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ALASKA
GENERAL STOCK OWNERSHIP
CORPORATION

Sponsor Substitute for House Bill No. 240
Sponsor Substitute for Senate Bill No. 170

CONTENTS

HOW IT WORKS:	Alaska General Stock Ownership Corp.
EXPLANATION:	Federal GSOC Provisions
AGSOC ILLUSTRATED:	Transactional structure
TAX TREATMENT:	General Stock Ownership Corporations
TWO POINTS:	AGSOC is not a "Giveaway" AGSOC is not State Ownership
BILL SUMMARY:	State Legislation
SPONSOR SUBSTITUTE:	AGSOC Legislation

HOW IT WORKS

THE ALASKA GENERAL STOCK OWNERSHIP CORPORATION

- * A corporation is formed and each resident of Alaska is issued one share of stock.
- * The corporation borrows money to invest in profitable projects, having assured itself of the investment's soundness.
- * Private lenders will be willing to provide loans because they can be secured by the assets of AGSOC and, if necessary subject to legislative approval, by a state guarantee.
- * The loan proceeds will be invested in the project or projects, making AGSOC an owner and thus making each Alaskan (as a shareholder of AGSOC) an owner.
- * Earnings from the project will be used to pay off the loan.
- * Dividend payments can be made to AGSOC shareholders as soon as profits are made. Once the loan is paid off, all profits from the corporation's investments will be paid out to the shareholders.

EXPLANATION: FEDERAL GSOC PROVISIONS

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

Charter Provisions

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

GSOC Taxation

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

Shareholder Taxation

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

**STATE
GUARANTY**



LOAN



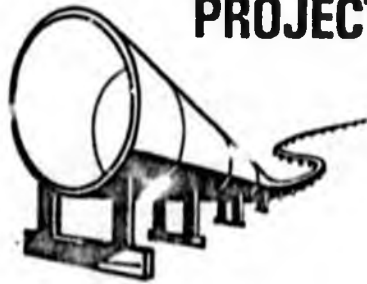
CORPORATION



BENEFICIARIES



**ENERGY
PROJECT**



TAX TREATMENT OF GENERAL STOCK OWNERSHIP CORPORATIONS

THERE HAS BEEN CONFUSION OVER THE EXTENT TO WHICH GENERAL STOCK OWNERSHIP CORPORATIONS RECEIVE SPECIAL TAX TREATMENT. IN A GSOC THE CORPORATE INCOME TAX IS ELIMINATED AND THE INCOME OF THE CORPORATION IS TAXED DIRECTLY TO THE SHAREHOLDERS AT THEIR OWN PERSONAL RATES.

SIMILAR TAX TREATMENT HAS APPLIED TO SMALL CORPORATIONS FOR MANY YEARS. A CORPORATION WITH 10 OR FEWER SHAREHOLDERS MAY ELECT TO BE TREATED AS A "SUBCHAPTER S" CORPORATION. IT IS THEN EXEMPT FROM THE CORPORATE INCOME TAX AND THE CORPORATION'S INCOME IS TAXED TO THE SHAREHOLDERS IN MUCH THE SAME MANNER AS IN A GSOC. IN FACT, THE PROVISIONS OF INTERNAL REVENUE CODE "SUBCHAPTER S" WERE USED AS A MODEL IN DRAFTING THE GSOC TAX LAW.

THUS, THE GSOC TAX BENEFITS ARE NEW AS APPLIED TO CORPORATIONS WITH A LARGE NUMBER OF SHAREHOLDERS, BUT SIMILAR PROVISIONS HAVE BEEN IN EFFECT WITH RESPECT TO SMALL CORPORATIONS FOR SOME TIME.

TWO IMPORTANT POINTS ABOUT THE ALASKA GENERAL STOCK OWNERSHIP CORPORATION

1. THE AGSOC IS NOT A "GIVEAWAY".

AGSOC stock would be issued to all citizens of Alaska. No cash investment is required of the shareholder because the AGSOC would borrow the funds necessary for profitable investments. The loan could be secured by the AGSOC assets and a state guarantee. As the loan is repaid the citizens' AGSOC equity increases.

This type of financing is not unique. The wealthy often borrow money on a nonrecourse basis for investment in profitable enterprises. They use their profits to repay the loans leaving themselves with an increased net worth. The AGSOC simply allows the rest of our citizens access to this type of financing.

2. AGSOC IS NOT STATE OWNERSHIP.

The stock of AGSOC will be held by the citizens of Alaska. They will vote this stock for a board of directors responsible for running the AGSOC in a profitable manner. AGSOC will be run in the same way as a typical business corporation. The only role for the State in AGSOC will be chartering the corporation and, if necessary, subject to legislative review, guaranteeing loans to the AGSOC.

In Alaska AGSOC may be an alternative to what would otherwise be State ownership of equity interests in some of Alaska's major energy projects. It was out of concern for this possibility that AGSOC was born.

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.

50.900 defines resident as a person who lives in Alaska and intends to remain here permanently. The definition allows for temporary travel or employment outside without loss of residency. 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 fund. 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 personnel 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.

50.900. DEFINITIONS.

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

Two-Factor Theory And ESOP Financing

Why, In An Advanced Industrial Economy,
Substantial Income-Producing Capital
Must Be Owned By Corporate Employees

And

How--With Very Slight Changes In Basic
Business Strategy--This Can Be
Effectively Accomplished Through Employee
Stock Ownership Plan (ESOP) Financing:

- °The Most Potent Instrument For The Purpose
- °The Most Advantageous To The Corporation
- °The Most Beneficial To Employees

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Although two-factor economics is a new and fundamental concept, it is simple and straightforward. The reasoning runs as follows:

1. While it is true that people, participating in the economy through the performance of their various tasks, are a basic source of productive input, they are not the only source of productive input.
2. Non-human things, such as land, structures and machines, also make productive input into the economy.
3. The division of the input sources into two types is both necessary and adequate, because the ownership of labor power cannot be concentrated, while the ownership of non-human things can easily be concentrated. It is, after all, an individual's property in an input factor that entitles him to receive what it produces.
4. Under the logic and morality of a market economy, productive input into the economy is the basis for the individual's right to receive income from it. Economic outtake is conditioned on economic input. To accountants and businessmen, this relationship is simply double-entry bookkeeping. To economists, it is "Say's Law" or "Say's Identity". To moralists, it is the Puritan Ethic, or simply the principle of economic justice defined by Aristotle. To lawyers, it is the principle of private property, under which the owners of capital and the individual owners of labor power are accorded the income equivalent of what each privately-owned input factor contributed to production.

Figure 1: **SAY'S LAW THE BASIC LAW OF TWO-FACTOR ECONOMICS**

For every dollar spent, somebody gets a dollar in economic value. Say's Law is simply a prose statement of the principle of double-entry bookkeeping, which is the logic of a private property, market economy.

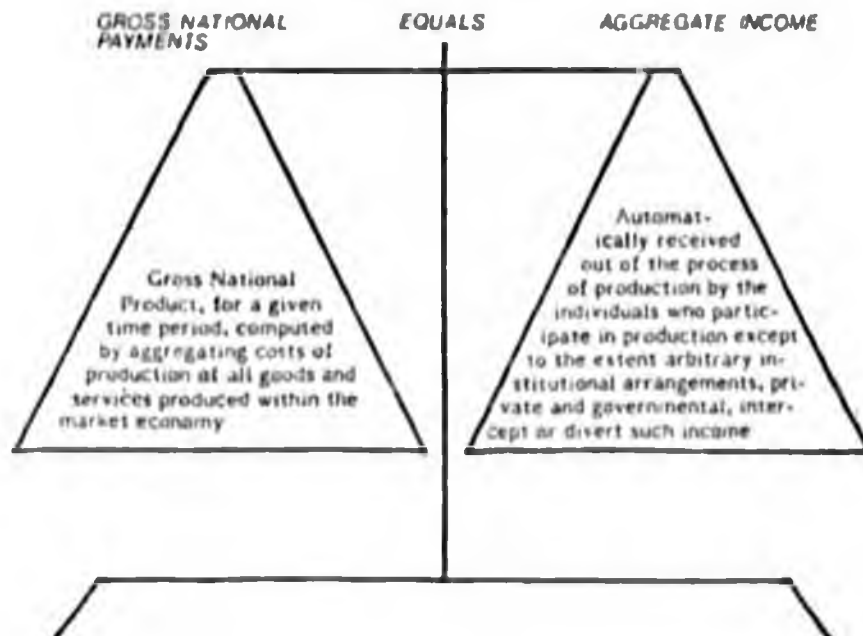
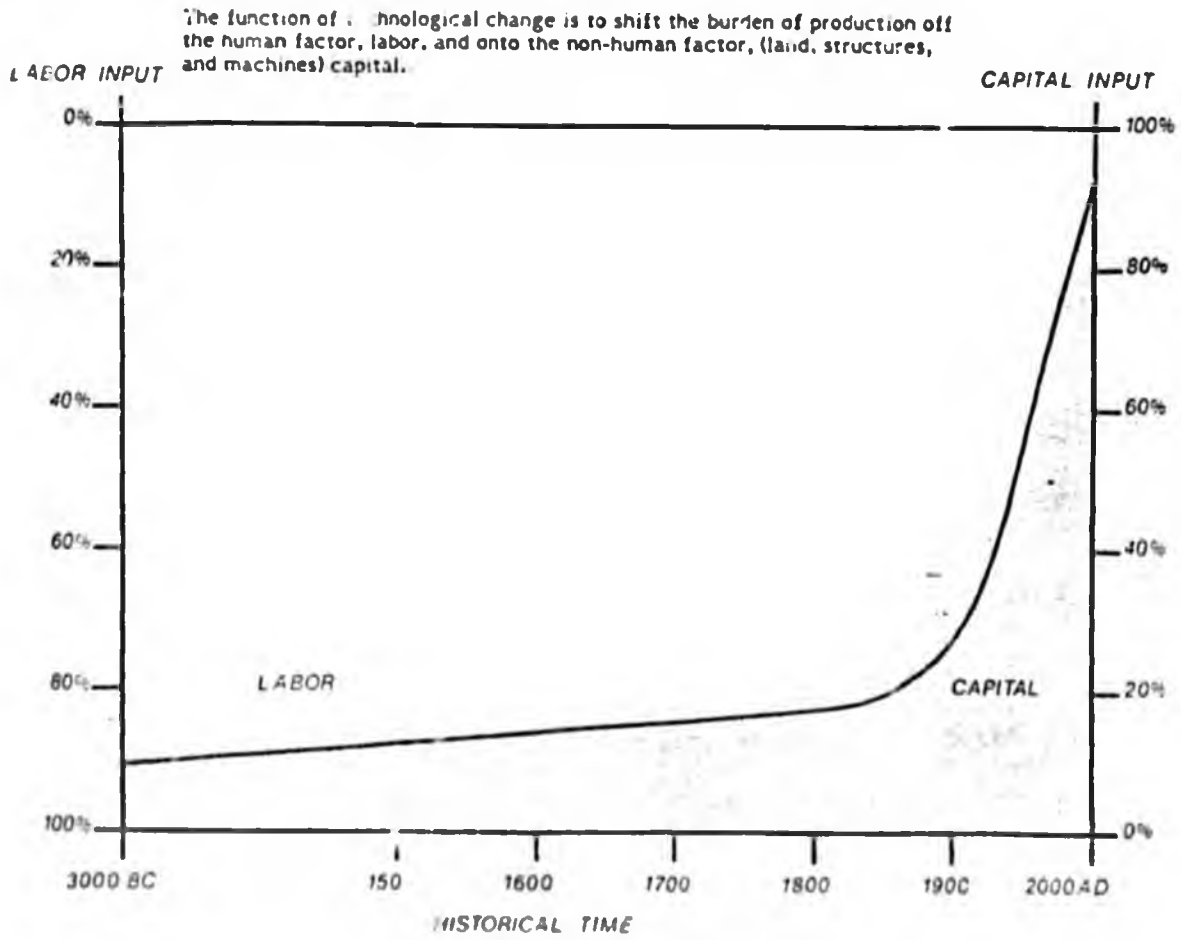


Figure 2: SAYS LAW ILLUSTRATED ON THE BASIS OF 1973 STATISTICS (IN BILLIONS)

<u>Gross National Product</u>		<u>Pre-tax Income</u>	
Less adjustments for capital consumption allowances, indirect business tax and non-tax liability, business transfer payments and other minor adjustments.		Pre-tax Income Automatically Arising out of Production and Received by the Participants in Production	
CONSUMER COSTS OF:		INCOME OF PARTICIPANTS IN:	
Agriculture, forestry, and fisheries	\$ 37.8	Agriculture, forestry, and fisheries	\$ 37.8
Mining	9.7	Mining	9.7
Contract construction	57.5	Contract construction	57.5
Manufacturing	291.9	Manufacturing	291.9
Transportation	39.3	Transportation	39.3
Communications	21.7	Communications	21.7
Electric, gas, and sanitary services	19.8	Electric, gas, and sanitary services	19.8
Wholesale and retail trade	151.5	Wholesale and retail trade	151.5
Finance, insurance, and real estate Services	118.9	Finance, insurance, and real estate Services	118.9
Government and government enterprises	133.6	Government and government enterprises	133.6
Foreign trade and transactions	162.9	Foreign trade and transactions	162.9
	<u>9.6</u>		<u>9.6</u>
	\$1,054.3		\$1,054.3

5. Technological advance, which is the phenomenon responsible for the Industrial Revolution, as well as our own automation revolution, and all of the intermediate revolutions brought about by science and technology, changes, and is intended to change, the input mix. It shifts the burden of production off labor (the human factor) and onto capital (the non-human factor). Technological change does not operate directly on labor. It cannot increase the productiveness of an individual worker. It increases the productiveness of machines, tools, structures, land and processes. The economic productiveness of human workers--what they can accomplish with their unaided muscles or minds has not changed during the course of history, if the value of that productiveness is determined objectively and competitively by the free operation of the law of supply and demand.

Figure 3: THE FUNCTION OF TECHNOLOGICAL CHANGE



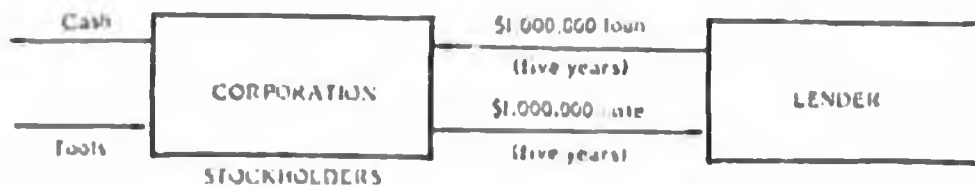
6. In the United States economy, the world's most advanced, the process of technological change has gone so far that most of the goods and services today are produced by capital instruments; only a minor portion of the productive input is made by people. With rare exceptions, it is capital that produces affluence. Labor, in a free labor market, can normally produce only subsistence. The relative distribution of aggregate personal income between workers (roughly 3/4ths) and the owners of capital (1/4th) does not reflect the relatively higher productive input by capital because our governmental economic policy (the Employment Act of 1946), and implementing legislation, attempts to repeal the law of supply and demand as it applies to the value of labor. This is the purpose of minimum wage laws, coercive fixing of wages, vast governmental make-work programs, government subsidies to industry and other government entities to "create" jobs, etc.

The costs of all such efforts enter into the costs of production, directly or indirectly, and thus are inflationary precisely because they are not reflected in the increased production of goods and services by labor. Such costs, neither representing increased labor input nor labor shortages, are, in fact, disguised welfare. They are injected into the costs of the same quantities of goods and services that, prior to the coerces increases, would have been produced at lower costs. These attempts to overvalue labor constitute the monetization of welfare.

7. The shifting of the input mix from labor to capital would cause no economic problem, even under competitive labor markets, if the declining productiveness of labor were offset by increasing capital ownership, i.e., if, as technology diminished the productive role of the human factor, workers simultaneously acquired ownership of enough productive capital to compensate for their loss, or even better, enough capital to provide what few labor-dependent persons have ever achieved, a truly affluent standard of living.
8. Unfortunately, traditional techniques of finance do exactly the reverse of what the situation logically requires. They insure that all newly-formed capital will be automatically owned by those who own all existing capital. Under these techniques, the \$100 billion-plus of new capital formation that comes into existence each year in the U.S. economy becomes owned by a tiny proprietary class--5% of consumer units at most. If averaged over the past 15 years, about 98% of new capital formation in the corporate sector (which produces more than 85% of total private sector goods and services) is financed out of direct cash flow or borrowings repaid out of cash flow.

Figure 4: CONVENTIONAL CORPORATE FINANCE

Including internal cash flow, borrowings repaid from after-tax cash flow, accelerated depreciation, depletion, and investment tax credit, but excluding sale of new stock to the public for cash

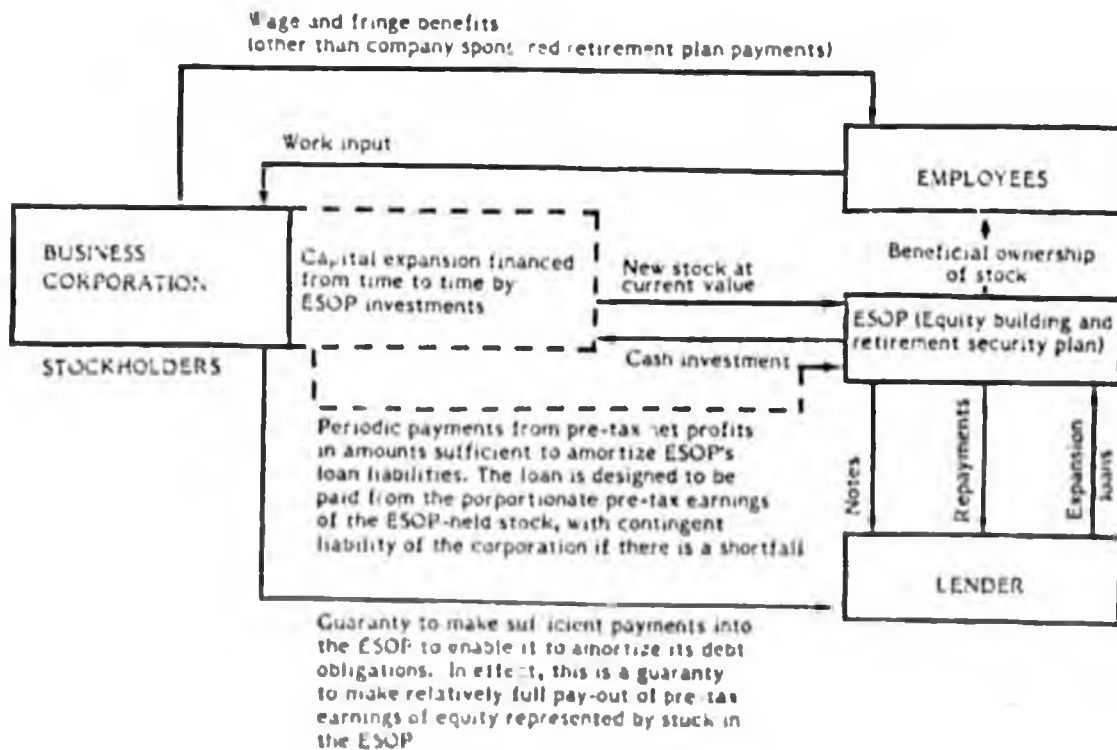


These methods of financing new capital formation have one common characteristic: they do not create a single new stockholder. The portion of new capital formation (about 2%) financed by sale of equity stock to the public does not alter this propensity. Every qualitative study of stock ownership to date shows that ownership of virtually all individually-owned productive capital is lodged in the top 5% of consumer units. These are the families who have excess funds to buy newly-issued stock. Conventional finance has created this monopoly.

9. The logic of business finance is to invest in productive capital that will pay for itself within a reasonably short space of time, normally three to five years, and then go on throwing off wealth indefinitely, its productive power being replenished through depreciation funds set aside out of gross income before net income is computed. Two-factor financing techniques, of which the most widely used today is the Employee Stock Ownership Plan or ESOP, makes this logic available to employees.

Figure 5: BUSINESS CORPORATION FINANCED BY A PROPERLY DESIGNED ESOP

Intended to simultaneously (1) finance growth of the corporation, and provide second incomes for the employees (if the stock is dividend paying and, after shares are paid for, the dividends pass through the ESOP currently to the employees) and (2) to build retirement security in the form of equity capital ownership.

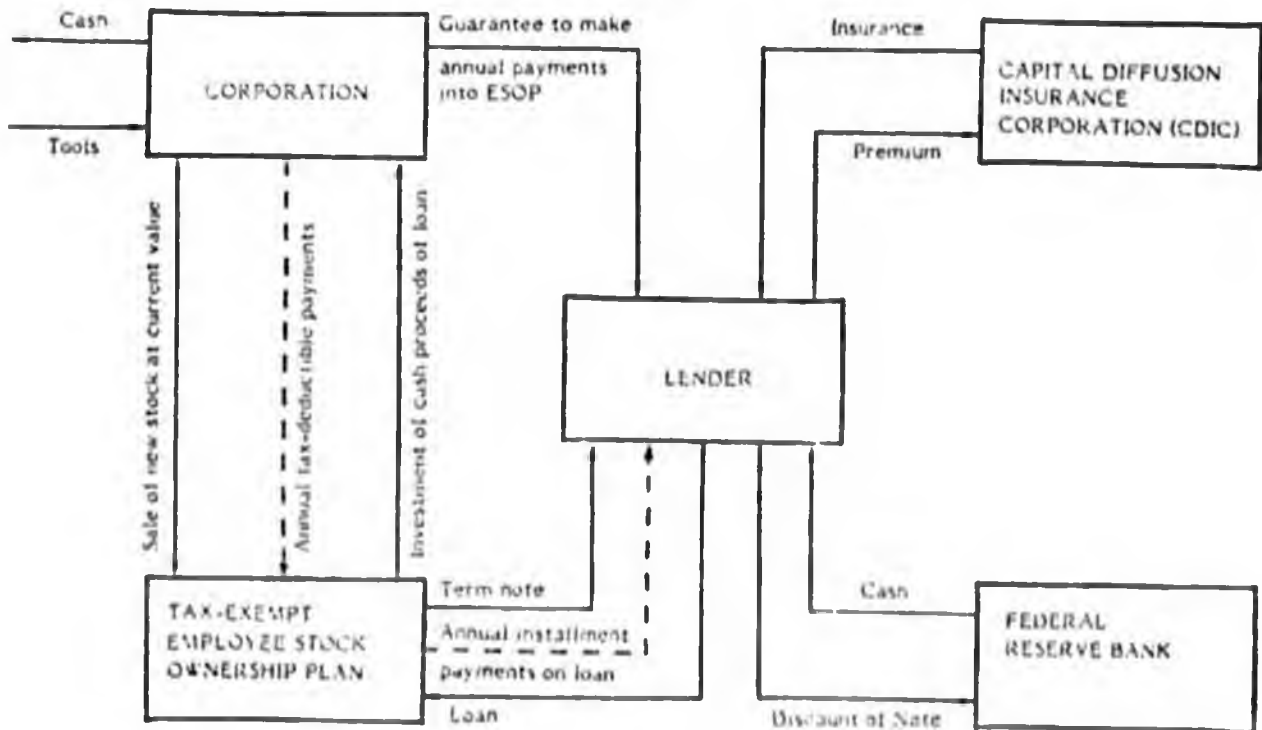


10. ESOP financing, on the one hand, provides low cost capital, through the use of pre-corporate-tax funds, to finance corporate growth, and on the other hand, builds ownership into workers without diminishing their take-home pay or calling upon their small or nonexistent savings.
11. With minor legislative changes to provide capital diffusion insurance (modeled after FHA insurance) for lenders that make sound ownership broadening loans and to make the financing paper held by lenders discountable at a rate not in excess of the administrative costs of the Federal Reserve Bank, two factor techniques provide means for financing unlimited growth, while building market power, economic security, and growing current second incomes from capital* into the masses of workers; thus the market power of potential consumers rises in step with the productive output of the economy.

*Where the stock in the ESOP pays a dividend, the plan often provides that, after each particular share of stock is paid for, the dividends on it shall currently pass through the trust into the workers' pockets.

Figure 6: FINANCING ECONOMIC GROWTH

Financing economic growth by monetizing productive capital while building market power into consumers through ESOP financing

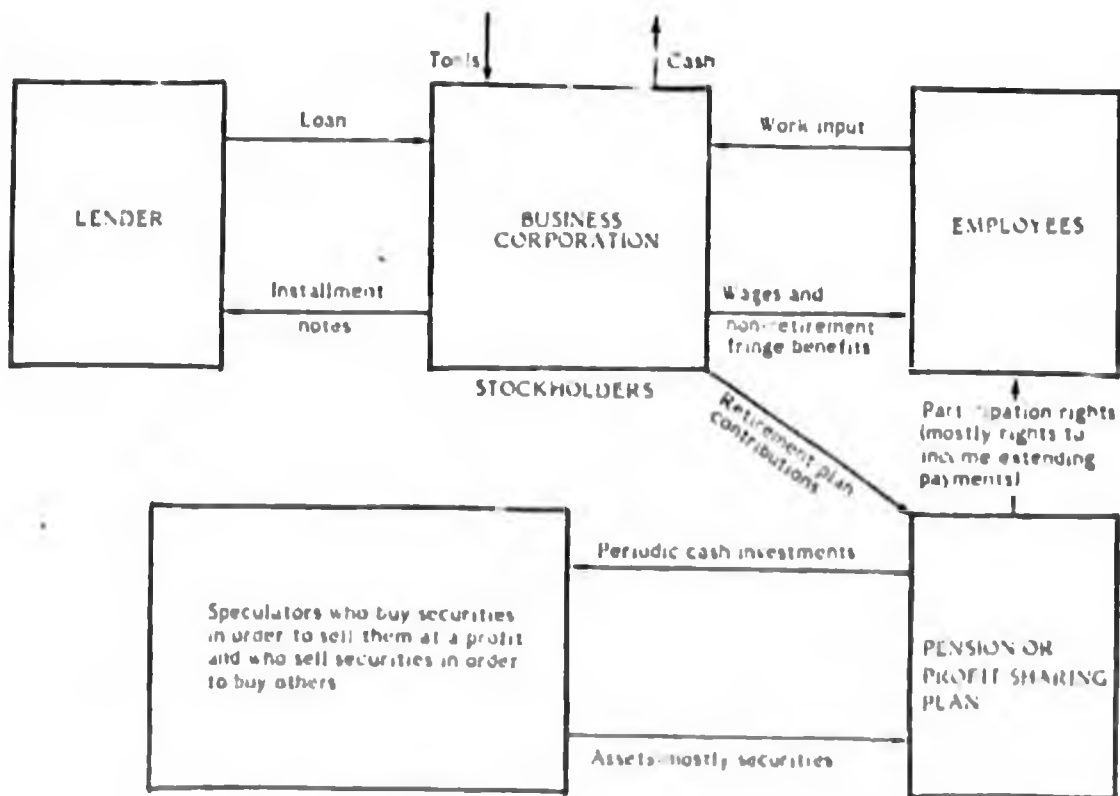


12. Inflation is eliminated. Institutional barriers, such as lack of "money" to finance solid, self-liquidating economic growth are eliminated; legitimate leisure, built upon the ownership of a holding of productive capital that will enable a man or woman to produce a viable income, becomes possible over a reasonable working lifetime; and the burden of public taxes imposed upon producers to support the non-productive and under-productive can ultimately be virtually eliminated. Fully productive households and individuals do not need to be subsidized.

13. The ESCOP is an enormous cost-saver for the corporation which--sooner or later--can substitute it for a fixed-benefit pension plan, or any other pension plan or conventional profit-sharing plan. All payments by the corporation into these conventional plans are pure cost.

Figure 7: CONVENTIONAL FINANCING OF A BUSINESS CORPORATION

Conventional financing of a business corporation, other than by sale of new stock to the public for cash, with conventional pension or profit sharing plans invested wholly in assets purchased from sources other than the employer-corporation.

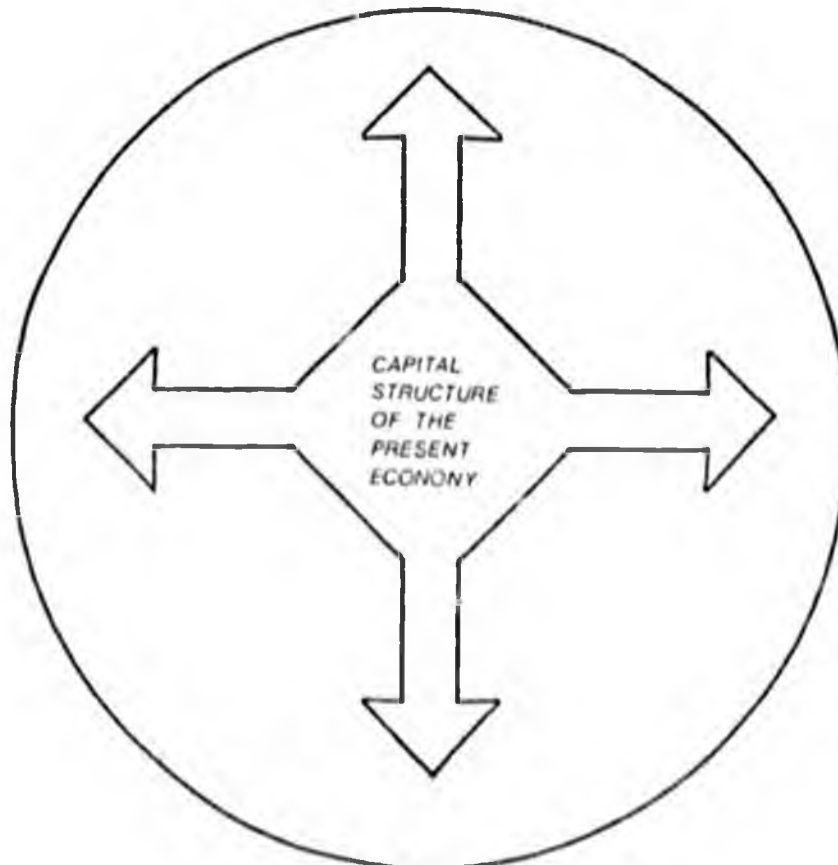


Compared with the ESOP (see Figure 5), not only does the identical dollar paid by the corporation to build stock ownership into employees also finance corporate growth, but corporate growth can be accomplished on pre-tax dollars. By comparing the ESOP (Figure 5) with conventional economic security-building plans (Figure 7), you will see that the ESOP enables the corporation to gain \$3 of advantage for each dollar spent. And it conforms to the sound economic goal of enabling employees, who work hard and well over a reasonable working lifetime, to retire singularly well off.

14. Finally, because the economic goal implicit in Two-Factor Theory is to expand the U.S. economy (and any other economy that adopts it) sufficiently to enable all consumers to live well--general affluence--while also producing the technology to protect the environment, a change to a two-factor policy by business and government could give us twenty-five years or more of legitimate full employment. This would be time enough for society to adjust to a world in which each person will spend less time in economic work and more time in the work of civilization.

Figure 8: OBJECTIVE OF TWO-FACTOR ECONOMICS

Capital structure of the present economy, owned by 5% of consumers, expands ten-fold to create the SECOND ECONOMY, owned primarily by the 95% of consumers who now own no capital



SUGGESTED READING ON TWO-FACTOR ECONOMICS

Books

THE CAPITALIST MANIFESTO by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1958. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

THE NEW CAPITALISTS by Louis O. Kelso and Mortimer J. Adler (Originally published by Random House, New York, 1961. Republished 1975 and presently available through Greenwood Press, 57 Riverside Avenue, Westport, Connecticut 06880, Tel. (203) 226-3571.)

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

Testimony

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

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

Reports and Publications

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

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

"A Symposium on Employee Stock Ownership Plans", The American University Law Review, Spring 1977, Volume 26, No. 3, prepared by The Washington College of Law, American University, Washington, D.C.

"Making New Capitalists -- A Creative Response to Income Inequities" prepared by the 1977-78 Twentieth Session, Executive Seminar in National and International Affairs, Department of State

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**A Discussion of the Financial Foundation
for General Stock Ownership Plans***

by

Stephen A. Buser
(April 1979)**

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I. Preface and Summary

A General Stock Ownership Corporation (GSOC) is not a magical money machine. In the absence of external support in some form, a GSOC cannot be expected to earn a net cash flow simply by borrowing from one group of capital owners in order to finance asset acquisitions from other capital owners. Inappropriate analogies are sometimes drawn between financed asset acquisitions that a GSOC might undertake and those that wealthy individuals and solvent firms undertake as a matter of routine. By definition, wealthy individuals and solvent firms have equity bases to cushion temporary or chronic operating deficits. In contrast, the financial condition of an unsubsidized GSOC, is similar to that of any other firm whose liabilities exceed its assets; it is insolvent. Like any other insolvent firm, a GSOC can be made to show an operating profit if given sufficient subsidies in the form of donated cash or assets, tax benefits, and/or credit assistance. However, since these subsidies would have earned a normal return if put to alternative uses, it is erroneous to attribute a GSOC "profit" to its leverage-acquisitions. Any such "profit" is simply a residual of the normal return on the subsidies invested in a GSOC, after the GSOC's own expenses have been deducted.

Therefore, despite optimistic claims by a few exuberant supporters, a GSOC is more accurately described as an elaborate financial device for capturing and redistributing the federal taxes currently paid on privately owned assets. Since these tax payments can be sizable, the implicit federal subsidy represents a potentially valuable source of State revenue. However, under the federal "enabling" legislation a GSOC's tax liability is not forgiven but instead is passed through to (and borne fully by) the citizen shareholders of the GSOC. Technically, the federal tax "break" is limited distributions in excess of the

GSOC (pass through) tax liability. This provision carries important implications both for the financial viability of the GSOC and for the form of the distribution of the federal subsidy.

In terms of financial viability, the pass-through restriction, reduces the portion of the federal subsidy that a GSOC can use to cover its own overhead and debt-service expenses. Projected GSOC operating deficits (which any pure leverage investment company would run) must be funded from some other source. Most likely, State assistance will be required on a continuing basis and in an amount that is significant when measured against the after-tax benefits received by the citizens of the State.

In an attempt to lessen its own subsidy burden, a State might direct its GSOC to acquire assets that would generate a low (or even a zero) pass through tax liability. However, to the extent that such assets also generate low tax liabilities for existing owners, the federal subsidy is reduced as well. The "solution" that seems implicit in the federal legislation is for the GSOC to acquire assets that are eligible for tax credits and/or accelerated depreciation charges from owners who have already exhausted such benefits for themselves. Since nonsubsidized firms have a similar tax incentive for acquiring such assets, a GSOC must expect to pay prices above those that would otherwise prevail in the secondary market for depreciated assets. Sales at inflated prices would allow the selling firms to capitalize a greater portion of their scheduled tax payments to the federal government, reducing the portion of the subsidy captured by the GSOC.

GSOC advocates have suggested that careful investment analysis might eliminate such overpricing. However, the GSOC's investment team, will be virtually totally dependent on projections provided by the selling firms. Experi-

enced negotiators for selling firms also have been known to cite pressing cash needs or other smokescreens in an effort to convince buyers that the assets are actually offered below the prevailing market prices. Experienced buyers recognize, of course, that if such were in fact the case, a rational seller would always sell at the higher market price unless the sale at the lower price constituted an implicit payment for some past or future consideration. Such might be the case in a "pilot" program where a selling firm has a clear incentive to "prove" that the GSOC is viable in order to establish a future flow of subsidy benefits. In other cases, selling firms may simply rely on the observation that even at inflated prices, the GSOC will show a "profit" as long as the federal subsidy is less than fully capitalized by the seller.

Despite the apparent inevitability of the diversion of GSOC subsidies to selling firms, even GSOC directors with impeccable standards may be hard pressed to determine the true extent of these diversions. Efforts at extensive investment analysis might succeed in limiting the subsidies to selling firms but only ^{by} creating another type of subsidy diversion in its place since the required analysis is apt to be quite expensive, and these costs must be subsidized as well. Regrettably, it is unlikely that even an outside "watch dog" agent (perhaps established by the State legislature) could successfully monitor GSOC activities. On the contrary, the risk appears far greater that outside pressure will be exerted on the GSOC directors to use their considerable subsidy powers in support of particular firms or banks that might be deemed "essential" to the State or local economy. In fact, it might be argued by some that the GSOC has a "moral obligation" to provide such support as long as it can do so and still show an operating "profit." For example, subsidy diversions to the shareholders of particular firms might be regarded as necessary to continue employment for

workers who might otherwise face a loss of jobs. Unfortunately, the firms destined for subsidy diversions are capital intensive rather than labor intensive so that GSOC subsidy diversions are apt to be extremely inefficient (in terms of cost per worker) as a means of providing job security.

When the inherent disadvantages of the GSOC concept are measured against the ambiguous federal support for the program, a State may decide that the "price" it must pay for a GSOC is too high in relation to the potential benefits. Even if a State determines that GSOC benefits are "offered" at a bargain under the federal legislation, the State should be aware that the citizen-shareholders in a GSOC will share the federal and State subsidies with the GSOC bureaucracy and with the firms that sell assets or lend funds to the GSOC. While subsidy diversions in small amounts might be regarded as "normal" operating costs, the potential for large-scale subsidy diversions cannot be ignored. Such diversions are not necessarily "bad," but they defeat the expressed purpose of the GSOC concept by funneling benefits to existing capital owners rather than to new capital owners. At present the "unintended beneficiaries" of a GSOC program appear to be the shareholders of capital intensive firms, as well as banks and other lending institutions that might win the favor of a particular board of GSOC directors. The federal immunity from personal income taxes on distribution in excess of the GSOC pass-through tax liability obviously benefits citizens in the highest tax brackets the most. Those who pay little or nothing in the way of taxes obviously receive little or no benefits from this tax "break." Those suffering the most from the proposed GSOC program would be firms that would have to compete with the GSOC, either in the market for credit or in the market for depreciated assets. In addition, despite the fact that the costs of the federal and State subsidies would be dispersed, every dollar of benefits distributed

by the GSOC will have to be made up, either in the form of additional tax revenues to replace those diverted or in the form of greater inflation if the lost tax revenues are not made up.

Economists note that asset transfers do not create new cash flows. In fact, transfer programs, no matter how socially desirable they might be, absorb rather than generate market value as new costs are merely grafted onto the existing economy. Thus economists place a heavy burden of proof on the proponents of particular plans to show that their plans are adequately funded (or subsidized) and that the benefits actually accrue to the targeted groups. Unfortunately, despite the force of a highly emotional call for action, the GSOC backers have not satisfied these basic requirements. "Faith" and "vision" are all that have been offered in support of the contention that a GSOC can achieve its intended goals and avoid becoming simply one more program that promises broad-based benefits but instead imposes broad-based costs and funnels the benefits to familiar recipients, the banks, the capital intensive industries, and of course, bureaucracy itself.

II. Financial Viability of a GSOC

Case 1: Viability without external support

To appreciate the limitations of the federal GSOC legislation, it is important to understand precisely how and why a GSOC is not financially viable without external support. So so, let us reexamine a hypothetical example of financed capitalism found on p. 71 of the report submitted by Kelso & Co. to the Alaska State Legislature, "Design of an Alaskan General Stock Ownership Plan, Volume I" (February 15, 1979). In that example, a Mr. Adams borrows \$200,000 and builds a fourplex which he rents out for a total of \$24,000 per year. For simplicity, the drafters of the Kelso & Co. report abstract from vacancy risk, from taxes, from overhead expenses, and even from interest on the loan. Such simplifications might have served the narrow purposes of the commission issued by the State to Kelso & Co. They do little, however, to reassure a potential lender who is concerned with the financial viability of a GSOC. For example, with an interest rate of 10% (generous by today's standards), the annual debt service on a ten-year fully amortized loan is \$32,500 rather than the \$20,000 figure used in the interest-free example. Thus even if the \$24,000 earnings figure is reinterpreted as net taxes and net of all expenses, the financed acquisition plan would fall considerably short of the goal of self-liquidation. Instead of an excess annual cash flow of \$4,000 found in the zero-interest example, Mr. Adams would have to cover a short-fall of \$8,500 per year over the life of the loan. The loan could be amortized over a longer period, thus reducing the annual debt service. However the interest alone amounts to \$20,000 per year so that a self-liquidating the mortgage would have to be written with exceptionally long maturity. At an interest rate of 12% or better, the mortgage could never be paid off out of the projected rents alone.

Advocates for the concept of financed capitalism might observe that the rental rates chosen by the drafters of the Kelso & Co. report were arbitrary and just happened to be too low in order to make sense when representative charges are introduced. Therefore, it is important to recognize that even if the example were restructured so that Mr. Adams would have been able to arrange self-liquidating financing for his investment, that does not mean he would sell his fourplex to the GSOC at a price that (in the absence of external support) would allow the GSOC to finance the acquisition with a self-liquidating loan. On the contrary, rather than sell at such a price, Mr. Adams would simply refinance any outstanding mortgage against his fourplex, in order to raise the same amount of additional cash that the sale would have produced (after repaying the loan). Thus even though the financed capitalism concept might work for original investments, the model breaks down when it is applied to asset transfers. As long as asset sellers require full compensation for the stream of earnings they relinquish, the debt service on loans to provide such compensation must exhaust the full value of the asset's earning potential. Otherwise, the alternative of financed asset retention dominates the decision to sell the asset.

In reaching this general conclusion, it must be remembered that external factors, such as tax considerations, have not yet been introduced. Similarly, differences in borrowing capacities have not yet been considered. Thus the general conclusion is not contradicted by examples of asset acquisitions that are entirely financed via self-liquidating loans to individuals or firms who can secure the loan pledging more than just the asset's own earnings. Implicit in such arrangements is the very important premise that, if needed, the borrower can draw on other funds or resources. In contrast, a GSOC has no equity base to use

as supplemental collateral for loans. Thus in the absence of external support, a GSOC would be unable to acquire assets via self liquidating loans even though equity firms and some individuals might be able to do so. GSOC's are by no means unique in this regard. Extensive analysis of investment companies (including mutual funds) confirms that these equity institutions would not be viable as pure-debt firms. I.e., they do not earn a rate of return equal to their risk-adjusted cost of capital.

Case 2: Viability under the federal legislation

The federal "enabling" legislation is not a legal requirement for the operation of a GSOC. It is merely an open admission that a GSOC is not financially viable without external support of some form. On its own a GSOC would not earn leverage arbitrage profits, it would make leverage arbitrage losses as would any other pure-debt investment company. Without an equity base or an external subsidy to offset these losses no lender would extend funds to a GSOC. This observation, more than any other single factor, explains why pure-leverage investment companies have failed to materialize on their own despite promises of sure profits offered by advocates of financed capitalism.

Recent federal legislation grants qualifying GSOC's immunity from the federal corporate income tax. Had immunity been granted in an unrestricted form, a GSOC would have been able to use a greater portion of the pretax earnings on assets to cover GSOC overhead and to service the debt raised to finance asset acquisitions. Any excess subsidy would then have been available for distribution to citizen-shareholders or for accumulation as equity in the GSOC. To illustrate this point, let us return to the previous example, and assume that the pretax earnings on Mr. Adams' fourplex had been \$40,000, of which he was required to pay \$10,000 in federal taxes and another \$6,000 in state

taxes, leaving \$24,000 for expenses and debt service. Under federal (but not state) immunity, the GSOC would have the use of \$34,000 per year, and thus, over some price range, could afford to offer Mr. Adams more for the asset than he would be able to raise via his own self-liquidating loan. At such a price, Mr. Adams would capitalize all of the after-tax earnings plus a portion of the earnings stream otherwise lost to the federal government. In such a case, both Mr. Adams and the GSOC would benefit at the expense of the U.S. Treasury.

Apparently the U.S. Congress did not intend that the federal legislation reduce to merely a tax dodge (at least not so simply). Therefore, in granting GSOC's immunity, the "enabling" legislation also mandates that the equivalent tax liability be passed through to the citizen-shareholders without regard for the special tax status of the recipients. Had the GSOC been a viable-self-supporting firm, the pass-through restriction would not have been especially significant. A GSOC would simply pass through its own tax savings in order to cover the tax liability that it must also pass through. However, the GSOC requires these (or some other) funds to cover the amount by which its overhead and interest costs will exceed its (after-tax) earnings. Thus, as presently structured, the federal legislation does nothing to improve the financial condition of a GSOC. To qualify for the tax subsidy, the GSOC must accept an offsetting financial commitment.

Despite this negative assessment, a GSOC would have the same opportunities for tax-arbitrage exchanges as any other firm would, and it might be able to make use of such opportunities to strengthen its financial base. Tax savings arise if the tax payments that would have been made by an existing owner (by Mr. Adams in the hypothetical example), are less than those that a GSOC would incur and this difference is less than fully capitalized in the sale of the asset to

the GSOC. The corresponding portion of the pre-tax earnings flow is, in effect, donated by the federal government rather than purchased from the previous asset owner. Such opportunities arise as a matter of routine because of federal tax laws that provide acquisition tax credits and/or accelerated depreciation charges which are renewable only if the qualified assets are transferred to new owners. Thus a GSOC might earn a tax-arbitrage profit by acquiring depreciable assets from owners that have already exhausted the liberal tax benefits for themselves. Unfortunately, these assets offer similar tax advantages for acquiring firms other than GSOC's. Thus GSOC's must bid against other firms for these assets, and this competition will allow the selling firms to realize even greater portions of their projected tax payments.

Since a GSOC cannot earn tax-arbitrage profits by acquiring assets from firms in lower tax brackets than the GSOC (based on the pass-through computation), the only way that a GSOC might be able to strengthen its own financial base is to divert a portion of the federal tax subsidy to the shareholders of large capital-intensive corporations seeking to unload some of their depreciable assets after the initial tax benefits have been gutted.

This description of the federal legislation is vastly different from the expressed intentions of the backers of the GSOC concept. So much so in fact, that it is difficult to imagine that the U.S. Congress had a similar goal in mind in settling on the form of this particular "enabling" legislation. It would be far easier to explain the federal "enabling" legislation as an attempt to provide large capital-intensive firms with additional relief from federal taxation.

Case 3: Viability under alternative forms of State assistance

At present, the extent of federal support for a GSOC appears anything but overwhelming. Kelso & Co. or some other source may be able to furnish a

description of the type of asset acquisitions that would recover enough of the federal subsidy to render a GSOC financial viability. As yet, however, no such encouragement has been provided. Nor is there any evidence for a legitimate reference to required State assistance as "start-up" costs. Surprisingly few of the proposed budget items are truly nonrecurring. On the contrary, virtually all of the GSOC's expenses contribute to the annual deficits that a GSOC must run in the absence of continuing financial assistance. These annual deficits are projected as substantial and must be supported from some external source. Moreover even after these deficits have been absorbed (by the State), the State must directly or indirectly provide for every dollar of benefits distributed by the GSOC (in excess of the GSOC tax liability). Recall the federal "contribution" is limited to forgiving the personal taxes that citizen-shareholders would otherwise owe on these excess distributions.

Although there are many forms that State assistance might take, any such assistance reduces to two basic dimensions, perpetual year-by-year maintenance, and/or an initial endowment. As a substitute for equity capital in a normal firm, an initial endowment of cash or earning assets would provide an income flow needed for an initial operating margin. To the extent that such an initial subsidy is insufficient, supplemental annual subsidies will be required as well. One obvious possibility for an annual maintenance subsidy is immunity from the State corporate income tax. In essence, the State could donate its own tax flow in support of the federal subsidy. Assuming that this benefit is less than fully capitalized in the sale prices of assets, the GSOC would then capture at least a part of the State subsidy (with the balance accruing to the seller of the asset as with the federal tax subsidy).

Credit assistance provides an alternative form of a maintenance subsidy. Instead of furnishing additional revenue, a credit subsidy is designed to reduce

borrowing costs and hence lower debt service claims against GSOC income. Agency status would provide the GSOC with direct access to the tax exempt borrowing market. Equivalently, the State could borrow (or divert funds from other uses) and lend to the GSOC at rates less than those charged in the fully taxable market. In either case, however, the State could have earned the higher (market) rate, on its funds and thus the State, should regard the difference in revenue as a subsidy to the GSOC.

Loan guarantees have been proposed as a low cost form of subsidy. Unfortunately, it is only the visibility of the cost that is low. In any insurance situation, such as a loan guarantee, it is not the visible or out-of-pocket expense that determines the true cost to the insurer. Far more important is the associated risk that must be borne. Without a highly diversified asset base to support precise actuarial assessments, the invisible costs of insurance are usually regarded as prohibitive rather than as negligible. If lenders (who are apt to be more highly diversified than the State) believed that these costs were negligible, they would not offer a substantial reduction in rates in exchange for a loan guarantee. The fact that lenders are willing to accept less interest in exchange for a loan guarantee indicates that they presume that the implicit risks are high. In effect, lenders are betting the difference in interest charges that even with massive federal and State subsidies, the GSOC may be overextended in relation to its financial commitments. It is important to note that financial overextension can arise even if the asset portfolio of a firm is of the highest possible quality.

A normal firm that is overextended but otherwise sound is referred to as undercapitalized. In order to raise debt capital, such a firm may first have to raise additional equity capital. In the case of a GSOC, there is no initial equity capital, only a subsidy base. If this base is insufficient to assure an adequate

operating profit margin, the condition of the GSOC is analogous to that of the undercapitalized firm. Loan guarantees provide an additional subsidy, and eliminate the lender's risks. But, since there is no reason to presume that the State has any advantage over lenders in terms of bearing such risks, any apparent "profit" from selling loan guarantees (in exchange for lower borrowing costs) is purely illusory.

In terms of pure cost effectiveness, direct cash payments provide by far the most efficient form for subsidies since they are the least costly to administer. However, these payments are also the most visible and therefore they are often the least attractive from a political standpoint. Opting for less visible but also less efficient forms of subsidy makes it difficult, if not impossible, for the State to assess the extent of its own subsidy. (Just as it is already difficult to assess the extent of the subsidy implicit in the federal GSOC legislation.) For a State that is truly concerned about the extent of its own subsidy to the GSOC program, it is especially important to consider only the most cost-effective and visible subsidy program. It is difficult to imagine what is to be gained, other than short-run political expediency, by burying the unavoidable costs of a GSOC through a series of complex financial arrangements.

III. Distribution of the federal and State subsidies

A GSOC may be useful as a device for capturing and redirecting federal tax revenues on earning assets. However, the GSOC's own budget, no matter how spartan, can only draw from the subsidy pool. Moreover, even before the subsidies get to the GSOC, a portion will be diverted to asset sellers in the form of inflated market prices. An additional portion of the subsidies will be absorbed by banks and other lenders who earn more money from engaging in leverage-arbitrage of their own than they do by creating those opportunities for others.

This observation explains why the powerful bank lobby did not oppose the "enabling" federal legislation. That lobby would almost certainly have opposed any serious attempt at diffusing stock ownership since it is precisely this issue--disintermediation--that the banks have lobbied against for so many years. However, the GSOC legislation promises to cut banks in on the subsidy (at least those banks who win the favor of the GSOC directors).

Under scrupulous and cold-blooded financial management, it might be possible to hold the subsidy diversions to a minimum. But to do so, the GSOC's directors must turn a deaf ear to the pleas of special interest groups. It is to be expected, however, that the GSOC directors will be besieged with requests for help from particular firms or industries that might be deemed essential to the State or local economy. Moreover, the subsidy diversion would be largely hidden in the sense that the GSOC still would be able to show a "profit" as long as it retains enough of the subsidy. Thus it may be difficult for GSOC directors to defend a decision to "support" some firms and some banks but not others. Such dilemmas always raise the possibility that political or other nonfinancial factors may influence the operating decisions of a GSOC.

In sum, while supporters may yet be able to show that GSOC benefits outweigh the additional costs that a State must bear under the federal "enabling"

legislation, thus far, little evidence has been offered in support of that contention. Instead, the case that has been presented is long on moral posturing, and long on railing against the sorry state of affairs that now exists, but painfully short in terms of sound economic reasoning that would lead one to believe that a GSOC offers any reasonable hope of achieving the expressed objectives. If left unattended, the existing biases in the federal legislation would funnel benefits to existing capitalists, as stockholders in banks and capital intensive firms, and to new GSOC bureaucrats, leaving an as yet undetermined fraction for (excess) distribution to citizen-shareholders. Even this distribution is regressive in the sense that the federal tax savings is greater for those in higher tax brackets. Since the same citizens must pay for the State subsidies (as well as their portion of the federal subsidy) either in the form of increased taxes or in the form of increased inflation (assuming that taxes are not raised), it is far from clear that the benefits outweigh the costs for any group of citizens. It should be clear, however, that the society as a whole loses since new costs are created but no new revenues are created to pay for those costs.

In the absence of "clarifying" analysis, the decision before the Alaska State Legislature appears to be one of whether or not to assist capital intensive firms in recovering part of the taxes they currently pay to the federal and State government. If so, a GSOC might be an appropriate vehicle, one that would also benefit selective banks and would create supporting jobs through its own bureaucracy. If sufficiently subsidized through tax benefits, loan guarantees, etc., a GSOC might even produce a modest excess cash flow to citizen-shareholders. However, if this is the ultimate goal, the State would be far better off to scrap the proposal for a costly administrative structure (the GSOC) and eliminate the subsidy diversions by simply distributing to its citizens the equivalent of the

proposed State subsidies to the GSOC. If it is deemed essential that checks be considered as "dividend" disbursements rather than as transfer payment (which they will be in either case), then the State might adopt a more ennobling title such as "the return on a citizen's share in State Wealth." It is doubtful that many citizens will feel all that different once they have cashed their checks. Only the banks and the capital intensive firms appear to have a strong financial incentive for favoring the more cumbersome and costly GSOC alternative.

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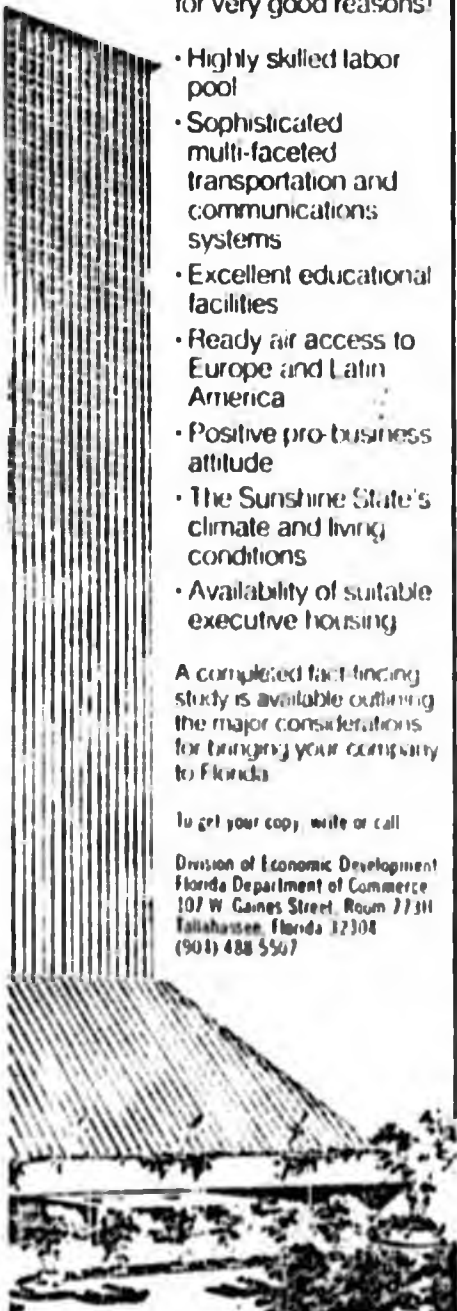
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Senator Gravel finally got his Government Stock Ownership scheme into law, but who, all things considered, wants it?

A bad idea whose time, alas, came



Senator Gravel of Alaska
A curious way to build a constituency for capitalism.

By Fern Schumer

IN THE Waning hours of the 95th Congress a new economic animal was born—the Government Stock Ownership Corp. The GSOC (pronounce it "Gee, Sock") owes its life to Senator Mike Gravel of Alaska, who, in the rush toward adjournment, tacked the idea into the big tax-cut bill. It is an odd beast, a sort of state-chartered mutual fund. A state could use its credit to borrow right and left for the GSOC, so that the corporation could invest in stock. It would distribute each year at least 90% of the profits to its shareholders, who, in turn, would be credited with the income for federal tax purposes. (Shareholders would not be able to use GSOCs as tax shelters, however, because they would not be allowed to flow through any losses.)

In theory, any state can now set up a GSOC. One can almost hear the bond salesmen and underwriters of the world bracing to handle a flood of new state-guaranteed issues. But, in fact, few are likely to, and only Alaska, with its huge natural resources and small population, seems more than mildly interested.

Not the least peculiar thing about the GSOC beast is that it all but totally separates risk from reward. If the Alaska legislature runs with the idea, each of Alaska's 405,000 residents would receive a free share of stock and its dividends. But the corporation's only real asset in the beginning would be the state's ability to guarantee huge loans, the proceeds of which would be invested by the corporation. As in any state, however, a lot of Alaskans don't pay taxes. Furthermore, Alaska is unique in that it has a native group of people who live off the land and have no cash income. Is it fair that only taxpayers absorb the risk of GSOC, while an initial group of Alaska residents reaps the benefits?

After the stock has been distributed, of course, there will also be an ever-growing divergence between the stockholders, on the one hand, and taxpayers and citizens on the other. As people move to the state, they may not be eligible for a share of stock. At the same time, citizens who lived in Alaska and have since moved may still own stock.

The scheme would create a conflict between the risk-bearing taxpayers and

other stockholders. For instance, GSOC proponents are talking about investments on the scale of \$1.5 billion. (That money the corporation might buy BP's 16% share of the oil pipeline. (BP is rumored to be eager to get its money out to help cover mounting exploration costs in the North Sea and elsewhere.) In that case, the state would be guaranteeing a \$1.5 billion loan—its total indebtedness now is only \$694 million, with guarantees in various forms for about another \$400 million. The state's credit rating would clearly be affected. If it needs to borrow more money, say, for a public works project, interest rates would be higher. Who would pay these higher rates? The taxpayer, of course. The stockholders who are taxpayers would have a direct, obvious stake in the corporation's profits and a less obvious inter-

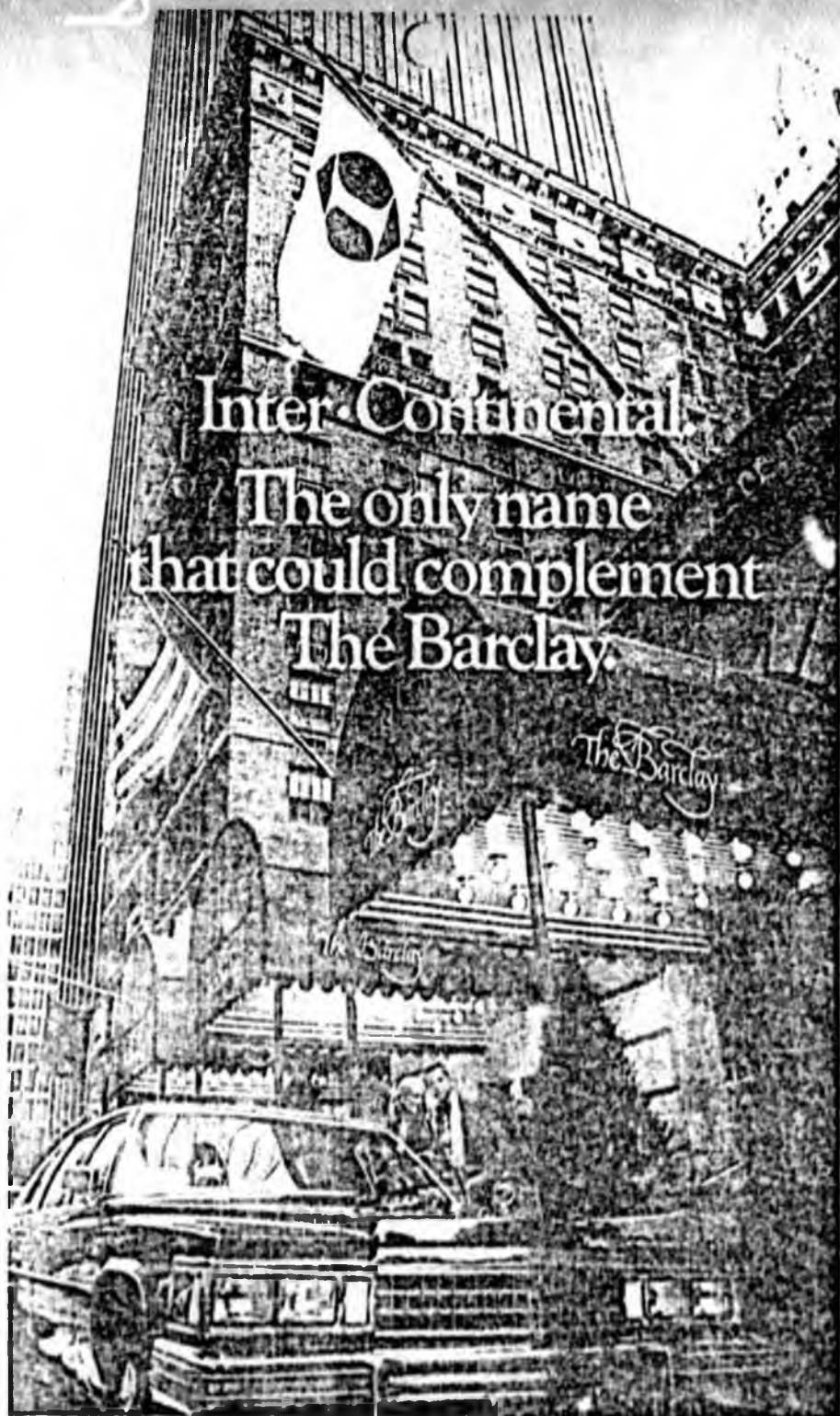
"Not the least peculiar thing about GSOC is that it all but totally separates risk from reward. Is it fair that only taxpayers absorb the risk while an initial group of Alaska residents reaps the benefits?"

est in holding down taxes.

Gravel nevertheless, is pushing GSOC as a way "to build a constituency for capitalism." He got the idea from the theories of economist Louis Kelso, godfather of the employee stock ownership plans in effect at a good many U.S. companies. Alaska shows at least tentative interest in pushing the idea. The state has given Kelso a \$180,000 contract to draw up a GSOC blueprint and is spending an additional \$60,000 on other related consulting work. Kelso's blueprint is due next February, and the legislature is expected to tackle it shortly after that.

Gravel's staff has looked with particular longing at BP's 16% share of the Alaska oil pipeline. That would produce revenues of \$106 million a year, they reckon. After operating costs and annual debt payments, about \$158 million would be left to distribute to shareholders. That, each of Alaska's citizen shareholders would get a dividend check for \$390 a year. BP projects its revenues will be \$322 million this year and \$437 million next year if the pipeline runs at capacity.

GSOC, in a way, is another offspring of Proposition 13. "People recognize that once the money flows into the state treasury, it's harder to get it back into the hands of the people," says Milt Barker, a fiscal expert for the state legislature. GSOC may be perceived as one way to refer the money into the people's hands. But the Alaska legislature had better take a hard look at Kelso's blueprint and add up the hidden costs before it funds the nation's first GSOC. ■



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April 10, 1979

The Honorable Mike Miller
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Juneau, Alaska 99811

Dear Representative Miller:

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

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

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

1. THE FIRST FULL PARAGRAPH ON PAGE 3

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Two

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

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

2. THE LAST FULL PARAGRAPH ON PAGE 3

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Three

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

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

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

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

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Four

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

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

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

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

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

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Five

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

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

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

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

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Six

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

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

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

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

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

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

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Seven

speculation.

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

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

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

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Eight

7. PAGE 11, SECTION IV. CORPORATE DEMOCRACY

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

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

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

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

8. DESIRABILITY OF A HIGH FORUM REQUIREMENT

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

9. LEGISLATION ASSURING ADEQUATE NOTICE OF MEETINGS

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

10. THE CORPORATE BY-LAWS

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

The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Nine

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

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

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

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

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

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

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

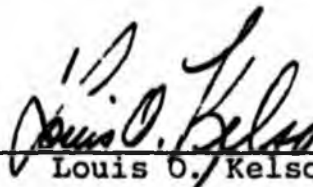
The Honorable Mike Miller
Chairman, State Affairs Committee
April 10, 1979
Page Ten

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

Sincerely,

KELSO & CO., INCORPORATED

By


Louis O. Kelso

By


John A. Miskimen

LOK/JAM:ch

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

10. [Frances Ulmer, Director
Division of Policy
Development & Planning

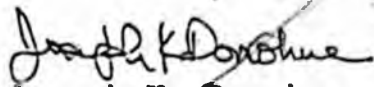
DATE: March 19, 1979

FILE NO:

TELEPHONE NO:

FROM: AVRUM M. GROSS
ATTORNEY GENERAL

SUBJECT: Policy & Legal Issues
Surrounding AGSOC Legislation
(SSSB 170 and SSHB 240)

By: 
Joseph K. Donohue
Assistant Attorney General

You have requested a brief outline of the various issues which the Administration should review in the context of the analysis of the AGSOC legislation presently before the legislature (SS for B 170 and SS for HB 240). The following is an outline of those issues from the Department of Law's perspective:

I. TAXATION

The Revenue Act of 1978 added Subchapter U to the Internal Revenue Code 1954, 26 U.S.C. §1391 through §1397. This legislation provides for the creation of a general stock ownership corporation (GSOC) and it authorizes special tax treatment for those corporations which qualify. The federal legislation requires that all GSOCs be chartered by an act of the State Legislature or by a referendum and further requires that each state charter provide as follows:

1. That the charter provide for the issuance of only one class of stock;
2. That the charter provide for the issuance of shares only to eligible individuals; "eligible individuals" are further defined as those who are residents of the State as of the date specified in the State's enabling legislation and who continue to be residents of the State as of the date of the issuance of the shares;
3. That the charter provide for the issuance of at least one share of stock for each eligible individual;

4. That the charter provide that no share of stock shall be transferred by the shareholder other than by will or by intestate succession, until after five years from the date of issuance (except where the shareholder ceases to be a resident); that no share of stock be transferred to a person other than a resident; and that no share of stock be transferred to any individual who would as a result of the transaction acquire more than ten shares of the GSOC.

In addition, the GSOC may not acquire more than twenty percent of the shares of any other existing corporation; the GSOC may not acquire property through the right of eminent domain; the GSOC's charter must mandate that it qualify as a GSOC under the Internal Revenue Code; and finally, the GSOC must be chartered and organized between December 31, 1978, and before January 1, 1984.

Thus, AGSOC (Alaska GSOC) as set out by Louis Kelso's proposal in SSSB 170 would create a corporation whose shareholders consisted of every resident of the State of Alaska as of the time the State charter goes into effect who remain a resident until the date of the first issuance of the AGSOC shares. The AGSOC is treated as a private corporation and not as a governmental unit for purposes of the Internal Revenue Code, except that a qualifying AGSOC is not subject to federal corporate income taxes. Instead, AGSOC's "taxable income" which is calculated in accordance with the Internal Revenue Code (with minor exceptions not relevant here) would be attributed directly to the shareholders in proportion to the number of shares held and would be taxed as individual income to those shareholders. This dividend income does not qualify for the exclusion from gross income normally associated with the first \$100.00 of dividend income. See 26 U.S.C. §116.

The AGSOC is required to distribute at least ninety percent of its "taxable income" for any tax year. 26 U.S.C. §139 (a). The failure of an electing AGSOC to make the required ninety percent distribution would subject it to a penalty of twenty percent of the excess amount required to be distributed over that amount actually distributed. The federal scheme is intended to give the AGSOC a significant competitive advantage since the corporation can operate free of corporate income taxes at the federal level. On the other hand, this ten percent maximum on retained earnings

may, indeed probably will, prohibit a corporation's expansion into major new investment areas on the basis of these earnings alone. New investment opportunities which arise in the future would require AGSOC to again obtain significant debt financing which may, in turn, require multiple state guarantees.

The first question which arises is whether or not the policy evidenced by the federal legislation (i.e., freedom from corporate income taxation) should be paralleled at the State level. The present SS for SB 170 would operate to exempt the AGSOC from the State's corporate income tax levied pursuant to AS 43.20. See AS 43.20.021, which incorporates by reference subchapter U of Chapter 1 of subtitle A of the Code. AS 43.20.021 provides for a delayed incorporation of tax exemptions. Those provisions of the Code adopted after 1975 "which change or modify exemptions from tax or credits against tax are not adopted by reference as a part of this chapter until the second January 1 following the effective date of the federal law". Here GSOC's exemption would go into effect at the State level on January 1, 1980. The AGSOC, however, would be subject to state severance taxes (AS 43.55), state oil and gas property taxes (AS 43.56), as well as the state's new oil and gas corporate income tax (AS 43.21.010) should the AGSOC invest in oil and gas production or pipeline transportation property. The investment opportunity presently recommended by Kelso's group is that the new AGSOC purchase BP's share of TAPS.

AGSOC's investment in the oil and gas arena would present several important policy questions which should be analyzed prior to the Administration's endorsement of the present legislation. By purporting to give each resident of the State a direct interest in the development of the State's natural resources, it would become an independent voice for more rapid exploitation of those resources. Because the dividends to the residents would, as presently proposed, be directly affected by the nature and extent of the State oil and gas tax policy, it would likely become a lobbying force for lower State taxes. Obviously, lots of tradeoffs are involved, but the political and economic issue reduces itself to the following: Would it be better to expedite resource development and lower State taxes in such a case in order to allow AGSOC's shareholders to benefit directly (albeit by only a marginal increase in their dividend) and at the same time deprive the State treasury of potentially enormous revenues which could be devoted to various social welfare programs? These programs would ultimately return greater proportionate benefits to those in the lower income brackets in the State and possibly lesser benefits (than AGSOC) to those in the upper income brackets.

However, they have also indicated that there was a significant probability (about 75%) that AGSOC would have to return to the Administration and to the legislature, and ultimately to the people at the polls, for approval of a major extension of State credit or guarantees to secure loans of sufficient size to enable AGSOC to invest in TAPS, construct a gas line, etc.

SSSB 170 presently contains only one financing device-- 10.50.100. The bill proposes the creation of a loan guarantee fund which will be a special fund segregated from all other funds of the State. It purports to be a trust fund for the uses and purposes of this section, but no uses and purposes are set forth in that section. As proponents of the measure have stated that the sole purpose is to guarantee loans for startup or organizational costs of the corporation, they have agreed to both clarify the uses to which the monies can be put and to a statement of a definite limit on the appropriations into the fund (\$5,000,000.00). In addition, this section charges the Commissioner of Revenue with reviewing applications for loan guarantees (for the purpose of guarding against fraud and misrepresentation). It is suggested that the Commissioner of Revenue be given broader review powers such as the ability to disapprove a loan on the basis of its general inadvisability.

To accommodate these various concerns, the following substitute for AS 10.50.100 contained in SSSB 170 is submitted for consideration:

A) There is a special fund of the State known as the Alaska General Stock Ownership Corporation Loan Guarantee Fund, which shall not exceed \$5,000,000.00. and which shall be completely segregated from all other funds of the State. This fund is a trust for the uses and purposes of this section.

B) The Commissioner of Revenue shall use the fund to guarantee loans solely for startup costs (and not to include major investment financing) made to the corporation by lenders other than the State. In guaranteeing loans, the Commissioner of Revenue shall review the loans for the purpose of ascertaining the general soundness of the proposed loan and for the purpose of guarding against fraud

and misrepresentation. The guarantee of a loan may not be for an amount in excess of the unobligated balance in the fund at the time the guarantee is made.

Whereas the above minor technical changes can clarify or limit the general purpose of the loan guarantee fund as originally proposed, the manner in which AGSOC would approach the State and apply for an appropriation or legislation which would enable them to utilize the public credit of the State of Alaska to guarantee a major investment in the future is not treated in this bill. Senator Gravel has testified that such an extension of public credit would be in accordance with the procedures which pertain to the issuance of general obligation bonds which require the ratification of the voters at the polls. Thus, Senator Gravel has argued that no major extension of public credit would occur without the ultimate participation of all the voters of the State who would, of course, include most of the AGSOC shareholders.

Senator Gravel is basing his procedural argument on Article IX, §8, State Constitution, which states:

"No state debt shall be contracted unless authorized by law for Capital improvements and ratified by the majority of the qualified voters of the State who vote on the question."

Although the issue deserves further review by this department, it is suggested that this provision on its face does not apply to the type of guarantee contemplated by Senator Gravel and the proponents of the AGSOC, since the investment would not qualify as a capital improvement authorized by law under this section. See City of Juneau v. Hickson, 373 P2d 743 (Alaska 1962).

Rather, it would appear that Article IX, §6, applies in this context:

"No tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."

Under this provision, all that would be required for an extension of credit to the AGSOC would be legislation appropriating a sufficient amount of money to guarantee AGSOC's commitment. Thus, it appears that something on the order of a loan guarantee fund on a vaster scale would in fact be required but such legislation would not be subject to voter ratification at a subsequent general election. Since Kelso's investment consultants have based their advice on the assumption that there could be a call on the general credit of the State without a significant appropriation to back up any guarantees, the ability of the State treasury to make such an appropriation and its fiscal impact on other State programs has never been carefully analyzed.

Thus, three questions need to be considered: (1) Whether there is any constitutional mechanism for extending the State's credit without the necessity of a large appropriation which may not be fiscally sound or economically feasible; if not, whether AGSOC's proponents who have assumed the availability of access to the State's credit have any alternative suggestions for the financing of the corporation which should be statutorily treated at this time; (2) Whether this statute should incorporate a statutory procedure or requirement for voter ratification of any major investment proposal, funded by direct appropriation into a guarantee loan fund; and (3) Whether a constitutional amendment would be required to allow the State to guarantee AGSOC's loans.

III. DEPOLITICIZING THE AGSOC

The proponents of the AGSOC have conceived of this entity as operating as a private corporation subject to the very few qualifications imposed on it by federal law. Thus, the corporation is subject to the standard provisions of the Alaska Business Corporation Act, AS 10.05, except where inconsistent with the state or federal enabling legislation. The proponents have argued that AGSOC stands the best chance of being a success, (i.e., operating at a profit which will be shared in by most Alaskan residents) if it is structured as a completely private corporation. However, it should be noted that there is nothing in the federal legislation which would preclude the AGSOC's establishment as a state agency or public corporation.

No matter how the AGSOC is ultimately designed, it would be foolhardy to believe that this entity would not quickly become highly politicized and ultimately, if it is successful, become an extremely powerful political force in

the State. Assuming it is established as a private corporation, it would present the following issues:

A) AGSOC: A Fourth Branch of Government

A successful AGSOC, representing as it would the residents of the State of Alaska would in essence, become a fourth branch of government. It will be a fourth forum in which State environmental, social, economic and tax questions will be vigorously debated. The Governor's control over this corporation is limited to appointing the first board of directors. After that the corporation will, as presently designed, operate completely independent of any state agency, albeit it will be subject to all applicable state regulatory provisions. Given the composition of the corporation, it would become quickly susceptible to the pressures of any cohesive organized group of residents within the State, such as large labor unions, native corporations, etc. That is, any private organization containing a large number of resident votes could well form a block in the nature of a voters' trust, which could be used to gain control, or at least to form an influential minority on the board of directors.

The board, and indirectly management, would be subject to election by the same or a similar constituency as the Governor of the State. Thus, the chairman of the board could conceivably end up representing a larger number of Alaskan residents than the Governor of the State. The Governor would be put in the somewhat anomalous position of dealing with a more popular, albeit apolitical, leader representing the fourth estate, i.e., AGSOC.

Although one could argue that AGSOC violates the fundamental political theory of the State Constitution which established only three branches of government, this objection is more of a philosophical one than a legal one, and it is not anticipated that any such challenge could be successfully formulated and presented to the State courts. Finally, under this general category of concerns relating to its impact on the present institutional balance of power as contemplated by the State Constitution, it should be noted that

management of the corporation, members of the board of directors of the corporation, could, and very well might, utilize their position as a forum for criticism of the Administration's economic policies and ultimately as a launching pad for State elective office.

B) Specific Constraints: Lobbying and Political Contributions. Since AGSOC will purport to represent the people of the State of Alaska, it could be argued that since that function is also served by the Governor of the State and by the legislature in the political arena, AGSOC should be prohibited from participating in that same arena, or at least be made subject to stringent restrictions. It is suggested that AGSOC should be prohibited from lobbying, from making political contributions to candidates for State offices, and that strict proxy review mechanisms should be added to the bill to ensure that the board of directors act in a politically neutral fashion. For instance, AGSOC's board, in its annual report, would be allowed to analyze the impact of State taxes on its percapita dividends. However, the board would not be able to affirmatively encourage the shareholders to write their legislators and call for a lower rate of taxation. The shareholders would have to draw their own conclusions. Obviously, the shareholders would then be allowed to contact their legislators and express their opinion on the subject.

Furthermore, a AGSOC endorsement of a political candidate would obviously be a cherished one. Even though AGSOC's proponents at present claim that this corporation is merely another private corporate entity, we have absolutely no guarantees that management in future years will not take full advantage of its position as representative of the residents of Alaska and try to see its political and economic policy preferences implemented by vigorous participation in the political arena. AGSOC endorsements and political contributions might therefore best be prohibited.

C) Litigation With The State. AGSOC, just like any other major corporate entity, would become subject to various State regulatory laws, and the

possibility for confrontation is obvious. For instance, should AGSOC become the vehicle for financing the gas line, AGSOC would have a corporate interest in raising the tariff on the pipeline which would be assessed against the State, and the State as producer and shipper would have an interest in lowering the tariff in order to maximize State royalty and severance tax revenues to the treasury.

In addition, the proponents of AGSOC have stated on several occasions that in order for it to result in tangible benefits to the individual Alaskan shareholder, it must invest in vast development projects which will involve vast returns (hopefully). Thus, there is every likelihood that AGSOC would become a major force for concentration of economic power in the State and might ultimately develop or acquire monopoly control over one or more economic sectors. This, in turn, would present anti-trust problems, both under state and federal law, and the following scenarios are possible: 1) Since AGSOC is not a State agency, it would not enjoy the "state action" exemption from the federal anti-trust laws and it would likewise be subject to treble damage actions for any economic injuries arising out of violations of the Sherman or Clayton Anti-Trust Acts, 15 U.S.C., §1, et seq., and (2) The State could find itself litigating at great expense against AGSOC in order to require it to divest itself of various interests, or to require it to cease and desist from some specific anti-competitive practice.

The anti-trust example is one of many. It could occur in the environmental sector, the banking and securities area, the tax area, or in any other area of commercial endeavor. The State and AGSOC, if engaged in litigation with each other, would be drawing on resources which ultimately affect the same individuals, i.e., the taxpayers versus the shareholders. Should the State prevail and obtain a fine, such a fine would, itself, seem counterproductive.

Some suggestions for mitigating the underlying irony of the State litigating against the people of the State, i.e., AGSOC, and the potential for enormous waste of common resources which is inherent in any extensive litigation such as a protest of a pipeline tariff, might be as follows:

1) When a dispute arises between the State and AGSOC, the matter could be held in abeyance until the next legislature to allow the latter to determine by legislation the proper resolution of the matter; or the matter could be submitted to an arbitration panel established by statute.

2) Other means of controlling litigation between AGSOC and the State would be to create a disincentive to any litigation. One such disincentive would be a modification of the court rules relating to the award of costs and attorney's fees to provide that the State would always be entitled to receive its actual costs and attorney's fees incurred in the litigation of any action involving AGSOC. In addition, AGSOC's right to costs and attorney's fees would arise only in those cases where the court makes an express finding that the State's prosecution or defense was frivolous or lacking in good faith.

IV. CORPORATE DEMOCRACY

One of the most important policy questions which must be addressed in any analysis of AGSOC is whether or not resident shareholders' right to participate in and to influence corporate decision making is adequately protected or assured by the normal corporate procedures set forth in AS 10.05. The following is a list of specific issues which the administration and the legislature should address in its analysis of the AGSOC legislation:

1) Classified Directors. The present sponsor substitute provides for a board of directors consisting of nine members divided into three classes of three members each. Three directors will therefore be eligible for an election during any one year. See AS 10.50.030. A highly classified

board of directors such as this would limit the ability of minorities within the State to obtain representation on the board of directors. Every shareholder has one vote, and if all nine directors were elected at the same time, there is a greater opportunity for minorities such as native organizations, etc., to elect at least one board member. A highly classified board would tend to heavily favor urbanized Alaska.

2) Cumulative Voting. AS 10.05.162 presently provides that shareholders may, at an election for directors, cumulate their votes by giving one candidate as many votes as the number of directors to be elected, multiplied by the number of that shareholder's shares. However, a corporation may provide in its bylaws (modified by board of directors' resolutions) that shareholders cannot cumulate their votes but must vote shares held by them on an election-by-election basis. Cumulative voting is another device to help ensure minority representation on the board of directors. By leaving it optional, as stated in AS 10.05.162, the board of directors could amend the bylaws to prohibit cumulative voting. It is suggested that it might be desirable for the AGSOC legislation to expressly state that cumulative voting cannot be prohibited by shareholder or by director action.

3) Voting Trusts. In accordance with AS 10.05.171, voting trusts may be created by any number of shareholders who wish to confer upon a trustee the right to vote or otherwise represent the shareholders for a period not exceeding ten years. The existence or toleration of voting trusts within the AGSOC context is a question which should be carefully analyzed. At this point in time, it is suggested that their prohibition might be advisable or at least a limitation imposed on the number of years that they can remain in existence. For instance, AGSOC proponents indicate that the original AGSOC will be coming back to the legislature for each major investment proposal. Thus, within a ten-year period, two or three major investment schemes may have been considered and acted upon, and a ten-year voting trust would allow a trustee undue amount of influence over any of these decisions.

4) Amendment of The Articles of Incorporation. AS 10.05.276 presently provides that the board of directors shall adopt a resolution setting out a proposed amendment directing that it be submitted to a vote at the annual or special meeting of the shareholders. Thus, it appears that the initiative to amend the articles must come from the board, and it may be desirable to provide for an amendment which would allow the shareholders to propose amendments to the articles of incorporation that can be taken up and voted on at annual meetings.

5) Quorum of Shareholders. AS 10.05.153 presently provides that, unless otherwise provided in the articles of incorporation, the majority of the shares entitled to vote constitutes a quorum in a meeting of shareholders. (The section provides for a minimum of one-third of the shares.) The quorum requirement is something that the legislature may wish to mandate by statute. Here, of course, the higher the quorum requirement, the greater the difficulty the corporation will have in holding an annual meeting. However, a high quorum requirement would necessitate vigorous promotional and educational programs to ensure the presence of the quorum at each annual meeting and might indirectly spur the corporation to greater efforts to include or request the participation of all shareholders of the State in corporate decision making.

6) Notice of Meetings of Shareholders. AS 10.05.138 presently provides that meetings of shareholders may be held at the place (either inside or outside the State) as may be provided in the bylaws. In addition, an annual meeting of the shareholders shall be held at the time provided in the bylaws. Special meetings of the shareholders may be called by the president, the board of directors, and holders of not less than one-tenth of all the shares entitled to vote at the meeting.

AS 10.05.141 in addition requires written or printed notice of all meetings, such notice shall be delivered not less than ten nor more than fifty days before the date of the meeting, either personally or by mail.

Obviously, together these rules operate to favor incumbent management. Annual meetings could

be rescheduled by a change in the bylaws which requires a vote of the board of directors. The board could, on short notice, i.e., as little as ten days, present the shareholders with any major issue it chose, such as the election of new directors or consideration of a major investment proposal.

The legislature might well wish to consider statutory safeguards which would ensure adequate notice of the time, place and purpose of any meeting which would preclude manipulation of the timing of any meeting to the advantage of the incumbents.

7) Bylaws. AS 10.05.135 presently provides that the board of directors shall have the power to alter, amend or repeal the bylaws unless it is reserved to the shareholders by the articles of incorporation. Again, it is suggested that the amendment of the bylaws might be a power which should be reserved to the shareholders in order to ensure adequate public review of any change in the management's approach to the conduct of the corporation's business.

8) Financing of Proxy Fights, Access to Voting Lists and Mailing Machinery. Several commentaries concerning modern corporate battles note the inherent advantage which incumbent management has through its control of the corporate machinery for sending out mailings, soliciting support, and arguing its cause before the shareholders. This is done at corporate expense, whereas opposing or dissenting shareholders frequently have to finance such efforts from private sources. Amendments might well be considered which would allow shareholders who can obtain a certain number of qualified signatures to utilize the corporation's mailing machinery at the corporation's expense. This procedure should be especially encouraged in the context of elections for the board of directors. Candidates who can either obtain a nomination by the board of directors or the support of a pre-determined percentage of the shareholders should be entitled to publish information concerning themselves, their experience, their policy preferences and their criticisms of existing management at the corporation's expense.

V. PRIVATE CORPORATION: CLOSED CLASS OF SHAREHOLDERS

Two other constitutional issues should be mentioned briefly in this context. First, the federal legislation authorizing the creation of GSOC mandates that the shareholder group be made up of a closed class (i.e., those residents who satisfy the eligibility requirements imposed by state law as of the date of the state charter, and who remain residents as of the date of the issuance of the shares). Thus, future residents would be ineligible for one of the free shares of AGSOC. Under Kelso's present plan, AGSOC shareholders who leave the state and become nonresidents would be entitled to retain their dividends and voting rights in AGSOC. Persons leaving the state who wish to sell their shares could, of course, sell to new residents who wish to participate in the AGSOC. In addition, oldtime residents could acquire as many as ten shares in AGSOC through purchase or inheritance.

These two factors, when combined, could lead to the following scenario: The initial one hundred percent of the AGSOC shares could be concentrated in as few as ten percent of the original shareholders. Those shareholders, in turn, could become residents of other states, and thus it is theoretically possible that ten or twenty years from the original issuance, AGSOC shareholders could be composed of a select group of resident Alaskans and nonresident former Alaskans. Ironically, it may be at this very time that the state may be called upon to honor its guarantee, and thus the state's credit rating and ability to issue bonds at favorable interest rates would be adversely affected, and the people who would be called upon to bear the burden of AGSOC adventures would be the taxpaying class of Alaskans at that time. This potential for a sharp dichotomy between the shareholder class of AGSOC and the resident population of the state deserves closer analysis. Kelso's report contains no estimates of the transiency rates of the Alaskan population and no projections as to the future composition of its AGSOC.

The legal issue which overlaps this general policy question is whether or not the closed class nature of the AGSOC offends the equal protection provisions of the state or federal constitutions. Wilmer, Cutler & Pickering, in their memorandum of December 15, 1978, on the constitutional issues, felt that such a provision might be successfully

defended against a federal constitutional challenge. A closer question is presented under the state constitutional provision which has been interpreted somewhat more stringently than its federal counterpart. See Isakson v. Richey, 550 P2d 359 (Alaska 1976). Under this provision, a substantial question is raised as to whether or not the AGSOC arbitrarily discriminates against future residents of the state.

Secondly, a derivative issue is whether or not the use of the public credit for the direct benefit of a private corporation whose shareholders will, over time, form a distinct class within the state (possibly a minority class) qualifies under the "public purpose" requirement of Article IX, §6 of the Alaska State Constitution.



*PARTICIPATION
DISTRIBUTION
LIMITATION*

AGSOC
THE FINANCIAL PLUMBING

Hearings before the
State Affairs Committee
March 20, 1979

Submitted by:
Jeffrey R. Gates
Hewitt Associates
Lincolnshire, Il.

THE AGSOC - AN OWNERSHIP STRATEGY

The American Dream - A Piece of the Action

Iron Law of Development - consume less, invest more
Catch-22 - Iron Law of Ownership

The Financial Plumbing of Stock Ownership (See Exhibit 1)

Captive Capital - Less than 10% of stock transfers are for
directly fostering new capital formation.

New York Stock Exchange 1975 shareowner census:

- (1) 5-year decline of 18.3%.
Quantitative vs. qualitative measure.
- (2) Average age of typical shareholder increased
five years over 5-year span.

Joint Economic Committee figures re stock ownership (1975):

- (1) 0.5% own 50%.
- (2) 1% claim 46% of dividends.
- (3) Working non-professionals (76% of work force)
own 19%.

(See Exhibit 2)

Debt:Equity ratio for U.S. manufacturers rose from 23% to
43% from 1964-1974.

Consumer Debt:

1960 - \$56.1 billion
1976 - \$217.8 billion

Comments from the Media - Why ESOPs are also called "Kelso Plans"
(See Exhibit 3)

Historical Context

Industrial Homestead Act (See Exhibit 4)
Life, Liberty and ... (See Exhibit 5)

Contractual Context - Access to Ownership

The Evolving Social Contract

"A corporation is an artificial being, invisible, intangible,
and existing only in the contemplation of the law. Being
the mere creature of the law, it possesses only those prop-
erties which the charter of its creation confers on it, either
expressly, or as incidental to its existence."

-John Marshall-

Market Context

Work Ethic - The Employment Act of 1946

"All we seek is an America; where every person is given the chance to productively contribute to his country and where he can receive a fair and equitable share of the wealth that production creates."

-Coretta Scott King-

Industrial Context

Exchange Ethic

"Salary" vs. "Compensation"

Salary - salt; "not worth his salt", "In the sweat of thy face shalt thou eat bread."

Compensation - a balancing of accounts (See Exhibit 6)

Post-Industrial Context

Incomes policy designed as participation-in-production policy
The Affluent Society (1958) - "device for breaking the nexus between production and income security"

Breaking the nexus:

Federal Expenditures

1960 - \$91.3 billion

1979 - \$504 billion

Federal Budget

1960 - slight surplus

1978 - deficit of \$61.7

Federal Transfer Payments

1960 - \$20.6 billion

1979 - \$198 billion

"There are no free lunches on welfare."

-Joseph Califano-
Secretary of HEW

"There is no more complete rejection of a person than to give them a job you know and they know is useless."

-F. Ray Marshall-
Secretary of Labor

A PIECE OF THE ACTION

VAN NOSTRAND
REINHOLD

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FIGURE ONE

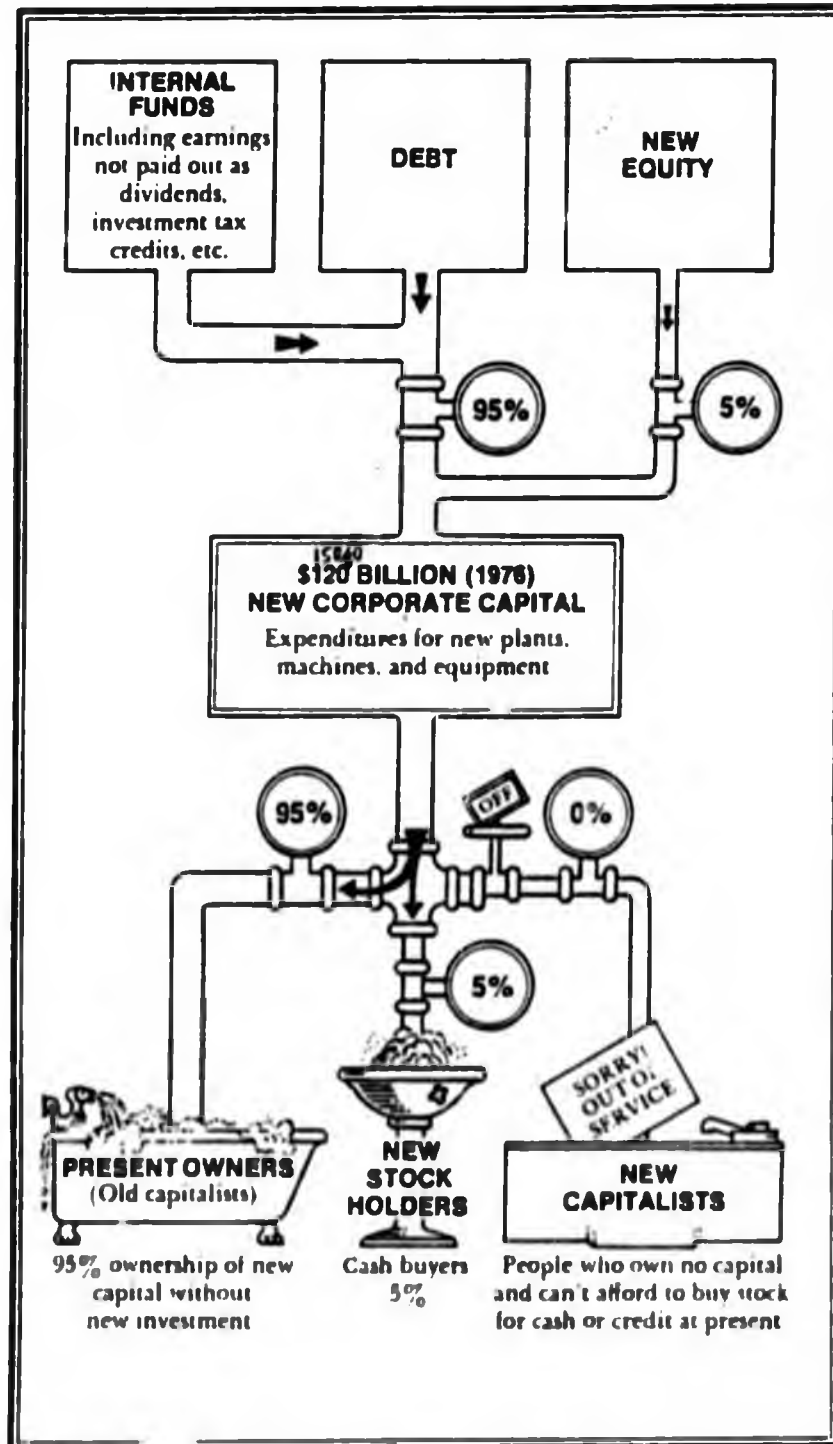
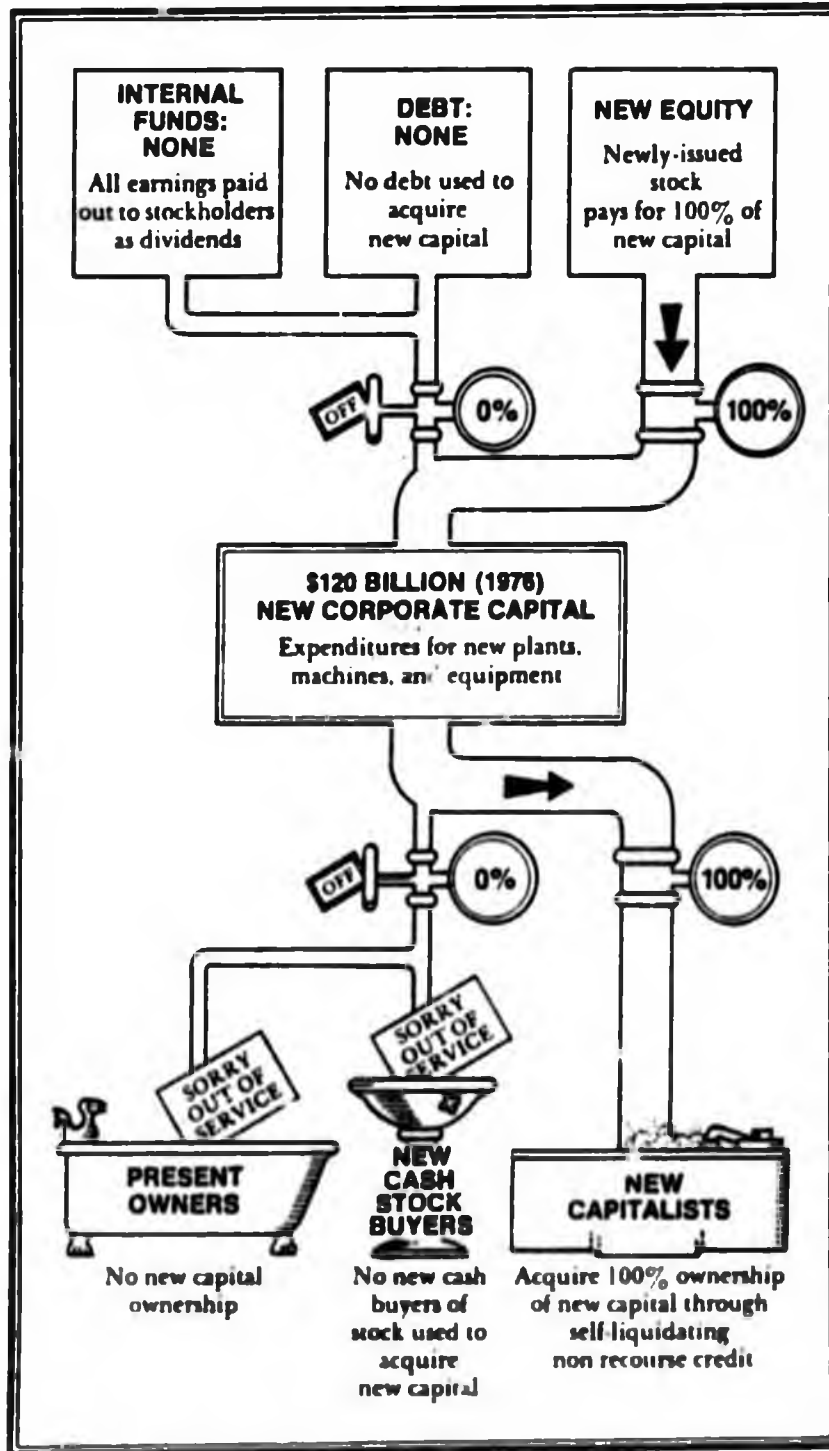


FIGURE TWO



PERSONAL WEALTH: COMPOSITION AND DISTRIBUTION

Personal wealth in the U.S. in 1972 totaled \$4.3 trillion while net worth totaled \$3.5 trillion. Evenly distributed, this would mean that the average sized family would have a financial net worth of \$59,200. Less than one family in eight approached that figure in 1972:

TABLE 1.—PERSONAL WEALTH, 1972

Asset	All persons (1)	Value (billions) held by the richest—		Share held by the richest—	
		1 percent	6 percent	1 percent	6 percent
		(2)	(3)	(4)	(5)
Real estate.....	\$1,492.6	\$225.0	\$645	15.1	43.2
Corporate stock.....	870.9	491.7	629	26.5	72.2
Bonds.....	151.0	94.6	124	68.0	78.5
Cash.....	749.8	101.2	278	13.5	37.1
Govt instruments.....	77.5	40.8		52.7	
Life insurance.....	141.0	10.0	475	7.0	40.5
Trusts.....	99.4	89.4		89.9	
Miscellaneous.....	853.6	83.3		9.8	
Total assets.....	94,344.4	\$1,035.9	\$2,152	21.1	49.5
Liabilities.....	258.5	131.0	360	16.2	37.1
Net worth.....	3,535.9	915.9	1,852	25.9	52.4
Number of persons (millions).....	209.0	2.1	12.8		

Source: Cols. (1), (2), and (4): James D. Smith and Stephen D. Franklin, "The Distribution of Wealth Among Individuals and Families," 1973. Cols. (3) and (5): Internal Revenue Service, "Personal Wealth," 1976.

From: "Broadening the Ownership of New Capital: ESOPs and Other Alternatives," A staff study of the Joint Economic Committee (1976) p. 7.

This JEC report notes that "... the distribution of income has remained virtually unchanged since World War II: the top quintile of the population holds just over 40 percent of the income and the lowest quintile has 5 percent. Even these figures understate how rich the rich really are for the top quintile of families have almost 80 percent of total wealth. Clearly, income will not become more equally distributed in this country until the base of wealth holdings is broadened." Id.

Other studies document that wealth is even more concentrated than the JEC indicates:

Robert J. Lampman, National Bureau of Economic Research, The Share of Top Wealth-holders in National Wealth, 1922-1956, (Princeton University Press, 1962).

Marshall E. Blume, Jean Crockett and Irwin Friend, "Stock Ownership in the United States: Characteristics and Trends," Survey of Current Business, November, 1974 at 16.

Expanded Ownership, (Sabre Foundation, 1971). This contains a survey of the studies on "The Distribution of Wealth in the Twentieth Century," by Prof. James D. Smith of Pennsylvania State Univ.

COMMENTS FROM THE MEDIA
WHY ESOPs ARE ALSO CALLED "KELSO PLANS"

Kelso and Adler's book could start a revolution.

Casper Weinberger
February, 1958

In those discussions there is as much of the wanderings of a madman as there is of cannibalism.

Pravda, March 25, 1959
in a review of The Capitalist Manifesto (1958) by Kelso & Adler

A crackpot theory. Instead of saying labor's exploited, as Marx did, Kelso says capital's exploited. It's worse than Marx. It's Marx stood on its head.

Milton Friedman
Time, Jan. 29, 1970

I think some economists such as Milton Friedman have given too short a shrift to the Kelso plan. It's an example of one means of accomplishing a broadening of wealth ownership... a quiet evolution in wealth ownership rather than the unquiet revolutions wealth owners have faced too often in the past.

Carl Madden, chief economist
U.S. Chamber of Commerce

A capitalist is someone who derives a substantial share of his income from his equity in producing companies. On this scale the figures are discouraging. Approximately ninety percent of the capital of this country is owned by five or less percent of the American people.

Louis Kelso of San Francisco, a lawyer-economist, has for years felt that he has a radical answer to the problem.

William F. Buckley
Feb. 24, 1970

There is a conspicuous void in the arguments and the programs of the counter-culture groups of this country, in that they have produced no well-formulated economic theories.

Unfortunately and ironically, Lou Kelso, who has some very imaginative economic proposals, has been offering them for many years to the establishment, the dinosaur culture.

So either Kelso is a lousy salesman or the dinosaurs are convinced their own designs will see them through.

The Whole Earth Catalog
Spring 1970

Louis O. Kelso, possibly the only genuine revolutionary in the United States.

Berkeley Daily Gazette
July 16, 1971

Kelso's formula sounds like Lydia Pinkham's Vegetable Compound. The whole theory sounds crazy. But, then, one may recall, they said all that of Copernicus too.

James J. Kilpatrick
Jan. 20, 1972

Kelsoism is not accepted by modern scientific economics as a valid and fruitful analysis of the distribution of income but rather it is regarded as an amateurish and cranky fad.

Paul Samuelson
The San Juan Star
April 27, 1972

Like the emperor's clothes, it looks beautiful. But when you look closely, you find there's nothing there.

Sar Levitan, economist

Taxation has its limitations as a method of achieving better economic distribution since for this purpose it is essentially remedial. We must also take a positive approach by finding new ways to spread ownership of future capital growth more broadly in our society. This will be a fertile field for creative ideas and experimentation in the years ahead by both government and the private sector.

One such approach has been developed by Louis Kelso. Kelso makes a convincing argument that many of the deficiencies of our economic system could be alleviated if ways were found to broaden the ownership of the means of production.

John D. Rockefeller 3rd
The Second American Revolution (1973)

If a Little Capitalism Is Good, What's Wrong with a Lot?

Fred Harris, former Senator
A chapter title from
The New Populism (1973)

In America, the greatest, most famous capitalist country in the world, there are almost no capitalists. The largest majority, silent and noisy, are job sarfs, wage villeins. dependent on salaries for all the money they'll ever see.

The great, lazy, anti-Calvinist, hedonistic Kelsonian truth is that you can't get rich through labor because it doesn't produce enough wealth.

Kelso's idea won't solve all our problems; it can't possibly work out as nicely as Kelso thinks, but it can move us from this barren repetition of fifty-year-old disputes. There is no salvation either outside the Church or on this earth, but Kelso does bring a new way of looking, and if that isn't salvation it's at least an intermediary grace.

Nicholas von Hoffman
Esquire December 1973

If a country in which only a few men and women are citizens is politically unjust, the remedy is not to abolish citizenship but to make all men and women citizens. If an industrialized country in which only a few own all the capital is economically unjust, the remedy is not to abolish private capital but to make it possible for all to become owners of some of it.

Winnett Boyd, president
Arthur D. Little, Canada

Over one hundred years ago Abraham Lincoln signed the Homestead Act. There was a wide distribution of land and they didn't confiscate anyone's already privately owned land. They did not take from those who owned to give to others who did not own. It set the pattern for the American capitalistic system. We need an Industrial Homestead Act.... it is time to formulate a plan to accelerate the economic growth and production at the same time we broaden the ownership of productive capital. The American dream has always been to have a piece of the action.

Ronald Reagan
July 20, 1974

The Kelso plan is a gentle, non-Robin Hoodish approach to the redistribution of wealth which his father Huey always preached.

Charles Bartlett
Arizona Republic, Mar. 24, 1975

Kelso: McLuhan of economics?

The Village Voice
April 28, 1975

One of the great things that ESOPs have going for them is that they are such a natural from a political viewpoint: Who in populist Washington, whether liberal or conservative, would knock the idea of spreading corporate ownership?

Forbes, May 1, 1975

Since the 1940s, a lawyer named Louis O. Kelso has haunted America's corporate corridors, spinning fables about the advantages of a fringe benefit known as an employee stock ownership plan - ESOP, for short.

Money, June 1975

The Kelso doctrine is the only economic doctrine introduced in generations that could become a plank in either the Democratic or Republican platform.

Barron's, July 21, 1975

Bring on those tired, labor-plagued, competition-weary companies and ESOP will breathe new life into them. They will find ESOP better than Getitol. It will revitalize what is wrong with capitalism. It will increase productivity. It will improve labor relations. It will promote economic justice. It will save the economic system. It will make our form of government and our concept of freedom prevail over those who don't agree with us.

Senator Russell B. Long
Chairman, Senate Finance Committee
October 20, 1975

These plans (ESOPs) have been heralded as the basic solution for many of our economic ills. Specifically, one of our chief proponents who will be testifying today, has said the widespread adoption of ESOPs will accomplish the following objectives: the restoration and acceleration of economic growth to unprecedented levels; create legitimate full employment for two or three decades; and lay the foundation for arresting inflation.

I must confess that these are some claims. Certainly no one since I have been chairing this committee has come before us with any program that promises that much.

Senator Hubert H. Humphrey
Chairman, Joint Economic Committee
ESOP Hearings, Dec. 11, 1975

Louis O. Kelso is an economic seer whose time may have come.

Milton Moskowitz
San Francisco Chronicle
May 24, 1975

No one is putting in an ESOP just to be a nice guy.

Pension consultant quoted in
New York Times, Nov. 5, 1975

Like the case for acupuncture, it sounds bizarre, even alarming - but a suspicion remains that there may be something to it.

Fortune, March, 1976

Some brokers are saying that the ESOP trend may be exercising as much influence on the future as the computer.

San Francisco Business
January, 1976

Kelso's plan is so radical that it is difficult to take seriously.

Fortune, March, 1976

Panaceas often have a way of turning into Pandora's boxes.

Business Week editorial
Mar. 8, 1976

The conservative but populist chairman of the Senate Finance Committee has become an evangelical disciple of Louis O. Kelso, a San Francisco attorney who has long championed various forms of 'worker capitalism.'

The most powerful defense of ESOP comes from Long, who waxes as fervent on the subject as Kelso.

Time, Oct. 4, 1976

As one member of this committee, Mr. Kelso, let me express my appreciation to you for the tremendous contribution that you have made and the pioneering work that you have done in the interest of employee stock ownership. We are, in many respects, holding these hearings here because of the work you have done in the area.

Senator Russell B. Long
Chairman, Senate Committee
on Finance
July 19, 1978