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Needless to say, such expansions of bank credit cannot create any useful capital goods. All that such bank credit, as these authors propose and endorse, can do is to transfer ownership of existing capital goods from their rightful owners to those receiving the proceeds of the bank loan. It is done by a process that probably not one in a million can detect, for each loan reduces each person's purchasing power only infinitesimally. However, over a period of time such loans have a tremendous effect. Any expansion on the scale proposed by these authors would quickly depreciate the already shaky value of the dollar.

The authors propose that their plan will make everyone a capitalist merely by the creation of such bank credits. They believe that future earnings from the capital so created will pay off the loans with interest and that thereafter the borrowers will be entitled to all further earnings for evermore. Such income is then supposed to make it possible to sustain millions without any further effort on their part.

Such a program is absolute nonsense. It could not work once people realized what it meant. It would certainly not encourage an increase in real savings, the only kind businessmen can use. The greatest incentive for the increase of capital is for people to believe that their savings are safe from either direct or indirect confiscation. The scheme proposed is an indirect confiscation of the wealth of others. It could not and would not increase wealth in any useful form. It would merely dilute titles to existing wealth until the point was reached when people no longer found it profitable to invest their savings in capitalistic production. They would then put their savings in gems, jewelry and precious metals that they could hide and quickly move should the authorities become too nosy.

VII. Proposals provide for a free society.

The first fifty or more pages of the book make no mention of the government controls involved. However, starting on about page 55, such controls are mentioned on almost every succeeding page. In short, the scheme provides that a governmental agency would insure all lending banks against all future human errors of their borrowers in investing their loans so they can be repaid by earnings without any further claim on the sum lent or what was bought with the sum so lent. A government agency would thus be forced to determine all future investments as well as the amounts banks might lend for the purpose of creating capitalists out of bank borrowers. By such a fantastic scheme of government controls of the very life-blood of business we would "start the process of industrialization without resort to past savings." (Pg. 55)

To get the plan started, they would force present corporations to pay out all earnings in dividends. To keep it going and put an end to uncontrolled investments, they would enact inheritance taxes which equalize the dividend income of the entire population, or so they think. They would prohibit those owning a certain amount of income from capital from working and thus competing for jobs. The government could control all monopolies by shutting off capital and creating competitors. The government would, of course, prevent all malinvestment.

"Each loan would be made in accordance with policies established by Congress and administered by the Federal Reserve System" or some other agency "as Congress might determine." (Pg. 61) If the politicians would decide which industries and which managements could have capital, pray tell where would any free enterprise exist??

On page 75 we learn that the government would impose "high standards for demonstrating feasibility of new enterprises or new expansions before their securities could qualify for CDIC-insured loans." Shades of Thomas A. Edison !!! Could he have gotten the capital for his inventions?

On page 69 we learn that American political history has been characterized by changes "required to increase its efficiency in the face of its large-scale tasks by eliminating much of its original decentralization." Shades of Adolf Hitler!!!

They do admit, "there is no doubt that government would exercise considerable power." However, they do not admit that it would exercise totalitarian power over the access to capital, without which no business could even exist. If men were not free in the economic realm, they would soon find that they had lost all that freedom had ever meant. Who could print books and papers? Those the politicians selected and allocated the needed capital. Who could build churches and schools? Those the politicians selected and allocated the needed capital. Who could work? Those the politicians decided were eligible.

One could go on and on but the reader who has read this far should easily see that it is merely another scheme for milking those who have produced, saved and invested wealth for the benefit of those who will keep the politicians in office. The book's authors would make everybody a capitalist by giving them a share of the wealth already produced by others.

If such a scheme were ever attempted, capital accumulation, the source of the ever higher American standard of living, would soon dry up. Men do not save and invest when they know their savings will be despoiled or confiscated. Workers and consumers alike are heavily indebted to those who have saved in the past. Without such additions to capital by every succeeding generation, our standard of living would have stood still. If the capital so carefully accumulated over the decades should be dissipated by any such illogical wild scheme as this proposal, Americans would be compelled to return to the living standard of the Indians. Our population would also have to shrink to that of a century or more ago.

THE PRECEDING PAGES WERE TREATED AS
A UNIT IN THE ORIGINAL FILE.

K-40 MRS. 107

WARNING

A person who signs a name other than his own on the petition, or who knowingly signs his name more than once for the same proposition at one election or who signs the petition knowing he or she is not a qualified voter, upon conviction is punishable by a fine of not more than \$1,000 or by imprisonment for not more than one year, or by both. (AS 15.45.100)

SUMMARY OF THE INITIATIVE

The proposed law will create a new private corporation, the Alaska General Stock Ownership Corporation (AGSOC), owned by Alaskans. AGSOC will invest in major projects within the state. It is required to distribute annually to its shareholders at least ninety percent of its income. The law creates a fund not to exceed \$5 million subject to legislative appropriation to guarantee loans to AGSOC for startup expenses, but provides no other state support for the corporation.

One share of AGSOC stock will be distributed free of charge to each Alaskan who is a resident at the time of the law's effective date. Only individual Alaskans may own AGSOC shares, and no one may own more than ten shares. The public must be notified of stock availability, and residents may elect not to receive stock. Residents have one year in which to receive a share without charge and an additional year during which they may purchase their share at book value. The stock may not be sold for five years unless the shareholder permanently leaves the state, in which case he must sell his stock to the AGSOC at book value.

Each share of stock may be voted at annual shareholder meetings with one-third required for a quorum. A corporate ballot and shareholder pamphlet will be prepared by the AGSOC, under regulations insuring fairness, and mailed to each shareholder. Shareholders vote their ballot by mail. Shareholders may (1) amend the bylaws and articles of the AGSOC, (2) nominate directors and place issues on the ballot by petition, (3) remove the entire board or any director at any time, (4) sue to remove a director for fraud or abuse of authority and, (5) in limited circumstances sue on behalf of the AGSOC.

AGSOC will be organized by three people appointed one each by the Governor, Speaker of the Alaska House of Representatives, and President of the Alaska Senate. These three people will select nine people as the original board of directors, subject to disapproval by two of the three state officials named above. The directors form the governing board of AGSOC. The initial appointed directors serve only until the first shareholders meeting, when they must stand for election. The organizational documents of the AGSOC must be submitted to the legislature, which may disapprove any provision. Legislative disapproval may be overridden by a shareholder vote.

The directors have management responsibility for AGSOC. The chairman and at least three-fourths of the nine member board must be Alaskans. Members will serve for two years with half the board elected each year. Officers of the AGSOC are appointed by the board which also defines their duties.

AGSOC may not endorse political candidates or ballot issues nor lobby the legislature. The legislature may amend the AGSOC law so long as the creditors of AGSOC are protected. Carried over substantially intact from existing Alaska law are provisions regarding sales of assets, dissolution of AGSOC, restatement of articles, annual reports, filing fees, procedural provisions, and regulatory authority of the Commissioner of Commerce.

IT'S TIME TO TAKE STOCK IN ALASKA

ALASKA GENERAL STOCK OWNERSHIP CORPORATION



**Everything You Always
Wanted To Know
About AGSOC...***

***...But Were Afraid To Ask.**

1. **Q. What is AGSOC?**

A. AGSOC stands for "Alaska General Stock Ownership Corporation." It would be a private owning and operating enterprise in Alaska. Every resident of Alaska as of the date of incorporation would be given a share of stock in the AGSOC, and its profits would be distributed to them as dividends.

2. **Q. Does AGSOC exist now?**

A. No. It must be created through law by the State Legislature or by popular vote.

3. **Q. Why should we create an AGSOC?**

A. There are five main benefits:

A) AGSOC gives all Alaskans a second income. This second income derives from production and development in the state. So:

B) It helps promote economic activity in Alaska. And just as important:

C) It keeps the profits from that activity in Alaska, rather than enriching outside companies. Also:

D) It puts the profit directly into the hands of Alaskans, without passing it through the state government and its costly bureaucracy. And:

E) It can give a preference for local hire, despite recent court decisions, by establishing a corporation policy to hire shareholders first.

AGSOC gives Alaskans a real stake in the free enterprise system because it allows them to participate in that system, as owners of capital.

4. **Q. How does AGSOC work?**

A. There are six steps:

A) AGSOC is created by the State.

B) Each resident of the state on the date of incorporation gets one share in AGSOC. There is no cost to get the share.

C) AGSOC management looks for sound investments in Alaska.

D) Having decided on an investment, AGSOC borrows money and makes the investment.

E) AGSOC operates the enterprise it has invested in, and this produces earnings for the AGSOC.

F) The earnings are used to pay off the loan and to pay dividends to shareholders.

5. **Q. What kinds of investment would AGSOC make?**

A. AGSOC would probably look for large and relatively low-risk projects. One possibility would be to purchase a part ownership of the trans-Alaska pipeline, which would produce earnings immediately. Other energy or resource projects, communications, or similar large industries would be appropriate for AGSOC investment.

6. **Q. How do we know this will work?**

A. It has the same chance, or better, as any sizable corporation dealing in sound investments. In fact, it has an extra safety value—since it will operate entirely with borrowed money, it will benefit from the judgment of the lenders as to the soundness of its investments.

7. **Q. How much will shareholders get?**

A. That depends on how much is invested and on the rate of return from each investment. As an example, AGSOC could purchase British Petroleum's share of TAPS. Last year, B.P.'s pre-tax profit from TAPS was \$127.2 million. Divided among 405,000 Alaskans, that would come to \$314 per person (\$1,256 per family of four). This is an indication of the kind of opportunities that are available, although it should not be taken as a precise indication of what an AGSOC share would earn. Generally, AGSOC would aim at a 20 percent annual return on investment, as other corporations do. The more AGSOC invested, assuming sound investment, the more each share would eventually earn.

8. **Q. Isn't this something for nothing, like a government handout?**

A. No, it isn't. What the AGSOC does is use a credit device, debt financing, to acquire capital tools to produce wealth. It's the capital tool itself that produces the wealth to pay for its cost. When that debt is satisfied or being satisfied the balance of the money, the profit, goes to the owner of the capital tool. This plan is to spread out the ownership of new productive wealth to more people, without taking one dime from the rich to give to the poor. The gift, and there is one, is from the genius of man in developing productive technology in our industrial society.

9. **Q.** If an investment turns sour, what liability do Alaskans have?
A. *The individual shareho'ler has no liability. That's an important reason for forming any corporation.*
10. **Q.** Why would anybody lend money to the AGSOC if the shareholders are not responsible for the debt?
A. *Because the loan is made on the strength of the productive investments. This is not unlike the mortgage on a building. The loan is made on the value and productive capacity, rental income, of the building. Often they are 100% financed.*
11. **Q.** Has anybody tried this before?
A. *Not exactly. People have formed corporations before, of course. But this is a new idea for a state to form a private corporation on behalf of its citizens. It is made possible by a federal tax law written by Senator Mike Gravel and passed by Congress last year.*
12. **Q.** Isn't this like socialism?
A. *Not at all—in fact, just the opposite. AGSOC would be a private corporation owned by private individuals, like General Motors or U.S. Steel or any other large American corporation. Under Socialism, corporations like these are run by the government. Socialism is a concentration of power by the state. AGSOC would operate completely independently of the state, just like U.S. corporations that are involved in Alaska or the rest of the country today.*
13. **Q.** But doesn't the state set up AGSOC?
A. *Yes. But it's like the Alaska Native Regional Corporations. They were set up by the government. All of Alaska's natives were named by the government as shareholders. But then the corporations embarked on their own independent courses. They're not run by the government—they're private companies, a part of the normal free enterprise system. AGSOC would be the same: created by the State, but then cut loose to operate independently in the private market.*
14. **Q.** But wouldn't there be a conflict of interests? The same people who would be voting in Alaska on state policy would be owners of the AGSOC?
A. *Yes, there would be a conflict. It is a conflict which already exists between private enterprise and the State. And it already affects individual Alaskans like those who own Native Corporation stock, or those who own General Motors or Alaska Airlines stock or any other stock in corporations operating in Alaska who also vote on State policy. When all Alaskans see that they have a stake in the private market, through their ownership of AGSOC stock, they will probably consider much more thoughtfully the implications of state regulation and other state policies toward private business. So yes, this conflict will exist—just as it already exists. And that will be good, because it will give a stronger constituency to the needs of private enterprise, and it will make for better considered state policies.*
15. **Q.** Since the AGSOC is statewide, won't a position on the board of directors be used as a stepping stone to higher political office?
A. *No more so than other positions like the head of a statewide bank, an owner of hotels or the president of a statewide communications company. The test of those positions and that of being an AGSOC board member is success, competence and skill. There's nothing wrong with proving one's self in that manner. It's the best criteria for political and private leadership.*

AGSOC: OPERATION AND SUPERVISION

16. **Q.** Would AGSOC get money from the state?
A. *No. AGSOC would get a relatively small loan guarantee from the state for start-up costs, probably about \$5 million. But there would not be a transfer of money to AGSOC like there was under the Native Claims Settlement Act.*
17. **Q.** Where does AGSOC get its money?
A. *AGSOC would borrow money to make its investments in Alaskan enterprises. This would be done by*

selling bonds, the same way other corporations do. The bonds would be purchased by traditional large lenders like banks and insurance companies.

18. Q. Why would they be willing to lend to AGSOC?

A. *Mostly on the strength of the investment to be made. An investment in the Trans-Alaskan pipeline, for example, would be looked at as a secure investment. In the first years, state guarantees of AGSOC loans might be desirable. Eventually the overall financial strength of the AGSOC would also help secure its borrowing.*

19. Q. Who would be running AGSOC?

A. *It would be run by a regular management team: President, Vice-presidents in charge of various areas, investment specialists and so on. The management would be accountable to the Board of Directors, and the Directors would be accountable to the shareholders (Alaska residents).*

20. Q. Who appoints the directors?

A. *At first, the nine directors would be appointed by a board which was selected by the Governor, the President of the State Senate and the Speaker of the State House of Representatives. But this appointed Board of Directors would stand for election by the shareholders at AGSOC's first annual meeting. And all directors would subsequently be elected by shareholders. The directors' terms would be staggered so that three seats would be up for election each year. The important point is that the directors are elected by the shareholders. The directors can be challenged and removed from the board by vote of the shareholders. This is the same as other corporations.*

21. Q. What's to keep the directors or the management from making a killing on the money they handle?

A. *The same laws which protect shareholders in other corporations: securities laws as well as state and federal laws on fraud, embezzlement, mismanagement and so on. In addition, the AGSOC cannot have retained earnings to reinvest or manipulate. All the money that comes in must be paid out by serving debt and paying dividends to shareholders except a small percentage of up to 10% to be used for paying the cost of operating the corporation.*

22. Q. Who monitors AGSOC?

A. *Again like other corporations: the Securities and Exchange Commission, the IRS, the State's Department of Commerce and most important, the shareholders themselves. In addition, several committees of the Congress will have a special interest in AGSOC.*

23. Q. Who decides what investments AGSOC will make?

A. *The management, subject to the approval of the Board of Directors, and ultimately a majority of the shareholders.*

24. Q. Who hires AGSOC's staff?

A. *The Board of Directors would appoint the corporation's officers, the officers would be responsible for hiring the rest of the AGSOC staff.*

25. Q. How big would AGSOC's staff be?

A. *AGSOC's start-up staff is estimated at about 25, from officers to secretaries. The number of AGSOC employees eventually depends on AGSOC's investments.*

26. Q. What would AGSOC's budget be?

A. *The budget for running AGSOC during the start-up period, 18 months to two years, has been estimated very roughly at about \$5 million.*

27. Q. What controls do Alaskans have over AGSOC?

A. *As shareholders, they control the corporation. They elect the Board of Directors, and they can remove a director by vote at any time. At annual meetings, shareholders can place issues and candidates on the corporation ballot. They can vote to dissolve the corporation. Individual shareholders can sue the directors on behalf of the corporation. A majority of the Board of Directors must always be Alaskans.*

28. **Q.** What kind of reports will AGSOC make to the people?
A. An annual report will go to each shareholder, detailing the operations and financial situation of the AGSOC. Semi-annual or quarterly reports will also be issued.
29. **Q.** Will AGSOC financial records be available to the public?
A. Yes.
30. **Q.** What controls do the Governor and the legislature have over AGSOC?
A. The same control they have over all other corporations chartered in Alaska.

AGSOC STOCK OWNERSHIP

31. **Q.** Who is qualified to own AGSOC stock?
A. Only residents of Alaska.
32. **Q.** Who is going to be given shares of AGSOC stock?
A. All those who are residents of Alaska as of a date set by law—in the case of the initiative petition, all those who are residents on the day 60 days after passage of the proposition.
33. **Q.** What if an AGSOC shareholder moves out of Alaska?
A. He or she must sell the stock to the AGSOC. The price of the stock would be set according to the book value of the AGSOC, as determined by independent accountants for the first five years.
34. **Q.** What about people who move into the state (or who are born) after AGSOC is formed?
A. They can buy the stock, or it can be bought for them, as it becomes available from AGSOC—first come, first-served. The price, again, would be based on book value. After five years, a market would probably develop in Alaska for the stock and people would be free to sell or buy as long as they are Alaskans. To take care of new births and new residents, additional AGSOC's could be formed or with a change in federal law, different classes of stock could be issued for different time frames or different investment portfolios.
35. **Q.** What about share-holders who die?
A. They can will their AGSOC stock to a qualified Alaskan, or it will be purchased at book value by the corporation for the first five years. Later, it could be sold for fair market value by the shareholders' estate to any Alaskan.
36. **Q.** How many shares can one person own?
A. No more than ten.
37. **Q.** How often will dividends be paid?
A. At least yearly.
38. **Q.** Will dividends be taxed?
A. Yes, like any other personal income.
39. **Q.** Can an AGSOC shareholder sell his stock?
A. During the first five years, it can be sold only to the AGSOC itself, at book value. After five years, the stock can be sold to any Alaskan so long as he doesn't end up with more than ten shares.
40. **Q.** What about minors?
A. A parent cannot sell his child's stock. Only the child can sell his or her stock upon reaching majority assuming the first five years have elapsed. Until majority, the dividends are paid to the parents.

AGSOC HISTORY

41. **Q.** Where did the idea of AGSOC get started?

A. You could say it started with Adam Smith, since his name and his *Wealth of Nations*, published in 1776, is often associated with the beginnings of a theory of the modern free-enterprise system. More to the point, though, it grew out of the nation's recent success with ESOPs (Employee Stock Ownership Plans). And it was made possible in 1978 when Congress adopted an amendment to the tax code outlined by Senator Mike Gravel.

42. Q. What is ESOP?

A. ESOP is a tax-assisted means for employees to buy the company they work for. In the words of ESOP organizer Louis Kelso, it's a way to "take everyone a capitalist." If the employees of a company also own the company, they have a bigger stake in how well the company performs. They get the rewards (i.e., the profits) when the company performs well, and they have a real stake in the free enterprise system. Many companies in Alaska are ESOPs now, including Yukon Office Supply, the Fairbanks Daily News-Miner, Alaska Northwest Publishing and Alaska Bank of the North.

43. Q. How would AGSOC be like ESOPs?

A. First, AGSOC has the same purpose: to make more people the owners of capital. As shareholders of AGSOC, each Alaskan would be part owner of a capital instrument, a corporation, that produces a profit for its owners. The ownership of capital is what constitutes wealth, because capital is what produces an income. So the main purpose of AGSOC, like that of ESOPs, is to gradually spread America's wealth among all the people.

Second, AGSOC is given tax assistance, as ESOPs are, in order to help achieve that goal.

44. Q. What kind of tax assistance does AGSOC get?

A. It does not pay corporation tax. It can therefore use all its earnings to pay back its lenders and to pay dividends to its shareholders, without having to pay the government first. Other corporations usually face taxes of about 45 percent.

45. Q. Why should AGSOC get special tax treatment?

A. Because the goal of spreading capital ownership is worth it. AGSOC will operate even more than most corporations on borrowed funds. The exemption from corporate tax is what makes it possible for AGSOC to pay its lenders and pay dividends at the same time.

46. Q. Does the shareholder pay tax on his dividend income?

A. Yes, it would be part of his or her personal income and would be taxed the same as other personal income.

47. Q. Isn't wealth already pretty well spread among Americans?

A. No. The income we earn for our work is spread more equally, but wealth, which is ownership of capital, is not. About 5 percent of Americans own some 50 percent of the nation's wealth. In fact, only 1 percent own about 25 percent of the wealth. And that has been the case since the beginning of this century. Without a deliberate effort to spread new wealth more fairly, it will remain concentrated in this way.

48. Q. Is AGSOC taking money away from somebody to "spread capital ownership"?

A. No. AGSOC would be a new corporation. Its profits would represent newly-created wealth, just as any corporation creates wealth through its successful enterprises. It's this newly-created wealth that is being distributed more fairly among a larger number of people by means of AGSOC and other general stock ownership corporations.

49. Q. Is this the same as Governor Hammond's Alaska Inc.?

A. No. Under Alaska Inc., the state would be in charge. It would decide how to distribute the wealth that was produced from Alaska's resources. Some of this money would inevitably be "creamed off" to pay for a growing state bureaucracy. AGSOC, on the other hand, is separate from the state. All its profits would go directly to its Alaskan shareholders.

50. Q. I'm confused as to who owns this wealth of Alaska now.

A. The Alaska state government owns the oil, gas and minerals. They are leased to permit these exploitations. The state receives royalties and taxes. That is the wealth that Hammond's Alaska Inc. would distribute.

The taxes that exploit Alaska's resources like pipelines, refineries and communications systems, are generally owned by large outside companies. Gravel's AGSOC is a device to acquire ownership of some of those tools for Alaskans so that the profit from the productive capability of those tools will go to Alaskans. In other words, its getting hold of wealth we don't already have as opposed to passing out the wealth in the state treasury.

51. Q. If AGSOC is such a good idea, why aren't other states starting their own general stock ownership corporations?

A. *Other states are looking into GSOPs, just as Alaska is. But Alaska has many unusual advantages: investment possibilities that appear well-suited to AGSOC, a small population, the experience of a somewhat similar enterprise in the regional Native corporations and the fact that an Alaskan Senator, Mike Gravel, thought up the whole idea.*

52. Q. Does Senator Gravel stand to benefit financially if AGSOC passes?

A. *He and his family stand to get one share each in AGSOC just like other Alaskans.*

THE PETITION

53. Q. What does this petition do?

A. *It requires the state to submit to the voters the question of whether AGSOC should be formed. The question would be put on the November, 1980, ballot. If AGSOC were created by the legislature next year, the question would not be put on the ballot.*

54. Q. Why is the petition needed?

A. *There's a limited time during which AGSOC can be formed, under the tax amendment passed by Congress last year. Alaska has until 1983. The state Legislature failed to pass AGSOC legislation during the 1979 session, although a bill was created. The petition ensures that Alaskans will have the opportunity to create AGSOC if they want to, even if the Legislature fails to create it or the Governor vetoes it.*

55. Q. If I sign the petition, do I have to vote for AGSOC?

A. *No. Signing the petition only means you're in favor of giving Alaskans the opportunity to decide for themselves about AGSOC.*

56. Q. Won't placing the issue on the ballot in 1980 discourage the legislature from action next session, passing the buck to the '80 elections?

A. *No, the legislature is sensitive to the decreasing time available to create an AGSOC. The House committee chaired by Representative Miller has done excellent work on a bill which will surely be brought to the full legislature.*

57. Q. Again, why do we need the petition?

A. *As a safety net—just in case. Also it's an educational device to inform all Alaskans on the proposition. Your signature, though not a vote, does show interest in the undertaking and serves to encourage the legislature.*

58. Q. Who supports the petition?

A. *Here are some legislators who have signed the petition. In the order they signed it: Jim Duncan (Juneau), Senator Bettye Fahrenkamp (Fairbanks), Senator Frank Ferguson (Kotzebue), Senator Mike Colletta (Anchorage), Senator Jalmar Kerttula (Palmer), Representative Oral Freeman (Ketchikan), Representative Al Osterback (Sand Point), Representative Dick Eliason (Sitka), Representative Leo P. Schaeffer (Kotzebue), Representative Vern Hurlbert (Sleetmute), Representative Terry Martin (Fairbanks), Representative Mike Belme (Anchorage), Representative Joe McKinnon (Anchorage), Representative Sally Smith (Fairbanks), Senator Clem Tillion (Hallbut Cove), Representative Pappy Moss (Delta Junction), Representative Fred Zharoff (Kodiak), Senator George Hohman (Bethel), Senator Bill Sumner (Anchorage), Representative Nels Anderson (Dillingham), Senator Terry Stimson (Anchorage), Representative Joyce Munson (Anchorage), Senator Pete Meland (Sitka).*

AGSOC
file

KELSO & CO.
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GREENSBORO, N.C.

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LOS ANGELES

January 2, 1980

RECEIVED
JAN 07 1980
BUDGET/AUDIT
COMMITTEE

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

Report 4
AGSOC Study

Dear Jim:

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

TAPS

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

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

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

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

Hon. James Duncan, Chairman
Legislative Budget and Audit Committee
State of Alaska
January 2, 1980
Page 2

LEASING

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

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

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

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

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

Leasing is a competitive business. Initially, we investigated AGSOC leasing aircraft to Alaska Air Lines, for example. However, Alaska Air Lines has multiple proposals for such leases and at much more favorable rates than could be offered by AGSOC. The reasons for strong competition, especially in aircraft, are the favorable tax advantages (increasing for those in higher than 50% tax brackets) and high resale residual values for aircraft after the initial lease terms. Many lessors will therefore sacrifice short term cash flow for current tax benefits and long term profits. The best

Hon. James Duncan, Chairman
Legislative Budget and Audit Committee
State of Alaska
January 2, 1980
Page 3

opportunities for AGSOC would seem to be areas of leasing where lease competition is not so high, e.g., for leasing to start-up business ventures, and in other situations where financing sources are difficult to obtain.

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

MOTEL AND HOTEL

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

FISHING

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

HARD ROCK MINERALS

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

OIL AND GAS

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

PETROCHEMICALS

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

AGRICULTURE

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

Hon. James Duncan, Chairman
Legislative Budget and Audit Committee
State of Alaska
January 2, 1980
Page 4

ELECTRIC POWER

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

ALASKA RAILROAD

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

TRANSPORTATION

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

FURTHER CANADIAN MOVES TO BROADEN OWNERSHIP OF INDUSTRY


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

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

Very truly yours,

KELSO & CO. INCORPORATED

By



Louis O. Kelso
Chairman of the Board

Alaska State Legislature

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CHAIRMAN
BUDGET & AUDIT COMMITTEE
MEMBER
FINANCE COMMITTEE

House of Representatives

MEMORANDUM

TO: ALL REPRESENTATIVES

FROM: Rep. Jim Duncan

SUBJECT: General Stock Ownership Corp.

DATE: March 6, 1979

Attached herewith is a copy of the General Stock Ownership Corporation bill summary for your reference.

I hope this helps you in your considerations for House Bill No. 240.

JD:jp
Attachment

ALASKA
GENERAL STOCK OWNERSHIP CORPORATION

BILL SUMMARY

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

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

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

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

DETAILED EXPLANATION

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

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

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

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

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

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

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

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

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

ANALYSIS: SECTION 1

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

50.010. ALASKA GENERAL STOCK OWNERSHIP CORPORATION CREATED.

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

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

50.020. ARTICLES OF INCORPORATION.

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

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

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

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

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

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

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

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

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

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

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

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

50.030. BOARD OF DIRECTORS.

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

50.040. NOTIFICATION OF ELIGIBLE SHAREHOLDERS.

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

50.050. CORPORATION NOT LIABLE TO SHAREHOLDERS.

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

50.060. LATE APPLICATION FOR SHARES.

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

50.070. PENALTIES FOR MISREPRESENTATION OF ELIGIBILITY AS SHAREHOLDER.

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

50.080. DIVIDENDS OF THE CORPORATION.

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

50.090. EXEMPTION FROM AS 10.05

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

50.100. LOAN GUARANTEE FUND.

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

50.300. DEFINITIONS.

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

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

July 24, 1979

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

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

Dear Mr. Chairman:

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

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

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

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

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advanced status of the project that can be presented to the next session of the Alaska Legislature. It is momentum-maintaining work; it is work that advances necessary preparations to the launching of AGSOC if the

The Honorable Jim Duncan, Chairman
Legislative Budget & Audit Committee
State of Alaska
July 24, 1979
Page Two

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

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

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

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

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

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

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

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

The Honorable Jim Duncan, Chairman
Legislative Budget & Audit Committee
State of Alaska
July 24, 1979
Page Three

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

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

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

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

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

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

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

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

The Honorable Jim Duncan, Chairman
Legislative Budget & Audit Committee
State of Alaska
July 24, 1979
Page Four

SPECIAL NOTE CONCERNING CONFERENCES WITH THE SECURITIES AND EXCHANGE
COMMISSION

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

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

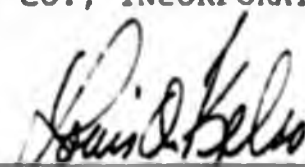
Since the scope of the work has been reduced, it is elementary that the overall fee should be reduced. To give us sufficient funding to enable us to make a significant contribution to foreshortening the time and work required upon passage of the AGSOC legislation before AGSOC can become an active force,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

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

Yours truly,

KELSO & CO., INCORPORATED

By



Louis O. Kelso, President and
Chief Executive Officer

LOK:cae

KELSO & CO.

INCORPORATED

INVESTMENT BANKERS

GREENSBORO, N.C.

SAN FRANCISCO

LOS ANGELES

June 19, 1979

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

Dear Mr. Chairman:

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

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

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

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

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

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

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Three

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

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

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Four

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

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

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

Analysis. Cataloging and Evaluation Of Financing Sources

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

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

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Five

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

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

Development of Types of Potential Investment Opportunities for AGSOC

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

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

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

The office of the Hon. Russell B. Long, Chairman of the United States Senate Finance Committee, estimates that there are approximately 3,000 Employee Stock Ownership Plans operating in the United States. The overwhelming evidence is that these financing techniques bring about spectacular improvements in the productivity, profits, sales, increase in net worth, and even income tax payments of the companies that adopt them. The ESOP is a double tax shield: it gives employees access, through

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Six

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

Virtually all of the estimated 3,000 or so ESOPs now in existence have been adopted since 1970 when the firm of Kelso & Co., Incorporated was organized. The ESOP functions by giving employee-participants (who become, through the ESOP trust, beneficial stockholders of their employer) access to the corporate pre-tax return on invested net worth of the shares which are allocated to their accounts to pay for the stock which they have bought. Furthermore, the ESOP defers (usually until the participant's retirement) taxation on the sums applied to amortization of acquisition debt. Thus the value of the stock received from the ESOP trust is partly taxable as ordinary income and partly at capital gain rates. Even this "deferred taxation" is the result of an historical accident. In seeking to apply the theory of capitalism to the practical financing problems of a business corporation in such manner as to build the ownership of newly formed capital, or newly acquired capital assets, into employees as those assets pay for themselves in pre-corporate-income tax dollars, it was expedient to use Section 401(a) of the Internal Revenue Code as a financing device, even though it was originally

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 12, 1979
Page Seven

intended only to provide "deferred compensation." Thus, the theory of capitalism, as applied to employee stock ownership plans, is not yet perfected to its ultimate efficiency, and will not be so until an employee, upon retirement, can take his portfolio of stock (or its cash equivalent) out of the ESOP trust without tax consequences, so long as he keeps it invested in productive capital which will help to make him a better income tax payer, and a better customer for business.

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

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

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

Development of Organizational Structure and Procedures for AGSOC

It has appeared to us that many of the questions raised about the future operations of AGSOC have resulted from the fact that little attention has been, or up to this point could be, devoted to developing and defining concretely a proposed rational

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Eight

management structure for AGSOC and operations procedures to enable it to accomplish the various tasks which it is expected to accomplish by the pending legislation. Under this proposal, working with management consultants approved by the representative of the Legislature, we would seek to define and design and appropriate management structure for AGSOC and operations procedures that can be readily adapted to it or adopted by its management to facilitate its accomplishing its various functions, including building its data-base, its identification and evaluation of investments, and its arranging for the financing of their acquisition; its establishment of escrow accounts for each of its stockholders; its organization of a trust department (or in the alternative its employment of a professional trustee) for the handling of its stockholder accounts, its dividends, its notifications to stockholders; its calling of meetings of its board and of its stockholders, etc.

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

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

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

The end result of this effort should enable AGSOC to fully live up to the expectations of the Securities and Exchange Commission from the moment that it becomes operational, and at the same time should enable the Securities and Exchange Commission to understand and to know what to expect from a general stock ownership corporation such as AGSOC. Many months of delays in the future, when such

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Nine

delays could be extremely costly, can, we are confident, be avoided by these efforts during the intervening months before the next session of the Eleventh Legislature of Alaska is convened.

Time of Performance

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

Our Proposed Fee for Services

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

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

None of the tasks specified herein is a finitely-bounded work project. Rather, each is in the nature of bridge work to connect the primary work done so far with the more advance status of the project that can be presented to the next session of the Alaska legislature. It is momentum-maintaining work; it is work

The Hon. Jim Duncan
Legislative Budget and Audit Committee
June 19, 1979
Page Ten

that advances necessary preparations to the launching of AGSOC if the pending legislation becomes law and by its very nature can save many times its cost in avoiding future AGSOC start-up delays.

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

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

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

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

KELSO & CO., INCORPORATED

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

10502
Alaska State Legislature

House of Representatives



MEMBER
FINANCE COMMITTEE

REPRESENTATIVE JIM DUNCAN
CHAIRMAN
BUDGET & AUDIT COMMITTEE

STATE CAPITOL
POUCH V
JUNEAU, ALASKA 99811
465-3818

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

August 14, 1979

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

Dear ~~Senator~~ *Mike* Gravel:

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

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

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

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

District 4

HAINES

JUNEAU · DOUGLAS

KLUKWAN

SKAGWAY

Hon. Mike Gravel

-2-

August 14, 1979

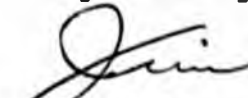
economy against a criterion of maximum return to stockholders.

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

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

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

Respectfully,



Jim Duncan

JD:jp

File of AGSOC

(bring up at 1st
S.A. meeting on AGSOC,
however, we should
consider these changes?)

Rep. Miller

WILMER, CUTLER & PICKERING

1666 K STREET, N. W.

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 JUDITH BABY WISE
 ROGER S. WITTEB

September 17, 1979

Representative James Duncan
 Chairman, Legislative Budget
 and Audit Committee
 Alaska Legislature
 Pouch V
 Juneau, Alaska 99811

Dear Representative Duncan:

I enclose a memorandum for your Committee on the federal tax and securities law issues raised by Senate Bill No. 170. The memorandum suggests several possible changes in S. 170 in order to facilitate the necessary federal action. Consistent with our contract with you of June 1, 1979, we have focused mainly on the securities and tax issues and have not attempted a review from the standpoint of constitutional questions or corporate law. However we have, in Section III of the memorandum, questioned the desirability on constitutional grounds, of the waiting period for eligibility under S. 170 and suggested an alternative.

Finally the memorandum outlines the approaches we recommend to the IRS and SEC. We would be grateful for your reaction to the memorandum and authorization to begin preliminary discussions with appropriate IRS and SEC officials. In the interest of time, we have begun drafting submissions to the two agencies along the lines proposed in our memorandum.

Sincerely,

Samuel A. Stern
 Samuel A. Stern

cc: Mr. Dale E. Staley

RECEIVED
 SEP 21 1979
 BUDGET/AUDIT
 COMMITTEE

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

September 14, 1979

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

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

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

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

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

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

I. SECURITIES REGULATION OF AGSOC

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

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

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

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

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

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

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

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

Provision of the
Securities Act of 1933

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

the same Act. We propose to argue both points to the SEC.^{5/}

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

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

^{6/} This section exempts from registration:

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

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

AGSOC will be an Alaska corporation as required by Rule 147. Its principal place of business will probably be located in Alaska (Rule 147(c)(1)(i) and (2)(iv)), although the latter is not required by S. 170.^{8/} We suggest that the legislature consider

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

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

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

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

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

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

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

asset provisions of the rule will only be applicable to the initial GSOC distribution if AGSOC becomes operational before its shares are distributed.^{11/}

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

[Footnote continued]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

usage^{19/} and cumulative voting^{20/} will limit shareholder power (while simultaneously barring usurpation of it by certain groups) and (6) AGSOC equity will be primarily supplied by loans from large financial institutions in reliance upon state guarantees. The existence of a diffuse, unsophisticated, and passive shareholder population together with a sophisticated and concerned set of creditors provides potential for abuses. S. 170 does not contain provisions which are adequate substitutes for most of the investor protections of the 1934 and 1940 Acts.^{21/}

^{19/} §§ 10.50.155 & 175.

^{20/} § 10.50.160.

^{21/} For example, because of the large shareholder population involved and the large sums of money which will be sought from financial institutions, this entity may have major impact upon financial markets. The SEC will probably be quite concerned about the contents of disclosures made to potential shareholders because of the lack of sophistication of this group of people compared with other investors in corporate securities. Particular care should be given to disclosure of the rights of minors and incompetents, who will probably compose a significant portion of shareholders. We propose to represent to the SEC that the notices to Alaska residents, the prospectus or other offering circulars, and other explanations of AGSOC made available to the public will contain full disclosure of the risks to shareholders.

In addition, S. 170 has no provision imposing fiduciary duties on officers or directors, other than requirements that loans not be made to officers or directors and

[Footnote continued on following page]

Our briefing memorandum prepared for the SEC will suggest that a modified form of 1934 Act regulation will be adequate to meet these problems during the five years after the initial distribution and that 1940 Act regulation would be unnecessarily burdensome. However, we anticipate that some modifications to S. 170 may be requested by the SEC during the course of these discussions because of the possibilities for abuse.

II. FEDERAL TAXATION OF AGSOC AND AGSOC SHAREHOLDERS

Subchapter U permits the creation of GSOCs by states and generally provides that a GSOC set up in conformance with its requirements will be exempt from federal taxation. 26 U.S.C. § 1392.^{22/} Taxation of the income of such corporations occurs at the shareholder level. § 1393. Shareholders also receive investment

[Footnote continued]

that distributions not be made unless there are adequate resources in the corporation. § 10.50.230. It provides for no periodic reports but only that shareholders may receive the most recent financial statements of the corporation upon written request. § 10.50.285.

22/ See generally Joint Committee on Taxation, General Explanation of the Revenue Act of 1978 (H.R. 13511, 95th Cong.; P.L. 95-600) (Joint Committee Print, March 12, 1979, pp. 321-24).

tax credits which would otherwise accrue to the corporation. § 1393(b). The corporation, rather than its shareholders, utilizes net operating losses which it may incur, and these may be carried forward for a ten-year period. § 172(b)(1)(H). The GSOC is required by Subchapter U to distribute 90 percent of its annual taxable income to shareholders,^{23/} (§ 1396), but to withhold 25 percent of such distributions for the IRS on behalf of shareholders. § 3402(r). AGSOC must file an informational tax return that identifies all shareholders and the distributions they have received. § 6039B.

Subchapter U permits a state to establish a GSOC between December 31, 1978 and January 1, 1984 by a charter enacted by the state legislature or a state-wide referendum. §§ 1391(a)(2) and (3). For the GSOC to qualify for the benefits of the Subchapter,

^{23/} These distributions must be made by January 31 of the year following the taxable year in question. A GSOC must maintain a segregated shareholder income account for purposes of accounting for such distributions. § 1394. At certain points, S. 170 refers to "dividends" rather than distributions. See, e.g., §§ 10.50.115(b), 10.50.140(a) and (b), 10.50.350, and 10.50.360; cf. § 10.50.215. These provisions should be conformed to the Subchapter U language.

its charter must provide for the issuance of only one class of stock, for the issuance of the stock only to "eligible individuals,"^{24/} for the issuance of at least one share of stock to each "eligible individual" unless such individual elects not to receive a share, and for certain restrictions on the transfer of shares. Id. § 1391(a)(4).^{25/} GSOCs may not own more than 20 percent of another company, (§ 1391(a), 1504), and may not obtain investment properties through the exercise of the state's power of eminent domain. § 1391(a)(5).

S. 170 contains the obligatory provisions required by Subchapter U^{26/} and generally appears to conform to the statutory standards. However, there are a few respects in which modifications to S. 170 may facilitate conformance of AGSOC with Subchapter U.

24/ Eligible individuals are defined as individuals who are residents of the chartering state during a period between "a date specified in the State's enabling legislation . . . and the date of issuance" of shares. § 1391(c).

25/ Shares may not be transferred for five years except by reason of death or if the shareholder ceases to reside in the state. Thereafter they may only be transferred to individual state residents who may not acquire more than 10 shares. Id. § 1391(a)(4)(D).

26/ See § 10.50.320(a), which requires AGSOC to set forth in its articles of incorporation Subchapter U's limitations on classes of shares, issuance, and restraints on alienation. S. 170 also requires that AGSOC must qualify under Subchapter U. § 10.50.320(9).

Taxation of Shareholders
at the Time of Distribution

Section 102 of the Internal Revenue Code provides that "gross income does not include the value of property acquired by gift" A gift has been defined as a voluntary transfer of property by one to another without any consideration or compensation therefor. Gray v. Barton, 55 N.Y. 68. The recipients of the shares are not required to do anything in order to be entitled to participate in AGSOC. They need only be residents of Alaska which they already are and will be. It cannot reasonably be argued that the possibility of becoming a shareholder will induce anyone to move to, or remain in Alaska. The recipients only have to be in Alaska to share in the disinterested generosity on the part of the donor. See Commissioner of Internal Revenue v. Duberstein, 363 U.S. 278 (1960).

It must be recognized that the IRS may resist treating the share distribution as a gift. For example, there is precedent for treating amounts as income where the recipient has done little or nothing to acquire the property. See Rev. Rul. 53-61, 1953-1 C.B. 17, holding treasure trove to be income to the finder. See also Cesarini v. United States, 428 F.2d 812 (6th Cir. 1970),

where a taxpayer was required to include in income currency discovered in a used piano bought at auction. The IRS has also held that payments under the Soil Bank Act, 7 U.S.C. § 1801, for refraining from planting crops constitute income. Rev. Rul. 60-32, 1960 C.B. 23. These precedents, which involve some minimal taxpayer activity, or induced inactivity, may be distinguishable in the mind of IRS. They do indicate, however, that there may be some reluctance on the part of IRS to exclude amounts from income, for example, where there is a transfer of property outside the normal family situation.

An alternative argument should also be considered. The receipt of shares by Alaska residents is comparable to a non-taxable transfer payment by a government. Support for the transfer payment analogy is found in the legislative history of Subchapter U.^{27/}

In general, the IRS has taken the position that transfer payments such as social welfare payments are not non-taxable, although no statutory authority for it to do so exists. United States v. Kaiser, 363 U.S. 299, 305-14 & App. (1960) (concurring opinion of Mr.

^{27/} Senator Gravel emphasized the hope that GSOC Income could ultimately become a substitute for welfare.

Justice Frankfurter); see, e.g., I.T. 3230, 1938-2 C.B. 136 (unemployment benefits); I.T. 3447, 1941-1 C.B. 191 (social security payments); Rev. Rul. 57-102, 1957-1 C.B. 26 (aid to the blind); Rev. Rul. 72-340, 1972-2 C.B. 31 (job training); Rev. Rul. 36-395, 1976-2 C.B. 16 (home rehabilitation grants).

Rev. Rul. 76-131, 1976-1 C.B. 16, holding that benefit payments under the Alaska Longevity Bonus Act are taxable appears readily distinguishable. Those payments are available to all Alaskans "to provide an incentive to continue uninterrupted residence in the State and under no circumstances is to be considered a form . . . of public relief." The payments by Alaska under this Act must have been sufficient in amount to provide a realistic inducement for persons to remain in the State and are comparable to the Soil Bank Act payments in Rev. Rul. 60-92, supra.

It will, of course, be helpful to a favorable determination by IRS that the value of these shares of AGSOC will be readily perceived to be negligible, or possibly zero. The cost basis for gain on a future sale of the shares by the donee shareholder will be the same as the cost to the donor, i.e., negligible or possibly zero. 26 U.S.C. § 1015. Accordingly, the IRS may

recognize the administrative convenience of not taxing the initial distribution but instead deferring the tax until eventual sale when the entire proceeds will be subject to tax.

Finally, in the event that IRS is unwilling to rule favorably on the tax treatment of the initial stock distribution, consideration may be given to obtaining the opinion of two reputable appraisers, if it can reasonably be anticipated that a conclusion of zero value will be reached. In view of the apparent negligible revenue loss involved, if any, it would be highly unlikely that such appraisal would not be accepted as conclusive of the issue.

Tax Consequences After the
Initial Distribution of Shares

Under federal law, AGSOC will become eligible for Subchapter U treatment once it qualifies and so elects. 26 U.S.C. 1392(a). It may revoke its election for a year or more with the consent of the Secretary of the Treasury. Id. § 1392(f). S. 170 provides that AGSOC shall be formed in conformance with Subchapter U, (§ 10.50.010), and that its Articles of Incorporation shall set out that it "must qualify" as a GSOC under Subchapter U. § 10.50.320(9). The Articles may be

amended in conformance with Section 10.50.365 et seq. but only if as amended the Articles "contain provisions which would be lawfully contained in original articles of incorporation at the time the amendment is made."

While the matter is not free from doubt, we believe the state legislation is thus more restrictive than Subchapter U,^{28/} and requires AGSOC to maintain its election as a Subchapter U entity. We believe it would be preferable to permit a maximum flexibility by allowing the Articles to be amended to drop Subchapter U status under the usual procedure whereby the Board of Directors (or 1000 shareholders) proposes an amendment subject to shareholder approval. § 10.50.375. To accomplish this end, we believe § 10.50.320(9) should be modified^{29/} and that the possibility of such a change should be added to the list in § 10.50.370.

28/ AGSOC may also lose its Subchapter U status under federal law by "ceasing to be" a GSOC, 26 U.S.C. § 1392(f), but it would appear that this can only occur by such affirmative actions as passing amendments which do not conform to § 1391(a)(4), acquiring assets through exercise of the power of eminent domain, or becoming a member of an affiliated group (i.e., obtaining a greater than 20% investment in another group).

29/ The phrase "unless any election to so qualify is terminated under section 1392(f) of such Subchapter" would be added to the section.

Tax consequences to individuals holding AGSOC shares are set forth in Subchapter U, and nothing in S. 170 raises questions in this regard. The Internal Revenue Code provides that the IRS may by rule provide for a certification procedure by which AGSOC could be exempt, as to non-taxpayers, from the requirement of section 3402(r) that the GSOC reserve 25 percent of distributions as withheld taxes on behalf of shareholders as if it were their employer. 26 U.S.C. 3402(r). We propose to explore the feasibility of establishing such a procedure with the IRS. While such a procedure is desirable from a social welfare perspective (permitting these individuals to receive full distribution value as soon as possible and removing the burden of filing a federal tax return), a technique will have to be established to minimize administrative burdens upon AGSOC which would have to determine and keep a record of which of its anticipated 400,000 shareholders were taxpayers in any given year.

Summary of Points
To Be Discussed with the IRS

We propose to present a brief memorandum describing AGSOC and S. 170 to officials of the IRS.

The focal point of our discussions will be the tax consequences of the initial distribution of shares. We propose to request a revenue ruling on this point on behalf of the citizen shareholders of the State of Alaska. Consideration should also be given to discussing the following matters with IRS:

- (1) Confirmation of our understanding of how Subchapter U will work, including
 - (a) AGSOC obligations to the IRS;
 - (b) AGSOC shareholder obligations to the IRS;
 - (c) The general type of reports IRS will desire from GSOCs and the types of regulations contemplated to be issued for GSOCs.
- (2) Confirmation that AGSOC as proposed in S. 170 will be viewed in conformance with Subchapter U, including
 - (a) That S. 170 is a sufficiently detailed "charter" within the meaning of 26 U.S.C. § 1391(a);^{30/}
 - (b) That the definition of "eligible individuals" conforms to Subchapter U requirements;

^{30/} It could be argued that such a charter must contain details of AGSOC governance as currently planned for the Articles of Incorporation.

- (c) That charging consideration for shares will not defeat Subchapter U status;
- (d) That S. 170 provisions requiring eligible individuals to apply for shares are compatible with Subchapter U status;^{31/}
- (e) That secondary issuances of shares will not be considered different classes of stocks in conflict with 26 U.S.C. § 1391(a)(4)(A).

III. CONSTITUTIONAL ISSUES

For purposes of determining who is an "eligible individual, the drafters of S. 170 would begin the mandatory period of state residency on the effective date of the enabling legislation. § 10.50.320(6). Persons who are entitled to receive shares thus must remain residents of Alaska for the entire period from the effective date of S. 170 until the date of issuance of shares.^{32/} As now defined, the class of eligible individuals is permanently fixed and any later issuances of shares by AGSOC apparently

^{31/} The federal legislation states that the GSOC shall provide for the "issuance of at least one share to each eligible individual," 26 U.S.C. § 1391(r)(4)(C). S. 170 makes clear that receipt of a share is dependent upon application by residents in response to state-wide notification procedures. § 10.50.345-360. We will attempt to clarify that the IRS does not deem GSOCs as under a duty to seek out and issue shares to all eligible individuals. Such a view could be fatal to AGSOC's tax-free status.

^{32/} These individuals are referred to herein as "charter residents."

may only be made to charter residents. We again call to your attention our reasons for questioning this approach, although it appears acceptable under Subchapter U.

First, this restriction of eligible individuals to members of a closed class of persons resident within the state at a fixed point in time may pose significant constitutional problems. See Wilmer, Cutler & Pickering, Memorandum for the Commissioner of Revenue, State of Alaska: Federal Constitutional Issues Presented by Alaska's GSOC (December 15, 1978).^{33/} S. 170 exaggerates some of the problems we have previously raised because it also provides that within five years of issuance, shares must be sold back to the corporation if charter residents leave the state or die leaving their shares to nonresidents. This means that the pool of AGSOC shareholders will include only those charter residents who stay within the state for five years (and the small group who move into the state within this period and inherit shares from a charter resident). After five years, right to AGSOC shares seemingly vests in charter residents and their heirs may retain

^{33/} (Hereinafter "Constitutional Memorandum"). As we indicated there, such limited eligibility for a government benefit must at least be based upon significant state interests as recited in legislative findings.

AGSOC shares even if they do not reside in Alaska. Establishing a fixed class which excludes Alaska citizens who are born in or move to Alaska after S. 170's effective date from AGSOC share issuances may then appear particularly inequitable in view of the fact that these non-Alaskan heirs will hold shares and receive AGSOC income. Even if later arriving residents may acquire shares from charter residents after the five-year period, there can be no assurance that a market in such shares will exist.

The possible constitutional problems are exacerbated by the fact the residency period to qualify as a charter resident could be lengthy, as AG OC must be organized and become sufficiently operational to issue shares.^{34/} The longer the eligibility period the more difficult it will be to verify compliance with residency requirements. A long residency period will also reduce

^{34/} Incorporators must be selected, and an initial slate of directors chosen. The latter are subject to disapproval within 15 days of their nominations which could cause delay. S. 170 § 4(b). The directors must prepare articles of incorporation and bylaws, and there is at least a 60-90 day period after they have been drafted and filed during which the legislature has the authority to disapprove any of their provisions. § 10.50.335. Activities before share issuance but after finalization of the articles and bylaws, including preparation of offering materials and procedures for share distribution, will also take considerable time,
[Footnote continued on following page]

the pool of eligible individuals and increase the number of Alaska citizens who will be resident within the state on the date of issuance or before distribution but ineligible to receive AGSOC shares. The latter will increase the potential for challenges to the constitutionality of AGSOC, and may undercut the political acceptability of AGSOC as well.

A possible solution to these problems would be to revise S. 170 to provide that the eligibility period will commence on a fixed date prior to the date of share issuance -- ^{35/} e.g., three to six months before issue. This approach has the advantage that if there is an issuance of shares subsequent to the initial distribution, later arriving residents could be included as long as they had

[Footnote continued]

for example, section 10.50.345 provides for notice to allow for application for shares of at least 90 days before the date of issuance. Litigation by opponents of some aspect of the program could cause indefinite delay. It appears extremely likely that the total period involved may exceed six months and could create constitutional problems under both the federal and State of Alaska constitutions. As we have mentioned previously, Alaska courts have taken a particularly strong stance against durational residency requirements. Constitutional Memorandum at 1, n.1, 34, n.38.

35/ The pivotal "date of issuance of shares" of S. 170 §§ 10.50.345 and 355 may not be effectual, since the bill appears to contemplate sporadic issue. Perhaps, the standard "the date of initial notification to the public of its intention to issue shares" would better carry out the purpose.

been and remained residents for the applicable period to the later issuance. This approach would, of course, exclude charter residents who leave the state prior to any secondary issuance.

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Mr. Dale E. Staley
Legislative Budget and
Audit Committee
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Re: Exemption of the Alaska General Stock Ownership
Corporation from the Investment Company Act of
1940.

Dear Dale:

I enclose a memorandum to the Budget and Audit Committee recommending several specific changes in the Alaska GSOC enabling legislation which have suggested themselves in the course of our consultations with the Staff of the SEC. We believe that representations to the Staff that these changes will be made would be most helpful in securing Staff support before the Commission for our request for a total exemption from the Investment Company Act for the first five years.

Also enclosed is a draft letter concerning these changes as well as a discussion of Alaska's law on conflict of interest which has been requested by the Staff. We ask you to clear these statutory changes and the draft letter in principle with the Committee. We will then forward the letter to the SEC Staff and ask that they recommend to the Commission that the requested exemption be granted if the Alaska legislation is amended along these lines. When and if we receive informal assurances, we will suggest that you proceed with the revisions.

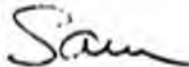
- 2 -

The Staff has also requested more information as to the nature of the investments which are planned for the AGSOC. We have told them that we do not believe portfolio securities will be among the investments to be made, but rather that the AGSOC will seek to become a joint venturer with other large enterprises in the development of various natural resources. We have been specifically asked whether it is contemplated that the AGSOC will own in excess of 25 percent of each entity in which it invests. Please clear with the Committee a representation whether ownership of this magnitude is or is not contemplated. Any additional information you could provide as to contemplated investments would be most helpful.

Your prompt response on these matters is appreciated. On the whole we have been encouraged by the Staff's receptivity to the GSOC concept.

On the IRS front, we understand that IRS, at the urging of a representative of the Treasury, will reconsider its initial unwillingness to rule. We will of course keep you posted.

Sincerely,



Samuel A. Stern

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

January 22, 1980

MEMORANDUM FOR THE ALASKA
LEGISLATIVE BUDGET AND AUDIT COMMITTEE

Re: Exemption of the Alaska General Stock Ownership Corporation from the Investment Company Act of 1940.

We have submitted to the staff of the Securities and Exchange Commission ("SEC") our memorandum of December 5, 1979, and discussed the submission with the staff on several occasions. As a result of our discussions, we believe certain steps are necessary and appropriate to secure total exemption for five years for the Alaska General Stock Ownership Corporation ("AGSOC") from operation of the Investment Company Act of 1940 ("ICA"). We have been given informal assurances that if the Division of Investment Management (the section of the SEC which regulates registered investment companies) will recommend granting the AGSOC total exemption for five years from operation of the ICA, SEC personnel will also recommend approval of our application for partial and temporary exemptions from operation of the Securities Act of 1933 and the Securities and Exchange Act of 1934.

We suggest that certain specific changes set forth below be made to the enabling legislation before its passage in its current form to maximize our chances of

persuading the Division of Investment Management that the AGSOC should be exempt from operation of the ICA. All of these suggested changes have been prompted by specific comments of the staff. The alternative will be at best a partial exemption and some measure of SEC regulation of the AGSOC.

a) Conflict of Interest

The SEC's primary concern is whether granting an exemption from operation of those provisions of the ICA which outlaw certain transactions which could involve conflicts of interest or self-dealing will result in a failure to protect AGSOC shareholders.

Section 17 of the ICA makes unlawful (absent an exemption by Commission order) certain transactions between an investment company and "affiliated persons," broadly defined.^{*/} Under section 17(a) it is unlawful for an

^{*/} The term is defined in section 2(a)(j) of the ICA:

"'Affiliated person' of another person means

"(i.) any person directly or indirectly owning, controlling, or holding with power to vote, 5 per centum or more of the outstanding voting securities of such other person;

"(B) any person 5 per centum or more of whose outstanding voting securities are directly or indirectly owned, controlled, or held with power to vote, by such other person;

[Footnote continued on following page]

"affiliated" person to sell or buy property or most securities to or from the investment company or to enter into joint ventures with or borrow money from the company.*/

[Footnote continued]

"(C) any person directly or indirectly controlling, controlled by, or under common control with, such other person;

"(D) any officer, director, partner, copartner, or employee of such other person;

"(E) if such other person is an investment company, any investment advisor thereof or any member of an advisory board thereof; and

"(F) if such other person is an unincorporated investment company not having a board of directors, the depositor thereof."

*/ Section 17(a) makes it unlawful for an "affiliated" person:

"(1) knowingly to sell any security or other property to such registered company or to any company controlled by such registered company, unless such sale involves solely

"(A) securities of which the buyer is the issuer,

"(B) securities of which the seller is the issuer and which are part of a general offering to the holders of a class of its securities, or

"(C) securities deposited with the trustee of a unit investment trust or periodic payment plan by the depositor thereof;

"(2) knowingly to purchase from such registered company, or from any company controlled by such registered company, any security or any other property (except securities of which the seller is the issuer); or

[Footnote continued on following page]

The SEC staff has pointed out: that various sections of the proposed AGSOC enabling legislation^{*/} could give rise to the kind of transactions which would be prohibited under section 17. For example, the Act (§§ 10.50.015(4), (5) and (7)) permits the AGSOC to buy and sell property and securities; the ICA, if applicable, would prohibit it from engaging in such a transaction with, for example, a person who is a director of the GSOC (or with a company on whose board their director also sits). The ICA might also prohibit the AGSOC from becoming a joint venturer with such a company, as contemplated in Act § 10.50.015(17), in certain circumstances.^{**/} Similarly, the Act § 10.50.015(6) permits

[Footnote continued]

"(3) to borrow money or other property from such registered company or from any company controlled by such registered company (unless the borrower is controlled by the lender)"

*/ References to "Act §" refer to section 1 of CSSS Senate Bill No. 170, introduced as amended April 27, 1979.

**/ Section 17(d) makes it "unlawful for any affiliated person of . . . a registered investment company . . . or any affiliated person of such a person . . . acting as principal to effect any transaction in which such registered company, or a company controlled by such registered company, is a joint or a joint and several participant with such person . . . for the purpose of limiting or preventing participation by such registered or controlled company on a basis different from or less advantageous than that of such other participant."

the AGSOC to lend money to its employees; since the ICA defines employees as "affiliated persons," such a loan would constitute a violation.

One option -- an option invited by the staff -- is to argue to the Commission why existing Alaska law on conflicts of interest adequately protects the public and why therefore there is no need for section 17 of the ICA to apply to AGSOC. Attached hereto as Attachment A is a draft of a letter we propose to send to the staff for its informal reaction. If we are not successful with this approach, it may be necessary to formulate certain modifications of the enabling legislation to include explicit prohibitions of transactions with persons who may have a conflict of interest.

b) Indemnification

The staff also commented on the scope of the AGSOC's power to indemnify provided by section 10.50.020 of the enabling legislation. The staff has indicated that these standards are acceptable to them as consistent with section 17(h) of the ICA, with the exception of the open-ended power granted in Act § 10.50.020(f), which widens the scope of possible indemnity to allow any corporate

choice. Although we realize that the provision was based on the American Bar Foundation's Model Business Corporation Act, it goes further than the ICA. We suggest strongly that Act § 10.50.020(f) be deleted from the legislation.

c) Miscellaneous

Below we discuss a series of miscellaneous changes to the legislation which have been suggested by our conversations with the staff. We request that you clear each of these changes in principle so that we may represent to the staff that they will be implemented if our exemption request is granted.

(i) Stock Options

The AGSOC is given the power to establish pension plans and other incentive plans for its directors, officers and employees. Act § 10.50.015(15). The staff has pointed out that section 18(d) of the ICA prohibits an investment company from granting stock options to its employees. We recommend that stock options be specifically excepted from Act § 10.50.015(15). The new section would read:

"(15) pay pensions and establish pension plans, pension trusts, profit-sharing plans, and other incentive plans for its directors, officers and employees, except that such pensions or plans shall not include the issuance of stock options;"

(ii) Later Issues

Under Act § 10.50.080, the AGSOC shareholders are permitted to set the price of shares to be sold in later issuances. The staff has pointed out that section 23(b) of the ICA requires that shares not be sold at an amount below the current net asset value of each share without the consent of a majority of the investment company's shareholders. Under Act § 10.50.150, one third of the AGSOC shareholders constitutes a quorum and, thus, one vote more than one sixth could set the price at less than net asset value. We recommend that you tighten the restriction in the AGSOC legislation to match the ICA. The second sentence of section 10.50.080 would be amended to read:

"The decision to issue shares without consideration or for consideration if that consideration is less than the current net asset value of such shares shall be made by the vote of a majority of the shareholders."

(iii) Payment Other Than Cash

The staff has also noted that Act § 10.50.085 allows payments for shares to be by transfer of property other than cash or in exchange for services. The ICA does not allow payment other than in cash (section 23(a)). We suggest conformance to the ICA in this minor matter. The

first sentence of Act § 10.50.085 would be amended to read:

"Consideration for the issuance of shares if required shall be paid in cash."

(iv) Interested Directors

Section 10(a) of the ICA provides that no investment company may have more than 60 percent of its Board of Directors be "interested persons". The ICA's definition of "interested" persons includes all affiliated persons and many others.^{*/} There is currently no similar restriction on who may serve on the Board of Directors of the AGSOC. In lieu of incorporating some sort of restriction along the lines of the ICA into the AGSOC legislation, we suggest that a provision along the lines of section 41 of the Model Business Corporation Act be added to the legislation. That section provides:

DIRECTOR CONFLICTS OF INTEREST

No contract or other transaction between a corporation and one or more of its directors or any other corporation, firm, association or entity in which one or more of its directors are

^{*/} "Interested person", as defined in section 2(a)(19) of the ICA, includes (unless exempted by Commission order) members or the immediate family of affiliated persons, affiliates or other interested persons of the company's investment adviser, legal counsel for the company or any partner or employee of such counsel, and any registered broker or dealer or an affiliate of such a broker or dealer.