

ALASKA LEGISLATURE SPECIAL COMMITTEE / SUBJECT FILES 86/2

920 SCOM32: AK GENERAL STOCK OWNERSHIP CORP. 1979-80

111 Three requirements imposed by subchapter U  
111 of the Internal Revenue Code will affect  
112 the investment policy of AGSOC. Because  
113 AGSOC may not be a member of an affiliated  
113 group, it cannot own 20 percent or more of  
114 the stock of another corporation. In  
114 addition, because AGSOC will not be  
116 entitled to the 85-percent dividends  
117 received deduction, it is unlikely that  
117 AGSOC will invest in portfolio securities.  
118 Furthermore, because AGSOC will be required  
119 to distribute 90 percent of its taxable  
120 income or to pay a 20-percent penalty on  
121 any undistributed amount in excess of 10  
121 percent, AGSOC is likely to seek  
122 investments that will produce sufficient  
122 cash flow to make dividend payments in an  
123 amount at least equal to the income tax  
123 liability incurred by any shareholder with  
124 respect to the earnings of AGSOC.

125  
126 Strict compliance with the registration and  
126 reporting requirements of the Act would be  
127 burdensome for AGSOC and would not produce  
128 compensating benefits. Because AGSOC stock  
129 may not be transferred for five years,  
129 there is little need for shareholders to  
130 have the kind of detailed information  
130 required by the registration and reporting  
131 requirements. Moreover, several provisions  
132 of AGSOC's enabling legislation will  
133 provide adequate disclosure and  
134 governmental oversight. These include: (1)  
135 required shareholder access to AGSOC's  
135 books, records, and financial statements;  
136 (2) oversight reports by the staff of the  
137 Congressional Joint Committee on Taxation;  
137 (3) required filings of detailed  
137 informational tax returns with the Treasury  
138 Department; and (4) requirements for  
139 periodic submissions to shareholders and  
139 regulation of the content of such  
140 submissions by the Administrator of the  
140 Alaska Securities Act.

141  
142 It is likewise inappropriate to require  
142 that AGSOC comply strictly with the  
142 provisions of the Act designed to produce  
143 honest and unbiased management for  
143 investment companies. This is so largely  
144 because AGSOC is not likely to invest in  
144 portfolio securities, does not plan to use  
145 traditional investment advisers or  
145 underwriters, and will not engage in more  
145 than occasional purchases or sales of  
146 securities. In addition, under its  
147 enabling legislation, AGSOC may not loan  
147 money to directors, officers, or employees,  
149 nor can AGSOC's officers or employees serve  
149 as directors. The legislation also will  
151 contain provisions that make most activity  
152 susceptible to the abuses suppressed by

152 section 17 of the Act subject to special  
153 clearance by AGSOC's board of directors.  
153 Moreover, it will be a misdemeanor for an  
154 AGSOC director, officer, or agent to make a  
155 false or fraudulent written statement  
155 affecting the value of AGSOC shares.  
155 Finally, the high visibility of AGSOC's  
156 transactions will provide a strong  
157 disincentive for self-dealing and dishonest  
157 or biased management.

159  
160 Strict compliance with the provisions of  
160 the Act designed to increase participation  
161 in management by security holders is also  
161 unnecessary. The AGSOC enabling  
162 legislation will contain comparable  
162 safeguards to assure participation in  
163 management by security holders. Direct  
164 shareholder voting will be required and  
165 proxy voting will not be permitted. AGSOC  
165 will distribute to shareholders information  
166 on matters to be voted upon at shareholder  
167 meetings, and these distributions will be  
167 subject to regulation by the Administrator  
168 of the Alaska Securities Act. Required  
169 periodic shareholder review and the  
169 expected intense public scrutiny of AGSOC  
170 management will provide additional  
171 safeguards. Finally, because AGSOC will  
172 not offer an opportunity to invest in a  
173 specific investment approach, there is not  
173 the same kind of need to require security  
174 holder approval of changes in investment  
174 policy as exists with respect to  
175 traditional investment companies.

176  
177 Many of the abuses sought to be prevented  
177 by the provisions of the Act relating to  
178 capital structure will be obviated by the  
179 enabling legislation, while other abuses  
179 are unlikely to beset AGSOC. In addition,  
180 some of the capital structure provisions  
180 are not relevant or are unduly burdensome  
181 with respect to AGSOC. A \$5 million State  
182 fund will be established to guarantee "seed  
183 money" loans for AGSOC. The fund will be  
184 administered by the Commissioner of  
185 Revenue. It will serve to prevent any  
186 potential difficulties caused by AGSOC's  
186 low initial net worth. The Act's  
187 prohibitions on multiple classes of stock  
187 with unequal voting rights, issuance of  
188 securities for services or property other  
188 than cash, and sales of common stock below  
189 current net asset value without shareholder  
189 approval, are unnecessary with respect to  
190 AGSOC, as these practices will be  
191 prohibited by the enabling legislation.  
193 Inasmuch as AGSOC is not expected to  
193 publicly offer its stock, debt securities,  
194 warrants, or subscriptions, the provisions  
194 of the Act designed to guard against abuses

195 with respect to such contingencies will be  
196 inapplicable to the company. Finally,  
197 compliance with provisions of the Act  
198 regarding asset coverage for debt  
199 securities should not be required of AGSOC.  
200 Substantial borrowing is essential to the  
201 success of the enterprise.

202 Congress enacted federal tax enabling  
203 legislation to permit formation of entities  
204 such as AGSOC. Congress believed such  
205 entities offered promise of broadening the  
206 ownership stake of citizens in private  
207 enterprise and of promoting understanding  
208 of the private enterprise system. Congress  
209 also thought such entities offered promise  
210 as an alternative to the present system of  
211 governmental transfer payments. A  
212 temporary exemption from the Act is  
213 appropriate to allow these congressional  
214 beliefs to be tested in an atmosphere free  
215 from unnecessary regulation.

216 Section 6(d) of the Act provides, in part, that the  
217 Commission, subject to such terms and conditions as may be  
218 necessary or appropriate in the public interest or for the  
219 protection of investors, shall exempt from all provisions of  
220 the Act any closed-end investment company that (1) has not and  
221 will not receive \$100,000 from the sale of its securities, and  
222 (2) will not publicly offer any security to any person who is  
223 not a resident of the state under the laws of which the company  
224 is organized, provided that the exemption is not contrary to  
225 the public interest or inconsistent with the protection of  
226 investors.

227 Applicant submits that AGSOC will meet the technical  
228 requirements for a section 6(d) exemption: It will be a  
229 closed-end company, will not have received over \$100,000 from  
230 the securities it has sold or proposes to offer for sale, and  
231 will not publicly offer any security to any person who is not a  
232 resident of the state under which it will be organized.  
233 Applicant submits further that the temporary and conditional  
234 exemption requested is not contrary to the public interest or

229 inconsistent with the protection of investors because, as  
229  
229 demonstrated in its application, AGSOC will be structured to  
230  
230 provide its security holders with all the relevant protections  
231  
231 embodied in the Act.  
232

232  
233           Section 6(c) of the Act provides, in part, that the  
233  
233 Commission, upon application, may conditionally or  
234  
234 unconditionally exempt any person, security, or transaction or  
235  
235 any class or classes of persons, securities, or transactions,  
236  
236 from any provision or provisions of the Act or of the rules  
236  
236 thereunder, if and to the extent that such exemption is  
237  
237 necessary or appropriate in the public interest and consistent  
238  
238 with the protection of investors and the purposes fairly  
238  
238 intended by the policy and provisions of the Act.  
240

240  
241           Applicant submits that the temporary and conditional  
241  
241 exemption requested is appropriate in the public interest,  
242  
242 within the meaning of section 6(c), because it will serve to  
244  
244 carry out congressional policy and to broaden participation in  
245  
245 the free enterprise system. Applicant submits further that the  
247  
247 exemption is consistent with the protection of investors and  
247  
247 the purposes fairly intended by the policy and provisions of  
248  
248 the Act, as required by section 6(c), because, as demonstrated  
249  
249 in the application, AGSOC will be structured to provide its  
250  
250 security holders with all the relevant protections embodied in  
250  
250 the Act.  
251

251  
252           Applicant has stated that the following condition may  
252  
252 be imposed in an order granting the temporary exemption it  
253  
253 requests: AGSOC will file with the Commission and distribute  
254  
254 to shareholders an annual report containing substantially all  
256  
256 of the information required in reports of investment companies  
256  
256 under section 30(a) of the Act.  
258

259           NOTICE IS FURTHER GIVEN that any interested person  
259 may, not later than \_\_\_\_\_, 1980, at 5:30 p.m., submit  
260 to the Commission in writing a request for a hearing on the  
261 matter accompanied by a statement as to the nature of his  
262 interest, the reason for such request, and the issues, if any,  
263 of fact or law proposed to be controverted, or he may request  
263 that he be notified if the Commission shall order a hearing  
264 thereon. Any such communication should be addressed:  
265 Secretary, Securities and Exchange Commission, Washington, D.C.  
266 20549. A copy of such request shall be served personally or by  
267 mail upon Applicant at the address stated above. Proof of such  
268 service (by affidavit or, in the case of an attorney-at-law, by  
269 certificate) shall be filed contemporaneously with the request.  
269 As provided by Rule 0-5 of the Rules and Regulations  
270 promulgated under the Act, an order disposing of the  
271 application herein will be issued as of course following said  
272 date unless the Commission thereafter orders a hearing upon  
272 request or upon the Commission's own motion. Persons who  
273 request a hearing, or advice as to whether a hearing is  
274 ordered, will receive any notices and orders issued in this  
274 matter, including the date of the hearing (if ordered) and any  
275 postponements thereof.

277                   For the Commission, by the Division of Investment  
277  
277 Management, pursuant to delegated authority.

George A. Fitzsimmons  
Secretary

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

#32:16

SCOMM

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

# STATE OF ALASKA

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

JUNEAU 99801

*Rep. Duncan*  
*GSOC File*  
AUDIT DIVISION  
POUCH W — ALASKA OFFICE BUILDING

FINANCE DIVISION  
POUCH WF — STATE CAPITOL

### MEMORANDUM

DATE: January 30, 1979

TO: Honorable Mike Colletta  
Honorable Jim Duncan  
Project Directors for the Kelso Study

FROM: Milt Barker, <sup>MB</sup> Fiscal Analyst  
Legislative Finance Division

SUBJECT: GSOC Recommendations

Mr. Louis Kelso indicated he would be glad to receive any recommendations on GSOC policies or reactions to the specific issues he raised during his January 25, 1979 presentation. Also attached is his draft GSOC legislation and an AG's response to some questions posed by Kelso which further elucidate some of the issues. Any responses should probably be in the mail by February 2 if they are to be considered for the publication of his report which is due February 15.

Following are issues raised at the January 25 hearing and in subsequent discussions:

1. What is the definition of an eligible individual for receiving GSOC stock? Kelso recommends all individuals, regardless of age, born before a particular date who are residents of and are domiciled in Alaska. In law, domicile turns on intent supported by objective tests. (See Section III of AG's opinion.) An unanswered question is the eligibility of military personnel.
2. What is the legal age for acquisition of shares? Kelso recommends the age of majority. Shares would be held in escrow until age 19.
3. Are shares of minors to be voted? Kelso recommends no voting of minor's shares. Legal guardian could be permitted to vote such shares under current law, AS 10.05.165(b).
4. What pecuniary rights over minor's shares would a legal guardian have? Kelso recommends guardian could not sell or alienate stock in any way.

Also recommends no dividends on stock in escrow. However, dividends could be paid and accumulated in escrow or paid to guardian for maintenance of child. (See Section IV of AG's opinion.)

5. On all shares held in escrow for whatever reason, Kelso recommends no dividends, inalienability, and no voting rights.
6. What happens to shares upon stockholder's death? Kelso recommends they be available for transfer through laws of descent. However, Section 5 of the draft legislation seems to give, even in this case, the GSOC a right of first refusal for the first five years after issuance, which may be intended only for those moving out of state. No transfer to non-residents, in any case, shall be made.
7. If a stockholder moves outside, shall he be required to sell his stock? Draft legislation does not require it, nor does federal law.
8. How will stock be valued? Kelso recommends book value for first five years; (no stock would be released from escrow for five years) market thereafter, with periodic appraisals to guide buyers and sellers.
9. Kelso recommends a nine-member board of directors, five of which must be Alaska residents at all times during their tenure. Appointment of board by the Governor is recommended. Legislative confirmation is not recommended to keep the GSOC as free as possible of the aura of state agency status. This might be of value if court challenge under equal protection or other constitutional articles is made.

Directors classified as to term of office are recommended. Each would serve three-year terms, with three directors elected each year. Classification may make it more likely that a couple factions will control the corporation. Electing all directors at once could provide broader representation. Existing mechanisms, which may create minority representation, are proxy voting (AS 10.05.159), cumulative voting (AS 10.05.162), and voting trusts (AS 10.05.171). Establishment of an executive committee (AS 10.05.195) can delegate the board's authority to two or more directors if articles of incorporation or bylaws so provide.

10. Although the draft legislation allows the GSOC to engage in its own trust operations and handling of stock, Alaska law heretofore has not permitted this. Fiduciary responsibility requires an outsider to handle these functions normally. Contract trust arrangements could be implemented faster than in-house, although Kelso thinks in-house may be cheaper. Kelso points out that "you don't want Bank of America to sign the checks".
11. The analysis by Wilmer, Cutler & Pickering said the most difficult problem with the GSOC is its "closed class" feature, which limits ownership to residents on a certain date and precludes persons who later qualify as residents from becoming shareholders.

"Whether to provide a mechanism for opening the class is a policy decision for the legislature," Wilmer, Cutler & Pickering said. "One possibility would be to rely on the apparent requirement in the Internal Revenue Code for a closed-class and open the class only if required by court decision. Another possibility would be to provide a mechanism for extending GSOC membership to new residents; this approach, however, should be cleared with the Internal Revenue Service as being consistent with the federal legislation."

Kelso suggests that one solution might be to allow new residents to purchase AGSOC stock at book value after a two-year waiting period.

Whether or not the GSOC could facilitate this by purchasing its own shares may be problematical since the federal law states that GSOC shares are transferable only to "eligible individuals". Certainly the GSOC or other entity could match buyers and sellers but this would not make for as smooth a market.

12. The appropriation for a loan for start-up costs in Section 9 in the GSOC draft will have to go in a separate bill or a fiscal note if it is to be an appropriation. However, under AS 37.10.070(a) (b), the Commissioner of Revenue could probably make such a loan on his own determination without an appropriation. Another alternative may be an appropriation to guarantee a private loan. A loan is preferred so that the IRS can't claim the GSOC has assets making the initial distribution of stock a taxable item.

January 30, 1979

13. The State guarantee of project financing proposed in Section 10 of the draft would probably require a referendum since, as a possible unfunded liability, it would be similar to bonded indebtedness. A straight state loan to the GSOC if funded from a state bond issue would certainly require a referendum. However, accepting the vote of the stockholders as the referendum among voters would probably not pass constitutional muster because of the divergence of the two groups.
14. What sorts of investments is the GSOC to make? Senator Sumner urges many smaller-scale investments and cited the principles of diversification and the prudent man rule. Mr. Kelso claims this is the rich man's prudent man rule, but that the poor man's prudent rule which is "put all your eggs in one basket", should be applied in this case.

The GSOC draft contemplates and philosophically opines for major capital-intensive types of investment. The tax rules applicable to GSOC's heavily favor capital intensive investments as long as the GSOC is highly leveraged, i. e., has a high debt to equity ratio. Large depreciation deductions are needed to offset large principal amortization payments so that taxable income is not greater than book income, thus, creating tax liabilities for shareholders without distributable earnings to cover them. The tax rules further favor capital intensive investment by allowing the pass-through to shareholders of the investment tax credit on machinery and equipment.

15. Kelso's study will include proposed articles of incorporation and bylaws, and a time and sequence table for implementing GSOC legislation.

Attachments 3

cc: Gas Pipeline Committee  
Budget & Audit Committee  
Rep. Terry Gardiner  
Rep. Russ Meekins

PROPOSED ALASKA STATE LEGISLATION

AN ACT TO CREATE ALASKA GENERAL STOCK OWNERSHIP CORPORATION  
AND TO AMEND THE ALASKA STATUTES IN CONNECTION THEREWITH

THE ESTABLISHMENT OF ALASKA GENERAL STOCK OWNERSHIP  
CORPORATION (AGSOC) BY THE LEGISLATURE OF THE STATE OF ALASKA

WHEREAS, the Legislature of the State of Alaska hereby finds and determines that it bears a share of the responsibility for providing the institutional background, framework and facilities for assuring, to the maximum extent of its ability so to do, the opportunity for every Alaskan resident legitimately to achieve economic self-sufficiency for himself and his dependents, both through the opportunity to engage in gainful employment to the extent that the existing state of technology and economic development within Alaska, from time to time, provide demand for such employment, and through the legitimate opportunity through all means consistent with the protection and sanctity of private property to acquire and build viable holdings of productive capital, either in the form of direct ownership of equity stock in business enterprises that in turn own productive assets and engage in the production of goods and services for use either within or without the State of Alaska; and

WHEREAS, this Legislature finds and determines that the heretofore conventionally used methods of financing economic development and growth and the production of economic goods and services tend to result in the ownership of newly formed capital and of productive capital resulting from changes in the ownership of existing productive capital, by the relatively small number of consumer units already well endowed with the ownership of productive wealth, and at the same time tend to deny to those who need to participate in the process of producing goods and services as a means of enabling themselves to enjoy reasonable levels of consumption, but who do not already own significant holdings of productive capital, the opportunity legitimately to acquire such ownership; and

WHEREAS, this Legislature finds that the conventional methods of business finance heretofore used in economic development and in effecting, through purchase and sale, the ownership of existing productive assets, by private-sector business itself, particularly by corporations, heavily relies upon the use of credit to acquire assets capable of producing the revenues through which such credit obligations can be repaid, but that this fundamental logic of private-sector business finance does not encompass and extend to the non-capital-owning majority of the residents of the State of Alaska, or indeed to the residents of any other state in the United States; and

WHEREAS, this Legislature finds and determines that the function of technological advance is to introduce into the process of producing economic goods and services technological means and processes that displace employment, and that when such technological advances are conventionally financed, they tend to increase the productive power of those

who are already excessively productive rather than of those individuals who are economically under-productive; and

WHEREAS, this Legislature further finds that conventional methods of business finance therefore tend to make the already excessively productive minority more economically productive still, but deny the acquisition of such additional economic productive power to those who have nothing to sell in the marketplace of production except their labor power; and

WHEREAS, this Legislature finds that this state of affairs inevitably creates within the great majority of residents of the State of Alaska an enormous mismatch between the level of unsatisfied needs and wants and the possession of productive power, represented not only by the personal labor power of the individuals involved, but by their ownership of significant holdings of productive capital, so that widespread poverty, and the need for widespread welfare and philanthropy, both public and private, results; and

WHEREAS, this Legislature finds and determines that the ideal free democratic society is one composed of economically self-sufficient consumer units, each capable of producing, through their privately owned productive power, the level of income necessary to maintain the reasonable lifestyles they separately and individually desire; and

WHEREAS, this Legislature further finds and determines that in our advanced industrial economy the predominant cause of poverty is the lack of the private and individual ownership of productive capital by consumer units made up of individuals and of families and that governmental policy in the past has been primarily focused upon measures which ameliorate, or are intended to ameliorate, the effects of such poverty, but which do not tend to attack and eliminate its cause; and

WHEREAS, this Legislature finds and determines that it is its duty towards its citizens and residents to take all reasonable steps within its power to assist those citizens and residents in raising their individually-owned productive power through assisting them legitimately to buy and pay for the ownership of productive capital, and thus, in due course, to release them from the bonds of poverty and to free the State Government and its taxpayers from the burdens of welfare and its citizens and residents from the need for such welfare; and

WHEREAS, this Legislature hereby finds and determines that it is due and proper that the State of Alaska insist, to the maximum degree feasible, that the economic development and growth of this State be carried out by private enterprise in ways which lead to the possession of economic self-sufficiency and autonomy of the individuals and families who make up the consumer units of the economy of this State, rather than in a manner that creates a few rich and many poor.

NOW, THEREFORE, BE IT, AND IT IS HEREBY ENACTED by the Legislature of the State of Alaska that the Governor of this State be, and he hereby is, authorized and directed forthwith to cause the incorporation of Alaska General Stock Ownership Corporation (AGSOC), by the filing of appropriate Articles of Incorporation with the Division of Banking and Securities of the Department of Commerce of this State and to

appoint as incorporators and as the first Board of Directors of AGSOC, or at least as a majority thereof, not less than five (5) nor more than nine (9) individuals having the experience, capabilities and commitments to the goals set forth in the Preamble to this Act; and the Executive Department of the State of Alaska is hereby authorized and directed to perform or to cause to be performed such additional acts as may be necessary or desirable to perfect the organization of AGSOC as a General Stock Ownership Corporation under Title VI of the Internal Revenue Code of 1954, as amended, and under this Act.

BE IT ENACTED THAT:

Section 1. Alaska General Stock Ownership Corporation shall be a domestic corporation for profit under the laws of the State of Alaska, and shall not be an agency or political subdivision of the State of Alaska.

Section 2.

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

(b) Members of the initial Board shall be divided into three (3) classes, each class consisting of three (3) individuals, designated as Class One directors, each with a term of one (1) year and until their successors are elected and qualified; Class Two directors, each with a term of two (2) years and until their successors are elected and qualified; and Class Three directors, each with a term of three (3) years and until their successors are elected and qualified. Vacancies in the nine (9) member Board of Directors of AGSOC, should the Governor fail to appoint all nine (9) members prior to incorporation of AGSOC, may be filled by the incumbent Board members who shall designate the class of each director so appointed to fill a vacancy.

Section 3. Alaska General Stock Ownership Corporation is hereby authorized and directed:

(a) to issue only one class of stock;

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

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

(d) to provide that no share of stock shall be transferable --

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

(ii) to any person other than an individual who is at the time of such transfer an individual resident of Alaska as defined herein, except that for purposes of such transfer the date thereof, rather than the date applicable to the initial issue of stock, shall apply;

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

(e) to perform all acts and conform to all legal requirements to qualify and thereafter to continue to qualify as a General Stock Ownership Corporation under the Internal Revenue Code of 1954, as amended; and

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

Section 4. Shares acquired by each eligible individual upon original issue by AGSOC shall not be sold, pledged, assigned, mortgaged, subject to encumbrance, voluntary or involuntary, or otherwise transferred by the shareholder prior to the expiration of the five (5) year period or until the shareholder shall reach the age of majority, as defined by Alaska law, or until the shareholder shall have complied with all reasonable rules and regulations of AGSOC pertaining to the release of such shares from escrow, whichever of said events shall be the last to occur, except in the event of death of the shareholder or upon the shareholder ceasing to be a resident of the State of Alaska.

Section 5. AGSOC shall have a right of first refusal to purchase shares of stock of AGSOC legally proposed to be transferred during the period of five (5) years after initial issuance thereof as provided in Section 3(d)(i) of this Act. Such shares may be held by the AGSOC in the general escrow or trust account of its trust or escrow division, in which event such stock shall continue its status as issued and outstanding stock of AGSOC for all purposes, except that such shares, while so held, shall not be voted nor shall they be entitled to dividends declared thereon. The Board of Directors shall also have the power to determine that such reacquired shares shall be cancelled and such shares of stock shall thereupon return to the status of authorized and unissued shares.

Section 6. AGSOC shall have the power to make and enforce reasonable rules and regulations with respect to the establishing of escrow accounts for each stockholder of the corporation; for releasing shares of stock to the owner or buyer thereof; for the operation of its trust division; for the transfer and recording of transfers of its stock if it determines to function as its own transfer agent; for the operation of its trust division if it determines to establish a trust division, and with respect to the issue, transfer, repurchase and other handling or dealing with its stock as its Board of Directors may adopt and promulgate. All such rules and regulations shall be published to the stockholders of AGSOC and shall be available in suitable form to any stockholder at any time upon request during regular business hours.

Section 7. For purposes of this Act the terms "resident", "eligible individual", or "qualified individual" shall have the same and identical meaning, and shall mean an individual, regardless of age, born before 12:00 o'clock midnight on \_\_\_\_\_, 1979, who is a resident of and is domiciled in the State of Alaska on such date and who remains a resident of Alaska through the date such stock of AGSOC is initially issued.

Section 8. The following amendments shall be and hereby are made to the Alaska Statutes:

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

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

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

"(7) Notwithstanding the foregoing or any other provisions of Title 10 of the Alaska Statutes, dividends may be declared and paid by a General Stock Ownership Corporation at any time and from any source to the extent deemed by the Board of Directors thereof necessary to comply with the distribution requirements of the laws of Alaska and of the United States."

(d) Title 10, Section 10.05.216, Subsection (e), is hereby amended by inserting at the beginning of the first sentence thereof the words: "(e) Except with respect to General Stock Ownership Corporations,".

(e) Title 10, Section 10.05.255(a), Subsection (7), is hereby amended by inserting at the beginning of the first sentence thereof the words: "(7) Except with respect to General Stock Ownership Corporations,".

(f) Title 10, Section 10.05.264, is hereby amended by inserting at the beginning of the first sentence thereof the words: "Except with respect to General Stock Ownership Corporations,".

(g) Title 45 is hereby amended by adding a new Section 45.55.139 thereto to read:

"Section 45.55.139. The stock of a General Stock Ownership Corporation organized under the Alaska General Stock Ownership Corporation Act is not a security and the issue or sale of such stock shall not be construed as a sale of a security or a sale of securities under this chapter."

Section 9. Preliminary Short Term Loan Financing for AGSOC. There is hereby appropriated from the general fund of the State of Alaska the

sum of \_\_\_\_\_ Dollars  
(\$ \_\_\_\_\_) as and for a short term loan, not exceeding five (5) years in duration, to Alaska General Stock Ownership Corporation to cover its organization and start-up expenses, including but not limited to: organization and qualification as a domestic corporation; contracting for legal, accounting and other professional services; employment of management and staff personnel to search out, analyze and evaluate potential investments and to create effective liaison with appropriate departments and agencies of the Federal and State Governments; arranging financing for acquisition of appropriate investments; identifying the persons who will be eligible to become stockholders of the Corporation; preparing a data base of stockholders eligible for initial issuance of AGSOC shares; establishing or arranging for appropriate trust and escrow departments or services; arranging for banking, stock registrar and other appropriate services; paying directors' fees and expenses; obtaining necessary licenses and paying fees and taxes, if any; procuring office facilities, equipment and supplies, travel, communication expense, and all other expenses normally expended in starting up a new enterprise. The term, amount and rate of interest of said loan shall be established by the Commissioner of Revenue of this State.

Section 10. State Guaranty of a Portion of AGSOC Project Financing.

(a) The Alaska General Stock Ownership Corporation Act contemplates that AGSOC shall make major investments in self-liquidating capital assets, either by acquisition or by construction and development thereof. Upon the determination by the Board of Directors of AGSOC to acquire or construct and develop a particular capital investment, and the determination of the price thereof, the Board of Directors and management of AGSOC, either at a regular annual meeting of the shareholders or at a special meeting of the shareholders, shall submit the question of the approval of the proposed acquisition or development and construction of such project, with an adequate description of the details and projected operational results thereof, to said shareholders for approval. Approval of such capital asset acquisition or development and construction thereof shall require the approval of a majority of the shareholders voting at a meeting of shareholders duly called and held, provided such majority shall be not smaller in number than the majority of the voters of the State of Alaska voting in the general election having the highest number of votes cast in any of the three (3) preceding general elections. Such approval, for all purposes, including compliance with Article IX, Section 8, of the Constitution of the State of Alaska, shall constitute ratification by a majority of the qualified voters of the State who vote on the question.

(b) In the event that the shareholders shall approve such capital asset acquisition or development and construction, and AGSOC shall arrange the financing thereof from private or public lending sources, or from a combination thereof, and if the Board of Directors shall determine that such financing cannot be obtained, or cannot be obtained on reasonable and feasible terms without a partial and subordinated guaranty of the repayment thereof by the State of Alaska, the appropriate officers of the State of Alaska are hereby authorized and directed, on behalf of the State of Alaska and as a pledge of its general

credit, to enter into and to execute such documents as may be necessary to evidence such guaranty as may be requested by the Board of Directors of AGSOC, up to a maximum amount equal to thirty-five percent (35%) of the aggregate cost of said project, including reasonable working capital therefor.

(c) In the event the State shall be called upon to make payment under any such partial guaranty of project financing for AGSOC, the claim of the State against AGSOC for repayment of such funds and interest thereon shall be subordinate to the rights of all lenders to and creditors of AGSOC who shall have extended credit or loaned funds to it in connection with such project.

Section 11. Identification of Residents of Alaska Eligible to Become AGSOC Shareholders.

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

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

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

Section 12. Civil and Criminal Penalties for Misrepresentation of Facts Determining Eligibility to Become AGSOC Shareholder.

(a) Any individual who shall have received stock upon original

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

(b) Any person who shall obtain for himself or for a person as to whom he is or has represented that he is a parental or legal guardian the issuance of shares of AGSOC through fraud, misrepresentation or by any deceitful or illegal means, shall be guilty of a (felony) (misdemeanor) for each share so issued and shall be subject to a fine of up to Five Thousand Dollars (\$5,000.00) upon conviction of each count of such fraud and to imprisonment for up to three (3) years in State prison for each count of such fraud as to which a final conviction shall be obtained.

## QUESTIONS RE ALASKA AGSOC-I PROJECT

Section 1391 of Revenue Act of 1978, Paragraph (a)(3), defines a GSOC as a corporation "chartered by an act of the State legislature."

1. Can an enabling act authorize the Governor to appoint a specified number of incorporators (who will also serve as first board) to incorporate a GSOC to be name AGSOC-I in conformity to the federal law and Alaska Corporations Code, as amended, and other general laws?
2. How does Alaskan law define "resident?"
  - a) What problems does this raise with regard to intent of AGSOC?
  - b) How solved?

Enabling legislation must:

- Fix date as of which a "resident" is defined.
- Define "eligible individual."

Determine under Alaska law: who is a resident?

- What is definition of resident for purposes of the Securities Act of 1933 intra-state exemption?

If no age restriction is placed on eligibility, do parents have natural guardianship powers and responsibilities over the property of their children?

- Must they periodically account?
- May a child's income be spent for his maintenance?
- Must a guardianship under Court supervision be applied for?
- Would not the burden be substantial?

3. Can AGSOC-I engage in a trust and escrow business with respect to its own stock?

Questions Re Alaska AGSOC-I Project  
Page 2

4. Could it by the enabling act be authorized to establish a trust department to establish escrows for AGSOC-I stockholders, handle stock transfer function, acquire company stock under rights of first refusal or otherwise and resell such stock to qualified buyers?

It is intended that all shares of AGSOC-I would be held in escrow by the trust department of the Corporation during the initial five-year inalienability period. Escrow would continue during the minority of any shareholder.

Can we protect stock while in escrow from being subjected to claims of creditors, liens, contractual purchase rights, etc.--in short, tight "spendthrift" provisions. Will this present problems under Alaska law?

5. Could enabling law provide that stock in its trust department shall continue to be outstanding stock except would earn no dividends and carry no voting rights until resold to qualified buyer?
6. Could enabling legislation give effective spendthrift protection during initial five-year non-transferability period.
7. Could enabling law appropriate grant or authorize loan of start-up financing or must such law be separate?
8. What would be impact on AGSOC-I and/or its stockholders of Alaskan tax laws?
9. What fees and taxes might Alaska impose on AGSOC-I that could be exempted by law?
- Corporate income tax (automatic adjustment to federal law?).
  - Corporation Commissioner's fees.
  - Any excise taxes, like stock transfer taxes.
  - Severance taxes if it produces oil or gas or other minerals.
  - Land taxes.
  - All taxes of every nature whatsoever.

Questions Re Alaska AGSOC-I Project  
Page 3

10. What steps would be necessary to synchronize operations with Alaska Blue Sky law?
  - a) Does Commissioner of Corporations administer Blue Sky law?
  - b) Could we get published regulations?

Note: we anticipate exemption from Federal 1933 Act, but will confer with SEC regarding conformity to 1934 Act.

11. To be practical, should AGSOC-I be exempted from effect of other Alaskan laws?
12. Are there models of other public or quasi-public corporations which have been incorporated in Alaska whose enabling legislation, articles or bylaws might be useful as guidelines? If so, could we be sent copies?
13. Could Attorney General advise on effect of profitable operations of AGSOC-I on flow of federal funds into Alaska?

I. HOW SHOULD "RESIDENT" BE DEFINED UNDER ALASKA LAW FOR THE PURPOSES OF AGSOC?

The Alaska statutes do not provide a uniform definition of the term "resident." Rather, the term is defined in each chapter in which it is applicable, and the wording of the definitions vary considerably. Specific statutory language aside, the definitions set out in the Alaska statutes fall into two main categories, those based on a durational residency requirement, and those based on an individual's intent.

A statute typical of the former type may be found in the Fish and Game provisions, at 16.35.180(b):

In this section, "resident" means a person who, for the immediately preceding year, has maintained a permanent place of abode inside the state, and who has continually maintained his residence in the state.

A statute typical of the second category of statutes defining "resident," those based on intent, is AS 36.95.010(5). This definition is a part of the Public Contracts provisions, and provides:

"Resident" means a person who maintains his domicile in the state: domicile is the true and permanent home of a person from which he has no present intention of removing and to which he intends to return whenever he is away;

Clearly, it will be necessary to choose between these types of definitions of "resident" when determining the meaning of the term for the GSOC. The choice of either will raise some constitutional issues, which are somewhat different under Alaska law than under federal law. The Alaska law issues will be discussed below.

II. THE ALASKA SUPREME COURT'S TREATMENT OF DURATIONAL RESIDENCY REQUIREMENTS

The Alaska Supreme Court has considered the constitutional implications of durational residency requirements in various contexts in recent years. An analysis of these cases indicates that the test applied by the Alaska Court for determining the constitutionality of durational residency requirements is somewhat stricter than that applied by the U.S. Supreme Court.

Durational residency requirements, as they necessarily involve a disparity of treatment between long-term and short-term

residents, are subject to attack under the equal protection clauses of state and federal constitutions. The traditional federal approach involves a two-tiered test with two standards of review, the rational basis test and the compelling state interest test, (strict scrutiny.) While our Court continues to apply the federal standard for evaluating the constitutionality of a classification under the U.S. constitution, \*/ it has developed a different approach in applying the Alaska constitution. A brief review of the recent Alaska cases involving durational residency requirements will best serve to demonstrate the Court's approach.

In State v. Van Dort, 502 P.2d 453 (Alaska 1972) the Court determined that a 75-day durational residency requirement for voting purposes was violative of the equal protection clause. The Court held that all durational residency requirements are prima facie invalid as in contravention of the equal protection clause because they penalize the right to travel. The Court noted that the only such requirements that could be countenanced were those absolutely necessary for administrative purposes. Applying the compelling state interest test, the Court determined that even Alaska's unique physical characteristics were insufficient to justify a requirement in excess of 30 days.

The following year, the Court considered State v. Wylie, 516 P.2d 142 (Alaska 1973) which involved a challenge to a one year durational residency requirement for preference in state employment. That case differed from Van Dort in that the interest sought to be protected in Wylie was not a constitutionally guaranteed one. Nonetheless, the Court applied the compelling state interest test, solely on the basis that the right to travel was infringed.

We therefore conclude that the right to interstate travel is itself a fundamental right and any classification which serves to penalize the exercise of that right must be subjected to strict judicial scrutiny. 516 P.2d at 147.

Applying the compelling interest test, the Court concluded that the durational residency requirement was not necessary to promote

---

\*/ State v. Erickson, 574 P.2d 1 at 11 (Alaska 1978).

the compelling governmental interest of reducing unemployment and "upgrading Alaska's human resources." 516 P.2d at 150. Additionally, the Court noted that the requirements were not tailored with sufficient precision to satisfy the compelling state interest test.

Soon after Wylie, the Court heard another case where it appeared that the right affected was neither fundamental nor a necessity for life. In State v. Adams, 522 P.2d 1125 (Alaska 1974) involving a challenge to the durational residency requirement for divorce (one year), the Court held that all durational residency requirements must be evaluated under the compelling state interest test, as all infringe upon the fundamental right to travel. The Court held that none of the state's alleged interests were sufficient to justify the requirement for those interests could be accomplished by less harsh methods. 522 P.2d at 1132.

Again in Gilbert v. State, 526 P.2d 1131 (Alaska 1974) the Court applied the compelling state interest test in a case involving durational residency requirements for election legislative office, a nonfundamental right. However, in Gilbert the state satisfied the test by offering three justifications for the requirement: exposure of the candidate to prospective constituents, assurance of legislative familiarity with state, and protection from frivolous candidates. 526 P.2d at 1134. For the first time, the choice of the stricter standard of review was not outcome determinative.

The most recent durational residency requirement case that has been considered by our Court is Hicklin v. Orbeck, 565 P.2d 159 (Alaska 1977), rev'd on other grounds, 98 S. Ct. 2482 (1978), a case involving a constitutional challenge to the "Alaska Hire" law which limited petroleum and pipeline jobs to one-year Alaska residents. Again, the Alaska Court held that durational residency requirements must be subjected to strict scrutiny under both the Federal and State Constitutions because they penalize those who have exercised their fundamental right to travel.

In Hicklin, the Court specifically rejected the argument

that strict scrutiny should not be applied unless the right denied was a fundamental one, or a basic necessity of life.

We have never used this "basic necessities" reasoning. 565 P.2d at 163.

Applying the compelling state interest test, the Court found that the interests the state was seeking to further through the law in question were similar to those it claimed in Wylie, reduction of unemployment rate for Alaska residents and use of resources to cultivate its human resources. 565 P.2d at 164. Again the Court found that the means chosen to achieve the ends were not the least drastic possible, and invalidated the durational residency requirement portion of the "Alaska Hire" laws.

Thus it can be seen that the Alaska Supreme Court has utilized the compelling state interest test in every situation in which the right to travel is impaired, which necessarily includes all durational residency requirements. The U.S. Supreme Court, on the other hand, has evaluated the right affected by the statute to determine whether the strict standard should be applied. Arguably, the Alaska Court has applied the standard somewhat more flexibly, by demonstrating that the choice of standard is not outcome determinative. Thus under the Alaska law as enunciated to date, the strict standard of review will be applied to every durational residency requirement, but that standard may be satisfied by a proper state showing as in Gilbert. The impact of the variance between the Alaska interpretation of the equal protection clause and the federal might well be actually minimal. See, State v. Endison, 574 P. 21 (Alaska 1978).

It should be noted that the ambiguity in this area might be resolved in the case of Thomas v. Bailey (No. 4204) presently awaiting decision of the Court. While the case, which involves the validity of the initiative proposition for the "Alaska Homestead Act" (which involves land grants to residents meeting certain durational residency requirements) could be decided on other grounds, the Court might take the opportunity to alter its rigid approach to the standard to be applied to durational residency requirements. If it is determined that the GSOC definition of "resident" were to be a durational residency requirement, it might

be advisable to await the outcome of the Thomas v. Bailey case to evaluate better the chances of its being upheld by the Alaska Court.

Even if the Court does not alter its position, it is possible that a durational residency requirement might be upheld by our Court if it is carefully drafted to demonstrate justifiable compelling state interests and to meet those interest in the least drastic manner possible. However, while possible, this prospect is far from probable.

### III. THE ALASKA SUPREME COURT'S APPROACH TO RESIDENCE REQUIREMENTS

If it is determined that the definition of "resident" for the purposes of GSOC should be based on intent, the strict scrutiny test will not be applied. In Lynden Transport Inc. v. State, 532 P.2d 700 (Alaska 1975) the Court noted that residency requirements not based on durational residency do not inhibit travel as is the case where certain privileges are withheld from those who change residence to a new state but do not meet durational requirements. Therefore, such a classification is not subjected to the compelling state interest standard.

Traditionally, classifications not judged by the compelling state interest test were upheld under the rational basis test, great judicial deference being accorded to conceivable legislative purposes that might justify classifications. In Alaska, however, the Court has established a different, and more rigorous, rational basis standard to be applied to classifications not requiring strict scrutiny. This test was enunciated for the first time in State v. Wylie, 516 P.2d 145 (Alaska 1975) wherein the court wrote:

Under the rational basis test, in order for a classification to survive judicial scrutiny, the classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike. 516 P.2d at 145.

In Isakson v. Riskey, 550 P.2d 359 (Alaska 1976) the Court had occasion to apply this new rational basis test for the first time. The Isakson Court noted that under their stricter

rational basis approach, "we will no longer hypothesize facts which would sustain otherwise questionable legislation as was the case under the traditional. . . standard." 550 P.2d at 362. Thus judicial deference to a broad range of conceivable legislative purposes and to imaginable facts that might justify classifications is greatly diminished. The new standard was intended to raise the lower tier of the equal protection standards "from virtual abdication to genuine judicial inquiry." 550 P.2d at 363.

Isakson involved a challenge to certain provisions of the Limited Entry Act to the effect that only commercial holders of gear licenses issued before January 1, 1973 could apply for permits for entry into commercial fishing. The purpose of the provision as determined by the Court was to segregate hardship and nonhardship cases at the application phase of the permit issuance process. The Court's next inquiry was whether the classification (holding a gear license prior to a certain date) bore a fair and substantial relation to the purpose of the legislation (the segregation of hardship and nonhardship cases.) The Court found that it did not, and that it in effect created an irrebutable presumption that no one acquiring a license after the cutoff date could suffer to requisite hardship necessary for an entry permit. 550 P.2d at 365. Thus the provision was found to be violative of the equal protection clause.

The next case in which the Court applied the Isakson rational basis test was State v. Reefer King Co., Inc., 559 P.2d 56, in which the constitutionality of a tax statute imposing a higher tax on "floating" processors than upon "shore-based" processors was challenged. Applying the Isakson rational basis test, the Court found that the distinction between mobile and stationary processors could be viewed as a tax incentive to encourage shore-based processors. The Court held that the tax differential bore a fair and substantial relationship to the goal of encouraging societal contributions of the type made by the shore-based processors.

In Hicklin v. Orbeck, 565 P.2d 159 (Alaska 1977), the Court invalidated the durational residency requirement in the

Initially, we must look to the purpose of the statute, viewing the legislation as a whole, and the circumstances surrounding it. It must be determined that this purpose is legitimate, that it falls within the police power of the state. Examining the means used to accomplish the legislative objectives and the reasons advanced therefore, the court must then determine whether the means chosen substantially further the goals of the enactment. Finally, the state interest in the chosen means must be balanced against the nature of the constitutional right involved.

Applying that analysis in Frickson, the Court determined that there was ample, respectable scientific evidence of harm from the use of cocaine to sustain the legislature's inclusion of cocaine in its classification of narcotics. The legislative goal, the Court determined, was legitimate, and the classification substantially related to that goal. 574 P.2d at 18.

These principal cases on classifications and equal protection do not provide clear answers to all of the GSOC questions on residency definition, but they do provide certain guidelines. It is probable that if the definition of resident for GSOC purposes is based solely on intent, it would be upheld by the Alaska Supreme Court. The classification would be subjected to the Isakson rational basis test, rather than the stricter compelling interest test, and if the provision would pass muster under the privileges and immunities clause, (as the Wilmer, Cutler and Pickering Memorandum of 12.15.78 indicates possible,) it would be upheld by our Court. It is important for the legislation to describe with specificity the purposes of the residency classification, as the Court would not hypothesize the possible purposes.

The outcome of a closed class of residents (based on intent as of a certain date) is less certain. If such an approach is selected, it would be important to draft the legislation in such a way as to avoid the "irrebutable presumption" analysis of Isakson. The Court would look to the purpose of the closed class provision to determine whether it is legitimate. While it is not possible to determine with certainty, it is possible that the justifications offered in the Wilmer, Cutler and Pickering Memorandum of 12.15.78 would be adjudged legitimate purposes.

If this is the case, the only problem would be to draft the legislation in such a way that there was an obvious close

correlation between the classification and the purposes of the statute. Were the first hurdle overcome, the second could probably be accomplished. The cases indicate that the Court will probably find a "fair and substantial relation to the purposes of the legislation" if the purposes are legitimate. \*/ However, it is not possible to be assured of the outcome. Therefore we suggest that you consider the possibility of an amendment to the Alaska Constitution to assure the success of such a provision. \*\*/

Without a Constitutional amendment, the only near certainty is that an open class of residents defined by intent would be permissible under Hicklin. In every other case, we recommend that a nonseverability clause be added to the provisions so that they will "self destruct" if the residency requirement is not upheld. Absent such a clause, the general savings clause of Title 1 would be applicable.

#### IV. GSOC SHAREHOLDERS WHO ARE MINORS

If no age restriction is placed on eligibility, and the GSOC shares are subject to the remainder of Alaska statutes, the gifts to minors might be subject to AS 45.60, the Alaska Uniform Gifts to Minors Act. These provisions very specifically set out exactly what happens to a gift of securities to a minor.

Under AS 45.60.011, a gift of a security to a minor must be made through a custodian, who must be adult member of the minor's family, other than the donor, a legal guardian or a trust company. The section refers to an "adult person" making the gift, but this could be held applicable to a state gift as well. Under the Act, the custodian is responsible for paying over to the minor the amount considered advisable for maintenance, with the remainder

---

\*/ But see Isakson irrebutable presumption approach.

\*\*/ This of course would merely assure the success of the provision in Alaska. For a federal level, analysis, see Wilmer, Cutler & Pickering Memorandum of 12/15/78.

to be delivered to the minor on his attaining 19 years of age. Court appointment is required by AS 45.60.091(8), and accounting may be required by petitioning the court pursuant to AS 45.50.071.

If the Alaska Uniform Gifts to Minors Act does not apply to gifts by a corporation (or by the state,) the child's income could still be spent for his maintenance under AS 25.20.040. Problems would arise in the cases of children without homes or taken from their homes, which questions are presently being considered by the Human Resources Section of the Attorney General's Office.

Another possibility which would avoid the problems implicit in the above approaches would be to exempt GSOC from other Alaska laws, and to provide for minor shareholders in the provisions themselves. A possible plan would be to require the GSOC to hold the shares of the minors for them, plus all income on those shares, until the minority is ended. As parents have the duty to provide maintenance for their children anyway, this would not seriously disadvantage any individual, and would provide every Alaska minor owning GSOC shares with a sum of accrued dividends upon achieving majority.

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

# STATE OF ALASKA

## DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

*Rep. Duncan*

*File  
ASOC*

JAY S. HAMMOND, GOVERNOR

POUCH K-STATE CAPITOL  
JUNEAU, ALASKA 99811

February 9, 1979

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

Dear Norma:

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

Sincerely,

AVRUM M. GROSS  
ATTORNEY GENERAL

By: *Teo Spengler*  
Teo Spengler  
Assistant Attorney General

TS:vr

Enclosures

cc: Milt Barker  
Legislative Finance

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

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

\*

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

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

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

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

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

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

## II

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

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

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

## III

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

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

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

\*

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

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

#### IV

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

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

There is insufficient information on which to respond.

\*

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

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

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

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

V

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

No.

\*

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

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

shattuck & grummett, inc.

ESTABLISHED 1905  
insurance · bonds

101 FIFTH AVENUE  
JUNEAU, ALASKA 99801

File  
Revenue  
G.S.O.P.  
w/ 10/19  
RSC

February 23, 1979

Honorable James Duncan  
State Representative  
Pouch V  
Juneau, Alaska 99811

Dear Jim:

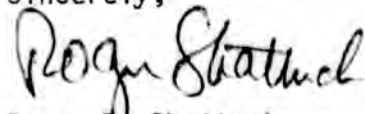
I would like to take this opportunity to express my opposition to your General Stock Ownership Plan (G.S.O.P.) bill.

I feel the State's royalty and/or permanent fund income would be more equitably used as a vehicle to reduce income taxes and increase revenue sharing. This would result in a distribution which relates in some manner to the widely varying burdens carried by different people by present income and property tax schedules.

I likewise find the \$100/200/300 tax credit bill passed last year distasteful. The person who pays, say, \$10,000 a year in State income tax realizes no more benefit than the person who previously paid only \$300 and only an insignificant benefit in comparison to the person who draws welfare and pays no taxes.

A program for an across the board percentage temporary tax credit or permanent tax reduction would be more equitable. A scaled credit with a smaller percentage applying to higher tax brackets would be less preferable than a flat credit but would still be preferable to last year's credit or the proposed G.S.O.P., which are both nothing more than thinly-veiled welfare programs.

Sincerely,



Roger R. Shattuck

RRS/ce

cc: Honorable Mike Miller  
Honorable Bill Ray

June 20, 1979

Mr. J. Roderick Heller, III  
Wilmer, Cutler and Pickering  
1666 K. Street, N.W.  
Washington, D.C. 20006

Dear Mr. Heller:

Please find enclosed two copies of Contract I and CSSS Senate Bill No. 170. Also, enclosed is a copy of the Rosenstein memorandum of June 12, 1979.

These items should be of value as a point of refence to direct your efforts on our Contract. I will, as agreed, be providing any other information that may become available.

Sincerely,

Dale E. Staley  
Legislative Assistant

DES/jp  
Enclosures

AGSOC EDUCATIONAL COMMITTEE

P.O. Box 3160  
Anchorage, Alaska 99510

File  
Finance  
ss AGSOC

JUNEAU  
465-3762

ANCHORAGE  
272-8457

FAIRBANKS  
456-6282

GSOC

TO: AGSOC INITIATIVE SPONSORS  
FROM: AGSOC EDUCATIONAL COMMITTEE  
DATE: OCTOBER 19, 1979  
RE: AGSOC EVALUATION

As you can see from the above heading, AGSOC now has operating offices in all three major cities for your convenience in obtaining materials and other information. Mail should still be directed to the AGSOC Educational Committee, P. O. Box 3160, Anchorage, Alaska, 99510.

In order to provide us with a current progress report, please take a few minutes to complete this questionnaire, sign, and return to the AGSOC Educational Committee. Additionally, as follow-up, we would appreciate you contacting the field office nearest you with a weekly signature count.

1. How many signatures have you turned in? \_\_\_\_\_
2. How many signatures do you have on hand? \_\_\_\_\_
3. What AGSOC materials do you have? \_\_\_\_\_

4. Do you need additional information such as the Question and Answer sheet? \_\_\_\_\_ Glossy informative brochure? \_\_\_\_\_  
One-page AGSOC summary? \_\_\_\_\_

5. How much time could you volunteer for AGSOC? How many hours a week? \_\_\_\_\_

6. Are you presently in touch with any of the field offices in Anchorage? \_\_\_\_\_

Fairbanks? \_\_\_\_\_

Juneau? \_\_\_\_\_

7. Can you suggest other AGSOC volunteers.

Name: \_\_\_\_\_

Address: \_\_\_\_\_

Phone: \_\_\_\_\_

Other Comments: \_\_\_\_\_

\_\_\_\_\_  
(print name)

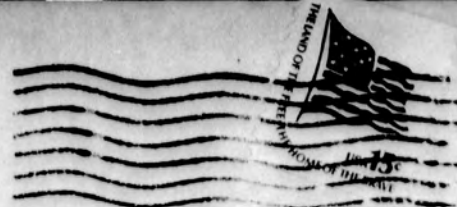
\_\_\_\_\_  
(address)

\_\_\_\_\_  
(home phone)

\_\_\_\_\_  
(business phone)

\*QUESTIONNAIRE IS SELF-ADDRESSED: PLEASE FOLD, STAPLE, STAMP, & MAIL. THANK YOU FOR YOUR COOPERATION.

AGSOC Educational Committee  
P. O. Box 3160  
Anchorage, Ak  
99510



The Honorable Jim Duncan  
RR 4 Box 4316  
Juneau, AK 99803

BT  
690  
99802

AGSOC EDUCATIONAL COMMITTEE  
P. O. BOX 3160  
ANCHORAGE, AK 99510

DONALD J. BEIGHLE  
ATTORNEY AT LAW  
310 MAIN STREET  
DEER LODGE, MONTANA 59722  
—  
TELEPHONE (406) 846-3302

March 19, 1979

Milt Barker  
Division of Legislative Finance  
Room 411, Capital Building, Pouch WF  
Juneau, Alaska 99811

Subject: Sponsor Substitute for  
House Bill No. 240

Dear Mr. Barker:

At your request I have reviewed the above legislation and the Report to the Alaska State Legislature by Kelso & Company (Kelso). As a result of my review I have developed some specific comments which I have outlined below.

Prior to addressing my comments it may be beneficial to review briefly my background. I have been practicing law for 18 years, the bulk of which has been in the corporate law or related areas. My employment history consists of serving for over 5 years as counsel to Sealaska Corporation the Native Regional Corporation for Southeast Alaska. Prior to my employment with Sealaska I was employed as an Assistant Attorney General for the State of Alaska and was also employed several years as an attorney for the United States Securities and Exchange Commission.

In preparing my comments I have not addressed, except in one instance, any Federal Securities problems. My reason for not addressing this aspect was that the report I reviewed from Kelso stated that a separate report has been prepared regarding the application of the Federal Securities Laws to General Stock Ownership Corporations. (GSOC's) Additionally I have limited my

Milt Barker  
March 19, 1979  
Page 2

comments to the establishment of the corporation, the stock distribution and related problems. Because of the limited period of time available I was unable to give as detailed an analysis to certain problem areas as they likely deserve. Additionally I lacked the time to completely coordinate the comments between the proposed legislation, the Federal Legislation authorizing GSOC's, the proposed Articles of Incorporation and By-Laws. Therefore some of my comments may not require a change in the legislation, but rather if accepted a modification of the Articles of Incorporation or the By-Laws. For ease in review where I have had a comment regarding the legislation I have set forth the specific legislative citation followed by my comments.

Sec. 10.50.020(2)

As drafted all Alaskan residents would receive stock in the corporation provided they were residents of the state on the effective date of the act and continued to be residents until the date of issuance of the shares. Some of the questions that should be addressed in this provision relate to minor children and residency.

An individual must be a resident on the date of the passage of the act and also on the date of issuance of the certificate. Having two dates which require verification will create some difficulty. The question should be addressed as to how the corporation will verify the residency on issuance of the certificates. The screening process is substantially easier when applications for issuance of stock are being reviewed and residence can be verified. However there may not be a satisfactory way to verify

Milt Barker  
March 19, 1979  
Page 3

residency on issuance of the certificate since the moving party in that instance is the corporation and not the individuals. One method may be to require that the individual again affirm his residency at the time of issuance. This may be an item which can be handled internally by the corporation rather than through legislation. However since a private corporation is involved a statutory method of screening may be highly desirable.

The area of stock issuance which will create the greatest difficulty is with minors. As written the legislation would authorize the issuance of stock to minors. However there is a substantial legal question whether minors can vote stock even if they were capable of doing so. Therefore some vehicle should be incorporated within the legislation to handle this problem. The Kelso report discussed an escrow, however this may not solve the problem. If the stock is issued, although it may not be delivered to the individual but rather escrowed, the rights of a stockholder in the corporation (absent agreement or legislation) normally vest in the party to whom the certificate is issued. The rights referred to would be those which normally flow from the ownership of stock. The two most important of such rights are the right to vote and the right to receive dividends. Therefore if the certificate is issued, although the certificate may be escrowed to prevent its transfer, the question of voting rights and dividends must be addressed. Specifically who receives the dividends and who votes the minor's stock. The legislation should establish a method for handling this situation. The legislation should recognize that most minors do not have legal guardians, that in a number of

Milt Barker  
March 19, 1979  
Page 4

instances a divorce will have occurred and each parent may wish to receive the dividends and vote the certificate. That minors will be residing with relatives, in foster homes or possibly be under state control and parental rights may or may not be terminated.

One method of handling the matter would be to escrow not only the minors stock but the dividends and further provide that the stock cannot be voted until the minor reaches majority. Alternatively some sort of custodianship under the Uniform Gift to Minors Act could be created to hold minors stock. This was done under the Settlement Act. The custodianships will create a substantial amount of difficulty as there will be disputes between parents and others as to who should act as custodian. In the majority of instances the parents will agree, but when you are discussing the entire minor population of a state it can be anticipated that a number of difficulties will occur. For example, a child because of a broken home or other reasons may be residing with a married sister. The problem of who will serve as a minor's custodian will likely amplify in a direct ratio to the magnitude of the dividends received. I would recommend that this aspect be treated in the legislation or in separate legislation if more desirable.

Sec. 10.50.020(3)

This section provides for the issuance of at least one share of stock to each eligible individual. Although the legislation could be interpreted as authorizing the issuance of more than one share the Kelso report discussed the issuance of one share per individual. Additionally the federal legislation limits the total amount of shares an individual can own to ten. Therefore, it

Milt Barker  
March 19, 1979  
Page 5

appears that most likely one share will be issued. A substantial problem will arise in estates wherein a single share is devised or inherited by more than one person. For example if Jane Smith a widow with three children dies intestate each of her children would receive one-third of her estate. If she owned one share of stock some method of allocation of the certificate must be available. Most corporations issue script or redeem partial shares for cash. Also even if the partial shares were issued the proposed by-laws provide for one vote per share. Therefore the voting rights could be lost. I would recommend that the legislation or the Articles of Incorporation provide for the issuance of partial shares and that further that the partial shares will carry voting rights. The one industry which deals in partial shares is the mutual fund industry. Many funds issue partial shares out to four decimal places. Therefore the computer program is undoubtedly available.

Some additional consideration should be given to the enrollment process which this section envisions with a view to the elimination of or reducing some of the potential difficulties. It is probably fair to say that the corporation will be inundated with applications. The applications may exceed by several hundred thousand the actual number of Alaska residents because of duplicate applications. As an example grandparents will file applications for their grandchildren, as will the parents, and in some instances the children will send in their own applications. All may not use the same identical name. In reviewing the legislation I did not see a method under which applications were reviewed. I would recommend that the legislation establish some type of administrative process

under which applications are reviewed. If the application is denied the legislation should provide for an appeal process. This method would be preferable to requiring that the matter be litigated in Superior Court. Along with the problem of verifying applications will be the problems of ineligible individuals being issued stock. With the numbers involved it is probable stock will be issued although the individual may be ineligible. Additionally there will be duplicates. That is an instance where two applications are approved for the same individual, either because of slightly different names on the application or for other reasons. I would recommend that the legislation provide for some type of administrative hearing process to remove stockholders from the register other than being required to litigate the matter in Superior Court, as the first and only process. Of course, there should be appeal rights.

Sec. 10.50.030(4)

This section limits the transferability of the shares. Again as with the problems with minors the process should be reviewed to determine if all possible situations are covered. For example what occurs if a person dies and the stock is inherited by non-resident persons. Although the legislation provides that the shares may not be "involuntarily transferred ... to an individual other than one who is a resident on the date of transfer" some method must be set forth for the disposition of the stock in such instances.

As noted earlier, the legislation requires the verification of residence at the time of passage of the legislation, at the time of issuance of the certificates and with this section at the time of transfer. As a result the corporation will face the problem

Milt Barker  
March 19, 1979  
Page 7

of the continued inquiry into residency. I would recommend that the legislation contain some method of verification such as the requirement that the individual execute an affidavit of residency, including within it information such as where tax returns are filed and related information.

Sec. 10.50.040

This section may not be sufficiently clear to furnish an adequate standard for the corporation to follow. As written, it appears that the corporation will commence issuing shares as the Alaskan public applies for the issuance. The alternative method would be to set forth an application period. Verify the applications and then issue the stock. However the matter is approached, the application period will produce an almost insurmountable volume of paper. With some 400,000 residents of Alaska the process of verification of applications will be extremely difficult. The application process will undoubtedly have to be computerized to handle the paper volume. I would recommend that before the legislation is adopted in its present form that some investigation should be made to determine the best method of handling the problem. Perhaps a specific application period with a cut off date for applications, followed by a verification of applications and then the issuance of shares may be preferable to a method wherein stock is issued as the applications are received.

Sec. 10.50.070

This section was covered under earlier comments wherein the recommendation was made to set up some type of administrative process to accept and deny applications with possibly an appeal right to the Superior Court. One of the items that should be

Milt Barker  
March 19, 1979  
Page 8

considered in the overall concept of the legislation is the cost to the individual and to the corporation. For example, to litigate matters in Superior Court could be relatively expensive.

#### Sec. 10.50.900(4)

The only comment I have again deals with minors. The definition of residence provides that a minor "takes the residence of his parent or legal guardian". Some additional thought should be given to situations such as a minor residing with relatives. Another problem is present with divorced parents. What occurs if the minor lives with his non resident mother for nine months of the year and spends summers with his resident father, is he a resident?

#### Federal Security Laws

Theoritically, the GSOC will not be subject to the registration provisions of the Securities Act of 1933 as the offering will be limited to Alaska residents. However, as noted earlier, I would anticipate some problems in insuring that only Alaska residents receive stock. Errors are likely to be made and the possibility exists that some nonresidents will be issued stock. Therefore I would not be confident the the exemption from the securities act for sales to residents of a single state would stand the test.. However, for stock to be subject to the registration provisions there must also be an offer or sale. If the legislation were to provide that the stock is being issued without consideration and does not constitute the offer to sell or the sale of a security it is possible that the registry provisions of the securities acts as far as the initial issuance of stock is concerned would not be applicable. The inclusion of this language in the legislation may assist in the application to the Securities and Exchange

Milt Barker  
March 19, 1979  
Page 9

Commission for a ruling that the initial stock issue is not subject to registration.

Of course, once the corporation is formed and the stock issued it will be subject to certain requirements of the Federal Securities Acts.

#### Conclusion

From my comments it can be determined that the concerns I have expressed deal with what could be stated as the "Non-typical" situation. However because of the number of residents of Alaska who will make application for the purchase of shares the nontypical situation may involve thousands of individuals. If one uses the standard that was consistently referred to while I was in the Marine Corps of the 10% (i.e. the 10% who always did things differently) you are talking about a group of 40,000 people. Additional problems will occur because of the lack of familiarity by many Alaskans with the ownership of stock. Therefore if the legislation makes provisions for handling matters such as minors voting stock or receiving dividends the path for all concerned will be substantially easier than inventing a cure as the situation is presented. In the area of the problems I have outlined to the extent possible the legislation in the area of stockownership and stockholder rights should recognize that the given family or individual situation may change. For example, it may be decided to establish a custodial agreement by the individual with whom the minor resides, the custodial form to be filed with the corporation. Once this happens it would appear the problem is solved. However divorces will occur and the minor may end up

Milt Barker  
March 19, 1979  
Page 10

living with his noncustodial parent who may even be a nonresident. Alternatively the minor may start living with a relative rather than his parents. As a result of these examples the voting rights and the dividends will be misdirected. Although the law has remedies to correct such situations as I have outlined, litigation between the individuals involved may not be warranted because of the cost. As a result the corporation may find itself in the middle of these type of disputes. From my experience it is impossible to guard against all situations. However, if the legislation addresses the subject the corporation will have the benefit of a specific legislative policy to follow in the area of stockholders and their rights. Not only would this save substantial sums of money but also if a stockholder's problems of ownership are eliminated or reduced he will be a better supporter of the corporation.

Sincerely,



Donald J. Beighle

DJB/dh

OUTLINE OF GSOP TESTIMONY PRESENTED BY  
DR. STEPHEN A. BUSER  
BEFORE THE ALASKA STATE LEGISLATURE,  
MARCH 20, 1979

- I. Opening remarks
- II. Comments on the financial base for the proposed GSOT
  - 1. Asset acquisitions
  - 2. Financing the acquisitions
  - 3. Loan guarantees and alternative forms of State assistance
  - 4. The GSOT budget
    - a) expenditures on investment analysis
    - b) other expenditures
  - 5. transfer restrictions on GSOT shares
- III. Summary evaluation
- IV. Concluding remarks

# Visual Displays Referenced in Dr. Buser's Testimony

Figure 1: Projected annual pre-tax returns on a hypothetical asset

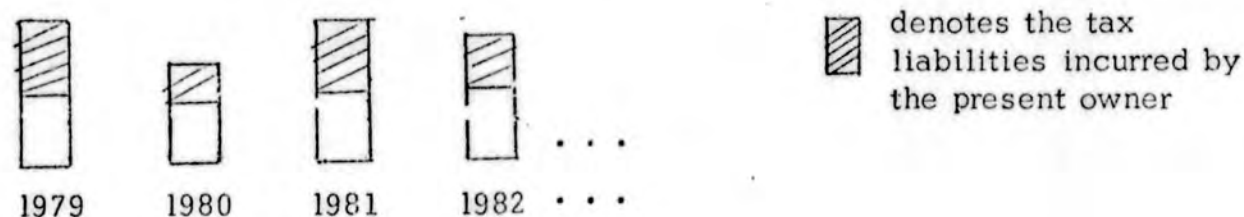


Figure 2: Projected annual debt service on loan financing asset acquisition

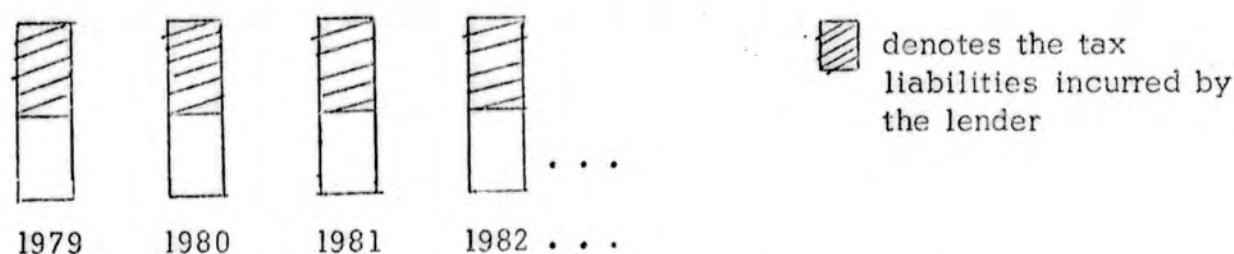
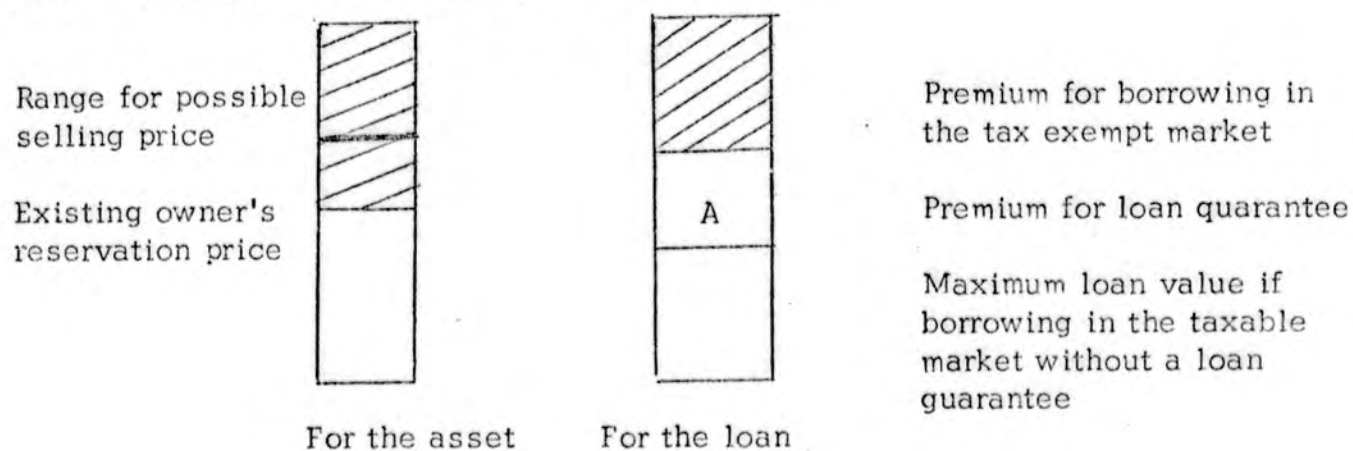


Figure 3: Current market values of the cash flows



WHARTON  ECONOMETRIC  
FORECASTING ASSOCIATES, INC.  
A NOT FOR PROFIT CORPORATION OWNED BY THE UNIVERSITY OF PENNSYLVANIA



3624 SCIENCE CENTER  
PHILADELPHIA, PENNSYLVANIA 19104  
215/386-9000

ABEL BELTRAN-DEL-RIO  
*Director - Latin American Projects*

March 22, 1979

Mr. Milton Barker  
State of Alaska  
Division of Legislative Finance  
Room 411 Capitol Bldg., Pouch WF  
Juneau, Alaska 99811

Dear Mr. Barker:

After a first reading of the material you kindly sent me, I have some initial comments to make, most of which I would like to pose in the form of questions:

- 1) After five years, how is the secondary market going to be organized for the sale of the GSOC stock?

One concern I have on this score relates to the underpricing of this stock vis-a-vis the price it will command on the stock market. It seems indispensable to keep the stock out of the regular valuation which would be given to it if sold on the regular market. Otherwise, its price will tend to go up until its rate of return falls to the level of the normal returns on the stock market. I have expressed this concern to Senator Gravel in various meetings and letters. Presumably, however, if the GSOC assets do not proliferate in the U.S., it would be easy to maintain the separation of the markets. But if they do, leakages would probably take place, which would tend to drive these prices up and also tend to lower the price of the other stock, tending to equalize their rates of return, as normally happens on any free market.

- 2) Is GSOC going to get preferential interest rates from lenders?

If this is the case, the undervaluation of the GSOC stock would be even higher, leading to the problem we mentioned before.

- 3) What is the size in dollars of the first issue of GSOC stock?

I was unable to find these numbers in the material I got.

\*\*\*

Mr. Milton Barker  
March 22, 1979  
2.

WHARTON EFA, INC.



- 4) What would be the incentive of the beneficiaries, the residents of Alaska, to participate in raising the productivity in the GSOC?

One of the most forceful arguments of Mr. Kelso for his proposals of capital diffusion has been to provide incentives for harder work and more productivity in the firms. How will this efficiency operate in the case of GSOC?

- 5) Would GSOC tend to diminish excessive (beyond the rate of labor productivity) wage labor demands?

This has been another argument in favor of capital diffusion made by Mr. Kelso.

- 6) What is the size of the dividends that are expected from the stock and how frequently would they be paid out to the "new capitalists"?

As you can see, my main questions relate to the quantities involved in the project. I think it would be very useful, if these estimations are available, to distribute them in order to better understand the project.

Aside from these questions, I would like to express my enthusiasm for the splendid accomplishment that the GSOC Bill represents. Since the publication of The Capitalist Manifesto in 1958, I have been following the work of Mr. Kelso and I am very happy to see that with the drive and dedication of Senator Gravel, the law is being changed to introduce the capital diffusion tool to the kit of economic policy in the U.S. This may represent a turning point in the history of economic policy making in this country and abroad.

Finally, I would like to ask you for ten copies of the material, to distribute them among my colleagues here at Wharton EFA, who are also very much in sympathy with the project and would like to know more about it.

Cordially yours,

A handwritten signature in cursive script, appearing to read 'Abel Beltran del Rio', written in dark ink.

Abel Beltran del Rio

ABR/as

## MEMORANDUM

TO: Rep. Jim Duncan  
FROM: Jerry Gauche  
RE: Policy & Legal Issues Surrounding AGSOC  
DATE: April 4, 1979

---

Following is a discussion of some political and legal issues raised by a memorandum dated March 19, 1979 from Avrum Gross, Attorney General, to Frances Ulmer, Director, Division of Policy Development & Planning, regarding the Alaska General Stock Ownership Corporation legislation, SSHB 240.

### I. TAXATION

The current sponsor substitute for HB 240 fulfills the requirements of Subchapter U of the Internal Revenue Code for tax qualification as a general stock ownership corporation and a corporation organized under its terms would be entitled to special tax treatment. The tax advantages available to GSOCs are presently available to all corporation with 15 or fewer shareholders. The Internal Revenue Code permits small business corporations to avoid corporate income taxes in much the same manner as a general stock ownership corporation. But, for the first time this concept of "integration" of the corporate and personal income tax has been extended to a large corporation through the GSOC.

#### A. State Income Tax.

Alaska law incorporates federal income tax changes unless the legislature acts. Tax benefits provided GSOCs could be denied to AGSOC by the Alaska legislature. However, for Alaska to take special steps to tax AGSOC as a typical corporation would reduce its ability to benefit its shareholders. In addition, the tax treatment provided GSOCs might well generate more income to the state per dollar of corporate earnings than the corporate income tax. In any event, no one has suggested that Alaska deny the tax benefits provided by federal law.

B. Other State Taxes.

AGSOC is subject to all state taxes including severance, property and, if certain investments are undertaken, the oil and gas corporate income tax. There has been no discussion of exempting AGSOC from these taxes and the Department of Revenue understandably opposes any exemption of AGSOC from the oil and gas corporate income tax. Such exemption could harm the state's case in litigation over that tax.

If AGSOC investments subject it to the oil and gas corporate income tax no special problems appear to be presented. The tax reaches income sheltered by multistate and multinational corporations through accelerated deductions, expenses, and shifting of income. AGSOC has no capacity to shift income out of Alaska nor the incentive to shelter income. The flow through of tax liability and high distribution requirements enable the AGSOC to function comfortably under the oil and gas corporate income tax if the tax should apply.

C. Potential Investments.

Several investments have been mentioned as possibilities for AGSOC. However, the concept of a general stock ownership corporation is to make investment decisions at the corporate level based on the good business judgement of professional managers following careful investigation of the alternatives. Selection of investments is designed to be made outside the political process. It is therefore impossible to suggest at this time which project or projects the AGSOC might find appropriate for investment. Because of this freedom of investment selection it would also be unwise to attempt to tailor the taxation of AGSOC through exemption from special taxes such as the oil and gas corporate income tax.

D. Policy Questions.

1. Pressure for Development.

Oil and gas development is one of many possible investments which may be explored by AGSOC. According to the Attorney General such an investment would encourage rapid exploitation of these resources because Alaskans would benefit directly. This suggests that if the people of Alaska benefit directly from development they will act irresponsibly with respect to Alaska's

resources. The status quo avoids any push for exploitation because Alaskans benefit only from taxes on the development earnings of outside corporations.

AGSOC provides an alternative to this status quo if one is willing to believe that Alaskans are capable of making proper decisions regarding their own economic destiny. For the first time, through AGSOC, development earnings will flow to Alaskans instead of the non-Alaskans who have, until now, controlled development in our state. Alaskans will continue to benefit from state ownership and control of the resources. In addition, they will have the opportunity to benefit from extraction and delivery as well.

There is no reason to believe that AGSOC will ravage Alaska in the name of ever higher profits. It is likely that the corporation will become a voice for more responsible development in Alaska. For the first time the people of the state will control a major corporation doing business in Alaska. AGSOC will be an exemplary corporate citizen because its activities will directly affect the quality of its shareholders' lives. Alaskans can be expected to demand responsible actions by the corporation. Unlike many developers here, if AGSOC dumps its garbage in Alaska it will be dumping it in the back yards of its shareholders.

## 2. State Revenues vs. AGSOC Income.

Will AGSOC become a lobbying force for lower state taxes? Every taxpayer in Alaska has some interest in lowering taxes. The real issue is whether AGSOC will change the balance between Alaskans' desire for more government services and lower taxes. Is there reason to believe that AGSOC shareholders will act differently with respect to taxes on AGSOC income than they do with respect to taxes on their other income?

The political and economic issues of state revenues versus disposable personal income are not new to Alaska or the nation. AGSOC does not significantly alter the trade off. The issue cannot be reduced to the simplistic choice between AGSOC dividends or social welfare programs. AGSOC will become only one relatively small component in the complex mix of taxes, government programs, and taxpayer perceptions. Increases in AGSOC dividends from lower taxes will not take food out of the mouths of the poor. AGSOC dividends may well benefit the poor as much, if not more than, the same amount of money doled out by the government as transfer payments.

In any event, there is no reason to presume that the AGSOC will lobby strongly for tax reduction. Alaskans already pay a significant share of their income in state taxes, but there has been no irresponsible drive to eliminate the personal income tax. Those same Alaskans will control the AGSOC. There is no reason to believe that the possibility of some additional dividend income will cause them to raid the state's treasury. The entire discussion of the trade off between state revenues and AGSOC income is mute if we assume that the people of Alaska and their elected representatives will continue to act responsibly in defining the relationship between state revenues and Alaskans' personal income.

## II. "DEPOLITICIZING" AGSOC

"Depoliticize" is a polite word for the elimination of political rights. Proposals to limit the political and legal rights of AGSOC imply that Alaskans cannot be trusted to distinguish between their roles as citizens and shareholders. Therefore, the citizens must be protected from making unfortunate economic decisions by denying the political and legal rights of their corporation. Underlying is the implication that Alaskans should not have the power, independently of the state government, to determine their own economic future.

To suggest that AGSOC will become a "fourth branch of government" is an insult to the integrity of the governor, the legislature and the voters of the state. The proposed abrogation of political rights seems designed to protect the legislature from the influence of a corporation owned by its own people. It seems the legislature needs protection from AGSOC, a corporation owned by Alaskans, more than from other powerful corporate influences in the state.

Attempts to "depoliticize" AGSOC require limitations on the political rights of the corporation. This limits the ability of the corporation to protect the interests of its shareholders. Such limitations suggest that AGSOC shareholders are either less deserving of full political rights than the shareholders of other corporations or so powerful that they do not need the political protections afforded the shareholders of other corporations.

Government is one of the most significant forces affecting the conduct of modern corporate business. Taxes, licensing, and regulation of environmental pollution, securities transactions, transportation, health and safety and many other governmental activities affect the profitability and continued existence of the corporation. In order to protect itself and its shareholders from arbitrary or ill considered actions by the government the corporation must be able to exercise its political rights.

A. Specific Limitations.

Several specific limitations on the political and legal rights of the AGSOC are suggested. It is appropriate to question whether any of these limitations would be constitutional as applied only to AGSOC? These proposals may well be the start of an attempt to limit the political and legal rights of all corporations chartered or doing business in Alaska. If they are appropriate for AGSOC why not for other Alaska corporations as well?

The right to make political contributions is already limited to \$1,000 per year per candidate. AS 15.13.070. The right to lobby is restricted by the existing disclosure provisions of Alaska law. The Attorney General suggests that AGSOC be denied the right to lobby, make political contributions, endorse candidates and reserve comment on state activities affecting the interests of its shareholders. In other words, if the state acts irresponsibly with respect to AGSOC the corporation cannot tell anyone or do anything to change the state's position. It must stand passively by while its shareholders suffer.

The justification for denying AGSOC political rights appears to be that it might have too much influence. Regarding the right to endorse candidates the Attorney General says, "[W]e have absolutely no guarantees that management . . . will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic preferences implemented by vigorous participation in the political arena." We do not deny the political rights of other groups and corporations simply because they seek to implement their political and economic preferences, that is the essence of our system, why should we limit the AGSOC?

There are three points raised by the Attorney General which warrant consideration:

1. Block Voting.

Block voting of AGSOC stock by influential Alaska groups such as natives or labor unions is a possibility. To the extent that the corporation is made more responsive to its shareholders block voting is facilitated. However, we should ask why it is inappropriate for these important Alaskan groups to have an influence on AGSOC? Why is their influence within AGSOC more to be feared than their existing influence within the economic or political arena?

2. Political Popularity.

The Attorney General points out that the governor could be in the "anomalous position of dealing with a more popular, albeit apolitical, leader representing" the AGSOC. This issue may present a political problem for the governor, but certainly is not grounds for denying the people of Alaska the benefits of a general stock ownership corporation.

3. The Springboard.

The suggestion is made that the AGSOC board members might use their positions as springboards to political office. It is not uncommon for individuals who have served in important posts within the state, both in government and the private sector, to subsequently run for political office. To protect against such an eventuality only in the case of the AGSOC would be to discriminate unfairly against that corporation. To deny the people an AGSOC because the directors might "utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office" seems narrow minded indeed.

B. Litigation with the State.

The Attorney General finds an "underlying irony" in the state litigating against the people of the state. This observation reflects again the confusion between the citizens of Alaska and the shareholders of AGSOC.

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

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

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

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

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

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

WORKING PAPER ON  
DIVIDEND DISPERSAL PROGRAMS

File:  
Revised  
ss Dividend Dispersal  
Programs

By Governor Jay S. Hammond

There is increasing interest in providing Alaskans with a "piece of the action" through some method of distributing "dividends."

I am encouraged by this for I believe it appropriate that all Alaskans receive some direct benefits from their resource wealth rather than simply receiving whatever more government we politicians think they should have.

-- ALASKA INC.

Some few years ago, I proposed a means by which a portion of income earned from investments of the public's resource wealth would be distributed in direct dividends to all "shareholders". This proposal became known as Alaska, Inc. I introduced a modified form of Alaska, Inc. again this year, as has Senator Sumner.

-- AGSOC

Another means of granting Alaskans a "piece of the action" has been proposed by Senator Gravel. This is known as "Alaskan General Stock Ownership Corporation" or AGSOC. Unlike Alaska, Inc. which disperses a portion of earnings from investments of citizen-owned resource wealth, an AGSOC would permit citizens to own shares of development programs which might relate - but not necessarily exclusively - to the manner in which that resource wealth was transported, refined or manufactured. The necessary capital to acquire ownership in such endeavor could come either from the sale of tax free revenue bonds, private financing or State guaranteed funds.

-- MUTUALLY EXCLUSIVE OR COMPATIBLE?

While the intent of both programs is similar, there are important distinctions. Moreover, while they are by no means mutually exclusive, I am increasingly convinced that insofar as the State's long term best interest is concerned, an AGSOC can best work only if an Alaska, Inc. program is first put into place and, as well, certain amendments are made to both bills now before us.

In order to discuss my reasons for so concluding, it is necessary first to explain how, ideally, I believe an Alaska, Inc. program should work.

-- MECHANICS OF ALASKA, INC

Each Alaskan would receive, annually, one share of 1/2 the earnings of Permanent Fund investments for every year they have resided in "an area where cost of living was recognized by the Federal government as warranting a 25 percent cost of living pay differential for its employees." While nothing is said about residency versus nonresidency, all Alaskans, of course, would qualify. Those with longer tenure would accrue more shares. Shares would not be transferable. However, new Alaskans, upon qualification, would as well receive shares.

Application for annual dividends could be made upon filing an income tax form attesting to ones having resided during most of the previous year in such a high C.O.L. area. Thus, persons who leave the state would no longer qualify after one year.

In a bill I presented to the Legislature this year, House Bill 99, such "dividends" would come only in the form of tax credits. Moreover, no one would qualify for more than one share for each year during which the applicant had paid State income taxes up to a total of five shares. This five-year limitation was proposed since Department of Revenue tax records are held for only five or six years.

While this approach was taken to curry support from those who wanted tax relief as well as for administrative convenience in checking an applicant's eligibility, it raises serious questions.

For example, all citizens, whether they're taxpayers or not, are impacted by Alaska's high cost of living. Moreover, if you truly believe, as I do, that Alaskans collectively own such resource wealth as their royalty oil, how can we justify dispersing income investments of collectively owned Alaskan wealth selectively to only those who make enough money to have to pay taxes? Accordingly, I would prefer that dividends go to all otherwise qualified citizens either in the form of tax credits or as a negative income tax return.

Additionally, since the rationale for dispersing dividends is based on the belief that with all their energy wealth Alaskans should receive at least some direct relief from the exceptionally high price they've had to pay for energy, then there is little rationale to compensate them for but 5 years of such impact. Compensation should be for each year so impacted.

Though determining the number of years for which each applicant is qualified may seem difficult, it is less difficult than obtaining similar data required for proof of eligibility for receipt of the longevity bonus, guide licenses, limited entry permits, or entry into a pioneer home.

To minimize administrative costs and the likelihood of perjury, we could require an affidavit from the applicant with two other "shareholders" as witnesses. If all parties were to lose eligibility should they perjure themselves, it is unlikely many would falsify claims. In those cases where no witnesses will come forward, shares could be confined to the number of years the applicant can provide documentation to prove his case, i.e., tax records, etc.

The conclusion that an Alaska, Inc. type program should be established before an AGSOC proposal was reached primarily because of the potentials of an AGSOC to place the shareholders' interests precisely at odds with State interests. For example, one AGSOC proposal involves partial purchase of the trans-Alaska oil pipeline. Should all shareholders then get dividends based on the profitability of that purchase, it is to the shareholders' benefit to get the highest possible price - i.e. tariff - for transporting oil. However, the State treasury, including the Permanent Fund, gets more money the lower the tariff. Thus, the AGSOC's interest would be precisely opposite those of the State in regard to the level of tariff. On the other hand, in the case of an Alaska, Inc. type distribution of Permanent Fund earnings, the interests of the State and the shareholders would be precisely the same.

Similarly, if an AGSOC were to invest in a petrochemical plant, its shareholders would benefit if we sold that plant our royalty oil at a cut rate. This too would be a loss to the State's Permanent Fund and to those who did not hold shares of that AGSOC.

Only by passing an Alaska, Inc. type program first could we likely establish conditions where the State and all Alaskans' interests were compatible insofar as maximizing the return from the citizens' resource wealth. Once in place, such programs reduce the likelihood of conflicting AGSOC proposals being undertaken.

In its present form, proposed AGSOC legislation has other problems:

1. Since only one share of stock goes to each person here in Alaska at the time each AGSOC is formed, ultimately there would be two types of Alaskans: those who were shareholders, and those who were not.

Remedy:

One way to remedy this is to amend the bill to provide one share of stock for each year the shareholder has resided in a locale where the government recognizes cost of living impact sufficient to warrant their payment of a 25 percent cost of living differential to government workers. Then all Alaskans would be shareholders.

2. AGSOC shares would be transferable, permitting money to leave Alaska. This should be amended since the prime objective and rationale is to insure that Alaskans get a "piece of the action" to compensate them, in part, for the exceptionally high cost of living impact here in Alaska. Accordingly, persons who have moved to Hawaii or California have no justification for receiving such cost of living offset.

Remedy:

A remedy would be to require that persons make application for their annual dividends on an Alaskan income tax filing form attesting to their having resided during most of the previous year in an area of qualifying high cost of living differential.

3. Another problem is, what if the AGSOC loses money? Who then pays off the bonds or other debt obligations? I am opposed to State guarantees. Would the AGSOC shareholders then become liable?

Remedy:

To offset this concern, were the Alaska, Inc. concept in place first, guarantees or collateral could be an AGSOC shareholder's prospective Alaska, Inc. dividends. Far better to use the AGSOC shareholder's prospective Alaska, Inc. dividends as such than use, as guarantees, Permanent Fund principle or general fund monies which belong to all Alaskans, not just AGSOC shareholders.

4. Under an AGSOC proposal some shareholders may be unwilling participants in programs to which they are philosophically or otherwise ill disposed.

Remedy:

If one is already a shareholder in an Alaska, Inc. program, they should be able to elect whether or not they wish to become an AGSOC shareholder. By so doing, they would not be compelled to participate in some development program they may not favor in order to get any "piece of the action" whatsoever.

Another reason why the Alaska, Inc. program should go in place first is because it would motivate placement of more oil wealth behind the Permanent Fund "rope" where it could not be used for more government or as guarantees for some shakey AGSOC proposal. Since Alaska, Inc. shareholder "dividends" are directly dependent upon the amounts of money placed in the Permanent Fund, there would be a countering pressure to those political pressures which create bigger government.

Because the Alaska, Inc. approach would provide "dividends" from an "enterprise" already returning revenues which belong to all Alaskans, the charge of "improper involvement of government into private sector affairs" is absent. Of course, since AGSOC's are not truly government functions the traditional "undue involvement" charge does not really wash. However, because of the potential impact on government funds to bail out ailing AGSOCs, a reverse concern may be valid: "undue involvement by the private sector in the affairs of government."

Other advantages recommending prior implementation of Alaska, Inc. are its comparative simplicity and the fact that unlike the speculative nature of any AGSOC, we would be betting on a "sure thing." For example, we know that we have a fully capitalized, debt free enterprise in the Permanent Fund which can immediately start paying "dividends". No loans must be made; bonds sold; speculation engaged in. We are already functioning "in the black." Surely if we're going to condition the public to feel comfortable with any "dividend distribution" system at all, we should start with a simplistic "sure" winner.

A major benefit of increasing contributions to the Permanent Fund is that the other half of the resultant increased recurring income from Permanent Fund investments would flow into the General Fund where it could supplant these non-recurring oil wealth dollars now improperly funding our day to day government operations. Such reduction of our dangerous dependence upon principle dollars for funding operations - which should be funded with income dollars - is imperative.

If the AGSOC program goes on the line first, the chances of finding surplus State dollars to place into the Permanent Fund would likely diminish.

Thus, while I favor both the Alaska, Inc. and AGSOC concepts for insuring all citizens a "piece of the action," I believe it imperative that the Alaska, Inc. program be placed on line before an AGSOC be established. Meanwhile, I would like the enabling AGSOC legislation amended to deal with those problems I've previously outlined.

#22:17

SCOMM

# KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

April 17, 1979

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

RE: The Russell Long Study of ESOP Company Results

Dear Senator Long:

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

Key conclusions (average ESOP life 3.3 years):

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

Average results (22 survey companies):

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

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

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

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

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

| <u>Manufacturing</u> | <u>Retail/Wholesale</u> | <u>Other</u>            |
|----------------------|-------------------------|-------------------------|
| Paper                | Food                    | Media Sales             |
| Telecommunications   | Cameras                 | Construction            |
| Graphic Arts         | Furniture               | Trucking                |
| Furniture            | Automobiles             | Hospital                |
| Sash and Doors       | Home Building Supplies  | Drilling Equip-<br>ment |
| Mirrors              |                         | Wholesaler              |
| Paint                |                         | General Whole-<br>saler |
| Plastics             |                         | Appliance               |
| Saws                 |                         | Distributor             |
|                      |                         | Food Processor          |

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

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

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

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

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

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

Cordially,



Dickson C. Buxton  
Chairman of the Board

DCB:ch  
Encls.

# STATE OF ALASKA

File  
AGSOC

## THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

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

### MEMORANDUM

TO: Representative Jim Duncan

FROM: Dale Staley *DES.*  
Legislative Aide

SUBJECT: Washington, D. C. Trip Report

DATE: October 22, 1979

Monday, 9-17-79:

Contacted Wilmer, Cutler & Pickering; on to Senator Gravel's office; call from Governor's D.C. office to review week's agenda, then review of WC & P 9-14-79 memo.

That afternoon, Jerry Gauche and I met with Sam Stern of WC & P to review 9-14-79 memo and future work to be contracted with WC & P. Mr. Stern expressed and we discussed the following concerns:

1. Whom their firm would be representing when requesting rulings from the S.E.C. and I.R.S., i.e., the State, Budget & Audit Committee, Governor, Prime Sponsor. . .
2. Value of stock during that period when AGSOC would be required to buy back. It seems that during the first years of operation, the stock could have a zero or negative book value. Thus, a stockholder who had to leave the State and return his share or shares to the corporation for book value may contend that such a value determination is unconstitutional in that no markets exist and the stock may be paying a dividend.
3. Duration of residency may be court-tested when considering the time-frame between effective date of legislation and date of issue as a requirement for application or receipt of the first share. If this question is brought to court, the date of issue could be delayed indefinitely.
4. Establishing legislative history as to the intent of the legislature in establishing the AGSOC, its proposed purpose, etc. is necessary to provide guidance to the initial

Memo to Jim Duncan  
October 22, 1979  
Page 2

framers of the corporation and for the courts as legal questions arise.

Tuesday, 9-18-79:

Kris Patterson of ANF had met with Bob Davies of NCSL to discuss agreements between state and federal governments. As I understand the process, the Governor contacts a federal agency indicating what he wants; that agency or a lead agency on Executive recommendation, and only with that recommendation begins to work with the State and the agency, develops an agreement to achieve the interagency cooperation toward achieving a specific goal. Another factor in this agreement process came up on the following day, the 19th, in a meeting with David Salazar of Alex Mercure's office. I will cover that point under that date.

On to lunch with Barbara Schlei and Jim Toomey of Department of Agriculture, Marketing Services. Bradner, DeMan, Patterson, Stockdale and I posed questions and fielded concerns expressed by Ms. Schlei and Mr. Toomey. They were emphatic in expressing their desire to assist in sensible development. That is, as Ms. Schlei put it, they would not be interested in assisting with massive agricultural development without first having considered such things as adequate transportation needs to support such successful development. Or, the creation of a large power generation station without reasonable planning for proper transmission of that power to areas of need. That is, if we really have our act together, Agriculture Marketing Services will give all the support they can draw in.

Lee Corcoran was very receptive and well informed about Alaska. DeMan seems to have established a very good rapport with Corcoran. Corcoran appeared to take a liking to Bradner and his political experience and background. This was a touch base meeting which was probably valuable in meetings with other Agriculture Department people, if he went to the trouble to contact others.

The possibility of hitting Cecil Andrus with the D-2 question was posed to John Katz. He was not the least bit interested in assisting in trying to put Andrus on the hot seat before Representatives of other states. So much for that.

Wednesday, 9-19-79:

Another meeting with John Katz, DeMan, Stockdale and myself. Katz laid out the situation; Gravel had really messed things

Memo to Jim Duncan  
October 22, 1979  
Page 3

up by killing the bill last year; then more about how much trouble he was having with Interior staffers lobbying against us on the lands issue.

Kris and I then had a meeting with David Salazar, while Bradner, DeMan and Stockdale met with David's boss, Alex Mercure in the Department of Agriculture. Mr. Salazar was very informative about the agreements Agriculture had with other states. He indicated that no agreement could be reached on any project until the groundwork had been completed. This would mean, as I see it, before Alaska could enter into a state-federal agreement, the design, engineering and impact paperwork would have to be completed for each project included in the proposed agreement. If my understanding of this is correct, there may be a great deal of work yet to be done before we could hope to enter into an agreement with the Feds.

NCSL meetings with Secretary of Transportation, Neil Godschmidt and Secretary of Energy, Charles Duncan were little more than high-powered presentations of the Administration's Windfall Profits Tax Bill. Both Secretaries stressed the importance such a tax would have for providing the resources to fund projects for that State or another; politically, Alaska doesn't appear to have the need for the funds such a tax will provide. The chill of northeast winters, industrial and agricultural states appear to be targets for dropping the revenues of Windfall Profits.

On to the residence of His Excellency, Peter Towe, Ambassador of Canada. A gracious man, as Ambassadors are supposed to be, but he didn't know anything about Federal Industries, White Pass & Yukon Railroad or the Klondike Highway. The Ambassador then called on his Counselor, Mr. Bob Blackburn, for assistance. Mr. Blackburn was very receptive and informed. He was familiar with the industry, highway and the area in general. Development of the north country appeared to be one of his basic concerns and with that; he was very aware of the importance of transportation corridors to proposed development. I hope we will soon receive a response to your letter of October 10, 1979 to Mr. Blackburn regarding continued utilization of both the railroad and highway between Skagway and Whitehorse.

Thursday, 9-20-79:

Breakfast at the Rayburn House Office Building with House congressional leaders, hoop-rah. On to Senator Gravel's office to meet with Jerry Gauche on AGSOC and further review

Memo to Jim Duncan  
October 22, 1979  
Page 4

of the WC & P 9-14-79 memo.

Lunch with Marilina Sanz, Agriculture Liaison for the Governor of Puerto Rico. Ms. Sanz indicated that the agreement they have with the Feds is one to provide technical and/or administrative assistance rather than an agreement which would also provide funding as we would anticipate for Alaska.

At the White House, Jack Watson, Assistant to the President for Intergovernmental Affairs introduced himself; Alfred Kahn, Chairman, Council on Wage and Price Stability; and Stuart Eizenstat, Assistant to the President for Domestic Affairs and Policy.

Eizenstat indicated the need to beef up the office of the President, making it more efficient and effective; the need for a new ethics law, civil service reform, more cost effective and less burdensome regulations, decrease paperwork required by agencies, establish zero-based budgeting for the executive, sunset certain items, direct funding more to distressed rural development areas, and extend general revenue sharing.

Alfred Kahn, Inflation Fighter, said the first blow should be at the federal level with fiscal restraint and monetary controls, and secondly, by the people generally. Regulatory reform, i.e., deregulation of basic industries to stimulate competition. He also indicated the need to lift some environmental controls that tend to be inflationary.

Jack Watson's presentation was basically on energy conservation stressing nine points before he was interrupted by President Carter. Those were as follows:

1. Van Pools - not subject to ICC, states should remove regulations;
2. Small Scale Hydro - Rural Energy Development Initiative;
3. Low-Income Weatherization - need to provide assistance money;
4. Utility Home Audits - to assist the home owner in conservation;
5. Building Energy Construction Standards - for federal building;
6. Technical Assistance for Energy Conservation;

Memo to Jim Duncan  
October 22, 1979  
Page 5

7. Lifting of non-sensical ~~rules~~<sup>rules</sup> and regulations;
8. Energy Facility Siting - to help speed logical development;
9. Development of an Emergency Conservation Program.

President Carter entered and made the same presentation the staff and administration had been playing over and over the last few months. That is, basically, support Windfall Profits Tax and all the good things that would come as a result. I must admit, the fact that this was the President of the United States, just standing some thirty feet from me talking to a relatively small group of about fifty or sixty people did make the whole thing sound a little more reasonable. On to the East Garden and a personal meeting with Jack Watson and the President . . . it was impressive.

Friday, 9-21-79:

Department of Agriculture, Farmers Home Administration, Gordon Cavanaugh, Administrator and Bob Butler, formerly of ASHA. Mr. Cavanaugh implied that ~~the~~ legislation currently in the mill, providing 10 million for Alaska may increase to 60 million. If this (S. 918) comes through at that high level, something should be worked out with existing lenders in the State to handle the additional funds. Mr. Butler indicated that under the current formula system, Alaska is receiving 1.75 million (FmHA) but that is to be increased to 21 million and he expects a lot of activity in Alaska this coming year.

John Waller, Assistant to Assistant Secretary Ernie Green and in charge of Employment and Training was very receptive and helpful. He should be sending us material on DOL's new thrust for American Indian and Migrant Worker Assistance. Mr. Waller should be a good contact if we find a need for any help from the Department of Labor.

DS/jp

96th Congress }  
1st Session }

COMMITTEE PRINT

THE ROLE OF THE FEDERAL GOVERNMENT  
AND EMPLOYEE OWNERSHIP  
OF BUSINESS

---

SELECT COMMITTEE ON SMALL BUSINESS  
UNITED STATES SENATE



REVISED MARCH 20, 1979

Printed for the use of the Select Committee on Small Business

---

U.S. GOVERNMENT PRINTING OFFICE

42-129 O

WASHINGTON : 1979

## SELECT COMMITTEE ON SMALL BUSINESS

GAYLORD NELSON, Wisconsin, *Chairman*

SAM NUNN, Georgia

JOHN C. CULVER, Iowa

WALTER D. HUDDLESTON, Kentucky

DALE BUMPERS, Arkansas

ROBERT MORGAN, North Carolina

JAMES R. SASSER, Tennessee

DONALD W. STEWART, Alabama

MAX BAUCUS, Montana

CARL LEVIN, Michigan

LOWELL P. WEICKER, Jr., Connecticut

BOB PACKWOOD, Oregon

ORRIN G. HATCH, Utah

S. I. HAYAKAWA, California

HARRISON H. SCHMITT, New Mexico

RUDY BOSCHWITZ, Minnesota

LARRY PRESSLER, South Dakota

WILLIAM B. CHERKASKY, *Executive Director*

COREY M. ROSEN, *Professional Staff Member*

ROBERT J. DOTCHIN, *Minority Staff Director*

## SUMMARY

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

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

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

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

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

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

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

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

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

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

## CONTENTS

---

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

## THE ROLE OF THE FEDERAL GOVERNMENT AND EMPLOYEE OWNERSHIP OF BUSINESS

### INTRODUCTION

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

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

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

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

<sup>1</sup> From data gathered for a forthcoming study by Donna Sockell of Cornell University.

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