ALASKA LEGISLATURE COMMITTEE FILES 1981-1982 8672

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The actual process of company development can proceed in a positive or negative way depending on different factors. A little-appreciated fact in starting or sustaining companies is that the structure of financial assistance employed needs to be appropriate to the situation of the company.

Five of the strategic components were:

1. Rural Development
2. Venture Capital
3. Start-up Financing and Expansion
4. Development or Investment Banking
5. Microbusiness

A significant portion of the ARRC's time and money were invested in companies falling into these five components. However, in pursuit of its more general development finance role, the ARRC also went on to define further components which were not acutal businesses:

6. Key Industrial Initiatives
7. Research and Development
8. Education and Information

Finally, a ninth category of investment emerged in a *de facto* way: the restructuring of company capital was not one of the original strategic components. It became a major economic and political issue for the ARRC when the organization acted as investment conduit for the legislature's $15 million Commercial Fish Purchasers Assistance Fund of 1980 and its companion, the Forest Products Producers Assistance Fund.

Performance 1979-81

It is the basic thesis of this essay that the ARRC made a great deal happen in real, practical, measurable terms -- not theory but working companies; not concepts but jobs; not ideas but payroll dollars in Alaskan pockets and tax dollars returning to the state. By analyzing the performance of the ARRC in each of its strategic components it is possible to create a composite picture of that success.

Rural Development

The ARRC sought to support those enterprises which promised compatibility with the markets, cultures, resources and labor supply found in rural Alaska.

While it is commonplace to see renewable resources being obtained in rural areas, it is far less usual to find functioning small enterprises established there. There are many reasons why running rural businesses is so hard and it goes almost without saying that the value of *any* business in rural Alaska must be judged by rural needs.

Kokechik is a rural business — a fishing enterprise funded by the ARRC. It is made up of Native people from three local villages on Cape Romanzof in western Alaska.

Their plan as initially presented was to fish for herring, a local and underexploited resource, and prepare the roe for shipment to Japan. They needed support for the construction of aluminum boats which would be seaworthy in local waters.

When the ARRC clarified and analyzed the Kokechik business plan with the villagers, a number of assumptions were changed. Among them was the decision that aluminum boats would be too costly and difficult to maintain.

An alternative was devised. Wooden boats were designed and the parts cut to order in Port Townshend. Villagers were trained in construction techniques; then all parts and the needed jigs were shipped to the villages where the boats were actually built.

Kokechik now has its own expanding fleet of small vessels profitably engaged in the herring roe fishery. Because they can build or repair their own boats and because they have developed a fishery appropriate to their skills and resources, the villagers have gained a good measure of local control over their lives. They have increased the resilience and productivity of their community.

By many common measures of financial productivity, this relatively small ARRC investment would not be deemed more than a modest success. But in terms of rural Alaska it has to be seen in light of bringing work and cash into small communities — and doing so on a scale and with technology that was consistent with local needs and standards.

Kokechik provided a useful prototype experience for the ARRC in developing business enterprises in rural Alaska.

Venture Capital

Venture financing commonly demands extrememly high average returns on investment, new or state of the art products and processes; relatively risky equity financial commitments to companies; and intensive management counselling with the leadership of these firms.

Measured against these traditional and narrow criteria, few enterprises within Alaska would ever be considered as worthy of "venture capital" investments.

The population of Alaska has also been quite sparse compared to states which have what are considered to be true venture capital opportunities. There are not a large number of would-be company founders with the needed management skill and operating experience to start and run businesses. For these and other reasons the venture capital industry is quite modest in the Northwest and virtually non-existent in Alaska.

Another factor weighing against venture opportunity is that historically there has been little money available in Alaska to divert from pressing immediate needs. Purposes like research and development, which tend to create totally new opportunities, have necessarily taken a low priority.

Because Alaska has relatively little research and development the oft repeated hope of the legislation, that indiginous new technology would be a substantial element of economic development in the state, may have been less than realistic.

One ARRC investment did meet the criteria for venture capital investment and that was TEPA. As those familiar with how this investment was interpreted, it was also and unfortunately one of the ARRC's most controversial and damaging investments so far as its public image and credibility were concerned.

To show why TEPA was a classic venture investment, one needs to consider the facts. TEPA, an Alaska company owned by Alaskans, presented plans for a new, energy-effici[illegible] process which converted fish wast[illegible] to a commercially desirable high-protein meal. The advantages t[illegible]a of converting what is now only an environmental problem into a new product and source of [illegible] were extremely attractive.

Looking towards future and potential new industrial development, an efficient Alaska-based fish meal process could be significant, indeed necessary to whitefish production, where up to 80% of the fish is scrap. P[illegible]spectiv[illegible] manufacturers of high-protein animal feed from Delta barley would stand to benefit from lo[illegible]ly produced fish meal, as would the ultimate users of the feed in a developed Alaska red meat industry. The process can even yield an organic fertilizer as an additional and desirable by-product.

Whatever TEPA's ultimate achievement (or lack thereof), the investment serves to illustrate how venture captial money is both needed and can have extremely valuable long-range benefits for Alaska.

Development or Investment Banking

The ARRC served as a catalyst between people, financing and opportunity to combine local investment opportunities with sources of finance beyond its own; and provided ongoing commitments of management time and expertise.

This type of investment is a highly active and even original form of financing. It usually finances businesses beyond their start-up phase and which are undergoing stress such as rapid change.

Icicle Seafoods provided the ARRC with its major experience in this type of finance.

Icicle is an important company in Alaska with over $100 million in sales for 1981. Owned by Alaskans, it employs some 2,790 people in communities all along the coast from Petersburg to Akutan. The wages paid, and goods and services bought by Icicle have in recent years become important to the communities in which the company operates.

Icicle enjoyed sevenfold increases in sales over the past decade and while this is cause for congratulation, it can also be a cause for caution in an Alaska business. Icicle was forced to resort to short term debt and similarly to find ways to finance ever-inflating operating expenses. Awaiting payment for its inventories became a costly proposition.

An essential characteristic of debt service is its regularity; payments are made on a strict schedule. When a significant portion of the worth of any company like Icicle is tied up by loans, or the loan terms are inappropriate, that business is in danger of losing control of its operation.

In recognition of its essential soundness and of the desirability of keeping control of Icicle in Alaskan hands, the ARRC took a leadership role in creating an investment which would allow Icicle to operate without overwhelming pressure from debt service.

Sohio, one of the world's largest oil companies, was brought in as a partner with the ARRC. A measure of success for the venture to the date of this report is the fact Icicle remains a tax-paying Alaska company. It has availed itself of normal short-term financing in the commercial banking industry. It provides jobs and a healthy amount of exported product.

Startup and Expansion

Such capital is used to begin new businesses or to help established ones grow in reasonable ways. It strongly resembles venture capital investment except for far lower expectations in terms of payback.

Because start-up and expansion investments are so easily defined, they carry with them the paradoxical danger of oversimplification. A small business is very vulnerable if for no other reason than it is small and can little afford mistakes or hard times.

When such a business gets its initial start in life or stretches its resources to expand, the enterprise is very often at risk because it lacks cash — everything is tied up in the company. Many small businesses therefore require the "breathing room" provided by equity investors.

Unfortunately the prospect of making equity investments in new enterprises or expansion is often unattractive. Small businesses are often risky or very long-term propositions, which are difficult and expensive to evaluate and monitor. But the investments have to be made in order for Alaska to gain the very substantial benefits that new or growing enterprises provide the state and its people.

The Alaska Bait Producers of Tenakee Springs is a start-up company which began with ARRC financing. The company converts an underutilized resource, herring, into a premium frozen bait which competes directly with imported baits. Success for Alaska Bait means the productive use of a renewable resource, the provision of jobs and the displacement of imports — all desirable economic goals of the ARRC.

SeaWard Shipyards in Ketchikan provides a different set of benefits, aimed at the fishing and timber industries. With the assistance of funding from the ARRC, SeaWard became able to provide boat and barge maintenance services out of Ketchikan. An alternative to the long trip to Puget Sound, captains can save on costly fuel, expensive crew time and unproductive time away from the fishery.

Greatland Farms used its ARRC investment to start something new for Alaska — a mushroom farm. Its goal was to produce up to 50% of the mushrooms now imported into Alaska. Mushrooms are a specialty item, and they offer very good value added for the labor and materials required. And each dollar spent on Greatland mushrooms is a dollar available for re-use within Alaska.

The *Aleutian Dragon*, the *Alaska Star* and the *Arctic Fisher* are all floating fish processors. These relatively small but fully operational units provide markets for many small coastal communities which lack processors of their own. Each vessel was financed initially with an investment from the ARRC.

Expansion projects can have dimensions of benefit which are quite similar to entirely new enterprises.

Seafoods of Alaska in Sterling uses Yukon River king salmon to produce a valuable specialty smoked product. With money from the ARRC, the company expanded its smoking capacity, installed freezers to enable year-round operation (and employment) and upgraded their marketing efforts to sell the greater output.

Mastercraft Kitchens and Alaskan Wood Products in Anchorage also increased their exports with assistance from the ARRC. The company uses Alaskan woods to produce a high-quality line of cabinetwork. It had been very successful in the Anchorage area and wanted to increase production. With money from the ARRC, — money available no place else — the organization met its growth goals.

The story at Alyeska Candy Kitchens was similar. The company, which makes confections based on Alaska wild berries, needed new machinery to become more productive. Tourism and a growing demand for their product made it imperative. With the ARRC as investor, Alyeska was able to make the needed expansion.

Microbusiness

This strategic component addressed the very special needs of companies made up of very few people such as the one-person or family enterprise.

Where almost anybody understands the old saying "it takes money to make money," very few have ever heard "*it takes money to lend and invest money.*" These unavoidable and often high expenses are frequently referred to as "transaction costs."

Such costs make it difficult or even impossible to borrow the relatively tiny sums required by a person committed to opening a microbusiness. The need for cash in rural areas and the need for untried business people to get experience are unlikely to provide more than barely adequate paybacks on investments made.

The ARRC, an instrumentality of the state charged with renewable resource development, was justifiably able to absorb or defer costs and near-term profit in the interests of encouraging Alaskans to run productive businesses.

The tiny companies which come under the component "microbusiness" may barely pay their own way.

However, small steps are far preferable to no steps at all. Every indication leads to the conclusion that Alaska needs to build a class of experienced, willing business people within the state if it is to see development take place.

Steik Enterprises in Ninilchik is an example of this kind of rural microbusiness. It is a Native-owned sawmill operation which will supply the logs needed for twenty homes, and certain sawmill products. A local resident can market the products.

Jobs were in fact created by Steik, and by Pine's Sawmill — a similar operation in Tok. But it could be argued that a major benefit, exclusive of job and income, was the experience itself — for the company founders and the employees alike. Such an experience can, it is hoped, yield future economic dividends from even wider and more far-reaching activity.

Capital Restructure

The process of converting impractical and potentially destructive forms of capital to more workable financing is termed "restructuring."

One phrase used to describe the process of debt restructure is that it allows a company to "work out" its debts rather than "sell out" its assets in bankruptcy.

As noted earlier, the restructuring of capital was not an original strategic component. But because the ARRC could make investments of the needed depth, breadth and complexity needed by the highly leveraged fish companies, it was the legislature's choice to invest the $15 million Commercial Fish Processors Assistance Fund, 1980 and further resources in the Forest Products Producers Assistance Fund.

Under provision of the Fish Processors Assistance Fund, the ARRC was permitted to suspend its normal standards for judging business investments. A perceived weakened market for salmon due to the collapse and predictions for record r[illegible]s resulted in the investment of the ent[illegible] $15 million in just ten weeks. The ARRC gave the companies back a great deal of control over their commercial futures by restructuring their finances.

The Assistance Fund money created a large but, measured over the long run, temporary imbalance in the ARRC portfolio. As investments were made in other renewable resource areas, the proportion of fish investment would have dropped. This would have been accelerated by the ARRC policy of pressing for the timely repurchase of state-held equity by private owners.

A number of familiar names in the industry received capital restructure investments: Ball Brothers; Martin Seafoods; Alaska Timber and the heatedly discussed Salamatof Seafoods.

The results of these major investments will, like most equity investments, require considerable time to mature and become profitable, if at all. Whatever the eventual outcome the fact remains that the companies supported by the ARRC during their financial difficulties are still controlled by Alaskans, still paying taxes, providing jobs and still creating valuable products with the state's renewable resources.

The Schnabel Lumber Company of Haines provides a useful insight into how capital restructuring can operate. The mill was faced with a problem: how to dispose of wood waste in compliance with environmental requirements. Such systems cost a great deal of money and Schnabel's capital structure would not tolerate such a huge load, but without the compliance they could not operate.

In conjunction with a special legislative initiative, the ARRC supplied Schnabel with credit and management counsel to assist (among a variety of things) with the purchase of a system which generates electricity using wood waste as fuel. Power produced over and above Schnabel's needs will meet most of local community's requirements.

Management innovations were also put to work at Schnabel. One was the institution of a "plant diversification fund." Under its provisions a portion of company earnings will be set aside until Schnabel can purchase needed equipment to expand its product line into dimension-cut lumber. Given its geographic location, the company may be able to both make more money and simultaneously displace imported dimension lumber with Alaskan product.

Another innovation at Schnabel was that of the Employee Stock Option Plan. This plan gives the employees the chance to buy Schnabel stock held by ARRC — in effect giving the people with the biggest stake in Schnabel's success a chance to share more fully.

The Stock Option Plan provided valuable precedent in more than one way because it is a mechanism by which the ARRC can ensure the timely return of its equity interest to private ownership. The tool of equity finance is invaluable, but it is not a long-term commitment intended to create a class of state owned business and industry.

Most of the ARRC's activity and by far the greatest proportion of cash invested in the ARRC portfolio is in the various components of company development. But because the ARRC was also intended to perform industry development, .. also made initiatives in that specialized field.

Industry development broke naturally into certain strategic components.

Key Industrial Initiatives

This component was defined as encompassing the total study, planning and eventual investment to develop entire industries — the complex, inter-dependent web including mutually supportive companies, talent and market development.

There were two areas of concentration in the key industrial component: studies leading towards regional or industrial marketing initiatives; and the beginnings of integration between companies in Alaska by forming value-added industrial links between their products.

This last is most clearly illustrated in the unrelated ARRC investment companies, Alaska Food Company and Trinity Resources. With backing from the ARRC, Alaska Food Company became the first company in many years to ship processed cod from a shore based plant in Alaska.

Its potential for making higher value-added products like breaded fish makes Alaska Food Company a much-needed step in the direction of higher-level industrial development. And its presence as a market for the long-discussed whitefish industry makes it a potentially key element in what amounts to new industry for Alaska.

Trinity Resources was a different class of investment for the ARRC than was Alaska Foods — a research and development effort aimed at investigating the practicality of automated long-line fishing for whitefish. Its importance beyond that primary purpose was that it linked directly to Alaska Foods.

Separated, the two organizations are individual companies; considered as interlinked components they could have provided information and experience leading towards a vertically integrated industry for whitefish.

The Yukon River and Kuskokwim forest studies were of more sweeping and long-range scope. They were each commissioned by the ARRC to help communities in these regions determine the economic practicality of developing their local renewable timber resources. Alaska's interior forests, unlike most others in North America are in need of innovations in harvest, transportation and products if they are to become practical business assets.

The ARRC's Seldovia Day Fisheries study considered ways to create higher-value processed food products from underutilized rock and whitefish species, and to do so from a day fishery with land-based processing. A traditional facility in Seldovia was essentially obsolete and the local people there were — with the aid of the ARRC — able to consider entirely new industrial alternatives.

Research and Development

The ARRC was directed by legislation to concentrate on the applied *development* of practical, short-range solutions to practical problems rather than long-term or basic *research* which today requires a sophisticated infrastructure of academic and business institutions.

Because it has considerable visibility and valu in the public eye, and because it is exciting and interesting, research and development investment is a category with considerable political and popular appeal.

An early research and development involvement was with an architectural firm in Anchorage. The ARRC participated with a conventional lender to enable the architects to build one of the first solar homes in Alaska. The fuel-saving benefits of the solar home design were untried so far as the mortgage lender was concerned, so the ARRC stepped in to guarantee that portion of the total money required.

Another energy-related investment was the ARRC's support of an engineering development project. The objective was to build a sturdy, low-maintenance electrical generating unit which would gasify wood, even driftwood, for fuel.

The engineers working on the system set themselves the goal of making it from widely available stock parts. This would help keep the price affordable and make the unit practical even in remote areas of Alaska. Naturally any use of wood gas for fuel would displace an equivalent amount of costly imported petroleum product.

The ARRC's flexibility as to financial tools is shown in its support of a demonstration for crabbing interests in the state. The "Quick Pic" is a device used in the blue crab industry around the Chesapeake Bay and elsewhere to improve yields from shoulder meat. The ARRC provided a deposit guarantee so Alaskan crab processors could see if it were applicable to local species.

Education and Information

The ARRC supported efforts to gather information, to act as a clearinghouse for data, to educate Alaskans who might some day form companies, and to inform the general public on issues of economic importance of renewable resources.

One of the earliest and most persistent challenges facing the ARRC was the relative scarcity of management and company founder talent within the state's limited population. This was evident from the number and demonstrably limited quality of concepts proposed for funding.

With ARRC support, the Entrepreneurial Studies program at Alaska Pacific University, began the arduous, essential long-term task of training and motivating people to start sound businesses in Alaska. Like research and development, such educational efforts would require years to prove out, and like research and development, they seem essential if Alaskan business is to make major progress.

On a more particular topic the ARRC helped fund the Alternative Energy Conference — a forum from which experts could speak to Alaskans about potentially valuable alternatives to expensive conventional energy use.

The ARRC supported the foundation and operation of the Alaska Seafood Marketing Institute. This organization takes a broad educational and motivational marketing approach to the challenges of selling all Alaska seafood products.

Its work concentrates on the establishment of a desirable and top-quality image for Alaska seafood. As demonstrated by other organizations, skilled generic promotion helps sustain, increase and create new demand for promoted products and can even help pricing in relation to less well-known goods.

In Summation

If the ARRC were to continue, it would certainly and necessarily continue renewable resource development in ways consistent with those already underway. Given the learning experience of its relatively few months of funded activity the organization would do certain things differently. But the productivity of its total work to date seems to indicate that the ARRC was more of a success in principle and in practice than it ever communicated.

Despite the trustees' recommendation that the ARRC as constituted be dissolved the basic needs which inspired it still exist. Many agree that Alaska needs to find ways to invest in itself — to create a healthier, self-sustaining economy.

The ARRC experience seems to prove by example that strong business enterprises, however small or undramatic, are one of the very soundest of investments to make. They are productive. And they are made up of the very people most committed to building a future for themselves in Alaska. Finding ways to encourage their success cannot but help the state both in the near term and for the forseeable future.

ALASKA RENEWABLE RESOURCES CORPORATION

Financial Statements and Schedules

June 30, 1981

(With Accountants' Report Thereon)

Peat, Marwick, Mitchell & Co.
Certified Public Accountants

Alaska Mutual Bank Building
601 West 5th Avenue, Suite 700
Anchorage, Alaska 99501

Board of Trustees
Alaska Renewable Resources Corporation:

We have examined the accompanying financial statements of Alaska Renewable resources Corporation as of and for the year ended June 30, 1981. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As discussed more fully in note 2 to the financial statements, loans and investments amounting to \$23,101,586 have been valued at fair value as determined by management. we have discussed with management their procedures for valuing such loans and investments and have inspected underlying documentation. While, in the circumstances, the procedures applied by management appear to be reasonable, determination of fair values involves subjective judgement which is not susceptible to substantiation by auditing procedures.

In our opinion, subject to the possible effect on the financial statements of the valuation of loans and investments determined by management, as described in the preceding paragraph, the aforementioned financial statements present fairly the financial position of Alaska Renewable Resources Corporation at June 30, 1981 and the results of its operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

The examination referred to above was directed primarily toward formulating an opinion on the financial statments of Alaska Renewable Resources Corporation, taken as a whole. The supplementary data included in Schedules 1 through 3 are presented for supplementary analysis purposes and are not necessary for a fair presentation of the financial position and results of operations and changes in financial position of Alaska Renewable Resources Corporation. The supplementary data have been subjected to the auditing procedures applied in the examination of the financial statements and, in our opinion, subject to the possible effect on the financial statements of the valuation of loans and investments determined by management, as described in the second paragraph, are stated fairly in all material respects only when considered in conjunction with the financial statements taken as a whole.

Peat, Marwick, Mitchell & Co.

August 29, 1981

ALASKA RENEWABLE RESOURCES CORPORATION

Development Fund Balance Sheet

June 30, 1981

Assets

Cash	$ 1,173,843
Interest bearing deposits	17,770,880
Certificates of deposit, pledged (note 3)	525,000
Other assets	72,376
Accrued interest receivable, loans (note 2)	1,175,909
Less reserve for possible uncollectible interest	384,528
Accrued interest receivable, net	791,381
Loans receivable (note 2):	
Agriculture	273,910
Commercial Fish Processors Assistance Fund	10,748,823
Fisheries	5,964,990
Forest assistance	164,276
Forest products	531,667
Total loans	17,683,666
Less reserve for possible uncollectible loans	261,147
Loans receivable, net	17,422,519
Investments in capital stock (note 2)	5,67[illegible]67
	$ 43,435,066

Liabilities and Fund Balance

Accounts payable	2,558
Payable to Operating Fund	57,466
Excess interest earned, payable to State of Alaska	549,043
Fund balance	42,825,999
Commitments (note 5)	
	$ 43,435,066

See accompanying notes to financial statements.

ALASKA
RENEWABLE
RESOURCES
CORPORATION

Operating Fund
Balance Sheet

June 30, 1981

Assets	
Cash	$ 608,666
Appropriation receivable from State of Alaska (note 4)	151,989
Receivable from the development Fund	57,466
	$ 818,121

Liabilities and Fund Balance	
Accounts payable	125,944
Accrued payroll	26,045
Legal fees payable to State of Alaska	57,466
Excess interest earned, payable to State of Alaska	40,331
Fund balance	568,335
Commitments (note 5)	—
	$ 818,121

See accompanying notes to financial statements.

ALASKA RENEWABLE RESOURCES CORPORATION

Statements of Revenues, Expenses and Change in Fund Balances

Year ended
June 30, 1981

	Operating Fund	Development Fund	Total
Revenues:			
State of Alaska	$ 2,311,020	31,812,291	34,123,311
Interest income, loans	-	1,993,430	1,993,430
Interest income, idle loans	40,331	502,786	543,117
Other	-	759	759
Total revenues	2,351,351	34,309,266	36,660,617
Expenses:			
Technical assistance	-	94,648	94,648
Development grants	-	167,439	167,439
Provision for possible uncollectible loans	-	261,147	261,147
Provision for possible uncollectible accrued interest	-	384,528	384,528
Other	-	3,065	3,065
Excess interest earned, payable to State of Alaska	40,331	804,561	844,892
Alaska Seafood Marketing Expenditures	631,665	-	631,665
Operating expenses:			
Salaries and benefits	555,213	-	555,213
Professional services	150,449	-	150,449
Legal	137,649	-	137,649
Travel and moving	68,962	-	68,962
Office rent	58,960	-	58,960
Office equipment rental	36,764	-	36,764
Utilities	27,554	-	27,554
Supplies	21,703	-	21,703
Printing and binding	8,776	-	8,776
Other	44,990	-	44,990
Total expenses	1,783,016	1,715,388	3,498,404
Excess of revenues over expenses	568,335	32,593,878	33,162,213
Fund balance at beginning of year	-	10,232,121	10,232,121
Fund balance at end of year	$ 568,335	42,825,999	43,394,334

See accompanying notes to financial statements.

ALASKA RENEWABLE RESOURCES CORPORATION

Notes to Financial Statements

June 30, 1981

(1) Summary of Significant Accounting Policies

Alaska Renewable Resources Corporation (ARRC) is a public corporation created by the Alaska Legislature in 1978 to promote the development and sustained use of Alaska's renewable resources. Funds for ARRC have been appropriated by the Legislature from proceeds received by the State from mineral leases, rentals, bonuses, and royalties on minerals produced on state lands. The significant accounting policies applied in accounting for these funds are as follows:

State Appropriations

Funds appropriated by the State for operating purposes are accounted for as revenue in the Operating Fund. Funds appropriated for loans, investments, technical assistance and grants are accounted for in the Development Fund.

Interest Income

Interest on loans is recognized as income only to the extent that management considers it collectible.

Loan Principal

Principal repayments on loans are available to ARRC for additional loans.

Non-Accrual Loans

The accrual of interest on loans is discontinued when payment of principal or interest is considered to be doubtful of collection. Interest income on non-accrual loans is recognized only to the extent payments are received.

Equity Investments

Investments in capital stock are carried at net realizable value as determined by management.

Income Taxes

ARRC is a political subdivision of the State of Alaska and, therefore, by statute, is exempt from state and federal income taxes.

Retirement Plan

All employees of ARRC participate in the State of Alaska Public Employees Retirement System (PERS). All pension costs are funded by the State as they accrue.

(2) Valuation of Loans and Investments

Loans are made at interest rates of 10% to prime plus 3% and for terms of several months to several years. Most loans are secured by property or equipment. A valuation allowance is provided for loans and accrued interest receivable when management and the Board of Trustees determine that a loan or accrued interest receivable may not be collectible and that the collateral securing the loan or accrued interest receivable may be insufficient to recover the recorded balance. At June 30, 1981, management has established a $261,147 provision for possible uncollectible loans and a $384,528 provision for possible uncollectible accrued interest receivable.

In determining the necessity for a valuation reserve, managment relies on financial data of investees and estimates the effects of future developments on the investee companies. All equity investments are valued at cost since, in management's opinion, insufficient time had elapsed since initial investment to determine any appreciation or depreciation in the investments, although management has determined that underlying collateral would be sufficient to liquidate its investments without loss.

(3) Pledged Assets

Rather than loaning funds directly to investees, ARRC may assist them in obtaining loans from banks by depositing funds at a bank as security for a loan. At June 30, 1981, $525,000 was deposited with banks as security for loans made by the banks.

(4) Appropriation Receivable from the State of Alaska

This receivable represents funds for payment of accounts payable balances at June 30, 1981.

(5) Commitments

In the normal course of business, there are outstanding various commitments such as guarantees and commitments to extend credit, which are not included in the accompanying financial statements, including loan guarantees of $180,000, undisbursed loan funds of approximately $625,000 and $13,674,000 of tentative loan commitments to investees. No material losses are anticipated as a result of these transactions.

ALASKA RENEWABLE RESOURCES CORPORATION

Loans Receivable

June 30, 1981

Schedule 1

Company	Amount
A. Agriculture:	
Alyeska Candy Kitchen	$ 34,785
Anchor Renewable Farms	119,125
Great'and Farms	120,000
	273,910
B. Commercial Fish Processors Assistance Fund:	
Ball Brothers, Inc.	3,000,000
Salamafof Seafoods, Inc.	2,575,491
Martin Clark	373,332
American Eagle	50,000
Alaska Food Co.	3,000,000
Icicle Seafoods, Inc.	400,000
New Seward, Inc.	1,350,000
	10,748,823
C. Fisheries:	
Kokechik	293,778
Pacific Barge	121,980
Sea Fisher	200,000
TEPA	348,489
SeaWard Shipyard	480,000
American Eagle	250,000
Martin's Seafood	450,000
Trinity Resources	296,048
Alaska Fish	125,000
Alaska Bait Producers	292,129
Sterling Seafoods	1,125,000
Alaska Food Co.	1,232,566
Ball Brothers, Inc.	750,000
	5,964,990
D. Forest Products Assistance Fund:	164,276
Alaska Timber Corp.	164,276
E. Forest Products:	
Woodyard	39,167
Steik	55,000
SeaWard Shipyard	100,000
Pine's Sawmill	22,500
Mastercraft	315,000
	531,667
Total loans	$ 17,683,666

ALASKA RENEWABLE RESOURCES CORPORATION

Investments in Capital Stock

June 30, 1981

Schedule 2

Company	Amount	Industry
TEPA	$ 200,000	Fish
SeaWard Shipyard	150,000	Forest Products
Trinity Resources	255,000	Fish
Kokechik	490	Fish
Ball Brothers, Inc.	500,000	Fish
Alaska Bait Producers	85,000	Fish
Alaska Food Co.	500,000	Fish
Alaska Woods, Inc.	100,000	Forest Products
Greatland Farms	50,000	Agriculture
Mastercraft	100,000	Forest Products
Salamatof Seafoods, Inc.	316,111	Fish
Alaska Fish	125,000	Fish
Sterling Seafoods	100,000	Fish
New Seward, Inc.	150,000	Fish
Icicle Seafoods, Inc.	3,047,466	Fish
	$ 5,679,067	

ALASKA RENEWABLE RESOURCES CORPORATION

Development Grants

June 30, 1981

Schedule 3

Company	Amount	Industry
Trinity Resources	$ 36,395	Fish
Future Farmers	2,344	Agriculture
Agriculture Symposium	13,700	Agriculture
APU Entrepreneurial Chair	100,000	General
Alaska Longline Fishermen's Association	15,000	Fish
	$ 167,439	

ALASKA RENEWABLE RESOURCES CORPORATION

Balance Sheets

December 31 and June 30, 1981

(Unaudited - See Accompanying Compilation Report of Peat, Marwick, Mitchell & Co.)

Assets	December 31	June 30
Cash	$ 397,381	1,782,509
Interest bearing deposits	14,767,677	17,770,880
Certificates of deposit, pledged (note 3)	525,000	525,000
Other assets	58,401	72,376
Accrued interest receivable, loans (note 2)	2,158,349	1,175,909
Less reserve for possible uncollectible interest	384,528	384,528
Accrued interest receivable, loans, net	1,773,821	791,381
Loans receivable (note 2):		
Agriculture	488,240	273,910
Commercial Fish Processors Assistance Fund	10,950,210	10,748,823
Fisheries	7,109,281	5,964,990
Forest assistance	792,309	164,276
Forest products	560,667	531,667
Total loans receivable	19,900,707	17,683,666
Less reserve for possible uncollectible loans	261,147	261,147
Loans receivable, net	19,639,560	17,422,519
Investments in capital stock (notes 2 and 5)	7,646,460	5,679,067
	$ 44,808,300	44,043,732
Liabilities and Fund Balance		
Accounts payable	1,225	2,558
Payable to Operating Fund	-	57,466
Excess interest earned, payable to State of Alaska	1,097,226	589,374
Fund balance	43,709,849	43,394,334
Commitments (note 4)		
	$ 44,808,300	44,043,732

See accompanying notes to financial statements.

ALASKA RENEWABLE RESOURCES CORPORATION

Legislative Recommendations

1982

Principal Problem Experienced	Reason	Possible Remedy	Recommended Solution
1. Redundant/ambiguous top management authority	1. Three trustees of equal authority and responsibility	1. Change Board structure	1. P/T board of seven members, majority from private sector
2. Goal ambiguity/ strategic confusion	2. Unclear/unfocused legislation	2. Restrict investments to R&D, start-ups, and expansions of ventures with less than $2 million net worth. Drop granting powers.	2. Legislated focus as shown to left under "possible remedy"
3. Operational bureaucracy	3. Department of Revenue/ Department of Administration perceptions of their responsibilities over ARRC operation. Legal opinions about constitutionality of funding.	3. Capitalize ARRC. Remove from Executive Budget Act. ARRC operates and invests from capital and earnings	3. Strengthen accountability requirements by requiring quarterly statements. Legislative Budget & Audit also contracts for additional audit by experienced firm.
4. Public concerns about market power	4. Narrow focus in industry targets/use of ARRC for emergency stabilization of fisheries industry	4. Broaden industry focus. Don't legislate emergency anticyclical investment goals. Be more realistic about portfolio balance.	4. Include all manufacturing/ processing in target industries

A REVIEW OF THE
DEPARTMENT OF REVENUE
ALASKA RENEWABLE
RESOURCES CORPORATION

November 13, 1981

AUDIT CONTROL NUMBER
04-012-0001-R

Commissioner, Department of Revenue	Thomas K. Williams
Deputy Commissioners, Department of Revenue:	
Taxation	Joseph K. Donohue
Treasury	Peter A. Bushre

Board of Trustees
Alaska Renewable Resources Corporation

Trustee, Chairman	H. Phillip Hubbard
Trustee	William F. Spear
Trustee	Dean F. Olson

STATE OF ALASKA

THE LEGISLATURE

BUDGET AND AUDIT COMMITTEE

AUDIT DIVISION
POUCH W—ALASKA OFFICE BUILDING

FINANCE DIVISION
POUCH WF—STATE CAPITOL

JUNEAU, ALASKA 99811

December 1, 1981

Members of the
Legislative Budget and Audit Committee:

In accordance with the provisions of Title 24 of the Alaska Statutes, the attached report is submitted for your review.

A REVIEW OF THE
DEPARTMENT OF REVENUE
ALASKA RENEWABLE
RESOURCES CORPORATION

November 13, 1981

Gerald L. Wilkerson

Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

TABLE OF CONTENTS

PURPOSE OF THE REVIEW

In accordance with the provisions of Title 24 of the Alaska Statutes and the "sunset" provisions of AS 44.66, we conducted a review of the Department of Revenue, Alaska Renewable Resources Corporation (ARRC) to determine if the Corporation should be allowed to terminate on June 30, 1982, be continued in its existing form, or if alternatives exist to better accomplish ARRC's purpose. In addition, we reviewed the effectiveness and efficiency of ARRC's operations and its compliance with applicable statutes.

ORGANIZATION AND FUNCTION

The Alaska Renewable Resources Corporation (ARRC) was created by Chapter 179, SLA 1978 as a public corporation and instrumentality of the State within the Department of Revenue but with a legal existence independent of and separate from the State.

The 1978 Legislature found that Alaska has renewable resources that are not being utilized to their full potential. Therefore, ARRC was given the following statutory purposes:

1. Facilitate the rehabilitation, enhancement and development of the State's renewable resources so as to strengthen the self-sustaining sectors of the State economy.

2. Sponsor research and development of technologies and innovations for the rehabilitation and enhancement of the State's renewable resources to achieve an appropriate use of the resources.

3. Identify new products, markets and technologies for renewable resource industries in the State which will constitute an appropriate use of the resources; stimulate the research and development of these products, markets and technologies; assist in the demonstration of their technical and economic feasibility; and assist in their introduction into commercial markets.

To accomplish its purposes, ARRC may provide financial assistance to qualified applicants through such methods as equity financing, debt financing, grants and technical assistance.

ARRC is governed by a three-member, full-time Board of Trustees responsible for all investment decisions. The Trustees are appointed by the Governor and confirmed by the Legislature for four-year terms. The Board employs an Executive Director who may, with the approval of the Board, select and employ additional staff as necessary.

RECENT HISTORY

The Alaska Renewable Resources Corporation began its organization effort in January of 1979 following the appointment of the Board of Trustees.

ARRC received its first capital investment appropriation through Chapter 80, SLA 1979 which appropriated $4.8 million for fisheries projects, $2.7 million for timber projects, $2.7 million for agriculture projects and $0.4 million for renewable energy projects. Chapter 93, SLA 1980 later reduced these appropriations by $5.6 million and added the Forest Product Producers Assistance Fund with a $5.2 million appropriation and a $0.4 million appropriation to the Commercial Fish Processors Assistance Fund.

Chapter 32, SLA 1980 gave ARRC the responsibility of administering the $15 million Commercial Fish Purchasers Assistance Fund and because of the urgency of providing the assistance, Chapter 32 also waived certain of ARRC's normal investment decision criteria.

Although ARRC received a FY'81 investment appropriation of $20 million, FY'82 legislation required ARRC to lapse the unexpended and unobligated portion of $18 million of the FY'81 appropriation. $2 million was carried into FY'82, but can only be invested with the expressed approval of the Governor. ARRC received no other FY'82 investment appropriation.

The responsibilities of administering the Commercial Fish Purchasers Assistance Fund have had a major impact on ARRC's operations. Because of the limited time available to provide assistance to commercial purchasers of the 1980 salmon harvest, ARRC was forced to spend the majority of its efforts on these investments. At September 30, 1981, approximately 65% of ARRC's total debt and equity investments were from this Fund. Other venture capital investments were, by necessity, overshadowed by these investments in the fisheries industry.

As of September 30, 1980, ARRC's outstanding debt and equity investments totaled $26,205,413 and ARRC had $13,128,889 in investment commitments (see Appendix A).

POLICY ISSUE

The 1978 Legislature found that one of the factors that has contributed to the slow development of renewable resource industries was the insufficiency of research and development financing and venture capital financing. As a result, it was declared the State's policy to rehabilitate, enhance, and develop its renewable resources by utilizing State funds derived from mineral lease bonuses, rentals of State land, and royalties from minerals produced on State land to assist the development of viable industries through the private sector.

The sunset review process includes a review of prior policy decisions. Therefore, the Legislature should again consider whether or not it is in the State's best interest to continue venture capital financing.

In making this decision, it is important to note that although there presently exist many sources of debt financing available through the State and commercial institutions, there are very few sources of high risk equity financing available.

If the Legislature decides the State should not be providing venture capital financing, the Alaska Renewable Resources Corporation should be allowed to terminate on June 30, 1982. The Legislature should then repeal all ARRC statutes and provide for the transfer and ultimate disposition of ARRC's portfolio. All cash and liquid assets should be transmitted to the Treasury. Guidelines should be established for the disposition of ARRC's equity investments. In doing so, the Legislature should provide sufficient time and flexibility to allow for a maximum return to the State. It should be recognized that this may well take longer than the one year wind-down period of ARRC. Priority consideration should be given to existing equity investors of each project. Again, a sufficient time frame should be provided so as not to unduly burden the financial stability of the projects.

Several alternatives exist for the disposition of the debt portion of ARRC's portfolio. These include but are not limited to transferring all loans to either the Department of Revenue or the Department of Commerce and Economic Development's Division of Business Loans. Commercial lending institutions could be allowed to purchase loans, with the State guaranteeing a portion of the loans. Loans could also be separated by resource sector, with Fisheries loans sold to the Commercial Fishing and Agriculture Bank or transferred to the Division of Business Loans; Agricultural loans could be transferred to the Agriculture Revolving Loan Fund; and Timber and Energy loans could be transferred to the Division of Business Loans.

If the Legislature determines it is in the State's best interest to continue venture capital financing, consideration should be given to the Findings and Recommendations section of this report.

It is our opinion that ARRC should not be continued as it is currently structured under the existing statutes. Recommendation No. 1 describes alternatives for consideration in restructuring ARRC and its related statutes.

If ARRC should be continued in its existing form, other recommendations are made to bring ARRC into statutory compliance.

Regardless of the final policy decision made, the Legislature should address the constitutionality issue surrounding the Alaska Renewable Resources Development and Investment Funds (AS 37.11.010-090) and ARRC's allocation from these funds as described in AS 37.12.020. It is the opinion of the Attorney General's Office that these statutes provide for an unconstitutional dedication of funds. This has led to differing opinions from the Attorney General and ARRC's counsel on certain aspects of ARRC's operations that could have a serious impact on the financial structure of ARRC as described in Recommendation No. 2.

FINDINGS AND RECOMMENDATIONS

Recommendation No. 1

The Legislature should consider alternatives to the current organizational structure and statutory provisions of ARRC.

It is our opinion that ARRC should not continue to exist in its present form under the existing statutes. The current structure and statutes do not provide an efficient or economical use of the corporation's resources. The statutory purpose of ARRC and related statutes do not provide the necessary legislative guidance to dictate the direction of ARRC efforts.

If the Legislature determines it is in the State's best interest to continue venture capital financing, the following alternatives should be included for consideration:

1. New Program of the Alaska Industrial Development Authority (AIDA).

   In recent years, there has been increasing emphasis on centralizing the State's loan programs within the pervue of AIDA. Including a new renewable resource venture capital program within AIDA would provide certain efficiencies and economies, since AIDA could most easily absorb the investment review and approval responsibilities. AIDA would also be in a position to best determine if other loan programs within AIDA would better serve the venture capital applicant.

   Due to the unique nature of venture finance decision making, a separate section of AIDA would be required. With proper statutory direction and a reduction of responsibilities currently required of ARRC, a small staff of investment officers and a director should be adequate to analyze investment applications and make recommendations to the Authority for formal action.

   Operating costs of the program should be subject to the Executive Budget Act. Investment funding could be through annual appropriations or a revolving loan fund within AIDA.

2. Renewable Resource Revolving Investment Fund Board.

   Due to the nature of venture capital financing, it may be desirous to separately administer the program. This program could be administered by a Renewable Resource Revolving Investment Fund Board under the Commissioner of the Department of Commerce and Economic Development or the Department of Natural Resources, much in a format like the Agriculture Revolving Loan Fund.

The Board should have final investment decision authority but could delegate limited disbursing authority to an Executive Director. The Board should not be full-time salaried employees as ARRC is currently structured, but should be compensated for travel and per diem when the Board meets.

Again, proper statutory direction and reduced scope would promote a more effective use of the Fund's resources.

Operating costs of administering the Fund should be subject to the Executive Budget Act and could be appropriated from the General Fund or program receipts.

Regardless of the alternative ultimately selected, the Legislature should review the current purposes and responsibilities of ARRC and consider, where necessary, providing a clear definition of the duties, responsibilities, and direction of investment efforts. Narrowing the scope of responsibilities would promote more intensive efforts in defined resource development areas. For example, ARRC is currently required to promote the marketing of renewable resource products. In a broad sense, this is also a responsibility of the Department of Commerce and Economic Development; more specifically, the creation of entities such as the Alaska Seafood Marketing Institute (Chapter 106, SLA 1981) should greatly decrease the need for ARRC's involvement in industry-wide marketing promotion.

Recommendation No. 2

The Legislature should consider the repeal of AS 37.11.010-090 and AS 37.12.020.

According to opinions issued by the Attorney General's Office, the Alaska Renewable Resources Development Fund (AS 37.11.010-040) and the Alaska Renewable Resources Investment Fund (AS 37.11.050-090) are in conflict with the constitutional prohibition against dedicated funds and are, therefore, a nullity.

AS 37.12.020 provides for the allocation to ARRC of five percent of the total receipts paid the State from mineral lease bonuses, rental of State lands, and royalties derived from minerals produced on State land. The Attorney General has also opined that this section, like the resource funds, is unconstitutional and, therefore, a nullity.

However, supported by their corporate counsel's opinions, ARRC has adopted several cash management and investment practices based on their interpretation of AS 37.12.020. It is the Attorney General's opinion that, since this section of Title 37 is a nullity, certain ARRC practices are not authorized by any other provisions of the Alaska Statutes.

As a result, ARRC is caught between differing legal opinions while still required to continue their day to day operations.

Therefore, to resolve ARRC's current dilemma and to provide clarification of intended fiscal procedures, the Legislature should consider repealing AS 37.11.010-090 and AS 37.12.020. In conjunction with Legislative action on these statutes, consideration should be given to affirming, revising, or enacting legislation to address findings contained in Recommendations No. 3 through No. 5. Those recommendations are made to bring ARRC into statutory compliance based on statutory interpretations by the Attorney General.

Recommendation No. 3

ARRC should discontinue expending repaid principal from previous loans.

AS 37.12.905(a) states that ARRC may expend money only as appropriated by the Legislature. However, it is a common practice of ARRC to use repaid principal from loans made from original appropriations to make additional loans. According to ARRC records, as of September 30, 1981, ARRC has made approximately $3.9 million of loans from repaid principal.

The Attorney General has stated that no legislative appropriations have been made to ARRC which would allow the expenditure of the repaid principal, and that any expenditure of those funds violates AS 37.12.095.

Recommendation No. 4

ARRC's funds should be deposited with and invested through the Treasury Division of the Department of Revenue.

In a prior ARRC audit report dated July 23, 1980, we found that ARRC was investing $242,000 in a repurchase agreement. We recommended that those funds be deposited with and invested through the Treasury Division. The recommendation was supported by an Attorney General's opinion which states the Department of Revenue has control over the investment of ARRC funds.

According to ARRC's records at September 30, 1981, ARRC's cash and investment accounts total in excess of $16.7 million. These deposits consist of principal and interest payments received from investees, loan commitment funds drawn out of Treasury, and interest earned on ARRC's investment of those idle commitment funds.

In line with the Attorney General's opinion, we make the following recommendations:

1. ARRC should remit all funds on deposit to the Treasury Division.

2. ARRC should review current loan commitments for which funds have been drawn out of the Treasury to determine if those commitments are still valid.

3. Funds for currently valid loan commitments should be deposited in the General Fund and ARRC should request the Department of Administration's Division of Finance to establish prior year encumbrances for these commitments.

4. Loan commitment funds that will not be disbursed should be lapsed to the General Fund.

5. ARRC, the Department of Revenue, and the Department of Administration should cooperate in the development of a procedure that provides for the timely disbursement of loan commitment funds to ARRC investees. Disbursement of these funds should only be made to the investee, and the Department of Revenue should not process vouchers requesting warrants made payable to ARRC.

Recommendation No. 5

ARRC trustees and employees should immediately resign from positions on the Board of Directors of ARRC investees.

ARRC's statute, AS 37.12.080(b)(4), states that they may not assume the responsibility for management of any project or exercise voting rights for any purpose within the scope of managerial control of its investees.

As a means of monitoring its investees, it is a common practice of ARRC to have a trustee or employee serve on the Board of Directors of its investees. However, the role of the Board of Directors of any business is to set management policy and direction. To protect against the possibility of an actual conflict of interest, or equally important, the appearance of a conflict, ARRC officials should not serve on the Board of Directors.

This recommendation does not apply to situations in which ARRC has determined that the directorship is necessary to protect its financial interest as provided by and under the circumstances described in AS 37.12.080(c).

Recommendation No. 6

ARRC should improve the documentation of its analysis of applications for financial assistance.

AS 37.12.080(a) specifies criteria ARRC must use in analyzing applications for financial assistance. Certain written findings of fact are required prior to the Board of Trustees' approval of assistance.

In a test of 32 resolutions approving financial assistance, written findings of fact could not be located for 9 applications, although reference was made to 8 of those written findings in the related resolutions.

In addition, although we found applicant files did contain documentation on proposals, plans of implementation, residency, and meeting the statutory purpose of ARRC, documentation supporting other required findings was not located in all cases. In a test of 16 applicant files, 13 did not contain documentation that ARRC considered the preferences and priorities of the residents in the area where the project is to be located as required by AS 37.12.080(a)(3). None contained documentation of a review of potential resource use conflicts, or that the applicant agreed to keep the project activity in the State if new industrial activity results as required by AS 37.12.080(a)(1). Nine of the files did not document that sufficient capital was not available from other sources at reasonable terms as required by AS 37.12.080(a)(1).

Similar documentation weaknesses were also noted in our review of resolutions and files approving grants to applicants.

We recommend that ARRC adequately document its analysis of the required criteria and prepare written Board findings prior to the approval of grant and financial assistance applications.

Recommendation No. 7

ARRC should implement procedures that provide public competition for technical assistance contracts.

AS 37.12.115 states that ARRC may provide financing for preinvestment activities such as feasibility studies and may provide funding for management advice and assistance to its investees as it considers necessary in the circumstances.

ANALYSIS OF PUBLIC NEED

Limited Analysis

The following analysis indicates both positive and negative attainments of ARRC and how its activities relate to the public need factors as defined by AS 44.66.050. This analysis is not intended to be comprehensive in nature.

I. The extent to which the board, commission or program has operated in the public interest.

As of September 30, 1981, ARRC had outstanding equity and debt investments in excess of $26 million and had commitments totalling over $13 million for renewable resources new or expanding businesses/projects.

However, ARRC has not developed procedures to accurately measure its effect on the State's economy.

II. The extent to which the operation of the board, commission, or agency program has been impeded or enhanced by existing statutes, procedures, and practices which it has adopted, and any other matter, including budgetary, resource, and personnel matters.

Chapter 32, SLA 1980 gave ARRC the responsibility of administering the $15 million Commercial Fish Purchasers Assistance Fund, which had a major impact on ARRC's operations. Because of the limited time available to provide the assistance to purchasers of the 1980 salmon harvest, ARRC was forced to spend the majority of its efforts on these investments. Other venture capital investments were, by necessity, overshadowed by this involvement in the fisheries industry.

In addition, it is our opinion that the current ARRC structure and statutes do not provide an efficient and economical use of the Corporation's resources. The statutory purpose of ARRC and related statutes do not provide the necessary legislative guidance to dictate the direction of investment efforts (see Recommendation No. 1).

III. The extent to which the board, commission or agency has recommended statutory changes which are generally of benefit to the public interest.

To date, ARRC has not submitted statutory change recommendations although most everyone involved agrees changes are necessary. ARRC does intend to submit proposed legislation changes to the 1982 Legislature.

Presently, ARRC does not provide for public competition for professional service technical assistance contracts related to venture projects. These contracts typically are for feasibility studies, marketing studies, and accounting services. ARRC usually makes these contracts with professional firms or individuals they have had prior contract experience with.

ARRC has developed detailed contracting procedures for professional and technical services which were reviewed and approved by the Department of Administration's contract review committee. The procedures include provisions for pre-qualification of contractors, public advertising, proposal evaluations, final contract negotiations, and contract monitoring.

However, ARRC has not yet implemented these procedures. We recommend implementation of these procedures to provide all interested parties the opportunity to compete for ARRC contracts.

Recommendation No. 8

ARRC should ensure that all equity investment agreements provide an option for the dispossession of ARRC's interest within a specified time.

To provide for the repayment of ARRC's equity investment capital, contract provisions should provide options that permit ARRC, at its discretion, to divest itself from an equity position. Without such provisions, equity capital could be held indefinitely by investees.

A specific time frame should be designated in each equity agreement that does not unduly burden the financial stability of the projects but does enable ARRC to recover its capital within a reasonable time.

IV. The extent to which the board, commission or agency has encouraged interested persons to report to it concerning the effect of its regulations and decisions on the effectiveness of service, economy of service, and availability of service which it has provided.

ARRC has prepared a plain language question and answer brochure that explains their purpose and investment procedures and encourages interested potential applicants to contact ARRC.

However, our test of applicant files showed that ARRC did not always consider the preferences and priorities of the residents in the area where the project was located as required by AS 37.12.080(a)(3) (see Recommendation No. 6).

V. The extent to which the board, commission or agency has encouraged public participation in the making of its regulations and decisions.

All regular meetings of the Board of Trustees are advertised in major newspapers in the State.

VI. The efficiency with which public inquiries or complaints regarding the activities of the board, commission or agency filed with it, with the department to which a board or commission is administratively assigned, or with the office of the ombudsman have been processed and resolved.

The State Ombudsman's Office lists three complaints against ARRC. One was closed as being premature and the other two were closed because the complainant failed to provide additional information.

VII. The extent to which a board or commission which regulated entry into an occupation or profession has presented qualified applicants to serve the public.

Not applicable to ARRC.

VIII. The extent to which state personnel practices, including affirmative action requirements, have been complied with by the board, commission or agency tc its own activities and the area of activity or interest.

We found no evidence of problems in this area.

IX. <u>The extent to which statutory, regulatory, budgeting or other changes are necessary to enable the agency, board or commission to better serve the interests of the public and to comply with the factors enumerated in this subsection</u>.

Please refer to the previous section, Findings and Recommendations.

APPENDIXES

APPENDIX A

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF INVESTMENTS
as of September 30, 1981
(UNAUDITED)
(Note 1)

Investee	Location	Business	Equity	Outstanding Debt (Note 2)	Commitments (Note 3)	Total (Notes 4 & 5)
Fisheries						
Alaska Food Company	Kodiak	Seafood Processing	$ 500,000	$ 5,581,332	$ 48,668	$ 6,130,000
Icicle Seafoods	Various/Alaska	Seafood Processing	3,077,466	400,000	22,534	3,500,000
Martin Clark	Naknek	Seafood Processing	-0-	394,290	-0-	394,290
American Eagle Seafoods	Gulf of Alaska	Floating Processor	-0-	200,000	-0-	200,000
New Seward	Kenai Peninsula	Icicle Leaseback	150,000	1,282,500	-0-	1,432,500
Ball Brothers	Dillingham	Seafood Processing	500,000	3,650,000	-0-	4,150,000
Salamatof Seafoods	Kenai	Seafood Processing	300,000	3,161,833	1,500,000	4,961,833
Sea Fisher	Southeast Alaska	Floating Processor	-0-	150,000	-0-	150,000
Kokechik	Cape Romanzof	Herring Fishery	490	278,588	-0-	279,078
TEPA	Coos Bay, Oregon	Fish Meal Products	200,000	354,615	911,485	1,466,100
Seaward Shipyard	Ketchikan	Vessel Maintenance	150,000	48[illegible],[illegible]00	-0-	630,000
Pacific Boat and Barge	Eagle River	Boat Building	-0-	1[illegible],836	38,748	166,584
Trinity Resources	Kodiak	Fishing/Processing	255,000	296,048	-0-	551,048
Martin's Seafoods	Anchorage	Seafood Processing	-0-	454,719	-0-	454,719
Alaska F.I.S.H.	Soldotna/Homer/Kodiak	Fishing Gear/Supply	125,000	103,702	-0-	228,702
Alaska Bait Producers	Tenakee Inlet	Bait Herring	85,000	357,129	42,871	485,000
Sterling Seafoods	Gulf/Southeast	Floating Processor	100,000	1,112,341	1,225	1,213,566
Kachemak Seafoods	Togiak	Seafood Processing	-0-	250,000	-0-	250,000
Seafoods of Alaska	Sterling	Smoked Salmon	120,000	428,000	-0-	548,000
Smokwa Shell	Kodiak	Seafood Processing	-0-	-0-	500,000	500,000
Alaska Venture Corp.	Interior Alaska	Identify Projects	-0-	-0-	500,000	500,000
Chugach Fisheries	Cordova	Seafood Processing	-0-	-0-	1,500,000	1,500,000
Agriculture						
Wild Berry Confections	Anchorage	Confectionery	-0-	34,245	300,000	334,245
Anchor Renewable Farms	Anchor Point	Greenhouse/Produce	-0-	119,468	532	120,000
Great Land Farm	Palmer	Mushroom Farm	50,000	170,000	-0-	220,000
Peninsula Greenhouse	Kenai	Greenhouse/Produce	-0-	-0-	550,000	550,000
Rice Fur Farm	North Pole	Fox Farm	-0-	-0-	154,000	154,000
Arctic Farm and Garden	North Pole	Feed Mill	-0-	-0-	1,500,000	1,500,000
Alaska Venture Corp.	Interior Alaska	Identify Projects	-0-	-0-	200,000	200,000

(continued next page)

APPENDIX A

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF INVESTMENTS

as of September 30, 1981
(UNAUDITED)
(Note 1)

Investee	Location	Business	Equity	Outstanding Debt (Note 2)	Commitments (Note 3)	Total (Notes 4 & 5)
Timber						
Schnabel Lumber Co.	Haines	Waste Wood/Electricity	-0-	44,783	3,555,217	3,600,000
Alaska Timber Co.	Klawock	Waste Wood/Electricity	-0-	400,361	1,199,639	1,600,000
The Woodyard	Juneau	Firewood	-0-	39,167	11,970	51,137
Pine's Sawmill	Tok	Sawmill	-0-	16,500	-0-	16,500
Steik Enterprises	Anchor Point	Sawmill	-0-	55,000	-0-	55,000
Mastercraft/Alaskan Wood	Anchorage	Wood Furniture	200,000	315,000	-0-	515,000
Chugach Natives, Inc.	Montague Island	Timber Survey	-0-	35,000	-0-	35,000
Seaward Shipyard	Ketchikan	Vessel Maintenance	-0-	100,000	-0-	100,000
Wood's Trawlers	Anchor Point	Fiberglass Vessels	-0-	-0-	50,000	50,000
Other						
Renewable Gas Development Corporation	Homer	Home Wood Gasification	-0-	-0-	242,000	242,000
Alaska Venture Corp.	Interior Alaska	Identify Projects	-0-	-0-	300,000	300,000
Total			$5,812,956	$20,392,457	$13,128,889	$39,334,302

Note 1: The Schedule of Investments was prepared from ARRC records. The information contained in the schedule was not audited by us and accordingly, we do not express an opinion on it.

Note 2: The outstanding debt amounts consist of principal only and do not include accrued interest payable to ARRC.

Note 3: Commitments represent funds drawn out of Treasury but not yet disbursed to investees.

Note 4: The total investments include debt and equity financing and do not include grants, technical assistance or miscellaneous pledges.

Note 5: The following investees are in bankruptcy proceedings:

Salamatof Seafoods
Alaska Food Company
Pacific Boat and Barge
Martin's Seafoods

APPENDIX B

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF GRANTS
April 1, 1980 - September 30, 1981
(UNAUDITED)
(Note 1)

Grantee	Location	Purpose	Amount
Alaska Pacific University	Anchorage	Entrepreneurial chair	$100,000
Future Farmers of America	Palmer	Livestock auction	2,344
University of Alaska Fairbanks Cooperative Extension	Anchorage	Agricultural symposium	13,700
Trinity Resources Corp.	Kodiak	Bottomfish demonstration project	36,395
Longline Fishermen's Association	Southeast	Bottomfish marketing project	15,000
Alaska Council on Economic Education (Note 2)	Fairbanks	Promote free enterprise	5,000
Total			$172,439

Note 1: The Schedule of Grants was prepared from ARRC records. The information contained in the schedule was not audited by us and accordingly, we do not express an opinion on it.

Note 2: The grant to the Alaska Council on Economic Education was approved by the Board of Trustees on April 29, 1981 but is undisbursed as of September 30, 1981.

APPENDIX C

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF TECHNICAL ASSISTANCE
April 1, 1980 - September 30, 1981
(UNAUDITED)
(Note 1)

Investee	Location	Business	Amount Disbursed	Amount Committed (Note 2)	Total
Fisheries					
Pacific Barge and Boat	Eagle River	Boat Building	$ 4,000	$ -0-	$ 4,000
Kokechik	Cape Romanzof	Herring Fishery	6,841	25,000	31,840
Stoknavik	Cape Romanzof	Herring Fishery	215	-0-	215
Sea Fisher	Southeast Alaska	Floating Processor	1,930	50,000	51,930
SeaWard Shipyard	Ketchikan	Vessel Maintenance	3,668	50,000	53,668
Alaska Bait Producers	Tenakee Inlet	Bait Herring	7,201	25,000	32,201
Martin's Seafoods (Note 3)	Anchorage	Seafood Processing	10,000	25,000	35,000
Martin Clark	Naknek	Seafood Processing	25,612	-0-	25,612
Salamatof Seafoods	Kenai	Seafood Processing	6,751	100,000	106,751
Ball Brothers	Dillingham	Seafood Processing	18,612	35,000	53,612
Trinity Resources	Kodiak	Fishing/Processing	754	-0-	754
Sea Catch	Kenai	Seafood Processing	500	-0-	500
Flying Fish and Crab (Note 3)	Homer	Test Quik-Pik Machine	-0-	20,000	20,000
TEPA	Coos Bay, Oregon	Fish Meal Products	-0-	25,000	25,000
Sterling Seafoods	Gulf/Southeast	Floating Processor	-0-	25,000	25,000
Sadie Cove Boat (Note 3)	Kachemak Bay	Wood Boat Market Study	-0-	10,000	10,000
Bob Woodward (Note 3)	Kodiak	Sea Urchin Feasibility	-0-	35,000	35,000
Swokwa Shell	Kodiak	Seafood Processing	-0-	50,000	50,000
Kachemak Seafoods	Togiak	Seafood Processing	-0-	20,000	20,000
Seafoods of Alaska	Sterling	Smoked Salmon	-0-	30,000	30,000
Alaska Seafood Marketing Institute	Juneau	Seafood Marketing	41,993	-0-	41,993
Agriculture					
Alaska Mushroom	Anchorage	Market Study	225	-0-	225
Anchor Renewable Farms	Anchor Point	GreeProduce	1,411	-0-	1,411
Great Land Farms	Palmer	Mushroom Farm	-0-	20,000	20,000
WildBerry Confections	Anchorage	Confectionery	-0-	50,000	50,000
DeVanney	Aleutian Islands	Livestock Farm	-0-	50,000	50,000
Rice Fur Farm	North Pole	Fox Farm	-0-	25,000	25,000
Commercial Berry Farms	Palmer	Market Study	-0-	25,000	25,000

(continued next page)

APPENDIX C

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF TECHNICAL ASSISTANCE
April 1, 1980 - September 30, 1981
(UNAUDITED)

Investee	Location	Business	Amount Disbursed	Amount Committed (Note 2)	Total
Timber					
Pine's Sawmill	Tok	Sawmill	$ 1,359	$ -0-	$ 1,359
Mastercraft/Alaskan Wood	Anchorage	Wood Furniture	12,038	50,000	62,038
Schnabel Lumber Co.	Haines	Sawmill	12,543	150,000	162,543
Interior Village Assoc.	Fairbanks	Rural Development	6,600	-0-	6,600
The Woodyard	Juneau	Firewood	1,219	-0-	1,219
Kuskokwim Corp.	Upper Kuskokwim River	Timber Study	15,000	-0-	15,000
The Fitzsimmins (Note 3)	Interior Alaska	Firewood Study	-0-	25,000	25,000
Just Logs (Note 3)	McGrath	Log Market Study	-0-	10,000	10,000
Total			$178,472	$930,000	$1,108,472

Note 1: The Schedule of Technical Assistance was prepared from ARRC records. The information contained in the Schedule was not audited by us and accordingly, we do not express an opinion on it.

Note 2: Commitments represent funds drawn out of Treasury but not yet disbursed to applicants/investees.

Note 3: Amounts committed for these projects were subsequently returned to Treasury and will not be used.

APPENDIX D

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF OTHER USE OF FUNDS
as of September 30, 1981
(UNAUDITED)
(Note 1)

Investee	Location	Purpose	Amount
Pledged Assets and Guarantees			
Flying Fish and Crab	Homer	Damage deposit	$ 25,000
Pits Solar Home	Anchorage	Mortgage guarantee	120,000
Ball Brothers	Dillingham	Note guarantee	180,000
Seafoods of Alaska	Sterling	Note guarantee	500,000
Licensing Agreements			
Anchor Renewable Farms	Anchor Point	Royalty from sales	4,500
Alternative Energy Development Corporation	Anchorage	Royalty from sales	53,900
Total			$883,400

Note 1: The Schedule of Other Use of Funds was prepared from ARRC records. The information contained in the Schedule was not audited by us and accordingly, we do not express an opinion on it.

APPENDIX E

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
SCHEDULE OF DELINQUENT LOANS
April 1, 1980 - September 30, 1981
(UNAUDITED)
(Note 1)

Investee	Principal Balance	Principal Past Due	Due Date	Interest Balance	Interest Past Due	Due Date	Total Past Due
Alaska Food Company	$1,451,332	$ -0-	N/A	$ 84,132	$ 73,247	09/15/81	$ 73,247
Alaska Food Company	1,000,000	-0-	N/A	91,000	81,000	08/31/81	81,000
Alaska Food Company	2,000,000	-0-	N/A	295,528	262,056	08/31/81	262,056
American Eagle Seafoods	150,000	150,000	07/31/81	16,639	14,639	09/01/81	164,639
American Eagle Seafoods	50,000	50,000	09/01/81	644	644	09/01/81	50,644
Ball Brothers	150,000	150,000	07/31/81	5,528	5,528	07/31/81	155,528
Ball Brothers	350,000	350,000	07/31/81	12,306	12,306	07/31/81	362,306
Martin's Seafoods	454,719	-0-	N/A	26,636	20,600	09/01/81	20,600
Pacific Boat and Barge	91,455	91,455	10/30/80	8,363	8,363	10/30/80	99,818
Pacific Boat and Barge	36,381	36,381	07/31/80	931	931	07/31/80	37,312
Sea Fisher	150,000	-0-	N/A	10,374	7,551	09/01/81	7,551
Seafoods of Alaska	130,000	-0-	N/A	4,983	2,817	09/01/81	2,817
SeaWard Shipyard	210,000	210,000	03/05/81	7,245	7,245	03/05/81	217,245
SeaWard Shipyard	20,000	20,000	03/05/81	690	690	03/05/81	20,690
Trinity Resources	175,000	-0-	N/A	6,563	6,563	08/31/81	6,563
Trinity Resources	61,048	61,048	06/30/81	4,629	4,629	06/30/81	65,677
Trinity Resources	60,000	60,000	06/30/81	4,425	4,425	06/30/81	64,425
Great Land Farms	50,000	-0-	N/A	1,080	447	09/01/81	447
Steik Enterprises	55,000	-0-	N/A	2,530	1,705	09/01/81	1,705
The Woodyard	39,167	39,167	Unknown	4,598	4,598	Unknown	43,765
Alaska Timber Company	400,361	-0-	N/A	9,097	4,434	08/01/81	4,434
Total	$7,084,463	$1,218,051		$597,921	$524,418		$1,742,469

Note 1: The Schedule of Delinquent Loans was prepared from ARRC records. The information contained in the Schedule was not audited by us and accordingly, we do not express an opinion on it.

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K–STATE CAPITOL
JUNEAU, ALASKA 99811

465-3600

July 29, 1980

RECEIVED
JUL 30 1980
LEGISLATIVE AUDIT

Mr. Gerald R. Wilkerson, CPA
Division of Legislative Audit
Pouch W
Juneau, Alaska 99811

Re: ARRC spending and investment practices
Our file: J-66-792-80

Dear Mr. Wilkerson:

You have asked whether (1) the statutory limitation on the Alaska Renewable Resources Corporation's (ARRC's) investments in a company includes outright loans, (2) whether technical assistance funding can come from ARRC's capital budget, (3) whether applicants for that assistance must meet the same requirements as those imposed for financial assistance, (4) whether ARRC must receive a return on expenditures for technical assistance, and (5) whether ARRC or the Department of Revenue has ultimate authority and control over the investment of ARRC's surplus funds. We will answer each question in turn.

1. <u>The statutory limitation on ARRC's investments relates to equity investments and does not include loans</u>.

AS 37.12.080(b) provides in relevant part that the ARRC board may not

> invest in more than 49 percent of the outstanding corporate stock or other corporate obligations issued by an applicant . . . .

Given their plain meaning, the words "corporate obligations" would certainly include promissory notes, bonds, and any other liabilities of the applicant. However, "[t]he notion that because the words of a statute are plain, its meaning is also plain is merely pernicious oversimplification." United States v. Monia, 317 U.S. 424, 431 (1943)(Frankfurter, J., dissenting). This is especially true where, as here, we are dealing with a statute which is the apotheosis of imprecision.

If we look at the statute as a whole, it seems rather obvious that ARRC will routinely be holding all or almost all of the promissory notes issued by applicants. The very reason for ARRC's participation is the unavailability of regular financing. Ch. 179, § 2, SLA 1978, set out as a note preceeding AS 37.12.010. Hence, giving the words "other corporate obligations" their plain meaning would confound the very purpose for the legislature's passing the statute in the first place. Accordingly, we concur in the interpretation placed on this prohibition by the ARRC board, i.e., as being applicable only to equity interests in applicant corporations.

2. Funding of technical assistance can come from ARRC's so-called capital budget.

We do not doubt that, as an accounting rule, technical assistance expenses should be considered as operating expenses as opposed to capital expenses. The problem here, however, is that the legislature appropriates to the capital budget without regard for the niceties of that distinction. That is true not only of ARRC's budget but of the entire budget generally. Accordingly, the mere fact that money has been appropriated to ARRC in that part of the budget denominated as being for "capital projects" does not, in and of itself, make it unavailable for expenditure for what are usually categorized as operating expenses.

Given the highly generalized nature of the appropriation to ARRC for capital projects and the absence of any legal significance in the denomination in the budget of appropriations for "capital projects," there are no legal restraints on ARRC's expending the latter for technical assistance. As a statutory rule, ARRC's own administrative expenses are to be budgeted as its operating expenses. AS 37.12.095(b) provides: "The total amount of the corporation's operating budget shall be specified separately in its budget and appropriated from the general fund." The ARRC projects, which -- by force of this statutory exclusion -- necessarily include technical assistance, are then to be budgeted separately, presumably as capital projects. This is precisely what appears to have been done here. In the 1979 appropriations bill, ch. 80, SLA 1979, at page 115 of the 1979 Temporary and Special Acts, $638,000 is appropriated to ARRC from the general fund under the general denomination of "operating expenditures." Id., at 69. On page 164, some $32 million, broken down into resource categories, is appropriated from "other funds" to ARRC under the general denomination of "capital projects." Accordingly, this use of the funds has to be valid valid under both AS 37.12.095 and chapter 80, SLA 1979.

3. Technical assistance must be limited to entities which are qualified applicants for financial assistance.

As ARRC counsel points out, the statute does not generally lend itself to certainty. On this matter, it is as follows:

> The corporation may provide funding for technical and management advice and assistance to qualified applicants as it considers necessary in the circumstances.

AS 37.12.115(b)(emphasis added). The statute defines "applicant" as follows:

> 'applicant' means a person making application to the corporation for financial assistance . . . .

AS 37.12.125(1)(emphasis added). The term "qualified applicant" is not included within the definitions section of the statute, but in effect, is defined by those provisions of the statute which describe the requirements for financial assistance in AS 37.12.085, which states that "[a]n applicant is qualified if," he has submitted a proposal under AS 37.-12.080(a)(1), is a three-year resident, and has not been a failure on previous projects with the corporation.

Counsel for ARRC suggests that it may be necessary for some applicants to receive technical assistance before they can qualify in that they are not capable of submitting a proposal under AS 37.12.080(a)(1) without that assistance.

But the requirements of AS 37.12.080(a)(1) are not that technically difficult, and there can be little question that, as a practical matter, an unsophisticated applicant with a great idea would have no problem meeting the loose requirements of section 80(a)(1). After that has been done, the board can "provide funding for technical and management advice and assistance to qualified applicants as it considers necessary in the circumstances." AS 37.12.115(b).

4. There is no requirement that the board realize a return on money provided for technical assistance.

We concur with ARRC's counsel that the statute does not require ARRC to realize a return on money provided for technical assistance. We think that it is left to the sound discretion of ARRC's board to determine whether money so used must be repaid. The House Finance Committee stated that the money would be repaid. 1978 H. Jour. 832. But the discretionary language of the statute to the effect that the money so used "may form a part of a later investment," must be deemed to control.

5. The Department of Revenue has control over the investment of ARRC funds.

We have concluded that the establishment of the Alaska Renewable Resources Development Fund, AS 37.11.010 - 040, the Alaska Renewable Resources Investment (nee Permanent) Fund, AS 37.11.050 - 090, and the Alaska Economic Disaster Impact Fund, AS 37.11.100, is in conflict with the constitutional prohibition against dedicated funds and is, therefore, a nullity. */

The 1974 legislation establishing these funds and the introduction in 1975 of bills to establish still other special purpose funds led to an opinion from this office in which we concluded that mineral revenues are within the constitutional prohibition against dedicated funds. 1975 Op. Atty. Gen. No. 2; Alaska Const., art. IX, § 7. The opinion, in turn, led to the adoption of a constitutional amendment to provide for a single exception to allow the dedication of certain mineral revenues to the Alaska Permanent Fund. Under the maxim expressio unius est exclusio alterius, all other dedications are excluded from the exception. 2A SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 47.23 (4th Sands ed. 1973). In other words, the constitutional amendment providing for the Alaska Permanent Fund precludes the establishment of these funds.

The "allocation" of these same mineral receipts to ARRC under AS 37.12.020, which was adopted in 1978, is similarly a proscribed dedication which is equally unconstitutional and, therefore, likewise a nullity. Aside from the exceptions made by the constitution itself for dedicated funds, the only way that public money can be made available for ex-

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*/ We had previously opined that, taken as an accounting device rather than as a dedication, the original 1974 enactment might be valid. Informal Op. Atty. Gen. Oct. 12, 1977. The 1978 legislation and ARRC's interpretation of its intended effect compels us to come now to a contrary conclusion.

penditure is by an appropriation. Alaska Const., art. IX, § 13. Appropriations can be made solely in appropriation bills. Alaska Const., art. II, § 13.

According , ARRC funds consist solely of the money appropriated to ARRC by the legislature in appropriation bills, nothing more, and nothing less, the provisions of AS 37.12.020 to the contrary notwithstanding. As with all other instrumentalities of the state government, ARRC's appropriations remain in the treasury under the control of the Department of Revenue until they are to be used, except to the extent that the legislature has provided to the contrary. There is nothing in AS 37.12.010 - 125 which provides to the contrary and which also conforms to the constitution.

Sincerely yours,

WILSON L. CONDON
ATTORNEY GENERAL

By: Rodger W. Pegues
Rodger W. Pegues
Assistant Attorney General

RWP/pjg

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

MEMORANDUM State of Alaska

TO: Gerald L. Wilkerson
Legislative Auditor

DATE: April 1, 1981

FILE NO: J-66-412-81

TELEPHONE NO: 465-3600

FROM: WILSON L. CONDON
ATTORNEY GENERAL

By:
Rodger W. Pegues
Assistant Attorney General

SUBJECT: Constitutionality of the Renewable Resources Investment Fund

You have asked us for our views on the constitutionality of the Renewable Resources Investment Fund. In our view, it is unconstitutional.

The Legislative Counsel has opined to the contrary, relying in part on a plain-language interpretation of the constitution's provisions on dedicated funds. The Alaska Supreme Court has occasionally used a plain-language interpretation to determine the meaning of a statute E.g., Alaska Mines and Minerals, Inc. v. Alaska Industri Bd., 354 P.2d 376, 379 (Alaska 1960). But a literal inte retation of the words of a statute or constitution should not applied if it will frustrate the framers' obvious intent and if the words can reasonably be given a different construction. 2 A. Sutherland, STATUTES AND STATUTORY CONSTRUCTION, § 46.07 (4th Sands ed. 1973). And even where the court states that, when the law is plain, there is nothing left for interpretation, Alaska Public Employees' Ass'n v. State, 525 P.2d 12, 14, n. 14 (Alaska 1974), the court does, in fact, interpret it. There simply is no rule that forbids the use of aids in construing the meaning of a statute however clear the words may appear on superficial examination. Train v. Colorado Public Interest Research Group, Inc., 426 U.S. 1, 9-11 (1976). For that reason, resort should be had to the records of the Constitutional Convention where, as here, they provide substantial aid in ascertaining the meaning and purpose of the prohibition against dedicated funds. */

When resort is had to the record, there can be no

*/ As a practical matter, the Alaska Supreme Court has consistently resorted to the Minutes of the Constitutional Convention. The only question is how much weight it will give to the remarks of delegates.

Gerald Wilkerson - 2 - April 1, 1981

question that the convention intended to bar the dedication of oil and gas revenues. 1975 Op. Atty. Gen. No. 9. We will not repeat that opinion here. The Alaska Supreme Court has yet to rule whether that intent will be given its effect. It may or may not. But until it does rule, it is our view that the words "tax or license" in article IX, section 7, of the constitution are flexible enough, in context, to include all revenues, and that therefore, the framers' intent must be given effect.

Giving the language of section 7 that meaning not only accords with the undisputable intent of the framers but also with the obvious conclusion of the voters that an exception from the prohibition against dedicated funds should be made with respect to at least 25 percent of certain mineral revenues. By expressly making this exception, the amendment includes all remaining mineral revenues within the bounds of the prohibition. That is, by necessary implication, all other dedications of mineral revenues are prohibited. 2 A. Sutherland, STATUTES AND STATUTORY CONSTRUCTION § 47.23 (4th Sands ed. 1973).

Accordingly, under article IX, section 7, of the Alaska Constitution, the dedication of five percent of mineral revenues for a special purpose prescribed by AS 37.11.020 is unconstitutional and invalid on its face. The additional dedications of interest and of amounts remaining in the fund, AS 37.12.060, are equally unconstitutional and invalid.

The Legislative Counsel also opines that an amendment made to article IX, section 7 by the same amendment which established the Alaska Permanent Fund grandfathered in dedications made prior to that amendment. Thus, in his view, even if the dedication for renewable resources had been unconstitutional, it was validated by this amendment. However, the Legislative Counsel's view here is directly contradicted by the rules established for amending the constitution.

The applicable constitutional provision reads as follows:

> The lieutenant governor shall prepare a ballot title and proposition summarizing <u>each</u> proposed amendment, and shall place them on the ballot for the next general election. If a majority of the votes cast on <u>the</u> proposition favor <u>the</u> amendment, <u>it</u> shall be adopted.

Alaska Const., art. XIII, § 1 (emphasis added). */ The applicable statute adds: "Each amendment shall be confined to one subject." AS 15.50.010. Arguably, the constitution itself might not impose a single-subject requirement, but it probably does, and the statute clearly does. Moreover, both require that the subject not merely be disclosed but, in the language of the statute, be identified by "a true and impartial summary." Here, neither the single-subject nor the disclosure requirement was met. Each is discussed in turn.

Generally, the rules applicable to statutory construction apply as well to the provisions of a constitution. 16 C.J.S. Constitutional Law § 15 (1956). The rule with respect to subjects is that where a statute contains two or more subjects but only one is disclosed by the title, the subject which is disclosed will be given its effect and the undisclosed subjects contained in the statute are invalid and of no effect. 1A A. Sutherland, STATUTES AND STATUTORY CONSTRUCTION § 18.08 (4th Sands ed. 1972). Cf., Port of Longview v. Taxpayers of Port of Longview, 533 P.2d 128 (Wash. 1975)(summary of constitutional amendment).

In the instant case, the title of the resolution which proposed the amendment disclosed that it would establish "an Alaska Permanent Fund for certain proceeds derived from non-renewable resources." The clear implication is that a single fund is to be established. It says nothing about establishing additional dedicated funds, by validation of unconstitutional dedications. The title remained unchanged in the legislature, notwithstanding two significant but little noticed amendments to the proposed amendment.

One of these amendments changed the word "constitution" to the word "section" in the last line of section 7 of article IX of the constitution to provide - in what can only be characterized as by stealth and deception - for the continuation of dedications existing not when the constitution was ratified back in 1956 but when the amended section was ratified, i.e., to grandfather in all the unconstitutional dedications established by law between 1956 and 1976.

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*/ Constitutional provisions providing for the legislature to propose amendments are strictly construed. Moore v. Shanahan, 486 P.2d 506, 511 (Kan. 1971). Here, the use of the singular militates against a conjunction of amendments which are not by their nature interconnected.

Gerald Wilkerson - 4 - April 1, 1981

We have taken the position that this amendment was without any effect */ because (1) to be effective, it had to (but did not) make reference to the invalid legislation it sought to validate, Matthews v. Quiniton, 362 P.2d 932, 938-939 (Alaska 1961); Annot. 171 A.L.R. 1072 (1947); (2) its subject (object or purpose) was not disclosed by the title or ballot summary as required under the constitution, art. XIII, § 1, the law, AS 15.50.020, and recognized legal principles, 16 AM. JUR.2d Constitutional Law § 45 (1979); and (3) its subject, retrospective validation of diverse, invalid dedicated funds, was separate from and in addition to the purpose or object of establishing a new, singular dedicated fund, and therefore, required separate treatment. Alaska Const., art. XIII, § 1; AS 15.50.010. See Kerby v. Luhrs, 36 P.2d 549, 554 (Ariz. 1934); 94 A.L.R. 1502 (1935). **/

The Legislative Counsel assumes without discussion that, with the slight guidance provided by the voters' pamphlet and ballot summary, the average voter would notice the change in words and would be able to comprehend that the change from "constitution" to "section" means that the amendment necessarily ratified or validated theretofore unconstitutional dedicated funds. No basis is given for this assumption. None exists.

In reviewing HJR 39 for the governor, this office missed the change in words altogether, and the reviewer made no mention of it. The review letter was signed by Attorney General Gross after further review by Assistant Attorney General Peterson. Neither of them noticed the change of words either.

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*/ We took the position in the spring of 1979 when, nearly three years after its adoption, this amendment was first brought to our attention by Douglas Pope, its likely author. Until then, we -- like thousands of others -- had never noticed it!

**/ The second of the significant but littled noted amendments to HJR 39 added the phrase "unless otherwise provided by law" to the proposed section 15 of article IX to provide that income from the permanent fund would go into the general fund unless otherwise provided by law. The effect or purpose of this latter change was not disclosed by the title or body of the proposition or by the committee report on the resolution. 1976 H. Jour. 685.

Gerald Wilkerson - 5 - April 1, 1981

In writing supporting and opposing statements on the constitutional amendment for publication in the voters' pamphlet, neither the officers of the State Chamber of Commerce -- who must be credited with at least as much percipience as the average voter -- nor former Speaker of the House Tom Fink (likewise) indicated any awareness of the change of words and its purpose or effect. One would think that the latter, who opposed the amendment, would certainly have mentioned the all encompassing validation of unconstitutional dedications as an additional reason for voting no on the question. The only reasonable inference is that the change was not discerned.

The Cordova Times editorialized in favor of the proposition. Friday, Oct. 29, 1976. It understood that "[o]nly the interest on the fund could be used to run the government," but it showed no awareness of the possibility of the amendment's grandfathering in other dedicated funds, or at any rate, it made no mention of it. The Fairbanks Daily News-Miner lauded the establishment of the permanent fund. Wednesday, Nov. 3, 1976. It cautioned about possible "multi-billion dollar pit of political shenanigans to rival the worst union pension fund scandals," but made no mention of additional multi-million dollar dedicated funds for special purposes. Earlier, Friday, October 29, 1976, the News-Miner had editorialized for the fund's establishment in a lengthy, detailed examination of the proposed constitutional amendment. Not one mention was made of the change in words which would validate the theretofore unconstitutional dedications.

While the News-Miner's editors had obviously given the proposition on the permanent fund a lot of thought, there is not the least indication that they discerned the possibility that the amendment grandfathered in other dedicated funds.

The Anchorage Times editorial for Sunday, October 24, 1976, described the pluses and minuses - mainly the latter - of the proposed permanent fund at length. The editorial's tone is so obviously unfavorable that it is unreasonable to assume that, even though they understood that replacing the word "constitution" with "section" would result in validating theretofore unconstitutional dedicated funds, the Times editors ignored it. One can only infer that they (too) missed it altogether. No other reason explains their omitting it from their list of drawbacks in the proposed constitutional amendment.

Following the election, Anchorage lawyer and former legislator Joe Josephson wrote about the permanent fund in his weekly newspaper column. Anchorage Times, Tuesday, Nov. 9,

Gerald Wilkerson - 6 - April 1, 1981

1976. While he indicated concern for th[illegible] effect that the existence of the new dedicated fund might ha[illegible]e on Alaska's governmental finance policies, and thereby, on [illegible]its economy, nothing in the column indicated any understandin[illegible] that the amendment validated dozens of theretofore unconsti[illegible]utional dedicated funds for special purposes. In sum, non[illegible] of the state's keenest observers appears to have even notic[illegible]d the amendment to section 7 of article IX.

In Short v. State, 600 P.2d 20,[illegible] 22 n. 4 (Alaska 1979), the court stated that due process is deni[illegible]ed if the ballot proposition fails to adequately notify the v[illegible]ters of the proposition's subject matter. And there is no [illegible]uestion that the constitution requires a summary of each amer[illegible]dment to be placed on the ballot. Alaska Const., art. XIII, § [illegible]. It seems pretty obvious here, that the summary and other [illegible]information on the proposition did not in any way indicate t[illegible] persons who were interested and concerned that the effect [illegible]of replacing "constitution" with "section" was to grandfathe[illegible] in unspecified, numerous dedicated funds for special purpos[illegible]es which had theretofore been unconstitutional.

The courts agree that adequate [illegible]notice of the subject matter is mandatory. The summary of a b[illegible]llot proposition must inform the voters of as many of its feat[illegible]res as word limitations allow. E.g., Redden v. Meyers, 513 P.2d [illegible]767 (Ore. 1973); Bazett v. Myers, 508 P.2d 199 (Ore. 1973). It [illegible]hould have been simple enough for the draftsman of the ballot ti[illegible]tle and summary here to state the principal features of the p[illegible]oposition, i.e., that among other things it validated hitherto [illegible]invalid dedications. One can only infer that the summary's dr[illegible]ftsman omitted to do so because he did not know that this was [illegible]a feature of the proposition. */ This omission was by no mea[illegible]s minor. It simply is not enough to leave it to the voters to [illegible]nfer certain effects or consequences. The duty to summarize [illegible]equires that adequate notice be made. [illegible]undleaf v. Myers, 520 P[illegible].2d 438 441-442 (Ore. 1974); Short v. State, 600 P.2d 20, 22, n[illegible]. 4, 25, n. 15 (Alaska 1979) (dicta). The failure to include the [illegible] purpose or object of the amendment in the summary excludes it [illegible]from the scope of the amendment. Port of Longview v. Taxpayers [illegible] of Port of Longview, 533 P.2d 128 (Wash. 1975).

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*/ In this instance, this office drafte[illegible] the summary. The proposed summary was reviewed by the lieute[illegible]ant governor's assistants and the director of elections. No[illegible]e caught the omission, i.e., no one noticed the change in words[illegible]

As regards separate subjects, the rule in this jurisdiction is liberal with respect to their inclusion in single measures. Short v. State, supra; Gellert v. State, 522 P.2d 1120 (Alaska 1974); Suber v. Alaska State Bond Committee, 414 P.2d 546 (Alaska 1966). It will be rare, indeed for our court to overturn any measure on the single-subject rule. */ Nevertheless, this might well be the one.

While both amendments are obviously parts of a broader single subject, i.e., dedicated funds, and therefore related, each is also separate with respect to its object and purpose. Joining the two in a single proposition deprives "the voter of his or her liberty of choice, forcing acceptance of an objectionable proposition by coupling it with an unrelated meritorious objective which the voter earnestly wants to support." Short v. State, 600 P.2d 20, 25 (Alaska 1979). In Short, the court held that coupling correctional facilities with public safety facilities in a single bond proposition was valid. Here, it would have to find that coupling the establishment of the uniquely popular permanent fund with validation of the previously established and unknown number of unconstitutional dedicated funds is valid. The comprehensive construction programs which underlay the decision in Gellert and Short and the "inextricably intertwined" taxation which underlay the decision in North Slope Borough v. Sohio Petroleum Corp., 585 P.2d 534, 545 (Alaska 1978), are missing here. There is neither a comprehensive plan nor an inextricable interrelation here. There is a rider, the very evil the rule described in Short is designed to preclude. 1A A. Sutherland, STATUTES AND STATUTORY CONSTRUCTION § 17.01 (4th Sands ed. 1972). Accordingly, the additional amendment violates the single-subject rule.

Accordingly, because the replacement of "constitution" with "section" in article IX, section 7, of the Alaska Constitution was not mentioned in the title of the resolution which proposed the amendment and was not made known to the voters and because conjoining it in the same ballot proposition as the establishment of the Alaska Permanent Fund violated the

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*/ The single-subject rule is applied to propositions for constitutional amendments by AS 15.50.010. Had this office perceived that the amendment contained two subjects, it would have placed each on the ballot separately in accordance with AS 15.-50.010 and the precise language of article XIII, section 1, of the constitution.

single-subject rule, it is a nullity and of no force or effect. The dedication of revenues for renewable resources was and is invalid.

RWP/pjg

cc: Honorable Thomas K. Williams
Commissioner
Department of Revenue

Ronald D. Lehr, Director
Division of Budget & Management
Office of the Governor

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

MEMORANDUM State of Alaska

TO: Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

DATE: November 2, 1981

FILE NO: J-66-058-82

TELEPHONE NO: 465-3600

RECEIVED
1981
LEGISLATIVE
AUDIT

FROM: WILSON L. CONDON
ATTORNEY GENERAL

By: Leslie J. Ludtke
Assistant Attorney General

SUBJECT: Audit of ARRC

You have asked this department's advice concerning four issues which have arisen in your audit of the Alaska Renewable Resources Corporation (ARRC). The questions raised by your audit are:

1. Did ARRC have authority to expend repaid principal from previous loans made?

2. Did ARRC have authority to expend funds appropriated by Chapter 33, SLA 1980 after January 31, 1981?

3. Did ARRC have authority to expend funds for post-investment technical assistance?

4. May an ARRC Trustee serve on the Board of Directors of an ARRC investee?

We will answer each question in turn.

1. ARRC may not expend funds except as appropriated by the legislature.

AS 37.12.095 provides that the corporation (ARRC) may expend money only as appropriated by the legislature. This provision is constitutionally mandated by Article IX, § 13 of the Alaska Constitution which allows money to be withdrawn from the treasury only by legislative appropriation. We have already advised your office that ARRC funds consist solely of the money appropriated to ARRC by the legislature in appropriation bills. (Formal opinion of the Attorney General, 7/29/80). No legislative appropriation has been made to ARRC which would allow the expenditure of the repaid principal from previous loans. Any expenditure of those funds therefore violates AS 37.12.095.

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

November 2, 1981
Page 2

2. ARRC may not expend funds appropriated by Chapter 33, SLA 1980 after January 31, 1981.

Section of FCCSSB 140 created the commercial fish purchasers assistance fund and provided for the administration of this fund by the board of trustees of ARRC. However, Section 4 of the same bill repealed the commercial fish purchasers assistance fund on January 31, 1981. Section 1 of FCCSSB 22, the appropriation bill which accompanied FCCSSB 140, appropriated the sum of $15,000,000 to this fund. The lapse date of this appropriation was June 30, 1981. It is clear that the difference in lapse dates between the act creating the fund and the appropriation bill creates a problem as to where the appropriation can be deposited after the fund is repealed.

In previous opinions, we have advised that if no fund is in existence to receive the specific appropriation from the general fund, (Informal opinion of the Attorney General 6/8/77) the funds must remain in the general fund. Similarly in order to expend an appropriation, the agency must have both the power to expend the money and must have the money itself. In this instance, ARRC has the money but it does not have the power to expend it. Therefore, because the legislature has not conferred the power upon ARRC to expend funds after January 31, 1981 to assist comercial fish purchasers, no funds appropriated for that purpose may be expended for that purpose after that date. Therefore, the unencumbered balance of the appropriation must lapse.

3. ARRC may expend funds for post-investment technical assistance.

AS 37.12.115(b) provides that ARRC may provide funding for "technical and management advice and assistance to qualified applicants as it considers necessary in the circumstances." The fact that the "qualified applicant" must have submitted a marketing plan under AS 37.12.085(1), does not preclude further funding for marketing studies or technical advice if ARRC considers that funding "necessary in the circumstances." In our formal opinion to your office on July 29, 1980 we advised you that the ARRC board may provide this type of assistance to qualified applicants where it considers the assistance necessary.

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

Gerald L. Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit

November 2, 1981
Page 3

4. An ARRC trustee who also serves on the Board of Directors of an ARRC investee may not vote on or participate in discussions concerning matters in which ARRC has a financial interest.

AS 37.12.065 specifically addresses the question you have raised in your request for advice. Apparently, an ARRC trustee was at the time of investment and is now a member of the board of trustees of an ARRC investee. AS 37.12.065 does not prohibit an ARRC trustee from maintaining such an interest, provided that that interest was acquired before the investment was made. In relevant part, 37.12.065 provides

> If a member or employee owns or controls such an interest, he shall immediately disclose the interest in writing to the board and refrain from participating in any manner in any activity relating to that interest.

This statute prohibits the board member from participating in activities affecting this interest either in the capacity of an ARRC trustee or as a board member of the corporation in which ARRC has an interest. In several previous opinions we have concluded that public officials may not participate in any manner in matters in which they have a financial interest. (Informal opinions of the Attorney General, 7/12/63, 3/5/81.) This same rule should be strictly applied to members of the ARRC board. Because of the peculiar quasi-governmental nature of their position, ARRC board members should be particularly cautious with respect to even an appearance of a conflict. In this instance, the ARRC board member should refrain from all discussions of the investment and any vote related to the investment.

LJL:vrb

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

OFFICE OF THE ATTORNEY GENERAL

POUCH K – STATE CAPITOL
JUNEAU, ALASKA 99811
PHONE: (907) 465-3600

December 17, 1981

RECEIVED
DEC 28 1981
LEGISLATIVE AUDIT

Gerald Wilkerson, CPA
Legislative Auditor
Division of Legislative Audit
Pouch W
Alaska Office Building
Juneau, Alaska 99811

Dear Mr. Wilkerson:

You have requested this department's advice regarding whether an Alaska Renewable Resources Corporation (ARRC) Trustee or employee may serve as a voting director on the board of an ARRC investee. We think that AS 37.12.080(b)(4) clearly prohibits ARRC from placing an employee or trustee on an investee's board for the purpose of exercising voting rights on matters relating to the management of the investee.

AS 37.12.080(b)(4) provides that ARRC may not "assume responsibility for management of any project in which it has invested and may not exercise voting rights for that purpose or for any other purpose which is within the scope of managerial control." This section absolutely prohibits exercising voting rights for any purpose "which is within the scope of managerial control." Under AS 10.05.174, the position of a director of a corporation is functionally defined to include management of the business and affairs of the corporation. Therefore, any exercise of voting rights by an ARRC Trustee or employee would necessarily be for a purpose which is within the scope of managerial control.

The only exceptions to this prohibition against voting as a member of the board of an ARRC investee are provided in AS 37.12.080(c). This section allows the ARRC board to take any action which it deems necessary to protect its investment. However, before the ARRC board may act under AS 37.12.085(c), it must find that actual circumstances or events threaten the

DEPARTMENT OF REVENUE
ALASKA RENEWABLE RESOURCES CORPORATION
ATTORNEY GENERAL OPINIONS

Gerald Wilkerson, CPA
Legislative Auditor

December 17, 1981
Page 2

investment. In the situation you have described in your opinion request, no circumstances exist which warrant extraordinary action under AS 37.12.085(c). We, therefore, conclude that if an ARRC trustee or employee is a director of an ARRC investee, that trustee or employee may not vote as a director of the ARRC investee.

Sincerely,

WILSON L. CONDON
ATTORNEY GENERAL

By:
Leslie J. Ludtke
Assistant Attorney General

LJL:vrb

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Renewable
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Corporation

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RECEIVED
JAN 11 1982
LEGISLATIVE
AUDIT

January 6, 1982

Gerald L. Wilkerson, Auditor
Budget and Audit Committee
Division of Legislative Audit
Pouch W
Juneau, Alaska 99811

Dear Mr. Wilkerson:

Thank you for the opportunity to respond to the audit recommendations in your Preliminary Review. We appreciate the time you have spent in analysing our activities.

For the most part, items 2, 3, 4, and 5 are matters which have been the subject of continuing debate and legal analysis since the beginning of our brief history. Responses to these items are unlikely to be surprising to you as they have been discussed at length in the course of the audit. Items 6 and 7 are operating matters which are discussed and for which remedial action is suggested. Item 8 is a policy matter which the Board feels is its prerogative to decide under the legislation. Although your basis for making the recommendation is understandable, we feel it does not take into account the practical realities of certain types of investments.

Recommendation No. 1 suggests that certain alternatives to the ARRC statute be considered. Although the Board is in agreement that changes are desirable, or even necessary, the alternatives it would suggest if asked, and the reasons therefore, would be very different from the ones offered in the letter.

<u>Policy approaches</u>

As general comment, the Board sees the overall audit as fair comment on a complex piece of legislation set in an extremely volatile practical and political landscape. On the other hand, since the document may stand as the only legislatively developed comment of substance for the legislature to consider in ARRC's sunset year, we had hoped perhaps for more detail and depth. It may be that such matters were outside the scope of the audit or, justifiably, the Division may have determined that it was ill equipped to consider the economic and industry-wide issues and data needed to make a thorough evaluation.

A leading authority on development finance has recently described the original basic concept of ARRC as "...one of the most innovative and creative ideas in development finance in the Western Hemisphere."* Such enthusiasm is not generated by the simple fact that the Corporation has the ability to provide equity financing, as the audit seems to suggest, but rather because it represents major a commitment to a number of specific premises in the field of development financing. Substantial resources are assigned to bottom up, enterprise development, pursuant to specific economy-wide goals, and yet the audit seems to characterize the ARRC, and the recommended successor organizations, as something akin to a midrange Small Business Investment Corporation. Thus, "venture capital financing", which is referred to repeatedly in the audit, represents only a small portion of the mature organization's function and investment program.

We note some tendency in the letter to base recommendations on abstract possibilities or literal readings of the statute rather than on the actual operation of the statute or its applied implementation. Without question, the Act is long and complex and, as well, has nuances and ambiguities, as most statutes do, which could be given various interpretations. There is much that could have happened and priorities could have been established and readings made in different ways by different persons or circumstances. But the purpose of a performance audit, as opposed to a critique of legislation, is to evaluate what did happen. The Act no longer stands alone as a

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* Belden Hull Daniels in a report to Senator Pat Rodey, Chair, Senate Interim Banking Committee, November 11, 1981.

speculative abstraction, but has been in the process of implementation for three years or more. There are particular events and personalities attached to the law; it has a history, a portfolio and a daily existence. It has established certain priorities and has taken some paths while avoiding others.

A critique which departs from a legalistic point of view is not as misleading as the narrowness referred to above, however, it lends a certain confusion to the audit, raises questions that are not really questions, and makes some recommendations less substantial than they could have been. An example would be the objection that ARRC's capitalization is a constitutionally prohibited "dedicated fund" as suggested on page 3 and in Recommendation No. 2. This is, as a practical matter, a non-issue.

Response to Recommendation No. 1

AGREE.

The letter states that ARRC should not continue to exist in its present form under the existing statutes. Support for this recommendation is that the enabling legislation lacks sufficient guidance and direction for the Board, and, that the structure and the statutes "...do not provide an efficient or economical use of the corporation's resources." Unfortunately these assertions are not supported by explanation, examples, or analysis which could be rebutted or explained.

It is not possible in our view to evaluate actual performance or to consider design alternatives without reference to a particular mission, strategies and standards of performance. The identification and characterization of the problems to be solved will dictate, to a very large extent, the preferred design of any organization established to solve them. In short, effectiveness requires that form must follow function. In this regard it is suggested that too little has been understood of the functions sought to be filled by an economic development entity such as ARRC. As a result we fear that the omission has lead to unwarranted conclusions, about ARRC's actual performance and, as well, to premature recommendations for a successor organization.

At the outset, a distinction must be made between legislative direction, as actually set forth in the statute, and the direction that various parties--legislative, executive and public--thought such an effort should take after the implementation had begun. Popular wisdom to the contrary, read as a whole, the ARRC legislation provides, or at the very least can be read to provide, very substantial guidance and direction. When analyzed, most objections to ARRC's activities were not to the effect that it didn't have direction, but that people didn't like the direction; they said they wanted or expected something different. The causes for this situation were various, but a root cause can be traced to the facts that (1) the provisions of the law were never publicized and debated prior to passage, and, (2) that passage was obtained without first securing the basic consensus it needed to get the company enough breathing space to get started.

Incidents illustrating this point are too numerous to list, but their cumulative effect was fatal to the organization. The ink was not yet dry on the Trustee appointment letters before a bill was introduced by the administration to usurp the first year's capitalization to clear land for the Barley project at Delta. The legislature held the company hostage, i.e., as interhouse trading stock, two sessions running, and in addition, plopped a 15 million dollar/one month operating problem (Emergency fish fund) on the company in its first year of investment. When pressed, bankers and others in the private sector approved "the concept" (as well they might since it was perhaps the most pro-private sector bill ever passed by the legislature) but not only failed to express their approval in any important way but were privately critical.

These examples are given not as any sort of excuse or rationalization but to serve notice of the extremely important nature of "bringing everyone along" if a successor organization is being contemplated. Likewise, and nearly as important, the very many excellent features of the ARRC should not be summarily tossed out simply because the Corporation is perceived as a political failure. With skillful consensus building and a few important legislative changes, ARRC, or an ARRC-like organization, can provide leadership and a national model for the most innovative, exciting and successful development financing in the United States.

Such a model will not be created, however, by the deepened control, reduced scope and limited nature of an organization recommended by the letter. In fact, one would have to seriously question, in spite of the substantial need for any source of equity financing in the Alaska economy, whether there is value at all in a "state agency" or "loan program" which is run by bureaucrats and/or part time volunteers, subject to annual appropriations, the Executive Budget Act and contracting procedures, and having limited latitude in its ability to structure deals. Such an approach not only ignores the ARRC experience, which was exactly the opposite, but the experience of every other similar fund established in the United States, public or private.

ARRC's difficulties in operating have not flowed from a lack of accountability or control--we have had legislative auditors actually sitting in our offices for about half of our operating existence. On the contrary, the difficulties have arisen from too much control and too much accessability. Had the legislature, for instance, actually cut off ARRC's operations with less than two weeks notice, as it nearly did last session, and set adrift a 40-some-odd million dollar portfolio, it would have resulted in an embarrassment of national proportions. This does not say that the legislature would not be entitled, or even justified, in doing so. It merely points up that a credible, effective financing institution which asks people to put their life's work in its hands must be insulated from short term political change no matter how justified it may seem.

Thus the Board would not only recommend that any amended ARRC or future organization not only be freed from the requirements of the Executive Budget Act, but that it be freed from the annual appropriations problem by being endowed with capitalization in the form of a fund, established all at once, or contributed to over time. Of the 400 or so equity wielding investment firms in the United States, all have such a character.

It is further recommended that considerably more thought be given to the advantages and disadvantages of various structural options when the organization's mission and functions are more fully described. Much confidence has been expressed, for instance, in the establishment of a public board, although no reasons for this have been given. (Indeed, no reasons have been given as to why the existing organization is insufficient, although the trustees themselves have noted some limitations.)

A part time public board is ordinarily used as a political buffer and as a bridge to the public of some government function. Both elements are necessary to an ARRC-like organization. It is difficult, however, to think of a volunteer, part time board which has, on its own, developed, or even overseen, an important overall policy, replete with necessary strategies, implementation objectives, and management oversight. Neither are part time boards suited to making and maintaining complex individual investment decisions. They are notorious for being the captives of their executive directors and are more likely than most to indulge in log rolling and vote trading based on economic, geographic or other external consideration. When investment decisions must be based on subjective and personal elements, strategic considerations, and solid technical analysis, the success of a part time public board would be a rare accident. Odds for its failure, or even scandal, would be high.

Trustee Spear has made the subject of organizational structure a part of a draft paper concerned with legislative design considerations if more discussion on this topic is desired. He has argued for a hybrid board of four public part time members and three full time trustees as are presently provided. The structure not only provides avenues to the private sector, buffering and public access but provides continuity, expertise and attention as well as protection against the inherent instability and fragile nature of the triumver.

Recommendation No. 2

The Legislature should consider the repeal of AS 37.11.010-090 and AS 37.12.020.

DISAGREE.

Corporate counsel has been requested to review his opinion on the statutes cited in this recommendation, and he has informed us that he stands behind that opinion, a copy of which is attached. See the February 20, 1980 opinion entitled "Stewardship of the Renewable Resources Fund." It is not clear what cash management and investment practices are found lacking by the auditor.

Recommendation No. 3

ARRC should discontinue expending repaid principal from previous loans.

DISAGREE.

This practice is supported by the opinion of corporate counsel; he stands behind that opinion, a copy of which is attached. See the December 2, 1980 opinion entitled "Reinvestment of Returned Investment Principal and Accounting Procedures." Reinvestment of returned principal is permitted by ARRC's enabling legislation.

Recommendation No. 4

ARRC's funds should be deposited with and invested through the Treasury Division of the Department of Revenue.

DISAGREE.

Again, see the two opinions of counsel attached, dated February 20, 1980 and December 2, 1980. ARRC's enabling legislation gives it responsibility for capital budget appropriations to it. ARRC's enabling legislation also provides for reinvestment of returned investment principal. That legislation does not, however, provide for reinvestment of earnings on investments. To the extent that ARRC's investment practices are in accord with those principles, the corporation's practices are supported by opinion of counsel.

Recommendation No. 5

ARRC trustees and employees should immediately resign from positions on the Board of Directors of ARRC Investees.

DISAGREE.

ARRC trustees and employees have from time to time been placed on investees' boards. ARRC requested and received an opinion of counsel on this practice, a copy of which is attached. See the opinion dated June 28, 1981 entitled "Trustees on Investees' Boards." ARRC has adopted this practice as a policy matter. Clearly, ARRC must maintain a careful watch over recipients of ARRC funding. The only truly effective way to monitor investments is by placing ARRC representatives on the investees' boards. In the commercial world, to do otherwise would be highly unusual; indeed, the failure of an investor to follow that course could very well be deemed to be less than prudent according to normal investment practices. It is the trustees' collective opinion that the policy is a sound one. To the extent that it is not permitted by ARRC's enabling legislation, the legislation should be changed.

Recommendation No. 6

ARRC should improve the documentation of its analysis of applications for financial assistance.

AGREE.

The staff throughout the past eighteen months has been developing, modifying and improving its practices and procedures with respect to documentation of investments.

The nine of 32 application files not evidencing written findings merely received conditional approval for financial assistance, subject to further review of financing plans and findings in the affirmative in accordance with AS 37.12.80(a), as was reuqired to obligate FY81 appropriated capital prior to year-end.

There are no excuses for the incompleteness of other applicant files. Immediate steps will be taken to assure the appropriate documentation of each portfolio company.

Recommendation No. 7

ARRC should implement procedures that provide public competition for technical assistance contract.

AGREE.

Final approval for the procedure was obtained from the Department of Administration in July, 1981. ARRC will begin implementation of its sequential elements in January, with completion of the first cycly of activity estimated to require 90 days.

Recommendation No. 8

DISAGREE.

ARRC has buy/sell provisions in several of its investment agreements, and has attempted during negotiations of investment terms to arrive at buy/sell provisions in all equity investments it has made. It should be understood that buy/sell provisions effectively place a ceiling on ARRC's return. Prospective investees have frequently regarded the 25 to 30% return expectation proposed by ARRC as unacceptably high, and have themselves elected not to include buy/sell formulas in final documents. It would, of course, be imprudent for ARRC to agree to return ceilings which fail to offer the prospect of rewards commensurate to risks taken.

As to the timing for the execution of stock options, all investment documents contain provisions attesting to ARRC's willingness to negotiate the sale of its interest at any time.

Thank you for your consideration of these comments.

Sincerely,

Wm Spear

William E. Spear
Trustee

AGRICULTURE

I

MEMORANDUM
TO: COCHAIRMEN GARDINER
ZHAROFF
FROM: JOHN SUND
DATE: MARCH 23, 1981
RE: AQUACULTURE HEARINGS

The committee has schedule hearings to be held on fisheries enhancement and rehabilitation and aquaculture for March 23 and 24. The basic outline of the hearings is as follows.

1.0 Monday 3 to 5 pm.

3-4. Overview of the state programs. Bob Roys, director of FRED will present the states program. Because the time is very limited the presentation will be very brief. Any detail of specific programs will be offered in response to questions from the committee.

4-5. Overview of the private not-for-profit program; AS 16.10.375-600 and AS 43.76. This program includes regional associations and individually owned not-for-profit corporations. There are five regional associations and the testimony will be offered in a panel approach to avoid repetition. They will review the history of the program, its current status and proposals for the future. The panel will consist of the following:

.1 Ron Wendte: Southern Southeast Regional Aquaculture Association: Ketchikan
.2 Derek Poon: Northern Southeast Regional Aquaculture Association: Sitka/Juneau
.3 Armin Koernig: Prince William Sound Aquaculture Association: Cordova
.4 Floyd Heimbuck: Cook Inlet Regional Aquaculture Association: Kenai
.5 Paul McCollum: Lower Yukon/Kuskokwim Aquaculture Association: Bethel

There are several individually owned not-for-profit aquaculture associations in the program. They are listed in the attachments. The problems they face are substantially the same as the regional associations although they do not have access to the resources of the regionals. Also there are actually and potential conflict areas between the regional associations and the individually owned corporations. The following will testify on their behalf:

.6 Ladd MacCauley: Douglas Island Pink and Chum Corp. Juneau

MEMORANDUM

TO: HOUSE RESOURCES COMMITTEE MEMBERS
FROM: COMMITTEE COUNSEL JOHN SUND
DATE: MARCH 23, 1981
RE: PACKET MATERIAL FOR AQUACULTURE HEAR[illegible]

The attached material consists of the following:

NECESSARY FOR THE ACTUAL HEARINGS

(1) Memorandum dated 3/23 to the committee cochairmen from Sund outlining the Monday hearings. One page.

(2) Memorandum dated 3/23 to the committee cochairmen from Sund outlining the Tuesday hearings and summarizing the issues. Five pages.

BACKGROUND MATERIAL: LEADING TO THE HEARINGS.

(3) Memorandum dated 2/27 to all interested parties from committee cochairmen requesting written response to various issues relating to aquaculture as outlined in an attached memorandum.

(4) Responses to the 2/27 letter from the following participants:
Southern Southeast Regional Aquaculture Association
Northern Southeast Regional Aquaculture Association
Cook Inlet Aquaculture Association
Lower Yukon/Kuskokwim Aquaculture Association
Department of Commerce and Economic Development
Governor's Office
Kodiak Area Native Association

(5) Department of Fish and Game; FRED; Fish Marking, Recovery And Evaluation Program.

BACKGROUND MATERIAL: AQUACULTURE

(6) "The Miller Report;" Analysis of Selected Elements of the Alaska Salmon Resource Development Program. A Report to the Aquaculture Policy Study Group of the Alaska Legislature. By Wally Miller; Leonard Lane; Bill Wilkerson.

MEMORANDUM

TO: COCHAIRMEN GARDINER
ZHAROFF

FROM: JOHN SUND

DATE: MARCH 23. 1981

RE: AQUACULTURE HEARINGS MARCH 24. 1981

The aquaculture hearings for Tuesday March 24 will focus on the issues which are creating the most difficulty at this time. The regional association representatives and the director of FRED met on Friday, March 20, 1981 with Committee Counsel Sund in preparation for these hearings. At that meeting many of the current issues were discussed. Because of the time constraints of the committee and that only 2 hours were available the following issues were determined to be the most important.

POSSIBLE COMMITTEE ACTION

There are four possible reasons for the committee to have these hearings and three possible actions that can be taken:

.1 Statutory change; bill required;
.2 Policy direction; resolution required;
.3 Budgetary matter; committee letter to finance committee;
.4 Information;

The action that the participants request the committee to consider are listed as the issues are summarized.

ISSUES FOR COMMITTEE ACTION

Summaries of the following issues are attached. One page of summary for each issue. The issue is appropriately numbered and titled at the top of the page. Further detail is provided in each members files.

1.0 FINANCING.
    .1 statutory changes
    .2 appropriation bill
    .3 recommendation to finance committee
2.0 BROODSTOCK POLICY
    .1 policy issue; possible resolution
3.0 FISH MARKING, RECOVERY AND EVALUATION
    .1 recommendation to finance committee
4.0 REGIONAL PLANNING
    .1 statutory changes
    .2 recommendation to finance committee