

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

913 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80 913

KELSO & CO.  
INCORPORATED  
INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

November 2, 1979

Hon. Jim Duncan  
Chairman  
Legislative Budget  
and Audit Committee  
State of Alaska  
Pouch V  
Juneau, Alaska 99811

Report 2  
AGSOC Study

Dear Jim:

It was good to see you and your associates again in Juneau. As you know, I was in Alaska from October 10th through the 19th and generally accomplished what I had planned. I had a total of 84 separate meetings on AGSOC matters during the trip.

During the month of October, our staff interviewed eleven potential financing sources as follows:

- 4 insurance companies
- 3 commercial banks
- 2 private lenders
- 2 foreign banks

All expressed interest in AGSOC developments, however, as anticipated, we are having difficulty with definitive information because of the uncertain initial capital structure of AGSOC. Unless AGSOC is to limit itself to immediately productive investments such as a TAPS participation, a substantial equity or quasi-equity base will have to be established. Based on the experience of British Columbia Resources Investment Corporation and relating it to the population of Alaska, suggests that \$80,000,000 could be raised through a supplemental common stock sale to residents. In the B.C. Resources' case, 15.0 million shares were gifted and 81.2 million shares sold to residents for \$487 million. Because of the ten share limitation, AGSOC would probably choose to use

Hon. Jim Duncan  
November 2, 1979  
Page Two

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We have had preliminary discussions with Dr. Jizmagian about working with us on certain aspects of the report. Your written consent is required under the contract. We have used him successfully in the past on several projects, most recently on the supplement contract last year for you on BP Pipelines, Inc. His background is enclosed for your review.

Sincerely,

KELSO & CO., INCORPORATED

  
John A. Miskimen  
Senior Vice President

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

Consultant to Kelso & Co., Incorporated

G. STEPHEN JIZMAGIAN

Dr. Jizmagian is the founder of GSJ Associates who specialties are economic research and statistical analysis. Before forming the firm, he was a senior partner of San Francisco Consultants for four years and prior to that, a senior staff consultant at Arthur D. Little, Inc. Most of his assignments at ADL were to analyze new ventures and help clients develop the strategy for the implementation of new industries or new businesses.

At San Francisco Consultants, he became active in the efforts of venture capital financing for new enterprises. Dr. Jizmagian has also assisted public and private clients in developing and using advanced long-range planning techniques. He has performed statistical analyses, statistical testing, and survey research for projects requiring expert testimony in civil court and regulatory commission hearings. He has just completed testifying for an antitrust case in which his econometric analysis resulted in a multimillion dollar damage award to the plaintiff by a jury verdict.

Dr. Jizmagian has performed many studies in the public utility field. He recently appeared as an expert economist in a California Public Utilities Commission hearing in the telephone industry for which he undertook research on the economic effects of regulation and competition. He has presented work on utility cost data before the California Public Utilities Commission and the Public Service Commission of New York. He performed an audit of a utility in Nevada for the Public Service Commission of Nevada. In addition, he has performed work for a California utility company and a Bell System telephone operating company.

Dr. Jizmagian received his ScB degree in Electrical Engineering, magna cum laude, from Brown University. After receiving an MS in Electrical Engineering and an MS in Statistics from Stanford University, he completed a PhD in Operations Research at Stanford. While at Stanford University, he served as a consultant to the RAND Corporation where he developed a large scale inventory model. At Brown University, he performed theoretical and laboratory research on particle size measurements. He has published papers and presented lectures in mathematical programming, optimal control systems, data processing, particle size analysis, and communications. He is a member of the Institute of Management Science, The Operations Research Society of America, Tau Beta Pi, and Sigma Xi.



# Alaska State Legislature

## House of Representatives

MEMBER  
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN  
CHAIRMAN  
BUDGET & AUDIT COMMITTEE

STATE CAPITOL  
POUCH V  
JUNEAU, ALASKA 99811  
465-3818

HOME ADDRESS  
RR 4 BOX 4316  
JUNEAU, ALASKA 99803  
789-9792

*November 14,*  
October 3, 1979

Louis O. Kelso, President  
Kelso & Co., Incorporated  
111 Pine Street  
San Francisco, California 94111

Dear Mr. Kelso:

Please find enclosed a State warrant (No. 170976) in the  
amount of ten thousand dollars (10,000.00). This is the  
*second* first installment as per our contract.

Sincerely,

*Jim*  
Jim Duncan

This warrant will be deemed paid unless redeemed within  
two years after the date of issue per AS 37.05.180

DATE OF ISSUE  
09 30 79  
MO. DAY YR.

TREASURY WARRANT  
STATE OF ALASKA  
JUNEAU, ALASKA

No. 170976

89-52  
1252

PAY TO THE ORDER OF

KELSO & CO  
111 PINE ST  
SAN FRANCISCO CA 94111

DO NOT FOLD, SPINDLE OR  
MUTILATE

| DOLLARS        | CENTS |
|----------------|-------|
| \$***10,000.00 |       |

\$10,000.00 330 170976

# 2170976# 12525200521

*W.R. Hudson*  
COMMISSIONER OF ADMINISTRATION

KELSO & CO.  
INCORPORATED  
INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

September 25, 1979

Invoice #2355

Legislative Budget and Audit Committee  
State of Alaska  
Pouch V, Juneau, Alaska 99811

---

I N V O I C E

First installment as per our contract  
dated August 17, 1979

\$10,000.00

*Hold for receipt  
of report.*

THANK YOU

RECEIVED  
OCT 1 1979  
BUDGET/AUDIT  
COMMITTEE

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

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

November 2, 1979

Hon. Jim Duncan  
Chairman  
Legislative Budget  
and Audit Committee  
State of Alaska  
Pouch V  
Juneau, Alaska 99811

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NOV 6 1979

BUDGET/AUDIT  
COMMITTEE

Report 2  
AGSOC Study

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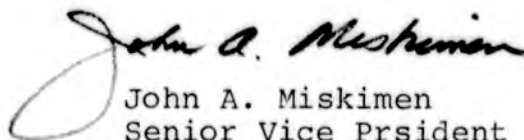
Hon. Jim Duncan  
November 2, 1979  
Page Two

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KELSO & CO., INCORPORATED

  
John A. Miskimen  
Senior Vice President

JAM:bp

# KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

## Consultant to Kelso & Co., Incorporated

### G. STEPHEN JIZMAGIAN

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# Alaska State Legislature

## House of Representatives

MEMBER  
Finance Committee

REPRESENTATIVE  
**JIM DUNCAN**  
CHAIRMAN  
Budget & Audit Committee

State Capitol  
Pouch V  
Juneau, Alaska 99811  
465-3818

Home Address  
P.O. Box 690  
Juneau, Alaska 99802

November 13, 1979

Louis O. Kelso, President  
Kelso & Co., Incorporated  
111 Pine Street  
San Francisco, California 94111

Dear Mr. Kelso:

Please find enclosed a State warrant (No. 194275) in the  
amount of Ten Thousand Dollars (\$10,000.00). This is the  
second installment as per our contract.

Sincerely,

This warrant will be deemed paid unless redeemed within  
two years after the date of issue per AS 37.05.180

DATE OF ISSUE  
11 07 79  
MO. DAY YR.

**TREASURY WARRANT**  
**STATE OF ALASKA**  
JUNEAU, ALASKA

**No. 194275**

89-52  
1252

PAY TO THE ORDER OF

KELSO & CO  
111 PINE ST  
SAN FRANCISCO CA 94111



\$10,000.00 330

2194275 1252 00520

DO NOT FOLD, SPINDLE OR  
MUTILATE

| DOLLARS        | CENTS |
|----------------|-------|
| \$***10,000.00 |       |

Commissioner of Administration

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

October 29, 1979

Invoice #2374

Legislative Budget and Audit Committee  
State of Alaska  
Pouch V, Juneau, Alaska 99811

---

I N V O I C E

Second installment as per our contract  
dated August 17, 1979

\$10,000.00

THANK YOU



RECEIVED  
OCT 31 1979  
BUDGET/AUDIT  
COMMITTEE

KELSO & CO.  
INCORPORATED  
INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

November 30, 1979

Hon. Jim Duncan  
Chairman  
Legislative Budget  
and Audit Committee  
State of Alaska  
Pouch V  
Juneau, Alaska 99811

RECEIVED  
DEC 3 - 1979  
BUDGET/AUDIT  
COMMITTEE

Report 3  
AGSOC Study

Dear Jim:

I am going to devote most of the report to B.C. Resources. After all, this is the closest example, I believe, to what we are talking about for Alaska. There is much we can learn from their experience.

On other fronts, Eric Bramstedt has nearly completed his study on inland marine and over-the-road investment opportunities along with the Alaskan Railroad. Steve Jizmagian is working on leasing of large equipment including aircraft. The unusual federal tax structure of AGSOC seems to offer some unique advantages for AGSOC in leasing. More of this next month. Investments are continuing with potential financing sources. During the month, we interviewed three more insurance companies, five commercial banks, three private lenders and two foreign banks.

British Columbia Resources Investment Corporation was initially conceived to be a vehicle to return to the private sector certain investments which were owned by the Province of British Columbia under their socialistic regime. The Government wanted to avoid the conflicts which can arise where it had regulatory authority over the forest products industry, for example, and yet had a direct holding in some pulp, lumber and plywood companies. In addition, the Government felt the process could provide a mechanism to raise some badly needed equity capital and would at the same time enable its citizens, who were watching their savings being eroded by inflation, to participate directly and individually in resource ownership.

Hon. Jim Duncan  
November 30, 1979  
Page Two

BCRIC was patterned after the Canada Development Corporation and the Alberta Energy Company. After enacting legislation, the Government appointed five prominent British Columbians to be the founding incorporators of the company and its initial directors. They had one common and very significant characteristic; they are all chief executive officers of their own highly successful B.C. headquartered public company, and their companies do not compete with any BCRIC investments.

The company then acquired their initial investments from the Province for a promissory note of \$151,000,000. The selection of investments (only from the Province's holdings) and the valuation of these investments was through a process audit by the Canadian investment firms of McCloud Young, A. E. Ames, Pemberton, and Richardson. BCRIC selected only good companies from the many Province holdings.

In order to give the ownership to the people, the Government agreed to exchange the \$151,500,000 promissory note in full settlement for 15,000,000 common shares. Of those 15,000,000 shares, they offered to give 12,000,000 away, or five each, to each of the eligible residents. At the same time as applications were to be received for free shares, BCRIC would accept subscriptions for further shares at \$6.00 each, to be issued from the treasury, to a maximum of 5,000 shares per eligible person. Book value before dilution was over \$10.00 per share. Bearer shares were to be used in order to save the corporation the expense of registering potentially 2.4 million shareholders. In order to have registered shares and be a voting shareholder, one had to purchase a minimum of 95 shares, to be added to the five free ones in order to qualify. Bearer shares could be traded just as registered shares, and the stock exchanges agreed to reduce the trading block to five shares. In order to cut down on shareholder costs, only registered owners received mailed notices. Annual and interim shareholder reports for bearer shares are distributed by delivery of 250 copies to each branch of a financial institution to be placed on counters for pick-up. Shareholder service costs are estimated at \$1.50 per year for registered holders.

The distribution was an awesome and expensive undertaking. Because it involved a potential distribution to 2.4 million people, it required the utilization of all the financial institutions in the Province. Without the full participation of those institutions,

Hon. Jim Duncan  
November 30, 1979  
Page Three

involving some 1,300 individual locations, the job could not have been accomplished. Each branch of these institutions agreed to accept applications upon presentation of two forms of identification. The computer operations at BCRIC then sorted to avoid duplications.

The distribution and the sale resulted in 87% of the eligible population, or 2,000,000 people, applying for their free shares and 130,000 individuals applying to buy 100 or more shares, yielding gross proceeds of \$487,500,000. Incidentally, another 40,000 people purchased extra shares, but not in sufficient number to be qualified for registration. In total, BCRIC has now 96,250,000 issued shares; the total cost of distributing all shares was \$15,000,000 or approximately 3% of proceeds to the company.

The response surprised everybody involved in the process. There were a number of factors that produced such astounding results. First, the Canadian stock market was buoyant and a lot of people were interested in the market generally, with gas and oil interest particularly strong. (The inclusion of the gas and oil leases in BCRIC assets added appeal.) Second, people in British Columbia have pride in their province, and they responded very positively to the concept of a totally B.C. operated and directed company in the resource field. Third, was the Premier's own personal support of the issue. Fourth, the Board of Directors had great provincial credibility. Fifth, the general momentum that the issue developed as people read about it, talked about it, and listened to the advice of professionals as well as their friends and neighbors. They felt it was attractively priced. And finally, of course, there was an element of straight speculation by people anticipating a fast, profitable turn.

Between late June and August 7th, when trading was to commence, there was deliberation on the question of the appropriateness of the company declaring its intention to provide assistance in the maintenance of an orderly market, should it be required. The issue was not underwritten. However, the Board had the courage of their conviction in the principles of a free market, and elected not to provide support. While that decision did take courage, it was also reinforced by the belief that the large majority of the original purchasers were long-term investors and not short-term speculators. Now that shares are traded on the Vancouver and Toronto Exchange, anybody across Canada can buy shares. (There is no holding period for the free or purchased shares.) To date, 22,000,000 shares have been traded (about 20% of the total).

BCRIC has been successful in keeping its image as a private company rather than a quasi-public body. It states its responsibilities only to shareholders and not to the Province. It has freedom to invest in companies outside of the Province.

Selection of new investments will be concentrated in the area of natural resources. BCRIC feels no restraint on its investment objectives through other companies, the government, or any social responsibility other than such responsibility any private company may hold. BCRIC intends to be an operating company rather than just as a holding company. Its initial and current holdings are:

81% of Canadian Cellulose, a public company and a major pulp and lumber producer in the Province.

100% of two medium-sized lumber producers, Kootenay Forest Products and Plateau Mills, the former also a producer of sheathing plywood.

10% of the shares of Westcoast Transmission, a natural gas pipeline company controlled by Pacific Gas & Electric Company.

A license to explore for gas and oil on some 2.3 million acres of public land in northeastern British Columbia.

BCRIC has a present equity capitalization of over \$600,000,000 through the offer and the initial holdings. In addition, it can borrow to put its total asset holdings over a billion. It currently generates about \$30,000,000 in earnings on a sales volume of \$300,000,000 through its present holdings. Its interest earnings on the cash proceeds of the issue are yielding over \$1,000,000 a week or over 11%; however, in order to stimulate growth, their policy is not to distribute dividends for three to five years.

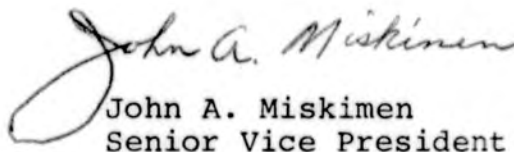
BCRIC feels that one of the benefits of wide citizen ownership is that employees of its companies see themselves as working for themselves and other citizens as owners rather than unknown shareholders or the government. BCRIC feels that many labor problems will be averted through this concept.

Hon. Jim Duncan  
November 30, 1979  
Page Five

Other than Alaska, other organizations have expressed interest in BCRIC. They include the Tennessee Valley Authority, British National Oil Company, and Petro Can. BCRIC will make people available for further specific discussions with Alaskan representatives when specific needs are identified.

Sincerely,

KELSO & CO., INCORPORATED

  
John A. Miskimen  
Senior Vice President

JAM:bp

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LCS ANGELES

November 30, 1979

Invoice #2392

Legislative Budget and Audit Committee  
State of Alaska  
Pouch V, Juneau, Alaska 99811

---

I N V O I C E

Third installment as per our contract  
dated August 17, 1979

\$10,000.00

THANK YOU

*Approved*  
*L. Juneau*



# Alaska State Legislature

## House of Representatives

MEMBER  
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN  
CHAIRMAN  
BUDGET & AUDIT COMMITTEE

STATE CAPITOL  
POUCH V  
JUNEAU, ALASKA 99811  
465-3818

HOME ADDRESS  
RR 4 BOX 4316  
JUNEAU, ALASKA 99803  
789-9792

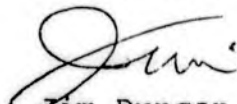
December 12, 1979

Louis O. Kelso, President  
Kelso & Co, Incorporated  
111 Pine Street  
San Francisco, California 94111

Dear Mr. Kelso:

Please find enclosed a State Warrant No. 211622 in the  
amount of Ten Thousand Dollars (\$10,000.00). This is the  
third installment as per our contract.

Sincerely,

  
Jim Duncan

This warrant will be deemed paid unless redeemed within  
two years after the date of issue per AS 37.05.180

DATE OF ISSUE

12 11 79  
MO. DAY YR.

TREASURY WARRANT  
STATE OF ALASKA

JUNEAU, ALASKA

No. 211622

89-52  
1252

PAY TO THE ORDER OF

KELSO & CO  
111 PINE ST  
SAN FRANCISCO CA 94111

DO NOT FOLD, SPINDLE OR  
MUTILATE

| DOLLARS          | CENTS |
|------------------|-------|
| \$ ****10,000.00 |       |

  
Commissioner of Administration

\$10,000.00 330 211622  
⑈ 2211622⑈ ⑆ 1252⑈ 0052⑆

10-18

John Mickiner @ our office in Juneau  
Native Corp. Shareholder persons

Schneider? possible 25% unlocatable residents  
also Spoken Pres. Gov. selection of initial  
Board -

what about judicial type selection process  
done ~~See John info on B.C. w/ly~~  
~~and David Reaume copy of yellow covered~~  
report also terms & conditions of Timber Contract

Copy that can't be receipt  
of site

in Power & Comm. General

Nat. Corp. would provide sufficient  
money

invest in AGSCC

B - group of investors

Have to find Cap More but  
cannot because of statute so there  
will be a trade of investments with  
B so B actually invest in Cap More  
should Mandate AGSCC not in any  
way get involved - such

KELSO & CO.  
INCORPORATED  
INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

January 2, 1980

Hon. James Duncan  
Chairman  
Legislative Budget and  
Audit Committee  
State of Alaska  
Pouch V  
Juneau, Alaska 99811

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JAN 07 1980  
BUDGET/AUDIT  
COMMITTEE

Report 4  
AGSOC Study

Dear Jim:

In this report we will update our report on TAPS, summarize our research into the potential of AGSOC engaging in the leasing business and report on the results of our research into other potential AGSOC investments.

TAPS

During this past month we have reviewed the past year's performance of TAPS and the current status of the FERC hearings on TAPS rates. In addition, we have updated our files on the BP ownership interest in TAPS.

The FERC hearings are proceeding at a slow pace with current interim rates in effect at the operators' requested levels. However, there is still the possibility that carriers may have to refund revenues if permanent rates are set by FERC at a level lower than the current rates. It is expected that final rate determination will be made by mid 1980.

Although no new oil has been discovered and total proven reserves are still 9.1 billion barrels, expansion of TAPS capacity is under way. Current flow capacity has been raised to 1.36 million barrels per day (up from the initial capacity of 1.16 million barrels per day) and should reach 1.42 million barrels per day by the end of 1980. Most of the higher flow capacity has been achieved through use of a special chemical additive, without construction of new pump stations, although new pump stations are being completed.

To date, only Arco, Exxon, and BP are participating in the capital expansions and BP's share should increase to a 16.8% ownership of TAPS by the end of 1980. Other revenue and expense items are in line with past projections except for the high cost of the additive. However, profitable operations exist with the interim rates in effect.

Hon. James Duncan, Chairman  
Legislative Budget and Audit Committee  
State of Alaska  
January 2, 1980  
Page 2

### LEASING

As we mentioned in our last report, leveraged leasing could offer some favorable tax advantages for AGSOC. Additionally, an AGSOC leasing program could stimulate many segments of the Alaskan economy which are currently restricted by lack of capital.

Although leasing is an alternative source of financing capital equipment, it offers advantages to both sides of the relationship. Both have some tax advantages, and although the leasing company assumes more risk, the lessee grants compensation for its diminished risk in higher rental payments.

There are many variables in the structure of a lease so that a single financial model would not cover all cases. However, for illustrative purposes, the following example shows the advantages to AGSOC:

Suppose a company were to lease a \$1,000,000 piece of equipment through AGSOC. If this equipment had a 20 year life, possible lease payments (under today's high interest rates) might be as high as \$175,000 per year or higher if a short term lease were executed. On the other hand, AGSOC's principal and interest payment could be under \$150,000 per year. Thus AGSOC could achieve a cash flow spread of at least 2-1/2% of the equipment value per year and under certain conditions this could be as much as 5%. However, the significant tax factors which would benefit AGSOC and its stockholders would be the investment tax credit and depreciation. In the first year of the investment, 10% of the value of the equipment could be claimed as a tax credit. Under the Federal legislation, Subchapter U to the Internal Revenue Code, this would be passed through directly to AGSOC's shareholders. The distribution of profits could be controlled by the depreciation schedule used so that up to the full value of the positive cash flow could be retained by AGSOC without tax penalty. This reserve could be used to offset future cash requirements or for new investment.

A major attractiveness of leasing for AGSOC is that it could borrow nearly 100% of the purchase price of certain investments. Our recent discussions with major banks, indicate that the banks would loan to AGSOC at favorable rates assuming a reasonable AGSOC capitalization. Additionally, for large investments, most institutions will provide necessary expertise in structuring the lease and managing the asset through the lease term.

Leasing is a competitive business. Initially, we investigated AGSOC leasing aircraft to Alaska Air Lines, for example. However, Alaska Air Lines has multiple proposals for such leases and at much more favorable rates than could be offered by AGSOC. The reasons for strong competition, especially in aircraft, are the favorable tax advantages (increasing for those in higher than 50% tax brackets) and high resale residual values for aircraft after the initial lease terms. Many lessors will therefore sacrifice short term cash flow for current tax benefits and long term profits. The best

Hon. James Duncan, Chairman  
Legislative Budget and Audit Committee  
State of Alaska  
January 2, 1980  
Page 3

opportunities for AGSOC would seem to be areas of leasing where lease competition is not so high, e.g., for leasing to start-up business ventures, and in other situations where financing sources are difficult to obtain.

We have reviewed the component parts of the Alaskan economy outlined in our October 2, report and have identified some possible areas where leasing opportunities may be found. We will summarize these findings here.

#### MOTEL AND HOTEL

We are currently reviewing opportunities in sale and leasebacks of hotel/motel sites and structures. This industry offers more favorable opportunities for AGSOC leasing since there are more favorable tax credits available in motel/hotel leasing than for other forms of commercial real estate.

#### FISHING

Currently, there are investment opportunities in Alaska for both processing vessels and on-shore processing plants. The vessels offer good opportunities since interim financing during construction would not be as big a handicap as construction of new plants. Leasing of fishing vessels, or sale and leasebacks of converted fishing vessels, also offer opportunities in the fishing industry. We are continuing to investigate these possibilities.

#### HARD ROCK MINERALS

There seems to be a potential for leasing mining equipment. We will investigate further.

#### OIL AND GAS

In gas pipeline construction, leasing opportunities exist in rolling stock used during construction. There also are opportunities for leasing drilling rigs or LNG storage tanks. The high value of storage tanks is attractive for an AGSOC investment.

#### PETROCHEMICALS

The development of a petrochemical industry using Alaskan resources has stimulated much interest in parts of Alaska. Construction financing is not an attractive leasing opportunity, but certain installed equipment may offer attractive opportunities.

#### AGRICULTURE

Agricultural equipment offers some lease opportunities although AGSOC might not want to compete in the financing for the leasing of relatively low value equipment.

Hon. James Duncan, Chairman  
Legislative Budget and Audit Committee  
State of Alaska  
January 2, 1980  
Page 4

#### ELECTRIC POWER

Potential for the leasing of prefabricated plants exists in Alaska. Major users of electric power or new hydroelectric plants may have financing difficulties. AGSOC may be able to lease a full plant to potential operators.

#### ALASKA RAILROAD

While we are studying the actual purchase of the ARR, there is also a potential lease opportunity in freight cars, locomotives and other equipment. As in the airline industry, rail car leasing is competitive with many players. We will analyze this further in our study of the Alaska Railroad.

#### TRANSPORTATION

We are currently investigating other surface transportation opportunities within which areas leasing potential is generally good.

#### FURTHER CANADIAN MOVES TO BROADEN OWNERSHIP OF INDUSTRY

The Federal Progressive Conservative Government of Canada has announced that if it is reelected in the forthcoming Federal election, it would offer five free shares in the \$3.3 billion integrated petroleum corporation, Petro-Canada, to every Canadian adult and to young Canadians upon their becoming eighteen years of age. Individuals and institutions in Canada would be permitted to purchase up to a maximum of 3% of Petro-Canada shares, but one-third of the equity would be retained by the Federal Government.

This is further evidence that Canada is moving in the direction of encouraging broad ownership of basic industry and resources by Canadians.

Very truly yours,

KELSO & CO., INCORPORATED

By



Louis O. Kelso  
Chairman of the Board

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

February 1, 1980

Invoice #2420

Legislative Budget and Audit Committee  
State of Alaska  
Pouch V  
Juneau, Alaska 99811

---

I N V O I C E

Final installment as per our contract  
dated August 17, 1979

\$10,000.00

THANK YOU

RECEIVED  
FEB 6 1980

BUDGET/AUDIT  
COMMITTEE

## United States Senate

WASHINGTON, D.C. 20510

### M E M O R A N D U M

*Went over #2, 2 and 3 with Kelso  
7-17-79. Saw him in detail 7-23*

TO: Senator Gravel

FROM: Tyler Jones

RE: Louis Kelso's proposal to the Legislature

DATE: July 5, 1979.

For \$245,000 Kelso proposed that his firm:

OK ✓ 1) Catalog and evaluate the financing sources for AGSOC, involving the discount ability of the Federal Reserve Bank and getting close to House and Senate banking committees as well as the administration; *specific as to #3*

? ✓ 2) Lay the foundation for working with the 1980 census with respect to necessary stockholder information. This would include adding questions to the Census Bureau's questionnaires for Alaska; *check further before Kelso.*

OK ✓ 3) Develop an outline of the types of investment opportunities for AGSOC; *specific, e.g. stock, bonds, etc. Kelso.*

4) Conduct educational efforts directed at the appropriate committees of Congress and their individual members and the U.S. Treasury Department and its officials;

? ✓ 5) Design the original management structure and procedure for AGSOC, "doing the management engineering" to develop internal structure and procedures so when the legislature or the voters approve AGSOC it will be ready to go;

WC+P 6) Establish an acceptable working relationship with the Securities and Exchange Commission with respect to future reporting and registration work. + IRS

Kelso proposed a \$35,000 retainer with \$35,000 monthly installments, for a total of \$245,000 when the work is completed after 6 months.

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

June 19, 1979

The Honorable Jim Duncan, Chairman  
Legislative Budget and Audit Committee  
State of Alaska  
Capitol Building  
Pouch W F  
Juneau, Alaska 99811

Dear Mr. Chairman:

RE: PROPOSAL TO UNDERTAKE AND EXECUTE SUPPLEMENTARY  
INTERIM WORK RELATING TO THE PROPOSED ALASKA  
GENERAL STOCK OWNERSHIP CORPORATION (THE CREATION  
OF WHICH IS THE SUBJECT OF S.B. NO. 170 AND H.B.  
NO. 240 IN THE STATE OF ALASKA ELEVENTH LEGISLATURE--  
FIRST SESSION) RELATING TO SEEKING CONGRESSIONAL  
IMPROVEMENT OF THE TAX POSITION OF CITIZEN-STOCKHOLDERS  
OF AGSOC UNDER FEDERAL PERSONAL INCOME TAX LAWS;  
DESIGNING AND DEVELOPING A PROPOSED MANAGEMENT  
STRUCTURE AND MANAGEMENT PROCEDURES FOR AGSOC;  
SEEKING CLARIFICATION AND FAVORABLE TREATMENT OF  
THE ULTIMATE SECURITIES ACTIVITIES OF AGSOC BY THE  
SECURITIES AND EXCHANGE COMMISSION; EVALUATING FOR  
THE BUDGET AND AUDIT COMMITTEE OF THE HOUSE OF  
REPRESENTATIVES OF THE STATE OF ALASKA THE DESIRABILITY  
OF CONGRESSIONAL AMENDMENT OF SUBCHAPTER U OF THE  
INTERNAL REVENUE CODE SO AS TO PERMIT MULTIPLE  
CLASSES OF STOCK TO BE ISSUED BY A GENERAL STOCK  
OWNERSHIP CORPORATION IN ORDER PERIODICALLY TO  
EXTEND ITS STOCKHOLDER BENEFITS TO NEW CATEGORIES  
OF RESIDENTS, TO HAVE STOCK THAT WOULD BE ELIGIBLE  
FOR AN EMPLOYEE STOCK OWNERSHIP PLAN, AND IF A  
FAVORABLE DECISION THEREON RESULTS, UNDERTAKING TO  
PERSUADE CONGRESS TO INITIATE AND ADOPT SUCH  
AMENDMENT; INITIATING LIAISON WITH THE UNITED  
STATES BUREAU OF CENSUS IN ORDER TO TAKE MAXIMUM  
ADVANTAGE OF ITS ACTIVITIES PRELIMINARY TO THE  
1980 FEDERAL CENSUS TO INITIATE BUILDING THE DATA  
BANK OF RESIDENTS OF ALASKA QUALIFIED TO BECOME  
STOCKHOLDER CONSTITUENTS OF AGSOC AND TO PROGRESS  
THE BUILDING OF SUCH DATA BANK, ON THE BASIS OF  
THE DEFINITIONS OF "QUALIFIED RESIDENT" IN SAID

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Two

PENDING STATE LEGISLATION; CONDUCTING A BROAD INVESTIGATION OF POTENTIAL TYPES OF INVESTMENT OF AGSOC AND PREPARING A CATALOG THEREOF; AND INITIATING AND COMPLETING A DEFINITIVE ANALYSIS OF THE DETAILS OF THE PENDING STATE LEGISLATION AND MAKING SUCH RECOMMENDATIONS THEREON AS MAY SEEM JUSTIFIED.

From information we have gathered in the course of our work pursuant to our now completed contract with the Legislature of the State of Alaska and our continued close liaison with representatives of the Legislature of the State of Alaska and the office of the Attorney General of Alaska, we think it safe to venture the assertion that no legislation ever to come under consideration by the Legislature has received more intensive and broad-gauge analysis and scrutiny than the legislation dealing with AGSOC. This is entirely fitting in view of the enormous potential significance of AGSOC to the economic and political wellbeing of the citizens of the State of Alaska. Nor can such meticulous care and consideration fail to benefit others beyond Alaska who, it seems probable, will seek to follow in the pioneering footsteps of the Alaskan Legislature.

Much has been accomplished through the study by legislators, by their staffs, by the sizable group of witnesses who have appeared before various Committee hearings, and by consultants in responding with analytical efforts and with proposed modifications to the pending legislation in the course of a year's thoughtful consideration of the AGSOC legislation.

However, the vast work done to date has raised almost as many questions as it has provided answers, and unremitting and painstaking work must continue to be done if the Legislature of the State of Alaska, upon convening its next session in January, 1980 is to have before it an AGSOC bill upon which it can act with confidence and with a minimum of doubts that any critical areas have been left unexplored.

In this proposal, we urge the State of Alaska to employ our firm, together with such subcontractors and consultants as we may, with the approval of the designated representative of the Budget and Audit Committee of the State of Alaska, employ to undertake and complete, (or complete so far as possible), a number of activities aimed at answering these unanswered questions and providing the Legislature with the basic analytical material to resolve most of the unresolved doubts.

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Three

Many trends in the economy of Alaska, of the United States, and in the field of international economic relations have developed during recent months that suggest greater urgency in avoiding loss of momentum in the AGSOC project. The importance of the energy resources of the State of Alaska have gained an even more awesome significance to the future of America. Regulatory confusion in the energy field has increased in complexity. The precariousness of the continued viability of the U. S. economy, as it is presently structured, has become more doubtful. The pace of nation-debilitating inflation has quickened. The willingness of Federal leadership to use further inflation-creating stimuli to cut unemployment meets rising opposition in the form of taxpayers' revolts. The needs for economic leadership and to clarify economic policy considerations--to which the Legislature of the State of Alaska can make major contributions with the launching of a carefully designed AGSOC--has risen to preeminence in the minds of many Americans.

The 95th Congress of the United States, in enacting Subchapter U of the Revenue Code of 1954, as amended, went further in recognizing the need for a new economic policy built upon broader ownership of capital than anyone with historical perspective could have confidently anticipated. Nevertheless, Subchapter U in its present form accomplishes only part of the necessary changes in our basic approach to financing business enterprise and facilitating individual acquisition of capital ownership that are necessary in order to construct a rational economic policy. While it is feasible, in certain highly productive investments, to so design financing structures that stockholders, or beneficial stockholders can buy productive capital and pay for it, both principal and interest, in after-personal-income-tax dollars, it is not in the interest of either State or Federal governments, nor certainly in the interest of accelerating the virtually dormant economic growth rate of our economy, for them to do so. The proof of this lies in the great success of ESOP financing. In that technique, which, like the AGSOC, is based upon the theory of capitalism, or two-factor economics, the employee has access to credit through which we can buy stock representing productive capital and pay for it, both principal and interest, in pre-corporate-income tax dollars from the return on invested net worth of the shares purchased, and defer personal taxation, normally to his retirement date. Clearly what is needed is to recognize that the purchase of capital under arrangements that make it possible to pay for it out of what that capital produces is, in reality, not an income transaction at all. Thus, it is of major importance to persuade

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Four

Congress to eliminate personal income tax liability upon stockholders of a General Stock Ownership Corporation as to all yield of the underlying capital applied to amortization of the purchase price, both principal and interest, and to do so permanently. The sooner the ownership of productive capital can begin producing added income for the new stockholder, the faster the income tax base grows, both for the Federal and State governments.

SUMMARY OF PRINCIPAL COMPONENTS OF WORK CONTEMPLATED BY THIS  
INTERIM PROPOSAL FOR THE LEGISLATURE OF THE STATE OF ALASKA  
DURING THE PERIOD JUNE 15 THROUGH DECEMBER 15, 1979

While our work on the AGSOC project for the State of Alaska has continued, at reduced speed, since the completion of that agreement upon delivery of our final report thereunder in January, 1979, we propose herein that the Legislature of the State of Alaska employ us to marshall the necessary manpower and talents to accomplish, between June 15, 1979 and December 15, 1979, under the direction of such representative of the Legislature of the State of Alaska as the joint Budget and Audit Committee of the State may designate, the following work projects for the purpose of supplementing and extending the preparatory work accomplished by the Eleventh Legislature of the State of Alaska, First Session, and by its consultants, including ourselves, towards establishing the Alaskan General Stock Ownership Corporation and in due course, if the legislation becomes law, enabling it to acquire significant productive capital ownership.

OK ✓  
Analysis, Cataloging and Evaluation Of Financing Sources

In the debates and discussions that took place during the Eleventh Legislature, First Session, both within the Legislature and between the Legislature and the Office of the Governor, the sources for financing the acquisition of capital assets for AGSOC of such magnitude as to be significant to the State's economy, were a major subject. In modifying the initial AGSOC bill, as first introduced, several restrictions were imposed upon the economic resources and power of the State itself and of its agencies.

It is critical now that realistic sources and methods for financing the acquisition of major capital assets by AGSOC be identified, and that the means by which such financing sources can be induced to participate be determined. We would undertake to analyze and catalog these sources, to evaluate them, and to generate strategic and tactical approaches with respect to each of them.

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Five

*Forma to pass*

? ✓ Laying the Foundation for Working With the 1980 Federal Census in  
Order to Develop a Stockholder Constituency Data Base

Preparations for the 1980 United States census are already well advanced. Failure to develop, in connection with the appropriate agencies of the State of Alaska, a working relationship that will enable Alaska to take advantage of the experience and major manpower expenditures of the Federal government in accomplishing the census in Alaska would be to miss a vital opportunity to accelerate the establishment of AGSOC if the Legislature adopts the necessary legislation during the forthcoming Session. The end result would force AGSOC into making duplicating expenditures that would waste its start-up funds. Maximizing the availability of the Federal census facilities and resulting data to the building of the list of residents qualified to become stockholders of AGSOC would, if the representative of the Legislature concurs with our views on this, be given the highest priority.

OK ✓ Development of Types of Potential Investment Opportunities for AGSOC

From our work in connection with AGSOC to date, we are well aware that it would be counterproductive, until AGSOC becomes an operating and functional reality, to investigate, evaluate, or initiate probing activities with respect of any particular investment opportunity for AGSOC.

At the same time, it is clear that a careful review of the types of investment opportunities that will be open to AGSOC is indispensable to a consideration of the feasibility and an estimate of the time that will be required to activate AGSOC once it is brought into existence. Our study would take into consideration all aspects of particular types of available investments that will be relevant and of interest to those who ultimately make and implement investment decisions for AGSOC.

NO Educational Efforts Directed at the Appropriate Committees of Congress and Their Individual Members, and at the United States Treasury Department and the Appropriate Officials Therein

The office of the Hon. Russell B. Long, Chairman of the United States Senate Finance Committee, estimates that there are approximately 3,000 Employee Stock Ownership Plans operating in the United States. The overwhelming evidence is that these financing techniques bring about spectacular improvements in the productivity, profits, sales, increase in net worth, and even income tax payments of the companies that adopt them. The ESOP is a double tax shield: it gives employees access, through

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
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credit, to the pre-corporate-income tax return on net worth of the shares that the employees have purchased through their ESOP in order to pay principal and interest on the debt incurred to make such acquisition. At the same time, the ESOP is a tax shield against current, year-to-year taxation of employees while they are accumulating viable capital estates. Federal tax law, however, is still flawed with respect to ESOPs: it taxes the employee when his portfolio (or its cash equivalent) is removed from the ESOP trust. This is simply evidence of the historical confusion resulting from the use, pioneered by our firm, of "deferred compensation" legislation for purely financing purposes, i.e., the purchase of capital assets and the payment of the purchase price out of the income thus produced. Legislation to correct that defect was introduced into the 54th Congress by U. S. Congressman William Frenzel (from Minnesota) and its introduction, we are informed, is planned again in the current Congress by Senator Long. Opposition to the last mentioned tax aspect, namely the elimination of personal income taxation upon taking possession of the capital accumulation as it is released from the trust, has been presented by the United States Treasury on the ground that it would cause an excessive loss of revenue to the Federal government. We have accumulated a great deal of evidence to the contrary, however, demonstrating that the Federal Government derives a net benefit from raising the productiveness and incomes of consumer units by equipping them with productive capital.

Virtually all of the estimated 3,000 or so ESOPs now in existence have been adopted since 1970 when the firm of Kelso & Co., Incorporated was organized. The ESOP functions by giving employee-participants (who become, through the ESOP trust, beneficial stockholders of their employer) access to the corporate pre-tax return on invested net worth of the shares which are allocated to their accounts to pay for the stock which they have bought. Furthermore, the ESOP defers (usually until the participant's retirement) taxation on the sums applied to amortization of acquisition debt. Thus the value of the stock received from the ESOP trust is partly taxable as ordinary income and partly at capital gain rates. Even this "deferred taxation" is the result of an historical accident. In seeking to apply the theory of capitalism to the practical financing problems of a business corporation in such manner as to build the ownership of newly formed capital, or newly acquired capital assets, into employees as those assets pay for themselves in pre-corporate-income tax dollars, it was expedient to use Section 401(a) of the Internal Revenue Code as a financing device, even though it was originally

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 12, 1979  
Page Seven

intended only to provide "deferred compensation." Thus, the theory of capitalism, as applied to employee stock ownership plans, is not yet perfected to its ultimate efficiency, and will not be so until an employee, upon retirement, can take his portfolio of stock (or its cash equivalent) out of the ESOP trust without tax consequences, so long as he keeps it invested in productive capital which will help to make him a better income tax payer, and a better customer for business.

This same logic is applicable to the General Stock Ownership Corporation legislation set forth in Subchapter U of the Internal Revenue Code, as the result of amendments adopted in the Revenue Act of 1978. However, the citizen-stockholder of a general stock ownership corporation is not yet as well off as an employee beneficial stockholder under an ESOP: for this latter has what is allegedly his "income" applied to the amortization of debt incurred to finance stock acquisition deferred, whereas the citizen-taxpayer under a general stock ownership corporation is taxed currently on that part of the corporation's income applied to the retirement of principal of debt incurred in acquiring capital investments.

Clearly, it is of the greatest urgency that the appropriate committees of Congress and their respective members, as well as the Department of Treasury and its appropriate officials, be educated to understand the logic of two-factor economics in order that the impact of AGSOC, once it is activated, not be slowed for years by the stretch-out of debt retirement resulting from the intervention of personal income taxes while the citizen taxpayer is purchasing his AGSOC stock.

We would concentrate our attention during the period covered by this proposal, either on bringing about the amendment of the GSOC legislation, or laying the foundation for its early amendment in the next session of this Congress. The end result, if we are successful, as we are confident we can be, will be a vast advance in the time when AGSOC can become income-significant to the people of Alaska, as well as to the tax collectors in governments at all levels.

#### Development of Organizational Structure and Procedures for AGSOC

It has appeared to us that many of the questions raised about the future operations of AGSOC have resulted from the fact that little attention has been, or up to this point could be, devoted to developing and defining concretely a proposed rational

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Eight

management structure for AGSOC and operations procedures to enable it to accomplish the various tasks which it is expected to accomplish by the pending legislation. Under this proposal, working with management consultants approved by the representative of the Legislature, we would seek to define and design and appropriate management structure for AGSOC and operations procedures that can be readily adapted to it or adopted by its management to facilitate its accomplishing its various functions, including building its data-base, its identification and evaluation of investments, and its arranging for the financing of their acquisition; its establishment of escrow accounts for each of its stockholders; its organization of a trust department (or in the alternative its employment of a professional trustee) for the handling of its stockholder accounts, its dividends, its notifications to stockholders; its calling of meetings of its board and of its stockholders, etc.

WCBP Establishing an Acceptable Working Arrangement With the Securities and Exchange Commission With Respect to Reporting of Activities; Avoiding or Simplifying Registration, Etc.

AGSOC will, in all probability, be the first general stock ownership corporation to make its appearance on the American financial stage. The securities laws of the United States were not designed to cope with such a corporation, even though it is defined by law as a private for-profit corporation, because its stock, through the proposed legislation, will be under many controls and restraints which do not apply to ordinary business corporations or their securities.

We would undertake as part of our work assignment during the forthcoming six-month period, under close liaison with the representative of the Legislature and with the Budget and Audit Committee and any other agencies of the State or consultants of the Legislature whom the Budget and Audit Committee may deem appropriate, the initiation and progressing of a dialogue with the regulatory and enforcement divisions of the Securities and Exchange Commission, looking toward the evolution of procedures to assure that the interests guarded by the securities laws will be protected, while avoiding unnecessary bureaucratic procedures that are not appropriate to a general stock ownership corporation.

The end result of this effort should enable AGSOC to fully live up to the expectations of the Securities and Exchange Commission from the moment that it becomes operational, and at the same time should enable the Securities and Exchange Commission to understand and to know what to expect from a general stock ownership corporation such as AGSOC. Many months of delays in the future, when such

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Nine

delays could be extremely costly, can, we are confident, be avoided by these efforts during the intervening months before the next session of the Eleventh Legislature of Alaska is convened.

#### Time of Performance

Our work under this proposal would, if agreeable to the designated representative of the Legislature, commence promptly upon the granting of a contract between this firm and the Budget and Audit Committee of the Legislature, and final reports would be delivered to the Legislature on or before December 15, 1979. We would, of course, as we have during the past five and one-half months of 1979, although our work under our previous agreement was concluded at the end of 1978, be prepared to explain, execute refinements of our work, and to cooperate with the needs of the Legislature in going forward with the AGSOC legislation.

#### Our Proposed Fee for Services

We would propose that upon the granting of a contract pursuant to this proposal, we be paid a retainer fee of \$35,000, and that we be paid on or before the 15th day of each month during the contract period, beginning with July 15 and concluding with December 15, 1979 a similar sum, for an aggregate payment of \$245,000. This fee would cover not only the services of our own personnel, but our out-of-pocket travel, computer time, and miscellaneous expense (which we estimate at approximately \$3,000 per month) and the fees and expenses of subcontractors and consultants employed with the consent and approval of the representative of the Budget and Audit Committee for the purpose of executing in full the work program contemplated by the proposal.

In our preliminary discussion of this proposal with members of the Alaskan Legislature and staff members on June 11-13, 1979, it was emphasized that it would be desirable for us to suggest separate fee amounts for each of the work items in the proposal. We think that this is not feasible because of the nature of the work proposed.

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advance status of the project that can be presented to the next session of the Alaska legislature. It is momentum-maintaining work; it is work

The Hon. Jim Duncan  
Legislative Budget and Audit Committee  
June 19, 1979  
Page Ten

that advances necessary preparations to the launching of AGSOC if the pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays.

We propose to deliver progress reports at 15-day intervals to the representative of the Legislature and its Budget and Audit Committee designated as our liaison if our proposal is accepted. If, as a result of these reports, it is desired that the emphasis we are giving to each portion of the work be changed, we will respond accordingly upon request.

Should the aggregate funding for this project be less than suggested herein, we would suggest that the seven installments be equally reduced to stay within the available budgeted goals as we can, within such budgetary restraints. Needless to say, we are open to your suggestions on all aspects of the matters covered by this letter.

We will, of course, be pleased to respond to any and all questions relating to this proposal. If you decide to proceed with the contract proposal herein outlined, please provide authorization hereof through signatures by officers authorized to obligate the state, and by delivery to us of a retainer check in the sum of \$35,000.

There is no task that we look forward to with greater pleasure than that of assisting the Alaskan General Stock Ownership Corporation not only to become a reality, but to be an enterprise that is prepared and has been so thoroughly equipped in advance to cope with its challenges that it will set a performance record that will not soon be broken.

KELSO & CO., INCORPORATED

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

cc

August 14, 1979

The Honorable Mike Gravel  
United States Senate  
3131 Dirksen Senate Office Bldg.  
Washington, D.C. 20510

Dear Senator Gravel:

I am taking this opportunity to inform you of our interim AGSOC work. Currently, we have two contracts in effect. The first of these is with Wilmer, Cutler & Pickering. The scope of their work is as follows:

1. Review federal securities law problems that would be raised by the proposed AGSOC legislation and initiate discussion with the federal Securities and Exchange Commission in accordance with recommendations set forth in Wilmer, Cutler & Pickering memorandum dated November 2, 1978.
2. Review federal tax problems that might arise in implementing the proposed AGSOC legislation including any federal tax problems that might occur upon initial distribution of shares. Initiate appropriate discussions with the Treasury Department and/or Internal Revenue Service and submit a federal tax ruling request if necessary to confirm the federal tax consequences of the AGSOC proposed legislation.

Our second contract is with Louis Kelso, who will provide the following services:

1. Development of potential investment opportunities for AGSOC. Analyze the Alaska economy and its total range of potential investment opportunities and evaluate those investment opportunities for their relative significance to the State's

Hon. Mike Gravel

-2-

August 14, 1979

economy against a criterion of maximum return to stockholders.

2. Analysis, cataloging and evaluation of financing sources. Correlate with each of the findings of Task I (Development of Potential Investment Opportunities for AGSOC) the potential financing sources and estimate the limits of funding available from each source, considering potentially available collateral or security and/or guarantee arrangement and estimate the effects upon interest costs.

We anticipate either extending one or both of these or contracting for further AGSOC research.

Please call if you have any questions or suggestions concerning this interim project.

Respectfully,

Jim Duncan

JD:jp



# Alaska State Legislature

## House of Representatives

MEMBER  
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN  
CHAIRMAN  
BUDGET & AUDIT COMMITTEE

STATE CAPITOL  
POUCH V  
JUNEAU, ALASKA 99811  
465-3818

HOME ADDRESS  
RR 4 BOX 4316  
JUNEAU, ALASKA 99803  
789-9792

August 30, 1979

Louis O. Kelso, President  
Kelso & Co., Incorporated  
111 Pine Street  
San Francisco, California 94111

Dear Mr. Kelso:

Please find enclosed a State warrant (#149374) in the amount of ten thousand dollars (\$10,000.00). This is the advance payment as required with our Professional Services Contract I.

Sincerely,

*Dale Staley*  
Jim Duncan For

JD:jp

This warrant will be deemed paid unless redeemed within two years after the date of issue per AS 37.05.180

DATE OF ISSUE  
08 24 79  
MO. DAY YR.

TREASURY WARRANT  
STATE OF ALASKA  
JUNEAU, ALASKA

No. 149374

89-52  
1252

PAY TO THE ORDER OF

KELSO & CO  
111 PINE ST  
SAN FRANCISCO CA 94111

DO NOT FOLD, SPINDLE OR  
MUTILATE

| DOLLARS          | CENTS |
|------------------|-------|
| \$ ****10,000.00 |       |

\$10,000.00 330 149374

⑈ 2149374 ⑈ ⑈ 1252 ⑈ 0052 ⑈

*W.P. Miller*  
COMMISSIONER OF ADMINISTRATION

## 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  
Sen. Mike Colletta  
Chairman, Legislative  
Budget & Audit Committee

25 Sept 78  
Date

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

Date

Steve Cowper  
Rep. Steve Cowper  
Chairman, House  
Finance Committee

20 Sept 1978  
Date

Jim Duncan  
Rep. Jim Duncan  
Vice-Chairman, Legislative  
Budget & Audit Committee

15 Sept 78  
Date

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.

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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 \$180,000. This sum would cover not only our services and all of our out-of-pocket expenditures, but the services and expenses of consultants, selected with advance approval by the State's representatives, to participate in the project.

We propose that the fee would be payable as follows:

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

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7 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

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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.

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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

I. Development of Potential Investment Opportunities for AGSOC.

Analyze the Alaska economy and its total range of potential investment opportunities and evaluate those investment opportunities for their relative significance to the State's economy against a criterion of maximum return to stockholders.

II. Analysis, Cataloging and Evaluation of Financing Sources.

Correlate with each of the findings of Task I (Development of Potential Investment Opportunities for AGSOC) the potential financing sources and estimate the limits of funding available from each source, considering potentially available collateral or security and/or guarantee arrangements, and estimate the effects upon interest costs.

1. Review federal securities law problems that would be raised by the proposed AGSOC legislation and initiate discussions with the federal Securities and Exchange Commission in accordance with recommendations set forth in Wilmer, Cutler & Pickering memorandum dated November 2, 1978.
2. Review federal tax problems that might arise in implementing the proposed AGSOC legislation, including any federal tax problems that might occur upon initial distribution of shares. Initiate appropriate discussions with the Treasury Department and/or Internal Revenue Service and submit a federal tax ruling request if necessary to confirm the federal tax consequences of the AGSOC proposed legislation.

6-13 Analysis, Cataloging and Evaluation Of Financing Sources

In the debates and discussions that took place during the Eleventh Legislature, First Session, both within the Legislature and between the Legislature and the Office of the Governor, the sources for financing the acquisition of capital assets for AGSOC of such magnitude as to be significant to the State's economy, were a major subject. In modifying the initial AGSOC bill, as first introduced, several restrictions were imposed upon the economic resources and power of the State itself and of its agencies.

It is critical now that realistic sources and methods for financing the acquisition of major capital assets by AGSOC be identified, and that the means by which such financing sources can be induced to participate be determined. We would undertake to analyze and catalog these sources, to evaluate them, and to generate strategic and tactical approaches with respect to each of them.

7-24 ✓ ADDITIONAL DETAILS -- ANALYSIS, CATALOGING AND EVALUATION OF FINANCING SOURCES

The research under this category must be correlated to the research under the category of "DEVELOPMENT OF TYPES OF POTENTIAL INVESTMENT OPPORTUNITIES TO AGSOC". (For each type of potential investment, we would expect to identify the potential financing sources, to evaluate the feasibility of success in obtaining financing, or portions of the financing, from each such source, and to analyze the implications of reliance upon such financing sources.

We would include within the scope of our analysis each potential financing source and our estimate of the limits of funding available from each source for each particular type of investment. Political and economic side-effects of the use of each particular financing source would be studied and the conclusions and relevant observations would be included in our report.

All known conventional sources, including banks, insurance companies, and other private suppliers, as well as all public sources, both within and without the State of Alaska would be studied. Each of these would be analyzed in the light of potentially available collateral or security or guarantee arrangements, and the effects upon interest costs would be estimated.

6-19 Development of Types of Potential Investment Opportunities for AGSOC

From our work in connection with AGSOC to date, we are well aware that it would be counterproductive, until AGSOC becomes an operating and functional reality, to investigate, evaluate, or initiate probing activities with respect of any particular investment opportunity for AGSOC.

At the same time, it is clear that a careful review of the types of investment opportunities that will be open to AGSOC is indispensable to a consideration of the feasibility and an estimate of the time that will be required to activate AGSOC once it is brought into existence. Our study would take into consideration all aspects of particular types of available investments that will be relevant and of interest to those who ultimately make and implement investment decisions for AGSOC.

7-24 ✓ FURTHER DETAILS -- DEVELOPMENT OF TYPES OF POTENTIAL INVESTMENT OPPORTUNITIES FOR AGSOC

This work will involve not only an analysis of the Alaskan economy and its total range of potential investment opportunities, but interviews with those whose long involvement in the Alaskan economy has given them a familiarity with facets of the economic structure unique to them or beyond the range of imagination of the analyst lacking such particularized experience. Certainly numerous repositories of information bearing on identification of the types of potential investment opportunities for AGSOC exist throughout departments and agencies of the State Government, the Federal Government in Alaska, and State and private universities and research centers. We will undertake, to the extent that the time available permits, to ferret out every type of such investment opportunity and evaluate it in terms of its priority and its implications for the orderly economic development of Alaska.

I Potential investment opportunities  
listed by relative significance of dividend pmts

II For each of items identified in Task I  
list, potential financing source  
possibility of success in obtaining financing  
limits of funds available  
the above considering collateral or  
security/guarantee arrangements  
potential resultant interest cost

KELSO & CO.

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INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

June 19, 1979

The Honorable Jim Duncan, Chairman  
Legislative Budget and Audit Committee  
State of Alaska  
Capitol Building  
Pouch W F  
Juneau, Alaska 99811

Dear Mr. Chairman:

RE: PROPOSAL TO UNDERTAKE AND EXECUTE SUPPLEMENTARY  
INTERIM WORK RELATING TO THE PROPOSED ALASKA  
GENERAL STOCK OWNERSHIP CORPORATION (THE CREATION  
OF WHICH IS THE SUBJECT OF S.B. NO. 170 AND H.B.  
NO. 240 IN THE STATE OF ALASKA ELEVENTH LEGISLATURE--  
FIRST SESSION) RELATING TO SEEKING CONGRESSIONAL  
IMPROVEMENT OF THE TAX POSITION OF CITIZEN-STOCKHOLDERS  
OF AGSOC UNDER FEDERAL PERSONAL INCOME TAX LAWS;  
DESIGNING AND DEVELOPING A PROPOSED MANAGEMENT  
STRUCTURE AND MANAGEMENT PROCEDURES FOR AGSOC;  
SEEKING CLARIFICATION AND FAVORABLE TREATMENT OF  
THE ULTIMATE SECURITIES ACTIVITIES OF AGSOC BY THE  
SECURITIES AND EXCHANGE COMMISSION; EVALUATING FOR  
THE BUDGET AND AUDIT COMMITTEE OF THE HOUSE OF  
REPRESENTATIVES OF THE STATE OF ALASKA THE DESIRABILITY  
OF CONGRESSIONAL AMENDMENT OF SUBCHAPTER U OF THE  
INTERNAL REVENUE CODE SO AS TO PERMIT MULTIPLE  
CLASSES OF STOCK TO BE ISSUED BY A GENERAL STOCK  
OWNERSHIP CORPORATION IN ORDER PERIODICALLY TO  
EXTEND ITS STOCKHOLDER BENEFITS TO NEW CATEGORIES  
OF RESIDENTS, TO HAVE STOCK THAT WOULD BE ELIGIBLE  
FOR AN EMPLOYEE STOCK OWNERSHIP PLAN, AND IF A  
FAVORABLE DECISION THEREON RESULTS, UNDERTAKING TO  
PERSUADE CONGRESS TO INITIATE AND ADOPT SUCH  
AMENDMENT; INITIATING LIAISON WITH THE UNITED  
STATES BUREAU OF CENSUS IN ORDER TO TAKE MAXIMUM  
ADVANTAGE OF ITS ACTIVITIES PRELIMINARY TO THE  
1980 FEDERAL CENSUS TO INITIATE BUILDING THE DATA  
BANK OF RESIDENTS OF ALASKA QUALIFIED TO BECOME  
STOCKHOLDER CONSTITUENTS OF AGSOC AND TO PROGRESS  
THE BUILDING OF SUCH DATA BANK, ON THE BASIS OF  
THE DEFINITIONS OF "QUALIFIED RESIDENT" IN SAID

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PENDING STATE LEGISLATION; CONDUCTING A BROAD INVESTIGATION OF POTENTIAL TYPES OF INVESTMENT OF AGSOC AND PREPARING A CATALOG THEREOF; AND INITIATING AND COMPLETING A DEFINITIVE ANALYSIS OF THE DETAILS OF THE PENDING STATE LEGISLATION AND MAKING SUCH RECOMMENDATIONS THEREON AS MAY SEEM JUSTIFIED.

From information we have gathered in the course of our work pursuant to our now completed contract with the Legislature of the State of Alaska and our continued close liaison with representatives of the Legislature of the State of Alaska and the office of the Attorney General of Alaska, we think it safe to venture the assertion that no legislation ever to come under consideration by the Legislature has received more intensive and broad-gauge analysis and scrutiny than the legislation dealing with AGSOC. This is entirely fitting in view of the enormous potential significance of AGSOC to the economic and political wellbeing of the citizens of the State of Alaska. Nor can such meticulous care and consideration fail to benefit others beyond Alaska who, it seems probable, will seek to follow in the pioneering footsteps of the Alaskan Legislature.

Much has been accomplished through the study by legislators, by their staffs, by the sizable group of witnesses who have appeared before various Committee hearings, and by consultants in responding with analytical efforts and with proposed modifications to the pending legislation in the course of a year's thoughtful consideration of the AGSOC legislation.

However, the vast work done to date has raised almost as many questions as it has provided answers, and unremitting and painstaking work must continue to be done if the Legislature of the State of Alaska, upon convening its next session in January, 1980 is to have before it an AGSOC bill upon which it can act with confidence and with a minimum of doubts that any critical areas have been left unexplored.

In this proposal, we urge the State of Alaska to employ our firm, together with such subcontractors and consultants as we may, with the approval of the designated representative of the Budget and Audit Committee of the State of Alaska, employ to undertake and complete, (or complete so far as possible), a number of activities aimed at answering these unanswered questions and providing the Legislature with the basic analytical material to resolve most of the unresolved doubts.

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Many trends in the economy of Alaska, of the United States, and in the field of international economic relations have developed during recent months that suggest greater urgency in avoiding loss of momentum in the AGSOC project. The importance of the energy resources of the State of Alaska have gained an even more awesome significance to the future of America. Regulatory confusion in the energy field has increased in complexity. The precariousness of the continued viability of the U. S. economy, as it is presently structured, has become more doubtful. The pace of nation-debilitating inflation has quickened. The willingness of Federal leadership to use further inflation-creating stimuli to cut unemployment meets rising opposition in the form of taxpayers' revolts. The needs for economic leadership and to clarify economic policy considerations--to which the Legislature of the State of Alaska can make major contributions with the launching of a carefully designed AGSOC--has risen to preeminence in the minds of many Americans.

The 95th Congress of the United States, in enacting Subchapter U of the Revenue Code of 1954, as amended, went further in recognizing the need for a new economic policy built upon broader ownership of capital than anyone with historical perspective could have confidently anticipated. Nevertheless, Subchapter U in its present form accomplishes only part of the necessary changes in our basic approach to financing business enterprise and facilitating individual acquisition of capital ownership that are necessary in order to construct a rational economic policy. While it is feasible, in certain highly productive investments, to so design financing structures that stockholders, or beneficial stockholders can buy productive capital and pay for it, both principal and interest, in after-personal-income-tax dollars, it is not in the interest of either State or Federal governments, nor certainly in the interest of accelerating the virtually dormant economic growth rate of our economy, for them to do so. The proof of this lies in the great success of ESOP financing. In that technique, which, like the AGSOC, is based upon the theory of capitalism, or two-factor economics, the employee has access to credit through which we can buy stock representing productive capital and pay for it, both principal and interest, in pre-corporate-income tax dollars from the return on invested net worth of the shares purchased, and defer personal taxation, normally to his retirement date. Clearly what is needed is to recognize that the purchase of capital under arrangements that make it possible to pay for it out of what that capital produces is, in reality, not an income transaction at all. Thus, it is of major importance to persuade

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Congress to eliminate personal income tax liability upon stockholders of a General Stock Ownership Corporation as to all yield of the underlying capital applied to amortization of the purchase price, both principal and interest, and to do so permanently. The sooner the ownership of productive capital can begin producing added income for the new stockholder, the faster the income tax base grows, both for the Federal and State governments.

SUMMARY OF PRINCIPAL COMPONENTS OF WORK CONTEMPLATED BY THIS  
INTERIM PROPOSAL FOR THE LEGISLATURE OF THE STATE OF ALASKA  
DURING THE PERIOD JUNE 15 THROUGH DECEMBER 15, 1979

While our work on the AGSOC project for the State of Alaska has continued, at reduced speed, since the completion of that agreement upon delivery of our final report thereunder in January, 1979, we propose herein that the Legislature of the State of Alaska employ us to marshall the necessary manpower and talents to accomplish, between June 15, 1979 and December 15, 1979, under the direction of such representative of the Legislature of the State of Alaska as the joint Budget and Audit Committee of the State may designate, the following work projects for the purpose of supplementing and extending the preparatory work accomplished by the Eleventh Legislature of the State of Alaska, First Session, and by its consultants, including ourselves, towards establishing the Alaskan General Stock Ownership Corporation and in due course, if the legislation becomes law, enabling it to acquire significant productive capital ownership.

Analysis, Cataloging and Evaluation Of Financing Sources

In the debates and discussions that took place during the Eleventh Legislature, First Session, both within the Legislature and between the Legislature and the Office of the Governor, the sources for financing the acquisition of capital assets for AGSOC of such magnitude as to be significant to the State's economy, were a major subject. In modifying the initial AGSOC bill, as first introduced, several restrictions were imposed upon the economic resources and power of the State itself and of its agencies.

It is critical now that realistic sources and methods for financing the acquisition of major capital assets by AGSOC be identified, and that the means by which such financing sources can be induced to participate be determined. We would undertake to analyze and catalog these sources, to evaluate them, and to generate strategic and tactical approaches with respect to each of them.

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Laying the Foundation for Working With the 1980 Federal Census in  
Order to Develop a Stockholder Constituency Data Base

Preparations for the 1980 United States census are already well advanced. Failure to develop, in connection with the appropriate agencies of the State of Alaska, a working relationship that will enable Alaska to take advantage of the experience and major manpower expenditures of the Federal government in accomplishing the census in Alaska would be to miss a vital opportunity to accelerate the establishment of AGSOC if the Legislature adopts the necessary legislation during the forthcoming Session. The end result would force AGSOC into making duplicating expenditures that would waste its start-up funds. Maximizing the availability of the Federal census facilities and resulting data to the building of the list of residents qualified to become stockholders of AGSOC would, if the representative of the Legislature concurs with our views on this, be given the highest priority.

Development of Types of Potential Investment Opportunities for AGSOC

From our work in connection with AGSOC to date, we are well aware that it would be counterproductive, until AGSOC becomes an operating and functional reality, to investigate, evaluate, or initiate probing activities with respect of any particular investment opportunity for AGSOC.

At the same time, it is clear that a careful review of the types of investment opportunities that will be open to AGSOC is indispensable to a consideration of the feasibility and an estimate of the time that will be required to activate AGSOC once it is brought into existence. Our study would take into consideration all aspects of particular types of available investments that will be relevant and of interest to those who ultimately make and implement investment decisions for AGSOC.

Educational Efforts Directed at the Appropriate Committees of Congress  
and Their Individual Members, and at the United States Treasury  
Department and the Appropriate Officials Therein

The office of the Hon. Russell B. Long, Chairman of the United States Senate Finance Committee, estimates that there are approximately 3,000 Employee Stock Ownership Plans operating in the United States. The overwhelming evidence is that these financing techniques bring about spectacular improvements in the productivity, profits, sales, increase in net worth, and even income tax payments of the companies that adopt them. The ESOP is a double tax shield: it gives employees access, through

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credit, to the pre-corporate-income tax return on net worth of the shares that the employees have purchased through their ESOP in order to pay principal and interest on the debt incurred to make such acquisition. At the same time, the ESOP is a tax shield against current, year-to-year taxation of employees while they are accumulating viable capital estates. Federal tax law, however, is still flawed with respect to ESOPs: it taxes the employee when his portfolio (or its cash equivalent) is removed from the ESOP trust. This is simply evidence of the historical confusion resulting from the use, pioneered by our firm, of "deferred compensation" legislation for purely financing purposes, i.e., the purchase of capital assets and the payment of the purchase price out of the income thus produced. Legislation to correct that defect was introduced into the 54th Congress by U. S. Congressman William Frenzel (from Minnesota) and its introduction, we are informed, is planned again in the current Congress by Senator Long. Opposition to the last mentioned tax aspect, namely the elimination of personal income taxation upon taking possession of the capital accumulation as it is released from the trust, has been presented by the United States Treasury on the ground that it would cause an excessive loss of revenue to the Federal government. We have accumulated a great deal of evidence to the contrary, however, demonstrating that the Federal Government derives a net benefit from raising the productiveness and incomes of consumer units by equipping them with productive capital.

Virtually all of the estimated 3,000 or so ESOPs now in existence have been adopted since 1970 when the firm of Kelso & Co., Incorporated was organized. The ESOP functions by giving employee-participants (who become, through the ESOP trust, beneficial stockholders of their employer) access to the corporate pre-tax return on invested net worth of the shares which are allocated to their accounts to pay for the stock which they have bought. Furthermore, the ESOP defers (usually until the participant's retirement) taxation on the sums applied to amortization of acquisition debt. Thus the value of the stock received from the ESOP trust is partly taxable as ordinary income and partly at capital gain rates. Even this "deferred taxation" is the result of an historical accident. In seeking to apply the theory of capitalism to the practical financing problems of a business corporation in such manner as to build the ownership of newly formed capital, or newly acquired capital assets, into employees as those assets pay for themselves in pre-corporate-income tax dollars, it was expedient to use Section 401(a) of the Internal Revenue Code as a financing device, even though it was originally

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intended only to provide "deferred compensation." Thus, the theory of capitalism, as applied to employee stock ownership plans, is not yet perfected to its ultimate efficiency, and will not be so until an employee, upon retirement, can take his portfolio of stock (or its cash equivalent) out of the ESOP trust without tax consequences, so long as he keeps it invested in productive capital which will help to make him a better income tax payer, and a better customer for business.

This same logic is applicable to the General Stock Ownership Corporation legislation set forth in Subchapter U of the Internal Revenue Code, as the result of amendments adopted in the Revenue Act of 1978. However, the citizen-stockholder of a general stock ownership corporation is not yet as well off as an employee beneficial stockholder under an ESOP: for this latter has what is allegedly his "income" applied to the amortization of debt incurred to finance stock acquisition deferred, whereas the citizen-taxpayer under a general stock ownership corporation is taxed currently on that part of the corporation's income applied to the retirement of principal of debt incurred in acquiring capital investments.

Clearly, it is of the greatest urgency that the appropriate committees of Congress and their respective members, as well as the Department of Treasury and its appropriate officials, be educated to understand the logic of two-factor economics in order that the impact of AGSOC, once it is activated, not be slowed for years by the stretch-out of debt retirement resulting from the intervention of personal income taxes while the citizen taxpayer is purchasing his AGSOC stock.

We would concentrate our attention during the period covered by this proposal, either on bringing about the amendment of the GSOC legislation, or laying the foundation for its early amendment in the next session of this Congress. The end result, if we are successful, as we are confident we can be, will be a vast advance in the time when AGSOC can become income-significant to the people of Alaska, as well as to the tax collectors in governments at all levels.

#### Development of Organizational Structure and Procedures for AGSOC

It has appeared to us that many of the questions raised about the future operations of AGSOC have resulted from the fact that little attention has been, or up to this point could be, devoted to developing and defining concretely a proposed rational

The Hon. Jim Duncan  
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management structure for AGSOC and operations procedures to enable it to accomplish the various tasks which it is expected to accomplish by the pending legislation. Under this proposal, working with management consultants approved by the representative of the Legislature, we would seek to define and design and appropriate management structure for AGSOC and operations procedures that can be readily adapted to it or adopted by its management to facilitate its accomplishing its various functions, including building its data-base, its identification and evaluation of investments, and its arranging for the financing of their acquisition; its establishment of escrow accounts for each of its stockholders; its organization of a trust department (or in the alternative its employment of a professional trustee) for the handling of its stockholder accounts, its dividends, its notifications to stockholders; its calling of meetings of its board and of its stockholders, etc.

Establishing an Acceptable Working Arrangement With the Securities and Exchange Commission With Respect to Reporting of Activities; Avoiding or Simplifying Registration, Etc.

AGSOC will, in all probability, be the first general stock ownership corporation to make its appearance on the American financial stage. The securities laws of the United States were not designed to cope with such a corporation, even though it is defined by law as a private for-profit corporation, because its stock, through the proposed legislation, will be under many controls and restraints which do not apply to ordinary business corporations or their securities.

We would undertake as part of our work assignment during the forthcoming six-month period, under close liaison with the representative of the Legislature and with the Budget and Audit Committee and any other agencies of the State or consultants of the Legislature whom the Budget and Audit Committee may deem appropriate, the initiation and progressing of a dialogue with the regulatory and enforcement divisions of the Securities and Exchange Commission, looking toward the evolution of procedures to assure that the interests guarded by the securities laws will be protected, while avoiding unnecessary bureaucratic procedures that are not appropriate to a general stock ownership corporation.

The end result of this effort should enable AGSOC to fully live up to the expectations of the Securities and Exchange Commission from the moment that it becomes operational, and at the same time should enable the Securities and Exchange Commission to understand and to know what to expect from a general stock ownership corporation such as AGSOC. Many months of delays in the future, when such

The Hon. Jim Duncan  
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delays could be extremely costly, can, we are confident, be avoided by these efforts during the intervening months before the next session of the Eleventh Legislature of Alaska is convened.

#### Time of Performance

Our work under this proposal would, if agreeable to the designated representative of the Legislature, commence promptly upon the granting of a contract between this firm and the Budget and Audit Committee of the Legislature, and final reports would be delivered to the Legislature on or before December 15, 1979. We would, of course, as we have during the past five and one-half months of 1979, although our work under our previous agreement was concluded at the end of 1978, be prepared to explain, execute refinements of our work, and to cooperate with the needs of the Legislature in going forward with the AGSOC legislation.

#### Our Proposed Fee for Services

We would propose that upon the granting of a contract pursuant to this proposal, we be paid a retainer fee of \$35,000, and that we be paid on or before the 15th day of each month during the contract period, beginning with July 15 and concluding with December 15, 1979 a similar sum, for an aggregate payment of \$245,000. This fee would cover not only the services of our own personnel, but our out-of-pocket travel, computer time, and miscellaneous expense (which we estimate at approximately \$3,000 per month) and the fees and expenses of subcontractors and consultants employed with the consent and approval of the representative of the Budget and Audit Committee for the purpose of executing in full the work program contemplated by the proposal.

In our preliminary discussion of this proposal with members of the Alaskan Legislature and staff members on June 11-13, 1979, it was emphasized that it would be desirable for us to suggest separate fee amounts for each of the work items in the proposal. We think that this is not feasible because of the nature of the work proposed.

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advance status of the project that can be presented to the next session of the Alaska legislature. It is momentum-maintaining work; it is work

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that advances necessary preparations to the launching of AGSOC if the pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays.

We propose to deliver progress reports at 15-day intervals to the representative of the Legislature and its Budget and Audit Committee designated as our liaison if our proposal is accepted. If, as a result of these reports, it is desired that the emphasis we are giving to each portion of the work be changed, we will respond accordingly upon request.

Should the aggregate funding for this project be less than suggested herein, we would suggest that the seven installments be equally reduced to stay within the available budgeted goals as we can, within such budgetary restraints. Needless to say, we are open to your suggestions on all aspects of the matters covered by this letter.

We will, of course, be pleased to respond to any and all questions relating to this proposal. If you decide to proceed with the contract proposal herein outlined, please provide authorization hereof through signatures by officers authorized to obligate the state, and by delivery to us of a retainer check in the sum of \$35,000.

There is no task that we look forward to with greater pleasure than that of assisting the Alaskan General Stock Ownership Corporation not only to become a reality, but to be an enterprise that is prepared and has been so thoroughly equipped in advance to cope with its challenges that it will set a performance record that will not soon be broken.

KELSO & CO., INCORPORATED

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

CO

KELSO & CO.  
INCORPORATED  
INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

July 24, 1979

The Honorable Jim Duncan  
Chairman  
Legislative Budget & Audit  
Committee  
State of Alaska  
State Capitol  
Pouch WF  
Juneau, Alaska 99811

SUBJECT: Modification of Our Proposal to the Budget & Audit Committee  
of the State of Alaska dated June 12, 1979

Dear Mr. Chairman:

In conversations that have taken place between you and several of your colleagues and officers of this firm since our proposal letter to you of June 12, 1979, (the "Interim Work Proposal"), you have indicated to us that the budgetary funds available for interim work on the AGSOC project are of a smaller magnitude than those contemplated by our Interim Work Proposal; that the Budget & Audit Committee wishes to see the scope of our work limited to the three basic areas mentioned below, and that the Committee would like a more detailed description of the scope of work envisaged in each of these three specific areas. A reduction in our charges for the diminished scope of work would, of course, follow.

ALLOCATION OF SPECIFIC COST ESTIMATES TO SPECIFIC ITEMS IN THE WORK  
PROJECT

In our Interim Work Proposal, at Pages 9 and 10, we stated:

"In our preliminary discussion of this proposal with members of the Alaskan Legislature and staff members on June 11-13, 1979, it was emphasized that it would be desirable for us to suggest separate fee amounts for each of the work items in the proposal. We think that this is not feasible because of the nature of the work proposed.

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advanced status of the project that can be presented to the next session of the Alaska Legislature. It is momentum-maintaining work; it is work that advances necessary preparations to the launching of AGSOC if the

The Honorable Jim Duncan, Chairman  
Legislative Budget & Audit Committee  
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Page Two

pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays."

On careful reexamination and discussion of this problem among the senior officers of our firm, we are still of the opinion that there is no way to identify particular steps in any of the areas of work proposed and to affix fee estimates to those steps. Rather, we propose controls in the nature of bi-weekly progress reports to the appropriate representative of the Alaska Legislature and its Budget & Audit Committee, with our commitment to respond to any suggested changes in direction or emphasis of the work, and, of course, implicitly the right of the Committee's representative to terminate our work on any payment date if it appears unsatisfactory.

We still believe these controls to be the only realistic ones that can be designed for the type of work involved. We could bill the Legislature retrospectively, following each bi-weekly report, but this would render the entire project excessively speculative, preventing our employing subcontractors or consultants, and placing burdens on our working capital which we are not prepared to assume.

We hope that the quality of our work under our previous contract has given the Legislature and the Budget & Audit Committee some measure of confidence in our integrity.

✓ ADDITIONAL DETAILS -- ANALYSIS, CATALOGING AND EVALUATION OF FINANCING SOURCES

The research under this category must be correlated to the research under the category of "DEVELOPMENT OF TYPES OF POTENTIAL INVESTMENT OPPORTUNITIES TO AGSOC". For each type of potential investment, we would expect to identify the potential financing sources, to evaluate the feasibility of success in obtaining financing, or portions of the financing, from each such source, and to analyze the implications of reliance upon such financing sources.

We would include within the scope of our analysis each potential financing source and our estimate of the limits of funding available from each source for each particular type of investment. Political and economic side-effects of the use of each particular financing source would be studied and the conclusions and relevant observations would be included in our report.

All known conventional sources, including banks, insurance companies, and other private suppliers, as well as all public sources, both within and without the State of Alaska would be studied. Each of these would be analyzed in the light of potentially available collateral or security or guarantee arrangements, and the effects upon interest costs would be estimated.

The Honorable Jim Duncan, Chairman  
Legislative Budget & Audit Committee  
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July 24, 1979  
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Unless objected to by the Committee or its representative, we would explore the levels of resistance which might be encountered in seeking unprecedented sources for financing, such as arranging, through legislative changes if necessary, for the discount of AGSOC loan paper with the Federal Reserve Bank.

All tactical information developed in the course of these studies would be carefully cataloged for use by AGSOC at such time as it needs financing.

FURTHER DETAILS -- LAYING THE FOUNDATION FOR WORKING WITH THE 1980 FEDERAL CENSUS IN ORDER TO DEVELOP A STOCKHOLDER CONSTITUENCY DATA BASE

Because the printing of questionnaire forms for use in the 1980 United States census has already begun, this is an area of great urgency. Preliminary conversations with census officials indicate little precedent for enlarging the activities of census workers to include what will be basically State-oriented data. Nevertheless, a willingness to explore the administrative rulings and procedures necessary to enable the collection of data which would be vital to AGSOC in building its stockholder identification base has been evidenced. All relevant legislation, administrative regulations, and judicial precedents will of necessity be reviewed simultaneously with the carrying on of conferences both at the regional and national levels of the Bureau of the Census.

It is clear that the data for AGSOC purposes must be of a higher order than that required for census purposes, since a flow of funds and allocation of liabilities between AGSOC and its stockholder constituencies will be involved, whereas no such relationships arise out of the national census as such.

Only the initiation and diligent prosecution of this work can throw light on more of the details that will be encountered.

FURTHER DETAILS -- DEVELOPMENT OF TYPES OF POTENTIAL INVESTMENT OPPORTUNITIES FOR AGSOC

This work will involve not only an analysis of the Alaskan economy and its total range of potential investment opportunities, but interviews with those whose long involvement in the Alaskan economy has given them a familiarity with facets of the economic structure unique to them or beyond the range of imagination of the analyst lacking such particularized experience. Certainly numerous repositories of information bearing on identification of the types of potential investment opportunities for AGSOC exist throughout departments and agencies of the State Government, the Federal Government in Alaska, and State and private universities and research centers. We will undertake, to the extent that the time available permits, to ferret out every type of such investment opportunity and evaluate it in terms of its priority and its implications for the orderly economic development of Alaska.

The Honorable Jim Duncan, Chairman  
Legislative Budget & Audit Committee  
State of Alaska  
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SPECIAL NOTE CONCERNING CONFERENCES WITH THE SECURITIES AND EXCHANGE COMMISSION

On Pages 8 and 9 of our Interim Work Proposal of June 12, 1979, we outlined our basis for believing that we should develop a working relationship for AGSOC with the Securities and Exchange Commission. The Committee proposes that this be one of the subjects eliminated from the presently proposed contract. In earlier discussions, someone mentioned the possibility that the Washington law firm of Wilmer, Cutler & Pickering might be employed, possibly by the Budget & Audit Committee, to discuss AGSOC with the Securities and Exchange Commission. That firm, because of its previous research on this subject for the Commissioner of the Department of Revenue, would, of course, be eminently qualified to negotiate the anticipated status of AGSOC's securities under the Federal securities laws.

We would like to reemphasize, however, that the theory of capitalism appears, for whatever reason, to be extremely difficult for lawyers and economists steeped in the conventional wisdom to totally master. We would, as a matter of precaution, rest easier if we participated, to whatever degree necessary, in such negotiations to make certain that the nature of AGSOC is fully understood by the representatives of the Securities and Exchange Commission. The decision on this, of course, lies with your Committee.

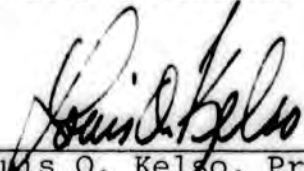
Since the scope of the work has been reduced, it is elementary that the overall fee should be reduced. To give us sufficient funding to enable us to make a significant contribution to foreshortening the time and work required upon passage of the AGSOC legislation before AGSOC can become an active force, we hope that the overall fee will not be reduced below \$150,000. If that funding were available, we would suggest that the payment pattern set forth in our original proposal of June 12, 1979, be modified -- both because of the reduction in the fee and the passage of time -- into a retainer of \$25,000 on the first day of August, 1979, and a like amount on the first day of each of the ensuing five months during the term of the contract.

Please do not hesitate to call the undersigned or Mr. John Miskimen of this firm should there be further questions.

Yours truly,

KELSO & CO., INCORPORATED

By

  
Louis O. Kelso, President and  
Chief Executive Officer

LOK:cae

# STATE OF ALASKA THE LEGISLATURE

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

## LEGISLATIVE AFFAIRS AGENCY

### MEMORANDUM

June 18, 1979

SUBJECT: Meeting with Kelso & Co., Inc.

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

Representative Mike Miller, Chairman  
State Affairs Committee

FROM: Kenneth M. Rosenstein *KMR*  
Legislative Counsel

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

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

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

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

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

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

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

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

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

(2) Prepare a detailed analysis of the bill.

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

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

cc: Milt Barker  
Jerry Gauche

# STATE OF ALASKA THE LEGISLATURE

## LEGISLATIVE AFFAIRS AGENCY

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

### MEMORANDUM

June 18, 1979

SUBJECT: Meeting with Professor Fessler

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

Representative Mike Miller, Chairman  
State Affairs Committee

FROM: Kenneth M. Rosenstein *KMR*  
Legislative Counsel

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

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

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

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

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

Professor Fessler had the following additional comments:

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

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

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

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

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

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

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

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

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

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

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

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

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June 18, 1979

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

KMR:jdn

cc: Milt Barker  
Jerry Gauche

**KELSO & CO.**  
**INCORPORATED**  
**INVESTMENT BANKERS**

**GREENSBORO, N.C.**

**SAN FRANCISCO**

**LOS ANGELES**

**April 10, 1979**

**The Honorable Mike Miller  
Chairman, State Affairs Committee  
Alaska State House of Representatives  
Pouch V  
State Capitol Bldg.  
Juneau, Alaska 99811**

**Dear Representative Miller:**

We are writing you to comment upon the principal items covered by the memorandum from The Honorable Avrum M. Gross, Attorney General (by Mr. Joseph K. Donohue, Assistant Attorney General), to The Honorable Frances Ulmer, Director of the Division of Policy Development & Planning, under date of March 19, 1979. We understand this memorandum has been considered by both State Senate and State Assembly Committees, but is presently before the State Affairs Committee. The subject of the memorandum is "Policy & Legal Issues Surrounding AGSOC Legislation (SSSB 170 and SSHB 240)". The memorandum states that it is in response to a request from The Honorable Frances Ulmer for a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently pending before the legislature.

The memorandum itself, the care and astuteness used in its preparation, and the wisdom of Miss Ulmer in requesting it, all attest the high degree of responsibility and thoroughness with which the legislature is studying the AGSOC legislation. We hope that our comments on certain of the provisions of the memorandum will prove of use to your Committee, and to others to whom you may wish to distribute copies.

For simplicity of reference, we will initiate each of our comments with a reference to the paragraph or paragraphs and to the page number in the memorandum of March 19th or 20th (March 20th being the date used on its separate pages). We will also number our paragraphs for easy reference in case you wish to ask questions or comment on this letter.

**1. THE FIRST FULL PARAGRAPH ON PAGE 3**

The question of whether the State should follow the policy of the federal legislation and exempt AGSOC from State corporate income tax and from certain other State level taxes which might otherwise be imposed on the corporation are, of course, precisely the kinds of questions that only the legislature can answer. There is one erroneous statement at the end of the paragraph, however, and that is that

The Honorable Mike Miller  
Chairman, State Affairs Committee  
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our firm, as investment bankers, is presently recommending "the new AGSOC purchase BP's share of TAPS." We, in our instructions from the legislature, were expressly requested to avoid recommendations as to AGSOC's investments, although, basically to illustrate feasibility, we believe, we were asked to do a feasibility study of that particular purchase.

In general, it will be obvious to your Committee that the taxes imposed on AGSOC at the corporate level would simply slowdown the rate at which AGSOC could amortize its debt incurred in acquiring productive investments from time to time, and thus slowdown the rate at which AGSOC is effective in building capital ownership into each Alaskan resident.

## 2. THE LAST FULL PARAGRAPH ON PAGE 3

In the last paragraph at the bottom of Page 3 (erroneously reproduced in our copy at the top of Page 4), it is postulated that by purporting to give each resident of the State a direct interest in the development of the State's natural resources, AGSOC would become an independent voice for more rapid exploitation of those resources, and that because the AGSOC is required to pay out substantially all of its net income to residents of the State, it "would likely" become a lobbying force for lower State taxes. We do not believe that these conclusions are by any means obvious or sound. It apparently has been overlooked that while AGSOC, as a corporation in which every resident owns an interest, is intended to build capital ownership in each such resident each resident also has other and independent interests. He has an interest in the overall tax impact on him. Thus if reducing the taxes on AGSOC raised his personal income tax, or his property tax, he would certainly take both into consideration and either of these events would undoubtedly have a far greater individual effect than lowering State taxes of the corporation of which he is a shareholder. It is inconceivable that AGSOC would become a lobbying force contrary to other basic interests of the residents of Alaska, simply because its stockholders would have ultimate control over AGSOC.

To be sure, as independent and privately owned capital is built into Alaskan residents, there will be less need for welfare and redistribution of income within the State of Alaska. The very theory upon which AGSOC is structured asserts that by enabling each resident to become, to whatever degree possible, economically autonomous and independent, such resident will be freed from the indignity of seeking welfare and other taxpayers will be freed from the unpleasant task of being forced to support strangers through taxation used for welfare purposes. These are "trade-offs" of a political and economic nature, but the underlying theory of AGSOC is that economic self-sufficiency through the ownership of income producing capital is preferable to welfare for some and redistributive taxes for others. We believe that this point should be clearly and thoroughly debated by the legislature and the question of whether the legislature prefers the prin-

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Chairman, State Affairs Committee  
April 10, 1979  
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ciple of capitalism or the principle of socialism should be determined.

3. THE SEVERAL PARAGRAPHS BEGINNING AT THE BOTTOM OF PAGE 4  
UNDER SECTION II. FINANCING

It is represented in the memorandum that Louis Kelso testified before the Joint Committee and has stated to various Administration officials that AGSOC will be able to obtain financing on the private market without recourse to State guarantees or State credit. This is not, we believe, an accurate summary of my personal testimony and statements to various Committees and to various individuals in the legislature.

I have pointed out that in addition to start-up funding in order to make AGSOC an operating reality, it should then seek the best sources of funding available. Some investments, it is possible, can be acquired through collateral financing, or other conventional types of corporate finance. On the other hand, some investments may require support by the State or by some appropriate or appropriately created State agency. The important point to be focused upon in this area is that conventional corporate and business finance tends specifically to make the rich richer and to fail to make the poor richer. We do not see how it can be considered objectionable for the people of the State to use their collective power to assist the individual residents -- all residents at the outset and new residents as these grow in significant numbers -- by amendments to the State and federal legislation, or by the Alaskan State Legislature's specifically incorporating future AGSOCs -- AGSOC-I, AGSOC-II, etc.

The points made in the remainder of Section II should, of course, be considered by the legislature in the light of the existing Constitutional provisions and the existing State machinery for backing up an enterprise -- AGSOC -- that is a private corporation but whose activities will address themselves to the solution of a public problem. AGSOC is a device to carry into practice preventative economic measures to avoid future poverty and to improve future affluence for Alaskan residents as a whole. We submit that these are noble public purposes and that in considering the use of the power of the State to support investments made by AGSOC, all of the income of which is commanded to be distributed to the stockholders of AGSOC, the legislature should not impose administrative barriers that would prevent AGSOC from competing effectively with giant corporations for investments. Investments of AGSOC will benefit all the residents of Alaska whereas investments of the traditional giant corporations primarily benefit the pinnacle wealth owners, a few of whom may be Alaskan residents, but most of whom will be non-residents and perhaps even non-U.S. citizens.

For our part, it would seem that the wisdom of the legislature in appropriating particular funds that can be used as guaranty funds is adequate assurance of careful review by the legislature on behalf of the people as a whole.

4. SECTION III. DEPOLITICIZING THE AGSOC BEGINNING ON PAGE 7

In general, it appears to us that the discussion here is made-up not of legal analysis primarily, but rather of political concerns.

In the first paragraph under this item is the statement that "it should be noted that there is nothing in the federal legislation which would preclude the AGSOC's establishment as a state agency or public corporation." We believe this is a misinterpretation of the federal law, which requires that a General Stock Ownership Plan be a private corporation even though its shareholders must include, at the outset, all residents of the State as of a date selected by the legislature and as of the date of the issuance of its stock.

We disagree with the unwarranted conclusion drawn in the paragraphs at the bottom of Page 7 and on Page 8, et seq. that, if successful, AGSOC would quickly become highly politicized and an extremely powerful force -- in fact a Fourth Branch of Government. If AGSOC were permitted to accumulate its net income and thus develop a vast reservoir of funds which it could spend as its Board of Directors saw fit, then these comments might be justified. But that is precisely what AGSOC is designed to avoid. Its income is promptly translated into the income of its broad base of stockholders. It is not designed to be a powerful entity for anyone except the people of the State as a whole. As the shareholders gain power, their power to control AGSOC, through election of directors and through the power, under general law, to initiate a suit to have questioned in court a misuse of funds by AGSOC, is, it would seem to us, an ironclad guaranty that AGSOC would never become a branch of government in any form.

Because of its very size, and its potential economic importance to the enormously broad base of Alaska residents, we do not believe the speculation that ultimately one-tenth of the residents could wind-up owning all of AGSOC. One very simple reason for this belief is that if the residents do not tenaciously hold on to their AGSOC stock, the legislature is free to incorporate successive new AGSOCs and to add assurances that they do keep their individual economic power and independence.

Thus we regard it as simply improbable and unfounded speculation that any "power blocks" of residents could be established or that, if established, they could not be controlled quite easily by stockholders' derivative litigation.

With the absolute necessity that for many if not most of its investments AGSOC will look to the economic power of the State, as determined by the legislature, to give it access to federal or private credit, we think that there is no basis for imagining that AGSOC could develop a constituency over which it has no control whatsoever. We also believe that since AGSOC must pay its income to its stockholders, and has no duty except to develop and produce wealth and to distribute

The Honorable Mike Miller  
Chairman, State Affairs Committee  
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it to those citizens, that the Board of Directors or the management of AGSOC could not become a political center or political leader of any kind whatsoever.

The last paragraph on Page 8 speculates that "Although one could argue that AGSOC violates the fundamental political theory of the State Constitution which established only three branches of government\*\*\*". As noted above, AGSOC is not, and could never be under the proposed legislation, a branch of government of any kind whatsoever. It is an instrumentality created by the State, just as the State creates the laws under which business corporations in general can be established, but upon which the governments, State and Federal, have imposed limitations to assure that it will work for all residents -- all stockholders -- rather than for one, or a few, as present corporate giants do. Having made a false assumption that AGSOC could be a "Fourth Branch of Government", it is natural to speculate on all the dangers that would flow from this impossible situation. The recommendation for bureaucratic regulation appears to us to be totally unwarranted and would impede the potential efficiency of AGSOC to improve the economic status -- legitimately -- of all residents of Alaska. There is no virtue in bureaucratic regulation as such. The stockholders would annually vote on directors and upon all issues put to them by the Board or by stockholder initiative. A broader and more diversified base for AGSOC could hardly be conceived. The power of AGSOC is in its stockholders, not in its Board of Directors or its management.

Sight seems to have been lost of the fact that AGSOC is meticulously designed as the new method of financing economic growth and development for the purposes of attacking the cause rather than merely the effects of poverty. This is precisely what it is designed to do and precisely what it must do under its structural regulations. That is its purpose. Since AGSOC must pay out substantially all of its earnings to its shareholders, its sole function is to connect each resident with capital ownership and income. Could a more desirable goal be conceived?

5. BEGINNING AT THE BOTTOM OF PAGE 8 AND CONTINUING ONTO PAGE 9 OF THE MEMORANDUM

The problem is raised that members of the Board of Directors of AGSOC could use their position as a forum for criticizing the Administration's economic policies and ultimately as a launching pad for State elective office.

This is not a very real concern because the only official obligation of the members of the Board of Directors of AGSOC is to develop and produce Alaskan wealth for ownership by every Alaskan resident. When members of the Board of Directors periodically run for election as such, if they are incumbents, they do so on their performance record, as does any elected official, public or private.

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The freedom of particular directors and/or officers of AGSOC to criticize the State's economic policies is nothing but the Constitutional right of all U.S. citizens to free speech. Precisely the reverse exists as well. The Governor, or any Committee of the legislature, is free to criticize the investments of AGSOC. It would appear to us that the absolute dependence from time to time of AGSOC upon specific legislative provision of economic support for its investments assures that any free speech that passes between the Board of Directors of AGSOC and any branch of the State Government will be tempered with these realities in mind.

Any activity within or without the State of Alaska could theoretically be a "launching pad" for public office. But AGSOC as an entity that makes every resident more affluent will increase the possible opportunities of every resident to run for State office, and to participate in local State and community affairs. This is a more democratic basis for the State than where only a few people can afford to run for office. Does Alaska want more or less democracy?

In the first full paragraph on Page 9 of the memorandum, it is suggested that AGSOC be prohibited from lobbying and from making political contributions to candidates for State offices. We would think it entirely proper that AGSOC be prevented from making political contributions out of its funds to candidates for State office. Indeed, since it must periodically come under the scrutiny of the entire legislature and the Governor, we find it difficult to imagine that such prohibition would not be voluntarily imposed upon itself. But nothing would be lost by including such limitations in the legislation.

However, we have grave reservations about "strict proxy review mechanisms" that would cause the directors to act in "a politically neutral fashion". AGSOC is not designed to act in a politically biased fashion, nor does its design so permit. It has one function: to make each resident wealthier and to deliver that wealth to him periodically and dependably. Nothing more. What the residents of Alaska do with their wealth would seem to us to be their business.

On general legal principles, it would appear to us that any stockholder of AGSOC could institute legal action to restrain AGSOC's Board from using the potential income belonging to the residents as stockholders for the benefit -- any benefit -- of the Board of Directors.

Only totalitarian states adopt edicts to shield bureaucrats from speaking freely, but AGSOC's single purpose assures the ease of its stockholders in holding it to the performance of its sole purpose.

#### 6. CAN AGSOC BECOME A CENTER OF CONCENTRATED ECONOMIC POWER?

This question is raised at the bottom of Page 9 and on Page 10 of the memorandum. We believe that this is random and unrealistic

speculation.

It is quite true that because of the vastness of its stockholder constituency, AGSOC should seek to invest in massive and highly productive economic developments and activities. But it is not true that this can lead to its becoming a "major force for concentration of economic power in the State\*\*\*". The design of AGSOC specifically makes this impossible for the very simple reason that it is required to pay out all of its income to its shareholders. That its shareholders will become more affluent, less dependent on redistribution of wealth, less dependent on welfare, and more powerful, is elementary. But this is the same as saying that its shareholders are the ones who have the power to scrutinize, correct, and contain any potential concentration of economic power in AGSOC.

The same is true of the risk that AGSOC may violate the Federal anti-trust laws. We have seen no lack of ability on the part of the Federal Anti-Trust Division to watch over this area of business activity. The periodic supervision by the legislature at the time it grants added support for any further investment by AGSOC assures that the State legislature itself can consider the question of whether any anti-trust monopoly action is involved. Certainly the absolute inability of AGSOC to accumulate internal funds defeats its power of ever exercising the main means by which business corporations violate anti-trust laws, namely by withholding the "wages of capital" from the owners of capital (the stockholders) and accumulating those funds to buy monopolistic power. Again, AGSOC is designed to make this impossible. We cannot conceive of the slightest need for any added limitations in this area.

We submit that the last sentence in the last paragraph on Page 10 of the memorandum, in itself, recognizes the improbability of the speculation involved in the preceding paragraphs. The fact that the stockholders of AGSOC and the people of the State are, and at all times will be identical, merely shows that AGSOC is, by its design, constrained through its broad ownership, and through the right of the legislature to launch any number of additional AGSOCs and to dry up its source of funding, designed to avoid any of the conflicts thus imagined.

Since the type of conflicts imagined in Pages 9 and 10 of the memorandum are unrealistic and cannot occur, the remedies proposed on Page 11 for this non-existent danger would seem to be entirely unnecessary. AGSOC's designed trust obligation -- to develop and produce wealth for all Alaskans -- assures that any wasteful or improper use of its resources could be enjoined by any of its stockholders under general principles of corporate law. The imagined problems simply do not and cannot exist, and if they did, they could be quickly restrained under these generally applicable legal principles.

7. PAGE 11, SECTION IV. CORPORATE DEMOCRACY

That the existence of classification of directors would limit the ability of minorities within the State to obtain representation on the Board of Directors of AGSOC is, in our opinion, without foundation in fact. Board classification is desirable to promote stable policies in corporate matters. The possibility of an entirely new Board being elected each year would be highly undesirable. Board membership will be in a corporation charged with a trust to represent all the people of the State of Alaska.

On the question of cumulative voting, we do not see, in a corporation with a stockholder base as vast as that proposed for AGSOC, that there would be any advantage in insuring cumulative voting. On the other hand, we see no disadvantage in assuring that cumulative voting must exist.

On the question of limiting the duration of any voting trusts, made in the paragraph at the bottom of Page 12, it would appear to us that this suggestion is a good one.

Similarly, providing for shareholders to initiate amendments to the Articles of Incorporation would be desirable where a substantial shareholder initiative, say 10%, or even 5%, of the registered shareholders' signatures would be required. It would not be desirable to permit a tiny handful of stockholders to upset the efficiency of the corporation in making its day-to-day decisions.

8. DESIRABILITY OF A HIGH FORUM REQUIREMENT

This would seem to us to simply impose clumsy procedures on the State's prime weapon in building preventative economic power into its citizens, i.e., measures to prevent future poverty from arising. AGSOC will be under a constant obligation to educate its stockholder constituency about the economics of capitalism and will, of necessity, become a source of economic education because it will enable, for the first time in history, every Alaskan to become a capital owner. To go further than this would seem to be probably wasteful in terms of paperwork and a pointless waste of time.

9. LESIGLATION ASSURING ADEQUATE NOTICE OF MEETINGS

In the second paragraph on Page 14 of the memorandum, suggestions with respect to this are made. We would think this entirely proper if the restriction does not obstruct reasonably efficient governance of the corporation.

10. THE CORPORATE BY-LAWS

The memorandum suggests that the power to amend the By-Laws should be reserved to the shareholders "in order to ensure adequate public review." We believe that such a provision would be too expen-

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sive and too restrictive in terms of efficient governance of the corporation, and excessively wasteful of time.

11. AGSOC'S FINANCING OF PROXY FIGHTS, ACCESS TO VOTING LISTS AND VOTING MACHINERY

We believe that the suggestion made in Paragraph 8 on Page 14 would be salutary if the signatures of 10% or more of shareholders were required. Otherwise, the corporation could waste time dealing with mere adventurers.

12. SECTION V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

In this matter, covered on Pages 15 and 16 of the memorandum, we believe that the first paragraph on Page 15 is in error in stating that federal legislation mandates that the shareholder group in AGSOC be made up of a "closed class" in any realistic sense, for the simple reason that it imposes no limitation upon the number of AGSOCs which the Alaskan Legislature could authorize. Thus a longtime resident might well wind-up holding shares in ten or fifteen different AGSOCs, while those who depart the State would only own shares in those AGSOCs whose stock ownership qualifications they had previously met.

The "scenario" imagined by the author of the memorandum in the second paragraph on Page 15 is simply unrealistic. The preventative economic measures involved in establishing AGSOC that strike at the cause of poverty rather than merely at the effects of poverty hold more promise for eliminating poverty than all past measures, State and Federal, dealing with this subject, for those measures merely apply band-aids to the effects of poverty.

The problems imagined here are under year-to-year control by the legislature since AGSOC must be created by a separate act of the legislature. Other AGSOCs can be created at will by the legislature. Changes in the law concerning transferability of its stock can be made by the legislature if experience proves that such changes are warranted. It is contemplated that the full thrust of AGSOC's educational stockholder relations program will induce most stockholders to hold onto their shares as their dearest economic possessions.

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We hope that the foregoing comments will be of use to your Committee in its deliberations. We would be pleased to respond to any requests for elaboration or to any questions.

Sincerely,

KELSO & CO., INCORPORATED

By

  
Louis O. Kelso

By

  
John A. Miskimen

LOK/JAM:ch

cc: The Honorable John G. Fuller,  
Vice Chairman, State Affairs Committee  
The Honorable Terry Gardiner,  
State Affairs Committee  
The Honorable Bill Parker  
State Affairs Committee  
The Honorable Terry Martin,  
State Affairs Committee  
The Honorable Ray E. Metcalfe,  
State Affairs Committee  
The Honorable Richard Eliason,  
State Affairs Committee  
Frances Ulmer, Director, Division  
of Policy Development & Planning

*Volume II*  
*+ WCAP Memo*  
*+ Subchapter II.*

AGSOC

INVESTMENT INVESTIGATION OUTLINE

- I. Determine the rationale for considering the acquisition in as much depth as possible.
  - A. Is the purchaser looking for a passive investment?
  - B. Is he looking to add his managerial ability or other special ability to the acquired company?
  - C. Is there an unusual advantage in an acquisition that combines one company with another so that the combined companies appear to have greater earnings potential than the companies operating separately -- for example, combining raw material supplier, manufacturer, or marketing organization?
  - D. Is the seller's reason for sale a satisfactory explanation from the prospective buyer's view?
- II. Make a "businessman's" review of the prospective acquisition including the following:
  - A. General and administrative.
    1. History of business.
    2. Legal form of organization -- major rights, provisions, and restrictions.
    3. Ownership of business. Will any acquired stockholder obtain a major position in combined company?
    4. General policies of corporation.
    5. Organization chart.
    6. Description of management personnel.
    7. Interest of management personnel in continuing after acquisition.
    8. Contracts and patents.
  - B. Product.
    1. Description of product.
    2. Competition.
    3. Distribution methods.
    4. New product development.
    5. Pricing policies.
    6. Marketing methods.
  - C. Manufacturing
    1. Process.
    2. Geographical location of plant.
    3. Plant facilities.
    4. Work force.
    5. Efficiency of plant.

D. Financial.

1. Obtain financial statements for at least five years.
2. Determine the reliability of the financial statements.
  - a. Audited or unaudited.
  - b. Unqualified opinion by CPA or otherwise.
3. If prospective purchaser is a company, ascertain similarities or differences in accounting principles, practices, and methods. Compare earnings, cash throw-off, net worth, and the like, of the two companies.
4. Assemble financial data with the view to determining a fair price to pay for the prospective acquisition.
  - a. Summarize earnings for last five years, setting out nonrecurring and other extraneous items separately.
  - b. Analyze variation between years.
  - c. Determine gross profit percentages of major products for recent years, if possible.
  - d. Schedule estimated sales and gross profits in total and by product for next two to three years, or longer if longer-range forecasts can be developed.
  - e. Determine changes in selling, general, and administrative expenses for the period covered by the sales forecast.
    - (1) Pay particular attention to the effect of the acquisition on expenses including:
      - (a) Depreciation charges if higher values will be assigned to fixed assets as a result of the acquisition.
      - (b) Amortization of goodwill arising in the acquisition.
      - (c) Changes in management, manufacturing product lines, or marketing programs.
  - f. Compute the standard financial ratios for the period under review, and undergone significant or unusual relationships and compare with industry ratios.
    - (1) Sales to accounts receivable.
    - (2) Inventory to cost of sales (turnover).
    - (3) Working capital ratio.
    - (4) Quick asset ratio.
    - (5) Earnings as a percentage of sales.
    - (6) Income taxes to net income.
    - (7) Earnings, cash throw-off, and sales growth rate.

- (8) Earnings stability test.
- (9) Earnings and book value per share if stock acquisition.
- (10) Cash throw-off.
- g. Prepare summary source and application of funds statement for the period under investigation and projected statements for two or three years, or longer if possible.
  - (1) Again, these should reflect post-acquisition changes.
  - (2) One major obstacle which must be overcome for a useful projection of source and application of funds is an estimate of capital addition requirements.
  - (3) Attention must also be directed to the maximum and minimum cash position itself during the year, particularly if a bootstrap purchase is contemplated.
- h. All major balance sheet accounts should be reviewed with probably the closest attention being directed to the following potential trouble spots:
  - (1) Accounts receivable.
    - (a) Past-due customer notes and accounts receivable.
    - (b) Balances in excess of 10 percent of total receivables.
    - (c) Adequacy of reserve for bad debts.
  - (2) Inventories.
    - (a) Latest review for obsolete stock and action taken thereon -- if there are long-term contracts in process, it is of special importance to ensure that costs to complete will not result in material losses not provided for.
    - (b) Relative balance of materials, especially month's supply of larger-value items.
    - (c) Physical inventory.
  - (3) Plant assets.
    - (a) Differences between book and tax basis of assets.
    - (b) Latest physical inventory of fixed assets and reconciliation of books.
  - (4) Investments in unconsolidated, partially owned companies.
    - (a) Market value, book value, and earnings of such investments with carrying amounts.

- (5) Income taxes.
  - (a) Differences between book and tax income for years under review (at least five) and satisfaction as to reasonableness of differences.
  - (b) Open tax years and potential areas of controversy.
- (6) Contingent liabilities and commitments.
  - (a) Contingent liabilities, particularly lawsuits, guarantees on behalf of customers, and service guarantees.
  - (b) Major purchase commitments for raw materials, plant expansion, and sales agreements.
  - (c) Liabilities under pension plans and profit-sharing plans.
  - (d) Lease commitments.