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STATE OF ALASKA
THE LEGISLATURE
LEGISLATIVE AFFAIRS AGENCY

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

MEMORANDUM July 12, 1977

SUBJECT: Permanent fund

TO: Representative Clark Gruening, Chairman
House Permanent Fund Committee

FROM: Billy G. Berrier, Director BGB
Division of Legal Services

You have requested my comments on the legal implications of the words "permanent" and "income producing" as used in the constitutional amendment authorizing the permanent fund on the legal standards and guides the legislature may wish to establish in legislation.

The relevant provision is Section 15, of Article IX which reads:

> "Section 15 ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State of Alaska shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law".

It is clear from the wording of the amendment itself and from the surrounding context that the concept is that a fund be created in which a portion of the mineral revenues of the state would be set aside in order to insure preservation for the future of that portion of the revenue. There can be no legitimate question that the objective is preservation of that portion as capital for the long term use of the state and its people and prevention of uses which are expedient in the short term but which would dissipate the capital of the fund. The paramount consideration must be the probable safety of the capital of the fund to be invested.

The term "permanent" as used three times in the body of the amendment and in the title of the fund would be read in the normal sense of that word since that reading is consistent with the context of the amendment, with the legislative and public discussion of the amendment, and with the understanding that the voters would be presumed to have in approving the amendment.

While the permanent fund is not a trust in the technical legal meaning of the term, the protection of capital required has substantial similarities to the requirements binding upon a trustee. This requirement is commonly referred to as the prudent-man rule. There have been numerous cases on this rule and many commentators have set out reasonable similar statements of the rule. A good statement is found in Scott on Trusts 3rd Ed in Sec. 227 (pages 1805 - 1806) which reads:

> "The only general rule which can be laid down as to investments is that the trustee is under a duty to make such investments as a prudent man would make of his own property having primarily in view the preservation of the estate and the amount and regularity of the income to be derived. In various forms this rule has been stated in innumerable cases. It involves three elements, namely care and skill and caution. The trustee must exercise a reasonable degree of care in selecting investments. He must exercise a reasonable degree of skill in making the selection. He must, in addition, exercise the caution which a prudent man would exercise where a primary consideration is the preservation of the funds invested."

This rule would seem to adequately set out the general parameters constitutionally required for permanent fund investments of principal. It would apply at two stages of the process. The legislature would be bound to apply it in exercising the duty to circumscribe and delineate investments required under the limitation in the constitution reading:

> "...the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investment. (emphasis added)

The managers of the fund are given no constitutional discretion under this clause. The discretion is lodged exclusively in the legislature; and, if the objectives of the permanent fund are to be attained, investments specifically designated by law as eligible for permanent fund investment must also meet the criteria of having as a primary consideration the preservation of the funds invested.

The legislation, however, would not be expected to detail the permissable investments. It would presumably designate specific investment catagories and create a management structure for the fund which would make the specific decisions as to which investments are to be made. Here again, the prudent-man rule would be applicable. In addition to designating specific catagories of investment, any legislation should also establish guidelines for the fund management which are consistent with the objective of the fund. The need for this arises because within a class which as a class meets the objectives of preservation of the funds invested, some specific investments would still not be made by a prudent man. Possibly this could be largely avoided by using an ultra restrictive approach to allowable catagories of investment but this approach would create or exacerbate other problems.

The primary difficulty with an ultra restrictive approach to allowable investments is that, as a matter of law, the problem of inflation would not be a factor in investment decisions. It can be reasonable assumed that inflation to some degree may be anticipated.

The argument has been made that inflation can realistically be anticipated to occur, that if principal is not increased in an amount to compensate for inflation the real value of the principal will decline even though the nominal value is maintained and that the duty of a prudent investor is to maintain the real value of the principal. Therefore, failure to account for inflation in investment policy violates the prudent-man rule of investment. I have found no authority to support this argument as a legal requirement. Factually, the argument would fall here. The constitutional amendment makes a clear distinction between principal which is permanent and income which is subject to expenditure by the normal appropriation process unless the legislature directs otherwise. At the time the amendment was adopted, inflation had occurred at an extremely high rate in the immediate past so it must be assumed that both the legislature and the public were conscious of inflationary effect. It would therefore, to support this argument, require assuming that investments which would have a capital appreciation, entirely apart from income earned, which is at least equal to inflation are the only permissable investments. This does not seem reasonable.

The argument that inflation must be taken into account does not seem valid here but that does not mean that inflation may not, or even that it should not, be taken into account. There is no reason that legislation establishing the management of the permanent fund and the disposition of fund income should not address this problem directly. I have suggested earlier that the legislation needs to establish standards for investments to avoid having to specify only ultra restrictive investments. The legislation could also require that the possible effects of inflation be a consideration in investment decisions made by the fund managers.

The term "income-producing" as used in the amendment presents serious conceptual difficulties. In context, this could simply be a restatement of the normal duty to make productive investments. In relation to trusts this has been stated:

> "It is the duty of a trustee to preserve the trust property and make it productive. It is ordinarily his duty to invest trust funds in such a way as to receive an income without improperly risking the loss of principal." (Scott on Trusts 227 p. 1805)

However, as stated earlier, the permanent fund is not a trust in the technical legal sense. Simply carrying over the trustee's duty could be misleading.

The term "income-producing" is not a term of art and has no fixed legal meaning differing from the conventional meaning of the term. It is possible that a court would hold that the term implies that maximum income consistent with safety of principal must be the exclusive criteria for investment. This would be consistent with trust law but it appears that the amendment contemplates broader considerations as well. It would appear more likely that other considerations, such as the effect particular investments would have on furthering public purposes other than maximization of income, could also be given weight. Some examples of other public purposes are providing jobs, improvement of the Alaskan economy and economic diversification.

It is clear that production of income is a necessary goal of each investment; it is probably that maximization of income consistent with safety of principal must be a major goal, ; but it appears unlikely that a court would hold that this must be the exclusive goal of permanent fund investment policy.

While the investment of the permanent fund differs from investment of state treasury surplus funds in several respects including the specific requirement of income producing investment of permanent fund principal, both have as major goals protection of principal and production of income. It is interesting to note that state treasury surplus fund investment specifies policy goals additional to the primary goals. On this point AS 37.10.075(f) provides:

> (f) Investment policy shall be formulated by the commissioner of revenue who shall be advised by a committee appointed by the governor which shall contain representation from the legislature. In formulating investment policy they shall consider maximum income and safety as governed by the prudent-man rule and the benefit to the private and public sectors of the economy in terms of increased housing and commercial credit, stimulated business activity, increased employment, support of the market for state and local bonds, increased public revenue together with the possible inflationary effect of the investment, and (h) and (i) of this section.

The question of what the term means as a matter of law will almost certainly be decided by the courts on a case by case basis. The questions involved are complex and change over time. In reasonably similar instances, the courts have refused to provide a general definition. For example the Alaska court in dealing with the term "capital improvements" as used in the Alaska Consitution said:

> "We believe it would be unwise for this court to attempt to provide an abstract definition of "capital improvements." We have concluded that it is beyond human ability to permanently circumscribe with mere words at a given point in time a concept which though limiting in aspect, is otherwise intended to provide a broad, permanent and continuing authority for municipalities to finance present as well as unforeseeable future needs." (Juneau v. Hixon 373 P2d 743 (Alaska 1962))

While it is my opinion the courts will be liberal in sustaining the reasonable expectations of the legislature and the fund managers, they are unlikely to allow investments which cannot reasonably be anticipated to produce maximum current income consistent with safety of principal modified by application of other permissable public policy considerations. It appears certain that investments which cannot reasonably be anticipated to produce direct income would not be allowed.

BGB:jpd

W.O. 4256

BY THE RULES COMMITTEE
BY REQUEST OF THE LEGISLATI
COUNCIL INTERIM COMMITTEE
ON THE ALASKA PERMANENT FUN

IN THE HOUSE

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to appropriations of income from the Alaska permanent fund."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.10.065 is amended by adding a new subsection to read:

(d) Plans for expenditures of income from the permanent fund shall be submitted to the legislature annually by the governor. The plans shall provide for apportionment of the income, as the governor considers appropriate, to the following:

(1) additional contributions to the Alaska permanent fund established in AS 37.10.065;

(2) additional contributions to the Alaska renewable resource development fund established in AS 37.11.010;

(3) dividend payments on shares established in AS 37.18.010 - 37.18.110; and

(4) contributions to the following loan funds:

(A) the agricultural loan fund (AS 03.10);

(B) the commercial fishing revolving loan fund (AS 16.-10.300 - 16.10.370);

(C) the fisheries enhancement loan program (AS 16.10.500 16.10.560);

(D) the senior citizens' housing development fund (AS 18.100.070);

(E) the veterans' loan program (AS 26.15);

(F) the child care facility revolving loan fund (AS 44.-

33.240 - 44.33.275);

(G) the water resources revolving loan fund (AS 45.86);

(H) the tourism revolving loan fund (AS 45.90);

(I) the small business revolving loan fund (AS 45.95).

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STATE OF ALASKA
THE LEGISLATURE

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

LEGISLATIVE AFFAIRS AGENCY

M E M O R A N D U M

July 14, 1977

SUBJECT: Whether contributions to the permanent fund over and above the constitutionally required minimum of 25 percent of the revenues from nonrenewable resources may be withdrawn at a later date, if (1) the additional contribution is comprised of an appropriation from the general fund, or (2) a statute requires deposit of more than the constitutionally required percentage of the revenues from nonrenewable resources.

TO: Billy G. Berrier
Director
Division of Legal Services

FROM: Joseph A. Guthrie
Legislative Counsel

The issue of whether funds deposited in the permanent fund over and above the 25 percent of those revenues required to be deposited by Article IX, Sec. 15, Alaska Constitution may be withdrawn from the fund would seem to depend on whether the following language of Article IX, sec. 15 refers to only the 25 percent minimum required or whether this language refers to all monies deposited in the permanent fund.

> "the principal of which shall be used only for those income producing investments specifically designated by law as eligible for permanent fund investments"

It seems clear to me that the inclusion of the words "at least" with reference to the 25 percent minimum make it clear that deposit of funds in addition to the 25 percent of revenues from nonrenewable resources was contemplated by the framers of this section. However, whether only an additional percentage of revenues from nonrenewable resources, or the deposit of funds from other sources as well, were contemplated for inclusion in the permanent fund is unclear. The words "at least" could refer to either possibility.

The existence of this ambiguity seems significant to me because of the fact that the section creating the permanent fund (Article IX, sec. 15) is framed as an exception to a

general prohibition against dedicated funds (Article IX, sec. 7). Review of the comments of the Committee on Finance and Taxation at the Constitutional Convention (Committee Proposal/9, December 16, 1955) reveals that dedication was regarded in terms of the earmarking of specified taxes and revenues to a specific purpose. For this reason, one may argue that the words "at least" refer only to the possibility of a deposit of a percentage of those revenues specified by the constitution of greater than 25 percent and that an appropriation to the fund from the general fund would not be encompassed by the language already quoted precluding withdrawals. Under this analysis, of course, deposits from those revenues specified in Article IX, sec. 15 of the Constitution in excess of the constitutionally required minimum could not be withdrawn.

On the other hand, one might argue that all deposits of money into the permanent fund, whatever their source, may not be withdrawn. This interpretation rests on the fact that the language limiting withdrawal already quoted refers to the words "permanent fund" in a manner which suggests that the fund is not solely comprised of dedicated revenues from the sources specified. Specifically, the words "shall be placed in a permanent fund" are used, rather than words expressing the thought that the funds from the specified revenues be preserved as a nest egg.

Conclusion

As stated earlier, it seems clear that deposits of the sources of revenue specified by Article IX, sec. 15, cannot be withdrawn. The fact that Article IX, sec. 15 is framed as an exception to a prohibition on dedication of the proceeds of particular state taxes and license (Article IX, sec. 7), rather than with reference to monies already in the general fund, would seem to argue in favor of an interpretation that funds deposited in the general fund via appropriation bill could be withdrawn. On the other hand, the general tenor of Article IX, sec. 15 would seem to argue that all deposits to the permanent fund, from whatever source, may not be withdrawn.

No cases on point came to light on review of provisions establishing permanent funds in New Mexico, Utah, and Montana.

I will look for a rule of statutory interpretation which might aid in the resolution of the aforementioned ambiguity.

JAG:jpd

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STATE OF ALASKA
THE LEGISLATURE

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

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM

July 14, 1977

SUBJECT: Alaska Inc.

TO: Representative Clark Gruening

FROM: Billy G. Berrier BGB
Director
Division of Legal Services

You have requested a revision of SB 348 to separate the "Alaska Inc." concept as embodied in that bill from the permanent fund and making other adjustments as necessary to avoid clear constitutional problems. A draft is attached separating this concept from the permanent fund; but, without taking an entirely new approach which is not compatible with the basic concepts of the bill, clear constitutional problems cannot be avoided.

The essential concept of the bill is novel. It may reasonably be summarized as a mechanism by which a portion of the revenue the state receives from disposition of nonrenewable resources of the state are distributed directly to certain of the people of the state. Eligibility for the distribution is based on durational residency within the state and increased in blocks as successive periods of residency occur for individual recipients.

It is clear from the context of the bill that the durational residency requirement is central to the concept. This is directly stated in the non-severability clause (Sec. 37.18.110) which provides that if the residency requirements are invalid, the entire chapter is invalid. The bill is so structured around this element that the essential concept of the bill cannot be retained if this element is removed.

Durational residence requirements are subject to strict scrutiny under the equal protection clause of the federal and state constitutions (Hicklin v. Orbeck Opn. 1435 Alaska

June 3, 1977). Under strict scrutiny, the law must be struck down unless the state can demonstrate that it is necessary to further a compelling state interest and is the least drastic means available to further that intent. (Dunn v. Blumstein 405 US 330, 31 L. Ed 274 (1972))

The use of strict scrutiny has not always resulted in holding the challenged law unconstitutional. (e.g. Gilbert v. State 526 P2d 1131 (Alaska 1974)) upholding three year requirement for legislative candidacy) but has often had that result (e.g. Shapiro v. Thompson 349 US 618, 22 L.Ed2d 600 (1969) (one year requirement for welfare benefit); State v. Wiley 516 P2d 142 (Alaska 1973) (one year requirement for public employment).

As pointed out earlier, the "Alaska Inc." concept is novel so that of the legion of cases on right to travel and durational residence requirements none are directly on point. An analysis must be made of the compelling state interest (which apparently is to promote a stable resident population, Sec. 37.18.010), the means used to further that interest and whether the means used are the least drastic means available to further that interest.

What result the court would reach is speculative; but there is certainly a clear and substantial constitutional question which, as noted, cannot be resolved while retaining the essential concept.

BGB:jpd

w.o. 4255

BY THE RULES COMMITTEE BY REQUEST OF THE LEGISLATIVE COUNCIL INTERIM COMMITTEE ON THE ALASKA PERMANENT FUND

IN THE HOUSE

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act establishing the Alaska resident dividend program; amending rules of procedure; and providing for an effective date."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37 is amended by adding a new chapter to read:

CHAPTER 18. ALASKA RESIDENT DIVIDEND PROGRAM.

Sec. 37.18.010. FINDINGS AND PURPOSE. (a) The legislature finds that there exists in Alaska a serious problem of population turnover. A substantial portion of the state's population is comprised of individuals who reside in Alaska for only a relatively short period of time. This is especially true in the state's larger cities. This constant turnover in population leads to political, economic, and social instability and is harmful to the state. It is in the public interest for the state to promote a stable resident population.

(b) The legislature also finds that the demands on and costs of state government have increased over the past few years at an excessive rate and that this increase has been permitted to occur, at least in part, by a feeling on the part of much of the electorate that those demands and costs do not have a significant economic impact upon them personally. It is in the public interest for the state to promote the involvement of its citizens in the budget-making process by providing them with a more personal and direct stake in the outcome of budget decisions.

(c) The legislature finds that establishment of a mechanism for

direct distribution to the people of resident dividends, and by which an individual's portion of that distribution will increase the longer he continues to be an Alaska resident, will promote the purposes of encouraging a stable resident population, and of providing the people with a more personal and direct stake in the outcome of the state's budget decisions.

Sec. 37.18.020. ALASKA RESIDENT DIVIDEND PROGRAM. There is established in the Department of Revenue the Alaska resident dividend program. The program may be funded by the legislature by appropriations from the general fund.

Sec. 37.18.030. AMOUNT OF PAYMENTS. Each of the payments to be distributed under sec. 80 of this chapter shall be equal to the quotient of the amount appropriated under sec. 20 of this chapter divided by the total number of duly credited shares as of December 31 of the year last preceding the year in which the appropriation was made.

Sec. 37.18.040. ELIGIBILITY FOR SHARES. (a) As of December 31, 1979, each eligible resident of Alaska who makes timely application under sec. 70 of this chapter shall be credited by the commissioner with one share under this chapter for each five-year period since January 1, 1974, in which he has been an eligible resident, as defined in sec. 100 of this chapter, or would have been but for being too young by five years or less to register to vote.

(b) Shares are not transferable in any way whatsoever, and no payments may be made, other than as expressly provided in sec. 80 of this chapter, to anyone other than the eligible resident. Shares do not survive the death of their holder, and any alienation is void as against public policy. If a share should be declared or ordered by a court to be alienated in any way, it ceases to exist for purposes of this chapter until and unless it is restored to the person from whom it was alienated

Sec. 37.18.050. ELIGIBILITY FOR PAYMENTS. Each eligible resident of Alaska, who has one or more shares under this chapter, and who makes timely application under sec. 70 of this chapter, shall receive one payment for each share to which he is entitled under sec. 40 of this chapter.

Sec. 37.18.060. DETERMINATION OF ELIGIBLITY. (a) Any person who applies for a share or for a payment or payments must make proof of eligibility satisfactory to the commissioner. The commissioner may not credit any person with a share or make a payment to any person until and unless proof of that person's eligibility sufficient to satisfy a reasonable person has been made to the commissioner.

(b) Proof of eligibility may be made by applicants from school attendance records, state and local tax and licensing records, voter registration records, birth and marriage certificates, selective service records, sworn affidavits from others having knowledge of a person's residence, and other forms of documentary evidence which a reasonable person would rely on in the conduct of his own affairs. An affidavit from an applicant without supporting evidence of eligibility is not satisfactory proof of eligibility.

(c) A person may attempt to make proof by waiving his right to privacy and authorizing the commissioner to make a search of any and all local, state, and federal records and any private employment records which may tend to prove his eligibility. The commissioner's making any search of records is entirely discretionary, and he is under no duty to make the search or to exercise reasonable care in making the search, if he does so; the entire risk is upon the applicant.

(d) Upon his determination of a person's eligibility for a share or for a payment, the commissioner shall, by first class mail, notify the person of that determination. If the person is determined to be

ineligible, he shall be informed by certified mail, of the following:

(1) the reason for his ineligibility;

(2) that he may file additional proof or file a request for a hearing before the commissioner at which to present proof of his eligibility; and

(3) that his failure to do one or the other within 30 days makes the decision final and unappealable.

(e) If a person does not file additional proof or file a request for a hearing with the commissioner within 30 days after his receipt of the commissioner's notice of the determination, the commissioner's decision becomes final as to the period involved and there can be no further appeal. This time limit is jurisdictional.

(f) If a person files additional proof or files a request for a hearing with the commissioner within 30 days after he receives the commissioner's notice of the determination and, after the additional evidence has been considered or the hearing held, he is still determined to be ineligible, he may appeal to the superior court within 30 days after he receives notice of the final decision. This time limit is jurisdictional, and no suit may be brought after it has elapsed. In considering the appeal, the superior court is to review solely on the record which was before the commissioner and to use the reasonable-basis test on factual matters and its own judgment on the law. The same standard of review shall apply if a further appeal is taken to the supreme court. This requirement is substantive, not procedural.

(g) A person not eligible as of December 31 in any year may establish or reestablish eligibility as of December 31 in subsequent years.

Sec. 37.18.070. APPLICATION PERIOD. (a) In order to receive a payment or to be credited with a share, an eligible person must first

apply for one or both on the Alaska net income tax form or on another form provided by the commissioner.

(b) The application covers the last preceding period ending on December 31 in which the applicant was eligible for a payment or to be credited with a share or both.

(c) The application, together with the proof of eligibility required by sec. 60 of this chapter, for the year or five-year period claimed as of December 31 must be filed with the commissioner or, if mailed, postmarked no later than the following April 15. This filing date is mandatory. Any application not timely filed or postmarked will be returned, and the applicant is not eligible for the year for which the late application was made. This provision does not bar subsequent presentation of additional proof of eligibility so long as the application was timely filed. A year for which a person would have been eligible but for his failure to file a timely application may subsequently be counted toward a five-year period to be eligible for a share under this chapter.

Sec. 37.18.080. PAYMENTS. (a) Following the application, payments shall be made as soon as practical after January 1 of the year in which the legislature appropriates money to the program.

(b) If the payment is to a person presently incarcerated as punishment for committing a crime, it shall be made to the Department of Health and Social Services to offset the expense to the state of the incarceration.

(c) At the request of the person to whom payments are to be distributed and to the extent allowed under federal law, distribution of payments may be deferred or otherwise set aside so as to defer the payment of income taxes. Payments may also be made as tax credits or rebates at the request of the person to whom payments are to be

distributed.

Sec. 37.18.090. PENALTIES. (a) Any person who wilfully submits false or misleading information to the commissioner in making proof of his eligibility or of the eligibility of another is guilty of a misdemeanor.

(b) In addition to any criminal penalties imposed, any person convicted of violating (a) of this section whose conviction is not reversed is not, and can never become, an eligible resident under this chapter, forfeits any shares with which he may have been credited, and is not, and can never become, eligible to be credited with any shares or to receive any payments.

Sec. 37.18.100. DEFINITIONS. In this chapter, unless the context requires otherwise,

(1) "commissioner" means the commissioner of revenue or his designee;

(2) "department" means the Department of Revenue;

(3) "eligible resident" means any person who is registered to vote under the Election Code, is a resident of Alaska under AS 15.05.020, filed (or whose parent or parents filed) a resident Alaska income tax return for the year preceding his application, and was physically present in Alaska for more than one-half the period between January 1 and December 31 last preceding his application for one or more payments or for a share, or both, or who, if not so physically present was temporarily absent for reasons of professional, vocational or other special education for which a comparable program was not reasonably available in Alaska, post-secondary education, military service, medical treatment, or service in Congress;

(4) "five-year period" includes any cumulation of periods within a span of no more than 10 years which totals five full years;

(5) "share" means a right to receive payment from distributions made under this chapter and credited by the department to an eligible resident.

Sec. 37.18.110. NONSEVERABILITY. If the residency requirements of this chapter are invalid, the provision is nonseverable, and the entire chapter is invalid and of no force or effect.

* Sec. 2. In sec. 1 of this Act, the enactment of AS 37.18.060(e) and (f) has the effect of imposing a jurisdictional limitation on the operation of Appellate Rule 45, Alaska Rules of Court Procedure, in that an appeal under the rule (having to do with appeals from administrative decisions to the superior court) must be brought from the commissioner's decisions as to eligibility within 30 days or the courts will have no jurisdiction to hear it. This is an exercise of the legislature's authority over the jurisdiction of the courts, but because it also effects an implied, narrow amendment to Appellate Rule 45 by imposing this jurisdictional time limit instead of the procedural time limit of the same duration which will continue to apply to other appeals, this section has also been included.

* Sec. 3. This Act takes effect immediately in accordance with AS 01.-10.070(c).

w.o. 4256

BY THE RULES COMMITTEE
BY REQUEST OF THE LEGISLATIVE
COUNCIL INTERIM COMMITTEE
ON THE ALASKA PERMANENT FUND

IN THE HOUSE

HOUSE BILL NO.

IN THE LEGISLATURE OF THE STATE OF ALASKA

TENTH LEGISLATURE - SECOND SESSION

A BILL

For an Act entitled: "An Act relating to appropriations of income from the Alaska permanent fund."

BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

* Section 1. AS 37.10.065 is amended by adding a new subsection to read:

(d) Plans for expenditures of income from the permanent fund shall be submitted to the legislature annually by the governor. The plans shall provide for apportionment of the income, as the governor considers appropriate, to the following:

(1) additional contributions to the Alaska permanent fund established in AS 37.10.065;

(2) additional contributions to the Alaska renewable resources development fund established in AS 37.11.010;

(3) dividend payments on shares established in AS 37.18.010 - 37.18.110; and

(4) contributions to the following loan funds:

(A) the agricultural loan fund (AS 03.10);

(B) the commercial fishing revolving loan fund (AS 16.-10.300 - 16.10.370);

(C) the fisheries enhancement loan program (AS 16.10.500 - 16.10.560);

(D) the senior citizens' housing development fund (AS 18.100.070);

(E) the veterans' loan program (AS 26.15);

(F) the child care facility revolving loan fund (AS 44.-

33.240 - 44.33.275);

(G) the water resources revolving loan fund (AS 45.86);

(H) the tourism revolving loan fund (AS 45.90);

(I) the small business revolving loan fund (AS 45.95).

#160

STATE OF ALASKA
THE LEGISLATURE

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

LEGISLATIVE AFFAIRS AGENCY

MEMORANDUM September 21, 1977

SUBJECT: Permanent Fund (Work Order No. 4305)

TO: Representative Clark Gruening

FROM: Billy G. Berrier
Director, Division of Legal Services

Kenneth E. Vassar
Staff Attorney

You have requested an opinion relating to the following questions:

(1) May bonded debt of the state or of local governments be retired or purchased with permanent fund principal or interest?

(2) Assuming a permanent fund structure as proposed in HB 298, what legislative power of confirmation exists and can the legislature establish a system of periodic reconfirmations?

1. Bonded Indebtedness. The authority for any expenditure of permanent fund principal or interest is Section 15, Article IX of the Constitution of the State of Alaska. This section reads:

"Section 15. ALASKA PERMANENT FUND. At least twenty-five percent of all mineral lease rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments and bonuses received by the State of Alaska shall be placed in a permanent fund, the principal of which shall be used only for those income-producing investments specifically designated by law as eligible for permanent fund investments. All income from the permanent fund shall be deposited in the general fund unless otherwise provided by law."

The use of permanent fund principal to retire the bonded indebtedness of state or local governments is clearly prohibited by this language. Permanent fund principal may only be used for "income-producing investments specifically designated by law." The retirement of bonded indebtedness is not income-producing unless you take an extremely broad definition of income-producing as including the savings to the state and local governments of payments of interest on their outstanding bonds. In light of the clear intent of the section, which is to preserve the principal of the fund, such a wide sweeping definition would be improper.

The use of income produced by permanent fund investments to retire state and local government bonds could legitimately be provided by law. The proper disposition of permanent fund income, under section 15, is left for the determination of the legislature.

Whether the permanent fund principal may be used to purchase state and local bonds depends upon whether such purchase is "income-producing" as that term is used in section 15. Under general principles of trust law, the trend of modern authority is to measure "income-producing" by the "prudent investor" rule. In essence, the trustee is required to adhere to a standard of good faith, reasonable prudence, sound discretion and care in making trust investments. He must invest as a prudent businessman would do in making a permanent disposition of his own funds, considering both the probable income and probable safety of capital. Also, under trust law, the fact that a type of investment is permissible does not necessarily mean that the investment is proper, for in selecting from among the permissible investments, the trustee must exercise reasonable care, skill and prudence. All circumstances must be taken into account, including such things as minimizing risks to capital and the need to obtain a fair return on the investment. Usually, investments in sound government securities which are neither in default nor threatening default, in high grade corporate bonds, and in first mortgages on real estate, provided the margin of security is adequate, have been held to be reasonable and prudent.

As expressed to you in a previous memorandum from this office, the permanent fund is not, strictly speaking, a trust, and the permanent fund management may be allowed to

take into consideration a somewhat wider range of considerations in making investments of permanent fund principal.

Therefore, since investment in government securities would be proper under the prudent investor rule, as delineated above, it is proper for the permanent fund.

The use of income from permanent fund investments to purchase state and local government bonds, again, would be legitimately within the realm of legislative determination.

2. Confirmation. The issue of the extent of the legislative confirmation power was addressed in Bradner v. Hammond, 553 P.2d 1 (1976). In that case, the Supreme Court of Alaska held that the legislative confirmation power is limited to those offices described in Sections 25 and 26 of Article III of the state constitution and does not extend to other executive agencies. However, it is not clear from the opinion whether this limitation applies to confirmation of the heads of independent corporations located within the executive department.

The opinion is based upon the theory of separation of powers among the branches of government, and the court's concern centered primarily on legislative interference and intermeddling with essentially executive functions. Presumably, then, as the function of a particular entity becomes less executive in nature, the court's concern would decrease. An independent corporation located within the executive department would have little in the nature of an executive function, particularly where the corporation's sole function is to make income-producing investments. While the permanent fund corporation, as envisioned in HB 298, would be located within the Department of Revenue, it would be an independent instrumentality. In DeArmond v. Alaska State Development Corporation, 376 P.2d 717 (1962), the supreme court recognized that such independent corporations may be located in the executive branch while maintaining freedom from outside control in making its decisions. The court stated:

> In this case we believe the corporation is essentially what the legislature says it is: an instrumentality of the state within the Department of Commerce, with a legal existence separate from the state....

Therefore, if the court's concern is with maintaining the separation of powers among the branches of state government, the establishment of confirmation procedures for the heads of the corporation should raise no serious problem.

With this in mind, it is necessary to take a closer look at the organizational structure of the permanent fund corporation as proposed in HB 298. Under that bill, the permanent fund corporation will exist as an independent legal entity located within the Department of Revenue. General policy and long-range operating plans for the corporation will be established by the policy board. The investment committee will have sole responsibility for approving investment proposals. The president, who will be appointed by the policy board, will sit as chairman of the policy board and of the investment committee and will be responsible for the ordinary business of the corporation. Since both the president and the investment committee members are appointed by the policy board, it may be assumed that the policy board is at the head of the corporation.

The duties of the policy board are not executive in nature. The policy board establishes policy for the corporation. An executive function relates to the enforcement and administration of policy decisions. In the case of the permanent fund corporation, it would seem that this function is to be performed by the investment committee. So, there would be two arguments favoring legislative confirmation of the policy board's membership. One argument is that, under Bradner v. Hammond, independent corporations within the executive department are so far from executive duties that they do not fall within the ambit of that decision. The other argument is that the policy board in this case is particularly non-executive in nature, and hence there is even less concern for the separation of powers concept.

You have also asked whether reconfirmation may be established for members of the board. It would seem that, if the legislature has the power of confirmation initially, the power to require reconfirmation would be implied. Therefore, a system of reconfirmation would be within the legislature's power to establish.

A caveat to the foregoing should be noted here. While it is our opinion that Bradner v. Hammond is limited to heads of executive agencies which are directly subordinate to the governor and does not apply to independent corporations located within the executive branch, it is possible that the court actually meant to strictly limit the legislative confirmation power to those agencies described in the constitution. In that case, of course, there would be no power of confirmation whatsoever over the permanent fund policy board.

KEV:jpd

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Alaska State Legislature

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House of Representatives

MEMORANDUM

To: Bill Berrier, Director
Div. of Legal Services

From: Clark Gruening, Chairman
House Permanent Fund Committee

Date: June 28, 1977

Re: Permanent Fund and "Alaska Inc."

Bill, I hope your summer is enjoyable and you have had some relaxation since the last shots of the session were fired.

Would you please prepare a memo report with citation of authority on federal and Alaska constitutional problems in establishing Alaska Inc., in general and as specifically outlined in SB 348 (HB 525).

As you may know, Covington and Burling of D.C. are doing research for the Department of Revenue on the federal tax problems but here the House Special Committee on the Alaska Permanent Fund is concerned with other constitutional and legal problems with its establishment.

Another aspect of the present Alaska Inc. proposal bothers me and that is its marriage to the Permanent Fund. It is plain to me that if 50 percent of all the Permanent Fund earnings are paid out as per Alaska Inc., the principal or corpus of the fund will not be very permanent at all unless earning roughly equivalent to the rate of inflation over the next twenty years. I'm enclosing a December 16, 1976 Department of Commerce & Economic Development study on that problem. I would like your thoughts on the legal implications of the words "permanent" and "income-producing" on the legal standards and guides the legislature may wish to establish.

In order to examine a proposal which divorces "Alaska Inc." from the Permanent Fund, please prepare a bill which sets up the following procedure for treatment of all non-renewable resources revenues which are subject to the permanent share:

An Appropriation bill submitted by the Governor (in addition to the General Appropriation bill) which apportions the above revenue as the Governor deems appropriate (according to best revenue projections) to 1) additional PF Contributions (above 25%); 2) additional contributions to the Renewable Resources Development Fund; 3) various state revolving loan programs and 4) direct dividends to people who hold shares of Alaska Inc.

Please make whatever changes in SB 348 necessary to separate it from the Permanent Fund and have dividends paid directly from an appropriation from the General Fund. Make whatever other adjustments you feel are necessary to avoid clear constitutional problems.

The House Permanent Fund Committee will be meeting on July 15 and 16 in Anchorage. I would appreciate the report and "draft bill" in time for our July 15 and 16 meeting in Anchorage. Please call me if you have any questions.