

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECTS 86/2
900 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

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

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

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

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

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

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

gpc

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

DATE: March 19, 1979

FILE NO:

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERAL

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

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

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

I. TAXATION

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

1. That the charter provide for the issuance of only one class of stock;
2. That the charter provide for the issuance of shares only to eligible individuals; "eligible individuals" are further defined as those who are residents of the State as of the date specified in the State's enabling legislation and who continue to be residents of the State as of the date of the issuance of the shares;
3. That the charter provide for the issuance of at least one share of stock for each eligible individual;

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

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

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

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

Frances Ulmer, Director
DPDP

March 20, 1979
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may, indeed probably will, prohibit a corporation's expansion into major new investment areas on the basis of these earnings alone. New investment opportunities which arise in the future would require AGSOC to again obtain significant debt financing which may, in turn, require multiple state guarantees.

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

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

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

II. FINANCING

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

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

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

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

A) There is a special fund of the State known as the Alaska General Stock Ownership Corporation Loan Guarantee Fund, which shall not exceed \$5,000,000.00. and which shall be completely segregated from all other funds of the State. This fund is a trust for the uses and purposes of this section.

B) The Commissioner of Revenue shall use the fund to guarantee loans solely for startup costs (and not to include major investment financing) made to the corporation by lenders other than the State. In guaranteeing loans, the Commissioner of Revenue shall review the loans for the purpose of ascertaining the general soundness of the proposed loan and for the purpose of guarding against fraud

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

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

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

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

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

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

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

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

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

III. DEPOLITICIZING THE AGSOC

The proponents of the AGSOC have conceived of this entity as operating as a private corporation subject to the very few qualifications imposed on it by federal law. Thus, the corporation is subject to the standard provisions of the Alaska Business Corporation Act, AS 10.05, except where inconsistent with the state or federal enabling legislation. The proponents have argued that AGSOC stands the best chance of being a success, (i.e., operating at a profit which will be shared in by most Alaskan residents) if it is structured as a completely private corporation. However, it should be noted that there is nothing in the federal legislation which would preclude the AGSOC's establishment as a state agency or public corporation.

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

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

A) AGSOC: A Fourth Branch of Government

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

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

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

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

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

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

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

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

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

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

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

- 1) When a dispute arises between the State and AGSOC, the matter could be held in abeyance until the next legislature to allow the latter to determine by legislation the proper resolution of the matter; or the matter could be submitted to an arbitration panel established by statute.
- 2) Other means of controlling litigation between AGSOC and the State would be to create a disincentive to any litigation. One such disincentive would be a modification of the court rules relating to the award of costs and attorney's fees to provide that the State would always be entitled to receive its actual costs and attorney's fees incurred in the litigation of any action involving AGSOC. In addition, AGSOC's right to costs and attorney's fees would arise only in those cases where the court makes an express finding that the State's prosecution or defense was frivolous or lacking in good faith.

IV. CORPORATE DEMOCRACY

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

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

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

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

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

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

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

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

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

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

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

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

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

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

V. PRIVATE CORPORATION: CLOSED CLASS OF
SHAREHOLDERS

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

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

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

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

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

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

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AS A UNIT IN THE ORIGINAL DOCUMENT.

Gary

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April 10, 1979

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

Dear Debbie:

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

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

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

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

Here's hoping I get asked back.

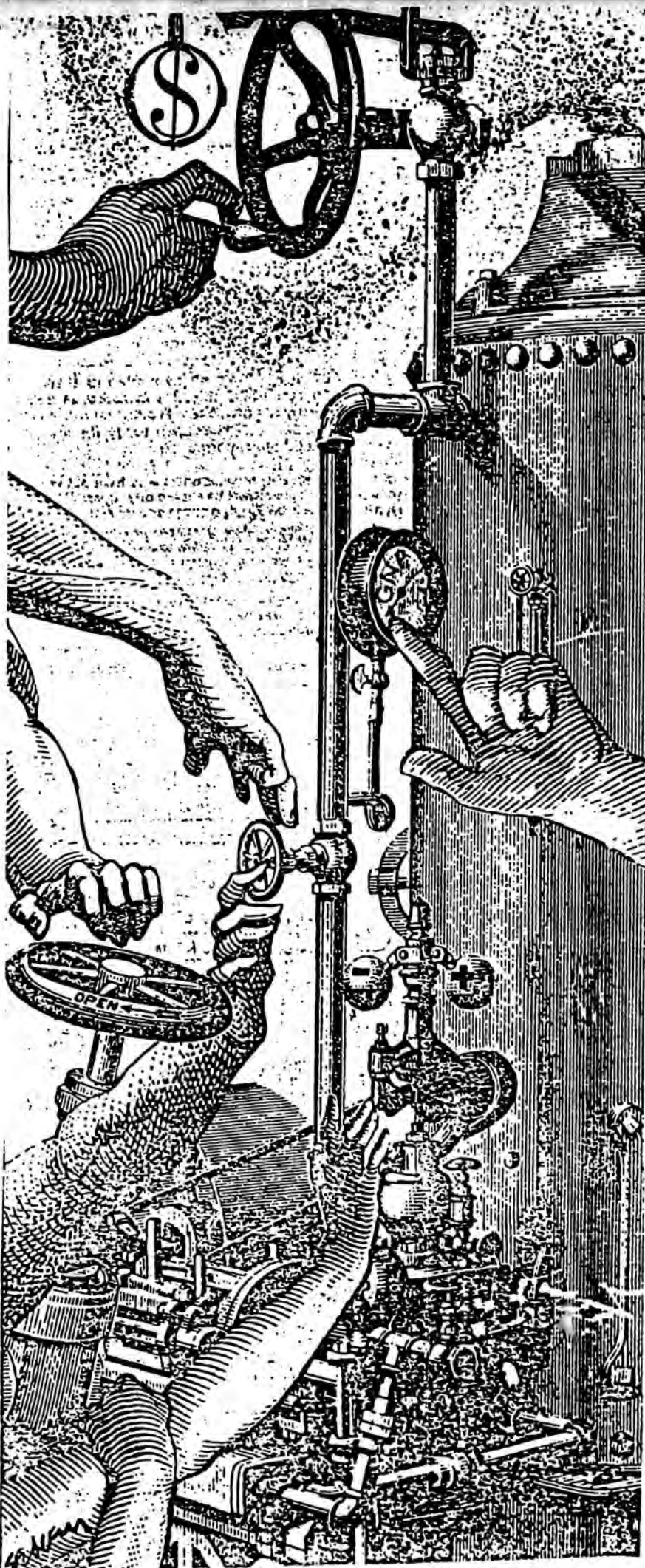
Yours truly,

HEWITT ASSOCIATES

Jeffrey R. Gates

JRG:cb
Enclosures

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



AGSOC

THE FINANCIAL PLUMBING

Hearings before the
State Affairs Committee

March 20, 1979

Submitted by:

Jeffrey R. Gates
Hewitt Associates
Lincolnshire, Il.

THE AGSOC - AN OWNERSHIP STRATEGY

The American Dream - A Piece of the Action

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

The Financial Plumbing of Stock Ownership (See Exhibit 1)

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

New York Stock Exchange 1975 shareowner census:

- (1) 5-year decline of 18.3%.
Quantitative vs. qualitative measure.
- (2) Average age of typical shareholder increased
five years over 5-year span.

Joint Economic Committee figures re stock ownership (1975):

- (1) 0.5% own 50%.
- (2) 1% claim 46% of dividends.
- (3) Working non-professionals (76% of work force)
own 19%.

(See Exhibit 2)

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

Consumer Debt:

1960 - \$56.1 billion
1976 - \$217.8 billion

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

Historical Context

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

Contractual Context - Access to Ownership

The Evolving Social Contract

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

-John Marshall-

Market Context

Work Ethic - The Employment Act of 1946

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

-Coretta Scott King-

Industrial Context

Exchange Ethic

"Salary" vs. "Compensation"

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

Compensation - a balancing of accounts (See Exhibit 6)

Post-Industrial Context

Incomes policy designed as participation-in-production policy
The Affluent Society (1958) - "device for breaking the nexus between production and income security"

Breaking the nexus:

Federal Expenditures

1960 - \$91.3 billion

1979 - \$504 billion

Federal Budget

1960 - slight surplus

1978 - deficit of \$61.7

Federal Transfer Payments

1960 - \$20.6 billion

1979 - \$198 billion

"There are no free lunches on welfare."

-Joseph Califano-
Secretary of HEW

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

-F. Ray Marshall-
Secretary of Labor

A PIECE OF THE ACTION

VAN NOSTRAND
REINHOLD

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FIGURE ONE

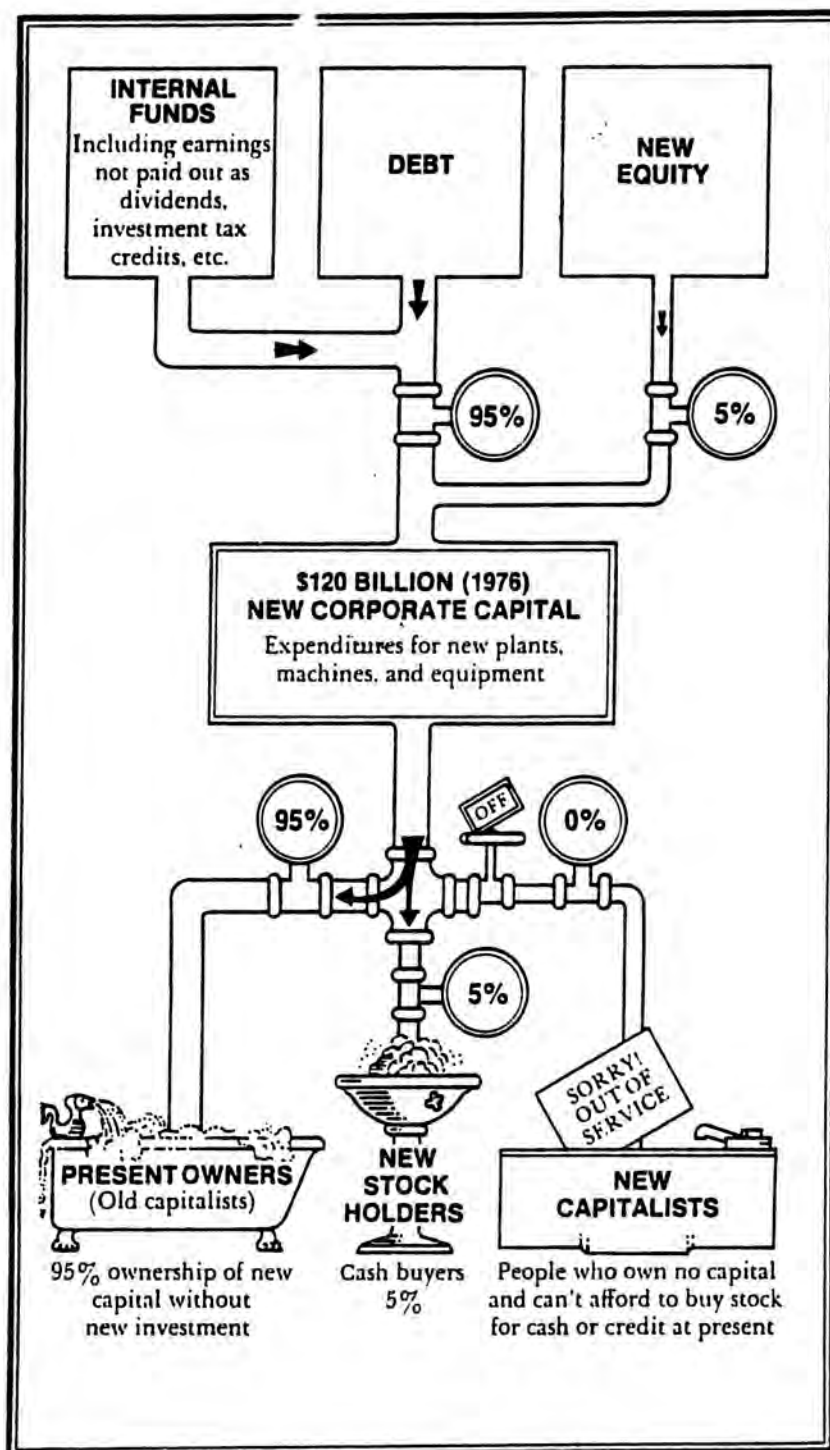
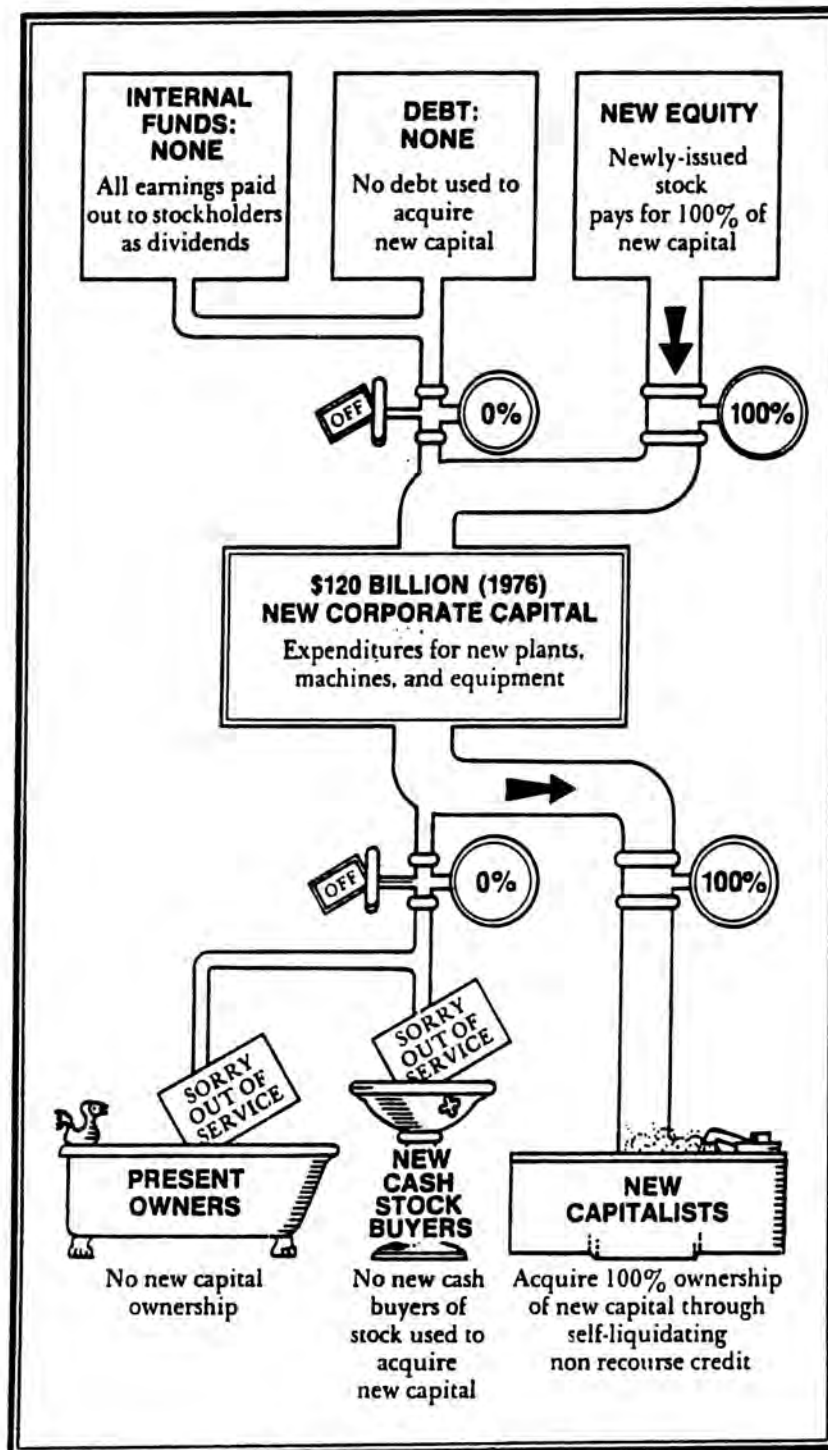


FIGURE TWO



PERSONAL WEALTH: COMPOSITION AND DISTRIBUTION

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

TABLE 1.—PERSONAL WEALTH, 1972

Asset	All persons (1)	Value (billions) held by the richest—		Share held by the richest—	
		1 percent (2)	6 percent (3)	1 percent (4)	6 percent (5)
Real estate.....	\$1,492.6	\$225.0	\$645	15.1	43.2
Corporate stock.....	870.9	491.7	629	55.5	72.2
Bonds.....	158.0	94.8	124	60.0	78.5
Cash.....	749.8	101.2	278	13.5	37.1
Debt instruments.....	77.5	40.8		52.7	
Life insurance.....	143.0	10.0		7.0	
Trusts.....	99.4	89.4	475	89.9	40.5
Miscellaneous.....	853.6	83.3		9.8	
Total assets.....	\$4,344.4	\$1,045.9	\$2,152	24.1	49.5
Liabilities.....	808.5	131.0	300	16.2	37.1
Net worth.....	3,535.9	915.9	1,852	25.9	52.4
Number of persons (millions).....	209.0	2.1	12.0		

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

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

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

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

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

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

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

COMMENTS FROM THE MEDIA
WHY ESOPs ARE ALSO CALLED "KELSO PLANS"

Kelso and Adler's book could start a revolution.

Casper Weinberger
February, 1958

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

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

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

Milton Friedman
Time, Jan. 29, 1970

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

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

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

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

William F. Buckley
Feb. 24, 1970

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

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

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

The Whole Earth Catalog
Spring 1970

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

Berkeley Daily Gazette
July 16, 1971

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

James J. Kilpatrick
Jan. 20, 1972

Kelsoism is not accepted by modern scientific economics as a valid and fruitful analysis of the distribution of income but rather it is regarded as an amateurish and cranky fad.

Paul Samuelson
The San Juan Star
April 27, 1972

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

Sar Levitan, economist

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

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

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

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

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

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

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

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

Nicholas von Hoffman
Esquire December 1973

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

Winnett Boyd, president
Arthur D. Little, Canada

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

Ronald Reagan
July 20, 1974

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

Charles Bartlett
Arizona Republic, Mar. 24, 1975

Kelso: McLuhan of economics?

The Village Voice
April 28, 1975

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

Forbes, May 1, 1975

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

Money, June 1975

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

Barron's, July 21, 1975

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

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

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

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

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

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

Milton Moskowitz
San Francisco Chronicle
May 24, 1975

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

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

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

Fortune, March, 1976

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

San Francisco Business
January, 1976

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

Fortune, March, 1976

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

Business Week editorial
Mar. 8, 1976

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

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

Time, Oct. 4, 1976

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

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

The APEX TRIANGLE *Corporation*


AN EQUAL
OPPORTUNITY
ENTERPRISE

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WELCOME

REW

SUNDAY, MARCH 11, 1979

C1

By William Greider

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

The questions themselves sound vaguely Marxist, which is one reason why welfare state liberals have always ducked. Liberalism is defined and disciplined by its right wing adversaries, whose red baiting effectively scares off new ideas, even new questions I could make no argument that the long march of liberal solutions to social injustice — tinkering with wage floors, moving cash from one group to another, propping up the poor and the weak, protecting the sick and the jobless from catastrophe — all these are evasions of the more fundamental questions about wealth and its gross maldistribution.

If liberal government could not do anything about the distribution of wealth, then it must concentrate on wages and particular benefits, propelling the welfare state deeper and

deeper into private economic chokeholds. Essentially, the federal government hands out coupons, little tickets that entitle qualified citizens to buy food at a supermarket, to occupy an apartment in a subsidized building, to buy medicine at the ghetto pharmacy, to pick up a little cash on the first of the month, to bill the Treasury for catastrophic illness.

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

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

Roughly speaking, this is the road American politics traveled to its present frustrations. The liberal mindset, honorable and well-intentioned, cannot confront the natural limits that always will stand in its way. One cru-



cial boundary in the politics of redistributing cash is the private wage system. Nobody really believes Washington should give a nonworker coupons that are more generous than the wages earned by his neighbor, the worker.

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

I could argue that, in the final bal-

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

WHO OWNS America? I am pleased to report that this question will be raised next winter when all conventional politicians are campaigning in the New Hampshire presidential primary. Not by a bunch of parlor lefties. Not by desperate liberals searching for jazy new rhetoric. The question will be raised by a strange lit-

tle group called the Ownership Campaign which, if one forced an ideological identity on this eclectic collection of individuals, probably would be called right-of-center.

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

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

This is the voice of economic individualism — the old American dream of yeoman independence that was buried in the modern era of big government, big corporations. These people are tak-

ing the original impulses of the American experience and trying to graft them onto modern corporate capitalism. At the edges, there is a barbarous yelp of protest borrowed from Ayn Rand. The heart of the idea, including the approach to banking and credit, is as old as Jefferson and Jackson, more radical than any reform entertained by the New Deal.

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

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

THOSE WHO find single issue politics nettlesome and disruptive

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

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

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

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

His political director is 25-year-old Luis Granados, a newly graduated law-

yer from Takoma Park, who knows the operations of a political campaign from serving local candidates but who lacks the jaded amorality of experienced operatives. Granados learned economics from ordinary experience:

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

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

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

Johnson is the only one with experience in a presidential primary. He received 35,000 votes in New Hampshire

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



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

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

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

Ownership History

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

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

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

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

-Alexander Hamilton-

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

-Virginia Declaration of Rights-
June 12, 1776

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

-Declaration of Independence-
July 4th, 1776

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

- Massachusetts Declaration of
Rights -
October 25, 1780

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

-Bill of Rights-
December 15, 1791

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

-Benjamin Franklin, 1783-

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

-Rousseau, Social Contract-

The nations of our time can't prevent the conditions of men from becoming equal; but it depends upon themselves whether the principle of equality is to lead them to servitude or freedom.

-de Tocqueville-

final comment in Democracy in America

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

-Thomas Hart Benton-

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

-Hannah Arendt-

in On Revolution

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

-Aldous Huxley-

...In Harlem, for instance, all of the stores are owned by white people, all of the buildings are owned by white people. The black people are just there paying rent, buying the groceries; but they don't own the stores, clothing stores, food stores, any kind of stores; don't even own the homes they live in. They are all owned by outsiders, ...

"When the thing is finally sparked, the white man is not there-he's gone. The merchant is not there, the landlord is not there, the one they consider to be the enemy isn't there. So, they knock at his property. This is what makes them knock down the store windows and set fire to things, and things of that sort.

-Malcom X-

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

-Richard Nixon-

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

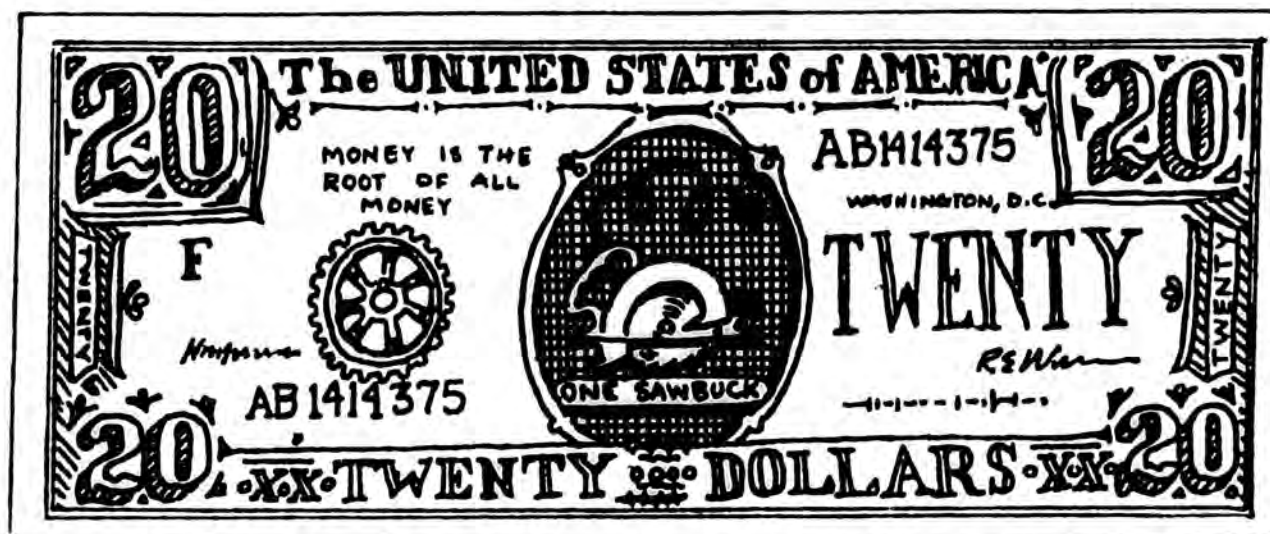
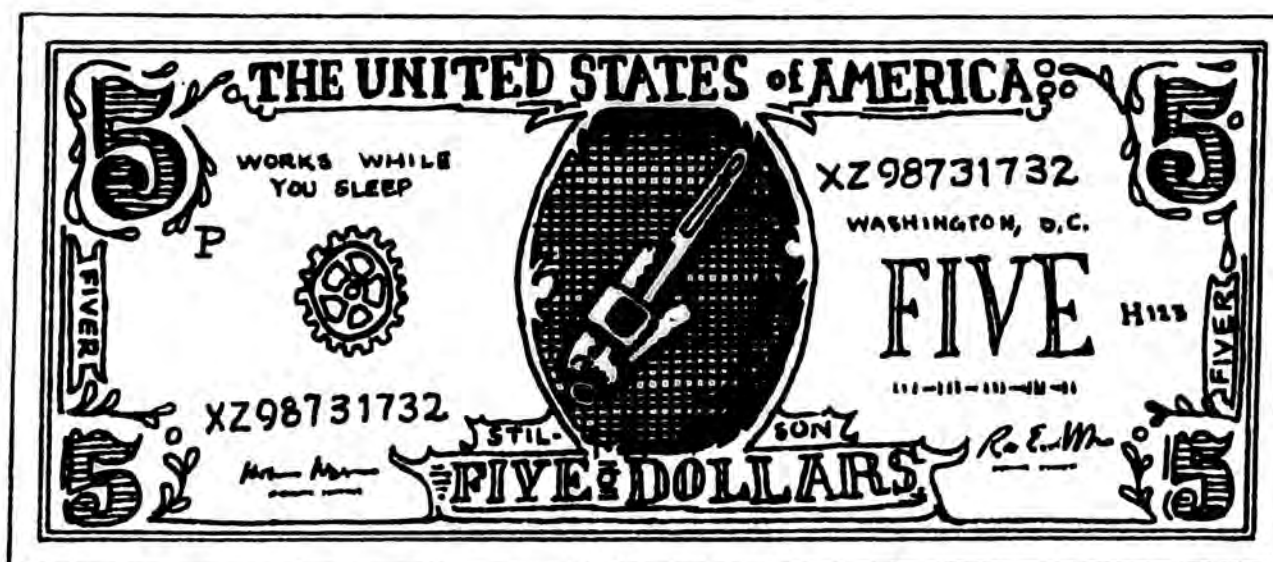
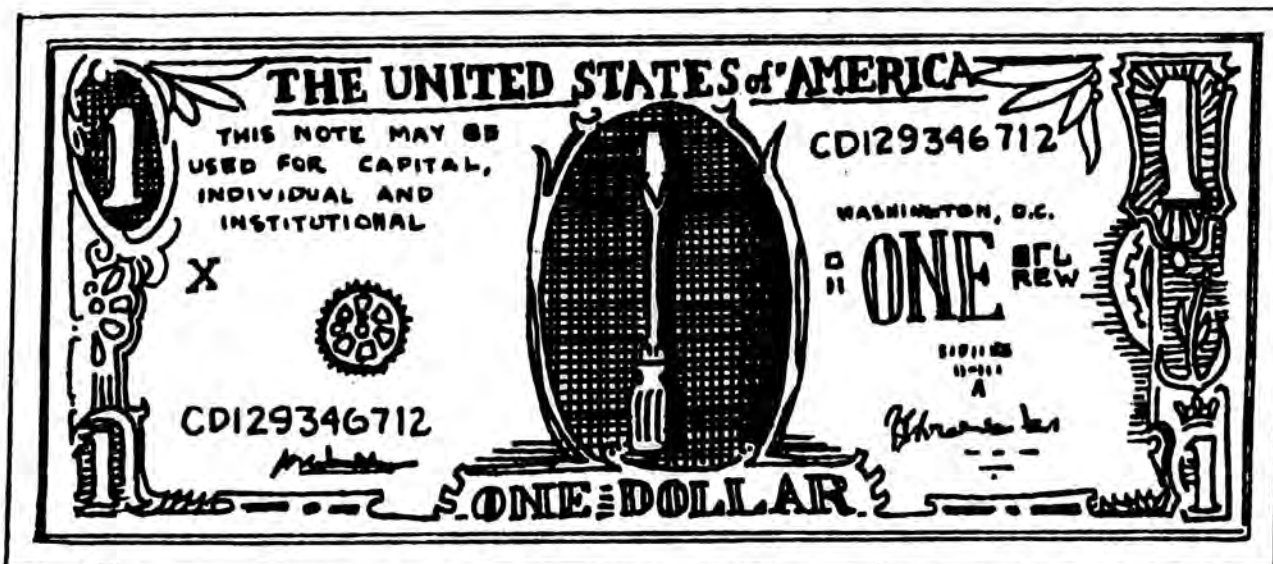
-Charles A. Reich-

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

-Walter P. Reuther-
President, United Auto Workers

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

-Reinhold Niebuhr-



Share the Wealth

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

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

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

SURVEY OF
TAX REDUCTION ACT ESOPS
HIGHLIGHTS REPORT

April 1979



Hewitt Associates

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SURVEY HIGHLIGHTS

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

Purpose of Survey

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

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

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

TRASOP Prevalence

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

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

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

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

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

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

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

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

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

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

TRASOP Characteristics

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

- 93.8% are separate plans (not attached to an existing company plan).
- 40.9% of the plans are extended to all or most employees (meeting age/service requirements) and 59.1% are extended to all or most salaried employees (or salaried and non-union hourly employees); however, several plans exclude officers, directors, or members of executive stock or incentive plans.
- 70.9% of the plans use the \$100,000 individual annual maximum of covered compensation for allocation purposes; 29.1% use a limit of less than \$100,000.
- Of the 129 plans responding to the issue, 71 plans (55.0%) anticipated a benefit for the average employee of less than \$200 for the most recent year, 45 plans (34.9%) anticipated a benefit of from \$200 to \$500, and 13 plans (10.1%) anticipated a benefit of more than \$500.
- 35.2% of the plans use some form of the maximum service requirement (up to three years) for participation. This is made possible by the fact that a TRASOP must provide for immediate vesting.
- 33.1% of the plans provide for the additional 1/2% tax credit available because of employee contributions.
- 62.1% of the plans make distributions only at termination of employment; 18.7% make rolling seven-year payouts; 16.2% give participants a choice between rolling seven-year payouts and distributions only at termination.



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JANUARY 1979

**TRASOPs—more
attractive after the
REVENUE ACT OF 1978**

TRASOPs—more attractive after the REVENUE ACT OF 1978

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

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

Indeed, a 1978 survey of Fortune-listed companies, conducted by Hewitt Associates, revealed that 152 of 530 survey participants (29%) currently have or were in the process of implementing such plans—up from only 13% of companies surveyed a year earlier. (See **Figure 1**, p. 47) Further, 84% of surveyed major utilities are now TRASOP companies, as are 77% of the largest oil and coal companies, plus 63% of surveyed companies

in the wood, paper, and fiber industries.

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

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

EVOLUTION OF THE "TRASOP"

The TRASOP originated in the Tax Reduction Act of 1975. In its

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

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

The Tax Reform Act of 1976

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

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

The 1976 Act also permitted a sponsor to recover certain plan expenses. And, in a further attempt to enhance the TRASOP's financial attractiveness, the 1976 legislation offered an additional $\frac{1}{2}\%$ investment credit—provided a company's employees made matching contributions to the plan.

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

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

NEW INCENTIVES: THE REVENUE ACT OF 1978

The Revenue Act of 1978 ("1978 Act") is the third piece of Congressional legislation in the past $3\frac{1}{2}$ years to affect the TRASOP; however, the 1978 changes directly affecting the TRASOP itself are less dramatic than the amendments generally expanding the availability of the investment credit.

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

expenditures to make a TRASOP worthwhile.

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

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

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

Participation

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

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

Employee Matching

The 1978 Act made the employee matching feature a permanent part of the Code and simplified its administration. In 1976, the Senate had passed a provision allowing a TRASOP company to claim an additional 2% ESOP investment credit. The Conference Committee scaled

that back to the existing extra 1% credit plus an additional 1/2% if employees made a matching contribution. This matching provision turned out not to be quite the enticement intended. It soon became clear that the administrative complexities of the contributory feature were more than most companies cared to handle.

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

Under the 1978 Act, an employee need not be counted as a plan participant (and, thus, eligible for matching) unless he or she is employed on the last day of the plan year. Also, the employer now need only make the company's matching contribution (and can only claim the extra credit) in the year in which employee matching contributions are actually made. Because employees may be provided 24 months in which to make their matching contribution, this change means that in a given year, a company may be able to claim a TRASOP investment credit in excess of 1 1/2%.

Voting Stock

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

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

Figure I. TRASOP PREVALENCE IN FORTUNE-LISTED COMPANIES

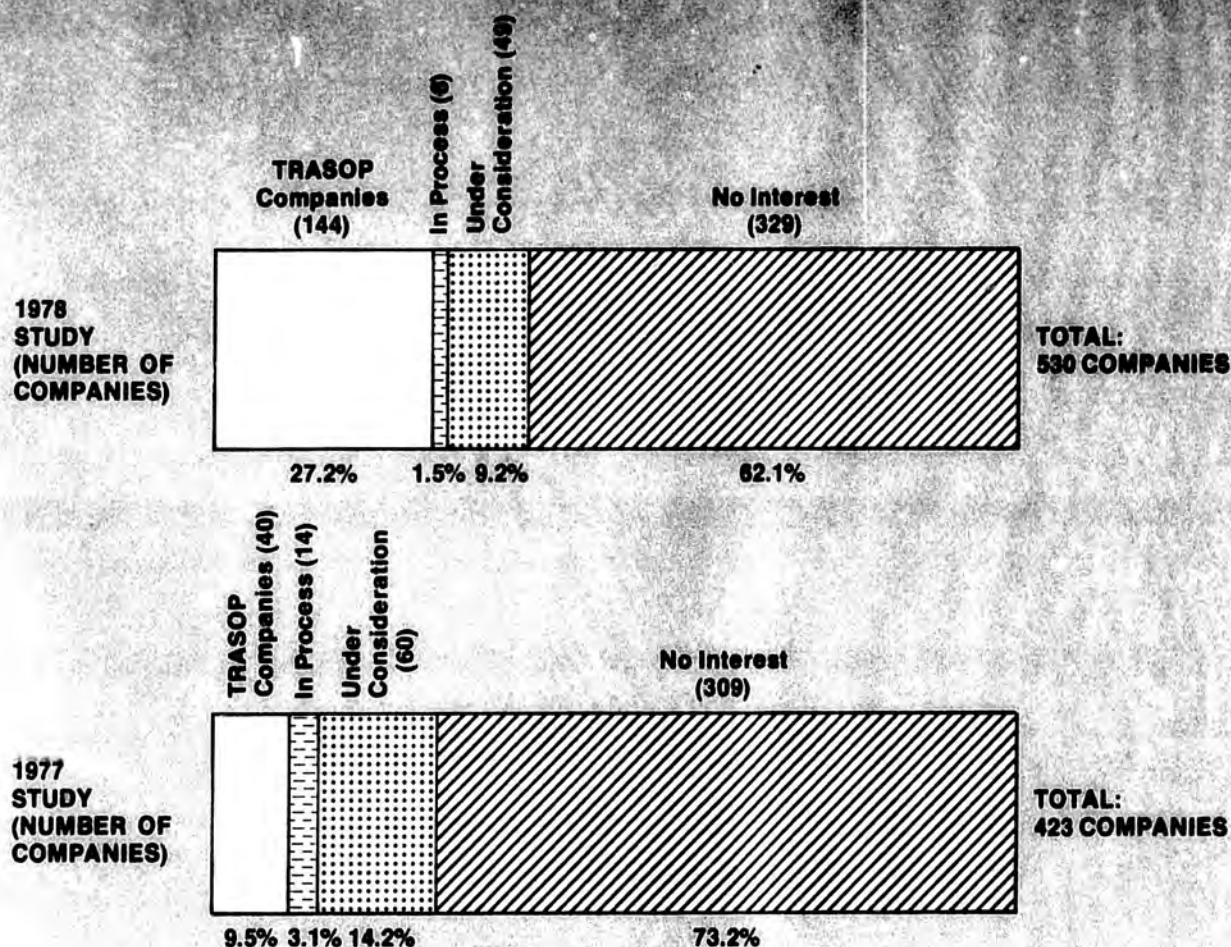
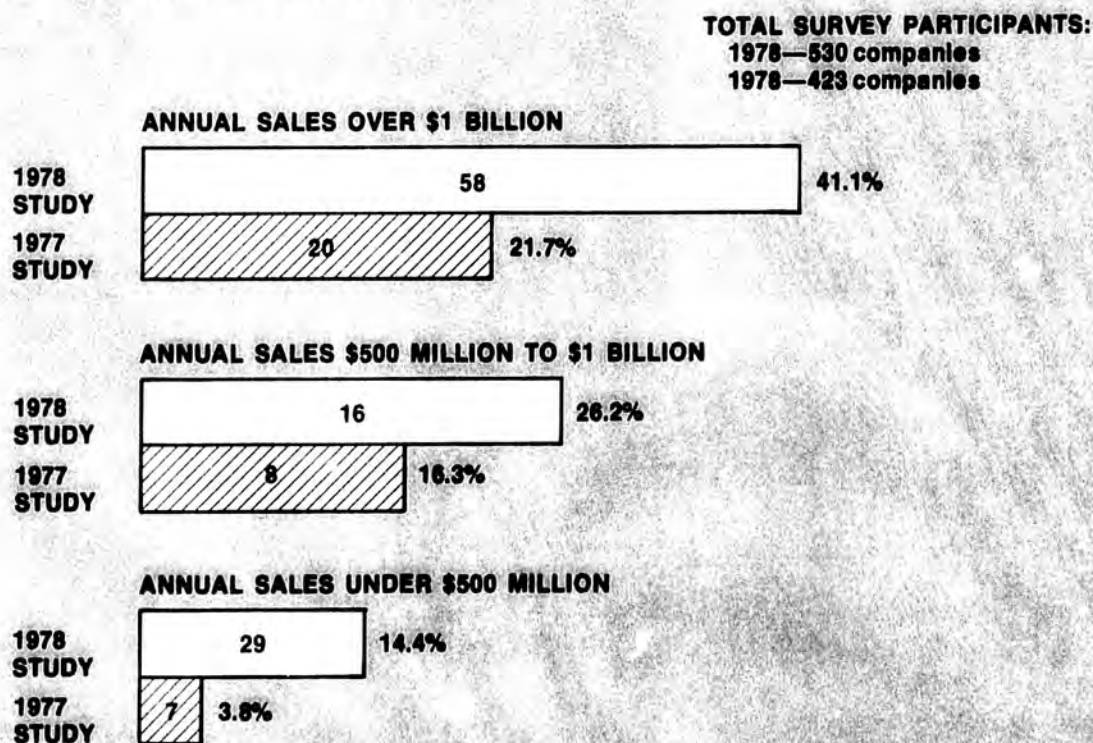


Figure II. TRASOP PREVALENCE BY COMPANY SIZE (Industrial Companies Only)



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

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

Distribution Options

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

The 1978 Act made it easier for employees to "roll over" their stock into a tax-sheltered Individual Retirement Account ("IRA"). Federal law generally exempts an employee from taxation on such a distribution provided the actual assets received are rolled over within 60 days into an IRA. However, IRA trustees were often reluctant to accept employer securities, particularly in the case of

closely held stock. And, if the employee sold his stock to the company or the plan, he thereby changed the nature of the assets and lost the rollover advantage. The new law permits an employee to sell employer securities received in a distribution and rollover the proceeds into his personal IRA.

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

Minimum Tax Relief

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

Tax preference items include the accelerated depreciation on certain real property, certain capital gains, and several other items listed in the tax code. In determining the amount subject to the

15% minimum tax, the corporation first totals all of its tax preference items. From that amount, it subtracts the amount by which its tax liability for the year exceeds certain listed tax credits. The new legislation provides that TRASOP contributions need not be included in the list of tax credit items reducing the corporation's tax liability (inasmuch as the reduction of tax liability is "offset" by such contributions).

Plan Costs

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

Thus, as with the 1976 Act, the 1978 Act permits a company to recover ten percent of the first \$100,000 contributed to the plan.

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

TRASOP: DO OR DO WITHOUT?

Total Compensation Objectives

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

However, if partial employee ownership does not fit well with either the management style or the overall compensation strategy, the available tax savings

should probably be foregone in favor of benefit plans making for a better marriage with manage-

ment's objectives. Despite the obvious financial appeal of an employee benefit paid for with

What Might Have Been

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

The proposed legislation would also have permitted a corporation to deduct the expense of dividends paid on stock in the plan provided such dividends were passed through to participants on a current basis. At the Senate Finance

Committee hearings on the bill, however, the Treasury's tax policy staff suggested that the matter be withdrawn for future consideration in the larger context of integrating the personal and corporate income tax. Consequently, the dividend deductibility provision does not appear in the legislation as enacted.

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

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

Coverage

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

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

Thus, a plan could cover salaried personnel only, corporate headquarters employees, or those employed in a specific plant or location (assuming, of course, that plan coverage is otherwise nondiscriminatory). This approach has the effect of increasing the per participant benefit but may create employee

relations problems internally. Alternatively, the investment credit of other related companies may be allocated among all employees of the controlled group. Or, the tax credits of related companies may be allocated solely to those employees of the divisions or subsidiaries having generated such credits. This feature provides a substantial amount of flexibility in TRASOP plan design.

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

Regardless of the source to which the plan looks for its acquisition of employer stock, a financial manager should evaluate the TRASOP's long-term dilutionary effect on current shareholders. The seemingly insignificant TRASOP stockholdings in year one could become substantial. In practice, however, it seems likely that employees would elect cash instead of stock on termination. In turn, that stock may be reacquired on behalf of future partici-

pants so the problem of dilution may be a concern more theoretical than real. Also, in the case of closely-held companies, it appears likely that TRASOPS will be permitted to attach a right of first refusal to stock distributed from the plan.

Benefit Amounts

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

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

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

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

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

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

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

feature can effectively exclude short-term employees from participation and may provide some incentive for employees to remain with the company.

Plan Administration

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

LOOKING AHEAD

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

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

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

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SCHOOL OF LAW

DAVIS, CALIFORNIA 95616

April 4, 1979

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

Dear Chairman Miller:

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

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

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

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

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

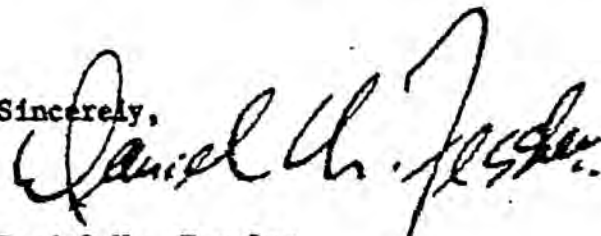
The Honorable Mike Miller
Chairman
State Affairs Committee

April 4, 1979

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

Best personal regards,

Sincerely,



Daniel W. Fessler
Professor of Law

DWF:bf

Enclosures

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1 THE STATE AFFAIRS COMMITTEE OF THE ALASKA HOUSE OF
2 REPRESENTATIVES

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

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

8 DATE: April 4, 1979

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

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

23
24 My perception of the need for revision: The pending proposal is that the
25 legislature create the AGSOC as a "private" corporation essentially regulated
26 under the terms of Chapter 05 of the Alaska Statutes (The Alaska Business
27 Corporation Act). As I indicated in my testimony, this general statute is a
28 bare bones version of the "Model Act" which is, in turn, fashioned after the

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

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

10 Why is the board of directors of a corporation organized under a
11 statutory framework such as the Model Act virtually unchecked in these circum-
12 stances? To begin our assessment we should think in terms of the content of
13 three documents: the statutory framework, the articles of incorporation, and
14 the bylaws. It is no accident that the Kelso Report presents this legislature
15 with a package containing a recommended content for each of these essential
16 documents. Here is a point the Kelso Report does not stress: the legislature
17 has control only over the statutory framework (the enabling legislation now
18 before the Committee). Once the CSOP is formed by this legislation, the
19 incorporators (See, Sec. 10.50.010(a), p. 1 SS HB 240) will adopt the articles
20 of incorporation and it will then be beyond the powers of this or subsequent
21 legislatures to interfere with the content of that fundamental document. Once
22 the incorporators have elected themselves as the initial board of directors
23 (See, Sec. 10.50.030(b), p. 3 SS HB 240), they will act in that capacity to
24 adopt the content of the bylaws. Again, it will be too late for the legisla-
25 ture to exert its will. Thus unless changes are made you will have surrendered
26 to these nine appointed individuals sole determination over the content of the
27 documents which will become the framework in which the corporation will
28 actually be structured and function. Your only chance for effective influence

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

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

3
4 PROPOSAL NUMBER ONE: THAT DIRECTORS BE SUBJECT TO REMOVAL BY ORDER OF A
5 SUPERIOR COURT UPON SUIT BY 100 OR MORE SHAREHOLDERS OF THE GENERAL STOCK
6 OWNERSHIP CORPORATION.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

15
16 PROPOSAL NUMBER THREE: THAT THE ENABLING ACT REGULATE THE STANDING OF
17 SHAREHOLDERS TO INAUGURATE ACTIONS AGAINST DIRECTORS OR OFFICERS BROUGHT
18 FOR THE BENEFIT OF THE CORPORATION (SHAREHOLDER'S DERIVATIVE ACTIONS).

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

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

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

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

25 The matters which should be covered by statute include:

26 * Who among the shareholders may bring such an action?

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

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

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

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

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

18 Defending a derivative action is time consuming and expensive and
19 there is always a danger that a shareholder will bring an ill-
20 founded or vexatious action simply to harass management or in the
21 hope that he will be "bought off" with an out-of-court settlement.
22 To minimize the instance of such "strike suits," many states in the
23 1940's adopted the practice of requiring a litigating shareholder to
24 post a bond as a precondition to maintaining the action, a bond which
25 would hold the defendants harmless against their costs of litigation
26 (including attorney's fees) in the event the shareholder should fail
27 to prevail. There is no current Alaska law on this point. Rule 23.1
28 is silent. My suggestion is that the Committee borrow the best

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

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

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

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

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

10 Yes. In all jurisdictions this is mandatory if the court returns a
11 judgment against the defendant officers or directors. All proceeds
12 of the judgment are paid into the corporate treasury on the theory
13 that the action has vindicated harm done to the corporation and not
14 the litigating shareholder. The shareholder receives an allowance
15 from these funds sufficient to cover the costs of the litigation.

16 But what if the resolution is by way of an informal settlement? This
17 is the dark side of this type of litigation. Frequently shareholders
18 are offered a tidy sum (e.g., \$20,000) if they will dismiss their
19 suit. They keep the money and none of the other shareholders are the
20 wiser. New York simply prevents this. There can be no informal
21 settlement. Any dismissal predicated upon a compromise must be pre-
22 sented to the court, its terms noticed to the other shareholders, and
23 any proceeds paid into the corporate treasury.

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

28 / / / / /

1 DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in
2 principle the concept of permitting derivative actions by share-
3 holders in the General Stock Ownership Corporation? YES ____ NO ____
4 If "yes," does the Committee favor regulating the derivative action
5 by special provisions in the enabling act? YES ____ NO ____ If
6 "yes," does the Committee favor:
7 * The suggested standing rules? YES ____ NO ____
8 * The suggested provision on exhaustive intra corporate
9 remedies? YES ____ NO ____
10 * The suggested provision on the posting of a security bond
11 for the defendants' costs of litigation? YES ____ NO ____
12 * The suggestion that there be no compromise or dismissal of
13 such an action without court approval? YES ____ NO ____
14 * The suggested provision that the litigating shareholder in
15 all circumstances be forced to account to the corporation
16 for any proceeds realized from such a derivative action?
17 YES ____ NO ____

18
19 11. PROPOSALS DESIGNED TO INCREASE THE INFORMATION AVAILABLE TO AND THE
20 POTENTIAL ROLE OF SHAREHOLDERS IN THE GENERAL STOCK OWNERSHIP CORPORATION.

21
22 PROPOSAL NUMBER FOUR: THAT THE ENABLING ACT BE AMENDED TO PROVIDE
23 LIABILITY FOR AN OFFICER OR AGENT WHO WRONGFULLY REFUSES TO ALLOW A SHARE-
24 HOLDER, OR A SHAREHOLDER'S AGENT OR ATTORNEY, TO EXAMINE AND MAKE
25 EXTRACTS FROM CORPORATE BOOKS AND RECORDS.

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

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

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

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

25 DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the
26 concept of a statutory right of shareholders in the General Stock
27 Ownership Corporation to inspect corporate books and records?

28 YES ____ NO ____ Should this sum be levied: (a) per

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

2
3 PROPOSAL NUMBER FIVE: THAT THE SHAREHOLDERS BE GIVEN THE POWER TO
4 INITIATE AMENDMENTS TO THE BYLAWS.

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

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

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

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

3
4 III. PROPOSALS DESIGNED TO IMPROVE THE QUALITY OF BOARD DECISION MAKING.

5
6 PROPOSAL SIX: THAT THE BOARD BE ENABLED TO TRANSACT BUSINESS BY USE OF
7 A CONFERENCE TELEPHONE OR SIMILAR COMMUNICATIONS EQUIPMENT.

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

14 Explanation: One of the difficulties inherent in a body of nine members
15 is to physically gather them in the same place at the same time for the trans-
16 action of Board business. In large corporate entities this is frequently
17 difficult. The result has been a tendency to permit the Board to divide
18 itself into smaller working committees or an "executive committee" to which is
19 delegated most of the Board's function and authority. There is a price paid
20 for such a solution. Decisions are made without the participation of the full
21 membership. Yet a non-classical solution is at hand, and from my personal
22 observation, a very familiar aspect of life in Alaska--the use of modern
23 communications equipment to hold board meetings notwithstanding the fact that
24 the members are not in the same place at the same time. Both California and
25 Delaware now permit this and the reported experience is very satisfactory. I
26 would suggest that such a provision be made a permanent amendment to Sec.
27 10.05.198 for all corporations formed in Alaska. It certainly merits adoption
28 in the special case of the GSOC.

1 DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the
2 concept of permitting the directors to hold meetings via the use
3 of conference telephones or similar communications equipment with
4 participation in such a meeting constituting presence in person?

5 YES ____ NO ____.

6
7 PROPOSAL NUMBER SEVEN: THAT REGARDLESS OF COMMITTEE ASSIGNMENTS EVERY DIRECTOR
8 HAVE A RIGHT TO ATTEND THE MEETINGS OF ANY COMMITTEE AND BE PRIVY TO ALL BOOKS
9 AND RECORDS.

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

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

1 DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor
2 the concept of granting directors a statutory right to attend
3 the meetings of any Board committee and to have access to minutes
4 and records? YES _____ NO _____
5

6 END OF THIS TRANSMISSION — SEPARATE LETTER BEING TRANSMITTED NEXT.
7
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THE PRECEDING DOCUMENT(S) MAY NOT FILM
LEGIBLY BECAUSE OF POOR QUALITY OF THE
ORIGINAL.

jsop

March 12, 1979

The Honorable Mike Miller
Chairman
House State Affairs Committee

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

Dear Sirs:

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

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

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

The Honorable Mike Miller
The Honorable Brad Braley

March 12, 1979

Page 2

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

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

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

Sincerely,

Jay S. Hammond
Governor

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

7sep
March 8, 1979

Ronald J. Trevithick
4847 Queens Court
Anchorage, Alaska 99504

Dear Ron,

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

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

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

Best wishes,

Mike Colletta
Senate Majority Leader

MC/das

Ownership owned by citizens of D.

↳ Loans to private cooperation
Broadly owned.

Directors elected by stockholders

Only chartering of coop

↳ perhaps financial assistance

3/5/79

2/27/79 - wanting Jerry to find permanent
spot. will discuss then

3/28/79 - Sam Jerry copy of article.
Deli
Orelia

Ronald J. Trevithick

4847 QUEENS COURT • ANCHORAGE, ALASKA 99504

February 21, 1979

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

Dear Senator Colletta:

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

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

Respectfully submitted



Ronald J. Trevithick

Handwritten notes:
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