This problem was seen as possibly inhibiting the sale of those shares. It was explained that §215 merely established monetary limits on what a GSOC could distribute to shareholders and in that limited context treasury shares would not be considered.

In addition, Mr. Kelso outlined a proposal for his firm's continued work on the bill. The proposal included the following items:

(1) Study the feasibility of integrating the compilation of eligible shareholders with the federal census to be conducted next year. If it appears feasible, begin the negotiation of the details with the Bureau of Census.

(2) Prepare a detailed analysis of the bill.

(3) Prepare a catalog of the types of potential investments, without specifying particular investments, that would be available to the GSOC.

(4) Lobby the Congress for certain amendments to subchapter U of the Internal Revenue Code. Amendments would be sought to (A) allow the acquisition of capital assets without the payment of taxes on the earnings used to pay the principal for the asset; and (B) permit more than one class of GSOC shares in order for GSOC employees to create an employee stock ownership plan and to enable a nationally underwritten sale of stock to proceed.

cc: Milt Barker
Jerry Gauche

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

April 17, 1979

The Honorable Russell B. Long
United States Senator
217 Russell Senate Office Bldg.
Washington, D.C. 20510

RE: The Russell Long Study of ESOP Company Results

Dear Senator Long:

Results are in from 22 corporations out of our first pilot mailing to 30 corporations carefully selected to reflect a cross section of our ESOP company clients by sales volume, number of employees, and type of industry. We will be sending out a general mailing to the rest of our clients who have had plans installed and operating long enough to provide us with realistic results to add to the survey. This survey shows that your initial thoughts are correct: ESOPs are not a revenue drain on the Treasury -- they help offset deficits, they don't create them! Also, these plans have increased productivity in the companies surveyed and this is the best way to fight inflation. The ESOPs also created tax sheltered capital for these companies to use in increasing employment opportunity -- and this saves our government money and reduces transfer payments.

Key conclusions (average ESOP life 3.3 years):

1. Federal taxes paid (up \$24,419,000) -- 112% increase.
2. Productivity per employee -- 38% increase.
3. Total sales -- 67% increase.
4. Corporate profits -- 125% increase.
5. Number of people employed -- 30% increase.

Average results (22 survey companies):

	<u>Annual Sales</u>	<u>Employees</u>	<u>Productivity</u>
Pre-ESOP	\$20,858,000	333	\$76,545
Post-ESOP	\$34,597,000	433	\$104,864
Increase	+67%	+30%	+38%
	<u>Average Annual Pre-Tax/Pre-ESOP Income</u>		<u>Average Annual Taxes Paid</u>
Pre-ESOP	\$699,000		\$300,000
Post-ESOP	\$1,574,000		\$636,000
Increase	+125%		+112%

The Honorable Russell B. Long
United States Senator
April 17, 1979
Page Two

The survey covered private companies which have had an ESOP for an average of 3.3 years and, in the aggregate, had annual sales prior to the ESOP installation of \$458,880,000. Today's annual sales are \$761,136,000. Most of these companies have been in business for over 30 years; four for over 50 years; one for over 80 years; six have been in business for 10 years or less. These companies employed 7,323 employees prior to the ESOP installation and now employ 9,529 people. The average annual sales per employee (productivity) were \$76,545 prior to the ESOP installation and are \$104,590 now. The companies had profits in the period prior to the ESOP installation of \$50,775,000 compared to \$114,314,000 since then and in the same period. They paid taxes in the period prior to the ESOP of \$21,777,000 and \$46,200,000 after.

These companies range in current sales from \$4,174,000 to \$157,000,000; from 35 employees to 1,500; from \$152,500 annual profits to \$10,033,000.

The companies represented in our pilot survey are in the following fields of endeavor:

Manufacturing

Paper
Telecommunications
Graphic Arts
Furniture
Sash and Doors
Mirrors
Paint
Plastics
Saws

Retail/Wholesale

Food
Cameras
Furniture
Automobiles
Home Building Supplies

Other

Media Sales
Construction
Trucking
Hospital
Drilling Equipment
Wholesaler
General Wholesaler
Appliance
Distributor
Food Processor

The combined additional revenue to the Treasury from corporate taxes (and capital gains taxes paid by shareholders selling to the ESOP) was \$24,423,000 -- an average of \$1,110,000 per company over a period of 3.3 years -- and this doesn't include participants' taxes. However, the value of shares has been substantially enhanced due to the increased profitability and net worth created by corporate stock sales to the ESOP plus larger after-tax accumulated earnings.

The stockholders have a continuing market for their shares and all employees have a vested interest in maintaining and building stock values for their own self-interest. This obviously works for the mutual benefit of all shareholders -- ESOP participants and others.

We will have additional information to you soon on the amount of stock in the accounts of the 9,529 people who work for these 22 pilot

The Honorable Russell B. Long
United States Senator
April 17, 1979
Page Three

survey companies; the percent this constitutes of the total fair market value of the companies; the projected value of employee accounts; and the additional revenues this will provide our Treasury. Also, the average number of years these companies have been in business prior to the ESOP installation.

Thanks, again, for the leadership you have given the Employee Stock Ownership concept. At last count, there were over 3,000 companies that decided to spread their capital base. There are still thousands more companies in our country large and stable enough to adopt ESOPs. Your new proposed legislation will be helpful in encouraging the formation of new plans for these companies.

Cordially,



Dickson C. Buxton
Chairman of the Board

DCB:ch
Encls.

THE ROLE OF THE FEDERAL GOVERNMENT
AND EMPLOYEE OWNERSHIP
OF BUSINESS

SELECT COMMITTEE ON SMALL BUSINESS
UNITED STATES SENATE



REVISED MARCH 20, 1979

Printed for the use of the Select Committee on Small Business

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1979

SELECT COMMITTEE ON SMALL BUSINESS

GAYLORD NELSON, Wisconsin, *Chairman*

SAM NUNN, Georgia

JOHN C. CULVER, Iowa

WALTER D. HUDDLESTON, Kentucky

DALE BUMPERS, Arkansas

ROBERT MORGAN, North Carolina

JAMES R. SASSER, Tennessee

DONALD W. STEWART, Alabama

MAX BAUCUS, Montana

CARL LEVIN, Michigan

LOWELL P. WEICKER, JR., Connecticut

BOB PACKWOOD, Oregon

ORRIN G. HATCH, Utah

S. I. HAYAKAWA, California

HARRISON H. SCHMITT, New Mexico

RUDY BOSCHWITZ, Minnesota

LARRY PRESSLER, South Dakota

WILLIAM B. CHERKASKY, *Executive Director*

CORRY M. ROSEN, *Professional Staff Member*

ROBERT J. DOTCHIN, *Minority Staff Director*

SUMMARY

In the last several years, there has been a growing trend for employees to own substantial equity in the companies for which they work. It has been estimated that there are between 1,000 and 3,000 employee stock ownership plans ("ESOPs") in the country, and in at least 90 cases, employees, through ESOPs or other means, have actually purchased a majority interest in their companies. In part, the popularity of ESOPs has been a result of special tax incentives enacted in the last five years; in part it stems from the belief on the part of many companies that ESOPs provide a unique means of financing growth and providing an employee benefit plan with the same dollars. Similarly, the trend towards employee acquisition of business has partly been encouraged by government loans, 13 of which have been made to date. On the other hand, roughly 70 percent of the employee owned companies have been formed in this decade, so government assistance had usually not been a factor. This report will review the information available on employee ownership of business, with particular emphasis on the role the government has played and might play in the future.

Employee ownership has been sold primarily as a means to increase worker motivation and productivity by giving employees a clearer stake in their companies. A comprehensive study by the University of Michigan's Survey Research Center has confirmed that this argument is valid. In a study of 98 firms, the study found that companies with employee ownership were 1.5 times as profitable as comparable conventional firms. They also found that employee and managerial satisfaction was higher, and that managers reported increased productivity. Other studies of the plywood industry and individual case studies have confirmed these findings, and the plywood studies showed, in addition, that wages were 25 percent higher in employee owned firms than non-employee owned firms. The higher wages were compensated for by 30 percent greater productivity in the worker owned companies. Finally, the Michigan study showed that the greater the amount of equity owned by employees, the greater the profits.

The most popular form of employee ownership is the employee stock ownership plan. In its typical form, a company establishes an ESOP and the ESOP includes an employee stock ownership trust. The trust secures a loan for company growth, with the company pledging to make whatever funds are necessary available to the ESOT to repay the loan. The ESOT uses the loan funds to purchase company stock, so that the company gets the money from the loan and the trust gets the stock. As the loan is repaid, the stock vests with employees. Contributions to the trust to repay the loan are tax deductible, so that the company can, in effect, deduct both the principal and interest on the loan, instead of the interest only. In addition to this tax benefit, companies making qualified investments can receive an additional 1 percent-1.5 percent credit if the investment is financed through an ESOP.

The benefits and disadvantages of ESOPs have been widely disputed. For the company, there are, in some cases, cheaper ways to borrow, and the issuance of new stock to an ESOT dilutes the value of existing stock. The employee, although he pays nothing for the ESOP (unless there is a contribution plan), may be asked by the company to rely on the ESOP as his employee benefit plan in lieu of something else. If the company succeeds, this will be to his benefit; if it fails, the benefit is worthless. For companies with good prospects without access to other sources of equity capital, however, ESOPs appear to be very useful for financing growth as well as being very beneficial for individual employees. Moreover, the ability to deduct both principal and interest payments on loans makes ESOPs uniquely suited to employee purchases of companies. There is no other means by which this could be accomplished as well in these situations. Finally, ESOPs offer special tax advantages to owners of nonpublic companies who wish to transfer ownership of their companies, either gradually or through an immediate sale, to their employees.

While ESOPs have gained in popularity as a tool for existing companies, employee purchases of companies have gained in popularity in cases where companies would otherwise close. In the last decade, perhaps 50 or 60 such purchases have occurred. In most cases, an ESOP is used, but a variety of other ownership forms, including producer cooperatives and simple direct purchases of companies through the sale of stock to employees and others, have also been used. The motivation for such purchases is generally to preserve jobs that would otherwise be lost when a company plans to close, relocate, or be purchased by an unrelated interest. Roughly 70 percent of the employee purchases since 1971, in fact, have been of conglomerate subsidiaries which were scheduled to close. Most of the rest appear to have been voluntary sales by owners of independent businesses to their employees when the owners were ready to retire. The companies that have been purchased in this way appear to have been very successful, in many cases transforming companies or subsidiaries with poor performance records into profitmakers. Despite their success, however, efforts by employees to purchase their businesses still face enormous obstacles in the areas of financing and simply organizing people around what is still an unconventional goal.

Government policy toward employee ownership has been mixed. On the one hand, the Congress has enacted special tax benefits for ESOPs, and the Small Business Administration, the Economic Development Administration and the Farmers Home Administration have all made loans to employee organizations which have purchased their businesses. The ESOP tax incentives, however, are limited primarily to capital intensive, large companies. Certain so-called incentives for ESOPs, in fact, actually only have the effect of equalizing the treatment of ESOPs with other employee benefit plans. Government loans have been made, but not frequently—SBA has made three, EDA nine, and FmHA only one. The SBA has expressed reluctance to make loans to employee organizations and will not make loans to companies or employee organizations through ESOPs, arguing that the employee stock ownership trust is not formally a small business and therefore does not qualify for a loan. EDA has made more loans, but their legislative mandate is such that they must give priority to companies suf-

fering from the effects of disasters, defense realignments, or government regulations. FmHA officials have expressed enthusiasm for the idea of employee ownership, but their loan program has not been seen, as yet, as a potential source of funding. Even if it were more broadly known that FmHA were favorable, however, only companies in places of less than 25,000 people would be eligible, and even then small business would be encouraged to go to SBA.

In the 95th Congress, a bill was introduced by Congressmen Kostmayer, Lundine and McHugh to create a special program in EDA, with \$100 million in loan funds for employee or employee/community organizations seeking to purchase firms that would otherwise close, relocate, or be sold to outside interests. Loans would be granted only if feasibility studies confirmed that the company could make a profit when reorganized. The bill was not acted on, however, and will be reintroduced in the 96th Congress.

In the Senate, Senators Nelson and Long will introduce legislation to mandate that the SBA guarantee loans to ESOTs on a non-discriminatory basis, and that SBA guarantee loans to employee organizations seeking to purchase their businesses when they would otherwise close, relocate, or be sold to unrelated interests. These loans would also be granted on the basis of feasibility studies, without regard to the individual assets of employees, a criterion that, if in effect, would make it all but impossible for employee organizations to secure credit. Senator Nelson also plans to introduce legislation similar to the House bill mentioned above.

Given the lack of enthusiasm and regulatory policy of SBA and the legal limitations on EDA, legislation such as that proposed by Nelson, Long, Kostmayer, Lundine and McHugh is necessary if the government is to take a more active role in encouraging employee ownership. The alternative to this policy would be to allow the businesses to close and to make the variety of transfer payments that are involved when there is extended unemployment, such as occurs when a plant closes. Given the success of employee ownership, it seems much the wiser course for the government to make or guarantee loans, the large majority of which would almost certainly be repaid, then to spend money on various programs designed to ease the impact of unemployment. Of course, such loans should only be made to companies with reasonable prospects for success, and the government should not strive to make loans in every instance. Government encouragement of the concept and practice of employee ownership, however, could convince at least some conventional credit sources to treat it as just another way of organizing a business. That, it appears, would be a very positive development which could significantly increase the productivity, wealth, and job satisfaction of employees, as well as preserve and improve local businesses. Finally, it would accomplish these things within the framework of free enterprise rather than government regulation.

CONTENTS

	Page
Summary.....	iii
Introduction.....	1
I. Dimensions of employee ownership.....	2
II. Employee stock ownership plans.....	4
III. Non-ESOP modes of ownership.....	10
IV. Transfer of ownership to employees.....	14
V. Government support for employee ownership.....	16
VI. Evaluating employee ownership.....	18
VII. Case studies.....	19
VIII. Legislation.....	22
Conclusion.....	24

THE ROLE OF THE FEDERAL GOVERNMENT AND EMPLOYEE OWNERSHIP OF BUSINESS

INTRODUCTION

In the last several years, there has been a growing trend for employees to own substantial equity in the companies for which they work. In a large number of cases, employees have actually purchased their firms. In some instances, employee ownership has been encouraged by government tax benefits or by direct or guaranteed loans, but in others it has been the result of purely private initiatives. Whatever the causes of the trend towards employee ownership may be, however, the results appear to be very positive: A broader distribution of equity and participation in the capitalist system, the preservation of businesses and jobs that would otherwise have been lost, greater profits, and higher levels of productivity, wages, and worker and management job satisfaction.

Problems have been encountered as well, of course, particularly in the area of transition to new management forms and preventing employee owned companies from being sold to other interests, but the apparent success of the experiment suggests that it merits serious attention by the government. If employee ownership as a concept is successful it could help provide a means of preventing unemployment, broadening economic opportunity, and increasing productivity. This report will evaluate employee ownership of business and the role the government currently plays in encouraging or discouraging it.

According to various estimates, there are approximately 1,000-3,000 employee stock ownership plans (ESOPs) in the United States, the vast majority of which provide employees with a minority of stock in a company. In addition, there are at least ninety companies in which a majority of the assets are owned by employees (both management and hourly—companies owned only by management employees are not considered in this figure). These companies range in size from several employees to several thousand. A list of the companies is included in the appendix. As the list shows, the companies are widely distributed around the country and represent a broad range of industries. 80 percent of these firms were formed since 1971 and 57 percent since 1975, and roughly 70 percent were the result of a corporate divestiture.¹ As later sections will make clear, these companies have been very successful. They have higher profits, wages, and productivity levels than comparable firms.

Two main arguments support the idea of employee ownership. One is that it would make possible a broader distribution of wealth in the United States.²

¹ From data gathered for a forthcoming study by Donna Sockell of Cornell University.

² For a detailed discussion of this issue and possible remedies, including employee ownership, see "Broadening the Ownership of New Capital: ESOPs and Other Alternatives," a staff study for the Joint Economic Committee, U.S. Congress, June 17, 1976.

In 1972, for instance, 6 percent of the people in this country held 49.5 percent of all assets, including 72.2 percent of all stock, and had 52.4 percent of the total net worth.³ A broader distribution of wealth, it is argued, would increase not only the material well-being of people, but also would give them a greater sense of participation in the economic system. This in turn would result in greater productivity.

The second argument is that employee ownership provides a means to save businesses and jobs when a company would otherwise close, be liquidated, or relocate, possibly abroad. Many companies close for reasons unrelated to profitability, such as the retirement of the owner or cash needs of a conglomerate; while others which were previously unprofitable can be made profitable when employees actually own the company. Employee ownership, in these cases, would provide a very desirable alternative to a program of government transfer payments for unemployed workers. This, of course, would also be a tremendous benefit to the community which would otherwise lose the business activity and have to be a contributor to the unemployed.

The Government policy on employee ownership has been mixed. The Small Business Administration, the Farmers Home Administration, and especially the Economic Development Administration have made loans to employee organizations who have purchased their firms, but the number of loans has been limited (13) and most employee take-overs have had to be accomplished through conventional financing means. At this point, financing employee ownership conventionally is extremely difficult. Government tax support for employee ownership has concentrated on ESOPs, giving substantial benefits to companies who can take advantage of these provisions.

The remainder of this report will develop these points in detail, with particular attention to companies actually owned by employees, as it is in this area that Congress will be considering new legislation next year.

I. DIMENSIONS OF EMPLOYEE OWNERSHIP

As mentioned above, according to one estimate approximately 1,000-3,000 firms have ESOPs.⁴ ESOPs are employee ownership plans in which employer contributions and/or the use of employee stock ownership trusts as leveraging devices are used to transfer stock ownership to employees over a period of time. Their operation will be discussed in detail below. There are, in addition, an undetermined, but probably small, number of companies whose assets are directly owned by employees, either through stock purchase or cooperative purchase of assets.

Roughly ninety firms have been identified in which a majority of the equity is owned by a majority of the employees. This list probably is fairly comprehensive for all but the smallest of businesses, since it excludes what is probably a large number of small producer cooperatives.

The characteristics of employee owned firms recently have been explored by the University of Michigan's Survey Research Center.

³ James D. Smith and Steven Franklin, "The Distribution of Wealth Among Individuals and Families," 1975.

⁴ Employee Ownership: Report to the Economic Development Administration, Survey Research Center, Institute for Social Research, University of Michigan, estimated 1,100 in 1977, while the Employee Stock Ownership Council of America estimated 3,000 to committee staff in 1978.

In a survey of 100 employee owned firms, the Center found that 68 of 98 firms for which data was available were owned through ESOPs.⁵ In a related study, about one-third of the firms were found to be small, using the Small Business Administration's criteria.⁶ The ESOP firms tended to be larger than the non-ESOP firms.⁷ Table 1 gives a detailed breakdown of the size characteristics of the surveyed firms.

TABLE 1.—SIZE CHARACTERISTICS OF EMPLOYEE OWNED FIRMS BY OWNERSHIP TYPE
[In percent]

	ESOP's (68)	Direct (30)	Total (98)
Number of employees:			
4 to 99.....	18	20	18
100 to 249.....	18	37	23
250 to 999.....	38	23	34
1,000 plus.....	26	20	25

Source: "Employee Ownership, op. cit."

The percentage of equity owned by employees varies considerably as well:

TABLE 2.—PERCENT OF EQUITY OWNED BY EMPLOYEES, BY EMPLOYEE TYPE, AND BY OWNERSHIP PLAN
[Percent owned by all workers/percent owned by hourly workers]

	Ownership plan					
	ESOP's		Direct		Total	
	All	Hourly	All	Hourly	All	Hourly
Percent of equity owned:						
0 to 9.9.....	4	50	4	16	4	40
10 to 49.9.....	18	43	18	20	18	36
50 to 100.....	78	7	78	64	78	24

Source: "Employee Ownership, op. cit."

The table shows that employees own a majority of the equity in a majority of the companies. This is probably misleading, however, if it is taken to be representative of all companies with some degree of employee ownership. The 100 companies identified for the survey are probably owned by employees more than the several hundred not identified, since the survey was not a random sampling, but simply a survey of all the companies the authors could find that were known to have employee ownership. Those with substantial employee ownership, being unusual, are probably better known and thus more likely to be included. Committee staff, for instance, has been able to find only 90 companies in the country in which a majority of the equity is owned by a majority of employees. It appears, therefore, that in most companies with employee ownership allow employees to own only a minority of the stock, and that the distribution of ownership is skewed towards management.

The table is more revealing with respect to the differences between direct and ESOP ownership. In directly owned companies, hourly workers are much more likely to own a majority of the equity (64 per-

⁵ Employee Ownership, op. cit., p. 7.

⁶ Sockell, op. cit.

⁷ Employee Ownership, op. cit.

cent of the cases), whereas in ESOP companies hourly workers own considerably less (only 7 percent of the ESOP companies have hourly employees owning a majority of the equity). These companies concentrate ownership in managers, since most distribute stock according to salary to qualify for certain tax benefits. Overall, the study found that regardless of ownership form, firms of moderate size (100-250 workers) were most likely to be owned by hourly workers.⁸

The study found that companies chose to become partly or wholly owned by employees for a variety of reasons, but ESOP firms cited employee incentives most commonly, closely followed by the financial benefits to the firm of using ESOPs for capital acquisition. Directly owned companies cited saving jobs most frequently.⁹ The reason for this is that ESOPs are generally set up by existing companies as employee benefit plans, while direct employee ownership is usually the result of employee efforts to keep a plant alive.

In the following sections, ESOP and direct ownership plans will be evaluated in greater detail. The overall performance of employee owned firms will then be evaluated, followed by a section on government support for the idea and one on pending legislation.

II. EMPLOYEE STOCK OWNERSHIP PLANS

Employee Stock Ownership Plans are largely the effort of Louis Kelso, a San Francisco attorney who has argued that the success of the capitalist system will depend on broadening stock ownership. When a company sets up an ESOP it can now qualify for a number of tax benefits, a result of Congress's favorable position on the plans. Partly as a result of these benefits, ESOPs have been spreading widely in recent years.

Under an ESOP, a company establishes an employee stock ownership trust (ESOT). As Congress specified in the Employee Retirement Income Security Act of 1974, the trust, if properly established, qualifies as a stock bonus plan under section 401(a) of the Internal Revenue Code. The Trust then arranges a loan from a bank or other credit source to be used for company capital needs. The creditors will require that the company fully guarantee the ESOT borrowing, something the company is specifically allowed to do under the 1974 Pension Reform Act. The Trust uses the money it has received from the creditor to purchase company stock. The stock stays in the Trust: the company pledges to pay the Trust sufficient amounts to repay the principal and interest on the loan. Interest and principal are tax deductible, up to 15 percent of the covered payroll or 25 percent if the plan is being used as a retirement fund. The company benefits in that normally only interest payments are deductible on a loan. The entire contribution to the ESOT is thus in pretax dollars, so that a company in a 46-percent bracket will, in effect, be paying only 54 percent of the cost of both the program and the loan. The employees benefit because they will acquire the stock, which will vest with them as the loan is repaid. Vesting usually begins a few years after the loan is made. The employees receive their stock when they retire, died, or leave the company.

⁸ *Employee Ownership*, op. cit., pp. 14-5.

⁹ *Employee Ownership*, op. cit.

Ten year income averaging, rollover into Independent Retirement Accounts, and capital gains treatment of the income, are the usual ways to avoid paying high taxes on the benefits. During their period of employment, however, the employees have paid nothing for the stock.

This added stake in the company, theoretically, will help the morale and motivation of the employees, resulting in greater productivity. The distribution of stock is usually made according to salary.¹⁰ Plan participation is voluntary.

This description of ESOPs suggests that they allow a company to use the same dollars to repay a loan and to establish an employee benefit plan, while deducting much of the cost through tax writeoffs. As we shall see below, moreover, ESOPs have additional special tax benefits. There is, however, considerable disagreement about the actual benefits of ESOPs both for the company and for the worker.

ESOPS AND TAXES

The Tax Reduction Act of 1975 established an additional 1-percent investment tax credit for any company setting up a qualified ESOP. The essential new qualifications were that the stock had to be distributed according to salary (ignoring amounts over \$100,000), stock voting rights had to be passed through, and vesting had to be immediate. Until that time, ESOPs had been limited primarily to small, closely held companies which have used ESOPs as a means of creating a market for their stock, transferring ownership of stock to favored employees, or establishing an employee benefit plan. Use for financing growth was less common.¹¹ The 1-percent credit meant, however, that a company which was making investments, qualified under the investment credit provisions of the law, could receive from the government an amount equal to 1 percent of the cost of the investment if they established an ESOP. In other words, the government would make a contribution to the ESOP. The 1975 Act applied only to 1975 and 1976. In 1976, however, it was extended to 1980 and increased to 1.5 percent, provided the employees contributed .5 percent (otherwise the 1-percent credit applied). In 1978, the credit was further extended to 1983.

ESOPs established under this act (called TRASOPs) have been found primarily in large, capital intensive industries, for it is these companies who are making large enough investments and have few enough employees so that the 1- or 1.5-percent credit amounts to a significant amount per employee.¹² By contrast, for a large retailer, for instance, the benefit per employee would be less than \$10.¹³ Under these conditions, the cost of establishing the plan would exceed its benefits, especially since the plan requires that employees have voting rights. Even if a company had an ESOP, it might choose not to use the credit if it were small or labor intensive, due to the additional plan requirements stipulated by the act. Finally, a company cannot be sure that the credit will last beyond 1983, even though the ESOP obligation established under the bill would continue past that date.

¹⁰ *Employee Ownership*, op. cit.

¹¹ *ESOPs—An Analytical Report*, Hewitt Associates, 1977, p. 12.

¹² *Broadening the Ownership of New Capital*, op. cit., pp. 41-9.

¹³ *Making New Capitalists—A Creative Response to Income Inequities*, Richard J. Smith, Department of State Executive Seminars, 1978, p. 18.

In addition to the limits of the tax advantage under the Tax Reduction Act, there is some debate over the usefulness of ESOPs to finance growth and employee benefit funds with pretax dollars. A company could borrow money from a creditor and make a stock contribution equal to the principal amount of the loan to an employee fund. The tax situation of the company would be precisely the same, since it could deduct the interest on the loan and the amount being contributed in stock to the fund.¹⁴ While the difference between the two approaches would be negligible for the employer, except that he would not have to create an ESOT, the employee might notice a very important difference: under an ESOP, the entire amount of the loan is credited to the ESOT at the time the loan is made (in stock). In the alternative plan, stock accumulates only as the loan is repaid. The employee thus loses all the appreciation on the stock not credited to the fund over the life of the loan, an appreciation which could be substantial, especially during periods of inflation. Viewed conversely, if the employee must wait for installments of stock over a period of years, he is, in effect, having the value of the stock discounted by its anticipated appreciation, including the amount due to inflation.

In sum, the tax benefits for a company employing an ESOP are significant for some companies, but for most the tax laws simply put ESOPs on a similar footing with other employee benefit plans. The increase in their use, therefore, probably cannot be attributed to tax incentives per se. In fact, as of 1978, only 200 TRASOPs had been set up, but, altogether, there were at least five times as many ESOPs.¹⁵ The spread of ESOPs, therefore, must be attributed to its other uses: a vehicle for financing, a genuine desire of employers to broaden stock ownership as a means to increase employee incentives, or as a means to transfer ownership of a company to employees. Data referred to above confirm this view. The following sections will explore these areas in greater specificity.

ESOP'S AS A FINANCING VEHICLE

The primary advantages of ESOPs as financing vehicles were listed at the outset of this chapter: The entire loan repayment (principal and interest) is deductible, there is a tax credit for some companies of 1 or 1.5 percent, a source is provided for buying out large stockholders or transferring stock to employees, and ESOP financing can be used simultaneously for a wide variety of financial needs and setting up an employee benefit plan with the same dollars. These advantages must be set against a number of disadvantages:

(1) A company could follow the example set forth on the preceding page and contribute stock to a fund as it repaid the loan. This would be less beneficial for employees, but the company would retain the stock, and thus any appreciation it might have, for a longer time.

(2) The issuance of new stock to the ESOT will mean a dilution of stock value for existing shareholders unless the new growth financed through the ESOP is large enough to offset the dilution. This can be of serious concern in a small, privately held company, especially if the plan carries voting rights with it.

¹⁴ *Making New Capitalists*, op. cit., p. 19.

¹⁵ *Making New Capitalists*, op. cit., p. 20.

(3) ESOPs must conform to pension laws and, if a credit is sought, TRASOP provisions. The cost of compliance may be a significant barrier for some companies.^{15a}

Of course, in any case, a company seeking to finance new growth must evaluate all the costs of whatever financing method it chooses—debt financing (eg; conventional loans), equity financing (eg; selling stock), or ESOP financing. One careful analysis of the costs of these approaches was made by Hewitt Associates. The study assumed that the company was in the highest tax bracket and thus could make full use of the principal and interest deduction features of ESOP, but did not assume the 1 percent credit was claimed. The study concluded that ESOP financing was better than debt financing by 15 percent over a 10-year period, but 15–20 percent worse than equity financing.¹⁶ Of course, this example makes a number of important assumptions, but it does suggest that ESOPs should be more popular with closely held companies, since they would have difficulty with equity financing. Other than publicly held companies using the 1.5 percent credit of TRASOPs, this does seem to be true among ESOP companies.

The study also may be less applicable to small firms with lower corporate tax rates. For them, the ability to deduct the principal and interest portions of the payments to the Trust are less important than for more highly taxed firms.

As with the tax benefits for ESOPs, then, the financing benefits appear mixed and appropriate only to certain firms. A large or moderate sized company with a payroll large enough so that the borrowing it envisaged would be less than the 15 percent limit on deductibility would be ideally suited for ESOPs.

The previous two sections, however, have disaggregated the benefits of ESOPs and evaluated them separately. In fact, the primary advantage of an ESOP is that it can simultaneously be used for financing, for tax benefits in some cases, and for establishing an employee benefit plan, a plan which, by disbursing ownership, should increase motivation. While a company might be able to accomplish all these goals separately for the same money, ESOPs provide a convenient device to do all three which, at least for some companies, could provide important financial benefits.

ESOPs should not be evaluated only as a tool for the company, however, since they have important consequences for employees as well, as will be discussed below.

USING ESOP'S TO TRANSFER OWNERSHIP TO EMPLOYEES

Before turning to the effects of ESOPs on employees, however, one additional function of the plans needs to be considered their use to transfer a business to its employees. It is in this respect that ESOPs are particularly helpful. All analysts, including those critical of ESOPs, seem to agree that they provide a very advantageous approach for these situations.

There are two situations in which a company is sold—a divestiture from a parent company or a sale from an independent owner upon retirement, death, movement to a new position, etc.

^{15a} For a comprehensive review of ESOP financing disadvantages see Jared Kaplan, "ESOP's Fable," *Taxes*, 1975, pp. 898–912.

¹⁶ ESOP's—An Analytical Report, Hewitt Associates, 1977, pp. 34–5.

In the divestiture case, an ESOP would work as follows: The parent company creates a new company, which in turn creates an ESOP. The ESOP sets up an ESOT which secures a loan, which the new company (and sometimes the parent company) guarantees, using the assets of the company it is about to buy as collateral. The ESOT uses the money from the loan to buy the new company. The assets of the new company are exchanged for stock in the company (in effect, the ESOT gives the assets to the new company in return for an equivalent value in stock). The loan is repaid through the ESOT by the new company, which has pledged to make sufficient funds available to the ESOT for repayment. The payments through the ESOT, of course, are deductible up to the 15-percent or 25-percent limit.¹⁷

The company could accomplish the same thing by getting a bank loan and then setting up an employee benefit fund and making stock contributions equal to principal payments. This would amount to the same thing as an ESOP, except that the employees, who are now the owners of the company, would not get the full benefit of stock appreciation as the loan is being repaid. Since the employees now own the company, there would be no reason not to set up a plan in this manner.

Unless a government agency or the parent firm is backing up the loan to the ESOP, it is unlikely that a bank or other creditor would loan the money for the purchase of the company unless the individual employees could put forward a substantial amount of their own capital. The ESOP device, therefore, is not a magical tool for creating capital and credit where none existed before, but it is extremely useful in many circumstances.

The main benefit it offers is the creation of a market for the subsidiary. When a parent company decides to close or sell a subsidiary, other buyers may be reluctant to take the firm over. In many cases, the buyers simply may be other conglomerates only. ESOPs thus offer a way to sell a company so that new company is an independent, locally owned firm. Because the ESOP offers a means for purchasing the company in pretax dollars the new buyers are off to a better start than if they had to raise their capital on their own to buy the firm (in that case only the interest would be deductible). The result of all this is that the parent company has a buyer and the employees, rather than losing their jobs or being taken over by another conglomerate, can keep their jobs and have a stake in their new company.

ESOPs are also very useful when an owner wants to sell his company or his share in his company. Normally the sale of stock by an owner to his corporation is taxed as income, unless all or most of the stock is sold at one time, which an owner may not want to do as he plans to leave a company over a period of time. Under an ESOP, the owner simply makes contributions to an ESOT (straight contributions, not new borrowings), which the ESOT then uses to buy the stock. The IRS has held that this is not the same as a normal stock purchase and the sale of the stock is treated as a capital gain.¹⁸

In addition, of course, in any sale by an owner to his employees, the ESOP offers the same advantages as in the divestiture case: Creation of a market and the ability of employees to buy the company in pretax dollars.

¹⁷ "ESOP: Pluses and Minuses", Robert Reum and Sherry Milliken Reum, *Taxes*, July-August, 1976, p. 139.

¹⁸ Neil Wassner, statement before the Joint Economic Committee, hearings on ESOPs, 1975.

Unlike the other aspects of ESOPs, then, their use in transferring ownership seems almost unequivocally beneficial, especially for the employee purchasers. Only in the case where a company desires to sell to another company through an exchange of stock (which would avoid capital gains taxes) would an ESOP purchase present a problem. This option only applies, however, in cases where a subsidiary is highly marketable and another conglomerate with desirable stock is interested.

ESOPs AND EMPLOYEES

ESOPs are clearly beneficial to employees seeking to buy their firms, but in ongoing concerns their benefits depend on the values of the employees.

ESOP proponents claim that ESOPs provide employees with stock at no cost to them. Thus, even if the company goes out of business and the stock becomes worthless, the employees have not lost anything. This, however, is an unrealistic view, since the ESOPs are likely to be viewed by the company as a form of employee compensation, thus reducing the need for other modes of compensation.

For the employee, in many cases, the choice is between an ESOP and some other form of employee benefit plan, such as profit sharing or, in some cases, a pension plan. Ownership of stock in the company is only beneficial, of course, inasmuch as the value of the stock increases. If the stock increases at rate faster than the loan rate, then the employees benefit more than had the money simply been returned through profitsharing.¹⁹ If the stock declines, the employees lose, and if the plan represents their pension, they could face serious problems. Since most firms do eventually close, this is a problem that must be addressed.²⁰ In California, ESOP insurance at reasonable rates has started.²¹ Employees can also be assured of gaining some equity when the company is sold or liquidated.

On the other hand, data will show later that employee owned firms do much better than non-employee owned firms, and the more equity employees own, the better the companies do. If a company succeeds, an employee, over the life of his participation, could accumulate considerable sums. ESOP proponents point to workers who have left ESOPs with hundreds of thousands of dollars. Finally, participation in ESOPs is voluntary, and employees could bargain for a choice of employees—ESOPs or a like contribution to another benefit plan.

Unions have generally opposed ESOPs due to the risks involved and due to a fear that worker-owners will be co-opted by management.²² Where ESOPs are an employee benefit program, clearly the employees have the most to lose in relation to other alternatives. Employees must choose whether participation in their companies' possible success or failure is worth more than a more secure and conventional plan. The decision is not unlike deciding whether or not to buy stock or put money in the bank, except that the employee knows the stock better and can contribute to its value.

Where ESOPs are used to purchase or eventually transfer ownership to employees, however, the situation may be viewed differently.

¹⁹ *Broadening the Ownership of Capital*, op. cit., p. 37, and *ESOP's: An Analytical Report*, op. cit., pp. 24-5.

²⁰ *Broadening the Ownership of Capital*, op. cit., p. 36.

²¹ Statement of Louis Kelso before JEC hearings, op. cit.

²² *Broadening the Ownership of New Capital*, op. cit., p. 38.

Now the employees must choose between a simple wage and an opportunity to earn a wage and partake substantially in the company's direction and future. The risks are greater, but, since individual employees are not liable if a company does go bankrupt or suffer losses except inasmuch as salaries may decline, the risks are not as great as normal ownership. All of the psychic and financial opportunities are present, however.

These psychic rewards, of course, are one reason why ESOPs are established. Management hopes that employees will be stimulated to greater levels of productivity. Their hopes seem to be confirmed by the studies available (cited below in section VI), although it appears that ESOPs which provide only small amounts of stock to employees have little impact. Employee ownership of substantial equity, on the other hand, provides considerable incentives.

In sum, ESOPs present both risks and advantages for employers and employees, and each case must be evaluated individually. Nonetheless, ESOPs appear very useful for transferring ownership to employees and, in ongoing businesses, can often create substantial opportunities for businesses and employees. While not the financial miracle some proponents claim, they have important advantages, perhaps the most significant of which is the possibility for a new way of organizing American worklife by creating a much broader participation in the capitalist system.

III. NON-ESOP MODES OF OWNERSHIP

While ESOPs have gained considerable popularity and constitute the bulk of employee ownership plans, there are alternatives to ESOPs. The most common of these alternatives are cooperative ownership, in which all or most employees purchase shares of a company and participate in its management, and direct ownership, in which employees purchase all or part of a company but retain traditional management forms. Both forms have advantages and disadvantages, but both require that individual employees put up a substantial amount of their own capital in order to purchase their companies, a process that requires not only considerable willingness to undertake risk on the part of employees, but also requires tremendous organization and leadership in order to assure that the employees will actually put forth the necessary capital in the limited time available to purchase the firm. While this obviously presents significant obstacles, using this procedure may make lenders and the company's prior owners more willing to loan or sell than in an ESOP situation, where employees may not be risking any of their own assets.

COOPERATIVE OWNERSHIP

There are an unknown number of producer cooperatives in the United States, most of them small, non-conventional local businesses often motivated by concerns other than profit. While these businesses present an interesting alternative to traditional business forms, they will not be discussed in this report, which is, instead, focusing on uses of employee ownership in the more traditional sphere of business organized primarily for profit. The reader interested in these businesses

is referred to Daniel Zwerdling's excellent collection, *Democracy at Work*.²²

Cooperatives have been used to organize more traditional businesses in at least a few industries, and case histories are available for those in agriculture, garbage collection, and plywood manufacturing. Of these, the most detailed information is available on plywood coops, and they present an important and illustrative example of the potential and problems of cooperative organization.

In the Pacific Northwest, there are currently about 16 cooperative plywood companies, about half the number that have been created at one time or another in the last 50 years. Most are of moderate size, and collectively they account for about one-eighth of the total Douglas Fir Plywood output.²⁴ The first of the cooperatives was formed in 1921 in the Seattle area, which had a large Scandinavian population with a cooperative tradition.²⁵ The company's success led to the formation of other plywood coops, sometimes at the instigation of promoters who took advantage of the workers.

The coops provided that each member would be allowed to buy only one share. In many companies, this could be done through a payroll deduction plan. Every shareholder is guaranteed a job. Wages are the same for all shareholders, but all the companies have non-owner general managers who are paid substantially more. Also, many companies hire non-owning workers, especially for temporary or less-desirable jobs, and most companies have incentive pay systems for unpleasant work. Shareholders elect a board of directors from among their ranks, and the directors meet periodically to make policy decisions. Day to day management is in the hands of the general manager. Directors, of course, continue at their jobs, and most usually serve for a limited time. Working shareholders are paid conventional wages, but at the end of the year are returned "surpluses" (the coop word for profits). Share values generally increase, and now are worth from \$20,000 to \$200,000.²⁶

The subsequent resale of stock by retiring workers is limited to people who will or could become workers in the company (although it is not necessary to take a job immediately). Dividends are very limited so that benefits of ownership will accrue primarily to worker-owners. Shareholders can demand a job at any time when they are not working.²⁷

Overall, the plywood coops have been successful. Some have made a great deal of money for their owners, while others have just survived and still others have failed. Given the often difficult conditions in the industry over the period of their existence, however, the companies have an admirable performance record. Workers, in addition to the share value they have accumulated, are paid about 25 percent more than in comparable plywood companies and are about 30 percent more productive.²⁸ Interestingly, Northwest plywood unions are uncomfort-

²² Daniel Zwerdling, *Democracy at Work* (Association for Self-Management, Washington, D.C., 1978).

²³ Bruce Stokes, "Worker Participation and the Quality of Worklife", (Worldwatch Institute, Washington, D.C., 1978), p. 28.

²⁴ Carl J. Bellas, *Industrial Democracy and the Worker Owned Firm*, (New York, Praeger Publishers, 1972), p. 17.

²⁵ For an excellent review of the plywood coops and their structure see Katrina Berman, *Worker Owned Plywood Companies* (Pullman, Washington State University Press, 1967).

²⁶ Berman, *op. cit.*

²⁷ Paul Bernstein, "Run Your Own Business", *Working Papers for a New Society*, v. 2, No. 2, summer, 1974.

table with the coops, since the role of the union is less important in the coops (most do have unions, but they are mostly concerned with relatively minor matters) and since coops will reduce worker pay when the company is not doing well.²⁹

Management of the coops can present problems, since the workers are always tempted to reduce investment for the future in order to increase wages or surplus returns in the present. When financial problems arise, raising new capital becomes difficult, since it cannot be raised through stock-offerings and some creditors have been reluctant to make loans.³⁰ Nonetheless, most of the plywood coops have managed to overcome these problems.

In fact, of the plywood companies that have gone out of business, four did so because they were too successful. Share values increased so much that no new investors could be found who were willing to buy the shares. Those with enough money would not be interested in working in the company, with the result that in order to dispose of the shares and to raise new capital the companies were forced to sell to larger firms. Of course, in addition, the shareholders made substantial profits through the sale and generally urged that the sale be made.³¹ Some other plywood coops only lasted a short time, as they were the creation of promoters trying to unload a dying business or simply to get rich quick by taking a substantial fee for their efforts.³² According to Bernstein, only four of the coops simply failed once they had been established.³³

One way to solve the problem of shares costing too much to attract new worker-owners would be for all companies to use a payroll deduction plan. Another approach would be to limit share value to a certain amount for the worker and have the company purchase the excess value, contributing the excess amount (a percentage of the actual share value) to a pension fund which would be recapturable by the employee only when he left the company.³⁴ The problem, although difficult, is capable of resolution, provided the coop plans ahead.

Coops do present one significant tax benefit to owners in that the IRS has ruled payments to shareholders could not be considered taxable corporate income, allowing the owners to transfer profits to themselves at lower tax rates than would be the case if they were retained as company profits. IRS rules require, however, that the coops show that the wages they pay are not in excess of reasonable labor costs. Since the coop workers have been more productive than their non-coop counterparts, the IRS has allowed the coops to pay substantially higher compensation to their employees.³⁵

In sum, the coop experience in the plywood industry has been generally successful, demonstrating that workers can own their companies and manage them as well, and in so doing make high wages and a company "profit" (which they can keep for themselves). Although growth and management problems do arise, the problems have not been insurmountable. The rewards for the workers—a secure, high paying job in their own company—have been, it seems, well worth the efforts

²⁹ Berman, *op. cit.*, p. 127.

³⁰ Bellas, *op. cit.*, p. 97.

³¹ Bernstein, *op. cit.*

³² Berman, *op. cit.*

³³ Bernstein, *op. cit.*

³⁴ Bernstein, *op. cit.*

³⁵ Berman, *op. cit.*, pp. 165 and 175.

to overcome obstacles. It appears, however, that few other cooperative ventures exist, and none are so widespread or well-developed as the plywood coops. Detailed information about them is not available. The most that can be said, then, is that the coop alternative shows considerable promise, but has been too uncommon to justify any firm conclusions about the precise role it might play in American business.

DIRECT WORKER OWNERSHIP OF BUSINESS

The phenomenon of workers buying their companies directly is a relatively recent one in this country. In this situation, when a company would otherwise close or relocate, workers, sometimes in cooperation with local community people, agree to raise the money needed to buy the firm themselves, generally through a purchase of stock issued by the new company. Of all forms of worker ownership, this is the most simple and direct as far as transition arrangements are concerned. It is not, however, easy to accomplish.

From the data gathered by the Survey Research Center and by committee staff, it appears that about one-fourth of the the employee owned firms (where employees own half the equity or more) are owned directly by employees or employee-community groups. The term direct ownership here is simply meant to distinguish between firms in which ownership is accomplished through an ESOP or through a cooperative and firms in which employees or employees and local people simply purchase the stock of a company on a normal stock offering basis (although stock may be limited to employees or local people, and ownership of more than a certain amount of shares may be prohibited). Unlike coops, owners can own more than one share.

The direct ownership concept is surely the simplest of the three arrangements discussed. When a plant is about to close, an organization is formed to sell stock in a new company which will buy the old plant from its previous owner. Generally, it appears that the stock offering is not limited to employees in order to facilitate raising the necessary capital, although some companies limit subsequent resale to the company or to employees. In some cases, the sale has been from former owners who have gradually transferred stock to employees over a period of time, while the company continued in operation, while in a few cases, employers have simply given the stock to their employees (most notably in International Group Plans of Washington, D.C.).

When a benevolent owner does not exist, raising the necessary capital in this manner can be extremely difficult. Employees may be asked to raise thousands of dollars in a few days or a few weeks. Banks may be very unwilling to loan money at this point, given the uncertainty of the endeavor at this early stage. Employees may end up owning worthless stock. Nonetheless, since their jobs are at stake, the investment risk may seem worthwhile. From the information available to the committee, it does not appear that any employees have lost their investments in the cases that follow this pattern that have occurred in this decade, when most of the employee takeovers have taken place.

Once the stock is owned by the company, and operating loans are secured, the company has a number of options concerning the role employees will play as owners. From the cases on which information is available, however, a common pattern seems to have emerged: Employees vote their stock, as would any owner, but the board of directors

rarely has substantial employee representation and worker participation in management is generally limited. The employees, in buying the company, are naturally primarily concerned with preserving their jobs, and give little thought to how the company will be run once it is saved. Moreover, it appears most companies do not plan for the transfer of stock from retiring employees to new employees, so that the idea of employee ownership may fade over time. Some companies do not even provide that stock must be sold back to the company, so that an outside interest can purchase a majority of company stock. This is precisely what happened in one of the best known cases of employee ownership, the Vermont Asbestos Group.³⁰

The result of this lack of planning can be employee disenchantment after a few years. In this respect, ESOPs and cooperatives have clear advantages: in that they specifically address questions of stock ownership and employee voting rights (although ESOPs, unlike coops, have no requirements for employee participation in management and many ESOP promoters oppose the idea). Nonetheless, this is not an inherent disadvantage for direct ownership. The problems of ownership transfer and employee participation can be resolved, but they must be addressed at an early stage, prior to the disappearance of a majority of the stock or the alienation of employee owners.

While direct ownership is the simplest way of transferring ownership to employees from a financial standpoint, it does not offer the tax benefits available to employee owners under an ESOP (the ability to deduct principal and interest repayments on the loans used to buy the company—employee owners in the direct ownership model can only deduct their interest, or nothing at all if they used their own savings) or coops (the ability to return profits to employees without having the company pay taxes on the profits). The value of these tax savings will vary from case to case, but certainly should be a consideration when employees purchase a company.

IV. TRANSFER OF OWNERSHIP TO EMPLOYEES

The previous sections have explored the three basic modes of employee ownership and in so doing have discussed how each can be used to transfer ownership to employees. In this section, the reasons for transferring ownership to employees and the obstacles involved in doing it will be discussed.

Transfer of ownership occurs primarily under four conditions: (1) A company sets up an employee stock ownership plan as an employee benefit, usually either to provide an incentive to employees or to help finance expansion (or both), (2) a conglomerate decides to divest itself of a subsidiary, (3) an independent owner dies, retires, or leaves the business, and (4) an owner decides to give his company to his employees.

ESOPs have been discussed in detail above. This form of transfer is generally initiated by the employer and results in employees owning a minority of company stock, although there are cases, such as Hallmark Cards, in which employees will eventually own a majority of the stock. The use of an ESOP by management does not need further elaboration at this point, however.

³⁰ Zwerdling is again insightful on this point. See Zwerdling, *op. cit.*, pp. 53-76.

A decision by an owner to give his company to his employees is, to the committee's knowledge, very rare, although a few cases have been documented.³⁷ The practice appears unusual enough, however, not to merit discussion here.

The other two cases are more common and more interesting, and both involve the actual sale of a company to its employees. As such, they provide potential for saving jobs and business activity in communities that would otherwise lose them, or for preventing independent or potentially independent businesses from being swallowed by conglomerates.

Sockell has concluded that almost all of the cases of employees purchasing a firm have occurred in this decade, with the exception of the plywood companies.³⁸ Of these purchases, the large majority appear to be corporate divestitures.³⁹ Precise data are not available on all instances of known employee purchases, however, so estimates such as these are only approximate.

It may appear at first blush that a company that could not survive as a subsidiary of a conglomerate will also not survive as an employee owned firm. This, however, is often not the case. In many cases, a conglomerate sets certain rates of return (typically around 15 percent) it expects from its subsidiaries. If they do not achieve these rates, they are closed or sold. Employee owners, however, may well be satisfied with a lower, but still profitable, rate of return, since their jobs are at stake. In other cases, a conglomerate may simply find that a subsidiary does not fit into its current plans, or that it needs the cash that would result from a sale. Finally, conglomerates may mismanage firms, saddling them with substantial overhead costs or making inappropriate decisions. Even a subsidiary that is well run, moreover, might be better run by employee owners, since their new owners would presumably work harder than before.

Sociologist William Whyte, who is heading a research project at Cornell University's School of Industrial and Labor Relations on this project, has cited these reasons and others as the explanation for the fact that, to the knowledge of researchers in the field, of the companies which have had employee takeovers in this decade, all are still in operation, and many have been turned from money losers into profit makers.⁴⁰ Given what many economists see as the over-acquisition of the sixties and seventies, there could be ample opportunities for employee ownership in the years ahead.⁴¹ For employees and communities where conglomerates have erred, employee ownership may be the only way out of a desperate situation.

For independent owners who are retiring, leaving their company, or who have died, transfer to employees may be a very attractive alternative. An extensive survey of owners of wholesale distributing companies showed that few have given serious thought to this problem, and most had unrealistic expectations about prospects for their company's sale.⁴² Although use of the techniques is still uncommon, its advan-

³⁷ See Zwerdling, *op. cit.*, pp. 113-130.

³⁸ Sockell, *op. cit.*

³⁹ Sockell, *op. cit.*

⁴⁰ William Whyte, "In Support of the Voluntary Job Preservation and Community Stabilization Act", n. E3326 of the *Congressional Record* of June 19, 1978.

⁴¹ "How To Buy Your Own Company", *Dun's Review*, November 1977.

⁴² "Profile of the Perpetuation Crisis", National Association of Wholesale Distributors, 1975, p. 5.

tages—creating a market for the owner, preserving jobs for the employees, and providing an opportunity for the owner to see his company perpetuated as an independent business—suggest that it deserves much more serious consideration.

Despite the clear advantages of selling to employees, many conglomerates or individual owners are reluctant to do so. In some cases, an owner or conglomerate can sell a company to another company through an exchange of stock. Such exchanges are not taxed, whereas cash purchases are treated as capital gains. Using an ESOP can reduce some of the tax disadvantage in some situations, but not all. Many sellers simply do not take the idea of employee ownership seriously and refuse to negotiate with employees or fail to provide notice far enough in advance so that employees can organize. In some cases, a company can gain more through a liquidation sale and tax writeoff than it could through a sale, while in others a company is closing a subsidiary in one place to relocate elsewhere, and does not want anyone to own its former plant, since it would be a competitor.

Research on failures of employees to buy their firms is, unfortunately, very limited, but it appears that more important than any of the above reasons for failure is simply the inability of employees to raise the capital needed in a short enough time.⁴³ The problems in raising the money are obvious: employees must be organized quickly around a novel idea, cash must often be raised from low asset employees, and creditors must be convinced that an unconventional approach can work. Every case with which the committee is familiar in which employees succeeded in making the purchase has involved something extraordinary: A benevolent owner, and exceptionally talented organizer, or government assistance—assistance almost always prompted by the intervention of a Senator or Congressman.

The problems of transition, of course, suggest a role for the federal government as a source of credit or credit guarantees. The idea has intuitive appeal: in any case in which a firm would otherwise close or relocate the government has, in effect, two choices. It can pay unemployment insurance and possibly food stamps and welfare to unemployed workers or it can loan the workers money for buying the plant and keeping their jobs. In the first case, the money is a permanent transfer; in the second, it is a loan and, presumably, most of the loans will be repaid. As the next section will indicate, however, government involvement in employee ownership has been spotty and generally reluctant.

V. GOVERNMENT SUPPORT FOR EMPLOYEE OWNERSHIP

In this section, government support for employee ownership will be reviewed. As tax support for ESOPs has already been discussed, this section will focus on loan programs for employees who attempt to buy their businesses. There are four potential sources of funds: EDA's title IX program; SBA's 7a program, Farmers Home Business and Industrial Loans, and Loans to Producer Coops from the Cooperative Bank.

The Economic Development Administration, an agency of the Commerce Department, can grant and loan funds under its Title IX

⁴³ Robert Stern and Tore Holland Hammer, "Buying Your Job: Reconsiderations on Recent Experience", paper delivered at the 9th World Congress of Sociology, Uppsala, Sweden, Aug. 14-19, 1978.

program for business development in areas of high unemployment. EDA regulations require that assistance be given on a priority basis to areas affected by defense realignment, Environmental Protection Agency caused plant shutdowns, and disasters. All other assistance under this title receives lower priority. Nonetheless, to the committee's knowledge (records are not available with precise information) EDA has assisted nine employee organizations to purchase their companies, either through low-interest loans or grants to local agencies who in turn use the money to make loans to the employee organizations. In at least some of the cases, the assistance was a result of political pressure on the agency, but at least some of the agency's administrators have shown enthusiasm for the idea. Given the agency's required priorities, however, it is doubtful that EDA assistance can expand beyond its currently very limited scope without specific Congressional action. A proposal along these lines will be discussed later.

The Small Business Administration can make loans and guarantee loans under its 7a program. Direct loans are limited to \$350,000 and guarantees to 90 percent of the loan for not more than \$500,000. SBA has guaranteed three loans to employee organizations and appears to be about to guarantee a fourth. The SBA will not, however, make or guarantee loans to an ESOP. SBA regulations state that an ESOP is not a small business and that the advantages of an ESOP could be obtained in other ways.⁴⁵ While it is true that an ESOP or its trust is not formally a small business, it is simply a creation of a business, and its loans are formally guaranteed by the business. The distinction between the ESOP and the business is purely a paper distinction, and Senators Nelson and Long have expressed their disappointment and disagreement with the SBA position on this matter. Moreover, while it is true that in some cases a business could get the tax advantages of an ESOP without setting one up, as pointed out earlier, the employees benefit more if an ESOP is established than if an ESOP alternative is created. As was also pointed out, ESOPs are excellent tools for employee purchase of businesses, and there are on alternative methods of accomplishing the same tax purposes in this case. Since the SBA has stressed to the staff their concern with making loans to preserve or (in the case of a spinoff of a subsidiary) create independent small businesses, their refusal to make loans to ESOPs, which accomplish this extremely well, seems very contradictory and shortsighted.⁴⁶

The loans SBA has guaranteed, then, have been in non-ESOP cases, but, even here, SBA officials have told staff that they do not see making loans to employee organizations as consistent with the primary purpose of the agency (as they see it), namely to assist individual entrepreneurs. Given SBA guidelines for making loans, which include sufficient collateral on the part of those receiving the loans, it is easy to understand why the SBA, at this time, is not likely to be a primary source of loans to employees. If SBA were to become an effective force in this area, its rules on ESOPs would have to be changed and its evaluation of loans to employee organizations would have to be based on an assessment of the future prospects of the company.

⁴⁵ Letter from A. Vernon Weaver, Administrator, SBA, to the Honorable Russell Long, May 15, 1978.

⁴⁶ See Jan. 23, 1958, SBA memo reprinted in Opinion Digest, No. 56, Feb. 26, 1965 for SBA policy of encouraging the preservation and creation of small business.

The Farmers Home Administration also can make loan guarantees to employees and has done so in one instance (Bates Fabric in Maine). FmHA loans are not restricted by size of firm and can be as large as necessary, but must be made to businesses in places of 25,000 people or less. FmHA does, however, encourage small businesses even in these areas to approach SBA. Farmers Home officials have expressed enthusiasm about the idea of employee ownership to the staff, but said that they have not had many inquiries. For businesses in qualified areas, then, FmHA might be a logical place to seek credit.

Finally, the Cooperative Bank, created by the 95th Congress, can make loans to producer coops. There is a \$10 million limit on these funds, since the bank was primarily intended for consumer coops. The program is just beginning, but could provide a modest source of capital for employee ownership.

Overall, then, government involvement has been limited—probably less than 15 or 20 percent of the cases of employee ownership known to the committee involved government assistance. As the next section will make clear, however, the government could stand to benefit itself and the country significantly by becoming more involved in employee ownership.

VI. EVALUATING EMPLOYEE OWNERSHIP

Employee ownership of companies has worked. The overwhelming preponderance of evidence shows that employee owned firms are both more profitable and productive than similar conventional firms and that employee ownership results in better working conditions for everyone. Most importantly, where employees have bought their companies, it results in the preservation of jobs that would otherwise be lost. This is not to say that there are not pitfalls in employee ownership—a program for the support of employee ownership could result in aiding shaky businesses to take advantage of their employees if not carefully administered, and even successful employee owned firms have had difficulty determining the role employees should play in management, but the overall record of employee ownership is very impressive.

In a study of the plywood industry, Paul Bernstein found that employee owned firms had 30 percent higher productivity and 25 percent higher wages than conventional firms.⁴⁶ In addition, of course, each employee owner has equity in the company. In the Survey Research Center study of 100 employee owned firms, profits were 1.5 times higher in employee owned firms than non-employee owned firms, and the greater the equity owned by employees, the higher the profits (the study included a variety of ownership arrangements, from a minority employee ownership arrangement to full ownership).⁴⁷ Managers surveyed in the study reported much higher levels of employee satisfaction with employee ownership compared to the prior conventional ownership of their companies.⁴⁸ They also contended that employee ownership improved productivity and work atmosphere.⁴⁹

⁴⁶ Paul Bernstein, "Worker-Owned Plywood Firms Steadily Outperform Industry," *World of Work Report*, June 24, 1977.

⁴⁷ *Employee Ownership*, *op. cit.*, p. 24.

⁴⁸ *Employee Ownership*, *op. cit.*, p. 30.

⁴⁹ *Employee Ownership*, *op. cit.*, p. 35.

The idea of employee ownership is also a popular one: a 1975 national poll by Hart Research showed that a margin of 66 percent to 25 percent would prefer to work in an employee owned firm.⁵⁰

Perhaps the most important data, however, concerns the companies who would have gone out of business had employees not bought the company. Of the companies purchased by employees in the seventies, to the knowledge of the staff and researchers in the area, all are still in business, and many are succeeding where predecessors were failing. All told, perhaps 50,000 to 100,000 jobs have been saved. As a job creation program alone, employee ownership would compare very favorably to government funded public works jobs.

There are problems as well, however. Employee participation in management is often not planned, resulting in disenchantment of workers. According to the Survey Research Center, only about half the ESOP companies allow significant employee input into decisions and only 27 percent allow employees to vote their stock. By contrast, non-ESOP firms almost unanimously allow voting rights, and generally (77 percent of the firms) allow for employee input into major decisions.⁵¹ Sockell's more detailed study of the issue showed that of 32 firms surveyed, only nine allowed direct participation in management by employees, although 23 allowed stock to be voted.⁵²

Arguments can be made on either side of the issue of employee participation in management, but research conclusively shows that productivity increases with worker participation.⁵³

Research by Zwerdling cited above showed that when such participation is not allowed, workers-owners become alienated. While still pleased to have their jobs, they feel their equity position should give them more of a say in company operations. At the very least then, companies contemplating employee ownership should give serious thought to worker participation and be prepared to allow as much participation as possible.

Finally, it is possible that employees could be sold a company that was dying or had poor prospects. This happened in a few cases in the plywood industry in the fifties, although there are no apparent cases of it in the wave of employee takeovers in the seventies. ESOP plans could be used to reduce employee compensation or to substitute stock in a weak company for a pension fund. At this point, however, these problems seem to have been very minor compared to the success of the idea of employee ownership. Moreover, there is no reason why employees are not capable of making sound financial decisions, nor is there any reason to believe that the government would be unable, when it makes loans to employee organizations, to avoid assisting weak companies take advantage of their employees. These dangers should be avoided, but they should not be allowed to prevent the government from encouraging what has been an extremely successful experiment.

VII. CASE STUDIES

Some of the points made above can best be illustrated by specific examples. The following section will, therefore, briefly detail instances of employee takeovers of firms.

⁵⁰ Quoted by Whyte in Whyte, *op. cit.*

⁵¹ Employee Ownership, *op. cit.*, p. 21.

⁵² Sockell, *op. cit.*

⁵³ Paul Blumberg, *Industrial Democracy* (London: Constable, 1968), p. 123. Blumberg cites a number of studies to this effect.

SOUTH BEND LATHE

In 1975, Amsted Industries, a Chicago based conglomerate, decided to liquidate its South Bend Lathe subsidiary. The company employed 500 people and, although one of the few lathe manufacturers in the country, was just barely breaking even. SBL executives believed that with proper management, the company could make a profit, however, and decided to try to purchase it themselves. The executives joined with the union and city officials (South Bend was still recovering from the loss of Studebaker years before) and took their case to the EDA. EDA quickly agreed to grant \$5 million to the city which in turn loaned the money to SBL's newly created ESOT. With this as a start, the company was able to secure another \$4.5 million (roughly) and purchase the plant from Amsted. The employees in this arrangement put up none of their own money, but as the loan is repaid over 25 years will gradually build up equity in the company (the employees will have a percentage of the stock vested prior to the full 25 years, however). The loans are secured by the company's assets, which were worth at least the \$10 million paid for the company.⁵⁴

After the first year, the company had 20% higher productivity and 10% more pretax profits than the year before, and has continued profitably since. A typical employee at the plant accumulated about \$2,000 in stock in his or her ESOP account.⁵⁵ While the reports of SBL's success have been glowing, there are reports that workers feel that the plant continues to operate as before as far as their role is concerned, and that greater employee participation is needed.⁵⁶

VERMONT ASBESTOS GROUP

One of the most publicized employee ownership stories is that of the Vermont Asbestos Group. In late 1974 the GAF company decided that new EPA regulations and declining profits at its Vermont asbestos mine subsidiary made the mine no longer profitable and decided to close it. In Vermont's depressed Northern Kingdom, the closing of the mine meant that the almost 200 workers would have a difficult, if not impossible, time in finding new employment. Spurred by an aggressive former maintenance supervisor, the employees decided to try to buy the company. After a long and difficult process, employees were able to raise \$100,000 and finally convince enough banks and the SBA to loan them enough money (\$2.15 million) to buy the company from GAF. GAF agreed to sell the company for \$400,000—a very good price. In the next year, the VAG, as the company was now called, installed all the needed pollution equipment.

In the next few years, fortuitous events in the world market made VAG a tremendously profitable company. Employee owners' wages went up substantially and the value of the stock, most of which was owned by employees, increased in value from \$50 a share to \$3,500 a share in 1976. Unfortunately, the company was not able to cope with success. Worker-owners were not pleased with the limited role they were playing in management, and disputes over how much money to

⁵⁴ *Newsweek*, Sept. 1, 1975, p. 49.

⁵⁵ *Time*, Oct. 4, 1976, p. 80.

⁵⁶ Zwerdling, *op. cit.*, 63-76.

reinvest and how much to redistribute were frequent. The originator of the employee ownership movement lost his leadership position in the company, and many employees sold their stock. Unofficial reports now say that a majority of the stock is owned by one local individual.⁵⁷

The VAG experience shows the potential that employee ownership has for saving jobs, but it also shows the need for planning ways to keep stock in the hands of workers if the goal of employee ownership is to be maintained, and the need to come to grips with the fact that when employees become owners they may demand a greater role in management.

MOHAWK VALLEY CORP.

In early 1976 the Sperry Rand Company announced plans to close its Library Bureau division in Herkimer, New York. The Bureau had been making a small profit, but less than what Sperry expected from its subsidiaries. Library Bureau managers and employees were convinced that the company, which makes library furniture and has several hundred employees, could be profitable enough and has local ownership and organized an effort to purchase the company from Sperry. At first, Sperry was extremely reluctant to sell at all, since it could liquidate for more than the employees were willing to pay. Under intense pressure from Congressional representatives, however, Sperry agreed to sell for \$6 million. The employees and members of the community raised \$2 million through the sale of stock, with an initial pledge of \$1,000 per employee in nonrefundable funds as a pledge to Sperry and to pay for legal and other costs. EDA arranged a \$2 million loan and another \$2 million was secured from local banks. The company has established an ESOP and the workers will eventually own all the stock in the company.

During its first year of operation the company made a profit, but during its second broke just about even. Company officials attribute that to the cost of the loans and expansion, plus a loss of business as a result of uncertainty on the part of customers during the transition period. Company officials are very optimistic about the future, however.

As in other companies, employees have a limited role in management, but, in this case, this is partly the result of the wishes of the employees, who have not actively sought a role in management decision.⁵⁸

JONES AND PRESNELL

When the W. T. Grant Co. went bankrupt in 1976, one of its subsidiaries, Jones and Presnell, a firm specializing in color photographs of children, decided to try to survive on its own. The company set up an ESOT, which was able to secure a bank loan to buy the company from W. T. Grant. The loan was for \$3.5 million, and another \$1 million was raised from company capital and an existing profit sharing plan. During the first year of operation, company employees took voluntary salary cuts, but by the end of the year, the company has succeeded in stabilizing its business and, as of the time of the report on

⁵⁷ Data for the above information comes from a report by Edgar May, "Mining for Jobs and Profit," Springfield, Vt., 1977. Reports of the end of worker ownership in VAG are from several people following the situation.

⁵⁸ Information on the Mohawk Valley Corp. is from conversations with company officials and staff and from testimony at a hearing in Jamestown, N.Y. on employee ownership held by Congressman Stanley Lundine, Nov. 20, 1978.

which this is based was published, seemed well on its way to financial stability.⁵⁹

KASANOF'S BAKERY

In 1976 Fink Baking Co. of Brooklyn decided to close its subsidiary, Kasanof's Bakery, a profitable Boston bakery employing almost 300 people in the Roxbury section of the city. Although the company had been making a profit, labor problems and a long legal dispute over the noise levels of the bakery made future prospects very uncertain. The company had a good reputation and dedicated customers, however, and the employees, spurred by a local self-management group, made an effort to buy the firm. While this organization was getting started, the plant was closed and the workers went on unemployment. Despite that, and despite the fact that most were low income workers from the poor Roxbury area, they were able to raise \$200,000 from funds owed them by the company for vacation pay and a smaller additional amount from their own savings, which were already depleted by their unemployment. The workers would use the \$200,000 plus as a down payment and finance the acquisition of the company with a \$1.8 million bank loan, hopefully guaranteed by EDA and/or SBA. The company's owners, however, insisted on an additional \$20,000 per month to cover security and other costs of keeping the plant open. The workers would not be reimbursed any of this money, even if the deal failed. Unable to raise the \$20,000 and unable to get a decision from the government agencies, the employees gave up and the plant closed.⁶⁰

Of course, there are numerous other examples, but few have been documented very well—stories concerning the initial transition appear in newspapers, but followup stories are hard to find. Research at Cornell has confirmed the continued existence of most the companies, but little is known at this point about individual company performance. Related research at the Survey Research Center has provided information on the overall success and characteristics of the companies, but the individual cases on which that data are based are not available to the public. The cases here represent a sampling of some typical examples where information is available in some detail, but should not be taken as a basis for generalizations. For instance, in these examples, government involvement was much more significant than it usually is. All of the cases were medium sized firms, whereas, as previously pointed out, firm size varies from several to several thousand. What can be generalized is that in each case that succeeded jobs were saved and companies went on to become profitable. The comparison with the Kasanof case, where the government paid hundreds of workers months of unemployment, is instructive.

VIII. LEGISLATION

In addition to tax legislation for ESOP discussed above, during the 95th Congress, Congressmen Kostmayer, Lundine, and McHugh introduced H.R. 11222, "The Voluntary Job Preservation and Community Stabilization Act". The bill would create a \$100 million loan

⁵⁹ *Wall Street Journal*, "Jones and Presnell, a Grant Unit, Survives Via Leveraged Employee Ownership Plan," July 22, 1976, p. 6.

⁶⁰ Information in this section from the *Boston Phoenix*, Apr. 20, 1977.

fund in EDA to make loans to employees and employee organizations who are purchasing plants that would otherwise close or relocate. In approving the loan funds, the administrator of EDA would first require a feasibility study, for which EDA could also loan funds, which would have to include a plan for repayment of the loan, with provisions for employee payroll deductions if necessary. The bill allows for members of the community to participate in ownership as well. The bill attracted approximately 75 cosponsors, and will be reintroduced in the 96th Congress. Senator Nelson will introduce a similar, but not identical, bill in the Senate in that Congress.

Senators Nelson and Long will also introduce a bill in the Senate to require that the SBA include ESOTs as eligible for SBA loans and loan guarantees under all SBA programs. The bill will also encourage the SBA to make loans to employee organizations seeking to purchase their companies when they would otherwise close, relocate, or be purchased by a large business. Again, feasibility studies would be required, and loans could be made for this purpose. The bill would require, however, that the assessment of the soundness of the loan be based on the feasibility report for the company's prospects, and not on the individual assets of employees.

The advisability of such legislation most likely will be challenged on the basis of the risk the government is taking in making loans to employees or employee organizations. Even if individual employees were held liable for their portion of the loan, collecting the loan from individuals who have left the company, or from all the employees should the company fail, would be impractical and probably impossible. Moreover, this lack of direct liability could encourage some business owners to sell to their employees when their company is failing and other buyers cannot be interested.

These arguments have some merit but are not, on the whole, persuasive. Any loan to the employee organization, whether to an ESOT or to the company itself, would be secured by the assets of the company, so the government's liability would be limited to the difference between the worth of the assets and the amount of the loan or loan guarantee. In any loan guarantee, the pledge of the borrower's personal assets is more a test of good faith than a source of likely funds for repayment in the case of default.

Of course, with employees, this test of good faith may be lacking if there is no practical way to make individuals responsible. This presents two problems: (1) Cases where employee owners simply walk out on a firm; and (2) cases where employee owners are sold a bad company. In the first case, the problem is substantially alleviated by the fact that the employees stand to lose their jobs if the loan is not repaid, and there is likely to be considerable effort on their part, therefore, to make the company succeed at all costs. Data on employee owned firms confirm this argument. The threat of employees gullibly buying a company with poor prospects, figuring that they will not be liable if it fails, is more serious, but the agencies and the banks making the loan will have a feasibility report which should help them weed out such cases. Moreover, in most cases of employee ownership for which information is available, employees have put up some of their own money to buy the company, and even in ESOP arrangements where they do not, in the first few years, most employees accumulate

thousands of dollars worth of stock in the ESOT, which they will not get if the company fails.

What this suggests is that in making loans to employee organizations, the fact that individual employees may not be liable does introduce an element of risk not present when a conventional loan is made. This risk, for the reasons cited above, is small, however, and should be offset by the fact that employee owned firms are more successful than non-employee owned firms. In general, loans to employee owned firms should be more likely to be repaid, then, if these data are considered. All current loans to employee owned firms from the government (13) are being repaid.

Any decision to proceed with a government program should proceed on the basis of comparing alternatives, however. When a plant is closing or relocating, the government has a choice: it can make a loan, which will have a good chance of repayment, although one might argue whether the chance is as good as a conventional loan at this early date, or it cannot make a loan. If it does not make a loan, it will pay unemployment insurance and possibly food stamps, welfare, public works employment, or CETA money as well. Clearly, if there is a reasonable chance that the company could succeed as an employee owned firm, a loan to preserve the jobs would be vastly cheaper than the alternatives, as well as substantially more productive for the employees and the community.

In addition to these loan programs, it should be noted that Senator Long may introduce further legislation to encourage ESOPs through the tax system.

CONCLUSION

Employee ownership of business is still in its very early stages in this country, and government involvement in the process has been limited. Nonetheless, the experience with employee ownership so far has been very positive and encouraging. Employee ownership of business could provide a way to save jobs, save businesses, increase productivity, and spread the benefits of capitalism—goals the government has spent billions to achieve in the past. For much smaller sums, in the forms of loans and limited tax incentives, the government may be able to accomplish the same goals by supporting this promising form of free enterprise.

LIST OF EMPLOYEE OWNED FIRMS

1. A. C. Lawrence Leather Co., Paris, Maine.
2. Advance Micro Devices, Sunnyvale, Calif.
3. Algoma Plywood, Algoma, Wis.
4. Allied Plywood, Alexandria, Va.
5. American Cast Iron Pipe Co., Birmingham, Ala.
6. American Tube and Controls, West Warwick, R.I.
7. Arrow Lakes Dairy, Cranston, R.I.
8. Associated Freight Lines, Oakland, Calif.
9. Astoria Plywood, Astoria, Oreg.
10. Bates Fabrics Inc., Lewiston, Maine.
11. Beyda Stores.
12. Boston Consulting Group, Boston, Mass.
13. Brookings Plywood, Brookings, Oreg.

14. Brooks Camera, San Francisco, Calif.
15. Buffelin Woodworking, Tacoma, Wash.
16. Chicago and Northwestern Trans, Chicago, Ill.
17. Crosby Valve, Wrentham, Mass.
18. Elma Plywood, Elma, Wash.
19. Everett Plywood and Door, Everett, Wash.
20. Fairbanks Daily News Miner, Fairbanks, Alaska.
21. Fort Vancouver Plywood Co., Vancouver, Wash.
22. Gladding Corp., Gladding, Maine.
23. Graybar Electric, New York, N.Y.
24. Great Western Inorganics, Golden, Colo.
25. Hardel Mutual Plywood, Olympia, Wash.
26. Hoguam Plywood, Tacoma, Wash.
27. Huebner Publications, Solon, Ohio.
28. Infant's Specialty, San Francisco, Calif.
29. Independent Mining & Mfg., Connellsville, Pa.
30. International Group Plans, Washington, D.C.
31. International Poultry, Willamantic, Conn.
32. Jamestown Metal Products, Jamestown, N.Y.
33. Jones and Presnell Studios, Charlotte, N.C.
34. Kansas City Star, Kansas City, Mo.
35. Katz Agency, New York, N.Y.
36. Kreamo Bakers, Inc., South Bend, Ind.
37. Lacey Plywood, Lacey, Oreg.
38. Lionel D. Edie & Co., New York, N.Y.
39. Linton Plywood, Portland, Oreg.
40. Manalytics, San Francisco, Calif.
41. Marott Shoes Stores, Inc., Indianapolis, Ind.
42. Medford Veneer, White City, Oreg.
43. Merchant & Evans Co., Mt. Laurel, N.J.
44. Milwaukee Journal Co., Milwaukee, Wis.
45. Mohawk Valley Community Corp., Herkimer, N.Y.
46. Mt. Baker Plywood, Bellingham, Wash.
47. Mullach Steel, Bridgeville, Pa.
48. Multnomah Plywood, Portland, Oreg.
49. Muses (Menswear), Atlanta, Ga.
50. National School Studios, Bloomington, Minn.
51. North Pacific Plywood, Tacoma, Wash.
52. NWL Transformers, Bordentown, N.J.
53. Okonite Corp., Ramsey, N.J.
54. Operations Research, Inc., Silver Spring, Md.
55. Pacific Paperboard Products, Stockton, Calif.
56. Paine Lumber Co., Oshkosh, Wis.
57. Peninsula Newspaper, Palo Alto, Calif.
58. Puget Sound Plywood, Tacoma, Wash.
59. Radio Distributing Co., Inc., South Bend, Ind.
60. Rich-Sea Pak Corp., Brunswick, Ga.
61. Saski, Walker, Roberts & Ass., Sausalito, Calif.
62. Saratoga Knitting Mills, Saratoga, N.Y.
63. S-B Printers, Honolulu, Hawaii.
64. South Bend Lathe, South Bend, Ind.
65. Squire Heating Supply Co., Columbus, Ohio.
66. Stevenson CoPly, Washougal, Wash.

67. Sullair, Michigan City, Ind.
68. Spartan Motors Inc., Lansing, N.C.
69. Vermont Asbestos Group, Eden, Vt.
70. Washington Plywood, Tacoma, Wash.
71. Webb's City, St. Petersburg, Fla.
72. Western States Plywood, Port Orford, Oreg.
73. Woodland Mobile Homes, Mountain View, Calif.
74. Luna Beverage Distributors, North Babylon, N.Y.

POTENTIAL WORKER-OWNED FIRMS ¹

1. Abrogast Bastion, Allentown, Pa.
2. Bearing Specialty, San Francisco, Calif.
3. Natural Beers Inc., Yonkers, N.Y.
4. Crows Publications, Portland, Oreg.
5. Steiger Tractor, Fargo, N. Dak.
6. SWA Group, Sausalito, Calif.
7. Summers Electric, Dallas, Tex.
8. Resistance Corp., Bremen, Ind.
9. Gray Tool, Kansas City, Mo.
10. Hallmark Cards, Kansas City, Mo.
11. Hatfield Packing, Hatfield, Pa.
12. Construction City.
13. Devor Nursery, Pleasanton, Calif.
14. First Bank Shares, Boca Raton, Fla.
15. W. H. Newholds Son Corp., Philadelphia, Pa.
16. O'Conner Lumber Co., Mass.
17. San Mateo Times, San Mateo, Calif.

In addition, Western Bank and Trust of California has apparently sold 41 of its units to employees.

ADDENDUM

Since the first printing of this study there have been a number of developments. On February 8, 1979, Senators Nelson, Stewart, Hatch, Weicker and Pressler introduced S. 388, the Small Business Employee Ownership Act. This bill would authorize the Small Business Administration to guarantee loans to ESOTs and to employee organizations seeking to purchase their businesses when they would otherwise close or relocate. A companion bill, H.R. 2480, was introduced on February 28 in the House by Congressmen Baldus, Kostmayer, Bedell and Daschle. On February 27, 1979 the Senate Small Business Committee held hearings on S. 388, and a majority of the committee is now committed to the bill. The Small Business Administration, in the meantime, has revised its stance on employee ownership, and has said that it would reconsider the issue. In addition, the SBA, with some reservations, gave its support to S. 388.

¹ Firms with plans to become employee-owned in the next several years.

Congressmen Kostmayer, Lundine and McHugh reintroduced the Voluntary Job Preservation and Community Stabilization Act in the House, and a similar bill will be introduced in the Senate in mid-March by Senators Gravel, Nelson, Heinz, and Hatfield. Senator Williams will be introducing legislation also containing employee ownership provisions, along with provisions requiring pre-notification of plant closings providing for certain employee protections when a plant closes.

The Farmers Home Administration continues its policy of placing a high priority on employee ownership, and the Department of Housing and Urban Development is considering ways to use its urban development action grant program to encourage employee ownership. The Carter administration is drafting legislation to create a national development bank within the Economic Development Administration, and has asked staff members of the offices involved in the employee ownership concept to assist in drafting provisions in that legislation.

○

ALASKA
GENERAL STOCK OWNERSHIP
CORPORATION

Sponsor Substitute for House Bill No. 240
Sponsor Substitute for Senate Bill No. 170

CONTENTS

EXPLANATION: FEDERAL GSOC PROVISIONS

AGSOC STRUCTURE ILLUSTRATED

BILL SUMMARY: STATE LEGISLATION

SPONSOR SUBSTITUTES: SSSB 170 & SSHB 240

GSOC FINANCIAL PROJECTIONS: FOR ILLUSTRATION ONLY

EXPLANATION: FEDERAL GSOC PROVISIONS

Federal law provides income tax advantages to certain broadly owned corporations. These companies, known as General Stock Ownership Corporations (GSOCs), are exempt from corporate income tax. GSOCs are privately owned corporations designed to leverage the typical citizen into capital ownership. As such the stock is to be distributed free of charge and investments purchase entirely through borrowed funds. As the loans are paid down from investment earnings equity is built into the shareholders.

Charter Provisions

To qualify as a GSOC a corporation must be specially chartered by a state and have a single class of stock distributed to each qualified state resident. Transfers of stock must be limited to the earliest of five years from issue or the shareholder's death or emigration from the state. No shareholder may own or acquire more than 10 shares.

GSOC Taxation

The GSOC is exempt from corporate income taxes, but its shareholders must report their share of GSOC income personally. GSOC income is computed like that of other corporations with special treatment for tax credits. Audit adjustments are included in income of the corporation for the year during which they are finally determined. Net losses are subject to a 10 year carryover and investment credit and recapture is prorated to the shareholders.

Shareholder Taxation

GSOC shareholders are taxed on their share of GSOC income. If a shareholder disposes of his stock GSOC income will be prorated on a daily basis. The shareholder's stock basis will be increased by GSOC income attributed to him and reduced by cash distributions. Since GSOC shareholders are attributed GSOC income distributions from the GSOC are generally tax free. Distributions greater than attributed income are nontaxable to the extent of the shareholder's basis and the excess taxed as capital gains. To assure shareholders have cash for taxes on their share of GSOC income GSOCs must distribute 90% of taxable income by January 31. Noncompliance will subject the GSOC to a 20% tax on the distribution deficiency. To assure payment of taxes the GSOC must withhold 25% of each distribution. The amount withheld is a credit against shareholder income taxes. Individuals not required to pay taxes (because of insufficient income) may avoid withholding on GSOC distributions.

STATE
GUARANTY

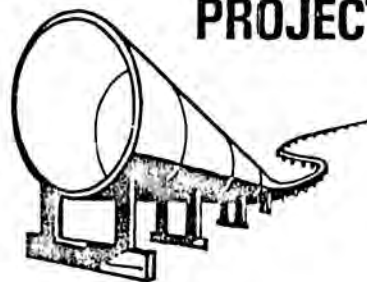


CORPORATION



BENEFICIARIES

ENERGY
PROJECT



ALASKA
GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

Federal law requires 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 consistent with the AGSOC act. The shares of the AGSOC will be owned and voted by the citizens of Alaska with each resident holding a share of stock.

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

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

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

DETAILED EXPLANATION

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

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

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

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

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

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

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

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

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

ANALYSIS: SECTION 1

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

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

This section directs the Governor to appoint nine people as the incorporators and initial board members of the Alaska General Stock Ownership Corporation. These nine people, a majority of whom must be Alaskans, will adopt corporate articles and by-laws 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 clarifies 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 inconsistent with Chapter 5 of Alaska Statutes Title 10, AGSOC will be subject to all the rules applicable to any other Alaska business corporation.

50.020. ARTICLES OF INCORPORATION.

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

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

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

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

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

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

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

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

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

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

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

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

50.030. BOARD OF DIRECTORS.

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

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 personnel 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 loses 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.

50.070. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER.

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

50.080. DIVIDENDS OF THE CORPORATION.

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

50.090. EXEMPTION FROM AS 10.05

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

50.100. LOAN GUARANTEE FUND.

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

50.900. DEFINITIONS.

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

Introduced: 3/6/79
Referred: Commerce

1 IN THE SENATE

BY COLLETTA, STIMSON AND FAHRENKAMP

2 SPONSOR SUBSTITUTE FOR SENATE BILL NO. 170

3 IN THE LEGISLATURE OF THE STATE OF ALASKA

4 ELEVENTH LEGISLATURE - FIRST SESSION

5 A BILL

6 For an Act entitled: "An Act creating the Alaska General Stock Ownership
7 Corporation; and providing for an effective date."

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

9 * Section 1. AS 10 is amended by adding a new chapter to read:

10 CHAPTER 50. ALASKA GENERAL STOCK OWNERSHIP CORPORATION.

11 Sec. 10.50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION

12 CREATED. (a) The governor shall appoint nine persons, at least five of
13 whom are residents of the state, to act as incorporators of the Alaska
14 General Stock Ownership Corporation.

15 (b) The corporation is a general stock ownership corporation and
16 shall be formed in accordance with subchapter " of the Internal Revenue
17 Code of 1954, as amended, (26 U.S.C. secs. 1391 - 1397), and with
18 AS 10.05. The corporation is subject to the provisions of AS 10.05,
19 except when inconsistent with this chapter or 26 U.S.C. sec. 1391(a).

20 (c) The corporation is not and may not be considered to be an
21 agency, instrumentality, or political subdivision of the state for any
22 purpose.

23 Sec. 10.50.020. ARTICLES OF INCORPORATION. The corporation's
24 articles of incorporation shall provide

25 (1) for the issuance of only one class of stock,

26 (2) that shares of stock may be issued only to individuals
27 who were residents of the state on the effective date of this Act, and
28 who continued to be residents until the date of issuance of the shares;

29 (3) for the issuance of at least one share of stock to each

1 individual eligible under (2) of this section, unless that individual
2 elects within one year after the date of issuance not to receive the
3 share;

4 (4) that no share of stock may be voluntarily or involun-
5 tarily transferred

6 (A) or encumbered by a shareholder, other than by will
7 or under the laws relating to intestate succession, until five
8 years after the date of issuance of the share, except if the share-
9 holder ceases to be a resident of the state;

10 (B) to an individual other than one who is a resident on
11 the date of transfer;

12 (C) to an individual who, after the transfer, would own
13 more than 10 shares of stock of the corporation;

14 (D) or encumbered by a shareholder under 18 years of age
15 or encumbered by that shareholder's parent or legal guardian;

16 (5) that the corporation must qualify as a general stock
17 ownership corporation under subchapter U of the Internal Revenue Code of
18 1954, as amended, (26 U.S.C. secs. 1391 - 1397);

19 (6) that the corporation may not invest in properties
20 acquired by it, or for its benefit, through the right of eminent domain;

21 (7) that the corporation has a first option to purchase, at
22 book value, its shares of stock offered to be transferred by a share-
23 holder within five years after the date of issuance of the shares; if
24 the corporation exercises the right to purchase, shares purchased shall
25 be considered treasury stock and not entitled to dividends, if any, or
26 to voting privileges.

27 Sec. 10.50.030. BOARD OF DIRECTORS. (a) The corporation shall be
28 governed by a board of directors. A majority of the members of the
29 board of directors shall be residents of the state at all times during

1 their terms of office. Except as provided in (b) of this section, the
2 term of office of each director is three years. A director, upon the
3 expiration of his term, shall continue to hold office until his succes-
4 sor is elected and qualified.

5 (b) The initial board of directors shall consist of the incorpor-
6 ators of the corporation. The board shall, as nearly as possible, be
7 equally divided into three classes of directors. The initial class one
8 directors shall serve one-year terms of office; the initial class two
9 directors shall serve two-year terms of office; and the initial class
10 three directors shall serve three-year terms of office.

11 Sec. 10.50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS. Beginning
12 not less than 90 days before the issuance of any stock, the corporation
13 shall at least weekly notify the public of its intention to issue stock
14 and the method for qualifying and applying for shares. The notice shall
15 be by publication in at least one newspaper of statewide circulation, by
16 radio and television announcements, and by other means the corporation
17 determines to be appropriate and reasonable, and shall be continued at
18 least once each month for 11 months following the date of issuance of
19 shares.

20 Sec. 10.50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS. Registra-
21 tion as a shareholder of the corporation is a responsibility solely of
22 an individual eligible under AS 10.50.020(2) to receive shares of the
23 corporation. The corporation may not be held liable for

24 (1) any loss resulting directly or indirectly from the
25 failure of an individual to apply for shares of the corporation; or

26 (2) payment of a declared or paid dividend to an individual
27 who would have been entitled to receive the dividend had he been a
28 shareholder at the time of declaration or payment.

29 Sec. 10.50.060. LATE APPLICATION FOR SHARES. An individual eli-

gible under AS 10.50.020(2) to receive shares of the corporation who failed to apply for the shares before their issuance may apply for and receive the shares any time within one year after the date of issuance if he is otherwise qualified to own stock of the corporation and upon the payment of the book value of the shares.

Sec. 10.50.070. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER. (a) The ownership interest in shares of the corporation's stock issued to an individual ineligible to receive the shares who has presented fraudulent or misleading information regarding his eligibility to own the shares, is void upon the issuance of an appropriate order by the superior court. The ineligible individual is also liable for the full amount of dividends, or other distributions to shareholders received by him plus interest from the date of distribution, and legal fees and costs of recovery incurred by the corporation. This section applies to an individual who has presented fraudulent or misleading information regarding the eligibility of another person for whom he acts in the capacity of legal guardian.

(b) An individual who transfers or obtains shares of the corporation, or in his capacity as legal guardian obtains shares of the corporation for another, through fraud, misrepresentation, or any deceitful or illegal means is guilty of a felony.

Sec. 10.50.080. DIVIDENDS OF THE CORPORATION. Dividends, or other distributions, may be declared and paid by the corporation at any time and from any source to the extent considered necessary by the board in order to comply with the distribution requirements of subchapter U of the Internal Revenue Code of 1954, as amended, (26 U.S.C. secs. 1391 - 1397), except that no dividend or other distribution may be declared if the corporation is insolvent or if the declaration would cause the corporation to become insolvent.

1 Sec. 10.50.090. EXEMPTION FROM AS 10.05. The corporation is
2 exempt from the requirements of AS 10.05.012, 10.05.216(e), 10.05.255(7),
3 and 10.05.264.

4 Sec. 10.50.100. LOAN GUARANTEE FUND. (a) There is a special fund
5 of the state known as the "Alaska General Stock Ownership Corporation
6 loan guarantee fund" which shall be completely segregated from all other
7 funds of the state, and which is a trust fund for the uses and purposes
8 of this section.

9 (b) The commissioner of revenue shall use the fund to guarantee
10 loans made to the corporation by lenders other than the state. In
11 guaranteeing loans the commissioner of revenue shall review the loans
12 for the purpose of guarding against fraud and misrepresentation. A
13 guarantee of a loan may not be for an amount in excess of the un-
14 obligated balance of the fund at the time the guarantee is made.

15 Sec. 10.50.900. DEFINITIONS. In this chapter,

16 (1) "board" means the board of directors of the Alaska
17 General Stock Ownership Corporation;

18 (2) "corporation" means the Alaska General Stock Ownership
19 Corporation;

20 (3) "fund" means the Alaska General Stock Ownership Corpora-
21 tion loan guarantee fund;

22 (4) "resident" means an individual who maintains a permanent
23 place of abode in the state with the intention of making the state his
24 permanent place of residence and who resides in the state continuously
25 except for temporary purposes only and with the intent of returning; a
26 person may not be considered to have gained a residence solely by reason
27 of his presence and he may not lose it solely by reason of his absence
28 while in the civil or military service of this state or of the United
29 States or of his absence because of marriage to a person engaged in the

1 civil or military service of this state or the United States; while a
2 student at an institution of learning; while in an institution or asylum
3 at public expense; while confined in public prison; while engaged in the
4 navigation of waters of this state, of the United States, or of the high
5 seas; or while residing upon an Indian or military reservation; a minor
6 takes the residence of his parent or of his legal guardian; a married
7 woman may establish her own residence and does not presumptively take
8 the residence of her husband.

9 * Sec. 2. AS 37.10.065(a) is amended by adding a new paragraph to read:

10 (9) secured loans to the Alaska General Stock Ownership
11 Corporation.

12 * Sec. 3. AS 37.10.070(a) is amended by adding a new paragraph to read:

13 (14) bonds or other forms of indebtedness of the Alaska
14 General Stock Ownership Corporation.

15 * Sec. 4. AS 45.55.140(a) is amended by adding a new paragraph to read:

16 (12) a security issued by the Alaska General Stock Ownership
17 Corporation.

18 * Sec. 5. Notwithstanding any other provision of law, a civil action to
19 contest the legality of this Act is barred unless the complaint is filed
20 within one year of the effective date of this Act. The purpose of this
21 limitation on suits is to insure that, after the expiration of a reasonable
22 period of time, the right, title, and interest of shareholders of the Alaska
23 General Stock Ownership Corporation will be vested with certainty and that
24 the corporation will be able to carry on its business activities with cer-
25 tainty.

26 * Sec. 6. Notwithstanding AS 01.10.030, the requirements of this Act for
27 eligibility to receive original issue shares of the Alaska General Stock
28 Ownership Corporation are not severable. If those requirements, or the
29 application of them to any person or circumstance, are held invalid, this Act

1 is void in its entirety.

2 * Sec. 7. AS 10.50.070(b) is amended to read:

3 (b) An individual who transfers or obtains shares of the corpora-
4 tion, or in his capacity as legal guardian obtains shares of the
5 corporation for another, through fraud, misrepresentation, or any
6 deceitful or illegal means is guilty of a class C felony.

7 * Sec. 8. Sections 1 - 6 of this Act take effect immediately in accor-
8 dance with AS 01.10.070(c).

9 * Sec. 9. Section 7 of this Act takes effect January 1, 1980.

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25

26

27

28

29

GSOC FINANCIAL PROJECTIONS

Assumptions: Purchase of 15.85% interest in TAPS line
 Interest rate on financing of 7%
 Current annual flow of 1.2 million barrels per day
 Tariff of \$5.50 per barrel uninflated
 Cost of acquisition \$1.3 billion
 Inflation of operating costs by 7% per annum

Based on these assumptions the GSOC could distribute \$286.00 in dividends to each shareholder during its first full year of operations while paying off its loan.

NET INCOME

(\$000)

YEAR	DELIVERY VOLUMES (000 BBL'S)	TARIFF	REVENUES	OPERATING EXPENSES	INTEREST	DEPRECIATION AND AMORTIZATION	INCOME TAX	NET INCOME	CITIZEN SHAREHOLDER INCOME
		\$	\$	\$	\$	\$	\$	\$	ACTUAL \$
1978	64062	5.50	352341	70400	91000	54167	0	128774	206
1979	64062	5.50	352341	83000	87200	54167	0	127070	202
1980	64062	5.50	352341	89760	83417	54167	0	124997	277
1981	64062	5.50	352341	96043	79825	54167	0	122506	272
1982	64062	5.50	352341	102766	75833	54167	0	119575	265
1983	64062	5.50	352341	109960	72042	54167	0	116172	250
1984	64062	5.50	352341	117650	68250	54167	0	112266	249
1985	64062	5.50	352341	125094	64450	54167	0	107822	239
1986	64062	5.50	352341	134707	60666	54167	0	102801	220
1987	64062	5.50	352341	144137	56875	54167	0	97162	215
1988	64062	5.50	352341	154376	53083	54167	0	90865	201
1989	64062	5.50	352341	165022	49291	54167	0	83061	186
1990	64062	5.50	352341	176573	45500	54167	0	76101	169
1991	64062	5.50	352341	188933	41700	54167	0	67533	150
1992	64062	5.50	352341	202150	37916	54167	0	58100	129
1993	64062	5.50	352341	216309	34125	54167	0	47740	106
1994	64062	5.50	352341	231451	30333	54167	0	36390	00
1995	64062	5.50	352341	247652	26541	54167	0	23901	53
1996	64062	5.50	352341	264907	22750	54167	0	10437	23
1997	64062	5.50	352341	283337	18950	54167	0	-4321	0
1998	64062	5.50	352341	303304	15166	54167	0	-20376	0
1999	64062	5.50	352341	324621	11375	54167	0	-37822	0
2000	64062	5.50	352341	347345	7503	54167	0	-56754	0
2001	64062	5.50	352341	371659	3791	54167	0	-77276	0

ALASKA GSOP

CASH FLOW

(\$000)

YEAR	REVENUES	NET INCOME	TOTAL SHAREHOLDER DISTRIBUTION	DEPRECIATION AND AMORTIZATION	DISMANTLING RESERVE	PRINCIPAL PAYMENTS	NET CASH FLOW	CUMULATIVE CASH FLOW
	\$	\$	\$	\$	\$	\$	\$	\$
1979	352341	120774	115097	54167	7400	54167	20277	20277
1980	352341	127070	114370	54167	7918	54167	20626	40903
1981	352341	124997	112497	54167	8472	54167	20972	61075
1982	352341	123906	110255	54167	9065	54167	21316	83191
1983	352341	119575	107610	54167	9700	54167	21657	104040
1984	352341	116172	104555	54167	10379	54167	21996	126044
1985	352341	112266	101039	54167	11106	54167	22333	149177
1986	352341	107022	97040	54167	11803	54167	22665	171842
1987	352341	102001	92521	54167	12715	54167	22995	194037
1988	352341	97162	87446	54167	13605	54167	23321	218150
1989	352341	90065	81779	54167	14557	54167	23643	241001
1990	352341	83061	75475	54167	15576	54167	23962	265763
1991	352341	76101	68491	54167	16566	54167	24276	290039
1992	352341	67533	60780	54167	17033	54167	24586	314625
1993	352341	58100	52290	54167	19001	54167	24891	339516
1994	352341	47740	42966	54167	20417	54167	25191	364707
1995	352341	36390	32751	54167	21846	54167	25405	390192
1996	352341	23901	21503	54167	23375	54167	25773	415965
1997	352341	10437	9393	54167	25011	54167	26055	442020
1998	352341	-4321	0	54167	26762	54167	22441	464461
1999	352341	-20376	0	54167	28635	54167	0259	472720
2000	352341	-37022	0	54167	30639	54167	-7103	465537
2001	352341	-56754	0	54167	32704	54167	-23970	441567
2002	352341	-77276	0	54167	35079	54167	-42197	399370

INTEREST RATE: 700 TAX RATE: 0 INFLATION RATE: 070

PIPELINE VALUE: 1300000 POPULATION RATE: 000 POPULATION: 405

ALASKA EXPENSE: 64700 DIRECT EXPENSE: 6300

MEMORANDUM

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

FROM: Arlon R. Tussing

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

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

1. Louis O. Kelso, et al, Design of an Alaskan General Stock Ownership Plan, Volume I. (February 15, 1979);
2. Kelso & Co., (untitled) documents on British Petroleum's interest in TAPS (December 7, 1978);
3. Alaska House of Representatives, Sponsor Substitute for House Bill No. 240 (March 6, 1979);
4. Wilmer, Cutler & Pickering, Federal Constitutional Issues Presented by Alaska's GSOC (December 15, 1978);
5. Senator Mike Gravel, various speeches, Congressional Record citations on GSOCs (1978 & 1979).

MEMORANDUM
Page Two

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

QUESTIONS ABOUT AN ALASKA GENERAL STOCK
OWNERSHIP CORPORATION

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

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

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

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

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

2. GSOCs in Alaska. The GSOC concept (like that of "Alaska, Inc.") appeals to legislators and other Alaskans because it may be a Constitutional way to use the state's petroleum revenue to increase the wealth of present resident Alaskans without permanently swelling the size of state government or attracting a host of immigrants to share in the windfall. In my opinion, something like a GSOC as contemplated in H.B. 240 may indeed be the best way to give

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

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

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

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

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

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

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

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

Their outside business interests;

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

Size and prestige of the organization;

Their social and business philosophies, ideals and ideologies; and

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

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