1155 HSA HB 240 (FILE NO. 1)

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 gold-

plating.

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 again 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 th 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 State Legislature

House of Representatives

Ray Metcalfe
Pouch V
State Capitol
Juneau, Alaska 99811

April 6, 1979

The Honorable Avrum M. Gross
Pouch K
Juneau, Alaska 99811

Dear Mr. Gross:

Thank yc for you. timely response to my earlier proposal.

I have reviewed the problems that you have outlined with the original draft of my proposal Attached hereto is a redraft of that same proposal bearing two minor changes. The changes therein are for the purpose of addressing each of those problems that you found with my proposal. As you had indicated in your letter to me in the third paragraph of the first page, for a committee of the Legislature to negotiate agreements with the Matanuska/Susitna Borough is not a legislative function, is outside the purview of the Legislature and is a responsibility of the executive branch. Therefore, I have revised paragraph four of the first page of my proposal, to bring the recommended duties of the proposed committee within a proper legislative function.

In the fourth paragraph of your response to my proposal, you have indicated a potential conflict with A.S. 44.06.160. and A.S. 44.06.200-A.S. 44.06.260.. Therefore in paragraph three of my pro,osed method of moving the capital, I have added one more subparagrph of paragraph three which you will note as Item (d). Item (d) calls for the repeal of those statutes for the purpose of eliminating the potential conflict of the law.

It would appear from your response to my original proposal, that such action of repealing the above mentioned statutes would alleviate any potential conflict between the FRANK Initiative and this proposal. In addition to the removal of the conflict of the FRANK Initiative and the above mentioned statutes, you might also notice that the proposal goes one step further in removing any requirement to build a city as outlined by the commission's existing plan, On the first

page, paragraph three, item (c) requires that the Legislature must find the proposed capital improvements to be sufficient to accomodate the Governor's Office, the Legislature, the Legislative staff, and any other state personnel that the Legislature feels must be near or within the new capitol building.

Considering that this subject is coming before the State Affairs Committee meeting on Friday, April 6th, being the day of delivery of this letter, it would be most sincerely appreciated if your office could expeditiously review the minor changes in my proposal, in order to allow this matter to be discussed in the State Affairs Committee meeting beginning at 1:15 p.m. on the 6th.

Sincerely,

Ray Metcalfe
Representative

RM/ddp

1) A capital move proposal offered by Rep. Ray Metcalfe for the purpose of attempting to find an economically sound method of moving the capital that will hopefully,

A) Meet with the scrutiny of the Attorney General's office,

B) Satisfy the provisions of the 1978 FRANK Initiative,

C) Satisfy the 1974 mandate to move the capital,

D) Meet with the satisfaction of the people of the Matanuska/Susitna Borough.

2) This proposal is for the purpose of outlining a step-by-step method of moving the capital to Willow, Alaska, via an avenue that, if agreed to and pursued, will not encounter any insurmountable obstacles that might otherwise prevent the concept expressed herein, from being fully implemented.

3) This outline will be subject to the passage of the following legislation:

A) Enabling legislation to allow the Matanuska/Susitna Borough unlimited selection rights to those lands currently reserved for the development of a new capital city.

B) The passage of a concurrent resolution requesting the state to enter into negotiations with the Matanuska/Susitna Borough for the purpose of moving the capital.

C) An eventual approval by the Legislature of all plans, all negotiated agreements, and a decision by the Legislature that the State of Alaska finds the proposed capital improvements to be of sufficient magnitude to accomodate the Governor's office, the Legislature, the Legislative staff, and any other state personnel that the Legislature feels must be near or within the new capital building.

D) Legislation repealing Alaska State Statute, A.S. 44.06.160. and A.S. 44.06.200 - A.S. 44.06.260.

4) Immediately following the passage of legislation as outlined in item (D) above, the Legislature shall appoint a Capital Move Steering Committee. It shall be the responsibility of the Capital Move Steering Committee, to advise the Matanuska/Susitna Borough as to what that committee feels the Legislature as a whole will consider to be necessary for the completion of the project as outlined herein.

5) To the extent the Attorney General finds necessary, for the purpose of meeting the requirements of the FRANK Initiative, the Matanuska/Susitna Borough shall agree to pay for all salary, per diem and travel of those involved in the negotiations to be conducted between the State of Alaska and the Matanuska/Susitna Borough.

6) The Matanuska-Susitna Borough shall, in cooperation with the committee of the Legislature, prepare a basic site plan which shall consist of

A) All future major thoroughfares throughout the capital city,

B) All major corridors for future utility trunk line development,

C) All sites for major public facilities of the future,

D) Planting and zoning of major tracks of land to be made available to private industry for further subdivision and development of business, industrial and residential facilities, and

E) To the extent the committee and Borough find necessary, prepare a planned unit zoning plan for business and other industry immediately surrounding that site which is selected for the development of the new capital building.

7) In addition to the general site plan, the Matanuska-Susitna Borough shall, in consultation with the committee, develop detailed plans for a building that the committee determines to be of sufficient size to accomodate the Governor's office, the Legislature, and all state personnel determined by the committee to be necessary for the first meeting of the Legislature. Additionally, the Borough, in consultation with the committee, shall also determine what other facilities will be required in terms of capital improvements through the year 1992, as well as determine within what time frame the additional state facilities shall be constructed.

8) As a part of those negotiations,

A) The state shall agree to provide all rights-of-way to the Borough for construction of necessary access roads and other infrastructure items to be built by the Borough and others as described herein.

B) The Borough shall agree to construct all state facilities and other necessary infrastructure within a time fram to be outlined in those negotiations, and hand over to the State of Alaska in fee simple title, and with no incumberments, all those state facilities determined to be needed through the year 1992.

C) The State shall agree to occupy each facility constructed immediately following completion of said facility.

D) Upon completion of each facility the Matanuska-Susitna Borough shall be required to pay all costs involved in the moving of personnel, records and equipment from the capital city of Juneau to the new capital city of Willow.

9) Should the costs of maintenance and operation be determined by the Attorney General to be a cost that cannot be paid by the State of Alaska through the year 1992, because of the provisions of the FRANK Initiative, the Borough shall assume those responsibilities, unless or until, the Borough has secured a decision by a court of the State of Alaska determining such cost to be costs which the State would not be precluded from paying because of the provisions of the FRANK Initiative.

10) The entire agreement negotiated between the Matanuska-Susitna Borough and the committee of the Legislature shall be subject to the passage of legislation allowing the Matanuska-Susitna Borough unlimited rights to select lands from within the 64,000 acre proposed capital site, that in the Borough's opinion, will be necessary for the purpose of securing as well as paying for

A) All bonded indebtedness incurred by the Matanuska-Susitna Borough as a result of the capital city development,

B) All debts incurred from private financial sources as a result of the development of the new capital city,

C) All costs otherwise incurred by the Matanuska-Susitna Borough as a result of the development of the new capital city

D) Sufficient cash to equal a reasonable return for the risk the Matanuska-Susitna Borough has taken, which shall equal not more than 18% of all combined total costs and indebtedness incurred by the Matanuska-Susitna Borough.

11) All revenues produced from the sale of lands from the Matanuska-Susitna Borough to private industries shall be applied to the existing bonded indebtedness that has resulted from the construction of a new capital in Willow, or shall be escrowed for the payment of future bonds or bond payments that are anticipated to be incurred by the Matanuska-Susitna Borough as a result of the capital city development.

12) Once sufficient cash revenues have been generated by the Matanuska-Susitna Borough from the sale of lands, to cover all the costs and profits as outlined herein, the unlimited selection rights of the Borough shall cease, and all land that has not yet been sold by the Borough shall be returned to the State of Alaska.

13) In summary, it is to be understood that within this proposal it is understood that the Matanuska-Susitna Borough shall be required to pay for any and all costs of the capital move that are determined by the Attorney General to be a cost that the State is precluded from paying throughout the year 1992 as a result of the FRANK Initiative, as well as assume full responsibility for all bonded indebtedness incurred for capital improvements through that same period of time.

14) All costs shall be outlined in detail prior to any final agreement between the State of Alaska and the Matanuska-Susitna Borough. Should there be any dispute between the Attorney General's office and the Matanuska-Susitna Borough with regard to what costs the State is precluded from paying as a result of the provisions of the FRANK initiative, or for any other reason, the Matanuska-Susitna Borough shall pursue an expeditious settlement of the disputed matter via a decision of the courts of the State of Alaska.

15) Once final agreement is reached between the Matanuska-Susitna Borough and the committee of the Legislature, that agreement shall be submitted to the Legislature for its final approval, and the move shall be completed as expeditiously as possible thereafter.

STATE OF ALASKA
THE LEGISLATURE

LEGISLATIVE AFFAIRS AGENCY

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

M E M O R A N D U M March 9, 1979

SUBJECT: Capital Move Concept
(Work Order No. 6821)

TO: Representative Mike Miller

FROM: Kenneth E. Vassar
Legislative Counsel

You have requested a legal opinion relating to the "Capital Move Concept" outlined in the rough draft of an agreement between the Matanuska-Susitna Borough and the state which you have furnished us. At the outset, I think it is appropriate to discuss the FRANK initiative and the effect of any attempt to avoid it.

I would have to approach any plan which would attempt to provide for the relocation of the capital without the expenditure of state money with a skeptical attitude as to its viability in the courts. Such a plan must avoid any expenditure of state money for the physical relocation of the present functions of state government and must also avoid incurring any obligation on the part of the state to pay any state money at any time in the future for such physical relocation. Even assuming that such a plan does exist, any prognosis as to the viability of the plan comes with a very large caveat, which will be explained in the following paragraph.

In the ordinary review of statutes, a court will apply the law in accordance with the literal meaning of the words used in the statutes unless there is some ambiguity which requires it to go behind the words of the statutes and look at the legislative intent. The phrase "State money may be expended," as it is used in the FRANK initiative, appears to be unambiguous, and so it would be fair to assume that a court would apply the law strictly in accordance with the language in the initiative under normal circumstances. Thus, a plan which does not involve the expenditure of any state money, now or in the future, for the physical relocation of the

present functions of the state government might be expected to survive a FRANK initiative attack. However, the magnitude of the issue and the fact that this is an initiative rather than a legislative enactment would take the interpretation of this language far from normal circumstances, and a court might go beyond the literal interpretation of the words used in the initiative and examine the purpose behind the words.

If this were the case, the court would surely give some weight to the "Purposes" section of the initiative. That section includes the following language:

> It is the purpose of this act to insure that the people of Alaska will have the opportunity to make an intelligent and objective decision on relocating the capital with all pertinent data available to them concerning the costs to the State. . . .

Since it would be only of relatively mild interest to the people to know the costs of the move after the move had begun, and since it would leave little room for decision making by the people at that point, I would assume that a court would view this purpose as applying before any move began. It would follow that a court could interpret the language of the initiative to actually mean that no movement of the present functions of state government may begin before the required bond issue election.

Turning now to the "Capital Move Concept," I would like to begin with a summary of my perception of the plan. Since the concept does not appear to present all the details of the plan, this summary and the following analysis may include some assumptions on my part relating to those details. Under the plan the borough would select from, or trade borough land for, a minimum of 6,240 acres of state land at the relocation site. The existing provisions of law relating to borough selections and exchanges of land are found in AS 29.18.205 and 29.18.209. In return, for the selection or trade, the borough would prepare a basic site plan for the capital city and finance and construct a building for use as a part of the total state office complex. When the building is completed, it would be turned over to the state for occupancy, and the borough would be allowed to charge rent on the building in an amount sufficient to cover debt service on a portion of the bonds issued by the borough for

the project. The state would provide rights of way to the borough for the construction and would establish an appropriate body to consult with the borough. The borough would return title to lands it receives under the agreement to the state if (1) the borough is repaid for all its expenditures; (2) any bonds issued by the borough are retired or assumed by the state; and (3) the borough regains entitlement to selection of an equal amount of land.

Before getting into an analysis of the concept in relation to the FRANK initiative, I have some comments about the selection and transfer of land under AS 29.18.205. That law allows boroughs to select vacant, unappropriated and unreserved state land within their boundaries. Under the terms of the 1974 initiative (AS 44.06.130), the land from which selections would be made under the concept submitted is classified as reserved use lands. Therefore, it is ineligible for selection under AS 29.18.205 absent some legislative action. It appears, however, that the land would be eligible for a land exchange under the authority of AS 29.-18.209. The exchange would have to be for land owned by the borough of equal value to the state land. The determination of equal value would be incumbent upon the director of the division of lands and the commissioner of natural resources.

The following paragraphs relate to the "Capital Move Concept" on a paragraph-by-paragraph basis with specific attention to the relationship of the concept to the FRANK initiative.

1. As noted before, this paragraph will require a land exchange rather than a municipal selection. In order to fulfill his statutory duties (which cannot be contracted away), the director will be required to determine whether there is a public interest to support the exchange and whether the land offered by the borough is of approximately equal value to the land offered by the state (including the non-monetary value of public benefits). In addition, the director must give notice of the exchange to the governing body of the borough under AS 38.05.305 and to the public under AS 38.-05.345. Finally, while AS 29.18 requires a survey to be conducted or paid for by the municipality for municipal selections under that chapter, it does not expressly require the municipality to survey or pay for the cost of a survey of land proposed to be exchanged.

The director's duties, particularly those relating to the giving of notice, appear to require the expenditure of some state money. Thus, the FRANK initiative prohibition could apply to this section. In the absence of statutory requirements relating to surveys, the state may be required to pay for the survey of the land subject to the exchange; this would be prohibited by the FRANK initiative.

2. Since this paragraph relates solely to planning by the borough, there would appear to be no FRANK initiative questions.

3. Since this paragraph relates solely to financing and construction of a building by the borough, there would appear to be no FRANK initiative questions.

4. This paragraph requires the state to provide rights of way to the borough for construction of necessary access roads and other infrastructure items to be built by the borough. This is a power granted to the director under AS 38.05.350. If the application is made in accordance with regulations promulgated under AS 38.05.330, it appears that there would be no required expenditure of money for the granting of the rights of way.

5. Under this paragraph, the state would be required to establish an appropriate body to consult with and coordinate the work of the borough to ensure compliance with the agreed plans. I am not sure how this body would be established; however, it appears that its duties would require travel and per diem allowances and possibly salaries. These obviously will require the expenditure of state money. Again, the FRANK initiative may prohibit this expenditure.

6. After the completion of the building, the borough will turn it over to the state to permit meetings of the legislature in the building. The borough, six months after completion of the building, will charge the state rent based upon the proportionate amount of revenue raised by the sale of bonds for the construction of the building.

There are two questions with regard to this paragraph. First, the obligation to pay rent would require an expenditure of state money. The obligation to maintain and operate a municipal building leased to the state for state purposes would

also require an expenditure of state money. Either of these expenditures could be violative of the FRANK initiative. The ultimate question would be whether they are expenditures for the physical relocation of the present functions of state government or whether they are expenditures for some other purpose. This could be the ambiguity that would justify a court's decision to look at the purpose of the initiative rather than relying on a literal interpretation of the words used in the initiative.

The second question also relates to the FRANK initiative. It seems that tying rental payments to an amount sufficient to cover debt service on a portion of the bonds equal to the ratio of borough expenditures on the building to total borough expenditures raises a strong argument that the borough is acting as a "straw man" for the purpose of the bond issuance. It could be argued that there is very little difference between the state issuing the bonds itself and the state contracting to pay the debt service on the bonds used to construct the building. A court, even if it found the payment of rent permissible under the FRANK initiative, could determine that tying the rent to payment of the bonds is impermissible.

7. This paragraph provides that, if the borough is repaid for its expenditures and if the bonds issued by the borough are retired, the borough will return the land it receives under the agreement to the state.

In order to accomplish this, the state could assume or pay off any amounts outstanding on the bond issuance; and I assume it would be the state that would reimburse the borough for its expenditures. Of course, none of this can happen until the FRANK initiative requirements are satisfied, amended or repealed.

8. This paragraph appears to have no FRANK initiative repercussions.

In conclusion, it would appear that, if I have understood the plan you have presented to us correctly, the plan could not be implemented without violating the provisions of the FRANK initiative.

KEV:jdn

CAPITAL MOVE CONCEPT

The objective of this concept is to provide a reasonable alternative plan for fulfilling the mandate of the people of Alaska to commence relocation of the capital to Willow by October 1, 1980.

1. Once the concept outlined herein is agreed upon, the Matanuska-Susitna Borough will be entitled to receive under Borough selection (or trade) a minimum of ,240 net acres within the Willow capital site area. Those 6,240 acres will be net of the areas designated in the site plan for state facilities, for streets, access roads and other infrastructure and for public use items. In return, the Borough agrees to carry out the undertakings outlined below.

2. The Borough, in consultation with the state, will prepare a basic site plan for the capital city. This plan will show the location of the state office complex, and the siting of infrastructure items to be built by the Borough hereunder. The Borough, with appropriate state input, will also prepare detailed plans for all the facilities it is to construct, including provision for their future expansion.

3. In accordance with the detailed plans, the Borough will finance and construct a building of not less than 75,000 square feet suitable for use as a part of the total state office complex, to be completed by January 1, 1981.

4. The state will provide rights of way to the Borough for construction of necessary access roads and other infrastructure items to be built by the Borough or by others hereunder.

5. The state will establish an appropriate body to consult with and coordinate the work of the Borough to ensure compliance with the agreed plans.

6. When the building referred to in paragraph 3 is completed, it will be turned over to the state for occupancy, to permit meetings of the legislature to be held at the site no later than 1981. Costs of maintenance, operation and desired alterations, if any, of this building and attendant infrastructure will be defrayed by the state commencing with the date of availability for occupancy. If revenue or other bonds to finance construction hereunder by the Borough remain outstanding, the Borough shall be entitled, commencing six months after the date of availability for occupancy, to receive rental payments for the structure not to exceed an amount sufficient to cover debt service on a portion of the bonds equal to the ratio which total expenditures by the Borough on account of the building and attendant infrastructure bears to total expenditures by the Borough under this agreement.

7. The Borough will return to the state title to lands transferred to it by the state hereunder and which have not previously been disposed of by the Borough or designated for

public (other than state) use, provided the following shall have occurred:

(a) The Borough shall have been repaid for the total amount of its expenditures.

(b) The revenue or other bonds (if any) issued for carrying out this agreement have been retired. (To accomplish this, the state may, at its option, at any time assume or pay off any amounts outstanding.)

(c) The Borough shall have regained entitlement to selection of lands equal to the number of acres originally selected or traded under this agreement.

8. Implementation of this concept is subject to obtaining any necessary approvals by appropriate authorities, together with confirmation of the powers of the parties hereto to carry out the obligations outlined.

UNIVERSITY OF CALIFORNIA, DAVIS

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SCHOOL OF LAW

DAVIS, CALIFORNIA 95616

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 <u>not</u> 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 Wm. Fessler

Daniel Wm. Fessler
Professor of Law

DWF:hf

Enclosures

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 individuals 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

coalition in the GSOC. We must deal with the fundamental characteristic of a corporate entity, the shares of which are held in lots of one . . . and by more than 400,000 individuals.

The Kelso Report recognizes the problem of human inertia inherent in such diffuse shareholdings when it proposes to set a quorum for shareholder attendance at annual and special meetings at one third of the shares voting either in person or by proxy (an absentee ballot). At any meeting at which such a quorum is ascertained to be present, a vote of a majority of that quorum is sufficient to elect directors. Simple arithmetic will reveal that a simple majority of one-third is one-sixth of the shares plus one. Such a scheme is permitted by Sec. 10.05.153 of the Alaska Business Corporation Act if the articles of incorporation are so drafted. I favor this aspect of the proposed articles contained in the Kelso Report because I fear that setting a higher quorum requirement might preclude the shareholders from effectively meeting. How then does this guide us as to the machinery for removal of directors by shareholder vote? I propose that the entire board might be removed for any reason either at an annual or special meeting of shareholders for which notice of such a proposal had been given (as provided in Sec. 10.05.141) upon the vote of a majority of a quorum of the shares present in person or by proxy.

If the shareholders desire to remove less than the entire board, we have a different problem. Here is a danger that a special interest group or other faction might attempt to gang up on a single director for his or her policies and seek to accomplish this at a special meeting which may well be attended by fewer shares than were present at the annual meeting which elected the targeted director. We can guard against this possibility by drafting the statute to provide that in the event that there is an attempt to remove less than the entire board, the resolution shall fail

unless the number of shares cast for rem[illegible] exceeds the numbe[illegible] 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 action 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 so 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 tele[illegible] 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 m[illegible]bership. 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 danger in this lack of understanding of the corporation by most Natives is that the Native community in Alaska is becoming corporatized. As with most economically disadvantaged minorities, the Native leadership pool is limited. And the action has switched from the political to the economic front. Former political leaders, many of whom were instrumental in getting the Claims Act passed, were naturally attracted by the economic clout of the corporations —as well as the $40,000 to $50,000 salaries many top officers are paid. Because of their former political status and because of the corporations' overwhelming importance to the Native community, the firms' officers are frequently still looked upon by their shareholders as broad-based community leaders, even though their perspectives and interests have narrowed somewhat.

With a few exceptions, the Native firms are corporations just like IBM and AT&T. And, while most of the corporate leaders say they realize that part of their mission is to help preserve the traditional Native life-styles, the ultimate success of a corporation is, as Koniag's Karl Armstrong noted, determined by that one quantifiable measure—profits and losses. And as corporations were designed more for stability than for democracy, they were also designed more to protect proprietary interests than to require disclosure and openness. It is not surprising that some of the Native corporations decline to disclose the salaries of officers, for example, or that some are reluctant to discuss negotiations with oil companies, even with their own shareholders.

Given the limitations and potential pitfalls involved in the modern corporate structure, it is somewhat surprising that, during the years of debate preceding the Alaska Native Claims Settlement Act, the focus was almost solely on the corporation as the vehicle for a settlement. Remarkably, the pre-settlement debate gave no serious consideration to developing a more democratic entity that would more nearly meet the economic and cultural needs of the Native peoples. As established, the Native corporations leave important decision-making power in the hands of a few corporate leaders. The individual shareholder's sole check on the corporation is a limited one: he or she can cast a vote at the annual stockholders' meeting for members of the board of directors. As the book *Alaska Native Land Claims*, the Alaska Native Foundation's detailed analysis of the Claims Act, puts it:

> Although a corporation's stockholders are its owners, the role of stockholders in the life of a typical corporation is a very limited one. . . . What the corporation sets out to do, and how effectively it accomplishes it, is dependent upon the qualities of judgment brought to the enterprise by corporate leaders.

Although directors are elected on the basis of one person, one vote, it is difficult for stockholders in most of the Native corporations to mount effective challenges to the group in power. This is due partly to a lack of political sophistication; partly to geographical factors which make it difficult for dissidents to get together to organize their opposition; and largely to the power of corporate incumbents to use the proxy.

The level of democracy in the corporations could be improved considerably, however, if the Native firms were organized in a different corporate form—along the lines of cooperatives. Such changes could be achieved through revisions in corporate bylaws rather than through amendments to the Native Claims Act. A key to the cooperative structure is maximum decision-making power by the stockholders, rather than by a few directors and corporate managers. Because the regional corporations all have more than 1,000 stockholders, it probably would be unwieldy for them to call full meetings every time there is a policy, or major investment, decision to be made. Instead, a representative assembly of, say, 100, could be established this would not only democratize the corporate decision-making process, but also would involve more deeply a greater number of individual stockholders, thereby reinforcing the feeling that the corporation is really theirs. Art Danforth, secretary-treasurer of the Cooperative League of the United States, told us that cooperatives at their best "can be kind of like New England town meetings," in that they involve the nearest thing possible to direct democracy under the corporate structure. In a situation where the corporate structure is an unfamiliar one, such as is the case with many Alaska Natives, and where there are even language barriers, the cooperative system would be far preferable, because important decisions affecting the future of the culture would be made by a representative group of Natives rather than just by a small number of corporate managers.

During the battle leading up to passage of the Claims Act, the Native lobbyists stressed the need for a settlement that would enable the Native cultures to survive and would also allow the Natives to

prosper financially. A per capita disbursement wouldn't have made a lot of sense, since the Natives treat land used to sustain their subsistence way of life as community property. Certainly, the paternalistic Indian policies of the past—a federal agency protecting the interests of its wards—have been discredited.

But there *are* problems with the Claims Act. Some Native leaders told us that one troubling aspect of the act is that Natives born after 1971 cannot obtain stock in any of the corporations except through inheritance. Even more worrisome is the provision that allows Natives to sell their stock after 1991, which raises the specter of eventual non-Native control. For example, in the case of Doyon, the largest of the regions,[17] the value of its land alone could make a stockholder's 100 shares worth more than $130,000 in 1992. With such value, many individual stockholders may be tempted to sell. Finally, there is an obvious built-in conflict between the goals of protecting a way of life and making profits. And some Natives have expressed the worry that the end result of corporatizing Alaska's Native people could be the same thing that happened when the Menominee Indians of the Midwest had their tribal status terminated and had land from their former reservation in the Menominee Forest turned over to them and corporatized. As the Native American Rights Fund described the aftermath of the Menominee Termination Act signed into law on June 17, 1954:

> The tribal assets were turned over to a new corporation, Menominee Enterprises, Inc. (MEI), and suddenly Menominee survival was based on knowledge of a complicated corporate style of living including: par value stocks, voting trusts, income bonds and shareholders' rights. . . .
>
> The effects of termination and corporate-style management of Menominee assets pitted brother against brother and parents against their children. It increased the poverty of most individual Menominees, created political turmoil, and brought on economic chaos. . . .

[17] The approximate amount of land due to each of the regions (including villages within the regions) under the Alaska Native Claims Settlement Act is: Doyon, 12 million acres; Calista, 6.2 million; Arctic Slope, 5.1 million; Bristol Bay, 2.9 million; NANA, 2.2 million; Cook Inlet, 1.2 million; Ahtna, 1.7 million; Aleut, 1.3 million; Koniag, 1 million; Chugach, 920,000; Bering Straits, 2.1 million; Sealaska, 200,000.

The approximate amount of federal and mineral royalty money that will go to each region under the Claims Act is: Sealaska, $200 million; Calista, $165 million; Doyon, $115 million; Bering Straits, $85 million; Cook Inlet, $75 million; Bristol Bay, $65 million; NANA, $60 million; Arctic Slope, $48 million; Aleut, $40 million; Koniag, $40 million; Chugach, $15 million; Ahtna, $12 million.

MEI, as well as individual Menominees, were forced to sell corporate shares and land in order to pay county and state taxes. As a result, acres and acres of the heartland of the magnificent Menominee forest were sold to non-Indians and Menominee reservation lands fell into the hands of non-Indian developers who destroyed religious sites and the cultural character of the community.

The report went on to note that unlike the Alaskan Natives, the Menominees did not have actual control of the corporation; this instead was handled by "non-Indian businessmen and so-called experts . . . to insure its success." Also, the Menominees faced immediate taxation of their lands, while the Alaska Native corporations have no such problem on undeveloped lands until 1992. Eventually, the Menominees asked restoration of their tribal status so that they could hold on to some of their financial assets, land, and tribal culture.[18]

Although there are differences in the Menominee and Alaska settlements, there are enough similarities to make the future uncertain for some of the corporations and the Native cultures. Yet, despite all the legal snafus and internal conflicts within the corporations, there still is no question that the Land Claims Act has given the Alaska Natives more political and economic clout than any minority group in the U.S. has ever commanded in one state. An orientation speech that was given by management for workers on the trans-Alaska oil pipeline illustrates this:

> Now, then, you may come upon a small Indian village of twelve or fifteen families somewhere up along the Yukon. You are to treat these people with respect. When you see them you may wonder why you are to treat them with respect. Well, we can give you three very good reasons. First, because they are people. Second, because they were here first and they owned the land before we did. Third, because their Native Land Claims corporations have got the money to hire the best legal talent in the United States.

There is an old Native saying that, "The way to beat the white man is with the white man's tools." As NANA's Hensley put it: "Anything that came along that helped us survive, we took ahold of it." The corporation, he told us, is just another of the white man's

[18] In the event the Alaska Native corporations ran into financial difficulty, what would the federal government's responsibility be, if any? Law professor Monroe E. Price, of the University of California, Los Angeles, noted that the situation is unclear. "No one knows what continues to be the relationship between the Alaska Native and the United States after the implementation of the Alaska Native Claims Settlement Act."

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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

John A. Miskimen

LOK/JAM:ch
Encls.

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.

111 PINE STREET, SAN FRANCISCO, CALIFORNIA 94111 [415] 788-7484

(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 SU H 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

LOK:ma

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

Senator Mike Colletta
Project Director

Date

Rep. Jim Duncan
Project Director

1/12/79
Date

AGSOC Plan Overhaul Advised

By NANCY HARRIS
Empire Staff Reporter

The House State Affairs Committee, wary of the power which might be vested in the board of directors of the proposed Alaska General Stock Ownership Corp. (AGSOC), has agreed that a new set of laws should be drafted to govern the corporation.

The committee is responding to a warning from a University of California law professor that the Alaska Business Corporations Act is not designed to control a corporation such as AGSOC and that its board members could become the nine most powerful persons in Alaska.

Professor Daniel Fessler last week sent the committee proposed amendments to legislation setting up AGSOC which he says are designed to make the board of directors more responsive to corporation shareholders.

In addition, the panel agreed that a new chapter under Alaska's corporations laws should be drafted to deal specifically with general stock ownership plans.

The committee has held a series of hearings on the AGSOC proposal since early March, but just last week started addressing specific changes in the legislation. Identical bills introduced in the House and Senate (HB240 and SB170) were drafted from a plan produced for the Legislature by Louis Kelso, an economist who fathered the idea of general stock ownership plans.

The measures, as introduced, only set up the framework for the corporation, which would be a private business in which all Alaskan residents would be shareholders.

Under the AGSOC proposal, the state would loan the corporation several million dollars to finance start-up costs. The initial board of directors would be appointed by the governor and would adopt articles of incorporation and bylaws.

Fessler cautioned the committee that once the corporation was launched, the legislature would have no further say in how it is run and that AGSOC's citizen shareholders would have little power to affect corporate decision-making.

The committee decided to build restrictions on the AGSOC board into the enabling legislation, while at the same time working to keep it an entirely private corporation.

Amendments tentatively agreed to by the committee include:

—Giving shareholders power to initiate amendments to the corporation's bylaws. Under current law, a corporation can restrict

Continued on Page 2

AGSOC...

Continued from Page 1

that power to its board of directors. Fessler said the AGSOC board would be likely to adopt that restriction, but that could be prevented by giving the power to shareholders, also, in the enabling legislation.

—Requiring legislative approval of the articles of incorporation and bylaws adopted by the first board.

—Restricting AGSOC's ability to lobby and campaign. Representatives of the administration, and others, have expressed fear that AGSOC could create a powerful lobby by the citizen shareholders to repeal taxes and restrictions on industries the corporation invested in.

—Limiting the initial loan guarantee fund to strictly "start up" expenses not to exceed $5 million. The legislation currently does not spell out what the initial appropriation would be used for. Some lawmakers are concerned that the corporation would have to keep coming back to the state for more money and that there were no safeguards to prevent a drain on the state's treasury.

—Requiring a voter referendum for later appropriations and loan guarantees.

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

April 10, 1979

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

Dear Representative Miller:

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

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

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

1. THE FIRST FULL PARAGRAPH ON PAGE 3

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

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

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

2. THE LAST FULL PARAGRAPH ON PAGE 3

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

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

ciple of capitalism or the principle of socialism should be determined.

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

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

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

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

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

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

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

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

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

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

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

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

it to those citizens, that the Board of Directors or the management of AGSOC could not become a political center or political leader of any kind whatsoever.

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

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

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

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

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

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

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

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

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

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

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

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

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

speculation.

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

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

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

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

7. PAGE 11, SECTION IV. CORPORATE DEMOCRACY

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

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

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

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

8. DESIRABILITY OF A HIGH FORUM REQUIREMENT

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

9. LESIGLATION ASSURING ADEQUATE NOTICE OF MEETINGS

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

10. THE CORPORATE BY-LAWS

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

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

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

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

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

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

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

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

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

Sincerely,

KELSO & CO., INCORPORATED

By _____
Louis O. Kelso

By _____
John A. Miskimen

LOK/JAM:ch

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

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.

MEMORANDUM

To: MG

From: Jerry Gauche

Re: Markup Issues for State Affairs

Date: 4/23/79

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1. Question of whether petition signed by 100 shareholders is too open to abuse and whether the number of signatures required for shareholder nominations or ballot issues should be some higher number like 500 or 1,000.

2. Directors should be able to suggest changes in bylaws to be voted on by the shareholders even though the shareholders prposed the bylaw. Currently the bill, at page 18, line 2, restricts the board from making such proposals for one year after the meeting at which a shareholder bylaw was proposed.

3. Could allow more outside directors and still assure Alaskan control by providing that a quorum of the board may not be constituted without a majority of Alaskan directors (instead of the current treatment of requiring that only 1/4 of the board be from outside). Bill at page 18 line 12.

4. Add clause which insures that legislative disapproval

IF ARTICLES OR BYLAWS AND ANY LEGISLATIVE CHANGES TO THE GSOC CHAPTER WILL NOT AFFECT FINANCIAL COMMITMENTS OF THE CORPORATION. BILL SECTIONS 330 (PAGE 32) AND 635 (PAGE 57).

5. SUGGEST THAT TO LIMIT SHARE OWNERSHIP TO ALASKANS PROVIDE DURING FIRST YEAR ANYONE CAN GET SHARES FREE OF CHARGE, AFTER FIRST YEAR AND UP TO YEAR SIX MUST PAY BOOK VALUE. BILL SECTION 7, PAGE 60/61.

6. NEW PROVISIONS ON APPOINTMENT OF INCORPORATORS.

7. DISCUSS REMOVING THE LOBBIEST SECTION FROM THE COMMITTEE AMENDMENT REGARDING POLITICAL ACTIVITIES.

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 $500,000 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 77th 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

Source: Taming the Giant Corporation
Nader, Green, and Seligman

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.

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. Aloha 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: