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Report on State Bonds for Small Scale Local Energy Project Loan Fund (State Measure No. 3)

City Club of Portland (Portland, Or.)
REPORT ON
STATE BONDS FOR SMALL SCALE
LOCAL ENERGY PROJECT LOAN FUND
(STATE MEASURE NO. 3)

PURPOSE: “Constitutional amendment would authorize state to sell bonds, backed by state credit, up to one-half of one percent of value of taxable property in Oregon, to create a loan fund to finance small scale local energy projects. All loans from fund must be secured. If loan repayments are not enough to repay debt, measure requires annual levy on property in Oregon, or other funds made available by legislature, to repay bond principal and interest.”

To the Board of Governors
The City Club of Portland:

I. INTRODUCTION

Your Committee was appointed to report on State Ballot Measure No. 3 which would amend the Oregon Constitution by adding Article XI-J. The proposed amendment was referred to the voters by Senate Joint Resolution 24 of the 1979 Legislature. If the proposed amendment (“Amendment”) is adopted, legislation already enacted by the Legislature will become effective which creates the Small Scale Local Energy Loan Program (Chapter 672, Or. Laws 1979) (“Act”).

Article XI, Sec. 7 of the Oregon Constitution prohibits the Legislature from creating any substantial debt of the State. Authorization of a significant bond issue therefore requires a constitutional amendment. This has been done in the past for various purposes, as expressed in Articles XI-A through XI-I.

Because the Amendment and the Act are intertwined, your Committee considered it appropriate to study and report on both.

A. THE AMENDMENT

Ballot Measure No. 3 would amend the Oregon Constitution in the following major respects:

1. To enact Article XI-J permitting the State’s credit to be loaned and indebtedness incurred to create the Small Scale Local Energy Project Loan Fund. This fund is to be used to finance loans to develop “small scale local energy projects.”

2. To empower the State to borrow up to one-half of one percent of the true cash value of all taxable property in the State to provide funds with which to carry out the purposes of the Amendment.

3. To provide for ad valorem taxes to be levied annually in a sufficient amount to provide for payment of the bonds issued, and to permit the Legislature to provide other revenues to supplement or replace the tax levies.1

4. To require the Legislature to enact legislation to carry out the Amendment.

1The Act is an exercise by the Legislature of its option to provide other revenues to supplement or replace tax levies. Under the Act, the primary source of funds for payment of the bonds issued is loan repayment. If the Act is properly administered, no tax levies should be required.
B. THE ACT

Should Ballot Measure No. 3 be approved by the voters, the implementing legislation provides as follows:

1. Any individual, small business, non-profit cooperative or corporation, or municipal corporation may apply to obtain loan funds for a small scale local energy project.

2. “Small scale local energy project” is defined as “any system, mechanism, or series of mechanisms located in Oregon that uses renewable resources including, but not limited to, solar, wind, geothermal, bio-mass, waste heat or water resources to supply energy including heat, electricity and substitute fuels to meet a local community or regional energy need in this state.”

3. Written applications are to be made to the Oregon Department of Energy (DOE). Applicants must pay an application fee of the lesser of $100.00 or 1% of the amount of the loan applied for, and the DOE must charge the applicant for any additional costs incurred in connection with the application.

4. The DOE director must appoint a seven-member Small Scale Local Energy Project Advisory Committee (“Advisory Committee”) to review applications and rules adopted by the DOE, and to make recommendations thereon. Members of the Advisory Committee are to represent the citizens’ interests and to be knowledgeable in small scale energy technology, natural resource development, environmental protection, finance, agriculture, local government operations and utility operations. At least three members must reside outside the Willamette Valley.

5. The director is charged with administration of the loan fund. After consultation with the Advisory Committee, the director is to establish standards and criteria (“Rules”) for projects to be funded. The Rules are required to encourage diversity in projects funded, give preference to projects proposed by individuals and small businesses, assure acceptability of environmental impacts, and require consideration of the potential contribution of the project to meeting the State's energy needs if developed at other suitable locations.

6. Initial review of applications is made by the DOE staff which recommends approval or denial and the loan amount. The applications are referred to the Advisory Committee for review. The Advisory Committee then refers the application to the director for a final decision.

7. The director's decision must be based on findings that:
   a. The project meets the established standards and criteria;
   b. The project is consistent with preservation and enhancement of environmental quality;
   c. The project is feasible;
   d. The plan for development of the project is satisfactory;
   e. The applicant is qualified, credit-worthy and responsible;
   f. There is a need for the project;
   g. The applicant's financial resources are adequate to provide working capital to maintain the project after completion; and
   h. Monies in the loan fund are or will be available for the development of the project.

8. An unsuccessful applicant may request the Advisory Committee to review the director's decision. A majority of the members of the Advisory Committee may authorize appeal of the director's action to the Governor. The decision of the Governor is final. Neither the decision of the director, nor of the Governor may be appealed in the courts.

2 "Small business" is defined by the Act as follows: “A sole proprietorship, partnership, cooperative or corporation domiciled in Oregon organized for profit and employing less than 100 persons. 'Small business' does not include subsidiary firms of sole proprietorships, partnerships, cooperatives or corporations organized for profit and employing 100 or more persons.” (Chapter 672, Oregon Laws 1979, section 1[9]).
9. If the application is approved, the applicant and the director must enter into a loan contract requiring sufficient collateral for the loan; providing the interest rate and repayment schedule, a procedure for formal declaration of default, and for field inspection of the project; and providing that the state's liability under the contract is contingent upon the availability of money.

10. The Act specifies the type of security that the director must require from various classes of applicants and the actions he may take upon default in a loan.

11. If other financial assistance is obtained for a project after a loan has been granted, all such funds are required to be used first to repay the State.

12. The director, after consultation with the State Treasurer, is required to issue and sell general obligation bonds as necessary to carry out the Act.

13. A sinking fund is created separate from the State's General Fund to provide for the payment of the costs of administration and for payment of principal and interest on bonds issued. The sinking fund consists of application fees, repayment of monies loaned and interest on the monies, and such monies as may be appropriated to the fund by the Legislature, together with monies obtained from the sale of any refunding bonds or monies received from ad valorem taxes, as well as interest earned on any cash balances invested by the State Treasurer.

14. If the sinking fund is insufficient to make payments required, the director may request the Legislature or Emergency Board to appropriate funds. When monies become available in the sinking fund, the General Fund shall be reimbursed for any monies appropriated by the Legislature or Emergency Board.

15. The Act becomes effective if and when the Amendment is adopted by the voters. Full text of the Amendment is set forth as Appendix A to this Report. Full text of the Act is available at the City Club office.

II. SCOPE OF STUDY

In defining the scope of its charge, your Committee agreed that it should determine whether the proposed Amendment and Act are a proper and effective means of achieving the goal of encouraging renewable resource development. Your Committee did not attempt to study or document the need for development of these resources. Despite a comprehensive effort to locate any opponents of the measure, your Committee was unable to locate any persons who either questioned the need for development of resources or opposed the measure. Persons interviewed by the Committee are listed in Appendix B.

Although not within the scope of its charge, during the course of its study, the Committee reviewed materials concerning the need for development of renewable energy resources. The Bibliography attached as Appendix C lists some of the background material.

III. ARGUMENTS ADVANCED IN FAVOR OF THE AMENDMENT AND THE ACT

The following arguments were advanced in favor of the Amendment and Act, some of which arguments your Committee finds more persuasive than others:

1. The Act complements other state and federal programs to encourage the development of renewable energy resources, thus helping Oregon to become more energy self-reliant.

2. The Act encourages the use of renewable resources to replace exhaustible, environmentally objectionable, conventional resources such as oil, gas and nuclear.

3. The Act provides low-cost loans to help overcome the primary obstacle to more widespread use of renewable energy resources—high initial capital costs.
4. The Act helps to alleviate growing demands on existing and planned energy production facilities.

5. If properly administered, the program should cost the taxpayers nothing and no additional taxes should be required.

6. Projects developed under the Act will create jobs and otherwise improve Oregon's economy. The potentially enlarged market for alternative energy devices may also encourage the development of new technologies.

7. The Act provides for individual ownership of energy production facilities, thereby helping to decentralize energy production and to minimize the crippling effect which could result from interruption of a central power supply system.

8. Decentralization of power production may minimize some adverse environmental consequences related to centralized power production.

9. The preference for granting loans to individuals and small businesses and the availability of loans to municipal governments may make funds available to groups which have traditionally had more difficulty in obtaining funds than large businesses.

10. If existing technology is not fully perfected, low-interest loans are an appropriate way to encourage potential users of these resources to accept risks involved in the development and use of alternative energy devices.

11. The Amendment will eliminate a constitutional obstacle to state borrowing to develop renewable resource projects. If the Amendment is adopted, the Legislature may make any changes in the Act it later may deem appropriate to improve the loan program.

12. The Act avoids the primary objections to a related 1977 proposal by minimizing the discretion of the DOE director and eliminating a loan preference to existing utilities.

IV. ARGUMENTS ADVANCED IN OPPOSITION TO THE AMENDMENT AND THE ACT

The following arguments were advanced against the Amendment and Act, some of which arguments your Committee finds more persuasive than others:

1. The State's bonding capacity is finite and is overused as a means for raising funds. Using bonding to provide a loan pool for many small loans may be inefficient and uneconomical.

2. To limit loans to "small scale" projects is unwise. Size is an arbitrary standard by which to judge the merits of a renewable energy project. Any worthy project should be encouraged.

3. The Act's emphasis on credit-worthy applicants and properly secured loans largely discourages the use of these loans for new device development and experimentation which also must be encouraged.

4. The administrative provisions of the Act are suspect because:
   (a) Administration is entrusted to the Oregon DOE which has no expertise in loan matters and now has an inadequate staff to effectively deal with the administrative burdens of such a large-scale program. Development of financial expertise may be a needless duplication within State government, thus encouraging the further growth of government bureaucracy.
   (b) Extensive rule-making will be required to fill gaps in the Act left by vague definitions and nebulous standards. Rule-making may lead to long delays before the loan program can be implemented.
   (c) It may be difficult to find qualified volunteers to serve on the Advisory Committee because it is an unpaid position which will require an extensive time commitment to make the program work effectively.
   (d) Conventional lenders, from whom consent to the creation of a prior or subordinate lien may be required, may not be willing to give such consent.
5. Provisions in the Act may result in costly litigation to resolve disputes:
   (a) Challenging the non-reviewability of loan decisions;
   (b) Based on a possible conflict between the Act and Amendment and Article XI-D dealing with State development of water power resources.

6. The provisions of the Act concerning security for loans:
   (a) Make arbitrary distinctions with respect to the type of security required from borrowers;
   (b) Require security from municipalities which is not realistically necessary and may discourage use of the program;
   (c) Will preclude those who most need the program from qualifying.

7. The provisions concerning the effect on existing loans are almost unintelligible and seem to preclude conventional lenders from accelerating their loans based on existence of or default on the State's loan. These provisions may unconstitutionally interfere with contractual rights and may stand in the way of lender consent to State liens.

8. The State should not be in the money lending business.

V. DISCUSSION AND CONCLUSIONS

The Amendment and Act are designed to encourage use of renewable energy resources, primarily on a small scale, through the availability of low-interest loans. Its objectives are as follows:

1. To increase energy supply for Oregonians;
2. To utilize hitherto undeveloped renewable energy resources to supplement existing conventional energy sources;
3. To help supply consumers with low-cost energy;
4. To serve local communities throughout Oregon; and
5. To be fiscally self-sustaining.

If fully utilized, under current State assessed true cash value, approximately $300,000,000 could be available for loans under the program.

The pressing need for development of alternatives to dwindling or exorbitantly priced conventional energy resources dictates that action must be taken to encourage development of renewable resources without further delay. The use of the State's bonding capacity to make available low-interest loans for capital construction is one way the use of these resources can be encouraged.

The Amendment and Act fill a gap in the State's energy program. While there are now limited grants, loans, and tax credits available for renewable energy projects, there is no comprehensive State program for providing funds needed to purchase and install such devices. The Oregon DOE believes that the primary impediment to more widespread use of existing renewable energy technology is the high initial capital cost for construction and installation. The Act is designed to finance initial construction costs rather than operating costs, and should promote wider use of renewable energy. According to DOE research, low-cost loans can be one of the most effective incentives to the development of renewable energy resources, and may be more effective than tax credit programs to stimulate the use of renewable resources.

3 "New Energy Directions for Oregon," Governor Atiyeh's presentation to the Joint Session of the Oregon Legislature on March 16, 1979, at page 35.


5 This information was obtained in an oral interview with David Philbrick, DOE Administrator of Renewable Resources, on December 5, 1979.
Proponents of the measure state that the program under the Act is fiscally sound, and should cost the taxpayers nothing because the program is intended to be self-supporting through loan repayment assured by requirements concerning credit-worthiness of applicants and loan security. Your Committee agrees that if properly administered, the program will cost the taxpayers nothing. However, voters should be aware that improper administration, unexpected defaults or subsequent changes in the Act could result in taxpayer liability. The bonds are secured by the credit of the State. If loan defaults result in the sinking fund being inadequate to repay the bonds as they come due, the State is required to retire the bonds from its General Fund. If adequate sums are not otherwise available to the State, statewide property taxes will be levied.

The State's bonding capacity is theoretically a finite resource, and if too many State bonds are issued, the State's bond rating could suffer, thus raising the interest rate on State bonds and increasing the cost of State borrowing. However, knowledgeable witnesses from the State Treasurer's Office have testified that even if all the bonds contemplated for this program were issued, the State's bond rating would not be adversely affected. Furthermore, your Committee believes that the proposed program merits high priority among those projects competing for the State's bonding capacity. Your Committee believes that the use of bonds to finance this program is appropriate.

State bonds were selected as a funding device primarily because their tax-exempt status permits them to be sold to the public at low interest rates, thus creating a pool of funds that can be loaned to borrowers at a low rate. During the course of its study your Committee spent considerable time studying the bond provisions of the Act. Witnesses differed in their opinions on the nature of the bonds that would be sold. Although the measure purports to create general obligation bonds, experts in the field of bond law testified that a possibility exists that at least some of the bonds sold may be legally treated as industrial development bonds. After study, your Committee concluded that this should make no significant difference in the effectiveness of the Act. Properly administered, the bonds can remain tax exempt and provide a low-cost source of funds, whether classed as general obligation or as industrial development bonds.

It is unclear whether loan applications will be evaluated before bonds are sold or whether bonds will be sold before loan applications are taken. If legally possible, your Committee believes the bonds should be sold first. If applications precede the bond sale, the lag-time between application and receipt of funds could cause the cost of the project to increase beyond the amount of the loan applied for, possibly rendering the loan useless to the borrower. This lag-time may result from time needed to accumulate a sufficient number of worthy applications to justify the cost of a bond sale and to ensure that the diversity in projects required by the Act is met.

Both the Amendment and Act use the term “small scale local energy project.” The Act defines “small scale local energy project” as “any system, mechanism or series of mechanisms located in Oregon that uses renewable resources . . . to meet a local community or regional energy need in this state.” The definition does not state that the project must be “small.”

Because the Act sets no size limitation, could administrators lawfully use size as a basis on which to reject an otherwise worthy application? Conversely, would they be free under the Amendment to approve a loan to fund a massive hydro-electric project so long as the project is “located in Oregon” and “meets a local community or regional energy need” in Oregon? Administrative rules might resolve this dilemma by further defining “small scale

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6 Some witnesses suggested that it might have been more economical or efficient to provide for a revolving loan fund out of existing “excess” State funds to fund this program rather than to issue bonds. However, proponents counter that it is not politically feasible to raise a large loan pool out of existing State funds or to convince the voters that taxes should be raised to create such a pool.

7 Experts testified that bond issues of less than approximately $1 million do not justify the expenses of issuance.
local energy project,” although the Act itself may have preempted the administrators from defining that phrase.

Various other aspects of the Amendment and Act could also lead to costly litigation. The security provisions of the Act provide that, for loans to non-profit organizations and municipalities, “the existence or foreclosure” of the State’s lien “shall not cause the acceleration of payments on the affected real property.” For other applicants, the existence or foreclosure of the State’s lien “shall not require the acceleration of payments . . .” If any of this language precludes acceleration by a prior conventional lender, a constitutional challenge based on interference with contract would be likely. To avoid this confrontation, lenders may redesign their loan contracts to preclude borrowers from utilizing the program. Your Committee believes that these provisions of the Act are both troublesome and unnecessary. They should be deleted by the Legislature as soon as possible.

Another possible cause of litigation may be the “conflict” perceived by some people between the Amendment and Article XI-D of the Oregon Constitution. Article XI-D requires State development of water resources to be administered by a three-member nonpartisan elected panel. If hydro-electric projects are funded under the Act, the question may be raised whether such projects must constitutionally be administered by a three-member elected body, or whether such projects may be administered by the DOE as contemplated by the Act. Although the Small Scale Local Energy Project Loan Program may be challenged on this basis, we believe the possibility of such a challenge is minimal.

Other security aspects of the Act also received criticism. For example, the Act makes distinctions among the types of security required from various classes of borrowers. Non-profit cooperatives and corporations are required to give a lien upon real property and upon any income realized from the project. On the other hand, in the case of loans to applicants other than municipal corporations or non-profit cooperatives or corporations, the director has discretion to require security other than real property. In the case of municipal corporations, the director may accept any form of security found adequate. The rationale behind these distinctions was not explained to the satisfaction of your Committee.

Your Committee lauds the underlying goal of the security provisions—to require adequate security to keep the program fiscally sound while permitting the director to be flexible. Although the goal was a commendable one, your Committee found the security provisions almost unintelligible and deserving of more attention than they appear to have received in the drafting process.

As presently constituted, by its own admission, the DOE lacks sufficient financial expertise to act as the “big-time banker” which it would become under this program. The staff of the DOE presumably is fully occupied with tasks currently assigned to it. If the measure is approved, the DOE will need to increase its staff to handle administration of the program. Although the DOE is well qualified to evaluate the energy aspects of loan applications, it is not now equipped to make decisions about the adequacy of security and the credit-worthiness of applicants. Your Committee believes the DOE can develop such expertise, as has the Water Resources Division in the administration of its Water Development Loan Fund, but we suggest that charging the DOE with administration of the financial aspects may not have been the wisest assignment of tasks. Although outside the scope of its study charge, your Committee suggests that the Legislature address the possible creation of a state agency charged with the administration of the financial aspects of all state loan programs.

The Advisory Committee may help to decrease the burden on the director and staff of the DOE. The Advisory Committee is required to be knowledgeable in the areas of finance, energy and environmental matters. However, the Act does not provide for payment to Advisory Committee members except for the reimbursement of expenses. It may be difficult to find qualified persons to sit on the Advisory Committee under these circumstances, particularly considering that the tasks with which they are charged by the Act may be extremely time consuming if the volume of applications is as large as proponents
suggest. Although the Advisory Committee will fill a valuable role, we do not believe it can be relied upon substantially to diminish the administrative burdens placed upon the director and staff by this program.

It can be argued that the State should not be in the money lending business at all, and that worthy projects will find funds available in the private sector; as the cost of energy rises and the use of alternative and renewable energy becomes more feasible, worthy projects will be privately financed. Your Committee found this argument unpersuasive. In light of the pressing need for the immediate development of renewable energy resources, it is appropriate for the State to fill the void which now exists by making financing available to help defray high initial capital costs which have been cited as the largest impediment to increased use of renewable energy. If private funds later become available, the State program can be phased out or discontinued.

Another obstacle to more widespread use of these resources is the risk involved in the utilization of relatively new technologies. For example, the effectiveness of solar energy devices for supplying energy needs is dependent on the weather. Government subsidies (such as the use of the State's bonding capacity to make low interest loans) seem appropriate at this time to encourage people to assume these risks.

In conclusion, although your Committee believes the Act is troublesome in many respects, it unanimously believes that the Amendment should be adopted by the voters without further delay in order to permit the use of the State's credit for development of renewable resource projects. Your Committee regrets what it considers to be flaws in the Act. However, if any of these perceived flaws make administration of the program difficult, such defects in the Act can be corrected by the Legislature.

VI. RECOMMENDATION

Your Committee concludes that State Measure No. 3 is in the public interest and recommends unanimously that the City Club support a YES vote at the May 20, 1980, primary election.

Respectfully submitted,
Richard P. Hutchison
Fred M. Jory
Mary Madden
Robert D. Newell
Linda Wick
Kenneth M. Winters
Valerie D. Fisher, Chairperson

Approved for publication by the Research Board on February 28, 1980 and authorized by the Board of Governors for distribution to the membership for discussion and action on Friday, April 4, 1980.
APPENDIX A

Be it resolved by the Legislative Assembly of the State of Oregon:

Paragraph 1. The Constitution of the State of Oregon is amended by creating a new Article to be known as Article XI-J and to read:

ARTICLE XI-J

SECTION 1. Notwithstanding the limits contained in sections 7 and 8, Article XI of this Constitution, the credit of the State of Oregon may be loaned and indebtedness incurred in an amount not to exceed one-half of one percent of the true cash value of all of the property in the state for the purpose of creating a fund to be known as the Small Scale Local Energy Project Loan Fund. The fund shall be used to provide financing for the development of small scale local energy projects. Secured repayment thereof shall be and is a prerequisite to the advancement of money from such fund.

SECTION 2. Bonds of the State of Oregon containing a direct promise on behalf of the state to pay the face value thereof, with the interest therein provided for, may be issued to an amount authorized by section 1 of this Article for the purpose of creating such fund. The bonds shall be a direct obligation of the state and shall be in such form and shall run for such periods of time and bear such rates of interest as provided by statute.

SECTION 3. Refunding bonds may be issued and sold to refund any bonds issued under authority of sections 1 and 2 of this Article. There may be issued and outstanding at any time bonds aggregating the amount authorized by section 1 of this Article but at no time shall the total of all bonds outstanding including refunding bonds, exceed the amount so authorized.

SECTION 4. Ad valorem taxes shall be levied annually upon all the taxable property in the State of Oregon in sufficient amount to provide for the payment of principal and interest of the bonds issued pursuant to this Article. The Legislative Assembly may provide other revenues to supplement or replace, in whole or in part, such tax levies.

SECTION 5. The Legislative Assembly shall enact legislation to carry out the provisions of this Article. This Article supersedes any conflicting provision of a county or city charter or act of incorporation.

Paragraph 2. The amendment proposed by this resolution shall be submitted to the people for their approval or rejection at a special election held throughout the state on the same date as the next regular primary election.

APPENDIX B

PERSONS INTERVIEWED

Bud Bartels, Manager of the State of Oregon, Water Development Loan Program
Gary Bauer, Public Affairs, Portland General Electric Co.
Richard Campbell, Vice President, The Bank of California
Donald Corson, General Manager, Oregon Appropriate Technology
Douglas Courson, Bond Counsel, Ragen, Roberts, O'Scannlain, Robertson & Neill
Richard Eyeman, President, Emerald P.U.D.
State Senator Edward Fadeley, Chairman, Senate Committee on Energy and Environment
Lynn Frank, Director, Oregon Department of Energy
Andrew Freeman, former researcher for the Senate Committee on Energy and Environment and current Assistant Director of the Oregon Wilderness Coalition
Gordon Fultz, Staff Associate and Lobbyist, League of Oregon Counties
Fred Hansen, Deputy State Treasurer
Margie Harris and Lee Johnson, Western SUN
Marion Hemphill, Energy Advisor, City of Portland
Mike Hennessy, Senior Public Affairs Representative, Pacific Power & Light Co.
Milton Jones, former Administrator and Legal Counsel to the State of Oregon Senate Committee on Energy and Environment and currently Legal Counsel to the Oregon State Senate Judiciary Committee
Nancy McKay, Staff Associate and Lobbyist, League of Oregon Counties
Kevin Peterson, Manager of Municipal Bond Division, State Treasurer's Office
David Philbrick, Administrator of Renewable Resources, Oregon Department of Energy
Walt Pollock, Head, Energy Conservation Section, Bonneville Power Administration, U.S. Department of Energy and member, Oregon Solar Task Force
Sam VanVactor, Director, Northwest Energy Policy Workshop, Portland State University
APPENDIX C

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