SCOMM

#32:13

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

October 2, 1979

Hon. Jim Duncan
House of Representatives
State Capitol
Pouch V
Juneau, Alaska 99811

Dear Jim:

The initial task in our project for Alaska has been to assemble and analyze the existing data, plans and concepts bearing on the Alaskan economy. These have included existing financial and demographic data; goals for revenue, housing, amenities, commerce and industry; and Alaska's unique resources. We will soon be ready to begin an assembly of demographic data at the State, region and community level. The data will include projections of population, disposable purchasing power, housing, and consumer and commerce expenditures. Based on projected demand for goods and services, and the projected availability of goods and services in the State, we will estimate what might accrue to or be required by various industries under several reasonable assumptions.

Because of its natural resources, geography and population, Alaska has a unique opportunity to develop new industries. For example, there are several types of industry which require or could benefit from water access or availability and our study will investigate them. The present analysis cannot include industry feasibility studies, but we will flag industry opportunities for further follow-up by the AGSOC staff.

We have divided the existing Alaskan economy into the following component parts and assigned staff to each for study and review:

Motel & Hotel	Manufacturing
Fishing	Alaska Railroad
Hard Rock Minerals	Airlines
Oil & Gas	Financial Institutions
Petrochemicals	Communications
Agriculture	Truck Transport
Construction	Services
Electric Power	Miscellaneous

Hon. Jim Duncan
October 2, 1979
Page Two

Our first field trip to Alaska will begin the week of October 8th. Louis Kelso and John Miskimen will visit companies, trade associations, Chambers of Commerce and government leaders in Juneau, Anchorage, Fairbanks and Ketchikan. To give you some idea of the field work that will be needed, there are nine telephone utilities in Alaska each with revenues of over $1 million annually.

We have added two new staff members largely for this project. Eric Bramstedt is a well known transportation and general public utility analyst with some twenty-two years of experience. Owen Henry has backgrounds in economics and accounting.

We have completed cataloging the preliminary list of financing sources. To provide for maximum possible interaction with the financial community, we will meet weekly with potential investors from this list to determine preliminary indications of interest. The list will thus be gradually reduced to more manageable size for complete analysis and evaluation. This process will be ongoing during the contract period.

Sincerely,

KELSO & CO., INCORPORATED

John Miskimen

John A. Miskimen
Senior Vice President

JAM:bp

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

November 2, 1979

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

Report 2
AGSOC Study

Dear Jim:

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

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

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

All expressed interest in AGSOC developments, however, as anticipated, we are having difficulty with definitive information because of the uncertain initial capital structure of AGSOC. Unless AGSOC is to limit itself to immediately productive investments such as a TAPS participation, a substantial equity or quasi-equity base will have to be established. Based on the experience of British Columbia Resources Investment Corporation and relating it to the population of Alaska, suggests that $80,000,000 could be raised through a supplemental common stock sale to residents. In the B.C. Resources' case, 15.0 million shares were gifted and 81.2 million shares sold to residents for $487 million. Because of the ten share limitation, AGSOC would probably choose to use a convertible debenture issue in lieu of straight common. We look forward to the meeting in Vancouver on November 9th for further discussion of this matter.

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

Sincerely,

KELSO & CO., INCORPORATED

John A. Miskimen

John A. Miskimen
Senior Vice Prsident

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS
GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

Consultant to Kelso & Co., Incorporated

G. STEPHEN JIZMAGIAN

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

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

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

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

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 (415) 788-7454

Alaska State Legislature

House of Representatives

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

MEMBER
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

November 14,
~~October 3~~, 1979

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

Dear Mr. Kelso:

Please find enclosed a State warrant (No. ~~170976~~ 194275) in the amount of ten thousand dollars (10,000.00). This is the second ~~first~~ installment as per our contract.

Sincerely,

Jim
Jim Duncan

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

DATE OF ISSUE
09 30 79
MO. DAY YR.

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

No. 170976

89-52
1252

DO NOT FOLD, SPINDLE OR MUTILATE

DOLLARS	CENTS
$****10,000	00

PAY TO THE ORDER OF

K LSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

$10,000.00 330 170976

⑈2170976⑈ ⑆1252⑉0052⑆

W.R. Hudson
COMMISSIONER OF ADMINISTRATION

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

September 25, 1979

Invoice #2355

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

I N V O I C E

First installment as per our contract dated August 17, 1979	$10,000.00

Hold for receipt of report.

THANK YOU

RECEIVED
OCT 1 1979
BUDGET/AUDIT COMMITTEE

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS
GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

November 2, 1979

RECEIVED
NOV 6 1979
BUDGET/AUDIT
COMMITTEE

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

Report 2
AGSOC Study

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

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Sincerely,

KELSO & CO., INCORPORATED

John A. Miskimen

John A. Miskimen
Senior Vice Prsident

JAM:bp

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

Consultant to Kelso & Co., Incorporated

G. STEPHEN JIZMAGIAN

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

Alaska State Legislature

House of Representatives

State Capitol
Pouch V
Juneau, Alaska 99811
465-3818

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

MEMBER
Finance Committee

REPRESENTATIVE
JIM DUNCAN
CHAIRMAN
Budget & Audit Committee

November 13, 1979

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

Dear Mr. Kelso:

Please find enclosed a State warrant (No. 211622 ~~194275~~) in the amount of Ten Thousand Dollars ($10,000.00). This is the third ~~second~~ installment as per our contract.

Sincerely,

Jim

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

DATE OF ISSUE
11 07 79
MO. DAY YR.

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

No. 194275

89-52
1252

THE SEAL OF THE STATE OF ALASKA

PAY TO THE ORDER OF

KELSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

DO NOT FOLD, SPINDLE OR MUTILATE

DOLLARS	CENTS
$ ***10,000	00

W.R. Hudson
Commissioner of Administration

$10,000.00 330 194275

⑈2194275⑈ ⑆1252⑉0052⑆

HAINES JUNEAU - DOUGLAS KLUKWAN SKAGWAY

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

October 29, 1979

Invoice #2374

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

I N V O I C E

Second installment as per our contract dated August 17, 1979	*$10,000.00*

THANK YOU

OK
Jim Duncan

RECEIVED
OCT 31 1979
BUDGET/AUDIT
COMMITTEE

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

November 30, 1979

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

RECEIVED
DEC 3 - 1979
BUDGET/AUDIT
COMMITTEE

Report 3
AGSOC Study

Dear Jim:

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

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

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

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

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

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

The distribution was an awesome and expensive undertaking. Because it involved a potential distribution to 2.4 million people, it required the utilization of all the financial institutions in the Province. Without the full participation of those institutions, involving some 1,300 individual locations, the job could not have been accomplished. Each branch of these institutions agreed to accept applications upon presentation of two forms of identification. The computer operations at BCRIC then sorted to avoid duplications.

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

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

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

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

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

> 81% of Canadian Cellulose, a public company and a major pulp and lumber producer in the Province.
>
> 100% of two medium-sized lumber producers, Kootenay Forest Products and Plateau Mills, the former also a producer of sheathing plywood.
>
> 10% of the shares of Westcoast Transmission, a natural gas pipeline company controlled by Pacific Gas & Electric Company.
>
> A license to explore for gas and oil on some 2.3 million acres of public land in northeastern British Columbia.

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

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

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

Sincerely,

KELSO & CO., INCORPORATED

John A. Miskimen

John A. Miskimen
Senior Vice President

JAM:bp

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

November 30, 1979

Invoice <u>#2392</u>

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

I N V O I C E

Third installment as per our contract dated August 17, 1979	*$10,000.00*

THANK YOU

Approved
D. Duncan

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

Alaska State Legislature

House of Representatives

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

MEMBER
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

December 12, 1979

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

Dear Mr. Kelso:

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

Sincerely,

Jim

Jim Duncan

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

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

No. 211622

89-52
1252

DATE OF ISSUE
12 11 79
MO. DAY YR.

DO NOT FOLD, SPINDLE OR MUTILATE

DOLLARS	CENTS
$****10,000	00

PAY TO THE ORDER OF

KELSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

W.R. Hudson

Commissioner of Administration

$10,000.00 330 211622

⑈2211622⑈ ⑆1252⑉0052⑆

HAINES — JUNEAU-DOUGLAS — KETCHIKAN — SKAGWAY

10-18 John Miskiner @ our office in Juneau
Native Corp. Shareholder persons
Schnedor? possible 25% unlocatable residents
also Speaker Pres. Gov. selection of initial
Board -
what about judicial type selection process
done ~~Send John info on B.C. mtg~~
~~and David Reaume copy of [illegible] Council~~
~~report~~ also terms & conditions of Timber Contract

Corp. [illegible] can [illegible] accept
[illegible]
[illegible] Finance & Comm. General
[illegible] would provide support
money
[illegible] A ABSOC
B group of [illegible]
A would [illegible] Cap Move but
cannot because of statute so they
work a trade of investment with
B so B actually invests in Cap Move
should Mandate AGSOC not in any
way get involved in such

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

January 2, 1980

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

Report 4
AGSOC Study

Dear Jim:

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

TAPS

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

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

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

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

LEASING

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

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

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

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

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

Leasing is a competitive business. Initially, we investigated AGSOC leasing aircraft to Alaska Air Lines, for example. However, Alaska Air Lines has multiple proposals for such leases and at much more favorable rates than could be offered by AGSOC. The reasons for strong competition, especially in aircraft, are the favorable tax advantages (increasing for those in higher than 50% tax brackets) and high resale residual values for aircraft after the initial lease terms. Many lessors will therefore sacrifice short term cash flow for current tax benefits and long term profits. The best opportunities for AGSOC would seem to be areas of leasing where lease competition is not so high, e.g., for leasing to start-up business ventures, and in other situations where financing sources are difficult to obtain.

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

MOTEL AND HOTEL

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

FISHING

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

HARD ROCK MINERALS

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

OIL AND GAS

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

PETROCHEMICALS

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

AGRICULTURE

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

ELECTRIC POWER

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

ALASKA RAILROAD

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

TRANSPORTATION

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

FURTHER CANADIAN MOVES TO
BROADEN OWNERSHIP OF INDUSTRY

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

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

Very truly yours,

KELSO & CO., INCORPORATED

By Louis
Louis O. Kelso
Chairman of the Board

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

February 1, 1980

Invoice #2420

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

INVOICE

Final installment as per our contract dated August 17, 1979	$10,000.00

THANK YOU

RECEIVED
FEB 6 1980
BUDGET/AUDIT
COMMITTEE

MIKE GRAVEL
ALASKA

United States Senate

WASHINGTON, D.C. 20510

Went over #1, 2 and 3 with Kelso
7-17-79 [illegible] 7-23

M E M O R A N D U M

TO: Senator Gravel

FROM: Tyler Jones

RE: Louis Kelso's proposal to the Legislature

DATE: July 5, 1979.

For $245,000 Kelso proposed that his firm:

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

? 2) Lay the foundation for working with the 1980 census with respect to necessary stockholder information. This would include adding questions to the Census Bureau's questionnaires for Alaska; [illegible] Kelso.

OK 3) Develop an outline of the types of investment opportunities for AGSOC; [illegible]

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

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

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

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

June 19, 1979

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

Dear Mr. Chairman:

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

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

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

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

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

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

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

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

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

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

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

OK

Analysis, Cataloging and Evaluation Of Financing Sources

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

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

 Forms to press

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

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

ok Development of Types of Potential Investment Opportunities for AGSOC

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

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

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

The office of the Hon. Russell B. Long, Chariman of the United States Senate Finance Committee, estimates that there are approximately 3,000 Employee Stock Ownership Plans operating in the United States. The overwhelming evidence is that these financing techniques bring about spectacular improvements in the productivity, profits, sales, increase in net worth, and even income tax payments of the companies that adopt them. The ESOP is a double tax shield: it gives employees access, through credit, to the pre-corporate-income tax return on net worth of the shares that the employees have purchased through their ESOP in order to pay principal and interest on the debt incurred to make such acquisition. At the same time, the ESOP is a tax shield against current, year-to-year taxation of employees while they are accumulating viable capital estates. Federal tax law, however, is still flawed with respect to ESOPs: it taxes the employee when his portfolio (or its cash equivalent) is removed from the ESOP trust. This is simply evidence of the historical confusion resulting from the use, pioneered by our firm, of "deferred compensation" legislation for purely financing purposes, i.e., the purchase of capital assets and the payment of the purchase price out of the income thus produced. Legislation to correct that defect was introduced into the 54th Congress by U. S. Congressman William Frenzel (from Minnesota) and its introduction, we are informed, is planned again in the current Congress by Senator Long. Opposition to the last mentioned tax aspect, namely the elimination of personal income taxation upon taking possession of the capital accumulation as it is released from the trust, has been presented by the United States Treasury on the ground that it would cause an excessive loss of revenue to the Federal government. We have accumulated a great deal of evidence to the contrary, however, demonstrating that the Federal Government derives a net benefit from raising the productiveness and incomes of consumer units by equipping them with productive capital.

Virtually all of the estimated 3,000 or so ESOPs now in existence have been adopted since 1970 when the firm of Kelso & Co., Incorporated was organized. The ESOP functions by giving employee-participants (who become, through the ESOP trust, beneficial stockholders of their employer) access to the corporate pre-tax return on invested net worth of the shares which are allocated to their accounts to pay for the stock which they have bought. Furthermore, the ESOP defers (usually until the participant's retirement) taxation on the sums applied to amortization of acquisition debt. Thus the value of the stock received from the ESOP trust is partly taxable as ordinary income and partly at capital gain rates. Even this "deferred taxation" is the result of an historical accident. In seeking to apply the theory of capitalism to the practical financing problems of a business corporation in such manner as to build the ownership of newly formed capital, or newly acquired capital assets, into employees as those assets pay for themselves in pre-corporate-income tax dollars, it was expedient to use Section 401(a) of the Internal Revenue Code as a <u>financing device</u>, even though it was originally intended only to provide "deferred compensation." Thus, the theory of capitalism, as applied to employee stock ownership plans, is not yet perfected to its ultimate efficiency, and will not be so until an employee, upon retirement, can take his portfolio of stock (or its cash equivalent) out of the ESOP trust without tax consequences, so long as he keeps it invested in productive capital which will help to make him a better income tax payer, and a better customer for business.

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

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

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

Development of Organizational Structure and Procedures for AGSOC

No

It has appeared to us that many of the questions raised about the future operations of AGSOC have resulted from the fact that little attention has been, or up to this point could be, devoted to developing and defining concretely a proposed rational management structure for AGSOC and operations procedures to enable it to accomplish the various tasks which it is expected to accomplish by the pending legislation. Under this proposal, working with management consultants approved by the representative of the Legislature, we would seek to define and design and appropriate management structure for AGSOC and operations procedures that can be readily adapted to it or adopted by its management to facilitate its accomplishing its various functions, including building its data-base, its identification and evaluation of investments, and its arranging for the financing of their acquisition; its establishment of escrow accounts for each of its stockholders; its organization of a trust department (or in the alternative its employment of a professional trustee) for the handling of its stockholder accounts, its dividends, its notifications to stockholders; it calling of meetings of its board and of its stockholders, etc.

WCOP

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

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

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

The end result of this effort should enable AGSOC to fully live up to the expectations of the Securities and Exchange Commission from the moment that it becomes operational, and at the same time should enable the Securities and Exchange Commission to understand and to know what to expect from a general stock ownership corporation such as AGSOC. Many months of delays in the future, when such delays could be extremely costly, can, we are confident, be avoided by these efforts during the intervening months before the next session of the Eleventh Legislature of Alaska is convened.

Time of Performance

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

Our Proposed Fee for Services

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

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

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advance status of the project that can be presented to the next session of the Alaska legislature. It is momentum-maintaining work; it is work that advances necessary preparations to the launching of AGSOC if the pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays.

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

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

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

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

KELSO & CO., INCORPORATED

By Louis O. Kelso

Louis O. Kelso, President
and Chief Executive Officer

co

August 14, 1979

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

Dear Senator Gravel:

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

1. Review federal securities law problems that would be raised by the proposed AGSOC legislation and initiate discussion with the federal Securities and Exchange Commission in accordance with recommendations set forth in Wilmer, Cutler & Pickering memorandum dated November 2, 1978.

2. Review federal tax problems that might arise in implementing the proposed AGSOC legislation including any federal tax problems that might occur upon initial distribution of shares. Initiate appropriate discussions with the Treasury Department and/or Internal Revenue Service and submit a federal tax ruling request if necessary to confirm the federal tax consequences of the AGSOC proposed legislation.

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

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

economy against a criterion of maximum return to stockholders.

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

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

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

Respectfully,

Jim Duncan

JD:jp

Alaska State Legislature

House of Representatives

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

MEMBER
FINANCE COMMITTEE

August 30, 1979

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

Dear Mr. Kelso:

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

Sincerely,

Dale Staley

Jim Duncan for

JD:jp

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

DATE OF ISSUE
08 24 79
MO. DAY YR.

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

No. 149374

89-52
1252

DO NOT FOLD, SPINDLE OR MUTILATE

DOLLARS	CENTS
$***10,000	00

PAY TO THE ORDER OF

KELSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

THE SEAL OF THE STATE OF ALASKA

COMMISSIONER OF ADMINISTRATION

$10,000.00 330 149374

⑈2149374⑈ ⑆1252⑉0052⑆

31-01LH

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU 99801

CONTRACT BETWEEN

STATE OF ALASKA
LEGISLATIVE FINANCE DIVISION

AND

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

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

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

IT IS THEREFORE MUTUALLY AGREED THAT:

CLAUSE I - STATEMENT OF WORK

(A) The Contractor shall provide a design study for a General Stock Ownership Plan in the manner described in the Contractor's proposal to the State of Alaska, dated July 10, 1978, as amended by the deletions indicated on the attached copy of said proposal.

(B) The Contractor shall provide draft proposals of the State and Federal legislation necessary to implement the General Stock Ownership Plan developed in the design study.

? (C) The Contractor shall provide an analysis of the possible adverse effect upon the flow of Federal aid due to the successful establishment of an Alaskan General Ownership Plan and recommendations for dealing with this potential problem.

(D) The Contractor may purchase the services and provide for the expenses of other consultants or professionals selected with the written approval of the Project Director.

(E) In the event of any conflict between the amended proposal and this agreement, this agreement shall govern.

CLAUSE II - PERIOD AND DATES OF PERFORMANCE

(A) The Contractor shall submit the study and proposed legislation on or before February 1, 1979. The report shall be submitted in duplicate in a form suitable for offset printing to the Project Director.

(B) The period of this contract shall begin on the date it is executed by all parties and terminate on February 1, 1979 unless extended or terminated by written agreement.

CLAUSE III - PRJECT DIRECTOR

The Project D'-ector shall be Sen. Mike Colletta & Rep. Jim Duncan, c/o Legislative Fi.ance Division, Pouch WF, Juneau, Alaska 99811.

CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT

(A) Contractor's total compensation, including all expenses for the work described in Clause I, shall be $180,000, and shall be payable to the Contractor as follows:

(1) On the date this contract is executed - $30,000.

(2) The payment of the balance in monthly installments of $30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.

(3) Out-of-pocket expenditures approved in advance by the State of Alaska will be billed monthly and due within 15 days of billing therefor by Kelso & Co.

CLAUSE V - PROGRESS REPORTS

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

CLAUSE VI - RECORDS, DOCUMENTS, AUDIT

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

CLAUSE VII - ALL WRITINGS CONTAINED HEREIN

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

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

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

Louis O. Kelso

Louis O. Kelso
President & Chief
Executive Officer

September 1, 1978
Date

THE STATE OF ALASKA

Jim Duncan
Mike Colletta 25 Aug 78

Sen. Mike Colletta — Date
Chairman, Legislative
Budget & Audit Committee

John C. Sackett

Sen. John Sackett — Date
Chairman, Senate
Finance Committee

20 Sept 1978

Rep. Steve Cowper — Date
Chairman, House
Finance Committee

George Hohman
Jim Duncan 15 Sept 78

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS
GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

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

July 10, 1978

INTRODUCTION

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

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

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

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

PROPOSED FEE FOR OUR SERVICES IN THE ACCOMPLISHMENT OF THIS PROPOSAL

We propose as a fee for our services in developing and perfecting the design of an Alaskan General Stock Ownership Corporation, the sum of $180,000. This sum would cover not only our services and all of our out-of-pocket expenditures, but the services and expenses of consultants, selected with advance approval by the State's representatives, to participate in the project.

We propose that the fee would be payable as follows:

1. An initial retainer of $30,000 upon the execution on behalf of the State of Alaska of this proposal memorandum, thus establishing an agreement between our firm and the State of Alaska.

2. The payment of the balance in monthly installments of $30,000 each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.

7 An increase in a particular monthly fee (thus shortening the overall payment period) will be considered by the State of Alaska in the event approved out-of-pocket expenditures, combined with compensation for the ongoing efforts of our firm, for a particular month are materially higher than the average contemplated over the performance period.

COMPLETION OF THE DESIGN STUDY

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

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

LEGAL PROBLEMS

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

It seems at the outset reasonably clear that at the most, exemption from Federal personal income taxation on dividends declared by AGSOC on its stock can be achieved only so long as neither the stock nor the dividend income itself is available for personal disposition by the subscriber or stockholder. Beyond that point, Federal legislation will be required, but it is submitted, an excellent foundation has been made for such Federal exemption. It is necessary to effectively broaden the capital ownership base of the American economy, and the Joint Economic Committee has already officially recommended, in its 1976 Annual Report to Congress, that the rate of new capital formation be accelerated and that the base of ownership be broadened. It should be pointed out that the availability or non-availability of the Federal personal income tax exemption would not necessarily affect the feasibility of the plan itself, but rather, the length of time required for each stockholder's stock to pay its purchase price out of its dividends.

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

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

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

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

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

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

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

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

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

KELSO & CO., INCORPORATED

By______________________________
Louis O. Kelso, President and
Chief Executive Officer

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

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

Wilmer Cutler & Pickering

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

6-17

Analysis, Cataloging and Evaluation Of Financing Sources

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

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

7-24

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

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

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

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

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

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

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

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

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

I Potential investment opportunities
listed by relative significance of dividend pmts

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

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GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

June 19, 1979

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

Dear Mr. Chairman:

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

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

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

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

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

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

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

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

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

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

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

Analysis, Cataloging and Evaluation Of Financing Sources

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

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

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

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

Development of Types of Potential Investment Opportunities for AGSOC

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

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

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

The office of the Hon. Russell B. Long, Chariman of the United States Senate Finance Committee, estimates that there are approximately 3,000 Employee Stock Ownership Plans operating in the United States. The overwhelming evidence is that these financing techniques bring about spectacular improvements in the productivity, profits, sales, increase in net worth, and even income tax payments of the companies that adopt them. The ESOP is a double tax shield: it gives employees access, through credit, to the pre-corporate-income tax return on net worth of the shares that the employees have purchased through their ESOP in order to pay principal and interest on the debt incurred to make such acquisition. At the same time, the ESOP is a tax shield against current, year-to-year taxation of employees while they are accumulating viable capital estates. Federal tax law, however, is still flawed with respect to ESOPs: it taxes the employee when his portfolio (or its cash equivalent) is removed from the ESOP trust. This is simply evidence of the historical confusion resulting from the use, pioneered by our firm, of "deferred compensation" legislation for purely financing purposes, i.e., the purchase of capital assets and the payment of the purchase price out of the income thus produced. Legislation to correct that defect was introduced into the 54th Congress by U. S. Congressman William Frenzel (from Minnesota) and its introduction, we are informed, is planned again in the current Congress by Senator Long. Opposition to the last mentioned tax aspect, namely the elimination of personal income taxation upon taking possession of the capital accumulation as it is released from the trust, has been presented by the United States Treasury on the ground that it would cause an excessive loss of revenue to the Federal government. We have accumulated a great deal of evidence to the contrary, however, demonstrating that the Federal Government derives a net benefit from raising the productiveness and incomes of consumer units by equipping them with productive capital.

Virtually all of the estimated 3,000 or so ESOPs now in existence have been adopted since 1970 when the firm of Kelso & Co., Incorporated was organized. The ESOP functions by giving employee-participants (who become, through the ESOP trust, beneficial stockholders of their employer) access to the corporate pre-tax return on invested net worth of the shares which are allocated to their accounts to pay for the stock which they have bought. Furthermore, the ESOP defers (usually until the participant's retirement) taxation on the sums applied to amortization of acquisition debt. Thus the value of the stock received from the ESOP trust is partly taxable as ordinary income and partly at capital gain rates. Even this "deferred taxation" is the result of an historical accident. In seeking to apply the theory of capitalism to the practical financing problems of a business corporation in such manner as to build the ownership of newly formed capital, or newly acquired capital assets, into employees as those assets pay for themselves in pre-corporate-income tax dollars, it was expedient to use Section 401(a) of the Internal Revenue Code as a <u>financing device</u>, even though it was originally intended only to provide "deferred compensation." Thus, the theory of capitalism, as applied to employee stock ownership plans, is not yet perfected to its ultimate efficiency, and will not be so until an employee, upon retirement, can take his portfolio of stock (or its cash equivalent) out of the ESOP trust without tax consequences, so long as he keeps it invested in productive capital which will help to make him a better income tax payer, and a better customer for business.

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

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

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

<u>Development of Organizational Structure and Procedures for AGSOC</u>

It has appeared to us that many of the questions raised about the future operations of AGSOC have resulted from the fact that little attention has been, or up to this point could be, devoted to developing and defining concretely a proposed rational management structure for AGSOC and operations procedures to enable it to accomplish the various tasks which it is expected to accomplish by the pending legislation. Under this proposal, working with management consultants approved by the representative of the Legislature, we would seek to define and design and appropriate management structure for AGSOC and operations procedures that can be readily adapted to it or adopted by its management to facilitate its accomplishing its various functions, including building its data-base, its identification and evaluation of investments, and its arranging for the financing of their acquisition; its establishment of escrow accounts for each of its stockholders; its organization of a trust department (or in the alternative its employment of a professional trustee) for the handling of its stockholder accounts, its dividends, its notifications to stockholders; it calling of meetings of its board and of its stockholders, etc.

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

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

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

The end result of this effort should enable AGSOC to fully live up to the expectations of the Securities and Exchange Commission from the moment that it becomes operational, and at the same time should enable the Securities and Exchange Commission to understand and to know what to expect from a general stock ownership corporation such as AGSOC. Many months of delays in the future, when such delays could be extremely costly, can, we are confident, be avoided by these efforts during the intervening months before the next session of the Eleventh Legislature of Alaska is convened.

Time of Performance

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

Our Proposed Fee for Services

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

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

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advance status of the project that can be presented to the next session of the Alaska legislature. It is momentum-maintaining work; it is work that advances necessary preparations to the launching of AGSOC if the pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays.

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

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

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

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

KELSO & CO., INCORPORATED

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

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KELSO & CO.
INCORPORATED
INVESTMENT BANKERS
GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

July 24, 1979

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

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

Dear Mr. Chairman:

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

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

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

> "In our preliminary discussion of this proposal with members of the Alaskan Legislature and staff members on June 11-13, 1979, it was emphasized that it would be desirable for us to suggest separate fee amounts for each of the work items in the proposal. We think that this is not feasible because of the nature of the work proposed.
>
> None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advanced status of the project that can be presented to the next session of the Alaska Legislature. It is momentum-maintaining work; it is work that advances necessary preparations to the launching of AGSOC if the

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

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

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

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

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

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

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

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

Unless objected to by the Committee or its representative, we would explore the levels of resistance which might be encountered in seeking unprecedented sources for financing, such as arranging, through legislative changes if necessary, for the discount of AGSOC loan paper with the Federal Reserve Bank.

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

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

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

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

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

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

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

SPECIAL NOTE CONCERNING CONFERENCES WITH THE SECURITIES AND EXCHANGE COMMISSION

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

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

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

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

Yours truly,

KELSO & CO., INCORPORATED

By Louis O. Kelso

Louis O. Kelso, President and
Chief Executive Officer

LOK:cae

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

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

M E M O R A N D U M

June 18, 1979

SUBJECT: Meeting with Kelso & Co., Inc.

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

Representative Mike Miller, Chairman
State Affairs Committee

FROM: Kenneth M. Rosenstein KMR
Legislative Counsel

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

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

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

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

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

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

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

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

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

(2) Prepare a detailed analysis of the bill.

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

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

cc: Milt Barker
Jerry Gauche

STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

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

M E M O R A N D U M June 18, 1979

SUBJECT: Meeting with Professor Fessler

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

Representative Mike Miller, Chairman
State Affairs Committee

FROM: Kenneth M. Rosenstein
Legislative Counsel

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

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

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

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

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

Professor Fessler had the following additional comments:

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

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

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

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

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

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

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

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

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

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

(10) The prohibited political activities should be expressly declared as <u>ultra vires</u>.

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

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

KMR:jdn

cc: Milt Barker
Jerry Gauche

April 10, 1979

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

Dear Representative Miller:

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

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

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

1. THE FIRST FULL PARAGRAPH ON PAGE 3

The question of whether the State should follow the policy of the federal legislation and exempt AGSOC from State corporate income tax and from certain other State level taxes which might otherwise be imposed on the corporation are, of course, precisely the kinds of questions that only the legislature can answer. There is one erroneous statement at the end of the paragraph, however, and that is that our firm, as investment bankers, is presently recommending "the new AGSOC purchase BP's share of TAPS." We, in our instructions from the legislature, were expressly requested to avoid recommendations as to AGSOC's investments, although, basically to illustrate feasibility, we believe, we were asked to do a feasibility study of that particular purchase.

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

2. THE LAST FULL PARAGRAPH ON PAGE 3

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

7. PAGE 11, SECTION IV. <u>CORPORATE DEMOCRACY</u>

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

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

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

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

8. DESIRABILITY OF A HIGH FORUM REQUIREMENT

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

9. LESIGLATION ASSURING ADEQUATE NOTICE OF MEETINGS

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

10. THE CORPORATE BY-LAWS

The memorandum suggests that the power to amend the By-Laws should be reserved to the shareholders "in order to ensure adequate public review." We believe that such a provision would be too expensive and too restrictive in terms of efficient governance of the corporation, and excessively wasteful of time.

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

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

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

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

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

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

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

Sincerely,

KELSO & CO., INCORPORATED

By Louis O. Kelso
Louis O. Kelso

By John A. Miskimen
John A. Miskimen

LOK/JAM:ch

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

Volume II
+ WC&P Memos
+ Subchapter U.

AGSOC

INVESTMENT INVESTIGATION OUTLINE

I. Determine the rationale for considering the acquisition in as much depth as possible.

   A. Is the purchaser looking for a passive investment?
   B. Is he looking to add his managerial ability or other special ability to the acquired company?
   C. Is there an unusual advantage in an acquisition that combines one company with another so that the combined companies appear to have greater earnings potential than the companies operating separately -- for example, combining raw material supplier, manufacturer, or marketing organization?
   D. Is the seller's reason for sale a satisfactory explanation from the prospective buyer's view?

II. Make a "businessman's" review of the prospective acquisition including the following:

   A. General and administrative.
      1. History of business.
      2. Legal form of organization -- major rights, provisions, and restrictions.
      3. Ownership of business. Will any acquired stockholder obtain a major position in combined company?
      4. General policies of corporation.
      5. Organization chart.
      6. Description of management personnel.
      7. Interest of management personnel in continuing after acquisition.
      8. Contracts and patents.

   B. Product.
      1. Description of product.
      2. Competition.
      3. Distribution methods.
      4. New product development.
      5. Pricing policies.
      6. Marketing methods.

   C. Manufacturing
      1. Process.
      2. Geographical location of plant.
      3. Plant facilities.
      4. Work force.
      5. Efficiency of plant.

D. Financial.

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

(8) Earnings stability test.
(9) Earnings and book value per share if stock acquisition.
(10) Cash throw-off.

g. Prepare summary source and application of funds statement for the period under investigation and projected statements for two or three years, or longer if possible.
   (1) Again, these should reflect post-acquisition changes.
   (2) One major obstacle which must be overcome for a useful projection of source and application of funds is an estimate of capital addition requirements.
   (3) Attention must also be directed to the maximum and minimum cash position itself during the year, particularly if a bootstrap purchase is contemplated.

h. All major balance sheet accounts should be reviewed with probably the closest attention being directed to the following potential trouble spots:
   (1) Accounts receivable.
      (a) Past-due customer notes and accounts receivable.
      (b) Balances in excess of 10 percent of total receivables.
      (c) Adequacy of reserve for bad debts.
   (2) Inventories.
      (a) Latest review for obsolete stock and action taken thereon -- if there are long-term contracts in process, it is of special importance to ensure that costs to complete will not result in material losses not provided for.
      (b) Relative balance of materials, especially month's supply of larger-value items.
      (c) Physical inventory.
   (3) Plant assets.
      (a) Differences between book and tax basis of assets.
      (b) Latest physical inventory of fixed assets and reconciliation of books.
   (4) Investments in unconsolidated, partially owned companies.
      (a) Market value, book value, and earnings of such investments with carrying amounts.

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

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

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

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

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

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

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

Aid for Families With Dependent Children (AFDC)

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

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

Supplemental Income Program (SSI)

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

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

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

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

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

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

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

SECOND REQUEST

February 1, 1980

Invoice #2420

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

I N V O I C E

Final installment as per our contract dated August 17, 1979	$10,000.00

Approved

THANK YOU

3/17/80

RECEIVED
MAR 14 1980
BUDGET/AUDIT
COMMITTEE

Alaska State Legislature

House of Representatives

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

MEMBER
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

April 4, 1980

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

Dear Mr. Kelso:

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

Sincerely,

Jim Duncan

Jim Duncan

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

TREASURY WARRANT
STATE OF ALASKA
JUNEAU, ALASKA

No. 272045

89-52
1252

DATE OF ISSUE
04 02 80
MO. DAY YR.

DO NOT FOLD, SPINDLE OR MUTILATE

PAY TO THE ORDER OF

KELSO & CO
111 PINE ST
SAN FRANCISCO CA 94111

DOLLARS	CENTS
$****10,000	00

$10,000.00 330 272045

⑈2272045⑈ ⑆1252⑉0052⑆

W.R. Hudson

Commissioner of Administration

Exhibit 4

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

March 24, 1980

RECEIVED
MAR 27 1980
BUDGET/AUDIT
COMMITTEE

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

Dear Jim:

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

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

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

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

Graphs: Any prepared are in the final report

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

Other Documents: We prepared no other documents.

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

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

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

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

Regards,

John

John A. Miskimen
Senior Vice President

JAM:bp

Enclosures

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

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

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

(Meetings where anonymity was requested)

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

August 14, 1979

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

Dear Mr. Kelso:

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

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

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

Sincerely,

Jim Duncan

JD:jp

PROFESSIONAL SERVICES CONTRACT I

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

WITNESSETH THAT:

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

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

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

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

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

NOW THEREFORE, the parties hereto agree as follows:

ARTICLE I

Services to be Performed

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

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

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

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

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

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

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

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

ARTICLE II

Period of Performance

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

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

ARTICLE III

Consideration

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

1. On the date this contract is executed, Ten Thousand Dollars ($10,000).
2. The payment of the balance in monthly installments of Ten Thousand Dollars ($10,000) each, the first to be paid on the last day of the first full month subsequent to the acceptance of this proposal and the remaining installments in consecutive monthly payments.
3. Out-of-pocket expenditures approved in advance by the Chairman will be billed monthly and due within 15 days of billing therefor by KELSO & CO., INCORPORATED.

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

ARTICLE IV

Additional Contract Provision

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

ARTICLE V

All Writings Contained Herein

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

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

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

By: Louis O. Kelso
Louis O. Kelso, President

Date: 8/17/79

LEGISLATIVE BUDGET AND AUDIT COMMITTEE, STATE OF ALASKA

By: Jim Duncan
Rep. Jim Duncan, Chairman

DATE: 8/13/79

Approved as to Form:

John B. Clement
Legislative Affairs Legal Counsel

APPENDIX "A" TO PERSONAL SERVICE CONTRACT

ARTICLE A-1. Definitions:

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

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

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

ARTICLE A-2. Inspections and Reports:

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

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

ARTICLE A-3. State of Alaska Saved Harmless:

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

ARTICLE-4. Disputes:

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

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

ARTICLE A-5. Equal Employment Opportunity:

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

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

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

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

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

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

ARTICLE A-6. Termination:

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

ARTICLE A-7. No Assignment:

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

ARTICLE A-8. No Additional Work:

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

ARTICLE A-9. Independent Contractor:

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

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

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

September 7, 1978

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

Dear Mr. Kelso:

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

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

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

Very truly yours,

Mike Colletta

Mike Colletta, Project Director

Jim Duncan

Jim Duncan, Project Director

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

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

September 26, 1978

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

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

Re: The Alaskan General Stock Ownership Plan

Gentlemen:

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

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

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

These are the reasons:

1) The GSOP operates on pre-tax dollars.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Sincerely,

Louis O. Kelso

Louis O. Kelso
President

LOK/lrh
cc: Milt Barker

Enclosures

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

TELEPHONE
(415) 788-7200

CABLE ADDRESS
LOKINC

January 17, 1975

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

Dear Mr. President:

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

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

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

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

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

(OVER)

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

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

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

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

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

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

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

Louis O. Kelso, Inc.
Lawyers and Counselors

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

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

I respectfully urge your attention to the foregoing.

Sincerely,

Louis O. Kelso

Louis O. Kelso

LOK:rah
Enclosures

cc: The Honorable L. William Seidman

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

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

October 1, 1974

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

Dear Bill and Paul:

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

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

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

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

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

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

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

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

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

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

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

With best regards,

Sincerely,

Louis O. Kelso

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

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

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

By
Louis O. Kelso, Economist

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

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

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

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

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

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

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

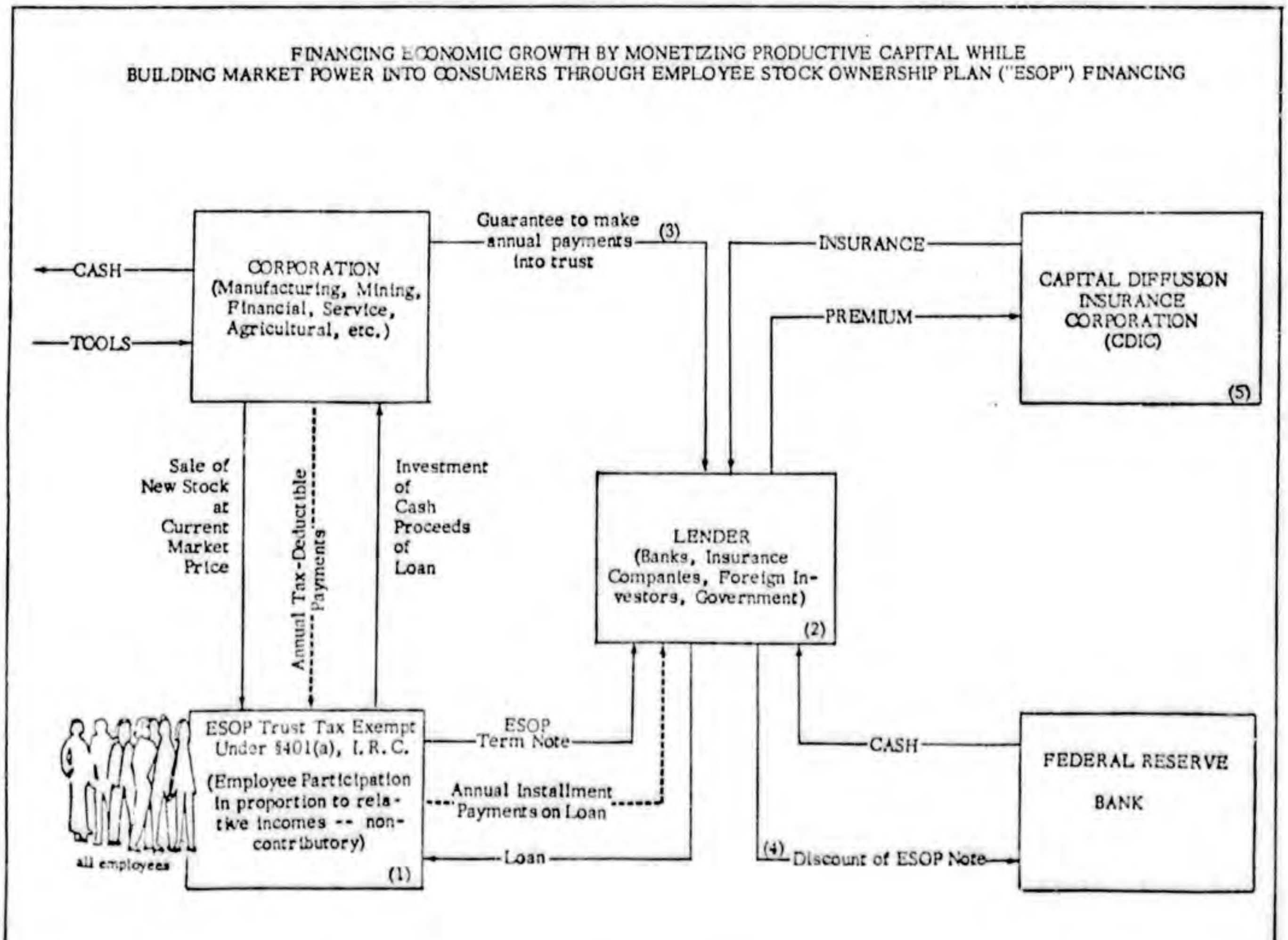
Modern inflation is of such nature that it can only be solved by radically increased investment in self-liquidating new capital formation. It is nothing short of a miraculous coincidence that we are facing a decade in which capital formation requirements exceed those of any past decade by several magnitudes.

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

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

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

THE BLUEPRINT FOR THE NEW ECONOMIC POLICY.



— *EXPLANATORY NOTES.*

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

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

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

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

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

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

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

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

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

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

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

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

SUGGESTED READING ON TWO-FACTOR ECONOMICS

Books

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

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

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

Testimony

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

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

Reports and Publications

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

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

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