HB

3002

LEGAL SERVICES

DIVISION OF LEGAL AND RESEARCH SERVICES
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MEMORANDUM July 24, 2006

SUBJECT: Sectional Summary (HB3002)

TO: Representative Lesil McGuire
Attn: Shalon Szymanski

FROM: Dennis C. Bailey
Legislative Counsel

You have requested a sectional summary of the above-described bill.

As a preliminary matter, note that a sectional summary of a bill should not be considered an authoritative interpretation of the bill and the bill itself is the best statement of its contents.

Section 1. Adds to the purpose section of the Alaska Stranded Gas Development Act (SGDA) provisions authorizing fiscal terms related to oil and gas agreements and taxes related to oil and gas business. Removes the restriction that new investment may not significantly alter existing taxes and royalties.

Section 2. If the contract creates one or more economically affected municipality, the contract shall provide for a periodic payment to the state that may be appropriated to the natural gas pipeline impact fund to benefit the economically affected municipalities.

Section 3. Establishes a special account and the Alaska natural gas pipeline impact construction impact fund. The legislature may appropriate money from the account to the fund to address the economic and social impacts incurred by a municipality or a nonprofit organization serving the unorganized borough during construction.

Requires the Department of Commerce, Community, and Economic Development (DCCED) to adopt regulations concerning application and eligibility and establishes priority for the most directly or severely impacted communities or organizations. Payments are made to municipalities and organizations to the extent money is available. The department must report to the legislature the grants received, the determinations of eligibility for future grants, and recommendations of the amounts to be granted, with written justification for past and potential grants.

In consultation with the municipal advisory group, the commissioner of DCCED shall use money appropriated to the impact fund to make grants to municipalities and non-profit organizations serving the unorganized borough for listed impacts.

Before making grant awards, the commissioner shall provide reasonable public notice of grant applications received, recommendations, preliminary determinations concerning eligibility, and proposal allocations. The commissioner must hold public meetings to receive comments about the preliminary determinations and allocations, and shall give notice of final grant awards. Grants may be awarded thirty days after such public notice is given.

Grant money may not be used to retire municipal debt. Natural gas pipeline construction impact fund money does not lapse.

A direct or severe impact is defined to mean a clearly demonstrable effect on a community that contributes to a material change to transportation, infrastructure, law enforcement, emergency services, health and human services, education, the labor force, population, wages, subsistence, or a socio-cultural impact brought about by construction.

Section 4. Municipal advisory groups are disbanded 90 days after final distribution of impact money or commencement of operation of the project. Expenses of the advisory group may be reimbursed by grant under AS 43.82.505.

Section 5. Regulations adopted by DCCED to determine local contribution in a revenue-affected municipality and to perform its duties under AS 14.17.510 shall establish assessment standards for property that would have been assessed but instead is generating a payment in lieu of taxes under a contract developed under SGDA. The regulations must establish assessment standards and ensure that this type of property is included in the full and true value of the city and borough school district for the purpose of determining required local contributions for education funding.

Section 6. Sections 1 and 2 are retroactive to January 1, 2004.

Section 7. The Act is effective immediately.

If I may be of further assistance, please advise.

DCB:med
06-441.med

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STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

July 12, 2006

The Honorable John Harris
Speaker of the House
Alaska State Legislature
State Capitol, Room 208
Juneau, AK 99801-1182

Dear Speaker Harris:

Under the authority of article III, section 18, of the Alaska Constitution, I am transmitting a bill relating to the Alaska Stranded Gas Development Act. This bill is a shorter version of SB 2004, which was introduced at my request during the Second Special Session of the Twenty-Fourth Alaska State Legislature. The provisions of the present bill are based largely on certain amendments to SB 2004 that were reflected in CSSB 2004(NGD). The bill I am transmitting would authorize the commissioner of revenue to negotiate fiscal terms relating to oil, and includes provisions relating to certain payments to municipalities and nonprofit organizations.

I continue to believe that the proposed fiscal contract originally negotiated with the producers would be in the public interest. However, it is my intent to be responsive to the concerns expressed by the Legislature and members of the public concerning the provisions in the fiscal contract that provide for fiscal certainty for certain taxes levied on the production of oil. I encourage the Legislature to continue its review of the fiscal contract and consider amendments to the Stranded Gas Development Act that will provide a sound foundation throughout the duration of the contract. I pledge the full cooperation of my administration to assist you in this effort, which is in the long-term fiscal interest of the state.

I urge your prompt and favorable consideration of this bill.

Sincerely yours,

Frank H. Murkowski
Governor

Enclosure

HB 3002

Greenberg Traurig

Memorandum

TO: Alaska State Legislature
Legislative Budget and Audit Committee
Attention: Senator Gene Therriault and Representative Ralph Samuels

FROM: Phillip C. Gildan

DATE: July 13, 2006

RE: Initial Comments on Senate Bill No. 3002, Amendments to the Alaska Stranded Gas Development Act, Introduced 7/12/06

Senate Bill No. 3002 (SB 3002) significantly differs from Senate Bill No. 2004 (SB 2004) introduced during the last Special Session of the Legislature on the same subject matter. This memorandum discusses the provisions of Section 1 and Section 6 of SB 3002 vis-à-vis the provisions of SB 2004 (and does not address the municipal/education provisions in Sections 2-5 of SB 3002).

SB 2004 had addressed numerous structural changes to the various provisions of the Alaska Stranded Gas Development Act (SGDA) to reconcile the provisions of the SGDA with the terms of the Alaska Stranded Gas Fiscal Contract (SGFC) as negotiated among the Administration and the Producers. In that sense, SB 2004 represented a micro level restructuring of the various directions of the Legislature to the Administration for development of a contract. With SB 3002, the Administration appears to have switched emphasis from a micro level restructuring of the SGDA to a macro level restructuring without specific revision to the Legislature's prior directions in the SGDA.

This macro level emphasis manifests itself in the singular revision to the Purpose finding of the Legislature set forth in AS 43.82.010. Where the current SGDA dictates that development of the State's stranded gas be effected "without significantly altering tax and royalty methodologies and rates on existing oil and gas infrastructure and production," SB 3002 reveres that purpose. Section 1 of SB 3002 eliminates the prohibition against significant alteration of existing oil and gas taxes and royalties, and then broadly expands the scope of the SGDA to

cover establishment of fiscal terms for all "oil and gas agreements and taxes for a qualified sponsor . . . and related to their oil and gas business activity in the state."

This macro level restructuring approach then takes advantage of the existing terms of the SGDA to obviate the necessity of micro level restructuring of the SGDA. In particular, AS 43.82.200(7) provides:

> Sec. 43.82.200. Contract development
>
> If the commissioner approves an application and proposed project plan under AS 43.82.140, the commissioner may develop a contract that may include
>
> (7) other terms or conditions that are
>
> (A) necessary to further the purpose of this chapter; or
>
> (B) in the best interests of the state.

Subsection (7)(A) above provides the vehicle, when combined with the SB 3002 revision to the Purpose of the SGDA, for the Administration to posit that no further amendments to the SGDA are necessary to reconcile the terms of its negotiated SGFC with the SGDA.

The final revision needed to complete the macro level restructuring of the SGDA appears in Section 6 of SB 3002. This section makes the Section 1 revision to the Purpose of the SGDA retroactive to January 1, 2004. This retroactivity clause tends to provide protection against a third party challenge that the Administration's negotiation of the proposed SGFC prior to authorization in the SGDA was invalid.

Greenberg Traurig

Memorandum

TO: Alaska State Legislature
Legislative Budget and Audit Committee
Attention: Senator Gene Therriault and Representative Ralph Samuels

FROM: Phillip C. Gildan

DATE: June 3, 2006

RE: SB 2004 Proposed Stranded Gas Development Act Conforming Legislation
Legislative Amendments For Consideration Re Alternate Dispute Resolution

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In addition to our June 2, 2006, memorandum addressing potential amendments to SB 2004, Section 11, regarding Project Entities, we have proposed an amendment for consideration addressing concerns regarding alternative dispute resolution provisions of the proposed SGFC.

This amendment arises from the following concerns based on review of the proposed Stranded Gas Fiscal Contract ("SGFC").

Waiver of Sovereign Immunity. The SGFC contains numerous provisions effecting a waiver of sovereign immunity by the State in various different capacities, predominantly to allow for claims to be brought against the State by the Producers. Under the doctrine of sovereign immunity, without an express waiver, the state would not be subject to claims actions. The determination to provide such waivers or not is a policy level decision. However, one feature usually attendant to a state's waiver of sovereign immunity is not expressly addressed in the SGFC: that is a reasonable monetary limitation on the size of individual and aggregate claims against the state, absent which the state's potential liability is limitless. If the legislature wishes to address this concern, an optional amendment to SB 2004 is set forth below in AS 43.82.200(5)(A).

Indemnification. The SGFC contains numerous provisions requiring the State to indemnify or reimburse the Producers for losses in a variety of different situations. See Sections 8.3, 10.10, 11.12 , 21.3 and 22.1(g)(ii). Indemnification is an equitable doctrine that shifts the risk of loss from a direct party that incurs the loss, to an indirect party for whom or on whose behalf the direct party was acting. The determination to provide indemnification or not is a policy level decision. However, one feature often attendant to a grant of indemnity which is missing from the SGFC indemnifications is a limitation against indemnifying a direct party for losses caused by its own negligence, intentional actions or crimes, and to further limit indemnity to actual damages. It is generally considered unfair to shift the risk of loss to an indirect party, where the direct party is at fault and caused the loss. If the legislature wishes to address these

concerns, optional amendments to SB 2004 are set forth below in AS 43.82.200(5)(B)(C) and (D).

Burdens of Proof/Presumptions/Remedies. Section 38.3 of the SGFC eliminates any legal or equitable presumptions in favor or against a party in the interpretation of the SGFC (except for a minor presumptions provided in Section 19.10 of the SGFC). Exhibit C to the SGFC provides mandatory dispute resolution procedures which apply to any Dispute pursuant to Article 26 of the SGFC. These provisions are policy level decisions, and may benefit any given party on any given dispute. Section 5.5 of the SGFC, however, purports to supersede the provisions of Section 38.3 and Exhibit C for a Dispute arising out of a Participant's failure to act by Diligence, imposing different burdens of proof, limiting available remedies and imposing different presumptions, each of which negatively impacts the State and benefits of the Participants. For example, the State's right to seek specific performance by the Producers as a remedy is removed and the State is limited to termination of the contract. As another example, the normal dispute burden of proof is raised from the preponderance of evidence standard to a clear and convincing standard, a significantly more difficult burden of proof for a claimant. Whether to provide such exception for this one Dispute is also a policy decision. If the legislature wishes to address this concern, options include subjecting a Section 5.5 Dispute to the same dispute resolution provisions as other Disputes under Article 26 and Section 38.3, or amending the SGDA as per proposes AS 43.82.200(5)(E) below.

Amend Section 3 of SB 2004, to further amend AS 43.82.200 (5) to read as follows:

Sec. 3. AS 42.82.200 is amended to read:

(5) Terms regarding arbitration or alternative dispute resolution procedures, **provided,**

(A) the state shall not agree to a waiver of sovereign immunity without a reasonable monetary limit on such waiver under the facts and circumstances;

(B) the state shall not agree to indemnify, or otherwise hold harmless any person or entity that has been adjudged in a judicial, administrative, or alternative dispute resolution proceeding to be liable for negligence or misconduct in the performance of the person's or entity's duty or has been adjudged guilty of a crime or had such criminal adjudication withheld subject to probationary terms;

(C) the state may not eliminate claims for actual damages incurred by the state, and may not eliminate the equitable rights to seek specific performance and injunctive relief;

(D) the state shall not provide reimbursement or indemnification of special, consequential, incidental, lost profits or punitive damages; and

(E) arbitration or alternative dispute resolution procedures shall incorporate equivalent presumptions and burdens of proof as set forth for civil trials in Rule 301, Presumptions in General in Civil Actions and Proceedings, and Rule 302, Applicability of Federal Law in Civil Actions and Proceedings, Alaska Rules of Evidence, as amended.

ATTACHMENTS

Memo Prepared by Mr. Phil Gildan of Greenberg Traurig
May 22, 2006 Memorandum on LLC choice of law
and
June 2, 2006 Memorandum proposed SGDA amendments

Greenberg Traurig

Memorandum

TO: Don Shepler

FROM: Phillip C. Gildan

DATE: May 22, 2006

RE: Alaska Natural Gas Pipeline: Form of Ownership Entity
Limited Liability Company/Choice of Laws

The choice of utilizing a Limited Liability Company (LLC) as the form of ownership entity for the Alaska Natural Gas Pipeline appears to have been agreed to among the Producers and the State negotiating team. This memorandum does not discuss the conclusion to use the indirect ownership structure of an LLC, vis-à-vis a direct ownership structure of an undivided joint interest (UJI) form of project ownership. Instead, this memorandum addresses only the question of choice of law as to formation of the LLC, and implications to the State from such choice. (Note: this memorandum does not address tax implications from choice of formation law).

From the Gas Pipeline Contract Presentations by the State negotiating team, it has been represented that the Producers and the State negotiating team have agreed upon use of the Delaware Limited Liability Company Act, Delaware Code, Title 6, Subtitle II, Chapter 18 ("Delaware Act") in lieu of the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act").

Why choose the Delaware Act to form an Alaska Pipeline LLC instead of using the Alaska Act? In broad general terms, the business community maintains the perception that Delaware Courts provide a more developed body of case law affecting business entities than other states, and accordingly provide greater certainty of prediction of outcome in the event of business disputes. The corollary of this perception holds that Delaware Chancery Court Judges have a greater expertise in resolution of business disputes than judges in other states, again leading to greater certainty of prediction of outcome. An undercurrent of the perception of Delaware superiority, from both a body of law and judiciary, is that decisions by Delaware courts on business entity issues more often favor management/majority owners over minority owners. These perceptions may or may not prove out on a case by case analysis, but help explain the prevalent practice in the corporate world to establish business entities in Delaware.

Significant Differences Between Acts/Implications to Alaska

The Delaware Act represents one end of the spectrum of LLC enabling acts. It provides less mandatory entity terms, rights and obligations in favor of flexibility of the parties to freely set their own terms, rights and obligations by contract. The Alaska Act falls in the middle of the

spectrum. It provides significant freedom for the parties to set their own terms, rights and obligations, but imposes certain minimum member protections that cannot be contracted away. These minimum member protections afforded by the Alaska Act can be incorporated into a Delaware Act LLC by negotiation between/among the member parties, but absent such negotiation, those member protections will not exist. Two of these protections will be discussed below.

1. Duty of Managing Members to Entity:

The Delaware Act imposes no duty on managing members to either the company or to the other members of the company. It permits the members to contractually eliminate or create duties for managing members, with the exception that the general contract law which implies a duty of good faith and fair dealing, which can not be eliminated. The statute states:

§ 18-1101. Construction and application of chapter and limited liability company agreement.

> (a) The rule that statutes in derogation of the common law are to be strictly construed shall have no application to this chapter.
> (b) It is the policy of this chapter to give the maximum effect to the principle of freedom of contract and to the enforceability of limited liability company agreements.
> (c) To the extent that, at law or in equity, a member or manager or other person has duties (including fiduciary duties) to a limited liability company or to another member or manager or to another person that is a party to or is otherwise bound by a limited liability company agreement, the member's or manager's or other person's duties may be expanded or restricted or eliminated by provisions in the limited liability company agreement; provided, that the limited liability company agreement may not eliminate the implied contractual covenant of good faith and fair dealing.

The Alaska Act, however imposes an express duty on managing members to act in the best interest of the company and adopts an ordinary prudent person standard of care. This duty is imposed as statutory protection of minority members (and other managing members) rights from a manager or managing member acting in its own self-interest which may be contrary to the business of the entity and the investment backed interests of the other members. It states:

AS 10.50.135. Duty of care.

> (a) A person who is a manager or a managing member of a limited liability company shall perform the duties of management in good faith, in a manner the person reasonably believes to be in the best interests of the company, and with the care, including reasonable inquiry, that an ordinarily prudent person in a like position would use under similar circumstances.

Without the duty of care that the Alaska Act provides, a manager or managing members controlling an entity could act in their own self interest and contrary to the interest of the entity's business, with only the implied covenant of good faith, which is a significantly lower standard of care and more difficult to apply if the parties have contractually elected not to impose a duty to the entity.

2. Indemnity of Managing Members.

The Delaware Act grants broad discretion to the members to indemnify and hold harmless any member from and against any claims and demands without limitation. It states:

§ 18-108. Indemnification.

> Subject to such standards and restrictions, if any, as are set forth in its limited liability company agreement, a limited liability company may, and shall have the power to, indemnify and hold harmless any member or manager or other person from and against any and all claims and demands whatsoever.

The Alaska Act also provides the right to indemnify members, but imposes specific limitations on the ability to indemnify members, with material procedural terms enumerated. It states (with emphasis added):

AS 10.50.148. Indemnification of managers, managing members, employees, and agents; insurance.

> (a) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action or proceeding, whether civil, criminal, administrative, or investigative, other than an action by or in the right of the company, by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee, or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement of expenses, attorney fees, judgments, fines, and amounts paid in settlement actually and reasonably incurred by the person in connection with the action or proceeding ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company, and, with respect to a criminal action or proceeding, the person had no reasonable cause to believe the conduct was unlawful.*** The termination of an action or proceeding by judgment, order, settlement, conviction, or upon a plea of nolo contendere or its equivalent, does not create a presumption that the person did not act in good faith and in a manner which the person reasonably believed to be in or not opposed to the best interests of the company, and, with respect to a criminal

action or proceeding, the person had reasonable cause to believe that the conduct was unlawful.

(b) A limited liability company may indemnify a person who was, is, or is threatened to be made a party to a completed, pending, or threatened action by or in the right of the company to procure a judgment in its favor by reason of the fact that the person is or was a manager, managing member, employee, or agent of the company, or is or was serving at the request of the company as a manager, managing member, employee, or agent of another limited liability company, partnership, joint venture, trust, or other enterprise. Indemnification may include reimbursement for expenses and attorney fees actually and reasonably incurred by the person in connection with the defense or settlement of the action ***if the person acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the company. Indemnification may not be made in respect of any claim, issue, or matter as to which the person has been adjudged to be liable for negligence or misconduct in the performance of the person's duty to the company except to the extent that the court in which the action was brought determines upon application that, despite the adjudication of liability, in view of all the circumstances of the case, the person is fairly and reasonably entitled to indemnity for expenses that the court considers proper.***

(c) To the extent that a manager, managing member, employee, or agent of a limited liability company has been successful on the merits or otherwise in defense of an action or proceeding referred to in (a) or (b) of this section, or in defense of a claim, issue, or matter in the action or proceeding, the manager, managing member, employee, or agent shall be indemnified against expenses and attorney fees actually and reasonably incurred in connection with the defense.

(d) ***Unless otherwise ordered by a court, indemnification under (a) or (b) of this section may only be made by a company upon a determination that indemnification of the manager, managing member, employee, or agent is proper in the circumstances because the manager, managing member, employee, or agent has met the applicable standard of conduct set out in (a) and (b) of this section. The determination shall be made by the members.***

Without these limitations on indemnification, indemnity protection could be contractually provided even in those instances where the indemnified party acted against the interests of the entity, had causal or contributing negligence, or committed a crime.

3. **Dispute Resolution/Venue:** Neither the Delaware Act nor the Alaska Act dictates any particular form of dispute resolution or the location of venue for any dispute resolution proceeding involving companies organized under their respective acts. Under both of the acts, the parties may seek resort to the courts of each respective state to resolve disputes, but such resort is not mandated.

As presented in the proposed Alaska Stranded Gas Fiscal Contract, the parties are proposing a structurally developed alternative dispute resolution process and procedures. Under

the Contract, the substantive law of the State of Alaska applies with the Alaska Superior Court the venue for award judgment of matters arising out of the Contract. This may mitigate towards aligning the dispute resolution processes under the Contract and the LLC into a single integrated process, as disputes that might be anticipated to arise under the LLC or the Contract would likely implicate the other necessitating a global resolution under both.

From the Administration's presentations, however, it appears that the parties may be considering a traditional dispute resolution procedure for LLC related disputes, with venue in the Delaware Chancery Court, under the argument discussed above that Delaware judges would be more proficient in adjudicating claims arising from the Delaware LLC statute. Aside from an inconvenient forum arguments as the project and many of the participants will be located in Alaska, the likelihood of conflicting dispute resolution procedures and forums would likely eliminate any perceived superiority of Delaware Judges over Alaska Judges in interpreting Delaware LLC laws, particularly where the Delaware Act essentially waives statutory protections in lieu of contract agreement – such that no particular expertise in the Delaware Act may be necessary, but only expertise with contract interpretation in the context of pipeline project issues, in which the Alaska courts may have superior experience and proficiency.

Greenberg Traurig

Memorandum

TO: Alaska State Legislature
Legislative Budget and Audit Committee
Attention: Senator Gene Therriault and Representative Ralph Samuels

FROM: Phillip C. Gildan

DATE: June 2, 2006

RE: Alaska Stranded Gas Fiscal Contract:
Summary of Concerns Regarding Structure/Governance/Operation of Entities to Be Formed to Own And Operate the Various Elements of the Pipeline Project
Legislative Options

We have been requested to summarize our primary concerns with the draft Alaska Stranded Gas Fiscal Contract, dated May 24, 2006 (the "SGFC") and to review SB 2004, the SGDA Conforming Amendments proposed by the Administration ("SB 2004 Amendments") legislative options to address our concerns. This memorandum addresses one of those concerns; the lack of specificity of terms and conditions addressing the structure, governance and operation of the various Project Entities referenced in the ASGFC to be created to implement the Project, and own and operate the various Project elements (the "Entities Concern").

For purposes of this memorandum and for continuity of review, unless otherwise defined, the capitalized terms we have used in this memorandum have the same meaning given such terms in the SGFC.

Article 4 of the SGFC provides a general Project description, identifying the following Project elements: Gas Transmission Pipelines, GTP, Mainline, NGL Plant, Alaska to Alberta Project, and Alberta to Lower 48 Project. Within Article 5, Article 6, Article 7 and Article 9, the drafters of the SGFC provide that separate legal entities will be created to develop, own and operate each of the Project elements, and to implement the general terms of the SFGC (an "Entity" or collectively the "Entities"). The SGFC, however, provides little guidance or direction as to the structure, governance and operation of such Entities, the coordination between and among the Entities and the parties to the SGFC, or the interface of the terms and obligations set forth in the SGFC with the as yet unknown terms and conditions in the Project Entity agreements. As an example of some of the fundamental terms and conditions omitted from the SGFC are the following:

- form of entity and choice of establishing law;

- terms of Entity governance controlling the relationships among the interest holders, management and the entity;
- terms of Entity ownership, including initial and periodic capital contributions, duties among members and to the Entity, member transfer and buy-out issues, accounting and tax allocations, liquidation and dissolution, reporting and record keeping, audit and review;
- terms of Project implementation, including management, member voting, minority protections, staffing, procurement, vendor selection, asset acquisition and divestiture, amendment of Qualified Project Plan, creation of sub-entities, milestone triggers and approvals;
- terms of Project operating agreements addressing how the Project will be administered, termination and replacement of operators, compensation;
- terms regarding Project Tariff design, FERC applications, initial and continuing Open Seasons, expansion and extension, contracting with shippers;

The significance of these missing terms and conditions can be seen based on the duties and responsibilities which the SGFC delegates to the Project Entities. The Project Entities are charged to undertake the Project planning under the Qualified Project Plan, to update and amend the Qualified Project Plan, to structure and process the FERC and NEB project application and certification review, to determine whether to proceed with construction, to determine whether to terminate the Project or proceed to operation, to determine financing plans for the Project and capital contribution obligations, to structure the Pipeline tariff, to decide whether to Expand or Extend the Pipeline, and to own and operate the designated segments of the pipeline system both within and without the state.

However, the Contract contains scant direction regarding the Project Entities, and the Legislature has not been provided with drafts of any of the proposed Project Entity agreements. It is our understanding that negotiations are still on-going to develop the first and primary of these agreements—an agreement among the Producers and the State providing for the creation, governance, management, financing, capital contributions, operations and administration of the "Mainline Entity," and providing the structure and implementation criteria for the Qualified Project Plan.

The importance of the Project Entity agreements to the implementation of the intent of the Legislature set forth in the SGDA to assure the construction of the Project can hardly be overstated. Just listing the breadth and depth of the decisions and responsibilities delegated to the Project Entities under the Contract demonstrates the point. The apparent difficulty the Producers and the Administration are having in finalizing the first of the these agreements for the Mainline Entity, and their inability to complete such negotiations in time for submittal with the proposed Contract, proves the importance of the terms and conditions of the Project Entity agreements.

While we are told that the terms of the Mainline Entity LLC agreement are still being negotiated it is not clear that any of the Project Entity agreements will be provided to the

Legislature for comment or for approval. Indeed, SB2004 provides that the Commissioners of Revenue and Natural Resources will be authorized to enter into "collateral agreements" after execution of the Contract, and expressly without required approval of the Legislature (*See* Section 11 of SB 2004).

This is troubling since the specific terms of the Project Entity agreements can limit the rights and actions of the State with respect to critical decisions affecting the project. For example, it would be expected that the Mainline Entity LLC agreement will specify the voting rights of the participants with respect to approving the filing of the application for a FERC certificate. Likewise, it would be expected that the agreement will specify the voting rights of the State with respect to the decision to accept or reject a certificate and to proceed with construction of the project or terminate. Decisions with respect to voluntary expansions of the line will also presumably be addressed in the LLC agreement, as will decisions with respect to the pricing of expansion capacity (*i.e.*, whether it will be priced incrementally or on a rolled-in basis).

Even as basic a decision as where to establish the Mainline Entity can have significant impact on the likelihood of success of the Project. The state law in which an LLC is established can establish or negate certain duties among the parties which serve to protect minority members. The Alaska LLC Act imposes a much greater duty of care and fair dealing upon owners of an LLC than does the Delaware LLC law—which the Administration has indicated is intended to be the state in which the Mainline Entity LLC will be established. Such a duty of care and fair dealing is important where, as here, the State is a minority interest owner of the LLC. Without such duties being imposed by law the managing members of the LLC or the majority owners would be free to pursue their own self interests, and pursue activities contrary to the interest of the LLC and the Project. The choice that the Administration seems to have made with respect to the state in which to establish the LLCs is not optimal from the State's standpoint as a minority interest owner.

These missing terms and conditions are essential contractual elements. Without an agreement among the parties on these essential contract terms and conditions, the SGFC could be interpreted as nothing more than an agreement to agree, which may not reach the level of an enforceable contract.

Attached to this memorandum as an exhibit is an illustrative legislative amendment that provides an example of the type of guidance and direction to the commissioners of revenue and natural resources regarding Entity agreement terms and conditions that the legislature could consider to address the concerns discussed above.

EXHIBIT I

ILLUSTRATIVE LEGISLATIVE AMENDMENT

TO THE SB 2004 AMENDMENTS

Amend Section 11, by replacing AS 43.82.437(a) with the following:

Sec. 11. AS 43.82 is amended by adding a new section to read:

Sec. 43.82.437. Collateral Agreements. (a) The commissioner of revenue with the concurrence of the commissioner of natural resources may negotiate collateral agreements that are required to implement the state's acquisition of an ownership interest in the project **and each project entity to be created to own and operate any part of the project** that is the subject of a proposed contract developed under this chapter. **Each such collateral agreement shall be a condition subsequent to the proposed contract developed under this chapter, shall be subject to review and authorization to execute by the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session, and upon approval may be entered into by the public corporation as provided in (b) below.** The authority of the commissioner of revenue to negotiate collateral agreements on behalf of the state lapses 180 days after the effective date of the law authorizing the contract under AS 43.82.435, **provided, that with respect to collateral agreements submitted by the commissioner of revenue to the legislature or the Legislative Budget and Audit Committee within the 180 day time limit, the time limit shall be extended to 5 days after authorization has been approved. Each project entity collateral agreement to be negotiated shall incorporate the following minimum elements:**

(1) if organized to do business in the state, the project entity shall be a limited liability company organized under the Alaska Revised Limited Liability Company Act, AS Chapter 10.50 ("Alaska Act");

(2) for project entities organized under the Alaska Act, the operating agreement adopted under AS 10.50.095, or equivalent governing document for project entities organized under other jurisdictions ("Operating Agreement"), shall include the limitation that the state's obligation to fund continuing capital and operating obligations shall be subject to annual appropriation by the legislature; and provide further that the state's failure to appropriate a capital or operating obligation shall not be deemed a default of the state's obligation, but shall be deemed only to reduce the state's ownership interest on a pro rata basis based upon the amount of the failed appropriation relative to the amount of the capital or operating obligations funded by the remaining project owners.

(3) the Operating Agreement shall provide that the state shall not agree to a waiver of sovereign immunity without a reasonable monetary limit on such waiver under

the facts and circumstances; and provided further, that the state shall not indemnify, or otherwise hold harmless any person or entity that has been adjudged in a judicial, administrative, or alternative dispute resolution proceeding to be liable for negligence or misconduct in the performance of the person's or entity's duty or has been adjudged guilty of a crime or had such criminal adjudication withheld subject to probationary terms; provided further, that the state may not eliminate claims for actual damages incurred by the state, and may not eliminate the equitable rights to seek specific performance and injunctive relief; and provided further that the rights and limitations provided in this subsection shall apply to collateral agreements to be entered into under AS 43.82.437.

(4) the Operating Agreement shall provide that in the event of a dispute between or among the members of the entity, a subsidiary entity, an affiliate of a member, a member representative, and any other person or legal entity that has a membership or ownership interest in an owner entity of the project, such dispute shall be subject to the dispute resolution terms and procedures set forth in the contract as approved by the legislature pursuant to AS 43.82.435. The term "dispute" shall mean a dispute, matter, controversy or claim arising out of or relating to any owner entity of the project, to any ownership interest in the project, to any agreement between or among the members or owners of any owner entity of the project arising out of or relating to such owner entity of the project, or to the operation, management, or implementation of the project, including its interpretation, construction, performance, enforcement, privileges, rights or obligations. Such dispute resolution terms shall incorporate equivalent presumptions and burdens of proof as set forth for civil trials in Rule 301, Presumptions in General in Civil Actions and Proceedings, and Rule 302, Applicability of Federal Law in Civil Actions and Proceedings, Alaska Rules of Evidence as amended.

(5) the Operating Agreement shall provide that the managing members and member representatives owe a duty to act in the best interest of the entity and perform their duties in good faith towards the goal of implementation of the project.

(6) the Operating Agreement shall provide that the entity shall not effect a material change or amendment to the Qualified Project Plan without the review and authorization of the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session.

(7) the Operating Agreement shall provide that the members of the governing body of any subsidiary entity organized by the entity shall be the members of the governing board of the entity, unless otherwise authorized by the legislature, or the Legislative Budget and Audit Committee if the legislature is not in session.

(8) the Operating Agreement shall provide the state the unilateral right to initiate expansions of the project, provided the state funds or obtains third party funding from a credit worthy customer for each such expansion or extension, and shall include terms for voluntary expansion, including:

A) holding periodic (every 3-5 years) binding or non-binding open seasons to assess market demand for expansion;

B) commit to satisfy all creditworthy demands for capacity expansion in reasonable engineering increments;

C) commit expansion for creditworthy shippers in less-than reasonable engineering increments when such shippers commit to contributions in aid of construction sufficient to keep the project entity whole, including authorized return; and

D) commit the project entity to propose and defend the use of rolled-in pricing for all expansions.

(9) the Operating Agreement shall provide that in the event the entity elects to contract with a vendor to operate the entity or implement the project, such vendor shall be independent of and not an affiliate of the members of the entity.

(10) the Operating Agreement shall provide that state member shall have the right to participate in all meetings of the governing board of the entity and vote on all decisions of the entity, including, but not limited to, decisions affecting tax allocations between or among the taxpaying members of the entity.

(11) the Operating Agreement shall provide that the state member shall have the right to review all books and records of the entity, including, but not limited to, all contracts, and to audit the finances of the entity at any time and from time to time.

(12) the Operating Agreement shall provide that upon termination, liquidation or dissolution of the entity, the state shall have a right of first refusal and option to acquire all of the assets of the entity at the then fair value of the assets.

(13) the Operating Agreement shall provide that in the event a member seeks to transfer or divest its ownership interest in the entity, the state shall have a right of first refusal and option to acquire the member's ownership interest at the then fair value of the interest.

(14) the Operating Agreement shall provide that in the event that the entity seeks to transfer or divest any or all of the project assets, the state shall have a right of first refusal and option to acquire such project assets at the then fair value of such project assets.

(15) the Operating Agreement shall include a right of first refusal and option by which the state may acquire all or any part of the project assets in the event that Federal Energy Regulatory Commission of the United States Department of Energy, the United States Department of Justice, the Federal Trade Commission, or other applicable federal or state agency or adjudicatory body orders one or more qualified sponsor or the qualified

sponsor group, or their affiliates, to divest any or all ownership interest in the project, at the then fair value of such project assets.

(16) the Operating Agreement shall provide that the project entity shall utilize project financing supported by federal guarantee instruments as defined in the Alaska Natural Gas Pipeline Act to the maximum extent available from the Federal Treasury, and shall limit the equity portion of project capitalization to no more than 20% of total capital.

For purposes of this section (a), the term "fair value" means the value as agreed to by the affected members or as determined under the dispute resolution process if no agreement can be reached, provided fair value shall be determined based on original cost less depreciation, comparable sales or income approach valuation methodologies.

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 1
Bill Version: HB 3002
(H) Publish Date: 7/12/06

Revision Date/Time (Note if correction):
Dept. Affected: Natural Resources
Title: Stranded Gas Development Act Amendments
RDU: Resource Development
Component: Oil and Gas Development
Sponsor: Rules by Request of the Governor
Requester: Governor
Component No. 439

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
1037 GF/Mental Health						
Other (Specify Type--Do not abbreviate)						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0
Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill would amend the Alaska Stranded Gas Development Act including provisions relating to certain payments to municipalities and nonprofit organizations.

There is no anticipated cost to DNR from this bill.

Prepared by: William Van Dyke, Acting Director
Phone 269-8800
Division: Oil and Gas
Date/Time 7/12/2006
Approved by: Michael Menge, Commissioner
Date 7/12/2006
Agency: Natural Resources

(Revised 9/7/2005 OMB)

FISCAL NOTE

STATE OF ALASKA
2006 LEGISLATIVE SESSION

Fiscal Note Number: 2
Bill Version: HB 3002
(H) Publish Date: 7/12/06

Revision Date/Time (Note if correction):
Dept. Affected: Revenue
Title: Stranded Gas Development Act Amendments
RDU: Administration and Support
Component: Commissioner's Office
Sponsor: Rules Committee
Requester: Governor
Component No.: 123

Expenditures/Revenues (Thousands of Dollars)

Note: Amounts do not include inflation unless otherwise noted below.

OPERATING EXPENDITURES	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Personal Services						
Travel						
Contractual						
Supplies						
Equipment						
Land & Structures						
Grants & Claims						
Miscellaneous						
TOTAL OPERATING	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES						
CHANGE IN REVENUES ( )						

FUND SOURCE (Thousands of Dollars)

1002 Federal Receipts						
1003 GF Match						
1004 GF						
1005 GF/Program Receipts						
Bond Proceeds						
Bond Bank Investment Earnings						
TOTAL	0.0	0.0	0.0	0.0	0.0	0.0

Estimate of any current year (FY2006) cost: 0.0

Mark this box (X) if funding for this bill is included in the Governor's FY 2007 budget proposal:

POSITIONS

Full-time						
Part-time						
Temporary						

ANALYSIS: *(Attach a separate page if necessary)*

This bill amends the Alaska Stranded Gas Development Act (AS 43.82) (SGDA) to clarify and/or provide additional authority for the development of stranded gas fiscal contract terms relating to oil. The bill also includes provisions relating to certain payments to municipalities and nonprofit organizations and creates an impact grant fund.

Funding for negotiations under the SGDA has been previously provided and no additional funding is required as a result of this legislation.

Prepared by: Jerry Burnett
Phone 465-2312
Division: Administrative Services
Date/Time 7/12/06 12:00 AM
Approved: Steve Porter
Date 5/9/2006
Agency: Department of Revenue

(Revised 9/7/2005 OMB)

May 29, 1998

The Honorable Tony Knowles
Governor
State of Alaska
P.O. Box 110001
Juneau, Alaska 99801-0001

Re: SCS CSHB 393(FIN) -- Alaska Stranded Gas Development Act
A.G. file no: 883-98-0083

Dear Governor Knowles:

At the request of your legislative director, Pat Pourchot, we have reviewed SCS CSHB 393(FIN), the Alaska Stranded Gas Development Act, which would authorize the commissioner of revenue to develop new fiscal terms for projects that develop stranded natural gas resources in the state.

The bill is identical in most important respects to the bill introduced at the request of the governor. The bill is largely the product of the North Slope Gas Commercialization Team, which was established last year by House Bill 250. The team, which consisted of the attorney general, the commissioner of revenue, and the commissioner of natural resources, was charged with recommending terms for a contract that would improve the economic feasibility and competitiveness of a North Slope gas project. The team also was asked to recommend legislative provisions necessary or appropriate to implement such a contract. The purpose of the team s efforts and of the bill is to enable the state to create a fiscal regime appropriately tailored to the development of some or all of the approximately 35 trillion cubic feet of gas on the North Slope. Today that gas is stranded there because of the prohibitive cost of getting it to market.

Sections 1 through 9 of the bill would authorize the commissioner of revenue to develop the terms of a fiscal contract with sponsors of projects to develop known gas reserves that currently cannot be marketed economically. Unlike the governor s proposal, the bill is limited to liquefied natural gas (LNG) projects. In a letter of intent adopted by the Senate, Senator Kelly explains that while the state has studied the economics of a North Slope LNG project, no comparable study has been made of the next most likely alternative, a gas-to-liquids (GTL) project. The letter of intent suggests that the state should continue to explore any method of commercializing its stranded gas resources, and that an economic analysis of GTL may support amending the Stranded Gas

Development Act to include i' The North Slope Gas Commercialization Team s Report to the Governor of December 15, 19' .1 fact identifies an LNG project as the most promising alternative for commercializing North Slo[illegible] gas and focuses its economic analysis exclusively upon it, although the fiscal principles in the Report which are incorporated in the bill, could be applied more broadly.

The payments required by the contract would replace some or all of the state and local taxes that would otherwise apply to qualified sponsors as a consequence of their participation in a qualified project. Those taxes might include: (1) the state and local ad valorem property taxes that would be imposed on the project facilities; (2) the production or severance tax that would be imposed on the gas produced and marketed by the project; and (3) the state corporate income tax obligation arising as a consequence of the construction and operation of the project. In addition, the commissioner of natural resources may develop terms, which the commissioner of revenue may include in a contract, addressing timing and notice of the state s right to take its royalty gas in kind, as well as a method for valuing the state s royalty share of gas. In effect, the bill would permit the commissioner of revenue to develop terms that would replace the state s current fiscal regime --which, if applied to a North Slope gas project today, would be relatively regressive and front-end loaded -- with a regime that is more progressive and back-end loaded, in an effort to lower the risk of the project and boost the rate of return that investors could expect.

The principal difference between this bill and the version introduced at the governor s request is that the former, though empowering the commissioner of revenue to negotiate fiscal terms, does not authorize the commissioner to actually execute the contract. Instead, sec. 3 of the bill adds AS 43.82.435, which provides that the governor may transmit a contract developed under this chapter to the legislature together with a request for authorization to execute the contract. The section further provides that the contract is not binding unless the governor is authorized to execute the contract by a subsequent enactment. In the view of legislative counsel, this aspect of the bill may reflect an encroachment by the legislature upon the powers properly reserved to the executive branch under the Alaska Constitution. However, legislative counsel also recognized that the executive is free as a matter of comity to acquiesce in what amounts to the legislature s request for more active oversight. In fact, the governor, in the transmittal letter accompanying his proposed legislation, encouraged the legislature to review the contract and approve it before it became effective. The governor made this request because of the importance of North Slope gas development to the state.

We agree with legislative counsel that the governor may acquiesce in the approach adopted by the legislature. We also note that it is far from clear that the legislature s approach would, in fact, violate the separation of powers doctrine. The legislature arguably has not usurped an executive function, but rather has divided its delegation of authority into two steps, rather than the traditional one. It should be noted, moreover, that both the negotiation of the contract and its submission to the legislature are discretionary. Finally, it is relevant that the contract that is to be provided to the legislature involves the state s fiscal regime, a subject substantially within the purview of the legislative branch under art. IX of the Alaska Constitution. Since the contractual payments in lieu of taxes authorized by this bill could be characterized as, in essence, a new tax, the legislature may well be required to levy the new tax by law. Viewed in this light, the legislature s approach might not only be permissible, but necessary, under the constitution.

There are a number of other important issues raised by this legislation. First, art. IX, sec. 1 of the Alaska Constitution provides that [t]he power of taxation shall never be surrendered. The bill raises the surrender of the taxing power question because it contemplates development of a long-term contract that reflects the fiscal terms applicable to the sponsors of a stranded gas project. The legislation itself, however, is not unconstitutional under art. IX, because it does not purport to bind future legislatures. Instead, it merely authorizes the commissioners of revenue and natural resources to develop appropriate contract terms. Authorization to execute the contract will not be delegated to the executive branch until the legislature has had an opportunity to review the contract and ascertain whether its terms are in the public interest Even if that authorization is given, the legislature may expressly provide that the contract s fiscal terms are binding only so long as no future legislature decides to exercise the taxing power in a different way. In other words, the surrender of the taxing power issue may never arise. A concrete analysis of the issue must be left to the day the legislature decides whether, and if so under what terms, it will allow execution of a contract at all.

The second issue is the bill s provision in sec. 3, adding AS 43.82.500 - 43.82.520, for municipal participation and revenue sharing. Like the former Industrial Incentive Act (AS 43.25, repealed in 1986), the bill recognizes that changes in the state s tax regime will be ineffective to encourage development unless municipal tax changes are also included. Unlike the former Act, the bill includes provisions to ensure that affected municipalities receive a fair and reasonable share of the payments from a project that affects them. The bill also creates a municipal advisory group to assist the commissioner in developing the contract terms that may affect municipalities.

Third, the bill recognizes that the commissioners of revenue and natural resources may have to review confidential company data in order to develop fiscal terms that best advance the state s interests. The people of the state, nowever, have a right to know the basis for administrative decisions affecting their welfare. The bill strikes a balance between, on the one hand, the state s interest in encouraging competition and the right of companies to keep proprietary information from their competitors and, on the other hand, the public s right to review their elected and appointed officials decisions. The bill does this by limiting confidential treatment to proprietary information that, if revealed, would both affect a company s competitive position and significantly diminish the value of the information. In addition, information loses its confidential status as soon as confidentiality is no longer necessary to protect the company s competitive position or the information s value.

Finally, an important goal of this legislation is to facilitate the hiring of Alaskans in all phases of the construction and operation of a stranded gas project. The bill adds AS 43.82.230, which requires employers participating in a project to advertise locally for available positions and use Alaska job service organizations located throughout the state. Most significantly, the commissioner is directed, [w]ithin the constraints of law, to include a provision in a contract requiring sponsors to employ qualified Alaska residents and Alaskan-owned businesses. The commissioner of labor will prepare and present to the legislature an annual report compiled from state data bases, particularly quarterly unemployment insurance reports, regarding the residency of employees working in the state on the project. We see no constitutional problem with these aspects of the bill, because the bill expressly provides that the Alaska hire provisions in the contract must be consistent with the constraints of law.

Finally, we note that although the bill is unique in many respects, the legislature has passed comparable measures to encourage industrial development in the past. For example, the liquefied gas plant, gas pipeline and related facilities on the Kenai Peninsula benefitted directly from the Alaska Industrial Incentive Act, former AS 43.25. Without the tax advantages provided by the Act at that time, the Kenai LNG facility might never have been built. Today, that facility is a significant source of jobs and property tax revenues in the Cook Inlet area.

We see no legal problems presented by this bill.

Sincerely,

Bruce M. Botelho
Attorney General

BMT:JPG:jfs

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MEMORANDUM May 23, 2006

SUBJECT: Authority of legislature to approve or reject an executive branch contract (Work Order No. 24-LS1939)

TO: Representative Les Gara

FROM: Theresa Bannister
Legislative Counsel

You have stated that the oil companies or the governor may argue that legislative approval is not needed for the Alaska Stranded Gas Fiscal Contract (Contract) because that legislative role violates the separation of powers doctrine of the state constitution. You have asked what the likelihood is that the argument would prevail.

Based on current authority, it is my opinion that the legislative approval required by AS 43.82.435 would probably be held to violate the separation of powers doctrine of the state's constitution. Notwithstanding this conclusion, however, the legislature's inherent power over the fiscal matters of the state, the size and uniqueness of the contract, and a limited line of authority in New Jersey and Virginia, do provide some basis for arguing that the approval does not violate the separation of powers doctrine.

Contracts to implement and execute the laws of the state are normally considered to fall within the province of the executive branch, so requiring the approval of an executive branch contract by the legislature appears to be an intrusion into executive branch powers. While the legislature may enact standards for the exercise of an executive power, it may generally not reserve the power to approve or authorize a particular action. For example, former AS 37.05.280, which required legislative approval of certain leases of state office space, was held to violate the doctrine of separation of powers.[1]

Although some executive and legislative powers overlap (e.g., regulations are legislative in nature), the Supreme Court in this state has held that the separation of powers doctrine requires that the blending of governmental powers will not be inferred in the absence of an express constitutional provision.[2] Although the legislature has extensive power over

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[1] Marine View Chapter Juneau Tenants Association v. Alaska State Housing Authority, Superior Court, First Judicial District, 1JU-80-1037 Civ., Nov. 3, 1981.

[2] Bradner v. Hammond, 553 P.2d 1, 8 (Alaska 1976).

the purse strings of the state, there is no express authority in the state constitution that allows the legislature to approve executive branch contracts or requires the executive branch to submit its contracts to the legislature for approval.

The executive branch has, for many years, taken the position that the requirement for legislative approval of royalty oil contracts is unconstitutional.[3] However, while the executive branch has consistently asserted that legislative approval provisions are unconstitutional, it has often complied with these requirements as an accommodation to the legislative desire for oversight.

The Department of Law has held fairly consistently to the position that negotiation of contracts is the prerogative and obligation of the administration, to the exclusion of the legislature, citing separation of powers principles:

> [O]ur office [that is, the Department of Law] has noted that a statute requiring legislative approval of an individual contract . . . was possibly constitutionally infirm. 1987 Inf. Op. Att'y Gen. (April 1; 663-87-0392); 1985 Inf. Op. Att'y Gen. (Aug. 13; 166-065-86); 1981 Inf. Op. Att'y Gen. (Nov. 3; J66-159-82); 1976 Inf. Op. Att'y Gen. (Feb. 11; Boness).[4]

In addition, the attorney general has stated:

> In approving individual contracts, the legislature does not exercise a lawmaking function. Consequently, in the absence of a constitutional grant of such power or some unique circumstance that we cannot presently contemplate, a statute requiring legislative approval of an individual contract is a violation of the separation of powers.[5]

However, from the inception of consideration of the bill that eventually became the Alaska Stranded Gas Development Act, the Knowles administration (eventually acknowledging that because the contractual payments in lieu of taxes provisions are potentially troublesome, legislative involvement "might not only be permissible, but necessary, under the constitution"[6]) drew a clear line between the process of negotiation

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[3] See Governor's transmittal letter for SB 164 dated April 22, 1995, Senate Journal, pages 1190-1191.

[4] Quoted in Opinion of the Attorney General 1988-2, August 30, 1988.

[5] 1981 Inf. Op. Att'y Gen. (Nov. 3; J66-159-82), at 4 - 5.

[6] The source of the quoted language is the bill analysis letter for SCS CSHB 393(FIN) (Alaska Stranded Gas Development Act), pp. 5 - 6, prepared by the Office of the Attorney General, May 29, 1998, and reads in part:

of the terms and conditions of a proposed contract, an activity reserved to the executive, and exercise of a power of approval of a contract as proposed (expressed in terms of an "authorization to execute") that has been transmitted to the legislature for review and approval before the contract's final execution. Under this approach it could be argued that while legislative approval of a contract is exceptional, the circumstances under which payment in lieu of taxes is to substitute for actual tax receipts is also unprecedented and could justify this intrusion into executive branch powers. The size and uniqueness of the proposed contract may tempt one to conclude that the separation of powers doctrine is not violated in this situation, but there does not appear to be much authority to support that conclusion.

There is a line of reasoning that would allow a legislature more leeway in this regard where there is no possibility of significant interference with the executive branch's discretion, as in this case where the governor presents the contract to the legislature for an up or down vote. This line of reasoning regarding legislative oversight appears in New Jersey where the court recognized the importance of legislative oversight where projects require continued budget appropriations.[7] In that case, the court seemed to place importance on the limited potential that the legislative action had to interfere with executive action and emphasized that the legislature had no control over the agency's projects unless the Governor first approved them.[8] However, there was a vigorous dissent in the case, and the dissent cited an Alaska case to support its position.[9] This case

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> . . . We . . . note that it is far from clear that the legislature's approach would, in fact, violate the separation of powers doctrine. The legislature arguably has not usurped an executive function, but rather has divided its delegation of authority into two steps, rather than the traditional one. It should be noted, moreover, that both the negotiation of the contract and its submission to the legislature are discretionary. Finally, it is relevant that the contract that is to be provided to the legislature involves the state's fiscal regime, a subject substantially within the purview of the legislative branch under art. IX of the Alaska Constitution. Since the contractual payments in lieu of taxes authorized by this bill could be characterized as, in essence, a new tax, the legislature may well be required to levy the new tax by law. Viewed in this light, the legislature's appro might not only be permissible, but necessary, under the constitution.

[7] Enourato v. N.J. Building Auth., 448 A.2d 449, 453 (New Jersey 1982).

[8] Enourato at 453 - 454.

[9] Enourato at 461.

was cited by a Virginia court to hold that a legislative approval requirement (in a situation similar to that in Enourato) did not violate the separation of powers doctrine.[10]

In conclusion, while it may be possible to successfully make a case in this situation that the legislature's approval does not violate the separation of powers doctrine, there seems not to be much authority for that position.

If I may be of further assistance, please advise.

TLB:med
06-392.med

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[10] See Baliles v. Mazur, 297 S.E.2d 695, 700 - 701 (Virginia 1982) (emphasizing the reasonableness of legislative oversight for major projects).

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MEMORANDUM June 22, 2006

SUBJECT: Proposed Natural Gas Pipeline Contract (Work Order 24-LS1968)

TO: Representative Les Gara
Attn: Darcy Dugan

FROM: Tamara Brandt Cook
Director TBC

(1) *Does the legislation proposed by the Governor during the last special session, HB 2001, 2002, 2003, and 2004, provide the legal authority for the Governor to execute the proposed natural gas pipeline contract, as far as you know?*

It is my understanding that it is the Governor's position that the legislation he introduced, taken together, provide the necessary legal basis for the execution of the proposed contract. The administration is, obviously, keenly aware of both the provisions of existing law and the content of the proposed contract. I have no reason to suspect that the Governor, through mistake, omission, or otherwise, failed to request all the changes to statute necessary to accomplish his goal of making it possible to execute the contract in the form it was in during the last special session.

(2) *If all four bills presented by the Governor were enacted by the legislature, but the legislature subsequently failed to approve the proposed contract, is it possible that the Governor could, nonetheless, execute substantially the same agreement?*

An existing provision of the Alaska Stranded Gas Development Act provides for legislative approval of a contract developed under that Act.

> Sec. 43.82.435. Legislative authorization. The governor may transmit a contract developed under this chapter to the legislature together with a request for authorization to execute the contract. A contract developed under this chapter is not binding upon or enforceable against the state or other parties to the contract unless the governor is authorized to execute the contract by law. The state and the other parties to the contract may execute the contract within 60 days after the effective date of the law authorizing the contract.

Contracts to implement and execute the laws of the state are normally considered to fall within the province of the executive branch under the separation of powers doctrine.

separation of powers grounds, the issue will then be whether that requirement is severable from the rest of the Alaska Stranded Gas Development Act or whether the entire Act falls. A general severability clause has been enacted and appears at AS 01.10.030. The Alaska Supreme Court has found that AS 01.10.030 creates a weak presumption in favor of severability. A specific severability clause included in a bill creates only a slightly higher presumption of severability. (Lynden Transport, Inc. v. State, 532 P.2d 700, pages 712 and 713 (Alaska 1975) A provision is not severable unless it appears that the remainder of the Act can be given legal effect and that the legislature intended the Act to stand in the event the provision is invalid. (Id. at page 713; Vik v. CFEC, 636 P.2d 597 (Alaska 1981))

So, despite the presumption in favor of severability, it is at least possible that the court, having concluded that the requirement for legislative approval is invalid, would go on to decide that the approval provision is not severable from the remainder of the Act. If this is the result the legislature prefers (that the Alaska Stranded Gas Development Act itself fall if the approval provision falls, probably taking the contract with it), when the legislature considers amendments to that Act in the future it could include a provision expressly stating that AS 01.10.030 does not apply and that it is the intention of the legislature that the requirements of AS 43.82.435 not be severed. On the other hand, the legislature could bolster the presumption in favor of severability by added language that specifically states that if AS 43.82.435 is held invalid, the legislature intends that the balance of the Act continue to apply.

TBC:lmb
06-198.lmb

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MEMORANDUM May 18, 2006

SUBJECT: Effect of state contract on the initiative process (Work Order No. 24-LS1940)

TO: Representative Paul Seaton

FROM: Dennis C. Bailey
Legislative Counsel

This memo responds to your question asking what would be the legal basis or effect of a contract attempting to preempt the effect of an initiative. The short answer is that the people may enact legislation to the same extent the legislature has the power to legislate. It is unlikely that a contract with the state could revoke, compromise, or impair the right of initiative. However, assuming the contract is valid, its terms may have the effect of avoiding the application of the initiated law in certain circumstances or for certain periods of time.

Legislation through initiative.

Article XI, sec. 1 of the Constitution of the State of Alaska provides:

> Initiative and Referendum. The people may propose and enact laws by the initiative, and approve or reject acts of the legislature by the referendum.[1]

The power of the legislature to legislate and the power of the people to legislate by initiative are generally coextensive. Article XII, sec. 11 provides:

> As used in this constitution, the terms "by law" and "by the legislature," or variations of these terms, are used interchangeably when related to law-making powers. Unless clearly inapplicable, the law-making powers assigned to the legislature may be exercised by the people through the initiative, subject to the limitations of art. XI.[2]

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[1] The right of initiative is limited by article XI, sec. 7 which provides, "The initiative shall not be used to dedicate revenues, make or repeal appropriations, create courts, define the jurisdiction of courts or prescribe their rules, or enact local or special legislation. The referendum shall not be applied to dedications of revenue, to appropriations, to local or special legislation, or to laws necessary for the immediate preservation of the public peace, health, or safety."

[2] The term "clearly inapplicable", as used in article XII, sec. 11, is interpreted in Brooks v. Wright, 971 P.2d 1025, 1029 (Alaska 1999), where the court suggested that the

The right of initiative should be liberally construed to permit exercise of that right, Thomas v. Bailey, 595 P.2d 1, 3 (Alaska 1979). Further, the subject matter limitations that the Alaska Constitution places on initiatives should be narrowly interpreted. Brooks v. Wright, 971 P.2d 1025 (Alaska 1999).

Since the legislature clearly has the power to levy new taxes and change the rate of existing taxes, and since these powers are not excluded by article XI, sec. 7, it appears that the power to levy a new tax or change the rate of an existing tax may be exercised by initiative.

Preemption of tax imposed by initiative.
Your question also asks whether a contract could preempt the effect of a tax imposed by an initiative.

Article IX, sec. 1[3] of the Constitution of the State of Alaska prohibits legislative action (by initiative or by the legislature) which surrenders, suspends, or contracts away the power to tax. Article IX, sec. 4 also provides for exemptions from taxation under conditions and exceptions which may be provided by law. These exceptions would apply equally to law created by the initiative or by the legislature. In other words, a person could receive an exemption from a tax imposed by initiative or by legislative enactment. Likewise, a contract, if valid, could provide for payments in lieu of taxes for a tax enacted by either means. Such a contract would, presumably, address the application to the contracting parties of both existing tax law and future amendments to that law, whether they be accomplished through initiative or legislative enactment. It seems unlikely, however, that ever an otherwise enforceable contract could provide for a tax exemption as such because exemptions must be provided "by law" or "by general law" not by contract. Art. IX, sec. 4.

Finally, you asked for a prediction whether the Alaska Supreme Court would uphold the use of contracting power to "undermine the effect of an initiative." I am reluctant to predict whether the proposed contract and the related legislation in their final form are enforceable, or the effect of the initiative on the terms of the contract.

If I may be of further assistance, please advise.

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framers added that phrase "so that the initiative would not replace the legislature where the legislature's power serves as a check on other branches of government, such as legislative power to define courts' jurisdiction or override judicial rules."

[3] "The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article." Art. IX, sec. 1, Constitution of the State of Alaska.