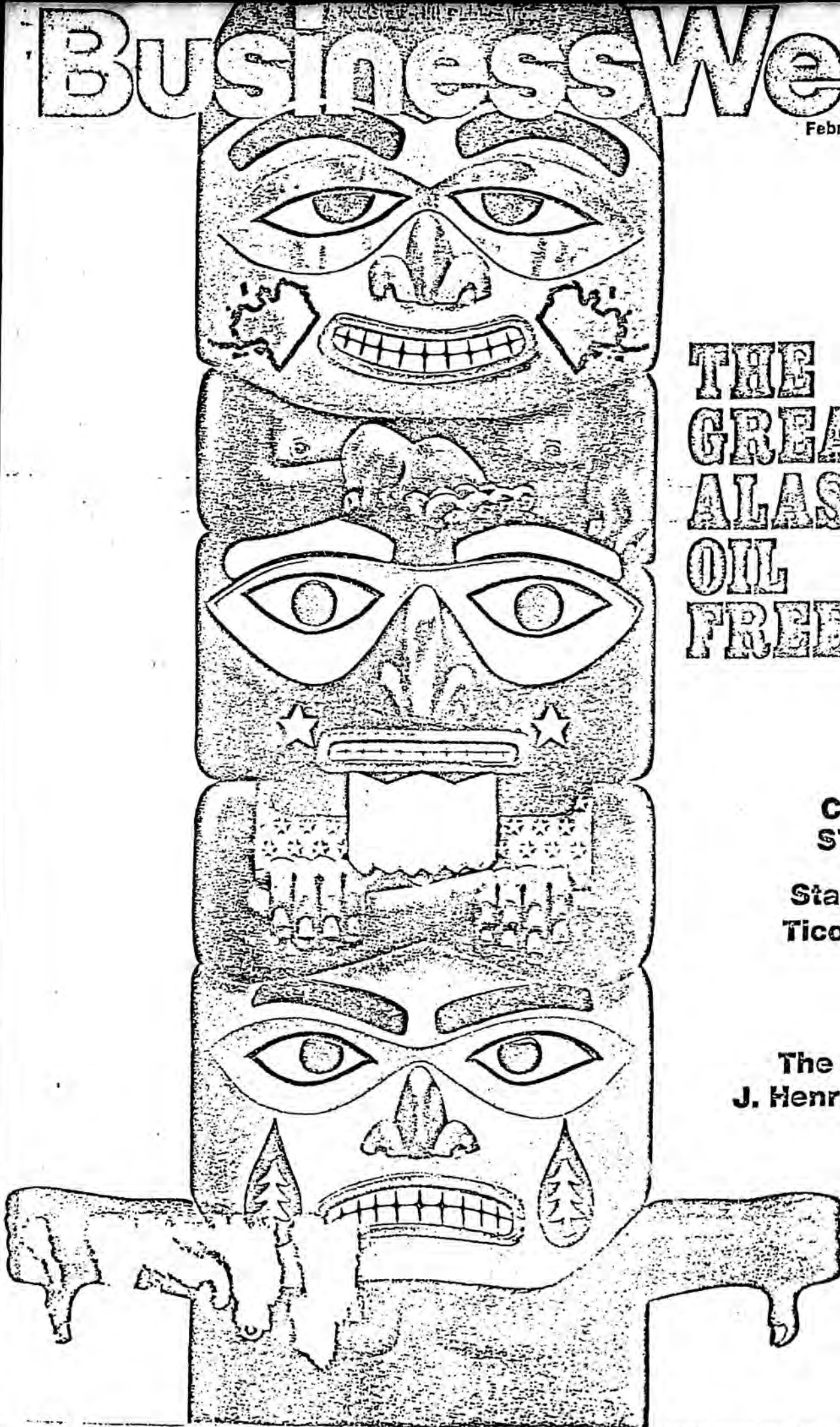


ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

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BusinessWeek

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THE GREAT ALASKAN OIL FREEZE

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Ticor • MetPath

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

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THE GREAT ALASKAN OIL FREEZE

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

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

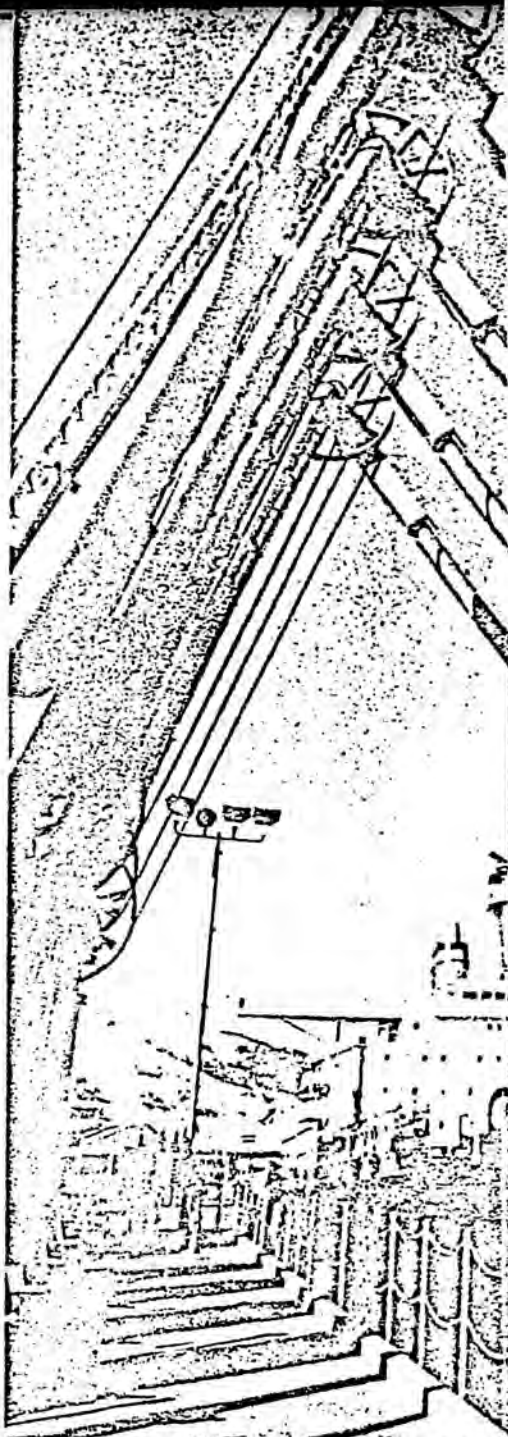
When Gulf Oil Corp. closed its Alaskan exploration office on Jan. 31, it became the 21st energy company to back away since 1971, according to the Alaska Oil & Gas Assn. The pace of that trend is speeding up. Exxon Corp., owner of 20.3% of the 9.4 billion bbl. of proved reserves at Prudhoe Bay, cut its exploration staff by more than one-quarter late last year. Shell Oil Co. says it cannot keep its offshore exploratory teams in

readiness much longer without more activity. And Standard Oil Co. (Ohio), owner of 53% of the Prudhoe oil and a vast amount of Alaskan geological data, says it is thoroughly reevaluating its future in the state.

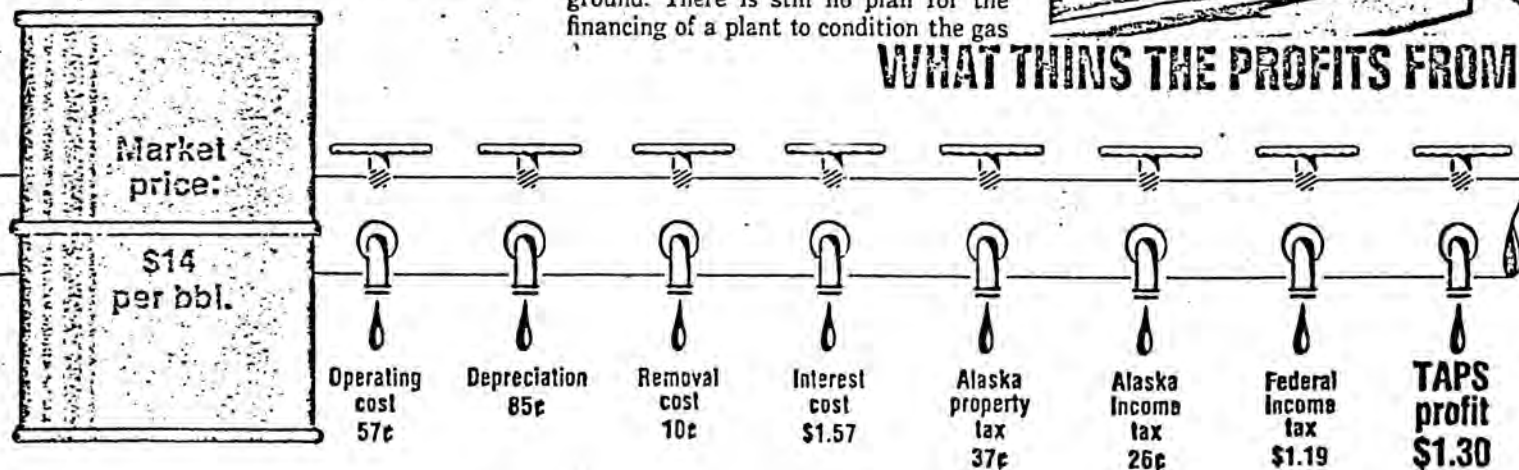
All of Alaska's oil has not yet been discovered, so the departure of exploration teams is a serious blow to the U. S. goal of energy independence. At stake are an estimated 30 billion bbl. of undiscovered Alaskan oil, the mean average of estimates made by the U. S. Geological Survey. These potential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

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

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



WHAT THINS THE PROFITS FROM



Net taxes and royalties to Alaska: 2.45

Net taxes to federal

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

A Robin Hood-like approach

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

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

Alaska's June measure—an income tax levied only on oil and gas companies—combines with other changes to raise overall oil taxes some 900% in the past decade. Alaska, whose rates before the Prudhoe discovery were the lowest of

the major producing states, now imposes the highest burden. Sohio watched the June tax alone swallow up \$60 million in 1978, increasing the company's state and federal taxes for all operations by 37% to \$222 million.

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

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

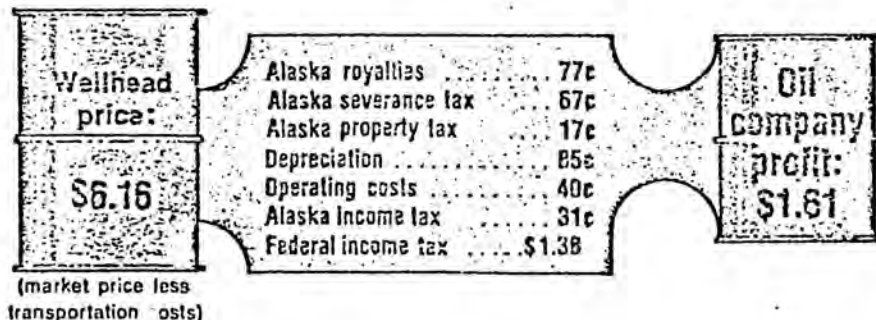
And that does not include the state's 1969 collection of Prudhoe lease payments of \$906 million, which help maintain a general fund surplus of \$761 million. Nor does it count about \$75 million of oil and gas royalty money, which Alaska in 1979 will sock into its "permanent fund," a sort of endowment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

Robert McAuley—BW

ASKAN OIL



*Composite of West Coast and Gulf Coast destinations
Data: BW estimates



Environment 257

Net profit to oil and pipeline owners: \$2.91

Where Alaska spends its oil money

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

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

"There's a popular misconception that we're rolling in wealth," says Alaska Governor Jay S. Hammond. In 1978, for example, individual income taxes declined \$64.6 million from 1977, reflecting completion of oil pipeline construction and related activities. Some 40% of jobs

in Alaska are supplied by government, including federal and military employment, and Anchorage banker Robert R. Richards says that this high level of public spending has helped avoid "a more severe post-pipeline downturn."

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

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

Between 2,500 and 2,800 high school students will be affected by this ultra-high-cost project, which amounts to \$40,000 per student, not including future generations who will also benefit. One isolated high school in Teller, 90 mi. north of the Seward Peninsula, will cost

nearly \$250 per sq. ft. by the time it is finished this year, and it will serve just 15 to 20 students. Another, in Kipnuk, in western Alaska, will cost \$2.2 million and be used by 50 to 60 students.

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

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

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

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

In the meantime, the oil company owners of the Prudhoe gas, perhaps the only companies whose assets could attract the private capital required for the line, refuse to participate. Already

swamped with debt and high operating costs from its Alaskan ventures, Sohio says it will make no investment in the conditioning plant or pipeline. Says Exxon, the company with the greatest wherewithal: "Producers are prohibited by Congress from equity investment in the line. Although they may contribute funds or provide debt guarantees, producers, under these circumstances, could not exercise control over their investment. We do not believe we should commit shareholders' funds, or our financial support, therefore."

If, despite these difficulties, Prudhoe gas does make it to market, Alaskan taxes will come into play as they have with oil. The new income tax will apply to gas. And Alaska has raised its severance tax—the levy placed on resources removed from the ground—on gas from 1% in 1966 to 10% in 1977. A 1973

property tax of 2¢ per \$1,000 of assessed value will also apply to the gas line and all production properties.

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

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

THE WORLD

UNITED STATES

Atlanta Peachtree Plaza
Chicago Continental Plaza
Cincinnati Cincinnati Plaza (mid 1950)
Costa Mesa, Orange County, Cal. South Coast Plaza
Detroit Detroit Plaza
Detroit (Southfield) Michigan Inn
Hawaii, Big Island Mauna Kea Beach
Hawaii, Honolulu (Waikiki) Ilikai
Hawaii, Maui (Wailea) Wailea Beach
Houston Galleria Plaza & Houston Oaks
Kansas City, MO Crown Center
Los Angeles Century Plaza
Los Angeles Bonaventure (Downtown)
Los Angeles The Plaza
New York The Plaza
Phoenix The Arizona Biltmore
Pittsburgh Carlton House
Portland, ORE Benson
San Francisco Miyako & St. Francis
Seattle Olympic & Washington Plaza
Seattle Space Needle Restaurant
Tulsa Williams Plaza
Washington, D.C. Mayflower

AUSTRALIA

Sydney (Affiliated) Wentworth

CANADA

Calgary Calgary Inn
Edmonton Edmonton Plaza
Montreal Bonaventure
Toronto Hotel Toronto
Vancouver Bayshore Inn
Winnipeg Winnipeg Inn

DENMARK

Copenhagen Hotel Scandinavia

EL SALVADOR

San Salvador Camino Real

GUATEMALA

Guatemala City Camino Real

HONG KONG

Hong Kong Shangri-La (early 1961)

JAPAN

Tokyo Miyako
Kyoto Takenawa Prince & Tokyo Prince

MEXICO

Acapulco Las Brisas
Cancun Camino Real
Cancun Camino Real
Cancun Camino Real (Fall 1930)
Cancun Camino Real
Mexico City Alameda & Camino Real
Mexico City Camino Real
Mexico City Camino Real

NORWAY

Oslo Hotel Scandinavia

PHILIPPINES

Manila Philippine Plaza

SINGAPORE

Singapore Shangri-La

SOUTH AFRICA

Johannesburg Carlton

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

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

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

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

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

Expensive failures

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

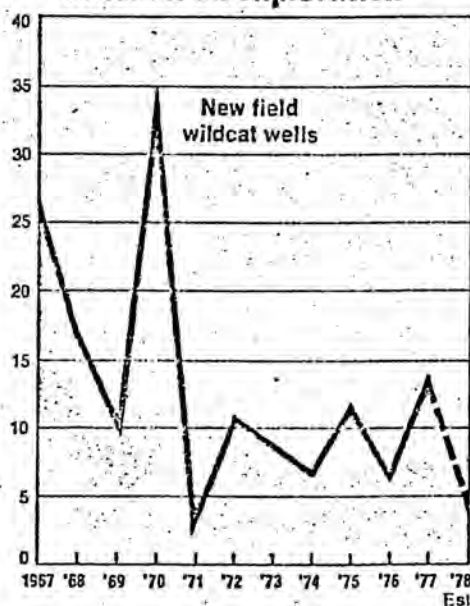
In 1975 the federal government hired private contractors to start on an exploration project drilling on the 23 million-acre National Petroleum Reserve on the North Slope. Since then, contractors have drilled 14 dry holes. Originally targeted for 26 exploratory wells, the program will virtually be halted at a total 19 holes under President Carter's

1980 budget request. At that point, some \$626 million will have been appropriated for what has been, so far, a total bust.

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

Alaska's exploratory opportunities have been further limited by Presidential action. In December, the Carter

The cutback in Alaskan oil exploration



Data: American Association of Petroleum Geologists, American Petroleum Institute

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

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

...to understand what his lawyer is talking about!" says Business Week



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

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

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

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

A controversial partnership

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

Although exploitation of Alaska's energy resources is mired in delays and uncertainties, the state government is toying with a scheme to become directly involved with energy through a general stock ownership plan, a proposal permitted by a tax law change that Gravel pushed through Congress last year. It would establish each Alaskan citizen as a stockholder in a state-chartered corporation that, Gravel suggests, ought to get into the oil business. The first likely target: buying out BP's remaining 15.8%

ownership of PARS. In London, BP confirms that it has not only been approached by Alaskan officials about the purchase but would give it strong consideration. Alaska's legislature is currently considering the stock ownership plan and is awaiting results of a \$205,000 study it has commissioned from San Francisco's Louis O. Kelso, the proponent of employee stock ownership plans. Unhappily, there are unanswered questions, such as who qualifies as a citizen and what influence the state would have on oil operations.

Many in the oil industry, of course, are less than thrilled about having a partner whose decisions would be made by the politicians in Juneau. Not only has the legislature frequently raised taxes, but it



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

has also passed some 35 nontax regulations on oil and gas companies in the last 10 years. A new income tax will cost oil companies an estimated \$166 million, compared with the state's former income tax provision, which collected \$10 million. Richard B. Palmer, senior vice-president at Texaco Inc., says the company has long been concerned about marketing Alaskan oil "but now a more serious concern is state taxation."

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

Killing the goose

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

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

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

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

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

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

A shortsighted decision

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

The consequences of holding back on investing in

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

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

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

Fitting Amtrak to size

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

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

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

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

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PLEASE NOTE: THE FOLLOWING PAGES WERE TREATED
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March 5, 1979

To: All Members of the Press

From: Senator Mike Colletta

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

March 5, 1979

To: Representative Jim Duncan

From: Senator Mike Colletta

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

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

March 5, 1979

To: All Senators

From: Senator Mike Colletta

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

ALASKA
GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

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

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

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

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

ANALYSIS: SECTION 1

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

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

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

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

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

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

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

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

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

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

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

50.060. LATE APPLICATION FOR SHARES.

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

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Alaska State Legislature

SENATOR MIKE COLLETTA

SENATE FLOOR LEADER

February 23, 1979



Senate

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

Dear Senator Gravel,

Please find enclosed copies of the following reports:

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

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

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

Best personal regards,

Mike Colletta
Senate Majority Leader

MC/das

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UNITED STATES POSTAL SERVICE
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PS Form 3811, Nov. 1976

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San Francisco, Ca 94111

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C. Hurd

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SF, CA 94111

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MEMO TO FILE

February 21, 1979

FROM: Marcie

RE: Kelso Study and SB 170

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

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

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

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

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

Kelso's office is not redrafting the bill.

MEMORANDUM

February 21, 1979

TO: SAM
PRINT SHOP

FROM: SENATOR MIKE COLLETTA

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

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

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

YOUR ASSISTANCE IN THIS MATTER IS APPRECIATED.

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

REQUEST FOR DUPLICATING

LA-A 1

Date Submitted: _____

Acct. No.: _____

Date Required: _____

Department: _____ Division: Legislative Budget & Audit

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

WORK DESCRIPTION: Off Set Print

KELSC REPORT: DESIGN OF AN ALASKAN GENERAL STOCK OWNERSHIP PLAN

VOLUME 1

* * * * *

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LOS ANGELES

February 16, 1979

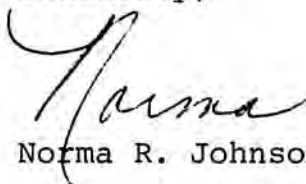
Ms. Marcie Sharrock
c/o Senator Mike Colletta
Pouch V
Juneau, Alaska 99811

Dear Marcie:

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

Thanks for your help.

Sincerely,



Norma R. Johnson

NRJ:ch
Encl.

KELSO & CO.

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INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

February 12, 1979

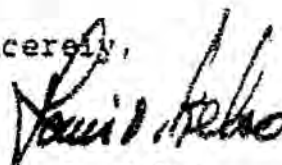
Senator Mike Colletta
c/o Office of the
Hon. Jay Hammond
State Capitol Building
Juneau, Alaska

Dear Senator Colletta:

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

Our basic report and appendix will be sent via Alaska Airlines Flight No. 69 arriving in Juneau at 8:15 p.m. Tuesday, February 13th.

Sincerely,



Louis O. Kelso

A BILL

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

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

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

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

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

Section 4. INITIAL BOARD OF DIRECTORS.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Section 8. DEFINITION OF RESIDENT.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Section 12. TRUST ACCOUNT WITH DEPARTMENT OF REVENUE.

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

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

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

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

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

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

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

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

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

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

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720P

Alaska State Legislature

SENATOR MIKE COLLETTA



SENATE FLOOR LEADER

Senate

February 19, 1979

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

Senator Gravel,

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

Respectfully yours,

Mike Colletta

Mike Colletta
Senate Majority Leader

MC/das

STATE OF ALASKA

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

Sen. Colletta

JAY S. HAMMOND, GOVERNOR

POUCH K-STATE CAPITOL
JUNEAU, ALASKA 99811

February 9, 1979

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

Dear Norma:

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

Sincerely,

AVRUM M. GROSS
ATTORNEY GENERAL

By: *Teo Spengler*
Teo Spengler
Assistant Attorney General

TS:vr

Enclosures

cc: Milt Barker
Legislative Finance

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

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

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

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

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

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

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

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

II

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

- a) DOES THE COMMISSIONER OF CORPORATIONS ADMINISTER BLUE SKY LAWS?
- b) COULD WE GET PUBLISHED REGULATIONS? NOTE: WE ANTICIPATE EXEMPTION FROM FEDERAL 1933 ACT, BUT WILL CONFER WITH SEC REGARDING CONFORMITY TO 1934 ACT.

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

III

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

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

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

*

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

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

IV

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

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

There is insufficient information on which to respond.

*

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

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

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

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

V

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

No.

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

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

glop

Catherine A. Chandler
Attorney at Law
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Anchorage, Alaska 99501

*2/5/79. Cathy called
she has spoken with
M. Lopp and is in
good contact with him
will be*

February 2, 1979

*Send copy of this to
Sen. Gravel & L. Kelso*

Senator Mike Colletta
Senate Majority Leader

*Copy sent
2/19/79*

Senator Bill Sumner
Chairman, Senate Resources Committee

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

Gentlemen:

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

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

Hope to see you again in the near future.

Best regards,

Cathy

Catherine A. Chandler, Attorney
Alaska Petrochemical Company

Enclosures

CAC:srb

Jim Lopp's innovative bonds

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

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

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

Creative financier. Such turmoil helps explain why the strapping (6 ft.-4 in.; 205-lb.) banker with the dazzling smile and infectious enthusiasm is viewed by his critics as opportunistic and irresponsible. But Lopp also is possibly the most creative figure in public finance. "The best thing about Jim Lopp," says a competitor, after claiming he acts "more

like a promoter than an investment banker," is that he "keeps the fees up. He sells his ideas, not cheaper service."

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

Stephen Castagneto



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

all in 1975, when Lopp and two cohorts from Blyth joined the firm.

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

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

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

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

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

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

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

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

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

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

In 1973 he began work on a tax-exempt financing for the port facilities at Valdez, the southern terminal of the Alaska pipeline, using the 1968 wharf exemption. In the early 1970s he also began developing municipal bond insurance for unrated issuers. "We were turned down by every major insurance company for five years running," he

says. Finally, four insurers, led by Aetna Life & Casualty Co., joined in the Municipal Bond Insurers Assn. The MBIA has insured some 660 issues with par value of \$3.3 billion, yielding over \$50 million in premiums. "It's not huge," says one competitor, "but it certainly has been good for certain issuers."

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

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

Now Lopp is running hard with the mortgage bonds, which will need much

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

state enabling legislation. "Organizing this effort has been a bear cat," he says, "but I learned from the pollution experience how to do it."

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

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

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

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

Growing Up at Kutak Rock & Huie

The Omaha law firm is making a national impact with

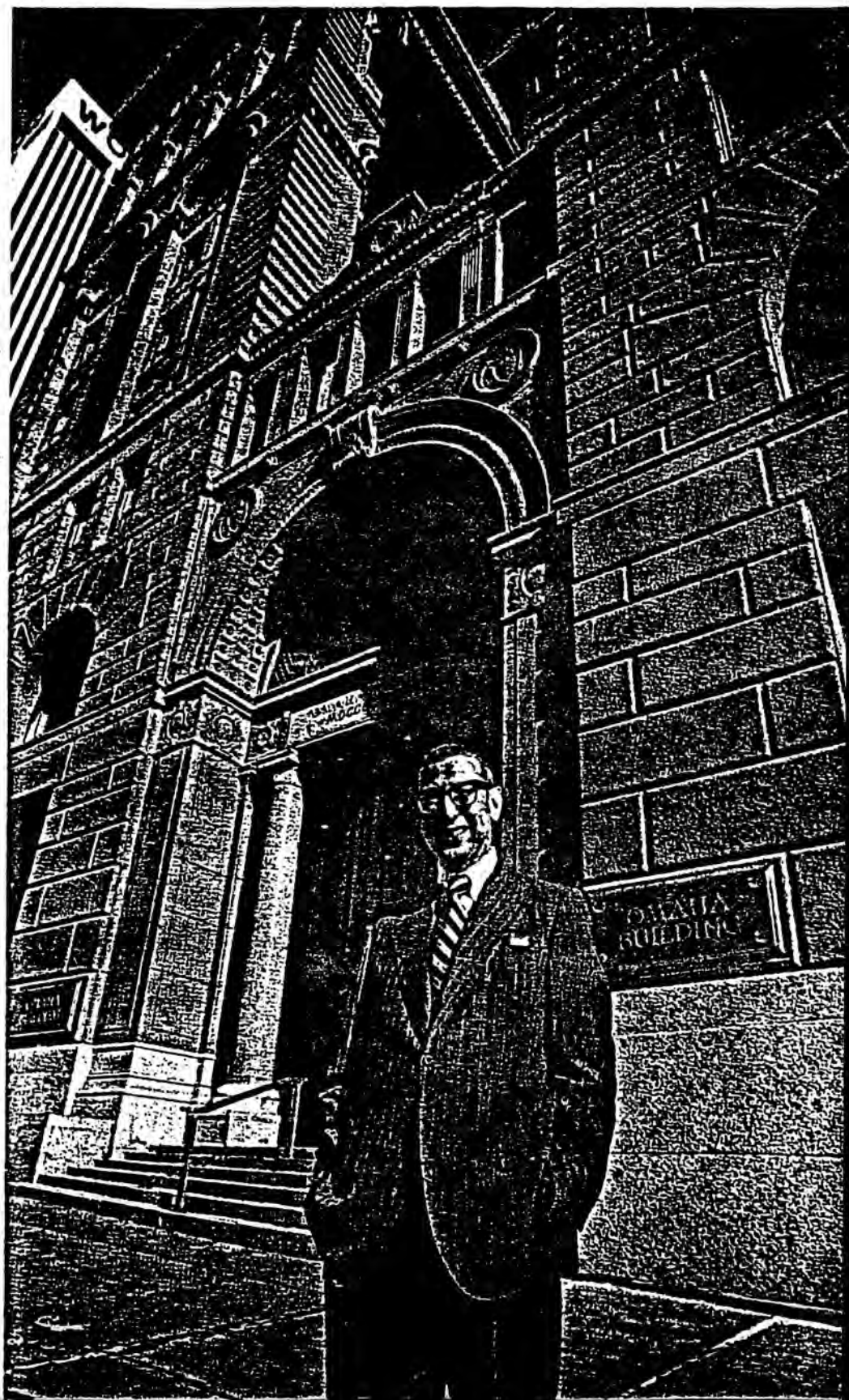
by WALTER KIECHEL III

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

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

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

Research associate: Jo Thomson



a management style that flouts all the rules.

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

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

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

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

Kutak lives in a modest apartment, brimful with books and the modern paintings he avidly collects, but he has dreams of grandeur for his firm. He sees it growing to perhaps 400 lawyers in 1983, 175 of them in Omaha—roughly twice the present Nebraska contingent. In his vision, Kutak Rock will enter one new city a year over

the next five years. Since 1977, it has merged with, or started up, offices in Atlanta, Denver, and Washington; Minneapolis is already scheduled for next year. By the late 1980's, Kutak expects to have perhaps seventeen offices nationwide.

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

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

A fateful wave from the window

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

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

vidual very active in this area, W. James Lopp II.

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

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

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

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

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

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

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

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

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

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

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

"I couldn't have a closer friend"

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

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

continued

BALDOR®

sales and earnings hit record highs

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eighteenth consecutive year
of increased sales as
demand grows for high-
efficiency electric motors

For the first half of 1978, Baldor, the fastest-growing manufacturer of high-efficiency, industrial electric motors, shattered last year's six-month record sales and earnings by substantial margins. Sales were nearly \$80,000,000, net earnings exceeded \$4,000,000. Put in percentages:

net sales up
31%

net earnings up
60%

net earnings per
common share up
57%

cash dividends per
common share up
50%

The above figures, however, reveal only part of the "Baldor story." For example: Baldor sales for the first half of 1978 exceeded all of 1975 sales.

Second quarter sales for 1978 passed the entire year's sales for 1972.

And June, 1978 sales, Baldor's all-time biggest month, topped the yearly sales for 1966.

For 1977 annual report and more information about this 58-year-old Company with a track record of steady, consistent growth, write: R. S. Boreham, Jr., President, Baldor, Fort Smith, AR 72902.



A racquetball court is only one of the amenities available in the lawyers' club on the top floor of the Kutak Rock building in Omaha.

Other features include a large dining-and-meeting room, a kitchen, locker rooms, a bar, and a leather-chaired lounge.

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

Aside from tax-exempt financing, the practice of Kutak Rock's four offices remains largely local. Clients, with one or two exceptions, tend to be of middling to small size. In Omaha, the partnership represents J.L. Brandeis & Sons department stores and Father Flanagan's Boys Town, both traditional clients of a local firm with which Kutak Rock merged. The Washington office does legislative and lobbying work for Citibank, a relationship that again results from merger with an existing firm.

Atlanta office has as its principal client M/RIA, the city's rapid-transit system, worth about \$900,000 a year in legal fees. The lawyers in Atlanta also do work for Standard Federal Savings & Loan Association, some local businesses of the auto-dealership category, and a wide range of litigation clients. Kutak Rock's southern trial attorneys are, for example, currently handling Mrs. Herman Talmadge's divorce from the Senator.

The law firm does not, however, serve as principal outside counsel to any company on the FORTUNE lists of the largest industrial corporations. Some lawyers believe that without such clients, no legal partnership can claim to be a "national firm," which is what Kutak Rock aspires to be. Kutak himself has a loftier-sounding notion of why the firm is seeking what he calls a "national presence." The idea, he says, is not to get clients, but to "better serve each other as lawyers." He envisions

that each city will have a specialty, with its expertise available to all the other offices. "Atlanta," he says, "will have expertise in mass-transit law, and Denver in the natural-resources area." Thus an Atlanta client could draw upon tax advice from Washington, consult with agribusiness attorneys from Minneapolis, or have tax-exempt securities work done out of Omaha.

Talent will bring in the business

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

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

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

continued

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

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

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

The plant that flopped

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

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

Bob Kutak was involved, at different
continued

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

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

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

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

The Hruska connection

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

continued

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120 FORTUNE October 23, 1978

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

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

The "graybeards" learned by doing

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

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

Kutak Rock's clients don't seem to mind that its young lawyers are thrown into the

courtroom, or onto deals, more quickly than some other firms would permit. After all, Wall Street investment bankers can choose their lawyers from among the best. Other practitioners who have worked with the law firm, particularly in the tax-exempt financing area, express admiration in the genteel tones reserved for fellow lawyers. A partner at one Wall Street firm describes Kutak Rock's lawyers as "very professional, a good outfit." He adds, "It's incredible what they've done in the last five years."

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

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

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

United States Senate

WASHINGTON, D.C. 20510

December 12, 1978

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

Dear Mike:

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

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

Sincerely,



Jerry Gauche
Legislative Aide

MG/jg

MIKE GRAVEL
ALASKA

United States Senate

WASHINGTON, D.C. 20510

October 26, 1978

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

Dear Debi:

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

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

1. Washington Post front page article of Sunday, October 22, 1978
2. Finance Committee report on GSOPs
3. Floor statement from the Congressional Record of Saturday, October 14, 1978
4. Title VI of H.R. 13511, the GSOP legislation

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

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

Sincerely,


Mike Gravel

MG/jg

Enclosures

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

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

October 3, 1978

M E M O R A N D U M

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

FROM: Milt Barker MB
Legislative Finance Division

SUBJECT: Congressional GSOP Actions

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

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

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

Senator Mike Colletta
Rep. Jim Duncan

10/3/78
Page 2

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

MBB:pw
Attachments

cc: Steve Cowper
Budget & Audit Committee Members
Terry Gardiner



Congressional Record

PROCEEDINGS AND DEBATES OF THE 95th CONGRESS, SECOND SESSION

Vol. 124

WASHINGTON, THURSDAY, JUNE 22, 1978

No. 96

Senate

GENERAL STOCK OWNERSHIP PLANS

IT TAKES MONEY TO MAKE MONEY

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

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

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

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

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

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

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

EMPLOYEE STOCK OWNERSHIP PLANS

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

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

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

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

THE GENERAL STOCK OWNERSHIP PLAN

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

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

However, I think it is important that ownership in such investments be held by the people directly rather than through the State government. Direct ownership

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

THE GSOP AT WORK

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

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

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

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

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

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

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

WHAT CAN A GSOP MEAN

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

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

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

S. 3223

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

SECTION 1. GENERAL STOCK OWNERSHIP TRUSTS.

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

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

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

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

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

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

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

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

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

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

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

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

4
treated, for purposes of such Code, as dividends.

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

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

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

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

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

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

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

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

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

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

SEC. 4. FAILURE TO DISTRIBUTE.

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

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

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

Section 511(a)(2) of the Internal Revenue Code of 1954 (relating to organizations subject to tax) is amended by inserting "or in

section 501(c)(22)" after "section 501(c)(1)".

SEC. 6. ELIGIBILITY FOR INDUSTRIAL DEVELOPMENT BONDS.

Section 109(b)(3) of the Internal Revenue Code of 1954 (relating to exempt persons) is amended by adding at the end thereof the following new subparagraph:

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

SEC. 7. EFFECTIVE DATE.

The amendments made by this Act, and the provisions of section 2 of this Act, shall apply with respect to taxable years beginning after December 31, 1970.

P R E S S R E L E A S E

FOR IMMEDIATE RELEASE
September 21, 1978
P.R. #76

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

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

General Stock Ownership Plans

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

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

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

At least 95 percent of the income of these corporations which is not used to pay corporate operating expenses would be required to be distributed to the shareholders each year. However, these distributions would not be eligible for any exclusion for dividends received and would not constitute earned income for purposes of the maximum tax on earned income.

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

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

THE FOLLOWING DOCUMENT(S) MAY NOT FILM
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ORIGINAL.

J. General Stock Ownership Corporations

(Sec. 201 of the bill)

Present law

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

Reasons for change

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

Explanation of provisions

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

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

This rule applies to an election made under either subsection (i) or (ii) of Treasury Regulations 1.1361-2(b) (2), relating to the method of electing not to be treated as a partnership.

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

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

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

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

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

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

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

Taxation of shareholders.—Under the bill, each shareholder would include in his gross income his daily prorated portion of the GSOC's taxable income. Such income would be included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. If an income in the hands of the shareholder would be treated as ordinary income and would not be eligible for either the partial dividend exclusion (sec. 316) or the maximum tax of earned income.

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

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

be treated as a tax-free distribution. Any distribution in excess of such previously taxed income would be taxed in the same manner as a distribution from a regular corporation (sec. 301(c)).

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

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

Distribution requirements.—A GSOC would be required to distribute 90 percent of its taxable income to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the deficiency (that is, the difference between the required distribution and the actual distribution) would be imposed on the GSOC. The amount of such tax would be allowed as a deduction to the GSOC for the year in which it is paid.

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

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

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

Effective date

The provision applies to corporations chartered and organized after December 31, 1972.

Revenue effect

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

THE PRECEDING DOCUMENT(S) MAY NOT FILM
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Synopsis of the letter from Louis O. Kelso
to Senator Mike Colletta and Representative Jim Duncan
dated September 26, 1978

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

1. It will be difficult to develop a GSOP emphasizing individual choice.
2. A GSOP can, under the proper federal regulations, allow the development of capital ownership by persons who can not develop this capital ownership under any other system given today's economic environment. The reasons for this phenomenon are as follows:

- a. The GSOP operates on pre-tax dollars.

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

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

In the technological life style of today a person needs the "power of labor" AND the "power of capital" to acquire the productive power necessary to live. #3 The "power of labor" is acquired at birth since slavery is outlawed in the United States. The "power of capital" can not be acquired by more than a few under the present system. Due to the nature of our technological society the value of the "power of labor" is decreasing as compared with the value of the "power of capital." Therefore, a new system must be implemented to preserve the integrity of the US Constitution. A tenet of the new system, as proposed in two-factor economics, is the tax treatment of a GSOP. Since the stock is not earning income until the dividends have paid the purchase price, the stock should not be taxed until the consumer is in fact earning an income from his or her stock.

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

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

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

1. Corporation's would have to guarantee that all profits, after debt service, depreciation and operating reserves, would be periodically declared as dividends rather than reinvested.

Corporation's would have to have a guarantee of an assured source of similar financing by their lending institution and by the Federal Reserve Board of Governors as long as future capital requests are feasible and reasonable.

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

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

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

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

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

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

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

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

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

KELSO & CO.
INCORPORATED

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

LOUIS O. KELSO
PRESIDENT

September 26, 1978

The Honorable Mike Colletta
Alaskan State Senator

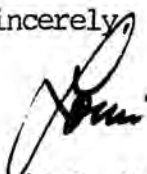
Dear Senator:

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

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

Best regards,

Sincerely,



Louis O. Kelso

LOK:ch

*Our work on the time and sequence
table is taking longer than we estimated,
but it should be completed by
week end.*

Lok.

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDINGFINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

CONTRACT BETWEEN

STATE OF ALASKA
LEGISLATIVE FINANCE DIVISION

AND

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

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

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

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I - STATEMENT OF WORK

- (A) The Contractor shall provide a design study for a General Stock Ownership Plan in the manner described in the Contractor's proposal to the State of Alaska, dated July 10, 1978, as amended by the deletions indicated on the attached copy of said proposal.
- (B) The Contractor shall provide draft proposals of the State and Federal legislation necessary to implement the General Stock Ownership Plan developed in the design study.
- (C) The Contractor shall provide an analysis of the possible adverse effect upon the flow of Federal aid due to the successful establishment of an Alaskan General Ownership Plan and recommendations for dealing with this potential problem.

- (D) The Contractor may purchase the services and provide for the expenses of other consultants or professionals selected with the written approval of the Project Director.
- (E) In the event of any conflict between the amended proposal and this agreement, this agreement shall govern.

CLAUSE II - PERIOD AND DATES OF PERFORMANCE

- (A) The Contractor shall submit the study and proposed legislation on or before February 1, 1979. The report shall be submitted in duplicate in a form suitable for offset printing to the Project Director.
- (B) The period of this contract shall begin on the date it is executed by all parties and terminate on February 1, 1979 unless extended or terminated by written agreement.

CLAUSE III - PROJECT DIRECTOR

The Project Director shall be Sen. Mike Colletta & Rep. Jim Duncan,
c/o Legislative Finance Division, Pouch WF, Juneau, Alaska
99811.

CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT

- (A) Contractor's total compensation, including all expenses for the work described in Clause I, shall be \$180,000, and shall be payable to the Contractor as follows:
 - (1) On the date this contract is executed - \$30,000.
 - (2) The payment of the balance in monthly installments of \$30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.
 - (3) Out-of-pocket expenditures approved in advance by the State of Alaska will be billed monthly and due within 15 days of billing therefor by Kelso & Co.

CLAUSE V - PROGRESS REPORTS

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

CLAUSE VI - RECORDS, DOCUMENTS, AUDIT

All documents, reports and writings produced in the course of the work performed under this contract are, upon delivery to the Agency or at the termination of this agreement, whichever occurs first, the property of the Agency. Contractor understands that State shall have an unlimited license, without further compensation, to reproduce and use all materials containing any claims of copyright by Contractor.

CLAUSE VII - ALL WRITINGS CONTAINED HEREIN

This agreement contains all the terms and conditions agreed upon by the parties. No other understandings, oral or otherwise, regarding the subject matter of this agreement shall be deemed to exist or to bind either of the parties to this agreement.

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

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

Louis O. Kelso
Louis O. Kelso
President & Chief
Executive Officer

September 1, 1978
Date

THE STATE OF ALASKA

Mike Colletta 25 Aug 78
Sen. Mike Colletta Date
Chairman, Legislative
Budget & Audit Committee

John C. Sackett
Sen. John Sackett Date
Chairman, Senate
Finance Committee

Steve Cowper 20 Sept 1978
Rep. Steve Cowper Date
Chairman, House
Finance Committee

Jim Duncan 1 Sept 78
Rep. Jim Duncan Date
Vice-Chairman, Legislative
Budget & Audit Committee

KELSO & CO.
INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

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

July 10, 1978

INTRODUCTION

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

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

The Hon. Mike Colletta, Senator
The Hon. John Sackett, Senator
The Hon. Steve Cowper, Member of the House of Representatives
State of Alaska
July 10, 1978
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The thrust of the work proposed to be undertaken pursuant hereto is the development of the design characteristics of an institution capable of being used by the State of Alaska to build into its citizens individually the equity ownership of some predetermined portion of the capital facilities developed or constructed from time to time to exploit and to realize the economic value of the resources of the State of Alaska. In this initial phase, we are not to concern ourselves with particular potential investments nor with specific activities designed to educate or test the opinion of particular groups of people on any of the aspects of the design which it is the purpose of our study to develop and recommend to the State of Alaska. The focus is to be upon design, and upon the identification and solution of legislative (state and federal), legal, accounting, tax, business, economic and finance problems foreseeably incidental to the implementation of the design so to be recommended.

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

PROPOSED FEE FOR OUR SERVICES IN THE ACCOMPLISHMENT OF THIS PROPOSAL

We propose as a fee for our services in developing and perfecting the design of an Alaskan General Stock Ownership Corporation, the sum of \$130,000. This sum would cover not only our services and all of our out-of-pocket expenditures, but the services and expenses of consultants, selected with advance approval by the State's representatives, to participate in the project.

We propose that the fee would be payable as follows:

1. An initial retainer of \$30,000 upon the execution on behalf of the State of Alaska of this proposal memorandum, thus establishing an agreement between our firm and the State of Alaska.
2. The payment of the balance in monthly installments of \$30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.

The Hon. Mike Colletta, Senator
The Hon. John Sackett, Senator
The Hon. Steve Cowper, Member of the House of Representatives
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July 10, 1978
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An increase in a particular monthly fee (thus shortening the overall payment period) will be considered by the State of Alaska in the event approved out-of-pocket expenditures, combined with compensation for the ongoing efforts of our firm, for a particular month are materially higher than the average contemplated over the performance period.

COMPLETION OF THE DESIGN STUDY

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

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

LEGAL PROBLEMS

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

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

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

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

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

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

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

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

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

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

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

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

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

KELSO & CO., INCORPORATED

By _____
Louis O. Kelso, President and
Chief Executive Officer

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

June 5, 1978.

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

Attention: Mr. Jerry Gauche

Dear Jerry:

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

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

Here is the problem as I see it.

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

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

let us examine the similarities and distinguishing characteristics of each:

Similarities and Differences:

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

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

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

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

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

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

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

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