ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 8672

914 SCOMM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80 974

ESTIMATED POTENTIAL IMPACT OF AGSOC DIVIDEND PAYMENTS ON THE FLOW OF FEDERAL FUNDS TO RESIDENTS OF THE STATE OF ALASKA

(This information was prepared by Mr. Gordon Landes, Department of Social Services, Division of Public Assistance, Juneau, Alaska.)

There are five major welfare programs that provide federal funds to Alaska or directly to residents of Alaska. All of these programs would be affected by AGSOC income paid to Alaskan residents.

Following are the programs and a discussion of funding for Alaska fiscal year 1980 (July 1, 1979 to June 30, 1980).

1. Medicaid. This $33,934,300 program is funded 50% federal and 50% state, both benefits and administrative costs.

Eligibility is dependent primarily on eligibility for a cash assistance program listed below. If, for instance, an AGSOC dividend payment of $200 per person were made in a month, the following would be the effect on each program:

Aid for Families With Dependent Children (AFDC)

a. ($22,734,500) Ineligibility for month of payment receipt for all recipients. Small reduction in Medicaid federal dollars (AFDC recipients are not large Medicaid consumers by total dollars expended). Increase in administrative expense. Some major medical needs experienced in the month of ineligibility would have to be met by one of two existing state-only medical programs.

b. Possible ineligibility in subsequent months for family units which retained the AGSOC payment. This would create a small federal dollar loss.

Supplemental Income Program (SSI)

Ineligibility for a few recipients who have other non-SSI income. SSI programs are on a quarterly basis. Effective 7/1/79 maximum standard payment per individual will be approximately $610 with a $60 per quarter total unearned income excluded. A very small loss of federal Medicaid dollars because most of those becoming ineligible for SSI would become eligible for some supplemental program and therefore ineligible for Medicaid.

2. Supplemental Security Income (SSI). Federally funded and administered cash assistance for aged, blind and disabled. Eligibility on a quarterly basis with $20 per month of unearned income disregarded. A $200 AGSOC payment would reduce SSI payments by $140 for the quarter of receipt of the AGSOC dividend. Large loss of federal dollars and increased federal administrative expense.

3. Aid for Families With Dependent Children (AFDC). Under current AFDC state payment standards and program operations, a $200 AGSOC payment would make all recipients ineligible for the month of receipt. Large administrative burden for the state. Loss of $930,000 in federal program funds. Savings in state AFDC funds of $930,000.

4. Adult Public Assistance (APA). ($6,898,600) State funded and state administered program for aged, blind and disabled. Decrease in federal SSI expenditures will increase state

expense for those who become ineligible for SSI by AGSOC payment but remain within higher income limits of APA. Increased state administrative costs. Some persons over income for SSI but close to or under APA standards would become ineligible for the month AGSOC payment received. (Some of those would have continued eligibility for Medicaid which is important because SSI/APA's are large -- 50% or more of total dollars -- Medicaid users.) Overall effect would be a total decrease in APA state expenditures, $20 monthly disregard of total unearned income. Eligibility established month-by-month.

5. Food Stamp Program (FSP). ($8,000,000) State administered, 100% federally funded. Recent major changes in the FSP program have potential to change the characteristics of the food stamp participants in Alaska. At present it is likely that a $200 per person payment in any one month would render a majority of the 6,000 Alaskan FSP households ineligible for the payment month. Large administration burden for the state. Large loss of federal dollars.

In addition to these programs, the Bureau of Indian Affairs operates a general assistance program in Alaska. This program operates with financial criteria similar to the state's AFDC program. Approximate expenditures for federal forthcoming fiscal year $6,000,000. It is probable that many BIA-GA recipients would become ineligible for the month of AGSOC payment. Large loss of federal dollars and large federal administrative expense.

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

SECOND REQUEST

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

Approved

3/17/80

THANK YOU

RECEIVED
MAR 14 1980
BUDGET/AUDIT
COMMITTEE

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

Alaska State Legislature

House of Representatives

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

MEMBER
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

April 4, 1980

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

Dear Mr. Kelso:

Please find enclosed a State of Alaska Treasury Warrant No. 272045, in the amount of ten thousand dollars ($10,000.00), which is final payment as per our contract.

Sincerely,

Jim Duncan

Jim Duncan

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

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

DATE OF ISSUE
04 02 80
MO. DAY YR.

No. 272045

89-52
1252

DO NOT FOLD, SPINDLE OR MUTILATE

DOLLARS	CENTS
$****10,000	00

PAY TO THE ORDER OF

KELSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

$10,000.00 330 272045

⑈2272045⑈ ⑆1252⑉0052⑆

W.R. Hudson
Commissioner of Administration

Exhibit 4

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

March 24, 1980

RECEIVED
MAR 27 1980
BUDGET/AUDIT COMMITTEE

Representative Jim Duncan
Chairman
Legislative Budget & Audit Committee
Pouch V
Juneau, Alaska 99811

Dear Jim:

Dale Staley of your office has called our attention to the provisions of the first paragraph on page 3 of the Professional Services Contract I, dated August 17, 1979. The paragraph states that "all reports, correspondence, graphs, computer programs, and other documents prepared under this contract are the property of the Committee." It further states, "Copies of all reports, correspondence, graphs, computer programs, and other documents shall be sent to Representative Jim Duncan."

The wording of this paragraph may be the standard format for your contracts, but we do not believe it is very applicable in this case.

Reports: The only reports prepared were the monthly summaries and the final report.

Correspondence: Was limited to requests for specific documents or reports prepared by various organizations.

Graphs: Any prepared are in the final report

Computer Programs: The only one used was the BP Pipelines program sent previously to your predecessor as Chairman, Senator Colletta.

Other Documents: We prepared no other documents.

We could copy and send you several large boxes of research materials accumulated during the course of our work. Since not covered by the contract, we would require reimbursement for copying and shipping expense.

Much of our investigative work involved meetings with individuals. I am attaching a list of meetings which is not inclusive, but covers most of them.

If we can be of further help, let us know.

Regards,

John

John A. Miskimen
Senior Vice President

JAM:bp

Enclosures

Francis A. Gallelo - Coopers & Lybrand - Anchorage
Lloyd M. Pernela - Earth Resources Co. of Alaska - Fairbanks
Hugh D. Campbell - Crocker Bank - San Francisco
William R. Wilkinson - Wilkinson, Volberg & Co. - Orinda, CA
Robert R. Conway - Packaging Innovators Corp. - Hayword, CA
Paula P. Easley - Resource Development Council - Anchorage
Frank Murkowski - Alaska National Bank - Fairbanks
John A. Carlson - Mayor of Fairbanks
Jerry Gauche - Senator Gravel's Office - Washington, D. C.
Emill Notti - Doyon, Ltd. - Fairbanks
Digby H. Cook - Doyon, Ltd. - Fairbanks
Dave Walker - British Petroleum Co., Ltd. - London
Richard Stitt - Sealaska Corporation - Juneau
Lee E. Fisher - Resource Development Council - Anchorage
Nicholas Caputa - Bank of America - San Francisco
Earl Davis - Interior Village Association - Fairbanks
Robert M. Haverfield - Arctic First Federal Savings & Loan - Fairbanks
Bernie Aidinoff - Sullivan & Cromwell - New York City
William Waugaman - Usibelli Coal - Fairbanks
Kenneth E. Zamzow - Department of Revenue - Anchorage
Samuel S. Demientieff - Interior Village Association - Fairbanks
Bertram L. Wagnon - Department of Commerce and Economic Development - Juneau
Douglas J. Blattmachr - First National Bank of Fairbanks - Fairbanks
Dale Lucas - BP Pipelines, Inc. - San Francisco
Robert Doolittle - J.C. Bradford & Co. - Nashville
Bill Scott - Peat, Marwich & Mitchell - Anchorage
Stephen D. Slingsby - Statewide California Business and Industrial Development Corp. - Newport Beach, CA
Monte Taylor - Exxon - Anchorage
Dennis Ciocca - Blyth Eastman Dillon - San Francisco
Alastair Manson - BP North America - New York
Thomas K. Williams - Department of Revenue - Anchorage
Sterling Gallagher - John Nuveen Co. - Juneau

Robert Atwood - Anchorage Times - Anchorage
Larry Iverson - Yukon Office Supply - Anchorage
Edward Slevin - Slevin-Brown Associates - San Francisco
Jack Bachman - Northwest Alaska Pipeline Co. - Salt Lake City
Mark Lewis - City of Valdez - Valdez
Larry Eppenbach - Consultant Alaska - Juneau
Robert J. Person - Coopers & Lybrand - San Francisco
Paul Gavora - Market Basket Enterprises - Fairbanks
Peter Haggland - Air North - Fairbanks
Steve Karakash - Yukon Office Supply - Anchorage
William B. May - Chevron U.S.A., Inc. - San Francisco
Earl E. Blaser - Farm-N-Sea - Valdez
Jeffrey R. Gates - Hewitt Associates - Chicago
Bill Sheffield - Sheffield Enterprises - Anchorage
C. W. Sneeden - Fairbanks Daily News Miner - Fairbanks
David M. Reaume - Department of Commerce & Economic Development - Juneau
Herbert E. Hart - Bateman, Eichler - San Francisco
Ron Koerfer - Foster & Marshall - Fairbanks
Gregory Gray - Citibank - San Francisco
Elliot Schrier - Manalytics, Inc. - San Francisco
William E. Chatlos - Georgeson & Co. - New York City
David S. M. Lanier, Jr. - Davis, Skaggs & Co. - San Francisco
Robert Hunt - Seattle Trust & Savings Bank - Seattle
R. O. Hammond - Western Airlines - Los Angeles
James H. Schilt - Hanan & Kiebler - San Francisco
William J. Green - Alaska National Bank - Fairbanks
Mark Ringstad - Usibelli Coal - Fairbanks
Gary Gassaway - Standard Oil of California - San Francisco
Roger Hughes - Foster & Marshall - Fairbanks
James Miller - Federal Railroad Administration - Washington, D. C.
Stanley Zuckerman - World Airways - Oakland
Willard Allan - Alaska Airlines - Seattle
John R. Morris - John R. Morris Associates - San Francisco

David Helliwell - British Columbia Resources - Vancouver
Paul Schoenemann - Arthur D. Little - San Francisco
Robert Borlick - Department of Energy - Washington, D. C.
Ivan Peterson - Citicorp Leasing - Los Angeles
Alvin Ramciatti - Itel Corp. - San Francisco

(Meetings where anonymity was requested)

Sun Company	Radnor, Pennsylvania
Anchorage Natural Gas Co.	Anchorage
Alaska Electric Light & Power Co.	Juneau
Wien Air Alaska	Anchorage
Wells Fargo	San Francisco
Seattle First National Bank	Seattle
Aetna Life & Casualty	Hartford
Swiss Bank Corporation	New York
Continental Bank	Chicago
Connecticut General Life	Hartford
Kerr Steamship	San Francisco
Continental Assurance	Chicago
Northern Trust Company	Chicago
U.S. Leasing	San Francisco
Sumitomo Bank of California	San Francisco
Travelers Insurance	Hartford
Credit Suisse	New York
Occidental Life Insurance	Los Angeles
Irving Trust Co.	New York
Metropolitan Life Insurance	New York

August 14, 1979

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

Dear Mr. Kelso:

Please find enclosed two copies of Professional Services Contract I. This contract sets out the terms and conditions for two segments of the work as you proposed in your letter of June 24, 1979.

I need to have one signed contract returned to my office in order to release the advance as indicated in Article III, Cosideration.

Please do not hesitate to call if you have any further questions.

Sincerely,

Jim Duncan

JD:jp

PROFESSIONAL SERVICES CONTRACT I

This Contract, effective the 15th day of August, 1979, between the LEGISLATIVE BUDGET AND AUDIT COMMITTEE, STATE OF ALASKA, Pouch V, Juneau, Alaska 99811 (hereinafter called the COMMITTEE), and KELSO & CO., INCORPORATED, 111 Pine Street, San Francisco, California 94111 (hereinafter called the CONTRACTOR),

WITNESSETH THAT:

WHEREAS, the COMMITTEE is concerned with the sources of financing the acquisition of capital assets, for the Alaska General Stock Ownership Corporation (hereinafter called the AGSOC), which are of such a magnitude as to be significant to the State's economy; and

WHEREAS, the COMMITTEE is desirous of obtaining further review of certain technical aspects of the investment and financing opportunities and certain additional features that might be included in planning the successful operation of AGSOC; and

WHEREAS, the State requires certain professional contractual services in connection with such review; and

WHEREAS, the CONTRACTOR is willing to undertake the performance of this contract under the terms of this contract; and

WHEREAS, the COMMITTEE may enter into contracts for professional services;

NOW THEREFORE, the parties hereto agree as follows:

ARTICLE I

Services to be Performed

The CONTRACTOR shall provide for the COMMITTEE and report thereon in writing the following services:

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.

The CONTRACTOR may purchase the services and provide for the expenses of other consultants or professionals selected with the written approval of the COMMITTEE.

The COMMITTEE may, from time to time, request changes in the scope of the services of the CONTRACTOR to be performed under this Agreement. Such changes, including any increase or decrease in the amount of the CONTRACTOR'S compensation, which are mutually agreed upon by and between CONTRACTOR and the COMMITTEE, must be incorporated in written amendments to this Agreement.

All reports, correspondence, graphs, computer programs, and other documents prepared under this contract are the property of the COMMITTEE and it shall have the full right to use these documents for its purposes, or otherwise, when and where the COMMITTEE may designate without any claim on the part of the CONTRACTOR for additional compensation. Copies of all reports, correspondence, graphs, computer programs, and other documents shall be sent to Representative Jim Duncan, Chairman, Legislative Budget & Audit Committee (the CHAIRMAN), Pouch V, Juneau, Alaska 99811.

The work shall be done in accordance with generally recognized standards of professional consulting services. In the event that any work does not meet these standards, the CHAIRMAN may serve written notice on the CONTRACTOR and satisfactory correction shall be made within ten (10) days. Completion dates for any portion(s) of the work shall be set by mutual agreement except as otherwise set forth herein. Failure to complete the work on time shall result in liquidated damages of One Hundred Dollars ($100) per day, except for delays due to causes beyond the control and without fault or negligence of the CONTRACTOR. Liquidated damages shall not exceed the total payments allowed under this contract and may be deducted from payments that are owing.

The COMMITTEE may terminate this contract upon written notice of the necessity for doing so and payment shall be made for satisfactory work performed prior to CONTRACTOR'S performance, if not disposed of by agreement between the parties, shall be decided in accordance with Appendix A hereto.

ARTICLE II

Period of Performance

A. The CONTRACTOR shall submit the study on or before February 1, 1980. The report shall be submitted in duplicate in a form suitable for offset printing to the Chairman.

B. The period of this contract shall begin on August 15, 1979 and terminate on February 1, 1980 unless extended or terminated by written agreement.

ARTICLE III

Consideration

In full consideration of the CONTRACTOR'S performance hereunder, the COMMITTEE shall pay the CONTRACTOR Sixty Thousand Dollars ($60,000), including all expenses as described in Article I, and shall be payable to the CONTRACTOR as follows:

1. On the date this contract is executed, Ten Thousand Dollars ($10,000).
2. The payment of the balance in monthly installments of Ten Thousand Dollars ($10,000) 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 Chairman will be billed monthly and due within 15 days of billing therefor by KELSO & CO., INCORPORATED.

The CONTRACTOR shall keep the Chairman informed monthly as to the progress of the work performed under this agreement.

ARTICLE IV

Additional Contract Provision

Appendix A attached hereto and made a part hereof sets forth additional general contract provisions of this contract.

ARTICLE V

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 dates indicated below.

CONTRACTOR: KELSO & CO., INCORPORATED 111 Pine Street San Francisco, California 94111	LEGISLATIVE BUDGET AND AUDIT COMMITTEE, STATE OF ALASKA
By: Louis O. Kelso Louis O. Kelso, President	By: Jim Duncan Rep. Jim Duncan, Chairman
Date: 8/17/79	DATE: 8/13/79

Approved as to Form:

John B. Clement

Legislative Affairs Legal Counsel

APPENDIX "A" TO PERSONAL SERVICE CONTRACT

ARTICLE A-1. Definitions:

(a) The term "Committee" means the Legislative Budget and Audit Committee, State of Alaska;

(b) The term "Chairman" means the Chairman of the Committee.

(c) The term "State" means the State of Alaska.

ARTICLE A-2. Inspections and Reports:

(a) The Chairman shall have the right to inspect, in such manner and at all reasonable times as it deems appropriate, all activities of the Contractor arising in the course of its undertakings under this contract.

(b) The Contractor shall make progress and other reports in such manner and at such times as the Chairman may reasonably require in accordance with the contract.

ARTICLE A-3. State of Alaska Saved Harmless:

The Contractor shall hold and save the State, its officers, agents and employees, harmless from liability of any nature or kind, including costs and expenses, for or on account of any or all suits or damages of any character whatsoever resulting from injuries or damages sustained by any person or persons or property by virtue of any wrongful act or omission of Contractor not specifically directed by the State or its duly authorized agents.

ARTICLE-4. Disputes:

(a) Except as otherwise provided in this contract, any dispute concerning a question of fact arising under this contract which is not disposed of by agreement shall be decided by the Chairman, who shall reduce his decision to writing and mail or otherwise furnish a copy thereof to the Contractor. The decision of the Chairman shall be final and conclusive unless, within 30 days from the date of receipt of such copy, the Contractor mails or otherwise furnishes to the Chairman a written appeal. The decision of the Chairman shall be final and conclusive. This provision shall not be pleaded in any suit involving a question of fact arising under this contract as limiting judicial review of any such decision to cases where fraud by such official or his representative or board is alleged: Provided, however, that any such decision shall be final and conclusive unless the same is fraudulent or capricious or arbitrary or so grossly erroneous as necessarily to imply bad faith or is not supported by substantial evidence. In connection with any appeal proceeding under this clause, the Contractor shall be afforded an opportunity to be heard and to offer evidence in support of appeal. Pending final decision of a dispute hereunder, the Contractor shall proceed diligently with the performance of the contract and in accordance with the Chairman's decision.

(b) This Disputes clause does not preclude consideration of questions of law in connection with decisions provided for in Paragraph (a) above. Nothing in this contract, however, shall be construed as making final the decision of any administrative official, representative or board on a question of law.

ARTICLE A-5. Equal Employment Opportunity:

(a) The Contractor will not discriminate against any employee or applicant for employment because of race, color, religion, national origin, ancestry, age, or sex. The Contractor will take affirmative action to insure that applicants are employed and that employees are treated during employment without regard to their race, color, religion, national origin, ancestry, age, or sex. Such action shall include, but not be limited to, the following: employment, upgrading, demotion, or transfer; recruitment or recruitment advertising; layoff or termination, rates of pay or other forms of compensation; and selection for training, including apprenticeship. The Contractor agrees to post in conspicuous places, available to employees and applicants for employment, notices setting forth the provisions of this non-discrimination clause.

(b) The Contractor shall state, in all solicitations or advertisements for employees to work on State of Alaska contract jobs, that all qualified applicants will receive consideration for employment without regard to race, color, religion, national origin, ancestry, age or sex.

(c) The Contractor will include the provisions of Paragraphs (a) through (c) in this Article in every contract, and will require the inclusion of these provisions in every sub-contract entered into by any of its sub-contractors, so that such provisions will be binding upon each sub-contractor, as the case may be. For the purpose of including such provisions in any construction, maintenance, or service contract or sub-contract, as required hereby, the term "Contractor" and the term "Sub-contractor" may be changed to reflect appropriately the name or designation of the parties of such contract or sub-contract.

(d) The Contractor agrees that he will fully cooperate with the office or agency of the State of Alaska which seeks to deal with the problem of unlawful or invidious discrimination, and with all other State efforts to guarantee fair employment practices under this contract, and said Contractor will comply promptly with all requests and directions from the State Commission of Human Rights or any of its officers or agents relating to prevention of discriminatory employment practice.

(e) Full cooperation as expressed in clause (d) shall include, but not be limited to, being a witness in any proceeding involving questions of unlawful or invidious discrimination if such is deemed necessary by any official or agency of the State of Alaska, permitting employees of said Contractor to be witnesses or complainants in any proceeding involving questions of unlawful or invidious discrimination, if such is deemed necessary by any official or agency of the State of Alaska, participating in meetings, submitting periodic reports on the equal employment aspects of present and future employment, assisting in inspection of the construction site, and promptly complying with all State directives deemed essential by any office or agency of the State of Alaska to insure compliance with all Federal and State laws, regulations and policies pertaining to the prevention of discriminatory employment practices.

(f) Failure to perform any of the above agreements pertaining to equal employment opportunities shall be deemed a material breach of the contract.

ARTICLE A-6. Termination:

The performance of work under this contract may be terminated, in whole or from time to time in part, by the State whenever for any reason the Chairman shall determine that such termination is in the best interest of the State. Termination of work hereunder shall be effected by delivery to the Contractor of a Notice of Termination specifying the extent to which performance of work under the contract is terminated and the date upon which such termination becomes effective.

ARTICLE A-7. No Assignment:

The Contractor shall not assign this contract, nor any part thereof, nor any right to any of the monies to be paid him hereunder, nor shall any part of the work done or materials furnished under said contract be sublet except with the written consent of the Chairman.

ARTICLE A-8. No Additional Work:

No claim for additional work or materials not specifically herein provided, done or furnished by the Contractor will be allowed by the Committee, nor shall the Contractor do any work or furnish any material not covered by the contract unless such work is ordered or confirmed in writing by the Committee.

ARTICLE A-9. Independent Contractor:

The Contractor, and any agents and employees of the Contractor, shall act in an independent capacity and not as officers or employees or agents of the State in the performance of the contract.

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

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

September 7, 1978

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

Dear Mr. Kelso:

As you begin your study of General Stock Ownership Plan (GSOP) options for Alaska, we would like for you to include an examination of an alternative that would retain the investment decision with the individual. In other words, an individual would decide what common stock to purchase. Perhaps an approved list of corporations with good dividend records, mutual funds, or outright diversification requirements would be stipulated for allowable investments to ensure prudence on the part of individuals.

Basically, the concept we have in mind is very close to that developed in your published works such as Two Factor Theory. The thrust is to retain the wisdom of the free market in the investment decision. We recognize that Senator Gravel's bill as introduced does not offer this flexibility.

To the extent possible within the existing contract amount, please provide us with your analysis of this type of GSOP structure.

Very truly yours,

Mike Colletta

Mike Colletta, Project Director

Jim Duncan

Jim Duncan, Project Director

cc: Members, Budget & Audit Committee
Representative Steve Cowper
Milt Barker

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

September 26, 1978

The Legislature of the State of Alaska
Finance Division
Budget and Audit Committee
Pouch WF - State Capitol
Juneau, Alaska 99811

Attention: The Hon. Mike Colletta, Project Director
The Hon. Jim Duncan, Project Director

Re: The Alaskan General Stock Ownership Plan

Gentlemen:

We have received and reviewed your letter of September 7, 1978, and have given much thought to the ideas expressed therein.

In this letter, we will first set forth our reasoning for our conclusions that there will be difficulties in accomplishing fully what, on its face, would seem to be a simple request. We will then assure you of our best efforts to satisfy your requests.

To understand the key problem, please consider the following. Why should we hold forth the promise that under a GSOP, structured in accordance with two-factor economic principles, it will be possible for qualified individuals over a reasonable time period to acquire significant capital ownership, when it is quite apparent that under existing techniques of finance, the rich (with surplus funds and credit to finance investments) can acquire more productive capital, but the non-rich majority (about 95% of consumer units) cannot acquire it at all?

These are the reasons:

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

1) The GSOP operates on pre-tax dollars.

2) Under a GSOP, the individual whose capital ownership is being financed is not taxed, either under State or Federal income tax laws or under any other tax laws as the result of the acquisition of the capital he invests in, or on the funds used to effect the acquisition. He will be taxed, as we believe State and Federal tax laws will stand when our ultimate recommendations are implemented, at either ordinary income tax rates or at capital gain tax rates on his sale of the capital thus acquired. Our firm is urging the ultimate adoption of legislative changes to eliminate even this type of taxation. It is based on a misinterpretation of two-factor economics. Capital acquisition by individuals using two-factor methods involves the individual's acquisition of access to credit on terms where the capital (or stock representing capital ownership) can be purchased from the yield of that capital, distributed in a manner to accomodate the credit terms so made available.

3) Two-factor economics is based on one premise that is critical here: the right to life, a right which our Constitution guarantees each person within its jurisdiction, implies the right legitimately to acquire productive power adequate to enable him to pay for the means of enjoying a reasonable life style that suits him. Each person legitimately acquires ownership of his own labor power at birth and over the course of his growing to maturity simply because slavery of American citizens and residents is prohibited. But labor is only one of the two factors of production. With the advance of technological change which, at an accelerating rate, alters the input mix of the factors of production, constantly increasing the use of capital and diminishing the use of labor, it is imperative that our institutions make it both possible and effective for each consumer unit to legitimately* acquire ownership of sufficient capital to make up for its normal inability to produce an adequate income through sale of its labor power; indeed to increase that productiveness so as to enable it to enjoy its reasonable share of the goods and services made possible by technological advance. There are thus profound and compelling reasons why no government should treat the yield of capital devoted

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* i.e., consistently with the protection of the sanctity of private property.

to pay its purchase price for a financially under-powered or potentially financially under-powered consumer, be treated as taxable income. This is a purchase transaction, and only when payment of the purchase price is completed and the newly acquired capital begins to produce income for its new owner, to the extent that such income in fact is paid, that it should be treated as ordinary income and subjected to income tax like any other ordinary income.

4) There are many reasons why the concepts of two-factor economics cannot be used to bring about this result in any case except where the relevant laws and financing institutions are structured -- or sometimes restructured -- consistently with two-factor economic principles to facilitate capital acquisition by the poor or previously capital-less. This structuring and restructuring has taken place, at least to a workable degree, in the case of ESOPs. But the ESOP can be used only to enable employees of a corporation to acquire stock in their corporate employer or its corporate affiliates. Such structuring and restructuring also enabled us to establish one CSOP (Consumer Stock Ownership Plan), named Valley Nitrogen Producers, Inc., in California. That enterprise was designed to enable its more than 12,000 farmer owner-customers to lower the effective cost to them of chemical fertilizers to a small fraction of their previous costs. But its powerful competitors persuaded Congress to alter the tax laws, so that Valley Nitrogen's establishment could not be duplicated again today without eliminating the legal obstacles placed in the way. That this will be done at the Federal level in the near future, so that the principal of financing the types of enterprise that lend themselves to the CSOP technique can be implemented in the next two or three years, I regard as a certainty.

5) In The New Capitalists, published by Mortimer J. Adler and myself in 1961, with additional references made to it in my testimony before the Heineman Commission (1969) and in Two-Factor Theory: The Economics of Reality (co-authored with Patricia Hetter, 1967), we put forward the most comprehensive of general capital financing and capital-broadening plans, one which I will now call the Financed General Capital Ownership Plan (FINGCOP). It

differs from, though is closely related to, the GSOP that is the subject of our present design study.

6) The FINGCOP must be implemented primarily at the Federal legislative level. That this is so can be readily seen from the mention of only a few of the changes required in present laws and financing practices that prevail today:

- Corporations seeking to take advantage of this means of financing their growth must commit themselves to a full periodic payout of their net earnings to their shareholders, after debt service, depreciation, and operating reserves only, in exchange for the assurance from their investment bankers, bankers (or other lenders) and from the Federal Reserve Board of Governors, that their feasible and reasonable future capital requirements will be similarly financed if they so request. This is simply a restoration of private property to capital stock which does not have that right today.

- The wages of capital (capital net income) must be free of corporate income tax to the extent that it is applied upon the purchase price of the stock by individual stock buyers. Eventually the corporate income tax should be eliminated entirely and the income tax shifted to individuals.

- The wages of capital, to the extent applied on the purchase price of capital stock for an individual, must be free of the individual's income tax, and taxable as ordinary personal income only after such purchase price is paid. Only on subsequent sale of the stock so purchased by an individual would he be taxed at ordinary income rates on his gain (from a zero basis), and only then if he failed within 60 days to reinvest the proceeds in income-yielding productive capital.

- A Capital Diffusion Insurance Corporation (CDIC), the capital financing equivalent of FHA Insurance Program in the housing finance field, would be established to lower resistance of lendors to make FINGCOP loans. Since such loans are on assets intended to pay for themselves, the premiums of such insurance should be lower than FHA insurance premiums. CDIC could be established as a public agency or by private insurance companies, or both. (See the letter to President Ford and its enclosure attached hereto).

- The loan paper for FINGCOP financing should be made directly discountable at the Federal Reserve Bank at a price not exceeding the administrative costs of the costs of the Fed. I estimate this should not exceed 1/4 of 1%. If lenders then take their usual spread -- 1-1/2% to 2% -- for their initial feasibility analysis of the loan and for their policing of the loan covenants until it is repaid, an effective interest rate to individual citizen borrowers should not exceed 3%. At the National Monetary Policy level, this amounts to shifting from the monetization of welfare, as we do today, to the monetization of self-liquidating productive capital. Loans would be limited by law. Eligibility of capital buyers under this plan would, as in the case of a GSOP, be determined from time to time by law. Loans would be made into escrows established with any eligible bank or trust company of the borrower's selection. Trust officers or investment counsellors would guide the borrower on the selection of a reasonably diversified portfolio and could refuse the loan if not satisfied with the diversification.

7) From the discussions of the FINGCOP concept, it should be clear that difficulties are involved in designing a GSOP that would permit an individual to select various stocks in various corporations of his choice:

- To pay the cost of the stocks he would buy, he would have to use the dividends that are voluntarily paid by the issuing corporations, and then only after being reduced by his personal income tax, State and Federal. Such dividends are rarely as high as 25% of the corporation's pre-tax net income, and, after payment of individual income tax on them, would normally be less than the rate of interest on loan financing at the present or foreseeable future time, say 10%-12%, or more. So such stocks would <u>never</u> pay for themselves.

However, we do understand from your letter that the Committee is interested in maximizing the freedom of the individual to select his investments and to achieve diversification, and we will do our best to accommodate these interests of the Committee in our GSOP design study.

Sincerely,

Louis O. Kelso

Louis O. Kelso
President

LOK/lrh
cc: Milt Barker

Enclosures

LOUIS O. KELSO, INC.
LAWYERS AND COUNSELORS
111 PINE STREET
SAN FRANCISCO, CALIFORNIA 94111

TELEPHONE
(415) 788-7200

CABLE ADDRESS
LOKINC

January 17, 1975

The Honorable Gerald R. Ford
President of the United States
The White House
1600 Pennsylvania Avenue
Washington, D.C. 20500

Dear Mr. President:

I am dismayed at the inadequacy of the economic program as presented in your State of the Union Message. It incorporates the continued use of the Keynesian expedients that have papered-over our problems from the last depression to our new depression without correcting the structural defects that make our economy work so badly.

Up to now, it has been abundantly demonstrated that the chief Keynesian weapon against inflation is unemployment, and that the chief Keynesian weapons against unemployment are inflationary. Now that we have opened up a two-front war simultaneously on unemployment and inflation, using the same old Keynesian tools, we can hardly be headed for anything but the most colossal disaster in our economic history.

The alternative -- I am certain the only alternative -- is outlined in the statement I prepared for your Economic Summit Meeting on Inflation last September. A copy of that statement is enclosed herewith.

The program contemplated by my Summit statement, "A New Economic Policy to Meet the Needs of the American People and of the U.S. Economy," can effectively and within time limits short enough to permit restoration of confidence of the people in our economy, accomplish the following objectives:

-- Restoration and acceleration of economic growth to unprecedented levels through making possible financing of the enormous, self-liquidating new capital formation so desperately needed by the U.S. economy today, including making ourselves self-sufficient in energy, the building of hundreds of rapid transit systems, the total rehabilitation of our railroad system, the reawakening of our housing industry, the multiplication of our agricultural output by several magnitudes (since it is our best trade balance weapon), etc.;

(OVER)

-- Create legitimate (not boondoggle) full employment for two or three decades until we can get the American people in a position where a major portion of their incomes are derived from capital ownership;

-- Lay the foundation for arresting inflation and initiating the hardening of our money, for once the newly-formed capital has paid for itself, it will continue to throw off goods and services almost indefinitely;

-- Achieve these steps only through self-liquidating expenditures, rather than through welfare and tax cuts, which must be ever repeated and ever increased to close, year after year, the purchasing power gap;

-- Build market power -- adequate market power -- into the workers in the form of a second income from their privately-owned capital;

-- Finance these objectives without adding one cent to the Federal debt through the discount technique proposed in my Summit statement, which is nothing more nor less than a technique for monetizing self-liquidating newly-formed capital. Compare this with the present Administration program, which primarily monetizes welfare!

-- Permit the lowering of the interest rate on these selected basic types of self-liquidating new capital formation to 3% or less, assuring enormously greater economic power in the form of new productive industry.

I am also enclosing a copy of a bill for an act entitled the "Accelerated Capital Formation Act of 1975." This bill, which was introduced into the House this week by Congressman Frenzel from Minnesota contains very minor changes in the tax laws relating to Employee Stock Ownership Plan financing techniques that will radically enhance their attractiveness to corporations, to employees, to labor unions, and to voters. The provisions of this bill will accomplish all and more than would an increase in the investment credit which, for all its advantages in helping to stimulate business, never creates a single new stockholder. Rather, the investment credit merely exacerbates the concentration of ownership that is already our Number One problem.

LOUIS O. KELSO, INC.
LAWYERS AND COUNSELORS

Mr. President, I urge you to consider these points, and if you are persuaded of their soundness, as I am, to help bring about their substitution for the programs now under consideration.

Irrespective of what welfare or emergency measures might have to be taken to prevent immediate suffering as the result of the failure of the economy, the program I have outlined alone is a long-term solution and its vigorous employment would minimize the welfare expedients needed in the short term.

I respectfully urge your attention to the foregoing.

Sincerely,

Louis O. Kelso

Louis O. Kelso

LOK:rah
Enclosures

cc: The Honorable L. William Seidman

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

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

October 1, 1974

Mr. William Seidman, and
Professor Paul McCracken
Old Executive Office Building
Washington, D.C. 20500

Dear Bill and Paul:

The Summit Conference on Inflation was a confidence-inspiring event for those involved and, I think, for this country as a whole. The administration gained in credibility perceptibly.

The very public nature of the sessions, however, minimized the possibility of considering new ideas of a scope commensurate with the size and seriousness of the underlying economic problems.

A dozen or more speakers noted that they had heard "nothing new." Among them was Dr. Gwen Bymers as the mini-summit meeting of the Banking and Finance Community on September 20th — where the Bangert & Company proposal was presented. But the fact is that Bangert & Company's proposal is both new and critically relevant; it involves taking direct steps that lie within the powers of a democratic society towards eliminating inflation, financing greatly improved economic growth and bringing about two or more decades of full employment. I do not, of course, criticize Professor Bymers for not grasping the significance of what she had heard in the limited time available. My invitation came on such short notice that I had no time to prepare an advance summary of my presentation — a copy of which I now enclose.

As you sift through the suggestions and begin to formulate a new economic policy however, I urge you carefully to consider making a recommendation to Congress for amending the Employment Act of 1946 to expand the U.S. economic goal to include a policy favoring the broadening of the ownership of capital. While this would be a new departure, (or at least one that is new since the Homestead Acts), it is one directed towards the solution of the chief *real* problem. It would proclaim a new goal while also giving the Administration and Congress time to consider the means of implementation. If the implementation is timed carefully, any temporary revenue losses will be far less than the cost of make-work jobs and other welfare expedients required to shore up a stagnant economy.

I am fully aware that conventional banking thought is quite oblivious to the power and importance of using pure credit to finance new capital formation. For example, Governor Henry C. Wallich of the Federal Reserve Board, at the Conference for Corporation Executives on Wednesday, September 25, 1974, at the School of Advanced International Studies in Washington, D.C., stated:

> *"Conterproductive Proposals*
>
> "A variety of often ingenious suggestions were made during the pre-summit meetings that, upon closer analysis, have one feature in common: their application would require printing more money. Proposals to combat inflation burdened with this side effect do not carry conviction. *This applies, for instance, to well meant suggestions to expand credit in order to expand productive investment in order to expand output.* More output indeed would tend to restrain inflation, but not if it has to be financed by an expansion of money and credit." (Emphasis added)

The prevalence of this *non sequitur* variety of thinking is part of the explanation as to how we got into our present mess. Governor Wallich is certainly correct when he says, "More output indeed would tend to restrain inflation," and he is dead wrong when he asserts that such is not true if the expanded output "has to be financed by an expansion of...credit." Newly-formed capital in well-managed businesses (and the Federal Reserve Board can lay down regulations concerning the quality of feasibility studies) pays for itself *not just once, but repeatedly in cycles*, rarely of more than half dozen years each, its productiveness restored by depreciation practices that are universally used. Such *Ex Cathedra* and unsupportable statements should not shut off the only line of thinking that can lead us out of the inflation woods. Neither Governor Wallich, nor any one else could explain the financing of the industrialization of Japan over the last half century without acknowledging that new capital formation can indeed be financed out of pure credit without inflation. Japan's inflation came long after Japan had risen to high-level industrial status, and is due to essentially the same causes as that in the United States: the attempt to solve the income distribution problem through labor, when the great bulk of its wealth is in fact produced by capital. Japan's further mistake lay in failing to develop techniques, such as we have developed, to radically broaden the equity ownership base.

You both have copies of *Two-Factor Theory: The Economics of Reality*, written by Patricia Hetter and myself in 1967. In the appendix to that book is a draft of just such a revision of the Employment Act of 1946 which you could quickly adapt to suit your own views.

The world is facing a crisis arising out of the ultimately hopeless attempt to distribute as pay for labor the income derived from the overwhelming input of capital. This economic policy is clearly not working; nor can it ever work, for technology modifies the input mix into the economy in only one direction.

You have the opportunity to set us on the course to sound and necessary change in your formulation of the Administration's new economic policy recommendations to Congress.

Please give this suggestion your most careful consideration. I will be at your service, of course, should you find that I can be of help.

With best regards,

Sincerely,

Louis O. Kelso

KELSO & CO.
111 PINE STREET
SAN FRANCISCO, CALIFORNIA 94111

A NEW ECONOMIC POLICY TO MEET THE NEEDS OF THE AMERICAN PEOPLE AND OF THE U.S. ECONOMY

Proposals to the President of the United States
At the Economic Summit Meeting on Inflation
Convened in Washington, D. C.
September 27-28, 1974

By
Louis O. Kelso, Economist

As we meet to consider and recommend solutions to inflation and related problems now besetting the American economy, it is clear that fast and effective solutions are needed to:

— Resume and accelerate economic growth. The American economy derives its strength from its ability to bring into existence powerful capital instruments — the real source of its productive power and affluence — and to match them with skilled and motivated workers. We should never forget that economic strength depends on the ability to produce an abundance of low-cost, high quality goods and services, and to build market power into consumers in the process. Rapid economic growth is essential if we are to achieve self-sufficiency in energy within less than a decade; if we are to rehabilitate our railroad systems; if we are to rehabilitate our cities; achieve vastly expanded production of food and fiber at much lower costs in order to meet our share of the export demand and to solve our balance of payments problems; build a hundred or more new towns and a hundred or more rapid transit systems; and expand the production of basic goods and services in general.

— Create several million new jobs in the private sector in the course of expanding its output of goods and services. Certainly no one can suggest that we should find make-work employment in the public sector if, in fact, the expanding private sector requires more jobs.

— Protect the quality of our environment as we grow, which will further increase the need for new capital formation and for financing it.

— Achieve higher incomes for our poor and our middle classes, but by means other than increases in wages and salaries, in order to avoid increasing the costs of goods and services.

— Reverse inflation and achieve a gradual and continuous hardening of our money.

WHAT CAN ACCOMPLISH THESE OBJECTIVES WHEN SO MANY OTHER PLANS HAVE FAILED?

Modern inflation is of such nature that it can only be solved by radically increased investment in self-liquidating new capital formation. It is nothing short of a miraculous coincidence that we are facing a decade in which capital formation requirements exceed those of any past decade by several magnitudes.

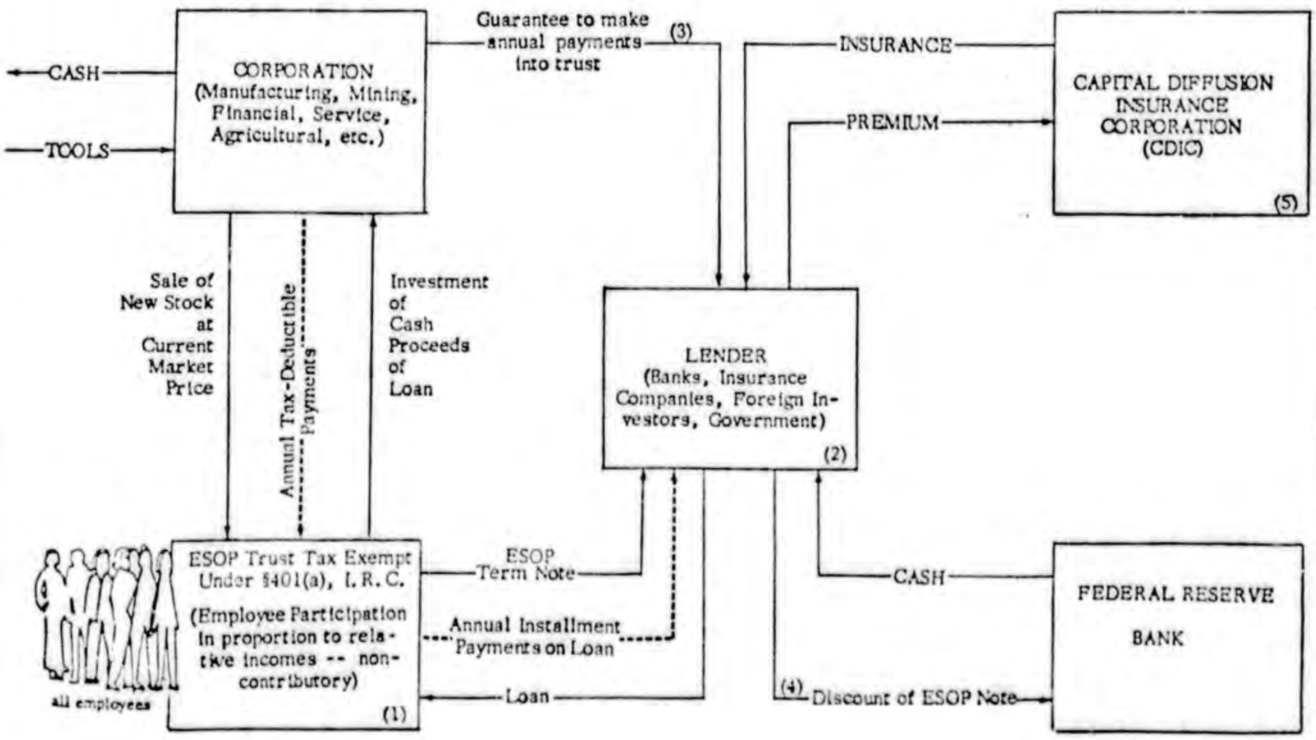
Not only is it true that we can and must invest our way out of inflation, while solving the other problems noted above, but credit for doing so at low interest rates is *unlimited.* Expenditures during the coming decade of upwards of 4.5 trillion on basic private-sector new capital formation, if structured to radically broaden corporate equity ownership and to minimize making the rich any richer, will reverse inflation, build market power into most consumers, create two or three generations of intense full employment, and shrink to a fraction of their present size the various government agencies devoted to attacking the effects of poverty while leaving its causes untouched. This program is an attack on the *cause* of poverty, namely, the low economic productiveness of the individual who does not own significant income-producing capital. It will cause taxpayers' incomes to rise, the purchasing power of their money to grow, and their taxes to fall well below present levels.

WHAT ERROR IS RESPONSIBLE FOR OUR UNEMPLOYMENT, INFLATION, STAGNATED ECONOMIC GROWTH, AND INCOME DISTRIBUTION MISMATCH?

Present U.S. economic policy calls for solving the income distribution problems for all consumers through full employment, and to the extent that is not achievable, through welfare. At the same time, science, engineering, and management of business, industry and agriculture, strive ceaselessly to eliminate employment to minimize costs. Inflation flows relentlessly and unendingly from attempts of the Federal government to reconcile these unreconcilables, all of which take the form — recognizable or not — of the monetization of welfare. Money representing welfare is inflation in its essence.

THE BLUEPRINT FOR THE NEW ECONOMIC POLICY.

FINANCING ECONOMIC GROWTH BY MONETIZING PRODUCTIVE CAPITAL WHILE BUILDING MARKET POWER INTO CONSUMERS THROUGH EMPLOYEE STOCK OWNERSHIP PLAN ("ESOP") FINANCING



— *EXPLANATORY NOTES.*

1. The Employee Stock Ownership Plan ("ESOP") Trust is a tax exempt entity organized to conform to Section 401(a) of the Internal Revenue Code. Not only are payments into it by the corporation deductible from corporate income tax within specified limits (maximum 25% of covered payroll), but the employees can accumulate capital ownership in the Trust until their retirement, free of annual income taxation.

2. In addition to banks, insurance companies, and foreign investors, all of which are currently eligible to make ESOP loans, consideration should be given to enlarging the power of savings and loan institutions to make such loans.

3. The corporate guarantee to make sufficient payments into the trust to enable the trust to meet its loan amortization requirements is, in effect, a pledge of the general obligation of the corporation *payable in pre-tax dollars.* In tax theory, this is a contribution to a qualified employee trust. In economic theory, it is merely a commitment on the part of the corporation to make a high payout of the wages (i.e., earnings) of the newly formed capital.

4. The direct discounting of the ESOP note with the Federal Reserve Bank should be strictly limited to basic financing of high priority, self-liquidating new capital formation, such as railroad rehabilitation, the building of new rapid transit systems, the expansion of agriculture, etc. It should never be used for consumer financing or mere purchase of existing assets. The interest rate should be limited to the administrative cost to the Federal Reserve Bank and the administrative cost to the lender, including a reasonable profit. We estimate this rate should not exceed 3% per annum to the ESOP borrower. No consideration of risk should be involved in the fixing of the interest rate, since the risk is covered in another way. (See Note 5 below.)

5. We recommend that Congress organize a capital financing counterpart of the FHA Insurance Fund designed for use primarily in the consumer housing field. Its name, suggested here, is Capital Diffusion Insurance Corporation. (For further discussion, see Kelso and Adler, *The New Capitalists,* Random House [1961]; Kelso and Hetter *Two Factor Theory: The Economics of Reality,* Random House Vintage Books [1967]; Testimony of Louis O. Kelso and Norman G. Kurland, Financial Markets Subcommittee of the Senate Finance Committee, September 24, 1973.)

This basic financing design, omitting the Capital Diffusion Insurance Corporation, and the arrangement for discounting ESOP notes directly with the Federal Reserve Bank (both of which we recommend Congress provide for with the control conditions herein outlined) has been successfully used by more than one hundred U.S. corporations under existing law. The newly-enacted Employee Retirement Income Security Act of 1974 greatly strengthens and enlarges the opportunities for the use of ESOP financing. (See in particular Sections 404[a][2], 407[b], 407[d][3][A], 407[d][6], 408[b][3], 408[e], 2003[a], 4975[d][3], 4975[d][13], 4975[e][7].)

WHY WOULD THE PLAN BRING ABOUT A CONTINUOUS HARDENING OF THE PURCHASING POWER OF MONEY?

The classical definition of inflation is too many dollars chasing too few goods. Since this plan is based upon the radical expansion of feasible and self-liquidating newly-formed capital, it involves bringing into existence productive facilities that will not only pay for themselves once within a reasonable number of years (normally 3 to 5), but these capital instruments, their productiveness preserved by depreciation practices which involve setting aside funds to restore and perpetuate their productive power before net income is computed, continue almost indefinitely to push goods and services into the markets without further capital costs. Furthermore, since the typical ESOP Trust covers all of the employees of each corporation employing it for financing purposes, employees are gradually put in a position where their increasing wage demands conflict with their accumulating capital ownership, and wage demands may be expected to flatten out. Since the typical ESOP Trust is designed so that, once stock is paid for, any dividends thereafter paid pass through the Trust into the employees' pockets, it becomes possible to raise employee incomes without raising corporate costs. Furthermore, the ESOP, by building significant capital ownership into employees over a working lifetime, will gradually replace fixed-benefit pension trusts and profit sharing arrangements that are invested only in secondhand equities. Since these do not finance growth of the sponsoring corporation, they are pure costs which can be gradually eliminated.

Finally, the rapid acceleration of the real growth of the U.S. economy, desperately needed and calling for large increases in employment, will render unnecessary the governmental costs of creating make-work jobs producing nothing of market value. The rolls of the unemployed will fall and in due course many government employees will be attracted by the advantages of working in industry under conditions providing opportunities for capital ownership, second incomes and economic security.

Second incomes from capital, paid to employees after their new capital holdings have paid for themselves, will enhance the market power of those with unsatisfied needs and wants. This "second income" is the wealth produced by capital — not monetized welfare such as is used today to close the purchasing power gap. The accelerated growth of the economy will make the poor richer without making the rich poorer, and will provide a larger income and property tax base for government. In the face of shrinking "need" or welfare demands, we can achieve every taxpayer's dream of a shrinking tax bite accompanied by increased purchasing power of the dollar.

CONVENTIONAL METHODS TO CLOSE THE PURCHASING POWER GAP OF THE POOR AND MIDDLE CLASS COMPARED TO THE PLAN BASED UPON ESOP FINANCING.

Conventional Economic Expedients	ESOP Financing Plan
Attacks only the effects of poverty.	Attacks the causes of poverty.
Increases dependence of the individual on the State.	Creates growing autonomy, increasing economic independence of the consumers who produce progressively more of their income through their privately-owned capital.
Progressively more inflationary.	Gradually deflationary through the hardening value of money. Living becomes easier because it is easier to produce goods and services and easier to buy and pay for them.
Demotivates economic activity through higher and higher taxes, redistribution and discouragement of craftsmanship.	By linking the worker's performance of his job with the acquisition of a viable capital estate, provides him the most powerful and satisfying motivating force in history.
Restrains economic growth.	Promotes accelerating economic growth.
Economy increasingly depends on taxation.	Economy increasingly depends on intelligent use of credit and the wise use of banking facilities to expand the private economy and enable all consumers to participate in production through capital ownership.
Numerous financial and institutional barriers to economic growth. "Where do we get the money?"	Institutional barriers to growth eliminated and only physical limits to growth remain.
Defy man's nature because they violate Machiavelli's Law: a man will forgive you for killing his father before he will forgive you for taking his patrimony.	The economy in which capital ownership is broadly owned conforms to the nature of man because it helps him to acquire a capital estate, protects his patrimony, and helps it to grow.
Concentrates economic and political power in the same hands and is eventually totalitarian.	Keeps the economic power out of the hands of the State and diffuses ownership broadly through all consumers. The State remains in the position of umpire and guide. The freedom of the individual can be protected by the individual, while political power from election to election is centralized in an administration. While government has enormous ability to make low-cost credit available for broadly-owned basic new capital formation, and has therefore enormous leadership capability within the society, economic power remains with the people.

SUGGESTED READING ON TWO-FACTOR ECONOMICS

Books

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

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

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

Testimony

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

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

Reports and Publications

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

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

FOR FURTHER INFORMATION CONTACT:

Kelso & Co., Incorporated
111 Pine Street, 18th Floor
San Francisco, CA 94111
Telephone: (415) 788-7454

SCOMM

#32:14

MIT

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

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

cc: J. Roderick Heller
Wilmer, Cutler & Pickering
1666 K Street, N.W.
Washington, D.C.

Rep. Terry ~~Miller~~ Gardiner

Rep. Russ Meekins

Rep. Mike Miller

WILMER, CUTLER & PICKERING
1666 K STREET, N. W.
WASHINGTON, D. C. 20006

November 2, 1978

MEMORANDUM

Summary of Recommendations Regarding
Federal Securities Regulation of
General Stock Ownership Corporations

A general stock ownership corporation ("GSOC") that is formed pursuant to the Revenue Act of 1978 potentially will be subject to at least three federal securities laws: (1) the Securities Act of 1933 (the "33 Act"), (2) the Securities Exchange Act of 1934 (the "34 Act") and the Investment Company Act of 1940 (the "40 Act"). The attached memorandum describes the operation of these provisions.

The 33 Act makes it unlawful to sell certain securities unless a registration statement for those securities has been filed with the Securities and Exchange Commission (the "SEC") and prohibits misleading information in registration or sale documents.

The 34 Act requires filing of a registration statement by companies whose securities are widely held, requires periodic reporting to the SEC of financial and other information, and sets forth rules governing the solicitation of proxies allowing one to vote shares of other investors at an annual meeting or to effect other corporate action requiring a shareholder vote.

The 40 Act requires the registration of companies which primarily invest in the securities of other companies, regulates certain conduct of such companies, and sets disclosure standards for them.

Because of the unique nature of the GSOC, we believe that a special application of the federal securities laws may be warranted.

We propose that representatives of the State, on behalf of a proposed Alaskan GSOC, promptly formulate for presentation to the SEC a program of related applications for administrative exemption from the various federal securities laws, conditioned on the undertaking that a GSOC would comply with disclosure and proxy rules specially tailored to circumstances in Alaska and to the unique nature of a GSOC. In particular, we recommend that the GSOC:

(1) Apply for a "no action" letter from the SEC that the 33 Act does not apply to a GSOC on the alternative grounds that the initial offer and sale of GSOC shares (a) will not be "for value" or (b) will qualify for the intrastate exemption;

(2) Seek a conditional and temporary exemption from the 34 Act and 40 Act patterned after the Alaska Native Claims Settlement Act. Under this proposal a GSOC would be required to provide an annual report to shareholders containing substantially all the information required in annual reports under the 34 Act, but no other information. The annual report required by the Revenue Act of 1978 to be submitted to the Treasury Department might be used for this purpose. The exemption period proposed would correspond with the five-year period when shares of a GSOC are generally nontransferable.

(3) Utilize the five-year exemption period to continue discussions with the SEC concerning the extent to which the unique character of the GSOC warrants special treatment under or exemption from other provisions of the federal securities laws. For example, since the shareholders of the GSOC will be state voters, it may be desirable to explore utilizing the state's ballot process as a proxy machinery. Other problems may require innovative techniques in this case of a corporation owned by a large number of investors who in many cases may be less sophisticated than the usual investor for whom existing proxy and disclosure rules were designed.

We believe that the SEC staff would be receptive to preliminary discussions of the problems raised in this memorandum and that those discussions should be initiated.

WILMER, CUTLER & PICKERING

WILMER, CUTLER & PICKERING
1666 K STREET, N.W.
WASHINGTON, D. C. 20006

November 2, 1978

MEMORANDUM FOR THE
COMMISSIONER OF REVENUE
STATE OF ALASKA

Application of Federal Securities
Laws to General Stock Ownership
Corporations

You have asked our advice with respect to the application of the federal securities laws to the organization and operation of a general stock ownership corporation ("GSOC").

Introduction -- the Nature of a GSOC.

A GSOC is defined in section 601 of the Revenue Act of 1978 (the "Act"). Under the Act, a state is authorized to charter a private corporation whose shares will be owned entirely by individuals who are residents of the state. Although the legislation does not specify whether the shares will be distributed with or without charge, its primary sponsor (Senator Gravel) has stated his intention that the shares will be issued without charge.*/

*/ 124 Cong. Rec. S19,168 (daily ed. Oct. 14, 1978).

It is contemplated that a GSOC will acquire an interest in one or more business enterprises with borrowed funds, perhaps aided by state grants or guarantees. The cash flow from the acquired business interests will be used to repay loans and pay dividends to the residents of the state who are its shareholders.

Under the Act, the GSOC will not be subject to corporate tax; instead the shareholders will be taxed currently on their pro rata share of the corporation's taxable income whether or not distributed. A GSOC will be required to distribute 90 percent of its taxable income each year to its shareholders.

The GSOC legislation was structured with a minimum of federal restrictions in order to provide states with maximum flexibility to organize a GSOC on their own terms. However, the corporate charter must provide that: (1) only one class of stock may be issued; (2) each resident will receive at least one share of the GSOC (unless a resident elects within one year not to receive his share); (3) shares may be owned only by individuals as opposed to legal entities; (4) shares may not be transferred for a five-year period, other than by will or by the laws of descent, except where the shareholder ceases to be a resident of the state; (5) shares may not be transferred to non-residents; and (6) ownership is limited to ten shares. In addition, a GSOC may not hold a 20 percent or more interest in any subsidiary, may not acquire its business properties from an unwilling seller through the use of the state's power of eminent domain and is required to file an annual report with the Secretary of the Treasury summarizing its operations for the year.

The precise mechanisms by which ownership will be restricted to residents of the chartering state and details of distribution, redemption and trade in shares of the GSOCs will be determined by a state's enabling legislation. Principles of federal constitutional law which may be relevant to choices among the various alternatives will be examined in a separate memorandum. This memorandum addresses the applicability of the federal securities laws to a GSOC and reviews legislative and administrative alternatives by which federal regulation may be avoided or minimized.

Application of the Federal Securities Laws.

There are eight federal statutes which comprise the "federal securities laws." */ In a variety of ways, each of these statutes appears designed to protect the investing public by regulating the activities of companies that raise capital by sale of their shares to the public, by monitoring the practices of persons in the business of trading in such "securities" or the business of managing the investments of others, and by ensuring public disclosure of accurate and relevant information. At least three of the eight statutes which are administered by the Securities and Exchange Commission (the "SEC" or the "Commission") may apply to a GSOC. **/

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*/ These are the Securities Act of 1933, the Securities Exchange Act of 1934, the Public Utility Holding Company Act of 1935, the Trust Indenture Act of 1939, the Investment Company Act of 1940, the Investment Advisers Act of 1940, the Securities Investor Protection Act of 1970, and certain aspects of the National Bankruptcy Act.

/ The Trust Indenture Act, regulating trust indentures covering particular types of debt securities, the Securities Investor Protection Act, providing certain protection for customers of brokers and dealers in securities who are forced to liquidate, and certain SEC responsibilities with respect to reorganizations under Chapter X of the Bankruptcy Act have no foreseeable application to the GSOCs. As will be explained <u>infra</u> at 17 n., the Investment Advisers Act and the Public Utility Holding Company Act may become relevant depending on the nature of GSOC operations, and should be explored at the appropriate time.

a) Securities Act of 1933.

i) The statute and its application.

The Securities Act of 1933 (the "33 Act") requires the disclosure of material information concerning companies when securities are sold to the public. The primary disclosure device is the Act's requirement that a company or other seller of securities file a detailed registration statement with the SEC and deliver the prospectus contained therein to prospective investors, in connection with the offer or sale of the securities to them. Registration statements are scrutinized by the SEC staff and must be declared "effective" by the SEC before sales of the securities registered may be made. Misleading or incomplete information in such materials or other selling communications is made unlawful by the antifraud provisions of the 1933 legislation and its implementing rules.*/

There are two reasons why the registration requirement of the 33 Act likely may not apply to a GSOC:

(i) No-sale theory.

The 33 Act's registration requirement is keyed to the sale (or offer for sale) of securities by

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*/ In addition, the 33 Act gives a person acquiring a security covered by a misleading registration statement or oral communication a civil cause of action against the directors of the company and others involved in preparation of the statement or communication.

any issuer. A "sale" is defined as "every . . . disposition of a security . . . for value."*/ If a GSOC issues its shares without charge, it would not appear to be selling (or offering for sale) shares "for value".**/ A no-action letter issued by the SEC in the case of corporations created under the Alaska Native Claims Settlement Act confirms our view.***/ See The Native Alaska Federation of Natives, Inc. (Jan. 28, 1974).****/

(ii) Intrastate offering exemption.

Even if a GSOC were to establish a subscription price for its shares, the GSOC may avoid the

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*/ 1933 Act, §§ 2(3), 4(1), and 5(a) and (c).

**/ It is possible, however, that the SEC could take the position that "value" inures to a GSOC from the ultimate creation of a trading market in GSOC shares. Cf. SEC v. Harwyn Indus. Corp., 326 F. Supp. 943 (S.D.N.Y. 1971).

***/ A no-action letter, although informative, is not an official interpretation by the SEC. It is nothing more than a representation of the SEC staff that, based upon the particular facts involved, they will not recommend to the Commission that it take enforcement action against the party seeking the advice. Thus, while we here and elsewhere discuss no-action letters, we are not talking about formal action by the Commission.

****/ A discussion of the legislative approach to securities laws problems in the Alaska Native Claims legislation is included at pp. 23-26.

registration requirement of the 33 Act if any of the several statutory exemptions from those requirements is applicable.*/ It is quite possible that the distribution of shares in the GSOC can qualify for the "intrastate offering" exemption provided in section 3a(11) of the 33 Act for:

> "any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a . . . corporation, incorporated by and doing business within, such State or Territory."***/

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*/ Although certain classes of securities and certain classes of transactions are exempt from the registration and prospectus delivery requirements of the 33 Act, they remain subject to the antifraud provisions of the 33 Act, including specifically §§ 12 and 17. The exemptions from registration set forth in §§ 3 and 4 of the 33 Act do not relieve an issuer of the registration requirements of the Securities Exchange Act of 1934 (the "34 Act") nor of the duty to comply with the antifraud provisions of that Act. United States v. Tallant, 547 F.2d 1291, 1297 (5th Cir.), cert. denied, 434 U.S. 889 (1977).

**/ 33 Act, § 3(a)(11). Another exemption is set out in § 3(a)(2) of the 33 Act, which exempts "any security issued . . . by any public instrumentality of one or more States or Territories . . . ." This "public instrumentality" exemption would not appear applicable since § 601 of the Revenue Act of 1978 provides that, for purposes of the Internal Revenue Code, "a GSOC shall be treated as a private corporation and not as a governmental unit."

***/ The exemption does not derive from any jurisdictional limit on the SEC's powers, since the federal laws can apply to any transaction using any facility of interstate commerce.

This exemption has become the subject of rule 147, which in an effort to define a "safe harbour" for those seeking the benefit of 3(a)(11) explains the particular elements which make up the exemption.*/ The section and the rule contain nothing to suggest that either is inapplicable to a GSOC, the shares in which can be owned only by residents of the chartering state, and which is unlikely to do business outside the state in question. Accordingly, if the strictures of the section and rule are observed, the securities of a GSOC can be issued without compliance with the registration and prospectus provisions of the 33 Act.

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*/ The SEC's rule (17 C.F.R. § 230.147) provides that an issuer shall be deemed to be doing business within a state if its principal office is there and if it derives more than 80% of its gross revenues from the state, has 80% of its assets there, and intends to use 80% of the proceeds from the issue there. In addition, the rule restricts resale to purchasers who are residents of the state for 9 months after the last sale by the issuer; the GSOC restriction is more severe, never allowing sale to nonresidents. A GSOC might, theoretically, hold more than 20% of its assets outside the state, if it invested in an external project, but this seems unlikely as a practical matter.

ii) Possibilities for legislative exemption.

GSOC sponsors also could seek special legislation to exempt */ shares in a GSOC from the 33 Act by a provision such as that contained in the Alaska Native Claims Settlement Act, 43 U.S.C. § 1625, discussed infra at pp. 23-26. **/ Since the central purpose of the 33 Act

*/ A blanket legislative exemption -- unlike the exemptions in § 3 of the Act -- might also provide relief from the federal antifraud provisions of the 33 Act. Most states, however, have antifraud regulations which would apply to a GSOC. See, e.g., § 45.55.010 of the Alaska Blue Sky law.

**/ See also the Asian Development Bank Act, which provides that "[a]ny securities issued by the Bank . . . shall be deemed to be exempted securities within the meaning of subsection (a)(2) . . ." of section 3 of the 33 Act. 22 U.S.C. § 285h(a).

As an alternative to a complete legislative exemption, the SEC could be given special rulemaking power to tailor reporting requirements to the unique situation of a GSOC. For example, the Asian Development Bank Act provides:

> "The Bank shall file with the Securities and Exchange Commission such annual and other reports with regard to such securities as the Commission shall determine to be appropriate in view of the special character of the Bank and its operations and necessary in the public interest or for the protection of investors." 22 U. S.C. § 285h(a).

The SEC is given authority in 22 U.S.C. § 285h(b) to suspend operation of the filing requirement. The SEC's regulations with respect to filings by the Asian Development Bank are found at [1978] 1 Fed. Sec. L. Rep. (CCH) ¶ 2025.

is to provide information so that an investor can make an informed decision whether to invest in securities being distributed by an issuer, a statutory exemption from the registration requirements of the 33 Act does not seem unreasonable, especially if the initial distribution of GSOC shares is free. An argument along these lines is even more persuasive if disclosure comparable to that required by the 34 Act, discussed below, is provided to the public once the opportunity to buy and sell GSOC shares shares arises at the end of five years.

b) Securities Exchange Act of 1934.

i) The statute and its application.

Among other things, the Securities Exchange Act of 1934 (the "34 Act"), extends the disclosure obligations of the 33 Act to the trading of securities after their initial distribution. The 34 Act requirements can apply whether the securities are (a) listed and traded on a national exchange or (b) unlisted and sold in the so-called "over-the-counter" market. The criteria which require filing include either (a) a prior 33 Act registration (§ 15(d)) or (b) 500 shareholders and $1 million in assets (§ 12(g)). For securities to which it applies, the 34 Act requires the filing with the SEC of information on certain registration forms; the information is comparable to that required by the 33 Act. After an initial filing, the 34 Act requires periodic "updating" reports to the SEC of financial and other information. In addition, issuers whose securities are required to be registered under the 34 Act may not solicit proxies (allowing management or anyone else to vote shares of investors at an annual meeting or to effect any corporate action which under state law must be accomplished by shareholder vote) unless they do so in compliance with the proxy rules of the Commission. Beyond stipulating the form and content of the proxy solicitation material, the proxy rules also allow any shareholder to submit proposals for corporate action for shareholder vote. The 34 Act also provides for the registration and regulation of the national securities exchanges and of brokers, dealers and transfer agents involved in the trading of non-exempt securities. Like the 33 Act, the 34 Act proscribes fraudulent or misleading practices in the purchase or sale of securities.

Although there are provisions in the Act for exemption, we do not believe exemption from the above-described 34 Act provisions can be assured without administrative or legislative action.

ii) Possibilities for exemption -- administrative.

No express statutory exemption in the 34 Act appears applicable to GSOC securities.*/ However, the SEC has authority under two separate sections to provide an exemption by administrative action.

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*/ Section 3(a)(12) exempts "municipal securities" from all provisions of the 34 Act except those dealing with registration and regulation of brokers and dealers, registration of securities associations, and regulation of associations of brokers and dealers and clearing agencies. However, the definition of "municipal securities" in section 3(a)(29) of the 34 Act appears to apply only to debt securities and therefore not to shares of a GSOC, as it is limited to "direct obligations of, or obligations guaranteed as to principal or interest by, a State or any political subdivision thereof, or any agency or instrumentality of a State . . . ." The legislative history confirms that state and municipal bonds were the focus of the section. See, e.g., Hearings before the Senate Banking and Currency Comm. on S. Res. 84 (72d Cong.) and S. Res. 56 and S. Res. 97 (73d Cong.), 73d Cong., 1st Sess. 7543-44 (March 27, 1934). A proposal to substitute "any security issued" for "any direct obligation guaranteed" was rejected. See Hearings before the House Interstate and Foreign Commerce Comm. on H.R. 7852 and H.R. 8720, 73d Cong., 2d Sess. 535 (March 6, 1934). Moreover, it is doubtful whether GSOC shares would be considered as "municipal" since section 601 of the Revenue Act of 1978 provides that a GSOC is a private corporation and not a governmental unit for purposes of the tax laws.

Section 12(h) of the 34 Act provides, in relevant part:

> "The Commission may by rules and regulations, or upon application of an interested person, by order, after notice and opportunity for hearing, exempt in whole or in part any issuer or class of issuers from [the registration, reporting and proxy provisions of the 34 Act] . . . any security of which is required to be registered . . . upon such terms and conditions and for such period as it deems necessary or appropriate, if the Commission finds, by reason of the number of public investors, amount of trading interest in the securities, the nature and extent of the activities of the issuer, income or assets of the issuer, or otherwise, that such action is not inconsistent with the public interest or the protection of investors."

The SEC also has authority under sections 3(a)(12) and 23(a) of the 34 Act to declare the securities of a GSOC "exempted securities." Section 3(a)(12) provides that "exempted securities" includes:

> "Such other securities (which may include, among others, unregistered securities, the market in which is predominantly intrastate) as the Commission may, by such rules and regulations as it deems consistent with the public interest and the protection of investors, either unconditionally or upon specified terms and conditions or for stated periods, exempt from the operation of any one or more provisions of this title which by their terms do not apply to an 'exempted security' or to 'exempted securities.'"

Since the anticipated market for the securities of a GSOC will be totally intrastate, the SEC might be convinced to issue some type of conditional or unconditional exemption.*/

iii) Trading Alternatives.

Section 12(g) of the 34 Act will prohibit brokers, dealers and transfer agents from processing trades of GSOC shares in the over-the-counter market unless the securities are registered with the Commission if the securities are not exempted. The traditional mechanisms for creation of a trading market in GSOC shares (the matching of sellers and buyers) thus will not be possible unless exemption from the 34 Act is attained. However, a rule proposed by the SEC provides that persons associated with any issuer of securities shall be deemed not to be brokers solely for performing "the ministerial and clerical work of effecting any transaction" if other tests of the rule are met.**/ Hence, it may be possible even lacking total 34 Act exemption to obtain clearance from the SEC that transfers between sellers and the GSOC and buyers and the GSOC

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*/ Cf. rule 3(a)12-2, 17 C.F.R. § 240.3a12-2, an exemption granted for securities guaranteed and managed by a state or political subdivision.

**/ Proposed rule 3a4-1, as proposed in Release No. 34-13195 (January 21, 1977), [1978] 2 Fed. Sec. L. Rep. (CCH) ¶ 21,152.

priced at a pro rata share of the GSOC's current asset value be facilitated by employees of the GSOC -- as long as those employees do not pursue the matching of buyers and sellers and thereby "make" a market.

iv) Possibilities of exemption -- legislative.

Because any administrative exemption from the 34 Act is within the discretion of the SEC, a legislative exemption may be necessary. There are at least two models for such an exemption. The Alaska Native Claims Settlement Act provides for total exemption from the 34 Act during the period that shares cannot be traded, but also accomplishes in large measure the disclosure function of the 34 Act by requiring that the Corporations send an annual report to shareholders. 43 U.S.C. § 1625.*/ The Asian Development Bank Act "deemed" the securities of the Bank to be exempt within the meaning of section 3(a)(12) of the 34 Act, but also provided for periodic filings with the Commission. 22 U.S.C. § 285h(a).**/

*/ As discussed infra, the exemptions in the Alaska Native Claims Settlement Act only apply until a trading market in the shares commences. Hence, a proposal that the GSOCs be exempt from the 34 Act for the first five years of operation will more likely succeed than a proposal of a permanent exemption.

**/ Similar treatment is given securities of the World Bank. [1978] 2 Fed. Sec. L. Rep. (CCH) ¶ 21,200.

c) Investment Company Act of 1940

i) The statute and its application.

The Investment Company Act of 1940 (the "40 Act") requires the registration of certain companies whose business is principally or entirely investing in the securities of other companies. It also sets forth fiduciary standards for their officers and directors, requires approval by the SEC of certain transactions involving insiders and affiliates of registered companies, provides for shareholder approval of various activities, and otherwise subjects the companies to financial and other disclosure requirements.

A GSOC appears to come within the definition of "investment company" in section 3(a) of the 40 Act, since each GSOC will be a company which "is or holds itself out as being engaged primarily, or proposes to engage primarily, in the business of investing, reinvesting, or trading in securities"*/ or "is engaged or proposes to engage in the

*/ The 40 Act's definition of "security" is the broad definition common to the federal securities laws. There may be room to argue that a GSOC's participation in joint ventures is outside the scope of this definition, although the definition specifically includes any "certificate of interest or participation in any profit-sharing agreement . . . or . . . investment contract." Section 2(a)(36).

business of investing, reinvesting, owning, holding, or trading in securities, and owns or proposes to acquire investment securities*/ having a value exceeding 40 per centum of the value of such issuer's total assets . . . ." 40 Act §§ 3(a)(1) and (3).**/ If a GSOC falls within the definition, it is subject to registration and regulation under the 40 Act.

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*/ "Investment securities" are all securities except government securities, securities of an employees' securities company, and securities of a majority-held subsidiary which is not an investment company. Section 3(a).

**/ A GSOC appears to be a closed-end, non-diversified management company under the definitions of sections 4 and 5 of the 40 Act, assuming that shares in a GSOC cannot be redeemed by a resident in exchange for "approximately his proportionate share of the issuer's currrent net assets" so as to create a "redeemable security" within the meaning of § 2(a)(32) of the 40 Act, and that the GSOC will not invest in a great number of projects nor hold less than a 10% interest in the projects in which it invests.

Any non-management person who for compensation advises the GSOC as to investment decisions may be subject to the Investment Advisers Act unless he can meet the tests of section 203(b)(1) of that Act (1) by having all clients residents of the state where he maintains his principal place of business and (2) by furnishing no advice respecting securities traded on a national exchange.

In addition, if a GSOC comes to own or control 10% or more of the voting securities of an electric public-utility company or a gas utility company (or another holding company) it will become subject to registration and regulation under the Public Utility Holding Company Act of 1935, absent successful application to the SEC for an exemption. Under this Act the Commission can limit a GSOC to a single, integrated public-utility system and incidentally necessary

[Footnote continued on following page]

ii) <u>Possibilities for exemption -- administrative</u>.

The 40 Act does contain statutory exemptions. None of them appears to apply to a GSOC. However, the Act does provide that the SEC, on its motion or by application, may conditionally or unconditionally exempt in whole or in part any person, security, or transaction from any provision or regulation of the 40 Act "if and to the extent that such exemption is necessary or appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of this title." § 6(c).

In addition, section 6(d) provides that the Commission "by rules and regulations or order, shall exempt a closed-end investment company from any or all provisions of this title . . ." with or without conditions if certain tests are met. If a GSOC issues its securities without charge, it appears that a GSOC would meet all the tests for this exemption including that "the aggregate sums

[Footnote continued]

business enterprises. The SEC shall exempt a holding company if it and the companies it "holds" operate exclusively or even predominantly in the state of organization under § 3(a)(1) and 17 C.F.R. § 250.2, unless exemption is not in the public interest.

Because of the possible application of the Public Utility Holding Company Act to potential investments of a GSOC, a legislative or administrative exemption from that Act also should be considered.

received by such company from the sale of all its outstanding securities, plus the aggregate offering price of all securities of which such company is the issuer and which it proposes to offer for sale, do not exceed $100,000." Our review of exemptions issued under § 6(d) indicates that it is probable that if such an exemption were granted, the GSOCs would be freed from many requirements of the Act. For example, the GSOC would not be required to follow the usual registration process; instead, it would be required to file with the SEC a statement of its investment policies. Instead of the usual periodic reporting requirements, a GSOC would be required to file semi-annual reports with its shareholders and the SEC.*/

iii) Possibilities for exemption -- legislative.

Because of the uncertainty of obtaining an unconditional administrative exemption from the 40 Act, consideration should be given to seeking legislation including a GSOC in the list of companies that statutorily are exempt under section 3(c) of the 40 Act.

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*/ See, e.g., Associated Life Ins. Investors Corp., SEC Investment Company Act Rel. No. 4574 (April 22, 1966); United Life Ins. Sec. Corp., SEC Investment Company Act Rel. No. 4193 (March 17, 1965); I.B.T., Inc., SEC Investment Company Act Rel. No. 3369 (November 28, 1961).

Our Recommendations

a) Questions of Policy.

Opportunities exist to seek administrative or legislative exemption for the GSOCs from SEC regulation. However, the substance of certain federal regulatory provisions governing traditional securities may be desirable in order to promote informed public participation in this new type of private enterprise. A decision should be made at an early stage as to what, if any, federal involvement in GSOC regulation is desirable to further the purposes for which GSOCs were created.

Two goals of the federal securities laws highly relevant to the purposes of the GSOC legislation are:

(1) initial and periodic disclosure of accurate and timely financial and other information to aid the public in making investment decisions and to allow for review of the actions of management; and

(2) a mechanism by which residents can be protected in the exercise of the power given them by state law to participate in control of the investment entity.

The disclosure function is promoted by each of the laws discussed above, but blanket application of these laws to the GSOC may be unduly expensive, burdensome and, in some instances, unnecessary. For example, since the 33 Act is designed primarily to ensure disclosure sufficient to enable an investor to decide whether to invest his funds in the securities of an issuer, the test of disclosure required under the 33 Act and its regulations seems largely irrelevant to the initial distribution of GSOC shares, especially if they are issued without charge. Thus, the disclosure and anti-self-dealing provisions of the 40 Act may be more germane to the GSOCs from their inception. The 34 Act, on the other hand, provides for disclosures to enable an investor to decide whether to buy or sell shares other than in an initial distribution. Since shares may not be transferred for five years (unless a shareholder ceases to be a resident), there should not be any substantial market for GSOC shares during the initial five-year period. Upon expiration of the five-year period, however, disclosure of the kind provided by the 34 Act will become relevant. In spite of the possibilities for exemption, we believe that efforts should be made to disseminate complete and accurate information about a GSOC, its officers and directors, since dealers in its shares as well as underwriters in its shares remain subject to enforcement action by the SEC, state authorities, and conceivably the Department of Justice, and to civil suit by injured investors if it is determined that fraud was involved in connection with the offer or sale of GSOC shares. It must be recognized that the notion of "fraud" under the securities laws is a very broad concept, and includes not only the dissemination of inaccurate information, but also the failure to disseminate material information necessary in order to make statements not misleading in the context in which they are made. Some courts have found fraud in corporate contexts in which incomplete or misleading disclosures may have arisen through inadvertence, rather than through conscious choice of the persons involved. We believe that disclosure rules specially tailored to the unique nature of the GSOCs could be fashioned to promote these desirable ends at a reasonable cost.

The 34 Act also provides the mechanisms for investor participation in management decisions pursuant to its regulation of solicitation of the votes -- or proxies -- of shareholders. The sponsors should decide how they desire the resident shareholders to exercise the traditional voting powers within the corporation which are given them by operation of state corporate law, and whether regulation of that method comparable to that provided by the 34 Act and 40 Act is desirable. We believe that protection of shareholder voting rights at a reasonable expense could be accomplished, perhaps through use of the state's ballot process. If the GSOC sponsors agree with the view that reasonable and carefully-tailored regulations designed to promote the ends of disclosure and suffrage should be made a part of the GSOC package, the question remains how to accomplish this end.

b) The Alternative of Legislative Relief.

The Alaska Native Claims Settlement Act, as amended, 43 U.S.C. § 1601 et seq. (the "Settlement Act"), provides an instructive example of a congressional compromise of a range of available options in regulating a unique corporate entity not unlike the GSOC. Under that Act, Congress disbursed federal funds to native peoples of Alaska in settlement of outstanding aboriginal land claims, and authorized the creation under Alaska law of a number of Regional Corporations to administer the funds and oversee land investment on behalf of native residents.

The original legislation, passed in 1971, did not address the question of the applicability of the federal securities laws and regulations to the Regional Corporations, but provided for an annual independent audit of each corporation, the results of which were to be transmitted to each shareholder, to the Secretary of the Interior and to appropriate committees of Congress.*/ As a result, the various Corporations were forced to seek individual administrative relief from the SEC.

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*/ This audit requirement remains in the law as amended. 43 U.S.C. § 1606(o).

An earlier draft of the legislation had, in lieu of the Regional Corporations, provided for two federally chartered corporations, one of which was to handle investments and business functions (the "Investment Corporation"). See Alaska Native Claims Settlement Act, Conference Report, S. Rep. 92-581, 92d Cong., 1st Sess. 41-42 (1971). The Senate bill had provided that those sections of the 40 Act, the Investment Advisers Act, the 33 Act and the 34 Act "relating to public disclosure, reporting, and protection of the interests of stockholders" and "consistent with the purposes of this Act . . ." should be applicable to the activities of the Investment Corporation for 12 years from the date of the Act. However, the Investment Corporation was to be granted statutory authority to apply to the SEC under § 6(c) of the 40 Act for exemption from any provisions of that Act resulting in hardship. In addition, the SEC was to be given explicit rulemaking authority to identify which provisions of any securities laws "consistent with the purposes and provisions of the legislation" would be applied to the Investment Corporation. In addition, the directors were required to prepare an annual report to the SEC including the information required under the ICA and "such additional information" as the SEC would require. Such reports were to be available at the offices of the Corporation, and a summary was to be sent to all shareholders. S. Rep. No. 92-405, 92d Cong., 1st Sess. 20-21, 131 (1971).

In 1975, the Settlement Act was amended to provide for total exemption of the Regional Corporations from operation of the 33 Act, 34 Act and 40 Act for the years during which shares in the Regional Corporations could not be transferred except by divorce, separation or death. 43 U.S.C. § 1625 provides:

> "Any corporation organized pursuant to this chapter shall be exempt from the provisions of the Investment Company Act of 1940 (54 Stat. 789), the Securities Act of 1933 (48 Stat. 74), and the Securities Exchange Act of 1934 (48 Stat. 881), as amended, through December 31, 1991. Nothing in this section, however, shall be construed to mean that any such corporation shall or shall not, after such date, be sub- [illegible] to the provisions of such Acts. Any such corporation which, but for this section, would be subject to the provisions of the Securities Exchange Act of 1934 shall transmit to its stockholders each year a report containing substantially all the information required to be included in an annual report to stockholders by a corporation which is subject to the provisions of such Act."

It should be noted that the SEC argued that 40 Act regulation was necessary for the protection of investors and that the Congress nonetheless decided that the Act as well as 33 Act and 34 Act regulation was unnecessarily burdensome and expensive. One reason Congress noted for its decision was that the lack of sophistication of most native residents of Alaska made the elaborate prospectus as required by SEC rules less likely to be useful than the SEC suggested.

Congress also was moved by the assurance that no trading in the shares would occur. It thus decided that application of the 34 Act was unnecessary while the stock could not be transferred. For the first five years, the GSOCs shares will be similarly restricted. However, in the interest of disclosure to the public of relevant information about the Corporations, Congress required an annual report to shareholders -- but not to the SEC -- containing substantially all information required under the annual reports under the 34 Act.*/

Based on the precedent of the Settlement Act, a legislative proposal could be fashioned. However, any legislative proposal might be subject to political opposition as special legislation for the State of Alaska, would have no guarantee of passage and, indeed, might prove unnecessary if an administrative solution can be forged with the SEC.

*/ H. Rep. No. 94-729, 94th Cong., 1st Sess. at 17-20 (1975).

c) The Alternative of Administrative Relief.

We propose that representatives of the State of Alaska, on behalf of a proposed GSOC, begin immediate exploration with the SEC of an administrative exemption from the various federal securities laws, conditioned on the undertaking that a GSOC would comply with disclosure and proxy rules specially tailored to circumstances in Alaska and to the unique nature of a GSOC. In particular, we recommend that the State:

(1) Apply for a "no action" letter from the SEC that the 33 Act does not apply to a GSOC on the alternative grounds that (a) the GSOC shares are not issued "for value" or (b) qualify for the intrastate exemption;

(2) Seek a conditional and temporary exemption from the 34 Act and 40 Act patterned after the Alaska Native Claims Settlement Act.*/ Under this proposal the only reporting requirement of the GSOC would be to provide an annual report to shareholders containing substantially all the information required in annual reports under the 34 Act. The annual report required by the Revenue Act of 1978 to be submitted to the Treasury

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*/ It might also be wise to seek exemption from the Public Utility Holding Company Act when, if ever, it appears that the investments to be made will fall within the Act's coverage.

Department might be used for this purpose. The proposed exemption period would correspond with the period when shares of a GSOC are generally nontransferable.

(3) Utilize the five-year exemption period to engage in a continuing dialogue with the SEC to determine how the securities laws could usefully be applied to a GSOC after the organizational period. For example, it may be desirable to fashion special proxy rules (perhaps utilizing the state's ballot process) to deal with the unique situation of a corporation owned by a large number of investors who in many cases may be less sophisticated than the average investor for whom existing proxy rules were designed.

We believe that the SEC staff would be receptive to preliminary discussions of the problems raised in this memorandum and that those discussions should be initiated.

WILMER, CUTLER & PICKERING

WILMER, CUTLER & PICKERING
1666 K STREET, N.W.
WASHINGTON, D. C. 20006

September 14, 1979

MEMORANDUM FOR THE LEGISLATIVE
BUDGET AND AUDIT COMMITTEE, STATE OF ALASKA

Subject: Proposed CSSS Senate Bill No. 170: Federal Tax and Securities Laws Issues and Suggested Approaches

You have asked us to review pending legislation[1/] permitting the establishment of an Alaskan General Stock Ownership Corporation ("AGSOC") in conformance with the recently enacted Subchapter U of the Internal Revenue Code.[2/] We have considered issues which may arise under the federal tax and securities laws in connection with this legislation, having previously, in our memorandum of November 2, 1978, for the Alaska Commissioner of Revenue, treated the securities law issues. This memorandum summarizes those issues, identifies optional approaches to resolution of certain problems, and identifies sections of S. 170 which you may wish to consider revising in order to facilitate regulatory approvals. We also propose an

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1/ CSSS Senate Bill No. 170, introduced as amended April 27, 1979. (Hereafter "S. 170").

2/ 26 U.S.C. §§ 1391-97, eff. November 6, 1978.

approach for our presentations to the Internal Revenue Service ("IRS"), and the Securities and Exchange Commission ("SEC") to facilitate the creation and operation of AGSOC in conformity with the federal regulatory provisions administered by those agencies.

I. SECURITIES REGULATION OF AGSOC

Our firm's Securities Law Memorandum of November 2, 1978, indicated that AGSOC will potentially be subject to provisions of three of the federal securities laws: the registration provisions of the Securities and Exchange Act of 1933 (the "1933 Act"); the registration, reporting, and proxy rules of the Securities Exchange Act of 1934 (the "1934 Act"), and the registration, conduct regulation and disclosure requirements of the Investment Company Act of 1940 (the "1940 Act").

S. 170 poses no securities regulation problems beyond those raised in our earlier memorandum.[3/] Because the statute is an adaptation of general corporation law,

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3/ However, we do recommend herein minor modifications to S. 170 to facilitate conformance with the intrastate exemption to the 1933 Act.

it does not deal with most of the subject areas which are likely to concern the SEC: particularly disclosure of risks to potential shareholders, periodic reports on financial condition, the administration of the "ballot" mechanisms, and fiduciary duties of officers and directors. Moreover, our initial approach to the SEC will be made at a time when the final form of the AGSOC has not yet been determined. For example, the question of the appropriate basis for exemption from the registration requirements of the 1933 Act must await a final decision as to whether payment of consideration will be required of Alaska citizens who wish to acquire AGSOC shares.[4/]

4/ We presume that an initial free issuance is preferred if we are able to obtain a ruling from the IRS that a tax will not be imposed upon citizens who receive shares. However, AGSOCA provides in Section 10.50.080 that

> "Shares may be issued without consideration or for consideration fixed by the shareholders before issuance. Consideration for shares shall be fixed by a vote of a majority of the shares voting on the issue."

This provision appears to suggest that AGSOC may charge consideration for shares only after the initial distribution as no shareholders will exist until then to fix the consideration. This point should be clarified if an initial charge for shares is contemplated. If you wish to leave the option open, Section 10.50.075 could be amended to read: "Shares may be issued without consideration or for consideration fixed by the Board of Directors before issuance."

We propose to present to the SEC a briefing memorandum describing the proposed AGSOC as set out in the S. 170 draft offered April 27, 1979, formally requesting a 1933 Act exemption, and requesting the commencement of negotiations to develop a modified form of 1934 Act regulation and a waiver of the 1940 Act's requirements during the first five years of AGSOC existence. We plan a preliminary presentation and discussions with the SEC prior to making detailed requests for rulings on the latter points so that we may involve them in establishing a creative approach to GSOC regulation. We hope to have received preliminary feedback from the SEC before S. 170 is passed in final form.

Provisions of the
<u>Securities Act of 1933</u>

We believe, as we indicated in our Securities Memorandum, that AGSOC should not be subject to the registration requirements of the 1933 Act, either on the basis that an initial distribution of shares is not a "disposition . . . for value" within the meaning of Section 2(3) of the 1933 Act, or on the basis of the "intrastate exemption" provided by Section 3(a)(11) of the same Act. We propose to argue both points to the SEC.[5/]

Even if the AGSOC shares are sold for consideration or if the SEC deems the disposition otherwise to be for value, we anticipate that we will be able to prevail on the theory that its shares are exempt from registration under the 1933 Act by virtue of the intrastate exemption in section 3(a)(11).[6/] The characteristics of offerings the SEC will deem as falling within

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5/ Of course, even if the initial distribution of shares is free of charge and thus falls within a "not for value" exemption to the Securities Act of 1933, any additional issuances which are for value would fall within the registration requirement unless they are otherwise exempt. This would include exchanges of shares for property or services as provided for in S. 170 § 10.50.085.

6/ This section exempts from registration:

> "Any security which is a part of an issue offered and sold only to persons resident within a single State or Territory, where the issuer of such security is a person resident and doing business within, or, if a corporation, incorporated by and doing business within, such State or Territory."

Section 3(a)(11) are described in non-exclusive Rule 147 (17 C.F.R. § 230.147).7/ The rule requires that both the purchasers of the securities and the issuer have certain characteristics to ensure that both are truly residents of the state and that sales and resales are restricted to state residents. We believe that several minor changes in S. 170 are advisable in that they will bring the AGSOC within Rule 147 and thus simplify our task if the intrastate exemption need be relied on (either for the initial or any later issues).

AGSOC will be an Alaska corporation as required by Rule 147. Its principal place of business will probably be located in Alaska (Rule 147(c)(1)(i) and (2)(iv)), although the latter is not required by S. 170.8/ We suggest that the legislature consider

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7/ Issuers may avail themselves of the intrastate exemption even if they do not satisfy all the provisions of this rule. 17 C.F.R. § 230.147 (Preliminary Notes, p. 1). If an issue satisfies all of Rule 147's provisions, however, the intrastate exemption will apply.

8/ S. 170 § 10.50.050 requires only that the corporation maintain a "registered office" within the state.

requiring AGSOC to have its principal place of business in Alaska as this would clarify this aspect of compliance with Rule 147.

Rule 147 restrictions on sales and resales to state residents are clearly satisfied by AGSOC.[9/] The basic purpose of Rule 147's limitations on resale is to ensure that securities do not enter the interstate marketplace. It does not appear that the fact that a few shares pass by descent after five years to out-of-state holders or that former residents may retain their AGSOC shares if they leave the state after five years is so inconsistent with those principles as to upset application of the exemption.

Rule 147 also requires that the issuer's business be conducted predominantly within the state in which the securities are distributed.[10/] The gross revenues and

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9/ Subchapter U and S. 170 provide that shares may only be transferred voluntarily or involuntarily to persons who are residents of the state. 26 U.S.C. § 1391(4)(D)(ii); S. 170 §§ 10.50.320(a)(6) & 8(B). The general prohibition against transfers except by descent for five years also helps to meet the Rule 147 requirement that resales in a nine-month period after the initial distribution be restricted to state residents. S. 170 also provides that if the shareholder leaves the state or shares pass by operation of law to a non-resident, the corporation shall repurchase them at book value. S.170, Section 4(c).

10/ The issuer must derive at least 80 percent of its gross revenues from within the State and have at least
[Footnote continued on following page]

asset provisions of the rule will only be applicable to the initial GSOC distribution if AGSOC becomes operational before its shares are distributed. 11/ The use of proceeds provision will only apply if AGSOC charges for the shares, and it may be satisfied easily by segregating issue proceeds to ensure that they are spent within Alaska. If AGSOC is to acquire an asset prior to share distribution we must know what the asset is to formulate arguments that the asset and its income are "within" the State within the meaning of Rule 147 and section 3(a)(11). AGSOC will presumably be acquiring a minority participation in a joint venture as an asset. If majority control of that venture is in the hands of non-Alaskans, it is arguably not an Alaska asset. Also, income may or may not be deemed derived from within the state -- e.g., sales of oil to out-of-state corporations may be deemed non-Alaska income. Even if the initial

[Footnote continued]

80 percent of its assets within the State. Rule 147 (c)(2)(i) and (ii). It must also intend to use 30 percent of the net proceeds from sales of the issues in question within the State.

11/ Rule 147 provides that if gross revenues for the most recent twelve-month period are less than $5,000, the proceeds provision is not applicable.

distribution is of shares in a shell company, it will be necessary to examine whether AGSOC revenues can be deemed to arise from the "operation of a business or of real property within the state," with regard to subsequent issues of shares. The legislature may wish to consider so restricting the corporation in its enabling legislation.

S. 170 does not now specifically provide for procedures required by Rule 147 to ensure that the reality comports with the intent of the issuer.[12/] We recommend that the legislature amend S. 170 to provide for adequate legends on share certificates;[13/] and that

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12/ A legend on the share certificates must identify the limitations on resale and warn of the lack of registration, stop transfer instructions must be given to the transfer agent, and purchasers must be required to make written representations as to their residence. Rule 147 (b)(1). The issuer must also restrict sales of shares which are part of the same issue and make appropriate disclosures. *Id.* § (f)(2) and (3). S. 170 does require that eligible individuals apply for shares and that their interest will become void if it is determined that they misrepresented their eligibility. § 10.50.345-360. The SEC may wish to make rules in this regard or examine AGSOC procedures for establishing residency prior to authorizing sale or distribution without registration.

13/ S. 170 § 10.50.105 provides for extremely limited information to be contained on the certificate. We recommend that the legislature amend this section to require disclosure on the certificate of all the restraints on transfer, including the fact that shares are not transferable to non-residents on the certificate.

the AGSOC provide for the application and stop transfer requirements in the articles of incorporation or the by-laws.

The Securities Exchange Act of 1934
and The Investment Company Act of 1940

As was indicated in our firm's Securities Memorandum, AGSOC does not fall within any statutory exemptions to either the 1934 or the 1940 Acts, and without special provision by the SEC, it will be required to register its securities, to file periodic reports, to comply with proxy rules, to comply with disclosure and trading rules under the 1934 Act and to file under and comply with the fiduciary standards of the 1940 Act.

The primary goals of the 1934 Act are to ensure that shareholders have adequate information concerning the financing and operations of registered companies to permit informed investment decisions, to ensure that shareholders have similar information when they are called upon to vote on corporate matters, and finally to ensure that sales and exchanges of shares occur in a free and open fair market exchange. The 1940 Act has similar goals although it additionally imposes certain fiduciary standards upon the management of investment companies because of the risks that it might usurp control of shareholder assets.

S. 170 permits the AGSOC to be run as a fairly conventional private corporation. It is primarily subject to control by the legislature in its initial stages 14/ and it is thereafter subject to governance by shareholders 15/ and the board of directors. 16/ It is unique in other respects: (1) its shareholders, constituting a cross-section of the state's citizens, will be in large measure unsophisticated in the exercise of shareholder rights and investment decisions; 17/ (2) shareholders will have little or no initial equity investment in AGSOC; (3) they will be subject to severe limitations on sales or transfers of their shares, particularly during the first five years

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14/ The legislature must amend the enabling legislation pursuant to § 10.50.640 to control it thereafter.

15/ A vote of shareholders is required to amend the articles of incorporation, § 10.50.375, and to approve certain asset sales.

16/ The directors may create and amend the bylaws, § 10.50.125, and have other standard management powers of corporate directors.

17/ Many shareholders will be minors or other legal incompetents.

after distribution;[18/] (4) ownership of shares will remain unconcentrated by statutory mandate; (5) bars to proxy

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18/ In conformance with Subchapter U, S. 170 provides many restrictions which will make it extremely difficult for a trading market in AGSOC shares to develop. For example, shares may not be transferred, voluntarily or involuntarily, within the first five years after issuance, and they may thereafter only be transferred to "resident individuals of the chartering State." It will not be possible for security brokers or dealers to make a market in AGSOC shares if this section is interpreted to mean such entities cannot hold AGSOC shares. Also, since no individual can own more than ten shares, it may not be feasible to create a trading market funded through transfer fees in a manner comparable to those which exist for other private corporate securities. The legislature should, as we previously recommended, give serious consideration to empowering AGSOC to be its own transfer agent or to the creation of a transfer mechanism for bringing together willing buyers and sellers.

Another potential problem is presented by the involuntary transferor. The AGSOC legislation provides at several points that redemption of shares shall be at book value. It is possible that there will be no or negative book value for the shares at stages during the operation of the corporation, when the carrying value of assets approximates the unamortized acquisition debt. This means that shareholders who leave the state or whose shares pass by operation of law to non-residents during the first five years after issuance may end up being forced to "sell" for far less than what would otherwise be market value. The legislature may wish to consider enabling AGSOC to pay a "fair market value" rather than book value to avoid unfairness.