SCOMM

#32:2

STATE AFFAIRS COMMITTEE

TENTATIVE DECISIONS ON SSHB 240: 4/5/79

1. A NEW CHAPTER UNDER TITLE X SHOULD BE DRAFTED TO DEAL GENERALLY WITH GSOCS RATHER THAN TO PLUG INTO CH. 5.

2. THE GOAL OF THE COMMITTEE IS TO MAKE AGSOC AS NEARLY AS POSSIBLE A FULLY PRIVATE CORPORATION.

3. THE AUTOMATIC ADOPTION BY THE STATE OF THE FEDERAL TAX LAW CHANGES REGARDING GSOCS SHOULD BE ALLOWED TO BECOME EFFECTIVE, BUT NO EXEMPTIONS FROM OTHER STATE TAXES SHOULD BE INCLUDED.

4. DO NOT REQUIRE SEPARATE GSOCS FOR EACH INVESTMENT.

5. INVESTMENTS MADE BY THE GSOC WHICH DO NO REQUIRE STATE SUPPORT WILL NOT REQUIRE LEGISLATIVE APPROVAL.

6. A REFERENDUM WILL BE REQUIRED BEFORE EITHER AN APPROPRIATION OR STATE GUARANTEE IS UNDERTAKEN.

7. PROHIBIT OFFICERS AND EMPLOYEES OF THE CORPORATION FROM SERVING ON THE BOARD OF DIRECTORS.

8. LIMIT THE LOAN GUARANTEE FUND TO "STARTUP" EXPENSES NOT TO EXCEED $5 MILLION.

TWO ISSUES WHICH NEED SOME CLARIFICATION

1. SHOULD A SHAREHOLDER BE REQUIRED TO SELL HIS STOCK UPON LEAVING THE STATE PERMANENTLY?

2. SHOULD WE ALLOW A MINORITY OF THE BOARD TO BE FROM OUTSIDE. IF SO WHAT MAXIMUM PROPORTION? 1/4? 1/3? 1/6?

MEMORANDUM

TO: GOV. JAY HAMMOND

FROM: JERRY GAUCHE

RE: AGSOC ISSUES

DATE: APRIL 12, 1979

IT MAY BE HELPFUL TO COMMENT ON FOUR ISSUES WHICH APPEAR TO HAVE RECEIVED CONSIDERABLE DISCUSSION WITHIN THE ADMINISTRATION REGARDING AGSOC. THESE COMMENTS ARE BASED ON THE MOST RECENT AMENDMENTS BY THE HOUSE STATE AFFAIRS COMMITTEE. THE FOUR ISSUES ARE: (1) THE DISTINCTIONS BETWEEN AGSOC AND THE PERMANENT FUND; (2) FINANCING FOR AGSOC; (3) SHAREHOLDER CONTROL; AND, (4) POLITICAL IMPACT.

DISTINCTIONS BETWEEN AGSOC AND PERMANENT FUND

RESOURCE OWNERSHIP VS. CAPITAL OWNERSHIP

THE PERMANENT FUND RELYS FOR ITS REVENUES ON THE RESOURCES OWNED JOINTLY BY ALASKANS THROUGH THEIR GOVERNMENT. DEVELOPMENT OF THOSE RESOURCES IS CONTROLLED BY PRIVATE ENTERPRISE OWNED MOSTLY BY OUTSIDERS. AGSOC DOES NOT SEEK TO DISTRIBUTE EITHER THE RESOURCES OWNED BY ALASKANS THROUGH THEIR GOVERNMENT OR INCOME FROM THOSE

ASSETS. WHAT IT DOES SEEK TO DO IS TO GIVE ALASKANS A VEHICLE THROUGH WHICH THEY CAN PARTICIPATE IN THE DEVELOPMENT OF THEIR RESOURCES.

WHO PROFITS?

WHEN ALASKA RESOURCES ARE DEVELOPED BY OUTSIDERS THE OUTSIDERS PROFIT. ALASKA CAN SHARE IN ONLY A PART OF THE PROFITS FROM THAT DEVELOPMENT, THE PART WHICH CAN BE TAXED AWAY. HOWEVER THE STATE CANNOT TAX AWAY 100% OF THE PROFITS AND EXPECT FUTURE DEVELOPMENT BY OUTSIDERS. THE ENTIRE PROFITS FROM AGSOC PARTICIPATION IN DEVELOPMENT WILL REMAIN IN THE STATE BECAUSE THE SHAREHOLDERS OF AGSOC WILL BE ALASKANS.

TRUSTS VS. BUSINESS PARTICIPATION

THE PERMANENT FUND AND GOVERNMENT OWNED RESOURCES ARE VIEWED BY MANY AS A TRUST FUND FOR THE FUTURE, THE CORPUS OF WHICH SHOULD BE HELD INTACT AND INVESTED IN A CONSERVATIVE MANNER EITHER BY A BOARD OR INDIVIDUAL ALASKANS. AGSOC IS DESIGNED TO USE CREDIT IN ORDER TO GIVE ALASKANS ACCESS TO OWNERSHIP OF DEVELOPMENT CAPITAL IN THE STATE. THE PERMANENT FUND REPRESENTS ASSETS WHICH ALASKANS ALREADY OWN, AGSOC WILL BRING THEM OWNERSHIP OF NEW ASSETS. THE CONCEPT OF THE PERMANENT FUND AND AGSOC ARE NOT INHERENTLY COMPETATIVE, BUT COMPLIMENTARY. THE PERMANENT FUND QUESTION MAY BE SOLVED INDEPENDETLY OF AGSOC AND AGSOC CAN FUNCTION INDEPENDENTLY OF THE PERMANENT FUND.

State vs. Private Ownership

The permanent fund is a vehicle of the state and controlled by the elected officials of the state. It is a depository of state assets. The AGSOC is a private corporation controlled by its shareholders. Despite assertions otherwise, the fact that its shareholders are the residents of the state does not make it a political organization nor an arm of the state.

Financing of AGSOC

Legislative Review

No special legislation has been devised regarding state financial assistance for the AGSOC other than start-up costs. AGSOC is to be dealt with in the same manner as other private corpoations seeking state support. There is no mechanism whereby the state could be bound to financial support for AGSOC without legislative action. If state financial support is required for an investment AGSOC will be required to come before the legislature and the adminstration with a proposal which may or may not be approved by the legislature and signed by the Governor.

State Financing for Private Corporations

State involvement in financing private corporations is not new. But, present state support for private

CORPORATIONS BENEFITS ONLY THOSE PEOPLE IN ALASKA WHO HAVE ALREADY ACCUMULATED CAPITAL. THE STATE CURRENTLY HAS SOME $150 MILLION OF LOW INTEREST BUSINESS LOANS OUTSTANDING, BUT BECAUSE OF THE 75% LOAN LIMITS ONLY THOSE WITH EXISTING CAPITAL CAN QUALIFY. AGSOC BRINGS IN THE REST OF ALASKA IF THE LEGISLATURE AND THE GOVERNOR, AT THE REQUREST OF THE CORPORATION, SHOULD DETERMINE THAT STATE SUPPORT OF A PARTICULAR INVESTMENT BY THE AGSOC IS APPROPRIATE.

SHAREHOLDER CONTROL

THE HOUSE STATE AFFAIRS COMMITTEE IN DRAFTING A COMMITTEE SUBSTITUTE FOR THE AGSOC BILL HAS INCLUDED A NUMBER OF AMENDMENTS WHICH WILL MAKE THE BOARD OF DIRECTORS OF AGSOC MORE RESPONSIVE TO THE SHAREHOLDERS AND SHOULD ALAY FEARS THAT THE BOARD WILL BECOME AN INSULATED GROUP MORE POWERFUL THAN ANY OTHER IN THE STATE. THESE CHANGES INSURE THAT THE SHAREHOLDERS MAY PUT ISSUES AND BOARD CANDIDATES ON THE CORPORATION BALLOT, THAT THE INCUMBENT BOARD MAY NOT USE THE FUNDS OF THE CORPORATION TO MAINTAIN THEIR INCUMBANCY, AND THAT THE SHAREHOLDERS MAY, AT ANY TIME, REMOVE THE ENTIRE BOARD OR ANY MEMBER. IN ADDITION, THE COURTS ARE GIVEN JURISDICTION TO REMOVE A BOARD MEMBER JUDICIALLY AT SUIT OF THE SHAREHOLDERS OR THE ATTORNEY GENERAL.

POLITICAL IMPACT

MANY INFLAMATORY STATEMENTS HAVE BEEN MADE ABOUT THE POTENTIAL POLITICAL POWER OF THIS CORPORATION AND ITS BOARD MEMBERS. FUNDAMENTAL TO THE ARGUMENTS OVER THE QUESTION OF AGSOC POLITICAL INFLUENCE IS THE QUESTION OF WHETHER OR NOT THE PEOPLE OF ALASKA CAN BE TRUSTED TO MAKE PROPER DECISIONS REGARDING THEIR OWN FUTURE AND THE FUTURE OF THEIR STATE OR WHETHER, IN ORDER TO PROTECT THEM FROM MAKING THE WRONG DECISIONS, THE GOVERNMENT MUST BE INTERPOSED BETWEEN THE PEOPLE AND THE DECISIONS.

AGSOC ALLOWS THE PEOPLE, THROUGH THEIR CORPORATION, TO MAKE DECISIONS ON ECONOMIC DEVELOPMENT INDEPENDENTLY OF THE GOVERNMENT AND TO RECEIVE THE PROCEEDS OF SUCH DEVELOPMENT WITHOUT THEIR FIRST BEING FILTERED THROUGH THE GOVERNMENT. THIS DOES NOT, HOWEVER, MEAN THAT GOVERNMENT WILL BE EXPECTED TO ABROGATE ITS RESPONSIBILITIES WITH RESPECT TO PROPER REGULATION OF BUSINESS ENTERPRISES. FEAR OF POSSIBLE MISCONDUCT BY AGSOC IS REALLY FEAR THAT THE PEOPLE OF ALASKA WILL ACT IRRESPONSIBLY IF GIVEN THE CHANGE TO CONTROL THEIR OWN DESTINY. I THINK THAT THEY HAVE PROVEN OTHERWISE THROUGH THEIR POLITICAL DECISIONS IN THE PAST.

EXPLANATION: FEDERAL GSOC PROVISIONS

Federal law provides income tax advantages to certain broadly owned corporations. These companies, known as General Stock Ownership Corporations (GSOCs), are exempt from corporate income tax. GSOCs are privately owned corporations designed to leverage the typical citizen into capital ownership. As such the stock is to be distributed free of charge and investments purchase entirely through borrowed funds. As the loans are paid down from investment earnings equity is built into the shareholders.

Charter Provisions

To qualify as a GSOC a corporation must be specially chartered by a state and have a single class of stock distributed to each qualified state resident. Transfers of stock must be limited to the earliest of five years from issue or the shareholder's death or emigration from the state. No shareholder may own or acquire more than 10 shares.

GSOC Taxation

The GSOC is exempt from corporate income taxes, but its shareholders must report their share of GSOC income personally. GSOC income is computed like that of other corporations with special treatment for tax credits. Audit adjustments are included in income of the corporation for the year during which they are finally determined. Net losses are subject to a 10 year carryover and investment credit and recapture is prorated to the shareholders.

Shareholder Taxation

GSOC shareholders are taxed on their share of GSOC income. If a shareholder disposes of his stock GSOC income will be prorated on a daily basis. The shareholder's stock basis will be increased by GSOC income attributed to him and reduced by cash distributions. Since GSOC shareholders are attributed GSOC income distributions from the GSOC are generally tax free. Distributions greater than attributed income are nontaxable to the extent of the shareholder's basis and the excess taxed as capital gains. To assure shareholders have cash for taxes on their share of GSOC income GSOCs must distribute 90% of taxable income by January 31. Noncompliance will subject the GSOC to a 20% tax on the distribution difficiency. To assure payment of taxes the GSOC must withhold 25% of each distribution. The amount withheld is a credit against shareholder income taxes. Individuals not required to pay taxes (because of insufficient income) may avoid withholding on GSOC distributions.

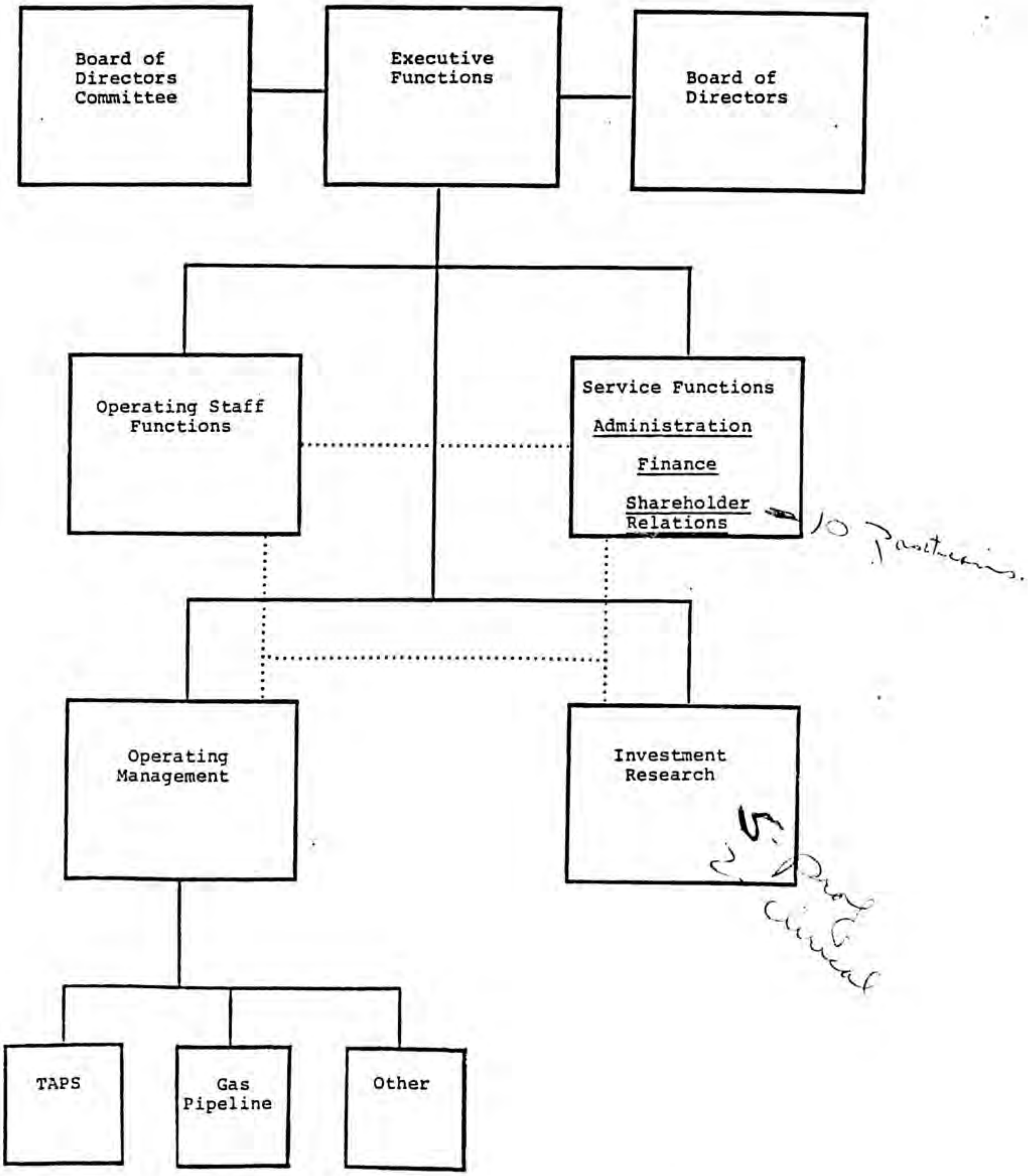
Assumptions: ① AGSOC does its own trust functions except Registrar.

② AGSOC has in-house research.

③ Does not include shareholder identification and programming.

AGSOC

Functional Block Diagram


Board of Directors Committee
Executive Functions
Board of Directors
Operating Staff Functions
Service Functions
Administration
Finance
Shareholder Relations
10 Positions.
Operating Management
Investment Research
5.
Prof & Clerical
TAPS
Gas Pipeline
Other

Kelso & Co., Incorporated
March 5, 1979

BC American Bank - $3.50 SH
+ package printing $400,000

AGSOC ESTIMATED
(First 12 Months)

EXPENSE AND VARIANCE STATEMENT

25 people

Department Total - All Departments Ex. Operating

THIS MONTH			LINE NO.	______ 19 ___	YEAR-TO-DATE	
ACTUAL adjustment	BUDGET	VARIANCE *		2	EX ACTUAL 1 clerical	VARIANCE *
	17,000		1	OFFICERS SALARIES Pres 65,000 - 35,000		
	38,500		2	OTHER SALARIES		
	---		3	BONUSES PAID		
	14,000		4	EMPLOYEE BENEFITS		
	12,500		5	RECRUITMENT & TRAINING		
			6			
	82,000		7	**TOTAL PAYROLL & PERSONNEL**		
	2,500		8	TELEPHONE & TELETYPE		
	100		9	TELEGRAMS & CABLES		
	---		10	TICKERS & QUOTATION SERVICES		
	15,000		11	PRINTING & SUPPLIES } compared with	19	
	12,500		12	POSTAGE } Used	for 3 Share	holders.
			13			
	30,100		14	**TOTAL COMMUNICATIONS**		
	7,500		15	RENT		
	---		16	DEPRECIATION & AMORTIZATION		
	1,000		17	EQUIPMENT RENTAL		
	200		18	MAINTENANCE & REPAIRS		
A	65,000	+760,000	19	E.D.P. SERVICE BUREAU EXPENSES	180,000 40,000	
	750		20	INSURANCE - NON PAYROLL		
			21			
	74,450		22	**TOTAL OCCUPANCY & EQUIPMENT**		
	1,000		23	ADVERTISING & PROMOTIONAL		
	250		24	PUBLICATIONS		
+5000	1,000		25	TRAVEL		
	100		26	ENTERTAINMENT & MEETINGS		
	200		27	MEMBERSHIP DUES & ASSESSMENTS		
	200		28	ASSOCIATION DUES & ASSESSMENTS		
			29			
	2,750		30	**TOTAL BUSINESS DEVELOPMENT**		
	---		31	ERRORS & BAD DEBTS		
	3,000		32	OUTSIDE RESEARCH SERVICES		
	4,500		33	PROFESSIONAL SERVICES		
	---		34	TAXES PAID		
	20,000		35	INTEREST PAID - SUB. CAPITAL		
	---		36	INTEREST PAID - OTHER		
	---		37	BANK SERVICE CHARGES		
	3,000		38	MISCELLANEOUS OTHER		
			39			
	30,500		40	**TOTAL OTHER EXPENSE**		
	219,800+		41	**TOTAL PERIOD EXPENSES**		
			42			
			43			
			44			
			45			

* ( ) Unfavorable Variance

+ Annualized = $2,637,600

Kelso & Co., Incorporated
March 5, 1979

Identification of shareholders - etc. Add. 1.6 M -

(First 12 Months)

EXPENSE AND VARIANCE STATEMENT

Department Total - All Departments Ex. Operating

THIS MONTH			LINE NO.*		YEAR-TO-DATE	
ACTUAL	BUDGET	VARIANCE*		______ 19 ___	ACTUAL	VARIANCE*
	17,000		1	OFFICERS SALARIES		
	38,500		2	OTHER SALARIES		
	—		3	BONUSES PAID		
	14,000		4	EMPLOYEE BENEFITS		
	12,500		5	RECRUITMENT & TRAINING		
			6			
	82,000		7	TOTAL PAYROLL & PERSONNEL		
	2,500		8	TELEPHONE & TELETYPE		
	100		9	TELEGRAMS & CABLES		
	—		10	TICKERS & QUOTATION SERVICES		
	15,000		11	PRINTING & SUPPLIES		
	12,500		12	POSTAGE		
			13			
	30,100		14	TOTAL COMMUNICATIONS		
	7,500		15	RENT		
	—		16	DEPRECIATION & AMORTIZATION		
	1,000		17	EQUIPMENT RENTAL		
	200		18	MAINTENANCE & REPAIRS		
	65,000		19	E.D.P. SERVICE BUREAU EXPENSES		
	750		20	INSURANCE - NON PAYROLL		
			21			
	74,450		22	TOTAL OCCUPANCY & EQUIPMENT		
	1,000		23	ADVERTISING & PROMOTIONAL		
	250		24	PUBLICATIONS		
	1,000		25	TRAVEL		
	100		26	ENTERTAINMENT & MEETINGS		
	200		27	MEMBERSHIP DUES & ASSESSMENTS		
	200		28	ASSOCIATION DUES & ASSESSMENTS		
			29			
	2,750		30	TOTAL BUSINESS DEVELOPMENT		
	—		31	ERRORS & BAD DEBTS		
	3,000		32	OUTSIDE RESEARCH SERVICES		
	4,500		33	PROFESSIONAL SERVICES		
	—		34	TAXES PAID		
	20,000		35	INTEREST PAID - SUB. CAPITAL		
	—		36	INTEREST PAID - OTHER		
	—		37	BANK SERVICE CHARGES		
	3,000		38	MISCELLANEOUS OTHER		
			39			
	30,500		40	TOTAL OTHER EXPENSE		
	219,800+		41	TOTAL PERIOD EXPENSES		
			42			
			43			
			44			
			45			

* ( ) Unfavorable Variance

+ Annualized = $2,637,600

Kelso & Co., Incorporated
March 5, 1979

HB 240

ALASKA
GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

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

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

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

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

DETAILED EXPLANATION

The bill creates a new Chapter 50, entitled "Alaska General Stock Ownership Corporation", within Title 10, the Corporations and Associations title, of Alaska Statutes. The act contains nine sections which may be summaried as follows:

Section 1 sets forth those areas where the AGSOC differs from a typical Alaska business corporation organized under Chapter 5 of Title 10. To the extent that these provisions do not conflict with the provisions of Chapter 5, the Alaska Business Corporations Act, Chapter 5 will apply;

Section 2 includes the corporation among those organizations eligible to receive secured loans from the Permanent Fund;

Section 3 allows the investment of surplus state funds in bonds of the AGSOC;

Section 4 exempts the AGSOC from registration under the Alaska securities laws while providing protection from fraud;

Section 5 creates a one year statute of limitations on suits brought to challenge legality of the AGSOC;

Section 6 makes the provisions regarding eligibility for stock ownership "nonseverable" in order to assure that if this fundamental section is found unconstitutional the entire law will be voided,

Section 7 makes fraud or misrepresentation in obtaining or selling shares of the AGSOC a Class C felony; and,

Sections 8 and 9 provide effective dates immediately following the Governor's signature for most of the legislation.

ANALYSIS: SECTION 1

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

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

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

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

50.020. ARTICLES OF INCORPORATION.

Federal law requires certain charter provisions for general stock ownership corporations and these are set out as requirements for the articles of incorporation of the Alaska General Stock Ownership Corporation. Each of the subsections in .020 set forth a different requirement which must be included in the AGSOC articles.

Subsection 1 provides that the AGSOC may issue only one class of stock which impliedly must be voting common stock.

Subsection 2 provides that stock may be issued only to a certain class of individuals. The group to whom stock may be issued, a closed class of original issue shareholders, are those people who fulfill two tests:

a) They were residents of Alaska, as defined by the definition Section .900, as of the effective date of the legislation which, under Section 8 of the bill, will be the day following the Governor's signing; and,

b) They remain residents of Alaska until the shares are issued.

50.900 defines resident as a person who lives in Alaska and intends to remain here permanently. The definition allows for temporary travel or employment outside without loss of residency. f a dispute arises over residency all of the facts and circumstances indicative of permanent residency must be considered.

Subsection 3 provides that at least one share of stock must be issued to each eligible resident unless that person elects within one year not to receive the stock. The legislation contemplates issuance of shares to eligible individuals free of charge with corporate investments financed entirely with borrowed funds. The one year period allows shareholders who do not wish to receive stock for whatever reason to reject their share, but this election not to receive stock is irrevocable and once made may not be changed.

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

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

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

Subsection 7 provides the AGSOC with a right of first option to purchase, at a price not less than book value, any stock offered for sale during the first five years of the corporation. The terms and conditions for exercise of this right will be set forth in detail in the corporate bylaws and a notice of the restriction will appear on the stock certificates or receipts.

The five year period for the right of first option parallels the time during which shareholders are prohibited from selling their stock. Only a limited number of shares will become available for sale during this period of time and it is unlikely that an organized market for AGSOC stock will develop during this period. Discretion is left with the corporation to pay prices higher than book value for the stock, but it is likely that the directors will determine that book value is the appropriate price.

Since shareholders who become non-residents during the five year period of transfer restrictions may be able to sell their stock at a high price in an uncontrolled market emigration might be encouraged. The option by the corporation provides a controlled market during the transfer restriction period and allows time to structure the full public market which will develop after the transfer restrictions lapse.

50.030. BOARD OF DIRECTORS.

This section sets out the provisions for AGSOC directors which differ from those applicable under Alaska Statutes Title 10, Chapter 5. The nine incorporators serve as the original board of directors and are divided into three groups in accordance with AS 10.05.186, except that only one-third of the directors will stand for election at the first annual meeting, one-third at the second annual meeting and one-third that the third annual meeting. Thereafter each director will serve for a term of three years as provided in AS 10..5.186. None of the other provisions of the Alaska Business Corporations Act regarding directors are changed and the normal rules of Chapter 5 apply to the AGSOC.

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

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

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

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

50.060. LATE APPLICATION FOR SHARES.

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

50.070. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER.

This section provides a civil right of action against individuals who obtain stock through fraud or misrepresentation and who sell stock on the same basis. It allows the stock to be voided, dividends to be recovered with interest and costs of the suit to be paid by the defendant.

50.080. DIVIDENDS OF THE CORPORATION.

Under the rules of the Alaska Business Corporations Act a corporation may pay dividends only out of earned surplus, the retained earnings of the corporation. Since the AGSOC is required by federal law to distribute 90% of its taxable income to its shareholders on an annual basis is may be necessary to distribute a dividend in excess of earned surplus. Such a situation can arise because accounting for tax purposes and for purposes of the corporation's books may not and are not required to be the same. For this reason an exception to the general rule of Chapter 5, Title 10, is required allowing the AGSOC to distribute dividends as required to meet the terms of Internal Revenue Code Subchapter U except where such distribution would cause the corporation to become bankrupt or when the corporation is already bankrupt. Bankruptcy in this situation means when the corporation is unable to meet its current obligations.

50.090. EXEMPTION FROM AS 10.05

This section exempts the AGSOC from the provisions of the Alaska Business Corporations Act which requires $1,000 of paid in capital before operation of the corporation commences.

50.100. LOAN GUARANTEE FUND.

This section establishes a fund within the Department of Revenue which is to be used to guarantee loans to the AGSOC by private lenders. This fund is intended to provide security for private credit to be used by the AGSOC for its startup expenses such as the costs of stock issue and the investigation of potential investments.

50.900. DEFINITIONS.

This section defines the terms used in Chapter 50. Especially important is the definition of resident since that definition will determine who is eligible to receive AGSOC stock without charge.

File
HB 240

M E M O R A N D U M

TO: All Legislators

FROM: Mike Miller, Chairman, House State Affairs Committee

DATE: April 26, 1979

Because of a high degree of interest and in response to a number of specific requests I am providing each legislator with a copy of the State Affairs Committee substitute for House Bill 240 (Creating the Alaska General Stock Ownership Corporation). The bill is of course quite hefty however we will be providing a sectional analysis and synopsis very shortly.

Original sponsors: Duncan, Cotten
Hurlbert, et al

IN THE HOUSE BY THE STATE AFFAIRS COMMITTEE

CS FOR SPONSOR SUBSTITUTE FOR HOUSE BILL NO. 240

IN THE LEGISLATURE OF THE STATE OF ALASKA

ELEVENTH LEGISLATURE - FIRST SESSION

A BILL

For an Act entitled: "An Act relating to general stock ownership corporations and creating the Alaska General Stock Ownership Corporation; changing Rule 23.1, Rules of Civil Procedure; and providing for an effective date."

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

* Section 1. AS 10 is amended by adding a new chapter to read:

CHAPTER 50. GENERAL STOCK OWNERSHIP CORPORATIONS.

ARTICLE 1. SUBSTANTIVE PROVISIONS.

Sec. 10.50.005. PURPOSES. A general stock ownership corporation may be organized under this chapter for any lawful purpose unless limited by the chartering legislation of a corporation.

Sec. 10.50.010. GENERAL STOCK OWNERSHIP CORPORATIONS. (a) A corporation organized under this chapter is a general stock ownership corporation and shall be formed in accordance with subchapter U, chapter 1 of the Internal Revenue Code of 1954, as amended (26 U.S.C. secs. 1391 - 1397), and with this chapter. A corporation is subject to the provisions of this chapter and 26 U.S.C. sec. 1391 - 1397.

(b) A corporation is not an agency, instrumentality, or political subdivision of the state for any purpose.

Sec. 10.50.015. GENERAL POWERS. A corporation may

(1) have perpetual succession in its corporate name unless a limited period of duration is stated in its articles of incorporation;

(2) sue and be sued in its corporate name;

(3) adopt a corporate seal and alter it, and use it by having

it or a facsimile of it impressed, affixed or reproduced;

(4) buy, lease, or otherwise acquire, own, hold, improve, use and otherwise deal in, real or personal property or any interest in property, except that the corporation may not invest in property acquired by it, or for its benefit, through the right of eminent domain;

(5) sell or otherwise dispose of all or any part of its property and assets;

(6) lend money to its employees other than its officers and directors, and otherwise assist its employees, officers and directors;

(7) buy or otherwise acquire, own, hold, vote, use, sell, mortgage, lend, pledge, or otherwise dispose of, and otherwise use and deal in shares or other interests in, or obligations of, other corporations, associations, partnerships or individuals, or in direct or indirect obligations of the United States or of any other government, state, territory, or municipality or of any instrumentality of them;

(8) make contracts and incur liabilities, borrow money at the rates of interest the corporation determines, issue notes, bonds, and other obligations, and secure its obligations by mortgage or pledge of all or any of its property, franchise and income;

(9) lend money for its corporate purposes, invest and reinvest its funds, and take and hold real and personal property as security for the payment of funds loaned or invested;

(10) conduct business, carry on operations, and have offices and exercise the powers granted by this chapter in a state, territory, district, or possession of the United States, or in a foreign country;

(11) elect or appoint officers and agents of the corporation, define their duties, and fix their compensation;

(12) make and alter bylaws not inconsistent with its articles of incorporation or with the laws of the state, for the administration

and regulation of the affairs of the corporation;

(13) donate for the public welfare or for charitable, scientific or educational purposes, and in time of war donate in aid of war activities;

(14) transact lawful business in time of war in aid of the United State in the prosecution of the war;

(15) pay pensions and establish pension plans, pension trusts, profit-sharing plans, and other incentive plans for its directors, officers and employees;

(16) cease it corporate activities and surrender its corporate franchise;

(17) have and exercise the powers of a limited or general partner or a joint adventurer in association with one or more persons, corporations, partnerships or associations;

(18) have and exercise lawful powers necessary to carry out the purposes for which the corporation is organized.

Sec. 10.50.020. INDEMNIFICATION OF OFFICERS, DIRECTORS, EMPLOYEES AND AGENTS; INSURANCE. (a) A corporation may indemnify a person who was or is a party or is threatened to be made a party to a threatened, pending, or completed action or proceeding, whether civil, criminal, administrative, or investigative, other than an action by or in the righ of the corporation, by reason of the fact that he is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise. Indemnification may be against expenses including attorney fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by him in connection with the action or proceeding if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to a criminal action or proceeding, had no reasonable cause to believe his conduct was unlawful. The termination of an action or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, does not, of itself, create a presumption that the person did not act in good faith and in a manner which he reasonably believed to be in or not opposed to the best interests of the corporation, and, with respect to a criminal action or proceeding, had reasonable cause to believe that his conduct was unlawful.

(b) A corporation may indemnify a person who was or is a party or is threatened to be made a party to a threatened, pending or completed action by or in the right of the corporation to procure a judgment in its favor by reason of the fact that he is or was a director, officer, employee, or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee, or agent of another corporation, partnership, joint venture, trust or other enterprise. Indemnification may be against expenses, including attorney fees, actually and reasonably incurred by him in connection with the defense or settlement of the action if he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the corporation. However, indemnification may not be made for any claim, issue or matter as to which the person has been adjudged to be liable for negligence or misconduct in the performance of his duty to the corporation except to the extent that the court in which the action was brought determines upon application that, despite the adjudication of liability, in view of all the circumstances of the case the person is fairly and reasonably entitled to indemnity for the expenses which the court considers proper.

(c) To the extent that a director, officer, employee or agent of a corporation has been successful on the merits or otherwise in defense of an action or proceeding referred to in (a) or (b) of this section, or in defense of any claim, issue or matter in the action or proceeding, he shall be indemnified against expenses, including attorney fees, actually and reasonably incurred by him in connection with it.

(d) Indemnification under (a) or (b) of this section, unless ordered by a court, shall be made by the corporation only as authorized in the specific case upon a determination that indemnification of the director, officer, employee or agent is proper in the circumstances because he has met the applicable standard of conduct set out in (a) and (b) of this section. This determination shall be made

(1) by the board of directors by a majority vote of a quorum consisting of directors who were not parties to the action or proceeding, or

(2) if such a quorum is not obtainable, or, even if obtainable if a quorum of disinterested directors so directs, by independent legal counsel in a written opinion, or

(3) by the stockholders.

(e) Expenses incurred in defending a civil or criminal action or proceeding may be paid by the corporation in advance of the final disposition of the action or proceeding as authorized by the board of directors in the specific case upon receipt of an undertaking by or on behalf of the director, officer, employee or agent to repay the amount unless it is ultimately determined that he is entitled to be indemininified by the corporation as authorized in this section.

(f) The indemnification provided by this section is not exclusive of any other rights to which a person seeking indemnification may be entitled under any bylaw, agreement, vote of stockholders or disinterested directors or otherwise, both as to action in his official capacity and as to action in another capacity while holding the office, and continues as to a person who has ceased to be a director, officer, employee or agent, and inures to the benefit of the heirs, executors and administrators of that person.

(g) A corporation may purchase and maintain insurance on behalf of a person who is or was a director, officer, employee or agent of the corporation, or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation, partnership, joint venture, trust or other enterprise against any liability asserted against him and incurred by him in such a capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against the liability under the provisions of this section.

Sec. 10.50.030. DEFENSE OF ULTRA VIRES. No act of a corporation and no conveyance or transfer or real or personal property to or by a corporation is invalid because the corporation did not have capacity or power to perform the act or to convey or receive the property. However, lack of capacity or power may be asserted as follows.

(1) The assertion may be made in a proceeding by a shareholder against the corporation to enjoin the performance of any act or the transfer of real or personal property by or to the corporation. If the unauthorized act or tranfer sought to be enjoined is being or to be performed or made under a contract to which the corporation is a party, the court may, if the parties to the contract are parties to the proceeding and if the court considers it equitable, set aside and enjoin the performance of the contract, and in so doing may allow compensation to the corporation or to the other parties to the contract for the loss or damage sustained by either of them resulting from the action of the court in setting aside and enjoining the performance of the contract.

The court may not award anticipated profits to be derived from the performance of the contract as a loss or damage sustained.

(2) The assertion may be made in a proceeding by the corporation, whether acting directly or through a receiver, trustee, or other legal representative, or through shareholders in a representative suit, against the incumbent or former officers or directors of the corporation.

(3) The assertion may be made in a proceeding by the attorney general to dissolve the corporation, or to enjoin the corporation from the transaction of unauthorized business.

Sec. 10.50.035. CORPORATE NAME. The corporate name shall contain the words "general stock ownership corporation" or an abbreviation of these words. It may not contain a word or phrase which indicates or implies that it is organized for a purpose other than the purpose contained in the articles of incorporation. It may not be the same as, or deceptively similar to, the name of a domestic corporation existing under the laws of the state or a foreign corporation authorized to transact business in the state, or a name which has been reserved or registered as provided in this chapter.

Sec. 10.50.040. RESERVATION OF CORPORATE NAME. (a) The exclusive right to the use of a corporate name may be reserved by

(1) a person intending to organize a corporation under this chapter;

(2) a corporation intending to change its name.

(b) Reservation of a corporate name is made by filing an application with the commissioner. If the commissioner finds that the name is available for corporate use, and not a reserved or registered business name as set out in AS 10.35.010 - 10.35.090, he shall reserve it for the exclusive use of the applicant for a period of two years. A reservation of corporate name may be renewed for one year.

(c) The holder of a reserved corporate name may transfer the right to the exclusive use of the corpor .e name to another person by filing a notice of transfer with the commissioner, signed by the holder and specifying the name and address of the transferee.

Sec. 10.50.045. FOREIGN GENERAL STOCK OWNERSHIP CORPORATIONS. Corporations organized under the laws of another state shall be governed according to AS 10.05.

Sec. 10.50.050. REGISTERED OFFICE AND REGISTERED AGENT. A corporation shall continuously maintain in the state a registered office which may be, but need not be, the same as its place of business, and a registered agent. The registered agent may be either an individual resident of the state whose business office is the same as the registered office, or a corporation organized under AS 10.05 whose business office is the same as the registered office.

Sec. 10.50.055. FILING LIST OF REGISTERED CORPORATIONS WITH SUPERIOR COURT. The commissioner shall file a list of the name of each corporation, the address of the registered office, and the name and address of the registered agent with each clerk of the superior court. The commissioner shall provide a periodic supplement to the list indicating additions, deletions and changes at least once every six months. The commissioner shall make the list available to the public for a fee prescribed by him.

Sec. 10.50.060. CHANGE OF REGISTERED OFFICE OR AGENT. (a) A corporation may change its registered office, agent, or both, by filing with the department a verified statement signed by the president or vice-president setting out

(1) the name of the corporation;

(2) the address of its registered office;

(3) the address of its new registered office if the registered office is to be changed;

(4) the name of its registered agent;

(5) the name of its new registered agent, if its registered agent is to be changed;

(6) that the change is authorized by resolution of its board of directors.

(b) If the commissioner finds that the verified statement complies with this chapter, he shall file it in his office. The change becomes effective when the statement is filed.

Sec. 10.50.065. REGISTRATION OF REGISTERED AGENT. (a) If the registered agent of a corporation changes the location of his office from one address to another within a city or town, or from one city or town in the state to another, he may change the registered office for each corporation for whom he is acting as registered agent by filing in the office of the commissioner a statement setting out

(1) the name of the agent;

(2) the address of his office before change;

(3) the address to which the office is changed; and

(4) a list of corporations for whom he is furnishing a registered office.

(b) The statement in (a) of this section must be executed by the registered agent in his individual name and, if the agent is a corporation it must be executed by its president or a vice-president and verified by him. The statement must be delivered to the commissioner and if he finds that the statement complies with this chapter, he shall file it in his office. The change becomes effective when the statement is filed.

(c) A registered agent may resign by filing a written notice, executed in duplicate, with the commissioner. The written notice of resignation shall set out the latest address of the principal office of the corporation and the names, addresses and titles of the most recent officers of the corporation known by the agent. The commissioner shall immediately mail a copy of the notice to the corporation at its principal office. The appointment of the agent terminates 30 days after receipt of the notice by the commissioner.

Sec. 10.50.070. SERVICE OF PROCESS ON CORPORATION. (a) The registered agent of a corporation is an agent upon whom process, notice or demand required or permitted by law to be served upon the corporation may be served.

(b) When a corporation fails to appoint or maintain a registered agent in the state, or when its registered agent cannot, with reasonable diligence, be found at the registered office, the commissioner is an agent of the corporation upon whom the process, notice, or demand may be served. Service is made upon the commissioner as agent by leaving with him, or with a clerk having charge of the corporation department of his office, duplicate copies of the process, notice or demand. When process, notice or demand is served on the commissioner, he shall immediately forward a copy of it by registered mail to the corporation at its registered office. Service on the commissioner is returnable in not less than 30 days.

(c) The commissioner shall keep a record of processes, notices and demands served upon him showing the time of service and his action with reference to the service. This chapter does not limit or affect the right to serve process, notice or demand required or permitted by law to be served upon a corporation in any other manner permitted by law.

Sec. 10.50.075. CREATION AND ISSUANCE OF SHARES. A corporation may create and issue the number of shares stated in its articles of incorporation and as provided in AS 10.50.320(a)(5) - (7). The shares shall be without par value.

Sec. 10.50.080.. CONSIDERATION FOR SHARES. (a) Shares may be issued without consideration or for consideration fixed by the shareholders before the issuance. Consideration for shares shall be fixed by a vote of a majority of the shares voting on the issue.

(c) Treasury shares may be disposed of by the corporation for consideration not more than the book value of the shares.

Sec. 10.50.085. PAYMENT FOR SHARES. (a) Consideration for the issuance of shares if required may be paid, in whole or in part, in money, in other property, tangible or intangible, or in labor or services actually performed for the corporation. When payment of the consideration for shares is received by the corporation, the shares are considered fully paid and nonassessable.

(b) A promissory note or future service does not constitute payment or part payment for shares of a corporation.

Sec. 10.50.090. JUDGMENT OF BOARD OR SHAREHOLDER AS TO VALUE OF CONSIDERATION CONCLUSIVE. In the absence of fraud in the transaction, the judgment of the board of directors or the shareholders as to the value of the consideration received for shares is conclusive.

Sec. 10.50.095. EXPENSES OF ORGANIZATION, REORGANIZATION AND FINANCING. The reasonable charges and expenses of organization or reorganization of a corporation, and the reasonable expenses of and compensation for the sale or underwriting of its shares, may be paid or allowed by the corporation out of the consideration received by it in payment for its shares without rendering the shares not fully paid and nonassessable.

Sec. 10.50.100. CERTIFICATES REPRESENTING SHARES. The shares of a corporation shall be represented by certificates signed by the president or vice-president and the secretary or an assistant secretary of the corporation, and may be sealed with the seal of the corporation or a facsimile of the seal. The signatures of the president or vice-president and the secretary or assistant secretary on a certificate may be facsimiles if the certificate is countersigned by a transfer agent, or registered by a registrar, other than the corporation itself or an employee of the corporation. If an officer who has signed or whose facsimile signature has been placed on a certificate ceases to be an officer before the certificate is issued, it may be issued by the corporation with the same effect as if he were an officer at the date of its issue.

Sec. 10.50.105. INFORMATION REQUIRED TO BE STATED ON CERTIFICATE. Each certificate representing shares shall state on the face

(1) that the corporation is organized under the laws of the state;

(2) the name of the person to whom issued;

(3) the number of shares which the certificate represents;

(4) a statement that the shares are without par value.

Sec. 10.50.110. FULL PAYMENT REQUIRED FOR CERTIFICATE. A certificate may not be issued for a share until the share is fully paid if consideration is required.

Sec. 10.50.115. ISSUANCE OF FRACTIONAL SHARES. (a) A corporation may issue a certificate for a fractional share.

(b) A certificate for a fractional share entitles the holder to exercise voting rights, to receive dividends, and to participate in the assets of the corporation in the event of liquidation.

Sec. 10.50.120. LIABILITY OF SUBSCRIBERS AND SHAREHOLDERS. (a) A holder of or subscriber to shares of a corporation is under no obligation to the corporation or its creditors with respect to the shares other than the obligation to pay to the corporation the full consideration for which the shares were issued or to be issued.

(b) An assignee or transferee of shares or of a subscription for shares in good faith and without knowledge or notice that the full consideration has not been paid is not personally liable to the corporation or its creditors for any unpaid portion of the consideration.

(c) An executor, administrator, conservator, guardian, trustee, assignee for the benefit of creditors, or receiver is not personally liable to the corporation as a holder of or subscriber to shares of a corporation but the estate and funds held by him are liable.

(d) A pledgee or other holder of shares as collateral security is not personally liable as a shareholder.

Sec. 10.50.125. BYLAWS. The board of directors shall adopt the initial bylaws of a corporation in accordance with AS 10.50.335. The power to alter, amend or repeal the bylaws or to adopt new bylaws is vested in the board of directors and the shareholders. The bylaws may contain provisions for the regulation and management of the affairs of the corporation consistent with law and the articles of incorporation.

Sec. 10.50.130. MEETINGS OF SHAREHOLDERS. (a) Meetings of shareholders shall be held in the state, as may be provided in the bylaws. The board of directors shall designate the place of the meeting.

(b) An annual meeting of the shareholders shall be held at the time provided in the bylaws. Failure to hold the annual meeting at the designated time does not work a forfeiture or dissolution of the corporation.

(c) Special meetings of the shareholders may be called by the president, by the board of directors, by the holders of not less than 1,000 shares, or by the other officers or persons provided in the articles of incorporation or the bylaws.

(d) The shareholders of a corporation may participate in a meeting of the shareholders by communicating simultaneously with the other shareholders from places designated in the notice of meeting by means of conference telephones or other communications equipment, so long as all shareholders participating in the meeting can hear one another.

Sec. 10.50.135. NOTICE OF SHAREHOLDERS' MEETINGS. (a) Beginning not less than 150 days before a meeting of shareholders, the corporation shall, at least weekly, notify the shareholders of the time and manner in which (1) nominations for the board of directors of the corporation may be made and (2) issues may be placed on the corporation ballot for consideration by the shareholders. Notice shall be by publication in newspapers in all regions of the state and shall appear at least weekly for not less than four weeks.

(b) Written or printed notice stating the place, day and hour of the meeting and, in case of a special meeting, the purpose for which the meeting is called, shall be delivered not less than 60 nor more than 90 days before the date of the meeting, either personally or by mail, by or at the direction of the president, the secretary, or the officer or persons calling the meeting, to each shareholder of record entitled to vote at the meeting. If mailed, the notice is considered delivered when deposited in the United States mail addressed to the shareholder at his address as it appears on the stock transfer books of the corporation, with postage prepaid.

Sec. 10.50.140. CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE. (a) To determine the shareholders entitled to notice of or to vote at a meeting of shareholders or an adjournment of a meeting, or entitled to receive payment of a dividend, or in order to make a determination of shareholders for any other proper purpose, the board of directors of a corporation may provide that the stock transfer books shall be closed for a stated period not exceeding 90 days. If the stock transfer books are closed to determine shareholders entitled to notice of or to vote at a meeting of shareholders, they shall be closed for at least 60 days immediately preceding the meeting.

(b) Instead of closing the stock transfer books, the bylaws, or in the absence of an applicable bylaw the board of directors, may fix in advance a date as the record date for the determination of shareholders. This record date shall be not more than 90 days and, in case of a meeting of shareholders, not less than 60 days before the date on which the particular action requiring the determination of shareholders is to be taken. If the stock transfer books are not closed and no record date is fixed for the determination of shareholders entitled to notice of or to vote at a meeting of shareholders, cr shareholders entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the board of directors declaring the dividend is adopted is, as the case may be, the record date for the determination of shareholders. When a determination of shareholders entitled to vote at a meeting of shareholders is made, the determination applies to an adjournment of the meeting except when the determination has been made through the closing of the stock transfer books and the stated period of closing has expired.

Sec. 10.50.145. VOTING LIST. (a) At least 60 days before each meeting of shareholders, the officer or agent having charge of the stock transfer books for shares of a corporation shall make a list of the shareholders entitled to vote at the meeting or an adjournment of the meeting, arranged in alphabetical order, with the address of and the number of shares held by each. The list shall be kept on file at the registered office of the corporation and is subject to inspection by a shareholder at any time during usual business hours for a period of 60 days before the meeting. The list shall also be produced and kept open at the time and place of the meeting and shall be subject to the inspection of a shareholder during the meeting. The original stock transfer books are prima facie evidence as to who are the shareholders entitled to examine the list or transfer books or to vote at a meeting of shareholders.

(b) Failure to comply with the requirements of this section does not affect the validity of the action taken at the meeting.

Sec. 10.50.150. QUORUM OF SHAREHOLDERS. One-third of the shares entitled to vote, represented in person or by ballots, constitutes a quorum at a meeting of shareholders. Each outstanding share is entitled to one vote on each matter submitted to a vote at a meeting of shareholders. If a quorum is present, the affirmative vote of the majority of the shares represented at the meeting and entitled to vote on the subject matter is the act of the shareholders, unless the vote of a great number is required by this chapter or the articles of incorporation or the bylaws.

Sec. 10.50.155. PROXY VOTING PROHIBITED. A shareholder may not vote by proxy.

Sec. 10.50.160. VOTING FOR DIRECTORS. At an election for directors every shareholder entitled to vote may vote the number of shares owned by him for as many persons as there are directors to be elected and for whose election he has a right to vote. Shareholders may not cumulate their votes.

Sec. 10.50.165. VOTING OF SHARES IN THE NAME OF ANOTHER. (a) Shares held by an administrator, executor, guardian or conservator may be voted by him, either in person or by ballot, without a transfer of the shares into his name.

(b) Shares standing in the name of a receiver may be voted by him, and shares held by or under the control of a receiver may be voted by him without the transfer of the shares into his name if authority to do so is contained in an appropriate order of the court by which the receiver was appointed.

Sec. 10.50.170. VOTING OF PLEDGED SHARES. A shareholder whose shares are pledged may vote the shares until they have been transferred into the name of the pledgee, and thereafter the pledgee may vote the shares so transferred.

Sec. 10.50.175. CORPORATION BALLOT. (a) The corporation shall prepare one ballot for each meeting of the shareholders. The ballot shall be mailed to t' shareholders with the notice of meeting. Candidates for the board of directors and proposals for shareholder consideration shall be included in the ballot as provided in this section.

(b) A candidate for director shall be nominated by

(1) a resolution adopted by the board of directors; or

(2) a petition signed by at least 1,000 shareholders and filed with the secretary of the corporation at least 120 days before the meeting at which the election is to be held.

(c) A proposal for amendment of the bylaws or other proper corporate purpose shall be included on the ballot if authorized by

(1) a resolution adopted by the board of directors setting out the proposal and directing that it be submitted to a vote at the meeting of shareholders; or

(2) a petition, setting out the proposal and directing that it be submitted to a vote at the next meeting of shareholders, signed by at least 1,000 shareholders and filed with the secretary of the corporation at least 120 days before the next meeting of shareholders.

(d) A written or printed notice setting out the candidates' qualifications for office or the proposals to be put to a vote of the shareholders and any materials in opposition to the proposals shall be given tc each shareholder of record entitled to vote within the time and in the manner provided in this chapter for the giving of notice of meetings of shareholders.

Sec. 10.50.180. BOARD OF DIRECTORS. (a) The business and affairs of a corporation shall be managed by a board of directors. At least three-quarters of the board of directors including the chairman of the board of directors must be residents of the state. The articles of incorporation or bylaws may prescribe other qualifications for directors. The compensation of directors shall be fixed by the bylaws.

(b) A director is entitled to attend any meeting of a committee of the board of directors whether or not he is a member of the committee. A director is entitled to inspect all records of any committee of the board of directors.

(c) An officer or employee of the corporation may not serve as a member of the board of directors.

Sec. 10.50.185. NUMBER OF DIRECTORS. (a) The number of directors of a corporation shall be at least three. The number of directors shall be fixed by the bylaws, except that the number constituting the initial board of directors shall be fixed by the chartering legislation.

(b) The number of directors may be increased or decreased by amendment to the bylaws, but a decrease may not shorten the term of an incumbent director.

(c) In the absence of a bylaw fixing the number of directors, the number shall be the same as that stated in the chartering legisation.

(d) The board of directors shall be divided into two classes, each class to be as nearly equal in number as possible, with the term of office of directors of the first class to expire at the first annual meeting of shareholders after their election, that of the second class to expire at the second annual meeting after their election. At each annual meeting after the classification the number of directors equal to the number of the class whose term expires at the time of the meeting shall be elected to hold office until the second succeeding annual meeting if there are two classes. No classification of directors is effective prior to the first annual meeting of shareholders.

Sec. 10.50.190. ELECTION OF DIRECTORS. At the first annual meeting of shareholders and at each annual meeting thereafter the shareholders shall elect directors. Each director holds office for the term for which he is elected and until his successor is elected and qualified.

Sec. 10.50.195. VACANCIES. A vacancy occurring in the board of directors may be filled by the affirmative vote of a majority of the remaining directors though the majority is less than a quorum of the board. A director elected by the board of directors to fill a vacancy shall serve until the next annual meeting. The shareholders shall elect a director for the unexpired term, if any, of the director's position to which the board elected his predecessor. A directorship to be filled by reason of an increase in the number of directors shall be filled by election at an annual meeting or at a special meeting of shareholders called for that purpose. In no case may a vacancy continue for longer than six months or until the next annual meeting, whichever occurs first.

Sec. 10.50.200. QUORUM OF DIRECTORS. A majority of the number of directors fixed by the bylaws, or in the absence of a bylaw fixing the number of directors, then of the number stated in the articles of incorporation, constitutes a quorum for the transaction of business unless a greater number is required by the articles of incorporation or the bylaws. The act of the majority of the directors present at a meeting at which a quorum is present is the act of the board of directors, unless the act of a greater number is required by the articles of incorporation or the bylaws.

Sec. 10.50.205. PLACE AND NOTICE OF DIRECTORS' MEETINGS. (a) Regular or special meetings of the board of directors maybe held only in the state.

(b) Regular meetings of the board of directors may be held with or without notice as prescribed in the bylaws. Special meetings of the board of directors shall be held after the notice prescribed in the bylaws. Attendance of a director at a meeting constitutes a waiver of notice of the meeting, except when a director attends a meeting for the express purpose of objecting to the transaction of any business because the meeting is not lawfully called or convened. The business to be transacted or the purpose of a special meeting of the board of directors must be specified in the notice or waiver of notice of the meeting.

Sec. 10.50.210. PARTICIPATION BY TELEPHONE. The members of the board of directors of a corporation, or a committee designated by it, may participate in a meeting of the board or committee by communicating simultaneously with each other by means of conference telephones or similar communications equipment, so long as all members participating in the meeting can hear one another. Participation in a meeting under this section constitutes presence in person at the meeting.

Sec. 10.50.215. DISTRIBUTIONS. (a) Except for distributions required to comply with subchapter U, chapter 1 of the Internal Revenue Code of 1954, as amended (26 U.S.C. secs. 1391 - 1397), a corporation may not make a distribution to its shareholders unless

(1) the amount of the retained earning of the corporation immediately before the proposed distribution equals or exceeds the amount of the proposed distribution; or

(2) immediately after giving effect to the proposed distribution

(A) the sum of the assets of the corporation, exclusive of goodwill, capitalized research and development expenses and deferred charges would be at least equal to one and one-fourth times its liabilities, not including deferred taxes, deferred income and other deferred credits; and

(B) the current assets of the corporation would be at least equal to its current liabilities or, if the average of the earnings of the corporation before taxes on income and before interest expense for the two preceding fiscal years was less than the average of the interest expense of the corporation for those fiscal years, at least equal to one and one-fourth times its current liabilities.

(b) In determining the amount of the assets of the corporation, no appreciation in value not yet realized may in any event be included, except for readily marketable securities, and profits derived from an exchange of assets may not be included unless the assets received are currently realizable in cash.

(c) For the purpose of this section "current assets" may include net amounts which the board has determined in good faith may reasonably be expected to be received from customers during the 12-month period used in calculating current liabilities under existing contractual relationships obligating the customers to make fixed or periodic payments during the term of the contract, after giving effect to future costs not then included in current liabilities but reasonably expected to be incurred by the corporation in performing the contracts.

(d) The amount of a distribution payable in property shall, for the purpose of this chapter, be determined on the basis of the value at which the property is carried on the corporation's financial statements in accordance with generally accepted accounting principles.

(e) Subparagraph (a)(2)(B) of this section does not apply to a corporation which does not classify its assets into current and fixed assets under generally accepted accounting principles.

Sec. 10.50.220. DISTRIBUTIONS IN PARTIAL LIQUIDATION. The board of directors may, from time to time, distribute to its shareholders in partial liquidation a portion of its assets, subject to the following provisions:

(1) A distribution may not be made at a time when the corporation is insolvent or when the distribution would render the corporation insolvent.

(2) A distribution may not be made unless the distribution is authorized by the affirmative vote of the holders of at least two-thirds of the shares voting on the issue at a meeting of shareholders.

(3) Each distribution, when made, shall be identified as a distribution in partial liquidation and the amount per share disclosed to the shareholders concurrently with the distribution.

Sec. 10.50.225. CERTAIN LOANS PROHIBITED. A loan may not be made by a corporation to its officers or directors, and a loan may not be made by a corporation secured by its shares.

Sec. 10.50.230. LIABILITY OF DIRECTORS IN CERTAIN CASES. (a) Directors who vote for or assent to the declaration of a dividend or other distribution of the assets of a corporation to its shareholders contrary to the provisions of this chapter or contrary to restrictions contained in the articles of incorporation are jointly and severally liable to the corporation for the amount of the dividend paid, or the value of assets distributed in excess of the amount of the dividend or distribution which could have been paid or distributed without a violation of the provisions of this chapter or the restrictions in the articles of incorporation.

(b) Directors who vote for or assent to the purchase by a corporation of its own shares contrary to the provisions of this chapter are jointly and severally liable to the corporation for the amount of consideration paid in excess of the maximum amount which could have been paid without a violation of the provisions of this chapter.

(c) The directors who vote for or assent to the distribution of assets of a corporation to its shareholders during the liquidation of the corporation without the payment and discharge of, or making adequate provision for, all known debts, obligations, and liabilities of the corporation are jointly and severally liable to the corporation for the value of the assets distributed, to the extent that the debts, obligations and liabilities of the corporation are not paid and discharged.

(d) The directors who vote for or assent to the making of a loan to an officer or director of the corporation, or the making of a loan secured by shares of the corporation, are jointly and severally liable to the corporation for the amount of the loan until it is repaid.

Sec. 10.50.235. EFFECT OF GOOD FAITH RELIANCE ON FINANCIAL STATEMENTS OR BOOK VALUE. A director is not liable under AS 10.50.230(a), (b) or (c) if

(1) he relied and acted in good faith upon financial statements of the corporation represented to him to be correct by the president or the officer of the corporation having charge of its books of account, or certified by an independent public or certified public accountant or firm of certified public accountants fairly to reflect the financial condition of the corporation; or

(2) in good faith in determining the amount available for a dividend or distribution he considered the assets to be of their book

value.

Sec. 10.50.240. PRESUMPTION OF CONSENT OF DIRECTOR AND FILING OF DISSENT. A director present at a meeting of the board of directors at which action on a corporate matter is taken is presumed to have assented to the action taken unless his dissent is entered in the minutes of the meeting or unless he files his written dissent to the action with the person acting as secretary of the meeting before its adjournment or forwards his dissent by registered mail to the secretary of the corporation within five days after the adjournment of the meeting. The right to dissent does not apply to a director who voted in favor of the action.

Sec. 10.50.245. DIRECTOR'S RIGHT TO CONTRIBUTION. A director against whom a claim is asserted under AS 10.50.230 - 10.50.240 is entitled to contribution from the other directors who voted for or assented to the action upon which the claim is asserted.

Sec. 10.50.250. OFFICERS. The officers of a corporation consist of a president, one or more vice-presidents as prescribed by the bylaws, a secretary, and a treasurer. Each of the officers shall be elected by the board of directors at the time and in the manner prescribed by the bylaws. Other necessary officers and assistant officers and agents may be elected or appointed by the board of directors or chosen in the manner prescribed by the bylaws. Two or more offices may be held by the same person, except the offices of president and secretary.

Sec. 10.50.255. DUTIES OF OFFICERS. Officers and agents of the corporation, as between themselves and the corporation, may perform duties in the management of the corporation as provided in the bylaws, or as determined by resolution of the board of directors not inconsistent with the bylaws.

Sec. 10.50.260. REMOVAL OF OFFICERS. An officer or agent may be removed by the board of directors when, in its judgment, the best interests of the corporation will be served. Removal is without prejudice to the contract rights of the person removed. Election or appointment of an officer or agent does not of itself create contract rights.

Sec. 10.50.265. BOOKS AND RECORDS. (a) A corporation organized under this chapter shall keep correct and complete books and records of account, minutes of the proceedings of its shareholders and board of directors, and a record of its shareholders, containing the names and addresses of all shareholders and the number and class of the shares held by each.

(b) A corporation organized under this chapter shall make these books and records, or certified copies of them, reasonably available for inspection at the registered office or principal place of business in the state by the Department of Commerce and Economic Development or a shareholder described by AS 10.50.270.

Sec. 10.50.270. SHAREHOLDER'S RIGHT TO EXAMINE BOOKS AND RECORDS. A shareholder, upon written demand stating the purpose of the demand, may, in person or by agent or attorney, at a reasonable time for a proper purpose, examine and make extracts from its books and records of account, minutes and record of shareholders.

Sec. 10.50.275. LIABILITY FOR REFUSAL OF EXAMINATION. An officer or agent who, or a corporation which, refuses to allow a shareholder, or his agent or attorney, to examine and make extracts from its books and records of account, minutes, and record of shareholders, for a proper purpose, is liable to the shareholder in a penalty of $1,000 for each day, in addition to other damages or remedy given him by law. It is a defense to an action for penalties under this section that the person suing has within two years sold or offered for sale a list of shareholders of the corporation or any other corporation or has aided or abetted a person in procuring a list of shareholders for this purpose, or has improperly used information secured through a prior examination of the books and records of account, or minutes, or record of shareholders of the corporation or any other corporation, or was not acting in good faith or for a proper purpose in making his demand.

Sec. 10.50.280. COURT MAY COMPEL INSPECTION. AS 10.50.265 - 10.50.285 do not impair the power of a competent court, upon proof by a shareholder of proper purpose, to compel the production for examination by the shareholder of the books and records of account, minutes, and record of shareholders of a corporation.

Sec. 10.50.285. SHAREHOLDERS' RIGHT TO FINANCIAL STATEMENT. Upon the written request of a shareholder of a corporation, the corporation shall mail to the shareholder its most recent financial statements showing in reasonable detail its assets and liabilities and the results of its operations.

Sec. 10.50.290. REMOVAL OF DIRECTORS BY SUPERIOR COURT. The superior court may upon an action filed by the attorney general or at least 100 shareholders of at least 18 years of age, remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation and may bar from reelection a director so removed for a period prescribed by the court. The corporation shall be made a party to the action.

Sec. 10.50.295. SHAREHOLDER REMOVAL OF DIRECTORS. (a) The entire board of directors an initial director, or a director elected by the board of directors may be removed from office by the affirmative vote of the holders of a majority of the shares voting at an annual or special meeting for which notice of the proposal has been given.

(b) An individual director may be removed if the number of votes cast for his removal exceeds the number of votes he received at the last preceding election during which he was a candidate for the office of director.

Sec. 10.50.300. SHAREHOLDERS' DERIVATIVE ACTION. (a) An action may be brought on behalf of a corporation, by a shareholder of the corporation, for a judgment in its favor.

(b) A person bringing suit under this section must be a shareholder at the time of bringing the action, and must have been a shareholder at the time of the transaction of which he complains or have received his shares by operation of law at that time.

(c) In an action under this section, the complaint shall set out with particularity the efforts of the plaintiff to secure the initiation of an action by the board of directors or the reasons for not making those efforts.

(d) An action under this section may not be discontinued, compromised or settled, without the approval of the court having jurisdiction of the action. If the court determines that the interests of the shareholders will be substantially affected by a discontinuance, compromise, or settlement, the court, in its discretion, may direct that notice, by publication or otherwise, be given to the shareholders whose interests it determines will be affected. If notice is required, the court may determine which one or more of the parties to the action must bear the expense of giving the notice, in an amount the court determines and finds to be reasonable, and the amount determined shall be awarded as special costs of the action and recoverable by the prevailing party.

(e) If the action on behalf of the corporation is successful, in whole or in part, or if anything is received by the plaintiff as the result of a judgment, compromise or settlement of an action, the court may award the plaintiff reasonable expenses, including reasonable attorney fees, and shall direct the plaintiff to account to the corporation for the remainder of the proceeds received by him. This subsection does not apply to a judgment rendered only for the benefit of an injured shareholder and limited to a recovery of the loss or damage sustained by him.

(f) In an action under this section, at any time within 30 days after service of summons upon the corporation or upon any defendant who is an officer or director of the corporation, or who held such office at the time of the transaction complained of, the corporation or other defendant may move the court for an order, upon notice and hearing, requiring the plaintiff to furnish security. The motion shall be based upon one or both of the following grounds:

(1) that there is no reasonable possibility that the prosecution of the cause of action alleged in the complaint will benefit the corporation or its shareholders; or

(2) that the moving party, if other than the corporation, did not participate in the transaction complained of in any capacity.

(g) If the court determines, after hearing the evidence adduced by the parties, that the moving party has established by a preponderance of the evidence any of the grounds upon which the motion is based, the court shall fix the nature and amount of security, not to exceed $50,000, to be furnished by the plaintiff for reasonable expenses, including attorney fees, which may be incurred by the moving party or the corporation in connection with the action, including expenses for which the corporation may become liable under this chapter. A ruling by the court on the motion is not considered a determination of any issue in the action or of its merits. The amount of the security may be increased or decreased in the discretion of the court upon a showing that the security provided has or may become inadequate or excessive, but the court may not increase the total amount of the security beyond $50,000 in the aggregate for all defendants. If the court, upon motion, decides that security must be furnished by the plaintiff as to any one or more defendants, the action shall be dismissed as to the defendant or defendants, unless the security required by the court is furnished within a reasonable time fixed by the court. The corporation and the moving party have recourse to the security in the amount the court determines upon the termination of the action.

(h) If the plaintiff, before an order or determination pursuant to a motion under (f) of this section, posts bond in the aggregate amount of $50,000 to secure the reasonable expenses of the parties entitled to make the motion, the plaintiff has complied with the requirements of this section and with any order for security. A pending motion under (f) of this section shall be dismissed and no further or additional bond or other security may be required.

(i) If a motion is filed under (f) of this section, no pleadings need be filed by the corporation or any other defendant and the prosecution of the action shall be stayed until 10 days after the motion has been disposed of.

Sec. 10.50.305. FRAUDULENT TRANSFERS OF SHARES. An individual who transfers or obtains shares of the corporation, or in his capacity as legal guardian obtains shares of the corporation for another, through fraud, misrepresentation, or any deceitful or illegal means is guilty of a felony.

Sec. 10.50.310. POLITICAL ACTIVITIES. (a) A corporation may not

(1) make contributions or spend money to influence the nomination or election of a candidate for office or the outcome of a ballot proposition or question;

(2) endorse a candidate for office or any side of a ballot proposition or question;

(3) make any expenditures, including reimbursement for travel and living expenses, or employ any person for the purpose of influencing legislative action.

(b) A corporation that knowingly violates this section or that knowingly causes, participates in, aids, or confirms a violation of this section is, upon conviction, punishable by a fine of not more than $10,000 for each offense.

(c) An individual who knowingly violates this section, whether acting for himself, on behalf of an employer, or in concert with another person, is, upon conviction, guilty of a misdemeanor.

(d) An individual who knowingly causes, participates in, aids, or confirms any violation of this section is, upon conviction, guilty of a misdemeanor.

ARTICLE 2. FORMATION OF CORPORATIONS.

Sec. 10.50.315. INCORPORATORS. Three or more natural persons at least 18 years of age may act as incorporators of a corporation by signing, verifying and delivering in duplicate to the commissioner articles of incorporation for the corporation.

Sec. 10.50.320. ARTICLES OF INCORPORATION. (a) The articles of incorporation of a corporation shall set out

(1) the name of the corporation;

(2) the period of duration, which may be perpetual;

(3) the purpose or purposes for which the corporation is organized;

(4) the aggregate number of shares which the corporation may issue;

(5) that only one class of stock may be issued by the corporation;

(6) that shares of stock may be issued only to individuals

who were residents of the state on the effective date of its chartering legislation and who continued to be residents until the date of issuance of the shares;

(7) that at least one share of stock shall be issued to each individual eligible under (6) of this subsection, unless that individual elects within one year after the date of issuance not to receive the share;

(8) that no share of stock may be voluntarily or involuntarily transferred

(A) or encumbered by a shareholder, other than by will or under the laws relating to intestate succession, until five years after the date of issuance of the share, except if the shareholder ceases to be a resident of the state;

(B) to an individual other than one who is a resident on the date of transfer;

(C) to an individual who, after the transfer, would own more than 10 shares of stock of the corporation;

(D) or encumbered by a shareholder under 18 years of age or encumbered by that shareholder's parent or legal guardian;

(9) that the corporation must qualify as a general stock ownership corporation under subchapter U of the Internal Revenue Code of 1954, as amended (26 U.S.C. secs. 1391 - 1397);

(10) any other provision consistent with law which the incorporators elect to set out in the articles of incorporation for the regulation of the internal affairs of the corporation, including a provision which, under this chapter, is required or permitted to be set out in the bylaws;

(11) the address of its initial registered office, and the name of its initial registered agent at that address;

(12) the number of directors constituting the initial board of directors and the names and addresses of the persons who are to serve as directors until their successors are elected and qualify;

(13) the name and address of each incorporator.

(b) It is not necessary to set out in the articles of incorporation any of the corporate powers enumerated in this chapter.

Sec. 10.50.325. FILING OF ARTICLES OF INCORPORATION. (a) Duplicate originals of the articles of incorporation shall be delivered to the commissioner. If the commissioner finds that the articles of incorporation conform to law, he shall, when all fees prescribed in AS 10.05.-708 - 10.05.774 have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) issue a certificate of incorporation and affix the other duplicate original to it.

(b) The certificate of incorporation, together with the duplicate original of the articles of incorporation affixed by the commissioner, shall be returned to the incorporators or their representative.

Sec. 10.50.330. EFFECT OF ISSUANCE OF CERTIFICATE OF INCORPORATION. Upon the issuance of the certificate of incorporation, the corporate existence begins. The certificate of incorporation is conclusive evidence that all conditions required to be performed by the incorporators have been complied with and that the corporation has been incorporated. The issuance of the certificate does not affect the right of the state to bring a proceeding to cancel or revoke the certificate of incorporation or for involuntary dissolution of the corporation.

Sec. 10.50.335. ARTICLES OF INCORPORATION AND INITIAL BYLAWS. (a) The corporation shall submit copies of the original articles of incorporation and the initial bylaws adopted under AS 10.05.340 to the legislature within 30 days of the issuance of the certificate of incorporation.

(b) The legislature, within 60 legislative days after receipt of a copy of the original articles of incorporation and the initial bylaws, may disapprove any provision of the articles of incorporation or bylaws by concurrent resolution. Disapproval by the legislature of a provision of the articles of incorporation or the bylaws of a corporation does not alter or impair the power of a corporation to fulfill the terms of a contractual agreement or impair the rights of a person with whom a corporation has entered into a contractual agreement.

(c) A provision of the articles of incorporation or the bylaws is suspended upon disapproval by the legislature and is of no effect unless approved by a majority of the shares voting on the issue at the next meeting of the shareholders.

Sec. 10.50.340. ORGANIZATION MEETING OF DIRECTORS. After the issuance of the certificate of incorporation an organizational meeting of the board of directors named in the articles of incorporation shall be held in the state, at the call of a majority of the incorporators, for the purpose of adopting bylaws, electing officers, and the transaction of other business as may come before the meeting. The incorporators calling the meeting shall give at least 10 days notice of the meeting by mail to each director named. The notice shall state the time and place of the meeting.

ARTICLE 3. APPLICATION FOR SHARES.

Sec. 10.50.345. NOTIFICATION OF ELIGIBLE SHAREHOLDERS. Beginning not less than 90 days before the initial issue of stock, the corporation shall at least weekly notify the public of its intention to issue stock and the method for qualifying and applying for shares. The notice shall be by publication in newspapers of all regions of the state, by radio and television announcements, and by other means the corporation determines to be appropriate and reasonable, and shall be continued at least one each month for 11 months following the date of is uance of shares.

Sec. 10.50.350. CORPORATION NOT LIABLE TO SHAREHOLDERS. Registration for issuance of the initial shares of the corporation is a responsibility solely of an individual eligible under AS 10.50.320(a)(6) to receive the initial shares of the corporation. The corporation may not be held liable for

(1) any loss resulting directly on indirectly from the failure of an individual to apply for shares of the corporation; or

(2) payment of a declared or paid dividend to an individual who would have been entitled to receive the dividend had he been a shareholder at the time of declaration or payment.

Sec. 10.50.355. LATE APPLICATION FOR SHARES. An individual eligible under AS 10.50.320(a)(6) to receive the initial shares of the corporation who failed to apply for the shares within one year after their issuance may apply for and receive the shares any time after one year and within two years after the date of issuance if he is otherwise qualified to own stock of the corporation and upon the payment of the book value of the shares.

Sec. 10.50.360. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER. The ownership interest in shares of the corporation's stock issued to an individual ineligible to receive the initial shares, who has presented fraudulent or misleading information regarding his eligibility to own those shares, is void upon the issuance of an appropriate order by the superior court. The ineligible individual is also liable for the full amount of dividends, or other distributions to shareholders received by him plus interest from the date of distribution, and legal fees and costs of recovery incurred by the corporation. This section applies to an individual who has presented fraudulent or misleading information regarding the eligibility of another person for whom he acts in the capacity of legal guardian.

ARTICLE 4. AMENDMENT.

Sec. 10.50.365. RIGHT TO AMEND ARTICLES OF INCORPORATION. A corporation may amend its articles of incorporation so long as its articles of incorporation as amended contain provisions which could be lawfully contained in original articles of incorporation at the time the amendment is made.

Sec. 10.50.370. PURPOSES FOR WHICH ARTICLES MAY BE AMENDED. Without limitation on the general power of amendment, a corporation may amend its articles of incorporation to

(1) change its corporate name;

(2) change its period of duration;

(3) change, enlarge or diminish its corporate purposes;

(4) increase or decrease the aggregate number of shares, or shares of a class, which the corporation may issue;

(5) exchange or cancel its shares, whether issued or unissued.

Sec. 10.50.375. PROCEDURE TO AMEND ARTICLES OF INCORPORATION. Amendments to the articles of incorporation shall be made in the following manner.

(1) The board of directors may adopt a resolution setting out the proposed amendment and directing that it be submitted to a vote at the next meeting of shareholders.

(2) A proposed amendment shall be submitted to a vote at the next meeting of shareholders if the secretary of the corporation receives a petition setting out the proposed amendment and is signed by at

least 1,000 shareholders.

(3) Written or printed notice setting out the proposed amendment or a summary of the changes to be effected shall be given to each shareholder of record entitled to vote within the time and in the manner provided in this chapter for the giving of notice of meetings of shareholders. If the meeting is an annual meeting, the proposed amendment or summary may be included in the notice of the annual meeting.

(4) At the meeting a vote of the shareholders entitled to vote shall be taken on the proposed amendment. The proposed amendment shall be adopted if it receives the affirmative vote of the holders of at least two-thirds of the shares voting.

(5) More than one amendment may be submitted to the shareholders and voted upon at one meeting.

Sec. 10.50.380. ARTICLES OF AMENDMENT. The articles of amendment shall be executed in duplicate by the corporation by its president or vice-president and by its secretary or an assistant secretary, and verified by one of the officers signing the articles, and shall set out

(1) the name of the corporation;

(2) the amendment adopted;

(3) the date of the adoption of the amendment by the shareholders;

(4) the number of shares outstanding and the number of shares voting;

(5) the number of shares voted for and against the amendment, respectively;

(6) if the amendment provides for an exchange or cancellation of issued shares, and if the manner in which this is carried out is not set out in the amendment, a statement of the manner in which it is to be carried out.

Sec. 10.50.385. FILING OF ARTICLES OF AMENDMENT. (a) Duplicate originals of the articles of amendment shall be delivered to the commissioner. If the commissioner finds that the articles of amendment conform to law, he shall, when all fees and franchise taxes prescribed in this chapter have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) issue a certificate of amendment and affix the other duplicate original to it.

(b) The certificate of amendment, together with the duplicate original of the articles of amendment affixed by the commissioner, shall be returned to the corporation or its representative.

Sec. 10.50.390. EFFECT OF CERTIFICATE OF AMENDMENT. (a) Upon the issuance of the certificate of amendment by the commissioner, the amendment becomes effective and the articles of incorporation are considered amended accordingly.

(b) No amendment may affect an existing cause of action in favor of or against the corporation, or a pending suit to which the corporation is a party, or the existing rights of persons other than shareholders. In the event the corporate name is changed by amendment, no suit brought by or against the corporation under its former name abates for that reason.

Sec. 10.50.395. RESTATED ARTICLES OF INCORPORATION. A corporation may at any time, by resolution adopted by the board of directors, restate its articles of incorporation as amended up to that time. Upon the adoption of the resolution, restated articles of incorporation shall be executed in duplicate by the corporation by its president or a vice-president and by its secretary or assistant secretary and verified by one of the officers signing the articles and shall set out all of the operative provisions of the articles of incorporation as amended up to that time together with a statement that the restated articles of incorporation correctly set out without change the corresponding provisions of the articles of incorporation as amended up to that time and that the restated articles of incorporation supersede the original articles of incorporation and all amendments to them.

Sec. 10.50.400. EXECUTION OF RESTATED ARTICLES OF INCORPORATION. Upon approval of the restated articles of incorporation, they shall be executed in duplicate by the corporation by its president or vice-president and by its secretary or assistant secretary, and verified by one of the officers signing the articles.

Sec. 10.50.405. CONTENTS OF RESTATED ARTICLES OF INCORPORATION. The restated articles of incorporation shall set out

(1) the name of the corporation;

(2) the period of its duration;

(3) the purpose or purposes which the corporation is authorized to pursue;

(4) the aggregate number of shares which the corporation may issue;

(5) any provisions, not inconsistent with law, which are set out in the articles of incorporation as amended, for the regulation of the internal affairs of the corporation;

(6) a statement that the restated articles of incorporation correctly set out without change the corresponding provisions of the articles of incorporation as amended, and that the restated articles of incorporation supersede the original articles of incorporation and all amendments to the original articles of incorporation.

Sec. 10.50.410. FILING OF RESTATED ARTICLES OF INCORPORATION WITH

COMMISSIONER. (a) Duplicate originals of the restated articles of incorporation shall be delivered to the commissioner. If the commissioner finds that the restated articles of incorporation conform to law, he shall, when all fees and franchise taxes prescribed in this chapter have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) issue a restated certificate of incorporation and affix the other duplicate original to it.

(b) The restated certificate of incorporation, together with the duplicate original of the restated articles of incorporation affixed by the commissioner, shall be returned to the corporation or its representative.

Sec. 10.50.415. EFFECT OF ISSUANCE OF RESTATED CERTIFICATE OF INCORPORATION. Upon the issuance of the restated certificate of incorporation, the restated articles of incorporation become effective and supersede the original articles of incorporation and all amendments.

ARTICLE 5. SALE OF ASSETS.

Sec. 10.50.420. SALE OR MORTGAGE OF ASSETS IN REGULAR COURSE OF BUSINESS. The sale, lease, exchange, mortgage, pledge, or other disposition of all, or substantially all, the property and assets of a corporation, when made in the usual and regular course of the business of the corporation, may be made upon the terms and conditions and for the consideration, which may consist in whole or in part of money or property, real or personal, including shares of another corporation, domestic or foreign, authorized by the board of directors. No authorization or consent of the shareholders is required.

Sec. 10.50.425. SALE OR MORTGAGE OF ASSETS OTHER THAN IN REGULAR

COURSE OF BUSINESS. A sale, lease, exchange, mortgage, pledge, or other disposition of all, or substantially all, the property and assets, with or without the good will, of a corporation, if not made in the usual and regular course of its business, may be made upon the terms and conditions and for the consideration, which may consist in whole or in part of money or property, real or personal, including shares of another corporation, as authorized in the following manner.

(1) The board of directors shall adopt a resolution recommending the sale, lease, exchange, mortgage, pledge, or other disposition and directing the submission of the resolution to a vote at the next meeting of shareholders.

(2) Written or printed notice shall be given to each shareholder of record entitled to vote at the meeting within the time and in the manner provided in this chapter for the giving of notice of meetings of shareholders, and, whether the meeting is an annual or a special meeting, shall state that the purpose, or one of the purposes, of the meeting is to consider the proposed sale, lease, exchange, mortgage, pledge, or other disposition.

Sec. 10.50.430. APPROVAL OF PLAN BY SHAREHOLDERS. At the meeting the shareholders may authorize the sale, lease, exchange, mortgage, pledge, or other disposition and may fix, or may authorize the board of directors to fix the terms and conditions and the consideration to be received by the corporation. Each outstanding share of the corporation is entitled to vote. The authorization requires the affirmative vote of the holders of at least two-thirds of the shares voting.

Sec. 10.50.435. ABANDONMENT OF PLAN BY BOARD OF DIRECTORS. After authorization by a vote of shareholders, the board of directors may, nevertheless, abandon the sale, lease, exchange, mortgage, pledge, or other disposition of assets, subject to the rights of third parties under contracts relating to the disposition, without further action or approval by shareholders.

Sec. 10.50.440. RIGHTS OF DISSENTING SHAREHOLDERS UPON SALE OR EXCHANGE OF ASSETS. If a sale or exchange of all or substantially all of the property and assets of a corporation other than in the usual and regular course of its business, or in connection with the dissolution and liquidation of the corporation, is authorized by a vote of the shareholders of the corporation, a shareholder who files a written objection with the corporation, before or at the meeting of shareholders at which the sale or exchange is authorized, and who does not vote in its favor may, within 10 days after the date on which the vote was taken, make written demand on the corporation for the payment to him of the fair value of his shares as of the day before the date on which the vote was taken. If the sale or exchange is effected, the corporation shall pay to the shareholder, upon surrender of his certificate or other evidence of ownership representing the shares, their fair value. The demand shall state the number of shares owned by the dissenting shareholder. A shareholder failing to make demand within the 10-day period is bound by the terms of the sale or exchange.

Sec. 10.50.445. NOTICE TO DISSENTING SHAREHOLDER. Within 10 days after the sale or exchange is effected, the corporation shall give notice that it is effected to each dissenting shareholder who has made demand as provided in AS 10.50.440 for the payment of the fair value of his shares.

Sec. 10.50.450. PAYMENT TO DISSENTING SHAREHOLDER AFTER AGREEMENT ON VALUE OF SHARES. If within 60 days after the date on which the sale or exchange was effected the value of the shares is agreed upon between the dissenting shareholder and the corporation, payment shall be made within 90 days after the date the sale or exchange was effected, upon the surrender of his certificate or certificates representing the shares. Upon payment of the agreed value, the dissenting shareholder ceases to have an interest in the shares or in the corporation.

Sec. 10.50.455. ACTION BY DISSENTING SHAREHOLDER TO COMPEL PAYMENT UPON FAILURE TO AGREE ON VALUE. If within the 60-day period the shareholder and the corporation do not agree, the dissenting shareholder may, within 60 days after the expiration of the 60-day period, file a petition in the superior court asking for a finding and determination of the fair value of the shares, and is entitled to judgment against the corporation for the amount of the fair value as of the day before the date on which the vote was taken approving the sale or exchange, together with interest to the date of the judgment. The judgment is payable only upon and simultaneously with the surrender to the corporation of the certificate or other evidence of ownership representing the shares. Upon payment of the judgment, the dissenting shareholder ceases to have an interest in the shares or in the corporation. Unless the dissenting shareholder files the petition within the 60-day period, he and all persons claiming under him are bound by the terms of the sale or exchange.

Sec. 10.50.460. EFFECT OF ABANDONMENT OR REVOCATION OF SALE OR EXCHANGE ON SHAREHOLDER'S RIGHTS. The right of a dissenting shareholder to be paid the fair value of his shares ceases when the corporation abandons the sale or exchange or the shareholders revoke the authority to make the sale or exchange.

Sec. 10.50.465. STATUS OF SHARES ACQUIRED FROM DISSENTING SHAREHOLDER. Shares acquired by the corporation pursuant to the payment of the agreed value or to payment of the judgment entered for the agreed value may be held and disposed of by the corporation as treasury shares.

ARTICLE 6. DISSOLUTION.

Sec. 10.50.470. EFFECT OF CERTIFICATE OF DISSOLUTION. Upon the issuance of the certificate of dissolution, the existence of the corporation ceases.

Sec. 10.50.475. VOLUNTARY DISSOLUTION BY ACT OF CORPORATION. (a) A corporation may be dissolved by the act of the corporation when authorized in the manner provided in this section and in AS 10.50.485.

(b) The board of directors shall adopt a resolution recommending that the corporation be dissolved, and directing that the question of dissolution be submitted to a vote at the next meeting of shareholders.

(c) A proposed dissolution of the corporation shall be submitted to a vote at the next meeting of shareholders if the secretary of the corporation receives a petition proposing dissolution signed by at least 100 shareholders.

(d) Written or printed notice shall be given to each shareholder of record entitled to vote at the meeting within the time and in the manner provided in this chapter for the giving of notice of meetings of shareholders, and, whether the meeting is an annual or special meeting, the notice shall state that the purpose of the meeting is to consider the advisability of dissolving the corporation.

(e) At the meeting a vote of shareholders entitled to vote shall be taken on the resolution to dissolve the corporation. Each outstanding share of the corporation may vote on the resolution. The resolution is adopted if it receives the affirmative vote of the holders of at least one-third of the shares entitled to vote.

Sec. 10.50.480. EXECUTION OF STATEMENT OF INTENT TO DISSOLVE. Upon the adoption of the resolution, a statement of intent to dissolve shall be executed in duplicate by the corporation by its president or vice-president and by the secretary or an assistant secretary, and verified by one of the officers signing the statement. The statement of intent to dissolve shall set out

(1) the name of the corporation;

(2) the names and addresses of its officers;

(3) the names and addresses of its directors;

(4) a copy of the resolution adopted by the shareholders authorizing the dissolution of the corporation;

(5) the number of shares outstanding;

(6) the number of shares voted for and against the resolution.

Sec. 10.50.485. FILING OF STATEMENT OF INTENT TO DISSOLVE. Duplicate originals of the statement of intent to dissolve shall be delivered to the commissioner. If the commissioner finds that the statement conforms to law, he shall, when all fees and franchise taxes prescribed in this chapter have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) return the other duplicate original to the corporation or its representative.

Sec. 10.50.490. EFFECT OF STATEMENT OF INTENT TO DISSOLVE. On the filing by the commissioner of a statement of intent to dissolve, the corporation shall cease to carry on business, except that necessary for the winding up of its business. However, corporate existence continues until a certificate of dissolution has been issued by the commissioner or until a decree dissolving the corporation has been entered by a competent court as provided in this chapter.

Sec. 10.50.495. PROCEDURE AFTER FILING OF STATEMENT OF INTENT TO DISSOLVE. After the commissioner has filed the statement of intent to dissolve, the corporation

(1) shall immediately mail notice of the filing to each known creditor of the corporation;

(2) shall proceed to collect its assets, convey and dispose of its property which is not to be distributed in kind to its shareholders, pay, satisfy and discharge its liabilities and obligations and do all other acts required to liquidate its business and affairs, and, after paying or adequately providing for the payment of its obligations, distribute the remainder of its assets, either in cash or in kind, among its shareholders according to their respective rights and interests;

(3) at any time during the liquidation of its business and affairs may apply to a court of competent jurisdiction in the state to have the liquidation continued under the supervision of the court;

(4) shall, if it has not completed dissolution proceedings within two years after the date the statement of intent to dissolve is filed, be involuntarily dissolved by the commissioner after 60 days notice of his intent to do so has been given to the corporation.

Sec. 10.50.500. MANNER OF REVOKING A VOLUNTARY DISSOLUTION PROCEEDING. (a) The board of directors may adopt a resolution recommending that the voluntary dissolution proceedings be revoked, and directing that the question of revocation be submitted to a vote at a special meeting of shareholders.

(b) A proposed revocation of a voluntary dissolution of the corporation shall be submitted to a vote at the next meeting of shareholders if the secretary of the corporation receives a petition proposing revocation signed by at least 1,000 shareholders.

(c) Written or printed notice, stating that the purpose of the meeting is to consider the advisability of revoking the voluntary dissolution proceedings, shall be given to each shareholder of record entitled to vote at the meeting within the time and in the manner provided in this chapter for the giving of notice of special meetings of shareholders.

(d) At the meeting a vote of the shareholders entitled to vote shall be taken on the resolution to revoke the voluntary dissolution proceeding. Adoption of the resolution requires the affirmative vote of the holders of at least two-thirds of the shares voting.

(e) Upon the adoption of the resolution, a statement of revocation of voluntary dissolution proceedings shall be executed in duplicate by the corporation by its president or vice-president and by its secretary or an assistant secretary, and verified by one of the officers signing the statement. The statement of revocation of voluntary dissolution shall set out

(1) the name of the corporation;

(2) the names and addresses of its officers;

(3) the names and addresses of its directors;

(4) a copy of the resolution adopted by the shareholders revoking the voluntary dissolution proceedings;

(5) the number of shares outstanding;

(6) the number of shares voted for and against the resolution.

Sec. 10.50.505. FILING OF STATEMENT OF REVOCATION OF A VOLUNTARY DISSOLUTION PROCEEDING. Duplicate originals of the statement of revocation of voluntary dissolution proceedings shall be delivered to the commissioner. If the commissioner finds that the statement conforms to law, he shall, when all fees and franchise taxes prescribed in this chapter have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) return the other duplicate original to the corporation or its representative.

Sec. 10.50.510. EFFECT OF STATEMENT OF REVOCATION OF A VOLUNTARY DISSOLUTION PROCEEDING. Upon the filing by the commissioner of a statement of revocation of a voluntary dissolution proceeding, the revocation of the proceeding becomes effective and the corporation may again carry on its business.

Sec. 10.50.515. EXECUTION OF ARTICLES OF DISSOLUTION. If a voluntary dissolution proceeding has not been revoked, then when all debts, liabilities, and obligations of the corporation have been paid and discharged, or adequate provision has been made for payment, and all of the remaining property and assets of the corporation have been distributed to its shareholders, articles of dissolution shall be executed in duplicate by the corporation by its president or vice-president and by its secretary or an assistant secretary, and verified by one of the officers signing the articles. The articles of dissolution shall set out

(1) the name of the corporation;

(2) that the commissioner has filed a statement of intent to dissolve the corporation, and the date on which the statement was filed;

(3) that all debts, obligations and liabilities of the corporation have been paid and discharged or that adequate provision has been made for payment;

(4) that the remaining property and assets of the corporation have been distributed among its shareholders in accordance with their respective rights and interests;

(5) that there are no suits pending against the corporation, or that adequate provison has been made for the satisfaction of a judgment, order or decree which may be entered against the corporation in a

pending suit.

Sec. 10.50.520. FILING OF ARTICLES OF DISSOLUTION. (a) Duplicate originals of the articles of dissolution shall be delivered to the commissioner. If the commissioner finds that the articles of dissolution conform to law, he shall, when all fees and franchise taxes prescribed in this chapter have been paid,

(1) endorse on each duplicate original the word "filed" and the date of the filing;

(2) file one duplicate original in his office;

(3) issue a certificate of dissolution and affix the other duplicate original to it.

(b) The certificate of dissolution, together with the duplicate original of the articles of dissolution affixed, shall be returned to the representative of the dissolved corporation.

Sec. 10.50.525. EFFECT OF CERTIFICATE OF DISSOLUTION. Upon the issuance of the certificate of dissolution the existence of the corporation ceases, except for the purpose of suits, other proceedings and appropriate corporate action by shareholders, directors and officers as provided in this chapter.

Sec. 10.50.530. INVOLUNTARY DISSOLUTION. (a) A corporation may be dissolved involuntarily by the commissioner when

(1) the corporation is delinquent six months in filing its annual report or in paying a license filing fee or penalty;

(2) the corporation has failed for 30 days to appoint and maintain a registered agent in this state; or

(3) the corporation has failed for 30 days after change of its registered office or registered agent to file in the office of the commissioner a statement of the change;

(4) the corporation has failed for two years to complete

dissolution under a statement of intent to dissolve; or

(5) a vacancy in the board of directors of a corporation is not filled within six months or the time of the next annual meeting, whichever occurs first.

(b) A corporation may not be involuntarily dissolved unless the commissioner has given the corporation at least 60 days notice of its delinquency or omission by certified mail addressed to its registered office or in care of one of its principal officers or directors, at the last known address of the officer or director, as shown by the records of the commissioner, and the corporation has failed to correct the neglect, omission or delinquency before involuntary dissolution.

(c) When a corporation has given cause for involuntary dissolution and has failed to correct the neglect, omission or delinquency as provided in this section, the commissioner shall dissolve the corporation by issuing a certificate of involuntary dissolution containing a statement that the corporation has been dissolved, the date, and the reason for which it was dissolved. The original certificate of dissolution shall be placed in the department files and a copy of it mailed to the corporation at its registered office or in care of one of its principal officers or directors, at the last known address of the officer or director, as shown by the records of the commissioner. Upon the issuance of the certificate of involuntary dissolution, the existence of the corporation shall cease, except as otherwise provided in this section, and its name shall be available to and may be adopted by another corporation no less than six months after the dissolution.

(d) A corporation dissolved by the commissioner under the provisions of this section may be reinstated by the commissioner at any time within two years from the date of the certificate of involuntary dissolution whenever it is established to the satisfaction of the commissioner that in fact there was no cause for the dissolution, or whenever the neglect or delinquency resulting in dissolution has been corrected and payment made of double the amount delinquent along with the amount the corporation would have paid had it not been dissolved during the two-year period. Reinstatement may not be authorized if the same or a deceptively similar corporate, limited partnership, reserved or registered name is currently on file with the commissioner, unless the corporation being reinstated contemporaneously amends it articles of incorporation to change its name to conform with the provisions of this chapter.

(e) Nothing in this section relieves a corporation reinstated under this section from penalty of forfeiture of its powers as a corporation in case of failure to pay subsequently accruing licenses and taxes imposed by a law of this state.

(f) An action arising out of a contract assigned by a corporation dissolved under this section may be brought in the name of the assignee. The fact of assignment and of purchase by the plaintiff shall be set out in the complaint or other process. The defendant may avail himself of any matter of defense of which he might have availed himself in a suit upon the claim by the corporation, had it not been dissolved under this section.

(g) Service of process on a corporation dissolved under this section sh..ll be made in the same manner prescribed by law as if the corporation had not been dissolved.

(h) In addition to any other remedies provided by law a corporation may be dissolved involuntarily be a decree of the superior court in an action filed by the attorney general when it is established that

(1) the corporation procured its certificate of incorporation through fraud; or

(2) the corporation has continued to exceed or abuse the authority conferred upon it by law.

Sec. 10.50.535. VENUE AND PROCESS. (a) An action for the involuntary dissolution of a corporation shall be commenced by the attorney general in the superior court.

(b) Summons shall issue and be served as in other civil actions. If process is returned not found, the attorney general shall publish notice as in other civil cases in a newspaper published in the judicial district where the registered office of the corporation is situated, containing a notice of the pendency of the action, the title of the court, the title of the action, and the date on or after which default may be entered. The attorney general may include in one notice the names of any number of corporations against which actions are pending in the same court.

(c) The attorney general shall have a copy of the notice mailed to the corporation at its registered office within 10 days after the first publication of it.

(d) Notice shall be published at least once each week for two successive weeks, and the first publication may begin at any time after the summons has been returned.

(e) Unless a corporation is served with summons, no default may be taken against it earlier than 30 days after the first publication of the notice.

Sec. 10.50.540. JURISDICTION OF COURT TO LIQUIDATE ASSETS AND BUSINESS OF CORPORATION. The superior court may liquidate the assets and business of a corporation in the cases provided in AS 10.50.545 - 10.50.560.

Sec. 10.50.545. ACTION BY SHAREHOLDER FOR LIQUIDATION. In an action by a shareholder, the superior court may liquidate the assets and business of a corporation when it is established

(1) that the directors are deadlocked in the management of the corporate affairs and the shareholders are unable to break the deadlock, and that irreparable injury to the corporation is being suffered or is threatened by reason of the deadlock;

(2) that the acts of the directors or those in control of the corporation are illegal, oppressive or fraudulent;

(3) that the shareholders are deadlocked in voting power, and have failed, for a period which includes at least two consecutive annual meeting dates, to elect successors to directors whose terms have expired or would have expired upon the election of their successors; or

(4) that the corporate assets are being misapplied or wasted.

Sec. 10.50.550. ACTION BY CREDITOR FOR LIQUIDATION. In an action by a creditor, the superior court may liquidate the assets and business of a corporation when

(1) the claim of the creditor has been reduced to judgment and an execution on the judgment has been returned unsatisfied and it is established that the corporation is insolvent; or

(2) the corporation has admitted in writing that the claim of the creditor is due and owning and it is established that the corporation is insolvent.

Sec. 10.50.555. LIQUIDATION ON APPLICATION BY CORPORATION. Upon application by a corporation which has filed a statement of intent to dissolve, as provided in this chapter, to have its liquidation continued under the supervision of the court, the superior court may liquidate the assets and business of the corporation.

Sec. 10.50.560. LIQUIDATION IN ACTION BY ATTORNEY GENERAL FOR DISSOLUTION. When an action has been filed by the attorney general to dissolve a corporation and it is established that liquidation of its business and affairs should precede the entry of a decree of dissolution, the superior court may liquidate the assets and business of a corporation.

Sec. 10.50.565. JOINDER OF SHAREHOLDERS NOT MANDATORY. It is not necessary to make shareholders parties to an action or proceeding for liquidation of the assets and business of a corporation unless relief is sought against them personally.

Sec. 10.50.570. PROCEDURE IN LIQUIDATION OF CORPORATION BY COURT. In a proceeding to liquidate the assets and business of a corporation, the superior court may issue injunctions, appoint a receiver pendente lite with powers and duties as the court may direct, and take other proceedings necessary to preserve the corporate assets wherever situated and carry on the business of the corporation until a full hearing is had.

Sec. 10.50.575. APPOINTMENT OF RECEIVER. After a hearing held upon such notice as the court may direct to be given to all parties to the proceedings and to any other parties in interest designated by the court, the court may appoint a liquidating receiver with authority to collect the assets of the corporation, including amounts owing to the corporation by shareholders on an unpaid portion of the consideration for the issuance of shares. The liquidating receiver may, subject to the order of the court, sell, convey and dispose of all or a part of the assets of the corporation wherever situated, either at public or private sale.

Sec. 10.50.580. DISPOSITION OF ASSETS OR PROCEEDS FROM SALE OF ASSETS. The assets of the corporation or the proceeds from a sale, conveyance or other disposition of assets shall be applied to the expenses of liquidation and to the payment of the liabilities and obligations of the corporation. Remaining assets or proceeds shall be distributed among shareholders according to their respective rights and interests.

Sec. 10.50.585. STATED POWERS AND DUTIES OF RECEIVER. The order appointing the liquidating receiver shall state his powers and duties. The powers and duties may be increased or diminished at any time during the liquidation proceedings.

Sec. 10.50.590. COMPENSATION OF RECEIVER AND ATTORNEYS. The court may allow from time to time as expenses of the liquidation compensation to the receiver and to attorneys in the proceeding, and direct the payment of compensation out of the assets of the corporation or the proceeds of a sale or disposition of assets.

Sec. 10.50.595. POWER OF RECEIVER TO SUE AND BE SUED. A receiver of a corporation appointed under AS 10.50.570 - 10.50.600 may sue and defend in all courts in his own name as receiver of the corporation.

Sec. 10.50.600. APPOINTING COURT HAS EXCLUSIVE JURISDICTION. The court appointing the receiver has exclusive jurisdiction of the corporation and its property, wherever situated.

Sec. 10.50.605. QUALIFICATIONS OF RECEIVERS. A receiver shall be a citizen of the United States or a corporation authorized to act as receiver, which corporation may be a domestic corporation or a foreign corporation authorized to transact business in the state. A receiver shall give the bond the court directs with sureties the court requires.

Sec. 10.50.610. FILING OF CLAIMS IN LIQUIDATION PROCEEDINGS. (a) In a proceeding to liquidate the assets and business of a corporation, the court may require creditors of the corporation to file with the clerk of the court or with the receiver, in the form the court prescribes, proof under oath of their respective claims.

(b) If the court requires the filing of claims, it shall fix a date, not less than four months from the date of the order, as the last day for the filing of claims, and shall prescribe the notice to be given to creditors and claimants of the date fixed. Before the date fixed, the court may extend the time for the filing of claims.

(c) A creditor who fails to file proof of his claim on or before the date fixed may be barred by order of the court from participating in the distribution of the assets of the corporation.

Sec. 10.50.615. DISCONTINUANCE OF LIQUIDATION PROCEEDINGS. The liquidation of the assets and business of a corporation may be discontinued at any time during the liquidation proceeding when it is established that cause for liquidation no longer exists. In this event, the court shall dismiss the proceeding and direct the receiver to redeliver to the corporation its remaining property and assets.

Sec. 10.50.620. DECREE OF INVOLUNTARY DISSOLUTION. In a proceeding to liquidate the assets and business of a corporation, when the costs and expenses of the proceeding and the debts, obligations and liabilities of the corporation have been paid and discharged and the remaining property and assets are not sufficient to satisfy and discharge the costs, expenses, debts and obligations, and all the property and assets have been applied to their payment, the court shall enter a decree dissolving the corporation.

ARTICLE 7. GENERAL PROVISIONS.

Sec. 10.50.625. AS 10.05 INCORPORATED BY REFERENCE. The provisions of AS 10.05.699 - 10.05.819 apply to a corporation organized under this chapter and are incorporated by reference as a part of this chapter, except when inconsistent with this chapter.

Sec. 10.50.630. FALSE STATEMENTS AFFECTING VALUE OF SHARES. A director, officer or agent of a corporation who knowingly concurs in making, publishing or posting either generally or privately to the shareholders or other persons (1) a written report, exhibit, statement of its affairs or pecuniary condition or notice containing any material statement which is false, or (2) an untrue or wilfully or fraudulently exagerated report, prospectus, account, statement of operations, values, business, profits, expenditures or prospects, or (3) any other paper or document intended to produce or give, or having a tendency to produce or give, the shares of stock in the corporation a greater value or a less apparent or market value than they really possess, or who refuses to make any book entry or post any notice required by law in the manner required by law, upon conviction, is guilty of a misdemeanor.

Sec. 10.50.635. DIRECTOR MAKING UNLAWFUL DIVIDEND OR DISTRIBUTION OF ASSETS. A director of a corporation who concurs in any vote or act of the directors of the corporation to knowingly and with dishonest or fraudulent purpose make a dividend or distribution of assets either with the design of defrauding creditors or shareholders or of giving a false appearance to the value of the stock and thereby defrauding subscribers or purchasers, upon conviction, is guilty of a misdemeanor.

Sec. 10.50.640. RESERVATION OF POWER. The legislature reserves the power to make amendments to this chapter to apply to all existing and future corporations organized under this chapter. An amendment to this chapter may not alter or impair the power of a corporation to fulfill the terms of a contractual agreement or impair the rights of a person with whom a corporation has entered into a contractual agreement.

Sec. 10.50.645. DEFINITIONS. In this chapter,

(1) "articles of incorporation" means the original or restated articles of incorporation and all amendments;

(2) "authorized shares" means the shares which the corporation may issue;

(3) "certificate" means any evidences of ownership of shares of a corporation;

(4) "chartering legislation" means the Act of the legislature or an initiative approval by the voters that creates a general stock ownership corporation;

(5) "commisssioner" means the commissioner of commerce and economic development;

(6) "corporation" means a general stock ownership corporation;

(7) "department" means the Department of Commerce and Economic Development;

(8) "franchise tax" means the annual corporation tax imposed under Alaska law on corporations (AS 10.05.71);

(9) "insolvent" means inability of a corporation to pay its debts as they become due in the usual course of its business;

(10) "net assets" means the amount by which the total assets of a corporation, excluding treasury shares, exceed the total debts of the corporation;

(11) "resident" means an individual who maintains a permanent place of abode in the state with the intention of making the state his permanent place of residence and who resides in the state continuously except for temporary purposes only and with the intent of returning; a person may not be considered to have gained a residence solely by reason of his presence and he may not lose it solely by reason of his absence while in the civil or military service of this state or of the United States or by reason of his absence because of marriage to a person engaged in the civil or military service of this state or the United States; a person may not be considered to lose his residence while a student at an educational institution, while in an institution at public expense, while confined in prison, while engaged in the navigation of waters of this state, of the United States, or of the high seas, or

while residing upon an Indian or military reservation; a minor takes the residence of his parent or of his legal guardian; a married woman may establish her own residence and does not presumptively take the residence of her husband;

(12) "shareholder" means one who is a holder of record of a share in a corporation;

(13) "shares" means the units into which the proprietary interest in a corporation is divided;

(14) "subscriber" means one who subscribes for a share in a corporation before or after incorporation;

(15) "treasury shares" means shares which have been issued, have been subsequently acquired by and belong to the corporation, and have not either by reason of the acquisition or thereafter, been cancelled or restored to the status of authorized but unissued shares; treasury shares are "issued" shares, but not "outstanding" shares.

Sec. 10.50.650. SHORT TITLE. This chapter may be cited as the Alaska General Stock Ownership Corporation Act.

* Sec. 2. AS 37.10.070(a)(6) is amended to read:

(6) other securities, including [CORPORATE] securities of corporations other than general stock ownership corporations;

* Sec. 3. AS 45.55.130 is amended by adding a new subsection to read:

(b) A copy of all annual reports, ballots, consent authorizations and other materials relating to the shareholder ballots, published or made available by any person to the shareholders of a general stock ownership corporation, shall be filed with the administrator concurrently with its distribution to the shareholders. The administrator shall have authority to review all documents submitted and make regulations regarding content of shareholder materials to insure fairness, completeness, and nondiscrimination.

* Sec. 4. (a) The governor, the speaker of the house of representatives, and the president of the senate, shall each appoint one person to act as incorporators of the Alaska General Stock Ownership Corporation which shall be formed in accordance with subchapter U, chapter 1, of the Internal Revenue Code of 1954, as amended (26 U.S.C. secs. 1391 - 1397) and AS 10.50. The incorporators shall select nine persons to act as the initial board of directors of the corporation and shall submit their names to the governor, to the speaker of the house of representatives, and to the president of the senate. A majority of the governor, the speaker of the house of representatives, and the president of the senate may disapprove a candidate for the initial board of directors within 15 days of receipt of [illegible] incorporators' nominations.

(b) The articles of incorporation of the Alaska General Stock Ownership Corporation shall provide that all shareholders of the corporation shall be residents of the state as defined in AS 10.50.640(11), and that if a shareholder ceases to be a resident of the state or his shares pass by operation of law to a nonresident,

(1) within five years of the date of issuance of his shares the corporation shall purchase the shares at book value;

(2) more than five years after the date of issuance of his shares the shareholder or his executor, administrator or guardian shall have the right to sell the shares to the corporation at book value.

(c) There is a special fund of the state known as the "Alaska General Stock Ownership Corporation loan guarantee fund", which may not exceed $5,000,000, which shall be completely segregated from all other funds of the state, and which shall be used by the commissioner of revenue to guarantee loans made to the Alaska General Stock Ownership Corporation by lenders other than the state solely for initial costs of the corporation and not for the acquisition by the corporation of major investments. In guaranteeing a loan, the commissioner of revenue shall review the loan for the purposes of ascertaining the general soundness of the proposed loan and guarding against fraud and misrepresentation. The guarantee of a loan may not be for an amount in excess of the unobligated balance of the fund at the time the guarantee is made.

* Sec. 5. In sec. 1 of this Act, AS 10.50.300 has the effect of changing Rule 23.1, Rules of Civil Procedure, with respect to shareholder derivative suits brought by the shareholders of a general stock ownership corporation. The changes

(1) make provision for notification of shareholders in the event of dismissal or settlement of the suit;

(2) require that the plaintiff account to the corporation for proceeds received by him if the suit is successful; and

(3) provide that the court may require the plaintiff to furnish security for the suit.

* Sec. 6. This Act takes effect immediately in accordance with AS 01.10.070(c).

File
Revenue
GSOP
&
w/ ltr
Bill

shattuck & grummett, inc.
ESTABLISHED 18[illegible]3
insurance · bonds
301 SEWARD STREET
JUNEAU, ALASKA 99801

CURTIS G. SHATTUCK
ALLEN D. SHATTUCK
ROGER R. SHATTUCK, C.P.C.U.

MICHAEL A. GRUMMETT
ROGER GRUMMETT
NANCY L. BURNS

February 23, 1979

Honorable James Duncan
State Representative
Pouch V
Juneau, Alaska 99811

Dear Jim:

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

Does not Replace or [illegible] Gen. Fund

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

Not paid Plan. but [illegible]

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

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

Sincerely,

Roger Shattuck

Roger R. Shattuck

RRS/ce
cc: Honorable Mike Miller
    Honorable Bill Ray

PHONE 586-2414 INSURE AND BE SURE TELEX 994-5313

Looking at the proposal to buy BP's ownership in the TAPS Pipeline

There are a number of problems that come to mind when reviewing the numbers provided in the back of the GSOP proposal. These are some of them:

The aquisition price of the BP pipeline is listed at 1.3 billion dollars. BP, however, has reported a book value of its TAPS investment of 1.463 billion dollars in filings before the F.E.R.C. This is a difference of 163 million dollars in the purchase price.

The most serious problem is in the listed tariff of $5.50. I guess that the $5.50 tariff is simply the tariff that BP asked for less their allowance for federal income taxes. Otherwise I have no idea where $5.50 came from since no company or regulator has used it before. BP filed a tariff with the F.E.R.C. of $6.35. That is now in effect on a refundable basis. On June 19, 1977, the I.C.C. rejected the $6.35 tariff and set the BP tariff at $4.68. This lower tariff was $1.67 lower than the one filed. It was lower because the I.C.C. used a different formula to compute rate of return than the oil companies used. The U.S. Supreme Court upheld the lower tariff.

Now the higher tariff is in effect, but only for a while on a refundable basis. Everyone but everyone knows its comming down when the F.E.R.C. completes it hearings, expected by this summer. The first phase of the F.E.R.C. hearing only consider treatment of income taxes, rate of return, and rate base methodology. These items alone will lower the tariff to around $4.50. Phase II of the F.E.R.C. hearings will consider new numbers for depreciation, operating costs, removal cost of the pipeline, and a number of other items including the cost overruns. This will lower the tariff much more. In fact, the State of Alaska has already spend more than 1 million dollars documenting a case for disallowing 1.5 billion dollars of cost overruns. If accepted this will lower the rate base by 16%, forcing rates even lower. If the cost overruns are disallowed, the pipeline will not be that profitable for BP, which is probably why they want to sell it.

Furthermore, the tariff will actually decrease as the rate base is depreciated. (Even without increased throughput) Since the pipeline is different from a telephone or electric utility, which is always adding on plant, the rates decrease dramatically as the bonds are paid off and the equity investment depreciated. Tariffs later on will be very low.

The operating costs of the pipeline will increase some but that will have little affect on the tariff, since the big costs are capital costs, such as debt servicing, ect. For example, current operating expenses are around 25¢ a barrel for the pipeline. Even if this doubled in ten years, it would only be an increase of another 25¢.

The primary advantage a GSOP has over another firm is the tax treatment. It pays no federal income taxes. This cost savings is substantial, but they will all be passed on to the ratepayer. There will be no bonnanza for the State from the BP pipeline, in terms of income.

It may, however, be worthwhile for the State to own it, if only to lower the cost of bringing North Slope oil to market. The GSOP tax savings would be passed on to shippers in the form of a lower tariff, this in turn would increase wellhead values, and increase our royalty and severance tax income. From this point of view the investment might make good sense. But to look at those great dividends the GSOP report talks about is very missleading.

Jamie Love
AkPIRG
3/14/79

SECTION BY SECTION ANALYSIS OF VOLUNTARY BROADENED STOCK OWNERSHIP, JOB PRESERVATION AND COMMUNITY STABILIZATION ACT.

SECTION 1. TITLE

SECTION 211. FINDINGS

(1)Unemployment is a serious problem that causes grave economic loss and social suffering to individuals, their families and the Nation;

(2)Unemployment insurance program is under financial and administrative pressure and greatly taxes the resources of the Nation;

(3)Unemployment should be prevented wherever possible by strengthening local responsibility and providing individuals with an ownership base in corporations,

(4)Federal initiatives to reduce unemployment should be multifaceted and should be designed to prevent the loss of jobs in the first place;

(5) Shutdowns, sales to unrelated outside interests and resulting outmigration of industrial, manufacturing, business and agricultural concerns causes grave social and economic harm to employees;

(6)Experience and research have shown that in some cases employee or employee-community purchase of such concerns can save jobs, maintain viable economic enterprises and strengthen the local economy;

(7)Current shortage of capital formation will hamper Nation's economic growth;

(8)Present concentration of capital ownership has created too great a disparity between the "haves" and the "have-nots";

(9)Current alarming decrease in productivity could be alleviated by employee ownership;

(10)It is necessary to provide a National program of federal financial assistance to avoid plant shutdowns, sales of companies to unrelated outside interests or the outmigration of such concerns and to promote broadened stock ownership by employees.

SECTION 212. STATEMENT OF PURPOSES

(a)Purpose is to save jobs and stabilize communities through a voluntary program that will facilitate employee or employee-community purchases through employee stock ownership plans or general stock ownership corporations of concerns that would be otherwise shut down, sold to unrelated outside interests or moved out of such communities. Federal Government shall provide:

(1) Information to employee or employee-community groups about the option offered under this Act;

(2) Technical Assistance to evaluate feasibility of option offered under this Act;

(3) Information to current owners of firm about the option offered under this Act;

(4) Technical Assistance to employee or employee-community groups on aspects of ownership transfer under this Act;

(5) Loans and loan guarantees to employee or employee-community groups to provide funds for technical assistance and startup and operating costs associated with purchase of concern.

(b)Further purpose is to support the local tax base by maintaining viable concerns through federal loans and loan guarantees and to test this program as an alternative to unemployment insurance (and other methods of dealing with unemployment).

SECTION 213. DEFINITIONS (Self-explanatory).

SECTION 214. FEDERAL ASSISTANCE.

(a)Existing EDA offices, working in cooperation with State and Local entities, will identify firms in danger of closing down or relocating and which have a potential for acquisition through a form of ownership described in this Act.

(b)In those cases where firms may be able to be kept in operation profitably, EDA will furnish information about this program to the employees and the community.

(c)(1)Loans for technical assistance and loan guarantees for startup and operating costs may be provided to employee and employee-community organiztions that have had an application for funds approved under Section 215.

(2) In order to apply for assistance, an organization must meet the following requirements:

(A)Incorporate under the laws of the State in which the plant is located;

(B)Certify that a form of ownership has been adopted by the members of the organization after full consideration of their alternatives under State law, certify that the form of ownership insures continuous provision of information to individual stockholders and allows for inclusion of new employees and provides for acquisition of stock of those no longer associated with the firm.

(d)For the purpose of enabling employee or employee-community groups to purchase firms which would otherwise close, be sold to unrelated outside concerns or be relocated or in which more than 20 percent of the outstanding stock is available for puchase, EDA may guarantee loans in order to provide equity funding for purchase of concern. The rate of interest shall not exceed the prevailing rate for loans on similar accounts made for creditworthy purchasers in the community.

(e)Employee or employee-community groups may adopt any ownership form they choose, including employee stock ownership plans, provided they are qualified under the IRS code, provided that all employees are offered an opportunity to participate in the ownership plan, and that employees subject to collective bargaining agreements shall be included in such an offering, unless the union representing such employees waives, in writing, participation in the plan.

SECTION 215. APPLICATIONS

(a)EDA may provide loans and loan guarantees to any organization which applies for assistance, if the feasibility study conducted under subsection (b) provides reasonable grounds to expect that the proposed transfer of ownership will assure the likelihood of full repayment of any government loans or loan guarantees and will result in a viable business enterprise.

(b)EDA will conduct a feasibility study within 60 days after receiving an application to determine whether reasonable grounds exist to expect that the proposed transfer will be successful.

(c)(1)EDA may provide loans and loan guarantees to any organization whose application has been approved.

(2)The Secretary shall establish a reserve fund of 15 percent of the total amount of loan guarantees outstanding as authorized under the Act.

(d)Technical assistance may be provided to eligible organizations under this section.

(e)Not more than 10 percent of the amount of loans or loan guarantees may be used for consulting services in connection with this transfer of ownership.

SECTION 216. NONDISCRIMINATION

SECTION 217. WAIVER OF SECURITIES ACT OF 1933

(a)The section allows the Secretary of Commerce to exempt employee or employee-community organizations from select provisions of the Securities Act of 1933 to facilitate purchase of the plant.

SECTION 218. REPORT

(a)EDA will evaluate the success or failure of the program and report to Congress at the end of two years and again after six years.

SECTION 219 AUTHORIZATIONS.

(a)(1)Loan guarantees are authorized for six fiscal years.

(2)Total loan guarantees shall be the higher of (A) $100,000,000 or (B) 1 percent of the amount expended for unemployment compensation during fiscal year 1978. For each of the succeeding six fiscal years, the amount of funds authorized shall be increased by 10 percent.

(b)Total authorizations for loans are not to exceed $15,000,000 for each of the six fiscal years.

(c)Total appropriation to cover loan guarantees shall be 15 percent of the amount specified in subsection (a).

(d)(1)10 percent of the appropriated funds may be used for feasibility studies, technical assistance and associated administrative costs.

(2)Funds appropriated under subsection (c) which are not used for purposes outlined in subsection (d) may be placed in the reserve fund and used to reduce appropriations in future years.

SECTION 2. AMENDMENTS TO THE INTERNAL REVENUE CODE

(a)Amends the ESOP provision of the IRS code to increase the employers' contribution to a leveraged ESOP from 25 percent to 50 percent.

(b)Technical amendment.

(c) Amends the General Stock Ownership Corporation provision of the IRS code to allow a class of stockholders who are smaller than all citizens of a State to be eligible to set up a GSOC.

FACT SHEET ON VOLUNTARY BROADENED STOCK OWNERSHIP, JOB PRESERVATION AND COMMUNITY STABILIZATION ACT

Legislation would amend TITLE II of PWEDA so that EDA would be specifically authorized to make loans guarantees for loans made to employee or employee/community organizations seeking to purchase their firms when they would otherwise close, relocate, or have a substantial part of their stock purchased by an outside interest.

***Plant shutdowns are a major source of unemployment. According to United Auto Workers, Michigan lost more than 200,000 jobs to plant shutdowns between 1966 and 1976. Since 1960, New England lost 9 percent and the Midwest 13 percent of its manufacturing employment. In Watsontown, Pennsylvania last year Zenith decided to phase out 1,000 jobs at the last U.S. color TV plant in a community of 5,000 people. Ohio, the scene of another massive shutdown of Youngstown Sheet and Tube affecting 5,000 people, lost over 10 percent of its manufacturing employment in the same period.

***Employee ownership provides a free enterprise, community based solution to the problem of unemployment and economic dislocation, while simultaneously providing an effective means to increase productivity and provide for capital growth.

***Employee ownership provides a workable solution to two major problems in the U.S. economy: decline in productivity and unemployment. In addition to preventing unemployment, employee-owned firms are 1.5 times more profitable and significantly more productive (30% in one major study) than comparable conventional firms. An EDA report has found increased job satisfaction, lower absenteeism, fewer job greivances and better communication among workers and managers in employee-owned firms.

***EDA has made loans for employee-ownership plans, but their legislative mandate is such that they must give priority to companies suffering the effects of disasters, defense realignments, or government regulations.

*** Legislation would amend TITLE II so that loan guarantees would be made to employee or employee-community organizations, including those using ESOP or GSOP plans. The decision to make a guarantee would be based on a feasibility study of the particular situation for which EDA could make such a loan. Employee or employee-community groups must show that they will use the money to purchase the company, that the company is viable or would become viable under employee ownership, and that the distribution of ownership shares will not discriminate against lower paid employees or against any individual on the grounds of race, sex, religion, etc.

***Bill authorizes Secretary of Commerce to make technical assistance available to company employees seeking to purchase their firms and requires her to conduct studies of the issue of employee ownership.

***Bill authorizes $100 million in loan guarantees, with a 15% reserve fund to be appropriated to cover guarantees. Bill also authorizes $15 million in loans for feasibility studies.

Jerry Gauche

Benefits of Employee Stock Ownership Plans affected markedly by the 1978 Revenue Act

by RONALD L. LUDWIG *and* JOHN E. CURTIS, JR.

The new law incorporates TRASOPs into the Code and places restrictions on employer securities, put options, and voting pass-through rules. In addition, changes made by other Code provisions make ESOPs and TRASOPs more advantageous. In this article, the authors analyze all of the changes made by the Act and indicate that further changes may be forthcoming which will add to advantages of such plans.

SIGNIFICANT CHANGES were made concerning ESOPs (Employee Stock Ownership Plan) and TRASOPs (ESOPs permitting additional investment credits) by the Revenue Act of 1978 (P.L. 95-600, 11/6/78). In addition, other proposals, most notably S. 3241, which would have given a tax credit based on covered payroll to an employer who adopted and funded a TRASOP, reflect a growing Congressional awareness of, and support for, the broadening of employee stock ownership. This will undoubtedly result in further legislation to expand and refine ESOPs and TRASOPs.

Changes in TRASOP operations

TRASOP part of the Code. Clearly, the most far-reaching change for ESOPs and TRASOPs which occurred in 1978 was the incorporation of the TRASOP provisions in new Section 409A.[1] Congress only extended the additional investment tax credits for TRASOP contributions through 1983,[2] and the TRASOP provisions were codified in substantially the same form as they previously existed; that is, an employer that makes the required contributions to a TRASOP may claim an additional investment tax credit equal to 1% of its qualified investment each year, with an additional credit equal to ½% of its qualified investment, provided that employees match that ½% portion of the employer's TRASOP contribution. Since TRASOPs are now a part of the Code, however, Senator Russell B. Long will work to make the provisions permanent next year. In addition, the Treasury Department and the White House are urging that the TRASOP tax credit should be based upon a percentage of wages rather than capital investment. This modification in the TRASOP concept will probably be made by the end of 1983.

While the Senate Committee on Finance was looking at the question of whether to make TRASOPs a part of the Code, it was recognized that there was really no significant distinction between a TRASOP which is "qualified" and one which is not. Accordingly, it was determined that a TRASOP should be required to comply with all applicable requirements of Section 401(a).[3] In general, a plan must be established by the last day of the employer's taxable year in order to be qualified for that year. The use of the additional investment tax credit for determining TRASOP contributions causes a problem in that it may be many months after the close of the year before an employer can determine whether a TRASOP is feasible. Both the 1975 Tax Reduction Act and the 1976 Tax Reform Act provided that a TRASOP need be established only at the time the additional investment tax credit is claimed. The question of qualification under Section 401(a) for the initial TRASOP year was unclear. To resolve this problem, the Congress agreed that a TRASOP may satisfy the requirements of Section 401(a) even though it is not adopted by the last day of the first taxable year for which it is effective, provided that it is adopted by the due date for the filing of the employer's tax return for that year.[4]

Coverage of subsidiaries. Recognizing that more employers might wish to adopt a TRASOP as a result of its extension and improvement under the Act, the Congress attempted to alleviate certain potential problems which might impede full participation by all employers within a controlled group of corporations. For example, Section 414(b) applies the 80% test of Section 1563 in determining whether a subsidiary would be included within a controlled group for purposes of participation in a qualified plan. In addition, even if a parent corporation and a subsidiary corporation met the requisite ownership test, there were problems in providing stock of the parent corporation for the benefit of employees of the subsidiary. If the parent corporation were to make a capital contribution of its stock to the subsidiary for purposes of the subsidiary's TRASOP contribution, the contribution by the subsidiary to the plan might have resulted in taxable gain to the subsidiary. Finally, securities law problems could possibly arise if the subsidiary was making cash contributions to the TRASOP for purchase of stock of the parent corporation, while an offering of the parent corporation's securities was in process.

To resolve these problems, Section 409A(l)(4) provides that only a 50% stock ownership test must be met for a first tier subsidiary to participate in a TRASOP established by the parent corporation. For each tier of subsidiaries below that, the 80% test would be applied. However, the 80% standard would continue to be applied for all other purposes of determining qualified status or possible discrimination. Section 409A(m) provides that a subsidiary would not recognize income as a result of the transfer of the parent corporation stock to a TRASOP. Clearly, however, the subsidiary would be eligible for the investment tax credit allowable for its TRASOP contribution.

TRASOP allocations. A major administrative problem in the TRASOP area has been the requirement that each employee who participated in the TRASOP at any time during the year must share in the allocation of stock representing the employer's annual TRASOP contribution. This applied even if he was employed for only a short time during the year and had terminated service prior to the end of the year. This created a great recordkeeping problem in that each such employee would receive an allocation (and in most cases a distribution) of stock for the year in which he ceased to be employed by the employer. Since the Act requires all TRASOPs to satisfy the requirements of Section 401(a), no specific reference to allocations of contributions was needed in Section 409A, since as qualified plans TRASOPs can require that an individual must be an employee on the last day of the year to receive a TRASOP allocation. The $100,000 limit on compensation and the requirement that TRASOPs allocate contributions in pro-

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portion to compensation was continued under the Act.[5]

TRASOP contributions. Since the Tax Reform Act of 1976, many companies which have adopted a TRASOP have decided not to take advantage of the additional 1½% investment tax credit provided by that Act. The matching employee contribution provisions are unclear and difficult to administer. One of the major reasons for this has been the Revenue Service's failure to promulgate Regulations dealing with the required matching employee contributions. Congress attempted to alleviate this problem in the Revenue Act of 1978 but failed to do so. According to the Senate Finance Committee, the Act would have provided that an employer's additional contribution for the 1½% investment tax credit (and the claiming of that amount of credit on the employer's Federal income tax return) would have been based upon the times when the employees make their TRASOP contributions. In addition, it was to provide that the employee contributions (and consequently the employer contributions relative to the 1½% investment tax credit) could have been made at any time up to two years following the close of the taxable year for which the 1% additional investment tax credit is claimed. Either Regulations or "technical corrections" to the Act will be necessary to implement this new feature.

Since TRASOPs have been made a part of the Code and since the tax credit for TRASOP contributions has been extended through 1983, Congress felt the provisions relating to withdrawal of TRASOP contributions if the investment tax credit is recaptured should be stricken. It is inconsistent with the employee benefit nature of TRASOPs to permit amounts previously contributed to be withdrawn. However, the employer will still be able to reduce TRASOP contributions in future years, or claim a tax deduction, for any portion of the 1% (or 1½%) portion of any recaptured investment tax credit.[6] When (and if) the TRASOP contribution tax credit is made a permanent part of the Code in future years, there should be no further concern by employers.

Employer securities

Section 409A(l) makes certain revisions to the definition of employer securities for TRASOP purposes. In general, employer securities will be common stock (of any class) which is readily tradable on an established securities market. The rules of prior law which required the use of common stock with dividends and voting rights no less favorable than other common stock have been so modified for publicly-traded companies. Where there is no readily tradable common stock (for closely-held companies), the existing rule has been modified to permit the use of common stock having a combination of voting power and dividend rights equal to or in excess of common stock having the greatest voting power and the greatest dividend rights. In addition, preferred stock which is convertible at any time at a reasonable conversion price into common stock meeting the above requirements may be used in lieu of common stock. The use of other employer securities (such as convertible debentures) for TRASOP purposes is prohibited for years beginning after 1978.

The Committee Reports also imply that similar definition of employer securities will also apply to leveraged ESOPs under Section 4975(e)(7). The Act itself does not include such a requirement. However, the special increase on the dollar amount of annual additions under Section 415(c)(6), which is applicable to ESOPs and TRASOPs, has been amended to limit its application to such employer securities only.[7]

Put options and stock distributions. In 1976 the IRS proposed Regulations regarding ESOPs. These Regulations contained significant problems which, if allowed to go unchanged, would have seriously curtailed the adoption of ESOPs by employers and the broadening of stock ownership among employees. In the Conference Report on the Tax Reform Act of 1976, Congress specifically instructed the IRS and the Department of Labor regarding the ways in which the Proposed Regulations were unsatisfactory. The agencies published final ESOP Regulations in 1977 which generally alleviated the problems under the Proposed Regulations. However, in the area of "put options," the final ESOP Regulations did not totally remove obstacles that acted as a deterrent to the adoption of ESOPs. The Department of Labor and the IRS felt that any participant who receives a distribution of stock of a closely-held corporation from an ESOP should have a market for the stock. The agencies felt that the best vehicle for guaranteeing such a market is to require that a closely-held employer grant a "put option" to the participant to resell his stock to the employer. However, the final Regulations applying to leveraged ESOPs contained overly restrictive requirements regarding the duration of the put option, the terms for resale of the stock by the participant and other related matters. Many employers were concerned that the effect of these onerous put option Regulations would be to make the leveraged ESOP unworkable for some closely-held corporations. It was expected that TRASOP Regulations would include similar put option provisions when distributed stock is not readily tradable.

At the same time, Congress realized that ESOPs (and TRASOPs) have been faced with a problem in that they have generally been required by the IRS to distribute a participant's interest in shares of employer stock. This has been the case even though Reg. 1.401-1(b)(1)(iii) only requires that benefits from a stock bonus plan be "distributable" in stock of the employer company. Many employees wish to convert their distributed stock interest to cash immediately, particularly if the stock is not publicly traded. Congress recognized that it was inappropriate to require the ESOP to incur the administrative burden of issuing shares of employer stock, with the employer repurchasing such stock immediately. At the same time, Congress felt that an employee who really wanted to receive a distribution of employer stock should be able to do so. Therefore, Congress decided that, subject to a participant's right to demand a distribution of employer stock, an ESOP or TRASOP may elect to distribute cash or employer stock.[8] This right to demand stock must be communicated in writing when a distribution is due.

Any participant in a leveraged ESOP or TRASOP who receives a distribution of employer securities which are not readily tradable on an established market is required by Section 409A(h)(1)(B) to be given a put option on such stock, based on the following terms:

1. Upon receipt of the employer stock,

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the distributee must have up to six months to require that the employer repurchase this stock at its fair market value. Although, the obligation to repurchase stock under the put option would apply to the employer, not to the ESOP or TRASOP, it is permissible for the ESOP or TRASOP to actually make the purchase in lieu of the employer. If the distributee does not exercise the put option within the six-month period, the option will temporarily lapse.

2. After the close of the employer's taxable year in which the temporary lapse of a distributee's put option occurs, and following a determination of the value of the employer stock (determined in accordance with Regulations) as of the end of that taxable year, the employer will notify each distributee (who did not exercise the initial put option in the preceding year) of the new value of the employer stock. Each such distributee will then have up to three months to require that the employer repurchase his employer stock. If the distributee does not exercise this second put option, then the employer stock will no longer be subject to a mandatory put option.

3. At the option of the party repurchasing employer stock under the put option, such stock may be repurchased on an installment basis over a period of five years. If the distributee agrees the repurchase period may be extended to a period of ten years. As security for the installment repurchase, the seller must at least be given a promissory note, the full payment of which could be required by the seller if the repurchaser defaults in the payments of a scheduled installment payment. In addition, if the term of the installment obligation exceeds five years, the employee must be given adequate security for the outstanding amount of the note.

4. Because a distributee might wish to contribute the ESOP or TRASOP distribution to an IRA in a "tax-free" rollover and because the contribution would have to be made before the expiration of the first six-month put option period, the IRA trustee must be able to exercise the same put option as the actual distributee.

The cash distribution and put option provisions of the Act are effective for years beginning after 1978. It is expected that Regulations on ESOPs and TRASOPs will be modified to reflect the Finance Committee's directions with regard to put options. These provisions are applicable only to TRASOPs and leveraged ESOPs, but it would certainly be consistent with the intent of Congress for such provisions to be extended to all ESOPs and stock bonus plans.

Voting pass-through. The most controversial ESOP decision which the Congress made in the Act was to require "pass through" voting rights on certain employer stock acquired by qualified defined contribution plans.

For companies which are publicly-traded (generally, those registered under Section 12 of the 1934 Securities Exchange Act) the requirement for full pass-through of voting rights on employer securities to TRASOP participants is continued. For other employers, a "limited" voting pass-through requirement applies with respect to corporate matters which (by law or corporate charter) must be decided by *more than* a majority vote of outstanding common shares voted.[9] The Finance Committee report indicated that this was intended to include major corporate issues such as mergers, acquisitions, etc. requiring shareholder approval. The Act extends these TRASOP voting requirements to leveraged ESOPs for years beginning after 1978, presumably only with respect to stock acquired after that date in a transaction contemplated by the ESOP loan exemption.[10]

Further, the Act, Section 143, adds new Section 401(a)(22), extending this limited voting pass-through requirement to any defined contribution plan maintained by an employer whose stock is not publicly-traded, if more than 10% of plan assets are represented by employer securities after 1979. It appears that this requirement applies only to stock acquired after that date.

These provisions in the Act are a bit unclear and appear to exempt many employers from having to comply with the limited voting pass-through requirement. On October 18, 1978, Senator Long issued a statement stating that it is his intent that ESOPs be treated the same as all other defined contribution plans investing in employer securities with respect to the voting pass-through provision. The statement mentions a study to be conducted by the Treasury Department on this matter and invites comments from affected businesses. It appears that, if Senator Long is convinced that companies will not adopt ESOPs or will terminate ESOPs because of the voting pass-through requirement, he will work toward deleting these provisions from the law.

The Senate Finance Committee report states that the Treasury Department is to conduct a one-year study and to report to the Committee on the extent to which voting rights and financial disclosure should be given to participants under ESOPs and TRASOPs holding employer stock issued by closely-held corporations. The Treasury is to work with representatives of businesses, the Department of Labor and the Congressional staffs on this study. In addition, the study is to consider the resale rights (put options, etc.) which should be available to a participant receiving a distribution of employer stock from an ESOP, TRASOP or stock bonus plan.

The Act itself does not include a provision relating to this study. It is understood, however, that the Finance Committee expects such a study to be completed by Treasury during the first six months of 1979. The study may well result in a reconsideration of the voting rights and put option provisions included in the Act. In this regard, a 1976 staff report prepared for the Joint Economic Committee recommended that voting rights should be passed through to ESOP participants only when the employer is publicly-traded.

ESOP definition. The Act has also modified the definition of ESOP in Section 4975(e)(7) to limit its application to "leveraged ESOPs."[11] It is apparent that this definition was included in the Code (by ERISA) primarily for purposes of the ESOP loan exemption in Section 4975(d)(3). The definition of ESOP in ERISA Section 407(d)(6) has remained unchanged for purposes of the ERISA Section 408(e) "sale exemption" from the prohibited transaction rules and the definition of "eligible individual account plan" in ERISA Section 407(d)(3).

Under the Act, leveraged ESOPs will be subject to the new TRASOP rules

[1] Act, Section 141(a).

[2] Act, Section 141(e), amending Section 46(a)(2)(E).

[3] Section 409A(a)(1).

[4] Section 409A(f)(2).

[5] Section 409A(b). Compare with Section 301(d)(3) of the Tax Reduction Act of 1975.

[6] Sections 409A(g) and 48(n)(4).

[7] Act, Section 141(f)(7).

[8] Sections 409A(h)(1)(A) and (2).

[9] Section 409A(e).

[10] Act, Section 141(f)(5)(C), amending Section 4975(e)(7).

[11] Act, Section 141(f)(5).

[12] Act, Section 141(f)(5)(C). See Section 409A(e) and (h).

[13] Sections 2039(c), (f).

regarding voting rights on employer securities and the cash distribution/put option rule, effective for years beginning after 1978.[12]

Other changes affecting plans

Estate tax exclusion. The Act also contained changes which affect employee benefit plans in addition to ESOPs and TRASOPs. Under the Tax Reform Act of 1976, a lump-sum distribution from a qualified plan is no long eligible for the estate tax exclusion under Section 2039(c). It has been unclear since that time whether the denial of the estate tax exclusion is applicable only to a distribution for which the special ten-year averaging provisions for income tax treatment is elected under Section 402(e) or whether it applies to any total distribution, even if no favorable income tax treatment is actually elected by the distributee.

In attempting to resolve this problem, Congress was concerned that the party claiming the estate tax exclusion (the administrator of the estate) and the party receiving a lump-sum distribution treatment (the designated beneficiary) could be different individuals with conflicting interests. Accordingly, it was agreed that the estate tax exclusion would be permitted for a lump-sum distribution only if the distributee agreed in writing not to elect lump-sum distribution treatment for income tax purposes.[13]

Minimum tax. Any reduction in income taxes which occurs as the result of a credit claimed under Section 38 may result in increased liability for the minimum tax on tax preferences. Since the TRASOP tax credit is claimed as a result of the investment tax credit provided by Section 46 of the Code, its actual basis for claim is Section 38. Therefore, even if an employer received no net benefit from the reduction of taxes by reason of the TRASOP contribution offsetting its tax saving, it might find itself paying an increased minimum tax. For this reason, Section 56(c) now provides that the tax credit for TRASOP contributions (the additional 1% and ½% investment tax credit) is added back to the regular tax for the purpose of computing liability for the minimum tax under Section 56, thus precluding any minimum tax resulting from the TRASOP contributions. This provision was specifically made retroactive to all years in which an employer claimed an additional investment tax credit for a TRASOP contribution.

Capital gains. One of the most beneficial aspects of the Act which affects ESOPs is the reduction of taxes on capital gains, through the increased capital gains exclusion and the elimination of capital gains from the add-on minimum tax provisions. This change may result in many participants having lower income tax payable upon receipt of lump sum distributions from ESOPs, inasmuch as unrealized appreciation in employer securities received in such distribution will be taxed as a long term capital gain upon subsequent sale. Further, the reduction in taxes on capital gains will be an added incentive to the sale of stock to an ESOP by a major shareholder. This should result in greater uses of ESOPs to transfer ownership from shareholders to employees.

IRA provisions. The Act makes a number of changes in the provisions relating to IRA rollovers which will affect ESOPs as well as other plans. The Act includes a provision allowing the rollover of the proceeds from the sale of any property received in kind in a lump-sum distribution. This change and the other changes in the Act relating to IRA rollovers will result in more beneficial treatment of ESOP participants in providing flexibility with respect to the planning of distributions.

Possible future ESOP changes

During the period between the date S. 3241 was introduced and the date which Congress passed H.R. 13511, it became clear that a TRASOP tax credit based upon payroll will eventually be enacted into law, either as an alternative to, or substitute for the TRASOP investment tax credit. In introducing S. 3241, Senator Long specifically stated that "At the same time, the bill will make ESOPs attractive to labor-intensive employers which . . . make their investment in salaries and wages . . ." On October 3, 1978, the Treasury Department sent to each Senator an analysis of each provision of the Revenue Act of 1978. In analyzing the provisions on ESOPs, the Treasury Department stated that "we do believe that the investment credit base for TRASOPs should be converted to a partial credit based on wages." In addition, on September 22, 1978, Mr. Stuart Eizenstat, Assistant to the President for Domestic Affairs and Policy, wrote to Senator Long on ESOPs. In that letter, Mr. Eizenstat stated that "the challenge is to move toward broadened stock ownership in a way which is . . . fair both as between different industries and firms and employees within a given business enterprise." Clearly, this is directed toward a payroll based TRASOP credit, which would provide an equal benefit to each employee-participant. Finally, at the conclusion of the Senate debate on H.R. 13511 (October 10, 1978), Senator Jacob Javits (R.-N.Y.), who has been critical of ESOPs and TRASOPs in the past, made the following statement regarding employee stock ownership: "If a tax credit is to be provided for TRASOPs, I would prefer using a wage base for such a credit rather than an investment base." These statements all reflect a common feeling about the wage-based TRASOP credit. ✫

Normal retirement age not *per se* actuarially reasonable

THE SERVICE has stated in *Rev. Rul.* 78-331, IRB 1978-37, 8, that actuarial assumptions which are required to be "reasonable" must be tested in light of anticipated experience. There is nothing in the Code or Regulations relating to qualified pension plan requirements which makes the assumption that employees will retire at the normal retirement age specified in the plan reasonable *per se.*

Thus, if the most reasonable expectation is that employees will not retire at the normal age specified in the plan, the choice of the retirement age assumption must, in combination with all other assumptions, be reasonable in light of anticipated experience, *i.e.,* the frequency of early or late retirements.

Section 412(c)(3) mandates that all actuarial assumptions and methods must be, in the aggregate, reasonable, taking into account the experience of the plan and reasonable expectations. This applies to the minimum funding requirements of Section 412 as well as to the deductibility of an employer's contributions to the plan under Section 404(a)(1)(A). Therefore, if the use of the normal retirement age is not a reasonable assumption, the actuarial assumptions in the aggregate could be found not to be reasonable.

If the effect of a plan's subsidized early retirement benefit is ignored, the plan could fail to satisfy the minimum funding requirements of Section 412 be-

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December 8, 1978

MEMORANDUM TO MEMBERS

OF THE ESOP COUNCIL OF AMERICA

FROM: Ronald L. Ludwig, General Counsel

RE: Recent ESOP Developments

FINAL ESOP REGULATIONS

On November 17, 1978, the Internal Revenue Service published final regulations relating to certain ESOP requirements under Section 4975(e)(7) of the Internal Revenue Code. This publication finalized those items of the ESOP regulations which had been presented in temporary and proposed form on September 2, 1977. The final regulations are in substantially the same form as proposed last year and cover the following matters:

Continuing Loan Provisions

The terms of an ESOP must specifically provide for protections and rights attributable to stock acquired with the proceeds of an ESOP loan. These rights primarily relate to the "put option" requirements of the ESOP loan regulations, as well as prohibitions against certain other restrictions on "leveraged" stock. These provisions must continue to apply to "leveraged" stock, even after the ESOP loan is repaid and even if the plan ceases to be a "leveraged" ESOP in the future.

Integration with Social Security

The final regulations make it clear that an ESOP established after November 1, 1977, may not be "integrated" with Social Security. A plan must have been designated as an "ESOP" on that date in order to be integrated. An existing integrated ESOP may not increase the extent of its integration with Social Security, but may continue to increase the level of integration (as the taxable wage base increases) if the ESOP so provided on that date.

Dividend Pass-Through

An ESOP will not fail to satisfy the requirements of Code Section 401(a) merely because it provides for the current distribution of cash dividends to participants. Under a stock bonus plan which is an ESOP, such current distributions must be made within two years after received by the ESOP.

Multiple Plans

In general, an ESOP which was not in existence on November 1, 1977, may not be considered together with another qualified plan for purposes of satisfying the non-discrimination requirements of the Code. There is an exception whereby two or more ESOPs established after that date may be considered together for this purpose, provided that each ESOP holds substantially the same proportions of various classes of employer securities.

Effect of 1978 Revenue Act

These final regulations do not take into account the changes in ESOP requirements enacted in the Revenue Act of 1978. ESOP Council members have previously been supplied with our summary of these changes. It is expected that the ESOP regulations will be modified in the future to reflect such changes. It is also expected that there will be a "Technical Corrections" bill introduced in Congress early in 1979. Various clarifications of the ESOP provisions in the Act are necessary. Any ESOP Council member with suggestions for changes on this should contact Ron Ludwig as soon as possible.

TREASURY DEPARTMENT STUDY ON VOTING PASS-THROUGH

The Revenue Act of 1978 included provisions requiring certain pass-through of voting rights to participants under ESOPs, TRASOPs, stock bonus plans and other plans investing in employer securities. The Senate Finance Committee report on the Act mandated the Treasury Department to study the question of voting rights, financial disclosure, and resale rights to be available under ESOPs of closely-held corporations.

The Treasury Department has informed Senator Long that "... every effort will be made to report to Congress by July, 1979." The study will be expanded to consider voting rights applicable under plans maintained by publicly-traded corporations, as well as closely-held corporations.

The ESOP Council is presently developing a questionnaire to be sent to all members, soliciting their views on the items to be considered in the Treasury Department study. The results of the responses will be compiled and presented to the Treasury Department, Senator Long and other key members of Congress. In this way we will be in a position to accurately reflect the feelings and concerns of our members in connection with the study. We expect that the questionnaire will be forwarded to you early in 1979. At the same time, we will encourage all ESOP Council members to comment directly on this issue to their representatives in Congress. Any member having suggestions for items to be covered in our questionnaire should contact Ron Ludwig at your earliest convenience.

ELIMINATION OF FORM EBS-1

On November 21, 1978, the Department of Labor proposed regulations which would eliminate the ERISA requirement for filing Form EBS-1, Plan Description. If finalized, the requirement would be satisfied by the filing of the Summary Plan Description with DOL. This change will become effective on the date of adoption of final regulations. The elimination of Form EBS-1 will reduce the paperwork and administrative burdens for all plans covered by ERISA.

PLAN AMENDMENTS TO COMPLY WITH FINAL REGULATIONS

On November 20, 1978, the Internal Revenue Service issued Announcement 78-175, to specify the time periods for amending all plans to comply with final ERISA regulations. Generally, any necessary amendments must be made by the end of the first plan year that begins after a new regulation is adopted and must be effective as of the first day of that year.

If a new regulation specifically provides for a different effective date, the date specified in the regulation will be controlling. In addition, where a plan satisfied prior ERISA guidelines, no amendment need be made earlier than June 30, 1979. Finally, if the plan met the conditions of the IRS Special Reliance Procedure, the amendment need not be made effective prior to the first plan year beginning after December 31, 1977.

TRASOP REGULATIONS

It is expected that final TRASOP regulations covering the 1% additional investment tax credit will be published by IRS very soon. This will not include provisions relating to the 1/2% credit requiring matching employee contributions. ESOP Council members will be advised when these regulations are issued.

ESOP DETERMINATION LETTERS

On October 1, 1978, the IRS issued Commissioner Delegation Order No. 112 (Rev. 5), concerning authority to issue determination letters relating to employee plans matters. Included was a delegation to the District Directors of key districts to issue determination letters with respect to whether a plan constitutes an ESOP under Code Section 4975(e)(7). The ESOP regulations issued on September 2, 1977, had indicated that such determinations could be secured from IRS.

It is our understanding that the National Office of IRS is working on specific procedures for ESOP determination letters. Under existing procedures for Form 5301 (Application for Determination), determination letters generally relate only to "qualified" status under Code Section 401(a), and not to "ESOP status" under the regulations. We will advise ESOP Council members when we obtain more definitive information on this matter.

WAGE-PRICE GUIDELINES

It appears that ESOP and TRASOP contributions are included as fringe benefits for purposes of the seven percent limit on pay increases under the President's voluntary anti-inflation program. The Council on Wage and Price Stability is presently considering possible changes in the wage guidelines applicable to fringe benefits. It is expected that regulations will be published by CWPS in the near future and that there will be some liberalization in the standards applying to costs needed to maintain current fringe benefit levels.

MARSHALL v. PENN

On November 21, 1978, the U.S. Court of Appeals for the Tenth Circuit issued its opinion affirming the 1976 decision of the U.S. District Court which had ordered the rescission of a transaction involving the "conversion" of a profit sharing plan into an ESOP and the use of existing plan assets to purchase Company stock. The Court of Appeals held

"The Expanded Employee Stock Ownership Act of 1978—A Summary and Analysis"

(By John E. Curtis, Jr., Counsel, Senate Finance Committee and Ronald L. Ludwig, Attorney at Law, San Francisco, and Counsel to Employee Stock Ownership Council of America)

I. TRASOP LEGISLATION

A. Commentary

On June 23, 1978, Senator Russell B. Long, Chairman of the Senate Committee on Finance, introduced the "Expanded Employee Stock Ownership Act of 1978" (S. 3241). This bill marks the latest major congressional effort towards broadening the access of employees to stock and capital ownership in their employers. In the Regional Rail Reorganization Act of 1973,[1] Congress provided that the Consolidated Rail Corporation (CONRAIL) could use an employee stock ownership plan (ESOP) as part of its financing program, thereby enabling CONRAIL employees to share in ownership of the new railroad system. In the Employee Retirement Income Security Act of 1974,[2] Congress for the first time formally recognized ESOP as an employee benefit plan and established criteria for its adoption and operations. In the Trade Act of 1974,[3] as part of the relief package being established for companies which are members of foreign trade impacted industries, Congress provided that some preference would be given for assistance to such companies which use an ESOP in conjunction with federal loan guarantees. In the Tax Reduction Act of 1975,[4] Congress established the "TRASOP," an ESOP funded through an additional investment tax credit allowed for corporate employees. The Tax Reform Act of 1976[5] expanded the provisions for TRASOPs and provided guidance to the federal agencies for developing final ESOP regulations.

The purposes of the Expanded Employee Stock Ownership Act of 1978 are to further the steps already taken by prior ESOP legislation and to make the ESOP a better instrument for providing stock ownership to employees. The bill accomplishes these goals primarily by expanding the use of the TRASOP, the special form of ESOP presently tied to the additional investment tax credit available under the Tax Reduction Act of 1975, as amended by the Tax Reform Act of 1976. For purposes of this article, the term "TRASOP" will be used to refer to a "tax credit ESOP," while the term "ESOP" will apply to any ESOP (including a TRASOP). The purpose of this analysis is to explain each provision contained in the bill and to analyze the background problem or underlying reason for its inclusion.

Changes for TRASOP

The major changes made by S. 3241 are in the TRASOP area. As part of the overall increase in the investment tax credit from 7 percent to 10 percent, the Tax Reduction Act of 1975 provided for an additional 1 percent investment tax credit. This credit could be claimed by an employer that adopted a TRASOP (satisfying the requirements established by that Act) and contributed to the TRASOP an amount of employer stock (or cash to buy stock) equal in value to the amount of the additional tax credit claimed. The Tax Reform Act of 1976 expanded this concept, providing that an employer could claim an additional ½ percent investment tax credit for TRASOP contributions (thereby increasing its total available investment tax credit to 11½ percent provided that participating employees made matching contributions to the TRASOP equal to the additional ½ percent investment tax credit). Such employee contributions were a mandatory prerequisite for the claiming of the additional ½ percent investment tax credit by the employer. It is important to note that the additional investment tax credit for TRASOP contributions would largely be available only to capital-intensive corporations, and would have little applicability to labor-intensive corporations. In addition, the Tax Reform Act of 1976 extended the additional investment tax credit for TRASOP contributions only through 1980. This was because the TRASOP was tied to the investment tax credit increase from 7 percent to 10 percent which is due to expire on December 31, 1980.

[1] Pub. L. 93-236.
[2] Pub. L. 93-406.
[3] Pub. L. 93-618.
[4] Pub. L. 94-12.
[5] Pub. L. 94-455.

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MARSHALL v. PENN

On November 21, 1978, the U.S. Court of Appeals for the Tenth Circuit issued its opinion affirming the 1976 decision of the U.S. District Court which had ordered the rescission of a transaction involving the "conversion" of a profit sharing plan into an ESOP and the use of existing plan assets to purchase Company stock. The Court of Appeals held that Mr. Penn's actions as an ESOP fiduciary were subject to the "solely in the interest of participants" and "prudence" tests of ERISA Sections 404(a)(1)(A) and (B) and affirmed the lower court's finding that these requirements had been violated in connection with the "conversion."

The District Court had found that the primary purpose of the profit sharing plan had been to provide retirement income to participants and that the "conversion" to an ESOP had resulted in a situation in which participants' legitimate expectations of benefits were severely jeopardized. The Court of Appeals held that rescission of the "conversion" was a proper remedy to protect the participants' interests and to effectuate the purposes of the original profit sharing plan.

It is clear that the Penn case involved a situation of extreme abuse under ERISA. The District Court had specifically stated that it was not ruling that a "conversion" of a profit sharing plan into an ESOP would always be a violation of the ERISA fiduciary rules. It is also clear that any situation involving the "conversion" of an existing plan into an ESOP must be approached with extreme caution in the event that existing plan assets are to be used to purchase Company stock.

We do not regard the Penn case as a precedent which jeopardizes the proper establishment and operation of an ESOP under ERISA. It appears that it is a decision relating to the use of profit sharing plan assets to invest in Company stock, where the profit sharing plan had previously operated as a "retirement plan." The case does point out, however, that all ESOP transactions will be judged in the context of compliance with ERISA's fiduciary rules.

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"THE EXPANDED EMPLOYEE STOCK OWNERSHIP ACT OF 1978—A SUMMARY AND ANALYSIS"

(By John E. Curtis, Jr., Counsel, Senate Finance Committee and Ronald L. Ludwig, Attorney at Law, San Francisco, and Counsel to Employee Stock Ownership Council of America)

I. TRASOP LEGISLATION

A. *Commentary*

On June 23, 1978, Senator Russell B. Long, Chairman of the Senate Committee on Finance, introduced the "Expanded Employee Stock Ownership Act of 1978" (S. 3241). This bill marks the latest major congressional effort towards broadening the access of employees to stock and capital ownership in their employers. In the Regional Rail Reorganization Act of 1973,[1] Congress provided that the Consolidated Rail Corporation (CONRAIL) could use an employee stock ownership plan (ESOP) as part of its financing program, thereby enabling CONRAIL employees to share in ownership of the new railroad system. In the Employee Retirement Income Security Act of 1974,[2] Congress for the first time formally recognized ESOP as an employee benefit plan and established criteria for its adoption and operations. In the Trade Act of 1974,[3] as part of the relief package being established for companies which are members of foreign trade impacted industries, Congress provided that some preference would be given for assistance to such companies which use an ESOP in conjunction with federal loan guarantees. In the Tax Reduction Act of 1975,[4] Congress established the "TRASOP," an ESOP funded through an additional investment tax credit allowed for corporate employees. The Tax Reform Act of 1976[5] expanded the provisions for TRASOPs and provided guidance to the federal agencies for developing final ESOP regulations.

The purposes of the Expanded Employee Stock Ownership Act of 1978 are to further the steps already taken by prior ESOP legislation and to make the ESOP a better instrument for providing stock ownership to employees. The bill accomplishes these goals primarily by expanding the use of the TRASOP, the special form of ESOP presently tied to the additional investment tax credit available under the Tax Reduction Act of 1975, as amended by the Tax Reform Act of 1976. For purposes of this article, the term "TRASOP" will be used to refer to a "tax credit ESOP," while the term "ESOP" will apply to any ESOP (including a TRASOP). The purpose of this analysis is to explain each provision contained in the bill and to analyze the background problem or underlying reason for its inclusion.

Changes for TRASOP

The major changes made by S. 3241 are in the TRASOP area. As part of the overall increase in the investment tax credit from 7 percent to 10 percent, the Tax Reduction Act of 1975 provided for an additional 1 percent investment tax credit. This credit could be claimed by an employer that adopted a TRASOP (satisfying the requirements established by that Act) and contributed to the TRASOP an amount of employer stock (or cash to buy stock) equal in value to the amount of the additional tax credit claimed. The Tax Reform Act of 1976 expanded this concept, providing that an employer could claim an additional ½ percent investment tax credit for TRASOP contributions (thereby increasing its total available investment tax credit to 11½ percent provided that participating employees made matching contributions to the TRASOP equal to the additional ½ percent investment tax credit). Such employee contributions were a mandatory prerequisite for the claiming of the additional ½ percent investment tax credit by the employer. It is important to note that the additional investment tax credit for TRASOP contributions would largely be available only to capital-intensive corporations, and would have little applicability to labor-intensive corporations. In addition, the Tax Reform Act of 1976 extended the additional investment tax credit for TRASOP contributions only through 1980. This was because the TRASOP was tied to the investment tax credit increase from 7 percent to 10 percent which is due to expire on December 31, 1980.

[1] Pub. L. 93–236.
[2] Pub. L. 93–406.
[3] Pub. L. 93–618.
[4] Pub. L. 94–12.
[5] Pub. L. 94–455.

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S. 3241 makes significant changes in TRASOPs. In the first place, it increases the investment tax credit which an employer can claim for its TRASOP contribution from one percent to two percent. In addition, it removes the provisions for matching employee contributions to the TRASOP: rather, any employee contributions are to be purely voluntary and subject to a decision by the employer at the time that the TRASOP is adopted or amended. More significantly, the TRASOP provisions are to be permanently incorporated within the Internal Revenue Code in new §§44G and 416. This means that TRASOPs would not expire with the tax cuts under the Tax Reduction Act of 1975. Finally, in an effort to broaden this type of ESOP, the bill provides an alternative tax credit based on payroll for labor-intensive companies which adopt a TRASOP and contribute stock to it. This provides a tax credit equal to 1 percent of the compensation of all participating employees under the TRASOP, provided that the employer contributes to the TRASOP an amount of stock (or cash used to purchase stock) equal in value to the tax credit claimed.

In introducing S. 3241, Senator Long noted that this country faces a serious shortage of capital formation. The Chase Manhattan Bank has predicted that over the next decade our economy will require 1.5 trillion dollars of new capital formation. S. 3241 attempts to partially resolve that capital shortage by requiring that the employers who adopt and fund a TRASOP will be doing so in a manner that will generate additional capital formation. The bill requires that at least one-half of the tax credit claimed for TRASOP contributions (whether based on the additional investment tax credit or the payroll credit) would have to be represented by the transfer of newly-issued securities to the TRASOP.

A major problem which exists in the TRASOP area is the requirement[6] that each employee who participated in the TRASOP at any time during the year must share in the allocation of stock representing the employer's annual TRASOP contribution, even if he was no longer employed at the end of the year. This creates a great recordkeeping problem in that a record had to be maintained as to the location of each terminated participant so that he can receive an allocation (and in most cases a distribution) of stock for the year in which he ceased to be employed by the employer and ceased to be a TRASOP participant. The bill provides that an employer need allocate stock from its current TRASOP contribution only to participants who are employed on the last day of the TRASOP plan year. This is an optional provision and does not preclude an employer, if it so chooses, from making allocations of employer securities to the TRASOP account of a participant who terminated employment during the year.

The Tax Reduction Act of 1975, in establishing the TRASOP, required that each participant must be entitled to direct voting rights on all stock allocated to him under the TRASOP.[7] Generally, TRASOPs have been established only by large capital-intensive corporations, most of which are publicly-traded. For these companies, the expense and burden of providing participants with the proxy solicitation materials regarding the voting of such shares is relatively minor. However, the requirement for the pass-through of voting rights has acted as a deterrent for closely-held corporations which desired to adopt a TRASOP. With the creation of the labor-intensive tax credit for TRASOP contributions, this problem would be magnified. Many of the companies which would take advantage of these provisions are closely-held and would be deterred from establishing a TRASOP (and thereby broadening its ownership base) because of a requirement that TRASOP stock be voted by participants. Therefore, the bill requires the pass-through of voting rights to participants only when the employer is a publicly-traded company (generally, a company which is reporting to the Securities and Exchange Commission under the Securities Exchange Act of 1934). This approach was first suggested in the staff report of the Joint Economic Committee on ESOPs which was issued in 1976.

In establishing the requirements which a TRASOP must satisfy in order to obtain the additional investment tax credit, the Tax Reduction Act of 1975 provided that a TRASOP, whether or not "qualified" under § 401(a) of the Internal Revenue Code, would have to meet the minimum participation standards for qualified plans under Code § 410.[8] Under § 410(b)(2)(A), employees covered by a collective bargaining agreement could be excluded provided that retirement benefits were the subject of good-faith bargaining between the employer and the

[6] Section 301(d)(3), Tax Reduction Act of 1975.
[7] Section 301(d)(5).
[8] Section 301(d)(7)(c).

bargaining representatives. Since many TRASOP's were adopted during the term of existing collective bargaining agreements, some employers which adopted TRASOP's elected not to include union members as participants. In order to alleviate this apparent unfairness, the bill provides that all employees who are covered by a collective bargaining agreement will become participants in the TRASOP (subject to minimum age and service requirements) unless their bargaining representatives waive their right to participate in the TRASOP. The Committee Report on the bill is expected to expand upon this and point out that bargaining on the TRASOP issue will in no way reopen an existing collective bargaining agreement for bargaining on other issues.

Cash distribution option

In 1976, the IRS promulgated proposed regulations regarding ESOPs. These regulations contained significant problems which, if allowed to go unchanged, would have seriously curtailed the adoption of ESOP's by employers and the broadening of stock ownership among employees. In the Conference Report on the Tax Reform Act of 1976, Congress specifically instructed the IRS and the Department of Labor regarding the ways in which the proposed regulations were unsatisfactory. The agencies published final ESOP regulations in 1977 which generally alleviated the problems under the proposed regulations. However, in one critical area, the final ESOP regulations did not totally remove obstacles that acted as a deterrent to the adoption of ESOPs. These were the regulations regarding the granting of "put options" to employees who receive a distribution of ESOP stock acquired under ERISA's "ESOP loan exemption." The Department of Labor and the IRS felt, and justifiably so, that any participant who receives a distribution of stock of a closely-held corporation from an ESOP should have a market for the stock. This is an extremely critical point when an employee might well find himself holding employer stock for which there is no market at the time he is subject to income tax liability on his ESOP distribution. The agencies felt that the best solution for such a problem is to require that a closely-held employer grant a "put option" to the participant to resell his stock to the employer. In establishing this right, the final regulations contained very specific requirements regarding the duration of the put option, the terms for resale of the stock by the participant and other related matters. Many employers were concerned that the effect of these onerous put option regulations would be to make the leveraged ESOP unworkable for closely-held corporations. Accordingly, the bill provides that if the terms of the ESOP give each employee the option (prior to the distribution of benefits) of receiving cash in lieu of employer stock as his ESOP benefit, there would be no requirement that an employee who elected to receive stock be granted a put option. In this way, each employee is given the option to receive cash in lieu of stock and, therefore, is not faced with the problem of lack of marketability. This change would allow an ESOP to avoid the requirements for put options under the regulations and would simplify the administration of the ESOP, while at the same time offering employees the ability to "cash out" their ESOP shares. The bill provides such an employee election would not constitute the offering of a security under federal or state securities laws.

Charitable deduction

S. 3241 provides that an individual (or an estate or trust) will be eligible to claim a charitable deduction (for income, estate and gift tax purposes) for any "donation" to an ESOP. This would include an outright "gift" to an ESOP and a "bargain sale" to an ESOP. However, to assure that such deduction will not be providing a tax benefit for a transaction designed to benefit the donor (directly or indirectly), the bill establishes criteria which must be met in order for the deduction to be available. The donation to the ESOP must be allocated among participants in a nondiscriminatory manner, pursuant to Code § 401(a)(4). In addition, no part of the donation may be allocated to the donor or persons related to the donor under Code § 267(b). Finally, no portion of the donation may be allocated to any other persons owning (directly or indirectly) more than 25 percent of any class of employer securities. This provision would create an alternative to traditional contributions to charity (or private foundatoins) for major shareholders and would be an incentive to provide stock ownership for employees.

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Dividend deduction

S. 3241 would allow a tax deduction for dividends paid on employer stock held by an ESOP, provided that such dividends were "passed-through" to participants within sixty days after the close of the year in which paid. This provision would be limited to dividends on voting common stock). The purpose of this provision is to encourage ESOPs to provide participants with an immediate tangible benefit of stock ownership. Section 803(h) of the Tax Reform Act of 1976 has made it clear that an ESOP could currently pay out such dividends to participants in cash. This provision of the bill would serve as an incentive to pay out dividends by providing a tax deduction to the employer.

Other tax changes

The bill also contains certain changes which affect employee benefit plans other than ESOPs and TRASOPs. Under the Tax Reform Act of 1976, a lump-sum distribution from a qualified plan is no longer eligible for the estate tax exclusion under Code §2039(c). It is unclear whether the denial of the estate tax exclusion is applicable to any total distribution or whether it applies only to a distribution for which the special ten-year averaging provisions for income tax treatment is elected under §402(e).

In order to clarify this matter, the bill provides that the estate tax exclusion would be denied only when lump-sum distribution income tax treatment is elected under Code § 402(e). In addition, the estate tax exclusion would be extended to a TRASOP not qualified under § 401(a) to the extent applicable to qualified plans.

In order to defer taxation on a lump-sum distribution through a "rollover" to an individual retirement account (IRA), any property (such as employer stock) received in the distribution must be "rolled over" in the same form as it is received.[9] This requirement has created a problem with respect to distributions of employer stock from an ESOP. It is often difficult to find an IRA trustee willing to receive a rollover of employer stock, particularly if the stock is not publicly traded. In addition, an ESOP distributee frequently elects to resell stock received in a lump sum distribution back to the employer (or the ESOP) immediately, often pursuant to the put option granted at the time of distribution. However, under existing law if the participant were to resell his shares of employer stock he is not permitted to roll over the cash proceeds from the sale to an IRA and thereby defer tax on the distribution. Therefore, the bill provides that an employee may resell employer stock to the employer or to the ESOP (or other plan) and still defer taxation on the distribution by rolling over the cash proceeds of the sale to an IRA. In addition, the bill provides that an employee who elects to receive cash in lieu of employer stock from an ESOP will also be able to transfer the cash distribution as a rollover contribution to an IRA.

S. 3241 also provides that participation in a TRASOP (whether or not "qualified") would not preclude deductible IRA contributions by the participant under Code §§ 219 and 220. If the participant did not participate in any other plan qualified under § 401(a), he would still be entitled to contribute to an IRA. This provision would remedy the problem of participation in a TRASOP (possibly representing a small percentage of pay) denying the opportunity for retirement savings by an individual through an IRA.

Under existing Code § 402(e), a participant who receives a distribution from a qualified plan which constitutes a "lump-sum distribution" may elect to take advantage of the ten-year forward averaging provision available for such a distribution. However, if the distribution to the participant includes employer securities which have appreciated in value during the time that they were held by the plan, the participant is taxed only on the plan's cost basis for such securities. The appreciation will be taxed as long-term capital gain upon subsequent disposition. In the event of an immediate resale of the securities, total tax liability will be a combination of ten-year averaging and capital gain treatment. In many cases, this results in greater tax liability than if the entire value of the distribution were subject to ten-year averaging. In order to alleviate this increased tax burden and to provide greater simplicity in calculating the tax liability on a lump sum distribution including employer securities, the bill would allow an election to the recipient to treat the entire distribution (including appreciation in value of employer securities) as ordinary income for purposes of § 402(e) and the ten-year

[9] Code § 402(a)(5).

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averaging provisions. This is similar to the election added in Code § 402(e)(4)(L) in 1976 to allow ten-year averaging with respect to pre-1974 participation.

Under the Tax Reform Act of 1976, an employer which makes a TRASOP contribution and which later recaptures a portion of this investment tax credit, may, if the TRASOP has allocated contributions to separate segregated accounts, recapture a portion of the stock from the TRASOP.[20] It is also worth noting that the employer would have the option of leaving the stock in the TRASOP and simply taking a deduction for that portion of the contribution which is reflected by the recapture. However, assuming that the employer wished to actually recapture any stock from the TRASOP, a problem is presented for participants. This is because the participant must receive his entire distribution within a single year in order to be eligible for the beneficial tax treatment on lump-sum distributions.[21] Any amount held in the segregated account would probably not be distributed to him at that time, resulting in the loss of lump-sum distribution treatment for a significant number of employees. Therefore, the bill provides that if such a situation exists and the TRASOP is holding stock for its participants in segregated accounts subject to recapture, an employee who receives a distribution of the remaining portion of his benefit under the TRASOP will still be eligible to elect lump-sum distribution treatment on that portion. Any amount later distributed to him from a segregated account will simply be treated as ordinary income. However, the beneficial tax treatment which attaches to a lump-sum distribution will be eligible for the initial distribution.

Under present law,[22] any reduction in taxes which occurs as the result of a credit claimed under Code § 38 may result in increased liability for the minimum tax on tax preferences. Since the TRASOP tax credit is claimed as a result of the investment tax credit provided by § 46 of the Code, its actual basis for claim is § 38. Therefore, if an employer received no net benefit from the reduction of taxes by reason of the TRASOP contribution offsetting its tax savings, it might find itself paying an increased minimum tax. For this reason, the bill adds back the credit for a TRASOP contribution (the additional investment tax credit or the tax credit based on payroll) to the regular tax computation for purposes of determining liability for the minimum tax under § 56.

With the exception of the minimum tax relief provided by the bill, all sections of the bill will generally be effective for taxable years beginning after December 31, 1977. Because the problems created by the minimum tax on tax preferences would have dated back to the effective date of the Tax Reduction Act of 1975, the effective date of that section is for all plan years beginning after December 31, 1974.

Increase in ESOP contribution limits

On July 14, 1978, Senator Mike Gravel introduced S. 3291 to propose an additional incentive for ESOPs. Under S. 3291, the deduction limits under Code § 404(a) and the allocation limits under Section 415(c) for ESOP contributions would be increased from 25 percent of covered payroll to 50 percent of covered payroll. These increased limits would be subject to the restrictions on allocations to officers, shareholders and highly-compensated employees included in existing Code § 415(c)(6).

Conclusion

S. 3241 and S. 3291 demonstrate the interest of the Senate Finance Committee in providing increased incentives for the adoption of ESOPs to allow for greater "ownership-sharing" opportunities for employees. On July 19–20th, the Finance Committee held ESOP hearings to consider these bills and other matters relating to ESOPs. It may be expected that action on these bills will occur sometime this year and that ESOPs will continue to be encouraged by Congress.

[20] Code § 402(e)(4)(A).
[21] Section 301(d)(8)(B)(iii).
[22] Code § 56.

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GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

March 17, 1978

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

Attention: Mr. Jerry Gauche
Legislative Aide

Dear Senator Gravel:

In Mr. Kelso's absence from the city, he asked that I forward to you the enclosures which he thought you may find of interest.

Sincerely,

Jan Bertsche for
Louis O. Kelso

Enclosures

THE FOLLOWING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

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FILE:CD96: TITLE/LINE--SET 1                                         ITEMS 1-8 OF 8
1. H.R.5: SPON=Rep Rodino: INDX=State taxation: STLI=Interstate Taxation Act
2. H.R.153: SPON=Rep Broomead: INDX=Foreign investments: STLI=Foreign
              Investment Disclosure Act
3. H.R.261: SPON=Rep Dellums: INDX=Intelligence services: STLI=Omnibus
              Intelligence Community Reorganization and Reform Act of 1979
4. H.R.395: SPON=Rep Guyer, et al.: INDX=Old age, survivors and disability
              insurance
5. H.R.1509: SPON=Rep Frenzel: INDX=(NOT PRESENT): STLI=Expanded Employee
              Stock Ownership Act of 1979
6. H.R.2203: SPON=Rep Kostmayer, et al.: INDX=(NOT PRESENT)
7. S.7: SPON=Sen Cranston: INDX=Veterans: STLI=Veterans Health Care Amendments
              of 1979
8. S.388: SPON=Sen Stewart, D., et al.: INDX=(NOT PRESENT)
READY FOR NEW COMMAND:
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S.388                                                          (CD96) 02/06/79
Sen Stewart, D., et al.                                Senate Small Business
SUMMARY:
A bill to promote the *OWNERSHIP* of small businesses by their *EMPLOYEES* and
to provide a means whereby *EMPLOYEES* can purchase their companies where the
companies would otherwise be closed, liquidated, or relocated, and to assure
that firms owned wholly or partly by their *EMPLOYEES* are eligible for all
forms of assistance from the Small Business Administration.
CHRONOLOGY OF ACTIONS:
***** CHRON NONE *****
PAGE 1 OF 1. READY FOR NEW COMMAND OR NEW OPTION:
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H.R.2203                                                       (CD96) 02/15/79
Rep Kostmayer, et al.                  House Banking, Finance and Urban Affairs

COSPONSOR                                  COSPONSORED ON          WITHDRAWN ON
Rep Lundine                                  02/15/79
Rep McHugh                                   02/15/79
PAGE 1 OF 1. READY FOR NEW COMMAND OR NEW OPTION:
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S.388                                                          (CD96) 02/06/79
Sen Stewart, D., et al.                                Senate Small Business

COSPONSOR                                  COSPONSORED ON          WITHDRAWN ON
Sen Nelson, G.                               02/06/79
Sen Weicker                                  02/06/79
Sen Hatch                                    02/06/79
Sen Pressler                                 02/06/79
PAGE 1 OF 1. READY FOR NEW COMMAND OR NEW OPTION:
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THE PRECEDING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

NAEC

[illegible] 2-22-79

February 14, 1979

Mr. Jerry N. Gauche
Legislative Aide
U. S. Senator Mike Gravel
3121 Senate Office Building
Washington, D. C. 20510

This is to confirm that expense arrangements have been worked out for your trip to San Francisco and your valued participation on the Legislative & Legal Update Workshop panel.

We will send you a check in advance to cover one round-trip air fare. We have made a double room reservation for you and Mrs. Gauche at the Hotel St. Francis for the nights of March 8 and 9. Please pay your own expenses, including hotel, and submit an expense account for reimbursement.

I'm enclosing another copy of the brochure. Note the reception the evening of March 8. Look forward to meeting you then.

Eugene V. Gear
Executive Director

EVG:pdm
Enclosure

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United States Senate

COMMITTEE ON FINANCE
WASHINGTON, D.C. 20510

March 13, 1978

MEMORANDUM

TO: Senator Russell B. Long
Jim Guirard

FROM: Jack Curtis

RE: ESOP Legislation for 1978

There are several aspects of the investment tax credit ESOP which we should try to correct. In addition, the continuation of the coal strike will provide a vehicle upon which Senator Long can base his concept of an ESOP tied to covered payroll in the same way an investment tax credit ESOP is tied to the investment tax credit.

Briefly, I suggest the inclusion of the following items in a separate bill on ESOP:

1. Increase the investment tax credit available to ESOP to 2%, but require that the new 1% credit be made up of new stock. (This promotes the capital formation aspect of ESOP. Also, we would delete the entire matching ½ percent provision.)

2. Provide a tax credit for an ESOP continuation for labor-intensive companies, using the coal strike as the keynote for this provision, and possibly for the entire bill. In this, we would require that ½ the credit taken be made up of new stock.

3. Provide that this tax credit not be treated like an item of tax preference. (This was an oversight which has been brought to our attention several times this spring. For example, Weyerhouser, Armco Steel, and Wilbur Mills have raised it.)

4. Provide that unions will not be automatically excluded from participation in the ESOP. (This was brought to our attention by Senator Robert Byrd and the IBEW.)

5. Provide that employees will still receive lump-sum distribution (10-year averaging) on stock distributed from an ESOP even if a portion of the stock is held in a separate subject to recapture by the employer pursuant to the Tax Reform Act of 1976.

6. Clarify section 2039(c) of the Code to allow an estate tax exclusion for amounts distributed from an ESOP if lump-sum distribution treatment (10-year averaging) is not elected on the distribution.

7. Amend Code section 219 to exclude an investment tax credit ESOP from the list of plans, the adoption of which precludes contributions to an IRA.

8. Amend Code section 402(a)(5) to permit a "rollover" to an IRA of cash proceeds from the sale of stock received in lump-sum distribution from an ESOP. (Present law requires the rollover of the stock itself--this creates a problem for the remaining employees and the employer which would wish to reacquire the stock for the ESOP.)

9. Extend "new jobs" tax credit under Code Sections 551-553 beyond 1978, conditioned upon stock contributions to an ESOP like the investment tax credit ESOP.

10. Possibly provide an energy tax credit provision if stock is put into an ESOP.

96TH CONGRESS
1ST SESSION

H. R. 1589

To amend the Internal Revenue Code of 1954, and the Tax Reduction Act of 1975, with respect to employee stock ownership plans.

IN THE HOUSE OF REPRESENTATIVES

JANUARY 29, 1979

Mr. FRENZEL introduced the following bill; which was referred to the Committee on Ways and Means

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A BILL

To amend the Internal Revenue Code of 1954, and the Tax Reduction Act of 1975, with respect to employee stock ownership plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Expanded Employee Stock Ownership Act of 1979".

SEC. 2. CREDIT FOR ESTABLISHING EMPLOYEE STOCK OWNERSHIP PLAN.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 of the Internal Revenue Code of 1954 (relating to credits allowed) is amended by inserting after section 44B the following new section:

"SEC. 44C. EMPLOYEE STOCK OWNERSHIP PLAN CONTRIBUTIONS.

"(a) GENERAL RULE.—In the case of a corporation which meets the requirements of section 416, there is allowed as a credit against the tax imposed by this chapter for the taxable year, an amount equal to the greater of—

"(1) not more than 2 percent of the qualified investment (as determ·‑ed under subsections (c) and (d) of section 46) of the taxpayer for the taxable year, or

"(2) not more than 1 percent of the aggregate participants' compensation (as defined in section 415(c)(3)) paid by the corporation during the taxable year.

"(b) TRANSFER OF NEW EMPLOYER SECURITIES REQUIRED.—The credit allowable under subsection (a) for any taxable year shall not be allowed unless, in meeting the requirements of such section for such taxable year, employer securities equal in value to the credit claimed are transferred to the trust and at least the total amount of the credit claimed under subsection (a)(1) in excess of 1 percent of the qualified investment, or at least one-half of the credit claimed under subsection (a)(2) is represented by new employer securities transferred to the trust. For purposes of this subsection, the term 'new employer securities' means employer securities (as defined in section 416(a)(9)) not previously issued.

"(c) LIMITATION BASED ON TAX LIABILITY; CARRYOVER OF EXCESS CREDIT.—

"(1) LIMITATION.—The amount of the credit allowed under subsection (a) for the taxable year shall not exceed so much of the liability for tax for the taxable year as does not exceed $50,000, plus 95 percent of as much of the liability of the taxpayer for tax under this chapter for the taxable year as exceeds $50,000.

"(2) CARRYOVER OF EXCESS CREDIT.—If the amount of the credit determined under subsection (a) for the taxable year exceeds the amount of the limitation imposed by paragraph (1) for such taxable year (hereinafter in this paragraph referred to as the 'unused credit year'), such excess shall be—

"(A) an ESOP credit carryback to each of the 3 taxable years preceding the unused credit year, and

"(B) an ESOP credit carryover to each of the 7 taxable years following the unused credit year, and

subject to the limitations imposed by paragraph (1), shall be taken into account under the provisions of subsection (a) in the manner provided in that subsection.

The entire amount of the unused credit for an unused credit year shall be carried to the earliest of the 10 taxable years to which (by reason of subparagraphs (A) and (B)) such credit may be carried and then to each of the other 9 taxable years to which it may be carried.

"(d) LIMITATION WITH RESPECT TO CERTAIN COMPANIES.—In th. case of a regulated public utility, no credit shall be allowed by subsection (a) if the taxpayer's cost of service for ratemaking purposes is reduced by reason of any portion of the credit allowable by subsection (a) (determined without regard to this subsection), or if the base to which the taxpayer's rate of return for ratemaking purposes is applied is reduced by any reason of any portion of the credit allowed by subsection (a) (determined without regard to this subsection).".

(b) Subpart B of part I of subchapter D of chapter 1 of such Code is amended by adding at the end thereof the following new section:

"SEC. 416. SPECIAL EMPLOYEE STOCK OWNERSHIP PLANS.

"(a) PLAN REQUIREMENTS FOR TAXPAYERS CLAIMING SECTION 44C CREDIT.—In order to meet the requirements of this subsection—

"(1) Except as expressly provided in subsections (b) and (c), a corporation (hereinafter in this subsection referred to as the 'employer') shall establish an employee stock ownership plan (described in paragraph (2)) which is funded by transfers of employers securities in accordance with the provisions of paragraph (6) and which meets all other requirements of this subsection.

"(2) The plan referred to in paragraph (1) shall be a defined contribution plan established in writing which—

"(A) is a stock bonus plan, a stock bonus and a money purchase pension plan, or a profit-sharing plan,

"(B) is designed to investment primarily in employer securities, and

"(C) meets such other requirements (similar to requirements applicable to employee stock ownership plans as defined in section 4975(e)(7)) as the Secretary may prescribe.

"(3) The plan shall provide for the allocation of all employer securities transferred to it or purchased by it (because of the requirements of section 44C) to the account of each participant (who is an employee of the employer at the close of the plan year or, if applicable, the date as of which the allocation is made) as of the close of each plan year in an amount which bears substantially the same proportion to the amount of all such securities allocable to all participants in the plan for that plan year as the amount of compensation paid to such participant (disregarding any compensation in excess of the first $100,000 per year) bears to the compensation paid to all such participants during that year (disregarding any compensation in excess of the first $100,000 with respect to any participant). Notwithstanding the preceding sentence, the allocation to participants' accounts may be extended over whatever period may be necessary to comply with the requirements of section 415. For purposes of this paragraph, the amount of compensation paid to a participant for a year is the amount of such participant's compensation within the meaning of section 415(c)(3) for such year.

"(4) The plan must provide that each participant has a nonforfeitable right to any stock allocated to his account under paragraph (3), and that no stock allocated to a participant's account may be distributed from that account before the end of the 84th month beginning after the month in which the stock is allocated to the account except in the case of separation from the service, death, or disability.

"(5) The plan must provide that, in the case of securities issued by an employer which has a class of securities registered under section 12 of the Securities

Exchange Act of 1934, or which would be required to be so registered except for the exemption from registration provided in subsection (g)(2)(8) or (g)(2)(9) of that section, each participant is entitled to direct the plan as to the manner in which any employer securities which are allocated to the account of the participant are to be voted.

"(6) On making a claim for credit under section 44C, the employer shall state in such claim that it agrees, as a condition of receiving any such credit—

"(A) to transfer employer securities to the plan having a value at the time of the claim equal to the amount of the credit claimed under section 44C for the taxable year, a portion of which, as required in section 44C(b), shall consist of new employer securities (as defined in section 44C(b)),

"(B) except as provided in subparagraph (C), to effect the transfer not later than 30 days after the tune (including extensions) for filing its income tax return for a taxable year, and

"(C) in the case of an employer whose credit (as determined under section 44C(a)) for a taxable year, exceeds the limitations of subsection (c) of such section to effect that portion of the transfer allocable to credit carryovers of such excess credit at the time required under subparagraph (B) for the taxable year to which such portion is carried over.

For purposes of meeting the requirements of this paragraph, a transfer of cash shall be treated as a transfer of employer securities if the cash is, under the plan, used to purchase employer securities.

"(7) Notwithstanding any other provision of law to the contrary, if the plan does not meet the requirements of section 401—

"(A) stock transferred under paragraph (6) and allocated to the account of any participant under paragraph (3) and dividends thereon shall not be considered income of the participant or his beneficiary under this chapter until actually distributed or made available to the participant or his beneficiary and, at such time, shall be taxable under section 72 (treating the participant or his beneficiary as having a basis of zero in the contract),

"(B) no amount shall be allocated to any participant in excess of the amount which might be allocated if the plan met the requirements of section 401, and

"(C) the plan must meet the requirements of sections 410 and 115.

"(8)(A) Except as provided in subparagraph (B)(iii), if the amount of the credit determined under section 46 is recaptured or redetermined in accordance with the provisions of section 47 and the amount of the credit claimed under section 44C for the taxable year to which such recapture or redetermination relates was computed under paragraph (1) of section 44C(a), the amounts transferred to the plan under this subsection and allocated under the plan shall remain in the plan or in participant accounts, as the case may be, and continue to be allocated in accordance with the plan.

"(B) If the amount of the credit determined under section 46 for a taxable year is recaptured in accordance with the provisions of section 47 and the amount of the credit claimed under section 44C for the taxable year to which such recapture relates was computed under paragraph (1) of section 44C(a)—

"(i) the employer may reduce the amount required to be transferred to the plan under paragraph (6) of this subsection, for the current taxable year or any succeeding taxable years by the portion of the amount so recaptured which is attributable to reduction in the qualified investment (as determined under section 46 (c) and (d) of the employer),

"(ii) notwithstanding the provisions of paragraph (12), the employer may deduct such portion, subject to the limitations of section 404 (relating to deductions for contributions to an employees' trust or plan), or

"(iii) if the requirements of subsection (c)(1) are met, the employer may withdraw from the plan an amount not in excess of such portion.

"(C) If the amount of the credit claimed by an employer for a prior taxable year under section 38 is reduced because of a redetermination of the qualified investment for such prior taxable year which becomes final during the taxable year, and the employer transferred amounts to a plan which were taken into account for purposes of this subsection for that prior taxable year, then—

"(i) the employer may reduce the amount it is required to transfer to the plan under paragraph (6) of this subsection for the taxable year or any succeeding taxable year by the portion of the amount of such reduction in the credit or increase in tax which is attributable to the contribution to such plan, or "(ii) notwithstanding the provisions of paragraph (12), the employer may deduct such portion subject to the limitations of section 404.

"(9) For purposes of this subsection—

"(A) EMPLOYER SECURITIES.—The term 'employer securities' means common stock issued by the employer or a corporation which is a member of a controlled group of corporations which includes the employer with voting power and dividend rights no less favorable than the voting power and dividend rights of other common stock issued by the employer or such controlling corporation, or securities issued by the employer or such controlling corporation, convertible into such stock. For purposes of this subparagraph, the term 'controlled group of corporations' has the meaning given to such term by section 1563(a), except that—

"(i) 'more than 50 percent' shall be substituted for 'at least 80 percent' each place it appears in section 1563(a)(1), and

"(ii) the determination shall be made without regard to subsections (a)(4) and (e)(3)(C) of section 1563.

"(B) VALUE.—The term 'value' means the average of closing prices of the employer's securities, as reported by a national exchange on which securities are listed, for the 20 consecutive trading days immediately preceding the date of transfer or allocation of such securities or, in the case of securities not listed on a national exchange, the fair market value as determined in good faith and in accordance with the regulations issued by the Secretary.

"(10) The Secretary shall prescribe such regulations and require such reports as may be necessary to carry out the provisions of this section.

"(11) If the employer fails to meet any requirement imposed under this section or under any obligation undertaken to comply with a requiremenc of this section, he is liable to the United States for a civil penalty of an amount equal to the amount involved in such failure. The preceding sentence shall not apply if the taxpayer corrects such failure (as determined by the Secretary) within 90 days after notice thereof. For purposes of this paragraph, the term 'amount involved' means an amount determined by the Secretary, but not in excess of the amount of the credit claimed by the taxpayer for the taxable year under section 44C(a) and not less than the product of one-half of 1 percent of such amount multiplied by the number of months (or parts thereof) during which such failure continues. The amount of such penalty may be collected by the Secretary in the same manner in which a deficiency in the payment of Federal income tax may be collected.

"(12) Notwithstanding any provision of this title to the contrary, no deduction shall be allowed under section 162, 212, or 404 for amounts transferred to an employee stock ownership plan and taken into account under this subsection.

"(13) (A) As reimbursement for the expense of establishing the plan, the employer may withhold from amounts due the plan for the taxable year for which the plan is established, or the plan may pay, so much of the amounts paid or incurred in connection with the establishment of the plan as does not exceed the sum of 10 percent of the first $100,000 that the employer is required to transfer to the plan for that taxable year under paragraph (6) and 5 percent of any amount in excess of the first $100,000 of such amount.

"(B) As reimbursement for the expense of administering the plan, the employer may withhold from amounts due the plan, or the plan may pay, so much of the amounts paid or incurred during the taxable year as expenses of administering the plan as does not exceed the smaller of—

"(i) the sum of 10 percent of the first $100,000 and 5 percent of any amount in excess of $100,000 of the income from dividends paid to the plan with respect to stock of the employer during the plan year ending with or within the employer's taxable year, or

"(ii) $100,000.

"(14) The return of a contribution made by an employer to an employee stock ownership plan designed to satisfy the requirements of this subsection or subsection (b) (or a provision for such a return) does not fail to satisfy the requirements of this subsection, subsection (b), section 401(a), or section 403(c)(1) of the Employee Retirement Income Security Act of 1974 if—

"(A) the contribution is conditioned under the plan upon determination by the Secretary that such plan meets the applicable requirements of this subsection, subsection (b), or section 401(a),

"(B) the application for such a determination is filed with the Secretary not later than 90 days after the date on which the credit under section 44C is allowed, and

"(C) the contribution is returned within one year after the date on which the Secretary issues notice to the employer that such plan does not satisfy the requirements of this subsection, subsection (b), or section 401(a).

"(15) Notwithstanding any provision of this title to the contrary, employees who are included in a unit of employees covered by a collective-bargaining agreement between an employee representative and one or more employers and who satisfy the minimum age and service requirements, if any, established by the plan shall not be excluded from eligibility under the plan, unless the employee representative declines coverage for employees in the unit. Where the employee representative declines coverage, section 410(b)(2)(A) shall apply.

"(b) ADDITIONAL PLAN REQUIREMENTS.—

"(1) The employer may not make participation in the plan a condition of employment and the plan may not require employee contributions as a condition of participation in the plan. However, the plan may permit employee contributions to be made.

"(2) Employee contributions (if any) under the plan must meet the requirements of section 401(a)(4) (relating to contributions).

7

"(c) Recapture.—

"(1) General rule.—Amounts transferred to a plan under subsection (a)(6) may be withdrawn from the plan by the employer if the plan provides that while subject to recapture—

"(A) amounts so transferred with respect to a taxable year are segregated from other plan assets, and

"(B) separate accounts are maintained for participants on whose behalf amounts so transferred have been allocated for a taxable year.

"(2) Coordination with other law.—Notwithstanding any other law or rule of law, an amount withdrawn by the employer will neither fail to be considered to be nonforfeitable nor fail to be for the exclusive benefit of participants or their beneficiaries merely because of the withdrawal from the plan of amounts described in paragraph (1), nor will the withdrawal of any such amount be considered to violate the provisions of section 403(c)(1) of the Employee Retirement Income Security Act of 1974.

"(d) Effect of Recapture Provisions on Distribution to a Participant (or His Beneficiary).—A distribution to a participant (or his beneficiary) which otherwise satisfies the requirements of subsection (e)(4)(A) of section 402 shall be treated as a lump sum distribution for purposes of section 402, notwithstanding the fact that a portion of the amount allocated to the participant's account under the plan as provided in this section is retained in the plan following the distribution to him in order to permit an amount previously transferred to the plan to be withdrawn by his employer under subsection (a)(8)(B) of this section. Any portion of this amount retained in the plan which is not withdrawn by the employer and which is subsequently distributed to the participant (or his beneficiary) shall not be treated as a lump sum distribution.".

(c) CONFORMING CHANGES.—

(1) Paragraph (2) of section 46(a) of such Code (relating to amount of credit for current taxable year) is amended—

(A) by striking out "Except as otherwise provided in subparagraph (B), in the case of property described in subparagraph (D)," and inserting in lieu thereof the following: "In the case of property described in subparagraph (C),",

(B) by striking out subparagraph (B) and redesignating subparagraphs (C) and (D) as (B) and (C), respectively,

(C) by striking out "subparagraph (D)," in subparagraph (B) (as so redesignated) and inserting in lieu thereof "subparagraph (C)",

(D) by striking out "subparagraphs (A) and (B)" in subparagraph (C) (as so redesignated) and inserting in lieu thereof "subparagraph (A)", and

(E) by striking out the last sentence of subparagraph (C) (as so redesignated).

(2) Subparagraph (A) of section 46(c)(3) of such Code (relating to public utility property) is amended by striking out "subsection (a)(2)(C)" and inserting in lieu thereof "subsection (a)(2)(B)".

(3) Paragraph (9) of section 46(f) of such Code (relating to limitation in case of certain regulated companies) is amended—

(A) by striking out "makes an election under subparagraph (B) of subsection (a)(2)," and inserting in lieu thereof "claims the credit allowed by section 44C,",

(B) by striking out "then, notwithstanding the prior paragraphs of this subsection, no credit shall be allowed by section 38 in excess of the amount which would be allowed without regard to the provisions of subparagraph (B) of subsection (a)(2)" and inserting in lieu thereof "then no credit shall be allowed by such section".

(d) Clerical Amendments.—

(1) The table of sections for subpart A of part IV of subchapter A of chapter 1 of such Code is amended by inserting immediately after the item relating to section 44B the following new item:

"Sec. 44C. Employee Stock Ownership Plan Contributions.".

(2) The table of sections for subpart B of part I of subchapter D of chapter 1 of such Code is amended by adding at the end thereof the following new item:

"Sec. 416. Special employee stock ownership plans.".

SEC. 3. TREATMENT OF ANNUITIES FOR ESTATE PURPOSES.

Subsection (c) of section 2039 of such Code (relating to exemption of annuities under certain trusts and plans) is amended—

(1) by striking out "(other than a lump sum distribution described in section 402(e)(4), determined without regard to the next to the last sentence of section 402(e)(4)(A))" and inserting in lieu thereof "(other than an amount which the taxpayer elected, under section 402(e)(4)(B), to treat as a lump sum distribution)", and

(2) by inserting after "section 401(a)" in paragraph (1) the following: ", or under an employee stock ownership plan".

SEC. 4. RETIREMENT SAVINGS BY ESOP PARTICIPANTS.

(a) AMENDMENT OF SECTION 219.—Paragraph (4) of section 219(c) of such Code (relating to participation in governmental plans by certain individuals) is amended—

(1) by inserting "; PARTICIPATION IN CERTAIN EMPLOYEE STOCK OWNERSHIP PLANS" after "INDIVIDUALS" in the caption of such paragraph, and

(2) by adding at the end thereof the following new subparagraph:

"(C) CERTAIN EMPLOYEE STOCK OWNERSHIP PLANS.—A participant in an employee stock ownership plan described in section 416 is not considered to be an active participant in a pian described in subsection (b)(2) solely because of his participation in the employee stock ownership plan.".

(b) AMENDMENT OF SECTION 220.—Paragraph (5) of section 220(c) of such Code (relating to participation in governmental plans by certain individuals) is amended—

(1) by inserting "; PARTICIPATION IN CERTAIN EMPLOYEE STOCK OWNERSHIP PLANS" after "INDIVIDUALS" in the caption of such paragraph, and

(2) by adding at th᾿ end thereof the following new sentence: "A participant in .n employee stock ownership plan which meets the requirements of section 416 is not considered to be an active participant in a plan

described in subsection (b)(3) solely because of his participation in the employee stock ownership plan."

SEC. 5. ROLLOVER OF ESOP INTO IRA.

Paragraph (6) of section 402(a) of the Internal Revenue Code of 1954 (relating to special rollover rules) is amended by adding at the end thereof the following new subparagraph:

"(C) CASH IN LIEU OF EMPLOYER SECURITIES.—For purposes of paragraph (5), the transfer of all money received in lieu of a distribution of employer securities (as defined in section 416(a)(9)(A)) or of the proceeds from the sale of a distribution of employer securities to the employer or to the trust or plan maintained by the employer, shall be treated as a transfer of a distribution of such securities.".

SEC. 6. PUT-OPTION REQUIREMENT FOR CERTAIN ESOP CONTRIBUTIONS.

Notwithstanding any other provision of law, an employee stock ownership plan (as defined in section 416 or 4975(e)(7) of the Internal Revenue Code of 1954) which permits a participant to elect to receive cash in lieu of a distribution of employer securities shall not be required to provide a put option for any securities distributed from the plan, nor shall the provision of such an election be deemed to be an offering of a security to the participant for purposes of Federal securities laws.

SEC. 7. ELECTION WITH RESPECT TO UNREALIZED APPRECIATION OF EMPLOYER SECURITIES.

Subparagraph (J) of section 402(e)(4) of such Code (relating to unrealized appreciation of employer securities) is amended by inserting after "there shall be excluded" the following: ", at the election of the taxpayer (made at such time and in such manner as the Secretary may prescribe by regulation),".

SEC. 8. DEDUCTIBILITY OF CERTAIN ESOP CONTRIBUTIONS, BEQUESTS, ETC.

(a) Dividends Paid Deduction.—In addition to the deductions provided under section 404(a) of the Internal Revenue Code of 1954, there shall be allowed as a deduction to an employer the amount of any dividend paid by that employer during the taxable year with respect to employer securities (as defined in section 416(a)(9) of such Code) if—

(1) the employer securities were held on the record date for the dividend by an employee stock ownership plan, and

(2) the dividend received by the plan is distributed, not later than 60 days after the close of the plan year in which it is received, to the employees participating in the plan, in accordance with the plan provisions.

(b) Bequests; Charitable Contributions, Etc.—For purposes of sections 170(b)(1), 642(c), 2055(a), and 2522 of the Internal Revenue Code of 1954, a contribution, bequest, or similar transfer of employer securities or other property to an employee stock ownership plan shall be deemed a charitable contribution to an organization described in section 170(b)(A)(vi) of such Code, if—

(A) such contribution, bequest, or transfer is allocated, pursuant to the terms of such plan, to the employees participating under the plan in a manner consistent with section 401(a)(4) of such Code;

(B) no part of such contribution, bequest or transfer is allocated under the plan for the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of section 267(b) of such Code, or any other person who, in the year of contribution or any of the five preceding taxable years, has owned, directly or indirectly, more than 25 percent in value of any class of outstanding employer securities (as defined in section 416(a)(9) of such Code) under the provisions of section 318(a) of such Code; and

(C) such contribution, bequest, or transfer is made only with the express approval of such employee stock ownership plan.

SEC. 9. ELIMINATION OF MINIMUM TAX ON EMPLOYEE STOCK OWNERSHIP PLAN CONTRIBUTIONS.

In determining the regular tax deductions under section 56(c) of the Internal Revenue Code of 1954, the taxes imposed by chapter 1 of such Code shall not be reduced—

(1) in the case of a taxable year ending after December 31, 1974, and beginning before January 1, 1978, by the excess, if any, of the credit determined pursuant to section 46(a)(2)(B) of such Code over the credit which would have been determined pursuant to section 46(a)(2)(A) of such Code, or

(2) in the case of a taxable year beginning after December 31, 1977, by the amount of credit determined pursuant to section 44C of such Code.

SEC. 10. EFFECTIVE DATE.

Except as provided in section 9, the amendments made by this Act shall apply with respect to taxable years beginning after December 31, 1977.

96TH CONGRESS
1ST SESSION

S. 388

To promote the ownership of small businesses by their employees and to provide a means whereby employees can purchase their companies where the companies would otherwise be closed, liquidated, or relocated, and to assure that firms owned wholly or partly by their employees are eligible for all forms of assistance from the Small Business Administration.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 8 (legislative day, JANUARY 15), 1979

Mr. STEWART (for himself, Mr. NELSON, Mr. WEICKER, Mr. HATCH, and Mr. PRESSLER) introduced the following bill; which was read twice and referred to the Select Committee on Small Business

A BILL

To promote the ownership of small businesses by their employees and to provide a means whereby employees can purchase their companies where the companies would otherwise be closed, liquidated, or relocated, and to assure that firms owned wholly or partly by their employees are eligible for all forms of assistance from the Small Business Administration.

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

II—E

That this Act may be cited as the "Small Business Employee Ownership Act".

SEC. 2. The Congress finds and declares that—

(1) employee ownership of firms has been shown to be a successful means of organizing an enterprise and that employee-owned firms are likely to have greater productivity rates, better long-range prospects, greater employee and management job satisfaction, and broader distribution of the company's profits and equity than similar nonemployee-owned firms;

(2) employee ownership of firms provides a means for preserving jobs and business activity where they would otherwise be lost due to company closings, liquidations, or relocations;

(3) employee ownership of firms provides a means of keeping a small business small when it might otherwise be sold to a conglomerate or other large enterprise;

(4) employee ownership provides a means for creating a new small business from the sale of a subsidiary of a large business, when such a subsidiary would otherwise be closed, liquidated, relocated, or sold to another large business;

(5) unemployment insurance programs, welfare payments, and job creation programs are less desirable

and more costly for both the Government and program beneficiaries than loan programs to maintain employment in firms that would otherwise close, be liquidated, or relocate;

(6) the continued closing of small businesses or the sale of small businesses to conglomerates represents an undesirable and anticompetitive trend towards economic concentration;

(7) the slow growth in productivity in the United States contributes to inflation and balance-of-payments deficits;

(8) the present concentration of capital ownership has created too great a disparity between the very wealthy few and the low- and moderate-income majority;

(9) by making and guaranteeing loans to employee stock ownership trusts or other employee organizations, the Small Business Administration could provide feasible and desirable methods for the transfer of all or part of a company's ownership to employees, by aiding employee organizations in purchasing small business concerns that would otherwise close, be liquidated, or relocate, or in purchasing subsidiaries of companies which would close, be liquidated, or relocate, and would, if independently owned, be small businesses.

SEC. 3. (a) It is the purpose of this Act to include as small business concerns any employee-owned company which would otherwise be defined as small, or any employee organization, or employee stock ownership plan, established for the purpose of purchasing a business which, when purchased, would otherwise be defined as a small business, and to make such employee-owned firms or employee organizations eligible for all assistance available to small business concerns as provided in the Small Business Act.

(b) It is the further purpose of this Act to assure that a small business using an employee stock ownership plan which qualifies under the specifications as set forth in this Act can obtain assistance from the Small Business Administration through an employee stock ownership trust.

(c) It is the final purpose of this Act to assure that the Small Business Administration shall give a high priority to guaranteeing loans to employee-owned firms, to employee organizations or employee stock ownership plans seeking to buy their firms, and that such assistance shall be made available by the Small Business Administration on the basis of a firm's future prospects rather than past performance or individual employee-owner assets.

SEC. 4. Section 7 of the Small Business Act is amended by adding at the end thereof the following:

"(m)(1) As used in this subsection, the term—

"(A) 'employee organization' means any organization representing employees of a company which is a small business concern as presently constituted or, if the company is a subsidiary of a large business, would be a small business concern if independently owned;

"(B) 'employee' means any full-time employee of a small business concern;

"(C) 'employee stock ownership plan' or 'ESOP' means a plan described in section 4975(e)(7) of the Internal Revenue Code of 1954;

"(D) 'Administrator' means the Administrator of the Small Business Administration;

"(E) 'employee stock ownership trust' or 'ESOT' means a trust created by a small business concern or an employee organization as part of an employee stock ownership plan and which, among other functions, can (i) borrow funds for the purpose of investment in company stock and (ii) can receive contributions of stock from the small business concern or employee organization;

"(F) 'startup and operating costs' means the funds required to acquire ownership of a small business concern and operate it.

"(2)(A) The Administrator is directed to make all assistance available under this section available to employee organizations, employee-owned small business concerns, and employee stock ownership trusts which meet the qualifications specified in this subsection.

"(B) Assistance to employee-owned business concerns shall be made on the same basis as assistance to nonemployee-owned firms, except as specifically provided in this Act.

"(C) Assistance to small business concerns using an employee stock ownership plan shall be made to the employee stock ownership trust on the same basis as assistance is made to companies not using an employee stock ownership plan, if—

"(i) the company seeking the assistance through an ESOT guarantees to the Administrator that it will be responsible for providing such funds as shall be necessary to the ESOT for the repayment of the obligation incurred by the ESOT;

"(ii) the trustee of the ESOT warrants in writing that funds acquired by the ESOT with the assistance of the Small Business Administration will be used solely for the purpose of purchasing stock in the small business concern adopting the ESOP: *Provided,* That nothing in this section shall limit the activities of ESOT's with regard to funds acquired from other sources except as may otherwise be specified by law;

"(iii) all stock issued to the ESOT pursuant to the assistance made available through this subsection fully vests with employees of the small business concern no later than the expiration date of the assistance;

"(iv) a plan certified by legal counsel for the business concern adopting the ESOP is presented to the Administrator which assured that notwithstanding any other provisions of law, allocations of stock to participants in the ESOP will ignore all compensation of participants in excess of $50,000 when annual compensation is used as a guide for such allocation: *Provided,* That any allocation formula adopted under the ESOP must be one which satisfies the requirements of the Internal Revenue Code.

"(3) Loans to employee organizations, including employee organizations establishing an ESOP and using an ESOT, shall be guaranteed as provided in this section for the purpose of acquiring a small business concern in which the employees work, or for acquiring a subsidiary which, if independently owned, would be a small business concern, and in which the employees work: *Provided,* That—

"(A) the small business concern or subsidiary would otherwise close, be liquidated, or relocated, or be purchased by a large business, or the owner and employees agree to a transfer of ownership to the employees;

"(B) an employee organization has completed a feasibility report showing the management capability planned for the new firm, a marketing analysis, and such other features as the Administrator may require;

"(C) at the time the employee organization submits an application for a guarantee or a loan as provided in this subparagraph (B), whichever comes first, the organization provides a plan certified by legal counsel to the Administrator demonstrating that—

"(i) all employees will be offered an opportunity to participate in the ownership plan, and that employees subject to a collective bargaining agreement will be included in such an offering, unless the union representing the employees in the bargaining specifically requests, in writing, exclusion from the plan;

"(ii) at least 50 per centum of the total stock or other asset value of the firm will be owned by at least 50 per centum of the employees by the time the assistance made available from the Administration expires, or any other Government assistance made at the same time expires, whichever occurs later;

"(D) in the case of subsidiaries, a plan is provided demonstrating that once the transfer of the subsidiary to the employees is completed, the subsidiary will be an independent business which qualifies as a small business concern; and

"(E) in addition to the requirement in subparagraph (C), the organization, at the same time, must provide a plan which is certified by its legal counsel and which would—

"(i) provide that where stock is distributed, it will carry full voting rights and be vested by the expiration of the last Government assistance made available at the time the Small Business Administration assistance is made available;

"(ii) enable the concern to retire stock being sold by employees leaving the firm or make the stock available to new employees;

"(iii) provide for a periodic review of the mode of company organization and the role employee owners will play in the management of the concern;

"(iv) except in the case of an ESOP, provide a method whereby the loan to the employee organization can be repaid by employee members through a system of payroll deductions should other methods or repayment as may be specified in the loan application be unable to provide the necessary cash; and

"(v) provide adequate management contracts to assure management expertise and continuity.

"(4) Assistance under this paragraph shall be provided on a high-priority basis and shall be made when the feasibility study required shows that the future prospects of the firm show a likelihood of an ability to repay any loans guaranteed, and when the Administrator determines that the company will generate sufficient revenues to provide a reasonable assurance of repayment. The individual business experience or personal assets of individual employee-owners shall not be used as loan guarantee criteria, except inasmuch as certain employee-owners may assume managerial responsibilities, in which case business experience or ability may be considered.

"(5) The principal amount of any loan guaranteed under this section may not exceed $1,000,000.

"(6) For the purpose of the feasibility study specified in 3(B), the Administrator is authorized to loan not more than $10,000 to the employee organization, at the same rate as the current cost of money to the Government and which shall be repayable within three years: *Provided*, That if the feasibility report does not result in a Small Business Administration guarantee, the loan shall be considered a grant.

"(7) Nothing in this section affects the status of any ESOP under section 401 of the Internal Revenue Code of 1954.

"(8) The Administrator shall compile a separate list of applications for assistance under this provision, indicating which applications were accepted and which were denied, and shall report periodically to Congress on the status of employee-owned firms assisted by the Small Business Administration.

"(9) The Administrator is authorized to make the guarantees under this subsection directly to the seller of a small business concern or a subsidiary of a large business that would become a small business upon independently owned as specified in section 4(M)(3)(D): *Provided,* That the guarantees under this subsection must be made in accordance with the provisions of this subsection for employee ownership. *And provided further,* That—

"(A) In guaranteeing assistance under this subsection, the Administrator will guarantee payments on installment sale contracts by the buyer to the seller: *Provided,* That no more than 90 per centum of the total remaining obligation at the time of default shall be paid;

"(B) In the case of default, the seller will have the option of (1) paying the Small Business Administration 90 per centum of the total amount paid on the contract at the point of default and exercising his option to reassume title to the business, in which case the Small Business Administration will be relieved of any further obligations to the seller, including the obligation to pay 90 per centum of the remaining payments on the contract, or (2) assigning to the Small Business Administration the option of assuming title to the business and receiving, in a lump sum, 90 per centum of the remaining payments due on the contract;

"(C) If the seller should take option (2), the Small Business Administration may resell the business or its assets, or may seek another individual to reassume the contract and make the remaining payments to the Small Business Administration.

SEC. 5 DEFINITIONS OF MINORITY-OWNED FIRMS WITH ESOP'S.—After the words in section 8(a)(4)(A) "* * * at least 51 per centum of the stock is owned by one or more socially and economically disadvantaged individuals; add the phrase, "or in the case of a company with an employee stock ownership plan, in which 51 per centum of the stock in the company is allocated through an ESOT to one or more socially and economically disadvantaged individuals;".

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H.R. 462 WITH REVISIONS PROPOSED BY
KELSO BANGERT & CO. INCORPORATED TO
THE JOINT COMMITTEE ON INTERNAL
REVENUE TAXATION, JANUARY 20, 1976

H.R.____

94th CONGRESS

2nd Session

AN ACT

To provide for accelerated capital formation.

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

Section 1. Title - This Act may be cited as the "Accelerated Capital Formation Act of 1976."

Section 2. Purpose - The purpose of this Act is to provide incentives for accelerated financing of the formation of U.S. corporate capital and to encourage voluntary means for broadly diffusing equity ownership among employees of U.S. enterprises both (a) with respect to existing capital, by means consistent with the protection of private property, and (b) with respect to newly formed capital, by means which extend the logic of conventional business finance to corporate employees.

January 16, 1976

Section 3. Amendment of Internal Revenue Code - The Internal Revenue Code of 1954 is amended by adding the following new Section 416 at the end of Subpart B of Part I of Subchapter D of Chapter 1:

Section 416 - EMPLOYEE STOCK OWNERSHIP PLAN FINANCING

(a) Definitions.

(1) Employee Stock Ownership Plan - The term "employee stock ownership plan" means a technique of corporate finance that utilizes a defined contribution plan which satisfies the requirements of Section 401(a) and is designed -

(A) to invest primarily in employer stock;

(B) to meet general capital financing requirements of a corporation, including capital growth and transfers in the ownership of employer stock;

(C) to build into employees beneficial ownership of employer stock, substantially in proportion to their relative compensation;

(D) to receive loans or other extensions of credit to acquire employer stock, with such loans or credit secured primarily by a commitment by the employer to make future payments to the plan (which may include dividends on employee stock) in amounts sufficient to enable such loans (and interest thereon) to be repaid; and

(E) to limit the liability of the plan (and its participants) for repayment of any such loan (including interest) to payments received from the employer (which may include dividends on employer stock) and to that portion of the employer stock acquired with the proceeds of such loan which represents that portion of the loan remaining unpaid.

(2) Regulations - The Secretary or his delegate may prescribe regulations further defining "employee stock ownership plan" consistent with the provisions of this Section. An employee stock ownership plan which satisfies the requirements of this Section shall also satisfy the definition in Section 4975(e)(7) and the definitions under Section 301(d)(2) of the Tax Reduction Act of 1975 and Section 407(d)(6) of the Employee Retirement Income Security Act of 1974.

(3) Employer Securities and Employer Stock - For purposes of this Section, the term "employer securities" means securities issued by the employer corporation or by an affiliate of such employer, and the term "employer stock" means employer securities which constitute common stock or preferred stock convertible (at a reasonable conversion ratio) into common stock.

(4) Diversification - The term "invest primarily in employer stock," in subparagraph (1)(A) of this subsection, shall not preclude an employee stock ownership plan from diversifying its investments in order to provide participating employees

(or their beneficiaries) with the optional benefits described in paragraph (c)(2), or from providing a reasonable reserve for the repurchase of employer securities from former participants or beneficiaries.

(b) Special Deductions.

(1) Dividends on Employer Securities - In the case of an employer maintaining an employee stock ownership plan, there shall be allowed as a deduction the amount of any dividend paid by such employer (or its affiliate) during the taxable year with respect to employer securities, provided -

(A) such employer securities were held on the record date for such dividend by the employee stock ownership plan, by an individual stock ownership plan described in paragraph (c)(5) of this Section, or by an individual holding employer securities distributed to him from the employee stock ownership plan; and

(B) any dividend received by such employee stock ownership plan or individual stock ownership plan is distributed, not later than sixty (60) days after the close of the plan year in which it is received, to the employees, former employees and their beneficiaries having accounts under the employee stock ownership plan, or for whose benefit the individual stock ownership plan is maintained, in accordance with provisions of such plan; or

(C) any dividend received by the employee stock ownership plan is applied, not later than sixty (60) days after the close of the plan year, to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of employer stock.

(2) Employer Contributions - Notwithstanding the limitations under Section 404(a), there shall be allowed as a deduction to an employer the amount of any contributions paid on account of a taxable year [as described in Section 404(a)(6)] to an employee stock ownership plan, provided such contributions are applied to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of employer stock.

(3) Certain Donative Transfers - For purposes of Sections 170(a)(1) and (b)(1), 642(c)(1), 2055(a) and 2522, a contribution, bequest or similar transfer of employer securities or other property to an employee stock ownership plan shall be deemed a charitable contribution to an organization described in Section 170(b)(1)(A)(vi), provided -

(A) such contribution, bequest or transfer _s allocated, pursuant to the terms of such plan, to the employees (or former employees or their beneficiaries) participating under the plan, in a manner consistent with Section 401(a)(4);

(B) no part of such contribution, bequest or transfer is allocated under the plan fo- the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of Section 267(b), or any other person who owns more than 25% of any class of outstanding employer stock, under the provisions of Section 318(a);

(C) such contribution, bequest or transfer is made only in accordance with the express provisions of the employee stock ownership plan; and

(D) such contribution, bequest or transfer is treated as an employer contribution to the plan for purposes of Sections 402 and 411.

(c) Treatment of Participants.

(1) Allocation of Employer Stock -

(A) Employer stock acquired by an employee stock ownership plan through acquisition indebtedness incurred by the plan, in connection with the financing of capital requirements of the employer corporation (or its affiliates), shall be allocated annually among the accounts of the participants to the extent that contributions by the employer (and dividends received by the plan on employer stock) are applied to the repayment of such acquisition indebtedness (including interest), in accordance with the terms of the plan and substantially in proportion to their relative compensation.

(B) The allocation for each plan year shall represent that portion of employer stock acquired with proceeds of any loan the cost of which bears substantially the same ratio to the cost of all employer stock acquired with proceeds of that loan as the amount of loan principal and interest repaid by the plan for that plan year bears to the total amount of principal and interest payable by the plan during the term of such loan.

(2) Distribution of Benefits - Upon retirement or death, or following separation from service, an employee participating under an employee stock ownership plan (or his beneficiary, in the event of death) is entitled to a distribution of his nonforfeitable interest under the plan in the employer securities or other investments allocated to his accounts, in accordance with the provisions of the plan. If the plan so provides, the participant (or beneficiary) may elect (prior to or following separation from service) to receive all or a portion of his distribution from the plan in -

(A) other employer securities;

(B) cash;

(C) a diversified portfolio of income producing assets;

(D) a nontransferable annuity contract; or

(E) any combination of the above.

(3) Mandatory Repurchase of Employer Securities Under Certain Circumstances - An employee stock ownership plan may

provide for the mandatory repurchase of employer securities from an individual receiving a distribution thereof if all other outstanding employer securities of the same class, whether or not acquired under the plan, are subject to mandatory repurchase from nonemployee shareholders under similar circumstances.

(4) Taxability on Distributions -

(A) Upon receipt of a lump sum distribution [as described in Section 402(e)(4)(A)] from an employee stock ownership plan, or in the event of termination of an employee stock ownership plan, an individual may exclude from gross income that portion of his distribution from the plan which is held by him in the form of employer securities or is transferred to, and held or reinvested within sixty (60) days in, an individual stock ownership plan described in paragraph (5) of this subsection, as a rollover contribution described in Section 402(a)(5), for the purpose of providing that individual with dividends on such employer securities or other forms of realized current income from income producing assets held in such individual stock ownership plan.

(B) Upon subsequent sale or disposition of any such employer securities (except upon death), or distribution of any such assets from the individual stock ownership plan, to the extent that proceeds realized from such sale, disposition or distribution are not exchanged for other employer securities, or reinvested within sixty (60) days in income producing assets under an individual stock ownership plan, the total amount of such proceeds (or the fair market value of any property transferred without adequate consideration) shall be treated as ordinary income to that individual.

(5) Individual Stock Ownership Plans - An individual stock ownership plan which is established to receive proceeds distributed from an employee stock ownership plan, as described in paragraph (4) of this subsection, shall be an individual retirement account, under Section 408(a), in all respects, except that -

(A) the requirements of paragraphs (6) and (7) of Section 408(a) shall not be applicable;

(B) the taxes provided in Sections 408(f) and 4974 shall not be applicable;

(C) the total realized current income (excluding gains on the sale of assets) of the plan must be distributed, not later than sixty (60) days following the close of the taxable year in which such income is received by the plan, to that individual for whose benefit the plan is maintained; and

(D) the plan may only hold amounts which are attributable to distributions from an employee stock ownership plan.

(6) Taxability of Dividends - An individual receiving a distribution under paragraphs (b)(1) or (c)(5)(C) of this Section shall be subject to taxation under Section 402(a)(1), and the provisions of Section 116(a) shall not apply to such distribution.

(7) Limitation on Accumulation -

(A) A contribution by an employer which is deductible under paragraph (b)(2) of this Section, or a transfer described in paragraph (b)(3) of this Section, and any forfeitures attributable thereto, shall not be included in the meaning of annual addition under Section 415(c)(2).

(B) No contribution to (or forfeitures under) an employee stock ownership plan may be allocated to the accounts of any individual if the total value (as of the close of the plan year) of the employer securities and other investments accumulated under the plan for the benefit of that individual equals or exceeds $500,000, less the amount of any such accumulation for that individual under any other employee stock ownership plan (including amounts held in any individual stock ownership plan established under this Section).

(d) Special Provisions.

(1) Fiduciary Responsibility - The acquisition or holding of employer stock, or the incurring of acquisition indebtedness for the purchase thereof, by an employee stock ownership plan shall satisfy the exclusive benefit requirement of Section 401(a) and the fiduciary duties under Section 404(a)(1) of the Employee Retirement Income Security Act of 1974, provided -

(A) the conditions of Section 4975(d)(3) and (13) are satisfied with respect to any transaction between the plan and a disqualified person; and

(B) the same standards of prudence and fiduciary responsibility that corporate management must exercise with respect to its shareholders are satisfied.

(2) Procedure for Advance Opinions - Upon application by an employee stock ownership plan, the Secretary of the Treasury or his delegate shall, within sixty (60) days, issue an advance opinion as to whether a proposed transaction involving that employee stock ownership plan will satisfy all the requirements described in paragraph (1) of this subsection, and any such opinion shall be binding upon the Secretary. Such opinion of the Secretary or his delegate shall be a determination with respect to qualification for purposes of Section 7476(a), relating to certain declaratory judgments of the Tax Court, except that administrative remedies shall be deemed to have been exhausted after sixty (60) days following application by the plan. The Secretary or his delegate shall, within ninety (90) days following the enactment of this Section, promulgate regulations and guidelines for the implementation of the procedure described in this paragraph.

Section 4. Amendment of Employee Retirement Income Security Act - Part 4 of Title I of the Employee Retirement Income Security Act of 1974 (P.L. 93-406) is amended by adding the following subsection (d) to Section 404:

> (d) In the case of an employee stock ownership plan [as defined in Section 416(a)(1) of the Internal Revenue Code of 1954], the acquisition or holding of qualifying employer securities, or the incurring of acquisition indebtedness for the purchase thereof, shall satisfy the requirements of paragraph (a)(1), provided -
>
> (1) the requirements of Section 408(b)(3) and (e) are satisfied with respect to any transaction between the plan and a party in interest; and
>
> (2) the same standards of prudence and fiduciary responsibility that corporate management must exercise with respect to its shareholders are satisfied.

Section 5. Effect of Economic Stabilization - Payments by an employer to an employee stock ownership plan, as defined in Section 416(a)(1) of the Internal Revenue Code of 1954, for the purpose of enabling such plan to repay acquisition indebtedness incurred for the purchase of employer stock, or other contributions to such plan, shall not be treated as compensation, fringe benefits or deferred compensation payments for the purposes of any laws, executive orders or regulations designed to control, establish guidelines or otherwise stabilize employee compensation or benefits, but shall be treated as the equivalent of debt service payments made in the normal course of financing the capital requirements of that employer.

PROPOSED AMENDMENTS TO INTERNAL REVENUE CODE RELATING TO DEDUCTIONS FOR ESOP CONTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (10) to subsection (a) of Section 404 of Subpart A of Part I of Subchapter D of Chapter 1:

(10) Employee stock ownership plans - In the case of an employee stock ownership plan described in Section 4975(e)(7), notwithstanding the provisions of paragraphs (1), (3) and (7), there shall be allowed as a deduction the amount of any contributions paid to the plan on account of a taxable year, as described in paragraph (6), provided such contributions are applied by the plan to the repayment of acquisition indebtedness (including interest) incurred for the purchase of qualifying employer securities.

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (5) to subsection (c) of Section 415 of Subpart A of Part I of Subchapter D of Chapter 1:

(5) Employee stock ownership plans - Employer contributions described in Section 404(a)(10), and any forfeitures attributable thereto, shall not be included in the meaning of annual addition under paragraph (2), so long as the employee stock ownership plan provides that no contribution (or forfeitures) may be allocated to the accounts of any participant if the total value (as of the close of the plan year) of the qualifying employer securities and other investments accumulated under the plan for his benefit equals or exceeds $500,000, less the amount of any such accumulation for that participant under any other employee stock ownership plan described in Section 4975(e)(7).

PROPOSED AMENDMENT TO INTERNAL REVENUE CODE RELATING TO DONATIVE TRANSFERS TO AN ESOP

The Internal Revenue Code of 1954 is hereby amended by adding the following new subparagraph (G) at the end of paragraph (1) of Section 170(b) of Part VI of Subchapter B of Chapter 1:

(G) Certain transfers to an employee stock ownership plan - For purposes of paragraph (a)(1) and of this paragraph, and for purposes of Sections 642(c)(1), 2055(a) and 2522, a contribution, bequest or similar transfer of qualifying employer securities or other property to an employee stock ownership plan, as described in Section 4975(e)(7), shall be deemed a charitable contribution to an organization described in subparagraph (A)(vi), provided -

(i) such contribution, bequest or transfer is allocated, pursuant to the terms of such plan, to the employees (or former employees or their beneficiaries) participating under the plan, in a manner consistent with Section 401(a)(4);

(ii) no part of such contribution, bequest or transfer is allocated under the plan for the benefit of the taxpayer (or decedent), or any person related to the taxpayer (or decedent) under the provisions of Section 267(b), or any other person who owns more than 25% of any class of outstanding qualifying employer securities, under the provisions of Section 318(a);

(iii) such contribution, bequest or transfer is made only in accordance with the express provisions of the employee stock ownership plan; and

(iv) such contribution, bequest or transfer is treated as an employer contribution to the plan for purposes of Sections 402 and 411, but not for purposes of Sections 404 and 415.

PROPOSED AMENDMENT TO INTERNAL REVENUE CODE TO PERMIT CORPORATE TAX DEDUCTION FOR DIVIDENDS PAID ON EMPLOYER STOCK IN CONNECTION WITH AN ESOP

The Internal Revenue Code of 1954 is hereby amended by adding the following new Section 251 at the end of Part VIII of Subchapter B of Chapter I:

Sec. 251 - DIVIDENDS PAID IN CONNECTION WITH AN EMPLOYEE STOCK OWNERSHIP PLAN.

(a) Deduction Allowed - In the case of a corporation maintaining an employee stock ownership plan, as defined in Section 4975(e)(7), there shall be allowed as a deduction the amount of any dividends paid during the taxable year with respect to qualifying employer securities, as defined in Section 4975(e)(8), provided -

(1) such qualifying employer securities were held on the record date for such dividend by the employee stock ownership plan or by an individual holding qualifying employer securities distributed to him from the employee stock ownership plan; and

(2) any dividend received by such employee stock ownership plan is distributed, not later than sixty (60) days after the close of the plan year in which it is received, to the employees, former employees and their beneficiaries having accounts under the employee stock ownership plan, in accordance with the provisions of such plan; or

(3) any dividend received by the employee stock ownership plan is applied, not later than sixty (60) days after the close of the plan year, to the repayment of acquisition indebtedness (including interest) incurred by the plan for the purchase of qualifying employer securities.

PROPOSED AMENDMENT TO INTERNAL REVENUE CODE RELATING TO ESOP ALLOCATIONS AND DISTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (20) to subsection (a) of Section 401 of Subpart A of Part I of Subchapter D of Chapter 1:

(20) A trust forming part of an employee stock ownership plan, as defined in Section 4975(e)(7), shall not constitute a qualified trust under this Section unless the provisions of the plan satisfy the requirements of this paragraph.

(A) Qualifying employer securities acquired by the plan through acquisition indebtedness incurred by the plan, in connection with the financing of capital requirements of the employer corporation (or its affiliates), shall be allocated annually among the accounts of the participants to the extent that contributions by the employer (and dividends received by the plan on qualifying employer securities) are applied to the repayment of such acquisition indebtedness (including interest), in accordance with the provisions of the plan and substantially in proportion to their relative compensation. The allocation for each plan year shall represent that portion of qualifying employer securities acquired with the proceeds of any loan the cost of which bears substantially the same ratio to the cost of all qualifying employer securities acquired with the proceeds of that loan as the amount of loan principal and interest repaid by the plan for that plan year bears to the total amount of principal and interest payable by the plan during the term of such loan.

(B) Upon retirement or death, or following separation from service, an

(OVER)

employee participating under the plan (or his beneficiary, in the event of his death) is entitled to a distribution of his nonforfeitable interest under the plan in the employer securities or other investments allocated to his accounts, in accordance with the provisions of the plan. If the plan so provides, the participant (or beneficiary) may elect (prior to or following separation from service) to receive all or a portion of his distribution from the plan in -

(i) other employer securities;

(ii) cash;

(iii) a diversified portfolio of income producing assets;

(iv) a nontransferable annuity contract; or

(v) any combination of the above.

(C) An employee stock ownership plan may provide for the mandatory repurchase of employer securities from an individual receiving a distribution thereof if all other outstanding employer securities of the same class, whether or not acquired under the plan, are subject to mandatory repurchase from nonemployee shareholders under similar circumstances.

PROPOSED AMENDMENT TO INTERNAL REVENUE CODE RELATING TO DEFERRAL OF TAXATION ON ESOP DISTRIBUTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (5) to subsection (e) of Section 402 of Subpart A of Part I of Subcahpter D of Chapter I:

(5) Employee stock ownership plans -

(A) Upon the receipt of a lump sum distribution from an employee stock ownership plan, as defined in Section 4975(e)(7), an individual may exclude from gross income that portion of the distribution which is held by him in the form of employer securities or is transferred to, and held or reinvested within sixty (60) days in, an individual stock ownership plan described in subparagraph (C) of this paragraph, as a rollover contribution described in subsection (a)(5), for the purpose of providing that individual with dividends on such employer securities or other forms of realized current income from income producing assets held in such individual stock ownership plan.

(B) Upon subsequent sale or disposition of any such employer securities (except upon death), or distribution of any such assets from the individual stock ownership plan, to the extent that the proceeds realized from such sale, disposition or distribution are not exchanged for other employer securities, or reinvested within sixty (60) days in income producing assets under an individual stock ownership plan, the total amount of such proceeds (or the fair market value of any property transferred without adequate consideration) shall be treated as ordinary income to that individual.

(C) Individual Stock Ownership Plans - An individual stock ownership plan which is established to receive proceeds distributed from an employee stock ownership

(OVER)

plan, as described in this paragraph, shall be an individual retirement account, under Section 408(a), in all respects, except that -

(i) the requirements of paragraphs (6) and (7) of Section 408(a) shall not be applicable;

(ii) the taxes provided in Sections 408(f) and 4974 shall not be applicable;

(iii) the total realized current income (excluding gains on the sale of the plan must be distributed, not later than sixty (60) days following the close of the taxable year in which such income is received by the plan, to that individual for whose benefit the plan is maintained; and

(iv) the plan may only hold amounts which are attributable to distributions from an employee stock ownership plan.

PROPOSED AMENDMENT TO
INTERNAL REVENUE CODE
RELATING TO IRS "NO-ACTION" PROCEDURE
FOR ESOP TRANSACTIONS

The Internal Revenue Code of 1954 is hereby amended by adding the following new paragraph (7) at the end of subsection (f) of Section 4975 of Chapter 43:

(7) Procedure for advance opinions with respect to employee stock ownership plans - Upon application by an employee stock ownership plan, as defined in subsection (e)(7), the Secretary or his delegate shall, within sixty (60) days, issue an advance opinion as to whether a proposed transaction involving that employee stock ownership plan will satisfy all the requirements described in paragraphs (3) and (13) of subsection (d). Such opinion shall be binding upon the Secretary, and shall be deemed to be a determination with respect to qualification for purposes of Section 7476(a), relating to certain declaratory judgments of the Tax Court, except that administrative remedies shall be deemed to have been exhausted after sixty (60) days following application by the plan. The Secretary or his delegate shall, within ninety (90) days following the enactment of this paragraph, promulgate regulations and guidelines for the implementation of the procedure described in this paragraph.

PROPOSED AMENDMENT TO ERISA CLARIFYING FIDUCIARY DUTIES APPLICABLE TO ESOP TRANSACTIONS

The Employee Retirement Income Security Act of 1974 is hereby amended by adding the following new subsection (d) to Section 404 of Part 4 of Subtitle B of Title I:

(d) In the case of an employee stock ownership plan, as defined in Section 407(d)(6), the acquisition or holding of qualifying employer securities, or the incurring of acquisition indebtedness for the purchase thereof, shall satisfy the requirements of paragraph (a)(1), provided -

(1) the requirements of subsections (b)(3) and (e) of Section 408 are satisfied with respect to any transaction between the plan and a party in interest; and

(2) the same standards of prudence and fiduciary responsibility that corporate management must exercise with respect to its shareholders are satisfied.

PROPOSED AMENDMENTS TO
INTERNAL REVENUE CODE
RELATING TO DEFINITION OF ESOP

The Internal Revenue Code of 1954 is hereby amended by restating paragraph (7) of subsection (e) of Section 4975 of Chapter 43 to read as follows:

(7) Employee stock ownership plan - The term "employee stock ownership plan"satisfies the requirements of Section 401(a) and is designed -

(A) to invest primarily in qualifying employer securities;

(B) to meet general capital financing requirements of a corporation, including capital growth and transfers in the ownership of qualifying employer securities;

(C) to build into employees beneficial ownership of qualifying employer securities, substantially in proportion to their relative compensation;

(D) to receive loans or other extensions of credit to acquire qualifying employer securities, with such loans or credit secured primarily by a commitment by the employer to make future payments to the plan (which may include dividends on qualifying employer securities) in amounts sufficient to enable such loans (and interest thereon) to be repaid; and

(E) to limit the liability of the plan (and its participants) for repayment of any such loan (including interest) to payments received from the employer (which may include dividends on qualifying employer securities) and to that portion of the qualifying employer securities acquired with the proceeds of such loan which represents that portion of the loan principal remaining unpaid.

(OVER)

The Secretary or his delegate may prescribe regulations further defining "employee stock ownership plan" consistent with the provisions of this paragraph. An employee stock ownership plan which satisfies the requirements of this paragraph shall also satisfy the definitions under Section 301(d)(2) of the Tax Reduction Act of 1975 and Section 407(d)(6) of the Employee Retirement Income Security Act of 1974.

The Internal Revenue Code of 1954 is hereby amended by inserting the following new subparagraph (C) after subparagraph (B) in paragraph (8) of subsection (e) of Section 4975 of Chapter 43:

(C) For purposes of an employee stock ownership plan, as defined in paragraph (7), qualifying employer security means an employer security which is common stock or preferred stock convertible (at a reasonable conversion ratio) into common stock.

Two Important Points About the
ALASKA GENERAL STOCK OWNERSHIP CORPORATION

1. The AGSOC is not a "giveaway".

AGSOC stock would be issued to all citizens of Alaska. No cash investment is required of the shareholder because the AGSOC would borrow the funds necessary for profitable investments. The loan could be secured by the AGSOC assets and a state guarantee. As the loan is repaid the citizens' AGSOC equity increases.

This type of financing is not unique. The wealthy often borrow money on a nonrecourse basis for investment in profitable enterprises. They use their profits to repay the loans leaving themselves with an increased net worth. The AGSOC simply allows the rest of our citizens access to this type of financing.

2. AGSOC is not State ownership.

The stock of AGSOC will be held by the citizens of Alaska. They will vote this stock for a board of directors responsible for running the AGSOC in a profitable manner. AGSOC will be run in the same way as a typical business corporation. The only role for the State in AGSOC will be chartering the corporation and, if necessary, subject to legislative review, guaranteeing loans to the AGSOC.

In Alaska AGSOC may be an alternative to what would otherwise be State ownership of equity interests in some of Alaska's major energy projects. It was out of concern for this possiblity that AGSOC was born.

John MisBimmons:

1. - There is no difference between Taxation of AGSOC + Subchapter S Corp.

2. - Wording in bill should be changed to determine what a Loan Guarantee fund is about. Start up costs should be capitalized Etc.

Joe Sonneman -

1. Fallacy - that AGSOC is not ~~a~~ the same as a private corporation.

2. When all People get ~~[illegible]~~ money ~~the~~ only ~~thing~~ that will happen is ~~that~~ price go up.

AGSOP - is a nominal increase in wealth but is it a real increase in wealth

Duncan - -

Q → Where does it say in the Regulation ~~that~~ for securing of future debt - that it would require a vote of the People!

Jim Thompson - Problem Areas

1) States Role?..

2) States credit Rating

3) Proxy Solicitations under Fed. Law.

4) Provision for grandfathering

5) - Selling of Stock Again

3/20/79 - Hewitt + Associate (Jeff Gates)
Concept of GSOP Been around for 30 yrs.
But Legislation has not been.

Ludwig - ESO Council of America

AGSOP - ESOP

What are Possibilities that AGSOC will Need no other Financial ASSISTANCE

① UCLA - ESOP - Survey
② Study on Productive - by Cal State
③ Prod. + Esop - Tannentaum - Mich. State U.

M + M's - melt in your mouth not in your hand

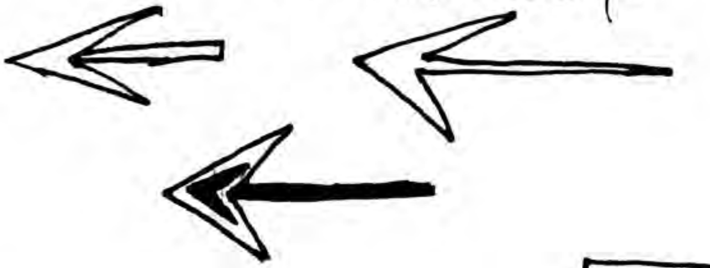
So Few
↓
For So Many
↓
For So Little

M + M's
"Always have their foot in their mouth"

Econ 459 - "I flunked that in college"

Dr. Stephen A. Buser - 3/20/79

① Fed Reg. - really is a Subsidy for the ESOP



PF

PF

GSOC

Professor Kessler!!

(1) Enabling Leg.
(2) Articles Inc
(3) ByLaws

- State Corp. Act -
1) 20% of Shareholders can call mtg.!
How would you get agreement between 20% -
Never been a corp. in the U.S. with such a diffused mgmnt structure!!

2) - Tremendous power vested in Bd of Directors because of above + present legislation.

3/ Leg. can not amend Article ~~becau~~ because it is a contract!!

Takes substantial amt of time to change your body of Corp. - (Not under influence of Gov.)

4) Believes Bd of Directors will become "Self-perpetuating"

Kesslers Proposal for changes in Legislation

1. Make Directors Accountable

add A - Removable by a Superior Court
Give Standing to go to court -
Top Priority!!
10% S Holder
1% Shareholders etc. etc.
A.G. - ETC.

- B. - Shareholder bring "derivative Suit"
SH may Sue in name of corp. -
in certain instances - S/H
held harmless against his cost of
Litigation
Provide by Statute a Scheme
for bringing Suits - but not allow
abusing of Suit as has happened
Damages from a Derivative
suit go to the Corp.

Better Say Don't Want Derivative Alone. If Do Best provide by Statute

Presently have Law in Court Rule!!

C. - Removable By Shareholders.
"for cause" — at any time
when a majority of the Shares
will vote for removal of the
~~D~~ Director!!
of California law say removal
can be Done Simply because
we are Dissatisfied!!

C

D - Statute for Directors
~~must have knowledge of~~
certain ~~tenets~~ -

1.- Avoid Entrenchment

1) Bd member can't Serve more than 1 Term

2) Have proxies - appear on the General Election Ballot!

Necessary -

Clause that Says the Leg. has the right to change the enabling Act from time-to Time. -

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Page 104 - Yellow Book -

Creates 2 classes of Stock -

Because minors can't Vote

P. 105

☆

By Laws - Can not be amended or repealed by Shareholders !! - Should be changed!!

Important that Shareholders have the Right to amend the By-Laws of ~~the~~ Corporation!!! as well as the Bd of Directors !!

P.112 - Sect 1/5 S/B 1/10 by Law but practically lower

P.113 - 5 Days out of SH - Statute Says 10 Days!! - ~~Law~~ Practically longer

P.115 -

P.116 - Needs clarification Disclosure Device

P.117 - ~~S~~ Resignations

P. 117 - Special Meetings.

P 120 => Transferability Prohibits Stock options

P.121 -> Problem w/ 3 ~~Comm~~ members of Comm. Controlling - Actually 3 instead of 9-7

STATE
of ALASKA

MEMORANDUM

TO: Frances Ulmer, Director
Division of Policy
Development & Planning

DATE: March 19, 1979

FILE NO:

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERAL

SUBJECT: Policy & Legal Issues
Surrounding AGSOC Legislation
(SSSB 170 and SSHB 240)

By: Joseph K Donohue
Joseph K. Donohue
Assistant Attorney General

You have requested a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently before the legislature (SS for B 170 and SS for HB 240). The following is an outline of those issues from the Department of Law's perspective:

I. TAXATION

The Revenue Act of 1978 added Subchapter U to the Internal Revenue Code 1954, 26 U.S.C. §1391 through §1397. This legislation provides for the creation of a general stock ownership corporation (GSOC) and it authorizes special tax treatment for those corporations which qualify. The federal legislation requires that all GSOCs be chartered by an act of the State Legislature or by a referendum and further requires that each state charter provide as follows:

1. That the charter provide for the issuance of only one class of stock;

2. That the charter provide for the issuance of shares only to eligible individuals; "eligible individuals" are further defined as those who are residents of the State as of the date specified in the State's enabling legislation and who continue to be residents of the State as of the date of the issuance of the shares;

3. That the charter provide for the issuance of at least one share of stock for each eligible individual;

4. That the charter provide that no share of stock shall be transferred by the shareholder other than by will or by intestate succession, until after five years from the date of issuance (except where the shareholder ceases to be a resident); that no share of stock be transferred to a person other than a resident; and that no share of stock be transferred to any individual who would as a result of the transaction acquire more than ten shares of the GSOC.

In addition, the GSOC may not acquire more than twenty percent of the shares of any other existing corporation; the GSOC may not acquire property through the right of eminent domain; the GSOC's charter must mandate that it qualify as a GSOC under the Internal Revenue Code; and finally, the GSOC must be chartered and organized between December 31, 1978, and before January 1, 1984.

Thus, AGSOC (Alaska GSOC) as set out by Louis Kelso's proposal in SSSB 170 would create a corporation whose shareholders consisted of every resident of the State of Alaska as of the time the State charter goes into effect who remain a resident until the date of the first issuance of the AGSOC shares. The AGSOC is treated as a private corporation and not as a governmental unit for purposes of the Internal Revenue Code, except that a qualifying AGSOC is not subject to federal corporate income taxes. Instead, AGSOC's "taxable income" which is calculated in accordance with the Internal Revenue Code (with minor exceptions not relevant here) would be attributed directly to the shareholders in proportion to the number of shares held and would be taxed as individual income to those shareholders. This dividend income does not qualify for the exclusion from gross income normally associated with the first $100.00 of dividend income. See 26 U.S.C. §116.

The AGSOC is required to distribute at least ninety percent of its "taxable income" for any tax year. 26 U.S.C. §1396(a). The failure of an electing AGSOC to make the required ninety percent distribution would subject it to a penalty of twenty percent of the excess amount required to be distributed over that amount actually distributed. The federal scheme is intended to give the AGSOC a significant competitive advantage since the corporation can operate free of corporate income taxes at the federal level. On the other hand, this ten percent maximum on retained earnings may, indeed probably will, prohibit a corporation's expansion into major new investment areas on the basis of these earnings alone. New investment opportunities which arise in the future would require AGSOC to again obtain significant debt financing which may, in turn, require multiple state guarantees.

The first question which arises is whether or not the policy evidenced by the federal legislation (i.e., freedom from corporate income taxation) should be paralleled at the State level. The present SS for SB 170 would operate to exempt the AGSOC from the State's corporate income tax levied pursuant to AS 43.20. See AS 43.20.021, which incorporates by reference subchapter U of Chapter 1 of subtitle A of the Code. AS 43.20.021 provides for a delayed incorporation of tax exemptions. Those provisions of the Code adopted after 1975 "which change or modify exemptions from tax or credits against tax are not adopted by reference as a part of this chapter until the second January 1 following the effective date of the federal law". Here GSOC's exemption would go into effect at the State level on January 1, 1980. The AGSOC, however, would be subject to state severance taxes (AS 43.55), state oil and gas property taxes (AS 43.56), as well as the state's new oil and gas corporate income tax (AS 43.21.010) should the AGSOC invest in oil and gas production or pipeline transportation property. The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS.

AGSOC's investment in the oil and gas arena would present several important policy questions which should be analyzed prior to the Administration's endorsement of the present legislation. By purporting to give each resident of the State a direct interest in the development of the State's natural resources, it would become an independent voice for more rapid exploitation of those resources. Because the dividends to the residents would, as presently proposed, be directly affected by the nature and extent of the State oil and gas tax policy, it would likely become a lobbying force for lower State taxes. Obviously, lots of tradeoffs are involved, but the political and economic issue reduces itself to the following: Would it be better to expedite resource development and lower State taxes in such a case in order to allow AGSOC's shareholders to benefit directly (albeit by only a marginal increase in their dividend) and at the same time deprive the State treasury of potentially enormous revenues which could be devoted to various social welfare programs? These programs would ultimately return greater proportionate benefits to those in the lower income brackets in the State and possibly lesser benefits (than AGSOC) to those in the upper income brackets.

However, they have also indicated that there was a significant probability (about 75%) that AGSOC would have to return to the Administration and to the legislature, and ultimately to the people at the polls, for approval of a major extension of State credit or guarantees to secure loans of sufficient size to enable AGSOC to invest in TAPS, construct a gas line, etc.

SSSB 170 presently contains only one financing device--AS 10.50.100. The bill proposes the creation of a loan guarantee fund which will be a special fund segregated from all other funds of the State. It purports to be a trust fund for the uses and purposes of this section, but no uses and purposes are set forth in that section. As proponents of the measure have stated that the sole purpose is to guarantee loans for startup or organizational costs of the corporation, they have agreed to both clarify the uses to which the monies can be put and to a statement of a definite limit on the appropriations into the fund ($5,000,000.00). In addition, this section charges the Commissioner of Revenue with reviewing applications for loan guarantees (for the purpose of guarding against fraud and misrepresentation). It is suggested that the Commissioner of Revenue be given broader review powers such as the ability to disapprove a loan on the basis of its general inadvisability.

To accommodate these various concerns, the following substitute for AS 10.50.100 contained in SSSB 170 is submitted for consideration:

A) There is a special fund of the State known as the Alaska General Stock Ownership Corporation Loan Guarantee Fund, which shall not exceed $5,000,000.00. and which shall be completely segregated from all other funds of the State. This fund is a trust for the uses and purposes of this section.

B) The Commissioner of Revenue shall use the fund to guarantee loans solely for startup costs (and not to include major investment financing) made to the corporation by lenders other than the State. In guaranteeing loans, the Commissioner of Revenue shall review the loans for the purpose of ascertaining the general soundness of the proposed loan and for the purpose of guarding against fraud

> and misrepresentation. The guarantee of a loan may not be for an amount in excess of the unobligated balance in the fund at the time the guarantee is made.

Whereas the above minor technical changes can clarify or limit the general purpose of the loan guarantee fund as originally proposed, the manner in which AGSOC would approach the State and apply for an appropriation or legislation which would enable them to utilize the public credit of the State of Alaska to guarantee a major investment in the future is not treated in this bill. Senator Gravel has testified that such an extension of public credit would be in accordance with the procedures which pertain to the issuance of general obligation bonds which require the ratification of the voters at the polls. Thus, Senator Gravel has argued that no major extension of public credit would occur without the ultimate participation of all the voters of the State who would, of course, include most of the AGSOC shareholders.

Senator Gravel is basing his procedural argument on Article IX, §8, State Constitution, which states:

> "No state debt shall be contracted unless authorized by law for Capital improvements and ratified by the majority of the qualified voters of the State who vote on the question."

Although the issue deserves further review by this department, it is suggested that this provision on its face does not apply to the type of guarantee contemplated by Senator Gravel and the proponents of the AGSOC, since the investment would not qualify as a capital improvement authorized by law under this section. See City of Juneau v. Hickson, 373 P2d 743 (Alaska 1962).

Rather, it would appear that Article IX, §6, applies in this context:

> "No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

Under this provision, all that would be required for an extension of credit to the AGSOC would be legislation appropriating a sufficient amount of money to guarantee AGSOC's commitment. Thus, it appears that something on the order of a loan guarantee fund on a vaster scale would in fact be required but such legislation would not be subject to voter ratification at a subsequent general election. Since Kelso's investment consultants have based their advice on the assumption that there could be a call on the general credit of the State without a significant appropriation to back up any guarantees, the ability of the State treasury to make such an appropriation and its fiscal impact on other State programs has never been carefully analyzed.

Thus, three questions need to be considered: (1) Whether there is any constitutional mechanism for extending the State's credit without the necessity of a large appropriation which may not be fiscally sound or economically feasible; if not, whether AGSOC's proponents who have assumed the availability of access to the State's credit have any alternative suggestions for the financing of the corporation which should be statutorily treated at this time; (2) Whether this statute should incorporate a statutory procedure or requirement for voter ratification of any major investment proposal, funded by direct appropriation into a guarantee loan fund; and (3) Whether a constitutional amendment would be required to allow the State to guarantee AGSOC's loans.

III. DEPOLITICIZING THE AGSOC

The proponents of the AGSOC have conceived of this entity as operating as a private corporation subject to the very few qualifications imposed on it by federal law. Thus, the corporation is subject to the standard provisions of the Alaska Business Corporation Act, AS 10.05, except where inconsistent with the state or federal enabling legislation. The proponents have argued that AGSOC stands the best chance of being a success, (i.e., operating at a profit which will be shared in by most Alaskan residents) if it is structured as a completely private corporation. However, 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.

No matter how the AGSOC is ultimately designed, it would be foolhardy to believe that this entity would not quickly become highly politicized and ultimately, if it is successful, become an extremely powerful political force in the State. Assuming it is established as a private corporation, it would present the following issues:

A) AGSOC: A Fourth Branch of Government
A successful AGSOC, representing as it would the residents of the State of Alaska would in essence, become a fourth branch of government. It will be a fourth forum in which State environmental, social, economic and tax questions will be vigorously debated. The Governor's control over this, corporation is limited to appointing the first board of directors. After that the corporation will, as presently designed, operate completely independent of any state agency, albeit it will be subject to all applicable state regulatory provisions. Given the composition of the corporation, it would become quickly susceptible to the pressures of any cohesive organized group of residents within the State, such as large labor unions, native corporations, etc. That is, any private organization containing a large number of resident votes could well form a block in the nature of a voters' trust, which could be used to gain control, or at least to form an influential minority on the board of directors.

The board, and indirectly management, would be subject to election by the same or a similar constituency as the Governor of the State. Thus, the chairman of the board could conceivably end up representing a larger number of Alaskan residents than the Governor of the State. The Governor would be put in the somewhat anomalous position of dealing with a more popular, albeit apolitical, leader representing the fourth estate, i.e., AGSOC.

Although one could argue that AGOSC violates the fundamental political theory of the State Constitution which established only three branches of government, this objection is more of a philosophical one than a legal one, and it is not anticipated that any such challenge could be successfully formulated and presented to the State courts. Finally, under this general category of concerns relating to its impact on the present institutional balance of power as contemplated by the State Constitution, it should be noted that management of the corporation, members of the board of directors of the corporation, could, and very well might, utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office.

B) Specific Constraints: Lobbying and Political Contributions. Since AGSOC will purport to represent the people of the State of Alaska, it could be argued that since that function is also served by the Governor of the State and by the legislature in the political arena, AGSOC should be prohibited from participating in that same arena, or at least be made subject to stringent restrictions. It is suggested that AGSOC should be prohibited from lobbying, from making political contributions to candidates for State offices, and that strict proxy review mechanisms should be added to the bill to ensure that the board of directors act in a politically neutral fashion. For instance, AGSOC's board, in its annual report, would be allowed to analyze the impact of State taxes on its percapita dividends. However, the board would not be able to affirmatively encourage the shareholders to write their legislators and call for a lower rate of taxation. The shareholders would have to draw their own conclusions. Obviously, the shareholders would then be allowed to contact their legislators and express their opinion on the subject.

Furthermore, a AGSOC endorsement of a political candidate would obviously be a cherished one. Even though AGSOC's proponents at present claim that this corporation is merely another private corporate entity, we have absolutely no guarantees that management in future years will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic policy preferences implemented by vigorous participation in the political arena. AGSOC endorsements and political contributions might therefore best be prohibited.

C) Litigation With The State. AGSOC, just like any other major corporate entity, would become subject to various State regulatory laws, and the possibility for confrontation is obvious. For instance, should AGSOC become the vehicle for financing the gas line, AGSOC would have a corporate interest in raising the tariff on the pipeline which would be assessed against the State, and the State as producer and shipper would have an interest in lowering the tariff in order to maximize State royalty and severance tax revenues to the treasury.

In addition, the proponents of AGSOC have stated on several occasions that in order for it to result in tangible benefits to the individual Alaskan shareholder, it must invest in vast development projects which will involve vast returns (hopefully). Thus, there is every likelihood that AGSOC would become a major force for concentration of economic power in the State and might ultimately develop or acquire monopoly control over one or more economic sectors. This, in turn, would present anti-trust problems, both under state and federal law, and the following scenarios are possible: 1) Since AGSOC is not a State agency, it would not enjoy the "state action" exemption from the federal anti-trust laws and it would likewise be subject to treble damage actions for any economic injuries arising out of violations of the Sherman or Clayton Anti-Trust Acts, 15 U.S.C., §1, et seq., and (2) The State could find itself litigating at great expense against AGSOC in order to require it to divest itself of various interests, or to require it to cease and desist from some specific anti-competitive practice.

The anti-trust example is one of many. It could occur in the environmental sector, the banking and securities area, the tax area, or in any other area of commercial endeavor. The State and AGSOC, if engaged in litigation with each other, would be drawing on resources which ultimately affect the same individuals, i.e., the taxpayers versus the shareholders. Should the State prevail and obtain a fine, such a fine would, itself, seem counterproductive.

Some suggestions for mitigating the underlying irony of the State litigating against the people of the State, i.e., AGSOC, and the potential for enormous waste of common resources which is inherent in any extensive litigation such as a protest of a pipeline tariff, might be as follows:

1) When a dispute arises between the State and AGSOC, the matter could be held in abeyance until the next legislature to allow the latter to determine by legislation the proper resolution of the matter; or the matter could be submitted to an arbitration panel established by statute.

2) Other means of controlling litigation between AGSOC and the State would be to create a disincentive to any litigation. One such disincentive would be a modification of the court rules relating to the award of costs and attorney's fees to provide that the State would always be entitled to receive its actual costs and attorney's fees incurred in the litigation of any action involving AGSOC. In addition, AGSOC's right to costs and attorney's fees would arise only in those cases where the court makes an express finding that the State's prosecution or defense was frivolous or lacking in good faith.

IV. CORPORATE DEMOCRACY

One of the most important policy questions which must be addressed in any analysis of AGSOC is whether or not resident shareholders' right to participate in and to influence corporate decision making is adequately protected or assured by the normal corporate procedures set forth in AS 10.05. The following is a list of specific issues which the administration and the legislature should address in its analysis of the AGSOC legislation:

1) Classified Directors. The present sponsor substitute provides for a board of directors consisting of nine members divided into three classes of three members each. Three directors will therefore be eligible for an election during any one year. See AS 10.50.030. A highly classified

board of directors such as this would limit the ability of minorities within the State to obtain representation on the board of directors. Every shareholder has one vote, and if all nine directors were elected at the same time, there is a greater opportunity for minorities such as native organizations, etc., to elect at least one board member. A highly classified board would tend to heavily favor urbanized Alaska.

2) Cumulative Voting. AS 10.05.162 presently provides that shareholders may, at an election for directors, cumulate their votes by giving one candidate as many votes as the number of directors to be elected, multiplied by the number of that shareholder's shares. However, a corporation may provide in its bylaws (modified by board of directors' resolutions) that shareholders cannot cumulate their votes but must vote shares held by them on an election-by-election basis. Cumulative voting is another device to help ensure minority representation on the board of directors. By leaving it optional, as stated in AS 10.05.162, the board of directors could amend the bylaws to prohibit cumulative voting. It is suggested that it might be desirable for the AGSOC legislation to expressly state that cumulative voting cannot be prohibited by shareholder or by director action.

3) Voting Trusts. In accordance with AS 10.05.171, voting trusts may be created by any number of shareholders who wish to confer upon a trustee the right to vote or otherwise represent the shareholders for a period not exceeding ten years. The existence or toleration of voting trusts within the AGSOC context is a question which should be carefully analyzed. At this point in time, it is suggested that their prohibition might be advisable or at least a limitation imposed on the number of years that they can remain in existence. For instance, AGSOC proponents indicate that the original AGSOC will be coming back to the legislature for each major investment proposal. Thus, within a ten-year period, two or three major investment schemes may have been considered and acted upon, and a ten-year voting trust would allow a trustee undue amount of influence over any of these decisions.

4) Amendment of The Articles of Incorporation. AS 10.05.276 presently provides that the board of directors shall adopt a resolution setting out a proposed amendment directing that it be submitted to a vote at the annual or special meeting of the shareholders. Thus, it appears that the initiative to amend the articles must come from the board, and it may be desirable to provide for an amendment which would allow the shareholders to propose amendments to the articles of incorporation that can be taken up and voted on at annual meetings.

5) Quorum of Shareholders. AS 10.05.153 presently provides that, unless otherwise provided in the articles of incorporation, the majority of the shares entitled to vote constitutes a quorum in a meeting of shareholders. (The section provides for a minimum of one-third of the shares.) The quorum requirement is something that the legislature may wish to mandate by statute. Here, of course, the higher the quorum requirement, the greater the difficulty the corporation will have in holding an annual meeting. However, a high quorum requirement would necessitate vigorous promotional and euucational programs to ensure the presence of the quorum at each annual meeting and might indirectly spur thcorporation to greater efforts to include or request the participation of all shareholders of the State in corporate decision making.

6) Notice of Meetings of Shareholders. AS 10.05.138 presently provides that meetings of shareholders may be held at the place (either inside or outside the State) as may be provided in the bylaws. In addition, an annual meeting of the shareholders shall be held at the time provided in the bylaws. Special meetings of the shareholders may be called by the president, the board of directors, and holders of not less than one-tenth of all the shares entitled to vote at the meeting.

AS 10.05.141 in addition requires written or printed notice of all meetings, such notice shall be delivered not less than ten nor more than fifty days before the date of the meeting, either personally or by mail.

Obviously, together these rules operate to favor incumbent management. Annual meetings could be rescheduled by a change in the bylaws which requires a vote of the board of directors. The board could, on short notice, i.e., as little as ten days, present the shareholders with any major issue it chose, such as the election of new directors or consideration of a major investment proposal.

The legislature might well wish to consider statutory safeguards which would ensure adequate notice of the time, place and purpose of any meeting which would preclude manipulation of the timing of any meeting to the advantage of the incumbents.

7) Bylaws. AS 10.05.135 presently provides that the board of directors shall have the power to alter, amend or repeal the bylaws unless it is reserved to the shareholders by the articles of incorporation. Again, it is suggested that the amendment of the bylaws might be a power which should be reserved to the shareholders in order to ensure adequate public review of any change in the management's approach to the conduct of the corporation's business.

8) Financing of Proxy Fights, Access to Voting Lists and Mailing Machinery. Several commentaries concerning modern corporate battles note the inherent advantage which incumbent management has through its control of the corporate machinery for sending out mailings, soliciting support, and arguing its cause before the shareholders. This is done at corporate expense, whereas opposing or dissenting shareholders frequently have to finance such efforts from private sources. Amendments might well be considered which would allow shareholders who can obtain a certain number of qualified signatures to utilize the corporation's mailing machinery at the corporation's expense. This procedure should be especially encouraged in the context of elections for the board of directors. Candidates who can either obtain a nomination by the board of directors or the support of a predetermined percentage of the shareholders should be entitled to publish information concerning themselves, their experience, their policy preferences and their criticisms of existing management at the corporation's expense.

V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

Two other constitutional issues should be mentioned briefly in this context. First, the federal legislation authorizing the creation of GSOC mandates that the shareholder group be made up of a closed class (i.e., those residents who satisfy the eligibility requirements imposed by state law as of the date of the state charter, and who remain residents as of the date of the issuance of the shares). Thus, future residents would be ineligible for one of the free shares of AGSOC. Under Kelso's present plan, AGSOC shareholders who leave the state and become nonresidents would be entitled to retain their dividends and voting rights in AGSOC. Persons leaving the state who wish to sell their shares could, of course, sell to new residents who wish to participate in the AGSOC. In addition, oldtime residents could acquire as many as ten shares in AGSOC through purchase or inheritance.

These two factors, when combined, could lead to the following scenario: The initial one hundred percent of the AGSOC shares could be concentrated in as few as ten percent of the original shareholders. Those shareholders, in turn, could become residents of other states, and thus it is theoretically possible that ten or twenty years from the original issuance, AGSOC shareholders could be composed of a select group of resident Alaskans and nonresident former Alaskans. Ironically, it may be at this very time that the state may be called upon to honor its guarantee, and thus the state's credit rating and ability to issue bonds at favorable interest rates would be adversely affected, and the people who would be called upon to bear the burden of AGSOC adventures would be the taxpaying class of Alaskans at that time. This potential for a sharp dichotomy between the shareholder class of AGSOC and the resident population of the state deserves closer analysis. Kelso's report contains no estimates of the transiency rates of the Alaskan population and no projections as to the future composition of its AGSOC.

The legal issue which overlaps this general policy question is whether or not the closed class nature of the AGSOC offends the equal protection provisions of the state or federal constitutions. Wilmer, Cutler & Pickering, in their memorandum of December 15, 1978, on the constitutional issues, felt that such a provision might be successfully defended against a federal constitutional challenge. A closer question is presented under the state constitutional provision which has been interpreted somewhat more stringently than its federal counterpart. See Isakson v. Richey, 550 P2d 359 (Alaska 1976). Under this provision, a substantial question is raised as to whether or not the AGSOC arbitrarily discriminates against future residents of the state.

Secondly, a derivative issue is whethe or not the use of the public credit for the direct benefit of a private corporation whose shareholders will, over time, form a distinct class within the state (possibly a minority class) qualifies under the "public purpose" requirement of Article IX, §6 of the Alaska State Constitution.

MEMORANDUM

TO: Rep. Jim Duncan

FROM: Jerry Gauche

RE: Policy & Legal Issues Surrounding AGSOC

DATE: April 4, 1979

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

I. TAXATION

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

A. State Income Tax.

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

B. Other State Taxes.

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

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

C. Potential Investments.

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

D. Policy Questions.

1. Pressure for Development.

Oil and gas development is one of many possible investments which may be explored by AGSOC. According to the Attorney General such an investment would encourage rapid exploitation of these resources because Alaskans would benefit directly. This suggests that if the people of Alaska benefit directly from development they will act irresponsibly with respect to Alaska's resources. The status quo avoids any push for exploitation because Alaskans benefit only from taxes on the development earnings of outside corporations.

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

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

2. State Revenues vs. AGSOC Income.

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

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

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

II. "DEPOLITICIZING" AGSOC

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

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

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

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

A. Specific Limitations.

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

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

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

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

1. Block Voting.

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

2. Political Popularity.

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

3. The Springboard.

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

B. Litigation with the State.

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

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

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

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

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

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

REVENUE ACT OF 1978

Report of the Committee on Finance

United States Senate

H.R. 13511

J. General Stock Ownership Corporations

(Sec. 201 of the bill)

Present law

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

Reasons for change

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

Explanation of provisions

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

Definition of GSOC.—The bill provides that a corporation must meet certain statutory tests in order to be treated as a GSOC. First, the corporation must be chartered by an official act of the State legislature or by a State-wide referendum. Second, the GSOC's corporate charter must provide for the issuance of all authorized shares to eligible individuals provided that at least one share is issued to each eligible individual, and such eligible individual does not elect within one year after the date of issuance not to receive such share, and provides for certain restrictions on the transferability of the share. The transfer restriction must provide that the share cannot be transferred until the earliest to occur of (1) the expiration of 5 years from issuance (2) death or (3) failure to meet the State's residency requirements. In no event may shares of stock of a GSOC be transferred to nonresidents. Also, an individual may not acquire more than 9 shares by purchase. Third, the charter must provide that the GSOC is empowered to invest in properties (not including properties acquired by it or for its benefit through the right of eminent domain). Fourth, the GSOC may not be affiliated with any other corporation. Fifth, the GSOC must be organized after December 31, 1978, and before January 1, 1984. An eligible individual is any individual who is a resident of the chartering State as of the date specified in the corporate charter. A State may define a resident for purposes of its GSOC so long as such definition is consistent with constitutional principles.

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

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

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

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

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

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

Taxation of shareholders.—Under the bill, each shareholder would include in his gross income his daily prorated portion of the GSOC's taxable income. Such income would be included in the shareholder's gross income for the taxable year in which or with which the GSOC's taxable year ends. The income in the hands of the shareholder would be treated as ordinary income and would not be eligible for either the partial dividend exclusion (sec. 116) or the maximum tax of earned income.

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

Taxation of GSOC distribution.—Under the bill, distributions from a GSOC's taxable income previously taxed to a shareholder would be treated as a tax-free distribution. Any distribution in excess of such previously taxed income would be taxed in the same manner as a distribution from a regular corporation (sec. 301(c)).

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

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

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

Withholding requirements.—The bill requires the GSOC to withhold an amount equal to 25 percent of every distribution made to its shareholders. The amount of such withholding would be allowed as a refundable credit to the shareholder. The Treasury would be authorized to issue regulations providing a certification procedure for individuals who are nontaxpayers under which they may be exempted from the withholding requirement.

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

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

Effective date

The provision applies to corporations chartered and organized after December 31, 1978.

Revenue effect

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

No. 168—Part IV

Congressional Record

United States of America

PROCEEDINGS AND DEBATES OF THE 95th CONGRESS, SECOND SESSION

Vol. 124 WASHINGTON, SATURDAY, OCTOBER 14, 1978 No. 168—Part IV

Senate

GENERAL STOCKOWNERSHIP PLANS

Mr. GRAVEL. Mr. President, I would like to take a moment to compliment the Senate on one provision of this bill. This tax bill goes far toward stimulating the much needed growth of capital in our economy. But, there is one provision in this bill, a provision which I am proud to say was added by the Senate, which addresses the question of who will own this new capital.

The Joint Economic Committee estimated in 1974 that 1 percent of our population owned 25 percent of our wealth and more than 50 percent of all corporate stock. Studies indicate that these concentrations of wealth have not changed significantly in 50 years despite all our efforts at income redistribution and amelioration of poverty. The amendment regarding general stockownership plans in this bill is a significant step toward broadening the ownership of American wealth.

Leadership on the issue of broadening capital ownership has long and ably been carried by my colleague and friend, the chairman of the Finance Committee. His work in the area of employee stock ownership plans has laid the foundation for Federal policy on expanded capital ownership. Following in his footsteps I sought to extend the concept of broadened capital ownership beyond the employer employee relationship. The general stock ownership plan legislation contained in this bill is an important step in that direction. I would lke to thank Chairman LONG for his help in seeing these provisions adopted and to thank my fellow Finance Committee members who were supportive of my efforts.

There are a number of questions which my colleagues have put to me over the past few months and I would like to include some explanation of these issues for the RECORD.

First. What is a general stockownership corporation and how is it organized?

A general stockownership corporation would be formed either by act of a State legislature or by statewide referendum and each resident would be issued a share of stock. The residents would not be charged for their stock and would receive it free and clear. The corporation would borrow money to invest in profit-making ventures with the loan secured by the assets and, if necessary, by a State guarantee. Through this method the citizens of a State would become owners of capital. The earnings from the GSOP investments would be used to retire the loan and the balance distributed to the shareholders.

Second. What sort of technical requirements must be met in order to establish a general stock ownership corporation?

The bill authorizes States to establish privately owned GSOC's for the benefit of their citizens. A GSOC is a private corporation chartered by an act of a State legislature or by statewide referendum with a charter providing for first, the issuance of at least one share of stock to each eligible individual who does not elect within 1 year from the date of issuance not to receive such share; second, restrictions on transferability of shares (a) to nonresidents, (b) to an individual owning more than 9 shares or (c) until the earliest to occur of 5 years, upon [illegible] death, or failure to meet the State residency requirements. The GSOC must be chartered after December 31, 1978 and before January 1, 1983 and may not own more than 20 percent of any subsidiary corporation. GSOC investments are not limited, but a GSOC may not acquire a business from an unwilling seller through the State's power of eminent domain. This limitation does not apply to the State's power to acquire a right-of-way for a particular project, but precludes the involuntary sale of a business to the GSOC.

Third. What does the legislation mean when it refers to stock being distributed to "eligible individuals?"

An eligible individual is any individual who is a resident of the chartering State as defined in the State's enabling legislation so long as the definition is consistent with constitutional principles.

Fourth. GSOC's are entitled to taxation in a unique manner. What is the special tax treatment of these corporations?

GSOC's may elect to be exempt from Federal income taxation. The shareholders of an electing GSOC will report their proportionate share of the GSOC's taxable income on their Federal individual income tax returns. The election, made in a manner to be determined by regulation, is effective for the taxable year for which made on a timely filed return. The election may be terminated with, the consent of the Secretary of Treasury. It would be appropriate for the Secretary to consent to revocation for a taxable year where the tax liability of GSOC shareholders significantly exceeds cash distributions. Once the election is terminated the GSOC is subject to the normal Federal income tax and may not reelect. The taxable year of an electing GSOC shall end October 31, unless the Secretary of Treasury consents to a different taxable year.

A GSOC will compute its taxable income in the same manner as other corporations, but is not eligible for a dividends received deduction nor any tax credits. The GSOC is entitled to a 10-year carryover of any net operating losses. An audit adjustment resulting from an Internal Revenue Service final determination will be reflected in the [illegible] year in which such adjustment is made and not the taxable year to which it relates. The amount of such adjustment will be subject to an interest charge in an amount computed as though the income had been taxed to a nonselecting corporation.

Fifth. The corporation itself does not pay Federal income tax, but the income of the corporation is taxed to the shareholders?

Yes, each shareholder will include in his gross income his daily prorated share of the GSOC's taxable income. The shareholder will also be entitled to his pro-rata share of the GSOC investment credit and liable for any recapture computed at the corporate level. Income, credits and recapture will be included in the shareholder's gross income and reported on his return for the taxable year in which or with which the GSOC's taxable year ends. The income will be treated as ordinary income to the shareholders and will not be eligible for either the partial dividend exclusion—section 116—or the maximum tax on earned income. The shareholders of the GSOC will not be eligible to report any portion of a GSOC net operating loss on their returns and neither the corporation nor the shareholders will be entitled to the foreign tax credit on taxes paid by the GSOC.

Sixth. What about the shareholder's basis in his stock?

Shareholders will increase the tax basis of shares of GSOC stock to the extent they report income from the GSOC. Shareholders not required to file returns will increase the tax basis of shares to the extent they were attributed income from the GSOC. Distributions from the GSOC out of previously taxed income will decrease the tax basis of such shares.

Seventh. What about distributions of the stock itself, will the shareholder be taxed upon receipt of the stock and will [illegible] in his share at the time of receipt?

If the shares are distributed before any investment has been made by the GSOC, the shares will be treated as having a zero value as of the date of receipt. Therefore, no income would accrue to the [illegible] receipt and no tax liability would be of benefit. If investments have been made, the valuation of the shares should be made on a net asset basis so that if the GSOC investment were 100 percent leveraged, the shares distributed would have zero value and no income would accrue. If the shareholder receives his shares free of tax, he would have a zero basis in his stock at the time of receipt.

Eighth. If the GSOC shareholders are taxed on the income of the corporation, how do they receive this income and what is the treatment of distributions?

Distributions from a GSOC's taxable income previously taxed to a shareholder will be treated as a tax-free distribution. Any distribution in excess of such previously taxed income will be taxed in the same manner as a distribution from a regular corporation—section 301(c). Such distributions will first be treated as a tax-free reduction in basis to the extent thereof with any distribution in excess of basis treated as income from the sale or exchange of a capital asset. A GSOC will be required to distribute 90 percent of its taxable income to its shareholders by January 31 of the next succeeding year. To the extent a GSOC fails to meet this distribution requirement, a tax equal to 20 percent of the difference between the required distribution and the actual distribution is imposed on the GSOC. The amount of such tax is allowed as a deduction to the GSOC for the year in which it is paid.

Ninth. Are there any special filing requirements for GSOC's?

GSOC's are required to file Federal income tax returns meeting the timing requirements of regular corporate returns and showing information reported to each shareholder. GSOC's are also required to provide each shareholder a form 1099 showing the shareholder's—first, pro-rata income from the taxable year; second, tax-free distributions for the year; third, tax treatment of other distributions; fourth, amount of any investment credit or recapture for such year; and fifth, amount withheld for Federal income tax purposes. Regulations implementing the reporting requirements and other provisions of subchapter U should be given priority in light of the limited time within which GSOC's may be chartered.

Tenth. If the GSOC distributes all of the shareholder's portion of the GSOC earnings, what is to prevent the shareholder from spending this money prior to tax time and being left with a tax liability and no cash?

GSOC's must withhold an amount equal to 25 percent of every distribution made to their shareholder except shareholders who, under regulations issued by the Treasury, certify that they are nontaxpayers. The amount of such withholding will be allowed as a refundable credit to the shareholders.

Eleventh. Will the GSOP really be a breakthrough in the battle to broaden capital ownership. If so how will we know?

GSOC's are required to file annual reports with the Treasury summarizing their operations for each year. As the primary sponsor of the GSOC provisions I intend that these reports include studies of the effect of the GSOC on distribution of income and wealth, the level of transfer payments made or required, the social and demographic profiles of GSOC shareholders, the level of economic understanding of GSOC shareholders, and possible beneficial revisions to the GSOC legislation. The bill also requires the staff of the Joint Committee on Taxation to undertake a study of the operation and effect of GSOC's on capital formation, income and capital distribution, competing businesses, integration of the corporate and personal income tax, and the workability of the dividend withholding system. Through these studies I hope we can quantify the effect of GSOC's on expanding capital ownership. I would also like to see the Joint Committee address the broader question of capital ownership in our society and suggest to the Congress a system for annual measurement of our progress in broadening the ownership of capital in America.

federal register

THURSDAY, DECEMBER 14, 1978
PART III

THE NATIONAL ARCHIVES OF THE UNITED STATES • 1934 •

SECURITIES AND EXCHANGE COMMISSION

SHAREHOLDER COMMUNICATIONS

Shareholder Participation in the Corporate Electoral Process and Corporate Governance Generally

[8010-01-M]

Title 17—Commodity and Securities Exchanges

CHAPTER II—SECURITIES AND EXCHANGE COMMISSION

[Release Nos. 34-15384; IC-10510]

SHAREHOLDER COMMUNICATIONS, SHAREHOLDER PARTICIPATION IN THE CORPORATE ELECTORAL PROCESS AND CORPORATE GOVERNANCE GENERALLY

AGENCY: Securities and Exchange Commission.

ACTION: Final rules.

SUMMARY: The Commission today issued a release announcing the adoption of proposed rule, form and schedule amendments intended to provide shareholders with information to assist their more informed assessment of the structure, composition and functioning of issuers' boards of directors. The Commission also is adopting rules which afford shareholder-proponents an opportunity to review the accuracy of management statements in opposition to shareholder proposals prior to the mailing of issuers' proxy soliciting materials and which provide information about the terms of settlement of proxy contests.

EFFECTIVE DATES: The amendments to regulation 14A and schedule 14A are effective for fiscal years ending on or after December 25, 1978 for initial filings on or after January 15, 1979. The amendments to forms 8-K, 10-Q and N-1Q are effective for all issuers for filings made on or after January 15, 1979 for periods ending on or after December 25, 1978.

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SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today issued a release announcing the adoption of amendments to regulation 14A (17 CFR 240.14a-1 et seq.) and schedule 14A (17 CFR 240.14a-101) under the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq., as amended by Pub. L. No. 94-29 (June 4, 1975)], as well as related amendments to forms 8-K (17 CFR 249.308) and 10-Q (17 CFR 249.308a) thereunder and to form N-1Q (17 CFR 274.106) under the Investment Company Act of 1940 [15 U.S.C. 80a et seq.]. These amendments are intended to improve the information available to shareholders regarding (1) the structure, composition and functioning of issuers' boards of directors; (2) resignations of directors; (3) attendance at board and committee meetings; and (4) the terms of settlements of proxy contests. A rule which provides shareholder-proponents with an opportunity to review the accuracy of management statements in opposition to shareholder proposals prior to the mailing of issuers' proxy soliciting materials also has been adopted. A related proposal, which would have required disclosure of the voting policies and procedures of institutions subject to the Commission's proxy rules, which exercise voting rights with respect to equity securities held for [1] their own accounts or for the accounts of others, has been withdrawn.

I. Background

In April of 1977, the Commission authorized its staff to institute a broad re-examination of its rules relating to shareholder communications, shareholder participation in the corporate electoral process and corporate governance generally. As explained in Securities Exchange Act Release No. 13482 (April 28, 1977), 42 FR 23901 (May 11, 1977), the decision to undertake the study was based, in large part, on expressions of concern about the efficacy of existing mechanisms of corporate accountability, including proxy solicitations and the corporate electoral process. Preparatory to holding public hearings, written comments were solicited on a number of questions relating to: (1) the adequacy of existing avenues of communication between shareholders and corporations, and, particularly, whether shareholders should be provided with more information than is now available with respect to socially significant matters affecting their corporations; (2) whether Rule 14a-8, regarding shareholder proposals, should be amended to further facilitate the presentation of shareholder views and concerns in the corporate proxy materials; (3) the role of shareholders in the corporate electoral process; and whether the Commission should amend its proxy rules to provide shareholders access to corporate proxy materials for the purpose of nominating persons of their choice to serve on boards of directors; and (4) whether additional disclosure relevant to an assessment of the quality and integrity of management should be required. The Commission also raised general inquiries concerning the need for Federal minimum standards or Federal chartering legislation, the role of the self-regulatory organizations in improving corporate governance, and the costs and benefits associated with various regulatory approaches.

In the fall of 1977, the Commission held public hearings on these and related issues[2] in Washington, D.C., Los Angeles, New York and Chicago. More than 300 individuals and organizations testified or submitted written comments on a large number of issues ranging from narrow technical questions arising under existing proxy rules to broad, philosophical inquiries concerning means by which corporations can be made more responsive to shareholders and the public at large.

As discussed in greater detail in Securities Exchange Act Release No. 14970 (July 18, 1978), 43 FR 3[illegible] (July 24, 1978), the participants in the public comment and hearing phase of this proceeding expressed diverse opinions with respect to the scope of existing problems in corporate governance and corporate accountability and the means by which reform could best be achieved. There was, however, general support for the proposition that a strong board of directors, able to exercise independent judgment, is a critical element of corporate accountability. Various means of promoting more effective boards of directors were suggested, including promulgation by the Commission of disclosure requirements which would provide shareholders with better information concerning the composition, structure and functions of corporate boards, and thus indirectly encourage the adoption of more effective corporate governance mechanisms.

Based on its review of the comments and testimony submitted in this proceeding, as well as its experience in administering and enforcing the Federal securities laws, the Commission determined that shareholders may need additional information about the structure, composition and functions of corporate boards of directors and, therefore, on July 18, 1978, proposed for public comment the rule proposals discussed herein. In announcing their publication, the Commission indicated that the proposals represented the first stage of the Commission's response to the issues raised in its ongoing corporate governance study and would be followed by publication of a staff report on other important questions then under consideration, pos-

[1] See Securities Exchange Act Release No. 15385, also published today.

[2] Securities Exchange Act Release No. 13901 (August 28, 1977) contains a statement of the issues on which testimony and comments were requested. The identification of these issues was based, in part, on the public comments received in response to its prior release. Transcripts of the hearings and comment letters submitted during the hearing phase of the proceeding are available for inspection at the Commission's Public Reference Room, 1100 L Street NW., Washington, D.C. (File No. S7-693).

ble additional rule-making proposals and/or legislative recommendations.

The proposals evoked an enormous public response. In total, almost 600 individuals and organizations submitted letters in response to the Commission's request for public comments. Many of the thoughtful and comprehensive views expressed provided the Commission with helpful insights in its further consideration of the proposals.

By far the most controversial portion of the proposals was proposed item (6)(a)(6) of schedule 14A, which would have required that directors be identified as "management," "affiliated nonmanagement" and "independent." The use of the term "independent," in juxtaposition with statements in the release concerning the Commission's views about the importance of a strong board of directors capable of exercising independent judgment, and the desirability of key standing committees composed entirely of persons independent of management, provoked considerable controversy. Commentators asserted that the term "independent" conveyed a value judgment on the part of the Commission that persons meeting the Commission's definition of "independent" not only are preferable to "management" or "affiliated nonmanagement" directors but are, in fact, the only persons who are capable of exercising disinterested oversight and independent judgment. Further, a large number of commentators, on the erroneous assumption that certain of the proposals were designed primarily to influence corporate conduct rather than to provide useful information to shareholders, contended that these proposals were beyond the Commission's statutory authority.

The Commission believes that the rules adopted today will facilitate informed voting decisions and promote fair corporate suffrage and are an appropriate exercise of its rulemaking authority under section 14(a) of the Securities Exchange Act. The rules do not, as some commentators thought, constitute a regulatory effort by the Commission to prescribe or determine board composition or corporate governance mechanisms. The legislative history of the federal securities laws reflects a recognition that disclosure, by providing corporate owners with meaningful information about the way in which their corporations are managed, may promote the accountability of corporate managers.[3] Thus, while the federal securities laws generally embody a disclosure approach, it has long been recognized that disclosure may have beneficial effects on corporate behavior.[4] Accordingly, although the Commission's objective in adopting these rules is to provide additional information relevant to an informed voting decision, it recognizes that disclosure may, depending on determinations made by a company's management, directors and shareholders, influence corporate conduct. This sort of impact is clearly consistent with the basic philosophy of the disclosure provisions of the federal security laws.

After careful analysis of the comments which were submitted, the Commission has concluded that the rules adopted today will provide useful information to shareholders. In some respects it appears that certain of the rule proposals might have raised inferences unintended by the Commission. The Commission has, therefore, revised the proposals in several respects as discussed below.

II. DISCLOSURE OF BOARD COMPOSITION—ITEM 6(B)[5]

Item 6(a)(6), as proposed, would have required issuers, other than investment companies registered under the Investment Company Act of 1940, to identify each nominee and each director whose term of office as a director will continue after the annual meeting as an "independent," "affiliated nonmanagement" or "management" director, as those terms were defined in an instruction accompanying the item. In the case of an "affiliated nonmanagement director," issuers would have been required to describe the nature of the relationship by reason of which the nominee was so deemed.

As defined in the instruction to proposed item 6(a)(6), the term "management director" included, in addition to an officer or employee of the issuer, an officer or employee of any parent, subsidiary or other affiliate of the issuer. The term "affiliated nonmanagement director" referred to persons having certain specified economic and personal relationships to the issuer and its management. An "independent director" was defined as an individual who is neither a "management director" nor an "affiliated nonmanagement Director." However, the instruction indicated that designation of a nominee as an "independent director" would be inappropriate if the issuer is aware of relationships between the nominee and the issuer which, under the circumstances, reasonably could be viewed as interfering with the nominee's exercise of independent judgment.

In the release announcing publication of this proposed item, the Commission expressed its view that "the interests of shareholders are best served by a board of directors which is able to exercise independent judgment, ask probing questions of management and bring to the company a broader perspective than that of management." The Commission further expressed its belief that board composition is of such importance that shareholders whose proxies are solicited with respect to an election of directors should be provided with information concerning the affiliations of board members and nominees with management. Additionally, the Commission stated that the terms "independent" and "affiliated nonmanagement," as defined in proposed item 6(a)(6), were intended to distinguish between nonmanagement directors who are completely unaffiliated with the issuer and its management and those having certain business or personal relationships. The Commission recognized that the terminology it proposed to express this distinction might not be ideal and, therefore, specifically solicited suggestions for alternative terms.

Almost all of the comment letters contained an assessment of proposed item 6(a)(6) and, in fact, many commentators dealt only with this issue. Many believed that the proposal would place too much emphasis on disclosure concerning independence, to the exclusion of information regarding other attributes which are desirable for directors to possess, and a large number of commentators questioned whether the independence of a director can be ascertained solely from a description of his affiliations with the issuer. Nevertheless, there was substantial support for the proposition that shareholders should receive information on the proxy statement concerning the business and personal relationships of directors to the issuer. Commentators' views concerning the desirability of additional disclosure varied greatly. On the one hand, many commentators who acknowledged the usefulness of such information to shareholders in exercising their franchise asserted that current disclosure

[3] Under section 14(a), the Commission is charged with the responsibility of regulating the proxy soliciting process in order to assure "fair corporate suffrage" for every security holder, and to assure that each "stockholder [has] adequate knowledge as to the manner in which his interests are being served." H.R. No. 1383, 73d Cong. 2d Sess. 13 (1934); S. Rep. No. 792, 73d. Cong., 2d Sess. 12 (1934). In section 14(a), the Congress granted the Commission the authority to promulgate "such rules and regulations * * * necessary or appropriate in the public interest or for the protection of investors."

[4] See, e.g., S. Rep. No. 47, 73 Cong., 1st. Sess. 7 (1933); Brandeis, "Other People's Money" 92 (1932 ed.); Frankfurter, "The Federal Securities Act II," Fortune Mag. 53, 55 (Aug. 1933); Anderson, "The Disclosure Process in Federal Securities Regulation: A Brief Review," 25 Hastings L. J. 311, 318, 330 (1974). See generally, "Laurenzano v. Einbender," 264 F. Supp. 356 (E.D.N.Y. 1968).

[5] Item 6(b) corresponds to proposed item 6(a)(6)(i) and would apply to issuers other than registered investment companies.

requirements, specifically items 6 and 7 of schedule 14A,[6] provide sufficient information concerning director affiliations and conflicts of interest for shareholders to make reasonable judgments concerning the independence of directors. On the other hand, a large number of commentators stated that additional information regarding the business and personal relationships of nominees would be useful to shareholders.

Virtually all of the commentators expressed opposition to the proposed requirement that nonmanagement directors be identified in the proxy materials as "independent" or "affiliated." These commentators asserted that the use of these categories would provide no additional useful information to, and would, in fact, mislead or confuse, shareholders because the term "independent" attempts to reflect a state of mind which is not susceptible of measurement by reference to the existence or non-existence of certain relationships. Some commentators asserted that directors identified as other than "independent" would be perceived as incapable of exercising independent judgment and as a result corporations would be encouraged, in nominating persons to serve as directors, to select candidates on the basis of their lack of certain defined relationships with the issuer rather than their expertise or experience. Similarly, it was argued that otherwise well-qualified persons who would be designated as "affiliated" or "management" directors would be unwilling to serve. Without necessarily agreeing with all of these assertions, on balance the Commission has determined that a requirement that directors be categorized should not be adopted at this time.

The Commission recognizes the fact that the nonexistence of a particular economic or personal relationship with the issuer does not determine the quality of a nominee's performance on the board. The extent to which nominees possess other intangible attributes such as strength of character and good business judgment is also important. While an individual's capacity to render independent judgment is, in the final analysis, a qualitative matter, the nature and scope of a director's relationship with the issuer and its management certainly bears upon his independence, and, in the Commission's view, infomation respecting such relationships should be provided to shareholders when they exercise their franchise.

Thus, as adopted, item 6(b) requires a brief description, in tabular form to the extent possible, of any of certain significant economic and personal relationships which exist between the director and the issuer. These relationships are similar to those by virtue of which a director would have been deemed an "affiliated nonmanagement director" under proposed item 6(a)(6), but with several modifications.[6a]

A. FORMER OFFICERS AND EMPLOYEES

As proposed, the term "affiliated nonmanagement director" would have included any person who, within the last five years, had been an officer or employee of the issuer or any of its parents, subsidiaries or other affiliates.[7] Information concerning the principal occupations and employment of a nominee during the past five years, including the name and principal business of any organizations in which those occupations are carried on, is currently required to be disclosed pursuant to item 3(e) of Regulation S-K. Paragraph (1) of item 6(b) as adopted requires that if the organization is a parent, subsidiary or affiliate of the issuer that fact be disclosed as well.

B. RELATIVES OF OFFICERS

As proposed, the term "affiliated nonmanagement director" would have included a person who is related to an officer of the issuer, or any of its parents, subsidiaries or other affiliates by blood, marriage or adoption (except relationships more remote than first cousin). The few commentators who addressed this issue opined that disclosure should cover relationships to "executive officers"[8] only, consistent with the new proxy disclosure requirements adopted by the Commission subsequent to the publication of the subject proposals,[9] because family relationships to officers who are not in policy making positions would not be of sufficient significance to warrant disclosure. The Commission agrees in part, and therefore, as adopted, paragraph (2) of item 6(b) requires disclosure only of relationships to executive officers of the issuer, any of its parents, subsidiaries or other affiliates. However, because of the control relationship between an issuer and its affiliates, the Commission believes it appropriate to require disclosure of relationships between the nominee and executive officers of the issuer's affiliates.

C. OFFICER, DIRECTOR, EMPLOYEE AND OWNER OF A SIGNIFICANT SUPPLIER OR CUSTOMER

(1) *Persons Included*

Proposed item 6(a)(6) would have included within the definition of "affiliated nonmanagement director" any person who is or has within the last two years been an officer, director, employee or owner of an interest in excess of one percent of the equity of an entity which, as customer or supplier of the issuer, had or will have business transactions of a specified magnitude with the issuer.

Many commentators expressed a preference for the approach taken in item 4(f) of regulation S-K[10] which, as a general matter, would not require the disclosure of certain transactions between the issuer and another entity in which the director has an interest if that interest arises solely from the directorship of, or ownership of less than ten percent of, the other entity. These commentators asserted that information concerning less significant relationships to the issuer would not facilitate a meaningful assessment of potential conflicts. A small number of commentators also objected to the inclusion of any employee of the other entity, arguing that employees, other than executive officers, may have no influence over the other entity or stand to benefit from its business transactions with the issuer.

The Commission disagrees with these comments. As adopted, paragraph (3) of item 6(b) would require a description of economic relationships of the same persons referred to in proposed item 6(a)(6). In the Commission's view, if there is a significant amount of business between the issuer and the other entity, the interest of an owner of a one percent equity interest or an officer, director or an employee of that entity in maintaining the business relationship is sufficiently great that the relationships should be disclosed. Shareholders would then be able to reach their own conclusions on the extent to which such interests may conflict with those of the issuer or may impact upon that person's performance as a director of the issuer. For purposes of clarification t

[6] See discussion of coordination with regulation S-K, infra.

[6a] While the rules adopted herein do not retain the director categories proposed in our July release, for convenience, these categories have been employed in the text of this release solely for the purpose of explaining our responses to comments on those proposals and discussing the affirmative disclosure requirements which are adopted herein.

[7] An "affiliate" of a specified person is defined as a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified. Securities Exchange Act rule 12b-2, 17 CFR 240.12b-2.

[8] The term "executive officer" is defined in the instructions to item 3(b) of regulation S-K to mean the president, secretary, treasurer, any vice president in charge of a principal business function (such as sales, administration or finance) and any other person who performs similar policy making functions for the registrant.

[9] See Securities Exchange Act Release No. 15006 (July 28, 1978), 43 FR 34402.

[10] See discussion of coordination with regulation S-K, infra.

phrase "in excess of one percent equity interest in" has been substituted for the phrase "in excess of one percent of the equity of."

(2) *Amount of Business Between the Issuer and its Customers or Suppliers*

The types and size of business relationships the existence of which would render a director "affiliated" were covered by subparagraphs (A), (B), (D) and (E) of instruction 3(iii) to proposed item 6(a)(6). Subparagraphs (A) and (B) referred to customers of the issuer which made payments during the issuer's last fiscal year or proposed to make payments during the issuer's next fiscal year in an amount in excess of one percent of the issuer's gross revenues for its last fiscal year or $1,000,000, whichever is less. Subparagraphs (D) and (E) referred to suppliers to the issuer to which the issuer made payments during such entity's last fiscal year or proposed to make payments during such entity's next fiscal year in an amount in excess of one percent of such entity's gross revenues for its last fiscal year or $1,000,000, whichever is less.

Many commentators who addressed this issue opposed retention of the $1,000,000 threshold on the theory that $1,000,000 represents such an insignificant portion of the revenues of large corporations that it would be unreasonable to draw any inference from the existence of such an inconsequential relationship. Others noted that large corporations, because of the relative insignificance to them of transactions aggregating $1,000,000 and the complexity of their operations, would find it virtually impossible to maintain and examine the records necessary to determine whether they had done business in that amount with a particular entity.

The Commission is persuaded that the concerns expressed with respect to the $1,000,000 threshold may be valid and has determined that an economic test of significance expressed in terms of a percentage of revenues may be more workable. Therefore, subparagraph 3(i), (ii), (iv) and (v) of the item 6(b), as adopted, contains an economic standard based on one percent of consolidated gross revenues.

Additionally, in adopting these subparagraphs in final form, the Commission has incorporated the suggestions made by several commentators that certain kinds of tranactions be excepted from the calculation of the magnitude of business between the issuer and the other entity. Thus, in view of the absence of normal competitive factors in transactions involving the rendering of services as a public utility at rates or charges fixed in conformity with law or governmental authority, subparagraph 3(vii) excepts from the calculation of payments for property or services payments made in such transactions as well as payments representing rates or charges which are determined by competitive bids. Further, in accordance with the Commission's general intent to have included in the calculation payments arising from commercial rather than ordinary investment transactions, subparagraph 3(vii) also contains an exception for non-preferential dividends and other payments arising solely from the ownership of securities.

(3) *Creditor Relationships*

Under the instruction to proposed item 6(a)(6), a person who is an officer, director or one percent equity owner of certain creditors of the issuer would have been deemed to be an "affiliated nonmangement director." Subparagraph (C) of paragraph 3(iii) of the instruction to proposed item 6(a)(6) would have included within the class of affected creditors an entity to which the issuer was indebted at any time during the issuer's last fiscal year in an aggregate amount in excess of one percent of the issuer's total assets at the end of such fiscal year, or $1,000,000, whichever is less. A substantial number of commentators questioned the appropriateness of this test, asserting that an outstanding loan of $1,000,000 would not be of significance to most large banks. Deletion of the dollar threshold was recommended.

The Commission recognizes that a loan of $1,000,000 may represent an insignificant percentage of the total loan portfolio of most large financial institutions. The Commission is concerned, however, that the inherent nature of a debtor-creditor relationship and the potential conflicts between the interests of creditors and shareholders make it appropriate to retain a dollar threshold. In an effort to balance these competing concerns, subparagraph (3)(iii) of item 6(b), as adopted, requires disclosure of loans which exceed one percent of the issuer's consolidated total assets, or $5,000,000, whichever is less. Additionally, a new subparagraph (viii) has been added which permits debt securities which have been publicly offered or which are listed on a national securities exchange or quoted on the automated quotation system of a registered securities association to be excluded from the calculation of aggregate indebtedness.

(4) *Technical Amendments Contained in Subparagraph (3)(i)-(v) of Item 6(b)*

Proposed item 6(a)(6) referred to payments made during the last fiscal year of the issuer or other entity and those proposed to be made during the next fiscal year. A number of commentators expressed confusion concerning whether the term "next fiscal year" referred to the current fiscal year and, if not, whether payments for the current fiscal year were inadvertently omitted. As adopted, subparagraphs 3(i)-(v) have been revised to require disclosure concerning payments for the last fiscal year and for the current fiscal year. Consistent with the approach taken in Securities Exchange Act Release No. 14970, payments which are "proposed" to be made during the current fiscal year would include payments which are the subject of a formal agreement or are reasonably expected to be made pursuant to any understanding or course of conduct between the issuer and the other entity.

In addition, proposed item 6(a)(6) referred to payments made by or to the "issuer." It was clear from the context in which the term "issuer" was being used, however, that it referred to payments made by or to the issuer and its subsidiaries, and the commentators apparently so understood its use. A technical amendment clarifies this reference. A further technical amendment adds the word "consolidated" to modify the term "gross revenues." Subparagraph (3)(iii), as adopted, also reflects a technical amendment which adds the word "consolidated" to modify the term "assets."

(5) *Recipient of $25,000 from the Issuer*

As proposed, the definition of "affiliated nonmanagement director" would have included a person (as owner of an equity interest in any entity or otherwise) to whom the issuer directly or indirectly had made payments in the last fiscal year or to whom the issuer proposed to make payments in the next fiscal year, for property or services, in excess of $25,000 (other than fees as a director or retirement allowances). Most commentators who addressed this definition expressed confusion as to its meaning and asserted that the $25,000 threshold figures was unrealistically low. The Commission has determined that this proposal probably would provide little additional information of significance to shareholders since, in most cases, transactions involving payments to a director of $40,000 or more already are reportable under item 4(f) of regulation S-K. Accordingly, item 6(b) as adopted does not require such disclosure.

(6) *Attorneys and Investment Bankers*

The instruction to proposed item 6(a)(6) would have included within the definition of "affiliated nonmangement director" any person who is a member or employee of, or is associated with, a law firm which the issuer has retained in the last two years or proposes to retain in the next year and any person who is a director, partner, officer or employee of any investment banking firm which has performed services for the issuer in the last two years or which the issuer proposes to have perform services in the next year. While few commentators disagreed, in principle, with the concept that the relationship of lawyers and investment bankers with the issuer differs from that of other suppliers of goods and services, and that the significance of their affiliation to the issuer should be measured by a different standard, many felt that some threshold economic standard should be applied. These commentators stated that it is inappropopriate to deem "affiliated" a partner of a law firm retained for a minor matter or an investment banking firm which merely participates in an underwriting group.

Despite the objections of the commentators to the absence of an economic standard with respect to lawyers, the Commission has determined to require disclosure of the relationships as proposed. In view of the inherent conflicts faced by lawyers who serve both as directors and as counsel to corporations, the Commission is reluctant to limit disclosure of such relationships solely on the basis of an economic test.

With respect to disclosure of investment banking relationships, however, the Commission has determined that information concerning a director or nominee's relationship with a firm which has performed services for the issuer only as a participating underwriter in an underwriting syndicate is not sufficiently significant to warrant disclosure. Paragraph (5) of Item 6(b), as adopted, has been revised accordingly and would require disclosure of a director or nominee's relationship to an investment banking firm which has performed sevices for the issuer other than as a participating underwriter in an underwriting syndicate.

(7) *Control Persons*

The proposed definition of "affiliated nonmanagement director" would have included any person who is a control person of the issuer (other than as a director of the issuer). This paragraph was the subject of little commentary. As adopted, paragraph 6 of item 6(b) requires disclosure of this relationship.

D. DISCLOSURE OF OTHER RELATIONSHIPS WHICH ARE SUBSTANTIALLY SIMILAR IN NATURE AND SCOPE

Proposed item 6(a)(6) would have provided for the characterization as "independent" of directors who were neither "management" nor "affiliated nonmangement," as defined in the proposed item. In recognition of the difficulties inherent in any rigid definition of independence, an instruction to the proposed item indicated that it would be inappropriate to designate a nominee as independent if the issuer were aware of relationships between the nominee and the issuer which, under the circumstances, reasonably could be viewed as interfering with the nominee's exercise of independent judgment.

As indicated above, the Commission has determined not to require that directors be characterized in proxy statements but has adopted a requirement that certain business and personal relationships, discussed in detail above, be disclosed.

It is the Commission's intent, in adopting item 6(b), to provide shareholders with information necessary to an evaluation of a nominee's relationships to the issuer and the potential conflicts of interest with which he or she may be confronted. Because of the multiplicity of possible relationships which are similar to those as to which disclosure is specifically required and the Commission's concern that issuers not elevate form over substance in complying with this disclosure requirement, a new paragraph (7) has been included in item 6(b) which states that if the issuer is aware that the nominee has relationships substantially similar in nature and scope to those which are enumerated in paragraphs (1) through (7) of that item, disclosure of such relationships should also be included.

E. USE OF MISLEADING TERMINOLOGY IN PROXY STATEMENTS

As discussed above, the Commission has determined that a requirement that directors be categorized in proxy statements should not be adopted at this time. The Commission is concerned, however, that a variety of director "labels" are currently being used in a number of different contexts and in publications which reach shareholders. The use of such terms may not be comparable and may be confusing and susceptible to misunderstanding. These labels often obfuscate important distinctions between nonmanagement directors.[11] For example, the term "independent" often is employed to refer to all nonmanagement directors despite the fact that some such directors may have significant business or personal relationships with the issuer or its management.

In light of those concerns which commentators raised in opposition to Commission-mandated "labeling," as well as the confusing nature of "labels" as currently used, the Commission urges issuers not to "label" their directors until such a time as a system of director categorization which better serves the disclosure purposes of the federal securities laws is developed. A note to item 6(b) indicates that any issuer which, in a proxy statement, nevertheless chooses to categorize its directors should do so only after having considered both the existence or nonexistence of business and personal relationships between each director and the issuer or its management and the inherent inadequacy of "labels" currently in use. Where significant relationships do exist—including, but not limited to, those as to which disclosure would be required pursuant to item 6(b)—characterization of a director or nominee by any "label" connoting a lack of relationship to the issuer and its management may be materially misleading.[12]

F. INTERESTED PERSONS OF INVESTMENT COMPANIES

Proposed item 6(a)(6)(ii) would have required investment companies registered under the Investment Company Act of 1940 to identify in their proxy statements which nominees and other directors whose term of office will continue after the annual meeting are "interested persons" as the term is defined in that act. The item also would have required, with respect to any person so identified, a brief description of the relationship by reason of which the person is deemed to be an "interested person." Relatively few commentators addressed this part of the proposals. Some commentators expressed reservations about the use of the term "interested," pointing out that while some investment companies presently disclose which of their directors are "interested," others prefer to

[11] This problem is illustrated by a comparison of the findings of two recent surveys on the board composition of major U.S. corporations. One was conducted by Heidrick and Struggles, Inc., an executive recruiting firm. This study, which surveyed 1,000 of the largest companies as ranked by "Fortune", concluded that "[the] average percentage of outside directors on a board is 59.8 in 1978." "The Changing Board Update 1978," Heidrick & Struggles, Inc. The other survey, conducted by Spencer Stuart & Associates, Inc., a management consulting firm, examined 100 of the largest companies as ranked by "Fortune" for 1978. This survey studied, in addition to "inside" and "outside" directors, the number of "quasi-insiders," a term which included lawyers, commercial bankers, investment bankers, retired officers and persons with family relationships to corporate management, but did not include directors who may be affiliated with significant customers or suppliers of the issuer. The study did not determine whether persons identified as "quasi-insiders" had a business relationship with the issuer. The figures provided by the Spencer Stuart study indicate that, if "quasi-insiders" are excluded, the average percentage of outsider directors on corporate boards is 41.5 percent. See also, "The Boardroom is Becoming a Different Scene," Fortune Mag. (May 8, 1978).

[12] See "TSC Industires, Inc. v. Northway, Inc.," 426 U.S. 438 (1976).

designate only those persons who are "not interested" as such determination is easier to make. The Commission believes that because the term "interested person" is defined statutorily in the Investment Company Act and such persons are identified in prospectuses filed by registered investment companies, it is appropriate to require the identification of those persons in proxy statements. As adopted, item 6(c) requires the issuer to identify by an asterisk any nominee or director who is an "interested person" within the meaning of Section 2(a)(19) of the Act, and to briefly describe the nature of the relationship which renders him "interested."

III. COMMITTEE DISCLOSURE—PROPOSED ITEM 6(d)

As proposed, item 6(d) would have required disclosure of whether or not the issuer has a standing audit, compensation or nominating committee of its board of directors. If the issuer had such committees, it would have been required to identify each committee member and indicate whether he or she was a "management director," "unaffiliated nonmanagement director" or "independent director" as those terms were defined in proposed item 6(a)(6). Issuers that had a nominating committee also would have been required to state whether that committee would consider nominees suggested by shareholders and, if so, to indicate the procedure the shareholders should follow in submitting recommendations. Additionally, a note to the item indicated that a statement that the issuer had any of the named committees connoted that its committees perform certain functions customarily performed by such committees. Those functions were identified in the note. If the issuer disclosed the existence of a committee which, in fact, did not perform the enumerated customary functions, it would have been required to identify those customary functions which its committee did not perform.[13]

Although a majority of commentators favored disclosure of the existence of standing audit, nominating and compensation committees and of their membership, a substantial number objected to the requirement that the nonexistence of any of these committees also be disclosed.[14] This was particularly true with respect to nominating committees, which are less prevalent than other key standing committees. These objections were based on assertions that the disclosure of the nonexistence of committees was intended to encourage companies to establish the named committees, rather than to provide useful information to shareholders.

While the Commission recognizes that the adoption of this disclosure requirement in some instances may indirectly stimulate the establishment of audit, nominating and compensation committees, the Commission believes that disclosure of the nonexistence of the named committees serves a valid informational purpose. In particular, whether or not an issuer has an audit committee and, if so, information concerning its functioning would help the issuer's shareholders to assess the effectiveness of the board's oversight of the company's accounting functions. The recent enactment of the Foreign Corrupt Practices Act of 1977 has underscored the importance of effectively functioning audit committees.[15] Similarly, the Commission believes that disclosure of whether or not an issuer has a nominating committee and the functions performed by the committee would be material information to shareholders and could improve the director selection process by increasing the range of candidates under consideration while intensifying the scrutiny given to their qualifications. Finally, the Commission believes that similar disclosure concerning an issuer's compensation committee would permit investors to better assess the process by which management and director compensation is determined.[16]

In light of the importance of strong committee systems and their impact on the oversight capabilities of the board of directors, shareholders who are being asked to make voting decisions with respect to the election of directors are entitled to know whether or not these important committees exist. Accordingly, the Commission has determined to adopt the requirements in item 6(d) that the issuer state whether or not it has a standing audit, nominating or compensation committee, however designated, and, if so, identify each committee member. If the issuer is a registered investment company and has such committees, it would be required, pursuant to item 6(d), to identify by an asterisk which committee members are "interested" as defined in section 2(a)(19) of the Investment Company Act of 1940. However, under item 6(d) as adopted, information concerning compensation committees is not required of registered investment companies whose management functions are performed by external managers.

While the Commission has determined that there is a need for disclosure of meaningful information about committee functions, it is persuaded that adoption of a negative disclosure requirement—which would provide information to shareholders only of any customary functions *not* performed by an issuer's committee—is not appropriate at this time. In this regard, many commentators challenged the proposition that the indicated "customary" committee functions are accepted and stated that a definition of functions customarily performed by audit, nominating and compensation committees would not allow for needed flexibility. Similarly, some were concerned that a "laundry list" approach would set a ceiling or lowest common denominator and discourage committees from performing different functions, thus tending to deter the evolution of committee functions and limit experimentation. Others incorrectly asserted that negative disclosure serves no legitimate informational purpose and is intended solely to influence conduct.

The use of a negative disclosure approach in providing information concerning committee functioning was intended to shorten the required disclosures and to assure that boilerplate disclosures are avoided. It was not the Commission's intent, as some critics have suggested, to establish a comprehensive, rigid model for all committee operations. Thus, while the Commission believes that the statement of customary functions which was contained in the note to proposed item 6(d) [17] provides a convenient initial ref-

[13] As proposed, the item would also have required disclosure of the number of meetings held by each named committee. See discussion of Board Meetings and Attendance, infra.

[14] Item 8(e) of schedule 14A currently requires an issuer to state whether or not it has an audit or similar committee of the board of directors and, if so, to name the members of the committee.

[15] Pub. L. No. 95-213. Tit. I. §§102-103 (Dec. 19, 1977). See also "SEC v. Falstaff Brewing Co.," Civ. Action No. 77-894 supra, where the court found that the statement in the 1977 proxy statement regarding the existence of an audit committee of Falstaff's board of directors was materially false and misleading, in that the audit committee never met, or functioned. The proxy statement, thus, falsely conveyed to Falstaff's shareholders the impression that effective oversight of their company's accounting functions was being exercised by the board of directors.

[16] It should be noted that rule 16b-3, 17 CFR 240.16b-3, which provides an exemption from section 16(b) of the Securities Exchange Act for certain acquisitions of securities by officers, directors and principal stockholders, requires that discretionary allocations of such securities be made by, or only in accordance with the recommendation of a committee of disinterested persons, as defined therein.

[17] With respect to audit committees, the functions included engaging and discharging the independent auditors (or recommending such actions), directing and supervising special investigations, reviewing with the independent auditors the plan and results of the auditing engagement, reviewing the scope and results of the issuer's procedures for internal auditing, approving each professional service provided by the independent auditors prior to the performance of such services, reviewing the independence of the independent auditors, considering the

Footnotes continued on next page

erence for companies subject to the proxy rules, in light of the evolving nature of corporate committee systems and the varying characteristics and needs of different issuers, the Commission has concluded that a compendium of customary functions should not be set forth in a Commission rule at this time. The Commission is concerned, however, that disclosure of the existence of any of the committees named above would not be meaningful, absent some indication of the functions performed by the committees. Therefore, as adopted, the item has been revised to require, as was suggested by many commentators, a brief description of the functions actually performed by issuers' committees.[18]

IV. Attendance and Number of Meetings

A. Disclosure of the Number of Board and Committee Meetings Held

Proposed item 6(d) would have required disclosure of the number of meetings held by an issuer's standing audit, nominating and compensation committees since the date of the most recent annual meeting of shareholders. Similarly, proposed item 6(e)(1) would have required disclosure of the total number of meetings of the board of directors held since the date of the most recent annual meeting.

Some commentators argued that the number of meetings held is not a meaningful indication of the effectiveness of committee and board functioning and noted that in certain circumstances such disclosure may be misleading because the frequency and length of meetings must necessarily vary, depending on the specific circumstances and corporate entity involved. The Commission recognizes that the quality of the performance of a committee or a board is not necessarily a function of the quantity of time spent by its members. However, the Commission believes that the number of board and committee meetings held is a relevant factor which may be helpful to shareholders in evaluating the performance of their committees or boards and has therefore determined that adoption of the items is appropriate. If the issuer believes that particular circumstances make the number of meetings held susceptible to misinterpretations, it may, of course, include an appropriate explanation.

As a technical matter, several commentators noted that the proposed rule as originally drafted would not elicit disclosure of the total number of board or committee meetings held annually since it would require disclosure only of those meetings held since the date of the last annual meeting. Disclosure of the total number of board and committee meetings held annually would, of course, provide more meaningful information to shareholders. Accordingly, items 6 (d) and (e) have been revised to require disclosure of the number of meetings held during the issuer's last fiscal year.

B. Disclosure of Director Attendance—Item 6(e)

Proposed item 6(e)(1) would have required identification of each incumbent director who has attended less than 75 percent of the board meetings held. Similarly, proposed item 6(e)(2) would have required identification of any director who has failed to attend at least 75 percent of the total number of meetings held by all committees on which he sits.

Commentators who opposed the proposal indicated that, in their view, the fact that a director has attended less than 75 percent of the meetings of the board or of the relevant committees would not be a meaningful indication of the quality of his contribution to the board. Some were concerned that the disclosure would discourage highly qualified nonmanagement directors from serving on boards. Others observed that it might influence boards to reduce or increase the number of meetings to help directors meet the 75 percent threshold.

Another objection to the proposal was the belief of some commentators that the 75 percent figure was too high. In this regard, it was noted that special board or committee meetings may be scheduled on short notice and some committees may meet infrequently. Further, commentators opined that a failure to attain the 75 percent attendance record would invariably result in some proxy statement explanation and that a threshold that is too high would lead to a proliferation of explanations in the proxy materials. Several of these commentators urged the Commission to apply the 75 percent test in the aggregate. Others suggested that the percentage be lowered.

The Commission recognizes that in particular instances directors may provide the board with valuable insight and expertise without actually attending formal meetings on more than an intermittent basis. However, we believe that these occasions are likely to be the exception and that, in general, attendance is an indication of effective board and committee functioning and is relevant to an evaluation of directors for election purposes. In addition, the Commission is not persuaded that the contemplated disclosure would deter responsible boards from holding meetings when it is appropriate to do so.

Nevertheless, the Commission believes that the threshold is problematic in certain respects. In particular, board committees may not, on the average, meet frequently enough to assure that an attendance threshold based only on committee meetings will be meaningful. Accordingly, item 6(e) has been adopted in revised form to require disclosure only in the event that a director attends fewer than 75 percent of the aggregate number of meetings of the board and of the committees on which he sits. The item has also been revised to require disclosure with respect to meetings held during the "last fiscal year," rather than meetings held since the "date of the last annual meeting." As indicated above, this technical amendment is necessary to make the time period cover a full 12 months.

V. Resignations of Registrant's Directors—Item 6 of Form 8-K; Item 6(f) of Schedule 14A

As proposed, item 6 of form 8-K[19] and item 6(f) of schedule 14A would have required that if a director resigned or declined to stand for re-election because of a disagreement on matters involving business operations, policies, or practices, the issuer would be required to report the disagreement on form 8-K as well as in its proxy statement. Before filing its preliminary proxy materials with the Commission, the issuer would be required to furnish the director with a copy of its proposed statement. If the director disagreed with the issuer's characterization of the disagreement, he would be permitted to include in the proxy materials a brief statement presenting his views, provided he submitted his statement to the issuer within ten business days after receiving the issuer's statement.

Some commentators who opposed adoption of the proposal were concerned that this disclosure would dis-

Footnotes continued from last page

range of audit and nonaudit fees and reviewing the adequacy of the issuer's system of internal accounting controls. With respect to nominating committees, the functions included selecting or recommending to the full board nominees for election as directors and consideration of the performance of incumbent directors in determining whether to nominate them for re-election. The functions of compensation committees included approval (or recommendation to the full board) of the remuneration arrangements for senior management and directors, adoption of compensation plans in which officers and directors are eligible to participate and granting of options or other benefits under any such plans.

[18] In the interest of contributing to the ongoing evolution of committee functions, the Commission has instructed its Division of Corporation Finance to monitor proxy statement disclosures made in response to this item.

[19] This item was originally proposed as Item 5 but as adopted has been redesignated item 6.

courage the evolution of stronger boards by increasing divisiveness among board members. Others noted that the proposal might make it more difficult to attract and retain directors with divergent viewpoints. In addition, a number of commentators questioned the appropriateness of relying on an event, rather than the materiality of the underlying facts, to trigger disclosure. It was noted by some that under existing rules disagreements involving material information would already be required to be disclosed.

The Commission believes that disclosure of director resignations or declinations to stand for re-election would provide useful information to investors in assessing the quality of management, consistent with the increasing emphasis on the monitoring function of corporate boards. A director who wishes to make a public record of the disagreement which prompted his resignation from the board should have the opportunity to do so in a manner which will most likely come to the attention of the shareholders who elected him.

In proposing this disclosure requirement, the Commission had determined that the issuer should be required to provide the disclosure because it was concerned that if the requirement were to be premised only on an affirmative request by the director, the dynamics of most situations would be such that a director would feel pressure to refrain from "rocking the boat." However, after considering the commentary, the Commission believes that, on balance, it is more appropriate to require disclosure only upon the request of the director. If disclosure is triggered by director request, the director will have a forum if he chooses to use it, and the issuer will be relieved of any obligation to document and characterize what it believes are the reasons for director resignations.

Accordingly, item 6 of form 8-K and item 6(f) of schedule 14A have been revised to require disclosure of a director's resignation only if the director has furnished the registrant with a letter describing the disagreement relating to the registrant's operations, policies or practices and requesting that the matter be disclosed. If the issuer believes the description provided by the director is inaccurate or incomplete, it may, of course, include a statement of its views of the disagreement. The items, as adopted, include an express statement to that effect. The Commission believes that, as revised, the items will be less likely to create compliance problems and yet will still assure that directors who have resigned or declined to stand for re-election will be able to disclose this information in a manner which is most likely to reach shareholders.

VI. Shareholder—Proponent Consideration of Management's Statement in Opposition—Rule 14a-8(e)

As proposed, rule 14a-8(e) would have required an issuer to transmit to a shareholder-proponent ten business days before the filing of its preliminary proxy material any statement in opposition to the shareholder's resolution that the issuer intends to include in the proxy material.

The purpose of this proposal was to provide a shareholder-proponent with the opportunity to bring materially inaccurate statements contained in opposing statements to the attention of management and the Commission before the proxy materials are mailed to shareholders. As noted in the Commission's release announcing the proposed rule, a number of witnesses during the hearings indicated that under the present system a proponent does not have a practical means of curing any misstatements which are made in the discussion of his proposal. A recent federal court decision has raised questions as to the availability of judicial review for materially false statements made by management in connection with precatory shareholder proposals.[20] Further, witnesses at the hearings had noted that even if judicial review is available it is questionable in some instances whether it can provide a workable remedy. The deliberate pace of a court action may not be well suited to these types of problems since, unless a temporary restraining order or injunction has been granted, appropriate relief may not be available before the meeting.

A number of commentators opposed adoption of the proposal because they believed it would result in delay and is unnecessary in light of the lack of demonstrated abuses in this area and the legal remedies which are already available to shareholder-proponents. Nevertheless, the Commission believes it is appropriate to adopt proposed rule 14a-8(e) on an experimental basis. First, it simply would be more equitable if shareholder-proponents were permitted to see management's opposing statement before it is mailed to shareholders. Second, in light of the problems associated with a total reliance on judicial remedies and the limited Commission resources available for review of proxy materials, it appears appropriate for an effective administration of the proxy rules that a shareholder-proponent be given the opportunity to examine management's opposing statement for accuracy. Finally, it would appear to be in the best interests of all parties that questions concerning the factual accuracy of the opposing statements be resolved during the comment process.

Commentators also were concerned that the proposal would cause additional difficulties in complying with the already tight time deadlines characteristic of proxy season. A number of commentators suggested alternative means of avoiding extended delays. For example, it was suggested that "10 business days" be changed to "10 calendar days." It was also noted that, even though advice may be received from the staff 20 days before the filing date, the advice is often that management may exclude the proponent's proposal unless the proponent amends the proposal within a reasonable time. It was argued that it would be impossible in such cases to prepare a response to the shareholder 10 days before filing preliminary materials with the Commission. Some recommended that procedures similar to rule 14a-8(d) be adopted so that management would be provided a copy of the proponent's communication to the staff and would, as a result, be in a better position to respond promptly to staff inquiries.

The Commission agrees that timing problems could have arisen under the rule as proposed, particularly in instances where the staff has advised an issuer that the proposal may be omitted unless the proponent amends it in certain respects. Therefore, rule 14a-8(e) has been revised to provide that in those cases the issuer need not forward the statement in opposition until five calendar days after it has received an appropriately revised proposal. In other instances, issuers generally will know no later than 20 days before filing their preliminary proxy materials whether a proposal will be included and therefore would have at least 10 days to draft and mail to a shareholder-proponent any statement in opposition which it intends to include in the proxy statement.[21]

Additionally, commentators had expressed concern that the rule as initially drafted might provide a forum for further debate on the merits of the proposal. It was noted that the rule has the potential for drawing the staff into debate over social and political

[20] "Sisters of the Precious Blood v. Bristol-Myers Co.," Fed. Sec. L. Rep. ¶ 96,047 (1977), appeal dismissed, C. A. 2, 77-7299 (Jan. 11, 1978). In that case, the district court in effect held that there is no judicial remedy under section 14(a) for materially inaccurate statements made by management in connection with precatory shareholder proposals, i.e., proposals that request, rather than require, that management take certain actions.

[21] Where includability of a shareholder proposal is contested, in order to take advantage of the staff's no-action procedures, an issuer must file its objections with the Commission at least 50 days prior to filing its preliminary proxy materials (rule 14a-8(d)). As a general rule, the staff's no action position is communicated within 30 days of receipt of the issuer's objections.

issues. Nevertheless, a number of commentators concluded that this problem could be adequately remedied by revising the rule to clarify that a proponent's review is solely for the purpose of exposing possible violations of rule 14a-9. Rule 14a-8(e), as adopted, includes an additional sentence which states that if the proponent believes the statement in opposition contains a materially inaccurate statement, and wishes to bring this to the attention of the Commission, the proponent should provide the staff with a statement setting forth the reasons for this view and, at the same time, forward a copy of the statement to management. It is anticipated that any questions raised by proponents would be handled in connection with the staff's comments on the issuer's proxy material. This statement would clarify the procedure to be followed in administering the rule and also would help to assure that the issuer is able to promptly advise the staff of any appropriate supporting factual material. Further, the Commission believes this explicit statement will help to clarify that the rule is intended to elicit a proponent's views only to the extent that these views relate to material misstatements or omissions of a factual nature.

In adopting rule 14a-8(e), the Commission emphasizes that it is adopted on an experimental basis. The Commission intends to monitor closely the effect of the rule on the proxy review process, particularly with respect to timing, and will re-examine the rule at some later date.

VII. Disclosure of Terms of Settlement of Election Contests—Item 3(b)(6) of Schedule 14A; Item 7(d) of Form 10-Q

Proposed items 3(b)(6) of schedule 14A and 7(d) of form 10-Q would have required that an issuer disclose the settlement terms of an election contest, including the anticipated cost to the issuer. Commentators who responded to the proposed items generally either favored or did not oppose the proposed disclosure. The Commission believes that a discussion of the terms on which election contests are settled would provide shareholders with important information useful in making voting decisions and has therefore determined that adoption of the proposals is appropriate.[22]

The release proposing these items stated that the Commission did not intend that issuers be required to file an amended proxy statement solely to disclose the terms of settlement, if such amended proxy statement was not otherwise necessary, for example, because management's slate of nominees had changed. The release also indicated that if the proxy statement relating to the contest is not amended, the disclosure should be included in the proxy statement for the following year as well as in the quarterly report on form 10-Q. It should be noted that, contrary to the description contained in the release proposing the items, item 3(b)(6) would not require that the disclosure be provided in the proxy statement for the following year. Subsequent disclosure would be required only in the next quarterly report on form 10-Q (pursuant to paragraph (d) of item 7 of form 10-Q.) If the settlement has already been disclosed in proxy soliciting materials furnished to shareholders, instruction 5 to item 7 of form 10-Q provides that paragraph (d) of item 7 may be answered by reference to the information contained in such material.

VIII. Coordination with Regulation S-K

On July 28, 1978, as part of its efforts to standardize and integrate existing disclosure requirements, the Commission added four new disclosure items to regulation S-K, 17 CFR 229.20, including new item 3 which is captioned "Directors and Executive Officers."[23] At the same time, certain of the Commission's forms and regulations were amended to require that information which had been standardized in these new items be disclosed in accordance with the appropriate item of regulation S-K.

In the release announcing adoption of the new items of regulation S-K, it was noted that the amendments to item 6 of schedule 14A which are being adopted today had been published for comment and were then outstanding. The release indicated that, if adopted, the proposals would be adopted as amendments to item 3 of regulation S-K, which contains the type of disclosure requirements previously set forth under item 6. However, if adopted as part of item 3 of regulation S-K, which is required disclosure for a number of Commission forms, an express limitation would be necessary in order to limit their applicability to proxy statements. Moreover, the purpose of regulation S-K is to set forth standardized disclosure items which are common to several Commission forms. Therefore, the Commission believes it would be more appropriate to adopt the proposals as amendments to item 6 of schedule 14A. Accordingly, item 6 has been amended to designate the information required by item 3 of regulation S-K as paragraph (a) of the item. Proposed item 6(a)(6) has been adopted as paragraphs (b) and (c);[24] the remaining rule proposals are adopted under the same designations as proposed.

Additionally, it should be noted that, since the disclosure previously required by item 7(f) of schedule 14A is currently required under item 4(f) of regulation S-K, references to "item 7(f)" have been revised to read "item 4(f) of regulation S-K, 17 CFR 229.20" in item 6(b).

IX. Item 8 of Schedule 14A

Item 8(e) of schedule 14A, 17 CFR 240.101, currently requires disclosure of whether or not an issuer has an audit committee and, if so, of the names of the individual members of the audit committee. As item 6(d), which is adopted today and which requires information concerning audit, nominating and compensation committees, includes an identical requirement, paragraph (e) of item 8 has been deleted.

X. Certain Findings

As required by section 23(a)(2) of the Exchange Act, the Commission has specifically considered the impact which the amendments adopted herein would have on competition and has concluded that they impose no significant burden on competition. In any event, the Commission has determined that any possible burden will be outweighed by, and is necessary and appropriate to achieve the benefits of these amendments to investors and registrants.

Text of Amendments

PART 240—GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

17 CFR Parts 240 and 249 are amended as follows:

1. Section 240.14a-8 is amended by adding paragraph (e) as follows:

§ 240.14a-8 Proposals of security holders.

*   *   *   *   *

(e) If the management intends to include in the proxy statement a statement in opposition to a proposal received from a proponent, it shall, not later than ten calendar days prior to the date the preliminary copies of the proxy statement and form of proxy

[22] Since certain investment companies registered under the Investment Company Act of 1940 file their quarterly reports on Form N-1Q (17 CFR 274.104), a conforming amendment to that form has been adopted.

[23] Securities Exchange Act Release No. 15006 (July 28, 1978), 43 FR 31102. Regulation S-K was adopted in order to establish uniform disclosure requirements which may be used in preparing similar disclosures which were required by a number of Commission forms and regulations. See Securities Act Release No. 5893 (Dec. 23, 1977), 42 FR 65554.

[24] Paragraph (b) corresponds to proposed item 6(a)(6)(i). Paragraph (c) corresponds to proposed item 6(a)(6)(ii).

are filed pursuant to rule 14a-6(a), or, in the event that the proposal must be revised to be includable, not later than five calendar days after receipt by the issuer of the revised proposal, promptly forward to the proponent a copy of the statement in opposition to the proposal.

In the event the proponent believes that the statement in opposition contains materially false or misleading statements within the meaning of § 240.14a-9 and the proponent wishes to bring this matter to the attention of the Commission, the proponent should promptly provide the staff with a letter setting forth the reasons for this view and at the same time promptly provide management with a copy of such letter.

11. Section 240.14a-101 is amended by adding paragraph 6 to Item 3(b); revising Item 6, deleting old paragraph (e) of Item 8 and redesignating paragraph (f) of that item as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.[1]

* * * * *

Item 3. Persons Making the Solicitation.

* * * * *

(b) * * *

(6) If any such solicitation is terminated pursuant to a settlement between the issuer and any other participant in such solicitation, describe the terms of such settlement, including the cost or anticipated cost thereof to the issuer.

Instructions

1. With respect to solicitations subject to § 240.14a-11 (rule 14a-11), costs and expenditures within the meaning of this Item 3 shall include fees for attorneys, accountants, public relations or financial advisers, solicitors, advertising, printing, transportation, litigation and other costs incidental to the solicitation, except that the issuer may exclude the amount of such costs represented by the amount normally expended for a solicitation for an election of directors in the absence of a contest, and costs represented by salaries and wages of regular employees and officers, provided a statement to that effect is included in the proxy statement.

2. The information required pursuant to paragraph (6) of Item 3(b) should be included in any amended or revised proxy statement or other soliciting material relating to the same meeting or subject matter furnished to security holders by the issuer subsequent to the date of settlement.

* * * * *

Item 6. Directors and executive officers.

If action is to be taken with respect to election of directors, furnish the following information, in tabular form to the extent practicable, with respect to each person nominated for election as a director and each person whose term of office will continue after the meeting. However, if the solicitation is made on behalf of persons other than management, the information required need be furnished only as to nominees of the persons making the solicitation.

(a) The information required by item 3 of regulation S-K, 17 CFR 229.20;

(b) With respect to issuers other than investment companies registered under the Investment Company Act of 1940, describe any of the following relationships which exist:

(1) If the nominee or director has during the past five years had a principal occupation or employment with any of the issuer's parents, subsidiaries or other affiliates.

(2) If the nominee or director is related to an executive officer of any of the issuer's parents, subsidiaries or other affiliates by blood, marriage or adoption (except relationships more remote than first cousin);

(3) If the nominee or director is, or has within the last two full fiscal years been, an officer, director or employee of, or owns, or has within the last two full fiscal years owned, directly or indirectly, in excess of 1 percent equity interest in any firm, corporation or other business or professional entity:

(i) Which has made payments to the issuer or its subsidiaries for property or services during the issuer's last full fiscal year in excess of 1 percent of the issuer's consolidated gross revenues for its last full fiscal year;

(ii) Which proposes to make payments to the issuer or its subsidiaries for property or services during the current fiscal year in excess of 1 percent of the issuer's consolidated gross revenues for its last full fiscal year;

(iii) To which the issuer or its subsidiaries was indebted at any time during the issuer's last fiscal year in an aggregate amount in excess of 1 percent of the issuer's total consolidated assets at the end of such fiscal year, or $5,000,000, whichever is less;

(iv) To which the issuer or its subsidiaries has made payments for property or services during such entity's last fiscal year in excess of 1 percent of such entity's consolidated gross revenues for its last full fiscal year;

(v) To which the issuer or its subsidiaries proposes to make payments for property or services during such entity's current fiscal year in excess of 1 percent of such entity's consolidated gross revenues for its last full fiscal year;

(vi) In order to determine whether payments made or proposed to be made exceed 1 percent of the consolidated gross revenues of any entity other than the issuer for such entity's last full fiscal year, it is appropriate to rely on information provided by the nominee or director;

(vii) In calculating payments for property and services the following may be excluded:

(A) Payments where the rates or charges involved in the transaction are determined by competitive bids, or the transaction involves the rendering of services as a public utility at rates or charges fixed in conformity with law or governmental authority;

(B) Payments which arise solely from the ownership of securities of the issuer and no extra or special benefit not shared on a pro rata basis by all holders of the class of securities is received;

(viii) In calculating indebtedness for purposes of subparagraph (iii) above, debt securities which have been publicly offered, admitted to trading on a national securities exchange, or quoted on the automated quotation system of a registered securities association may be excluded.

(4) That the nominee or director is a member or employee of, or is associated with, a law firm which the issuer has retained in the last two full fiscal years or proposes to retain in the current fiscal year;

(5) That the nominee or director is a director, partner, officer or employee of any investment banking firm which has performed services for the issuer other than as a participating underwriter in a syndicate in the last two full fiscal years or which the issuer proposes to have perform services in the current year; or

(6) That the nominee or director is a control person of the issuer (other than solely as a director of the issuer).

(7) In addition, the issuer should disclose any other relationships it is aware of between the director or nominee and issuer or its management which are substantially similar in nature and scope to those relationships listed above.

NOTE.—In the Commission's view, where significant business or personal relationships exist between the director or nominee and the issuer or its management, including, but not limited to, those as to which disclosure would be required pursuant to item 6(b), characterization of a director or nominee by any "label" connoting a lack of relationship to the issuer and its management may be materially misleading.

(c) With respect to investment companies registered under the Investment Company Act of 1940, indicate by an asterisk any nominee or director who is or would be an "interested person" within the meaning of section 2(a)(19) of the Investment Company Act of 1940 and briefly describe the relationships by reason of which such person is deemed an "interested person."

(d)(1) State whether or not the issuer has standing audit, nominating and compensation committees of the Board of Directors, or committees performing similar functions. If the issuer has such committees, however designated, identify each committee member, state the number of committee meetings held by each such committee during the last fiscal year and describe briefly the functions performed by such committees. In the case of investment companies registered under the Investment Company Act of 1940, indicate by an asterisk whether that member is an "interested person" as defined in section 2(a)(19) of that Act. Information concerning compensation committees is not required of registered investment companies whose management functions are performed by external managers.

(2) If the issuer has a nominating or similar committee, state whether the committee will consider nominees recommended by shareholders and, if so, describe the procedures to be followed by shareholders in submitting such recommendations.

(e) State the total number of meetings of the board of directors (including regularly scheduled and special meetings) which were held during the last full fiscal year. Name each incumbent director who during the last full fiscal year attended fewer than 75 percent of the aggregate of (1) the total number of meetings of the board of directors (held during the period for which he has been a director) and (2) the total number of meetings held by all committees of the board on which he served (during the periods that he served).

(f) If a director has resigned or declined to stand for re-election to the board of directors since the date of the last annual meeting of shareholders because of a disagreement with the issuer on any matter relating to the issuer's operations, policies or practices, and if the director has furnished the issuer with a letter describing such disagreement and requesting that the matter be disclosed, the issuer shall state the date of resignation or declination to stand for re-election and summarize the director's description of the disagreement.

If the issuer believes that the description provided by the director is incorrect or incomplete, it may include a brief statement presenting its views of the disagreement.

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Item 8. Relationship with independent public accountants.

Old paragraph (e) is deleted.

(e) [No change from current paragraph (f).]

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PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

III. Section 249.308 is amended by revising instruction 6 to item 2; adding a new item 6; renumbering old item 6; and adding paragraph 4 to that item.

§ 249.308 Form 8-K, for current reports.

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Item 2. Acquisition or Disposition of Assets

* * * * *

Instructions.

6. Attention is directed to the requirements in item 7 of the form with respect to the filing of financial statements for business acquired and to the filing of copies of the plans of acquisition or disposition as exhibits to the report.

* * * * *

Item 6. Resignations of Registrant's Directors

(a) If a director has resigned or declined to stand for re-election to the board of directors since the date of the last annual meeting of shareholders because of a disagreement with the registrant on any matter relating to the registrant's operations, policies or practices, and if the director has furnished the registrant with a letter describing such disagreement and requesting that the matter be disclosed, the registrant shall state the date of such resignation or declination to stand for re-election and summarize the director's description of the disagreement.

(b) If the registrant believes that the description provided by the director is incorrect or incomplete, it may include a brief statement presenting its views of the disagreement.

(c) The registrant shall file a copy of the director's letter as an exhibit with all copies of the form 8-K required to be filed pursuant to general Instruction E.

Item 7. Financial Statements and Exhibits

[No change from present item 6 except to add paragraph (b)(4) as follows:]

4. Letters from directors furnished pursuant to item 6.

IV. Section 249.308a is amended by adding paragraph (d) to item 7; by adding a new instruction 5; and by renumbering old instruction 5.

§ 249.308a Form 10-Q, for quarterly reports under section 13 or 15(d) of the Securities Exchange Act of 1934.

* * * * *

Item 7. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) Describe the terms of any settlement between the registrant and any other participant (as defined in rule 14a-11 of regulation 14A under the Act) terminating any solicitation subject to rule 14a-11, including the cost or anticipated cost to the registrant.

* * * * *

Instructions.

5. If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (d), the paragraph may be answered by reference to the information contained in such material.

6. [No change from current instruction 5.]

* * * * *

Item 9. Exhibits and Reports on Form 8-K.

(a) * * *

4. Copies of any published reports furnished in response to item 7 (See item 7, instruction 6.).

PART 274—FORMS PRESCRIBED UNDER THE INVESTMENT COMPANY ACT OF 1940

V. Section 274.106 is amended by adding paragraph (d) to item 2 and by adding a new instruction 4.

§ 274.106 Form N-1Q, for quarterly reports of registered management investment company.

* * * * *

Item 2. Submission of Matters to a Vote of Security Holders.

* * * * *

(d) Describe the terms of any settlement between the registrant and any other participant (as defined in rule 14a-11 of regulation 14A under that Act) terminating any solicitation subject to rule 14a-11, including the cost or anticipated cost to the registrant.

* * * * *

Instructions.

4. If the registrant has furnished to its security holders proxy soliciting material containing the information called for by paragraph (d), the paragraph may be answered by reference to the information contained in such material.

(Sec. 12, 13, 14, 15(d), 23(a), 48 Stat. 892, 894, 895, 901 secs. 1, 3, 8, 49 Stat 1375, 1377, 1379; sec. 203(a) 49 Stat. 704; sec. 202, 68 Stat. 686, secs. 3, 4, 5, 6, 78 Stat. 565-568, 569, 570-574; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 28(c), 1, 2, 3-5, 84 Stat. 1435, 1497; secs. 10, 18, 89 Stat. 119, 155; sec. 308(b), 90 Stat. 57; sec. 204, 91 Stat. 1500; 15 U.S.C. 78, 78m, 78n, 78o(d), 78w(a))

The Commission finds that any changes in the amended rules and schedules adopted from those published in Securities Exchange Act Release No. 14970 have already been generally subject to comment and are either technical in nature or less burdensome than previous requirements so that further notice and rulemaking procedures pursuant to the Administrative Procedure Act (5 U.S.C. 553) are not necessary.

By the Commission.

George A. Fitzsimmons,
Secretary.

December 6, 1978.

[FR Doc. 78-34774 Filed 12-13-78; 8:45 am]

[8010-01-M]

SECURITIES AND EXCHANGE COMMISSION

[17 CFR Part 240]

[Release No. 34-15385]

SHAREHOLDER COMMUNICATIONS, SHAREHOLDER PARTICIPATION IN THE CORPORATE ELECTORAL PROCESS AND CORPORATE GOVERNANCE GENERALLY

AGENCY: Securities and Exchange Commission.

ACTION: Withdrawal of proposal.

SUMMARY: The Commission today issued a release announcing the withdrawal of a proposed amendment to its proxy rules which would have required disclosure of voting policies and procedures of institutions which are subject to the proxy rules and which exercise voting rights with respect to equity securities held for their own accounts or for the accounts of others.

EFFECTIVE DATE: December 6, 1978.

FOR FURTHER INFORMATION CONTACT:

Barbara Leventhal, Richard Nesson, Jennifer Sullivan or Michael Stakias, Division of Corporation Finance, Securities and Exchange Commission, Washington, D.C. (202) 755-1750.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission today issued a release announcing the withdrawal of a proposed amendment to regulation 14A (17 CFR 240.14a-1 et seq.) under the Securities Exchange Act of 1934 [15 U.S.C. 78a et seq., as amended by Pub. L. No. 94-29 (June 4, 1975)] which would have required disclosure of the voting policies and procedures of institutions which are subject to regulation 14A and which exercise voting rights with respect to equity securities held for their own accounts or for the accounts of others. In a related action also announced today, the Commission adopted amendments to regulation 14A and schedule 14A (17 CFR 240.14a-101) under the Securities Exchange Act of 1934 as well as related amendments to forms 8-K (17 CFR 249.308) and 10-Q (17 CFR 249.308a) thereunder. These amendments are intended to increase the information available to investors regarding (1) the structure, composition and functioning of issuers' boards of directors; (2) resignations of directors; (3) attendance at board and committee meetings; and (4) the terms of settlements of proxy contests. A rule which provides shareholders proponents with an opportunity to review management statements in opposition to shareholder proposals for accuracy prior to the mailing of issuers' proxy soliciting materials also has been adopted. See Securities Exchange Act Release No. 15384, which is set forth under rules and regulations in this issue.

DISCUSSION

In Securities Exchange Act Release No. 14970 (July 18, 1978), 43 FR 31945 (July 24, 1978), the Commission published for comment proposed amendments to its rules, forms and schedules which were designed to provide investors with information relevant to an informed assessment of the effectiveness of issuers' boards of directors, terms of settlements of proxy contests and the voting policies and procedure of certain institutions. Additionally, the Commission requested comments on a proposed rule which would afford shareholder-proponents an opportunity to review for accuracy management statements in opposition to shareholder resolutions prior to the mailing of issuer's proxy soliciting materials.

The proposal relating to institutional voting policies and procedures, proposed rule 14a-3(b)(11), would have required certain institutions and/or parent holding companies of certain institutions which are subject to the Commission's proxy rules to disclose in their annual reports to shareholders their voting policies and procedures with regard to securities held by them for their own account or for the account of others. The institution also would be required to describe any existing procedure for consulting beneficial owners and to disclose the number of times it voted for or against management or abstained from voting on any contested matter.

The impact of institutional voting on corporate governance is a subject as to which concern has been expressed by Congress, and the Executive Branch,[1] as well as by shareholders and other members of the investment community, both in correspondence with the Commission and its staff and in connection with the Commission's proxy rule hearings.[2] Proposed rule 14a-3(b)(11) was intended to elicit information concerning the exercise of voting power by institutions—information the Commission believes is relevant to the governance of portfolio companies and, with regard to certain investment companies, relevant to an assessment of the management of the institution itself. Nevertheless, the release announcing the proposal noted that many large institutions, such as banks and pension funds, are not subject to the proxy rules and therefore would be unaffected by the rule. The release also indicated that the class of persons that would receive the information required by the rule would not necessarily be the class most impacted by an institution's voting policies and procedures.

Many commentators who addressed the issue confirmed these concerns. Additionally, commentators indicated that the proposal's blanket approach might not be appropriate because the affected insitutions hold equity securities in many different capacities. It was noted that the particular arrangements under which an institution holds the securities has an impact on the relevance of its voting policies and proceedings to the institution's shareholders. For example, securities held under custodial or trust agreements may contain specific provisions concerning the voting of the securities. In a similar vein, parent holding companies of banks and insurance companies would, under the proposed rule, be providing information to *their* shareholders with respect to portfolio securities held and voted by subsidiary banks or insurance companies. Commentators also noted that even if the information were available to shareholders of the portfolio companies—the class of shareholders to whom the disclosure would generally be of the greatest interest—it would be very difficult for them to assess the disclosure unless a correlation between voting record and the identity of portfolio companies were also provided.

The Commission believes there is shareholder interest in institutional voting policies and procedures. Nevertheless, it is persuaded that proposed rule 14a-3(b)(11) is not an appropriate vehicle for eliciting such disclosure and has, therefore, determined to withdraw the proposal. However, the Commission commends the practice of a number of institutional commentators who indicated that they voluntarily provide their shareholders with information similar to the type contemplated by proposed rule 14a-3(b)(11). Other institutions are encouraged to provide their shareholders with such information of this type which they deem appropriate.

[1] See, e.g., Senate Subcommittee on Reports, Accounting and Management, Committee on Governmental Affairs, "Voting Rights in Major Corporations," 95th Cong., 1st Sess. (1978); Report of the President's Commission on Financial Structure and Regulation (1971).

[2] On September 27, 1977 the Commission commenced public hearings in connection with a broad reexamination of its rules relating to shareholder communications, shareholder participation in the corporate electoral process and corporate governance generally. See Securities Exchange Act Release No. 13482 (April 28, 1977), 42 FR 23901 (May 11, 1977); Securities Exchange Act Release No. 13901 (Aug. 29, 1977), 42 FR 44860 (Sept. 7, 1977).

In consideration of the foregoing, the proposal concerning institutional voting published in the FEDERAL REGISTER (43 FR 31945) on July 24, 1978, and circulated as Securities Exchange Act Release No. 14970 is hereby withdrawn.

By the Commission.

GEORGE A. FITZSIMMONS,
Secretary.

DECEMBER 6, 1978.

[FR Doc. 78-34775 Filed 12-13-78; 8:45 am]

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Bill Summary

Alaska General Stock Ownership Corporation

The general stock ownership corporation (GSOC) bill provides for the creation of a GSOC in Alaska and a new chapter of Alaska Statutes to regulate it. The AGSOC, taking advantage of new federal law, will be exempt from corporate income taxes. Income will be distributed to the shareholders and they will pay tax at their personal rates. The shareholders will be all the residents of Alaska as of the bill's effective date and stock will be distributed to them free of charge. The AGSOC will borrow funds to finance investments.

FORMATION OF THE AGSOC

The Alaska General Stock Ownership Corporation is formed by three incorporators appointed one each by the Speaker, Senate President and Governor. The incorporators will select nine people to serve as the initial board of directors subject to disapproval within 15 days by two of the three state officials mentioned. The incorporators will prepare and file the articles of incorporation to begin the AGSOC. The articles will include technical requirements of federal law restricting transfer of shares for five years and mandating issue of stock to all Alaska residents.

The directors, appointed by the incorporators, adopt bylaws, hire officers and begin the process of shareholder identification. The initial board serves only until the first shareholder meeting when the appointed directors must stand for election. The initial articles and bylaws of the corporation must be submitted to the legislature within 30 days of adoption and the legislature has 60 legislative days within which to disapprove of any provision by concurrent resolution.

AGSOC SHARES

One share of stock will be distributed free of charge to each Alaskans resident who was a resident on the effective date of the bill. Resident means a person who lives in Alaska and intends to remain here permanently. Only individuals may own AGSOC shares and no one may own more than ten. Each week for three months before issuance of stock the AGSOC must by newspaper, radio and television notify residents of their eligibility to receive stock. A resident who does not wish to receive stock may decline. For one year after the initial stock issue a qualified resident may receive his share of stock without charge and for an additional year may purchase his share for book value.

Federal law requires GSOCs to have a charter providing for the issuance of "at least one share (of stock) to each eligible individual." To fulfill this requirement the first share of GSOC stock must be issued without charge to the shareholders. However, there is no restriction upon subsequent sales of GSOC stock. Thus, provision is made for the subsequent sale of AGSOC stock if the shareholders approve.

SHAREHOLDER POWERS

Each share of stock may be voted at shareholder meetings with 1/3 of the shares required for a quorum. Proxies are prohibited and in their place a corporate ballot and shareholder's pamphlet will be prepared, under regulations insuring fairness, and mailed to each shareholder. Shareholders vote their ballot by mail and cumulative voting is prohibited. The shareholders may nominate directors and place issues on the corporate ballot by petition of 1,000 shareholders. Notice of the right to nominate directors and place issues on the corporation ballot must be made by publication at least 150 days before the shareholder meeting and the meeting notice and ballot must be mailed at least 60 days before the meeting.

AGSOC is required to keep complete books and records available for shareholder inspection and any corporate agent wrongfully refusing shareholder access may be fined $1,000 per day. Shareholders have the right to remove the entire board by a majority vote or any single director by a vote at least as large as that which elected him. The attorney general or 100 shareholders may file suit to remove a director for fraudulent or dishonest acts or gross abuse of authority. Any shareholder may file a derivative suit on behalf of the corporation if those responsible inside the AGSOC fail to do so. The shareholders have the right to amend the bylaws and with a 2/3 vote the articles of incorporation.

DIRECTORS AND OFFICERS

The board of directors has management responsibility for AGSOC. The chariman and at least 3/4 of the board must be Alaskans. Board meetings must be held in the state, but members may participate by conference telephone. Outside directors can never constitute a quorum except when meeting to fill vacancies in the board. AGSOC will have nine directors although the number may be changed in the bylaws. The entire appointed initial board will stand for election at the first annual meeting. Thereafter, members serve for two years with half the board elected each year. Criminal misdemeanor penalties are provided for directors making distributions designed to deceive creditors or shareholders of AGSOC and any agent of AGSOC who makes fraudulent statements regarding the value of shares.

Officers of the AGSOC are appointed by the board of directors and serve at their pleasure. The board establishes the duties of the officers and may replace them at any time.

OTHER PROVISIONS

AGSOC is prevented from making endorsements of political candidates or ballot issues and may not spend money for lobbying of the legislature. Many of the other provisions of the Committee bill have been carried over substantially from existing Alaska corporate law. The provisions regarding sales of assets outside the ordinary course of business, dissolution of the corporation, restatement of the articles of incorporation, requirements for annual reports to the Dept. of Commerce, filing fees and charges, procedural provisions and forms, and power of the Commissioner of Commerce are all basically the same provisions which apply to existing Alaska corporations. The bill does retain the right in the legislature to change the law with respect to AGSOC at any time so long as the creditors of the corporation are protected.

STATE OF ALASKA

JAY S. HAMMOND
GOVERNOR

OFFICE OF THE GOVERNOR

DIVISION OF POLICY DEVELOPMENT AND PLANNING

POUCH AD-JUNEAU 99811
PHONE 465-3577

April 19, 1979

The Honorable Mike Miller
Chairman
House State Affairs Committee
Alaska State Legislature
Pouch V
Juneau, Alaska 99811

Dear Mike:

Attached is a briefing memo prepared for the Governor's conference call with Senator Gravel last Friday. We offer it to your committee as a source of ideas for additional amendments to HB 240. In particular, the items on pages two through four include a number of points raised by Professor Fessler and others which have not yet been incorporated into the committee substitute. The most important of these are circled. If your committee decides to pursue any of these items, Administration staff will be available to provide assitance upon your request. One point not discussed in the memo which should be mentioned is the level of state financial assistance to AGSOC. The Governor recommended and and Senator Gravel agreed that the AGSOC should not be allowed to request or receive any state financial assistance (by appropriation, guarantee, or any other method).

While the Governor has not yet resolved all of the "First Level" questions for himself, he wants to share the ideas in this memo with your committee and to provide staff assistance, so that the best possible AGSOC bill might be developed.

Sincerely,

Fran Ulmer
Director

Enclosures

STATE of ALASKA

MEMORANDUM

DIVISION OF POLICY DEVELOPMENT AND PLANNING
OFFICE OF THE GOVERNOR

TO: Governor Jay S. Hammond

DATE: April 12, 1979

FILE NO:

TELEPHONE NO:

FROM: Frances A. Ulmer
Director

SUBJECT: AGSOC

The following questions still remain concerning SB 170/HB 240, the Alaska General Stock Ownership Corporation bill. There are really two levels of questions. The first are the more basic philosophical questions which defy technical resolution. They must be answered intuitively. The second level involve more tangible questions which can, to a greater or lesser degree, be resolved via amendment to the bill. However, consideration of second level questions assumes that the first level questions are resolved in favor of the basic AGSOC concept and a decision is made to develop the best possible bill.

First Level

1. What are the basic goals of AGSOC? Is AGSOC the best mechanism for achieving those goals?

   Basic goals: to provide broad capital ownership by Alaskans of either existing assets or new assets involved in resource development

   to provide dividends to supplement personal income.

2. Is there any way to avoid or resolve the basic conflict of interest between residents as taxpayers and citizens, and residents as shareholders?

   Examples; purchase of oil line share - tarrif question

   development of petrochemicals - royalty prices

   construction of gasline - oil recovery

   virtually any business - any regulation.

3. With respect to the above questions, can we expect AGSOC to become an important political force? Is it appropriate or possible (first amendment rights question) to prevent this?

4. Even with the amendments contemplated by either the House State Affairs Committee or the Administration regarding corporate governance, how likely is democratic control of AGSOC?

5. What is the likely extent of state subsidies to AGSOC? What will be the impact on the state's credit rating from passage of the bill? From actual extension of state financial aid?

Should procedures and/or conditions for extending such aid be included in the bill?

NOTE: The House State Affairs Committee has requested drafting of amendments to provide for a referendum for any state financial assistance to AGSOC. No legislative approval would be required for AGSOC investment not requiring state financial assistance.

6. Is it possible to resolve/avoid the "closed class" problem created by "old" residents being shareholders while "new" residents are not?

7. How will the Governor make decisions as to who shall constitute the first Board of Directors?

8. Does the Alaskan public want an AGSOC?

Second Level

1. What should be the procedures for electing the Board of Directors?

2. Should the state allow the federal corporate income tax exemption to pass through to state corporate income taxes?

NOTE: The House State Affairs Committee has agreed to pass through the tax exemption.

3. Should there be one AGSOC per investment or project, or should there be only one AGSOC which could invest in a variety of projects?

NOTE: Senator Colletta supports the former approach; House leaders support the latter.

4. Should people who leave the state be able to take their shares with them?

NOTE: The House State Affairs Committee has decided to mandate that people who cease to be residents transfer their shares either to a resident or to the corporation.

5. Is AS 10.05 of the Alaska Business Corporation Act the appropriate "regulatory umbrella" for AGSOC, or do we need a new chapter specifically designed for AGSOC?

NOTE: The House State Affairs Committee has requested drafting of a new "GSOC" chapter.

6. Should there be a limitation on, or incentives against, litigation between AGSOC and the state (because the same people bear the costs)?

Does AGSOC possess unfair competitive advantages which could lead to anti-trust problems?

7. What are the implications for AGSOC of SEC regulations?

8. What other changes to the bill, Articles of Incorporation, or Bylaws are desired by the Governor or the legislature?

House State Affairs Committee (tentative) desired amendments:

- Chairman of the Board must be Alaska resident.
- Nine member board, seven residents, two outsiders.
- No classified board; all directors elected every two years (mechanics, i.e., proxy issues, undecided).
- Directors removable by shareholders without cause.
- Statutory provision for derivative suits.
- Require legislative approval by resolution of articles and bylaws.
- Give shareholder the ability to amend bylaws.
- Allow board business to be conducted via telecommunications.
- Every director has right to attend all board committee meetings.
- Liability for officers' refusal to allow shareholder access to corporation books and records.
- Loan guarantee fund limited to start-up costs not to exceed $5 million.
- Delete Sections 2 and 3 regarding investments of GF surplus or permanent fund in AGSOC securities. Consider amendment to AS 37.10.070 to prohibit use of subsection 6 for investment of GF surplus in AGSOC. Also delete Sec. 4 which would exempt AGSOC securities from registration under the Alaska Securities Act of 1959 and from filing of sales and advertising literature.
- Prohibit officers and employees of corporation from serving on board.

Administration working Group desired actions or amendments:

- Statutory reservation by the legislature of the right to amend the statute - impairment of contracts issue.
- Development of election procedures for the Board, including financing of proxy fights, access to voting lists and mailing machinery, and consideration of a regionalized board.
- Solution of "single class of stock" issue created by the voting rights of shares held by minors.

- Assessment of the definition of "resident" provided in the bill.

- Assessment of potential for tax liability on initial issue or otherwise to be greater than dividend.

- Criminal liability of directors in certain instances.

- Provision for cumulative voting.

- Limitation on voting trusts.

- Requirement that feasibility analysis and other information be provided to the Governor and the legislature in sufficient time before a decision is necessary on financial or other state aid.

- Details of shareholder meetings, i.e., notice, location, quorum.

- Limitation on assignement of dividend rights.

- Limitation on ability of corporation to acquire Treasury shares.

- Shareholders' ability to amend the number and terms of office of the Board of Directors.

- Directors subject to removal by Superior Court at suit of 100 or more shareholders or Attorney General for fraudulent or dishonest acts or gross abuse.

- Limitation of ownership to one share.

April 19, 1979
HB 240

GENERAL SUMMARY

The proposed Committee substitute creates a new chapter 50, Title X, of Alaska Statutes entitled "General Stock Ownership Corporations." This chapter governs the creation, operation and termination of all general stock ownership corporations organized in Alaska. Many of the provisions have been carried over or adapted from existing Alaska corporate law. The bill is divided into 10 sections.

Section 1: This section contains the provisions of the new chapter 50 of Alaska Statutes, Title X, and constitutes the core of the Committee bill. It contains six articles which deal with shareholder rights and internal operation of the corporations (Article I: Substantive Provisions), formation of general stock ownership corporations (Article 2: Formation of Corporations), amendment of articles of incorporation (Article 3: Amendment of Articles), sale of corporation assets outside the ordinary course of business (Article 4: Sale of Assets), voluntary and involuntary termination of the corporate existance (Article 5: Dissolution), and miscellaneous provisions such as filing fees, criminal penalties, and amendment of the legislation (Article 6: General Provisions).

Section 2: This section prohibits the Commissioner of Revenue from investing surplus state funds in securities of general stock ownership corporations.

Section 3: This section requires that all shareholder materials be filed with the Commissioner of Commerce at the time of distribution to the shareholders. In addition, the Commissioner is given authority to regulate concerning fairness, completeness and nondiscrimination of shareholder materials. The filing provisions coordinate with other sections of the Alaska securities laws making it a crime to file false or misleading materials with the Commissioner.

Section 4:
Section 5:
Section 6: These three sections amend the criminal penalties provisions of section 1 of the bill to conform to the new criminal code which. becomes effective January 1, 1980. The provisions of section 1 are applicable upon signature by the governor and must therefor be amended as of January 1, 1980 to parallel the rest of the new criminal code.

Section 7: This section authorizes the governor to appoint nine persons to act as incorporators and the initial board of directors of the Alaska General Stock Ownership Corporation. This is the section which actually provides for the creation of a GSOC in Alaska. The section restricts share ownership of this corporation to Alaska residents and requires that shares be sold when a shareholder leaves the state or dies leaving his stock to an outsider. It also creates a special fund, not to exceed five million dollars, in the Dept. of Revenue to be used in guaranteeing private loans for the corporation's startup expenses.

Section 8: Section 1 of the bill amends Rule 23.1 of the Rules of Civil Procedure, dealing with derivative suits by shareholders of a general stock ownership corporation. Because it is amending a rule of the courts this provision must be approved by a 2/3 vote of each house. To allow separation of the vote section 8 amends the court rule.

Section 9: This section provides for an immediate effective date for the Committee bill.

Section 10: This section provides for a January 1, 1980 effective date for sections 4-6 which amend the criminal sanctions in the bill to parallel the treatment provided in the new criminal code which also becomes effective January 1, 1980.

SECTION BY SECTION ANALYSIS

This analysis of House State Affairs Committee action on the Alaska General Stock Ownership Corporation legislation describes the provisions of Section 1 of the Committee draft as of April 19, 1979. Since many of the provisions of the draft are carried over wholly or in part from the Alaska Business Corporations Act (ABCA) there is included at the end of each section description a reference to the corresponding section of the ABCA, if any.

ARTICLE 1. SUBSTANTIVE PROVISIONS.

.005. PURPOSES. This section makes it clear that, unless the enabling legislation for a GSOC provides otherwise, the corporation may engage in any legal business. (ABCA 10. 05.003).

.010. GENERAL STOCK OWNERSHIP CORPORATIONS. This section makes it clear that corporation organized under chapter 50, Title 10, are general stock ownership corporations subject to Internal Revenue Code Subchapter "U" and are not agencies of the state for any purpose.

.015. GENERAL POWER. This section grants to GSOCs the powers of normal corporations to conduct business. Two changes have been made in adapting the ABCA provisions to GSOCs.

1) There is a limitations in (4) preventing a GSOC from investing in property "acquired by it, or for its benefit, through the right of eminent domain . . . ." This limitation prevents GSOCs from acting in collusion with an agency or local government to acquire a going business from an unwilling seller. GSOCs are not prevented from investing in projects where some minor portion of the project is acquired through condemnation if the local government determines that the exercise of its condemnation power is appropriate.

2) The power to establish stock bonus plans is deleted from subsection (15) because of the special nature of GSOCs and the limitations on share ownership would make it difficult for a GSOC to adopt a qualified stock bonus plan for its employees. If the GSOC desires to have its employees benefit from growth in the value of GSOC stock the corporation could adopt a funded "phantom stock" program. (ABCA 10.05.009).

.020. INDEMNIFICATION OF OFFICERS, DIRECTORS, EMPLOYEES AND AGENTS; INSURANCE. This section is carried over unchanged from the ABCA and allows the corporation to indemnify its directors or employees for expenses and fines incurred as a result of thier actions on behalf of the corporation if they acted in good faith. Indemnification is disallowed in derivative suits where the defendant is guilty of negligence or misconduct in his duties unless the court determines the indemnification is proper. The corporation may purchase insurance on behalf of its directors and employees for claims against them arising out of their corporate positions. (ABCA 10.05.010).

.030. DEFENSE OF ULTRA VIRES. Meaning "beyond the power" an ultra vires act is one which the corporation did not have authority to perform. This section, carried over from the ABCA, provides that this lack of corporate power can be asserted by a shareholder, the corporation, or the attorney general. It may not, however, be asserted by another party to a transaction with the corporation as grounds for failing to perform. (ABCA 10.05.018).

.035. CORPORATE NAME. This section requires that a GSOC include in its corporate name the words "general stock ownership corporation" or an abbreviation thereof. In addition, the name may not be misleading or deceptively similar to the name of another corporation doing business in Alaska. (ABCA 10.05.021).

.040. RESERVATION OF CORPORATE NAME. This section allows a person or corporation to reserve a specific name for a general stock ownership corporation for a period of two years with a renewal period of one year. Reservation of a name might be used where an individual seeks to establish a GSOCs by initiative petition or where an existing GSOC seeks to change its name upon the approval of its shareholders. The name may be reserved by this section during the period in which the necessary activities are undertaken to make the name effective. (ABCA 10.05.024, .027, and .033).

.045. FOREIGN GENERAL STOCK OWNERSHIP CORPORATIONS. General stock ownership corporations chartered in another state and doing business in Alaska are subject to the rules of the Alaska Business Corporations Act (AS 10.05).

.050. REGISTERED OFFICE AND REGISTERED AGENT. The registered agent is the agent for the corporation upon whom legal papers may be served. This provision requires that the corporation maintain a registered office and agent within the state. (AS 10.05.045)

.055. FILING LIST OF REGISTERED CORPORATIONS WITH SUPERIOR COURT.
.060. CHANGE OF REGISTERED OFFICE OR AGENT.
.065. REGISTRATION OF REGISTERED AGENT.

These three sections set out the rules for registration of the registered agent with the Commissioner of Commerce, the listing of registered agents and offices with the superior courts throughout the state, and the method by which a registered agent may change the registered office or resign his position. These provisions are carried over intact from AS 10.05.048, .051, and .054 respectively.

.070. SERVICE OF PROCESS ON CORPORATION. In addition to designating the registered agent as agent for service of legal papers on the corporation this section allows the Commissioner of Commerce to be served on behalf of the corporation when the registered agent cannot be found. (AS 10.05.057).

.075. CREATION AND ISSUANCE OF SHARES. This section allows the corporation to create and issue shares of no par value stock. The total number of shares available for issue must be stated in the articles of incorporation. GSOCs are prohibited from issuing "par value" stock since that concept, developed for the protection of shareholders, has no application in a corporation such as the GSOC where shares are to be distributed initially without payment by the shareholders.

.080. CONSIDERATION FOR SHARES. The federal GSOC legislation requires that a GSOC have a charter providing for the issuance of "at least one share (of stock) to each eligible individual." In order to fulfill this requirement it appears that the first share of GSOC stock must be issued without charge to the shareholders. However, there does not appear to be any restriction in the federal legislation upon subsequent sales of stock by GSOCs except for the general limitations upon share ownership. In keeping with the Committee's desire for a generally applicable GSOC chapter provision is made for the subsequent sale of stock by GSOCs. Thus, this section allows the GSOC to issue shares without consideration or for a payment fixed in advance by a vote of the shareholders.

Sales of corporation stock by the corporation may not be made at a price in excess of book value if the shares sold are treasury shares, that is shares which have been issued and repurchased by the corporation. (AS 10.05.096).

.085. PAYMENT FOR SHARES. Payment for shares may be made in cash, other property or services, but not in notes or future services. (AS 10.05.099).

.090. JUDGMENT OF BOARD OR SHAREHOLDER AS TO VALUE OF CONSIDERATION CONCLUSIVE. This section allows the directors or the shareholders to conclusively determine the value of payment for shares in the absence of fraud. (AS 10.05.102).

.095. EXPENSES OF ORGANIZATION, REORGANIZATION AND FINANCING. In sales of stock by a corporation shares entitled to the full protections of limited liability must be fully paid and nonassessable. This means that the full sales price for the stock has been received by the corporation. However, if the stock is sold through an underwriter the fees will come out of the sales proceeds before they are paid to the corporation. Likewise, the organizational expenses of the corporation may be paid out of stock sales before the proceeds are remitted to the corporation. This section clarifys that in such cases the shares are deemed to be fully paid. (AS 10.05.111).

.100. CERTIFICATES REPRESENTING SHARES. This provisions sets out the requirements as to form of stock certificates which must be signed by the corporate officers. (AS 10.05.114)

.105. INFORMATION REQUIRED TO BE STATED ON CERTIFICATE. The stock certificates or other evidences of ownership must include information regarding the person to whom they are issued, that they are no par value shares, and that the corporation is organized in Alaska. (AS 10.05.117).

.110. FULL PAYMENT REQUIRED FOR CERTIFICATE. If payment is required for shares they may not be issued until full payment is received. (AS 10.05.120).

.115. ISSUANCE OF FRACTIONAL SHARES. GSOCs may issue fractional shares of stock and these fractional shares hold dividend, voting and distribution rights equal to their fractional interest. It may be necessary for a GSOC to issue fractional shares in the situation where a shareholder leaves his stock to his heirs and there is more than one child beneficiary. (AS 10.05.123).

.120. LIABILITY OF SUBSCRIBERS AND SHAREHOLDERS. This section, adopted directly from ABCA, limits the liability of shareholders and those who have agreed to purchase share to the amount which they agreed to pay to the corporation for the shares. Subsequent holders of the stock are protected if they received the stock in good faith. (AS 10.05.126).

.125. BYLAWS. The board of directors adopts the initial bylaws of a GSOC subject to review and rejection by the legislature under section 330 of the draft bill. Subsequent bylaws may adopted, amended or repealed only by a vote of the shareholders.

.130. MEETINGS OF SHAREHOLDERS. The time and location of the annual shareholders meeting is to be established in the bylaws. The specific place for the meeting may be set by the board. Special meetings of the shareholders may be called by the president of the corporation, the board or the holders of at least 500 shares. Shareholder meetings may be teleconferenced. (AS 10.05.138).

.135. NOTICE OF SHAREHOLDER'S MEETINGS. This section requirε written notice of shareholder's meetings mailed to sharε holders not less than 60 days before the meeting. In addition, notice of shareholders' rights to add ballot issues or nominate directors must be made by publication at least once a week for four weeks beginning at least 150 days before the meeting. (AS 10.05.141).

.140. CLOSING OF TRANSFER BOOKS AND FIXING RECORD DATE. To determine the shareholders of the corporation for purposes of a dividend distribution or voting rights the transfer books of the corporation may be closed prior to the date of the proposed activity or a "record date" may be established and the shareholders determined as of that date. Time limits are provided beyond which the transfer books may not be closed in order to protect shareholder voting rights and to allow interested parties to inspect the share records of the corporation prior to shareholders' meetings. (AS 10.05.144).

.145. VOTING LIST. The responsible officer of the corporation must make available at the registered office of the corporation beginning at least 60 days before any shareholders' meeting a list of the shareholders eligible to vote at the meeting and access to this list must be provided to all shareholders. (AS 10.05.147).

.150. QUORUM OF SHAREHOLDERS. 1/3 of the shares constitute a quorum for action by the shareholders and a majority vote of a quorum is sufficient to bind the shareholders in most cases. (AS 10.05.153).

.155. PROXY VOTING PROHIBITED. Because of the ballot mechanism whereby each shareholder is allowed to vote in person through his ballot proxies are unnecessary in general stock ownership corporations and are therefore prohibited.

.160. VOTING FOR DIRECTORS. Each shareholder may vote his shares for directors but cumulative voting is prohibited. This means that each share can cast only one vote for director in any contested election for a directorship position.

.165. VOTING OF SHARES IN THE NAME OF ANOTHER.
.170. VOTING OF PLEDGED SHARES.
These sections allow shares held by an administrator, executor or guardian to be voted by him without a transfer of the shares into his name. Shares held by a pledgee may be voted by the pledgor until transferred into the pledgee's name. (AS 10.05.165 and . 168).

.175. CORPORATION BALLOT. Voting at meetings of shareholders will be by ballot rather than through the normal corporate vehicle of proxies. The ballot will be prepared by the corporation subject to review for fairness by the Commissioner of Commerce. It will be mailed to each shareholder with the notice of the shareholders' meeting and voted by mailing it back to the corporation before the date of the meeting.

Shareholders may, by petition of 100 or more, nominate diretors and place issues on the corporate ballot. In addition, the directors may place issues and candidates on the ballot by a majority vote. Shareholder information on board candidates and ballot issues is to be provided to the shareholders by the corporation and these materials will be filed with the Commissioner of Commerce and subject to the regulations and criminal penalties applicable thereto.

The directors may not propose to amend any proposal sponsored and approved by the shareholders within one year of the meeting at which the proposal was approved.

.180. BOARD OF DIRECTORS. The board of directors is charged with management responsibility for the corporation and their compensation is to be fixed in the bylaws. At least 3/4 of the board must be residents of Alaska insuring that outside directors may never constitute a quorum of directors except when meeting to fill vacancies in directors seats until the next annual meeting of shareholders. (AS 10.05.174).

.185. NUMBER OF DIRECTORS. The minimum number of directors is three and the number is to be fixed in the bylaws except that the original number is fixed by the enabling legislation. If the bylaws are silent the number fixed in the enabling legislation is the proper number. The number of directors can be changed through a bylaw amendment.

The board members serve for two year terms and they are to be divided into classes with only half the board standing for election at any one annual meeting. This staggering of the board members' terms provides for some continuity of management on the board of directors. (AS 10.05.177).

.190. ELECTION OF DIRECTORS. Directors are to be elected at the annual meetings and each director hold office until his successor is elected and qualified. This prevents gaps in board membership except upon death or incompetance of a board member. (AS 10.05.183).

.195. VACANCIES. ''acancies in the board caused by death, resignation or incompetance may be filled by a majority vote of the remaining directors. Directors elected by the board to fill a vacancy must stand for election by the shareholders at the next shareholders' meeting and are elected to fill the remaining portion of the directors position originally filled by vote of the board. No vacancy may continue for more than 6 months or until the next shareholders' meeting. (AS 10.05.189).

.200. QUORUM OF DIRECTORS. A majority of the total number of directors fixed in the bylaws, articles or enabling legislation constitutes a quorum and action may be taken by a majority vote of a quorum. By allowing only ¼ of the board to be outsiders Alaskan control of the board is assured. One-quarter of the board can never constitute a majority of a quorum except in the event of a vacancy in which case the board must act to fill the vacancy. (AS 10.05.192).

.205. PLACE AND NOTICE OF DIRECTORS' MEETINGS. Directors meetings may be held only in Alaska and regular meetings of the board may be held without notice. Special board meetings require notice specifying the purpose of the meeting. (AS 10.05.198).

.210. PARTICIPATION BY TELEPHONE. Directors may participate in directors meetings by telephone if all the participants may hear and be heard by each other. (AS 10.05.199).

.215. DISTRIBUTIONS. Some restrictions on corporate distributions are necessary because the limited liability feature of corporations prohibits creditors from levying against shareholders if the corporation distributes its way to insolvency. The traditional restraints which have been used to protect creditors of corporations are the devices of stated capital, capital surplus, earned surplus and retained earnings. Through these devices corporations are required to keep at least something in the till for creditors.

However, the traditional restraints never ensured that cash would be on hand for creditors and they have been eroded by numerous exceptions allowing the corporation to designate capital surplus and create surplus by reduction of capital. As a result corporations have been able to make distributions beyond the point where liabilities to third parties were protected.

Under the ABCA dividends may generally be declared only out of earned surplus. (AS 10.05.204). There are several exceptions to this rule. Dividends may be paid in cash out of depletion reserves by natural resource companies and in stock out of capital surplus. (AS 10.05.204). However, a dividend may not be declared if the corporation would thereby be rendered insolvent. (AS 10.05.201). These restrictions provide some protection to creditors in that at least 75% of the amount received for shares must be allocated to stated capital, but the remaining 25% may be allocated to capital surplus available for distribution under certain circumstances.

Similarily, the ABCA provides that a corporation may acquire shares issued by it only from earned surplus except in special situations. (AS 10.05.012). This distinction between the sources from which shares may be purchased and those from which dividends may be paid does not make much sense since a purchase of shares on a prorata basis has the same effect as a dividend with regard to the protection of creditors.

To protect the creditors and shareholders of general stock ownership corporations and to rationalize restrictions upon the payment of dividends and repurchase of shares, this section provides restrictions on shareholder distributions based upon the current financial condition of the corporation. This section, adapted from a 1977 California amendment to the California Corporations Code, eliminates the concepts of stated capital and capital surplus in favor of a simple balance sheet test.

Under this section the corporation may always make the distribution required by subchapter "U" of the Internal Revenue Code. Thus, the corporation may always distribute to its shareholders an amount equal to 90% of its taxable income.

For distributions in excess of 90% of taxable income the corporation must fulfill either of two tests:

1) The corporation may make a distribution out of retained earnings.

2) If there are no retained earnings the corporation may make a distribution only if it meets a two pronged test:

   a) The assets of the corporation, after the distribution are at least equal to 1¼ times its liabilities, AND

   b) The current assets, after the distribution, are at least equal to the current liabilities (a "liquidity test").

   If the average pretax income plus interest expense for the two preceeding fiscal years is not at least equal to the average interest expense for those years the current assets must be at least 1¼ times current liabilities.

   If the corporation does not classify its assets into current and fixed in accordance with generally accepted accounting principles the current assets or liquidity test does not apply.

.220. DISTRIBUTIONS IN PARTIAL LIQUIDATION. Distributions in partial liquidation are special distributions which reduce the capital value of the corporation. They are distributions out of capital rather than earnings. These distributions may be made only upon a 2/3 vote of the shareholders and must be identified as distributions in partial liquidation. (AS 10.05.207).

.225. CERTAIN LOANS PROHIBITED. Loans by the corporation to its officers or directors are prohibited. (AS 10.05.213).

.230. LIABILITY OF DIRECTORS IN CERTAIN CASES. This section carried over from ABCA makes directors personally liable for distributions and stock purchases by the corporation in violation of the distribution limitations. (AS 10.05. 216).

.235. EFFECT OF GOOD FAITH RELIANCE ON FINANCIAL STATEMENTS OR BOOK VALUE. Directors are not liable under the preceeding section if they relied upon financial statements of the corporation represented to him to be correct. (AS 10.05. 219).

.240. PRESUMPTION OF CONSENT OF DIRECTOR AND FILING OF DISSENT. A director present at a meeting is presumed to consent to the action taken by the board at such a meeting unless he files a dissent in accordance with this section. (AS 10.0 5.222).

.245. DIRECTOR'S RIGHT TO CONTRIBUTION. A director sued for violation of the distribution rules is entitled to contribution (a sharing of the damages) from all directors assenting to or voting for the action. (AS 10.05.225).

.250. OFFICERS. Officers of the corporation are elected by the board of directors and serve at their pleasure. (AS 10.05.228).

.255. DUTIES OF OFFICERS. The board and the bylaws establish the duties of the corporate officers. (AS 10.05.231)

.260. REMOVAL OF OFFICERS. Officers may be removed by the board but removal does not prejudice contract rights. (AS 10.05. 234).

.265. BOOKS AND RECORDS. GSOCs are required to keep complete books and records and make them available for inspection by shareholders and the Dept. of Commerce at the principal place of corporate business or the registered office. (AS 10.05.237).

.270. SHAREHOLDER'S RIGHT TO EXAMINE BOOKS AND RECORDS. Shareholders have the right to examine books of the corporation at a reasonable time upon written demand. Access to the books of the corporation can be denied if sought for an "improper" purpose.

The proper purpose restriction is a carryover from common law where the restriction insured that the examination was for an honest purpose and not to gratify curiosity or for speculative or vexatious purposes. It was designed to make certain that the purpose of the shareholder desiring to make examinations must be germain to his interests as a shareholder, that it was proper and lawful in character, and that it was not inimical to the interests of the corporation.

To clarify the applicability of this common law doctrine a number of states, including Alaska, have adopted into their corporation codes an inspection of recor1s provision requiring the proper purpose. Under these provisions the shareholder is presumed to have the right of inspection and the lack of a proper purpose can only be asserted as a defense to a claim of wrongful denial of inspection. There is no comprehensive definition of what constitutes a proper purpose since there are innumerable valid reasons for a shareholder to inspect the books of his corporation. However, case law has indicated many such purposes a partial list of which would include:

1) To ascertain the value of a shareholder's stock.
2) To acquire knowledge to enable him to vote understandingly at a shareholder's meeting.
3) To investigate into consideration actually paid for stock and the failure to distribute dividends.
4) To investigate irregularities resulting in secret profits to officers of the corporation.
5) To determine correctness of financial statements and the existance of collateral for notes.
6) To determine whether a shareholder is being discriminated against in relation to his shares. (AS 10.05.237).

.275. LIABILITY FOR REFUSAL OF EXAMINATION. Any agent of the corporation wrongfully refusing shareholder access to the books and records of the corporation is subject to a fine of $1,000 per day for each day of wrongful refusal. (AS 10.05.243).

.280. COURT MAY COMPEL INSPECTION. Courts have the power to compel inspection of the corporations books. (AS 10.05.249).

.285. SHAREHOLDERS' RIGHT TO FINANCIAL STATEMENT. The corporation must provide the shareholders with a financial statement upon request. (AS 10.05.249).

.290. REMOVAL OF DIRECTORS BY SUPERIOR COURT. This new provision allows a court, upon the suit of the attorney general or 100 shareholders 18 or older, to remove a director for fraudulent or dishonest acts or gross abuse of authority and bar such director from reelection.

This provision is not a simple removal clause, but gives standing to the shareholders and the attoreny general to ask a court to remove a director for specific reasons. In order to have the court remove the director the shareholders or the attorney general bringing suit must still prove the director guilty of the offenses charged.

.295. SHAREHOLDER REMOVAL OF DIRECTORS. This section allows the shareholders to remove the entire board by a majority vote or any single director by a vote at least as large as that which elected him at his last election.

.300. SHAREHOLDERS' DERIVATIVE ACTION. This section allows shareholders to file an action on behalf of the corporation if those responsible inside the corporation fail to do so. Alaska Supreme Court Rule 23.1 provides for such an action, but does not specify the treatment of security for expenses or accounting of settlements. Because this section would amend a rule of court a 2/3 vote is required for passage and the provision is set forth separately in Section 8 of the bill.

This section allows the courts discretion to require security for expenses incurred in the prosecution of the derivative action. It requires court approval of any out of court settlement to insure that those prosecuting the suit may not simply be bought off. The proceeds of any successful action or settlement of a derivative suit must be accounted for to the court and the court is then authorized to award reasonable expenses to the parties.

.305. FRAUDULENT TRANSFERS OF SHARES. Transferring or obtaining shares of the corporation by fraud is a felony.

ARTICLE 2. FORMATION OF CORPORATIONS.

.310. INCORPORATORS. Incorporators are those persons who file the articles of incorporation to begin the corporation's existance. This must be done by at least three people over the age of 19. (AS 10.05.252).

.315. ARTICLES OF INCORPORATION. This section sets out the minimum requirements of the articles of incorporation for general stock ownership corporations. The article provisions required by subchapter "U" of the Internal Revenue Code are included in this section as requirements for GSOCs organized in Alaska. Other provisions are carried over from ABCA. (AS 10.05.255).

.320. FILING OF ARTICLES OF INCORPORATION. Articles of incorporation are to be filed with the Commissioner of Commerce who shall certify the filing and return one original of the articles to the corporation. (AS 10.05.258).

.325. EFFECT OF ISSUANCE OF CERTIFICATE OF INCORPORATION. Upon issuance of the certificate the corporate life begins. (AS 10.05.261).

.330. ARTICLES OF INCORPORATION AND INITIAL BYLAWS. This section provides for legislative review of the articles and initial bylaws. They must be submitted to the next session of the legislature and, if not disapproved within 60 days by concurrent resolution they are approved. Legislative disapproval may be overriden by a vote of the shareholders.

.335. ORGANIZATION MEETING OF DIRECTORS. The incorporators shall call an organizational meeting of directors in the state for the purpose of adopting bylaws, electing officers and conducting other business necessary to the organization of the corporation. (AS 10.05.267).

.340. NOTIFICATION OF ELIGIBLE SHAREHOLDERS. Since stock is to be distributed free of charge initially all Alaska residents must be notified of its availability. This section sets out the minimum notice requirements of weekly broadcast and publication for at least three month before stock distribution and monthly broadcase and publication for eleven months after distribution. These are minimum requirements only and the board of directors may determine that the corporation should take other steps to identify and notify potential shareholders.

.345. CORPORATION NOT LIABLE TO SHAREHOLDERS. Although GSOCs are required to take reasonable steps to notify potential shareholders of their right to stock the burden of applying for stock lies with the resident and the corporation is not liable for failure to notify or issue stock to a potential shareholder. If a resident makes application for stock after the distribution of one or more dividends he looses his right to those dividends and is entitled to receive only those dividends declared and paid after the date upon which his stock was issued to him.

.350. LATE APPLICATION FOR SHARES. Any individual who is eligible to receive an initial distribution of shares but who fails to apply for an issuance of stock may be issued a share at any time within one year of the original issue of stock upon application and payment of book value therefor. The one year period coincides with the period during which a shareholder may elect not to receive his stock and have his share cancelled. This cut off period protects the corporation and the other shareholders from those eligible reisents who are not identified and who fail to identify themselves hoping to see how the corporation fares before applying for their stock.

.355. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER. The superior court is given jurisdiction to void stock issued to an ineligible individual who obtained his shares by fraud and allows the corporation to recover any distributions paid to such a shareholder.

ARTICLE 3. AMENDMENT.

.360. RIGHT TO AMEND ARTICLES OF INCORPORATION. The articles of the corporation may be amended to include any legal provision. (AS 10.05.270).

.365. PURPOSES FOR WHICH ARTICLES MAY BE AMENDED. This section lists some, but not all, of the legal purposes for which the articles may be amended. (AS 10.05.273).

.370. PROCEDURE TO AMEND ARTICLES OF INCORPORATION. The board of directors or the shareholders can propose amendments to the articles of incorporation, but the articles may only be amended upon a 2/3 majority vote of a quorum of shareholders.

.375. ARTICLES OF AMENDMENT.
.380. FILING OF ARTICLES OF AMENDMENT.
.385. EFFECT OF CERTIFCATE OF AMENDMENT.
These three sections provide that an amendment approved by the shareholders to he articles of incorporation must be filed with the Commissioner of Commerce in the same manner as the original articles of incorporation and once certified by the Commissioner the amendment becomes effective. These sections are adopted directly from AS 10.05.285, .288, and .291 respectively.

.390. RESTATED ARTICLES OF INCORPORATION.
.395. EXECUTION OF RESTATED ARTICLES OF INCORPORATION.
.400. CONTENTS OF RESTATED ARTICLES OF INCORPORATION.
.405. FILING OF RESTATED ARTICLES OF INCORPORATION.
.410. EFFECT OF ISSUANCE OF RESTATED CERTIFICATE OF INCORPORATION.
These five section deal with restated articles of incorporation. Restated articles of incorporation for purposes of GSOCs are simply a consolidation and updating of the articles of incorporation with current amendments. This allows the corporation to have on file with the Commissioner a current copy of the articles of incorporation incorporating all amendments. The provisions are adopted essentially from ABCA except that GSOCs are not allowed to amend the articles of incorporation through filing restated articles and for that reason are allowed to file restated articles upon motion of the board of directors. (AS 10.05.294, .297, .300, .303, and .306 respectively).

ARTICLE 4. SALE OF ASSETS.

.415. SALE OR MORTGAGE OF ASSETS IN REGULAR COURSE OF BUSINESS. The board of directors may sell or dispose of all the assets of the corporation if it is in the ordinary course of the corporation's business. (AS 10.05.435).

.420. SALE OR MORTGAGE OF ASSETS OTHER THAN IN REGULAR COURSE OF BUSINESS. Sale of all the assets of the corporation other than in the ordinary course of business requires a vote of the shareholders. (AS 10.05.438).

.425. APPROVAL OF PLAN BY SHAREHOLDERS. A 2/3 vote of the shareholders is required to approve a sale of all the assets of the corporation outside the ordinary course of business. (AS 10.05. 441).

.430. ABANDONMENT OF PLAN BY BOARD OF DIRECTORS. Even though a vote of the shareholders is required to approve a sale of all the assets the sale may be abandon by the board since such sales are unusual and may require quick decisions which cannot be effectively put to the shareholders. If the shareholders are unhappy about the abandonment they have the power to remove the board and it is to be expected that the board would not abandon such a sale without good cause. (AS 10.05.444).

.435. RIGHTS OF DISSENTING SHAREHOLDERS UPON SALE OR EXCHANGE OF ASSETS.
.440. NOTICE TO DISSENTING SHAREHOLDER.
.445. PAYMENT TO DISSENTING SHAREHOLDER AFTER AGREEMENT ON VALUE OF SHARES.
.450. ACTION BY DISSENTING SHAREHOLDER TO COMPEL PAYMENT UPON FAILURE TO AGREE ON VALUE.
.455. EFFECT OF ABANDONMENT OR REVOCATION OF SALE OR EXCHANGE ON SHAREHOLDER'S RIGHTS.
.460. STATUS OF SHARES ACQUIRED FROM DISSENTING SHAREHOLDER.
These section deal with the shareholder who does not wish to be a part of the sale of substantially all the assets of the corporation in spite of the 2/3 majority vote of the shareholders. Such a shareholder can dissent from the sale and have the corporation purchase his shares. There are notice provisions and opportunity for the shareholder and the corporation to agree upon a purchase price for the shares. If the shareholder and the corporation cannot agree upon a price the matter can be decided by a court. If the sale is abandoned the dissenting shareholder looses his right to receive payment from the corporation for his share and he remains a shareholder. Shares acquired from a dissenting shareholder become treasury shares.

ARTICLE 5. DISSOLUTION.

GSOCs may be dissolved voluntarily by a 2/3 vote of a quorum of shareholders (.470) or by the Commissioner of Commerce (.525).

In a voluntary dissolution the question may be put to the shareholders upon action of the board or a petition of 100 shareholders (.470). Upon affirmative vote of the shareholders a statement of intent to dissolve signed by corporate officers (.475) is filed with the Commissioner of Commerce (.480). When the statement is officially filed by the Commissioner the corporation must cease doing business and wind up its operations (.465). However, the corporate existance continues while the corporation notifies creditors, collects and liquidates assets and pays off its obligations (.485)(.490). When the business of the corporation has been wound up articles of dissolution (.510) are filed with the Commissioner (.515) and when certified the corporate existance ceases (.520). Voluntary dissolutions may be revoked at any time by a 2/3 vote of the shareholders (.495) in which case the corporation files a statement of revocation (.500) and the dissolution process is terminated (.505).

A GSOC may be dissolved involuntarily by the Commissioner of Commerce with 60 days notice for failure to file reports or pay fees, failure to maintain a registered agent or office or change either without notice, and unfilled board vacancies continuing beyond the allowable time (.525). A corporation can be reinstated within two years upon remedy of the violation.

The superior court may dissolve a GSOC (.53) and has jurisdiction to liquidate the corporation's assets (.535). The Attorney General may bring suit to dissolve the corporation where there was fraudulent incorporation or continual abuse of corporate authority (.525).

In addition a suit for liquidation of the corporations assets may be brought by:

1) A shareholder where the board is deadlocked; the board is action in an illegal, oppressive, or fraudulent manner; the shareholders are deadlocked for two annual meetings; or, the corporation's assets are being misapplied (.540).
2) A creditor when the creditor's claim is unsatisfied and the corporation is insolvent (.545).
3) The corporation upon request to have a voluntary dissolution continued under court supervision(.550).
4) The Attorney General in conjunction with a suit for dissolution (.555).

The shareholders need not be a party to the action for liquidation (.560). The court has authority to appoint a qualified receiver (.600) for the corporation with power defined by the court (.580) to collect and sell its assets (.565)(.570). Proceeds are to be used to pay expenses allowed by the court (.585) and debts of the corporation with the remainder distributed to the shareholders (.575).

The receiver may sue and be sued (.590) and all claims against the corporation must be filed in a timely manner with the court or the receiver (.605). Liquidation may be terminated by the court (.610) but upon completion the court must enter a decree of dissolution (.615).

The article on dissolution is carried over substantially intact from ABCA (AS 10.05.465 - .594).

ARTICLE 6. GENERAL PROVISIONS.

.620. AS 10.05 INCORPORATED BY REFERENCE. In order to reduce duplication this section incorporates by reference Sections .699 through .819 of ABCA (AS 10.05.699 - .819). These sections deal with requirements for annual reports to be filed with the Commissioner of Commerce, filing fees and charges, procedural privisions and forms, and powers of the Commissioner of Commerce.

.625. FALSE STATEMENTS AFFECTING VALUE OF SHARES. An agent of a corporation who makes fraudulent statements regarding the value of shares is guilty of a misdemeanor.

.630. DIRECTOR MAKING UNLAWFUL DIVIDEND OR DISTRIBUTION OF ASSETS. A director who concurs in a distribution designed to deceive creditors or shareholders is guilty of a misdemeanor.

.635. RESERVATION OF POWER. Amendments to this chapter apply to all existing and future corporations organized under it.

.640. DEFINITIONS. Many of the definitions in this section are carried over from ABCA and may also be found in AS 10.05.825. However, there are two significant new definitions:

Certificate as used in the context of "stock certificate" may mean something other than the actual certificate such as a receipt evidencing ownership. This definition has been broadened in order to allow for the possibility that the stock certificates themselves may never be issued, but that the stock records may be kept by the corporation itself as the evidence of ownership in a particular shareholder which ownership would be represented in the hands of the shareholder by a receipt. Such a receipt would be required to carry all the same information as is required on the certificate itself.

Resident is defined as a person who lives in Alaska and intends to remain here permanently. The definition allows for temporary travel or employment outside without loss of residency. If a dispute arises over residency all of the facts and circumstances indicative of permanent residency must be considered.

TAX CONSEQUENCES OF GSOCs

The figures used in this example assume on the one hand ownership of a 15.84% interest in the TAPS line by a private corporation wholly owned by non-residents and on the other hand a similar interest owned by an Alaska general stock ownership corporation. An effort is made here to illustrate the effect of these different forms of ownership upon the tax revenues of the state of Alaska.

	NON-RESIDENT CORP.	GSOC
Taxable Income[1]	$131,548,000	$131,548,000
Alaska Corporate Tax (9.4%)	12,366,000	-0-
Cash for distribution	$119,182,000	$131,548,000
Distributions to Alaskans	-0-	$131,548,000
Alaskans subject to tax on[2] their distribution	-0-	51.85%
Distributions taxed by Ak.	-0-	$68,208,000
Average rate on distributions[3] taxed by Alaska		5.5%
Income to State of Alaska	$12,366,000	3,751,000

The second step in the analysis is to determine how much additional income will accrue to Alaskans from this type of corporation. Once that is determined we can apply a mulitplier to that income and determine the tax consequences of later transactions in which the additional income is spent and becomes income to someone else.

CASH AVAILABLE TO ALASKANS

Income to Alaskans after state income tax	-0-	$127,797,000
Alaskans subject to federal[4] income tax on distribution		51.85%
Distributions taxed by the federal government		66,263,000
Average federal rate on [5] distributions		27.5%
Federal taxes paid on distributions		18,222,000
Cash, after income taxes, available to Alaskans		
Total distribution to Alaskans		$131,548,000
Less Alaska income taxes		$3,751,000
Less federal income taxes		18,222,000
Total cash, after income taxes, available to Alaskans		$109,575,000

From this total cash available to Alaskans figure we can determine the secondary tax consequences of this addition to personal income in Alaska. The MAP econometric model of the Institute of Social and Economic Research in Anchorage uses a multiplier of 2 to determine the tax effect of additions to personal income in Alaska. Since the income has already been taxed once by Alaska in our calculations the model tells us that an additional 5.5% can be expected in state taxes, most of which would be realized within 18 months of the distribution.

ADDITIONAL STATE INCOME FROM MULTIPLIER

Portion of distribution taxed in Alaska[6]	$ 68,208,000
Additional 5.5% from taxes on income generated by spending of the additional disposable income	5.5%
Tax revenues to state from multiplier	$ 3,751,000

COMPARISONS

Income to Alaskans (pre federal income tax)	$ -0-	$124,046,000
Income to State	12,366,000	7,502,000
Total income to Alaska	$12,366,000	$131,548,000

[1] Derived from Arthur Anderson & Co. study "Prudhoe Bay Field and Trans-Alaska Pipeline System - Comparative State Tax Burden Study" Feb. 1979.

[2] The Department of Revenue estimates that approximately 210,000 Alaskan individuals pay income taxes out of a total population of 405,000. Thus, approximately 51.85% of Alaskans pay taxes to the state.

[3] The average rate of state income tax on the last dollar of income received by Alaskans who pay state income taxes is estimated by the Department of Revenue to be approximately 5.5%. Since any GSOC dividend would constitute additional income to the shareholders they would be taxed on this income at their marginal rate.

[4] This figure is approximately the same as those Alaskans subject to state income tax.

[5] Department of Revenue estimates that the average rate of federal income tax on the last dollar of income of those who pay federal taxes in Alaska lies between 25% and 30%. For purposes of this example these estimates are averaged to arrive at a rate of 27.5%.

[6] This is the same amount as found above on the line below footnote #2 and represents the amount received by those Alaskans subject to state income tax.

James Allen were able to create and fund the Economic and Development Corporation, a separate Swiss company, and pay $750,000 to Dr. Hubert Weisbrod, a Swiss attorney, to stimulate West German jet sales without the knowledge of the board or, apparently, other senior executives.

At 3M, chairman Bert Cross and finances vice president Irwin Hansen ordered the company insurance department to pay out $509,000 for imaginary insurance and the bookkeeper to fraudulently record the payments as a "necessary and proper" business expense for tax purposes. Although the transactions lacked required documentation, they were approved by both departments and later "verified" by Haskins and Sells, the outside auditor.

Ashland Oil Corporation's chief executive officer, Orwin E. Atkins, involved at least eight executives in illegally generating and distributing $801,165 in domestic political contributions, also without question. Not only was the board not informed until the Special Prosecutor's Office and Internal Revenue Service compelled Atkins to dribble out details of the misappropriation of funds, but Ernst and Ernst, Ashland's accountants, did not effectively investigate any of half a dozen separate accounts it discovered that suggested Ashland's illegal course of action.

The Legal Basis of Management Power

The legal basis for such a consolidation of power in the hands of the corporation's chief executive is the proxy election. Annually the shareholders of each publicly held corporation are given the opportunity of either attending a meeting to nominate and elect directors or returning proxy cards to management or its challengers signing over their right to vote. Few shareholders personally attend meetings. Sylvan Silver, a Reuters correspondent who covers over 100 Wilmington annual meetings each year, described representative 1974 meetings in an interview: At Cities Service Company, the 7th largest industrial corporation with some 135,000 shareholders, 25 shareholders actually attended the meeting; El Paso Natural Gas with 125,000 shareholders had 50 shareholders; at Coca Cola, the 69th largest corporation with 70,000 shareholders, 25 shareholders attended the annual meeting; at Bristol Meyers with 60,000 shareholders a like 25 shareholders appeared. Even "Campaign GM," the most publicized shareholder challenge of the past two decades, attracted no more than 3,000 of General Motors' 1,400,000 shareholders, or roughly two-tenths of one percent.

SOURCE: TAMING THE GIANT CORPORATION
NADER, GREEN, AND SELIGMAN

Thus, corporate directors are almost invariably chosen by written proxies. Yet management so totally dominates the proxy machinery that corporate elections have come to resemble the Soviet Union's euphemistic "Communist ballot"—that is, a ballot which lists only one slate of candidates. Although federal and state laws require the annual performance of an elaborate series of rituals pretending there is "corporate democracy," in 1973, 99.7 percent of the directorial elections in our largest corporations were uncontested.

Of the 6,744 corporations required to file data with the Securities and Exchange Commission, incumbent management retained control in at least 6,734 companies, or 99.9 percent. In the 500 largest industrial corporations—corporations which account for some 66 percent of the sales of all industrial corporations in the United States—no incumbent management was even challenged in 1973. One-sided as these results are, they are entirely typical for the largest business corporations. During the 18 years for which data are available, 1956–73, management has won 99.9 percent of all proxy solicitations in 10 out of 18 years.

THE BEST DEMOCRACY MONEY CAN BUY

The key to management's hegemony is money. Effectively, only incumbent management can nominate directors—because it has a nearly unlimited power to use corporate funds to win board elections while opponents must prepare separate proxies and campaign literature entirely at their own expense.

There is first management's power to print and post written communications to shareholders. In a typical proxy contest, management will "follow up" its initial proxy solicitation with a bombardment of five to ten subsequent mailings. As attorneys Edward Aranow and Herb Einhorn explain in their treatise, ***Proxy Contests for Corporate Control:***

> Perhaps the most important aspect of the follow-up letter is its role in the all-important efforts of a soliciting group to secure the *latest-dated* proxy from a stockholder. It is characteristic of every proxy contest that a large number of stockholders will sign and return proxies to one faction and then change their minds and want to have their stock used for the opposing faction.

The techniques of the Northern States Power Company in 1973 are illustrative. At that time, Northern States Power Company voluntarily employed cumulative voting, which meant that only 7.2 percent of outstanding shares was necessary to elect one director to Northern's 14-person board. Troubled by Northern's record on environmental and consumer issues, a broadly based coalition of public interest groups called the Citizens' Advocate for Public Utility Responsibility (CAPUR) nominated Ms. Alpha Snaby, a former Minnesota state legislator, to run for director. These groups then successfully solicited the votes of over 14 percent of all shareholders, or more than twice the votes necessary to elect her to the board.

Northern States then bought back the election. By soliciting proxies a second, and then a third time, the Power Company was able to persuade (or confuse) the shareholders of 71 percent of the 2.8 million shares cast for Ms. Snaby to change their votes.

Larger, more experienced corporations are usually less heavy-handed. Typically, they will begin a proxy campaign with a series of "build-up" letters preliminary to the first proxy solicitation. In Campaign GM, General Motors elevated this strategy to a new plateau by encasing the Project on Corporate Responsibility's single 100-word proxy solicitation within a 21-page booklet specifically rebutting each of the Project's charges. The Project, of course, could never afford to respond to GM's campaign. The postage costs of soliciting GM's 1,400,000 shareholders alone would have exceeded $100,000. The cost of printing a document comparable to GM's 21-page booklet, mailing it out, accompanied by a proxy statement, a proxy card, and a stamped return envelope to each shareholder might have run as high as $500,000.

Nor is it likely that the Project or any other outside shareholder could match GM's ability to hire "professional" proxy solicitors such as Georgeson & Company, which can deploy up to 100 solicitors throughout the country to personally contact shareholders, give them a campaign speech, and urge them to return their proxies. By daily tabulation of returned proxies, professional solicitors are able to identify on a day-by-day basis the largest blocks of stock outstanding which have yet to return a favorable vote.

Management's "army" in a proxy contest will also include attorneys to prepare necessary documents for the SEC and distract the opposition with costly litigation; accountants and statisticians to prepare the most self-serving financial analysis allowable; and public relations advisors to prepare advertisements for trade journals and the financial section of major newspapers. In the past 25 years there have been no more than a dozen instances in which insurgents have been able to match management expenses in a major proxy fight. Over the past decade, only the MGM proxy contest of 1967 has seen insurgents match management expenses in a large corporation's proxy contest for control.

A second advantage—and one that no outsider can match—is management's ability to use corporate personnel on its own behalf. Clerical help and clerical facilities including printing presses, photocopying machines, and addressing machines are invariably employed. Salespersons skilled in talking to customers are frequently assigned to the telephones to answer inquiries and to supplement the professional proxy solicitors by making direct calls to shareholders. Moreover, senior executives can be assigned to telephone particularly important shareholders who may be impressed by the personal call of a top executive.

State corporations law has done nothing to correct this inequality of corporate resources. Although leading cases in Delaware and New York have engaged in much gnashing of teeth about limiting management expenditures to: (a) proxy contests involving a "policy" issue, (b) expenditures necessary to inform shareholders about the "policy" issue, and/or (c) "reasonable" expenses—no decision since 1907 in either jurisdiction has denied management the power to expend corporate funds or use corporate personnel exactly as management chooses. Even such seemingly "unreasonable" expenditures as public relations counsel, "entertainments," chartered airlines, limousines, and the indirect cost to the corporation of using officers and employees on behalf of an incumbent director slate have survived judicial scrutiny. By contrast, state courts have firmly established the rule that insurgents, unlike management, are not entitled to reimbursement of any campaign expenses as a matter of right. Challengers must defray all their own expenses, with the single slim hope of later being reimbursed *if* they are successful and the stockholders approve.

MANAGEMENT CONTROL OF INFORMATION

Management's grip on corporate power is tightened by its authority to print and distribute annual, quarterly, and other reports to shareholders. Besides the formal proxy statement, these reports usually embody the only detailed information shareholders receive about their corporation.

Neither state nor federal law places any meaningful restrictions on the amount of money management may spend reporting to shareholders. SEC Proxy Rules *do* require certification of financial statements. The report, however, "may be in any form deemed suitable by the management" and is not subject to the same standards of truthfulness that the text of a proxy solicitation is subjected to. Consequently, though every word of an insurgent shareholder's communications with other shareholders may be challenged if it is arguably "false or misleading," most management reports are subject to no textual regulation whatever.

Unfortunately, management reports are frequently "false and misleading." They are often written in an upbeat public relations jargon which emphasizes "positive" aspects of the past business year while rationalizing or ignoring management mistakes, financial losses, corporate or executive criminal violations, or civil actions successfully prosecuted against the corporation. Frequently, as much as half of the text of an annual report is represented by oversized charts, colored illustrations, and kindred public relations gimmickry.

There is often little difference between the text of a failing corporation's annual report and a healthy corporation's report. For example, although subsequent congressional testimony made clear that Lockheed would have gone bankrupt unless it received an emergency loan guarantee from the federal government, Lockheed's 1969 annual report managed to ignore the prominent debate in Congress over whether the federal government should "bail out" the firm. Instead shareholders read the following:

> It is disappointing to have to record a net loss for the year. Yet setbacks like this are singularly possible in an industry so dependent upon government policy and the ebb and flow of domestic and international developments.
>
> We have experienced them before and in each case have emerged stronger than ever. We are confident this will be so again. We say this not out of easy optimism but from the knowledge that we have many broadly based defense and commercial programs with high business potential and that we are expending much technical effort to meet the nation's future needs.

The report then spent six pages suggesting that Lockheed's financial difficulties were primarily the result of contractual misunderstandings with the federal government. It strongly suggested that the federal government would compromise in these disputes. It was only *after* the Senate voted an Emergency Loan Guarantee by the razor-thin margin of 49–48 in August 1971 that Lockheed reported to its shareholders that without this congressional subsidy the corporation would have collapsed.

A similar lack of veracity appeared in the 1973 Annual Report of the Franklin New York Corporation, whose principal subsidiary was the Franklin National Bank, the largest state bank ever to fail in the United States. Just a few months before the Comptroller declared the Franklin National Bank insolvent, the corporation's management reported to its shareholders that "In 1973 Franklin crossed an important threshold so that it is now in a position to move forward in establishing itself as a major worldwide financial institution and a leading money center banking operation." Nowhere in the report was any mention made of the foreign currency speculation or improvident real estate loans which four months later caused the bank's demise. This was a serious omission, for the preponderance of financial loss caused by Franklin's collapse was absorbed by the shareholder-readers of this report, not the management or the public relations firm which wrote it. These shareholder-readers were given absolutely no warning of what was coming, no opportunity to exert their prerogative to change management or to vote a more timely dissolution.

Nor can insurgent shareholders obtain much additional information from their own corporation when they prepare for a proxy challenge. They lack the legal tools to gain access to live interviews with corporate executives, board meetings, or memoranda which could document internal debate, management error, derogations of law, sloppy execution of policy, or even the content of management's policy formulations.

All of which is a bizarre commentary on the Securities and Exchange Commission. The federal security laws emphasize disclosure. The Commission has claimed that its Proxy Rules "represent an effective contribution to corporate democracy" because disclosure enables individual investors to exercise some measure of control over the management of their corporation. Although the Securities and Exchange Act of 1934 authorizes the SEC to require annual and quarterly reports, including the authority to prescribe "the items or details to be shown in the balance sheet and the earnings statement . . . ," shareholders can not compel their corporation to give a product line or division accounting so as to uncover unprofitable operations. Specific management mistakes may thus be submerged in consolidated financial reports. Shareholders may wish to know whether executives are using expense accounts improperly or are being indemnified for certain civil or criminal liabilities. They cannot find out. They may wish to read minutes of the meetings of corporate directors—whom they elect—or reports of decisions by executives respecting corporate property—which shareholders own. Under federal securities laws, they have no legal rights to do so.

Under state statutory law, shareholders theoretically have broad rights to examine corporate records. State statutes typically authorize inspection of shareholder lists—without which a shareholder could not even begin a proxy solicitation—and "other books and records." But this access is circumscribed by legal requirements of "good faith," "proper purpose," and minimum share ownership, as well as ample opportunities for management to delay compliance with legitimate shareholder demands by forcing expensive court tests.

Almost invariably shareholders prevail in court battles to secure a shareholder list, for, as a leading Pennsylvania decision put it, ". . . the right to examine the stockholders' list is a basic privilege of every stockholder of a corporation and should be given the widest recognition as fundamental to corporate democracy." But the courts are reluctant to enforce shareholder demands for other information. Doctrinally, this has been rationalized as deterring excessive "stockholder agitation." The Supreme Court of Minnesota rather melodramatically explained why in the leading case of *State Ex rel. Pillsbury v. Honeywell:*

> In terms of the corporate norm, inspection is merely the act of the concerned owner checking on what is in part his property. In the context of the large firm, inspection can be more akin to a weapon in corporate warfare. The effectiveness of the weapon is considerable: "considering the huge size of many modern corporations and the necessarily complicated nature of their bookkeeping, it is plain that to permit thousands of shareholders to roam at will through their records will render impossible not only any attempt to keep their records efficiently, but the proper carrying on of their business." . . . Because the power to inspect may be the power to destroy, it is important that only those with a bona fide interest in the corporation enjoy the power. . . .

Alarming as the specter of "thousands of shareholders roaming at will" through once efficient corporations may be, it can only be conjured up by courts so cunning as to overlook their inherent judicial power to restrict any shareholder access to corporate data to reasonable numbers of shareholders at reasonable times and reasonable places. Yet phantom or not, this rationale has been employed in recent decisions to deny one A&P shareholder access to the minutes of board meetings and information relevant to store closings; to deny Ralston Purina shareholders access to monthly profit analyses employed by management; and to deny shareholders of Gulf Sulphur Corporation information concerning a firm with which Gulf proposed to merge.

MANAGEMENT CONTROL OF THE LAW

Management power is further entrenched by three significant legal advantages.

First, in approximately 90 percent of all large industrial corporations, cumulative voting is not required. In these corporations, a minority of shareholders—even a minority as substantial as 49.9 percent—may be precluded from electing even one director to the board.

Under cumulative voting, each shareholder is entitled to votes equal to the number of his or her shares multiplied by the number of directors to be elected. The shareholder may cast all his or her votes for a single candidate or distribute them among two or more candidates as he or she sees fit. Cumulative voting, therefore, helps to protect the *financial* interest of minority shareholders by assuring them voice on the board of directors. And it protects the *political* interest of minority shareholders. For without cumulative voting, the tendency of large industrial corporations to perpetuate one-party rule is powerfully enhanced. As Professor Charles M. Williams demonstrated after analyzing proxy contests for the years 1943–1948, corporations with cumulative voting were more than twice as likely to have proxy contests as those without.

Because of these benefits, cumulative voting has enjoyed considerable popularity. From 1870, when Illinois became the first state to require cumulative voting, until 1955, 23 states had established absolute requirements for cumulative voting. Additionally, federal law requires cumulative voting for over 5,000 banks subject to the Federal Banking Act of 1933 (although the intent of this law has often been frustrated by bank holding company structures); and the Securities and Exchange Commission has consistently required cumulative voting for corporations subject to the Public Utility Holding Act of 1935 and corporations undergoing reorganization under Chapter X of the Bankruptcy Act. As an attorney snapped in 1950 in frustration at Wisconsin's refusal to enact cumulative voting, "Cumulative voting is so obviously in accord with our basic political philosophy of group representation and the party system that it is difficult to understand the legislature's repeated rejection of it, except in terms of a response to the pressure of corporate management's interest."

Unfortunately, "the pressure of corporate management's interest" often does prevail in state corporation law. Between 1955 and 1972, five states dropped mandatory cumulative voting. In 1973, Michigan changed from mandatory to permissive cumulative voting; in 1974 both California and Ohio considered—but did not enact—similar legislation. Today, in Delaware, as well as 32 other states, cumulative voting is not required. True, in most of these states, cumulative voting is permitted. In practice, however, permissive cumulative voting offers little but an illusory right. Studies by Professor Williams in 1951 and the Conference Board in 1973 indicate that only about 15 percent of the corporations in states with permissive cumulative voting have provided for this right.

And even in those few corporations which voluntarily institute cumulative voting, most states provide ample devices to subvert it. Although cumulative voting aims to prevent a simple majority from maintaining absolute corporate control, Delaware permits a simple majority to amend the corporate charter to repeal cumulative voting. And Delaware and some 42 other jurisdictions allow the "classification" of the board of directors. This device reduces to one third or one half the number of directors required to stand for election anually and thus increases the minimum vote necessary to elect a director.

Management's second legal edge is its power to issue nonvoting stock or classes of stock with unequal voting rights. For example, prior to December 1, 1955, there were three classes of stock in Ford Motor Company: common, Class A, and Class B. Only the Class B shares (4.94 percent of total equity), all of which were owned by Ford family interests, were entitled to vote.

Only Illinois and a few other states forbid the issuance of classes or series of stock without voting rights. But the refusal of both the New York Stock Exchange and the American Stock Exchange to list corporations with nonvoting stock has substantially reduced the number of corporations which may totally eviscerate shareholder suffrage, although neither exchange actively enforces equal voting rights.

The third statutory device for impairing shareholder suffrage rights is a provision common to the law of Delaware and apparently every other jurisdiction requiring the submission of proxy materials only to *shareholders of record.* This innocent sounding requirement effectively disenfranchises approximately 50 percent of the beneficial owners of corporate stock in the largest industrial corporations. For approximately 50 percent of the stock in the 1,800 companies traded on the New York Stock Exchange is held by mutual funds, life insurance or property and casualty insurance companies, private pension funds (usually administered through commercial bank trust departments), state and local pension funds, foundations, university endowment funds or other institutional investors. The result is a mockery of shareholder democracy: *Approximately 50 percent of the votes in our largest industrial corporations are cast by financial intermediaries—not the real owners.*

These institutional shareholders provide virtually no check to corporate management. Most financial institutions, according to the SEC's 1971 *Institutional Investor Study*, follow what is known as "The Wall Street Rule": An investment in a business corporation is considered an investment in that corporation's management; if the financial institution ceases to like what management is doing, the institution sells the stock. By examining the voting practices of 215 large institutions between January 1, 1967 and September 30, 1969, the SEC determined that approximately 30 percent of these institutions *always* voted for management (in elections other than votes for directors). For the remaining institutions, both voting against management and abstention were found "to be a relatively infrequent phenomenon." For example, in only 26 instances did any of the 215 institutions vote against an acquisition favored by management, "a miniscule fraction of such transactions."

The SEC conducted its study before the proliferation of shareholder proposals directed at social issues and precipitated by Campaign GM. In the past five years, some financial institutions have established formal procedures to consider shareholder public policy or ethical proposals. According to newsletters published by the Council on Economic Priorities and the Investor Responsibility Research Center, a small number of church-related funds, foundations, and universities have supported shareholder proposals respecting disclosure of political contributions; withdrawal from South Africa, Rhodesia, or Namibia; opposition to military production; or review of corporate safety, environment, occupational discrimination, or community programs. Since most institutional shares are voted by banks, insurance companies, and mutual funds, and these financial institutions have shown only a negligibly greater willingness to oppose management, the overall pattern of institutional voting has changed little in the past five years.

MANAGEMENT CONTROL OF OTHER FUNDAMENTAL DECISION-MAKING

Historically, shareholders controlled the business corporation not only through the election of directors but also through shareholders' power to initiate and vote upon all fundamental changes in the character of the corporation. Management's ability to initiate change was carefully circumscribed by requiring two-thirds or three-fourths affirmative votes for charter amendments, bylaw changes, mergers, sales of assets, stock issuance, recapitalization, or dissolution and was further limited by shareholder appraisal and preemptive rights.

Under Delaware's General Corporation Law, shareholders have lost nearly all power to initiate corporate change. Only the board of directors may propose charter amendments, a merger, or a sale of assets. The SEC Proxy Rules complement Delaware's corporation law by denying shareholders opportunity to communicate opposition to management proposals or to suggest modifications in management's formal proxy proposals.

This rout has been substantially replicated in all other leading chartering states. Indeed, the trend of recent revisions to state corporation law has been to attempt to deny the shareholder any vote at all! Modern corporate draftsmen invariably write short, purely formal certificates of incorporation and then place most of a corporation's actual governing rules in its bylaws, which the certificate establishes can be revised by the corporation's directors without any shareholder vote. For example, when ITT reincorporated in Delaware in 1967, it did so by creating a Delaware corporation called the "DeLitt Corporation" and by then merging ITT, previously a Maryland corporation, into DeLitt. The certificate of incorporation of DeLitt was only 1½ pages long. It reads in toto:

CERTIFICATE OF INCORPORATION
OF
DELITT CORPORATION

Article 1

The name of the corporation is Delitt Corporation (hereinafter called the "Corporation"). The name and mailing address of its incorporators are as follows:

NAME	MAILING ADDRESS
John J. Navin	320 Park Avenue, New York, N.Y. 10022
William J. Donovan	320 Park Avenue, New York, N.Y. 10022
DeForest Billyou	320 Park Avenue, New York, N.Y. 10022

Article 2

The address of the registered office of the Corporation in the State of Delaware is No. 100 West Tenth Street, in the City of Wilmington, County of New Castle. The name of its registered agent at such address is The Corporation Trust Company.

Article 3

The purpose of the Corporation is to engage in any lawful act or activity for which corporations may be organized under the General Corporation Law of Delaware.

Article 4

The total number of shares of stock which the Corporation has authority to issue is 100 shares of capital stock of the par value of $100 per share.

Article 5

Whenever the vote of stockholders at a meeting thereof is required or permitted to be taken for or in connection with any corporate action by any provision of the General Corporation Law of Delaware, the meeting and vote of stockholders may be dispensed with if the holders of stock having not less than the minimum percentage of the vote required by statute for the proposed corporate action shall consent in writing to such corporate action being taken, provided that prompt notice must be given to all stockholders of the taking of such corporate action without a meeting and by less than unanimous written consent.

Article 6

In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized:

(a) To make, alter, amend or repeal the By-Laws of the Corporation.

(b) To direct and determine the use and disposition of any annual net profits or net assets in excess of capital; to set apart out of any of the funds of the Corporation available for dividends a reserve or reserves for any proper purpose; and to abolish any such reserve in the manner in which it was created.

(c) To establish bonus, profit-sharing, stock option, retirement or other types of incentive or compensation plans for the employees (including officers and directors) of the Corporation and to fix the amount of the profits to be distributed or shared and to determine the persons to participate in any such plans and the amounts of their respective participations.

(d) From time to time to determine whether and to what extent, and at what time and places and under what conditions and regulations, the accounts and books of the Corporation (other than the stock ledger), or any of them, shall be open to the inspection of the stockholders; and no stockholder shall have any right to inspect any account or book or document of the Corporation, except as conferred by statute or authorized by the Board of Directors or by a resolution of the stockholders.

(e) To authorize, and cause to be executed, mortgages and liens upon the real and personal property of the Corporation.

Article 7

The corporation reserves the right to amend, alter, change or repeal any provision contained in this Certificate of Incorporation, in the manner now or hereafter prescribed by statute, and all rights conferred upon stockholders herein are granted subject to this reservation.

The key sentence is contained in Article 6: "In furtherance and not in limitation of the powers conferred by law, the Board of Directors is expressly authorized: (a) To make, alter, amend or repeal the By-Laws of the corporation. . . ." What ITT tried to do, as so many other giant Delaware corporations have tried to do, was to totally shut shareholders out of the governing process except in those rare instances in which the Delaware General Corporation Law explicitly requires a shareholder vote—which is not very often.

True, technically, section 251(c) grants shareholders a vote on management merger proposals. But this, in fact, is a mere snare for the dim-witted. Only a small minority of corporate fusions actually trigger this shareholder vote. The overwhelming majority employ one of three conventional loopholes (discussed in the Sources).

Similarly, section 271 limits shareholder suffrage in a sale, lease, or exchange of assets to transactions involving "all or substantially all" of a corporation's property and assets. Since most large industrial corporations are highly diversified, this provision effectively insures their shareholders will never vote. For example, General Motors could sell an automobile division such as Pontiac or Cadillac and not require a vote. It could liquidate hundred-million-dollar plants which manufacture refrigerators, diesel engines, and trucks or auction off all of its Detroit real estate and relocate in the Peoples Republic of China, and shareholders would have no choice in the matter. Only if GM sold *all* assets used to manufacture "automotive products" (about 75 percent of the corporation) would a sale of assets require a shareholder vote.

Moreover, section 271 is the only Delaware statute concerning corporate divisions. A Delaware corporation may create and fund new subsidiary corporations, regardless of size; liquidate these subsidiaries or comparable divisions and distribute assets to shareholders; or spin-off new corporations altogether without any shareholder vote. As business corporations have evolved these new forms, Delaware and other principal chartering states have deliberately not kept pace. Corporate executives have not hesitated to take advantage of this laxity. In the past three years many Delaware corporations have "gone private" and bought up minority shareholdings at bargain prices during a depressed stock market. This will allow favored shareholders or the firm itself to reap the profits when the company's stock price rises. Other senior managements have used the merger provisions to prevent take-over bids—which can benefit all shareholders—by requiring super-majorities, such as 75 or 90 percent, to consent to any consolidation or sale of the companies assets.

Whither/Wither the Board of Directors?

But does not the board of directors with its sweeping statutory mandate "to manage the business and affairs of every corporation" provide an internal check on the power of corporate executives? No. Long ago the grandiloquent words of the statutes ceased to have any operative meaning. "Directors," William O. Douglas complained in 1934, "do not direct." "[T]here is one thing all boards have in common, regardless of their legal position," Peter Drucker has written. *"They do not function."* In Robert Townsend's tart analysis, "[M]ost big companies have turned their boards of directors into nonboards. . . . In the years that I've spent on various boards I've never head a single suggestion from a director (made as a director *at* a board meeting) that produced any result at all."

Recently these views were corroborated by Professor Myles Mace of the Harvard Business School, the nation's leading authority on the performance of boards of directors. In *Directors—Myth and Reality,* Mace summarized the results of hundreds of interviews with corporate officers and directors.

Directors do not establish the basic objectives, corporate strategies or broad policies of large and medium-sized corporations, Mace found. Management creates the policies. The board has a right of veto but rarely exercises it. As one executive said, "Nine hundred and ninety-nine times out of a thousand, the board goes along with management. . . ." Or another, "I can't think of a single time when the board has failed to support a proposed policy of management or failed to endorse the recommendation of management."

The board does not select the president or other chief executive officers. "What is perhaps the most common definition of a function of the board of directors—namely, to select the president—was found to be the greatest myth," reported Mace. "The board of directors in most companies, except in a crisis, does not select the president. The president usually chooses the man who succeeds him to that position, and the board complies with the legal amenities in endorsing and voting his election." A corporate president agreed: "The former company president tapped me to be president, and I assure you that I will select my successor when the time comes." Even seeming exceptions such as RCA's 1975 ouster of Robert Sarnoff frequently turn out to be at the instigation of senior operating executives rather than an aroused board.

The board's role as disciplinarian of the corporation is more apparent than real. As the business-supported Conference Board conceded, "One of the most glaring deficiencies attributed to the corporate board . . . is its failure to monitor and evaluate the performance of the chief executive in a concrete way." To cite a specific example, decisions on executive compensation are made by the president—with perfunctory board approval in most situations. In the vast majority of corporations, Professor Mace found, the compensation committee, and the board which approves the recommendations of the compensation committee, "are not decision-making bodies."

Directors do not even ask discerning questions. It is considered "discourteous," a breach of "corporate manners" for directors to "challenge" the president or other corporate officers. This can be a very expensive form of decorum, as the Penn Central's shareholders painfully discovered. At the time of its collapse in June 1970, Penn Central was the largest railroad in the country and the sixth largest industrial corporation overall. Within a two-year period, shareholders witnessed the decline of their shares from $86.50 to $2.75.

Why? "The board was definitely responsible for the trouble," recounted outside director E. Clayton Gengras. "They took their fees and they didn't do anything. Over a period of years, people just sat there. That poor man from the University of Pennsylvania [University President Gaylord P. Harnwell], he never opened his mouth. They didn't know the factual picture and they didn't try to find out." As the Penn Central rushed towards its monumental crack-up, the board routinely approved every proposal forwarded by management. Although Penn Central was desperate for capital, the directors paid out nearly $100 million in dividends. The board never saw a capital expenditures budget. It never understood the inaccuracies published in Penn Central's annual reports. Just six hours before the corporation filed its bankruptcy petition, the board routinely approved new contracts for eight corporate executives, apparently unaware even then of the dimensions of the Penn Central's crisis. "All of this raises the serious question as to whether giant corporations affecting the everyday lives of our population . . . should continue to be governed in the traditional fashion or whether a new system of corporate directorships should be devised," concluded the House Banking and Currency Committee.

Yet boards will continue to be dysfunctional as long as they remain the creature of the corporate chief executive. For it is the chief executive who, like the family owner-manager in a small corporation, selects new members of the board. And it is the chief executive who de-selects existing board members when nominations for the board are necessary for annual shareholders' meetings.

Our own survey of the boards of the 200 largest industrial corporations found that the average board had a total of 14.49 directors, including 7.93 "outsiders" (that is, directors who were not employees of the corporation) and 6.56 insiders (or employee directors). Some 69 percent of the outside directors were fellow corporate executives; 6 percent were investment bankers; 7 percent were lawyers. Only 2 percent were women; a lesser percentage were black. Hence over 90 percent of the directors of our largest corporations either worked for the corporate chief executive or were fellow corporate executives, corporate bankers, or corporate lawyers.

Most "outside" directors appear to be chosen because of their status. "Presidents and chairmen of large and respected companies," one corporate president observed, "enjoy the prestige of serving on similar large and respected company boards. They are identified with their peers. They find the experience socially satisfying. Outside directorships provide a few more lines in their *Who's Who*, and it is a little bit like being knighted to say 'I'm a director of General Motors, or General Electric, or AT&T.' " Frequently, the chief executive chooses his friends, or individuals known to be "sympathetic" or "congenial," to be directors. "You certainly don't want anyone on your board who even slightly might be a challenge on a question of your tenure, so you pick personal friends with prestige titles and names," a corporate president explained. Another executive agreed: "What would you do if you were president? You control the company and you control the board. You want to perpetuate this control. . . . You sure as hell are not going to ask Ralph Nader. . . ."

At its worst, the outside director system degenerates into a private club, as the president of a west coast company explained:

> You've got to remember that the outside directors of large national and regional companies are members of a sort of club. To be considered for admission you must have the title as president or chairman of a respectable and respected organization. This is what some young people call the Establishment. But these are the people you do business with, travel around with, serve on community projects with—and it has to be a group the members of which get along together. Regionally each area has its elite. Sometimes many will in fact be members of the same golf or social club. Here in Los Angeles you will find a great number of directors with membership in the Los Angeles Country Club; in Cleveland the same is true of the Union Club—each city has its hard core members of the club group.

Exceptions to this pattern become news events. In reporting on General Motors' 1971 annual shareholders' meeting, the *Wall Street Journal* noted that, "The meeting's dramatic highlight was an impassioned and unprecedented speech by the Rev. Leon Sullivan, GM's recently appointed Negro director, supporting the Episcopal Church's efforts to get the company out of South Africa. It was the first time that a GM director had ever spoken against management at an annual meeting." Now Rev. Sullivan is an unusual outside director, being General Motors' first black director and only "public interest" director. But what makes Leon Sullivan most extraordinary is that he was the first director in *any* major American corporation to come out publicly against his own corporation when its operations tended to support apartheid.

Yet as lethargic as outside directors usually are, employee directors tend to be even less effective. The typical vice president/inside-director is in a very precarious position at a board meeting. Unwilling to say anything in disagreement with his boss, he usually sits quietly and waits until he is called upon to speak. Disagreements with other corporate executives are invariably resolved out of the board room. The effect is to present outsiders with a "united front": to make the corporate chief executive's decisions seem inevitable.

So staffed, board meetings in most large industrial corporations have become formalized into a monthly or bimonthly ritual, usually lasting about one to three hours. Much of this time is consumed by perhaps a 30-minute to an hour review of operations for the last period (month or quarter) by the president or vice president of finance. This is followed by board approvals of capital appropriations and of the actions of the executive committee taken since the last meeting. The meeting often concludes after senior executives have described a new research development or a major operations program. Usually the entire meeting—which is closed to shareholders—is choreographed by the corporate chief executive. He chooses which officers shall speak. He writes the agenda. When he wants to be asked about a particular issue, he plants the relevant question.

The impossibility of so infrequent or so circumscribed meetings of the board enabling directors to effectively "manage" their corporation was sardonically illustrated by the congressional testimony of H. O. Havemeyer, a corporate chieftain of an earlier day:

> Q. As a member of that board, what else have you done?
> A. *Oh, I have convened and talked.*
> Q. You have convened and talked?
> A. *And adjourned.*
> Q. Well, you have convened and talked?
> A. *And adjounred.*
> Q. Well, what have you talked about?
> A. *Statistics.*

This testimony was given in 1887 when outside directors were typically the "tools" or "dummies" of the controlling corporate president or bank. A popular gag on Wall Street was that the role of an outside director was to receive his five-dollar gold piece at the start of each meeting and then obediently fall asleep. Directorial lassitude is not so obvious today. Yet considering that the size and complexity of corporate enterprise has significantly increased since 1887 while the frequency and length of directors' meetings has not, it is a fair assumption that the outsiders who obediently nod through ceremonial board meetings today are little better informed than their brethren who slept before them.

Certainly directors' sources of information remain as much subject to management control today as they did 90 years ago. After resigning from TWA's board, former United States Supreme Court Justice Arthur Goldberg had this complaint: "What the typical board of directors gets is a recommendation which seems monolithic. . . . It's not like a court, where a judge can order a brief from both sides." Recently the *quantity* of preparatory information available to outside directors has significantly increased. Yet the thickened reports and whirlwind plant tours are still only what the corporate chief executive wants outsiders to see. "In many corporations," found Professor Melvin Eisenberg, "the executives go so far as to wholly deny the board—supposedly entrusted with supreme power over the corporation—access to certain categories of information." For instance, a 1971 survey found that only 17 percent of 474 industrial firms sent manufacturing data to directors prior to board meetings, only 21 percent sent marketing data, and 11 percent sent no data at all.

And outside directors have little personal incentive to doubt management. A 1973 survey of 378 manufacturing corporations with assets of $50 million or more showed that outside directors received median annual fees of approximately $5,900, while inside directors generally are not paid at all. On top of the $100,000+ incomes typically earned by outside directors, who are corporate chief executives or vice presidents, leading investment bankers, or law firm partners, such annual retainers or meeting fees seem like peanuts. The result is counterproductive. Outside directors rationalize not doing very much by the fact they are not paid very much.

How, then, can one reconcile the grand imperative, "The business and affairs of every corporation . . . shall be managed by or under the direction of . . . a board of directors" with the reality of this "non decision-making body"? The fashionable response is that the board is a legal fiction. Management control has overwhelmed the rule of law.

This widely held view is only half right. Management has deposed the board of directors—but it has done so under color of law. No rule within the modern corporation statutes prohibits management from nominating and serving as directors. Corporation law has abrogated directional independence by omission. Moreover, even if the statutes provided structural safeguards to maintain the independence of the board, these could not undo the effect of two provisions found in most state corporation laws.

The first provision is exemplified by a Delaware Corporation Law section which provides that a director shall "be fully protected in relying in good faith upon . . . reports made to the corporation by any of its officers." The meaning of this provision is very simple. Directors have no duty to know. "Unless something occurs to put them on suspicion that something is wrong, directors are entitled to rely on the honesty and integrity of [management]," held the leading case of *Graham v. Allis-Chalmers Manufacturing Company.* Directors are not required to "put into effect a system of watchfulness." They need not anticipate problems nor verify the accuracy of reports upon which they rely.

A second provision of the Delaware General Corporation Law accomplishes the same result by allowing the board to *formally* delegate responsibility for most corporate business to a committee dominated by inside directors. Our survey of the 200 largest industrial corporations indicates that approximately two-thirds of the corporations had withdrawn directorial powers from the full board—typically a majority of whose members were outsiders—to an executive committee at least half of whose members were insiders.

A much smaller number of corporations accomplish a comparable result by delegating authority to an insider-dominated finance committee. In our survey of the 200 largest industrial corporations, we found that 16 corporations had delegated authority to a finance committee, half or more of whose members were insiders.

Examples of the delegation of the board's authority to either an insider-dominated executive or finance committee have been well described by attorney John A. McMullen:

> At IBM—four directors, all top level officers of the corporation, control the all-important executive and finance committees; in addition, three of them are members of the powerful Corporate Office. At GM, four or five men, all inside directors of the company, dominate the executive and finance committees of the board as well as the administration committee comprised of key officers and directors. . . . DuPont's executive committee consists of the company's chairman of the board, president, and six senior vice presidents. Each of these men is entirely relieved of day-to-day functional responsibilities; each operates jointly with his fellow committee

> members to set overall corporate policy, and acts only as an advisor to the operating department from which he originally derived his skills, training, and experience.

Yet, whether or not the board formally resolves to delegate operational authority to an executive committee between board meetings, the actuality is that employee directors or other senior executives invariably exercise the powers of initiation. It does not matter whether key corporate decisions are initiated by a single corporate autocrat or a board committee or a committee operating out of the office of the president. Senior executives call the shots. This is what Berle and Means meant by their insightful descriptions of "management control." This is why state corporation law is moribund. Not only is it written by corporate management's representatives, it is also hopelessly inaccurate. In appreciating the law of corporate governance, one rule above all others must be followed: *Concentrate on the omissions.* Where state law does not require directors to be, corporate executives inevitably are.

The Limitations of Shareholder Litigation

STATE LAW: THE NON-DUTY OF CARE

The erosion of shareholder authority within the corporation would be less serious if shareholders were able to oppose the abuses of corporate management in court. In theory, civil litigation remains the shareholder's ultimate check. The problem is that, except for certain limited claims under the federal securities laws, it rarely works. Long ago judicial doctrines reduced the state shareholder action to a trivial value.

Earliest was the judicial rejection of the principle of *ultra vires* action. In its classical form, the doctrine of *ultra vires* envisioned the corporate charter as a contract between the state, corporate management, and the shareholders. Corporations were prohibited from performing certain acts, not because they were illegal but because neither the state nor the shareholders had agreed to them. Shareholders could enjoin corporate officers and directors from engaging in actions "beyond their powers." Accordingly, in a leading 1867 case, a single shareholder blocked a railroad from extending its railway to a more distant point than that specified in the charter because that was not the enterprise he had bargained for.

With the rise of the corporate enabling acts, the principle of *ultra vires* declined. Shareholder limitations were overridden through court discoveries of "implied" or "auxiliary" powers. In the 1896 case of *Jacksonville M. P. Ry. & Nav. Co. v. Hopper*, for example, the United States Supreme Court held that the Florida railway company might engage in leasing and running a resort hotel, on the curious logic that "to maintain cheap hotels or eating houses . . . would not be so plainly an act outside the powers of a railway company as to compel a court to sustain the defense of ultra vires. . . ." By 1931, *Fletcher's Cyclopedia of Corporations* could proclaim, "the theory that a corporation can do no acts beyond its authority [has been] discarded by a majority of the courts in the country."

Paralleling the decline of *ultra vires* has been the universal refusal of state courts to hold corporate directors or officers liable for negligence. Because they are vested with great power over other people's property, the law has always nominally required, in the language of the present New York statute, that "Directors and officers shall discharge the duties of their respective positions in good faith and with that degree of diligence, care, and skill which ordinarily prudent men would exercise under similar circumstances in like positions."

In practice, the typical judicial or statutory formulation of the duty of care is too vague to require much of anything. As Yale Law School's Professor Joseph Bishop concluded after an extensive review of the case law:

> The search for cases in which directors of industrial corporations have been held liable . . . for negligence uncomplicated by self-dealing is a search for a very small number of needles in a very large haystack. Few are the cases in which the stockholders do not allege conflict of interest, still fewer those among them which achieve even such partial success as denial of the defendant's motion to dismiss the complaint.

In all, Professor Bishop was able to find only four recent cases in which a state court held that a shareholder had alleged a good cause of action for negligence uncomplicated by self-dealing. In only one of these cases did a state court rule on the merits that a corporate officer was liable for negligence. And in that case, the word "negligence" had been used as a euphemism for dishonesty.

This result is primarily the fault of statutory draftsmen. They have refused to identify *how* a corporate officer meets his duty of care. They have never identified what specific actions he must perform; what specific responsibilities are his. In the absence of a clear standard from the legislature, state courts have refused to guess.

At most, state courts will hold corporate directors or executives liable for conduct involving obvious self-enrichment such as fraud, misapplication of funds, diversion of corporate business opportunities, or causing the corporation to make excessive payment for the purchase of their property. Yet even in these types of cases, where the actions of corporate officers amount to simple and obvious theft, the procedural rules of state corporation law have been skewed to discourage shareholder suits.

The most onerous bars to shareholder litigation are the so-called "security for expenses" provisions enacted by New York, New Jersey, Pennsylvania, Michigan, California, and 13 other states. These provisions require a complaining shareholder owning less than a stated amount of stock—typically 5 percent of the stock or shares worth less than $50,000—to "give security for the reasonable expenses, including attorney's fees, which may be incurred" by both the corporation and the parties defendant in a shareholder action. Since the cost of defendants' legal fees may amount to hundreds of thousands of dollars, the security for expense provision, when enforced, presents a formidable barrier to shareholder action.

The rules respecting attorneys' fees pose a second procedural pitfall for shareholder actions. Nearly every jurisdiction provides that only shareholders whose suits are successful may be reimbursed by the corporation for attorneys' fees. This rule seeks to discourage attorneys from bringing nonmeritorious suits. Several states, however, further provide that attorneys' fees may be awarded only if a substantial monetary benefit is conferred upon the corporation. As a practical matter, this standard precludes shareholder litigation in all cases except those of overreaching where a monetary benefit—the amount taken—is readily apparent.

In all other cases it is normally cheaper to sell the stock than to compel the corporation to obey the law.

FEDERAL SECURITIES LAW: "TAKING OVER THE UNIVERSE GRADUALLY"?

To some extent, federal securities law—and federal court decisions—have compensated for the atrophy of state shareholder protection.

In 1968, the influential Second Circuit Court of Appeals handed down its celebrated *S.E.C. v. Texas Gulf Sulphur* decision which revolutionized the case law interpreting Rule 10b-5 under the 1934 Securities and Exchange Act. Rule 10b-5 provides that it is unlawful for any person to employ a fraudulent scheme, to make any untrue statement, or to fail to state a pertinent fact when purchasing or selling a security. *Texas Gulf* substantially broadened this antifraud rule by holding that corporate directors, officers, and employees violated 10b-5 when they purchased company stock knowing of a huge mineral strike before this fact was generally known or communicated to the public.

A federal district court, also in 1968, ruled in *Escott v. Bar Chris*—a decision some commentators initially believed would have even greater effect on directorial behavior than *Texas Gulf*. In *Bar Chris* security holders asserted that a bowling alley construction company that had sold them convertible debentures had filed a registration statement prior to the sale of the bonds which contained false statements and omissions. After concluding that the registration statement did, indeed, contain numerous inaccuracies, the district court stunned Wall Street by holding all nine directors who signed the prospectus—including two new to the board—liable. In summing up their liability, the court seemed to move far toward creating a federal duty of care, at least with respect to registration statements:

> Section 11 imposes liability in the first instance upon a director, no matter how new he is. He is presumed to know his responsibility when he becomes a director. He can escape liability only by using that reasonable care to investigate the facts which a prudent man would employ in the management of his own property. In my opinion, a prudent man would not act in an important matter without any knowledge of the relevant facts, in sole

> reliance upon representations of persons who are comparative strangers and upon general information which does not purport to cover the particular case. To say that such minimal conduct measures up to the statutory standard would, to all intents and purposes, absolve new directors from responsibility merely because they are new. This is not a sensible construction of section 11, when one bears in mind its fundamental purpose of requiring full and truthful disclosure for the protection of investors.

The cumulative result of these and other federal securities law decisions led the *Wall Street Journal* to exclaim in early 1973, "[D]irectors of corporations now face more perils than Pauline ever did!" In a similar vein, Harvard Law School's securities expert, Professor Louis Loss, observed in 1969 that "the great Rule 10b-5," which had emerged as the principal basis of liability under the federal securities laws, "seems to be taking over the universe gradually."

In retrospect, both views seem overstated. The basic reason the securities laws will neither "take over the universe" nor seriously "imperil outside directors" is that they are restricted to a discrete set of securities transactions. Although present securities laws do require corporate officers to file with the SEC accurate periodic financial reports and securities registration statements, not make false and misleading statements in proxies, nor defraud outsiders in connection with their own securities purchases or sales, the securities laws do not, emphasized the Supreme Court in 1971, reach transactions which otherwise involve "internal corporate mismanagement."

And in late 1973, the Second Circuit Court of Appeals held in *Lanza v. Drexel* that only corporate officers who recklessly or deliberately defrauded shareholders could be held liable for money damages under Rule 10b-5. In refusing to follow the reasoning of the district court in the *Escott v. Bar Chris* case, the appeals court made plain that an outside director who was "merely negligent" in his participation in a fraudulent securities transaction had little to fear.

The consequence of *Lanza* and similar recent decisions has been to leave federal securities law in a crazy quilt pattern. The federal securities laws, for example, will not reach a deliberate though not self-enriching decision of corporate executives to engage in an unprofitable line of business unless there has been an accompanying failure of disclosure. Nor will they reach decisions which *do* enrich corporate officers unless they involve security transactions. Liability seems so haphazard and fortuitous that former SEC Chairman William Cary was moved to complain:

> There is no justification for a *federal* law disciplining or holding a tippee liable for misusing inside information concerning management decisions but not monitoring the misconduct of management itself. . . . It is absurd that a corporate transaction, clearly unfair though perhaps not fraudulent, should be subject to attack in the federal courts only upon the ground that it has not been disclosed to shareholders rather than because of its inherent inequity.

NULLIFY THE JUDGMENT: INDEMNIFICATION INSURANCE

Not only is it difficult for shareholders to successfully sue their companies, but even successful judgments often can be nullified. Seventeen states today permit corporations to purchase indemnification insurance for their directors and officers against, in the words of a typical policy, any "wrongful act [committed] . . . in their capacities as directors or officers." A 1974 survey of the Fortune 500 list found that 80 percent of these companies carried indemnification insurance. A similar sample of corporations listed on the New York Stock Exchange found that 76.1 percent carried such insurance. Since indemnification insurance was virtually unknown as recently as a dozen years ago, and most insurance policies were purchased within the past five to seven years, it is a fair assumption that nearly every large industrial corporation permitted by state law will carry indemnification insurance within a short time.*

* One reason for the enormous leap in the number of corporations carrying indemnification insurance has been the scare tactics employed by the insurance companies. The general tenor of their approach is illustrated by an advertisement on page six of the *Wall Street Journal*, March 21, 1968, featuring a composite photograph of a board of directors presided over by a stuffed duck and the explanatory text, "As a corporate officer or director, you may be a sitting duck for a shareholder or third party liability suit." A similar ad appears on page nine of the same issue wherein a sullen looking stockholder announces that he "might just sue every company director reading this newspaper," and reminds the presumably panicking directors that he is just one of "24 million potential enemies."

There is, to be sure, a persuasive case for indemnifying corporate directors against the costs of nonmeritorious legal claims. If innocent directors had to settle such suits because they lacked the resources to hire competent attorneys, responsible men and women would be discouraged from becoming directors. But current indemnity statutes are not limited to the purpose of protecting innocent officers from the costs of nonmeritorious suits. They also protect guilty officers from accountability for their wrongs and reduce incentives for lawful conduct.

Delaware's statute exemplifies this overbreadth. It allows a corporation

> to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation . . . against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not the corporation would have the power to indemnify him against any such liability under the provisions of this section.

As written, this provision permits the corporation to insulate its officers from *all* potential liabilities. Officers may be insured against any negligence, self-dealing, looting the corporation or embezzlement, all conflicts of interest, and deliberate statutory violations. They may be reimbursed for violations of federal safety, civil rights, environmental, tax, or antitrust laws. They may even be insured against the same judgments in derivative actions that an earlier provision of the same statute provided a corporation could not indemnify directly.

Delaware defends such insurance as a form of compensation, arguing that the corporation could make a larger compensation arrangement with the executive and let him pay for the insurance himself. But the question is not how much officers' compensation should be, but rather whether wrongful acts *should* be indemnified at all. Why should an executive of a drug company be indemnified for the costs of a criminal fine if he is convicted of allowing a harmful drug to injure several thousand people when the same act as a private individual would send him to jail? An untenable double standard has been created. The more powerful an executive becomes, the less likely he is to pay for an abuse of power.

Conflicts of Interests

In almost every primary economic relation of the industrial corporation—to competing corporations, to banks, to suppliers, to distributors, to investors—the law now permits (in many instances, encourages) the most blatant division of loyalties.

Most threatening is the anticompetitive practice of *interlocking directorates*. A philosophic cornerstone of American business is that vigorous competition will enable firms to have comparable access to capital, supplies, distributors, and markets, and thus an equal chance to succeed or fail on the merits. But if competing corporations place directors on each other's boards, there is opportunity to conspire on price or territory. If corporate officers sit on the boards of their banks or suppliers or distributors, there arises the obvious temptation to obtain preferential treatment based on favor and friendship. Then the race is not to the swift, but to the well-connected. Louis Brandeis saw the problem early in this century:

> The practice of interlocking directorates is the root of many evils. It offends laws human and divine. Applied to rival corporations, it tends to the suppression of competition and to violation of the Sherman law. Applied to corporations which deal with each other, it tends to disloyalty and to violation of the fundamental law that no man can serve two masters. In either event it leads to inefficiency; for it removes incentive and destroys soundness of judgment. It is undemocratic, for it rejects the platform: "A fair field and no favors"—substituting the pull of privilege for the push of manhood.

With Brandeis as a major proponent, Congress in 1914 enacted the Clayton Act, section 8 of which expressly forbids any person from serving on the boards of two or more competing corporations. Until recently, however, section 8 had not been enforced. Through 1952, some 38 years after the enactment of the Clayton Act, the Department of Justice had not litigated a single case to a decision by a court. Through December 1975, the Department had instituted a total of 15 cases. The Federal Trade Commission, which has concurrent enforcement responsibilities, had filed only 13 complaints under section 8 of the Clayton Act through January 1965. Only one of these complaints resulted in a cease and desist order; the remainder were dismissed when the directors involved discontinued the prohibited relationship. As Chairman Emanuel Celler's House Antitrust Subcommittee concluded in 1965 after a lengthy study of interlocks among competitors: enforcement had been neither "prompt nor vigorous."*

Shortly after Celler's study was released, economist Peter Dooley calculated that there were a total of 4,007 directorships held by the directors of the 200 largest nonfinancial corporations and the 50 largest financial corporations. "While most of these directors sat on a single board, 562 sat on two or more boards: Five men held six directorships each. In all, 1,404 directorships were held by multiple directors." Two hundred and thirty-three of the 250 corporations had at least one director who sat on the board of at least one other of the largest corporations. Most significantly, fully 297 interlocks involved companies which were competitors. "While illegal under the Clayton Act," observed Professor Dooley, "the law has not been effectively enforced, so that the institution of interlocking directorates continues to provide a vehicle for restricting competition. . . ."

Our own more recent survey of the boards of directors of the 50 largest industrial corporations identified eight apparent instances of illegal interlocks. John T. Connor, for example, is both a director of General Motors and Chairman of Allied Chemical, though Allied Chemical produces seat belts, shoulder harnesses, and airbags, all of which GM either presently manufactures or potentially could. Dean McGee is a director of General Electric and Chairman of Kerr-McGee, though both sell nuclear fuels. Henry S. Wingate is a director of both U.S. Steel and International Nickel Company of Canada, both of which mine nickel, iron ore, and other competing metals.

Even beyond inadequate enforcement of its provisions, section 8 only forbids interlocks among competitive corporations. Interlocks among corporations which provide services, supplies, funding, or distribution for each other equally violate the fundamental law that no man can serve two masters. They are also far more numerous. In 1974, the Center for Science in the Public Interest analyzed interlocking directorates and advisory committee connections of the eighteen largest United States oil corporations. They found 460 interlocking connections in all, including 132 interlocks with banks, 31 interlocks with insurance companies, 12 interlocks with utilities, 15 interlocks with transportation corporations, and 224 interlocks with manufacturing and distribution corporations. Oil company ties with banks (which supply capital), insurance companies (which provide an underwriting service), distribution companies (which distribute oil company products), and utilities, transportation, and manufacturing corporations (which purchase oil products) inevitably diminish the arm's length atmosphere in which effective competition thrives.

Such clubbishness, however, is typical of this nation's largest corporations. Our survey of the 50 largest industrial corporations and 10 largest commercial banks found that the 50 largest industrialists had 54 interlocks with the 10 leading commercial banks and 24 interlocks among themselves. Our survey also established that it has become a common practice for the leading commercial banks to bring together competitors on their boards of directors. For example, on its board Chase Manhattan unites directors from competing companies in four industries: industrial chemicals (Allied Chemical, Celanese, and Commercial Solvents Corporation); drugs (Pfizer and Squibb); paper goods (Celanese and International Paper); and oil (Exxon, Royal Dutch Petroleum, and Standard Oil of Indiana). Continental Illinois brings together leading agricultural equipment producers Caterpillar Tractor and International Harvester; food producers Esmark and Kraftco; and railroads Chicago-Milwaukee and Illinois Central.

When interlocks are viewed on a city-by-city basis, it becomes clear that there are substantial social costs as well—as in the case of Minneapolis-St. Paul. In January 1971, Richard Gibson, a methodical staff reporter for the *Minneapolis Star*, described the social structure of a major industrial city by examining the boards of the 20 or so leading Twin City industrial corporations and eight leading banks. What he found was a tight little net or what he

* In the past three years the Federal Trade Commission has begun to enforce the Act, bringing three major actions, the most important of which required seven directors common to the boards of 12 competing oil and gas corporations to resign. More recently the Justice Department awoke from its long slumber and brought an action in 1975 against the Bank of America holding company and certain insurance companies which allegedly competed in providing designated services.

called swapping: Burlington Northern placed its executive on the board of General Mills, and General Mills reciprocated by placing an executive on the board of Burlington Northern. Honeywell, Pillsbury, 3M, and Dayton Hudson just placed executives everywhere, as did the leading banks.

But Gibson went beyond the statistics and examined the personalities involved. He found that the boards of the 30 leading corporations in a major metropolitan area of some two million people were dominated by 19 men. Eight served on three or more boards; five men served on four boards; six served on five boards or more. Crucially, these were the men that served as chairman or led the key committees. All but one of these men, Professor Walter Heller, was a corporate executive. Fourteen of the 19 were corporate chief executives. Examined in social terms, the economy of Minneapolis looks like an oligarchy.

Certainly no one would argue that all interlocks, whether among competitors, in financing, supply, or distribution relations, direct or indirect, lead to collusive behavior. But it is unnecessary that any interlock occur. There are sufficient directors available so that each board may be staffed by disinterested persons. The costs of interlocks—favoritism, joint price or output actions, discouragement of entrepreneurs—must be weighed against what are at best negligible advantages.

Conflict of interests can also occur when large industrial corporations invite their investment banker or outside counsel to serve on their boards. For the investment banker, especially, this creates a stark division of loyalty. In addition to underwriting security offerings and related corporate financial services, he typically does investment counseling, employs brokers, and administers mutual funds. He is just as likely to perceive his primary obligation to run to his investment clients as to the shareholders of the corporation he directs. As one top executive explained, "As soon as you have an investment banker [on the board], you put yourself in a position where one group of shareholders might be favored at the expense of other shareholders."

A worse situation occurs when the investment banker is favored at the expense of *all* shareholders. J. M. Juran and J. Louden, authors of the American Management Association's study, *The Corporate Director*, cited instances where investment bankers have been guilty of guiding the company into a poor acquisition to create a need for selling securities. Investment banker-directors have insisted on being involved—for a fee—when the corporation seeks to borrow money from an insurance company or other lender. And when a corporation has an investment banker on its board, it becomes very difficult to transact business with other investment bankers. "Having a senior partner of an investment banking firm on our board is notice to the world that we are his captive client," said one corporate president. "Of course this is the main reason investment bankers want to be on so many boards. They think of board membership as a very good way of assuring that the business of the company goes only to them. It's a sort of Operation Stakeout. It tags the company as belonging to one particular firm."

A similar division of loyalties occurs when corporate counsel serves on the board. Attorneys have a financial interest to increase the corporation's law bills, rather than economize for its shareholders. This inability of lawyer-directors to give disinterested counsel has led some law firms to discourage partners from serving on clients' boards. For example, New York City's Debevoise, Plimpton, Lyons and Gates will not permit a partner to go on a board without the approval of the firm as a whole. Skadden, Arps, Slate, Meagher and Flom, also of New York, flatly prohibits partners from becoming directors "except in extenuating cases." Nonetheless, an exhaustive 1971–72 study of some 12,000 companies, which filed information statements with the SEC, found that approximately one in six employs an attorney from the company's outside counsel as a director.

Aggravating the costs to shareholders of these structural conflicts of interest is the tolerance by modern corporate law of self-enriching executive conduct. As early as an 1846 Supreme Court opinion, the rule was well established that any contract between an interested director and his corporation was voidable at the mere insistence of the corporation or any of its shareholders regardless of the fairness or unfairness of the transaction. Professor Harold Marsh explained why:

> Under this rule it mattered not the slightest that there was a majority of so-called disinterested directors who approved the contract. The courts stated that the corporation was entitled to the unprejudiced judgment and advice of all of its directors and therefore it did no good to say that the interested director did not participate in the making of the contract on behalf of the corporation. . . .

By 1880, this principle "appeared to be impregnable. . . . It was stated in ringing terms by virtually every decided case, with arguments which seemed irrefutable, and it was sanctioned by age." One scholar termed this the "fundamental law of morals and of human nature" and identified its Biblical origin: "No man can serve two masters." "Fraud is too cunning and evasive," reasoned a New Jersey court, "for courts to establish a rule that invites its presence."

Today this principle is dead. The Delaware General Corporation Law not only tolerates interested conduct by corporate officers and directors; it has made self-dealing the norm.

Under current Delaware law, the chief executive of a corporation and other senior corporate executives may serve on the board of directors or compensation committee which: (1) sets executive salaries; (2) sells or purchases property from corporate executives; (3) loans money—on a secured or unsecured basis; with or without interest—to corporate executives; and (4) establishes pension plans, profit sharing plans, stock bonuses, retirement, benefit, incentive, and compensation plans (including "phantom stock"—a risk-free, cost-free stock option plan), trusts; health insurance; or deferred income plans for such corporate officers or their dependents.

Not only may corporate officers engage in such self-dealing but shareholders under Delaware law are nearly powerless to minimize the amount of corporate largess top executives pay themselves. Any contract or transaction between the corporation and an interested executive is permissible as long as it is "fair." But, in Delaware, fairness is presumed. Professor Ernest Folk, the leading commentator of Delaware's General Corporation Law, explains that "Given Delaware's presumption of sound business judgment with respect to board decisions, the courts will try to determine whether the decision can be attributed to any rational business purpose, and if so, there will be no judicial preemption of the decision."

There seem to be few practical limits to this doctrine. For example, if a corporate chief executive were so graceless as to embezzle $500,000, there is little question that even in Delaware he would be required to return the money and would be subject to criminal prosecution. Yet if that same corporate executive raised his salary $500,000 and received the approval of a board of directors he selected, there is equally little question that a Delaware court would term this "fair"—so long as the chief executive could point to similar salary increases in his industry or received the $500,000 through an "incentive bonus" or profit participation plan.

In the absence of judicial limitations, excessive remuneration has become the norm. In 1974 the executive compensation (salary, bonus, deferred income, and directors' fees) of the highest paid executive at the 50 largest industrial corporations was approximately $400,000—or about as much in one year as many of their employees earn in a lifetime and two and one-half times the average executive compensation of $145,000 earned by the highest paid executive at the 50 largest industrial corporations in 1963.

Contrary to the conventional wisdom, top executive salaries do not generally decrease in response to a decline in corporate sales or profits. In the recessionary years 1970–1973, Professor Wilbur Lewellen, a leading authority on executive compensation, found that the "mean" salary for the top executive at 50 large manufacturing corporations increased steadily from $251,867 in 1970, to $287,759 in 1971, $323,802 in 1972, and $389,277 in 1973.

But salary, bonus, and deferred income are only the most obvious benefits appropriated by corporate chieftains. Equally important is ownership income. Nearly every large industrial corporation offers its top executives stock options. These options allow executives to buy shares of stock in their corporation at a fixed price at any time or at specified times—often with the help of company-secured low interest loans or interest-free loans—and subsequently sell them.

From the shareholder's point of view, the result is a classic case of "heads we lose, tails you win." Over time, executives are able to build up a substantial fortune in corporate stock without personal risk. The more they do so, the more they dilute the value of other stockholders' shares.

We examined the stock holdings of the highest paid executives at the 50 largest industrial corporations to get some indication of the extent of executive stock holdings. From the start, we eliminated from consideration the seven highest paid chief executives whose stock holdings were either largely inherited or largely "founder's shares": Henry Ford II (Ford Motors), Robert Sarnoff (RCA), Brooks McCormick (International Harvester), Willard Rockwell (Rockwell International), Armand Hammer (Occidental Petroleum), Sanford McDonnell (McDonnell Douglas) and J. P. Grace (W. P. Grace). The 43 remaining chief executives were "employee" executives. Yet each owned an average of $1,566,009 of his corporation's stock, according to the most recent proxy statements filed with the SEC and the closing stock prices of October 1, 1975.*

This crude figure illustrates three points. First, primarily at shareholder expense, the top executives of our largest corporations can, and often do, build up million-dollar fortunes in corporate stock on top of their substantial cash and deferred compensation. Second, the income of top executives is significantly increased each year by dividends from their corporate stock. Using our 43 top executives as an example again, each received an average of $60,382 in dividend income in 1974 above and beyond a $400,000 salary. Third, each top executive will further be enriched by increases in the price of the stock. Professor Lewellen has determined that a similar list of chief executives at the fifty largest industrial corporations (after deleting "extreme values" such as inherited or founder's stockholdings) averaged $220,087 per year in capital gains income for the four years 1960–63.

* This figure is admittedly a very crude approximation of ownership income. On the one hand, it does not distinguish the shares the executives purchase with their own money from those the company gave them through stock options, stock bonuses, or loan arrangements. On the other hand, it understates the amount of ownership income of these executives by making no allowance for the fact that corporate chief executives frequently sell stock they own in their own corporation and put their money in other investments.

Additionally, pension or retirement benefits have swollen. McKinsey and Company's 1975 Executive Compensation Survey found that all but one of 577 major U.S. corporations studied had a pension or profit-sharing retirement plan to pay former executives a fixed income each year after they retire. Almost half of the companies provide either a thrift or savings plan or a profit-sharing plan in addition to the pension plan. Our own survey found that the 21 chief executives of the 50 largest corporations who disclosed their estimated annual retirement benefits anticipated an income of $133,910 per year after they retire. And corporate executives also enjoy other benefits such as life and medical insurance; free medical service; educational grants for their children; indemnification insurance; company apartments; country club membership; luncheon or dinner club membership; chauffeur-driven cars; free legal and tax counseling; personal financial counseling; expense accounts, and other amenities. This myriad of stock bonus, insurance, and benefit programs increases the income of corporate chiefs by approximately 50–75 percent above their $400,000 direct remuneration to an actual income of approximately $600,000 to $700,000 per year.

Yet if excessive remuneration were a conflict of interest confined to the corporate chief executive, it would seem small once it was divided by the total number of shares in most large industrial corporations. What makes the executive compensation conflict truly expensive is that the corporate chief executive not only sets his own salary but also determines the remuneration of other executives all the way down the line. It is clearly in the corporate chief executive's personal interest to seek the greatest possible rewards for his subordinates as well as himself. For a corporate chief who can "deliver" high salaries increases the personal loyalty of his subordinates. And the higher his subordinates' income, the higher the chief executive's income must be.

A good illustration of this is General Electric, where in 1974 Reginald Jones, the chairman, received a compensation of $501,200. Walter Dance, Jack Parker, and Herman Weiss, the next three highest paid executives, received $400,750; $400,500; and $400,000, respectively. The next 107 highest paid officers averaged direct compensation of $121,240. Aggregate figures for "executive groups" at the other 50 largest industrial corporations were approximately the same. In the average corporation, the 31 or so officers ranked immediately below the five highest paid executives received an average of $99,256 in direct remuneration, which would equal approximately $150,000 imputing the present value of stock bonus programs, retirement benefits, insurance, and other perquisites.

A compensation system is obviously askew when a private business corporation must pay a chief executive compensation and benefits of over $600,000 when this is 15 times the $40,000 or so the United States government must pay its highest ranking general, regulator, or Senator. Or when it must pay its next 20–100 senior executives an average of $150,000 each when the federal government expends a maximum of $38,000 per year to hire its highest ranking civil servants, and California, this nation's largest state, pays its governor $49,000.

This is not to deny that the entrepreneur or corporate founder who, at substantial risk, introduces a new or better good or service should not be given a substantial incentive to make an unusual personal contribution to society. But we are concerned here with the administrators of large industrial corporations who, at minimal personal risk, serve as the bureaucrats of private industry. These individuals receive their staggeringly large salaries and stock options by rising through executive ranks—in exactly the same way that government's civil servants rise through civil service ranks—and by then exploiting the laxity of state corporate laws that their predecessors helped write.

Remedies

REVAMPING THE BOARD

The modern corporation is akin to a political state in which all powers are held by a single clique. The senior executives of a large firm are essentially not accountable to any other officials within the firm. These are precisely the circumstances that, in a democratic political state, require a separation of powers into different branches of authority. As James Madison explained in the *Federalist No. 47:*

> The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few or many, and whether hereditary, self-appointed, or elective, may justly be pronounced the very definition of tyranny. Were the federal constitution, therefore, really chargeable with this accumulation of power, or with a mixture of powers, having a dangerous tendency to such an accumulation, no further arguments would be necessary to inspire a universal reprobation of the system.

A similar concern over the unaccountability of business executives historically led to the elevation of a board of directors to review and check the actions of operating management. As a practical matter, if corporate governance is to be reformed, it must begin by returning the board to this historical role. The board should serve as an internal auditor of the corporation, responsible for constraining executive management from violations of law and breach of trust. Like a rival branch of government, the board's function must be defined as separate from operating management. Rather than pretending directors can "manage" the corporation, the board's role as disciplinarian should be clearly described. Specifically, the board of directors should:

- establish and monitor procedures that assure that operating executives are informed of and obey applicable federal, state, and local laws;
- approve or veto all important executive management business proposals such as corporate by-laws, mergers, or dividend decisions;
- hire and dismiss the chief executive officer and be able to disapprove the hiring and firing of the principal executives of the corporation; and
- report to the public and the shareholders how well the corporation has obeyed the law and protected the shareholders' investment.

It is not enough, however, to specify what the board should do. State corporations statutes have long provided that "the business and affairs of a corporation shall be managed by a board of directors," yet it has been over a century since the boards of the largest corporations have actually performed this role. To reform the corporation, a federal chartering law must also specify the manner in which the board performs its primary duties.

First, to insure that the corporation obeys federal and state laws, the board should designate executives responsible for compliance with these laws and require periodic signed reports describing the effectiveness of compliance procedures. Mechanisms to administer spot checks on compliance with the principal statutes should be created. Similar mechanisms can insure that corporate "whistle blowers" and nonemployee sources may communicate to the board—in private and without fear of retaliation—knowledge of violations of law.

Second, the board should actively review important executive business proposals to determine their full compliance with law, to preclude conflicts of interest, and to assure that executive decisions are rational and informed of all foreseeable risks and costs. But even though the board's responsibility here is limited to approval or veto of executive initiatives, it should proceed in as well-informed a manner as practicable. To demonstrate rational business judgment, the directorate should require management "to prove its case." It should review the studies upon which management relied to make a decision, require management to justify its decision in terms of costs or rebutting dissenting views, and, when necessary, request that outside experts provide an independent business analysis.

Only with respect to two types of business decisions should the board exceed this limited review role. The determination of salary, expense, and benefit schedules inherently possesses such obvious conflicts of interest for executives that only the board should make these decisions. And since the relocation of principal manufacturing facilities tends to have a greater effect on local communities than any other type of business decision, the board should require management to prepare a "community impact statement." This public report would be similar to the environmental impact statements presently required by the National Environmental Policy Act. It would require the corporation to state the purpose of a relocation decision; to compare feasible alternative means; to quantify the costs to the local community; and to consider methods to mitigate these costs. Although it would not prevent a corporation from making a profit-maximizing decision, it would require the corporation to minimize the costs of relocation decisions to local communities.

To accomplish this restructuring of the board requires the institutionalization of a new profession: the full-time "professional" director. Corporate scholar frequently identify William O. Douglas' 1940 proposal for "salaried, professional experts [who] would bring a new responsibility and authority to directorates and a new safety to stockholders" as the origin of the professional director idea. More recently, corporations including Westinghouse and Texas Instruments have established slots on their boards to be filled by full-time directors. Individuals such as Harvard Business School's Myles Mace and former Federal Reserve Board chairman William McChesney Martin consider their own thoroughgoing approach to boardroom responsibilities to be that of a "professional" director.

To succeed, professional directors must put in the substantial time necessary to get the job done. One cannot monitor the performance of Chrysler's or Gulf's management at a once-a-month meeting; those firms' activities are too sweeping and complicated for such ritual oversight. The obvious minimum here is an adequate salary to attract competent persons to work as full-time directors and to maintain the independence of the board from executive management.

The board must also be sufficiently staffed. A few board members alone cannot oversee the activities of thousands of executives. To be able to appraise operating management, the board needs a trim group of attorneys, economists, and labor and consumer advisors who can analyze complex business proposals, investigate complaints, spot-check accountability, and frame pertinent inquiries.

The board also needs timely access to relevant corporate data. To insure this, the board should be empowered to nominate the corporate financial auditor, select the corporation's counsel, compel the forwarding and preservation of corporate records, require all corporate executives or representatives to answer fully all board questions respecting corporate operations, and dismiss any executive or representative who fails to do so.

This proposed redesign for corporate democracy attempts to make executive management accountable to the law and shareholders without diminishing its operating efficiency. Like a judiciary within the corporation, the board has ultimate powers to judge and sanction. Like a legislature, it oversees executive activity. Yet executive management substantially retains its powers to initiate and administer business operations. The chief executive officer retains control over the organization of the executive hierarchy and the allocation of the corporate budget. The directors are given ultimate control over a narrow jurisdiction: Does the corporation obey the law, avoid exploiting consumers or communities, and protect the shareholders' investment? The executive contingent retains general authority for all corporate operations.

No doubt there will be objections that this structure is too expensive or that it will disturb the "harmony" of executive management. But it is unclear that there would be any increased cost in adopting an effective board. The true cost to the corporation could only be determined by comparing the expense of a fully paid and staffed board with the savings resulting from the elimination of conflicts of interest and corporate waste. In addition, if this should result in a slightly increased corporate expense, the appropriateness must be assessed within a broader social context: should federal and state governments or the corporations themselves bear the primary expense of keeping corporations honest? In our view, this cost should be placed on the corporations as far as reasonably possible.

It is true that an effective board will reduce the "harmony" of executive management in the sense that the power of the chief executive or senior executives will be subject to knowledgeable review. But a board which monitors rather than rubber-stamps management is exactly what is necessary to diminish the unfettered authority of the corporate chief executive or ruling clique. The autocratic power these individuals presently possess has proven unacceptably dangerous: it has led to recurring violations of law, conflicts of interest, productive inefficiency, and pervasive harm to consumers, workers, and the community environment. Under normal circumstances there should be a healthy friction between operating executives and the board to assure that the wisest possible use is made of corporate resources. When corporate executives are breaking the law, there should be no "harmony" whatsoever.

ELECTION OF THE BOARD

Restructuring the board is hardly likely to succeed if boards remain as homogeneously white, male, and narrowly oriented as they are today. Dissatisfaction with current selection of directors is so intense that analysts of corporate governance, including Harvard Law School's Abram Chayes, Yale political scientist Robert Dahl, and University of Southern California Law School Professor Christopher Stone, have each separately urged that the starting point of corporate reform should be to change the way in which the board is elected.

Professor Chayes, echoing John Locke's principle that no authority is legitimate except that granted "the consent of the governed," argues that employees and other groups substantially affected by corporate operations should have a say in its governance:

> Shareholder democracy, so-called, is misconceived because the shareholders are not the governed of the corporations whose consent must be sought. . . . Their interests are protected if financial information is made available, fraud and overreaching are prevented, and a market is maintained in which their shares may be sold. A priori, there is no reason for them to have any voice, direct or representational, in [corporate decision making]. They are no more affected than nonshareholding neighbors by these decisions. . . .
>
> A more spacious conception of 'membership,' and one closer to the facts of corporate life, would include all those having a relation of sufficient intimacy with the corporation or subject to its powers in a sufficiently specialized way. Their rightful share in decisions and the exercise of corporate power would be exercised through an institutional arrangement appropriately designed to represent the interests of a constituency of members having a significant common relation to the corporation and its power.

Professor Dahl holds a similar view: "[W]hy should people who own shares be given the privileges of citizenship in the government of the firm when citizenship is denied to other people who also make vital contributions to the firm?" he asks rhetorically. "The people I have in mind are, of course, employees and customers, without whom the firm could not exist, and the general public, without whose support for (or acquiescence in) the myriad protections and services of the state the firm would instantly disappear. . . ." Yet Dahl finds proposals for interest group representation less desirable than those for worker self-management. He also suggests consideration of codetermination statutes such as those enacted by West Germany and ten other European and South American countries under which shareholders and employees separately elect designated portions of the board.

From a different perspective, Professor Stone has recommended that a federal agency appoint "general public directors" to serve on the boards of all the largest industrial and financial firms. In certain extreme cases such as where a corporation repeatedly violates the law, Stone recommends that the federal courts appoint "special public directors" to prevent further delinquency.

There are substantial problems with each of these proposals. It seems impossible to design a general ."interest group" formula which will assure that all affected constituencies of large industrial corporations will be represented and that all constituencies will be given appropriate weight. Even if such a formula could be designed, however, there is the danger that consumer or community or minority or franchisee representatives would become only special pleaders for their constituents and otherwise lack the loyalty or interest to direct generally. This defect has emerged in West Germany under codetermination. Labor representatives apparently are indifferent to most problems of corporate management that do not directly affect labor. They seem as deferential to operating executive management as present American directors are. Alternatively, federally appointed public directors might be frozen out of critical decision-making by a majority of "privately" elected directors, or the appointing agency itself might be biased.

Nonetheless, the essence of the Chayes-Dahl-Stone argument is well taken. The boards of directors of most major corporations are, as CBS's Dan Rather criticized the original Nixon cabinet, too much like "twelve grey-haired guys named George." The quiescence of the board has resulted in important public and, for that matter, shareholder concerns being ignored.

An important answer is structural. The homogeneity of the board can only be ended by giving to each director, in addition to a general duty to see that the corporation is profitably administered, a separate oversight responsibility, a separate expertise, and a separate constituency so that each important public concern would be guaranteed at least one informed representative on the board. There might be nine corporate directors, each of whom is elected to a board position with one of the following oversight responsibilities:

1. Employee welfare
2. Consumer protection
3. Environmental protection and community relations
4. Shareholder rights
5. Compliance with law
6. Finances
7. Purchasing and marketing
8. Management efficiency
9. Planning and research

By requiring each director to balance responsibility for representing a particular social concern against responsibility for the overall health of the enterprise, the problem of isolated "public" directors would be avoided. No individual director is likely to be "frozen out" of collegial decision-making because all directors would be of the same character. Each director would spend the greater part of his or her time developing expertise in a different area; each director would have a motivation to insist that a different aspect of a business decision be considered. Yet each would simultaneously be responsible for participating in all board decisions, as directors now are. So the specialized area of each director would supplement but not supplant the director's general duties.

Although not a symmetrical analogy, the most successful precedent for dividing the representative responsibilities and constituencies is, of course, the Constitution of the United States. There, too, a basic question was one of motivation: How to design a political administration which would retain an equal respect for the rights of all of its citizens. Only by arranging "ambition . . . to counteract ambition" did the Federalists believe such respect would endure. By granting the President, the two houses of Congress, and the judiciary different geographic constituencies, different terms, and different duties, the various factions of the nation's citizens were most likely to be insured some representation within the government. "Hence a double security arises to the rights of the people. The different governments will control each other, at the same time that each will be controlled by itself," explained Madison in *Federalist No. 51*.

In recent years, some business corporations have also perceived the advantages of creating constitutent voices within the structure of the firm. Reverend Leon Sullivan, the only black director on General Motors' board, has made plain that he considers it his special responsibility to advance the interests of GM's black employees and dealers. His representation, among other things, has led to an increase in the number of blacks being trained to be GM executives. Gillette's Vice President for Product Integrity, Robert Giovacchini, is said to perform a similar role. Although not a member of the board, Mr. Giovacchini has been given the authority to recall any Gillette product, quash any advertising claim, or order any packaging change he feels is necessary to protect the company's consumers.

Only by institutionalizing the duties and power that individuals like Reverend Sullivan and Robert Giovacchini hold can responsible corporate government be brought to each large firm.

For in most giant corporations, no specific executive official or board member is responsible for protecting the interests of employees, consumers, the environment, or local communities. No one outside of senior management reviews the most important business decisions to assure their compliance with law, financial integrity, efficiency, or long-term corporate goals. Because these concerns become everybody's general interest, they become nobody's particular interest—and often go unattended.

To maintain the independence of the board from the operating management it reviews also requires that each federally chartered corporation shall be directed by a purely "outside" board. No executive, attorney, representative, or agent of a corporation should be allowed to serve simultaneously as a director of that same corporation. Directorial and executive loyalty should be furthered by an

absolute prohibition of interlocks. No director, executive, general counsel, or company agent should be allowed to serve more than one corporation subject to the Federal Corporate Chartering Act.

Several objections may be raised. First, how can we be sure that completely outside boards will be competent? As elaborated subsequently, corporate campaign rules will be redesigned to emphasize qualifications. This will allow shareholder voters to make rational decisions based on information clearly presented to them. It is also a fair assumption that shareholders, given an actual choice and role in corporate governance, will want to elect the men and women most likely to safeguard their investments.

A second objection is that once all interlocks are proscribed and a full-time outside board required, there will not be enough qualified directors to staff all major firms. This complaint springs from that corporate mentality which, accustomed to 60-year-old white male bankers and businessmen as directors, makes the norm a virtue. In fact, if we loosen the reins on our imagination, America has a large, rich, and diverse pool of possible directorial talent from academics and public administrators and community leaders to corporate and public interest lawyers.

But directors should be limited to four two-year terms so that boards do not become stale. And no director should be allowed to serve on more than one board at any one time. Although simultaneous service on two or three boards might allow key directors to "pollinize" directorates by comparing their different experiences, this would reduce their loyalty to any one board, jeopardize their ability to fully perform their new directorial responsibilities, and undermine the goal of opening up major boardrooms to as varied a new membership as is reasonable.

The shareholder electoral process should be made more democratic as well. Any shareholder or allied shareholder group which owns .1 percent of the common voting stock in the corporation or comprises 100 or more individuals and does not include a present executive of the corporation, nor act for a present executive, may nominate up to three persons to serve as directors. This will exclude executive management from the nomination process. It also increases the likelihood of a diverse board by preventing any one or two sources from proposing all nominees. To prevent frivolous use of the nominating power, this proposal establishes a minimum shareownership condition.

Six weeks prior to the shareholders' meeting to elect directors, each shareholder should receive a ballot and a written statement on which each candidate for the board sets forth his or her qualifications to hold office and purposes for seeking office. All campaign costs would be borne by the corporation. These strict campaign and funding rules will assure that all nominees will have an equal opportunity to be judged by the shareholders. By preventing directorates from being bought, these provisions will require board elections to be conducted solely on the merit of the candidates.

Only the actual or "beneficial" owners of stock should be eligible to vote. Financial intermediaries shall be required to "pass through" voting rights in approximately the same manner that present New York and American Stock Exchange rules require broker-dealers to "pass through" proxies and corporate reports to shareholders owning stock in street name accounts. Already a number of major firms, including Sears, Roebuck, General Motors, McDonnell Douglas, and United States Steel, "pass through" voting rights to hundreds of thousands of employees holding stock in joint pension funds.

Finally, additional provisions will require cumulative voting and forbid "staggered" board elections. Thus any shareholder faction capable of jointly voting approximately 10 percent of the total number of shares cast may elect a director.

A NEW ROLE FOR SHAREHOLDERS

The difficulty with this proposal is the one that troubled Juvenal two millennia ago: *Quis custodiet ipsos custodes*, or, Who shall watch the watchmen? Without a full-time body to discipline the board, it would be so easy for the board of directors and executive management to become friends. Active vigilance could become routinized into an uncritical partnership. The same board theoretically elected to protect shareholder equity and internalize law might instead become management's lobbyist.

Relying on shareholders to discipline directors may strike many as a dubious approach. Historically, the record of shareholder participation in corporate governance has been an abysmal one. The monumental indifference of most shareholders is worse than that of sheep; sheep at least have some sense of what manner of ram they follow. But taken together, the earlier proposals—an outside, full-time board, nominated by rival shareholder groups and voted on by beneficial owners—will increase involvement by shareholders. And cumulative voting insures that an aroused minority of shareholders—even one as small as 9 or 10 percent of all shareholders—shall have the opportunity to elect at least one member of the board.

But that alone is hardly sufficient. At a corporation the size of General Motors, an aggregation of 10 percent of all voting stock might require the allied action of over 200,000 invididuals—which probably could occur no more than once in a generation. To keep directors responsive to law and legitimate public concerns requires surer and more immediate mechanisms. In a word, it requires arming the victims of corporate abuses with the powers to swiftly respond to them. For only those employees, consumers, racial or sex minorities, and local communities harmed by corporate depradations can be depended upon to speedily complain. By allowing any victim to become a shareholder and by permitting any shareholder to have an effective voice, there will be the greatest likelihood of continuing scrutiny of the corporation's directorate. Shareholder involvement can be further enhanced by the disclosures discussed in the next chapter, by the opportunity to attend periodically scheduled directors' meetings to ask questions or present grievances, and by reform of the shareholder derivative action so that any investor who identifies a corporate violation of law may bring lawsuit without risk of financial loss.

For the purpose of motivating the board to perform its intended role, however, it is appropriate to inject shareholders further into corporate governance wherever they have a financial or other incentive to perform effectively.

Six weeks before a vote on any fundamental transaction—which can be defined as executive proposals involving the purchase, sale, lease, merger, consolidation, financing, refinancing, dissolution, or liquidation of assets equal to, say, 10 percent of the corporation's total assets or over $100 million, or the authorization of corporate securities in any amount—the board should forward a written statement to the shareholders explaining the transaction, the vote by which the transaction was approved by the board, the reasons why members of the board approved the transaction, the reasons why other members opposed it, and the foreseeable costs and risks of implementing the proposal. This provision would provide for shareholder votes on all business decisions above a certain minimum size, however named. By requiring directors to publicly elaborate their reasoning—reasoning which may be judged not only during this vote but also during subsequent board elections or mismanagement suits—there would be a powerful incentive for directors to police themselves.

A complementary provision should allow any shareholder or allied shareholder group holding stock equal to a minimum of one percent of all outstanding stock to simultaneously publish a dissenting view or, at any time, to propose amendments to the corporate charter or bylaws.

AFFECTED COMMUNITIES

Shareholders are not the only ones with an incentive to review decisions of corporate management; nor, as Professors Chayes and Dahl argue, are shareholders the only persons who should be accorded corporate voting rights. The increasing use by American corporations of technologies and materials that pose direct and serious threats to the health of communities surrounding their plants requires the creation of a new form of corporate voting right. When a federally chartered corporation engages, for example, in production or distribution of nuclear fuels or the emission of toxic air, water, or solid waste pollutants, citizens whose health is endangered should not be left, at best, with receiving money damages after a time-consuming trial to compensate them for damaged property, impaired health, or even death.

Instead, upon finding of a public health hazard by three members of the board of directors or 3 percent of the shareholders, a corporate referendum should be held in the political jurisdiction affected by the health hazard. The referendum would be drafted by the unit triggering it—either the three board members or a designate of the shareholders. The affected citizens by majority vote will then decide whether the hazardous practice shall be allowed to continue. This form of direct democracy has obvious parallels to the initiative and referendum procedures familiar to many states—except that the election will be paid for by a business corporation and will not necessarily occur at a regular election.

What would happen to the local community if it voted to close a dangerous plant? Three answers seem reasonable. First, the board of directors should have the opportunity to modify the local plant to reduce the health hazard. If the board chooses to do so, it should be allowed to submit its modification plan as a subsequent referendum for community approval. Second, if the corporation chooses to leave after the vote, it should be required to immediately repay the local community for all damages to its health and property by the outlawed activity. This valuation proceeding should occur in federal district court. If the corporation chooses to leave before the referendum vote, it should additionally be required to pay its local employees salaries for a reasonable interim period. Third, the referendum voting procedure should be flexible. Local communities should be given the opportunity to vote upon an initiative calling for the corporation to remedy a specific health hazard by a designated date as an alternative to one calling for immediate closing of a plant. Similarly, the board should be given the opportunity to submit a plan of modification simultaneously with the initial referendum vote.

This type of election procedure is necessary to give enduring meaning to the democratic concept of "consent of the governed." To be sure, this proposal goes beyond the traditional assumption that the only affected or relevant constituents of the corporation are the shareholders. But no longer can we accept the Faustian bargain that the continued toleration of corporate destruction of local health and property is the cost to the public of doing business. In an equitable system of governance, the perpetrators should answer to their victims.

ARTICLES OF INCORPORATION OF SEALASKA CORPORATION

The undersigned natural persons, all of whom are above the age of 19 years, appointed by authority of the Central Council of the Tlingit & Haida Indians of Alaska, acting as incorporators of a corporation under the provisions of the Alaska Business Corporation Act (hereinafter referred to as the "Corporation Act"), and the Alaska Native Claims Settlement Act of December 18, 1971, 85 Stat. 688 (hereinafter referred to as the "Settlement Act"), do hereby adopt the following Articles of Incorporation:

Article I

NAME

The name of the Corporation is SEALASKA CORPORATION.

Article II

DURATION

The Corporation shall have perpetual existence.

Article III

PURPOSES AND POWERS

The purposes of the Corporation are to be the regional corporation authorized by section 7 of the Settlement Act for the Natives of the Southeastern Alaska region; to secure and administer the benefits of said Act for the Natives enrolled in said region pursuant to section 5 thereof; and to engage in any and all lawful enterprises, businesses, undertakings and activities permitted or not denied corporations under the Corporation Act or the Settlement Act.

Subject to these Articles, the Corporation shall have and may exercise any and all powers that are permitted or not denied corporations under the Corporation Act or the Settlement Act.

Article IV

SHARES

A. Subject to section 7(g) of the Settlement Act, the aggregate number of shares that the Corporation shall have authority to issue is two million. Such shares shall be common stock of a single class, shall be without par value, and shall be deemed fully paid and non-assessable upon issuance.

B. Until December 18, 1991, shares issued by the Corporation, inchoate rights thereto, and any dividends paid or distributions made with respect thereto may not be sold, pledged, subjected to a lien or judgement execution, assigned in present or future, or otherwise alienated, except pursuant to a court decree of separation, divorce or child support.

C. Shares issued by the Corporation shall:

1. Except as provided in paragraph D of this Article, carry a right to vote in elections for the board of directors and on such other matters as are presented to the shareholders;
2. Subject to the provisions of paragraph E of this Article, permit the holders to receive dividends and other distributions from the Corporation; and
3. Vest in the holders all rights of a shareholder in a business corporation organized under the laws of the State of Alaska.

D. Upon the death of a shareholder ownership of his shares shall be transferred in accordance with his last will and testament or under the applicable laws of intestacy, except that:

1. Until December 18, 1991, such shares shall carry voting rights only if the holder thereof through inheritance is a Native; and
2. In the event a deceased shareholder fails to dispose of his shares by will and has no heirs who are natural persons under the applicable laws of intestacy, such shares shall escheat to the Corporation.

E. When funds are distributed among Village Corporations in the Southeastern Alaska region pursuant to the provisions of the Settlement Act, anamount computed as follows shall be distributed as dividends, subject to the provisions of said Act, exclusively to the shareholders of the Corporation who are non-residents of those villages whose Corporations are distributees. The amount so distributed as dividends exclusively to such shareholders shall bear the same ratio to the amount distributed among the Village Corporations that the number of shares registered on the books of the Corporation in the names of such shareholders bears to the number of shares registered in the names of residents of such villages.

F. On January 1, 1992, all stock previously issued by the Corporation shall be deemed to be cancelled, and shares will be issued which shall not be subject to the restrictions set forth in paragraph B or in subparagraph 1 of paragraph D of this Article.

Article V

COMMENCING BUSINESS

If so restricted by law, the Corporation will not commence business until consideration of the value of at least $1,000 has been received.

Article VI

PREEMPTIVE RIGHTS

Except as may otherwise be provided by the Board of Directors, no stockholder of the Corporation shall have any pre-emptive rights to purchase, subscribe for or otherwise acquire any shares of stock of the Corporation now or hereafter authorized, or any securities exchangeable for or convertible into such shares, or any warrants or other instruments evidencing rights or options to subscribe for, purchase or otherwise acquire such shares.

Article VII

MANAGEMENT

The management of the Corporation shall be vested in a Board of Directors. Subject to the provisions of section 7(f) of the Settlement Act respecting the qualifications of Directors, the number, terms, and method of election of Directors shall be as prescribed in the Bylaws of the Corporation.

Article VIII

ARBITRATION

In the event of disagreement between the Corporation and a Village Corporation or Village Corporations over the provisions of a plan or plans formulated pursuant to section 7(l) of the Settlement Act, the issues in disagreement shall be submitted to arbitration before a panel of three arbiters, of whom one shall be chosen by the Corporation, one by the Village Corporation or Corporations involved in the disagreement, and one by the two so chosen by the parties. The arbitration shall be subject to the Alaska Uniform Arbitration Act.

Article IX

OFFICE AND AGENT

The address of the Corporation's initial registered office is:

114 South Franklin Street
Juneau, Alaska 99801

The name of the Corporation's initial registered agent at that address is:

John Borbridge, Jr.

Article X

INITIAL BOARD OF DIRECTORS

The initial Board of Directors shall be composed of fifteen persons who shall serve until the first annual meeting of shareholders or until their successors are elected and qualified. The names and addresses of the members of the initial Board of Directors are:

Name	Address
John Borbridge, Jr.	Juneau, Alaska
Bertrand C. Campbell, Jr.	Ketchikan, Alaska
Robert David, Sr.	Haines, Alaska
Sam L. Demmert	Yakutat, Alaska
Cyril W. George, Sr.	Angoon, Alaska
Gilbert Gunderson	Wrangell, Alaska
Aaron T. Isaacs, Jr.	Craig, Alaska
Clarence Jackson, Sr.	Kake, Alaska
Mark Jacobs, Jr.	Sitka, Alaska
Marlene Johnson	Hoonah, Alaska
Leonard Kato	Klawock, Alaska
Richard Kito	Petersburg, Alaska
Robert Lang	Juneau, Alaska
Byron Mallott	Juneau, Alaska
Charles Nelson	Ketchikan, Alaska

Article XI

INCORPORATORS

The names and addresses of the incorporators are:

Name	Address
John Borbridge, Jr.	Juneau, Alaska
Clarence Jackson, Sr.	Kake, Alaska
Marlene Johnson	Hoonah, Alaska
Leonard Kato	Klawock, Alaska
Richard Kito	Petersburg, Alaska

Article XII

AMENDMENT

Subject to section 7(e) of the Settlement Act, these Articles may be amended, restated or repealed from time to time in accordance with the Corporation Act.

In witness whereof the undersigned incorporators have hereunto set their hands and seals this 13th day of June, 1972.

John Borbridge, Jr. (SEAL)

Clarence Jackson Sr. (SEAL)

Marlene Johnson (SEAL)

Leonard Kato (SEAL)

Richard Kito (SEAL)

VERIFICATION

CITY OF WASHINGTON)
) ss
DISTRICT OF COLUMBIA)

I, the undersigned, a Notary Public duly commissioned to take acknowledgements and administer oaths in the District of Columbia, do hereby certify that on the 13th day of June, 1972, personally appeared before me John Borbridge, Jr., Clarence Jackson, Sr., Marlene Johnson, Leonard Kato, and Richard Kito, who, being by me first duly sworn, declared that they are the incorporators referred to in the foregoing Articles of Incorporation, that they signed the Articles as such that the statements contained herein are true.

Nancy L Lowe
NOTARY PUBLIC, D. C.

My Commission Expires March 31, 1977.

APPROVED
this 14th day of June, 1972,
in accordance with section 7(e)
of the Alaska Native Claims
Settlement Act of December 18, 1971
(85 Stat. 688).

Harrison Loesch
ASSISTANT SECRETARY OF THE INTERIOR

BYLAWS OF SEALASKA CORPORATION

Article I

IDENTIFICATION

A. Name. The name of the Corporation is SEALASKA CORPORATION.

B. Office and Agent. The address of the registered office of the Corporation is 114 South Franklin Street, Juneau, Alaska 99801; and the name of the registered agent at this address is John Borbridge, Jr.

C. Seal. The seal of the Corporation shall be in such form as the Board of Directors shall prescribe.

D. The fiscal year of the Corporation shall be as prescribed by the Board of Directors.

Article II

TEMPORARY LIMITATIONS OF POWERS

Notwithstanding the recitations contained in Article III of the Articles of Incorporation relating to the powers of the Corporation, prior to completion of the roll required by section 5 of the Alaska Native Claims Settlement Act of December 18, 1971, 85 Stat. 688 (hereinafter referred to as the "Settlement Act"), the issuance of shares as provided by section 7(g) of the Settlement Act, and the holding of the first annual meeting of shareholders thereafter, the powers of the Corporation shall be subject to the limitations hereafter set forth, except that, with the approval of the Secretary of the Interior, the Corporation may act beyond such limitations.

A. The Corporation shall not borrow funds in excess of the aggregate amount of $1,200,000.

B. The Corporation shall not expend or commit funds in excess of the aggregate amount of $1,200,000; nor for purposes other than organizational and to assemble and analyze data pertinent to land selections and related responsibilities; nor for more than one year in advance.

C. The Corporation shall not invest funds distributed under the Act for periods in excess of one year, provided that the Corporation may invest funds in readily marketable securities qualified for the investment of trust funds having maturities beyond one year.

D. The Corporation shall not make land selections.

Article III

SHAREHOLDERS

A. Annual Meeting. The annual meeting of shareholders, unless for compelling reasons the Board of Directors otherwise provides for particular years, shall be held within three months of the close of the fiscal year of the Corporation at such time as the Board of Directors shall prescribe.

B. Special Meetings. Special meetings of the shareholders may be called by the Board of Directors, the Chairman of the Board of Directors, the President, or the holders of not less than one-tenth of all shares entitled to vote at the meeting. Only such business shall be conducted at a special meeting as is specified in the notice thereof.

C. Place of Meetings. Unless otherwise provided by the Board of Directors, all meetings of shareholders shall be held at the registered office of the Corporation.

D. Notice of Meetings. Written notice stating the place, day, and hour of the meeting and, in case of a special meeting, the purpose or purposes for which the meeting is called, shall be delivered not less than 10 nor more than 50 days before the date of the meeting, either personnally or by mail, by or at the direction of the President, the Secretary, or the officer or persons calling the meeting, to each registered holder entitled to vote at such meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail postage prepaid addressed to the registered holder at his address as it appears on the stock transfer books of the Corporation. Waiver by a shareholder in writing of a notice of a shareholders' meeting shall be equivalent to the giving of such notice. whether in person or by proxy, at a shareholders' meeting shall constitute a waiver of notice of the meeting.

E. Quorum. A majority of the shares entitled to vote, represented in person or by proxy, shall constitute a quorum at a meeting of shareholders. The shareholders present at a duly organized meeting may continue to do business until adjournment, notwithstanding the withdrawal of enough shareholders to leave less than a quorum.

F. Closing of Transfer Books and Fixing Record Date. For the purpose of determining shareholders entitled to notice of or to vote at any meeting of shareholders, or any adjournment thereof, or entitled to receive payment of any dividend, or in order to make a determination of shareholders for any other proper purpose, the Board of Directors of the Corporation may provide that the stock transfer books shall be closed for a stated period but not to exceed, in any case, 50 days. If the stock transfer books shall be closed for any purpose of determining shareholders entitled to notice of or to vote at a meeting of shareholders, the books shall be closed for at least 10 days immediately preceding the meeting. In lieu of closing the stock transfer books, the Board of Directors may fix in advance a date as the record date for any such determination of shareholders, such date, in any case, to be not more than 50 days and, in case of a meeting of shareholders, not less than 10 days prior to the date on which the particular action, requiring this determination of shareholders, is to be taken. If the stock transfer books are not closed and, no record date is fixed for the determination of shareholders entitled to notice or to vote at a meeting of shareholders or shareholders entitled to receive payment of a dividend, the date on which notice of the meeting is mailed or the date on which the resolution of the Board of Directors declaring the dividend is adopted, as the case may be, shall be the record date for the determination of shareholders. When a determination of shareholders entitled to vote at any meeting of shareholders has been made as provided in this paragraph, the determination shall apply to any adjournment thereof, except where the determination has been made through the closing of the stock transfer books and the stated period of closing has expired.

G. List of Shareholderss. At least ten days before each meeting of shareholders, the officer or agent having charge of the share transfer book for shares of the corporation shall make a list of the shareholders entitled to vote at the meeting or an adjournment of the meeting, arranged in alphabetical order, with the address of and the number of shares held by each. The list shall be kept on file at the registered office of the corporation and is subject to inspection by a shareholder at any time during usual business hours for a period of 10 days prior to the meeting. The list shall also be produced and kept open at the time and place of the meeting and be subject to the inspection of a shareholder during the meeting. Failure to comply with the requirements of this paragraph does not affect the validity of the action taken at the meeting.

H. Voting. At any meeting of the shareholders every shareholder having the right to vote shall be entitled to vote in person, or by proxy appointed by an instrument in writing subscribed by such shareholder or his authorized attorney in fact, and bearing a date not more than eleven months prior to said meeting. Until after the first election of directors following completion by the Secretary of the Interior of a roll of Natives, pursuant to section 5 of the Settlement Act, only Natives enrolled in the southeastern Alaska region, pursuant to the Act, may be appointed as proxies. At an election for directors every shareholder entitled to vote may vote, in person or by proxy, the number of shares owned by him for as many persons as there are directors to be elected, or may cumulate his votes by giving one candidate as many votes as the number of directors to be elected multiplied by the number of his shares equals, or by distributing these votes on the same principle among any number of candidates.

I. Action Without A Meeting. Any action required to be taken at a meeting of the shareholders of the Corporation, or any action that may be taken at a meeting of the shareholders, may be taken without a meeting if a consent in writing setting forth the action so taken shall be signed by all of the shareholders entitled to vote with respect to the subject matter thereof.

Article IV

BOARD OF DIRECTORS

A. Composition. The business, affairs and property of the Corporation shall be managed by a Board of Directors composed of fifteen members. The terms of members, except those of members elected prior to and at the first annual meeting of shareholders held after the completion of the roll required by section 5 of the Settlement Act, shall be three years; five members to be elected at each annual meeting of shareholders as hereinafter prescribed. The terms of members of the initial board and of any successor board elected prior to the completion of such roll and the first annual meeting of shareholders held thereafter shall be one year, or until such first annual meeting of shareholders, whichever first occurs, and until their successors are elected and qualified. Members of the Board of Directors elected at and after such first annual meeting of shareholders shall be shareholders of the Corporation over the age of eighteen years.

B. Election. At the first annual meeting of shareholders held after completion of the roll, fifteen members shall be elected to the Board of Directors in three classes, each consisting of five members. The term of office of the directors of the first class shall expire at the first annual meeting of shareholders held after their elections. The term of office of the directors of the second class shall expire at the second annual meeting of shareholders held after their elections. The term of office of the directors of the third class shall expire at the third annual meeting of shareholders held after their elections. At each annual meeting after the first, five directors shall be elected whose terms shall expire at the third annual meeting of shareholders held after the meeting at which they are elected. Each director shall hold office for the term for which he is elected and until a successor is elected and qualified.

C. Removal. A director may be removed from office by majority vote of the shares eligible to votè, with or without cause, at any annual meeting of shareholders or at a special meeting called for that purpose.

D. Vacancies. A vacancy occurring in the Board of Directors may be filled by the vote of a majority of the remaining directors though the majority is less than a quorum of the Board. A director elected to fill a vacancy is elected for the unexpired term of his predecessor. A directorship to be filled by reason of an increase in the number of directors shall be filled by election at an annual meeting of shareholders or at a special meeting of shareholders called for that purpose.

E. Place of Meetings. Meetings of tne Board of Directors, annual, regular and special may be held at any place designated by the Board, or, in the case of a special meeting, at any place designated by the authority calling the meeting, either within or without the State of Alaska.

F. Annual Meetings. The Board of Directors shall meet each year immediately after the annual meeting of the shareholders for the purposes of election of a Chairman, organization, election of officers of the Corporation, and the consideration of any other business that may properly be brought before the meeting. No notice of any kind of this meeting shall be necessary either to old or new members of the Board of Directors. The Chairman shall preside at meetings of the Board of Directors and shall supervise the execution of actions taken by it.

G. Regular Meetings. The Board of Directors may from time to time provide for the holding of subsequent or regular meetings. No notice of any kind need be given to any members of the Board of Directors of any such meetings.

H. Special Meetings. Other meetings of the Board of Directors may be held upon notice by letter, telegram, cable, or radiogram, delivered for transmission not later than during the third day immediately preceding the day for the meeting, or by word of mouth, telephone or radiophone received not later than during the second day immediately preceding the day for the meeting, upon the call of the Chairman of the Board, the President of the Corporation, or a majority of the members of the Board of Directors then in office, at any place within or without the State of Alaska. Notice of any meeting of the Board of Directors may be waived in writing signed by the person or persons entitled to the notice, whether before or after the time of the meeting. Neither the business to be transacted at, nor the purpose of, any meeting of the Board of Directors need be specified in the notice or waiver of notice of the meeting.

I. Acting Without Assembling. Any action that may be taken at a meeting of the Board of Directors or of a committee thereof may be taken without a meeting if a consent in writing, setting forth the action to be taken, shall be signed by all of the Directors or all of the members of the committee, as the case may be. Without assembling the members of the Board of Directors or of a committee thereof can conduct a meeting by communicating simultaneously with each other by means of conference telephones or similar communications equipment.

J. Executive Committee. When the Board of Directors is not meeting, the powers of the Board may be exercised by an Executive Committee, consisting of the Chairman and four other members designated by the Board. In its exercise of the authority of the Board in the management of the Corporation, the Executive Committee, except as otherwise provided by resolutions of the Board, may do anything that the Board itself might lawfully do, except that it may not take any action contrary to or inconsistent with any action taken by the Board.

K. Transactions in Which Directors Have an Interest. Any contract or other transaction between the Corporation and one or more of its directors, or between the Corporation and any firm of which one or more of its directors are members or employees, or in which they are interested, or between the Corporation and any corporation or association of which one or more of its directors are shareholders, members, directors, officers, or employees, or in which they are interested, shall be valid for all purposes, notwithstanding the presence of the director or directors at the meeting of the Board of Directors of the Corporation that acts upon, or in reference to, the contract or transaction, and notwithstanding his or their participation in the action, if the fact of such interest shall be disclosed or known to the Board of Directors and the Board of Directors shall, nevertheless, authorize or ratify the contract or transaction, the interested director or directors to be counted in determining whether a quorum is present and to be entitled to vote on such authorization or ratification. This section shall not be construed to invalidate any contract or other transaction that would otherwise be valid under the common and statutory law applicable to it.

Article V

OFFICERS

A. Titles and Tenure. The officers of the Corporation shall be a President, a Vice President, a Secretary, and a Treasurer, each of whom shall be elected by the Board of Directors at such times, in such manner, and upon and for such terms as it shall prescribe. In addition to the above officers, the Board of Directors may designate and elect or appoint such other officers, assistant officers, and agents as it deems necessary at such times, in such manner, and upon and for such terms as it shall prescribe. Two or more offices may be held by the same person, except the offices of President and Secretary. No officer or agent of the Corporation need be a shareholder of the Corporation or a member of the Board of Directors. All officers and agents of the Corporation shall serve at the pleasure of the Board of Directors and may be removed by the Board or the

Executive Committee whenever in its judgment the best interests of the Corporation will be served. Removal is without prejudice to the contract rights of the person removed, but election or appoinement of an officer or agent by the Board of Directors, regardless of whether for a stated term, does not of itself create contract rights.

B. Duties. Officers and agents of the Corporation shall have and perform such duties as are prescribed from time to time by the Board of Directors.

Article VI

CERTIFICATES

A. Certificates Representing Shares. The shares of the Corporation shall be represented by certificates signed by the President or Vice President and the Secretary or an Assistant Secretary of the Corporation, and may be sealed with the seal of the Corporation or a facsimile of the seal. The signatures of the President or Vice President and the Secretary or Assistant Secretary upon a certificate may be facsimiles if the certificate is countersigned by a transfer agent, or registered by a registrar, other than the Corporation itself or an employee of the Corporation. If an officer who has signed or whose facsimile signature has been placed upon such certificate ceases to be an officer before the certificate is issued, it may be issued by the Corporation with the same effect as if he were an officer at the date of its issue.

B. Information To Be Stated on Face of Certificates. Each certificate representing shares shall state upon the face:

1. That the Corporation is organized under the laws of Alaska, subject to the provision of the Alaska Native Claims Settlement Act of December 18, 1971, P.L. 92-203 (85 Stat. 688);
2. The name of the person to whom issued;
3. The number of shares it represents; and
4. That the shares are without par value.

C. Additional Information. The Board of Directors may provide for the setting out on the face or back of each certificate such additional statements about the provisions of the Settlement Act as it believes would be helpful to the holder, including statements about restrictions upon alienation, and about variations in voting and dividend rights depending upon whether the holder is a Native or a non-Native or a resident or a non-resident of a village for which a Village Corporation is organized pursuant to the Settlement Act.

D. Regulations. The Board of Directors may make such rules and regulations as it deems appropriate to govern the issue, transfer, registration and replacement of certificates.

Article VII

AMENDMENTS

These Bylaws may be amended, repealed or restated by majority vote of the shares eligible to vote at any annual meeting of shareholders, or at any special meeting of shareholders called for that purpose, or by the Board of Directors, except that for a period of five years from the date of filing of the Articles of Incorporation of the Corporation the following provisions shall not be amended without the approval of the Secretary of the Interior:

A. Article II (Temporary Limitation of Powers);
B. Paragraph H (Voting) of Article III (Shareholders); and
C. Paragraphs A (Composition) and B(Election) of Article IV (Board of Directors).

APPROVED
this 14th day of June, 1972,
in accordance with section 7(e)
of the Alaska Native Claims
Settlement Act of December 18,
1971 (85 Stat. 688).

Harrison Loesch
ASSISTANT SECRETARY OF THE INTERIOR

Federal Credit Unions

Chapter 14 of Title 12 of the United States Code, as amended to April 19, 1977

§ 1751

Short Title.—This chapter may be cited as the "Federal Credit Union Act". (June 26, 1934, § 1, 48 Stat. 1216; Sept. 22, 1959, § 1, 73 Stat. 628.)

Act of June 26, 1934, cited to the text was entitled "An Act to establish a Federal Credit Union System, to establish a further market for securities of the United States and to make more available to people of small means credit for provident purposes through a national system of cooperative credit, thereby helping to stabilize the credit structure of the United States."

Subchapter I—General Provisions

§ 1752 **§ 101**

Definitions.—As used in this chapter—

(1) the term "Federal credit union" means a cooperative association organized in accordance with the provisions of this chapter for the purpose of promoting thrift among its members and creating a source of credit for provident or productive purposes;

(2) the term 'Administrator' means the Administrator of the National Credit Union Administration;

(3) the term 'Administration' means the National Credit Union Administration; and

(4) the term 'Board' means the National Credit Union Board.

*(4) The terms 'member account' and 'account' (when referring to the account of a member of a credit union) mean a share, share certificate, or share deposit account of a member of a credit union of a type approved by the Administrator which evidences money or its equivalent received or held by a credit union in the usual course of business and for which it has given or is obligated to give credit to the account of the member, and, in the case of a credit union serving predominantly low-income members (as defined by the Administrator), such terms (when referring to the account of a nonmember served by such credit union) mean a share, share certificate, or share deposit account of such nonmember which is of a type approved by the Administrator and evidences money or its equivalent received or held by such credit union in the usual course of business and for which it has given or is obligated to give credit to the account of such nonmember, and such terms mean those accounts of nonmember credit unions and nonmember units of Federal, State, or local governments and political subdivisions thereof in which payments are received by a credit union pursuant to section 107(6) of this Act;

(5) The terms 'State credit union' and 'State-chartered credit union' mean a credit union organized and operated according to the laws of any State, the District of Columbia, the several territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, which laws provide for the organization of credit unions similar in principle and objectives to Federal credit unions;

(6) The term 'insured credit union' means any credit union the member accounts of which are insured in accordance with the provisions of title II of this Act, and the

*Definitions of terms "member account" and "account" were added as paragraph (4) notwithstanding the existence of a paragraph (4) defining the term "Board."

term 'noninsured credit union' means any credit union the member accounts of which are not so insured;

(7) The term 'Fund' means the National Credit Union Share Insurance Fund; and

(8) The term 'branch' includes any branch credit union, branch office, branch agency, additional office, or any branch place of business located in any State of the United States, the District of Columbia, the several territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, at which member accounts are established or money lent.

(As amended Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub.L. 95-22, 91 Stat. 49).

§ 1752a § 102

Creation of Administration

(a) There is hereby established in the executive branch of the Government an independent agency to be known as the National Credit Union Administration (hereinafter referred to as the 'Administration'). The Administration shall consist of a National Credit Union Board (hereinafter referred to as the 'Board'), and an Administrator of the National Credit Union Administration (hereinafter referred to as the 'Administrator').

(b) The Administrator shall be appointed by the President, by and with the advice and consent of the Senate. He shall be the chief executive officer of the Administration and shall serve at the pleasure of the President.

(c) The Board shall consist of a Chairman and one member from each of the Federal credit union regions to be appointed by the President, by and with the advice and consent of the Senate. The Chairman shall be appointed from the country at large and shall serve at the pleasure of the President. In making appointments to the Board, the President shall appoint persons of tested credit union experience.

(d) The term of office of each member of the Board, other than the Chairman, shall be six years. However, the initial terms of the members first taking office shall expire as follows: one on December 31, 1970, and one at the end of each succeeding calendar year thereafter. Of the members so appointed, the President shall designate one to serve as Vice Chairman for a term expiring upon the expiration of his term as a member, or upon the expiration of the then current term of the Chairman, whichever is earlier. The Vice Chairman shall act as Chairman in the absence or disability of the Chairman. Any member of the Board may continue to servc as such after the expiration of his term of office until his successor has been appointed and has qualified.

(e) The President shall call the first meeting of the Board, and thereafter the Board shall meet on a quarterly basis, and at such other times as the Chairman or the Administrator may request, or whenever one-third of the members so request. The Board shall adopt such rules as it may see fit for the transaction of its business and shall keep permanent and complete records and minutes of its acts and proceedings. A majority of the voting members of the Board shall constitute a quorum. The Administrator shall seek the advice, counsel, and guidance of the Board with respect to matters of policy relating to the activities and functions of the Administration under this Act. The Administrator shall make an annual report to the President for submission to the Congress summarizing the activities of the Administration and making such recommendations as he deems appropriate. Such report shall be made after full consultation with the Board and shall contain any recommendations or comments submitted by the Board for inclusion in the report. The members of the Board shall be entitled to receive compensation at the rate of $75 for each day engaged in the business of the Administration pursuant to authorization by the Chairman, and shall be allowed travel expenses including per diem in lieu of subsistence as authorized by section 5703 of title 5 of the United States Code for persons in the Government service employed intermittently.

(f) The financial transactions of the Administration shall be audited by the General Accounting Office in accordance with the principles and procedures applicable to commercial corporate transactions and under such rules and regulations as may be prescribed by the Comptroller General of the United States. The audit shall be conducted at the place or places where the accounts of the Administration are kept.

(As amended Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1753 § 103

Federal credit union organization.—Any seven or more natural persons who desire to form a Federal credit union shall subscribe before some officer competent to administer oaths an organization certificate in duplicate which shall specifically state—

(1) the name of the association;

(2) the location of the proposed Federal credit union and the territory in which it will operate;

(3) the names and addresses of the subscribers to the certificate and the number of shares subscribed by each;

(4) the par value of the shares which shall be $5 each;

(5) the proposed field of membership, specified in detail;

(6) the term of the existence of the corporation which may be perpetual; and

(7) The fact that the certificate is made to enable such persons to avail themselves of the advantages of this Act.

Such organization certificate may also contain any provisions approved by the Administrator for the management of the business of the association and for the conduct of its affairs and relative to the powers of its directors, officers, or stockholders. (June 26, 1934, § 3, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 4, 73 Stat. 628, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1754 § 104

Approval of organization certificate.—The organization certificate shall be presented to the Administrator for approval. Before any organization certificate is approved, an appropriate investigation shall be made for the purpose of determining (1) whether the organization certificate conforms to the provisions of this chapter; (2) the general character and fitness of the subscribers thereto; and (3) the economic advisability of establishing the proposed Federal credit union. Upon approval of such organization certificate by the Administrator it shall be the charter of the corporation, and one of the originals thereof shall be delivered to the corporation after the payment of the fee required therefor. Upon such approval the Federal credit union shall be a body corporate and as such, subject to the limitations herein contained, shall be vested with all the powers and charged with all of the liabilities conferred and imposed by this chapter upon corporations organized hereunder. (June 26, 1934, § 4, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 5, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub.L. 91-468, 84 Stat. 1015).

§ 1755 § 105

Fees.—For the purpose of paying the costs incident to the ascertainment of whether an organization certificate should be approved, the subscribers to any such certificate shall pay, at the time of filing their organization certificate, the amount prescribed by the Administrator, which shall not exceed $20 in any case; and on the approval of any organization certificate they shall also pay a fee of $5. Not later than January 31 of each calendar year, each Federal credit union shall pay to the Administration, for the preceding calendar year, a supervision fee in accordance with a graduated scale prescribed by regulation on the basis of assets as of December 31 of such preceding year, but such fee shall in no event be less than $10 nor more than the applicable amount specified in the following table:

Total assets	*Maximum fee*
$500,000 or less	30 cents per $1,000.
Over $500,000 and not over $1,000,000	$150, plus 25 cents per $1,000 in excess of $500,000.
Over $1,000,000 and not over $2,000,000	$275, plus 20 cents per $1,000 in excess of $1,000,000.
Over $2,000,000 and not over $5,000,000	$475, plus 15 cents per $1,000 in excess of $2,000,000.
Over $5,000,000	$925, plus 10 cents per $1,000 in excess of $5,000,000.

All such fees shall be deposited with the Treasurer of the United States for the account of the Administration and may be expended by the Administrator for such administrative, supervisory, and other expenses incurred in carrying out the provisions of this chapter as he may determine to be proper, the purpose of such fees being to defray such expenses as far as practicable. No annual supervision fee shall be payable by the Federal credit union with respect to the year in which its charter is issued, or in which final distribution is made in its liquidation or the charter is otherwise canceled. (June 26, 1934, § 5, 48 Stat. 1217; June 29, 1948, § 2, 62 Stat. 1091; April 17, 1952, § 1, 66 Stat. 63; Sept. 22, 1959, § 5, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49, Oct. 19, 1970, Pub.L. 91–468, 84 Stat. 1015).

§ 1756 § 106

Reports and examinations.—Federal credit unions shall be under the supervision of the Administrator, and shall make financial reports to him as and when he may require, but at least annually. Each Federal credit union shall be subject to examination by, and for this purpose shall make its books and records accessible to, any person designated by the Administrator. The Administrator shall fix a scale of examination fees to be paid by Federal credit unions, giving due consideration to the time and expense incident to such examinations, and to the ability of Federal credit unions to pay such fees, which fees shall be assessed against and paid by each Federal credit union promptly after the completion of such examination. Examination fees collected under the provisions of this section shall be deposited to the credit of the special fund created by section 105, and shall be available for the purposes specified in such section. (June 26, 1934, § 6, 48 Stat. 1218; Dec. 6, 1937, § 1, 51 Stat. 4; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 6, 73 Stat. 629, Mar. 10, 1970, Pub.L. 91-206, 84 Stat. 49, Oct. 19, 1970, Pub.L. 91–468, 84 Stat. 1015).

§ 1757 § 107

Powers.—A Federal credit union shall have succession in its corporate name during its existence and shall have power—

(1) to make contracts;

(2) to sue and be sued;

(3) to adopt and use a common seal and alter the same at pleasure;

(4) to purchase, hold, and dispose of property necessary or incidental to its operations;

(5) to make loans, the maturities of which shall not exceed twelve years except as otherwise provided herein, and extend lines of credit to its members, to other credit unions, and to credit union organizations and to participate with other credit unions, credit union organizations, or financial organizations in making loans to credit union members in accordance with the following:

(A) Loans to members shall be made in conformity with criteria established by the board of directors: *Provided*, That—

(i) a residential real estate loan which is made to finance the acquisition of a one-to-four-family dwelling for the principal residence of a credit union member, the sales price of which is not more than 150 per centum of the median sales price of residential real property situated in the geographical area (as determined by the board of directors) in which the property is located, and which is secured by a first lien upon such dwelling, may have a maturity not exceeding thirty years, subject to the rules and regulations of the Administrator;

(ii) a loan to finance the purchase of a mobile home, which shall be secured by a first lien on such mobile home, to be used by the credit union member as his residence, or for the repair, alteration, or improvement of a residential dwelling which is the residence of a credit union member shall have a maturity not to exceed fifteen years unless such loan is insured or guaranteed as provided in subparagraph (iii);

(iii) a loan secured by the insurance or guarantee of the Federal Government, of a State government, or any agency of either may be made for the maturity and under the terms and conditions specified in the law under which such insurance or guarantee is provided;

(iv) a loan or aggregate of loans to a director or member of the supervisory or credit committee of the credit union making the loan which exceeds $5,000 plus pledged shares, be approved by the board of directors;

(v) loans to other members for which directors or members of the supervisory or credit committee act as guarantor or endorser be approved by the board of directors when such loans standing alone or when added to any outstanding loan or loans of the guarantor or endorser exceeds $5,000;

(vi) the rate of interest not exceed 1 per centum per month on the unpaid balance inclusive of all service charges;

(vii) the taking, receiving, reserving, or charging of a rate of interest greater than is allowed by this paragraph, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. If such greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back from the credit union taking or receiving the same, in an action in the nature of an action of debt, the entire amount of interest paid; but such action must be commenced within two years from the time the usurious collection was made;

(viii) a borrower may repay his loan, prior to maturity in whole or in part on any business day without penalty;

(ix) loans shall be paid or amortized in accordance with rules and regulations prescribed by the Administrator after taking into account the needs or conditions of the borrowers, the amounts and duration of the loans, the interests of the members and the credit unions, and such other factors as the Administrator deems relevant.

(B) A self-replenishing line of credit to a borrower may be established to a stated maximum amount on certain terms and conditions which may be different from the terms and conditions established for another borrower.

(C) Loans to other credit unions shall be approved by the board of directors.

(D) Loans to credit union organizations shall be approved by the board of directors and shall not exceed 1 per centum of the paid-in and unimpaired capital and surplus of the credit union. A credit union organization means any organization as determined by the Administrator, which is established primarily to serve the needs of its member credit unions, and whose business relates to the daily operations of the credit unions they serve.

(E) Participation loans with other credit unions, credit union organizations, or financial organizations shall be in accordance with written policies of the board of directors: *Provided*, That a credit union which originates a loan for which participation arrangements are made in accordance with this subsection shall retain an interest of at least 10 per centum of the face amount of the loan.

(6) to receive from its members, from other credit unions, from an officer, employee, or agent of those nonmember units of Federal, State, or local governments and political subdivisions thereof enumerated in section 207 of this Act and in the manner so prescribed, and from nonmembers in the case of credit unions serving predominately low-income members (as defined by the Administrator) payments on shares which may be issued at varying dividend rates, and payments on share certificates which may be issued at varying dividend rates and maturities, subject to such terms, rates, and conditions as may be established by the board of directors, within limitations prescribed by the Administrator.

(7) To invest its funds (A) in loans exclusively to members; (B) in obligations of the United States of America, or securities fully guaranteed as to principal and interest thereby; (C) in accordance with rules and regulations prescribed by the Administrator, in loans to other credit unions in the total amount not exceeding 25 per centum of its paid-in and unimpaired capital and surplus; (D) in shares or accounts of savings and loan associations or mutual savings banks, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation or the Federal Deposit Insurance Corporation; (E) in obligations issued by banks for cooperatives, Federal land banks, Federal intermediate credit banks, Federal home loan banks, the Federal Home Loan Bank Board, or any corporation designated in section 846 of Title 31 as a wholly owned Government corporation; or in obligations, participations, or other instruments of or issued

by, or fully guaranteed as to principal and interest by, the Federal National Mortgage Association or the Government National Mortgage Association; or in mortgages, obligations, or other securities which are or ever have been sold by the Federal Home Loan Mortgage Corporation pursuant to Section 305 or Section 306 of the Federal Home Loan Mortgage Cornoration Act; or in obligations or other instruments or securities of the Student Loan Marketing Association; (F) in participation certificates evidencing beneficial interests in obligations, or in the right to receive interest and principal collections therefrom, which obligations have been subjected by one or more Government agencies to a trust or trusts for which any executive department, agency, or instrumentality of the United States (or the head thereof) has been named to act as trustee; (G) in shares or deposits of any central credit union in which such investments are specifically authorized by the board of directors of the Federal credit union making the investment; and (H) in shares, share certificates, or share deposits of federally insured credit unions; (I) in the shares, stocks, or obligations of any other organization, providing services which are associated with the routine operations of credit unions, up to 1 per centum of the total paid in and unimpaired capital and surplus of the credit union with the approval of the Administrator: *Provided, however*, That such authority does not include the power to acquire control directly or indirectly, of another financial institution, nor invest in shares, stocks or obligations of an insurance company, trade association, liquidity facility or any other similar organization, corporation, or association, except as otherwise expressly provided by this Act:

(8) to make deposits in national banks and in State banks, trust companies, and mutual savings banks operating in accordance with the laws of the State in which the Federal credit union does business, and for Federal credit unions or credit unions authorized by the Department of Defense operating suboffices on American military installations in foreign countries or trust territories of the United States to maintain demand deposit accounts in banks located in those countries or trust territories, subject to such regulations as may be issued by the Administrator and provided such banks are correspondents of banks described in this paragraph;

(9) to borrow, in accordance with such rules and regulations as may be prescribed by the Administrator, from any source, in an aggregate amount not exceeding 50 per centum of its paid-in and unimpaired capital and surplus: *Provided*, That any Federal credit union may discount with or sell to any Federal intermediate credit bank any eligible obligations up to the amount of its paid-in and unimpaired capital;

(10) to levy late charges, in accordance with the bylaws, for failure of members to meet promptly their obligations to the Federal credit union;

(11) to impress and enforce a lien upon the shares and dividends of any member, to the extent of any loan made to him and any dues or charges payable by him;

(12) in accordance with rules and regulations prescribed by the Administrator, to sell to members negotiable checks (including travelers checks) and money orders, and to cash checks and money orders for members, for a fee which does not exceed the direct and indirect costs incident to providing such service;

(13) in accordance with rules and regulations prescribed by the Administrator, to purchase, sell, pledge, or discount or otherwise receive or dispose of, in whole or in part, any eligible obligations (as defined by the Administrator) of its members and to purchase from any liquidating credit union notes made by individual members of the liquidating credit union at such prices as may be agreed upon by the board of directors of the liquidating credit union and the board of directors of the purchasing credit union, but no purchase may be made under authority of this paragraph if, upon the making of that purchase, the aggregate of the unpaid balances of notes purchased under authority of this paragraph would exceed 5 per centum of the unimpaired capital and surplus of the credit union;

(14) to sell all or a part of its assets to another credit union, to purchase all or part of the assets of another credit union and to assume the liabilities of the selling credit

union and those of its members subject to regulations of the Administrator; and

(15) to exercise such incidental powers as shall be necessary or requisite to enable it to carry out effectively the business for which it is incorporated.

(June 26, 1934, § 7, 48 Stat. 1218; Dec. 6, 1937, § 2, 51 Stat. 4; July 31, 1946, § 1, 60 Stat. 744; June 29, 1948, § 2, 62 Stat. 1091; Oct. 25, 1949, § 1, 63 Stat. 890; May 13, 1952, 66 Stat. 70; Sept. 22, 1959, § 7, 73 Stat. 630; July 2, 1964, § 1, 78 Stat. 269; May 24, 1966, § 7, 80 Stat. 167; July 3, 1967, § § 2, 3, 81 Stat. 110; July 5, 1968, § 1, 82 Stat. 284; Aug. 1, 1968, § 80, 82 Stat. 545; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1017; June 23, 1972, Pub. L. 92-318, 86 Stat. 270; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Oct. 29, 1974, Pub. L. 93-495, 88 Stat. 1500; Dec. 31, 1974, Pub. L. 93-569, 88 Stat. 1866; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1758 § 108

Bylaws—In order to simplify the organization of Federal credit unions the Administrator shall from time to time cause to be prepared a form of organization certificate and a form of bylaws, consistent with this chapter, which shall be used by Federal credit union incorporators, and shall be supplied to them on request. At the time of presenting the organization certificate the incorporators shall also submit proposed bylaws to the Administrafor for his approval. (June 26, 1934, § 8, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 9, 73 Stat. 631; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1759 § 109

Membership.—Federal credit union membership shall consist of the incorporators and such other persons and incorporated and unincorporated organizations, to the extent permitted by rules and regulations prescribed by the Administrator, as may be elected to membership and as such shall each, subscribe to at least one share of its stock and pay the initial installment thereon and a uniform entrance fee if required by the board of directors, except that Federal credit union membership shall be limited to groups having a common bond of occupation or association, or to groups within a well-defined neighborhood, community, or rural district. Shares may be issued in joint tenancy with right of survivorship with any persons designated by the credit union member, but no joint tenant shall be permitted to vote, obtain loans, or hold office, unless he is within the field of membership and is a qualified member. (June 26, 1934, § 9, 48 Stat. 1219; July 31, 1946, § 2, 60 Stat. 744; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 10, 73 Stat. 631; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1760 § 110

Members' meetings.—The fiscal year of all Federal credit unions shall end December 31. The annual meeting of each Federal credit union shall be held at such time during the following January, February, or March and at such place as its bylaws shall prescribe. Special meetings may be held in the manner indicated in the bylaws. No member shall be entitled to vote by proxy, but a member other than a natural person may vote through an agent designated for the purpose. Irrespective of the number of shares held by him, no member shall have more than one vote. (June 26, 1934, § 10, 48 Stat. 1219; Sept. 22, 1959, § 11, 73 Stat. 631; Oct. 17, 1963, § 1, 77 Stat. 270; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1761 § 111

Management.—The business affairs of a Federal credit union shall be managed by a board of not less than five directors, and a credit committee of not less than three members, all to be elected at the annual members' meeting by and from the members, and by a supervisory committee of not less than three members nor more than five members, one of whom may be a director other than the treasurer, to be appointed by the board. Any vacancy occurring in the supervisory committee shall be filled in the same manner as original appointments to such committee. All members of the board and of such committees shall hold office for such terms, respectively, as the bylaws may provide. A record of the names and addresses of the members of the board and such committees and of the officers of the credit union shall be filed with the Administration within ten days after their election or appointment. No member of the board or of either such committee shall, as such, be compensated: *Provided, however*, That reasonable health, accident, and similar insurance protection shall not be considered compensation under regulations promulgated by the Administrator. (June 26, 1934, § 11, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 12, 73 Stat. 632; July 2, 1964, § 2, 78 Stat. 269; Mar. 10, 1970, Pub. L. 91–206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91–468, 84 Stat. 1015; Oct. 29, 1974, Pub. L. 93–495, 88 Stat. 1500).

§ 1761a § 112

Officers.—At their first meeting after the annual meeting of the members, the directors shall elect from their number a president, one or more vice presidents, a secretary, and a treasurer, who shall be the executive officers of the corporation. No executive officer, except the treasurer, shall be compensated as such. The offices of secretary and treasurer may be held by the same person. The duties of the officers shall be as determined by the bylaws. Before the treasurer shall enter upon his duties he shall give bond with good and sufficient surety, in an amount and character to be determined by the board of directors in compliance with regulations prescribed from time to time by the Administrator, conditioned upon the faithful performance of his trust. (June 26, 1934, § 11, 48 Stat. 1219; June 29, 1948, § 2, 62 Stat. 1091; Aug. 24, 1954, § 1, 68 Stat. 792; Sept. 22, 1959, § 13, 73 Stat. 632; Oct. 17, 1963, § 2, 77 Stat. 270; Mar. 10, 1970, Pub. L. 91–206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91–468, 84 Stat. 1015).

§ 1761b § 113

Directors.—The board of directors shall meet at least once a month and shall have the general direction and control of the affairs of the corporation. Minutes of all such meetings shall be kept. Among other things they shall act upon applications for membership; require any officer or employee having custody of or handling funds to give bond with good and sufficient surety in an amount and character to be determined by the board of directors in compliance with regulations prescribed from time to time by the Administrator, and authorize the payment of the premium or premiums therefor from the funds of the Federal credit union; fill vacancies in the board and in the credit committee until successors elected at the next annual meeting have qualified; have charge of investments other than loans to members, except that the board may designate a committee of not less than two to act as an investment committee, such investment committee to have charge of making investments under rules and procedures established by the board of directors; determine from time to time the maximum number of shares and share certificates and the classes of shares and share certificates that may be held; subject to the limitations of this chapter, determine the interest rates on loans, the security, and the maximum amount which may be loaned or provided in lines of credit; subject to such regulations as may be issued by the Administrator, authorize an interest refund to members of record at the close of business on the last day of any dividend period in proportion to the interest paid by them during the dividend period; and provide for compensation of necessary clerical and auditing assistance requested by the supervisory committee, and of loan officers appointed by the credit committee. The board may appoint an executive committee of not less than three directors to exercise such authority as may be delegated to it subject to such conditions and limitations as may be prescribed by the board. Such executive committee or one or more membership officers appointed by the board from among the members of the credit union, other than the treasurer, an assistant treasurer, or a loan officer, may be authorized by the board to approve applications for membership under such conditions as the board may prescribe; except that such committee or membership officer so authorized shall submit to the board at each monthly meeting a list of approved or pending applications for membership received since the previous monthly meeting, together with such other related information as the bylaws or the board may require. If a membership application is denied, the reasons therefor shall be furnished in writing to the person whose application is denied, upon written request. (June 26, 1934, § 11, 48 Stat. 1219; July 31, 1946, § 3, 60 Stat. 745; June 29, 1948; § 2, 62 Stat. 1091; June 30, 1954; § 1, 68 Stat. 335; Aug. 24, 1954, § 2, 68 Stat. 792; Sept. 22, 1959, § 14, 73 Stat. 632; July 2, 1964, § 3, 78 Stat. 269; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1761c § 114

Credit Committee.—The credit committee shall hold such meetings as the business of the Federal credit union may require and not less frequently than once a month to consider applications for loans and lines of credit. Reasonable notice of such meetings shall be given to all members of the committee. Except for those loans or lines of credit required to be approved by the board of directors in section 107(5) of this Act, approval of an application shall be by a majority of the entire committee and by all members of the committee who are present at the meeting at which the application is considered; except that the credit committee may appoint one or more loan officers, and delegate to him or them the power to approve loans and lines of credit. Each loan officer shall furnish to the credit committee a record of each application approved or not approved by him within seven days of the date of the filing of the application therefor. All applications not approved by a loan officer shall be acted upon by the credit committee. No individual shall have authority to disburse funds of the Federal credit union with respect to any loan or line of credit for which the application has been approved by him in his capacity as a loan officer. Not more than one member of the credit committee may be appointed as a loan officer. Applications for loans and lines of credit shall be made on forms prepared by such committee, which shall set forth the security, if any, and such other data as may be required. No loan may be made to any member if, upon the making of that loan, the member would be indebted to the Federal credit union upon loans made to him in an aggregate amount which would exceed 10 per centum of the credit union's unimpaired capital and surplus. For the purposes of this section an assignment of shares or the endorsement of a note shall be deemed security and, subject to such regulations as the Administrator may prescribe, insurance obtained under Title 1 of the National Housing Act shall be deemed adequate security. (June 26, 1934, § 11, 48 Stat. 1219; June 15, 1940, 54 Stat. 398; July 31, 1946, § § 4, 5, 60 Stat. 745; Oct. 25, 1949, § 2, 63 Stat. 890; Sept. 22, 1959, § 15, 73 Stat. 633; July 2, 1964, § 4, 78 Stat. 269; Dec. 13, 1967, § 1, 81 Stat. 567; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1761d § 115

Supervisory committee.—The supervisory committee shall make or cause to be made an annual audit and shall submit a report of that audit to the board of directors and a summary of the report to the members at the next annual meeting of the credit union; shall make or cause to be made such supplementary audits as it deems necessary or as may be ordered by the Administrator, and submit reports of the supplementary audits to the board of directors; may by a unanimous vote suspend any officer of the credit union or any member of the credit committee or of the board of directors, until the next members' meeting, which shall be held not less than seven nor more than fourteen days after any such suspension, at which meeting any such suspension shall be acted upon by the members; and may call by a majority vote a special meeting of the members to consider any violation of this chapter, the charter, or the bylaws, or any practice of the credit union deemed by the supervisory committee to be unsafe or unauthorized. Any member of the supervisory committee may be suspended by a majority vote of the board of directors. The members shall decide, at a meeting held not less than seven nor more than fourteen days after any such suspension, whether the suspended committee member shall be removed from or restored to the supervisory committee. The supervisory committee shall cause the passbooks and accounts of the members to be verified with the records of the treasurer from time to time, and not less frequently than once every two years. As used in this section, the term "passbook" shall include any book, statement of account, or other record approved by the Administrator for use by Federal credit unions. (June 26, 1934, § 11, 48 Stat. 1219; July 31, 1946, § § 3-6, 60 Stat. 745; June 29, 1948, § 2, 62 Stat. 1091; Sept. 22, 1959, § 16, 73 Stat. 633; July 5, 1968, § 1, 82 Stat. 284; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1762 § 116

Reserves.—(a) At the end of each accounting period the gross income shall be determined. From this amount, there shall be set aside, as a regular reserve against losses on loans and against such other losses as may be specified in regulations prescribed under this Act, sums in accordance with the following schedule:

(1) A credit union in operation for more than four years and having assets of $500,000 or more shall set aside (A) 10 per centum of gross income until the regular reserve shall equal 4 per centum of the total of outstanding loans and risk assets, then (B) 5 per centum of gross income until the regular reserve shall equal 6 per centum of the total of outstanding loans and risk assets.

(2) A credit union in operation less than four years or having assets of less than $500,000 shall set aside (A) 10 per centum of gross income until the regular reserve shall equal 7½ per centum of the total of outstanding loans and risk assets, then (B) 5 per centum of gross income until the regular reserve shall equal 10 per centum of the total of outstanding loans and risk assets.

(3) Whenever the regular reserve falls below the stated per centum of the total of outstanding loans and risk assets, it shall be replenished by regular contributions in such amounts as may be needed to maintain the stated reserve goals.

(b) The Administrator may decrease the reserve requirement set forth in subsection (a) of this section when in his opinion such a decrease is necessary or desirable. The Administrator may also require special reserves to protect the interests of members either by regulation or for an individual credit union in any special case.
(As amended Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1017; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1763 § 117

Dividends.—At such intervals as the board of directors may authorize, and after provision for required reserves, the board may declare, pursuant to such regulations as may be issued by the Administrator, a dividend to be paid at different rates on different types of shares and at different rates and maturity dates in the case of share certificates. Dividend credit may be accrued on various types of shares and share certificates as authorized by the board of directors. (June 26, 1934, § 13, 48 Stat. 1221; Sept. 22, 1959, § 18, 73 Stat. 634; Dec. 13, 1967, § 2, 81 Stat. 567; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1764 § 118

Expulsion and withdrawal.—A member may be expelled by a two-thirds vote of the members of a Federal credit union present at a special meeting called for the purpose, but only after an opportunity has been given him to be heard. Withdrawal or expulsion of a member shall not operate to relieve him from liability to the Federal credit union. The amount to be paid a withdrawing or expelled member by a Federal credit union shall be determined and paid in the manner specified in the bylaws. (June 26, 1934, § 14, 48 Stat. 1221; Sept. 22, 1959, § 19, 73 Stat. 634; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1765 § 119

Minors.—Shares may be issued in the name of a minor or in trust, subject to such conditions as may be prescribed by the bylaws. When shares are issued in trust, the name of the beneficiary shall be disclosed to the Federal credit union. (June 26, 1934, § 15, 48 Stat. 1221; Sept. 22, 1959, § 20, 73 Stat. 634, Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1766 § 120

Certain powers of the Administrator.—(a) The Administrator may prescribe rules and regulations for the administration of this chapter (including, but not by way of limitation, the merger, consolidation, and dissolution of corporations organized under this chapter).

(b) (1) The Administrator may suspend or revoke the charter of any Federal credit union, or place the same in involuntary liquidation and appoint a liquidating agent therefor, upon his finding that the organization is bankrupt or insolvent, or has violated any of the provisions of its charter, its bylaws, this chapter, or any regulations issued thereunder.

(2) The Administrator, through such persons as he shall designate, may examine any Federal credit union in voluntary liquidation and, upon his finding that such voluntary liquidation is not being conducted in an orderly or efficient manner or in the best interests of its members, may terminate such voluntary liquidation and place such organization in involuntary liquidation and appoint a liquidating agent therefore.

(3) Such liquidating agent shall have power and authority, subject to the control and supervision of the Administrator and under such rules and regulations as the Administrator may prescribe, (A) to receive and take possession of the books, records, assets, and property of every description of the Federal credit union in liquidation, to sell, enforce collection of, and liquidate all such assets and property, to compound all bad or doubtful debts, and to sue in his own name or in the name of the Federal credit union in liquidation, and defend such actions as may be brought against him as liquidating agent or against the Federal credit union; (B) to receive, examine, and pass upon all claims against the Federal credit union in liquidation, including claims of members on member accounts; (C) to make distribution and payments to creditors and members as their interests may appear; and (D) to execute such documents and papers and to do such other acts and things which he may deem necessary or desirable to discharge his duties hereunder.

(4) Subject to the control and supervision of the Administrator and under such rules and regulations as the Administrator may prescribe, the liquidating agent of a Federal credit union in involuntary liquidation shall (A) cause notice to be given to creditors and members to present their claims and make legal proof thereof, which notice shall be published once a week in each of three successive weeks in a newspaper of general circulation in each county in which the Federal credit union in liquidation maintained an office or branch for the transaction of business on the date it ceased unrestricted operations; except that whenever the aggregate book value of the assets and property of a Federal credit union in involuntary liquidation is less than $1,000, unless the Administrator shall find that its books and records do not contain a true and accurate record of its liabilities, he shall declare such Federal credit union in liquidation to be a "no publication" liquidation, and publication of notice to creditors and members shall not be required in such case; (B) from time to time make a ratable dividend on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction and, after the assets of such organization have been liquidated, make further dividends on all claims previously proved or adjudicated, and he may accept in lieu of a formal proof of claim on behalf of any creditor or member the statement of any amount due to such creditor or member as shown on the books and records of the credit union; but all claims not filed before payment of the final dividend shall be barred and claims rejected or disallowed by the liquidating agent shall be likewise barred unless suit be instituted thereon within three months after notice of rejection or disallowance; and (C) in a "no publication" liquidation, determine from all sources available to him, and within the limits of available funds of the Federal

credit union, the amounts due to creditors and members, and after sixty days shall have elapsed from the date of his appointment distribute the funds of the Federal credit union to creditors and members ratably and as their interests may appear.

(5) Upon certification by the liquidating agent in the case of an involuntary liquidation, and upon such proof as shall be satisfactory to the Administrator in the case of a voluntary liquidation, that distribution has been made and that liquidation has been completed, as provided herein, the Administrator shall cancel the charter of such Federal credit union; but the corporate existence of the Federal credit union shall continue for a period of three years from the date of such cancellation of its charter, during which period the liquidating agent, or his duly appointed successor, or such persons as the Administrator shall designate, may act on behalf of the Federal credit union for the purpose of paying, satisfying, and discharging any existing liabilities or obligations, collecting and distributing its assets, and doing all other acts required to adjust and wind up its business and affairs, and it may sue and be sued in its corporate name.

(c) After the expiration of five years from the date of cancellation of the charter of a Federal credit union the Administrator may, in his discretion, destroy any or all books and records of such Federal credit union in his possession or under his control.

(d) The Administrator is authorized and empowered to execute any and all functions and perform any and all duties vested in him hereby, through such persons as he shall designate or employ; and he may delegate to any person or persons, including any institution operating under the general supervision of the Administration, the performance and discharge of any authority, power, or function vested in him by this chapter.

(e) All books and records of Federal credit unions shall be kept and reports shall be made in accordance with forms approved by the Administrator.

(f)(1) The Administrator is authorized to make investigations and to conduct researches and studies of the problems of persons of small means in obtaining credit at reasonable rates of interest, and of the methods and benefits of cooperative saving and lending among such persons. He is further authorized to make reports of such investigations and to publish and disseminate the same.

(2)(A) The Administrator is authorized to conduct directly, or to make grants to or contracts with colleges or universities, State or local educational agencies, or other appropriate public or private nonprofit organizations to conduct, programs for the training of persons engaged, or preparing to engage, in the operation of credit unions, and in related consumer counseling programs, serving the poor. He is authorized to establish a program of experimental, developmental, demonstration, and pilot projects, either directly or by grants to public or private nonprofit organizations, including credit unions, or by contracts with such organizations or other private organizations, designed to promote more effective operation of credit unions, and related consumer counseling programs, serving the poor.

(B) In carrying out his authority under this paragraph, the Administrator shall consult with officials of the Office of Economic Opportunity and other appropriate Federal agencies responsible for the administration of projects or programs concerned with problems of the poor. The development and operation of programs and projects under this paragraph shall involve maximum feasible participation of residents of the areas and members of the groups served by such programs and projects, with community action agencies established under the provisions of the Economic Opportunity Act of 1964 serving, to the extent feasible, as the means through which such participation is achieved.

(C) In order to carry out the purposes of this paragraph, there is authorized to be appropriated, as a supplement to any funds that may be expended by the Administrator pursuant to section 105 and 106 for such purposes, not to exceed $300,000 for the fiscal year ending June 30, 1970, and not to exceed $1,000,000 for the fiscal year ending June 30, 1971.

(g) Any officer or employee of the Administration is authorized, when designated for the purpose by the Administrator, to administer oaths and affirmations and to take affidavits and depositions touching upon any matter within the jurisdiction of the Administration.

(h) The Administrator is authorized, empowered, and directed to require that every person appointed or elected by any Federal credit union to any position requiring the receipt, payment, or custody of money or other personal property owned by a Federal credit union, or in its custody or control as collateral or otherwise, give bond in a corporate surety company holding a certificate of authority from the Secretary of the Treasury under the Act approved July 30, 1947 (6 U.S.C, secs. 6–13), as an acceptable surety on Federal bonds. Any such bond or bonds shall be in form approved by the Administrator with a view to providing surety coverage to the Federal credit union with reference to loss by reason of acts of fraud or dishonesty including forgery, theft, embezzlement, wrongful abstraction, or misapplication on the part of the person, directly or through connivance with others, and such other surety coverages as the Administrator may determine to be reasonably appropriate or as elsewhere required by this chapter. Any such bond or bonds shall be in such an amount in relation to the money or other personal property involved or in relation to the assets of the Federal credit union as the Administrator may from time to time prescribe by regulation for the purpose of requiring reasonable coverage. In lieu of individual bonds the Administrator may approve the use of a form of schedule or blanket bond which covers all of the officers and employees of a Federal credit union whose duties include the receipt, payment, or custody of money or other personal property for or on behalf of the Federal credit union. The Administrator may also approve the use of a form of coverage bond whereby a Federal credit union may obtain an amount of coverage in excess of the basic surety coverage.

(i) In addition to the authority conferred upon him by other sections of this Act, the Administrator is authorized in carrying out his functions under this Act—

(1) to appoint such personnel as may be necessary to enable the Administration to carry out its functions;

(2) to expend such funds, enter into such contracts with public and private organizations and persons, make such payments in advance or by way of reimbursement, and perform such other functions or acts as he may deem necessary or appropriate to carry out the provisions of this Act; and

(3) to pay stipends, including allowances for travel to and from the place of residence, to any individual to study in a program assisted under this Act upon a determination by the Administrator that assistance to such individual in such studies will be in furtherance of the purposes of this Act.

(June 26, 1934, § 16, 48 Stat. 1221; Dec. 6, 1937, § 3, 51 Stat. 4; July 31, 1946, § 8, 60 Stat. 745; June 29, 1948, § 2, 62 Stat. 1091; June 30, 1954, § 2, 68 Stat. 336; Aug. 24, 1954, § 3, 68 Stat. 792; Sept. 22, 1959, § 21, 73 Stat. 635; July 5, 1968, § 2, 82 Stat. 285: Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Apr. 19, 1977, Pub. L. 95-22, 91 Stat. 49).

§ 1767 § 121

Fiscal agents and depositories.—Each Federal credit union organized under this chapter, when requested by the Secretary of the Treasury, shall act as fiscal agent of the United States and shall perform such services as the Secretary of the Treasury may require in connection with the collection of taxes and other obligations due the United States and the lending, borrowing, and repayment of money by the United States, including the issue, sale, redemption, or repurchase of bonds, notes, Treasury certificates of indebtedness, or other obligations of the United States; and to facilitate such purposes the Administrator shall furnish to the Secretary of the Treasury from time to time the names and addresses of all Federal credit unions with such other available information concerning them as may be requested by the Secretary of the Treasury. Any Federal credit union organized under this chapter, when designated for that purpose by the Secretary of the Treasury, shall be a depository of public money, except receipts from customs, under such regulations as may be prescribed by the Secretary of the Treasury. (June 26, 1934. § 17, 48 Stat. 1222; June 29, 1948, § 62 Stat. 1091; Sept. 22, 1959, § 22, 73 Stat. 637; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1768 § 122

Taxation.—The Federal credit unions organized hereunder, their property, their franchises, capital, reserves, surpluses, and other funds, and their income shall be exempt from all taxation now or hereafter imposed by the United States or by any State, Territorial, or local taxing authority; except that any real property and any tangible personal property of such Federal credit unions shall be subject to Federal, State, Territorial, and local taxation to the same extent as other similar property is taxed. Nothing herein contained shall prevent holdings in any Federal credit union organized hereunder from being included in the valuation of the personal property of the owners or holders thereof in assessing taxes imposed by authority of the State or political subdivision thereof in which the Federal credit union is located; but the duty or burden of collecting or enforcing the payment of such a tax shall not be imposed upon any such Federal credit union and the tax shall not exceed the rate of taxes imposed upon holdings in domestic credit unions. (June 26, 1934, § 18, 48 Stat. 1222; Dec. 6, 1937, § 4, 51 Stat. 4; Sept. 22, 1959, § 23, 73 Stat. 637; Oct. 14. 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1769 § 123

Partial invalidity; right to amend.—(a) If any provision of this chapter or the application thereof to any person or circumstance, is held invalid, the remainder of the chapter, and the application of such provision to other persons or circumstances, shall not be affected thereby.

(b) The right to alter, amend, or repeal this chapter or any part thereof, or any charter issued pursuant to the provisions of this chapter, is expressly reserved. (June 26, 1934, § 20, 48 Stat. 1222; Sept. 22, 1959, § 24, 73 Stat. 637; Oct. 19, 1970, Pub. L. 91-468. 84 Stat. 1015).

§ 1770 § 124

Space in Federal Buildings.—Upon application by any credit union organized under State law or by any Federal credit union organized in accordance with the term of this chapter, at least 95 per centum of the membership of which is composed of persons who either are presently Federal employees or were Federal employees at the time of admission into the credit union, and members of their families, which application shall be addressed to the officer or agency of the United States charged with the allotment of space in the Federal buildings in the community or district in which such credit union does business, such officer or agency may in his or its discretion allot space to such credit union if space is available, without charge for rent or services. (June 26, 1934, § 21, added July 9, 1937, 50 Stat. 487; Sept. 22, 1959, § 25, 73 Stat. 638; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1771 § 125

Conversion from Federal to State credit union and from State to Federal credit union.—(a) A Federal credit union may be converted into a State credit union under the laws of any State, the District of Columbia, the several Territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, by complying with the following requirements:

(1) The proposition for such conversion shall first be approved, and a date set for a vote thereon by the members (either at a meeting to be held on such date or by written ballot to be filed on or before such date), by a majority of the directors of the Federal credit union. Written notice of the proposition and of the date set for the vote shall then be delivered in person to each member, or mailed to each member at the address for such member appearing on the records of the credit union, not more than thirty nor less than seven days prior to such date. Approval of the proposition for conversion shall be by the affirmative vote of a majority of the members, in person or in writing.

(2) A statement of the results of the vote, verified by the affidavits of the president or vice president and the secretary, shall be filed with the Administration within ten days after the vote is taken.

(3) Promptly after the vote is taken and in no event later than ninety days thereafter, if the proposition for conversion was approved by such vote, the credit union shall take such action as may be necessary under the applicable State law to make it a State credit union, and within ten days after receipt of the State credit union charter there shall be filed with the Administration a copy of the charter thus issued. Upon such filing the credit union shall cease to be a Federal credit union.

(4) Upon ceasing to be a Federal credit union, such credit union shall no longer be subject to any of the provisions of this chapter. The successor State credit union shall be vested with all of the assets and shall continue responsible for all of the obligations of the Federal credit union to the same extent as though the conversion had not taken place.

(b) (1) A State credit union, organized under the laws of any State, the District of Columbia, the several Territories and possessions of the United States, the Panama Canal Zone, or the Commonwealth of Puerto Rico, may be converted into a Federal credit union by (A) complying with all State requirements requisite to enabling it to convert to a Federal credit union or to cease being a State credit union, (B) filing with the Administration proof of such compliance, satisfactory to the Administrator, and (C) filing with the Administration an organization certificate as required by this chapter.

(2) When the Administrator has been satisfied that all of such requirements, and all other requirements of this chapter, have been complied with the Administrator shall approve the organization certificate. Upon such approval, the State credit union shall become a Federal credit union as of the date it ceases to be a State credit union. The Federal credit union shall be vested with all of the assets and shall continue responsible for all of the obligations of the State credit union to the same extent as though the conversion had not taken place. (Added Sept. 22, 1959, § 26, 73 Stat. 638; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1772 § 126

Territorial application of chapter.—The provisions of this chapter shall apply to the several States, the District of Columbia, the several Territories, including the trust territories, and possessions of the United States, the Panama Canal Zone, and the Commonwealth of Puerto Rico. (June 26, 1934, § 22, added July 31, 1946, § 7, 60 Stat. 745; May 8, 1952, 66 Stat. 55; Sept. 22, 1959, § 27, 73 Stat. 639; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015; Aug. 22, 1974, Pub. L. 93-383, 88 Stat. 739).

§ 1772a § 127

Gifts.—The Administrator is authorized to accept gifts of money made unconditionally by will or otherwise for the carrying out of any of the functions under this chapter. A conditional gift of money made by will or otherwise for such purposes may be accepted and used in accordance with its conditions, but no such gift shall be accepted which is conditioned upon any expenditure not to be met therefrom or from income thereof unless the Administrator determines that supplementation of such gift from the fees he may expend pursuant to sections 1755 and 1756 of this title or from any funds appropriated pursuant to section 1756(f)(2)(C) of this title for the purpose of making such expenditure will not adversely affect the sound administration of this chapter. Any such gift shall be deposited in the Treasury of the United States for the account of the Administration and may be expended in accordance with section 105 or as provided in the preceding sentence. (July 5, 1968, § 3, 82 Stat. 285; Nov. 10, 1970, Pub. L. 91-206, 84 Stat. 49; Oct. 19, 1970, Pub. L. 91-468, 84 Stat. 1015).

§ 1773

District of Columbia credit unions; conversion to Federal status.—Any credit union organized under the District of Columbia Credit Unions Act, as amended, may apply for conversion into a Federal credit union by filing with the Administrator of the National Credit Union Administration (hereinafter referred to as the Administrator), pursuant to a resolution adopted by a majority of its directors, an organization certificate meeting the requirements of section 1753 of this title. (Pub. L. 88-395, § 1, Aug. 1, 1964, 78 Stat. 377; Mar 10, 1970, Pub. L. 91-206, 84 Stat. 48).

§ 1774

Approval of certificate; assets and obligations of applicant credit union.—The Administrator shall approve any such organization certificate meeting such requirements. Upon such approval, the applicant credit union shall become a Federal credit union, and shall be vested with all of the assets and shall continue responsible for all of the obligations of such applicant credit union to the same extent as though the conversion had not taken place. (Pub. L. 88-395, § 2, Aug. 1, 1964, 78 Stat. 377; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49).

§ 1775

Conditions upon conversion to Federal status.—Any District of Columbia credit union converting into a Federal credit union in accordance with section 1773–1775 of this title shall thereupon be subject to the limitations, vested with the powers, and charged with the liabilities conferred and imposed by this chapter upon credit unions organized thereunder, except that—

(1) no fee shall be imposed upon a credit union converting pursuant to sections 1773–1775 of this title as an incident to its conversion;

(2) any loan or investment made by a credit union converting pursuant to sections 1773–1775 of this title in conformity with the District of Columbia Credit Unions Act prior to its conversion, which does not conform to the requirements of this chapter and is still outstanding at the time of conversion, shall be liquidated at or before its maturity or, if it has no maturity date, in a prudent manner and within a resonable period of time;

(3) a credit union converting pursuant to sections 1773–1775 of this title shall submit proposed bylaws to the Administrator for his approval after its conversion, but not later than thirty days following its next annual meeting or six months after August 1, 1964, whichever is later: Provided, that any existing bylaw inconsistent with any other requirements of this chapter shall be deemed null and void.

(Pub. L. 88-395, § 3, Aug. 1, 1964, 78 Stat. 377; Mar. 10, 1970, Pub. L. 91-206, 84 Stat. 49).

BYLAWS

Federal Credit Union, Charter No. ________

(A corporation chartered under the laws of the United States}

Article I. Name—Purposes

SECTION 1. The name of this credit union is as stated in section 1 of the charter (approved organization certificate) of this credit union.

SEC. 2. The purpose of this credit union is to promote thrift among its members by affording them an opportunity to accumulate their savings, and to create for them a source of credit for provident or productive purposes.

Article II. Qualifications for Membership

SECTION 1. The field of membership of this credit union is limited to that stated in section 5 of its charter.

SEC. 2. Applications for membership from persons eligible to membership under section 5 of the charter shall be signed by the applicant on forms approved by the board. Upon approval of such an application by a majority of the directors or a majority of the members of a duly authorized executive committee or by a membership officer and upon his subscription to at least one share of this credit union and the payment of the initial installment thereon, and the payment of any uniform required entrance fee, the applicant is admitted to membership. The board may by resolution reduce the required entrance fee for members under 16 years of age.

SEC. 3. A number shall be assigned to each member as a means of identifying his account with the credit union.

SEC. 4. A member who withdraws all of his shareholdings thereby ceases to be a member. The board may by resolution require persons readmitted to membership to pay another entrance fee.

SEC. 5 The membership of members who are no longer within the field of membership on the day this bylaw is effective or thereafter, is terminated immediately: *Provided, however,* That the board may resolve that such members may retain membership if they meet certain reasonable minimum standards established by the board.

Article III. Shares of Members

SECTION 1. The par value of each share shall be $5. Subscriptions to shares are payable at the time of subscription, or in installments of at least 25 cents per month.

SEC. 2. The maximum amount of shares which may be held by any one member shall be established from time to time by resolution of the board.

SEC. 3. The shareholdings of a member who fails to complete payment of one share within 2 years of his admission to membership, or of a member who reduces his share balance below $5 and does not increase the balance to at least $5 within 2 years of the reduction, may be absorbed by a late charge upon authorization of the board.

SEC. 4. Shares may be transferred only from one member to another, by written instrument in such form as the board may prescribe. Such transfer shall carry dividend credits with it. The board may require payment of a fee not to exceed $1 for each such transfer and, if so required, such fee shall apply to all transfers.

SEC. 5. Money paid in on shares or installments of shares may be withdrawn as provided in these bylaws on any day when payment on shares may be made: *Provided, however,* That—

(a) The board shall have the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the whole or any part of the amounts so paid in by them.

(b) The board may determine that if shares are paid in under an accumulated payroll deduction plan, as prescribed in the *Accounting Manual for Federal Credit Unions,* they may not be withdrawn until credited to members' accounts.

(c) No member may withdraw shareholdings that are pledged as required security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the credit union.

(d) No member may withdraw any shareholdings below the amount of his primary or contingent liability to the credit union if he is delinquent as a borrower, or if borrowers for whom he is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or a loan officer.

(e) The share account of a person whose membership is terminated in accordance with article II, section 5, of these bylaws and the share account of a deceased member (other than one held in joint tenancy with another member) may be continued until the close of the dividend period in which the membership terminated, after which it shall be transferred to an account payable: *Provided, however,* That the shares may not be withdrawn or transferred below that person's primary or contingent liability to the credit union without the approval of the credit committee or a loan officer. Such shares may be retained as such until the close of the dividend period in which the member's liability to the credit union is liquidated.

"Required security," as used in this section, refers to shares which are in existence at the time the loan is made and specifically required to be pledged as security as part of a secured loan transaction.

Article IV. Receipting for Money—Passbooks

SECTION 1. Money paid in or paid out on account of shares, loans, interest, entrance and transfer fees, or late charges shall be evidenced by an appropriate voucher or receipt or by entries in a member's passbook which shall also identify the person acting on behalf of this credit union. The member's official permanent record for all transactions shall be the entries in the passbook or a statement of account when such a plan is used as prescribed in the *Accounting Manual for Federal Credit Unions.*

SEC. 2. If a passbook is lost or stolen, immediate notice of such fact shall be given to the treasurer, and written application shall be made for the payment of the amount due the member as represented by said passbook or for the issuance of a duplicate passbook. The board may require the filing of an adequate bond to indemnifv this credit union against any loss or losses resulting from the issuance of such duplicate passbook. The board may also require payment to this credit union of a reasonable charge to cover the cost of issuing a duplicate passbook.

Article V. Meetings of Members

SECTION 1. The annual meeting of the members shall be held within the period authorized in the Act, in the county in which the office of the credit union is located or within a radius of 100 miles of such office, at such time and place as the board shall determine and announce in the notice thereof.

SEC. 2. At least 7 days before the date of any annual or special meeting of the members, the secretary shall cause written notice thereof to be handed to each member in person, or mailed to each member at his address as the same appears on the records of this credit union; except that if the annual meeting is to be held during the same month as that of the previous annual meeting and if this credit union maintains an office that is readily accessible to members and wherein regular business hours are maintained, and the board so determines, notice of the annual meeting may be given by posting the notice thereof, in a conspicuous place in the office of this credit union where it may be read by the members, at least 14 days prior to such meeting. Any meeting of the members, whether annual or special, may be held without prior notice, at any place or time, if all the members entitled to vote thereat who are not present at such meeting shall in writing waive notice thereof, before, during, or after the meeting.

Notice of any special meeting shall state the purpose for which it is to be held, and no business other than that related to this purposo shall be transacted at the meeting.

Sec. 3. Special meetings of the members may be called by the president or by the supervisory committee as provided in these bylaws, and may be held at any location permitted for the annual meeting. A special meeting shall be called by the president within 30 days of the receipt of a written request of 25 members or 5 percent of the members as of the date of the request, whichever number is larger: *Provided, however,* That a request of no more than 200 members shall be required for such meeting. The notice of such special meeting shall be given as provided in section 2 of this article.

Sec. 4. The order of business at annual meetings of members shall be—

(a) Ascertainment that a quorum is present.

(b) Reading and approval (or correction) of the minutes of the last meeting.

(c) Report of directors.

(d) Report of the treasurer or the manager.

(e) Report of the credit committee.

(f) Report of the supervisory committee.

(g) Unfinished business.

(h) New business other than elections.

(i) Elections.

(j) Adjournment.

The members assembled at any annual meeting may suspend the above order of business upon a two-thirds vote of the members present at the meeting.

Sec. 5. Except as hereinafter provided, at annual or special meetings, 15 members shall constitute a quorum. If no quorum is present, an adjournment may be taken to a date not fewer than 7 nor more than 14 days thereafter; and the members present at any such adjourned meeting shall constitute a quorum, regardless of the number of members present. The same notice shall be given for the adjourned meeting as is prescribed in section 2 of this article for the original meeting, except that such notice shall be given not fewer than 5 days previous to the date of the meeting as fixed in the adjournment.

Article VI. Elections

Section 1. At least 30 days prior to each annual meeting, the president shall appoint a nominating committee of not fewer than 3 members. It shall be the duty of the nominating committee to nominate at least one member for each vacancy, including any unexpired term vacancy, for which elections are being held.

Sec. 2. After the nominations of the nominating committee have been placed before the members, the president shall call for nominations from the floor. When nominations are closed, tellers shall be appointed by the president, ballots shall be distributed, the vote shall be taken and tallied by the tellers, and the results announced. All elections shall be determined by plurality vote, and shall be by ballot except where there is only one nominee for the office.

Sec. 3. Nominations shall be in the following order:

(a) Nominations for directors.

(b) Nominations for credit committee members.

Elections may be by separate ballots following the same order as the above nominations or, if preferred, may be by one ballot for all offices.

SEC. 4. No member shall be entitled to vote by proxy, but a member other than a natural person may vote through an agent designated in writing for the purpose. A trustee, or other person acting in a representative capacity, shall not, as such, be entitled to vote.

SEC. 5. Irrespective of the number of shares held by him, no member shall have more than one vote.

SEC. 6. The names and addresses of members of the board, executive officers, executive committee, and members of the credit and supervisory committees shall be forwarded to the Administration in accordance with the Act and regulations in such manner as may be required by said Administration.

SEC. 7. The board may establish by resolution a minimum age, not greater than 16 years of age, as a qualification for eligibility to vote at meetings of the members, or to hold elective or appointive office, or both.

Article VII. Board of Directors

SECTION 1. The board shall consist of ______ members, all of whom shall be members of this credit union. The number of directors may be changed to an odd number not fewer than 5 nor more than 15 by resolution of the board. No reduction in the number of directors may be made unless corresponding vacancies exist as a result of deaths, resignations, expiration of terms of office, or other actions provided by these bylaws. A copy of the resolution of the board covering any increase or decrease in the number of directors shall be filed with the official copy of the bylaws of this credit union.

SEC. 2. Regular terms of office for directors shall be for periods of either 2 or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the election and qualification of successors. The regular terms shall be so fixed at the beginning, or upon any increase or decrease in the number of directors, that approximately an equal number of regular terms shall expire at each annual meeting.

SEC. 3. Any vacancy on the board, credit committee, or supervisory committee shall be filled by vote of a majority of the directors then holding office. Directors and credit committee members so appointed shall hold office only until the next annual meeting, at which any unexpired terms shall be filled by vote of the members, and until the qualification of their successors. Members of the supervisory committee so appointed shall hold office until the first regular meeting of the board following the next annual meeting of members at which the regular term expires and until the appointment and qualification of their successors.

SEC. 4. A regular meeting of the board shall be held each month at the time and place fixed by resolution of the board. The president, or in his absence the ranking vice president, may call a special meeting of the board at any time; and shall do so upon written request of a majority of the directors then holding office. Unless the board prescribes otherwise, the president, or in his absence the ranking vice president, shall fix the time and place of special meetings. Notice of all meetings shall be given in such manner as the board may from time to time by resolution prescribe.

SEC. 5. The board shall have the general direction and control of the affairs of this credit union and shall be responsible for performing all the duties customarily performed by boards of directors. This shall include but not be limited to the following:

(a) Directing the affairs of the credit union in accordance with the Act, these bylaws, the rules and regulations and sound business practices.

(b) Establishing programs to achieve the purposes of this credit union as stated in article I, section 2, of these bylaws.

(c) Establishing and supervising a loan collection program and authorizing the chargeoff of uncollectible loans.

(d) Determining that all persons appointed or elected by this credit union to any position requiring the receipt, payment or custody of money or other property of this credit union, or in its custody or control as collateral or otherwise, are properly bonded in accordance with the Act and regulations.

(e) Performing such additional acts and exercising such additional powers as may be required or authorized by applicable law and regulations.

Sec. 6. A majority of the number of directors (inclusive of any vacancies) shall constitute a quorum for the transaction of business at any meeting thereof; but fewer than a quorum may adjourn from time to time until a quorum is in attendance.

Sec. 7. If a director or a credit committee member fails to attend regular meetings of the board or credit committee, respectively, for 3 consecutive months, or otherwise fails to perform any of the duties devolving upon him as a director or a credit committee member, his office may be declared vacant by the board and the vacancy filled as herein provided. The board may remove any executive officer from office for failure to perform the duties thereof, after giving the officer reasonable notice and opportunity to be heard.

When any executive officer, membership officer, or executive committee member is absent, disqualified, or otherwise unable to perform the duties of his office, the board may by resolution designate another member of this credit union to act temporarily in his place. The board may also, by resolution, designate another member or members of this credit union to act on the credit committee when necessary in order to obtain a quorum.

Sec. 8. Any member of the supervisory committee may be suspended by a majority vote of the board of directors. The members of this credit union shall decide, at a special meeting held not fewer than 7 nor more than 14 days after any such suspension, whether the suspended committee member shall be removed from or restored to the supervisory committee.

Article VIII. Executive Officers, Executive Committee and Management Staff

Section 1. The executive officers of this credit union shall be a president, one or more vice presidents, a treasurer, and a secretary, all of whom shall be elected by the board and from their number. If more than one vice president is elected, the board shall determine their rank as first vice president, second vice president, et cetera. The offices of treasurer and secretary only may be held by the same person. Unless sooner removed as herein provided, the officers elected at the first meeting of the board shall hold office until the first meeting of the board following the first annual meeting of the members and until the election and qualification of their respective successors.

Sec. 2. Officers elected at the meeting of the board next following the annual meeting of the members, which shall be held not later than 7 days after the annual meeting, shall hold office for a term of 1 year and until the election and qualification of their respective successors: *Provided, however,* That any person elected to fill a vacancy caused by the death, resignation, or removal of an officer shall be elected by the board to serve for the unexpired term of such officer and until his successor is duly elected and qualified.

Sec. 3. The president shall preside at all meetings of the members and at all meetings of the board, unless disqualified through suspension by the supervisory committee. He shall countersign all notes of this credit union, and all checks, drafts, and other orders for disbursement of its funds as prescribed in article XV, section 2, of these bylaws. The president shall also perform such other duties as customarily appertain to the office of president or as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

Sec. 4. The ranking vice president available shall have and exercise all the powers, authority, and duties of the president during the absence of the latter or his inability to act.

Sec. 5. The treasurer shall be the manager of this credit union under the control and direction of the board unless the board has employed a separate manager. Subject to such limitations, controls and delegations as may be imposed by the board, he shall:

(a) Have custody of all funds, securities, valuable papers and other assets of this credit union.

(b) Sign all notes of this credit union, and all checks, drafts, and other orders for disbursement of its funds.

(c) Provide and maintain full and complete records of all the assets and liabilities of this credit union in accordance with forms and procedures prescribed in the Accounting Manual for Federal Credit Unions or otherwise approved by the Administration.

(d) Within 7 days after the close of each month, prepare and submit to the board a financial statement showing the condition of this credit union as of the end of the month, including a summary of delinquent loans. He shall promptly post a copy of such statement in a conspicuous place in the office of this credit union where it will remain until replaced by the financial statement for the next succeeding month.

(e) Prepare and forward to the Administration such financial and other reports as the Administration may require.

(f) If so authorized by the board and within standards and limitations prescribed by the board, employ tellers, clerks, bookkeepers, and other office employees, and have the power to remove such employees.

(g) Perform such other duties as customarily appertain to the office of treasurer or as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

The treasurer may be compensated for his services to such extent as may be determined by the board.

The board may employ one or more assistant treasurers, none of whom may also hold office as president or vice president, and may authorize them, under the direction of the treasurer, to perform any of the duties devolving on the treasurer, including the signing of checks. When designated by the board, any assistant treasurer may also act as treasurer during the temporary absence of the treasurer or in the event of his temporary inability to act.

SEC. 6. The board may employ a manager who shall not be a member of the board and who shall be under the direction and control of the board or of the treasurer as determined by the board. The manager may be assigned any or all of the responsibilities of the treasurer described in section 5 of this article.

The board may employ one or more assistant managers, none of whom shall be a member of the board. The board may authorize assistant managers under the direction of the manager, to perform any of the duties devolving on the manager, including the signing of checks. When designated by the board, any assistant manager may also act as manager during the temporary absence of the manager or in the event of his temporary inability to act.

SEC. 7. The board shall employ, fix the compensation, and prescribe the duties of such employees as may in the discretion of the board be necessary, and have the power to remove such employees, unless it has delegated these powers to the treasurer or manager; except that neither the board, the treasurer, nor the manager shall have the power or the duty to employ, prescribe the duties of, or remove any loan officer appointed by the credit committee, or necessary clerical and auditing assistance employed or utilized by the supervisory committee.

SEC. 8. The secretary shall prepare and maintain full and correct records of all meetings of the members and of the board, which records shall be prepared within 7 days after the respective meetings. The secretary shall promptly inform the Administration in writing of any change in the address of the office of this credit union or the location of its principal records. He shall give or cause to be given, in the manner prescribed in these bylaws, proper notice of all meetings of the members, and shall perform such other duties as he may be directed to perform by resolution of the board not inconsistent with the Act and regulations and these bylaws.

The board may employ one or more assistant secretaries, none of whom may also hold office as president, vice president, or treasurer, and may authorize them under direction of the secretary to perform any of the duties devolving on the secretary.

Sec. 9. The board may appoint an executive committee of not fewer than three directors to serve at its pleasure, to act for it with respect to specifically delegated functions authorized by the Act and regulations. The board may also authorize such executive committee or a membership officer appointed by the board to serve at its pleasure from among the members of this credit union other than a person authorized to disburse funds, to approve applications for membership under such conditions as the board and these bylaws may prescribe. No executive committee member or membership officer may be compensated as such.

Article IX. Credit Committee

Section 1. The credit committee shall consist of ______ members. All the members of the credit committee shall be members of this credit union. The number of members of the credit committee may be changed to not fewer than 3 nor more than 7 by resolution of the board. No reduction in the number of members may be made unless corresponding vacancies exist as a result of deaths, resignations, expiration of terms of office, or other actions provided by these bylaws. A copy of the resolution of the board covering any increase or decrease in the number of committee members shall be filed with the official copy of the bylaws of this credit union.

Sec. 2. Regular terms of office for credit committee members shall be for periods of either 2 or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the election and qualification of successors. The regular terms shall be so fixed at the beginning, or upon any increase or decrease in the number of committee members, that approximately an equal number of regular terms shall expire at each annual meeting.

Sec. 3. The credit committee shall choose from their number a chairman and a secretary. The secretary of the committee shall prepare and maintain full and correct records of all actions taken by it, and such records shall be prepared within 3 days after the action. The offices of chairman and secretary may be held by the same person.

Sec. 4. The credit committee may, by majority vote of its members, appoint one or more loan officers to serve at its pleasure, and delegate to him or them the power to approve loans, share withdrawals, releases and substitutions of security, within limits specified by the committee. Not more than one member of the committee may be appointed as a loan officer. Each loan officer shall furnish to the committee a record of each transaction approved or not approved by him within 7 days of the date of the filing of the application or request, and such record shall become a part of the records of the committe. All applications or requests not approved by a loan officer shall be acted upon by the committee. No individual may disburse funds of this credit union for any loan or share withdrawal which he has approved as a loan officer.

Sec. 5. The credit committee shall hold such meetings as the business of this credit union may require, and not less frequently than once a month. Notice of such meetings shall be given to members of the committee in such manner as the committee may from time to time, by resolution, prescribe.

Sec. 6. The credit committee or a loan officer shall inquire carefully into the character and financial condition of each applicant for a loan and his sureties, if any, to ascertain their ability to repay fully and promptly the obligations incurred by them and to determine whether the loan sought is for a provident or productive purpose and will be of probable benefit to the borrower. The credit committee shall endeavor diligently to assist applicants in solving their financial problems.

Sec. 7. No loan shall be made unless approved by the committee or a loan officer in accordance with applicable law and regulations.

Sec. 8. Subject to the limits imposed by applicable law and regulations, these bylaws, and the general policies of the board, the credit committee, or a loan officer, shall determine the security required for each loan, if any, and the terms upon which it shall be repaid. The security furnished shall be adequate in quality and character and consistent with sound lending practices. When funds are not available to make all the loans for which there are loan applications, preference shall be given, in all cases, to the applications for smaller loans if the need and credit factors are nearly equal.

Article X. Supervisory Committee

SECTION 1. The supervisory committee shall be appointed by the board from among the members of this credit union, one of whom may be a director other than the treasurer. The board shall determine the number of members on the committee, which shall not be fewer than 3 nor more than the maximum number permitted by the Act. No member of the credit committee or any employee of this credit union may be appointed to the committee. Regular terms of committee members shall be for periods of 1, 2, or 3 years as the board shall determine: *Provided, however,* That all regular terms shall be for the same number of years and until the appointment and qualification of successors. The regular terms shall expire at the first regular meeting of the board following each annual meeting.

SEC. 2. The supervisory committee members shall choose from among their number a chairman and a secretary. The secretary of the supervisory committee shall prepare, maintain, and have custody of full and correct records of all actions taken by it. The offices of chairman and secretary may be held by the same person.

SEC. 3. The supervisory committee shall make, or cause to be made, such audits, and to prepare and submit such written reports, as are required by the Act and regulations. The committee may employ and use such clerical and auditing assistance as may be required to carry out its responsibilities prescribed by this article, and may request the board to provide compensation for such assistance. It shall prepare and forward to the Administration such reports as may be required.

SEC. 4. The supervisory committee shall, from time to time and not less frequently than as required by the Act and regulations, cause the passbooks and accounts of all members to be verified with the records of the treasurer. The committee shall maintain a record of such verification.

SEC. 5. By unanimous vote the supervisory committee may suspend until the next meeting of the members any director, executive officer, or member of the credit committee. In the event of any such suspension, the supervisory committee shall call a special meeting of the members to act on said suspension which meeting shall be held not fewer than 7 nor more than 14 days after such suspension. The chairman of the committee shall act as chairman of the meeting unless the members select another person to act as chairman.

SEC. 6. By the affirmative vote of a majority of its members, the supervisory committee may call a special meeting of the members to consider any violation of the provisions of the Act, the regulations, or of the charter or the bylaws of this credit union, or to consider any practice of this credit union which the committee deems to be unsafe or unauthorized.

Article XI. Organization Meeting

SECTION 1. At the time application is made for a Federal credit union charter, the subscribers to the organization certificate shall meet for the purpose of electing a board of directors and a credit committee. Failure to commence operations within 60 days following receipt of the approved organization certificate (charter) shall be cause for revocation of the charter unless a request for an extension of time has been submitted to and approved by the Regional Director.

SEC. 2. The subscribers shall elect a chairman and a secretary for the meeting. The subscribers shall then elect from their number, or from those eligible to become members of this credit union, a board of directors and a credit committee, all to hold office until the first annual meeting of the members and until the election and qualification of their respective successors. If not already a member, every person elected under this section or appointed under section 3 of this article, must qualify within 30 days by becoming a member. If any person elected as a director or committee member or appointed as a supervisory committee member does not qualify as a member within 30 days of such an election or appointment, his office shall automatically become vacant and shall be filled by the board.

Sec. 3. Promptly following the elections held under the provisions of section 2 of this article, the board shall meet and elect the executive officers who shall hold office until the first meeting of the board of directors following the first annual meeting of the members and until the election and qualification of their respective successors. The board shall also appoint at this meeting a supervisory committee as provided in article X, section 1, of these bylaws. The members so appointed shall hold office until the first regular meeting of the board following the first annual meeting of the members and until the appointment and qualification of their respective successors.

Article XII. Loans to Members

Section 1. Loans to individuals shall be made only to members, and shall be made for provident or productive purposes in accordance with applicable law and regulations. Loans to a member other than a natural person shall not be in excess of its shareholdings in this credit union.

Sec. 2. Within the limitations prescribed by applicable law and regulations, the board shall fix from time to time the interest rates on loans, the rate of interest refund, if any, to be made to members, the maximum maturities and terms of payment or amortization of loans to members, and the maximum amount that may be loaned with and without security, to any member. When, by action of the board, the interest rates on future loans are reduced, similar action may be taken with regard to interest rates on unpaid balances of existing loans.

Sec. 3. The aggregate amount of loans to any member and the terms and conditions of such loans shall not exceed the limits permitted by applicable law and regulations.

Sec. 4. Any loan made to a director or member of the credit or supervisory committee and the aggregate of such loans shall be in compliance with the Act and regulations. No director or member of the credit or supervisory committee shall act as comaker, endorser or guarantor for borrowers from this credit union.

Sec. 5. A borrower may repay his loan prior to maturity, in whole or in part, on any business day.

Sec. 6. Applications for loans shall be on forms prepared and furnished by the credit committee and shall in each case set forth the purpose for which the loan is desired, the security, if any, and such other data as may be required by the committee or by applicable law and regulations.

Sec. 7. Subject to the limitations of applicable law and regulations, any member whose loan is delinquent for a period of 1 week or more may be required by the board to pay a late charge of 20 percent of the interest due, with a minimum of not less than 5 cents.

Article XIII. Reserves

Section 1. All entrance fees, transfer fees, late charges, and such other amounts as shall be required by the Act and regulations, shall be set aside as a regular reserve: *Provided, however,* That when the regular reserve thus established shall reach the minimum balance required by the Act and regulations, no further transfers except fees and late charges shall be required except up to such amounts permitted by law and as may be needed to maintain such minimum balance. Amounts in excess of the above requirements may be transferred to the regular reserve by authorization of the board. The regular reserve shall be used only for losses on loans to members (including unrecovered collection costs) and such other losses as are authorized by applicable law and regulations.

Sec. 2. In addition to the regular reserve, special reserves to protect the interests of members shall be established in accordance with the

Act and regulations. The board may also authorize the establishment of any additional reserves which it deems necessary.

Article XIV. Dividends

SECTION 1. The board shall establish dividend periods and declare dividends as permitted by the Act and in accordance with the following:

(a) The board shall establish annual, semiannual, or quarterly dividend periods or other dividend periods permitted by the Act in such a way that the last dividend period in any calendar year ends on December 31.

(b) The board may change the established dividend periods, such change to take effect after the close of the current dividend period, and shall take reasonable action to notify the members of the change; *except that* the change may be applied to the current period if the members are notified a reasonable time prior to the end of such period.

(c) Dividends may be declared by the board, for an established dividend period, from earnings available after provisiôn for reserves required by the Act and regulations, only during the last month of the period or the first month following the close of the period.

(d) Within the limitations of the Act, the board shall determine the number of days from and including the first day of the month during which shares may be fully paid up and earn dividend credit for the entire month. Dividend credit may not be earned for a fraction of a month.

SEC. 2. No dividend shall be declared or paid at a rate in excess of 6 percent per annum.

SEC. 3. A member shall be deemed to have one fully paid share for each $5 paid in, regardless of the number of shares for which he has subscribed.

Article XV. Deposit and Disbursement of Funds—Investments and Borrowing

SECTION 1. All funds of this credit union, except for petty cash and cash change funds authorized by section 3 of this article, shall be deposited in such qualified depository or depositories from among those authorized by applicable law and regulations as the board may from time to time by resolution designate, and shall be so deposited not later than the second banking day after their receipt: *Provided, however,* That receipts in the aggregate of $300 or less may be held as long as 1 week before they are deposited.

SEC. 2. All disbursements of funds of this credit union shall be made by checks or other written instruments signed by the treasurer, manager, assistant treasurer, or an assistant manager, and countersigned by the president, or in his absence or inability to serve, by the ranking vice president: *Provided, however,* That the board may by resolution eliminate the requirement of countersigning: *And provided further,* That the board may by resolution determine that disbursements may be made in cash in accordance with procedures prescribed in the *Accounting Manual for Federal Credit Unions* or otherwise approved by the Administration.

SEC. 3. A cash fund may be authorized by the board by resolution for the purpose of making change, and for such other purposes as prescribed in the *Accounting Manual for Federal Credit Unions.*

The board may authorize by resolution the establishment of a petty cash fund for postage, and for defraying other expense items in amounts of less than $10.

SEC. 4. The funds of this credit union shall be invested only as authorized by applicable law and regulations.

SEC. 5. The board may authorize borrowing and discounting operations on behalf of this credit union within the limitations prescribed by applicable law and regulations.

Article XVI. Expulsion and Withdrawal

SECTION 1. A member may be expelled only in the manner provided by the Act. Expulsion or withdrawal shall not operate to relieve a member of any liability to this credit union. All amounts paid in on shares by expelled or withdrawing members, prior to their expulsion or withdrawal, shall be paid to them in the order of their withdrawal or expulsion, but only as funds become available and only after deducting therefrom any amounts due from such members to this credit union.

Article XVII. Minors

SECTION 1. Shares may be issued in the name of a minor, or in trust therefor. When shares are so issued in trust, the trustee must be a member of this credit union in his own right, and the name of the beneficiary must be stated.

Article XVIII. Definitions

SECTION 1. When used in these bylaws the terms:

(a) *"Act"* means the Federal Credit Union Act, as amended.

(b) *"Administration"* means the National Credit Union Administration.

(c) *"Administrator"* means the Administrator of the National Credit Union Administration.

(d) *"Regulation"* or *"regulations"* means rules and regulations issued by the Administrator of the National Credit Union Administration.

(e) *"Applicable law and regulations"* means the Federal Credit Union Act and rules and regulations issued thereunder or other applicable Federal statutes and rules and regulations issued thereunder as the context indicates (such as The Higher Education Act of 1965).

(f) *"Net earnings,"* for a given period, means the balance remaining after deducting from the gross income of this credit union actually received during such period all expenses paid or payable during such period, and any losses sustained therein (as determined by the board) for which no specific reserve has been set aside. Amounts set aside during such period as a reserve shall not be deemed items of expense.

(g) *"Paid in and unimpaired capital,"* as of a given date, means the balance of the paid-in shares account as of such date, less any losses that may have been incurred for which there is no reserve or which have not been charged against undivided earnings.

(h) *"Surplus,"* as of a given date, means the credit balance of the undivided earnings account on such date, after all losses have been provided for and net earnings or net losses have been added thereto or deducted therefrom, as the case may be. Reserves shall not be considered as a part of the surplus.

SEC. 2. If included in the definition of the field of membership in the organization certificate (charter) of this credit union, the terms or expressions:

(a) *"Members of their immediate families"* includes grandparents, parents, husband, wife, children, grandchildren, brothers, and sisters, living under the same roof and in the same household.

(b) *"Organizations of such persons"* means an organization or organizations composed exclusively of persons who are within the field of membership of this credit union.

Article XIX. General

SECTION 1. All power, authority, duties, and functions of the members, directors, officers, and employees of this credit union, pursuant to the provisions of these bylaws, shall be exercised in strict conformity with the provisions of applicable law and regulations, and of the charter and the bylaws of this credit union.

SEC. 2. The officers, directors, members of committees, and employees of this credit union shall hold in confidence all transactions of this credit union with its members and all information respecting their personal affairs, except to the extent deemed necessary by the board in connection with the making of loans and the collection thereof.

SEC. 3. Notwithstanding any other provisions in these bylaws, any director, committee member, officer, or employee of this credit union may be removed from office by the affirmative vote of a majority of the members present at a special meeting called for the purpose, but only after an opportunity has been given him to be heard.

SEC. 4. No director, committee member, officer, agent, or employee of this credit union shall in any manner, directly or indirectly, participate in the deliberation upon or the determination of any question affecting his pecuniary interest or the pecuniary interest of any corporation, partnership, or association (other than this credit union) in which he is directly or indirectly interested. In the event of the disqualification of any director respecting any matter presented to the board for deliberation or determination, such director shall withdraw from such deliberation or determination; and in such event the remaining qualified directors present at the meeting, if constituting a quorum with the disqualified director or directors, may exercise with respect to this matter, by majority vote, all the powers of the board. In the event of the disqualification of any member of the credit committee or the supervisory committee, such committee member shall withdraw from such deliberation or determination.

SEC. 5. Copies of the organization certificate of this credit union, its bylaws and any amendments thereof, and any special authorizations by the Administration shall be preserved in a place of safekeeping. Returns of nominations and elections and proceedings of all regular and special meetings of the members and directors shall be recorded in the minute books of this credit union. The minutes of the meetings of the members, the board, and the committees shall be signed by their respective chairmen or presiding officers and by the persons who serve as secretaries of such meetings.

SEC. 6. All books of account and other records of this credit union shall at all times be available to the directors and committee members of this credit union. The charter and bylaws of this credit union shall be made available for inspection by any member.

SEC. 7. Each member shall keep the credit union informed about his current address. In the event a member fails to do this, a charge may be made to the member's share account for the actual cost of necessary locator service incurred in determining such address: *Provided, however,* That such charge shall not exceed $5. Such charge shall be made only for amounts paid to a person or concern normally engaged in providing such service, and shall be made against the account or accounts of any one member not more than once in any 12-month period.

Article XX. Operations Following an Attack on the United States

SECTION 1. In the event of an attack upon the United States, the officers and employees of the credit union shall continue to conduct the affairs of the credit union under such guidance from the directors as may be available and subject to conformance with any governmental directives during the emergency.

SEC. 2. In the event of an attack upon the United States of sufficient severity to prevent the conduct and management of the affairs and business of the credit union by its regularly elected directors, officers, and properly constituted committees as contemplated by these bylaws, any three available members of the then incumbent board of directors shall constitute a quorum of the board of directors for the full conduct and management of the affairs and business of the credit union including the approval of loans to members if the regularly elected credit committee is not available. In the event of the unavailability at such time of three members of the board, the vacancies, in order to provide a quorum of three, shall be filled as follows:

(a) If the regularly elected president or a regularly elected vice president is not available, the available person who is highest on the succession list for president last authorized by the board of directors shall automatically become an acting director if he is not a member of the board and acting president.

(b) If the regularly elected treasurer is not available, the available person who is highest on the succession list for treasurer last authorized by the board of directors shall automatically become an acting director if he is not a member of the board and acting treasurer.

(c) If a third director is necessary to make a quorum, he shall be the next highest available person on the succession list for president or upon the exhaustion of such list, the next highest available person on the succession list for treasurer.

The quorum of the board of directors as regularly constituted or as constituted above shall appoint additional directors as necessary to provide for a full board of five members, provided that: If there is available an even number of regularly elected directors in excess of five, the board shall appoint one additional director, in which case, a quorum shall then be a majority of the full board thus constituted. Persons selected as provided in this section shall hold office only until their successors are elected at the next annual meeting or at a special meeting called for that purpose and until the qualification of their successors; provided that the person selected pursuant to subsection (a) shall hold office as acting president and as acting director only until the regularly elected president or a regularly elected vice president becomes available; and that the person selected pursuant to subsection (b) shall hold offices as acting treasurer and as acting director only until the regularly elected treasurer becomes available. This bylaw shall be subject to implementation by resolutions by the board of directors passed from time to time for that purpose, and any provisions of these bylaws (other than this section) and any resolutions which are contrary to the provisions of this section or to the provisions of any such implementary resolutions shall be suspended until a regularly constituted board of directors can be obtained.

SEC. 3. In the event that the office of the credit union becomes unusable, as a result of an attack upon the United States, the credit union shall, if possible, establish temporary substitute quarters. The office of this credit union shall be established as soon as practicable thereafter at a suitable permanent location within the limits permitted by the charter of this credit union.

Article XXI. Amendments of Bylaws and Charter

SECTION 1. Amendments of these bylaws may be adopted and amendments of the charter requested by the affirmative vote of two-thirds of the authorized number of members of the board at any duly held meeting thereof if the members of the board have been given prior written notice of said meeting and the notice has contained a copy of the proposed amendment or amendments. No amendment of these bylaws or of the charter shall become effective, however, until approved in writing by the Administrator.

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PROCEDURE FOR ADOPTING AMENDMENTS TO BYLAWS

The attached certification forms are for use of the board of directors in adopting the amendments to the bylaws made available by the enactment of HR 3365.

The amendments have been approved in advance by the Administrator and may be placed in effect immediately by the credit union when the following actions are taken:

1. Adoption of the amendment by the board of directors at a meeting held in accordance with Article XXI, section 1 of the bylaws:

2. Execution of the Certificate of Resolution in triplicate;

3. Filing of the original of the Certification of Resolution with the credit union's official bylaws; and,

4. Mailing of two completed sets (Pages 1-6) of the Certification of Resolution to your NCUA regional office.

(NOTE: This Procedure Applies For Adopting Change #4)

CERTIFICATION OF RESOLUTION OF BOARD OF DIRECTORS

ADOPTING AMENDMENT TO BYLAWS

We, the undersigned, president and secretary of the ____________________

____ Federal Credit Union,

Charter No. ______, ______________________________ hereby certify:
(city, state)

That by affirmative vote of two-thirds of the members of the board at a duly held meeting thereof on ______________________, ______ the following resolution was adopted:

BE IT RESOLVED: That the following amendments of this credit union's bylaws are hereby adopted, as set forth below and approved in advance by the Administrator, National Credit Union Administration, to be effective immediately:

CERTIFICATE

Article II, Section 2, of the bylaws shall be amended to read as follows:

"Applications for membership from persons eligible to membership under section 5 of the charter shall be signed by the applicant on forms approved by the board. Upon approval of such an application by a majority of the directors or a majority of the members of a duly authorized executive committee or by a membership officer and upon his/her subscription to at least one share of this credit union and the payment of the initial installment thereon, and the payment of a uniform entrance fee if required by the board, the applicant is admitted to membership. If a membership application is denied, the reasons therefor shall be furnished in writing to the person whose application is denied, upon written request."

Article III, Section 5, of the bylaws shall be amended to read as follows:

"Money paid in on shares or installments of shares may be withdrawn as provided in these bylaws or regulation on any day when payment on shares may be made: Provided, however, That

(a) The board shall have the right, at any time, to require members to give, in writing, not more than 60 days notice of intention to withdraw the whole or any part of the amounts so paid in by them.

(b) The board may determine that if shares are paid in under an accumulated payroll deduction plan, as prescribed in the Accounting Manual for Federal Credit Unions, they may not be withdrawn until credited to members' accounts.

(c) No member may withdraw shareholdings that are pledged as required security on loans without the written approval of the credit committee or a loan officer, except to the extent that such shares exceed the member's total primary and contingent liability to the credit union. "Required security" as used in this subsection refers to shares which are in existence at the time the application is made and specifically required to be pledged as security as part of a secured transaction.

(d) No member may withdraw any shareholdings below the amount of his/her primary or contingent liability to the credit union if he/she is delinquent as a borrower, or if borrowers for whom he/she is comaker, endorser, or guarantor are delinquent, without the written approval of the credit committee or loan officer; except that shares issued in an irrevocable trust as provided in section 6 of this article are not subject to restrictions upon withdrawal except as stated in the trust agreement.

(e) The share account of a person whose membership is terminated in accordance with article II, section 5, of these bylaws may be continued until the close of the dividend period in which the membership terminated, after which it shall be transferred to an account payable. The share account of a deceased member (other than one held in joint tenancy with another member) may be continued until the close of the dividend period in which the administration of the deceased's estate is completed, but not to exceed a period of two years."

Article III of the bylaws shall be amended by adding a new section to read as follows:

"SECTION 6. Shares may be issued in a revocable or irrevocable trust, subject to the following:

(a) When shares are issued in a revocable trust, the settlor must be a member of this credit union in his/her own right, and the name of the beneficiary must be stated.

(b) When shares are issued in an irrevocable trust, the settlor or the beneficiary must be a member of this credit union in his/her own right, and the name of the beneficiary must be stated. For purposes of this section, shares issued pursuant to a pension plan authorized by the rules and regulations shall be treated as an irrevocable trust unless otherwise indicated in the rules and regulations.

(c) Trust accounts established prior to the effective date of this section shall not be affected. Trusts may be established pursuant to this section, provided such trusts, their terms and conditions are in accordance with the laws of this jurisdiction."

Article VII, Section 7, of the bylaws shall be amended to read as follows:

"If a director or a credit committee member fails to attend regular meetings of the board or credit committee, respectively, for 3 consecutive months, or otherwise fails to perform any of the duties devolving upon him/her as a director or a credit committee member, his/her office may be declared vacant by the board and the vacancy filled as herein provided. The board may remove any executive officer from office for failure to perform the duties thereof, after giving the officer reasonable notice and opportunity to be heard.

"When any executive officer, membership officer, executive committee member or investment committee member is absent, disqualified, or otherwise unable to perform the duties of his/her office, the board may by resolution designate another member of this credit union to act temporarily in his/her place. The board may also, by resolution, designate another member or members of this credit union to act on the credit committee when necessary in order to obtain a quorum."

Article VIII, Section 5(d), of the bylaws shall be amended to read as follows:

"Within 7 days after the close of each month, prepare and submit to the board financial statements showing the condition of this credit union as of the end of the month. He/She shall promptly post copies of such statements in a conspicuous place in the office of this credit union where they will remain until replaced by the financial statements for the next succeeding month."

Article VIII, Title and Sections 9, 10, 11, and 12 of the bylaws shall be amended to read as follows:

"Article VIII. Executive Officers, Executive Committee, Investment Committee and Management Staff (italics)

SECTION 9. The board may appoint an executive committee of not fewer than three directors, to act for it with respect to specifically delegated functions and subject to such limitations as prescribed by the board.

SECTION 10. The board may appoint one or more membership officers from among the members of this credit union to approve applications for membership under such conditions as the board and these bylaws may prescribe. Such membership officer or officers may not be a person authorized to disburse funds.

SECTION 11. The board may appoint an investment committee composed of not less than two to have charge of making investments under rules and procedures established by the board.

SECTION 12. No member of the executive committee, or investment committee, or membership officer may be compensated as such. Members of the executive committee, investment committee and membership officers shall serve at the pleasure of the board of directors."

Article IX, Sections 4, 6, 7, and 8 of the bylaws shall be amended to read as follows:

"SECTION 4. The credit committee may, by majority vote of its members, appoint one or more loan officers to serve at its pleasure, and delegate to him/her or them the power to approve application for loans or lines of credit, share withdrawals, releases and substitutions of security, within limits specified by the committee and within limits of applicable law and regulations. Not more than one member of the committee may be appointed as a loan officer. Each loan officer shall furnish to the committee a record of each transaction approved or not approved by him/her within 7 days of the date of the filing of the application or request, and such record shall become a part of the records of the committee. All applications or requests not approved by a loan officer shall be acted upon by the committee. No individual may disburse funds of this credit union for any application or share withdrawal which he/she has approved as a loan officer.

SECTION 6. The credit committee or loan officer shall inquire into the character and financial condition of each applicant for a loan or line of credit and his/her sureties, if any, to ascertain their ability to repay fully and promptly the obligations incurred by them and to determine whether the loan or line of credit will be of probable benefit to the borrower. The credit committee and its appointed loan officers shall endeavor diligently to assist applicants in solving their financial problems.

SECTION 7. No loan or line of credit shall be made unless approved by the committee or a loan officer in accordance with applicable law and regulations.

SECTION 8. Subject to the limits imposed by applicable law and regulations, these bylaws, and the general policies of the board, the credit committee, or a loan officer, shall determine the security if any required for each application and the terms of repayment. The security furnished shall be adequate in quality and character and consistent with sound lending practices. When funds are not available to make all the loans and lines of credit for which there are applications, preference shall be given, in all cases, to the smaller applications if the need and credit factors are nearly equal."

Article XII, Title and Sections 2, 3, 4, 5, and 6 shall be amended and Sections 3, 4, 5, 6, and 7 shall be renumbered to read as follows:

"Article XII. Loans to Members and Lines of Credit to Members (italics)

SECTION 2. Within the limitations prescribed by applicable law and regulations, the board shall fix from time to time the interest rates on loans, the rate of interest refund, if any, to be made to members, the maximum maturities and terms of payment or amortization of loans to members, the security, and the maximum amount which may be loaned. When by action of the board, the interest rates on future loans are reduced, similar action may be taken with regard to interest rates on unpaid balances of existing loans.

SECTION 3. Lines of credit may be extended to members in accordance with applicable law and regulations. The board shall fix from time to time the interest rates, the maximum maturity, terms of payment or amortization, the security, and the maximum amount which may be loaned under a line of credit agreement within the limitations prescribed by applicable law and regulations.

SECTION 4. The aggregate amount of loans and lines of credit to any one member and the terms and conditions of such loans and lines of credit shall not exceed the limits permitted by applicable law and regulations.

SECTION 5. Any loan or line of credit made to a director or member of the credit or supervisory committees shall be in compliance with the Act and regulations. Directors or members of the credit or supervisory committees may act as comaker, endorser or guarantor for borrowers from this credit union, subject to the provisions of the Act and regulations.

SECTION 6. A borrower may repay his/her loan prior to maturity, in whole or in part, on any business day without penalty.

SECTION 7. Applications for loans or lines of credit shall be on forms prepared and furnished by the credit committee and shall in each case set forth the security, if any, and such other data as may be required by the committee or by applicable law and regulations.

SECTION 8. Subject to the limitations of applicable law and regulations, any member whose loan is delinquent for a period of 1 week or more may be required by the board to pay a late charge of 20 percent of the interest due, with a minimum of not less than 5 cents."

Article XIII, Section 1, of the bylaws shall be amended to read as follows:

"All amounts as required by the Act and regulations, shall be set aside as a regular reserve: Provided; however, (italics) That when the regular reserve thus established shall reach the minimum balance required by the Act and regulations, no further transfers shall be required except up to such amounts permitted by law and as may be needed to maintain such minimum balance. Amounts in excess of the above requirements may be transferred to the regular reserve by authorization of the board. The regular reserve shall be used only for losses as authorized by applicable law and regulations."

Article XIV, Sections 1 and 2 of the bylaws shall be amended (Section 3 shall be deleted) to read as follows:

"SECTION 1. The board shall establish dividend periods and declare dividends as permitted by the Act and applicable regulations.

SECTION 2. No dividend shall be declared or paid at a rate in excess of:

(a) 7 percent per annum on share accounts,

(b) 7 3/4 percent per annum on share certificate accounts."

Article XVII, Section 1, of the bylaws shall be amended to read as follows:

"Shares may be issued in the name of a minor."

Article XVIII, Section 1, of the bylaws shall be amended by adding a new subsection (i) to read as follows:

"(i) "Share" or "shares" means all classes of shares and share certificates that may be held in accordance with applicable law and regulations."

Article XIX, Section 2, of the bylaws shall be amended to read as follows:

"The officers, directors, members of committees and employees of this credit union shall hold in confidence all transactions of this credit union with its members and all information respecting their personal affairs, except to the extent deemed necessary by the board in connection with the making of loans and the collection thereof and extending lines of credit.

"Notwithstanding the above, the board of directors may authorize participation in a credit reporting agency if it has determined that use of such an agency is essential in the making of loans and extending lines of credit and that information supplied by the credit union concerning its members will be made available only to legitimate lenders belonging to that agency."

That notice of the above meeting was given to board members in accordance with Article XXI, Section 1, of the bylaws:

That the foregoing resolution, together with the names of directors voting for the amendments, those voting against the amendments, and those absent from the meeting have been entered in full in the minutes of the board of directors of this Federal credit union.

President

Secretary

(This certification is to be executed in triplicate. The original is to be filed with the official bylaws. Two copies are to be sent to the regional office, NCUA)

STATE
of ALASKA

MEMORANDUM

TO: Frances Ulmer, Director
Division of Policy
Development & Planning

DATE: March 19, 1979

FILE NO:

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERAL

By: Joseph K Donohue
Joseph K. Donohue
Assistant Attorney General

SUBJECT: Policy & Legal Issues
Surrounding AGSOC Legislation
(SSSB 170 and SSHB 240)

You have requested a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently before the legislature (SS for B 170 and SS for HB 240). The following is an outline of those issues from the Department of Law's perspective:

I. TAXATION

The Revenue Act of 1978 added Subchapter U to the Internal Revenue Code 1954, 26 U.S.C. §1391 through §1397. This legislation provides for the creation of a general stock ownership corporation (GSOC) and it authorizes special tax treatment for those corporations which qualify. The federal legislation requires that all GSOCs be chartered by an act of the State Legislature or by a referendum and further requires that each state charter provide as follows:

1. That the charter provide for the issuance of only one class of stock;

2. That the charter provide for the issuance of shares only to eligible individuals; "eligible individuals" are further defined as those who are residents of the State as of the date specified in the State's enabling legislation and who continue to be residents of the State as of the date of the issuance of the shares;

3. That the charter provide for the issuance of at least one share of stock for each eligible individual;

4. That the charter provide that no share of stock shall be transferred by the shareholder other than by will or by intestate succession, until after five years from the date of issuance (except where the shareholder ceases to be a resident); that no share of stock be transferred to a person other than a resident; and that no share of stock be transferred to any individual who would as a result of the transaction acquire more than ten shares of the GSOC.

In addition, the GSOC may not acquire more than twenty percent of the shares of any other existing corporation; the GSOC may not acquire property through the right of eminent domain; the GSOC's charter must mandate that it qualify as a GSOC under the Internal Revenue Code; and finally, the GSOC must be chartered and organized between December 31, 1978, and before January 1, 1984.

Thus, AGSOC (Alaska GSOC) as set out by Louis Kelso's proposal in SSSB 170 would create a corporation whose shareholders consisted of every resident of the State of Alaska as of the time the State charter goes into effect who remain a resident until the date of the first issuance of the AGSOC shares. The AGSOC is treated as a private corporation and not as a governmental unit for purposes of the Internal Revenue Code, except that a qualifying AGSOC is not subject to federal corporate income taxes. Instead, AGSOC's "taxable income" which is calculated in accordance with the Internal Revenue Code (with minor exceptions not relevant here) would be attributed directly to the shareholders in proportion to the number of shares held and would be taxed as individual income to those shareholders. This dividend income does not qualify for the exclusion from gross income normally associated with the first $100.00 of dividend income. See 26 U.S.C. §116.

The AGSOC is required to distribute at least ninety percent of its "taxable income" for any tax year. 26 U.S.C. §1396(a). The failure of an electing AGSOC to make the required ninety percent distribution would subject it to a penalty of twenty percent of the excess amount required to be distributed over that amount actually distributed. The federal scheme is intended to give the AGSOC a significant competitive advantage since the corporation can operate free of corporate income taxes at the federal level. On the other hand, this ten percent maximum on retained earnings

However, they have also indicated that there was a significant probability (about 75%) that AGSOC would have to return to the Administration and to the legislature, and ultimately to the people at the polls, for approval of a major extension of State credit or guarantees to secure loans of sufficient size to enable AGSOC to invest in TAPS, construct a gas line, etc.

SSSB 170 presently contains only one financing device--AS 10.50.100. The bill proposes the creation of a loan guarantee fund which will be a special fund segregated from all other funds of the State. It purports to be a trust fund for the uses and purposes of this section, but no uses and purposes are set forth in that section. As proponents of the measure have stated that the sole purpose is to guarantee loans for startup or organizational costs of the corporation, they have agreed to both clarify the uses to which the monies can be put and to a statement of a definite limit on the appropriations into the fund ($5,000,000.00). In addition, this section charges the Commissioner of Revenue with reviewing applications for loan guarantees (for the purpose of guarding against fraud and misrepresentation). It is suggested that the Commissioner of Revenue be given broader review powers such as the ability to disapprove a loan on the basis of its general inadvisability.

To accommodate these various concerns, the following substitute for AS 10.50.100 contained in SSSB 170 is submitted for consideration:

> A) There is a special fund of the State known as the Alaska General Stock Ownership Corporation Loan Guarantee Fund, which shall not exceed $5,000,000.00. and which shall be completely segregated from all other funds of the State. This fund is a trust for the uses and purposes of this section.
>
> B) The Commissioner of Revenue shall use the fund to guarantee loans solely for startup costs (and not to include major investment financing) made to the corporation by lenders other than the State. In guaranteeing loans, the Commissioner of Revenue shall review the loans for the purpose of ascertaining the general soundness of the proposed loan and for the purpose of guarding against fraud

may, indeed probably will, prohibit a corporation's expansion into major new investment areas on the basis of these earnings alone. New investment opportunities which arise in the future would require AGSOC to again obtain significant debt financing which may, in turn, require multiple state guarantees.

7

The first question which arises is whether or not the policy evidenced by the federal legislation (i.e., freedom from corporate income taxation) should be paralleled at the State level. The present SS for SB 170 would operate to exempt the AGSOC from the State's corporate income tax levied pursuant to AS 43.20. See AS 43.20.021, which incorporates by reference subchapter U of Chapter 1 of subtitle A of the Code. AS 43.20.021 provides for a delayed incorporation of tax exemptions. Those provisions of the Code adopted after 1975 "which change or modify exemptions from tax or credits against tax are not adopted by reference as a part of this chapter until the second January 1 following the effective date of the federal law". Here GSOC's exemption would go into effect at the State level on January 1, 1980. The AGSOC, however, would be subject to state severance taxes (AS 43.55), state oil and gas property taxes (AS 43.56), as well as the state's new oil and gas corporate income tax (AS 43.21.010) should the AGSOC invest in oil and gas production or pipeline transportation property. The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS.

AGSOC's investment in the oil and gas arena would present several important policy questions which should be analyzed prior to the Administration's endorsement of the present legislation. By purporting to give each resident of the State a direct interest in the development of the State's natural resources, it would become an independent voice for more rapid exploitation of those resources. Because the dividends to the residents would, as presently proposed, be directly affected by the nature and extent of the State oil and gas tax policy, it would likely become a lobbying force for lower State taxes. Obviously, lots of tradeoffs are involved, but the political and economic issue reduces itself to the following: Would it be better to expedite resource development and lower State taxes in such a case in order to allow AGSOC's shareholders to benefit directly (albeit by only a marginal increase in their dividend) and at the same time deprive the State treasury of potentially enormous revenues which could be devoted to various social welfare programs? These programs would ultimately return greater proportionate benefits to those in the lower income brackets in the State and possibly lesser benefits (than AGSOC) to those in the upper income brackets.

> and misrepresentation. The guarantee of a loan may not be for an amount in excess of the unobligated balance in the fund at the time the guarantee is made.

Whereas the above minor technical changes can clarify or limit the general purpose of the loan guarantee fund as originally proposed, the manner in which AGSOC would approach the State and apply for an appropriation or legislation which would enable them to utilize the public credit of the State of Alaska to guarantee a major investment in the future is not treated in this bill. Senator Gravel has testified that such an extension of public credit would be in accordance with the procedures which pertain to the issuance of general obligation bonds which require the ratification of the voters at the polls. Thus, Senator Gravel has argued that no major extension of public credit would occur without the ultimate participation of all the voters of the State who would, of course, include most of the AGSOC shareholders.

Senator Gravel is basing his procedural argument on Article IX, §8, State Constitution, which states:

> "No state debt shall be contracted unless authorized by law for Capital improvements and ratified by the majority of the qualified voters of the State who vote on the question."

Although the issue deserves further review by this department, it is suggested that this provision on its face does not apply to the type of guarantee contemplated by Senator Gravel and the proponents of the AGSOC, since the investment would not qualify as a capital improvement authorized by law under this section. See City of Juneau v. Hickson, 373 P2d 743 (Alaska 1962).

Rather, it would appear that Article IX, §6, applies in this context:

> "No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

Under this provision, all that would be required for an extension of credit to the AGSOC would be legislation appropriating a sufficient amount of money to guarantee AGSOC's commitment. Thus, it appears that something on the order of a loan guarantee fund on a vaster scale would in fact be required but such legislation would not be subject to voter ratification at a subsequent general election. Since Kelso's investment consultants have based their advice on the assumption that there could be a call on the general credit of the State without a significant appropriation to back up any guarantees, the ability of the State treasury to make such an appropriation and its fiscal impact on other State programs has never been carefully analyzed.

. Thus, three questions need to be considered: (1) ? Whether there is any constitutional mechanism for extending the State's credit without the necessity of a large appropriation which may not be fiscally sound or economically feasible; if not, whether AGSOC's proponents who have assumed the availability of access to the State's credit have any alternative suggestions for the financing of the corporation which should be statutorily treated at this time; (2) Whether this statute should incorporate a statutory ? procedure or requirement for voter ratification of any major investment proposal, funded by direct appropriation into a guarantee loan fund; and (3) Whether a constitutional amendment ? would be required to allow the State to guarantee AGSOC's loans.

III. DEPOLITICIZING THE AGSOC

The proponents of the AGSOC have conceived of this entity as operating as a private corporation subject to the very few qualifications imposed on it by federal law. Thus, the corporation is subject to the standard provisions of the Alaska Business Corporation Act, AS 10.05, except where inconsistent with the state or federal enabling legislation. The proponents have argued that AGSOC stands the best chance of being a success, (i.e., operating at a profit which will be shared in by most Alaskan residents) if it is structured as a completely private corporation. However, 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.

No matter how the AGSOC is ultimately designed, it would be foolhardy to believe that this entity would not quickly become highly politicized and ultimately, if it is successful, become an extremely powerful political force in the State. Assuming it is established as a private corporation, it would present the following issues:

A) AGSOC: A Fourth Branch of Government
A successful AGSOC, representing as it would the residents of the State of Alaska would in essence, become a fourth branch of government. It will be a fourth forum in which State environmental, social, economic and tax questions will be vigorously debated. The Governor's control over this, corporation is limited to appointing the first board of directors. After that the corporation will, as presently designed, operate completely independent of any state agency, albeit it will be subject to all applicable state regulatory provisions. Given the composition of the corporation, it would become quickly susceptible to the pressures of any cohesive organized group of residents within the State, such as large labor unions, native corporations, etc. That is, any private organization containing a large number of resident votes could well form a block in the nature of a voters' trust, which could be used to gain control, or at least to form an influential minority on the board of directors.

The board, and indirectly management, would be subject to election by the same or a similar constituency as the Governor of the State. Thus, the chairman of the board could conceivably end up representing a larger number of Alaskan residents than the Governor of the State. The Governor would be put in the somewhat anomalous position of dealing with a more popular, albeit apolitical, leader representing the fourth estate, i.e., AGSOC.

Although one could argue that AGOSC violates the fundamental political theory of the State Constitution which established only three branches of government, this objection is more of a philosophical one than a legal one, and it is not anticipated that any such challenge could be successfully formulated and presented to the State courts. Finally, under this general category of concerns relating to its impact on the present institutional balance of power as contemplated by the State Constitution, it should be noted that management of the corporation, members of the board of directors of the corporation, could, and very well might, utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office.

B) Specific Constraints: Lobbying and Political Contributions. Since AGSOC will purport to represent the people of the State of Alaska, it could be argued that since that function is also served by the Governor of the State and by the legislature in the political arena, AGSOC should be prohibited from participating in that same arena, or at least be made subject to stringent restrictions. It is suggested that AGSOC should be prohibited from lobbying, from making political contributions to candidates for State offices, and that strict proxy review mechanisms should be added to the bill to ensure that the board of directors act in a politically neutral fashion. For instance, AGSOC's board, in its annual report, would be allowed to analyze the impact of State taxes on its percapita dividends. However, the board would not be able to affirmatively encourage the shareholders to write their legislators and call for a lower rate of taxation. The shareholders would have to draw their own conclusions. Obviously, the shareholders would then be allowed to contact their legislators and express their opinion on the subject.

Furthermore, a AGSOC endorsement of a political candidate would obviously be a cherished one. Even though AGSOC's proponents at present claim that this corporation is merely another private corporate entity, we have absolutely no guarantees that management in future years will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic policy preferences implemented by vigorous participation in the political arena. AGSOC endorsements and political contributions might therefore best be prohibited.

C) Litigation With The State. AGSOC, just like any other major corporate entity, would become subject to various State regulatory laws, and the possibility for confrontation is obvious. For instance, should AGSOC become the vehicle for financing the gas line, AGSOC would have a corporate interest in raising the tariff on the pipeline which would be assessed against the State, and the State as producer and shipper would have an interest in lowering the tariff in order to maximize State royalty and severance tax revenues to the treasury.

In addition, the proponents of AGSOC have stated on several occasions that in order for it to result in tangible benefits to the individual Alaskan shareholder, it must invest in vast development projects which will involve vast returns (hopefully). Thus, there is every likelihood that AGSOC would become a major force for concentration of economic power in the State and might ultimately develop or acquire monopoly control over one or more economic sectors. This, in turn, would present anti-trust problems, both under state and federal law, and the following scenarios are possible: 1) Since AGSOC is not a State agency, it would not enjoy the "state action" exemption from the federal anti-trust laws and it would likewise be subject to treble damage actions for any economic injuries arising out of violations of the Sherman or Clayton Anti-Trust Acts, 15 U.S.C., §1, et seq., and (2) The State could find itself litigating at great expense against AGSOC in order to require it to divest itself of various interests, or to require it to cease and desist from some specific anti-competitive practice.

The anti-trust example is one of many. It could occur in the environmental sector, the banking and securities area, the tax area, or in any other area of commercial endeavor. The State and AGSOC, if engaged in litigation with each other, would be drawing on resources which ultimately affect the same individuals, i.e., the taxpayers versus the shareholders. Should the State prevail and obtain a fine, such a fine would, itself, seem counterproductive.

Some suggestions for mitigating the underlying irony of the State litigating against the people of the State, i.e., AGSOC, and the potential for enormous waste of common resources which is inherent in any extensive litigation such as a protest of a pipeline tariff, might be as follows:

1) When a dispute arises between the State and AGSOC, the matter could be held in abeyance until the next legislature to allow the latter to determine by legislation the proper resolution of the matter; or the matter could be submitted to an arbitration panel established by statute.

2) Other means of controlling litigation between AGSOC and the State would be to create a disincentive to any litigation. One such disincentive would be a modification of the court rules relating to the award of costs and attorney's fees to provide that the State would always be entitled to receive its actual costs and attorney's fees incurred in the litigation of any action involving AGSOC. In addition, AGSOC's right to costs and attorney's fees would arise only in those cases where the court makes an express finding that the State's prosecution or defense was frivolous or lacking in good faith.

IV. CORPORATE DEMOCRACY

One of the most important policy questions which must be addressed in any analysis of AGSOC is whether or not resident shareholders' right to participate in and to influence corporate decision making is adequately protected or assured by the normal corporate procedures set forth in AS 10.05. The following is a list of specific issues which the administration and the legislature should address in its analysis of the AGSOC legislation:

1) Classified Directors. The present sponsor substitute provides for a board of directors consisting of nine members divided into three classes of three members each. Three directors will therefore be eligible for an election during any one year. See AS 10.50.030. A highly classified

board of directors such as this would limit the ability of minorities within the State to obtain representation on the board of directors. Every shareholder has one vote, and if all nine directors were elected at the same time, there is a greater opportunity for minorities such as native organizations, etc., to elect at least one board member. A highly classified board would tend to heavily favor urbanized Alaska.

2) Cumulative Voting. AS 10.05.162 presently provides that shareholders may, at an election for directors, cumulate their votes by giving one candidate as many votes as the number of directors to be elected, multiplied by the number of that shareholder's shares. However, a corporation may provide in its bylaws (modified by board of directors' resolutions) that shareholders cannot cumulate their votes but must vote shares held by them on an election-by-election basis. Cumulative voting is another device to help ensure minority representation on the board of directors. By leaving it optional, as stated in AS 10.05.162, the board of directors could amend the bylaws to prohibit cumulative voting. It is suggested that it might be desirable for the AGSOC legislation to expressly state that cumulative voting cannot be prohibited by shareholder or by director action.

3) Voting Trusts. In accordance with AS 10.05.171, voting trusts may be created by any number of shareholders who wish to confer upon a trustee the right to vote or otherwise represent the shareholders for a period not exceeding ten years. The existence or toleration of voting trusts within the AGSOC context is a question which should be carefully analyzed. At this point in time, it is suggested that their prohibition might be advisable or at least a limitation imposed on the number of years that they can remain in existence. For instance, AGSOC proponents indicate that the original AGSOC will be coming back to the legislature for each major investment proposal. Thus, within a ten-year period, two or three major investment schemes may have been considered and acted upon, and a ten-year voting trust would allow a trustee undue amount of influence over any of these decisions.

4) Amendment of The Articles of Incorporation. AS 10.05.276 presently provides that the board of directors shall adopt a resolution setting out a proposed amendment directing that it be submitted to a vote at the annual or special meeting of the shareholders. Thus, it appears that the initiative to amend the articles must come from the board, and it may be desirable to provide for an amendment which would allow the shareholders to propose amendments to the articles of incorporation that can be taken up and voted on at annual meetings.

5) Quorum of Shareholders. AS 10.05.153 presently provides that, unless otherwise provided in the articles of incorporation, the majority of the shares entitled to vote constitutes a quorum in a meeting of shareholders. (The section provides for a minimum of one-third of the shares.) The quorum requirement is something that the legislature may wish to mandate by statute. Here, of course, the higher the quorum requirement, the greater the difficulty the corporation will have in holding an annual meeting. However, a high quorum requirement would necessitate vigorous promotional and educational programs to ensure the presence of the quorum at each annual meeting and might indirectly spur thcorporation to greater efforts to include or request the participation of all shareholders of the State in corporate decision making.

6) Notice of Meetings of Shareholders. AS 10.05.138 presently provides that meetings of shareholders may be held at the place (either inside or outside the State) as may be provided in the bylaws. In addition, an annual meeting of the shareholders shall be held at the time provided in the bylaws. Special meetings of the shareholders may be called by the president, the board of directors, and holders of not less than one-tenth of all the shares entitled to vote at the meeting.

AS 10.05.141 in addition requires written or printed notice of all meetings, such notice shall be delivered not less than ten nor more than fifty days before the date of the meeting, either personally or by mail.

Obviously, together these rules operate to favor incumbent management. Annual meetings could be rescheduled by a change in the bylaws which requires a vote of the board of directors. The board could, on short notice, i.e., as little as ten days, present the shareholders with any major issue it chose, such as the election of new directors or consideration of a major investment proposal.

The legislature might well wish to consider statutory safeguards which would ensure adequate notice of the time, place and purpose of any meeting which would preclude manipulation of the timing of any meeting to the advantage of the incumbents.

7) Bylaws. AS 10.05.135 presently provides that the board of directors shall have the power to alter, amend or repeal the bylaws unless it is reserved to the shareholders by the articles of incorporation. Again, it is suggested that the amendment of the bylaws might be a power which should be reserved to the shareholders in order to ensure adequate public review of any change in the management's approach to the conduct of the corporation's business.

8) Financing of Proxy Fights, Access to Voting Lists and Mailing Machinery. Several commentaries concerning modern corporate battles note the inherent advantage which incumbent management has through its control of the corporate machinery for sending out mailings, soliciting support, and arguing its cause before the shareholders. This is done at corporate expense, whereas opposing or dissenting shareholders frequently have to finance such efforts from private sources. Amendments might well be considered which would allow shareholders who can obtain a certain number of qualified signatures to utilize the corporation's mailing machinery at the corporation's expense. This procedure should be especially encouraged in the context of elections for the board of directors. Candidates who can either obtain a nomination by the board of directors or the support of a predetermined percentage of the shareholders should be entitled to publish information concerning themselves, their experience, their policy preferences and their criticisms of existing management at the corporation's expense.

V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

Two other constitutional issues should be mentioned briefly in this context. First, the federal legislation authorizing the creation of GSOC mandates that the shareholder group be made up of a closed class (i.e., those residents who satisfy the eligibility requirements imposed by state law as of the date of the state charter, and who remain residents as of the date of the issuance of the shares). Thus, future residents would be ineligible for one of the free shares of AGSOC. Under Kelso's present plan, AGSOC shareholders who leave the state and become nonresidents would be entitled to retain their dividends and voting rights in AGSOC. Persons leaving the state who wish to sell their shares could, of course, sell to new residents who wish to participate in the AGSOC. In addition, oldtime residents could acquire as many as ten shares in AGSOC through purchase or inheritance.

These two factors, when combined, could lead to the following scenario: The initial one hundred percent of the AGSOC shares could be concentrated in as few as ten percent of the original shareholders. Those shareholders, in turn, could become residents of other states, and thus it is theoretically possible that ten or twenty years from the original issuance, AGSOC shareholders could be composed of a select group of resident Alaskans and nonresident former Alaskans. Ironically, it may be at this very time that the state may be called upon to honor its guarantee, and thus the state's credit rating and ability to issue bonds at favorable interest rates would be adversely affected, and the people who would be called upon to bear the burden of AGSOC adventures would be the taxpaying class of Alaskans at that time. This potential for a sharp dichotomy between the shareholder class of AGSOC and the resident population of the state deserves closer analysis. Kelso's report contains no estimates of the transiency rates of the Alaskan population and no projections as to the future composition of its AGSOC.

The legal issue which overlaps this general policy question is whether or not the closed class nature of the AGSOC offends the equal protection provisions of the state or federal constitutions. Wilmer, Cutler & Pickering, in their memorandum of December 15, 1978, on the constitutional issues, felt that such a provision might be successfully defended against a federal constitutional challenge. A closer question is presented under the state constitutional provision which has been interpreted somewhat more stringently than its federal counterpart. See Isakson v. Richey, 550 P2d 359 (Alaska 1976). Under this provision, a substantial question is raised as to whether or not the AGSOC arbitrarily discriminates against future residents of the state.

Secondly, a derivative issue is whethe or not the use of the public credit for the direct benefit of a private corporation whose shareholders will, over time, form a distinct class within the state (possibly a minority class) qualifies under the "public purpose" requirement of Article IX, §6 of the Alaska State Constitution.

QUESTIONS ON AGSOC FOR THE HOUSE STATE AFFAIRS COMMITTEE

1. How could AGSOC be structured so as not to create unnecessary conflicts between the public interest in business regulation and taxation and the shareholder's interest in higher dividends?

Yes 2. Would it be generally advisable to make attempts to depoliticize the AGSOC?

Should the AGSOC be allowed to lobby, make political contributions or come out with endorsements for particular candidates?

3. Do normal state corporation statutes provide sufficient protection for minority shareholders?

  - Is it inevitable the AGSOC would become an urban dominated corporation, given the population of the state?

  - How would rural members be able to participate other than by proxy given the expenses involved in travelling to meetings?

  - Should the board be classified, i.e. only a subset of the board coming up for election at one time

  - Should cumulative voting be mandatory?

  - Should voting trusts be prohibited?

  - Who should have the authority to amend articles of incorporation and bylaws?

  - How should proxy fights and shareholder-management disputes be financed - should both incumbants and challengers be financed by corporation money?

Still to be decided 4. Should exemption from federal income taxation be extended to state taxation in general?

* ☆ 5. What are the probabilities that AGSOC will need no other state assistance beyond start-up costs? Can AGSOC really operate as a purely private corporation?

  - Which particular investments would not require state financial aid?

  - Which particular investments would require state financial aid?

  * Ask Kelso representative to detail the mechanism whereby AGSOC requests state financial assistance.

  - What kind of impact on the state's credit rating would the potential access to state support and/or guarantees have? Is it fair that all residents bear the risk to the state's credit rating which benefits only the subset of residents who are shareholders?

6. What are the pros and cons of setting up the AGSOC up as a public corporation versus a private corporation, assuming it would be legal?

7. Is there further information which can be made available to the state which will help us to make a prudent decision on the AGSOC. Can such information be gathered before the end of this session?

Possible questions to be answered:

- Do Alaskan's want an AGSOC? Perhaps this issue needs an airing similar to that given to Alaska, Inc. via the Public Forum. Since AGSOC is to be a people's corporation, should the people deserve more involvement than has yet been provided?

- What are the political implications of a corporation whose shareholders comprise the voting public? Are there any existing situations which are similar elsewhere, and from which lessons can be drawn?

- What will be the impact on the state's credit rating if AGSOC requires different kinds of state financial assistance? If there is an impact, how much will non-shareholding residents be paying to benefit the shareholders?

- If AGSOC had been incorporated five or ten years ago, how many residents would be shareholders today? Or conversely, how many shareholders would still be residents? What can we expect for the future? Taxpayer turnover data is available to answer this question.

✓ — VOTE OF PEOPLE ~~FOR~~ REQUIRED
FOR $'s / Guarantees

✓ CAN'T TRANSFER

✓ ALL DIRECTORS ALASKANS

✓ UNDECIDED: # of Directors from out of state?
1 from each of 5 regions?

✓ Chairman MUST BE Alaskan

✓ DIR. CANNOT BE officers/[illegible]/employees

ARTON ECONOMETRIC
RECASTING ASSOCIATES, INC.
FOR PROFIT CORPORATION OWNED BY THE UNIVERSITY OF PENNSYLVANIA

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

March 22, 1979

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

Dear Mr. Barker:

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

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

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

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

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

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

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

***

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

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

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

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

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

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

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

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

Cordially yours,

Abel Beltran del Rio

ABR/as

(2) The purpose for which the purchase is to be made and whether the securities are to be retired, held in the treasury of the issuer or otherwise disposed of, indicating such disposition; and

(3) The source and amount of funds or other consideration used or to be used in making the purchases, and if any part of the purchase price or proposed purchase price is represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding, or trading the securities, a description of the transaction and the names of the parties thereto; and

(b) The issuer has at any time within the past 6 months sent or given to its equity security holders the substance of the information contained in the statement required by paragraph (a) of this section: *Provided, however,* That any issuer making such purchases which commenced prior to July 30, 1968 shall, if such purchases continue after such date, comply with the provisions of this rule on or before August 12, 1968.

[33 FR 14110, Sept. 18, 1968, as amended at 34 FR 6101, Apr. 4, 1969]

Regulation 14A: Solicitation of Proxies

§ 240.14a-1 Definitions.

Unless the context otherwise requites, all terms used in §§ 240.14a-1 to 240.14a-10 and in Schedule 14A have the same meanings as in the act or elsewhere in the general rules and regulations thereunder. In addition, the following definitions apply unless the context otherwise requires:

(a) *Associate.* The term "associate" used to indicate a relationship with any person, means (1) any corporation or organization (other than the issuer or a majority owned subsidiary of the issuer) of which such person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust or other estate in which such person has a substantial beneficial interest or as to which such person serves as trustee or in a similar fiduciary capacity, and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the issuer or any of its parents or subsidiaries.

(b) *Issuer.* The term "issuer" means the issuer of the securities in respect of which a proxy is solicited.

(c) *Last fiscal year.* The term "last fiscal year" of the issuer means the last fiscal year of the issuer ending prior to the date of the meeting for which proxies are to be solicited.

(d) *Proxy.* The term "proxy" includes every proxy, consent or authorization within the meaning of section 14(a) of the act. The consent or authorization may take the form of failure to object or to dissent.

(e) *Proxy statement.* The term "proxy statement" means the statement required by § 240.14a-3(a), whether or not contained in a single document.

(f) *Solicitation.* (1) The terms "solicit" and "solicitation" include:

(i) Any request for a proxy whether or not accompanied by or included in a form of proxy;

(ii) Any request to execute or not to execute, or to revoke, a proxy; or

(iii) The furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of a proxy.

(2) The terms do not apply, however, to the furnishing of a form of proxy to a security holder upon the unsolicited request of such security holder, the performance by the issuer of acts required by § 240.14a-7, or the performance by any person of ministerial acts on behalf of a person soliciting a proxy.

[17 FR 11431, Dec. 18, 1952, as amended at 21 FR 578, Jan. 26, 1956]

§ 240.14a-2 Solicitations to which §§ 240.14a-1 to 240.14a-11 apply.

Sections 240.14a-1 to 240.14a-11 apply to every solicitation of a proxy with respect to securities registered pursuant to section 12 of the Act, whether or not trading in such securities has been suspended, except the following:

(a) Any solicitation made otherwise than on behalf of the management of the issuer where the total number of persons solicited is not more than ten.

(b) Any solicitation by a person in respect to securities carried in his name or in the name of his nominee (otherwise than as voting trustee) or held in his custody, if such person:

(1) Receives no commission or remuneration for such solicitation, directly or indirectly, other than reimbursement of reasonable expenses;

(2) Furnishes promptly to the person solicited a copy of all soliciting material with respect to the same subject matter or meeting received from all persons who shall furnish copies thereof for such purpose and who shall, if requested, defray the reasonable expenses to be incurred in forwarding such material; and

(3) In addition, does no more than impartially instruct the person solicited to forward a proxy to the person, if any, to whom the person solicited desires to give a proxy, or impartially request from the person solicited instructions as to the authority to be conferred by the proxy and state that a proxy will be given if no instructions are received by a certain date.

(c) Any solicitation by a person in respect of securities of which he is the beneficial owner.

(d) Any solicitation involved in the offer and sale of securities registered under the Securities Act of 1933: *Provided*, That this paragraph shall not apply to securities to be issued in any transaction of the character specified in paragraph (a) of § 230.145 of this chapter.

(e) Any solicitation with respect to a plan or reorganization under Chapter X of the Bankruptcy Act, as amended, if made after the entry of an order approving such plan pursuant to section 174 of said act and after, or concurrently with, the transmittal of information concerning such plan as required by section 175 of said act.

(f) Any solicitation which is subject to Rule U-62 under the Public Utility Holding Company Act of 1935.

(g) Any solicitation through the medium of a newspaper advertisement which informs security holders of a source from which they may obtain copies of a proxy statement, form of proxy and any other soliciting material and does no more than (1) name the issuer, (2) state the reason for the advertisement, and (3) identify the proposal or proposals to be acted upon by security holders.

(15 U.S.C. 77 b, d, e, s, 78 1-n, 80a-20, 80a-37)

[17 FR 11431, Dec. 18, 1952, as amended at 30 FR 4753, Apr. 14, 1965; 37 FR 23637, Nov. 7, 1972]

§ 240.14a-3 Information to be furnished to security holders.

(a) No solicitation subject to this regulation shall be made unless each person solicited is concurrently furnished or has previously been furnished with a written proxy statement containing the information specified in Schedule 14A (§ 240.14a-101).

(b) If the solicitation is made on behalf of the management of the issuer, and relates to an annual meeting of security holders at which directors are to be elected, each proxy statement furnished pursuant to paragraph (a) of this section shall be accompanied or preceded by an annual report to security holders as follows:

(1) The report shall contain, in comparative columnar form, such financial statements for the last two fiscal years, prepared on a consistent basis, as will in the opinion of the management adequately reflect the financial position of the issuer at the end of each such year and the results of its operations for each such year: *Provided, however*, That investment companies registered under the Investment Company Act of 1940 need include such financial statements only for the last fiscal year. Consolidated financial statements of the issuer and its subsidiaries shall be included in the report if they are necessary to reflect adequately the financial position and results of operations of the issuer and its subsidiaries, but in such case the individual statements of the issuer may be omitted even though they are required to be included in reports to the Commission. Such financial statements and the notes thereto shall be in roman type at least as large and as legible as 10-point modern type except that to the extent necessary for convenient presentation financial statements, but not the notes thereto, may be in roman type at least as large and as legible as 8-point modern type. All such type shall be leaded at least 2 points. The Commission may, upon the request of the issuer, permit the omission of financial statements for the earlier of such two fiscal years upon a showing of good cause therefor.

(2) Any differences, reflected in the financial statements included in the report to security holders, from the principles of consolidation or other accounting principles or practices, or methods of applying accounting principles or practices, applicable to the financial statements of the issuer filed or proposed to be filed with the Commission, which have a material effect on the financial position or results of operation of the issuer, shall be noted and the effect thereof reconciled or explained in the financial statements or the notes thereto in such report. Financial statements included in the report may, however, omit such details or employ such condensation as may be deemed suitable by the management: *Provided*, That such statements, considered as a whole in the light of other information contained in the report shall not by such procedure omit any material information necessary to a fair presentation or to make the financial statements not misleading under the circumstances.

(3) The financial statements for the last two fiscal years required by paragraph (b)(1) of this section shall be certified by independent public or certified accountants, unless (i) the corresponding statements included in the issuer's annual report filed or to be filed with the Commission for the same fiscal years are not required to be certified, or (ii) the Commission finds in a particular case that certification would be impracticable or would involve undue effort or expense.

(4) The report shall include a summary of the issuer's operations containing the information required by Item 2 of Form 10-K (§ 249.308a) except for the reconciliations, exhibits and supplemental information required by the instructions thereto.

NOTE 1: Subparagraph (b)(10) permits the information required by this subparagraph to be set forth in any form deemed suitable by management.

NOTE 2: Guide 1 of the Guides for the Preparation and Filing of Reports and Registration Statements Under the Act (Release 34-10961, August 14, 1974) (39 FR 31894) and any other guides subsequently published by the Commission relating to Item 2 of Form 10-K (§ 249.308a) apply to annual reports to security holders.

(5) The report shall contain a brief description of the business done by the issuer and its subsidiaries during the most recent fiscal year which will, in the opinion of management, indicate the general nature and scope of the business of the issuer and its subsidiaries.

(6) The report shall contain information relating to the issuer's industry segments, classes of similar products or services, foreign and domestic operations and export sales furnished in accordance with the provisions of paragraphs (b), (c)(1)(i) and (d) of Item 1 of Regulation S-K, 17 CFR 229.20.

NOTE: Subparagraph (b)(10) permits the information required by this subparagraph to be set forth in any form deemed suitable by management.

(7) The report shall identify each of the issuer's directors and executive officers, and shall indicate the principal occupation or employment of each such person and the name and principal business of any organization by which such person is so employed.

NOTE: The term "executive officer" means the president, secretary, treasurer, any vice president in charge of a principal business function (such as sales, administration or finance) and any other person who performs similar policy making functions for the issuer.

(8) The report shall identify the principal market in which securities of any class entitled to vote at the meeting are traded, and shall state the high and low sales prices for such securities (or, in the absence of such information, the range of bid and asked quotation) and the dividends paid on such securities for each quarterly

period during the issuer's two most recent fiscal years.

(9) Management's proxy statement, or the report, shall contain an undertaking in bold face or otherwise reasonably prominent type to provide without charge to each person solicited, on the written request of any such person, a copy of the issuer's annual report on Form 10-K (§ 249.310) including the financial statements and the schedules thereto, required to be filed with the Commission pursuant to Rule 13a-1 (§ 240.13a-1) under the Act for the issuer's most recent fiscal year and shall indicate the name and address of the person to whom such a written request is to be directed. In the discretion of management, an issuer need not undertake to furnish without charge copies of all exhibits to its Form 10-K (§ 249.310) provided that the copy of the annual report on Form 10-K (§ 249.310) furnished without charge to requesting security holders is accompanied by a list briefly describing all the exhibits not contained therein and indicating that the issuer will furnish any exhibit upon the payment of a specific reasonable fee which fee shall be limited to the issuer's reasonable expenses in furnishing such exhibit.

NOTE: Pursuant to the undertaking required by the above paragraph (b)(9), an issuer shall furnish a copy of its annual report on Form 10-K (§ 249.310) to a beneficial owner of its securities upon receipt of a written request from such person. Each request must set forth a good faith representation that, as of the record date for the annual meeting of the issuer's security holders, the person making the request was a beneficial owner of securities entitled to vote at such meeting.

(10) Subject to the foregoing requirements, the report may be in any form deemed suitable by management and the information required by paragraphs (b)(4) to (b)(9) of this section may be presented in an appendix or other separate section of the report, provided that the attention of security holders is called to such presentation.

NOTE: Issuers are encouraged to utilize tables, schedules, charts, and graphic illustrations to present financial information in an understandable manner. Any presentation of financial information must be con**sistent with the data in the financial statements contained in the report and, if appropriate, should refer to relevant portions of the financial statements and notes thereto.**

(11) Paragraphs (b)(4) through (b)(10) of this section shall not apply to an investment company registered under the Investment Company Act of 1940. Subject to the requirements of paragraphs (b)(1) through (b)(3) of this section, the annual report to security holders of such investment company may be in any form deemed suitable by management.

(12) This paragraph (b) of this section shall not apply, however, to solicitations made on behalf of the management before the financial statements are available if solicitation is being made at the time in opposition to the management and if the management's proxy statement includes an undertaking in bold face type to furnish such annual report to all persons being solicited, at least 20 days before the date of the meeting.

(c) Seven copies of the report sent to security holders pursuant to this rule shall be mailed to the Commission, solely for its information, not later than the date on which such report is first sent or given to security holders or the date on which preliminary copies of solicitation material are filed with the Commission pursuant to Rule 14a-6(a) (§ 240.14a-6(a)), whichever date is later. The report is not deemed to be "soliciting material" or to be "filed" with the Commission or subject to this regulation otherwise than as provided in this rule, or to the liabilities of section 18 of the Act, except to the extent that the issuer specifically requests that it be treated as a part of the proxy soliciting material or incorporates it in the proxy statement by reference.

NOTE: To assist the staff, managements of issuers are requested to indicate in a letter transmitting to the Commission copies of their annual reports to shareholders or in a separate letter at or about the time the annual report is furnished to the Commission, whether the financial statements in the report reflect a change from the preceding year in any accounting principles or practices or in the method of applying any such principles or practices.

(d) If the issuer knows that securities of any class entitled to vote at a meeting with respect to which the issuer intends to solicit proxies, consents or authorization are held of record by a broker, dealer, bank or voting trustee, or their nominees, the issuer shall inquire of such record holder at least 10 days prior to the record date for the meeting of security holders (or at such later time as the rules of a national securities exchange on which the class of securities in question is listed may permit for good cause shown) whether other persons are the beneficial owners of such securities and, if so, the number of copies of the proxy and other soliciting material and, in the case of an annual meeting at which directors are to be elected, the number of copies of the annual report to security holders, necessary to supply such material to beneficial owners. The issuer shall supply such record holder in a timely manner with additional copies in such quantities, assembled in such form and at such a place, as the record holder may reasonably request in order to address and send one copy of each to each beneficial owner of securities so held and shall, upon the request of such record holder, pay its reasonable expenses for completing the mailing of such material to security holders to whom the material is sent.

NOTE 1: If the issuer's list of security holders indicates that some of its securities are registered in the name of a clearing agency registered pursuant to Section 17A of the Act, an issuer shall make appropriate inquiry of the agency and thereafter of the participants in such agency who may hold on behalf of a beneficial owner, and shall comply with the above paragraph with respect to any such participant.

NOTE 2: The requirement for sending an annual report to security holders of record having the same address will be satisfied by sending at least one report to a holder of record at that address provided that those holders of record to whom a report is not sent agree thereto in writing. This procedure is not available to issuers, however, where banks, broker dealers, and other persons hold securities in nominee accounts or "street names" on behalf of beneficial owners, and such persons are not relieved of any obligation to obtain or send such annual report to the beneficial owners.

NOTE 3: The attention of issuers' is called to the fact that broker-dealers have an obligation pursuant to 240.14b-1 and applicable self-regulatory requirements to obtain and forward annual reports and proxy soliciting materials to beneficial owners for whom such broker-dealers hold securities.

(Sec. 6, 7, 8, 10, 19(a), 48 Stat. 78, 79, 81, 85, secs. 12, 13, 14, 15(d), 23(a), 48 Stat. 892, 894, 901; secs. 205, 209, 48 Stat. 906, 908; sec. 203(a), 49 Stat. 704; secs. 1, 3, 8, 49 Stat. 1375, 1377, 1379; sec. 301, 54 Stat. 857; secs. 8, 202, 68 Stat. 685, 686; secs. 3, 4, 5, 6, 78 Stat. 565-568, 569, 570-574; sec. 1, 79 Stat. 1051; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3-5, 28(c), 84 Stat. 1435, 1497; sec. 105(b), 88 Stat. 1503; secs. 8, 9, 10, 11, 18, 89 Stat. 117, 118, 119, 121, 155; 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 78l, 78m, 78n, 78l(d), 78w(a).)

[39 FR 40768, Nov. 20, 1974, as amended at 42 FR 24064, May 12, 1977; 42 FR 35955, July 13, 1977; 42 FR 65560, Dec. 30, 1977]

§ 240.14a-4 Requirements as to proxy.

(a) The form of proxy (1) shall indicate in bold-face type whether or not the proxy is solicited on behalf of the management (2) shall provide a specifically designated blank space for dating the proxy and (3) shall identify clearly and impartially each matter or group of related matters intended to be acted upon, whether proposed by the management or by security holders. No reference need be made, however, to proposals as to which discretionary authority is conferred pursuant to paragraph (c) of this section.

(b) (1) Means shall be provided in the form of proxy whereby the person solicited is afforded an opportunity to specify by ballot a choice between approval or disapproval of each matter or group of related matters referred to therein as intended to be acted upon, other than elections to office. A proxy may confer discretionary authority with respect to matters as to which a choice is not so specified provided the form of proxy states in bold-face type how it is intended to vote the shares represented by the proxy in each such case.

(2) A form of proxy which provides both for the election of directors and for action on other specified matters shall be prepared so as clearly to provide, by a box or otherwise, means by which the security holder may withhold authority to vote for the election

of directors. Any such form of proxy which is executed by the security holder in such manner as not to withhold authority to vote for the selection of directors shall be deemed to grant such authority, provided the form of proxy so states in bold-face type.

Instruction. Subparagraph (2) of this paragraph does not apply (i) in the case of a merger, consolidation or other plan if the election of directors is an integral part of the plan and is not to be separately voted upon or (ii) if the only matters to be acted upon are the election of directors and the election, selection or approval of other persons such as clerks or auditors.

(c) A proxy may confer discretionary authority to vote with respect to any of the following matters:

(1) Matters which the persons making the solicitation do not know, a reasonable time before the solicitation, are to be presented at the meeting, if a specific statement to that effect is made in the proxy statement or form of proxy;

(2) Approval of the minutes of the prior meeting if such approval does not amount to ratification of the action taken at that meeting;

(3) The election of any person to any office for which a bona fide nominee is named in the proxy statement and such nominee is unable to serve or for good cause will not serve.

(4) Any proposal omitted from the proxy statement and form of proxy pursuant to § 240.14a-8 or § 240.14a-9.

(5) Matters incident to the conduct of the meeting.

(d) No proxy shall confer authority (1) to vote for the election of any person to any office for which a bona fide nominee is not named in the proxy statement, or (2) to vote at any annual meeting other than the next annual meeting (or any adjournment thereof) to be held after the date on which the proxy statement and form of proxy are first sent or given to security holders. A person shall not be deemed to be a bona fide nominee and he shall not be named as such unless he has consented to being named in the proxy statement and to serve if elected.

(e) The proxy statement or form of proxy shall provide, subject to reasonable specified conditions, that the shares represented by the proxy will be voted and that where the person solicited specifies by means of a ballot provided pursuant to paragraph (b) of this section a choice with respect to any matter to be acted upon, the shares will be voted in accordance with the specifications so made.

(Sec. 14, 48 Stat. 895; 15 U.S.C. 78n)

[17 FR 11432, Dec. 18, 1952, as amended at 31 FR 212, Jan. 7, 1966; 32 FR 20963, Dec. 29, 1967]

§ 240.14a-5 Presentation of information in proxy statement.

(a) The information included in the proxy statement shall be clearly presented and the statements made shall be divided into groups according to subject matter and the various groups of statements shall be preceded by appropriate headings. The order of items and sub-items in the schedule need not be followed. Where practicable and appropriate, the information shall be presented in tabular form. All amounts shall be stated in figures. Information required by more than one applicable item need not be repeated. No statement need be made in response to any item or sub-item which is inapplicable.

(b) Any information required to be included in the proxy statement as to terms of securities or other subject matter which from a standpoint of practical necessity must be determined in the future may be stated in terms of present knowledge and intention. To the extent practicable, the authority to be conferred concerning each such matter shall be confined within limits reasonably related to the need for discretionary authority. Subject to the foregoing, information which is not known to the persons on whose behalf the solicitation is to be made and which it is not reasonably within the power of such persons to ascertain or procure may be omitted, if a brief statement of the circumstances rendering such information unavailable is made.

(c) There may be omitted from the proxy statement any information contained in any other proxy soliciting material which has been furnished to each person solicited in connection with the same meeting or subject matter if a clear reference is made to the particular document containing such information.

(d) All printed proxy statements shall be in roman type at least as large and as legible as 10-point modern type, except that to the extent necessary for convenient presentation financial statements and other tabular data, but not the notes thereto, may be in roman type at least as large and as legible as 8-point modern type. All such type shall be leading at least 2 points.

(e) All proxy statements shall disclose on the first page thereof the complete mailing address, including ZIP code, of the principal executive offices of the issuer and the approximate date on which the proxy statement and form of proxy are first sent or given to security holders.

[17 FR 11432, Dec. 18, 1952, as amended at 36 FR 8935, May 15, 1971, as amended at 37 FR 23179, Oct. 31, 1972]

§ 240.14a-6 Material required to be filed.

(a) Five preliminary copies of the proxy statement and form of proxy and any other soliciting material to be furnished to security holders concurrently therewith shall be filed with the Commission at least 10 days prior to the date definitive copies of such material are first sent or given to security holders, or such shorter period prior to that date as the Commission may authorize upon a showing of good cause therefor. In computing the 10-day period the filing date of the preliminary material is to be counted as the first day and the 11th day is the date on which definitive material may be mailed to security holders.

NOTE: The officials responsible for the preparation of the preliminary material should make every effort to verify the accuracy and completeness of the information required by the applicable rules. The preliminary material should be filed with the Commission at the earliest practicable date. It should be accompanied by a letter, over the signature of an officer of the company or its counsel, stating whether the current preliminary material merely reflects an updating of the prior year's material (e.g., changes in the board of directors or nominees for election to the board) or includes changes of a material nature. All changes from the previously filed material should be identified in an accompanying marked copy of the proxy statement. If a change is material, the letter should include any explanatory comment which may be of assistance in the expeditious processing of the material.

(b) Five preliminary copies of any additional soliciting material, relating to the same meeting or subject matter, furnished to security holders subsequent to the proxy statement shall be filed with the Commission at least 2 days (exclusive of Saturdays, Sundays, and holidays) prior to the date copies of such material are first sent or given to security holders, or such shorter period prior to such date as the Commission may authorize upon a showing of good cause therefor.

(c) Eight definitive copies of the proxy statement, form of proxy and all other soliciting material, in the form in which such material is furnished to security holders, shall be filed with, or mailed for filing to, the Commission not later than the date such material is first sent or given to any security holders. Three copies of such material shall at the same time be filed with, or mailed for filing to, each national securities exchange upon which any class of securities of the issuer is listed and registered.

NOTE: The definitive material filed with the Commission should be accompanied by a letter indicating any material changes which have been made therein, other than those made in response to the staff's comments and, whenever possible, should also be accompanied by a marked copy of the definitive material indicating all changes made therein.

(d) If the solicitation is to be made in whole or in part by personal solicitation, three copies of all written instructions or other material which discusses or reviews, or comments upon the merits of, any matter to be acted upon and which is furnished to the individuals making the actual solicitation for their use directly or indirectly in connection with the solicitation shall be filed with the Commission by the person on whose behalf the solicitation is made at least five days prior to the date copies of such material are first sent or given to such individuals, or such shorter period prior to that date as the Commission may authorize upon a showing of good cause therefor.

(e) All copies of material filed pursuant to paragraph (a) or (b) of this section shall be clearly marked "Preliminary Copies" shall be for the information of the Commission only and shall not be deemed available for public inspection before definitive material has been filed with the Commission except that such material may be disclosed to any department or agency of the United States Government and to the Congress and the Commission may make such inquiries or investigation in regard to the material as may be necessary for an adequate review thereof by the Commission. All preliminary material filed pursuant to paragraph (a) or (b) of this section shall be accompanied by a statement of the date on which definitive copies thereof filed pursuant to paragraph (c) of this section are intended to be released to security holders. All definitive material filed pursuant to paragraph (c) of this section shall be accompanied by a statement of the date on which copies of such material have been released to security holders, or, if not released, the date on which copies thereof are intended to be released. All material filed pursuant to paragraph (d) of this section shall be accompanied by a statement of the date on which copies thereof are intended to be released to the individuals who will make the actual solicitation.

(f) Copies of replies to inquiries from security holders requesting further information and copies of communications which do no more than request that forms of proxy theretofore solicited be signed and returned need not be filed pursuant to this section.

NOTE: Where preliminary copies of materials are filed with the Commission pursuant to paragraph (a), the printing of definitive copies for distribution to security holders should be deferred until the comments of the Commission's staff have been received and considered.

(g) Notwithstanding the provisions of paragraphs (a) and (b) of this section and of § 240.14a-11(e), copies of soliciting material in the form of speeches, press releases and radio or television scripts may, but need not, be filed with the Commission prior to use or publication. Definitive copies, however, shall be filed with or mailed for filing to the Commission as required by paragraph (c) of this section not later than the date such material is used or published. The provisions of paragraphs (a) and (b) of this section and of § 240.14a-11(e) shall apply, however, to any reprints or reproductions of all or any part of such material.

(h) Where any proxy statement, form of proxy or other material filed pursuant to this section is amended or revised, two of the copies of such amended or revised material filed pursuant to this section (or in the case of investment companies registered under the Investment Company Act of 1940, three of such copies) shall be marked to indicate clearly and precisely the changes effected therein. If the amendment or revision alters the text of the material the changes in such text shall be indicated by means of underscoring or in some other appropriate manner.

(i) At the time of filing the preliminary proxy solicitation material, the persons upon whose behalf the solicitation is made, other than companies registered under the Investment Company Act of 1940, shall pay to the Commission, the following applicable fee: (1) For preliminary proxy material which solicits proxies for election of directors or other business for which a stockholder vote is necessary, but apparently no controversy is involved, a fee of $125; (2) for proxy material where a contest as set forth in Rule 14a-11 is involved a fee of $500 from each party to the controversy; and (3) for proxy material involving acquisitions or mergers, a fee of $1,000. Where both companies involved in the acquisition or merger must file proxy material with the Commission, each shall pay $500 of the fee. There shall be no refunds.

(j) Notwithstanding the foregoing provisions of this section, any proxy statement, form of proxy or other soliciting material included in a registration statement filed under the Securities Act of 1933 on Form S-14 (§ 239.23 of this chapter) shall be deemed filed both for the purposes of that Act and for the purposes of this section, but separate copies of such material need not be furnished pursuant to this section nor shall any fee be required under paragraph (i) of this section. However, any additional soliciting material used after the effective date of the registration statement on Form S-14 shall be filed in accordance with this section but separate copies of such material need not be filed as an amendment of such registration statement.

(15 U.S.C. 77 b, d, e, s, 78l-n, 80a-20, 80a-37)

[17 FR 11432, Dec. 18, 1952, as amended at 21 FR 578, Jan. 28, 1956; 26 FR 3810, May 3, 1961; 30 FR 4753, Apr. 14, 1965; 32 FR 1036, Jan. 28, 1967; 32 FR 20963, Dec. 29, 1967; 37 FR 1472, Jan. 29, 1972; 37 FR 23637, Nov. 7, 1972; 41 FR 53784, Dec. 9, 1976]

§ 240.14a-7 Mailing communications for security holders.

If the management of the issuer has made or intends to make any solicitation subject to §§ 240.14a-1 to 240.14a-10, the issuer shall perform such of the following acts as may be duly requested in writing with respect to the same subject matter or meeting by any security holder who is entitled to vote on such matter or to vote at such meeting and who shall defray the reasonable expenses to be incurred by the issuer in the performance of the act or acts requested.

(a) The issuer shall mail or otherwise furnish to such security holder the following information as promptly as practicable after the receipt of such request:

(1) A statement of the approximate number of holders of record of any class of securities, any of the holders of which have been or are to be solicited on behalf of the management, or any group of such holders which the security holder shall designate.

(2) If the management of the issuer has made or intends to make, through bankers, brokers or other persons any solicitation of the beneficial owners of securities of any class, a statement of the approximate number of such beneficial owners, or any group of such owners which the security holder shall designate.

(3) An estimate of the cost of mailing a specified proxy statement, form of proxy or other communication to such holders, including insofar as known or reasonably available, the estimated handling and mailing costs of the bankers, brokers or other persons specified in subparagraph (2) of this paragraph.

(b)(1) Copies of any proxy statement, form of proxy or other communication furnished by the security holder shall be mailed by the issuer to such of the holders of record specified in paragraph (a)(1) of this section as the security holder shall designate. The issuer shall also mail to each banker, broker, or other person specified in paragraph (a)(2) of this section a sufficient number of copies of such proxy statement, form of proxy or other communication as will enable the banker, broker, or other person to furnish a copy thereof to each beneficial owner solicited or to be solicited through him.

(2) Any such material which is furnished by the security holder shall be mailed with reasonable promptness by the issuer after receipt of a tender of the material to be mailed, of envelopes or other containers therefor and of postage or payment for postage. The issuer need not, however, mail any such material which relates to any matter to be acted upon at an annual meeting of security holders prior to the earlier of (i) a day corresponding to the first date on which management proxy solicited material was released to security holders in connection with the last annual meeting of security holders, or (ii) the first day on which solicitation is made on behalf of management. With respect to any such material which relates to any matter to be acted upon by security holders otherwise than at an annual meeting, such material need not be mailed prior to the first day on which solicitation is made on behalf of management.

(3) Neither the management nor the issuer shall be responsible for such

proxy statement, form of proxy or other communication.

(c) In lieu of performing the acts specified in paragraphs (a) and (b) of this section, the issuer may at its option, furnish promptly to such security holder a reasonably current list of the names and addresses of such of the holders of record specified in paragraph (a)(1) of this section as the security holder shall designate, and a list of the names and addresses of such of the bankers, brokers or other persons specified in paragraph (a)(2) of this section as the security holder shall designate together with a stateme..t of the approximate number of beneficial owners solicited or to be solicited through each such banker, broker or other person and a schedule of the handling and mailing costs of each such banker, broker or other person if such schedule has been supplied to the management of the issuer. The foregoing information shall be furnished promptly upon the request of the security holder or at daily or other reasonable intervals as it becomes available to the management of the issuer.

[17 FR 11433, Dec. 18, 1952, as amended at 21 FR 578, Jan. 26, 1956]

§ 240.14a-8 Proposals of security holders.

(a) If any security holder of an issuer notifies the management of the issuer of his intention to present a proposal for action at a forthcoming meeting of the issuer's security holders, the management shall set forth the proposal in its proxy statement and identify it in its form of proxy and provide means by which security holders can make the specification required by Rule 14a-4(b) (17 CFR 240.14a-4(b)). Notwithstanding the foregoing, the management shall not be required to include the proposal in its proxy statement or form of proxy unless the security holder (hereinafter, the "proponent") has complied with the requirements of this paragraph and paragraphs (b) and (c) of this section:

(1) *Eligibility.* At the time he submits the proposal, the proponent shall be a record or beneficial owner of a security entitled to be voted at the meeting on his proposal, and he shall continue to own such security through the date on which the meeting is held. If the management requests documentary support for a proponent's claim that he is a beneficial owner of a voting security of the issuer, the proponent shall furnish appropriate documentation within 10 business days after receiving the request. In the event the management includes the proponent's proposal in its proxy soliciting materials for the meeting and the proponent fails to comply with the requirement that he continuously be a voting security holder through the meeting date, the management shall not be required to include any proposals submitted by the proponent in its proxy soliciting materials for any meeting held in the following two calendar years.

(2) *Notice.* The proponent shall notify the management in writing of his intention to appear personally at the meeting to present his proposal for action. The proponent shall furnish the requisite notice at the time he submits the proposal, except that if he was unaware of the notice requirement at that time he shall comply with it within 10 business days after being informed of it by the management. If the proponent, after furnishing in good faith the notice required by this provision, subsequently determines that he will be unable to appear personally at the meeting, he shall arrange to have another security holder of the issuer present his proposal on his behalf at the meeting. In the event the proponent or his proxy fails, without good cause, to present the proposal for action at the meeting, the management shall not be required to include any proposals submitted by the proponent in its proxy soliciting materials for any meeting held in the following two calendar years.

(3) *Timeliness.* The proponent shall submit his proposal sufficiently far in advance of the meeting so that it is received by the management within the following time periods:

(i) *Annual Meetings.* A proposal to be presented at an annual meeting shall be received by the management at the issuer's principal executive offices not less than 90 days in advance of a date corresponding to the date set forth on the management's proxy statement released to security holders in connection with the previous year's annual meeting of security holders, except that if no annual meeting was held in the previous year or the date of the annual meeting has been changed by more than 30 calendar days from the date of the previous year's annual meeting a proposal shall be received by the management a reasonable time before the solicitation is made.

(ii) *Other Meetings.* A proposal to be presented at any meeting other than an annual meeting shall be received a reasonable time before the solicitation is made.

NOTE.—In order to curtail controversy as to the date on which a proposal was received by the management, it is suggested that proponents submit their proposals by Certified Mail-Return Receipt Requested.

(4) *Number and Length of Proposals.* The proponent may submit a maximum of two proposals of not more than 200 words each for inclusion in the management's proxy materials for a meeting of security holders. If the proponent fails to comply with either of these requirements, or if he fails to comply with the 200-word limit on supporting statements mentioned in paragraph (b) of this section, he shall be provided the opportunity by the management to reduce, within 10 business days, the items submitted by him to the limits required by this rule.

(b) If the management opposes any proposal received from a proponent, it shall also, at the request of the proponent, include in its proxy statement a statement of the proponent of not more than 200 words in support of the proposal, which statement shall not include the name and address of the proponent. The statement and request of the proponent shall be furnished to the management at the time that the proposal is furnished, and neither the management nor the issuer shall be responsible for such statement. The proxy statement shall also include either the name and address of the proponent or a statement that such information will be furnished by the issuer or by the Commission to any person, orally or in writing as requested, promptly upon the receipt of any oral or written request therefor. If the name and address of the proponent are omitted from the proxy statement, they shall be furnished to the Commission at the time of filing the management's preliminary proxy material pursuant to Rule 14a-6(a) (17 CFR 240.14a-6(a)).

(c) The management may omit a proposal and any statement in support thereof from its proxy statement and form of proxy under any of the following circumstances:

(1) The proposal is, under the laws of the issuer's domicile, not a proper subject for action by security holders;

NOTE.—A proposal that may be improper under the applicable state law when framed as a mandate or directive may be proper when framed as a recommendation or request.

(2) If the proposal would, if implemented, require the issuer to violate any state law or federal law of the United States, or any law of any foreign jurisdiction, to which the issuer is subject, except that this provision shall not apply with respect to any foreign law compliance with which would be violative of any state law or federal law of the United States;

(3) If the proposal or the supporting statement is contrary to any of the Commission's proxy rules and regulations, including Rule 14a-9 (17 CFR 240.14a-9), which prohibits false or misleading statements in proxy soliciting materials;

(4) If the proposal relates to the enforcement of a personal claim or the redress of a personal grievance against the issuer, its management, or any other person;

(5) If the proposal deals with a matter that is not significantly related to the issuer's business;

(6) If the proposal deals with a matter that is beyond the issuer's power to effectuate;

(7) If the proposal deals with a matter relating to the conduct of the ordinary business operations of the issuer;

(8) If the proposal relates to an election to office;

(9) If the proposal is counter to a proposal to be submitted by the management at the meeting;

(10) If the proposal has been rendered moot;

(11) If the proposal is substantially duplicative of a proposal previously submitted to the management by another proponent, which proposal will be included in the management's proxy materials for the meeting;

(12) If substantially the same proposal has previously been submitted to security holders in the management's proxy statement and form of proxy relating to any annual or special meeting of security holders held within the preceding 5 calendar years, it may be omitted from the management's proxy materials relating to any meeting of security holders held within 3 calendar years after the latest such previous submission:

Provided, That—(i) If the proposal was submitted at only one meeting during such preceding period, it received less than 3 percent of the total number of votes cast in regard thereto; or

(ii) If the proposal was submitted at only two meetings during such preceding period, it received at the time of its second submission less than 6 percent of the total number of votes cast in regard thereto; or

(iii) If the proposal was submitted at three or more meetings during such preceding period, it received at the time of its latest submission less than 10 percent of the total number of votes cast in regard thereto; and

(13) If the proposal relates to specific amounts of cash or stock dividends.

(d) Whenever the management asserts, for any reason, that a proposal and any statement in support thereof received from a proponent may properly be omitted from its proxy statement and form of proxy, it shall file with the Commission, not later than 50 days prior to the date the preliminary copies of the proxy statement and form of proxy are filed pursuant to Rule 14a-6(a), or such shorter period prior to such date as the Commission or its staff may permit, five copies of the following items: (1) The proposal; (2) any statement in support thereof as received from the proponent; (3) a statement of the reasons why the management deems such omission to be proper in the particular case; and (4) where such reasons are based on matters of law, a supporting opinion of counsel. The management shall at the same time, if it has not already done so, notify the proponent of its intention to omit the proposal from its proxy statement and form of proxy and shall forward to him a copy of the statement of reasons why the management deems the omission of the proposal to be proper and a copy of such supporting opinion of counsel.

(Sec. 5, 78 Stat. 569, 570; sec. 18, 89 Stat. 133 (15 U.S.C. 78n(a), 78w(a)); secs. 12(e), 20(a), 49 Stat. 823, 833 (15 U.S.C. 79l(e), 79t(a)); secs. 20(a), 38(a), 54 Stat. 822, 841 (15 U.S.C. 80a-20(a), 80a-37(a)).)

[41 FR 53000, Dec. 3, 1976]

§ 240.14a-9 False or misleading statements.

(a) No solicitation subject to this regulation shall be made by means of any proxy statement, form of proxy, notice of meeting or other communication, written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statements therein not false or misleading or necessary to correct any statement in any earlier communication with respect to the solicitation of a proxy for the same meeting or subject matter which has become false or misleading.

(b) The fact that a proxy statement, form of proxy or other soliciting material has been filed with or examined by the Commission shall not be deemed a finding by the Commission that such material is accurate or complete or not false or misleading, or that the Commission has passed upon the merits of or approved any statement contained therein or any matter to be acted upon by security holders. No representation contrary to the foregoing shall be made.

NOTE: The following are some examples of what, depending upon particular facts and circumstances, may be misleading within the meaning of this section.

(a) Predictions as to specific future market values or dividends.

(b) Material which directly or indirectly impugns character, integrity or personal reputation, or directly or indirectly makes charges concerning improper, illegal or immoral conduct or associations, without factual foundation.

(c) Failure to so identify a proxy statement, form of proxy and other soliciting material as to clearly distinguish it from the soliciting material of any other person or persons soliciting for the same meeting or subject matter.

(d) Claims made prior to a meeting regarding the results of a solicitation.

[31 FR 212, Jan. 7, 1966, as amended at 41 FR 19932, May 14, 1976]

§ 240.14a-10 Prohibition of certain solicitations.

No person making a solicitation which is subject to §§ 240.14a-1 to 240.14a-10 shall solicit:

(a) Any undated or postdated proxy; or

(b) Any proxy which provides that it shall be deemed to be dated as of any date subsequent to the date on which it is signed by the security holder.

[17 FR 11434, Dec. 18, 1952]

§ 240.14a-11 Special provisions applicable to election contests.

(a) *Solicitations to which this section applies.* This section applies to any solicitation subject to §§ 240.14a-1 to 240.14a-11 by any person or group of persons for the purpose of opposing a solicitation subject to §§ 240.14a-1 to 240.14a-11 by any other person or group of persons with respect to the election or removal of directors at any annual or special meeting of security holders.

(b) *Participant or participant in a solicitation.* For purposes of this rule the terms "participant" and "participant in a solicitation" include the following:

(1) The issuer;

(2) Any director of the issuer, and any nominee for whose election as a director proxies are solicited;

(3) Any committee or group which solicits proxies, any member of such committee or group, and any person whether or not named as a member who, acting alone or with one or more other persons directly or indirectly takes the initiative, or engages, in organizing, directing, or arranging for the financing of, any such committee or group;

(4) Any person who finances or joins with another to finance the solicitation of proxies, except persons who contribute not more than $500 and who are not otherwise participants;

(5) Any person who lends money or furnishes credit or enters into any other arrangements, pursuant to any contract or understanding with a participant, for the purpose of financing or otherwise inducing the purchase, sale, holding or voting of securities of the issuer by any participant or other persons, in support of or in opposition to a participant; except that such terms do not include a bank, broker or dealer who, in the ordinary course of business, lends money or executes orders for the purchase or sale of securities and who is not otherwise a participant; and

(6) Any other person who solicits proxies. The foregoing terms do not, however, include (i) any person or organization retained or employed by a participant to solicit security holders and whose activities are limited to the performance of his duties in the course of such employment; (ii) any person who merely transmits proxy soliciting material or performs other ministerial or clerical duties; (iii) any person employed by a participant in the capacity of attorney, accountant, or advertising, public relations or financial adviser, and whose activities are limited to the performance of his duties in the course of such employment; (iv) any person regularly employed as an officer or employee of the issuer or any of its subsidiaries who is not otherwise a participant; or (v) any officer or director of, or any person regularly employed by, any other participant, if such officer, director or employee is not otherwise a participant.

(c) *Filing of information required by Schedule 14B* (1) No solicitation subject to this section shall be made by any person other than the manageent of an issuer unless at least five usiness days prior thereto, or such horter period as the Commission may uthorize upon a showing of good ause therefor, there has been filed, ith the Commission and with each ational securities exchange upon hich any security of the issuer is sted and registered, by or on behalf f each participant in such solicitation, a statement in duplicate containg the information specified by chedule 14B.

(2) Within five business days after a olicitation subject to this section is made by the management of an issuer, r such longer period as the Commission may authorize upon a showing of ood cause therefor, there shall be led, with the Commission and with ach national securities exchange pon which any security of the issuer s listed and registered by or on behalf f each participant in such solicitation, other than the issuer, a statement in duplicate containing the information specified by Schedule 14B.

(3) If any solicitation on behalf of management or any other person has been made, or if proxy material is ready for distribution, prior to a solicitation subject to this section in opposition thereto, a statement in duplicate containing the information specified in Schedule 14B shall be filed by or on behalf of each participant in such prior solicitation, other than the issuer, as soon as reasonably practicable after the commencement of the solicitation in opposition thereto, with the Commission and with each national securities exchange on which any security of the issuer is listed and registered.

(4) If, subsequent to the filing of the statements required by paragraphs (c)(1), (2), and (3) of this section, additional persons become participants in a solicitation subject to this section, there shall be filed, with the Commission and each appropriate exchange, by or on behalf of each such person a statement in duplicate containing the information specified by Schedule 14B, within three business days after such person becomes a participant, or such longer period as the Commission may authorize upon a showing of good cause therefor.

(5) If any material change occurs in the facts reported in any statement filed by or on behalf of any participant, and appropriate amendment to such statement shall be filed promptly with the Commission and each appropriate exchange.

(6) Each statement and amendment thereto filed pursuant to this paragraph shall be part of the official public files of the Commission and for purposes of this regulation shall be deemed a communication subject to the provisions of § 240.14a-9.

(d) *Solicitations prior to furnishing required written proxy statement.* Notwithstanding the provisions of Rule 14a-3(a) (§ 240.14a-3(a)), a solicitation subject to this section may be made prior to furnishing security holders a written proxy statement containing the information specified in Schedule 14A (§ 240.14a-101) with respect to such solicitation: *Provided,* That—

(1) The statements required by paragraph (c) of this section are filed by or on behalf of each participant in such solicitation.

(2) No form of proxy is furnished to security holders prior to the time the written proxy statement required by Rule 14a-3(a) (§ 240.14a-3(a)) is furnished to security holders: *Provided, however,* That this paragraph (d) (2) shall not apply where a proxy statement then meeting the requirements of Schedule 14A (§ 240.14a-101) has been furnished to security holders by or on behalf of the person making the solicitation.

3) At least the information specified in Items 2(a) and 3(a) of the statement required by paragraph (c) of this section to be filed by each participant, or an appropriate summary thereof, is included in each communication sent or given to security holders in connection with the solicitation.

(4) A written proxy statement meeting the requirements of this regulation is sent or given to security holders at the earliest practicable date.

(e) *Solicitations prior to furnishing required written proxy statement; filing requirements.* Three copies of any soliciting material proposed to be

sent or given to security holders prior to the furnishing of the written proxy statement required by § 240.14a-3(a) shall be filed with the Commission in preliminary form, at least five business days prior to the date definitive copies of such material are first sent or given to security holders, or such shorter period as the Commission may authorize upon a showing of good cause therefor.

(f) *Application of this section to annual report.* Notwithstanding the provisions of § 240.14a-3 (b) and (c), three copies of any portion of the annual report referred to in § 240.14a-3(b) which comments upon or refers to any solicitation subject to this section, or to any participant in any such solicitation, other than the solicitation by the management, shall be filed with the Commission as proxy material subject to §§ 240.14a-1 to 240.14a-11. Such portion of the annual report shall be filed with the Commission in preliminary form at least five business days prior to the date copies of the report are first sent or given to security holders.

(g) *Application of § 240.14a-6.* The provisions of paragraphs (c), (d), (e), (f) and (g) of § 240.14a-6 shall apply to the extent pertinent, to soliciting material subject to paragraphs (e) and (f) of this section.

(h) *Use of reprints or reproductions.* In any solicitation subject to this section, soliciting material which includes, in whole or part, any reprints or reproductions of any previously published material shall:

(1) State the name of the author and publication, the date of prior publication, and identify any person who is quoted without being named in the previously published material.

(2) Except in the case of a public official document or statement, state whether or not the consent of the author and publication has been obtained to the use of the previously published material as proxy soliciting material.

(3) If any participant using the previously published material, or anyone on his behalf, paid, directly or indirectly, for the preparation or prior publication of the previously published material, or has made or proposes to make any payments or give any other consideration in connection with the publication or republication of such material, state the circumstances.

(Sec. 14, 48 Stat. 895; 15 U.S.C. 78n)

[21 FR 579, Jan. 26, 1956, as amended at 31 FR 212, Jan. 7, 1966; 32 FR 20964, Dec. 29, 1967; 33 FR 2993, Feb. 15, 1968]

§ 240.14a-12 Solicitation prior to furnishing required proxy statement.

(a) Notwithstanding the provisions of Rule 14a-3(a) (§ 240.14a-3(a)), a solicitation (other than one subject to Rule 14a-11 (§ 240.14a-11)) may be made prior to furnishing security holders a written proxy statement containing the information specified in Schedule 14A (§ 240.14a-101) with respect to such solicitation if—

(1) The solicitation is made in opposition to a prior solicitation or an invitation for tenders or other publicized activity, which if successful, could reasonably have the effect of defeating the action proposed to be taken at the meeting;

(2) No form of proxy is furnished to security holders prior to the time the written proxy statement required by Rule 14a-3(a) (§ 240.14a-3(a)) is furnished to security holders: *Provided, however,* That this paragraph (a)(2) shall not apply where a proxy statement then meeting the requirements of Schedule 14A (§ 240.14a-101) has been furnished to security holders by or on behalf of the person making the solicitation;

(3) The identity of the person or persons by or on whose behalf the solicitation is made and a description of their interests direct or indirect, by security holdings or otherwise, are set forth in each communication sent or given to security holders in connection with the solicitation, and

(4) A written proxy statement meeting the requirements of this regulation is sent or given to security holders at the earliest practicable date.

(b) Three copies of any soliciting material proposed to be sent or given to security holders prior to the furnishing of the written proxy statement required by Rule 14a-3(a)

§ 240.14a-3(a)) shall be filed with the Commission in preliminary form at least 5 business days prior to the date definitive copies of such material are first sent or given to security holders, or such shorter period as the Commission may authorize upon a showing of good cause therefor.

(Sec. 14, 48 Stat. 895; 15 U.S.C. 78n)

[31 FR 214, Jan. 7, 1966]

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

NOTES: A. Where any Item calls for information with respect to any matter to be acted upon and such matter involves other matters with respect to which information is called for by other items of this schedule, the information called for by such other items shall also be given. For example, a merger, consolidation, or acquisition or disposition of assets specified in Item 14, in which the security holders to be solicited will become or continue to be security holders of the surviving or acquiring company, shall be deemed to involve the election of directors if any person who will serve as a director of such company was not elected to such office by security holders of the issuer of the securities in respect of which proxies are to be solicited. In such case, Items 6 and 7 shall be answered with respect to each such person who will serve as a director of the surviving or acquiring company.

B. Where any item calls for information with respect to any matter to be acted upon at the meeting, such item need be answered in the management's soliciting material only with respect to proposals to be made by or on behalf of the management of the issuer.

C. Except as otherwise specifically provided, where any item calls for information for a specified period in regard to directors, officers or other persons holding specified positions or relationships, the information shall be given in regard to any person who held any of the specified positions or relationships at any time during the period. However, information need not be included for any portion of the period during which such person did not hold any such position or relationship provided a statement to that effect is made.

Item 1. Revocability of proxy. State whether or not the person giving the proxy has the power to revoke it. If the right of revocation before the proxy is exercised is limited or is subject to compliance with any formal procedure, briefly describe such limitation or procedure.

Item 2. Dissenters' rights of appraisal. Outline briefly the rights of appraisal or similar rights of dissenters with respect to any matter to be acted upon and indicate any statutory procedure required to be followed by dissenting security holders in order to perfect such rights. Where such rights may be exercised only within a limited time after the date of adoption of a proposal, the filing of a charter amendment or other similar act, state whether the persons solicited will be notified of such date.

Instruction. Indicate whether a security holder's failure to vote against a proposal will constitute a waiver of his appraisal or similar rights and whether a vote against a proposal will be deemed to satisfy any notice requirements under State law with respect to appraisal rights. If the State law is unclear, state what position will be taken in regard to these matters.

Item 3. Persons Making the Solicitation—(a) Solicitations not subject to § 240.14a-11 (Rule X-14A-11.) (1) If the solicitation is made by the management of the issuer, so state. Give the name of any director of the issuer who has informed the management in writing that he intends to oppose any action intended to be taken by the management and indicate the action which he intends to oppose.

(2) If the solicitation is made otherwise than by the management of the issuer, so state and give the names of the persons by whom and on whose behalf it is made.

(3) If the solicitation is to be made otherwise than by the use of the mails, describe the methods to be employed. If the solicitation is to be made by specially engaged employees or paid solicitors, state (i) the material features of any contract or arrangement for such solicitation and identify the parties, and (ii) the cost or anticipated cost thereof.

(4) State the names of the persons by whom the cost of solicitation has been or will be borne, directly or indirectly.

(b) *Solicitations subject to § 240.14a-11 (Rule X-14A-11).* (1) State by whom the solicitation is made and describe the methods employed and to be employed to solicit security holders.

(2) If regular employees of the issuer or any other participant in a solicitation have been or are to be employed to solicit security holders, describe the class or classes of employees to be so employed, and the manner and nature of their employment for such purpose.

(3) If specially engaged employees, representatives, or other persons have been or are to be employed to solicit security holders, state (i) the material features of any contract or arrangement for such solicitation and identify the parties, (ii) the cost or anticipated cost thereof, and (iii) the approximate number of such employees or employees of any other person (naming such other person) who will solicit security holders.

(4) State the total amount estimated to be spent and the total expenditures to date for, in furtherance of, or in connection with the solicitation of security holders.

(5) State by whom the cost of the solicitation will be borne. If such cost to be borne initially by any person other than the issuer, state whether reimbursement will be sought from the issuer, and, if so, whether the question of such reimbursement will be submitted to a vote of security holders.

Instruction. With respect to solicitations subject to § 240.14a-11 (Rule X-14A-11), costs and expenditures within the meaning of this Item 3 shall include fees for attorneys, accountants, public relations or financial advisers, solicitors, advertising, printing, transportation, litigation and other costs incidental to the solicitation, except that the issuer may exclude the amount of such costs represented by the amount normally expended for a solicitation for an election of directors in the absence of a contest, and costs represented by salaries and wages of regular employees and officers, provided a statement to that effect is included in the proxy statement.

Item 4. Interest of Certain Persons in Matters To Be Acted Upon—(a) Solicitations not subject to § 240.14a-11 (Rule X-14A-11). Describe briefly any substantial interest, direct or indirect, by security holdings or otherwise of each of the following persons in any matter to be acted upon, other than elections to office:

(1) If the solicitation is made on behalf of management, each person who has been a director or officer of the issuer at any time since the beginning of the last fiscal year.

(2) If the solicitation is made otherwise than on behalf of management, each person by whom or on whose behalf the solicitation is made.

Any person who would be a participant in a solicitation for purposes of § 240.14a-11 (Rule X-14A-11) as defined in paragraph (b) (2), (4), (5) and (6) thereof shall be deemed a person on whose behalf the solicitation is made for purposes of this paragraph (a).

(3) Each nominee for election as a director of the issuer.

(4) Each associate of the foregoing persons.

Instruction. Except in the case of a solicitation subject to this regulation made in opposition to another solicitation subject to this regulation, this sub-item (a) shall not apply to any interest arising from the ownership of securities of the issuer where the security holder receives no extra or special benefit not shared on a pro rata basis by all other holders of the same class.

(b) *Solicitations subject to § 240.14a-11 (Rule X-14A-11).* (1) Describe briefly any substantial interest, direct or indirect, by security holdings or otherwise, of each participant as defined in § 240.14a-11 (b) (2), (3), (4), (5) and (6) (Rule X-14A-11), in any matter to be acted upon at the meeting, and include with respect to each participant the information, or a fair and adequate summary thereof, required by Items 2(a), 2(d), 3, 4(b) and 4(c) of Schedule 14B.

(2) With respect to any person named in answer to Item 6 (b), described any substantial interest, direct or indirect, by security holdings or otherwise, that he has in any matter to be acted upon at the meeting, and furnish the information called for by Item 4(b) and (c) of Schedule 14B.

Item 5. Voting Securities and Ownership Thereof By Certain Beneficial Owners and Management. (a) State as to each class of voting securities of the issuer entitled to be voted at the meeting, the number of shares outstanding and the number of votes to which each class is entitled.

(b) Give the date as of which the record of security holders entitled to vote at the meeting will be determined. If the right to vote is not limited to security holders of record on that date, indicate the conditions under which other security holders may be entitled to vote.

(c) If action is to be taken with respect to the election of directors and if the persons solicited have cumulative voting rights, make a statement that they have such rights and state briefly the conditions precedent to the exercise thereof.

(d) Furnish the following information, as of the most recent practicable date, in substantially the tabular form indicated, with respect to any person (including any "group" as that term is used in section 13(d)(3) of the Act) who is known to the persons on whose behalf the solicitation is made to be the beneficial owner of more than five percent of any class of the issuer's voting securities. Show in Column (3) the total number of shares beneficially owned and in Column (4) the percent of class so owned. Of the number of shares shown in Column (3), indicate, by footnote or otherwise, the amount known to be shares with respect to which such listed beneficial owner has the right to acquire beneficial ownership as specified in Rule 13d-3(d)(1) under the Act (§ 240.13d-3(d)(1)).

(1) Title of class	(2) Name and address of beneficial owner	(3) Amount beneficially owned	(4) Percent of class

(e) Furnish the following information, as of the most recent practicable date, in substantially the tabular form indicated, as to each class of voting securities of the issuer or of its parents, other than directors' qualifying shares, beneficially owned by all directors and officers of the issuer as a group, without naming them. Show in Column (2) the total number of shares beneficially owned and in Column (3) the percent of class so owned. Of the number of shares shown in Column (2), indicate, by footnote or otherwise, the amount of shares with respect to which such persons have the right to acquire beneficial ownership as specified in Rule 13d-3(d)(1) (§ 240.13d-3(d)(1)) under the Act.

(1) Title of class	(2) Amount beneficially owned	(3) Percent of class

(f) If, to the knowledge of the persons on whose behalf the solicitation is made, a change in control of the issuer has occurred since the beginning of its last fiscal year, state the name of the person(s) who acquired such control, the amount and the source of the consideration used by such person or persons, the basis of the control, the date and a description of the transaction(s) which resulted in the change of control and the percentage of voting securities of the issuer now beneficially owned directly or indirectly by the person(s) who acquired control, and the identity of the person(s) from whom control was assumed. If the source of all or any part of the consideration used is a loan made in the ordinary course of business by a bank as defined by section 3(a)(6) of the Act, the identity of such bank shall be omitted provided a request for confidentiality has been made pursuant to section 13(d)(1)(B) of the Act by the person(s) who acquired control. In lieu thereof, the material shall indicate that the identity of the bank has been so omitted and filed separately with the Commission.

Instructions. 1. State the terms of any loans or pledges obtained by the new control group for the purpose of acquiring control, and the names of the lenders or pledgees.

2. Any arrangements or understandings among members of both the former and new control groups and their associates with respect to election of directors or other matters should be described.

(g) Describe any contractual arrangements, including any pledge of securities of the issuer, or any of its parents, known to the persons on whose behalf the solicitation is made, the operation of the terms of which may at a subsequent date result in a change in control of the issuer.

Instructions. 1. The percentages are to be calculated on the basis of the amount of outstanding securities, excluding securities held by or for the account of the issuer or its subsidiaries; however, such calculations may be made on the basis of outstanding securities plus securities deemed outstanding pursuant to Rule 13d-3(d)(1) (§ 240.13d-3(d)(1)) under the Act provided appropriate disclosure is made as to the method of calculating.

2. For the purposes of this item, beneficial ownership shall be determined in accordance with Rule 13d-3 under the Act (§ 240.13d-3).

3. Persons on whose behalf the solicitation is made shall be deemed to know the contents of any statements filed with the Commission pursuant to section 13(d) of the Act. Such persons may rely upon information set forth in such statements unless they know or have reason to believe that such information is not complete or accurate or that a statement or amendment should have been filed and was not.

4. For purposes of furnishing information pursuant to paragraph (d), the source and date of such information may be indicated.

5. Where more than one beneficial owner is known to be listed for the same securities, appropriate disclosure should be made to avoid confusion.

6. Paragraph (g) does not require a description of ordinary default provisions contained in the charter, trust indentures or other governing instruments relating to securities of the issuer.

Item 6. Nominees and directors. (a) If action is to be taken with respect to the election of directors, furnish the following information, in tabular form to the extent practicable, with respect to each person nominated for election as a director and each other person whose term of office as a director will continue after the meeting:

(1) Name each such person, state when his term of office or the term of office for which he is a nominee will expire, and all other positions and offices with the issuer presently held by him, and indicate which persons are nominees for election as directors at the meeting.

(2) State his present principal occupation or employment and give the name and principal business of any corporation or other organization in which such employment is carried on. Furnish similar information as to all of his principal occupations or employments during the last five years, unless he is now a director and was elected to his present term of office by a vote of security holders at a meeting for which proxies were solicited under this regulation.

(3) If he is or has previously been a director of the issuer state the period or periods during which he has served as such.

(4) State, as of the most recent practicable date, the approximate amount of each class of equity securities of the issuer or any of its parents or subsidiaries, other than directors' qualifying shares, beneficially owned directly or indirectly by him. If he is not the beneficial owner of any such securities, make a statement to that effect.

(5) If more than 10 percent of any class of securities of the issuer or any of its parents or subsidiaries are beneficially owned by him and his associates, state the approximate amount of each class of such securities beneficially owned by such associates, naming each associate whose holdings are substantial.

Instruction. For purposes of this item, beneficial ownership shall be determined in accordance with Rule 13d-3 under the Act (§ 240.13d-3).

(b) If any nominee for election as a director is proposed to be elected pursuant to any arrangement or understanding between the nominee and any other person or persons, except the directors and officers of the issuer acting solely in that capacity, name such other person or persons and describe briefly such arrangement or understanding.

(c) If fewer nominees are named than the number fixed by or pursuant to the governing instruments, state the reasons for this procedure and that the proxies cannot be voted for a greater number of persons than the number of nominees named.

Item 7. Remuneration and other transactions with management and others. (See Note C at the beginning of this section). Furnish the information called for by this item if action is to be taken with respect to (i) the election of directors, (ii) any bonus, profit sharing or other remuneration plan, contract or arrangement in which any director, nominee for election as a director, or officer of the issuer will participate, (iii) any pension or retirement plan in which any such person will participate or (iv) the granting or extension to any such person of any options, warrants or rights to purchase any securities, other than warrants or rights issued to security holders, as such, on a pro rata basis. However, if the solicitation is made on behalf of persons other than the management, the information required need be furnished only as to nominees for election as directors and as to their associates.

(a) Furnish the following information in substantially the tabular form indicated below as to all direct remuneration paid by the issuer and its subsidiaries during the issuer's last fiscal year to the following persons for services in all capacities:

(1) Each director of the issuer whose aggregate direct remuneration exceeded $40,000 and each of the three highest paid officers of the issuer whose aggregate direct remuneration exceeded that amount, naming each such director and officer.

(2) All directors and officers of the issuer as a group, stating the number of persons in the group without naming them.

Name of individual or number of persons in group	Capacities in which remuneration was received	Aggregate direct remuneration
(A)	(B)	(C)

Instructions. 1. Paragraph (a)(1) of this item does not apply to any person who was not named as a director or officer of the issuer in answer to Item 7 of Form 10 in the first registration statement filed on that form for the registration of a class of securities pursuant to section 12 of the Act, provided (i) such person has not been a director or officer of the issuer since the filing of such statement and (ii) the same information is not otherwise required to be disclosed in material filed with the Commission.

2. The information is to be given on an accrual basis if practicable. The tables required by this paragraph (a) and paragraph (b) below may be combined if the issuer so desires.

3. Do not include remuneration paid to a partnership to which any director or officer was a partner, but see paragraph (f) below.

(b) Furnish the following information in substantially the tabular form indicated as to all annuity, pension, or retirement benefits proposed to be paid to the following persons in the event of retirement at normal retirement date pursuant to any existing plan provided or contributed to by the issuer or any of its subsidiaries:

(1) Each director or officer named in answer to paragraph (a)(1), naming each such person.

(2) All directors and officers of the issuer who are eligible for such benefits, as a group, stating the number of persons in the group without naming them.

Col. (A)	Col. (B)	Col. (C)
Name of individual or number of persons in group	Amount set aside or accrued during issuer's last fiscal year	Estimated annual benefits upon retirement

Instructions. 1. The term "plan" in this paragraph and in paragraph (c) includes all plans, contracts, authorizations or arrangements, whether or not set forth in any formal document.

2. Column (B) need not be answered with respect to payments computed on an actuarial basis under any plan which provides for fixed benefits in the event of retirement at a specified age or after a specified number of years of service. In such case, Columns (A) and (C) need not be answered with respect to directors and officers as a group.

3. The information called for by Column (C) may be given in the form of a table showing the annual benefits payable upon retirement to persons in specified salary classifications.

4. In the case of any plan (other than those specified in Instruction 2) where the amount set aside each year depends upon the amount of earnings of the issuer or its subsidiaries for such year or a prior year, or where it is otherwise impracticable to state the estimated benefits upon retirement, there shall be set forth, in lieu of the information called for by Column (C), the aggregate amount set aside or accrued to date, unless it is impracticable to do so, in which case there shall be stated the method of computing such benefits.

(d) Describe briefly all remuneration payments (other than payments reported under paragraph (a) or (c) of this item) proposed to be made in the future, directly or indirectly, by the issuer or any of its subsidiaries pursuant to any existing plan or arrangement to (i) each director or officer named in answer to paragraph (a)(1), naming each such person, and (ii) all directors and officers of the issuer as a group, without naming them.

Instruction. Information need not be included as to payments to be made for, or benefits to be received from, group life or accident insurance, group hospitalization or similar group payments or benefits. If it is impracticable to state the amount of remuneration payments proposed to be made, the aggregate amount set aside or accrued to date in respect of such payments should be stated, together with an explanation of the basis for future payments.

(e) Furnish the following information as to all options to purchase any securities, from the issuer or any of its subsidiaries, which were granted to or exercised by the following persons since the beginning of the issuer's last fiscal year, and as to all options held by such persons as of the latest practicable date: (i) Each director or officer named in answer to paragraph (a)(1), naming each such person; and (ii) all directors and officers of the issuer as a group, without naming them:

(1) As to options granted during the period specified (i) state the title and aggregate amount of securities called for; (ii) state the average option price per share and (iii) if the option price was less than 100 percent of the market value of the security on the date of grant, such fact and the market price on such date shall be disclosed.

(2) As to options exercised during the period specified, state (i) the title and aggregate amount of securities purchased; (ii) the aggregate purchase price and (iii) the aggregate market value of the securities purchased on the date of purchase.

3. (i) Where the total market value on the granting dates of the securities called for by all options granted during the period specified does not exceed $10,000 for any officer or director named in answer to paragraph (a)(1), or $40,000 for all officers and directors as a group, this item need not be answered with respect to options granted to such person or group. (ii) Where the total market value on the dates of purchase of all securities purchased through the exercise of options during the period specified does not exceed $10,000 for any such person or $40,000 for such group, this item need not be answered with respect to options exercised by such person or group. (iii) Where the total market value as of the latest practicable date of the securities called for by all options held at such time does not exceed $10,000 for any such person or $40,000 for such group, this item need not be answered with respect to options held as of the specified date by such person or group.

Instructions. 1. The term "options" as used in this paragraph (e) includes all options, warrants or rights, other than those issued to security holders as such on a pro rata basis. Where the average option price per share is called for, the weighted average price per share shall be given.

2. The extension, regranting or material amendment of options shall be deemed the granting of options within the meaning of this paragraph.

3. (i) Where the total market value on the granting dates of the securities called for by all options granted during the period specified does not exceed $10,000 for any officer or director named in answer to paragraph (a)(1), or $40,000 for all officers and directors as a group, this item need not be answered with respect to options granted to such person or group. (ii) Where the total market value on the dates of purchase of all securities purchased through the exercise of options during the period specified does not exceed $10,000 for any such person or $30,000 for such group, this item need not be answered with respect to options exercised by such person or group. (iii) Where the total market value as of the latest practicable date of the securities called for by all options held at such time does not exceed $10,000 for any such person or $30,000 for such group, this item need not be answered with respect to options held as of the specified date by such person or group.

4. The information called for by this paragraph may be furnished in the form of the table set forth in Appendix A (§ 240.14a-103). In such case, the information need be furnished only for the period specified in this paragraph and information need not be included as to shares sold during the period. However, if Item 9, 10, or 11 is required to be answered, all of the information specified in Appendix A must be furnished for the 5-year period referred to therein and need not be separately furnished for the period specified in this paragraph.

(e) State as to each of the following persons who was indebted to the issuer or its subsidiaries at any time since the beginning of the last fiscal year of the issuer, (i) the largest aggregate amount of indebtedness outstanding at any time during such period, (ii) the nature of the indebtedness and of the transaction in which it was incurred, (iii) the amount thereof outstanding as of the latest practicable date, and (iv) the rate of interest paid or charged thereon:

(1) Each director or officer of the issuer;

(2) Each nominee for election as a director; and,

(3) Each associate of any such director, officer or nominee.

Instructions. 1. Include the name of each person whose indebtedness is described and the nature of the relationship by reason of which the information is required to be given.

2. This paragraph does not apply to any person whose aggregate indebtedness did not exceed $10,000 or 1 percent of the issuer's total assets, whichever is less, at any time during the period specified. Exclude in the determination of the amount of indebtedness all amounts due from the particular person for purchases subject to usual trade terms, for ordinary travel and expense advances and for other transactions in the ordinary course of business.

3. Notwithstanding Instruction 2, if the issuer or any of its subsidiaries is engaged primarily in the business of making loans and loans to any of the specified persons in excess of $10,000 or 1 percent of its total assets, whichever is less, were outstanding at any time during the period specified, such loans shall be disclosed. However, if the lender is a bank, such disclosure may consist of a statement, if such is the case, that the loans to such persons (i) were made in the ordinary course of business, (ii) were made on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons, and (iii) did not involve more than normal risk of collectibility or present other unfavorable features.

4. If to the knowledge of the persons on whose behalf the solicitation is made, any indebtedness required to be described arose under Section 16(b) of the Act and has not been discharged by payment, sta e the amount of any profit realized, that such profit will inure to the benefit of the issuer or its subsidiaries and whether suit will be brought or other steps taken to recover such profit. If in the opinion of counsel a question reasonably exists as to the recoverability of such profit, it will suffice to state all facts necessary to describe the transaction, including the prices and number of shares involved.

(f) Describe briefly any transactions since the beginning of the issuer's last fiscal year or any presently proposed transactions, to which the issuer or any of its subsidiaries was or is to be a party, in which any of the following persons had or is to have a direct or indirect material interest, naming such person and stating his relationship to the issuer, the nature of his interest in the transaction and, where practicable, the amount of such interest:

(1) Any director or officer of the issuer;

(2) Any nominee for election as a director;

(3) Any security holder named in answer to Item 5(d); or

(4) Any relative or spouse of any of the foregoing persons, or any relative of such spouse, who has the same home as such person or who is a director or officer of any parent or subsidiary of the issuer.

Instructions. 1. No information need be given in response to this Item 7(f) as to any remuneration or other transaction reported in response to Item 7(a), (b), (c), (d), or (e), or as to any transaction with respect to which information may be omitted pursuant to Instruction 2 to Item 7(b), the Instruction to Item 7(c), Instruction 3 to Item 7(d) or Instruction 2 or 3 to Item 7(e).

2. No information need be given in answer to this Item 7(f) as to any transaction where—

(a) The rates or charges involved in the transaction are determined by competitive bids, or the transaction involves the rendering of services as a common or contract carrier, or public utility, at rates or charges fixed in conformity with law or governmental authority;

(b) The transaction involves services as a bank depositary of funds, transfer agent, registrar, trustee under a trust indenture, or similar services;

(c) The amount involved in the transaction or a series of similar transactions, including all periodic installments in the case of any lease or other agreement providing for periodic payments or installments, does not exceed $40,000; or

(d) The interest of the specified person arises solely from the ownership of securities of the issuer and the specified person receives no extra or special benefit not shared on a pro rata basis by all holders of securities of the class.

3. It should be noted that this item calls for disclosure of indirect, as well as direct, material interests in transactions. A person who has a position or relationship with a firm, corporation, or other entity, which engages in a transaction with the issuer or its subsidiaries may have an indirect interest in such transaction by reason of such position or relationship. However, a person shall be deemed not to have a material indirect interest in a transaction within the meaning of this Item 7(f) where—

(a) The interest arises only (i) from such person's position as a director of another corporation or organization (other than a partnership) which is a party to the transaction, or (ii) from the direct or indirect ownership by such person and all other persons specified in subparagraphs (1) through (4) above, in the aggregate, of less than a 10 percent equity interest in another person (other than a partnership) which is a party to the transaction, or (iii) from both such position and ownership;

(b) The interest arises only from such person's position as a limited partner in a partnership in which he and all other persons specified in (1) through (4) above had an interest of less than 10 percent; or

(c) The interest of such person arises solely from the holding of an equity interest (including a limited partnership interest but excluding a general partnership interest) or a creditor interest in another person which is a party to the transaction with the issuer or any of its subsidiaries and the transaction is not material to such other person.

4. The amount of the interest of any specified person shall be computed without regard to the amount of the profit or loss involved in the transaction. Where it is not practicable to state the approximate amount of the interest, the approximate amount involved in the transaction shall be indicated.

5. In describing any transaction involving the purchase or sale of assets by or to the issuer or any of its subsidiaries, otherwise than in the ordinary course of business, state the cost of the assets to the purchaser and, if acquired by the seller within 2 years prior to the transaction, the cost thereof to the seller.

6. The foregoing instructions specify certain transactions and interests as to which information may be omitted in answering this item. There may be situations where, although the foregoing instructions do not expressly authorize nondisclosure, the interest of a specified person in the particular transaction or series of transactions is not a material interest. In that case, information regarding such interest and transaction is not required to be disclosed in response to this item.

(g) Describe briefly any transactions since the beginning of the issuer's last fiscal year or any presently proposed transactions, to which any pension, retirement, savings or similar plan provided by the issuer, or any of its parents or subsidiaries, was or is to be a party, in which any of the following persons had or is to have a direct or indirect material interest, naming such person and stating his relationship to the issuer, the nature of his interest in the transaction and, where practicable, the amount of such interest:

(1) Any director or officer of the issuer;

(2) Any nominee for election as a director;

(3) Any security holder named in answer to Item 5(d);

(4) Any relative or spouse of any of the foregoing persons, or any relative of such spouse, who has the same home as such person or who is a director or officer of any parent or subsidiary of the issuer; or

(5) The issuer or any of its subsidiaries.

Instructions. 1. Instructions 2, 3, 4, and 5 to Item 7(f) shall apply to this Item 7(g).

2. Without limiting the general meaning of the term "transaction" there shall be included in answer to this item any remuneration received or any loans received or outstanding during the period, or proposed to be received.

3. No information need be given in answer to this item with respect to—

(a) Payments to the plan, or payments to beneficiaries, pursuant to the terms of the plan;

(b) Payment of remuneration for services not in excess of 5 percent of the aggregate remuneration received by the specified person during the issuer's last fiscal year from the issuer and its subsidiaries; or

(c) Any interest of the issuer or any of its subsidiaries which arises solely from its general interest in the success of the plan.

Item 8. Relationship with independent public accountants. If the solicitation is made on behalf of management of the issuer and relates to an annual meeting of security holders at which directors are to be elected, or financial statements are included pursuant to Item 15, furnish the following

information describing the issuer's relationship with its independent public accountants:

(a) The name of the principal accountant selected or being recommended to shareholders for election, approval or ratification for the current year. If no accountant has been selected or recommended, so state and briefly describe the reasons therefor.

(b) The name of the principal accountant for the fiscal year most recently completed if different from the accountant selected or recommended for the current year or if no accountant has yet been selected or recommended for the current year.

(c) If a change or changes in accountants have taken place since the date of the proxy statement for the most recent annual meeting of shareholders and if in connection with such change(s) a disagreement between the accountant and issuer has been reported on Form 8-K or in the accountant's letter filed as an exhibit thereto, the disagreement shall be described. Prior to submitting preliminary proxy material to the Commission which contains or amends such description, the issuer shall furnish the description of the disagreement to any accountant with whom a disagreement has been reported. If that accountant believes that the description of the disagreement is incorrect or incomplete, he may include a brief statement, ordinarily expected not to exceed 200 words, in the proxy statement presenting his view of the disagreement. This statement shall be submitted to the issuer within ten business days of the date the accountant receives the issuer's description.

(d) The proxy statement shall indicate whether or not representatives of the principal accountants for the current year and for the most recently completed fiscal year are expected to be present at the stockholders' meeting with the opportunity to make a statement if they desire to do so and whether or not such representatives are expected to be available to respond to appropriate questions.

(e) If the issuer has an audit or similar committee of the Board of Directors, state the names of the members of the committee. If the Board of Directors has no audit or similar committee, so state.

Item 9. Bonus, profit sharing and other remuneration plans. If action is to be taken with respect to any bonus, profit sharing or other remuneration plan, furnish the following information:

(a) Describe briefly the material features of the plan, identify each class of persons who will participate therein, indicate the approximate number of persons in each such class and state the basis of such participation.

(b) State separately the amounts which would have been distributable under the plan during the last fiscal year of the issuer (1) to directors and officers and (2) to employees if the plan had been in effect.

(c) State the name and position with the issuer of each person specified in Item 7(a), who will participate in the plan and the amount which each such person would have received under the plan for the last fiscal year of the issuer if the plan had been in effect.

(d) Furnish such information, in addition to that required by this item and Item 7, as may be necessary to describe adequately the provisions already made pursuant to all bonus, profit sharing, pension, retirement, stock option, stock purchase, deferred compensation, or other remuneration or incentive plans, now in effect or in effect within the past 5 years, for (i) each director or officer named in answer to Item 7(a) who may participate in the plan to be acted upon; (ii) all present directors and officers of the issuer as a group, if any director or officer may participate in the plan, and (iii) all employees, if employees may participate in the plan.

(e) If the plan to be acted upon can be amended otherwise than by a vote of stockholders, to increase the cost thereof to the issuer or to alter the allocation of the benefits as between the groups specified in (b), state the nature of the amendments which can be so made.

Instructions. 1. The term "plan" as used in this item means any plan as defined in Instruction 1 to Item 7(b).

2. If action is to be taken with respect to the amendment or modification of an existing plan, the item shall be answered with respect to the plan as proposed to be amended or modified and shall indicate any material differences from the existing plan.

3. The following instructions shall apply to paragraph (d):

(a) Information need only be given with respect to benefits received or set aside within the past 5 years.

(b) Information need not be included as to payments made for, or benefits to be received from, group life or accident insurance, group hospitalization or similar group payments or benefits.

(c) If action is to be taken with respect to any plan in which directors or officers may participate, the information called for by Item 7(d)(1) and (2) shall be furnished for the last 5 fiscal years of the issuer and any period subsequent to the end of the latest such fiscal year, in aggregate amounts for the entire period for each such person and group. If any named person, or any other director or officer, purchased securities through the exercise of options during such period, state the aggregate amount of securities of that class sold during the period by such named person and by such named person and such other directors and officers as a group. The information called for by this Instruction 3(c) is in lieu of the information since the beginning of the issuer's last fiscal year called for by Item 7(d)(1) and (2). If employees may participate in the plan to be acted upon, state the aggregate amount of securities called for by all options granted to employees during the 5-year period and, if the options were other than "restricted" or "qualified" stock options or options granted pursuant to an "employee stock purchase plan", as the quoted terms are defined in sections 422 through 424 of the Internal Revenue Code, state that fact and the weighted average option price per share. The information called for by this instruction may be furnished in the form of the table illustrated in Appendix A (§ 240.14a-103). See Instruction 1 to Item 7(d).

4. If the plan to be acted upon is set forth in a written document, three copies thereof shall be filed with the Commission at the time preliminary copies of the proxy statement and form of proxy are filed pursuant to paragraph (a) of Rule 14a-6 (§ 240.14a-6).

Item 10. Pension and retirement plans. If action is to be taken with respect to any pension or retirement plan, furnish the following information:

(a) Describe briefly the material features of the plan, identify each class of persons who will be entitled to participate therein, indicate the approximate number of persons in each such class and state the basis of such participation.

(b) State (1) the approximate total amount necessary to fund the plan with respect to past services, the period over which such amount is to be paid and the estimated annual payments necessary to pay the total amount over such period, (2) the estimated annual payment to be made with respect to current services and (3) the amount of such payments to be made for the benefit of (i) directors and officers and (ii) employees.

(c) State (1) the name and position with the issuer of each person specified in Item 7(a) who will be entitled to participate in the plan, (2) the amount which would have been paid or set aside by the issuer and its subsidiaries for the benefit of such person for the last fiscal year of the issuer if the plan had been in effect, and (3) the amount of the annual benefits estimated to be payable to such person in the event of retirement at normal retirement date.

(d) Furnish such information, in addition to that required by this item and Item 7, as may be necessary to describe adequately the provisions already made pursuant to all bonus, profit sharing, pension, retirement, stock option, stock purchase, deferred compensation or other remuneration or incentive plans, now in effect or in effect within the past five years, for (i) each director or officer named in answer to Item 7(a) who may participate in the plan to be acted upon; (ii) all present directors and officers of the issuer as a group, if any director or officer may participate in the plan, and (iii) all employees, if employees may participate in the plan.

(e) If the plan to be acted upon can be amended otherwise than by a vote of stockholders to increase the cost thereof to the issuer or alter the allocation of the benefits as between the groups specified in (b)(3), state the nature of the amendments which can be so made.

Instructions. 1. The term "plan" as used in this item means any plan as defined in Instruction 1 to Item 7(b). Instruction 2 to Item 9 shall apply to this item.

2. The information called for by paragraph (b)(2) or (c)(2) need not be given as to payments made on an actuarial basis pursuant to any group pension plan which provides for fixed benefits in the event of retirement at a specified age or after a specified number of years of service.

3. Instruction 3 to Item 9 shall apply to paragraph (d) of this item.

4. If the plan to be acted upon is set forth in a written document, three copies thereof shall be filed with the Commission at the time preliminary copies of the proxy statement and form of proxy are filed pursuant to paragraph (a) of Rule 14a-6 (17 CFR 240.14a-6).

Item 11. Options, warrants or rights. If action is to be taken with respect to the granting or extension of any options, warrants or rights to purchase securities of the issuer or any subsidiary, furnish the following information:

(a) State (i) the title and amount of securities called for or to be called for by such options, warrants or rights; (ii) the prices, expiration dates and other material conditions upon which the options, warrants or rights may be exercised; (iii) the consideration received or to be received by the issuer or subsidiary for the granting of extension of the options, warrants or rights; (iv) the market value of the securities called for or to be called for by the options, warrants or rights as of the latest practicable date, and (v) in the case of options, the Federal income tax consequences of the issuance and exercise of such options to the recipient and to the issuer.

(b) State separately the amount of options, warrants or rights received or to be received by the following persons, naming each such person: (i) each director or officer named in answer to Item 7(a); (ii) each nominee for election as a director of the

issuer; (iii) each associate of such directors, officers or nominees and (iv) each other person who received or is to receive 5 percent or more of such options, warrants or rights. State also the total amount of such options, warrants or rights received or to be received by all directors and officers of the issuer as a group, without naming them.

(c) Furnish such information, in addition to that required by this item and Item 7, as may be necessary to describe adequately the provisions already made pursuant to all bonus, profit sharing, pension, retirement, stock option, stock purchase, deferred compensation, or other remuneration or incentive plans, now in effect or in effect within the past 5 years, for (i) each director or officer named in answer to Item 7(a) who may participate in the plan to be acted upon; (ii) all present directors and officers of the issuer as a group, if any director or officer may participate in the plan, and (iii) all employees, if employees may participate in the plan.

Instructions. 1. The term "plan" as used in this item means any plan as defined in Instruction 1 to Item 7(b).

2. Paragraphs (b) and (c) do not apply to warrants or rights to be issued to security holders as such on a pro rata basis.

3. Instruction 3 to Item 9 shall apply to paragraph (c) of this item.

4. If the options described in answer to this item are issued pursuant to a plan which is set forth in a written document, three copies thereof shall be filed with the Commission at the time preliminary copies of the proxy statement and form of proxy are filed pursuant to paragraph (a) of § 240.14a-6.

NOTE: The Commission should be informed, as supplemental information, when the proxy statement in preliminary form is filed, as to when the options, warrants or rights and the shares called for thereby will be registered under the Securities Act of 1933, or if such registration is not contemplated the section of the Act or rule of the Commission under which exemption from such registration is claimed and the facts relied upon to make the exemption available.

Item 12. Authorization or issuance of securities otherwise than for exchange. If action is to be taken with respect to the authorization or issuance of any securities otherwise than for exchange for outstanding securities of the issuer, furnish the following information:

(a) State the title and amount of securities to be authorized or issued.

(b) Furnish a description of the securities such as would be required to be furnished in an application on the appropriate form for their registration on a national securities exchange. If the terms of the securities cannot be stated or estimated with respect to any or all of the securities to be authorized, because no offering thereof is contemplated in the proximate future, and if no further authorization by security holders for the issuance thereof is to be obtained, it should be stated that the terms of the securities to be authorized, including dividend or interest rates, conversion prices, voting rights, redemption prices, maturity dates, and similar matters will be determined by the board of directors. If the securities are additional shares of common stock of a class outstanding, the description may be omitted except for a statement of the preemptive rights, if any. Where the statutory provisions with respect to preemptive rights are so indefinite or complex that they cannot be stated in summarized form, it will suffice to make a statement in the form of an opinion of counsel as to the existence and extent of such rights.

(c) Describe briefly the transaction in which the securities are to be issued, including a statement as to (1) the nature and approximate amount of consideration received or to be received by the issuer, and (2) the approximate amount devoted to each purpose so far as determinable for which the net proceeds have been or are to be used. If it is impracticable to describe the transaction in which the securities are to be issued, state the reason, indicate the purpose of the authorization of the securities, and state whether further authorization for the issuance of the securities by a vote of security holders will be solicited prior to such issuance.

(d) If the securities are to be issued otherwise than in a general public offering for cash, state the reasons for the proposed authorization or issuance and the general effect thereof upon the rights of existing security holders.

Item 13. Modification or exchange of securities. If action is to be taken with respect to the modification of any class of securities of the issuer, or the issuance or authorization for issuance of securities of the issuer in exchange for outstanding securities of the issuer, furnish the following information:

(a) If outstanding securities are to be modified, state the title and amount thereof. If securities are to be issued in exchange for outstanding securities, state the title and amount of securities to be so issued, the title and amount of outstanding securities to be exchanged therefor and the basis of the exchange.

(b) Describe any material differences between the outstanding securities and the modified or new securities in respect of any of the matters concerning which information would be required in the description of the securities in an application on the appropriate form for their registration on a national securities exchange.

(c) State the reasons for the proposed modification or exchange and the general effect thereof upon the rights of existing security holders.

(d) Furnish a brief statement as to arrears in dividends or as to defaults in principal or interest in respect to the outstanding securities which are to be modified or exchanged and such other information as may be appropriate in the particular case to disclose adequately the nature and effect of the proposed action.

(e) Outline briefly any other material features of the proposed modification or exchange. If the plan of proposed action is set forth in a written document, file copies thereof with the Commission in accordance with § 240.14a-6 (Rule X-14A-6).

Instruction. If the existing security is presently listed and registered on a national securities exchange, state whether it is intended to apply for listing and registration of the new or reclassified security on such exchange or any other exchange. If it is not intended to make such application, state the effect of the termination of such listing and registration.

Item 14. Mergers, consolidations, acquisitions and similar matters. (See Note A at the beginning of this section.) Furnish the following information if action is to be taken with respect to any plan for (i) the merger or consolidation of the issuer into or with any other person or of any other person into or with the issuer, (ii) the acquisition by the issuer or any of its security holders of securities of another issuer, (iii) the acquisition by the issuer of any other going business or of the assets thereof, (iv) the sale or other transfer of all or any substantial part of the assets of the issuer, or (v) the liquidation or dissolution of the issuer.

(a) Outline briefly the material features of the plan. State the reasons therefor and the general effect thereof upon the rights of existing security holders. If the plan is set forth in a written document, file three copies thereof with the Commission at the time preliminary copies of the proxy statement and form of proxy are filed pursuant to Rule 14a-6(a) (17 CFR 240.14a-6(a)).

(b) Furnish the following information as to the issuer and each person which is to be merged into the issuer or into or with which the issuer is to be merged or consolidated or the business or assets of which are to be acquired or which is the issuer of securities to be acquired by the issuer in exchange for all or a substantial part of its assets or to be acquired by security holders of the issuer. Where [illegible] is required, information essential to an investor's appraisal of the action proposed [illegible].

(1) Describe briefly the business of such person. Information is to be given regarding pertinent matters such as the nature of the products or services, methods of production, markets, methods of distribution and the sources and supply of raw materials.

(2) State the location and describe the general character of the plants and other important physical properties of such person. The description is to be given from an economic and business standpoint, as distinguished from a legal standpoint.

(3) Furnish a brief statement as to dividends in arrears or defaults in principal or interest in respect of any securities of the issuer or of such person, and as to the effect of the plan thereon and such other information as may be appropriate in the particular case to disclose adequately the nature and effect of the proposed action.

(4) Furnish a tabulation in columnar form showing the existing and the pro forma capitalization.

(5) Furnish in columnar form for each of the last 5 fiscal years a historical summary of earnings and show per share amounts of net earnings, dividends declared for each year and book value per share at the end of the latest period.

(6) Furnish in columnar form for each of the last 5 fiscal years a combined pro forma summary of earnings, as appropriate in the circumstances, indicating the aggregate and per share earnings for each such year and the pro forma book value per share at the end of the latest period. If the transaction establishes a new basis of accounting for assets of any of the persons included therein, the pro forma summary of earnings shall be furnished only for the most recent fiscal year and interim period and shall reflect appropriate pro forma adjustments resulting from such new basis of accounting.

(7) To the extent material for the exercise of prudent judgment in regard to the matter to be acted upon, furnish the historical and pro forma earnings data specified in (5) and (6) above for interim periods of the current and prior fiscal years, if available.

(8) The financial information relating to the issuer's industry segments, classes of similar products or services, foreign and domestic operations and export sales shall be furnished in accordance with the provisions of paragraphs (b), (c) (1) (i) and (ii) of Item 1 of Regulation S-K, 17 CFR 229.20.

Instructions. 1. The earnings per share and dividends per share amounts required by paragraphs (5) (b) and (6) shall be presented in tabular form where appropriate and equated to a common basis in exchange transactions.

2. Include comparable data for any additional fiscal years necessary to keep the summary from being misleading. Subject to appropriate variation to conform to the

nature of the business or the purpose of the offering, the following items shall be included: net sales or operating revenues; cost of goods sold or operating expenses (or gross profit); interest charges; income taxes; net income; special items, and net income and special items. The summary shall reflect the retroactive adjustment of any material items affecting the comparability of the results.

3. In connection with any unaudited summary for an interim period or periods between the end of the last fiscal year and the balance sheet date, and any comparable unaudited prior period, a statement shall be made that all adjustments necessary to a fair statement of the results for such interim period or periods have been included. In addition, there shall be furnished in such cases, as supplemental information but not as a part of the proxy statement, a letter describing in detail the nature and amount of any adjustments, other than normal recurring accruals, entering into the determination of the results shown.

4. Paragraph (b) shall not apply if the plan described in answer to paragraph (a) involves only the issuer and one or more of its totally held subsidiaries.

(c) As to each class of securities of the issuer, or of any person specified in paragraph (b), which is admitted to dealing on a national securities exchange or with respect to which a market otherwise exists, and which will be materially affected by the plan, state the high and low sale prices (or, in the absence of trading in a particular period, the range of the bid and asked prices) for each quarterly period within two years. This information may be omitted if the plan involves merely the liquidation or dissolution of the issuer.

Item 15. Financial statements.

(a) If action is to be taken with respect to any matter specified in Item 12, 13, or 14 above, furnish certified financial statements of the issuer and its subsidiaries such as would currently be required in an original application for the registration of securities of the issuer under the Act. All schedules other than the schedules of supplementary profit and loss information may be omitted.

Instructions. 1. Such statements shall be prepared and certified in accordance with Regulation S-X (Part 210 of this chapter). One copy of the definitive proxy statement filed with the Commission shall include a manually signed copy of the accountant's certificate.

2. Such statements may be omitted with respect to a plan described in answer to Item 14(a) if the plan involves only the issuer and one or more of its totally held subsidiaries.

(b) If action is to be taken with respect to any matter specified in Item 14(b), furnish for each person specified therein, other than the issuer, financial statements such as would currently be required in an original registration statement for registration of securities of such person pursuant to section 12 of the Act. Such statements shall be certified if practicable. Notwithstanding the foregoing, the following may be omitted: (1) All schedules other than schedules of supplementary profit and loss information; (2) statements for any totally held subsidiary of the issuer which is included in the consolidated statement of the issuer and its subsidiaries, and (3) statements for a person which is to succeed to the issuer, or to the issuer and one or more of its totally held subsidiaries, provided the capital structure and balance sheet of the successor immediately after the succession will be substantially the same as those of the issuer or the combined capital structures and balance sheets of the issuer and its totally held subsidiaries, as the case may be.

Instructions. 1. Such statements shall be prepared in accordance with Regulation S-X (Part 210 of this chapter) and, if certified, shall be certified in accordance with that regulation and one copy of the definitive proxy statement filed with the Commission shall include a manually signed copy of the accountant's certificate.

2. Instruction 2 to paragraph (a) shall apply to this paragraph.

(c) The Commission may, upon the request of the issuer, permit the omission of any of the statements herein required where such statements are not necessary for the exercise of prudent judgment in regard to any matter to be acted upon, or may permit the filing in substitution therefor of appropriate statements of comparable character. The Commission may also require the filing of other statements in addition to, or in substitution for, the statements herein required in any case where such statements are necessary or appropriate for an adequate presentation of the financial condition of any person whose financial statements are required, or whose statements are otherwise material for the exercise of prudent judgment in regard to any matter to be acted upon. In the usual case, financial statements are deemed material to the exercise of prudent judgment where the matter to be acted upon is the authorization or issuance of a material amount of senior securities, but are not deemed material where the matter to be acted upon is the authorization or issuance of common stock, otherwise than in an exchange, merger, consolidation, acquisition or similar transaction.

(d) The proxy statement may incorporate by reference any financial statements contained in an annual report sent to security holders pursuant to § 240.14a-3 (Rule X-14A-3) with respect to the same meeting as that to which the proxy statement relates, provided such financial statements substantially meet the requirements of this item.

Item 16. Acquisition or disposition of property. If action is to be taken with respect to the acquisition or disposition of any property, furnish the following information:

(a) Describe briefly the general character and location of the property.

(b) State the nature and amount of consideration to be paid or received by the issuer or any subsidiary. To the extent practicable, outline briefly the facts bearing upon the question of the fairness of the consideration.

(c) State the name and address of the transferor or transferee, as the case may be, and the nature of any material relationship of such person to the issuer or any affiliate of the issuer.

(d) Outline briefly any other material features of the contract or transaction.

Item 17. Restatement of accounts. If action is to be taken with respect to the restatement of any asset, capital, or surplus account of the issuer, furnish the following information:

(a) State the nature of the restatement and the date as of which it is to be effective.

(b) Outline briefly the reasons for the restatement and for the selection of the particular effective date.

(c) State the name and amount of each account (including any reserve accounts) affected by the restatement and the effect of the restatement thereon. Tabular presentation of the amounts shall be made when appropriate, particularly in the case of recapitalizations.

(d) To the extent practicable, state whether and the extent, if any, to which, the restatement will, as of the date thereof, alter the amount available for distribution to the holders of equity securities.

Item 18. Action with respect to reports. If action is to be taken with respect to any report of the issuer or of its directors, officers or committees or any minutes of meeting of its stockholders, furnish the following information:

(a) State whether or not such action is to constitute approval or disapproval of any of the matters referred to in such reports or minutes.

(b) Identify each of such matters which it is intended will be approved or disapproved, and furnish the information required by the appropriate item or items of this schedule with respect to each such matter.

Item 19. Matters not required to be submitted. If action is to be taken with respect to any matter which is not required to be submitted to a vote of security holders, state the nature of such matter, the reasons for submitting it to a vote of security holders and what action is intended to be taken by the management in the event of a negative vote on the matter by the security holders.

Item 20. Amendment of charter, bylaws of other documents. (No change in the text of the item; the following new instruction is added to the item.)

Instruction. Where the matter to be acted upon is the classification of directors, state whether vacancies which occur during the year may be filled by the board of directors to serve only until the next annual meeting or may be so filled for the remainder of the full term.

Item 21. Other proposed action. If action is to be taken with respect to any matter not specifically referred to above, describe briefly the substance of each such matter in substantially the same degree of detail as is required by Items 5 to 20, inclusive, above.

Item 22. Vote required for approval. As to each matter which is to be submitted to a vote of security holders, other than elections to office or the selection or approval of auditors, state the vote required for its approval.

(Secs. 6, 7, 8, 10, 19(a), 48 Stat. 78, 79, 81, 85; secs. 12, 13, 14, 15(d), 23(a), 48 Stat. 892, 894, 901; secs. 205, 209, 48 Stat. 906, 908; sec. 203(a), 49 Stat. 704; secs. 1, 3, 8, 49 Stat. 1375, 1377, 1379; sec. 301, 54 Stat. 857; secs. 8, 202, 68 Stat. 685, 686; secs. 3, 4, 5, 6, 78 Stat. 565-568, 569, 570-574; sec. 1, 79 Stat. 1051; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3-5, 28(c), 84 Stat. 1435, 1497; sec. 105(b), 88 Stat. 1503; secs. 8, 9, 10, 11, 18, 89 Stat. 117, 118, 119, 121, 155; 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 78l, 78m, 78n, 78o(d), 78w(a).)

[17 FR 11434, Dec. 18, 1952, as amended at 31 FR 212, Jan. 7, 1966; 31 FR 475, Jan. 14, 1966; 31 FR 2592, Feb. 10, 1966; 32 FR 20772, Dec. 23, 1967; 32 FR 20934, Dec. 29, 1967; 33 FR 2995, Feb. 15, 1968; 34 FR 7574, May 10, 1969; 35 FR 2940, Feb. 15, 1970. Redesignated, 30 FR 14946, Nov. 3, 1965; 39 FR 3920, Jan. 30, 1974; 40 FR 1012, Jan. 6, 1975; 42 FR 4425, Jan. 25, 1977; 42 FR 12354, Mar. 3, 1977; 42 FR 15309, Mar. 21, 1977; 42 FR 65566, Dec. 30, 1977]

Effective Date Note: In § 240.14a-101, Items 5 and 6 of Schedule 14A were amended at 42 FR 12354, and Item 5 was corrected at 42 FR 15309, effective August 31, 1977. For a document deferring the effective date until April 30, 1978, see 42 FR 44456, Aug. 31, 1977. For the convenience of the user, the superseded text is set forth as follows:

§ 240.14a-101 Schedule 14A. Information required in proxy statement.

* * * * *

Item 5. Voting securities and principal holders thereof.

(a) * * *

* * * * *

(d) If to the knowledge of the persons on whose behalf the solicitation is made, any person owns of record or beneficially more than 10 percent of the outstanding voting securities of the issuer, name such person, state the approximate amount of such securities owned of record but not owned beneficially and the approximate amount owned beneficially by such person and the percentage of outstanding voting securities represented by the amount of securities so owned in each such manner.

(e) If, to the knowledge to the persons on whose behalf the solicitation is made, a change in control of the issuer has occurred since the beginning of its last fiscal year, state the name of the person(s) who acquired such control, the amount and the source of the consideration used by such person or persons; the basis of the control, the date and a description of the transaction(s) which resulted in the change of control and the percentage of voting securities of the issuers now beneficially owned directly or indirectly by the person(s) who acquired control; and the identity of the person(s) from whom control was assumed. If the source of all or any part of the consideration used is a loan made in the ordinary course of business by a bank as defined by Section 3(a)(6) of the Act, the identity of such bank shall be omitted provided a request for confidentiality has been made pursuant to Section 13(d)(1)(B) of the Act by the person(s) who acquired control. In lieu thereof, the material shall indicate that the identity of the bank has been so omitted and filed separately with the Commission.

Instructions. 1. State the terms of any loans or pledges obtained by the new control group for the purpose of acquiring control, and the names of the lenders or pledgees.

2. Any arrangements or understandings among members of both the former and new control groups and their associates with respect to election of directors or other matters should be described.

(f) Describe any contractual arrangements, including any pledge of securities of the issuer, or any of its parents, known to the persons on whose behalf the solicitation is made, the operation of the terms of which may at a subsequent date result in a change in control of the issuer.

Instruction. Paragraph (f) does not require a description of ordinary default provisions contained in the charter, trust indentures or other governing instruments relating to securities of the issuer.

Item 6. Directors and Officers.

(a) * * *

(5) If more than 10 percent of any class of securities of the issuer or any of its parents or subsidiaries are beneficially owned by him and his associates, state the approximate amount of each class of such securities beneficially owned by such associates, naming each associate whose holdings are substantial.

§ 240.14a-102 Schedule 14B. Information to be included in statements filed by or on behalf of a participant (other than the issuer) pursuant to § 240.14a-11(c) (Rule 14a-11(c)).

Instructions. 1. The item numbers and captions of the items shall be included but the text of the items may be omitted if the answers thereto are so prepared as to indicate clearly the coverage of the items. Answer every item. If an item is inapplicable or the answer is in the negative, so state. The information called for by Items 2(a) and 3(a) or a fair summary thereof is required to be included in all preliminary soliciting by Rule 14a-11(d)(3).

2. If the participant is a partnership, corporation, association or other business entity, the information called for by Item 2, 3 and 4(b) and (c) shall be given with respect to each partner, officer and director of such entity, and each person controlling such entity, who is not a participant.

Item 1. Issuer. State the name and address of the issuer.

Item 2. Identity and background. (a) State the following:

(1) Your name and business address.

(2) Your present principal occupation or employment and the name, principal business and address of any corporation or other organization in which such employment is carried on.

(b) State the following:

(1) Your residence address.

(2) Information as to all material occupations, positions, offices or employments during the last ten years, giving starting and ending dates of each and the name, principal business and address of any business corporation or other business organization in which each such occupation, position, office or employment was carried on.

(c) State whether or not you are or have been a participant in any other proxy contest involving this or other issuers within the past ten years. If so, identify the principals, the subject matter and your relationship to the parties and the outcome.

(d) State whether or not, during the past ten years, you have been convicted in a criminal proceeding (excluding traffic violations or similar misdemeanors) and, if so, give dates, nature of conviction, name and location of court, and penalty imposed or other disposition of the case. A negative answer to this sub-item need not be included in the proxy statement or other proxy soliciting material.

Item 3. Interests in securities of the issuer. (a) State the amount of each class of securities of the issuer which you own beneficially, directly or indirectly.

(b) State the amount of each class of securities of the issuer which you own of record but not beneficially.

(c) State with respect to all securities of the issuer purchased or sold within the past two years, the dates on which they were purchased or sold and the amount purchased or sold on each such date.

(d) If any part of the purchase price or market value of any of the shares specified in paragraph (c) is represented by funds borrowed or otherwise obtained for the purpose of acquiring or holding such securities, so state and indicate the amount of the indebtedness as of the latest practicable date. If such funds were borrowed or obtained otherwise than pursuant to a margin account or bank loan in the regular course of business of a bank, broker or dealer, briefly describe the transaction, and state the names of the parties.

(e) State whether or not you are, or were within the past year, a party to any contract, arrangements or understandings with any person with respect to any securities of the issuer, including, but not limited to joint ventures, loan or option arrangements, puts or calls, guarantees against loss or guarantees of profit, division of losses or profits, or the giving or withholding of proxies. If so, name the persons with whom such contracts, arrangements, or understandings exist and give the details thereof.

(f) State the amount of securities of the issuer owned beneficially, directly or indirectly, by each of your associates and the name and address of each such associate.

(g) State the amount of each class of securities of any parent or subsidiary of the issuer which you own beneficially, directly or indirectly.

Instruction. For purposes of this item, beneficial ownership shall be determined in accordance with Rule 13d-3 under the Act (§ 240.13d-3).

Item 4. Further matters. (a) Describe the time and circumstances under which you became a participant in the solicitation and state the nature and extent of your activities as a participant in the solicitation.

(b) Furnish for yourself and your associates the information required by Item 7(f) of Schedule 14A (§ 240.14a-101).

(c) State whether or not you or any of your associates have any arrangement or understanding with any person—

(1) With respect to any future employment by the issuer or its affiliates; or

(2) With respect to any future transactions to which the issuer or any of its affiliates will or may be a party.

If so, describe such arrangement or understanding and state the names of the parties thereto.

(d) State the total amount contributed and proposed to be contributed by you in furtherance of the solicitation, directly or indirectly. If such amount exceeds or will exceed $500 in the aggregate.

Item 5. Signature. The statement shall be dated and signed in the following manner:

I certify that the statements made in this statement are true, complete, and correct, to the best of my knowledge and belief.

____

(Signature of participant or authorized representative)

____

(Date)

Instruction. If the statement is signed on behalf of a participant by the latter's authorized representative, evidence of the representative's authority to sign on behalf of such participant shall be filed with the statement.

(Secs. 12, 13, 14, 15(d), 23, 48 Stat. 892, 894, 895, 901; sec. 203(a), 49 Stat. 704; secs. 1, 3, 8, 49 Stat. 1375, 1377, 1379; sec. 202, 68 Stat. 686; secs. 3, 4, 5, 6, 10, 78 Stat. 565-568, 569, 570-574, 580; secs. 1, 2, 3, 82 Stat. 454, 455; secs. 1, 2, 3-5, 28(c), 84 Stat. 1435, 1479; sec. 105(b), 88 Stat. 1503; secs. 8, 9, 10, 18, 89 Stat. 117, 118, 119, 155; 15 U.S.C. 78l, 78m, 78n, 78o(d), 78w.)

[31 FR 260, Jan. 20, 1966, as amended at 32 FR 215, Jan. 7, 1967; 32 FR 20961, Dec. 29, 1967. Redesignated at 40 FR 51656, Nov. 6, 1975, and amended at 42 FR 12354, Mar. 3, 1977]

Effective Date Note: In § 240.14a-102, Item 3 was amended at 42 FR 12354, effective August 31, 1977. For a document deferring the effective date until April 30, 1978, see 42 FR [illegible], Aug. 17, 1977. For the convenience of the user, the superseded text is set forth as follows:

§ 240.14a-102 Schedule 14B. Information to be included in statements filed by or on behalf of a participant (other than the issuer) pursuant to § 240.14a-11(c) (Rule 14a-11(c)).

Item 3. Interests in securities of the issuer. (g) State the amount of each class of securities of any parent or subsidiary of the issuer which you own beneficially, directly or indirectly.

§ 240.14a-103 Appendix A (to Schedule 14A (§ 240.14a-101)).

The table set forth below is an illustration of the presentation in tabular form of the information required (in § 240.14a-101), by Item 7(d) and Instruction 3(c) to Item 9(d), which also applies to Items 10(d) and 11(c). If only Item 7(d) applies and Items 9, 10, and 11 are inapplicable, information need only be furnished for the period specified in Item 7(d), information as to shares sold may be omitted, and the reference at the foot of the table to options granted to employees may be omitted. See Instruction 4 to Item 7(d). Other tabular presentations are, of course, acceptable if they include the necessary data. Tabular presentation may not be needed if only a very few options have been granted.

"The following tabulation shows as to certain directors and officers and as to all directors and officers as a group (i) the amount of options granted since the beginning of the fifth previous full fiscal year, (ii) the amount of shares acquired since that date through the exercise of options granted since that date or prior thereto, (iii) the amount of shares sold during such period of the same class as those so acquired, and (iv) the amount of shares subject to all unexercised options held as of ———— (Insert date)."

Common shares [1]	John Jones	James Smith	Richard Roe	All directors and officers as a group
Granted—196—to date:				
Number of shares				
Average per share option price	$	$	$	$
Exercised—196—to date:				
Number of shares				
Aggregate option price of options exercised	$	$	$	$
Aggregate market value of shares on date options exercised.	$	$	$	$
Sales—196—to date:				
Number of shares				([2])
Unexercised at 196—:				
Number of shares				
Average per share option price	$	$	$	$

In addition, during the period employees were granted options for —— share at an average option price per share of $——.

[1] All common share figures have been adjusted in accordance with the terms of the options to reflect the stock split in 19— and, where applicable, to give effect to share dividends.

[2] Sales by directors and officers who exercised options during the period 19— to date.

(Sec. 14, 48 Stat. 895; 15 U.S.C. 78n)

[32 FR 20967, Dec. 29, 1967]

§ 240.14b-1 Obligation of registered brokers in connection with the prompt forwarding of certain communications to beneficial owners.

A broker registered under Section 15 of the Act shall:

(a) Respond to an inquiry made in accordance with § 240.14a-3(d) by or on behalf of an issuer whose management is soliciting proxies, consents or authorization by promptly indicating, by means of a search card or otherwise, the approximate number of its customers who are beneficial owners of the issuer's securities that are held of record by the broker or its nominees; and

(b) Upon receipt of the proxy, other proxy soliciting material, and/or annual reports to security holders and of assurances that its reasonable expenses shall be paid by the issuer, forward such materials promptly to such customers.

(Secs. 14(a), 14(b) and 23(a) (15 U.S.C. 78n(a), 78n(b), 78w(a)))

[42 FR 35955, July 13, 1977]

Regulation 14C: Distribution of Information Pursuant to Section 14(c)

Source: Sections 240.14c-1 to 240.14c-101 appear at 31 FR 262, Jan. 7, 1966, unless otherwise noted.

§ 240.14c-1 Definitions.

Unless the context otherwise requires, all terms used in this regulation have the same meanings as in the Act or elsewhere in the general rules and regulations thereunder. In addi-

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

March 30, 1979

Frances A. Ulmer
Director
Division of Policy Development
  and Planning
Pouch AD
Juneau, Alaska 99811

Dear Fran:

We want to correct a statement made recently to you in a memorandum from Avrom M. Gross, Attorney General, by Joseph K. Donohue, Assistant Attorney General. The date of the memorandum is March 19, 1979, and the subject is "Policy and Legal Issues Surrounding AGSOC Legislation". On Page Three, at the end of the first paragraph, there is the following statement:

> "The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS."

This statement is not accurate.

Our contract with the Alaskan Legislature specifically prohibited investigation into potential investments. See Page Two of the attached proposal which became part of the final contract.

Subsequently, Amendment I to the contract provided for:

> "(F) The contractor shall provide an analysis demonstrating how a direct investment in a pipeline would be made by an Alaskan General Stock Ownership Corporation."

We are quite sure that our oral testimony before various legislative committees has never indicated a recommendation for purchase of BP's interest in TAPS or any other investment opportunity.

In commenting on the urgency, as we see it, of getting the legislation enacted in the present legislative year, we have noted only that rapidly shifting world politics could affect the availability of an investment like the BP interest in TAPS, should the Board of AGSOC and the legislature conclude that particular acquisition to be of interest. That comment was not intended to be a recommendation, nor were recommendations requested of us.

We have not yet seen the text of the memorandum by Mr. Donohue, and we may well have other comments when we do.

We hope that this will help to clarify our interest.

With best regards,

Sincerely,

Louis O. Kelso

Louis O. Kelso

John Miskimen

John A. Miskimen

LOK/JAM:ch
Encls.

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

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 terminated on February 1, 1979 unless extended or terminated by written agreement.

CLAUSE III - PROJECT DIRECTOR

The Project Director shall be ______________________ c/o Legislative Finance Division, Pouch WF, Juneau, Alaska 99811.

CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT

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

(1) On the date this contract is executed, August 25, 1978: - $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.

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. 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.

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
President & Chief
Executive Officer

____
Date

THE STATE OF ALASKA

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

__________________________ ________
Sen. John Sackett Date
Chairman, Senate
Finance Committee

__________________________ ________
Rep. Steve Cowper Date
Chairman, House
Finance Committee

KELSO & CO.
INCORPORATED
INVESTMENT BANKERS

GREENSBORO, N.C. SAN FRANCISCO LOS ANGELES

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

July 10, 1978

INTRODUCTION

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

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

The 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.

> 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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STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

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

AMENDMENT I

to the

CONTRACT BETWEEN

STATE OF ALASKA
LEGISLATIVE FINANCE DIVISION

AND

KELSO & CO., INCORPORATED

The Legislative Finance Division and Kelso & Co., Incorporated hereby amend the contract to which they are parties as follows:

1. CLAUSE I - STATEMENT OF WORK is amended by adding the following paragraph:

> "(F) The contractor shall provide an analysis demonstrating how a direct investment in a pipeline would be made by an Alaskan General Stock Ownership Corporation."

2. CLAUSE II - PERIOD AND DATES OF PERFORMANCE is amended by:

   (a) deleting "February 1, 1979"; and

   (b) inserting "February 15, 1979" in both paragraphs (A) and (B)..

3. CLAUSE IV - COMPENSATION AND METHOD OF PAYMENT is amended by:

(a) deleting "$180,000" and inserting "205,000"; and

(b) adding the following sentence to subparagraph (1):

"On the date that Amendment I is executed - $25,000."

IN WITNESS WHEREOF, the parties have executed this amendment 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

January 15, 1979
Date

STATE OF ALASKA

Mike Colletta

Senator Mike Colletta
Project Director

Date

Jim Duncan

Rep. Jim Duncan
Project Director

1/12/79
Date

CHUGACH ELECTRIC ASSOCIATION, INC.

BY-LAWS

As Amended April 18, 1973

ARTICLE I

MEMBERSHIP

SECTION 1. Requirements for Membership. Any person, firm, association, corporation, or body politic, or subdivision thereof, may become a member of CHUGACH ELECTRIC ASSOCIATION, INC. by:

(a) Making a written application for membership therein;

(b) Agreeing to purchase from the Association electric energy as hereinafter specified;

(c) Agreeing to comply with, and be bound by, the articles of incorporation and by-laws of the Association, and any rules and regulations adopted by its board of directors; and

(d) Paying the membership fee hereinafter specified;

provided, however, that no person, firm, association, corporation, or body politic, or subdivision thereof, shall become a member unless and until he, or it, has been accepted for membership by the board of directors or the members. No person may hold more than one membership in the Association, and no membership in the Association shall be transferable, except as provided in these by-laws.

At each meeting of the members held subsequent to the expiration of a period of six months from the date of incorporation of the Association, all applications received more than ninety days prior to such meeting which have not been accepted, or which have been rejected by the board of directors, shall be submitted by the secretary to such meeting and, subject to compliance by the applicant with the requirements hereinabove set forth, any such application may be accepted by vote of the members. The secretary shall give each such applicant at least ten days written notice of the date of the members' meeting to which his application will be submitted, and such applicant shall be entitled to be present and heard at the meeting.

SECTION 2. Membership Certificates. Membership in the Association shall be evidenced by a membership certificate, which shall be in such form and shall contain such provisions as shall be determined by the board of directors. No membership certificate shall be issued for less than the membership fee fixed in these by-laws, nor until such membership fee has been paid. In case a certificate is lost, destroyed or mutilated, a new certificate may be issued therefor upon such uniform terms and indemnity to the Association as the board of directors may prescribe.

SECTION 3. Joint Membership. A husband and wife may apply for a joint membership and, subject to the compliance with the requirements set forth in Section 1 of this Article, may be accepted for such membership. The term "member" as used in these by-laws shall be deemed to include a husband and wife holding a joint membership, and any provisions relating to the rights and liabilities of membership shall apply equally with respect to the holders of a joint membership. Without limiting the generality of the foregoing, the effect of the hereinafter specified actions by, or in respect to, the holders of a joint membership shall be as follows:

(a) The presence at a meeting of either or both shall be regarded as the presence of one member and shall have the effect of constituting a joint waiver of notice of the meeting;

(b) The vote of either separately, or both jointly, shall constitute one joint vote;

(c) A waiver of notice signed by either or both shall constitute a joint waiver;

(d) Notice to either shall constitute notice to both;

(e) Expulsion of either shall terminate the joint membership;

(f) Withdrawal of either shall terminate the joint membership;

(g) Either, but not both, may be elected or appointed as an officer or director, provided that both meet the qualifications for such office.

SECTION 4. Conversion of Membership. (a) A membership may be converted to a joint membership upon the written request of the holder thereof, and the agreement by such holder, or his or her spouse, to comply with the articles of incorporation, by-laws, and rules and regulations adopted by the board of directors. The outstanding membership certificate shall be surrendered, and shall be reissued by the Association in such manner as shall indicate the changed membership status.

(b) Upon the death of either spouse who is a party to the joint membership, such membership shall be held solely by the survivor. The outstanding membership certificate shall be surrendered, and shall be reissued in such manner as shall indicate the changed membership status; provided, however, that the estate of the deceased shall not be released from any debts due the Association.

SECTION 5. Membership and Service Connection Fees. The membership fee shall be five dollars, upon the payment of which fee, the member shall be eligible for one service connection; provided, the board of directors may, as a condition to service, require the payment of a consumer deposit or the furnishing of other acceptable security in lieu thereof.

SECTION 6. Purchase of Electric Energy. Each member shall, as soon as electric energy shall be available, purchase from the Association all electric energy used on the premises specified in his application for membership, and shall pay therefor monthly at rates which shall from time to time be fixed by the board of directors; provided, however, that the board of directors may limit the amount of electric energy which the Association shall be required to furnish to any one member. Each member shall pay to the Association such minimum amount per month, regardless of the electric energy consumed, as shall be fixed by the board of directors from time to time. Each member shall also pay all amounts owed by him to the Association as and when the same shall become due and payable.

SECTION 7. Termination of Membership. (a) Any member may withdraw from membership upon compliance with such uniform terms and condition as the board of directors may prescribe. The board of directors of the Association may, by the affirmative vote of not less than two-thirds of all the directors, expel any member who fails to comply with any of the provisions of the articles of incorporation, by-laws, or rules or regulations adopted by the board of directors, but only if such member shall have been given written notice by the secretary of the Association that such failure makes him liable to expulsion, and such failure shall have continued for at least ten days after such notice was given. Any expelled member may be reinstated by vote of the board of directors, or by vote of the members at an annual or special meeting. If it appears that the best interest of the Association would be thereby served, the board of directors may, by resolution, cancel the membership of a member:

(1) who has ceased to purchase energy from the Association for a period of six (6) months;

(2) who had a disconnect order in effect for thirty (30) days without signing an order to reconnect; or

(3) to whom electric utility service has been discontinued because of the nonpayment of any moneys due the Association; provided, that such delinquency shall have continued for at least thirty (30) days after the discontinuance of such service.

(b) Upon the withdrawal, death, cessation of existence or expulsion of a member, the membership of such member shall thereupon terminate, and the membership certificate of such member shall be surrendered forthwith to the Association. Termination of membership in any manner shall not release a member or his estate from any debts due the Association.

(c) In case of withdrawal or termination of membership in any manner, the Association shall repay to the member the amount of the membership fee paid by him; provided, however, that the Association shall deduct from the amount of the membership fee the amount of any debts or obligations owing from the member to the Association.

ARTICLE II

RIGHTS AND LIABILITIES OF MEMBERS

SECTION 1. Property Interest of Members. Upon dissolution, after paying, or discharging, or adequately providing for the payment or discharge of all its debts, obligations and liabilities, other than those to patrons arising by reason of their patronage, the Association shall distribute any remaining sums, first to patrons for the pro rata return of all amounts standing to their credit by reason of their patronage, and second, to members for the pro rata repayment of membership fees. Any sums then remaining shall be distributed among its members and former members in proportion to their patronage, except as participation in such distribution may have been legally waived. In the event of the lawful liquidation, through transfer or sale of all the property and assets of the Association, the proceeds of such liquidation, transfer or sale shall be distributed in the same manner as hereinabove provided for in the case of dissolution.

SECTION 2. Non-liability for Debts of the Association. The private property of the members shall be exempt from execution or other liability for the debts of the Association, and no member shall be liable or responsible for any debts or liabilities of the Association.

ARTICLE III

MEETINGS OF MEMBERS

SECTION 1. Annual Meeting. The annual meeting of the members shall be held at such convenient date, on or after the 1st day of April, and on or before the 1st day of May of each year, at such place or building in the Anchorage Precinct, Third Judicial District, State of Alaska, as shall be designated by the board of directors on the notice of meeting, for the purpose of electing directors, passing upon reports for the previous fiscal year, and transacting such other business as may come before the meeting. Failure to hold the annual meeting at the designated time shall not work a forfeiture or dissolution of the Association.

SECTION 2. Special Meetings. Special meetings of the members may be called by resolution of the board of directors, or upon a written request signed by any three directors to the president, or by a written request made to the president and signed by a sufficient number of members to constitute a quorum as defined in Section 5, Article III, and it shall thereupon be the duty of the secretary to cause notice of such meeting to be given as hereinafter provided. Special meetings of the members may be held at any place within the Anchorage Precinct specified in the notice of the special meeting.

SECTION 3. Notice of Members' Meetings. Written or printed notice, stating the place, day and hour of the meeting and, in case of a special meeting, or an annual meeting at which business requiring special notice is to be transacted, the purpose or purposes for which the meeting is called, shall be delivered not less than thirty days before the date of the meeting, either personally or by mail, by or at the direction of the secretary, or upon a default in duty by the secretary, by the persons calling the meeting, to each member. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the member at his address as it appears on the records of the Association, with postage thereon prepaid. The failure of any member to receive notice of an annual or special meeting of the members shall not invalidate any action which may be taken by the members at any such meeting.

SECTION 4. Waiver of Notice. Any person entitled to notice of a meeting may waive such notice in writing, either before or after such meeting. If any such person shall attend such meeting, such attendance shall constitute a waiver of notice of such meeting, unless such person participates therein solely to object to the transaction of any business because the meeting has not been legally called or convened.

SECTION 5. Quorum. So long as the number does not exceed five hundred, ten per centum of the total number of members present in person shall constitute a quorum. If the total number of members shall exceed five hundred, fifty members, or three per centum of the members, whichever is the greater number, present in person, shall constitute a quorum. If less than a quorum is present at any meeting, a majority of those present in person may adjourn the meeting from time to time without further notice. If a meeting is called, but not held for lack of a quorum, the total number of members being in excess of five hundred, fifty members, or two per centum of the members, whichever is the greater number, shall constitute a quorum for each meeting subsequent thereto, whether convened by action of the members or otherwise, until a quorum is present and a meeting can be held, after which the quorum for the meeting next following shall revert to fifty members, or three per centum of the members, whichever is the greater number. The minutes of each meeting shall contain a list of the members present in person.

SECTION 6. Voting. Each member shall be entitled to only one vote upon each matter submitted to a vote at a meeting of the members. All questions shall be decided by a vote of a majority of the members voting thereon in person, except as otherwise provided by law, the articles of incorporation, or these by-laws.

SECTION 7. Order of Business. The order of business at the annual meeting of the members and, insofar as possible, at all other meetings of the members, shall be essentially as follows:

1. Report on the number of members present in person in order to determine the existence of a quorum.
2. Reading of the notice of the meeting and proof of the due publication or mailing thereof, or the waiver or waivers of notice of the meeting, as the case may be.
3. Reading of unapproved minutes of previous meetings of the members and the taking of necessary action thereon.
4. Presentation and consideration of reports of officers, directors and committees.
5. Election of directors.
6. Unfinished business.
7. New business.
8. Adjournment.

ARTICLE IV

DIRECTORS

SECTION 1. General Powers. The management of the business and the affairs of the Association shall be vested in a board of seven directors who shall exercise all of the powers of the Association, except such as are by law, the articles of incorporation, or by these by-laws conferred upon or reserved to the members.

SECTION 2. Election and Tenure of Office. The persons named as directors in the articles of incorporation shall compose the board of directors until the first annual meeting, or until their successors shall have been elected and shall have qualified. Directors shall be elected by secret ballot at annual meetings of the membership, by and from the members, to serve for a three-year term, or until their successors have been elected and qualified; provided, that directors elected to fill vacancies as provided in Article IV, Section 8 of these by-laws, as amended, shall serve only for the unexpired portion of the term vacated. At the first such election under this provision, members of the board shall be elected as follows: three members to one-year terms; two members to two-year terms; and two members to three-year terms. At each subsequent annual meeting, members shall be elected to fill the seats on the board which become vacant under the schedule hereby set forth, or which become vacant as contemplated by Article IV, Section 8 of these by-laws, as amended. If any election of directors shall not be held on the day designated herein for the annual meeting, or at any adjournment thereof, a special meeting of the members shall be held within a reasonable time thereafter for the purpose of electing directors. Directors may be elected by a plurality vote of the members.

SECTION 3. Qualifications. No person shall be eligible to become or remain a director, or to hold any position of trust in the Association, who:

(a) Is not a member and bona fide resident for at least one year in the area served or to be served by the Association; or

(b) Is in any way employed by, or financially interested in, a competing enterprise, or a business selling electric energy or supplies to the Association, or a business primarily engaged in selling electrical or plumbing appliances, fixtures or supplies to the members of the Association.

Upon establishment of the fact that a director is holding office in violation of any of the foregoing provisions, the board of directors shall remove such director from office.

Nothing contained in this section shall affect in any manner whatsoever the validity of any action taken at any meeting of the board of directors.

SECTION 4. Nominations. It shall be the duty of the board of directors to appoint, not less than sixty days before the date of a meeting of the members at which directors are to be elected, a committee on nominations, consisting of not less than five nor more than seven members, who shall be selected from different sections so as to insure equitable representation. No member of the board of directors may serve on such committee. The committee, keeping in mind the principle of geographical representation, shall prepare and post at the principal office of the Association, at least twenty days before the meeting, a list of nominations for directors, which may include a greater number of candidates than are to be elected. Any fifteen or more members, acting together, may make other nominations by petition not less than fifteen days prior to the meeting, and the secretary shall post such nominations at the same place where the list of nominations made by the committee is posted. The secretary shall mail with the notice of the meeting, or separately, but at least seven days before the date of the meeting, a statement of the number of directors to be elected and the names and addresses of the candidates, specifying separately the nominations made by the committee on nominations and the nominations made by petition, if any.

SECTION 5. General Manager. The board of directors may appoint a general manager, who may be, but who shall not be required to be, a member of the Association. The general manager, together with such other staff, agents, and employees as he may select with the consent of the board of directors shall perform such duties and shall exercise such authority as the board of directors may from time to time vest in him.

SECTION 6. Rules and Regulations. The board of directors shall have power to make, adopt and enforce such rules and regulations, not inconsistent with law, the articles of incorporation, or these by-laws, as it may deem advisable for the management of the affairs and business of the Association, for the protection of its investment, and for the interest and welfare of the members thereof.

SECTION 7. Removal of Directors by Members. Any member may bring charges against a director and, by filing with the secretary such charges in writing, together with a petition signed by at least a sufficient number of members to constitute a quorum as defined in Section 5, Article III, may request the removal of such director by reason thereof; provided, however, that the signatures of members shall be acceptable only when affixed to a sheet on which the petition therein is fully set forth; and, provided further, that the person who solicited the signatures affixed to such petition shall acknowledge thereon before a person authorized to take acknowledgments of deeds that he had read the petition and the said charges against such director to each of the members prior to the latter subscribing their names thereto. Such director shall be informed in writing of the charges at least ten days prio to the meeting of the members at which the charges are to be considered, and shall have an opportunity at the meeting to be heard in person, or by counsel, and to present evidence in respect of the charges; and the person or persons bringing the charges against him shall have the same opportunity. The question of the removal of such director shall be considered and voted upon at the meeting of the members, and any vacancy created by such removal may be filled by vote of the members at such meeting without compliance with the foregoing provisions with respect to nominations.

SECTION 8. Vacancies. Vacancies caused by the removal of directors by the members shall be filled as provided in Article IV, Section 7, above, subject, however, to the provisions of Article IV, Sections 2 and 3. Any other vacancy occurring in the board shall be filled by the affirmative vote of the majority of .he remaining directors, and the member so elected to the board shall serve until the next annual meeting of the members, or until his successor has been elected and qualified. At the annual meeting next following the existence of such vacancy, the members shall elect one of their number to serve as director during the unexpired portion of the term vacated, subject, however, to the provisions of Article IV, Sections 2, 3, and 4 of these by-laws.

SECTION 9. Compensation. Directors shall not receive any salary for their services as directors, except that, by resolution of the board of directors, a fixed per diem and travel expenses of attendance, if any, may be allowed for attendance at each meeting of the board of directors, or a meeting of a committee thereof, or when a director is otherwise representing the Association in an official capacity. No director shall receive compensation for serving the Association in any other capacity, nor shall any close relative of a director receive compensation for serving the Association, unless the payment and amount of compensation shall be specifically authorized by a vote of the members, or the service by such director or close relative shall have been certified by the board of directors as an emergency measure.

ARTICLE V

MEETINGS OF DIRECTORS

SECTION 1. Regular Meetings. A regular meeting of the board of directors shall be held without notice immediately after, and at the same place as, the annual meeting of the members. A regular meeting of the board of directors shall also be held monthly at such time and place in the Anchorage Precinct, Third Judicial District, State of Alaska, as the board of directors may provide by resolution. Such regular monthly meetings may be held without notice other than such resolution fixing the time and place thereof.

SECTION 2. Special Meetings. Special meetings of the board of directors may be called by the president, or by any three directors, and it shall thereupon be the duty of the secretary to cause notice of such meeting to be given as hereinafter provided. The president or the directors calling the meeting shall fix the time and place, which shall be in the Anchorage Precinct, Third Judicial District, State of Alaska, for the holding of the meeting.

SECTION 3. Notice of Directors' Meetings. Written notice of the time, place and purpose of any special meeting of the board of directors shall be delivered to each director not less than five days previous thereto, either personally or by mail, by or at the direction of the secretary, or upon a default in duty by the secretary, by the president or the directors calling the meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the director at his address as it appears on the records of the Association, with postage thereon prepaid.

SECTION 4. Quorum. A majority of the board of directors shall constitute a quorum; provided, that if less than a majority of the directors are present at said meeting, a majority of the directors present may adjourn the meeting from time to time; and, provided further, that the secretary shall notify any absent directors of the time and place of such adjourned meeting. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors.

SECTION 5. Attendance at Meetings. If a director is absent from three successive regular board meetings, such absences may, for good cause shown, be excused by the board. If such absences are not excused by the board, or if the director is absent from four successive regular board meetings, with or without good cause, he shall be deemed to have resigned from the board of directors, and the vacancy thereby resulting will be filled as provided in Article IV, Section 8, of these by-laws.

ARTICLE VI

OFFICERS

SECTION 1. Number. The officers of the Association shall be a president, vice-president, secretary and treasurer, and such other officers as may be determined by the board of directors from time to time. The offices of secretary and treasurer may be held by the same person.

SECTION 2. Election and Term of Office. The officers shall be electu annually by ballot, by and from the board of directors, at the meeting of the board of directors held immediately after the annual meeting of the members. If the election of officers shall not be held at such meeting, such election shall be held as soon thereafter as conveniently may be. Each officer shall hold office until the first meeting of the board of directors following the next succeeding annual meeting of the members, or until his successor shall have been elected and shall have qualified. A vacancy in any office shall be filled by the board of directors for the unexpired portion of the term

SECTION 3. Removal of Officers and Agents by Directors. Any officer or agent elected or appointed by the board of directors may be removed by the board of directors whenever in its judgment the best interests of the Association will be served thereby. In addition, any member of the Association may bring charges against an officer and, by filing with the secretary such charges in writing, together with a petition signed by at least a sufficient number of members to constitute a quorum as defined in Section 5, Article III, may request the removal of such officer by reason thereof; provided, however, that the signatures of members shall be acceptable only when affixed to a sheet on which petition therein is fully set forth; and, provided further, that the person who solicited the signatures affixed to such petition shall acknowledge thereon before a person authorized to take acknowledgments of deeds that he had read the petition and the said charges against such officer to each of the members prior to the latter subscribing their names thereto. The officer against whom such charges have been brought shall be informed in writing of the charges at least ten days prior to the board meeting at which the charges are to be considered and shall have an opportunity at the meeting to be heard in person, or by counsel, and to present evidence in respect of the charges; and the person or persons bringing the charges against him shall have the same opportunity. In the event the board does not remove the officer, the question of his removal shall be considered and voted upon at the next meeting of the members.

SECTION 4. President. The president shall:

(a) Be the principal executive officer of the Association and, unless otherwise determined by the members or the board of directors, shall preside at all meetings of the members and the board of directors;

(b) Sign any deeds, mortgages, deeds of trust, notes, bonds, contracts or other instruments authorized by the board of directors to be executed, except in cases in which the signing and execution thereof shall be expressly delegated by the board of directors or these by-laws to some other officer or agent of the Association, or shall be required by law to be otherwise signed or executed; and

(c) In general, perform all duties incident to the office of president and such other duties as may be prescribed by the board of directors from time to time.

SECTION 5. Vice-President. In the absence of the president, or in the event of his inability or refusal to act, the vice-president shall perform the duties of the president, and when so acting, shall have all the powers of, and be subject to all the restrictions upon, the president. The vice-president shall also perform such duties as from time to time may be assigned to him by the board of directors.

SECTION 6. Secretary. The secretary shall:

(a) Keep the minutes of the meetings of the members and of the board of directors in one or more books provided for that purpose;

(b) See that all notices are duly given in accordance with these by-laws, or as required by law;

(c) Be custodian of the corporate records and seal of the Association, and affix the seal of the Association to all documents, the execution of which on behalf of the Association under its seal is duly authorized in accordance with the provisions of these by-laws:

(d) Keep a register of the names and post office addresses of all members;

(e) Have general charge of the books of the Association;

(f) Keep on file at all times a complete copy of the articles of incorporation and by-laws of the Association containing all amendments thereto, which copy shall always be open to the inspection of any member, and at the expense of the Association, forward a copy of the by-laws and of all amendments thereto to each member; and

(g) In general perform all duties incident to the office of secretary, and such other duties as from time to time may be assigned to him by the board of directors.

SECTION 7. Treasurer. The treasurer shall:

(a) Have charge and custody of, and be responsible for, all funds and securities of the Association;

(b) Be responsible for the receipt of, and the issuance of receipts for, all moneys due and payable to the Association, and for the deposit of all such moneys in the name of the Association in such bank or banks as shall be selected in accordance with the provisions of these by-laws; and

(c) In general, perform all the duties incident to the office of treasurer and such other duties as from time to time may be assigned to him by the board of directors.

SECTION 8. Delegation of Duties. In the absence of an officer, or in the event of his inability or refusal to act, the board of directors will appoint one of their number to perform the duties of his office; provided, that the offices of president and vice-president may not be combined with any other office; and, provided further, nothing herein shall limit the right and duty of the vice-president to perform the duties of the president in the event that the president is absent, is unable to act, or refuses to act. The board of directors may provide for the delegation of one or more of the duties of the secretary and treasurer to the general manager, or to the general manager's designee.

SECTION 9. Bonds of Officers. The treasurer, and any other officer or agent of the Association charged with responsibility for the custody of any of its funds or property, shall give bond in such sum, and with such surety, as the board of directors shall determine. The board of directors, in its discretion, may also require any other officer, agent or employee of the Association to give bond in such amount and with such surety as it shall determine.

SECTION 10. Compensation. The powers, duties and compensation of officers, agents and employees shall be fixed by the board of directors, subject to the provisions of these by-laws with respect to compensation for directors and close relatives of directors.

SECTION 11. Reports. The officers of the Association shall submit, at each annual meeting of the members, reports covering the business of the Association for the previous fiscal year. Such reports shall set forth the condition of the Association at the close of such fiscal year.

ARTICLE VII

PATRONAGE CAPITAL

SECTION 1. Patronage Capital. The Association shall at all times be operated on a cooperative, nonprofit basis for the mutual benefit of its patrons. The Association's operations shall be so conducted that all patrons, members and non-members alike, will through their patronage furnish capital for the Association, subject to the provisions for sinking funds and reserves as provided by Article VIII of these by-laws.

In order to induce patronage and to assure that the Association will operate on a nonprofit basis, the Association is obliged to account on a patronage basis to all its patrons, members and non-members alike, for all amounts received from the furnishing of electric energy in excess of operating costs and expenses properly chargeable against the furnishing of electric energy. All such amounts in excess of operating costs and expenses, at the moment of receipt by the Association, are received with the understanding that they are furnished by the patrons, members and non-members alike, as capital. The Association is obligated to pay all such amounts in excess of operating costs and expenses to the patrons by credits to a capital account for each patron. The books and records of the Association shall be set up and kept in such a manner that at the end of each fiscal year the amount of capital, if any, so furnished by each patron, is clearly reflected and credited in an appropriate record to the capital account of each patron, and the Association shall within a reasonable time after the close of the fiscal year notify each patron of the amount of capital so credited to his account. All such amounts credited to the capital account of any patron shall have the same status as though they had been paid to the patron in cash in pursuance of a legal obligation to do so, and the patron had then furnished the Association corresponding amounts for capital. In the event of dissolution or liquidation of the Association, after all outstanding indebtedness of the Association shall have been paid, outstanding capital credits shall be retired without priority on a pro rata basis before any payments are made on account of property rights of members. If, at any time prior to dissolution or liquidation, the board of directors shall determine that the financial condition of the Association will not be impaired thereby, the capital then credited to patrons accounts may be retired in full or in part. Any such retirements of capital shall be made in order of priority according to the year in which the capital was furnished and credited, the capital first received by the Association being first retired. Capital credited to the account of each patron shall be assignable only on the books of the Association pursuant to written instructions from the assignor, and only to successors in interest or successors in occupancy in all or a part of such patron's premises served by the Association, unless the board of directors, acting under policies of general application, shall determine otherwise. All other amounts received by the Association from its operations in excess of costs and expenses shall, insofar as permitted by law, be:

(a) Used to offset any losses incurred during the current or any prior fiscal year; and

(b) To the extent not needed for that purpose, allocated to its patrons on a patronage basis, and any amount so allocated shall be included as part of the capital credited to the accounts of patrons, as herein provided.

In the event that a non-member patron shall elect to become a member of the Association, the capital credit to the account of such non-member patron may be supplied by the Association toward the payment of membership fee on behalf of such non-member patron.

Notwithstanding any other provision of these by-laws, the board of directors, at its discretion, shall have the power at any time, upon the death of any patron, if the legal representatives of his estate shall request in writing that the capital credited to any such patron be retired prior to the time such capital would otherwise be retired under the provisions of these by-laws, to retire capital credited to any such patron immediately upon such terms and conditions as the board of directors, acting under policies of general application, and the legal representatives of such patron's estate shall agree upon, provided, however, that the financial condition of the Association will not be impaired thereby.

ARTICLE VIII

FISCAL MANAGEMENT AND ACCOUNTING

SECTION 1. Revenues and Expenditures. The board of directors shall adopt and maintain a system of accounting for receipts and expenditures in conformance with the laws of the United States and of the State of Alaska applicable to cooperative associations and corporations, which system shall at all times provide the proper reserves for payments of interest and principal on outstanding indebtedness, reserves for taxes, insurance, depreciation, replacement of capital plant and facilities, and such other reserves and accounts as the board of directors shall deem proper.

SECTION 2. Accounting System and Reports. The accounting system adopted and maintained by the board of directors shall conform to such rules and regulations applicable to accounting systems, their establishment and operation, as may from time to time be promulgated by the Administrator, Rural Electrification Administration, United States Department of Agriculture, and which may be established by any applicab'e laws, rules and regulations of the United States, the State of Alaska, or any regulatory agency thereof of competent jurisdiction. The board of directors shall also, after the close of each fiscal year, cause to be made a full, complete and independent audit of the accounts, books, and financial condition of the Association as of the end of such fiscal year. Such audit reports shall be submitted to the members at the annual meeting next following.

ARTICLE IX

DISPOSITION OF PROPERTY

SECTION 1. Disposition of Property. (a) The board of directors shall have full power and authority to authorize the execution and delivery of a mortgage or mortgages, or a deed or deeds of trust, of any and all of the property, rights, privileges, licenses, franchises and permits of the Association, whether acquired or to be acquired, and wherever situated, as well as the revenues therefrom, all upon such terms and conditions as the board of directors shall determine, to secure any indebtedness of the Association.

(b) The Associatior may not sell, lease, or otherwise dispose of all or a substantial portion of the Association's property unless such sale, lease or other disposition is authorized by the affirmative vote of not less than the majority of all the members of the cooperative; provided, however, the board of directors may, upon the authorization of the majority of those members of the Association present at a meeting of its members, sell, lease, or otherwise dispose of all or a substantial portion of its property to another cooperative or to the holder or holders of any notes, bonds, or other evidence of indebtedness issued to the United States of America or any agency or instrumentality thereof.

ARTICLE X

SEAL

The corporate seal of the Association shall be in the form of a circle and shall have inscribed thereon the name of the Association and the words "Corporate Seal, State of Alaska."

ARTICLE XI

FINANCIAL TRANSACTIONS

SECTION 1. Contracts. Except as otherwise provided in these by-laws, the board of directors may authorize any officer or officers, agent or agents, to enter into any contract, or execute and deliver any instrument, in the name and on behalf of the Association, and such authority may be general or confined to specific instances.

SECTION 2. Checks, Drafts, etc. All checks, drafts or other orders for the payment of money, and all notes, bonds or other evidences of indebtedness issued in the name of the Association, shall be signed by such officer or officers, agent or agents, employee or employees of the Association, and in such manner, as shall from time to time be determined by resolution of the board of directors.

SECTION 3. Deposits. All funds of the Association shall be deposited from time to time to the credit of the Association in such bank or banks as the board of directors may select.

SECTION 4. Change in Rates. Written notice shall be given to the Administrator of the Rural Electrification Administration of the United States of America not less than ninety days prior to the date upon which any proposed change in the rates charged by the Association for electric energy becomes effective.

SECTION 5. Fiscal Year. The fiscal year of the Association shall begin on the first day of January of each year and shall end on the thirty-first day of December of the same year.

ARTICLE XII

MISCELLANEOUS

SECTION 1. Membership in Other Organizations. The Association shall not become a member of, or purchase stock in, any other organization without an affirmative vote of the members at a fully held meeting, the notice of which shall specify that action is to be taken upon such proposed membership or stock purchase; provided, however, that the Association may, upon the authorization of the board of directors, purchase stock in or become a member of any corporation or organization organized on a nonprofit basis for the purpose of engaging in or furthering the cause of rural electrification, or with the approval of the Administrator of REA, of any other corporation for the purpose of acquiring electric facilities.

SECTION 2. Waiver of Notice. Any member or director may waive in writing any notice of a meeting required to be given by these by-laws. The attendance of a member or director at any meeting shall constitute a waiver of notice of such meeting by such member or director, except in case a member or director shall attend a meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting has not been lawfully called or convened.

ARTICLE XIII

AMENDMENTS

SECTION 1. These by-laws may be altered, amended or repealed by t'e members at any regular or special meeting, provided the notice of such meeting shall have contained a copy of the proposed alteration, amendment or repeal.

SECTION 2. By-Laws Committee. It shall be the duty of the board of directors to appoint, not less than sixty days before the annual membership meeting, a committee on by-laws, consisting of not less than five nor more than seven members, who shall be selected from different sections of the service area of the Association so as to insure equitable representation. No member of the board of directors may serve on such a committee. The committee shall review the by-laws of the Association, consider any recommendations for revisions thereof which may be made by the board of directors or any member, and report their recommendations concerning the by-laws to the annual membership meeting. Nothing herein shall be interpreted to limit the authority of the board of directors to propose changes in the by-laws, or the right of the members to call a special meeting for any proper purpose pursuant to Article III, Section 2, herein.

MEMORANDUM

TO: Representative Jim Duncan, Chairman
Budget and Audit Committee
Alaska State Legislature

FROM: Arlon R. Tussing

RE: Questions about an Alaska General Stock Ownership Corporation (GSOC)

I am submitting these preliminary comments at the request of Mr. Milt Barker of the Division of Legislative Finance. They are based upon my review of the following materials:

1. Louis O. Kelso, et al, Design of an Alaskan General Stock Ownership Plan, Volume I. (February 15, 1979);

2. Kelso & Co., (untitled) documents on British Petroleum's interest in TAPS (December 7, 1978);

3. Alaska House of Representatives, Sponsor Substitute for House Bill No. 240 (March 6, 1979);

4. Wilmer, Cutler & Pickering, Federal Constitutional Issues Presented by Alaska's GSOC (December 15, 1978);

5. Senator Mike Gravel, various speeches, Congressional Record citations on GSOCs (1978 & 1979).

I regret that I was not able to present these comments in person to the House State Affairs Committee on March 20, 1979, but I hope that they will be of use to you. Please let me know if you have any further questions.

QUESTIONS ABOUT AN ALASKA GENERAL STOCK OWNERSHIP CORPORATION

1. GSOCs in General. Louis Kelso's concept of the General Stock Ownership Corporation (GSOC) has much in common with socialist and welfare state programs for redistributing wealth.* Instead of directly expropriating or taxing away property for redistribution, however, Kelso's approach would use the government's credit to finance specially created corporations, whose shares would be dealt out to eligible citizens. The individual shareholder in GSOC thus could regard any dividends he received as earnings from his ownership of private capital rather than as a government handout.

Like confiscation or condemnation, GSOCs would create no new wealth for society. The money used to create the GSOC would have to be bid away from private investors who did not have the same access to the government's power to tax (or, in the case of a federally-sponsored GSOC, to print money) in order to make good on their obligations. Because

* Kelso's accusations against present-day capitalism could well have come from a handbook of revolutionary Marxism. His program, it appears, is a remedy for "endemic poverty . . . misuse of technology, resource waste, despoilation of the environment, declining personal freedom, increasing lawlessness and civil disorder, the waning of liberal education, the civil rights impasse, the youth revolt, urban concentration, rising public and private debt, public loss of confidence in leadership and the seemingly irreversible advance toward a totalitarian society." [Kelso, et al, p. 16].

the "losers" would be widely scattered and impossible to identify individually, however, we could expect this kind of property redistribution to be less painful and less socially disruptive than more traditional socialist schemes.

There is nothing novel or radical in this aspect of the GSOC. Private individuals and corporations already benefit from a wide variety of federal and state loan and guarantee programs: each of them reallocates resources and redistributes wealth as surely (if not as visibly) as would taxation or government ownership of industry. GSOCs would no more revolutionize or redeem the capitalist system than do the existing programs of government credit for housing, agriculture, shipbuilding, rural electrification or education. The value of the GSOC concept to Alaska must be judged not by the sweeping claims of its inventors, but rather by whether specific proposals are properly tailored to the state's specific problems.

2. GSOCs in Alaska. The GSOC concept (like that of "Alaska, Inc.") appeals to legislators and other Alaskans because it may be a Constitutional way to use the state's petroleum revenue to increase the wealth of present resident Alaskans without permanently swelling the size of state government or attracting a host of immigrants to share in the windfall. In my opinion, something like a GSOC as contemplated in H.B. 240 may indeed be the best way to give

Alaskans a personal stake in the state's natural resource income. But the GSOC concept is still a very rough one, and there are a number of reservations and cautions even apart from technical legal issues, that I would like to raise here. As the Legislature deliberates further on the GSOC concept, I would expect to raise other problems and perhaps to offer some suggestions for improving the pending legislation.

3. Widely distributed ownership vs. broad-based control. GSOCs may very well be a means of widening ownership in Alaska industry, but widely distributed ownership is not the same thing as broadly-based control. It is a truism that corporations with widely dispersed share ownership are the easiest for small groups of insiders to control. They are practically immune both to stockholder revolts and to hostile takeover attempts (which are often the only way in which an ineffective management can be replaced).

Small shareholders normally do not take an interest in corporate affairs, and it is usually not worth their time to do so. Most shareholders express any dissatisfaction with management by selling their stock, not by becoming active in corporate politics. Otherwise, they routinely give their proxies to management, or simply decline to vote at the annual meeting. This experience in ordinary business corporations is duplicated in "non-profit" economic enterprises with widely spread ownership, such as cooperatives, credit unions, savings and loan associations, and mutual insurance companies.

By limiting any person's interest to ten shares of GSOC stock, the proposed legislation assures that shareholders generally will not have a large enough stake to warrant their taking an active part in the corporation's affairs on the basis of economic self-interest. This limitation on individual share ownership, the absence of cumulative voting and the staggered terms of office for directors, almost guarantee a self-perpetuating management.

In this setting, the alternative of vigorous controversy among the shareholders is hardly more attractive, however. Any activists, apart from the insider group itself, are likely to be more concerned with personalities and politics then with prudent business management. Alaska can already offer a few prominent examples of broadly-based corporations with such a malady.

4. Motivations of the Directors. Since the officers and directors of a GSOC will not be selected on the basis of a substantial ownership position, and may not obtain such a position, the legislature should consider in advance just what kind of people will constitute this self-perpetuating insider group, and what their motivations are likely to be. Such a group is more likely to be moved by considerations

other than profitability than a board and management representing large shareholders, for example:

> **Their outside business interests;**
>
> **Officers' salaries, directors' fees, and other perquisites;**
>
> Size and prestige of the organization;
>
> Their social and business philosophies, ideals and ideologies; and
>
> The approval of other businessmen, the media, or the community at large.

These are on the whole the considerations that motivate the boards of many "charitable" enterprises: "non-profit" hospitals, for example, are notorious for bad management, inefficiency, and petty corruption. None of the foregoing motives is necessarily reprehensible, and they are not always at odds with the interest of the shareholders in maximizing profits or capital gains. But as a small shareholder I would prefer to have a few large shareholders on the board looking at the bottom line, and, in their own self-interest looking askance at inefficiency, empire-building or goldplating.

5. Vulnerability to speculative promotions. Alaska is a fertile field for promotional schemes, and GSOCs may be just made to order for them. The big private gains in industrial development projects are not made on the operating profits of ownership (Kelso's theories notwithstanding), but from promotional and organizational expenses: land speculation and sales; engineering, consulting, legal and underwriting fees; and the purchase and sale of corporate assets --- all of which can be capitalized into a GSOC's initial "investment."

The Board of Directors of GSOCs will almost inevitably be made up of people who make their living, or at least many of whose friends make their living, by such pursuits. Those who were strangers to that way of life when they were appointed or elected as Directors would not remain so for long. It is likely that an Alaska GSOC of the kind presently contemplated would be tempted to invest in projects that sophisticated profit-motivated capitalists would shun, and for which the legislature would not have been willing to appropriate public funds.

6. State Loan Guarantees. One seeming advantage of the GSOC concept is that the state money backing GSOC credit would bring a double return to Alaska --- once from the investment earnings the government earns on money in the

guarantee fund, and once aga_n from the citizens' GSOC dividends. But state funds needed to back GSOC debt would be considerable (in the case of the proposed BP Pipeline purchase, over $1 billion), they would be immobilized for any other purpose, and they would truly be at risk --- particularly if GSOCs were capitalized with 100 percent debt, as seems to be necessary if the corporations are to be created without an appropriation of equity capital from the general fund.

The proposed legislation is not clear who is to propose and approve state loan guarantees for the purchase of GSOC assets. There seems to be a Constitutional question whether such a guarantee could be authorized by the Legislature, or even by a popular referendum, but that is an issue outside my area of competence.

7. Investment in TAPS. A share in TAPS is one of the worst investments an Alaska GSOC could possibly make. If something went wrong at the Prudhoe Bay field, with the pipeline or terminal, or in the world petroleum market --- the state could simultaneously be faced with (1) a drastic decline in the oil revenues that support state government and underpin the Alaska economy, (2) an obligation to make good on defaulted pipeline bonds (either out of a guarantee fund or out of reduced general fund revenues), and (3) loss of the value of GSOC stock in the hands of individual Alaskans.

The fact that such a scenario is even imaginable makes it very unlikely that the present holders of pipeline bonds would agree to their assumption by an Alaska GSOC, or that they take any state loan guarantee seriously. As some big lenders have stated about state backing for gas pipeline debt, they would justifiably expect Alaska to try to recover any loss by means of higher taxes on oil and gas production, thereby further undermining the soundness of the lenders' other loans to the owners of TAPS. The same considerations apply, with only slightly less force, to GSOC investments in other facilities for transporting North Slope hydrocarbons.

If the Legislature were to authorize creation of a GSOC, however, there will surely be a clamor (which may well become irresistible) for it to finance or buy into the Alaska Highway gas pipeline, a North Slope gas conditioning plant, the Alpetco refinery, a Fairbanks petrochemical plant, or a natural gas liquids pipeline on terms that no rational private investor would accept. This is my own main concern about GSOCs today. But, for some Alaskans, it may well be a point in their favor.

ALASKA

GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

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

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

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

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

ANALYSIS: SECTION 1

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

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

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

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

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

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

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

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

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

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

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

50.060. LATE APPLICATION FOR SHARES.

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

SUMMARY OF TESTIMONY

Robert D. Hamrin

In 1976, the Joint Economic Committee recommended to Congress that it "be made national policy to pursue the goal of broadened capital ownership" and a follow-up staff study concluded that "serious consideration should be given to plans that are open to all individuals."

I wish to congratulate the state of Alaska for taking the first bold steps toward implementing such a plan. I also wish to emphasize that a primary virtue of the proposed AGSOC is its simplicity in dealing with one class of stock distributed equally to all citizens. It is most likely that refinements will be made over time but for now, it is important that a track record begins to be established and people's reactions gauged. I firmly believe that the AGSOC, if established, will long be heralded as the first move toward "economic democracy."

As an economist who has examined all the major ideas for broadening capital ownership, I feel the AGSOC is the right step at the right time. The current national policy for broadening capital ownership, ESOPs and TRASOPs, is good so far as it goes, but that is not far enough since the majority of individuals would not significantly benefit from such employee-centered plans.

The AGSOC would benefit every citizen; it would allow all Alaskans to share directly in their highly productive economy; it should establish a stronger foundation for future economic growth due to the increased consumption demand flowing from the augmented incomes of consumers; it is the best plan for providing a more equitable distribution of income and wealth without disturbing present holdings; and by enabling all citizens to "participate" in production through capital ownership, they should gain a better understanding of the workings of the private enterprise system.

The full text of my prepared statement presents a critique of the Kelso study which focuses on a number of inaccurate statements made in the "economic reasoning" section. My statement also contains some specific comments regarding the AGSOC bill: I question whether an emigrating shareholder, particularly in the first few years, should be allowed to take stock with him; there should be provisions for how the stock shares from future major investments would be distributed as well as for repayment of the loan; the question of who the beneficiaries should be in the future and whether shares should be equally distributed needs to be examined.

Testimony for Division of Legislative Finance
regarding
Alaska General Stock Ownership Corporation (AGSOC)

Robert D. Hamrin

The Right Step at the Right Time

In its 1976 Annual Report, the Joint Economic Committee made the following recommendation to Congress:

> To provide a realistic opportunity for more U.S. citizens to become owners of capital, and to provide an expanded source of equity financing for corporations, it should be made national policy to pursue the goal of broadened capital ownership.

Four months later, the Committee published a staff study which after examining numerous means by which to achieve broadened capital ownership concluded:

> Since this is a goal for all Americans and not just employees of corporations, serious consideration should be given to plans that are open to all individuals...

Three years later, the state of Alaska is to be congratualated for taking the first bold steps toward implementing such a plan. Talk, especially in Washington, D.C., comes cheap and there is much talk regarding the ills of our society and even a fair amount regarding possible remedies. But 95% of talk ends there. Of the 5% that does result in new policies or actions, 90-95% is simply a replay of old ideas, perhaps slightly modified. Rare, extremely rare, is the example of a bold, creative new solution actually being implemented. This is the primary point that should be remembered in the midst of the specific details which follow.

In the same vein, althougha few "complicating" suggestions are offered below, a primary virtue of the proposed plan is its simplicity. It deals with one class of stock distributed equally to all citizens. This is as it should be for the initial general plan for broadened capital ownership.

If, for example, a choice of stocks from a diversified portfolio were offered to households, wise or simply early recipients could quickly deplete the supply of "choice stock" and individuals who are not knowledgeable and perhaps have never owned stock would be handicapped in making wise choices on a diversified portfolio.

The ACSOC, if established, will be long remembered as the first concrete step towards "economic democracy." The intent of this phrase has been incisively portrayed by Winnett Boyd:

> If a country in which only a few men and women are citizens is politically unjust, the remedy is not to abolish citizenship but to make all men and women citizens. If an industrialized country in which only a few own all the capital is economically unjust, the remedy is not to abolish private capital but to make it possible for all to become owners of some of it.

An Economic Perspective

Statistics show that in the early 1970s, nearly one out of every eight American families had essentially no financial net worth and the majority had a financial net worth of less than $10,000. This illustrates the fragile, debt-underwritten affluence of American households and the fact that the economic democracy spoken of above is far from a reality.

If economic democracy is to be the goal, then ESOPs and TRASOPs which constitute the current national policy for broadening capital ownership cannot be the final answer. Because the majority of individuals would not significantly benefit from such employee-centered plans, there is a lack of interest and support for them. This again points to the need for a plan that reaches everyone. There is much to be said for the excitement stemming from a commonly shared experience among all Alaskan citizens that such a plan is likely to generate.

The ACSOC has many attractive features. It can benefit everyone or be targeted to whatever groups may be desired. It does rot favor corporate officers or executives, or persons employed by the most successful or most capital-intensive corporations. It does not force a rift between a worker and his or her union nor does it create a climate in which union leaders might take control of corporations. It does not depend, as ESOPs and TRASOPs do, upon tax subsidies, tax benefits, or the loss of tax revenues.

What the ACSOC does do is most important. It allows all Alaskans to share directly in their highly productive economy, thus increasing purchasing power as more dollars flow as dividends to lower and middle income households. Relatedly, it should establish a stronger foundation for future economic growth which would be stimulated by the increased consumption demand flowing from the augmented incomes of consumers. It also does more in terms of providing a more equitable distribution of income and wealth without disturbing present holdings than any other plan that has been suggested to date. A final important non-economic benefit is that by enabling all citizens to "participate" in production not only through their labor but also through capital ownership, the ACSOC will lead to a better understanding by Alaskans of the workings of the private enterprise system.

Basically, the ACSOC is recognizing that some portion of the state's immense "public wealth" should be distributed directly to the people. The state government can facilitate this by providing a mechanism whereby all individuals have equal access to credit in order to obtain stock on the basis of its anticipated future earnings.

Critique of the Kelso Study

My general reaction to the Kelso study was one of disappointment. In specifying the legal and financial design of the ACSOC, it did not go much beyond the provisions specified in the Revenue Act of 1978. The other major part - the economic reasoning supporting the bill - was riddled with incorrect statements, some of a serious nature which should be divorced from the considerations on establishing an AGSOC. What was needed was not simply the "design" of an AGSOC but an analysis of it which would specify first why this type of corporation should be established over other means of broadening capital ownership and second its numerous effects.

Before highlighting the incorrect statements in the "economic reasoning" section, I have two questions regarding the design of this project as proposed by Kelso. The first regards his statement on page 5 that the proposed design permits an "emigrating shareholder to take his stock with him in order to continue to enjoy its income in the future." This seems to violate the spirit of the AGSOC proposal. It does not seem right that someone who recently moved to Alaska with the intent of staying only a few years can leave with a share of stock within a couple of years.

The more serious matter regards the question of future financing and distribution of newly created stock. On page 28, the Kelso study discusses new residents purchasing shares from the initial distribution which the corporation had bought back. I could find no discussion, however, of how the shares from a second major investment a few years hence would be distributed. Would just new residents receive such shares? Would all residents receive the shares? If so, would they all receive equal shares? This point needs to be clarified in the bill.

Regarding the economic reasoning section, the most serious problem is the insertion of Kelso's two factor theory contention that we have been operating under one factor (labor) theory and policy: "The notion that labor is the only, or chief, factor of production is the keystone of the conventional economic wisdom." (p. 17) This is patently false as capital has been at the forefront of economic analysis for most of this century. The danger is that linking the AGSOC to two-factor theory would instantly discredit the AGSOC. Furthermore, there is no need to bring one factor, two factor or even three factor (which is what economics has emphasized for 200 years) theory into a discussion of a plan to broaden capital ownership.

It should also be noted that the so-called two factor theory is really the clearest example one could hope to see of a one factor theory: "an age when wealth is chiefly produced by things" (p. 21) or "affluence is not the product of the human factor but the non-human factor." (p. 22) Such statements have no basis in reality.

Other statements that are incorrect are: "still pretending to believe that labor's productivity is rising" (pp. 16-17) because everyone has acknowledged for years the decade long decline in labor productivity; "there could be no physical shortage of purchasing power..." (p. 23) because the concept of a physical shortage cannot relate to purchasing power; and "since the corporate sector produces 87% of non-agricultural, non-governmental goods and services, it also generates 87% of the economy's' purchasing power" (p. 25) because purchasing power and production are not equivalent to each other, being two distinct phenomena. There is also a factual error on p. 10 for the maximum corporate income tax rate is now 46%.

Specific Comments and Recommendations

I have a number of concerns regarding dividends. First, it is unclear to me when they start being distributed. Also, does the 90% mandatory payout refer to net income after the loan payment has been made? Relatedly, I could find no provisions in the bill related to repayment of the loan, particularly regarding the time period. This should be clearly specified.

Regarding the distribution of dividends, I have noted that a one share per citizen distribution is appropriate in the beginning. However, if the goal is to provide capital ownership to those who otherwise would likely never own capital, the idea of distributing future shares according to income level should be explored. It is hard to justify giving free shares to that top 5% Kelso so often refers to who own most of the income-producing capital today. Perhaps a simple sliding scale would be most equitable: 3 shares to those making $0 - 12000; 2 shares for $12 - 25000, 1 share for $25 - 40000 and no shares for $40000 and above. The question of whether all citizens or just adults should be share recipients needs to be examined. Also, should long-standing Alaskan citizens receive favored treatment over newcomers? Such questions would become more significant as future investments are undertaken by AGSOC.

My other set of comments relate to project evaluation. Senator Gravel has suggested the type of evaluation he would like to see in the Congressional Record of October 24, 1978. I encourage the Alaskan State Legislature to incorporate these requirements into the legislation establishing the AGSOC: that the annual report of the GSOC filed with the Treasury Department include studies of the effect of the GSOC on distribution of income and wealth, the level of transfer payments made or required, the social and demographic profiles of GSOC shareholders, the level of economic understanding of GSOC shareholders, and possible beneficial revisions to the GSOC legislation. The legislature may also want to more closely examine the effect on state revenues and outlays as well as conduct a more in-depth survey of a sample of recipients which could be used as input to an annual "Report from the People" which could be distributed to all Alaskans.

Robert D. Hamrin

Biographical Sketch

Received his B.A. Magna Cum Laude from St. Olaf College in 1968 and his Ph.D. in Economics from the University of Wisconsin in 1972. Served as Assistant Professor at Hong Kong Baptist College (1972-73) and University of Idaho (1973-74). Came to the Joint Economic Committee as a staff economist where his two major areas from 1974-78 were broadening capital ownership and long-run U. S. economic growth prospects. His principal duties regarding the capital ownership area were to staff the J.E.C. hearings in December 1975 and author the staff study Broadening the Ownership of New Capital: ESOPs and Other Alternatives. In 1978, he wrote a book under a Rockefeller Foundation grant titled Rethinking Economics: The Realities of the 1980s which will be published by Praeger in late 1979. He is currently serving as the Senior Policy Economist at the U.S. Environmental Protection Agency.

4-4

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

I. Opening remarks

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

III. Summary evaluation

IV. Concluding remarks

Visual Displays Referenced in Dr. Buser's Testimony

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

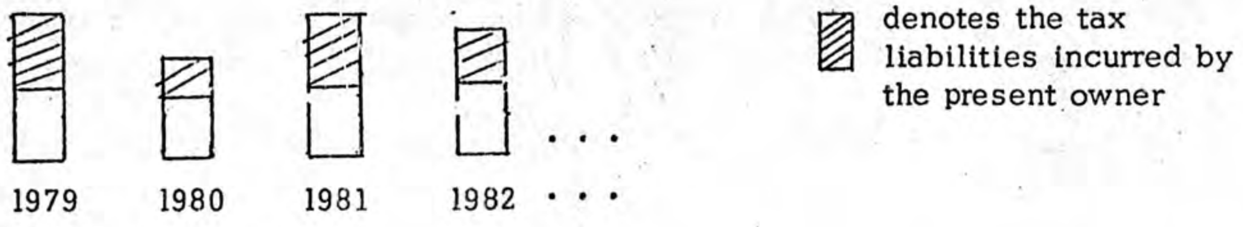

1979
1980
1981
1982 . . .
▨ denotes the tax liabilities incurred by the present owner

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

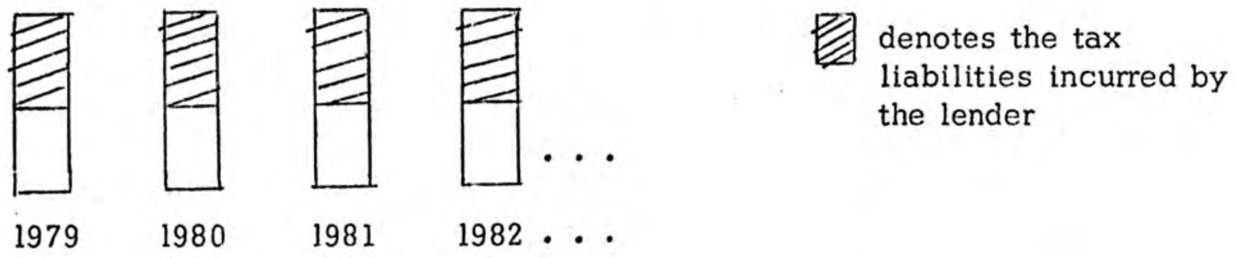
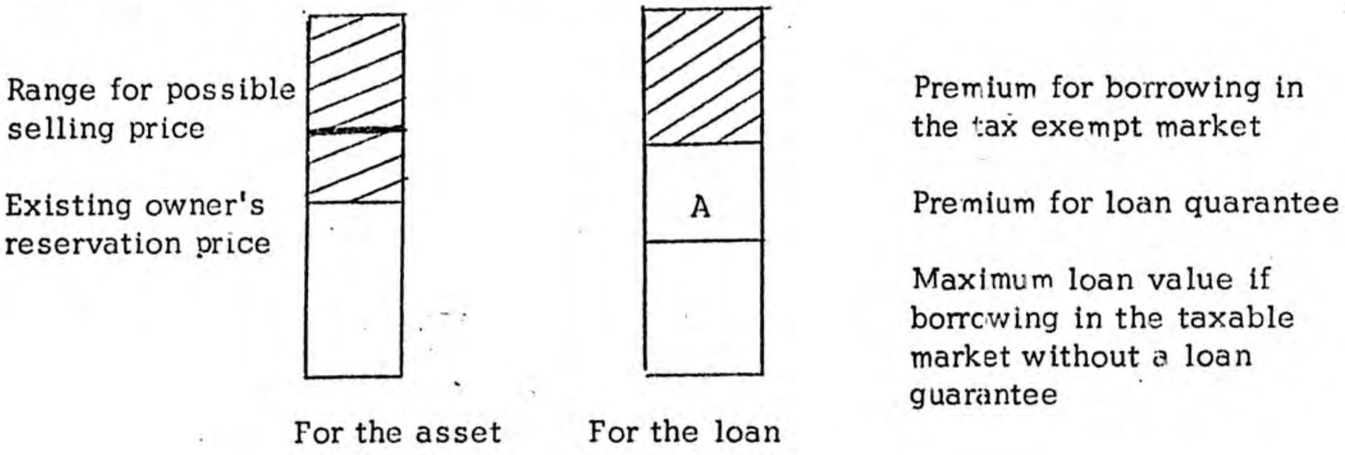
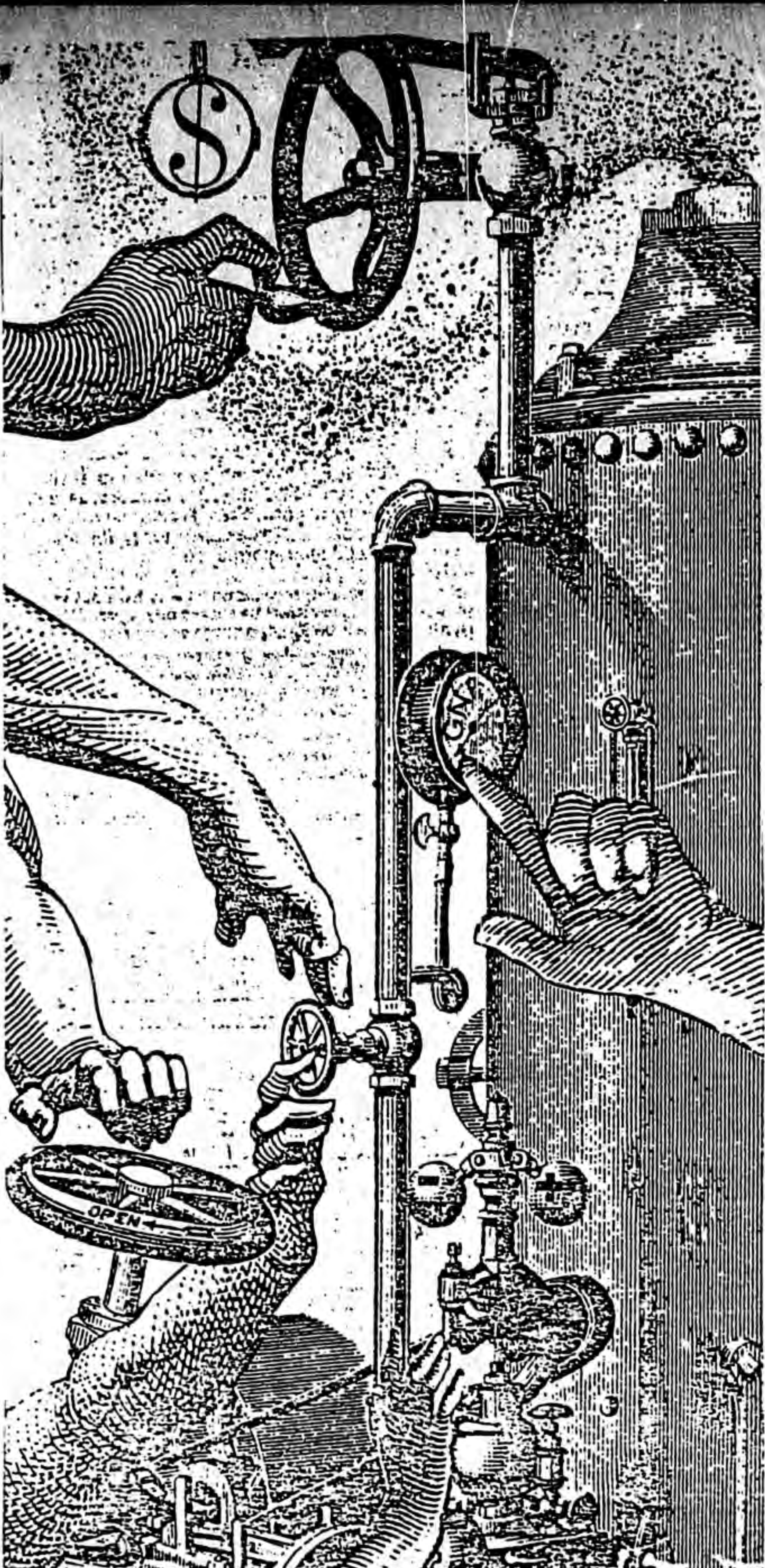

1979
1980
1981
1982 . . .
▨ denotes the tax liabilities incurred by the lender

Figure 3: Current market values of the cash flows


Range for possible selling price
Existing owner's reservation price
A
Premium for borrowing in the tax exempt market
Premium for loan quarantee
Maximum loan value if borrowing in the taxable market without a loan guarantee
For the asset
For the loan



AGSOC

THE FINANCIAL PLUMBING

Hearings before the

State Affairs Committee

March 20, 1979

Submitted by:

Jeffrey R. Gates
Hewitt Associates
Lincolnshire, Il.

THE AGSOC - AN OWNERSHIP STRATEGY

The American Dream - A Piece of the Action

Iron Law of Development - consume less, invest more
Catch-22 - Iron Law of Ownership

The Financial Plumbing of Stock Ownership (See Exhibit 1)

Captive Capital - Less than 10% of stock transfers are for directly fostering new capital formation.

New York Stock Exchange 1975 shareowner census:
(1) 5-year decline of 18.3%.
Quantitative vs. qualitative measure.
(2) Average age of typical shareholder increased five years over 5-year span.

Joint Economic Committee figures re stock ownership (1975):
(1) 0.5% own 50%.
(2) 1% claim 46% of dividends.
(3) Working non-professionals (76% of work force) own 19%.

(See Exhibit 2)

Debt:Equity ratio for U.S. manufacturers rose from 23% to 43% from 1964-1974.

Consumer Debt:
1960 - $56.1 billion
1976 - $217.8 billion

Comments from the Media - Why ESOPs are also called "Kelso Plans"

(See Exhibit 3)

Historical Context

Industrial Homestead Act (See Exhibit 4)
Life, Liberty and ... (See Exhibit 5)

Contractual Context - Access to Ownership

The Evolving Social Contract

"A corporation is an artificial being, invisible, intangible, and existing only in the contemplation of the law. Being the mere creature of the law, it possesses only those properties which the charter of its creation confers on it, either expressly, or as incidental to its existence."

-John Marshall-

Market Context

Work Ethic - The Employment Act of 1946

"All we seek is an America where every person is given the chance to productively contribute to his country and where he can receive a fair and equitable share of the wealth that production creates."

-Coretta Scott King-

Industrial Context

Exchange Ethic

"Salary" vs. "Compensation"

Salary - salt; "not worth his salt", "In the sweat of thy face shalt thou eat bread."

Compensation - a balancing of accounts (See Exhibit 6)

Post-Industrial Context

Incomes policy designed as participation-in-production policy

The Affluent Society (1958) - "device for breaking the nexus between production and income security"

Breaking the nexus:

Federal Expenditures
1960 - $91.3 billion
1979 - $504 billion

Federal Budget
1960 - slight surplus
1978 - deficit of $61.7

Federal Transfer Payments
1960 - $20.6 billion
1979 - $198 billion

"There are no free lunches on welfare."

-Joseph Califano-
Secretary of HEW

"There is no more complete rejection of a person than to give them a job you know and they know is useless."

-F. Ray Marshall-
Secretary of Labor

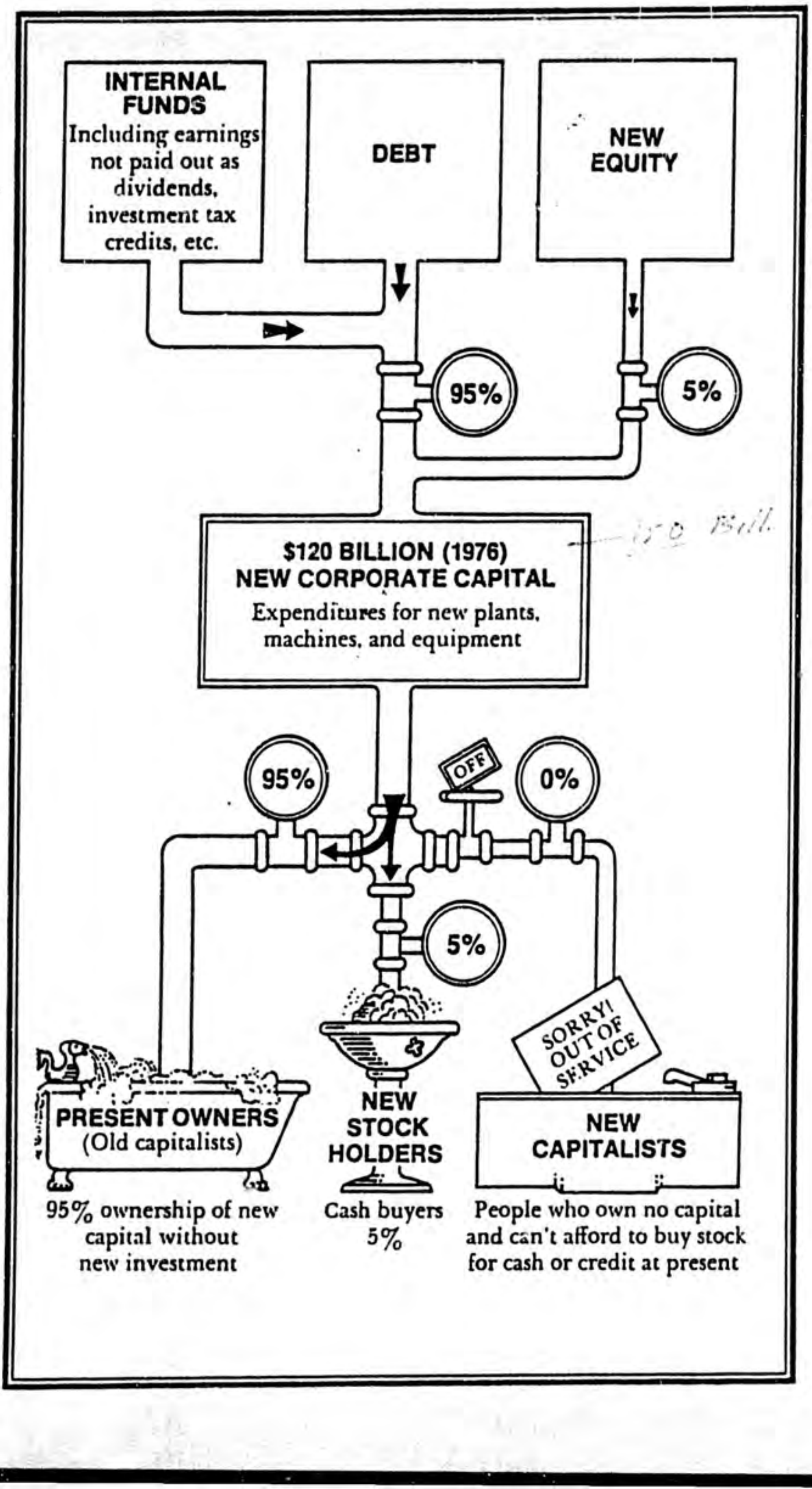
Exhibit 1

A PIECE OF THE ACTION

VAN NOSTRAND
REINHOLD

Copyright © 1977 by Stuart M. Speiser

FIGURE ONE


INTERNAL FUNDS
Including earnings not paid out as dividends, investment tax credits, etc.
DEBT
NEW EQUITY
95%
5%
$120 BILLION (1976)
NEW CORPORATE CAPITAL
Expenditures for new plants, machines, and equipment
95%
OFF
0%
5%
SORRY! OUT OF SERVICE
PRESENT OWNERS
(Old capitalists)
NEW STOCK HOLDERS
NEW CAPITALISTS
95% ownership of new capital without new investment
Cash buyers 5%
People who own no capital and can't afford to buy stock for cash or credit at present

—150 Bill. 1978)

FIGURE TWO

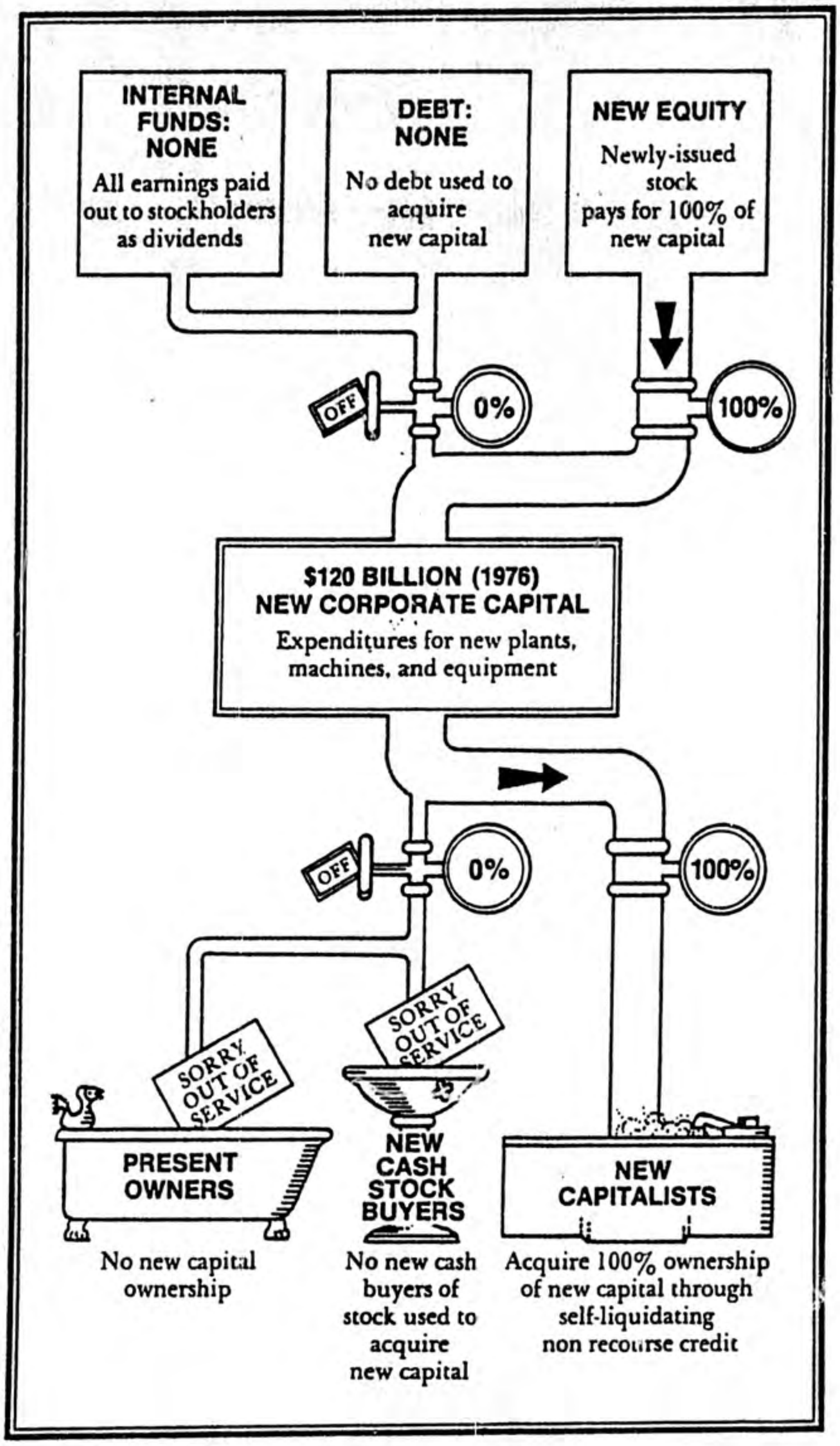
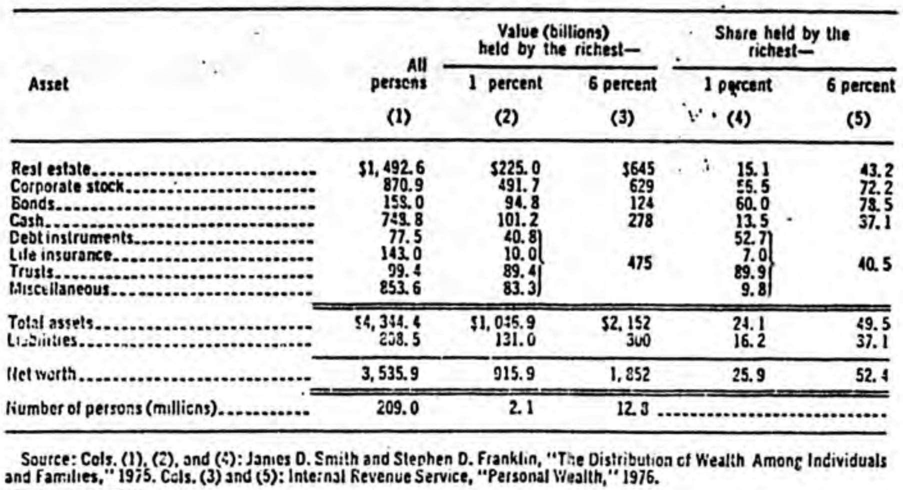

INTERNAL FUNDS: NONE
All earnings paid out to stockholders as dividends
DEBT: NONE
No debt used to acquire new capital
NEW EQUITY
Newly-issued stock pays for 100% of new capital
OFF
0%
100%
$120 BILLION (1976) NEW CORPORATE CAPITAL
Expenditures for new plants, machines, and equipment
OFF
0%
100%
SORRY OUT OF SERVICE
SORRY OUT OF SERVICE
PRESENT OWNERS
No new capital ownership
NEW CASH STOCK BUYERS
No new cash buyers of stock used to acquire new capital
NEW CAPITALISTS
Acquire 100% ownership of new capital through self-liquidating non recourse credit

Exhibit 2

PERSONAL WEALTH: COMPOSITION AND DISTRIBUTION

Personal wealth in the U.S. in 1972 totaled $4.3 trillion while net worth totaled $3.5 trillion. Evenly distributed, this would mean that the average sized family would have a financial net worth of $59,200. Less than one family in eight approached that figure in 1972:

TABLE 1.—PERSONAL WEALTH, 1972



Asset	All persons	Value (billions) held by the richest—		Share held by the richest—	
		1 percent	6 percent	1 percent	6 percent
	(1)	(2)	(3)	(4)	(5)
Real estate	$1,492.6	$225.0	$645	15.1	43.2
Corporate stock	870.9	491.7	629	55.5	72.2
Bonds	158.0	94.8	124	60.0	78.5
Cash	749.8	101.2	278	13.5	37.1
Debt instruments	77.5	40.8	475	52.7	40.5
Life insurance	143.0	10.0		7.0	
Trusts	99.4	89.4		89.9	
Miscellaneous	853.6	83.3		9.8	
Total assets	$4,344.4	$1,046.9	$2,152	24.1	49.5
Liabilities	808.5	131.0	300	16.2	37.1
Net worth	3,535.9	915.9	1,852	25.9	52.4
Number of persons (millions)	209.0	2.1	12.8		

Source: Cols. (1), (2), and (4): James D. Smith and Stephen D. Franklin, "The Distribution of Wealth Among Individuals and Families," 1975. Cols. (3) and (5): Internal Revenue Service, "Personal Wealth," 1976.

From: "Broadening the Ownership of New Capital: ESOPs and Other Alternatives," A staff study of the Joint Economic Committee (1976) p. 7.

This JEC report notes that "... the distribution of income has remained virtually unchanged since World War II: the top quintile of the population holds just over 40 percent of the income and the lowest quintile has 5 percent. Even these figures understate how rich the rich really are for the top quintile of families have almost 80 percent of total wealth. Clearly, income will not become more equally distributed in this country until the base of wealth holdings is broadened." Id.

Other studies document that wealth is even more concentrated than the JEC indicates:

Robert J. Lampman, National Bureau of Economic Research, The Share of Top Wealth-Holders in National Wealth, 1922-1956, (Princeton University Press, 1962).

Marshall E. Blume, Jean Crockett and Irwin Friend,"Stock Ownership in the United States: Characteristics and Trends," Survey of Current Business, November, 1974 at 16.

Expanded Ownership, (Sabre Foundation, 1971). This contains a survey of the studies on "The Distribution of Wealth in the Twentieth Century," by Prof. James D. Smith of Pennsylvania State Univ.

Exhibit 3

COMMENTS FROM THE MEDIA

WHY ESOPs ARE ALSO CALLED "KELSO PLANS"

Kelso and Adler's book could start a revolution.

Casper Weinberger
February, 1958

In those discussions there is as much of the wanderings of a madman as there is of cannibalism.

Pravda, March 25, 1959
in a review of The Capitalist
Manifesto (1958) by Kelso & Adler

A crackpot theory. Instead of saying labor's exploited, as Marx did, Kelso says capital's exploited. It's worse than Marx. It's Marx stood on its head.

Milton Friedman
Time, Jan. 29, 1970

I think some economists such as Milton Friedman have given too short a shrift to the Kelso plan. It's an example of one means of accomplishing a broadening of wealth ownership.... a quiet evolution in wealth ownership rather than the unquiet revolutions wealth owners have faced too often in the past.

Carl Madden, chief economist
U.S. Chamber of Commerce

A capitalist is someone who derives a substantial share of his income from his equity in producing companies. On this scale the figures are discouraging. Approximately ninety percent of the capital of this country is owned by five or less percent of the American people.

Louis Kelso of San Francisco, a lawyer-economist, has for years felt that he has a radical answer to the problem.

William F. Buckley
Feb. 24, 1970

There is a conspicuous void in the arguments and the programs of the counter-culture groups of this country, in that they have produced no well-formulated economic theories.

Unfortunately and ironically, Lou Kelso, who has some very imaginative economic proposals, has been offering them for many years to the establishment, the dinosaur culture.

So either Kelso is a lousy salesman or the dinosaurs are convinced their own designs will see them through.

The Whole Earth Catalog
Spring 1970

Louis O, Kelso, possibly the only genuine revolutionary in the United States.

Berkeley Daily Gazette
July 16, 1971

Kelso's formula sounds like Lydia Pinkham's Vegetable Compound. The whole theory sounds crazy. But, then, one may recall, they said all that of Copernicus too.

James J. Kilpatrick
Jan. 20, 1972

Kelsoism is not accepted by modern scientific economics as a valid and fruitful analysis of the distribution of income but rather it is regarded as an amateurish and cranky fad.

Paul Samuelson
The San Juan Star
April 27, 1972

Like the emperor's clothes, it looks beautiful. But when you look closely, you find there's nothing there.

Sar Levitan, economist

Taxation has its limitations as a method of achieving better economic distribution since for this purpose it is essentially remedial. We must also take a positive approach by finding new ways to spread ownership of future capital growth more broadly in our society. This will be a fertile field for creative ideas and experimentation in the years ahead by both government and the private sector.

One such approach has been developed by Louis Kelso. Kelso makes a convincing argument that many of the deficiencies of our economic system could be alleviated if ways were found to broaden the ownership of the means of production.

John D. Rockefeller 3rd
The Second American Revolution (1973)

If a Little Capitalism Is Good, What's Wrong with a Lot?

Fred Harris, former Senator
A chapter title from
The New Populism (1973)

In America, the greatest, most famous capitalist country in the world, there are almost no capitalists. The largest majority, silent and noisy, are job serfs, wage villeins. dependent on salaries for all the money they'll ever see.

The great, lazy, anti-Calvinist, hedonistic Kelsonian truth is that you can't get rich through labor because it doesn't produce enough wealth.

Kelso's idea won't solve all our problems; it can't possibly work out as nicely as Kelso thinks, but it can move us from this barren repitition of fifty-year-old disputes. There is no salvation either outside the Church or on this earth, but Kelso does bring a new way of looking, and if that isn't salvation it's at least an intermediary grace.

Nicholas von Hoffman
Esquire December 1973

If a country in which only a few men and women are citizens is politically unjust, the remedy is not to abolish citizenship but to make all men and women citizens. If an industrialized country in which only a few own all the capital is economically unjust, the remedy is not to abolish private capital but to make it possible for all to become owners of some of it.

Winnett Boyd, president
Arthur D. Little, Canada

Over one hundred years ago Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already privately owned land. They did not take from those who owned to give to others who did not own. It set the pattern for the American capitalistic system. We need an Industrial Homestead Act.... it is time to formulate a plan to accelerate the economic growth and production at the same time we broaden the ownership of productive capital. The American dream has always been to have a piece of the action.

Ronald Reagan
July 20, 1974

The Kelso plan is a gentle, non-Robin Hoodish approach to the redistribution of wealth which his father Huey always preached.

Charles Bartlett
Arizona Republic, Mar. 24, 1975

Kelso: McLuhan of economics?

The Village Voice
April 28, 1975

One of the great things that ESOPs have going for them is that they are such a natural from a political viewpoint: Who in populist Washington, whether liberal or conservative, would knock the idea of spreading corporate ownership?

Forbes, May 1, 1975

Since the 1940s, a lawyer named Louis O. Kelso has haunted America's corporate corridors, spinning fables about the advantages of a fringe benefit known as an employee stock ownership plan - ESOP, for short.

Money, June 1975

The Kelso doctrine is the only economic doctrine introduced in generations that could become a plank in either the Democratic of Republican platform.

Barron's, July 21, 1975

Bring on those tired, labor-plagued, competition-weary companies and ESOP will breathe new life into them. They will find ESOP better than Getitol. It will revitalize what is wrong with capitalism. It will increase productivity. It will improve labor relations. It will promote economic justice. It will save the economic system. It will make our form of government and our concept of freedom prevail over those who don't agree with us.

Senator Russell B. Long
Chairman, Senate Finance Committee
October 20, 1975

These plans (ESOPs) have been heralded as the basic solution for many of our economic ills. Specifically, one of our chief proponents who will be testifying today, has said the widespread adoption of ESOPs will accomplish the following objectives: the restoration and acceleration of economic growth to unprecedented levels; create legitimate full employment for two or three decades; and lay the foundation for arresting inflation.

I must confess that these are some claims. Certainly no one since I have been chairing this committee has come before us with any program that promises that much.

Senator Hubert H. Humphrey
Chairman, Joint Economic Committee
ESOP Hearings, Dec. 11, 1975

Louis O. Kelso is an economic seer whose time may have come.

Milton Moskowitz
San Francisco Chronicle
May 24, 1975

No one is putting in an ESOP just to be a nice guy.

Pension consultant quoted in
New York Times, Nov. 5, 1975

Like the case for acupuncture, it sounds bizarre, even alarming - but a suspicion remains that there may be something to it.

Fortune, March, 1976

Some brokers are saying that the ESOP trend may be exercising as much influence on the future as the computer.

San Francisco Business
January, 1976

Kelso's plan is so radical that it is difficult to take seriously.

Fortune, March, 1976

Paneceas often have a way of turning into Pandora's boxes.

Business Week editorial
Mar. 8, 1976

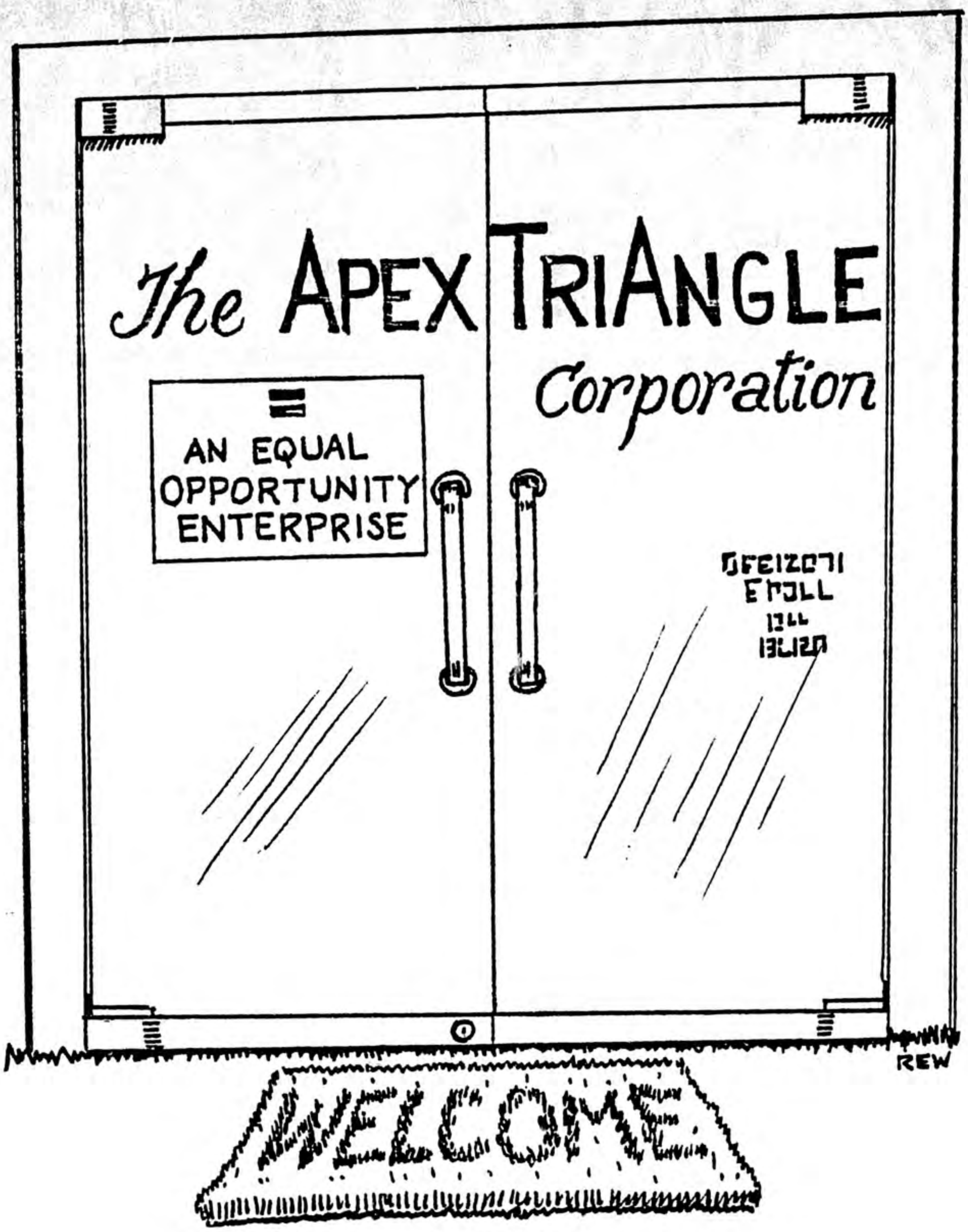
The conservative but populist chairman of the Senate Finance Committee has become an evangelical disciple of Louis O. Kelso, a San Francisco attorney who has long championed various forms of 'worker capitalism.'

The most powerful defense of ESOP comes from Long, who waxes as fervent on the subject as Kelso.

Time, Oct. 4, 1976

As one member of this committee, Mr. Kelso, let me express my appreciation to you for the tremendous contribution that you have made and the pioneering work that you have done in the interest of employee stock ownership. We are, in many respects, holding these hearings here because of the work you have done in the area.

Senator Russell B. Long
Chairman, Senate Committee
on Finance
July 19, 1978


The APEX TRIANGLE Corporation
AN EQUAL OPPORTUNITY ENTERPRISE
WELCOME
REW

The Washington Post OUTLOOK Columnists / Editorials

SUNDAY, MARCH 11, 1979

A Radical Idea As Old As Lincoln

Against the Grain

By William Greider

THE TIME has come, perhaps, to ask the question modern liberalism has always ducked: Who owns America? Why is the wealth of this fantastic, egalitarian nation distributed so unjustly? Why must capital and its attendant political power be concentrated in the hands of the few while the masses have only a mortgage and, if they are lucky, a modest pension?

The questions themselves sound vaguely Marxist, which is one reason why welfare-state liberals have always ducked. Liberalism is defined and disciplined by its right-wing adversaries, whose red-baiting effectively scares off new ideas, even new questions. I could make an argument that the long march of liberal solutions to social injustice — tinkering with wage floors, moving cash from one group to another, propping up the poor and the weak, protecting the sick and the jobless from catastrophe — all these are evasions of the more fundamental questions about wealth and its gross maldistribution.

If liberal government could not do anything about the distribution of wealth, then it must concentrate on wages and particular benefits, propelling the welfare state deeper and deeper into private economic choices. Essentially, the federal government hands out coupons, little tickets that entitle qualified citizens to buy food at a supermarket, to occupy an apartment in a subsidized building, to buy medicine at the ghetto pharmacy, to pick up a little cash on the first of the month, to bill the Treasury for catastrophic illness.

No one who has talked to the recipients of these benefits or examined their actual condition can feel very satisfied with the results. Real pain and suffering, even hunger, truly are alleviated, but these people, still poor, have become prisoners of the government coupons.

The liberal imagination, knowing that real improvements in ordinary lives have flowed from the security programs, will insist on renewed dedication to the concept. If injustice persists, if some people still live in degradation while the rest of us live in royal luxury, then we must tinker with the coupons. Increase their cash value. Or invent new coupons for other items that these people cannot afford. Cars? Air conditioners? French bread?

Roughly speaking, this is the road American politics traveled to its present frustrations. The liberal mind-set, honorable and well-intentioned, cannot confront the natural limits that always will stand in its way. One crucial boundary in the politics of redistributing cash is the private wage system. Nobody really believes Washington should give a nonworker coupons that are more generous than the wages earned by his neighbor, the worker.

The other limitation is less obvious but more harsh: As the welfare state created safety nets for the poor and the weak, other, stronger groups in society invented their own versions of coupons, serving their own needs, and sold them to the government. Price-support systems for farmers; tax loopholes and housing subsidies for the middle class; guaranteed markets for industrial sectors; guaranteed jobs for unions strong enough to demand them.

I could argue that, in the final balance, the welfare state cares best for the prosperous, not the poor. But the main point is that virtually everyone, every economic sector, now participates in the government transfer of cash from one pocket to another. Meanwhile, the fundamental injustice of concentrated wealth is not altered in the slightest.

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WHO OWNS America? I am pleased to report that this question will be raised next winter when all conventional politicians are campaigning in the New Hampshire presidential primary. Not by a bunch of parlor lefties. Not by desperate liberals searching for jazzy new rhetoric. The question will be raised by a strange little group called the Ownership Campaign which, if one forced an ideological identity on this eclectic collection of individuals, probably would be called right-of-center.

The Ownership Campaign is an assortment of businessmen, government technocrats, old labor types, young idealists and blue-collar political neophytes. All of them came from different starting points to a shared conclusion: The welfare state fails ultimately to achieve justice; the government must intervene instead to create a broad distribution of capital wealth, stock ownership in the new productivity capacity of the future.

These inspired amateurs think this is the idea of the 1980s, since it did not become the idea of the 1970s. They see a way to renew industrial growth in America, to share the benefits of capitalism more equitably and to climb out of the cul-de-sac created by modern liberalism, the continuous elaboration of coupons. They believe labor should earn capital as well as wages. They believe citizens will never derive economic security, not to mention independence, as long as their well-being depends on government decisions.

This is the voice of economic individualism — the old American dream of yeoman independence that was buried in the modern era of big government, big corporations. These people are taking the original impulses of the American experience and trying to graft them onto modern corporate capitalism. At the edges, there is a barbarous yelp of protest borrowed from Ayn Rand. The heart of the idea, including the approach to banking and credit, is as old as Jefferson and Jackson, more radical than any reform entertained by the New Deal.

To grasp the full historical flavor, forget about all of the modern subsidy programs created in the last 40 years. Think instead of the really radical coupons handed out by government in the 19th century — Lincoln's Homestead Act. Through the national government, vast wealth was distributed free to ordinary Americans, including new immigrants, regardless of birth or education or economic status. The wealth was land and it was given freely, with one crucial condition: The people had to make it productive.

The ownership guerrillas believe stock in new industrial capacity can be distributed similarly, setting interest rates for ventures that represent real growth — not the paper games of borrowing and buying. Unlike the Marxist systems of shared wealth, nothing would be taken from the rich. Nor would the new factory become a state-owned industry, as in Britain or France. Anyone who has ever tried to use a telephone in France knows the limits of state socialism.

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THOSE WHO find single-issue politics nettlesome and disruptive

Greider is the editor of Outlook. His column appears weekly.

Exhibit 4

may be especially aggravated by the Ownership Campaign. It is raising money to enter not one, but two candidates in the 1980 New Hampshire primary — a Republican and a Democrat who will campaign jointly, share advertising costs and generally try to make the other conventional candidates take them seriously.

Neither major party has the intellectual vitality to take the plunge on this idea, though either could claim it as consistent with its past. The Ownership Campaign may end up looking silly, but can count itself successful if the horde of presidential candidates begins stealing their material.

Hold the smug laughter, for now. Some folks out there already understand this ownership pitch. When the farmers took their tractors to the Federal Reserve Board, demanding 3 percent interest rates, they were responding to the credit arguments of Norman Kurland, chairman of the Ownership Campaign. Kurland knows little about politics but he is one of those brilliantly obsessed figures one encounters in Washington, a person who cares more about ideas then making a living. Kurland has been pushing stock-ownership plans for more than a decade, undaunted by his limited success. He is the rarest combination — a creature who understands the banking laws yet continues to believe in the possibility of economic justice.

His political director is 25-year-old Luis Granados, a newly graduated lawyer from Takoma Park, who knows the operations of a political campaign from serving local candidates but who lacks the jaded amorality of experienced operatives. Granados learned economics from ordinary experience:

"I grew up middle class," he said. "I got a scholarship to a fancy prep school and I saw that end. Then I saw the other end, campaigning in poor neighborhoods. I just think the distribution of wealth is wrong. There's not sufficient difference in people to justify the differences in wealth."

This observation matches my own experiences as a reporter. Over the years, I have had many encounters with people on the bottom rung of our society — white mountaineers, black youths in the cities, migrant workers, poor people urban and rural. I always come away with a chilly feeling, a fresh recognition that most poor people could perform just as well as the rest of us, if they had gotten a few lucky rolls of the dice.

Others in the Ownership Campaign are not exactly bleeding hearts. They include Tim Maloney, a young new state legislator from Prince George's County; Anthony M. Carey, partner in a high-toned Baltimore law firm; Joe Rourke, a retired Massachusetts labor leader, and Wally Johnson, a former Republican mayor of Berkeley, Calif., who runs an aluminum scaffolding company called Up Right Inc.

Johnson is the only one with experience in a presidential primary. He received 35,000 votes in New Hampshire in 1976, running for vice president in the GOP primary on a single issue opposing congressional pay raises. This was 12,000 votes more than Jimmy Carter got in New Hampshire, but the press ignored Wally Johnson because he was not deemed to be serious.

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SERIOUS political people will be hostile to this idea. They will endorse the rhetoric of broadened ownership because it sounds like Mom and apple pie, but the major power centers of American politics feel threatened by the idea of actually distributing capital ownership to everyone.

Organized labor sees it as compromising the hard and clean lines of worker-management bargaining. Corporate management distrusts it as an ultimate threat to its own control of corporate behavior. Technocrats devoted to managing the welfare state do not wish for its demise. No-growth environmentalists do want a new industrial boom for this country. Status-conscious conservatives are offended by the egalitarian premise.

Listen carefully to their objections. These people have impressive arguments on why this scheme will not work or why it should not be tried. Listen, then ask yourself what these experts would have told Lincoln about his crazy plan for homesteading.

Exhibit 5

Ownership History

...That the inhabitants of the English colonies in North America, by the immutable laws of nature, the principles of the English constitution, and the several charters or compacts, have the following RIGHTS:

Resolved ... That they are entitled to life, liberty and property: and they have never ceded to any foreign power whatever, a right to dispose of either without their consent.

-Declaration and Resolves of the
First Continental Congress-,
October 14, 1774

"The control over a man's subsistence amounts to a control over his will."

-Alexander Hamilton-

...That all Men are by Nature equally free and independent, and have certain inherent Rights, of which, when they enter into a State of Society, they cannot by an Compact, deprive or divest their Posterity; namely, the Enjoyment of Life and Liberty, and the Means of acquiring and possessing Property, and pursuing and obtaining Happiness and Safety.

-Virginia Declaration of Rights-
June 12, 1776

...We hold these truths to be self-evident; that all men are created equal; that they are endowed by their Creator, with certain inalienable rights; that among these are life, liberty, and the pursuit of happiness. That to secure these rights, governments are instituted among men, deriving their just powers from the consent of the governed;...

-Declaration of Independence-
July 4th, 1776

All men are born free and equal, and have certain natural, essential, and unalienable rights; among which may be reckoned the right of enjoying and defending their lives and liberties; that of acquiring, possessing and protecting property; in fine, that of seeking and obtaining their safety and happiness.

- Massachusetts Declaration of
Rights -
October 25, 1780

Article V. No person shall ... be deprived of life, liberty, or property, without due process of law; nor shall property be taken for public use, without just compensation.

-Bill of Rights-
December 15, 1791

Private property is a creature of society, and is subject to the calls of that society, whenever its necessities shall require it...

-Benjamin Franklin, 1783-

Law is a very good thing for men with property and a very bad thing for men without property.

-Rousseau, Social Contract-

The nations of our time cannot prevent the conditions of men from becoming equal; but it depends upon themselves whether the principle of equality is to lead them to servitude or freedom.

-de Tocqueville-
final comment in Democracy in America

Tenantry is unfavorable to freedom. It lays the foundation for separate orders in society, annihilates the love of country, and weakens the spirit of independence. The tenant has in fact no country, no hearth, no domestic altar, no household god. The freeholder, on the contrary, is the natural supporter of a free government, and it should be the policy of republics to multiply their freeholders, as it is the policy of monarchies to multiply tenants.

-Thomas Hart Benton-

Jefferson, though the secret vote was still unknown at the time had at least a foreboding of how dangerous it might be to allow the people to share a public power without providing them at the same time with more public space than the ballot box and with more opportunity to make their voices heard in public than on election day. What he perceived to be the mortal danger to the republic was that the Constitution had given all power to the citizens, without giving them the opportunity of being citizens and of acting as citizens.

-Hannah Arendt-
in On Revolution

...if you believe in democracy...distribute property as widely as possible.

-Aldous Huxley-

...In Harlem, for instance, all of the stores are owned by white people, all of the buildings are owned by white people. The black people are just there paying rent, buying the groceries; but they don't own the stores, clothing stores, food stores, any kind of stores; don't even own the homes they live in. They are all owned by outsiders, ...
"When the thing is finally sparked, the white man is not there-he's gone. The merchant is not there, the landlord is not there, the one they consider to be the enemy isn't there. So, they knock at his property. This is what makes them knock down the store windows and set fire to things, and things of that sort.

-Malcom X-

Government has the responsibility to provide the climate in which Americans, all Americans, have an opportunity for good jobs; and not only for good jobs, but an opportunity if they have the ability and the desire, to be owners and managers, to have a piece of the action, because if they have a piece of the action, then they believe in the system rather than fighting against it.

-Richard Nixon-

Property performs the function of maintaining independence, dignity and pluralism in society by creating zones within which the majority has to yield to the owner. Whim, caprice, irrationality and 'antisocial' activities are given the protection of law; the owner may do what all or most of his neighbors decry. The Bill of Rights also serves this function, but while the Bill of Rights comes into play only at extraordinary moments of conflict or crisis, property affords day-to-day protection in the ordinary affairs of life. Indeed, in the final analysis the Bill of Rights depends upon the existence of private property.

-Charles A. Reich-

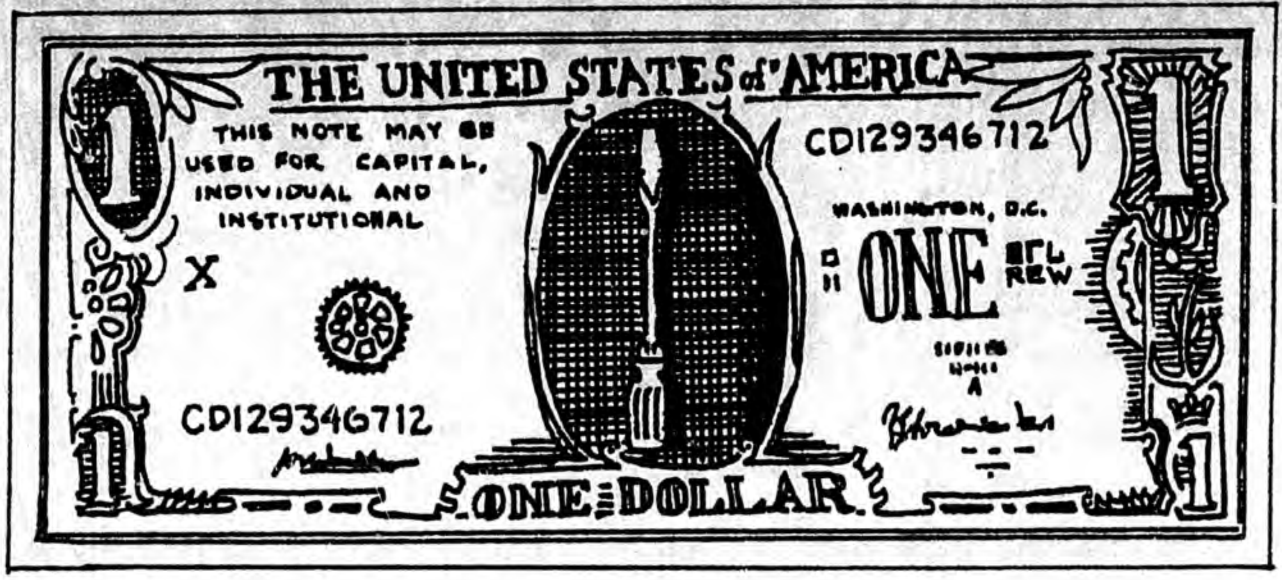
Profit sharing in the form of stock distributions to workers would help to democratize the ownership of America's vast corporate wealth which is today appallingly undemocratic and unhealthy.

-Walter P. Reuther-
President, United Auto Workers

"...democracy is a method of finding proximate solutions for insoluble problems."

-Reinhold Niebuhr-

Exhibit 6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THIS NOTE MAY BE USED FOR CAPITAL, INDIVIDUAL AND INSTITUTIONAL
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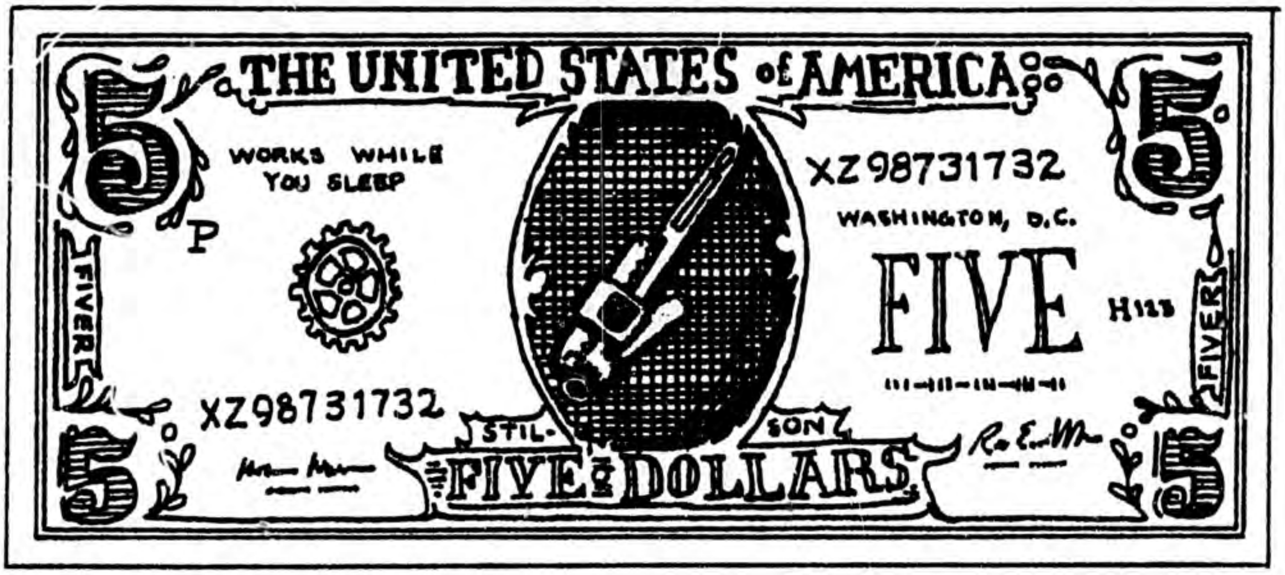
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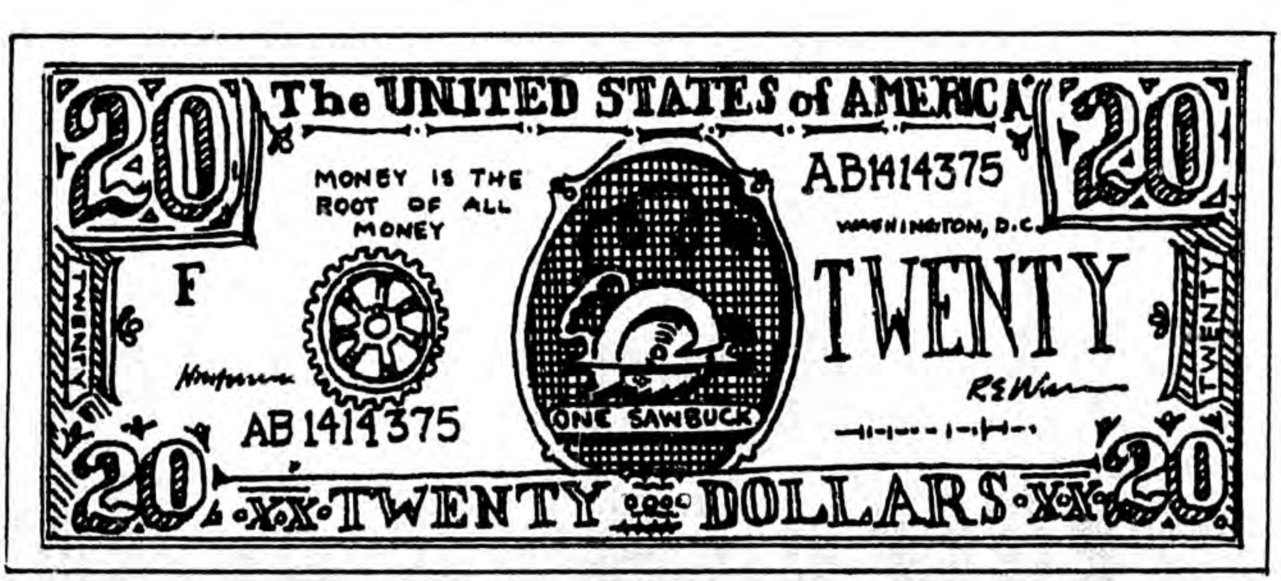
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ONE SAWBUCK
XX TWENTY DOLLARS XX
20

Fortune Magazine - February 26, 1979

Share the Wealth

During three years in power, a socialist government succeeded in nationalizing or buying into a number of British Columbia's natural-resource companies. But in 1975, exasperated voters of Canada's third-largest province threw the socialist premier out and elected William R. Bennett, the millionaire son of a previous B.C. premier. A champion of free enterprise, Bennett, 46, has found a way to undo part of the socialists' work. Every one of the province's 2.4 million residents will be offered five shares of British Columbia Resources Investment Corp., a holding company set up by the government.

B.C. Resources owns 81 percent of Canadian Cellulose, a $153-million forest-products firm, and 10 percent of Westcoast Transmission Co. (1977 sales: $735 million), which operates a natural-gas pipeline. B.C. Resources also has two wholly owned forest-products companies, and valuable oil- and gas-exploration rights on some 2.3 million acres.

Under Bennett's plan, 80 percent of the stock—some 12 million shares—will be distributed to every man, woman, and child who has lived in the province in the last year and is a Canadian citizen. They will also be eligible to buy more stock—up to 5,000 shares—at a discount. Each share of B.C. Resources has a book value of $10, and the company will be listed on the Vancouver Stock Exchange. "We live in a rich province," says the premier. "Now my government wants to give the people the opportunity to share these riches."

2111 Dawnlight Court
Anchorage, AK 99501
February 12, 1980

Representative Russ Meekins, Jr.
Chairman, House Finance Committee
Pouch WF
Juneau, Alaska 99811

Dear Russ:

Enclosed please find my examination of the proposed Alaska General Stock Ownership Corporation (AGSOC), entitled "Alaska's AGSOC Plan: A Study in Political Economy." As you know, this paper was prepared for the House Finance Committee under contract with the Division of Legislative Finance.

Given the formidable task of evaluating the potential implications of such a complex plan, I have endeavored to keep my analysis as clear, concise, and brief as possible. Please feel free to call on me if you need clarifications on any part of the paper.

I hope that my remarks will prove valuable to you and your committee as you evaluate the AGSOC bill.

Sincerely,

Larry

Larry L. Ross

ALASKA'S AGSOC PLAN:

A STUDY IN POLITICAL ECONOMY

by

Larry L. Ross

Prepared for
The House Finance Committee
of the State of Alaska
under contract with
The Division of Legislative Finance

February 15, 1980

I. INTRODUCTION

"Share the wealth. Every man a king." The history of America is dotted with innumerable schemes which promised to alleviate the trend toward an unequal distribution of wealth and its counterpart, income. In the mid-1800's Karl Marx and Friedrich Engels proposed a proletarian revolution to overthrow the capitalist mode of production. The more conservative Henry George, "a printer who thought much about economics,"[1] was nearly elected mayor of New York City in 1886 on a platform based on a single tax on land. In the 1930's Governor Huey Long of Louisiana promised to revise capitalism and make "every man a king." More recently, Howard Jarvis of California led a taxpayers' revolt culminating in the passage of Proposition 13, and is presently promoting a constitutional amendment to limit spending by the federal government.

The people of Alaska are now being asked to consider the implementation of an Alaska General Stock Ownership Corporation (AGSOC). Heavily supported by Senator Mike Gravel, the AGSOC proposal was developed by Louis Kelso of San Francisco, father of such share-the-wealth plans as ESOP (Employee Stock Ownership Plan) and CSOP (Consumer Stock Ownership Plan). According to Kelso, AGSOC is an "attempt to change the course of American Economic History, and eventually world history,"[2] by spreading the ownership of productive capital among a broad base of the citizenry. Kelso introduces his AGSOC proposal through a scathing attack of capitalism reminiscent of that levelled by Marx and Engels over a hundred years ago. Yet, in contrast to the founders of modern communism, Kelso's solution to capitalism's inherent tendency toward self-destruction is reform rather than revolution. Embracing the basic tenets of capitalism, Kelso expresses a burning concern that technology is speeding the system toward totalitarianism, the destruction of private property, and a resulting loss of human freedom. Enter AGSOC, a plan which Kelso says will "build the economic power of the people" through a re-distribution of Alaska's wealth.[3] And Kelso's dream is a lofty one: AGSOC, according to its author, "can build general affluence into all Alaskan citizens over a reasonably brief span of time."[4]

II. PURPOSE

The purpose of this paper is to evaluate the Alaska General Stock Ownership Corporation (AGSOC) from an ideological perspective, with an emphasis on economic rather than political analysis. More specifically, the paper (1) compares the AGSOC proposal with the basic tenets of free enterprise as defined and described by classical liberal economists, (2) compares the proposed AGSOC with the contemporary workings of the free enterprise system, and (3) analyzes the potential impact of AGSOC on the centralization of political and economic power in Alaska and the public policy implications of the state government functioning as both guarantor and regulator of AGSOC.

III. AGSOC AND FREE ENTERPRISE

In the view of nineteenth century or classical liberalism, the essence of free enterprise is summarized in one word: freedom. Smith, Ricardo, Say, Malthus, Mill--each valued individual economic freedom above all else. And to each, freedom involved two dimensions: (1) entry--the freedom of the individual to enter an industry, to establish a business enterprise; and (2) laissez faire--the freedom of the individual from restrictions on entry imposed by powerful institutions, most notably government.

Classical liberals believe that the power of government must be both limited and dispersed. In economic affairs, government's role should essentially be restricted to defining and preserving the rights of private property; to, as Milton Friedman states in Capitalism and Freedom, "determine, arbitrate, and enforce the rules of the game."[5] In most cases, therefore, the free market competitive forces of supply and demand should be utilized to provide those goods most wanted by society and to set prices. However, in the limited number of cases "in which strictly voluntary exchange is either exceedingly costly or practically impossible,"[6] government intervention might be justified. Examples according to Friedman include (1) technical monopolies (industries in which normal competition would naturally tend toward monopoly), (2) neighborhood effects (market exchanges which generate either spillover costs or benefits to third parties), and (3) paternalism (government accepting responsibility to care for persons unable to care for themselves, such as children and the mentally ill).[7] Finally, given the need for government in this limited number of situations, governmental power should be dispersed, not centralized. If government action is needed, let it occur at the lowest level possible, at the city rather than state level, at the state rather than federal level. As Friedman argues,[8]

> If I do not like what my local community does, be it in sewage disposal, or zoning, or schools, I can move to another local community, and though few may make this step, the mere possibility acts as a check. If I do not like what my state does, I can move to another. If I do not like what Washington imposes, I can have few alternatives in this world of jealous nations.

Classical liberal economists identify four distinct categories of productive resources, or factors of production. These are (1) land, or natural resources; (2) labor; (3) capital (tools, machinery, plant, equipment); and (4) entrepreneurial ability (responsibility for organizing production, adapting new technology to production, innovating, bearing risk, etc.). Because each factor is assumed to be scarce relative to human wants, each commands a price or "return" in the marketplace. Thus, rental income flows to land, wages to labor, interest payments to capital, and profit to entrepreneurial ability.

The classical liberal view, then, is that of an economy dominated by free competitive markets and with minimal government interference into individual affairs, a system emphasizing "freedom as the ultimate goal and the individual as the ultimate entity in the society."[9] In such a world, each person would be free to engage in "free enterprise" as he or she saw fit, to enter into contracts of his/her own choosing. The state's role would primarily be restricted to defining and preserving private property rights, except in cases of technical monopoly, neighborhood effects, or paternalism. With the role of the individual and the state thus defined, the economy would basically be self-regulating and would, in the nineteenth century view, automatically tend toward equilibrium at full employment.

The AGSOC proposal is based on what Louis Kelso, its developer, calls his "theory of Universal Capitalism or Two-Factor Economics."[10] This theory, which identifies only labor and capital as being productive resources, runs totally contrary to the classical liberal recognition of four factors. By omitting land and entrepreneurial ability from the factors of production, Kelso is apparently trying to differentiate himself from the classical liberal tradition as well as from the modern or Keynesian view. One wonders why Kelso does not simply go one step further and, like Marx, recognize only factor, labor, as being the source of all value. This, of course, would not serve Kelso's ends, since ultimately his solution to the unequal distribution of wealth and income under capitalism is reform of the system rather than revolution as proposed by Marxists.

It is interesting to note that, in fact, much of the critique of capitalism contained in Kelso's Report to the Alaska State Legislature bears great similarity to the Marxian analysis. In contrast to the classical liberal view of capitalism as a system offering opportunity and upward mobility for the working class, both Marx and Kelso see inequality as the natural result of competitive capitalism. And, like Marx, Kelso sees technology as being the engine of historical change. As Kelso states in his Report,[11]

> Labor power is broadly owned by the great majority of American workers, while the ownership of capital is highly contentrated. Thus, as earnings shift from labor to capital, without government interference, more and more income will flow to fewer and fewer people. It is the shifting of income as a result of technology which threatens the foundations of our society. It means that fewer and fewer people will own an even larger portion of our productive power and the income accompanying it while labor receives an ever decreasing portion.

While cloudiness surrounds the relationship between AGSOC and the State of Alaska, there is little doubt that the AGSOC plan deviates significantly from the classical liberal perspective regarding the relationship between business and the state. The AGSOC Educational Committee promotional pamphlet says that[12]

> The state would charter AGSOC and help identify all Alaska residents so that each would get a share of AGSOC stock.
>
> But once AGSOC was launched, it would be on its own.

A careful look at the remainder of this pamphlet, plus the proposed legislation, may lead one to conclude otherwise.

Unlike a private corporation, AGSOC would be created by a political body, the Alaska State Legislature. AGSOC's three incorporators would be political appointees, named to their positions by the governor, the president of the State Senate, and the speaker of the Alaska House of Representatives. These political appointees would then choose AGSOC's board of directors, which would appoint management. To whom will AGSOC's managers and directors ultimately be responsible, if not to the politicians who created them?

In contrast to the classical view of free enterprise as emphasizing almost exclusively private initiative and private financing of business, AGSOC would be tied to the state from its inception. These ties would include at the very least state loans or loan guarantees to pay AGSOC's start-up costs, and might also involve either state loan guarantees or direct state loans to finance AGSOC's proposed investments in large scale projects such as the Trans Alaska Pipeline System (TAPS), a natural gas pipeline, a fish processing plant, etc. Senator Gravel's comments notwithstanding, one wonders what rational businessperson would be willing to lend millions of dollars to a corporation which has no assets, no "track record," and therefore no collateral. The strong likelihood exists that AGSOC, conceived and born by an act of the state, will remain dependent on the state throughout its lifetime. Such government involvement in the private sector might be justified by classical liberals on the grounds of technical monopoly, neighborhood effects, and/or paternalism. But Kelso clearly points out that his motivation is to create a more equitable distribution of wealth and income in Alaska, to correct "the destruction of private property in the American economy, and hastening [of] the totalitarian society. . ."[13]

One of the beauties of the free enterprise system is that it treats everyone equally. The marketplace imposes severe fines on those who discriminate; racial ethnic, sexual distinctions are struck down by the impersonal free market. Each individual receives equal opportunity, equal access to economic power.

The AGSOC promotional pamphlet states that AGSOC would be "owned by all Alaskans."[14] This statement is deceiving. In reality AGSOC would not be owned by all Alaskans, but instead by a special class of Alaskans, those persons residing in the state between two specific points in time. Persons emigrating from Alaska before this period, and persons immigrating into Alaska after this period, would in general be excluded from AGSOC ownership. (Within limitations, some of these people might be able to acquire AGSOC shares secondhand.) From the classical liberal perspective, the proposed AGSOE would, through a political act, foster and promote economic discrimination in Alaska, a discrimination which, according to Kelso, is necessary in order to prevent dilution of capital.[15] Kelso even acknowledges that AGSOC is inconsistent with the principles of free enterprise: "ownership of shares is restricted to residents of Alaska, limiting the ability to develop a competitive and realistic market for the shares of AGSOC."[16]

Under the model of pure capitalism, the risks and uncertainties associated with free enterprise are borne by the owners of businesses. Profits (and losses) flow to entrepreneurs as compensation for sacrificing their scarce factor of production. AGSOC deviates from this model ir that AGSOC shareholders and AGSOC risk-bearers are two different groups of people. As previously mentioned, AGSOC would be owned by a special limited class of Alaskans. Yet the risks and uncertainties associated with AGSOC's investments would be borne by all Alaskans collectively, through the state's guarantees of loans to AGSOC, and/or direct state loans to the corporation. Put another way, all Alaskans, through use of state money, may wind up having to pay for AGSOC's losses. (This possibility was astutely pointed out by Mike Doogan in "An Analysis of the Two-Factor Theory As Applied to Alaska in Proposals for an Alaska General Stock Ownership Corportion.")[17] Contrary to the AGSOC promotional pamphlet's statement that "the idea behind AGSOC is to make every Alaskan a 'capitalist,'"[18] it appears that AGSOC might make some Alaskans capitalists, but at the expense of making all Alaskans share the risk of the capitalists' losses.

Included among the basic tenets of free enterprise are freedom of entry (the ability of individuals to both enter and leave markets of their own free will) and freedom of contract. The proposed AGSOC, by imposing restrictions on the selling and transfer of shares, as well as on the number of shares owned by a single shareholder, appears to curb both freedom of entry and freedom of contract, and to severely restrict traditional rights of private property. Kelso's Report to the Alaska State Legislature recommends "a far-ranging educational and communications program between AGSOC and its shareholders to encourage them to not sell their AGSOC shares." This program, when combined with Kelso's recommendation that, during the initial five year period, the selling price of any AGSOC stock "be pegged at book value, which could significantly discourage such sales,"[19] contradicts the principles of free enterprise and competitive capitalism.

Conclusion

The AGSOC plan, as proposed by Louis Kelso and Senator Mike

Gravel, represents a vast departure from the world of free enterprise envisioned by classical liberals. By imposing restrictions on free entry and private property rights, and by extending the role of the state into economic matters, AGSOC contrasts significantly with the dreams of Adam Smith and Milton Friedman. Despite the heralding of AGSOC as "a way to give everyone a stake in the free enterprise system,"[20] one is inevitably led to the conclusion that AGSOC would revise and perhaps re-define "free enterprise" to suit public (and perhaps private) aims.

IV. AGSOC AND MODERN CAPITALISM

America in the late twentieth century lies far from the dream world of pure capitalism envisioned by classical liberals. Big business, big banks, and big unions abound; the annual sales of our largest corporations exceed the Gross National Products of many foreign nations. Regardless of one's ideological viewpoint, it is difficult to deny the existence of significant market power (the ability of a firm to influence or set price) and its counterpart, barriers to entry.

Coupled with market power and barriers to entry is the fact that both income and wealth are unequally distributed in the United States. In 1976, for example, the lowest 20 percent of families received 5 percent of the income, while the highest 20 percent received 41 percent of the income; in addition, the top 5 percent of American families received about 16 percent of total income. Wealth (income-producing assets such as stocks, bonds, and land) is even more unequally distributed: it is estimated that in 1970 almost 40 percent of the country's wealth was held by less than 4 percent of the population.[21]

To promote distributional equity, to curb abuses of market power, and to insure freedom of entry, government at all levels has expanded its scope since the 1930's. Classical liberals limited government to defining and preserving private property rights and to providing those goods justified by technical monopolies, neighborhood effects, and paternalism. Government today far exceeds those boundaries, extending into nearly every aspect of American life, including (1) maintaining competition (e.g., antitrust, regulation, nationalization); (2) redistributing income (e.g., welfare, Medicare, subsidies, farm price supports, minimum wage laws, progressive income); and (3) stabilizing the economy through both monetary and fiscal policy, and direct market interventions such as wage-price controls. Federal, state, and local government expenditures today comprise roughly one-fourth of our Gross National Product.

The AGSOC plan of Louis Kelso is billed as a method of redistributing the wealth of Alaska so as to create a more equitable distribution of wealth and income. Any person who believes in the dignity of man and in egalitarian principles would have difficulty questioning AGSOC's stated aim: "to build the ownership of income producing capital into Alaskan residents."[22] The fundamental question is, therefore, not what is AGSOC's purpose, but will it accomplish its purpose?

As mentioned in section III of this paper, AGSOC would not benefit all Alaskans, but instead would bestow the privilege of owning wealth upon a special limited class of Alaskans. Furthermore, as Doogan points out, a potential exists for 10 percent of AGSOC shareholders to wind up owning 100 percent of AGSOC stock.[23] This raises doubts about AGSOC's ability to promote equity in wealth and income distribution.

What would be the effect of AGSOC on market power and barriers to entry? While this topic is pursued in section V of this paper, suffice to say that it appears that AGSOC will do little to either reduce the market power of big business, big banks, and big labor, or to break down existing barriers to entry. AGSOC, in fact, by creating a huge corporation with the state of Alaska's "blessing," may even intensify tendencies toward oligopoly and monopoly. State loans and/or loan guarantees to AGSOC, plus politically appointed incorporators and politically sensitive directors and managers, may actually have the effect of expanding the symbiotic relationship between American business and government which economist John Kenneth Galbraith describes in The New Industrial State. Instead of free enterprise, argues Galbraith, "we have an economic system which, whatever its formal ideological billing, is in substantial part a planned economy."[24]

Conclusion

AGSOC's ability to alter existing inequities in the distribution of wealth and income is doubtful. It also appears that AGSOC would be ineffective as a means of limiting market power or decreasing barriers to entry; in fact, through its mutualistic relationship with the state of Alaska, it may solidify existing market structures and haster the "planned economy."

V. AGSOC, POWER, AND THE STATE

AGSOC, a "strictly private enterprise, not a state corporation"[25] according to its supporters, is presented as a means of diffusing economic power in Alaska, a grass roots plan to return power to the people. However, as argued previously, it is not entirely clear that AGSOC will accomplish this goal; in fact, existing concentrations of power may be perpetuated and even increased if this plan is adopted. One thing is certain: AGSOC represents a blurring of the distinction between government and business, between public and private, between the individual and the state, between politics and economics.

The possibility that AGSOC may cause further centralization of economic power in Alaska has already been pointed out. AGSOC, by a political act, creates economic consequences, including at least (1) the birth of a special and limited class of Alaskans, owners of AGSOC capital; and (2) the potential for AGSOC to end up being owned by only 10 percent of its original shareholders. AGSOC owners and AGSOC risk-bearers are different groups of people; all of Alaska's residents, through state loans and/or loan guarantees to AGSOC, must bear the risk associated with AGSOC's investments. Yet, the profits made from such investments accrue only to the restricted class of AGSOC shareholders.

The separation of ownership and control in the modern corporation is an accepted fact of life. While AGSOC ownership would appear to be quite broadly diffused, as least during the initial five-year period, day-to-day control of AGSOC would lie in the hands of a few managers. A small management group chosen by an even smaller group of directors would possess power to make economic decisions affecting the lives of thousands of Alaskans. And these decisions would very likely be backed financially by all Alaskans collectively through the state.

It has been proposed that AGSOC invest in large scale capital-intensive enterprises, such as the Trans Alaska Pipeline System, the natural gas pipeline, etc. Such investments could, in effect, create a huge octupus-like holding company, whose tentacles extend into a variety of industries. The power of such a company could be enormous. It is apparent that AGSOC might involve extensive antitrust implications for both intrastate and interstate commerce.

The classical liberal tradition warns us that when political and economic affairs are mixed, a strong likelihood of concentration and centralization of power exists:[26]

> The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power may be eliminated--a system of checks and balances. By removing the organization of economic activity from the control of political authority, the market eliminates this source of coercive power. It enables economic strength to be a check to political power rather than a reinforcement.

AGSOC would be a politically created economic enterprise. AGSOC's incorporators, political appointees, would appoint a board of directors which would then hire management. To whom would AGSOC's managers and directors be ultimately responsible, if not to the state which gave birth to them? Would AGSOC be allowed to endorse political candidates or to make political contributions? If so, might it not exert much political as well as economic power? Would state and federal government employees, and elected and appointed government officials, be eligible to serve as AGSOC directors or managers? If so, conflicts of interest might naturally arise. Could managers or directors of existing large corporations also sit on AGSOC's board? And what about the probable formation of large AGSOC voting blocs by special interest groups? These are merely a few questions that need to be answered before definite conclusions can be reached concerning AGSOC's effect on the centralization of political and economic power in Alaska.

Several persons, including the governor of Alaska, have pointed out the tendency for AGSOC interests to at one time or another be at odds with state interests. The state is placed in the ambivalent position of being asked to serve as both guarantor and regulator of AGSOC. One wonders how effectively the state can function in both roles. For example, the state creates the AGSOC, which then becomes a profit maximizer seeking to exploit Alaska's natural resources; this exploitation is perhaps even supported by state loans or loan guarantees. Yet, the state is also charged with the responsibility of preserving the aesthetic qualities of the Alaska wilderness. Might not a conflict arise? In addition, would it not be in AGSOC's best interest for state income taxes on corporations to be lowered or even eliminated, or for AGSOC to receive a "special" exemption from state taxes?

If so, one measure of the cost of AGSOC might be the loss of state income tax revenues and the resulting foregone social welfare programs flowing to Alaskans. The AGSJC plan, offered as an aid for those at the lower end of the income scale, might actually result in a net loss in these groups' economic wellbeing.

Conclusion

Milton Friedman cautions that "if economic power is joined to political power, concentration seems almost inevitable. On the other hand, if economic power is kept in separate hands from political power, it can serve as a check and a counter to political power."[27] The AGSOC plan, if implemented, could create a monster whose power is immune from checks and balances; at the very least, a political allocation of resources would in some cases probably be substituted for an economic one (and also, sometimes, vice versa).

The changes which AGSOC would bring about in Alaska are unclear, and individual reactions to the plan are presently colored by emotionalism and rhetoric. Eventually, it is hoped, the fate of this share-the-wealth proposal will be decided through rational analysis tempered with careful consideration of Alaskans' values. Perhaps the following can serve as a guideline:[28]

> Freedom is a rare and delicate plant. Our minds tell us, and history confirms, that the great threat to freedom is the concentration of power. Government is necessary to preserve our freedom, it is an instrument through which we can exercise our freedom; yet by concentrating power in political hands, it is also a threat to freedom. Even though the men who wield this power initially be of good will and even though they be not corrupted by the power they exercise, the power will both attract and form men of a different stamp.

FOOTNOTES

[1] Paul A. Samuelson, Economics (10th ed.; New York: McGraw-Hill Book Company, 1976), p. 564.

[2] Kelso & Co., Inc., Design of an Alaskan General Stock Ownership Plan: A Report to the Alaska State Legislature, Vol. I (San Francisco: Kelso & Co., Inc., 1979), p. 9.

[3] Ibid., p. 24.

[4] Ibid., p. 16.

[5] Milton Friedman, Capitalism and Freedom (Chicago: The University of Chicago Press, 1962), p. 27.

[6] Ibid., p. 28.

[7] Ibid., pp. 28-34.

[8] Ibid., p. 3.

[9] Ibid., p. 5.

[10] Kelso et al, p. 15.

[11] Ibid., pp. 70-71.

[12] It's Time to Take Stock in Alaska (Anchorage, Alaska: AGSOC Educational Committee, 1979), p. 2.

[13] Kelso et al, p. 25.

[14] It's Time to Take Stock in Alaska, p. 1.

[15] Kelso et al, pp. 79-80.

[16] Ibid., p. 27.

[17] Mike Doogan, "An Analysis of the Two-Factor Theory As Applied to Alaska in Proposals for An Alaska General Stock Ownership Corporation"(paper prepared for the House Finance Committee of the State of Alaska under contract with the Division of Legislative Finance, March 9, 1979), pp. 12-13.

[18] It's Time to Take Stock in Alaska, p. 2.

[19] Kelso et al, p. 7.

[20] It's Time to Take Stock in Alaska, p. 1.

[21] William P. Albrecht, Jr., Macroeconomic Principles (Englewood Cliffs, N.J.: Prentice-Hall, Inc., 1979), pp. 70-71.

[22] Kelso et al, p. 7.

[23] Doogan, p. 14.

[24] John Kenneth Galbraith, The New Industrial State (Boston: Houghton Mifflin Company, 1967), p. 6.

[25] It's Time to Take Stock in Alaska, p. 2.

[26] Friedman, p. 15.

[27] Ibid., p. 16.

[28] Ibid., p. 2.

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April 4, 1979

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

Dear Chairman Miller:

I am enclosing the promised specific, suggested amendments to SSHB 240 which are addressed to the questions of accountability of the Board, the rights of shareholders, and procedures for Board and Board Committee meetings. In each instance I have attempted to describe the content of the proposed amendment and to offer an explanation of why I hold the view that such an amendment would be desirable. I have then attempted to break the amendment down into its component ideas and to give the Committee an opportunity to vote them up or down. My further function in this regard is then to draft statutory language which carries into effect the decisions of your Committee.

A number of critical questions concerning SSHB 240 are not addressed in this transmission. We have yet to discuss the regulation of proxies, their content and the vexing issue of how they will be financed. If the legislature desires to influence these thorny problems, now is the only opportunity. Another unfinished item is the future political activities of the GSOC. We can anticipate substantial first amendment problems if we embark on a project to muzzle the directors in their individual capacities. If the directors can speak to the public, the limitation on the "corporation's political activities" is, at best, theoretical. Working on this problem should present quite a challenge!

Finally, there are the proposals I advanced on the first evening of my testimony regarding criminal liability of directors in certain instances. I will work on these in the course of the next week.

✳ If I may offer a suggestion: (As I spend more and more time with SSHB 240 and the Alaska Business Corporations Act the more I become convinced that the better course is not to amend the existing corporations code to make room for the GSOC, but to begin anew and design a fully developed Code to regulate the GSOC, a set of laws designed with the special attributes of a general stock ownership corporation in mind and not as an afterthought. This project sounds bigger than it will turn out to be. I sincerely believe that working with your staff people it could be accomplished in a matter of weeks, although I would prefer to have the summer months to fine-tune the statute but, in the final analysis, having come this far with you,I am the servant of the Committee.)

I hope that this material proves of use to the Committee. When you have reached your decisions simply mail them back to me and I will sit down and draft the content of suggested legislation.

The Honorable Mike Miller
Chairman
State Affairs Committee

April 4, 1979

May I take this opportunity to thank you, the other members of the Committee, the various nonmembers who sat in on our discussions and the staff people for a splendid experience. People here have remarked that they have never seen me so energetic. One student commented that I seem to be following the "North Star." In any event, it has been an experience beyond the imagination of the scriptwriters for the "Paper Chase." I thank you all.

Best personal regards,

Sincerely,

Daniel W. Fessler

Daniel Wm. Fessler
Professor of Law

DWF:hf

Enclosures

THE FOLLOWING DOCUMENT(S) MAY NOT FILM LEGIBLY BECAUSE OF POOR QUALITY OF THE ORIGINAL.

TO: THE STATE AFFAIRS COMMITTEE OF THE ALASKA HOUSE OF REPRESENTATIVES

FROM: Professor Daniel Wm. Fessler, King Hall, the Law School of the University of California at Davis

SUBJECT: Suggested Amendments to Sponsor Substitute for House Bill 240: "An Act Creating the Alaska General Stock Ownership Corporation; and providing for an effective date."

DATE: April 4, 1979

Preliminary statement: At the conclusion of my appearance before the Committee last week I agreed with the members to prepare a series of written proposals for your consideration. Depending upon the sentiment of this body I will be directed in the drafting of amendments to the Sponsor's Substitute for House Bill No. 240. As will quickly become evident, it is time for the Committee to make some basic choices concerning the nature of the General Stock Ownership Corporation which it may wish to pass to the floor for consideration in the whole House. The suggestions which follow represent nothing beyond the scope of our discussion last week unless specifically indicated as "NEW." In each instance I will set forth the proposal and a brief statement illustrating specifically what it is that I am suggesting be accomplished if you elect to follow my recommendation.

I. SUGGESTIONS DESIGNED TO MAKE THE BOARD OF DIRECTORS MORE RESPONSIVE TO THE DESIRES OF SHAREHOLDERS OF THE GENERAL STOCK OWNERSHIP CORPORATION:

My perception of the need for revision: The pending proposal is that the legislature create the AGSOC as a "private" corporation essentially regulated under the terms of Chapter 05 of the Alaska Statutes (The Alaska Business Corporation Act). As I indicated in my testimony, this general statute is a bare bones version of the "Model Act" which is, in turn, fashioned after the

Illinois Business Corporation Act. Its essential feature is to give a corporation a license to create a very strong board of directors, a board which is effectively insulated from shareholder pressure during its tenure in office.

This is a crucial assertion. Once this corporation is created and deemed "private" the legislature will part with its major chance to have an effective voice in the behavior of such an instrumentality. If the GSOC is a successful economic venture the power of that unchecked body will rise dramatically and its ability to pursue conduct which subsequent legislatures may deplore is a real danger which ought to concern this present body.

Why is the board of directors of a corporation organized under a statutory framework such as the Model Act virtually unchecked in these circumstances? To begin our assessment we should think in terms of the content of three documents: the statutory framework, the articles of incorporation, and the bylaws. It is no accident that the Kelso Report presents this legislature with a package containing a recommended content for each of these essential documents. Here is a point the Kelso Report does not stress: the legislature has control only over the statutory framework (the enabling legislation now before the Committee). Once the GSOP is formed by this legislation, the incorporators (See, Sec. 10.50.010(a), p. 1 SSHB 240) will adopt the articles of incorporation and it will then be beyond the powers of this or subsequent legislatures to interfere with the content of that fundamental document. Once the incorporators have elected themselves as the initial board of directors (See, Sec. 10.50.030(b), p. 3 SSHB 240), they will act in that capacity to adopt the content of the bylaws. Again, it will be too late for the legislature to exert its will. Thus unless changes are made you will have surrendered to these nine appointed individuals sole determination over the content of the documents which will become the framework in which the corporation will actually be structured and function. Your only chance for effective influence is with respect to the content of the statute. If you adopt the current content of House Bill 240, you will hand these appointed individuals (only a majority of whom need be Alaskans) a blank check to narrow their accountability to all of the citizens of this state in their capacities as shareholders in the GSOC. The express terms of SSHB 240 already give to this Board the strong power position of "classification" meaning that the directors will serve three year terms with the nine members segregated into three classes so that only one third of the membership is up for election by the shareholders at each annual meeting. (See, 10.50.030(a)(b), pp. 2-3 SSHB 240). There is a pragmatic advantage in this proposed classification in that insures to the incumbent board the continuity inherent in the fact that a working majority of the Board will not be facing election. There is also a grave danger. Such a Board could ignore the wishes of a majority of the shareholders and yet maintain effective control and management over the corporation for two years. The people in their role as shareholders would be powerless. This body in its role as representative of the people would be equally powerless. True, it could deny the GSOC cooperation to the extent that it was requesting the legislature to call for an election to authorize a state guarantee of GSOC debt instruments (although see the Memorandum of Attorney General Gross under date of March 20, 1979, raising a question as to whether recourse to the people would actually be required). Yet this is a very indirect way of attempting to discipline the Board or correct the excesses of that body as viewed from the perspective of the legislature. I do not wish to belabor the point: if the members of this House feel that a different distribution of power as between the shareholders and the board, and as between the GSOC and the government of Alaska is desired . . . now is the time to act and the content of the enabling legislation is the proper forum for that action.

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PROPOSALS DESIGNED TO INCREASE THE ACCOUNTABILITY OF INDIVIDUAL DIRECTORS AND THE BOARD AS AN ENTITY:

PROPOSAL NUMBER ONE: THAT DIRECTORS BE SUBJECT TO REMOVAL BY ORDER OF A SUPERIOR COURT UPON SUIT BY 100 OR MORE SHAREHOLDERS OF THE GENERAL STOCK OWNERSHIP CORPORATION.

> I propose that the enabling legislation be amended to provide that a superior court may, at the suit of 100 shareholders or more or upon petition of the attorney general, remove from office any director in case of fraudulent or dishonest acts or gross abuse of authority or discretion with reference to the corporation and may bar from reelection any director so removed for a period prescribed by the court. In any such proceeding the corporation should be made a party to the action.

Explanation: This proposal is based upon Section 304 of the 1977 California Act with two important modifications: *first*, I propose that you alter the "standing requirement" from California's (". . . shareholders holding at least 10 percent of the number of outstanding shares. . . .") to one hundred shareholders. To follow the California percentage would be most unreal given the total diffusion of shareholdings in the GSOC (one share per resident). It would require a petition of 40,000 Alaskans or more! In any other private corporation it is perfectly possible for a single shareholder to own 10% or more of the outstanding shares and thus have standing under the California Act. Requiring one hundred Alaskans to join in this suit should ensure that a single angry shareholder could not inaugurate a vexatious complaint. The second modification is to specially grant to the Attorney General standing to initiate this removal litigation. I do this because while the attorney general may well have personal standing as a *resident* of Alaska to join in such a suit we must recognize that litigation may be costly and that frequently only the office of the attorney general may have the human and financial resources to prosecute a removal suit upon which may depend the welfare of the corporation (and with that, welfare and interests of Alaskans).

Now it must be immediately evident that this type of removal can only be for the most gross violations of the fiduciary responsibilities assumed by a director and that the statute only grants standing to potential litigants and subject matter jurisdiction to the superior courts. Naturally, the plaintiffs would have to prove the allegations of their complaint by a preponderance of the evidence before the superior court would be warranted in exercising the power vested in it by this statute. I should *add* that it is quite possible that if the legislature does *not* act to provide for removal of directors in circumstances such as are covered by this proposal, a superior court might entertain such suits on a theory that such a grave matter is within the court's inherent jurisdiction. There is precedent. See, *California Fruit Growers' Assn. v. Superior Court*, 8 Cal.App. 711, 97 Pac. 769 (1908). In my opinion, this is not a desirable alternative because the legislature would be without control over the vital questions of who had standing to initiate the litigation and what would be deemed sufficient grounds for this grave remedy.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of having directors subject to removal by order of a superior court? YES ____ NO ____. If "yes," is the Committee in favor of the proposed formula granting standing only to one hundred or more shareholders? YES ____ NO ____. Does the Committee favor granting standing to the Attorney General of Alaska to initiate a removal suit? YES ____ NO ____.

PROPOSAL NUMBER TWO: THAT ANY DIRECTOR OR THE ENTIRE BOARD MAY BE REMOVED BY THE SHAREHOLDERS WITHOUT CAUSE.

> I propose that at any annual meeting or a special meeting properly noticed for the purpose at which a quorum is present, a majority of the shares voting in person or by proxy may remove the entire board and elect replacement directors. I further propose that the shareholders have power to remove less than the entire board provided there are appropriate safeguards to minimize the chance that an angry faction of shareholders could oust a single director.

Explanation: Both California and Delaware have found it expedient to pass recent legislation enabling shareholders who have lost confidence in the Board of Directors to remove either the entire Board or individual members at a meeting especially called and noticed to entertain such a motion, and that such removal may be for any cause deemed sufficient by a majority of the shares. In both California and Delaware, the statutes grant the right of removal to an absolute majority of the shares (50% plus 1 share). Again, we must recognize that there may be individual or institutional shareholders who, though a handful in number, would command an absolute majority of the outstanding shares. Such a potential coalition of large shareholders is a strong check upon the Board of Directors. Unfortunately, there will be no such potential shareholder unless the number of shares cast for removal exceeds the number of shares which originally elected the director. Thus if he was elected by a majority of 261,000 shares at an annual meeting, a special meeting noticed to entertain a removal resolution would not accomplish that objective unless 261,001 shares voted "yes" (in person or by proxy) on that question. If the director was appointed (as in the case of the initial Board), or elected by the Board to fill a vacancy arising by death, incapacity, or resignation mid-term, I would propose that a simple majority of a quorum would be sufficient to remove that director.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of having directors susceptible of removal by vote of the shareholders? YES ____ NO ____. If so, is the Committee content with the suggested formula for that removal? YES ____ NO ____.

PROPOSAL NUMBER THREE: THAT THE ENABLING ACT REGULATE THE STANDING OF SHAREHOLDERS TO INAUGURATE ACTIONS AGAINST DIRECTORS OR OFFICERS BROUGHT FOR THE BENEFIT OF THE CORPORATION (SHAREHOLDER'S DERIVATIVE ACTIONS).

I propose that the enabling act be amended to regulate the standing of shareholders to inaugurate actions seeking declaratory relief or money damages as against officers and directors of the GSOC for the benefit of the corporation (shareholder's derivative actions); lodge discretion in the superior court respecting whether and in what amount a security bond for expenses of litigation should be required of such a plaintiff; preclude non-judicially approved out-of-court settlements of such actions; and, provide for an accounting to the corporation of any proceeds received by the litigating shareholder(s) whether by judgment, settlement, or compromise.

Explanation: One of the most important developments in the past half century in seeking to hold directors and officers accountable for harm they bring upon the corporation is the concept of the shareholders' action or derivative suit. If you adopt the hypothesis that the Board or certain of its members is guilty of action or inaction which has brought great harm to the GSOC and which violates the duties of care or loyalty to the corporation, it is unrealistic to assume that those very directors will authorize or encourage corporate counsel to bring an action naming them as defendants! For this reason it is necessary to give individual shareholders the right to bring the litigation in the name of the corporation. Any recovery of money damages goes to the corporate treasury, not to the litigating shareholder (save for reimbursing him/her for the costs of the litigation).

Nearly every jurisdiction permits such actions and most regulate the conduct of such litigation by statute. Alaska is one of the few jurisdictions which permits but does not regulate by statute. Fortunately, the Supreme Court has acted to fill this void by providing in Rule 23.1 of the Civil Rules certain regulations for derivative actions by shareholders. (Added by Supreme Court Order 258, November 16, 1976.) The Alaska rule is predicated upon and nearly identical to Rule 23.1 of the Federal Rules of Civil Procedure. In my opinion, it does not go far enough in policing derivative actions by shareholders in the context of the General Stock Ownership Corporation.

The matters which should be covered by statute include:

* Who among the shareholders may bring such an action?

I suggest that standing be limited to a shareholder who held his or her share at the time of the transaction of which complaint is made else an unscrupulous shareholder might merely "buy a lawsuit." And standing should be limited to a shareholder or shareholders with sufficient resources to be able to vigorously prosecute the action since a judgment will bind all of the other shareholders by its result.

- ***** Should the shareholder be required to exhaust intra-corporate remedies (e.g., make a demand upon the Board that it bring the action) as a precondition to commencing the action?

Modern statutes do not require the shareholder to make demands upon the Board if that would be a futile act (e.g., if the directors are named as the defendants it is unlikely that they would respond to the demand by directing suit against themselves). Thus I would propose that the shareholder be required to make demand upon the Board for corrective acction or to allege in his complaint before the superior court the reasons why he deems such a demand to be a futile gesture.

- ***** Should the shareholder be required to post a bond as a precondition to maintaining any derivative action?

Defending a derivative action is time consuming and expensive and there is always a danger that a shareholder will bring an ill-founded or vexatious action simply to harass management or in the hope that he will be "bought off" with an out-of-court settlement. To minimize the instance of such "strike suits," many states in the 1940's adopted the practice of requiring a litigating shareholder to post a bond as a precondition to maintaining the action, a bond which would hold the defendants harmless against their costs of litigation (including attorney's fees) in the event the shareholder should fail to prevail. There is no current Alaska law on this point. Rule 23.1 is silent. My suggestion is that the Committee borrow the best features of modern California and New York statutes on striking a balance on this vital question. Section 800 of the California Act leaves the trial court with substantial discretion to entertain a timely motion from defendants for the posting of such security. Thus the court could consider the nature of the plaintiff's allegations and project the likelihood of success. It would then exercise sound discretion in requiring that a bond be posted or in denying the request of the defendants. If a bond is required the court has further discretion to determine the amount of the bond. California presently limits the bond to a sum not more than $50,000. This ceiling is viewed as posing some protection against a judge who would simply price the plaintiff out of court with a bond requirement substantially beyond reasonable means. Again, the California Act provides that the amount of the bond may be raised or lowered (subject to the $50,000 ceiling) at any time during the course of the litigation upon the motion of either party or upon the court's own initiative as it seems the interests of fairness to require.

* Should the shareholder who has commenced a derivative action be allowed to compromise or "settle out of court"?

No, not in my opinion. This is very dangerous and tolerates "strike suits"--actions commenced with no solid ground but with the hope that management will tire of the time and expense of defending the litigation and "buy plaintiff off." New York is far ahead of other jurisdictions in warding off this danger. No action in the nature of a derivative suit may be settled or *compromised without* the approval of the court in which it was commenced and without notice to the other shareholders. This last feature is essential to protect the interests of both the court and the other shareholders. The court is protected for a judicially approved settlement precludes any shareholder from attempting to relitigate the same questions. The notice requirement permits other shareholders to come forward and object either to the terms of the proposed settlement or to offer to take up the suit and carry it forward in the event of an afterarising unwillingness of the original litigant.

* Should the litigating shareholder in all circumstances be forced to account to the corporation for any proceeds realized from such an action?

Yes. In all jurisdictions this is mandatory if the court returns a judgment against the defendant officers or directors. All proceeds of the judgment are paid into the corporate treasury on the theory that the action has vindicated harm done to the corporation and not the litigating shareholder. The shareholder receives an allowance from these funds sufficient to cover the costs of the litigation. But what if the resolution is by way of an informal settlement? This is the dark side of this type of litigation. Frequently shareholders are offered a tidy sum (e.g., $20;000) if they will dismiss their suit. They keep the money and none of the other shareholders are the wiser. New York simply prevents this. There can be no informal settlement. Any dismissal predicated upon a compromise must be presented to the court, its terms noticed to the other shareholders, and any proceeds paid into the corporate treasury.

If all of these features are incorporated into the enabling act, I am of the view that Alaska will have the best of all possible positions with the virtue of derivative actions and none of the vices inherent in strike litigation.

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DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor in principle the concept of permitting derivative actions by shareholders in the General Stock Ownership Corporation? YES ____ NO ____. If "yes," does the Committee favor regulating the derivative action by special provisions in the enabling act? YES ____ NO ____. If "yes," does the Committee favor:

- The suggested standing rules? YES ____ NO ____.
- The suggested provision on exhaustion of intra corporate remedies? YES ____ NO ____.
- The suggested provision on the posting of a security bond for the defendants' costs of litigation? YES ____ NO ____.
- The suggestion that there be no compromise or dismissal of such an action without court approval? YES ____ NO ____.
- The suggested provision that the litigating shareholder in all circumstances be forced to account to the corporation for any proceeds realized from such a derivative action? YES ____ NO ____.

II. PROPOSALS DESIGNED TO INCREASE THE INFORMATION AVAILABLE TO AND THE POTENTIAL ROLE OF SHAREHOLDERS IN THE GENERAL STOCK OWNERSHIP CORPORATION.

PROPOSAL NUMBER FOUR: THAT THE ENABLING ACT BE AMENDED TO PROVIDE LIABILITY FOR AN OFFICER OR AGENT WHO WRONGFULLY REFUSES TO ALLOW A SHAREHOLDER, OR A SHAREHOLDER'S AGENT OR ATTORNEY, TO EXAMINE AND MAKE EXTRACTS FROM CORPORATE BOOKS AND RECORDS.

I propose that an officer or agent who refuses to allow a shareholder or the agent or attorney of a shareholder to examine and make extracts from corporate books and records of account, minutes, and record of shareholders, for a proper purpose be made liable to the aggrieved shareholder for the penal sum of $1,000 in addition to other damages or remedy given such shareholder by law.

Explanation: Currently Sec. 10.05.240 of the Alaska Business Corporations Act confers upon shareholders a right to examine books and records. Section 10.05.243 provides a penalty for any officer or agent of the corporation who refuses to permit this inspection. Unfortunately, the penalty there provided (10% of the value of the shares owned by the aggrieved shareholder), is not much of a sanction in the context of the GSOC. In other contexts it may be very effective for it is obvious that the larger the number of shares owned by the aggrieved shareholder the more substantial are the consequences of denying the right of inspection. But a shareholder in the GSOC can never own more than 10 shares. Thus I propose to follow the current content of Alaska law in all particulars save for suggesting that a flat penal sum of $1,000 be established as the sanction.

The effective use of any of the shareholder checks upon management which are set forth in Suggestions One, Two and Three depend upon an effective ability to gain information as to the conduct of corporate affairs by the officers and the Board. Thus an effective right of inspection is essential. Indeed, the Committee might desire to see the penal sum imposed for each day there is a wrongful denial of the statutory right of inspection conferred by Sec. 10.05. 240.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of a statutory right of shareholders in the General Stock Ownership Corporation to inspect corporate books and records? YES ____ NO ____. Should this sum be levied: (a) per refusal _____; or, for each day of a refusal _____?

PROPOSAL NUMBER FIVE: THAT THE SHAREHOLDERS BE GIVEN THE POWER TO INITIATE AMENDMENTS TO THE BYLAWS.

The current statutes in Alaska provide that the articles may restrict the power to adopt, amend, and repeal bylaws to the Board of Directors. The Kelso Report recommends articles which do so restrict the power to the Board and it is likely that this is what a Board would do. I propose that the enabling act be amended to reserve a power of adoption, amendment or repeal of the bylaws to the vote or written assent of shareholders entitled to exercise a majority of the voting power of the GSOC. I would also propose that the act permit the Board to enjoy this power save for the fact that the Board could not, on its own motion, repeal or amend a bylaw which had been adopted by vote of the shareholders.

Explanation: As was dramatically illustrated by the content of the Kelso Report, the document which is most likely to contain the crucial provisions which govern the structure and operation of the General Stock Ownership Corporation is the bylaws. A significant feature in what is, in my opinion, the excessive grant of power to the Board in SSHB 240 is the potential for vesting this power exclusively in the Board. The balance can be redressed by simply amending the enabling act to provide for a sharing of this power in the case of a General Stock Ownership Corporation.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of permitting the shareholders to adopt, amend or repeal bylaws in the General Stock Ownership Corporation? YES ____ NO ____. If "yes," does the Committee favor the suggestion that this power be vested by statute in both the shareholders and the Board? YES ____ NO ____.

III. PROPOSALS DESIGNED TO IMPROVE THE QUALITY OF BOARD DECISION MAKING.

PROPOSAL SIX: THAT THE BOARD BE ENABLED TO TRANSACT BUSINESS BY USE OF A CONFERENCE TELEPHONE OR SIMILAR COMMUNICATIONS EQUIPMENT.

Given the significant distances as barriers to travel within the State of Alaska plus the strong likelihood that a minority of the directors will be non-Alaskans, I propose that the enabling act be amended to authorize the board to transact business by use of a conference telephone or similar communications equipment so long as all members participating in such a meeting can hear one another.

Explanation: One of the difficulties inherent in a body of nine members is to physically gather them in the same place at the same time for the transaction of Board business. In large corporate entities this is frequently difficult. The result has been a tendency to permit the Board to divide itself into smaller working committees or an "executive committee" to which is delegated most of the Board's function and authority. There is a price paid for such a solution. Decisions are made without the participation of the full membership. Yet a non-classical solution is at hand, and from my personal observation, a very familiar aspect of life in Alaska--the use of modern communications equipment to hold board meetings notwithstanding the fact that the members are not in the same place at the same time. Both California and Delaware now permit this and the reported experience is very satisfactory. I would suggest that such a provision be made a permanent amendment to Sec. 10.05.198 for all corporations formed in Alaska. It certainly merits adoption in the special case of the GSOC.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of permitting the directors to hold meetings via the use of conference telephones or similar communications equipment with participation in such a meeting constituting presence in person?

YES ____ NO ____.

PROPOSAL NUMBER SEVEN: THAT REGARDLESS OF COMMITTEE ASSIGNMENTS EVERY DIRECTOR HAVE A RIGHT TO ATTEND THE MEETINGS OF ANY COMMITTEE AND BE PRIVY TO ALL BOOKS AND RECORDS.

Current Alaska law permits the Board to divide itself into committees including an executive committee and to delegate board functions and authority. I have no quarrel with this concept but do suggest that the enabling act be amended to make it clear that regardless of committee assignments any director shall have the right to attend (but not participate in) any meeting of any committee and to have access to books and records pertaining to the activities or responsibilities of such committees as may, from time to time, be created.

Explanation: Again we illustrate what one jurist has termed the "law of laws" . . . that every advantage is purchased at a price. The desire to streamline and specialize the functions of directors is understandable but the price is the exclusion of those directors who are not appointed to key committees. Sometimes this problem assumes serious dimension as those directors who are perceived by the majority as raising vexing questions and airing dissenting views are simply shunted aside by exclusion from committee assignments. The legislature can go some distance toward minimizing this harm by providing by statute a right of each director to attend the meeting of any committee and to have access to books and records.

DIRECTIONS TO YOUR DRAFTING AIDES: Does the Committee favor the concept of granting directors a statutory right to attend the meetings of any Board committee and to have access to minutes and records? YES ____ NO ____

END OF THIS TRANSMISSION — SEPARATE LETTER BEING TRANSMITTED NEXT.

THE PRECEDING DOCUMENT(S) MAY NOT FILM
LEGIBLY BECAUSE OF POOR QUALITY OF THE
ORIGINAL.

MIKE GRAVEL
ALASKA

United States Senate

April 26, 1979

Dear Friends:

Governor Hammond in his "Working Paper on Dividend Dispersal Programs" criticises the House State Affairs Committee AGSOC bill. He assures me that his comments were not intended to give the impression that he would veto the AGSOC bill, but were offered as an aid in moving the bill forward. However, the Governor has made some assertions which are wrong and need to be corrected.

The Governor implies that AGSOC, like Alaska Inc., is merely a means of distributing "dividends" to Alaskans. AGSOC is not a scheme for distributing state assets to Alaskans, but a vehicle through which Alaskans can acquire new wealth independently of government. AGSOC is a vehicle for new capital ownership by the citizens of Alaska, not a scheme to distribute something they already own.

The Governor maintains that AGSOC would place the interests of the shareholders at odds with the interests of the state. The interests of the state are not independent of the interests of its people. The shareholders of AGSOC will be the people of Alaska. It is my conviction that people will be better citizens if they have a real economic interest in private enterprise and that they will act in their own best interests as economic shareholders and political citizens.

The Governor criticises AGSOC because it will create two types of citizens, shareholders and non-shareholders, and proposes as a remedy a scheme which creates many classes of citizens shareholders based on length of residency in Alaska. The Governor misses the point of AGSOC. The rational for AGSOC is not to "compensate" anyone for living in Alaska, but to provide a means other than the taxing power of the state for Alaskans to participate in the economic development of their state.

The House State Affairs Committee AGSOC bill prohibits ownership of AGSOC shares by outsiders. When a shareholder leaves the state he is required to sell his stock either to the corporation or another Alaskan.

The House Committee carefully considered the question of state financial assistance to AGSOC and made it clear that AGSOC was to be treated no differently than any other private corporation seeking state financial assistance. If, after full legislative action, the state decides to assist in AGSOC financing it will be doing no more than what it has already done for those Alaskans holding more than $150 million in state low interest business loans.

The corporate doctrine of limited liability protects the shareholders of AGSOC from any liability for the debts of the corporation.

There is no requirement that an Alaskans become a shareholder of AGSOC. He may reject the stock offered to him at any time within one year of its issue. If he becomes a shareholder and does not want the corporation involved in a particular investment he may put the question to a vote of the shareholders.

Best regards,

Mike

Mike Gravel

SHAREHOLDER POWERS

Each share of stock may be voted at shareholder meetings with 1/3 of the shares required for a quorum. Proxies are prohibited and in their place a corporate ballot and shareholder's pamphlet will be prepared, under regulations insuring fairness, and mailed to each shareholder. Shareholders vote their ballot by mail and cumulative voting is prohibited. The shareholders may nominate directors and place issues on the corporate ballot by petition of 1,000 shareholders. Notice of the right to nominate directors and place issues on the corporation ballot must be made by publication at least 150 days before the shareholder meeting and the meeting notice and ballot must be mailed at least 60 days before the meeting.

AGSOC is required to keep complete books and records available for shareholder inspection and any corporate agent wrongfully refusing shareholder access may be fined $1,000 per day. Shareholders have the right to remove the entire board by a majority vote or any single director by a vote at least as large as that which elected him. The attorney general or 100 shareholders may file suit to remove a director for fraudulent or dishonest acts or gross abuse of authority. Any shareholder may file a derivative suit on behalf of the corporation if those responsible inside the AGSOC fail to do so. The shareholders have the right to amend the bylaws and with a 2/3 vote the articles of incorporation.

DIRECTORS AND OFFICERS

The board of directors has management responsibility for AGSOC. The chariman and at least 3/4 of the board must be Alaskans. Board meetings must be held in the state, but members may participate by conference telephone. Outside directors can never constitute a quorum except when meeting to fill vacancies in the board. AGSOC will have nine directors although the number may be changed in the bylaws. The entire appointed initial board will stand for election at the first annual meeting. Thereafter, members serve for two years with half the board elected each year. Criminal misdemeanor penalties are provided for directors making distributions designed to deceive creditors or shareholders of AGSOC and any agent of AGSOC who makes fraudulent statements regarding the value of shares.

Officers of the AGSOC are appointed by the board of directors and serve at their pleasure. The board establishes the duties of the officers and may replace them at any time.

OTHER PROVISIONS

AGSOC is prevented from making endorsements of political candidates or ballot issues and may not spend money for lobbying of the legislature. Many of the other provisions of the Committee bill have been carried over substantially from existing Alaska corporate law. The provisions regarding sales of assets outside the ordinary course of business, dissolution of the corporation, restatement of the articles of incorporation, requirements for annual reports to the Dept. of Commerce, filing fees and charges, procedural provisions and forms, and power of the Commissioner of Commerce are all basically the same provisions which apply to existing Alaska corporations. The bill does retain the right in the legislature to change the law with respect to AGSOC at any time so long as the creditors of the corporation are protected.

WORKING PAPER ON

DIVIDEND DISPERSAL PROGRAMS

By Governor Jay S. Hammond

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

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

-- ALASKA INC.

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

-- AGSOC

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

-- MUTUALLY EXCLUSIVE OR COMPATIBLE?

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

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

-- MECHANICS OF ALASKA, INC

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

April 25, 1979

COMMITTEE SUBSTITUTE FOR HB 240

The general stock ownership corporation (GSOC) bill provided for the creation of a GSOC in Alaska. The corporation, taking advantage of new federal law, would be exempt from corporate income taxes. Income would be distributed annually to the shareholders and they would pay tax at their personal rate. The shareholders would be all the residents of Alaska as of the effective date of the bill and stock would be distributed to them free of charge. The GSOC would borrow funds to finance investment acquisitions.

House State Affairs Committee made extensive changes in the bill. The Committee Substitute creates an Alaskan GSOC and a new chapter of Alaska law to regulate it. The Committee addressed several policy problems with specific amendments described below.

CORPORATE DEMOCRACY

Alaska corporate law was perceived as inadequate for regulation of GSOCs because it tends to concentrate power in the corporate directors and, with the GSOCs broad stock ownership, provisions which insure director response to shareholders were required. To assure shareholder input to and control over the corporation and the board the Committee provided that:

1) Proxies are prohibited and in their place a corporate ballot and shareholder's pamphlet will be prepared, under regulations insuring fairness, and mailed to each shareholder. Shareholders vote their ballot and return it by mail. This prevents proxy battles and allows each shareholder to act on his own behalf.

2) Shareholders may amend the articles of incorporation and bylaws and may place issues on the corporate ballot and nominate board candidates through a petition signed by 1,000 shareholders.

3) Board and shareholder meeting must be held in Alaska and may be teleconferenced.

4) Materials mailed to shareholders must be filed with the Commissioner of Commerce and penalties are provided for false or misleading information.

5) Derivative suits may be filed by the shareholders on behalf of the corporation where the directors fail to act.

6) The chairman and 3/4 of the board must be Alaskans.

7) The entire board may be removed by a majority vote of the shareholders and any director by a vote of one more than elected him.

8) The superior court may remove a director for fraud or dishonesty upon suit by the attorney general or 100 shareholders.

9) It is a crime for directors to make unlawful distributions or false statements regarding share values and stiff penalties are provided for wrongful denial of shareholder access to GSOC books.

POLITICAL INFLUENCE

Concerns were expresses that the GSOC could become a major political influence in Alaska. To reduce potential GSOC political activity the Committee provided that:

1) The articles and bylaws of the GSOC must be submitted to the legislature for approval.

2) The legislature retains the right to amend laws affecting GSOCs subject only to protections for GSOC creditors.

3) Endorsement of candidates or issues and expenditures of money by GSOCs for political activities including lobbying of the legislature is prohibited.

4) Incorporators are appointed by the Governor, Speaker and Senate President with the original board, named by the incorporators, standing for election at the first shareholder's meeting.

FINANCING

Concerns were expressed that the state might be committed to supply monies for GSOC financial support. To limit the financial commitment of the state the Committee provided that:

1) There is no commitment to finance GSOC investments and no special treatment for GSOC requests for financial aid from the state. Like any private corporation state financial assistance to the GSOC would require a full legislative act.

2) The fund to guarantee private credit for GSOC startup expenses is limited to $5 million with review of commitments by the Commissioner of Revenue.

3) The Commissioner of Revenue does not have authority to invest surplus state funds in the GSOC nor may the permanent fund be so invested.

OWNERSHIP OF SHARES

HB 240 allowed an Alaskan to take his shares along upon leaving the state permanently. The only restriction was that when he sold the stock it must be sold to an Alaskan resident. This allowed outside shareholders.

Because of high residency turnover the Committee provided that shares may not be retained when a shareholder leaves Alaska, but must be sold. Federal law prohibits sales during the first five years unless the shareholder leaves Alaska. To discourage shareholders from leaving Alaska just to sell their shares all sales during this period must be made to the GSOC at book value. After five years shares of the GSOC may be freely traded within Alaska.

These amendments assure that only Alaskans will be shareholders of the Alaska General Stock Ownership Corporation.

MEMORANDUM

To: Gov. Jay Hammond

From: Jerry Gauche

Re: AGSOC Issues

Date: April 12, 1979

It may be helpful to comment on four issues which appear to have received considerable discussion within the administration regarding AGSOC. These comments are based on the most recent amendments by the House State Affairs Committee. The four issues are: (1) The distinctions between AGSOC and the permanent fund; (2) Financing for AGSOC; (3) Shareholder control; and, (4) Political impact.

Distinctions Between AGSOC and Permanent Fund

Resource Ownership vs. Capital Ownership

The permanent fund relys for its revenues on the resources owned jointly by Alaskans through their government. Development of those resources is controlled by private enterprise owned mostly by outsiders. AGSOC does not seek to distribute either the resources owned by Alaskans through their government or income from those

ASSETS. WHAT IT DOES SEEK TO DO IS TO GIVE ALASKANS A VEHICLE THROUGH WHICH THEY CAN PARTICIPATE IN THE DEVELOPMENT OF THEIR RESOURCES.

WHO PROFITS?

WHEN ALASKA RESOURCES ARE DEVELOPED BY OUTSIDERS THE OUTSIDERS PROFIT. ALASKA CAN SHARE IN ONLY A PART OF THE PROFITS FROM THAT DEVELOPMENT, THE PART WHICH CAN BE TAXED AWAY. HOWEVER THE STATE CANNOT TAX AWAY 100% OF THE PROFITS AND EXPECT FUTURE DEVELOPMENT BY OUTSIDERS. THE ENTIRE PROFITS FROM AGSOC PARTICIPATION IN DEVELOPMENT WILL REMAIN IN THE STATE BECAUSE THE SHAREHOLDERS OF AGSOC WILL BE ALASKANS.

TRUSTS VS. BUSINESS PARTICIPATION

THE PERMANENT FUND AND GOVERNMENT OWNED RESOURCES ARE VIEWED BY MANY AS A TRUST FUND FOR THE FUTURE, THE CORPUS OF WHICH SHOULD BE HELD INTACT AND INVESTED IN A CONSERVATIVE MANNER EITHER BY A BOARD OR INDIVIDUAL ALASKANS. AGSOC IS DESIGNED TO USE CREDIT IN ORDER TO GIVE ALASKANS ACCESS TO OWNERSHIP OF DEVELOPMENT CAPITAL IN THE STATE. THE PERMANENT FUND REPRESENTS ASSETS WHICH ALASKANS ALREADY OWN, AGSOC WILL BRING THEM OWNERSHIP OF NEW ASSETS. THE CONCEPT OF THE PERMANENT FUND AND AGSOC ARE NOT INHERENTLY COMPETATIVE, BUT COMPLIMENTARY. THE PERMANENT FUND QUESTION MAY BE SOLVED INDEPENDETLY OF AGSOC AND AGSOC CAN FUNCTION INDEPENDENTLY OF THE PERMANENT FUND.

State vs. Private Ownership

The permanent fund is a vehicle of the state and controlled by the elected officials of the state. It is a depository of state assets. The AGSOC is a private corporation controlled by its shareholders. Despite assertions otherwise, the fact that its shareholders are the residents of the state does not make it a political organization nor an arm of the state.

Financing of AGSOC

Legislative Review

No special legislation has been devised regarding state financial assistance for the AGSOC other than start-up costs. AGSOC is to be dealt with in the same manner as other private corpoations seeking state support. There is no mechanism whereby the state could be bound to financial support for AGSOC without legislative action. If state financial support is required for an investment AGSOC will be required to come before the legislature and the adminstration with a proposal which may or may not be approved by the legislature and signed by the Governor.

State Financing for Private Corporations

State involvement in financing private corporations is not new. But, present state support for private

CORPORATIONS BENEFITS ONLY THOSE PEOPLE IN ALASKA WHO HAVE ALREADY ACCUMULATED CAPITAL. THE STATE CURRENTLY HAS SOME $150 MILLION OF LOW INTEREST BUSINESS LOANS OUTSTANDING, BUT BECAUSE OF THE 75% LOAN LIMITS ONLY THOSE WITH EXISTING CAPITAL CAN QUALIFY. AGSOC BRINGS IN THE REST OF ALASKA IF THE LEGISLATURE AND THE GOVERNOR, AT THE REQUREST OF THE CORPORATION, SHOULD DETERMINE THAT STATE SUPPORT OF A PARTICULAR INVESTMENT BY THE AGSOC IS APPROPRIATE.

SHAREHOLDER CONTROL

THE HOUSE STATE AFFAIRS COMMITTEE IN DRAFTING A COMMITTEE SUBSTITUTE FOR THE AGSOC BILL HAS INCLUDED A NUMBER OF AMENDMENTS WHICH WILL MAKE THE BOARD OF DIRECTORS OF AGSOC MORE RESPONSIVE TO THE SHAREHOLDERS AND SHOULD ALAY FEARS THAT THE BOARD WILL BECOME AN INSULATED GROUP MORE POWERFUL THAN ANY OTHER IN THE STATE. THESE CHANGES INSURE THAT THE SHAREHOLDERS MAY PUT ISSUES AND BOARD CANDIDATES ON THE CORPORATION BALLOT, THAT THE INCUMBENT BOARD MAY NOT USE THE FUNDS OF THE CORPORATION TO MAINTAIN THEIR INCUMBANCY, AND THAT THE SHAREHOLDERS MAY, AT ANY TIME, REMOVE THE ENTIRE BOARD OR ANY MEMBER. IN ADDITION, THE COURTS ARE GIVEN JURISDICTION TO REMOVE A BOARD MEMBER JUDICIALLY AT SUIT OF THE SHAREHOLDERS OR THE ATTORNEY GENERAL.

POLITICAL IMPACT

MANY INFLAMATORY STATEMENTS HAVE BEEN MADE ABOUT THE POTENTIAL POLITICAL POWER OF THIS CORPORATION AND ITS BOARD MEMBERS. FUNDAMENTAL TO THE ARGUMENTS OVER THE QUESTION OF AGSOC POLITICAL INFLUENCE IS THE QUESTION OF WHETHER OR NOT THE PEOPLE OF ALASKA CAN BE TRUSTED TO MAKE PROPER DECISIONS REGARDING THEIR OWN FUTURE AND THE FUTURE OF THEIR STATE OR WHETHER, IN ORDER TO PROTECT THEM FROM MAKING THE WRONG DECISIONS, THE GOVERNMENT MUST BE INTERPOSED BETWEEN THE PEOPLE AND THE DECISIONS.

AGSOC ALLOWS THE PEOPLE, THROUGH THEIR CORPORATION, TO MAKE DECISIONS ON ECONOMIC DEVELOPMENT INDEPENDENTLY OF THE GOVERNMENT AND TO RECEIVE THE PROCEEDS OF SUCH DEVELOPMENT WITHOUT THEIR FIRST BEING FILTERED THROUGH THE GOVERNMENT. THIS DOES NOT, HOWEVER, MEAN THAT GOVERNMENT WILL BE EXPECTED TO ABROGATE ITS RESPONSIBILITIES WITH RESPECT TO PROPER REGULATION OF BUSINESS ENTERPRISES. FEAR OF POSSIBLE MISCONDUCT BY AGSOC IS REALLY FEAR THAT THE PEOPLE OF ALASKA WILL ACT IRRESPONSIBLY IF GIVEN THE CHANGE TO CONTROL THEIR OWN DESTINY. I THINK THAT THEY HAVE PROVEN OTHERWISE THROUGH THEIR POLITICAL DECISIONS IN THE PAST.

CHUGACH ELECTRIC ASSOCIATION, INC.

BY-LAWS

As Amended April 18, 1973

ARTICLE I

MEMBERSHIP

SECTION 1. Requirements for Membership. Any person, firm, association, corporation, or body politic, or subdivision thereof, may become a member of CHUGACH ELECTRIC ASSOCIATION, INC. by:

(a) Making a written application for membership therein;

(b) Agreeing to purchase from the Association electric energy as hereinafter specified;

(c) Agreeing to comply with, and be bound by, the articles of incorporation and by-laws of the Association, and any rules and regulations adopted by its board of directors; and

(d) Paying the membership fee hereinafter specified;

provided, however, that no person, firm, association, corporation, or body politic, or subdivision thereof, shall become a member unless and until he, or it, has been accepted for membership by the board of directors or the members. No person may hold more than one membership in the Association, and no membership in the Association shall be transferable, except as provided in these by-laws.

At each meeting of the members held subsequent to the expiration of a period of six months from the date of incorporation of the Association, all applications received more than ninety days prior to such meeting which have not been accepted, or which have been rejected by the board of directors, shall be submitted by the secretary to such meeting and, subject to compliance by the applicant with the requirements hereinabove set forth, any such application may be accepted by vote of the members. The secretary shall give each such applicant at least ten days written notice of the date of the members' meeting to which his application will be submitted, and such applicant shall be entitled to be present and heard at the meeting.

SECTION 2. Membership Certificates. Membership in the Association shall be evidenced by a membership certificate, which shall be in such form and shall contain such provisions as shall be determined by the board of directors. No membership certificate shall be issued for less than the membership fee fixed in these by-laws, nor until such membership fee has been paid. In case a certificate is lost, destroyed or mutilated, a new certificate may be issued therefor upon such uniform terms and indemnity to the Association as the board of directors may prescribe.

SECTION 3. Joint Membership. A husband and wife may apply for a joint membership and, subject to the compliance with the requirements set forth in Section 1 of this Article, may be accepted for such membership. The term "member" as used in these by-laws shall be deemed to include a husband and wife holding a joint membership, and any provisions relating to the rights and liabilities of membership shall apply equally with respect to the holders of a joint membership. Without limiting the generality of the foregoing, the effect of the hereinafter specified actions by, or in respect to, the holders of a joint membership shall be as follows:

(a) The presence at a meeting of either or both shall be regarded as the presence of one member and shall have the effect of constituting a joint waiver of notice of the meeting;

(b) The vote of either separately, or both jointly, shall constitute one joint vote;

(c) A waiver of notice signed by either or both shall constitute a joint waiver;

(d) Notice to either shall constitute notice to both;

(e) Expulsion of either shall terminate the joint membership;

(f) Withdrawal of either shall terminate the joint membership;

(g) Either, but not both, may be elected or appointed as an officer or director, provided that both meet the qualifications for such office.

SECTION 4. Conversion of Membership. (a) A membership may be converted to a joint membership upon the written request of the holder thereof, and the agreement by such holder, or his or her spouse, to comply with the articles of incorporation, by-laws, and rules and regulations adopted by the board of directors. The outstanding membership certificate shall be surrendered, and shall be reissued by the Association in such manner as shall indicate the changed membership status.

(b) Upon the death of either spouse who is a party to the joint membership, such membership shall be held solely by the survivor. The outstanding membership certificate shall be surrendered, and shall be reissued in such manner as shall indicate the changed membership status; provided, however, that the estate of the deceased shall not be released from any debts due the Association.

SECTION 5. Membership and Service Connection Fees. The membership fee shall be five dollars, upon the payment of which fee, the member shall be eligible for one service connection; provided, the board of directors may, as a condition to service, require the payment of a consumer deposit or the furnishing of other acceptable security in lieu thereof.

SECTION 6. Purchase of Electric Energy. Each member shall, as soon as electric energy shall be available, purchase from the Association all electric energy used on the premises specified in his application for membership, and shall pay therefor monthly at rates which shall from time to time be fixed by the board of directors; provided, however, that the board of directors may limit the amount of electric energy which the Association shall be required to furnish to any one member. Each member shall pay to the Association such minimum amount per month, regardless of the electric energy consumed, as shall be fixed by the board of directors from time to time. Each member shall also pay all amounts owed by him to the Association as and when the same shall become due and payable.

SECTION 7. Termination of Membership. (a) Any member may withdraw from membership upon compliance with such uniform terms and condition as the board of directors may prescribe. The board of directors of the Association may, by the affirmative vote of not less than two-thirds of all the directors, expel any member who fails to comply with any of the provisions of the articles of incorporation, by-laws, or rules or regulations adopted by the board of directors, but only if such member shall have been given written notice by the secretary of the Association that such failure makes him liable to expulsion, and such failure shall have continued for at least ten days after such notice was given. Any expelled member may be reinstated by vote of the board of directors, or by vote of the members at an annual or special meeting. If it appears that the best interest of the Association would be thereby served, the board of directors may, by resolution, cancel the membership of a member:

(1) who has ceased to purchase energy from the Association for a period of six (6) months;

(2) who had a disconnect order in effect for thirty (30) days without signing an order to reconnect; or

(3) to whom electric utility service has been discontinued because of the nonpayment of any moneys due the Association; provided, that such delinquency shall have continued for at least thirty (30) days after the discontinuance of such service.

(b) Upon the withdrawal, death, cessation of existence or expulsion of a member, the membership of such member shall thereupon terminate, and the membership certificate of such member shall be surrendered forthwith to the Association. Termination of membership in any manner shall not release a member or his estate from any debts due the Association.

(c) In case of withdrawal or termination of membership in any manner, the Association shall repay to the member the amount of the membership fee paid by him; provided, however, that the Association shall deduct from the amount of the membership fee the amount of any debts or obligations owing from the member to the Association.

ARTICLE II

RIGHTS AND LIABILITIES OF MEMBERS

SECTION 1. Property Interest of Members. Upon dissolution, after paying, or discharging, or adequately providing for the payment or discharge of all its debts, obligations and liabilities, other than those to patrons arising by reason of their patronage, the Association shall distribute any remaining sums, first to patrons for the pro rata return of all amounts standing to their credit by reason of their patronage, and second, to members for the pro rata repayment of membership fees. Any sums then remaining shall be distributed among its members and former members in proportion to their patronage, except as participation in such distribution may have been legally waived. In the event of the lawful liquidation, through transfer or sale of all the property and assets of the Association, the proceeds of such liquidation, transfer or sale shall be distributed in the same manner as hereinabove provided for in the case of dissolution.

SECTION 2. Non-liability for Debts of the Association. The private property of the members shall be exempt from execution or other liability for the debts of the Association, and no member shall be liable or responsible for any debts or liabilities of the Association.

ARTICLE III

MEETINGS OF MEMBERS

SECTION 1. Annual Meeting. The annual meeting of the members shall be held at such convenient date, on or after the 1st day of April, and on or before the 1st day of May of each year, at such place or building in the Anchorage Precinct, Third Judicial District, State of Alaska, as shall be designated by the board of directors on the notice of meeting, for the purpose of electing directors, passing upon reports for the previous fiscal year, and transacting such other business as may come before the meeting. Failure to hold the annual meeting at the designated time shall not work a forfeiture or dissolution of the Association.

SECTION 2. Special Meetings. Special meetings of the members may be called by resolution of the board of directors, or upon a written request signed by any three directors to the president, or by a written request made to the president and signed by a sufficient number of members to constitute a quorum as defined in Section 5, Article III, and it shall thereupon be the duty of the secretary to cause notice of such meeting to be given as hereinafter provided. Special meetings of the members may be held at any place within the Anchorage Precinct specified in the notice of the special meeting.

SECTION 3. Notice of Members' Meetings. Written or printed notice, stating the place, day and hour of the meeting and, in case of a special meeting, or an annual meeting at which business requiring special notice is to be transacted, the purpose or purposes for which the meeting is called, shall be delivered not less than thirty days before the date of the meeting, either personally or by mail, by or at the direction of the secretary, or upon a default in duty by the secretary, by the persons calling the meeting, to each member. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the member at his address as it appears on the records of the Association, with postage thereon prepaid. The failure of any member to receive notice of an annual or special meeting of the members shall not invalidate any action which may be taken by the members at any such meeting.

SECTION 4. Waiver of Notice. Any person entitled to notice of a meeting may waive such notice in writing, either before or after such meeting. If any such person shall attend such meeting, such attendance shall constitute a waiver of notice of such meeting, unless such person participates therein solely to object to the transaction of any business because the meeting has not been legally called or convened.

SECTION 5. Quorum. So long as the number does not exceed five hundred, ten per centum of the total number of members present in person shall constitute a quorum. If the total number of members shall exceed five hundred, fifty members, or three per centum of the members, whichever is the greater number, present in person, shall constitute a quorum. If less than a quorum is present at any meeting, a majority of those present in person may adjourn the meeting from time to time without further notice. If a meeting is called, but not held for lack of a quorum, the total number of members being in excess of five hundred, fifty members, or two per centum of the members, whichever is the greater number, shall constitute a quorum for each meeting subsequent thereto, whether convened by action of the members or otherwise, until a quorum is present and a meeting can be held, after which the quorum for the meeting next following shall revert to fifty members, or three per centum of the members, whichever is the greater number. The minutes of each meeting shall contain a list of the members present in person.

SECTION 6. Voting. Each member shall be entitled to only one vote upon each matter submitted to a vote at a meeting of the members. All questions shall be decided by a vote of a majority of the members voting thereon in person, except as otherwise provided by law, the articles of incorporation, or these by-laws.

SECTION 7. Order of Business. The order of business at the annual meeting of the members and, insofar as possible, at all other meetings of the members, shall be essentially as follows:

1. Report on the number of members present in person in order to determine the existence of a quorum.
2. Reading of the notice of the meeting and proof of the due publication or mailing thereof, or the waiver or waivers of notice of the meeting, as the case may be.
3. Reading of unapproved minutes of previous meetings of the members and the taking of necessary action thereon.
4. Presentation and consideration of reports of officers, directors and committees.
5. Election of directors.
6. Unfinished business.
7. New business.
8. Adjournment.

ARTICLE IV

DIRECTORS

SECTION 1. General Powers. The management of the business and the affairs of the Association shall be vested in a board of seven directors who shall exercise all of the powers of the Association, except such as are by law, the articles of incorporation, or by these by-laws conferred upon or reserved to the members.

SECTION 2. Election and Tenure of Office. The persons named as directors in the articles of incorporation shall compose the board of directors until the first annual meeting, or until their successors shall have been elected and shall have qualified. Directors shall be elected by secret ballot at annual meetings of the membership, by and from the members, to serve for a three-year term, or until their successors have been elected and qualified; provided, that directors elected to fill vacancies as provided in Article IV, Section 8 of these by-laws, as amended, shall serve only for the unexpired portion of the term vacated. At the first such election under this provision, members of the board shall be elected as follows: three members to one-year terms; two members to two-year terms; and two members to three-year terms. At each subsequent annual meeting, members shall be elected to fill the seats on the board which become vacant under the schedule hereby set forth, or which become vacant as contemplated by Article IV, Section 8 of these by-laws, as amended. If any election of directors shall not be held on the day designated herein for the annual meeting, or at any adjournment thereof, a special meeting of the members shall be held within a reasonable time thereafter for the purpose of electing directors. Directors may be elected by a plurality vote of the members.

SECTION 3. Qualifications. No person shall be eligible to become or remain a director, or to hold any position of trust in the Association, who:

(a) Is not a member and bona fide resident for at least one year in the area served or to be served by the Association; or

(b) Is in any way employed by, or financially interested in, a competing enterprise, or a business selling electric energy or supplies to the Association, or a business primarily engaged in selling electrical or plumbing appliances, fixtures or supplies to the members of the Association.

Upon establishment of the fact that a director is holding office in violation of any of the foregoing provisions, the board of directors shall remove such director from office.

Nothing contained in this section shall affect in any manner whatsoever the validity of any action taken at any meeting of the board of directors.

SECTION 4. Nominations. It shall be the duty of the board of directors to appoint, not less than sixty days before the date of a meeting of the members at which directors are to be elected, a committee on nominations, consisting of not less than five nor more than seven members, who shall be selected from different sections so as to insure equitable representation. No member of the board of directors may serve on such committee. The committee, keeping in mind the principle of geographical representation, shall prepare and post at the principal office of the Association, at least twenty days before the meeting, a list of nominations for directors, which may include a greater number of candidates than are to be elected. Any fifteen or more members, acting together, may make other nominations by petition not less than fifteen days prior to the meeting, and the secretary shall post such nominations at the same place where the list of nominations made by the committee is posted. The secretary shall mail with the notice of the meeting, or separately, but at least seven days before the date of the meeting, a statement of the number of directors to be elected and the names and addresses of the candidates, specifying separately the nominations made by the committee on nominations and the nominations made by petition, if any.

SECTION 5. General Manager. The board of directors may appoint a general manager, who may be, but who shall not be required to be, a member of the Association. The general manager, together with such other staff, agents, and employees as he may select with the consent of the board of directors shall perform such duties and shall exercise such authority as the board of directors may from time to time vest in him.

SECTION 6. Rules and Regulations. The board of directors shall have power to make, adopt and enforce such rules and regulations, not inconsistent with law, the articles of incorporation, or these by-laws, as it may deem advisable for the management of the affairs and business of the Association, for the protection of its investment, and for the interest and welfare of the members thereof.

SECTION 7. Removal of Directors by Members. Any member may bring charges against a director and, by filing with the secretary such charges in writing, together with a petition signed by at least a sufficient number of members to constitute a quorum as defined in Section 5, Article III, may request the removal of such director by reason thereof; provided, however, that the signatures of members shall be acceptable only when affixed to a sheet on which the petition therein is fully set forth; and, provided further, that the person who solicited the signatures affixed to such petition shall acknowledge thereon before a person authorized to take acknowledgments of deeds that he had read the petition and the said charges against such director to each of the members prior to the latter subscribing their names thereto. Such director shall be informed in writing of the charges at least ten days prior to the meeting of the members at which the charges are to be considered, and shall have an opportunity at the meeting to be heard in person, or by counsel, and to present evidence in respect of the charges; and the person or persons bringing the charges against him shall have the same opportunity. The question of the removal of such director shall be considered and voted upon at the meeting of the members, and any vacancy created by such removal may be filled by vote of the members at such meeting without compliance with the foregoing provisions with respect to nominations.

SECTION 8. Vacancies. Vacancies caused by the removal of directors by the members shall be filled as provided in Article IV, Section 7, above subject, however, to the provisions of Article IV, Sections 2 and 3. Any other vacancy occurring in the board shall be filled by the affirmative vote of the majority of the remaining directors, and the member so elected to the board shall serve until the next annual meeting of the members, or until his successor has been elected and qualified. At the annual meeting next following the existence of such vacancy, the members shall elect one of their number to serve as director during the unexpired portion of the term vacated, subject, however, to the provisions of Article IV, Sections 2, 3, and 4 of these by-laws.

SECTION 9. Compensation. Directors shall not receive any salary for their services as directors, except that, by resolution of the board of directors, a fixed per diem and travel expenses of attendance, if any, may be allowed for attendance at each meeting of the board of directors, or a meeting of a committee thereof, or when a director is otherwise representing the Association in an official capacity. No director shall receive compensation for serving the Association in any other capacity, nor shall any close relative of a director receive compensation for serving the Association, unless the payment and amount of compensation shall be specifically authorized by a vote of the members, or the service by such director or close relative shall have been certified by the board of directors as an emergency measure.

ARTICLE V

MEETINGS OF DIRECTORS

SECTION 1. Regular Meetings. A regular meeting of the board of directors shall be held without notice immediately after, and at the same place as, the annual meeting of the members. A regular meeting of the board of directors shall also be held monthly at such time and place in the Anchorage Precinct, Third Judicial District, State of Alaska, as the board of directors may provide by resolution. Such regular monthly meetings may be held without notice other than such resolution fixing the time and place thereof.

SECTION 2. Special Meetings. Special meetings of the board of directors may be called by the president, or by any three directors, and it shall thereupon be the duty of the secretary to cause notice of such meeting to be given as hereinafter provided. The president or the directors calling the meeting shall fix the time and place, which shall be in the Anchorage Precinct, Third Judicial District, State of Alaska, for the holding of the meeting.

SECTION 3. Notice of Directors' Meetings. Written notice of the time, place and purpose of any special meeting of the board of directors shall be delivered to each director not less than five days previous thereto, either personally or by mail, by or at the direction of the secretary, or upon a default in duty by the secretary, by the president or the directors calling the meeting. If mailed, such notice shall be deemed to be delivered when deposited in the United States mail, addressed to the director at his address as it appears on the records of the Association, with postage thereon prepaid.

SECTION 4. Quorum. A majority of the board of directors shall constitute a quorum; provided, that if less than a majority of the directors are present at said meeting, a majority of the directors present may adjourn the meeting from time to time; and, provided further, that the secretary shall notify any absent directors of the time and place of such adjourned meeting. The act of the majority of the directors present at a meeting at which a quorum is present shall be the act of the board of directors.

SECTION 5. Attendance at Meetings. If a director is absent from three successive regular board meetings, such absences may, for good cause shown, be excused by the board. If such absences are not excused by the board, or if the director is absent from four successive regular board meetings, with or without good cause, he shall be deemed to have resigned from the board of directors, and the vacancy thereby resulting will be filled as provided in Article IV, Section 8, of these by-laws.

ARTICLE VI

OFFICERS

SECTION 1. Number. The officers of the Association shall be a president, vice-president, secretary and treasurer, and such other officers as may be determined by the board of directors from time to time. The offices of secretary and treasurer may be held by the same person.

SECTION 2. Election and Term of Office. The officers shall be elected annually by ballot, by and from the board of directors, at the meeting of the board of directors held immediately after the annual meeting of the members. If the election of officers shall not be held at such meeting, such election shall be held as soon thereafter as conveniently may be. Each officer shall hold office until the first meeting of the board of directors following the next succeeding annual meeting of the members, or until his successor shall have been elected and shall have qualified. A vacancy in any office shall be filled by the board of directors for the unexpired portion of the term

SECTION 3. Removal of Officers and Agents by Directors. Any officer or agent elected or appointed by the board of directors may be removed by the board of directors whenever in its judgment the best interests of the Association will be served thereby. In addition, any member of the Association may bring charges against an officer and, by filing with the secretary such charges in writing, together with a petition signed by at least a sufficient number of members to constitute a quorum as defined in Section 5, Article III, may request the removal of such officer by reason thereof; provided, however, that the signatures of members shall be acceptable only when affixed to a sheet on which petition therein is fully set forth; and, provided further, that the person who solicited the signatures affixed to such petition shall acknowledge thereon before a person authorized to take acknowledgments of deeds that he had read the petition and the said charges against such officer to each of the members prior to the latter subscribing their names thereto. The officer against whom such charges have been brought shall be informed in writing of the charges at least ten days prior to the board meeting at which the charges are to be considered and shall have an opportunity at the meeting to be heard in person, or by counsel, and to present evidence in respect of the charges; and the person or persons bringing the charges against him shall have the same opportunity. In the event the board does not remove the officer, the question of his removal shall be considered and voted upon at the next meeting of the members.

SECTION 4. President. The president shall:

(a) Be the principal executive officer of the Association and, unless otherwise determined by the members or the board of directors, shall preside at all meetings of the members and the board of directors;

(b) Sign any deeds, mortgages, deeds of trust, notes, bonds, contracts or other instruments authorized by the board of directors to be executed, except in cases in which the signing and execution thereof shall be expressly delegated by the board of directors or these by-laws to some other officer or agent of the Association, or shall be required by law to be otherwise signed or executed; and

(c) In general, perform all duties incident to the office of president and such other duties as may be prescribed by the board of directors from time to time.

SECTION 5. Vice-President. In the absence of the president, or in the event of his inability or refusal to act, the vice-president shall perform the duties of the president, and when so acting, shall have all the powers of, and be subject to all the restrictions upon, the president. The vice-president shall also perform such duties as from time to time may be assigned to him by the board of directors.

SECTION 6. Secretary. The secretary shall:

(a) Keep the minutes of the meetings of the members and of the board of directors in one or more books provided for that purpose;

(b) See that all notices are duly given in accordance with these by-laws, or as required by law;

(c) Be custodian of the corporate records and seal of the Association, and affix the seal of the Association to all documents, the execution of which on behalf of the Association under its seal is duly authorized in accordance with the provisions of these by-laws:

(d) Keep a register of the names and post office addresses of all members;

(e) Have general charge of the books of the Association;

(f) Keep on file at all times a complete copy of the articles of incorporation and by-laws of the Association containing all amendments thereto, which copy shall always be open to the inspection of any member, and at the expense of the Association, forward a copy of the by-laws and of all amendments thereto to each member; and

(g) In general perform all duties incident to the office of secretary, and such other duties as from time to time may be assigned to him by the board of directors.

SECTION 7. Treasurer. The treasurer shall:

(a) Have charge and custody of, and be responsible for, all funds and securities of the Association;

(b) Be responsible for the receipt of, and the issuance of receipts for, all moneys due and payable to the Association, and for the deposit of all such moneys in the name of the Association in such bank or banks as shall be selected in accordance with the provisions of these by-laws; and

(c) In general, perform all the duties incident to the office of treasurer and such other duties as from time to time may be assigned to him by the board of directors.

SECTION 8. Delegation of Duties. In the absence of an officer, or in the event of his inability or refusal to act, the board of directors will appoint one of their number to perform the duties of his office; provided, that the offices of president and vice-president may not be combined with any other office; and, provided further, nothing herein shall limit the right and duty of the vice-president to perform the duties of the president in the event that the president is absent, is unable to act, or refuses to act. The board of directors may provide for the delegation of one or more of the duties of the secretary and treasurer to the general manager, or to the general manager's designee.

SECTION 9. Bonds of Officers. The treasurer, and any other officer or agent of the Association charged with responsibility for the custody of any of its funds or property, shall give bond in such sum, and with such surety, as the board of directors shall determine. The board of directors, in its discretion, may also require any other officer, agent or employee of the Association to give bond in such amount and with such surety as it shall determine.

SECTION 10. Compensation. The powers, duties and compensation of officers, agents and employees shall be fixed by the board of directors, subject to the provisions of these by-laws with respect to compensation for directors and close relatives of directors.

SECTION 11. Reports. The officers of the Association shall submit, at each annual meeting of the members, reports covering the business of the Association for the previous fiscal year. Such reports shall set forth the condition of the Association at the close of such fiscal year.

ARTICLE VII
PATRONAGE CAPITAL

SECTION 1. Patronage Capital. The Association shall at all times be operated on a cooperative, nonprofit basis for the mutual benefit of its patrons. The Association's operations shall be so conducted that all patrons, members and non-members alike, will through their patronage furnish capital for the Association, subject to the provisions for sinking funds and reserves as provided by Article VIII of these by-laws.

In order to induce patronage and to assure that the Association will operate on a nonprofit basis, the Association is obliged to account on a patronage basis to all its patrons, members and non-members alike, for all amounts received from the furnishing of electric energy in excess of operating costs and expenses properly chargeable against the furnishing of electric energy. All such amounts in excess of operating costs and expenses, at the moment of receipt by the Association, are received with the understanding that they are furnished by the patrons, members and non-members alike, as capital. The Association is obligated to pay all such mounts in excess of operating costs and expenses to the patrons by credits to a capital account for each patron. The books and records of the Association shall be set up and kept in such a manner that at the end of each fiscal year the amount of capital, if any, so furnished by each patron, is clearly reflected and credited in an appropriate record to the capital account of each patron, and the Association shall within a reasonable time after the close of the fiscal year notify each patron of the amount of capital so credited to his account. All such amounts credited to the capital account of any patron shall have the same status as though they had been paid to the patron in cash in pursuance of a legal obligation to do so, and the patron had then furnished the Association corresponding amounts for capital. In the event of dissolution or liquidation of the Association, after all outstanding indebtedness of the Association shall have been paid, outstanding capital credits shall be retired without priority on a pro rata basis before any payments are made on account of property rights of members. If, at any time prior to dissolution or liquidation, the board of directors shall determine that the financial condition of the Association will not be impaired thereby, the capital then credited to patrons accounts may be retired in full or in part. Any such retirements of capital shall be made in order of priority according to the year in which the capital was furnished and credited, the capital first received by the Association being first retired. Capital credited to the account of each patron shall be assignable only on the books of the Association pursuant to written instructions from the assignor, and only to successors in interest or successors in occupancy in all or a part of such patron's premises served by the Association, unless the board of directors, acting under policies of general application, shall determine otherwise. All other amounts received by the Association from its operations in excess of costs and expenses shall, insofar as permitted by law, be:

(a) Used to offset any losses incurred during the current or any prior fiscal year; and

(b) To the extent not needed for that purpose, allocated to its patrons on a patronage basis, and any amount so allocated shall be included as part of the capital credited to the accounts of patrons, as herein provided.

In the event that a non-member patron shall elect to become a member of the Association, the capital credit to the account of such non-member patron may be supplied by the Association toward the payment of membership fee on behalf of such non-member patron.

Notwithstanding any other provision of these by-laws, the board of directors, at its discretion, shall have the power at any time, upon the death of any patron, if the legal representatives of his estate shall request in writing that the capital credited to any such patron be retired prior to the time such capital would otherwise be retired under the provisions of these by-laws, to retire capital credited to any such patron immediately upon such terms and conditions as the board of directors, acting under policies of general application, and the legal representatives of such patron's estate shall agree upon, provided, however, that the financial condition of the Association will not be impaired thereby.

ARTICLE VIII

FISCAL MANAGEMENT AND ACCOUNTING

SECTION 1. Revenues and Expenditures. The board of directors shall adopt and maintain a system of accounting for receipts and expenditures in conformance with the laws of the United States and of the State of Alaska applicable to cooperative association and corporations, which system shall at all times provide the proper reserves for payments of interest and principal on outstanding indebtedness, reserves for taxes, insurance, depreciation, replacement of capital plant and facilities, and such other reserves and accounts as the board of directors shall deem proper.

SECTION 2. Accounting System and Reports. The accounting system adopted and maintained by the board of directors shall conform to such rules and regulations applicable to accounting systems, their establishment and operation, as may from time to time be promulgated by the Administrator, Rural Electrification Administration, United States Department of Agriculture, and which may be established by any applicable laws, rules and regulations of the United States, the State of Alaska, or any regulatory agency thereof of competent jurisdiction. The board of directors shall also, after the close of each fiscal year, cause to be made a full, complete and independent audit of the accounts, books, and financial condition of the Association as of the end of such fiscal year. Such audit reports shall be submitted to the members at the annual meeting next following.

ARTICLE IX

DISPOSITION OF PROPERTY

SECTION 1. Disposition of Property. (a) The board of directors shall have full power and authority to authorize the execution and delivery of a mortgage or mortgages, or a deed or deeds of trust, of any and all of the property, rights, privileges, licenses, franchises and permits of the Association, whether acquired or to be acquired, and wherever situated, as well as the revenues therefrom, all upon such terms and conditions as the board of directors shall determine, to secure any indebtedness of the Association.

(b) The Association may not sell, lease, or otherwise dispose of all or a substantial portion of the Association's property unless such sale, lease or other disposition is authorized by the affirmative vote of not less than the majority of all the members of the cooperative; provided, however, the board of directors may, upon the authorization of the majority of those members of the Association present at a meeting of its members, sell, lease, or otherwise dispose of all or a substantial portion of its property to another cooperative or to the holder or holders of any notes, bonds, or other evidence of indebtedness issued to the United States of America or any agency or instrumentality thereof.

ARTICLE X

SEAL

The corporate seal of the Association shall be in the form of a circle and shall have inscribed thereon the name of the Association and the words "Corporate Seal, State of Alaska."

ARTICLE XI

FINANCIAL TRANSACTIONS

SECTION 1. Contracts. Except as otherwise provided in these by-laws, the board of directors may authorize any officer or officers, agent or agents, to enter into any contract, or execute and deliver any instrument, in the name and on behalf of the Association, and such authority may be general or confined to specific instances.

SECTION 2. Checks, Drafts, etc. All checks, drafts or other orders for the payment of money, and all notes, bonds or other evidences of indebtedness issued in the name of the Association, shall be signed by such officer or officers, agent or agents, employee or employees of the Association, and in such manner, as shall from time to time be determined by resolution of the board of directors.

SECTION 3. Deposits. All funds of the Association shall be deposited from time to time to the credit of the Association in such bank or banks as the board of directots may select.

SECTION 4. Change in Rates. Written notice shall be given to the Administrator of the Rural Electrification Administration of the United States of America not less than ninety days prior to the date upon which any proposed change in the rates charged by the Association for electric energy becomes effective.

SECTION 5. Fiscal Year. The fiscal year of the Association shall begin on the first day of January of each year and shall end on the thirty-first day of December of the same year.

ARTICLE XII

MISCELLANEOUS

SECTION 1. Membership in Other Organizations. The Association shall not become a member of, or purchase stock in, any other organization without an affirmative vote of the members at a fully held meeting, the notice of which shall specify that action is to be taken upon such proposed membership or stock purchase; provided, however, that the Association may, upon the authorization of the board of directors, purchase stock in or become a member of any corporation or organization organized on a nonprofit basis for the purpose of engaging in or furthering the cause of rural electrification, or with the approval of the Administrator of REA, of any other corporation for the purpose of acquiring electric facilities.

SECTION 2. Waiver of Notice. Any member or director may waive in writing any notice of a meeting required to be given by these by-laws. The attendance of a member or director at any meeting shall constitute a waiver of notice of such meeting by such member or director, except in case a member or director shall attend a meeting for the express purpose of objecting to the transaction of any business on the ground that the meeting has not been lawfully called or convened.

ARTICLE XIII

AMENDMENTS

SECTION 1. These by-laws may be altered, amended or repealed by the members at any regular or special meeting, provided the notice of such meeting shall have contained a copy of the proposed alteration, amendment or repeal.

SECTION 2. By-Laws Committee. It shall be the duty of the board of directors to appoint, not less than sixty days before the annual membership meeting, a committee on by-laws, consisting of not less than five nor more than seven members, who shall be selected from different sections of the service area of the Association so as to insure equitable representation. No member of the board of directors may serve on such a committee. The committee shall review the by-laws of the Association, consider any recommendations for revisions thereof which may be made by the board of directors or any member, and report their recommendations concerning the by-laws to the annual membership meeting. Nothing herein shall be interpreted to limit the authority of the board of directors to propose changes in the by-laws, or the right of the members to call a special meeting for any proper purpose pursuant to Article III, Section 2, herein.

QUESTIONS ON AGSOC FOR THE HOUSE STATE AFFAIRS COMMITTEE

From Governor Hammond

1. How could AGSOC be structured so as not to create unnecessary conflicts between the public interest in business regulation and taxation and the shareholder's interest in higher dividends?

2. Would it be generally advisable to make attempts to depoliticize the AGSOC?

   Should the AGSOC be allowed to lobby, make political contributions or come out with endorsements for particular candidates?

3. Do normal state corporation statutes provide sufficient protection for minority shareholders?

   - Is it inevitable the AGSOC would become an urban dominated corporation, given the population of the state?

   - How would rural members be able to participate other than by proxy given the expenses involved in travelling to meetings?

   - Should the board be classified, i.e. only a subset of the board coming up for election at one time

   - Should cumulative voting be mandatory?

   - Should voting trusts be prohibited?

   - Who should have the authority to amend articles of incorporation and bylaws?

   - How should proxy fights and shareholder-management disputes be financed - should both incumbents and challengers be financed by corporation money?

4. Should exemption from federal income taxation be extended to state taxation in general?

5. What are the probabilities that AGSOC will need no other state assistance beyond start-up costs? Can AGSOC really operate as a purely private corporation?

   - Which particular investments would not require state financial aid?

   - Which particular investments would require state financial aid?

   * Ask Kelso representative to detail the mechanism whereby AGSOC requests state financial assistance.

   - What kind of impact on the state's credit rating would the potential access to state support and/or guarantees have? Is it fair that all residents bear the risk to the state's credit rating which benefits only the subset of residents who are shareholders?

6. What are the pros and cons of setting up the AGSOC up as a public corporation versus a private corporation, assuming it would be legal?

7. Is there further information which can be made available to the state which will help us to make a prudent decision on the AGSOC. Can such information be gathered before the end of this session?

Possible questions to be answered:

- Do Alaskan's want an AGSOC? Perhaps this issue needs an airing similar to that given to Alaska, Inc. via the Public Forum. Since AGSOC is to be a people's corporation, should the people deserve more involvement than has yet been provided?

- What are the political implications of a corporation whose shareholders comprise the voting public? Are there any existing situations which are similar elsewhere, and from which lessons can be drawn?

- What will be the impact on the state's credit rating if AGSOC requires different kinds of state financial assistance? If there is an impact, how much will non-shareholding residents be paying to benefit the shareholders?

- If AGSOC had been incorporated five or ten years ago, how many residents would be shareholders today? Or conversely, how many shareholders would still be residents? What can we expect for the future? Taxpayer turnover data is available to answer this question.

MEMORANDUM

To: Rep. Jim Duncan

From: Jerry Gauche

Re: Policy & Legal Issues Surrounding AGSOC

Date: April 4, 1979

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

I. TAXATION

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

A. State Income Tax.

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

B. Other State Taxes.

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

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

C. Potential Investments.

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

D. Policy Questions.

1. Pressure for Development.

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

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

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

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

2. State Revenues vs. AGSOC Income.

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

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

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

II. "DEPOLITICIZING" AGSOC

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

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

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

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

A. Specific Limitations.

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

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

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

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

1. Block Voting.

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

2. Political Popularity.

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

3. The Springboard.

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

B. Litigation with the State.

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

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

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

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

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

The existing system of laws was designed to protect the rights of the parties while arriving at a proper decision of the issues. It is sometimes costly, but we have yet to develop an alternative which arrives at better decisions more expeditiously and at lower cost. We are willing to live with the existing system for most purposes and put some faith in its ability to reach the right decision. By denying AGSOC access to this system we deny its shareholders the protections of our legal system. To say that those shareholders can protect their rights through the political system is no answer. To reduce their access to the legal system is to deny them the protections of that system which we extend to all other Alaska corporation and to make of them second class legal citizens.