SB

104

(FILE 4)

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Senate Judiciary Committee

SB 104 – Natural Gas Pipeline Project

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STATE OF ALASKA

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March 13, 2007

The Honorable Hollis French, Chair Senate Judiciary
Alaska State Legislature
State Capitol, Room 417
Juneau, AK 99801-1182

The Honorable Jay Ramras, Chair House Judiciary
Alaska State Legislature
State Capitol, Room 118
Juneau, AK 99801-1182

Re: AGIA Gas Production Tax Exemption

Dear Senator French and Representative Ramras:

I was recently asked in the Senate Judiciary committee about the extent to which the gas production tax exemption in article 3 of the Alaska Gasline Inducement Act (AGIA), SB 104 and HB 177, may provide fiscal certainty to parties that commit gas in the first binding open season of an AGIA project.

The current major North Slope producers have long maintained that they require some element of fiscal certainty before they commit their natural gas reserves to the gas pipeline. As you are aware, the previous administration attempted to offer the producers various concessions to provide the "fiscal certainty" they sought in a variety of ways through its proposed Stranded Gas Development Act (SGDA) contract. In my opinion these concessions went too far – both in terms of good public policy and the Alaska Constitution. I do not believe that a contractual lock-up of the state's fiscal system and other elements of state sovereignty for over three decades is either in the public's interest or supported by Art. IX, Sec. 1 of the Alaska Constitution.

The SGDA contract proposed by the Murkowski administration was extremely broad in its proposed contracting away of Alaska's sovereign powers of taxation. The operating assumption of the contract was exclusion from all state and local taxes unless specifically listed. For example, the SGDA contract would exempt North Slope producers from "any Tax on their oil and gas related business activity" subject to specific

exceptions under the contract, such as the capped tax under the fiscal stability cap and certain fixed payable taxes for items such as vessel taxes.

The proposed contract also contained other provisions antithetical to state sovereignty. These included restrictions on Regulatory Commission of Alaska authority over the project; requiring the state to arbitrate disputes that would otherwise be subject to state regulatory procedures or state judicial review; agreement that judgments against the state can be enforced in courts outside of Alaska; indemnification of tax payments made by the North Slope producers; and allowing offset of tax payments directly against state royalty revenues.

The AGIA, by contrast, is very narrowly focused. It takes a specific and limited approach to reducing the potential for production tax changes for parties that commit their gas to the pipeline licensed under the Act. Article 3 of the AGIA entitles parties that commit gas in the first binding open season to a production tax exemption. This exemption provides a financial cushion against increases in gas production taxes that may be adopted by future legislatures during the first 10 years of operation of the AGIA project and is a reasonable inducement for parties willing to commit gas to the licensed project early on.

Unlike the sweeping provisions in the proposed SGDA contract, the AGIA approach is consistent with the State's past practices and the Alaska Constitution. Several legal principles support this conclusion.

Art. IX, sec. 1 of the Alaska Constitution states: "the power of taxation shall never be surrendered. This power shall not be suspended or contracted away, *except as provided in this article.*"[1] If the sentence "[t]his power shall not be suspended or contracted away, *except as provided in this article*" ended at the comma (as originally proposed during the Alaska Constitutional Convention), there would no question that there is an absolute prohibition on the legislature's authority to provide some tax certainty.[2]

But the sentence does not end there. It contains the clause "*except as provided in this article.*" A basic tenet of statutory construction provides that "every word, sentence,

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1 Emphasis added.

2 In fact, the Constitutional Convention rejected the more prohibitive National Municipal League Model State Constitution that stated "[t]he power of taxation shall never be surrendered, suspended, or contracted away" for the current version, which adds the clause "except as provided in this article." 3 Constitutional Studies, PAS Staff Paper 9, Vol. 3, State Finances (1955): Public Administrative Service (P AS) Staff Paper, State Finance, at 15-16.

or provision in a statute was intended for some useful purpose, has some force and effect."[3]

Article IX does not go on to describe specific circumstances under which the power of taxation may be subject to contract, but it does give the legislature broad powers to enact tax exemptions by general law in sec. 4.[4]

To give force and effect to the clause "*except as provided in this article,*" I believe that a court would read sections 1 and 4 together. Thus, the legislature has power to contract away taxing authority as described in sec. 1 through the use of the tax exemptions set out in sec. 4.

This interpretation is supported by the related statutory tenet that "statute[s] should be construed so that effect is given to all its provisions and no part is inoperative or superfluous, void or insignificant."[5] To give effect to the final clause of sec. 1, that the power of taxation shall not be suspended or contracted away "except as provided in this article," art. IX must provide some authority. Article IX, sec. 4, provides authority for the legislature to set a tax exemption by contract. Without this authority, the clause "except as provided in this article" would have no meaning.

In fact, the legislature has on several occasions previously provided statutory tax exemptions that were described as having the force of contracts. For example, the Alaska Property Tax Act of 1949 authorized the tax commissioner to exempt new industries from license fees and excise or other taxes for up to 10 years. The 1949 Act "constituted "a contract between the [local] taxing unit, and the owner of the property."[6] Similarly, in 1957, the legislature provided for 10 year tax exemption certificates which, if granted, were deemed to be binding and in full force and effect upon the terms set forth for the period granted.[7] The 1968 Alaska Industrial Incentive Act provided for 10 year tax credits that were "considered a contract between the grantee and the state."[8] The 1957 and 1968 acts remained in effect until 1986.

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3 *Alaska Transp. Comm'n v. Airpac*, Inc. 685 P2.d 1248, 1253 (Alaska 1984).

4 Art. IX, sec. 4 describes tax exemptions for real and personal property of the state or its political subdivisions, property used exclusively for non-profit, religious, charitable, cemetery, or other educational purposes, and "other exemptions of like or different kind."

5 *Homer Elec. Ass'n v. Towsley*, 841 P.2d 1042, 1045 (Alaska 1992).

6 Ch. 10, SLA 1949.

7 AS 43.25.010 and 040.

8 AS 43.26.020 (Repealed § 63 ch 37 SLA 1986).

Like these models, AGIA limits itself to narrowly defined tax exemption. The AGIA not only follows the legislative models described above, but is more directly related to language of art. IX of the Constitution which gives the legislature broad powers to enact tax exemptions. Unlike the proposed SGDA contract, the AGIA stays within the bounds of art. IX and past practices by the legislature.

I recognize that differing opinions on this topic were expressed both within this Department and by legislative attorneys. This is not surprising given the complexity and unresolved nature of this issue. While I believe that the Alaska Constitution provides some limited mechanism for industrial incentives through binding tax exemptions, in my view former Attorney General Marquez's opinion on this topic, while thorough and well researched, reached too far in its conclusions that the SGDA contract would survive constitutional scrutiny. Rather, the most likely and defensible interpretation of Art. IX is that a legislature may agree to some binding tax treatment such as proposed in the AGIA, which is limited to exemptions, is limited in duration, and demonstrably serves an important public purpose.

This issue has not been addressed by an Alaska court. Thus, a party contemplating committing gas to the AGIA project will have to assess for themselves the likelihood that AGIA's production tax exemption would withstand a constitutional challenge. This issue may not be resolved before the first binding open season.

But, in my opinion, the provision would survive such scrutiny. Moreover, in the event that it did not, I have no doubt that future legislatures would honor the strong moral commitment that this legislation represents to parties who are willing to commit to the first binding open season.

I hope this clarifies my views on this subject. Please let me know if you have any additional questions.

Sincerely,

Talis J. Colberg
Attorney General

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Cindy Smith

From: infoweb@newsbank.com
Sent: Sunday, March 25, 2007 11:17 AM
To: Cindy Smith
Subject: Requested NewsBank Article

Paper: Juneau Empire (AK)
Title: My turn: Framers share their intentions - Governor's oil pipeline contract runs contrary to Alaska's Constitution
Author: VIC FISCHER and JACK COGHILL
Date: July 24, 2006

Debate over the governor's oil tax and gas line contract proposals includes a verbal tug-of-war over what the framers of Alaska's Constitution intended. As delegates to the convention that wrote the constitution, we KNOW what was intended.

Alaska achieved statehood to control its resources after decades of Outside exploitation. No delegate would have considered turning over Alaska's oil and gas resources or strip the Legislature and voters of the right to control the state's tax system, as would happen if the governor, oil companies and their agents managed to stampede the Legislature into a deal that is neither good for Alaska nor will advance pipeline construction.

We have studied the governor's proposals, and we believe that they are a fabulous deal for Exxon, BP and ConocoPhillips.

But, it's a bad deal for Alaska.

It's a bad deal because the companies get excessive control over major Alaska oil and gas resources, they obtain tremendous fiscal benefits, and they provide little in return.

The deal violates Alaska's Constitution, and it provides only limited benefits to Alaska's people. It's bad, because it does not guarantee there will be a gas pipeline. And the deal may not deliver the billions of dollars that are being dangled before us, but it surely puts the state at great risk.

Alaska's Constitution states: The power of taxation shall never be surrendered. But giving up the power to tax oil and gas is exactly what Exxon, BP, and ConocoPhillips demand, and what Murkowski supports in the proposed gas line contract.

Here is why their contract approach fails the taxation provisions of the constitution:

1. Giving up the right to tax oil and gas is clearly a "surrender", and that is patently unconstitutional.

2. The constitution authorizes temporary tax exemptions. The governor's proposals are not "temporary."

3. Only tax exemptions are authorized, not whole new tax regimes.

4. A tax exemption can only be "granted by general law," however, the governor's proposed Stranded Gas Act amendments would result in special legislation, which is prohibited by the constitution.

Alaska's Constitution also directs the Legislature to provide for the utilization and development of the state's resources - including oil and gas - for the "maximum benefit" of Alaska's people.

Does the Governor's deal meet the "maximum-benefit" test?

No. Here are just a few of the horrendous aspects of the proposed contract:

1. There is no commitment to build a gas line. There are no timelines, no benchmarks, no

enforcement provisions, and no real penalties for nonperformance.

2. There's no commitment to provide gas for Southcentral and other parts of Alaska. While four take-out points are provided for, the contract states that "gas does not have to be sold in Alaska."

3. The state agrees to indemnify producers for a variety of obligations and losses not of the state's making, and agrees to subvert the initiative process.

4. The contract repeatedly surrenders state management, regulatory authority, court jurisdiction, and other aspects of state sovereignty to the producers.

5. The state gives up its jurisdiction over existing and future North Slope oil and gas fields, including Point Thompson.

6. Beyond all that, the state accepts PPT tax provisions that, with credits and deductions, will provide a heyday for oil company accountants and attorneys, assuring minimal state revenues, no matter how high oil prices may be or how much the companies earn.

No, Alaskans do not need to sacrifice the public interest and take tremendous fiscal risks in order to develop gas resources. Despite all the rhetoric, the governor's deal with the producers is not going to bring us a gas line in the foreseeable future. .

Legislators should reject the PPT tax proposal. They should during this session adopt a gross production tax for oil, separate from gas taxes. They should reject the contract and Stranded Gas Act amendments. And they should proceed toward a contract that assuredly builds a gas pipeline, deals with gas only, and preserves Alaska's sovereignty.

This is not a matter of politics. It's what's right for Alaska.

• Jack Coghill and Vic Fischer were elected delegates in Alaska's Constitutional Convention, 1955-56. They both served in the territorial House of Representatives and the Alaska State Senate. Coghill also was lieutenant governor for four years.

Author: VIC FISCHER and JACK COGHILL

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Senator Hollis French

June 6, 2006

Dear Colleague,

Accompanying this letter is a legal memorandum that I've prepared which looks closely at the question of whether we can, consistent with our state constitution, provide the long term tax certainty requested by the Producers. The short answer is 'no.'

The danger in not confronting this central constitutional issue lies in the cost of delay. We must not take a course which is likely to lead to failure. Embarking on a gas line project which depends on a ruling in favor of tax certainty from our state supreme court is not wise. The overwhelming weight of constitutional history, past and present legal opinion, and established case law points to a ruling from our supreme court that hews to this general legislative truth: one legislature cannot bind the next.

The debate centers on our constitution's explicit prohibition against surrendering, suspending, or contracting away the power of taxation. I refer to this provision as the 'no surrender' clause. Many state constitutions have them. Our constitution does allow for exceptions to this rule, provided that the exceptions are done by 'general law.' The exact sentence reads: *Other exemptions of like or different kind may be granted by general law.* There are no other avenues for providing long term tax certainty. If it can't be done by 'general law,' then it can't be done at all.

Our courts have consistently defined 'general law' to mean 'statute.' Here is an example from the Alaska Supreme Court: "The basis for a home rule charter may be either a constitutional grant of authority, *a general law enacted by the state legislature*, or a combination of both." The obvious point to remember about laws enacted by any given state legislature is that they can be changed by the next one.

A statute enacting a contract does not solve the problem, if the contract provides long term tax certainty. Former Assistant Attorney General Jack Griffin put it this way: "To the extent the legislature may 'contract away' the taxing power, it may do so only by general law, which is to say that the 'contract' is subject to repeal or modification by any future legislature."

The policy behind the 'no surrender' clause came from overly generous long term tax exemptions granted by nineteenth century state legislatures to banks and railroads. When subsequent legislatures tried to alter these exemptions, the effected business interests went to court, claiming that their exemptions amounted to contracts, and that the proposed alteration was in violation of that contract. These cases resulted in rulings favorable to the businesses from the United States Supreme Court.

The reaction to these rulings was a series of state constitutional amendments designed to prevent the granting of these long term tax exemptions. Some nineteen states adopted 'no surrender' clauses. Alaska did so when its constitution was drafted in Fairbanks during the winter of 1955-56.

Since Statehood, there has not been a direct court challenge to a long term promise of tax certainty. The question is undecided by our supreme court. Yet there are many signals from our court, as well as from other states, that all point in one direction: statutory promises of long term tax exemptions do not survive in the face of a 'no surrender' clause. This line of thought was captured by our supreme court when it wrote, in a tax dispute between the oil industry and the state, "*the state could not, and did not, contract away its power as a sovereign to tax.*" While not a final statement of law on this subject, this sentence spells trouble for those seeking to bind the state to a promise of tax certainty for a decade or longer.

It is not just courts that view a long term tax freeze skeptically. The memorandum presents the opinions of former Attorney General Bruce Botelho, former assistant attorney general Jack Griffin, the director of the legislature's legal services division, Tam Cook, as well as Vic Fischer, one of the surviving drafters of our state constitution, who all express grave doubts about the legality of the long term tax promises desired by the Producers.

I hope that you and your staff will take the time to read the memorandum. I would be happy to discuss any point within it with anyone who is interested in the subject.

Sincerely,

Hollis French

Senator Hollis French

MEMORANDUM

Date: June 6, 2006

RE: Alaska's 'No Surrender' Clause and the Proposed SGDA Contract

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I. Introduction

The purpose of this memorandum is to explore whether it is legal under our state constitution to lock up the rates of taxation on oil and gas for a period of years.

There are some who believe that this question must be put off for a court to decide. There are good reasons for waiting, if your object is to wait. The better path is to confront the legal issues and make an educated assessment of them now, and to act accordingly.

It is worth keeping two points in mind during the consideration of this paper. First, the Trans-Alaska Pipeline was built without a long term tax freeze, and second, it is only the Producers – ConocoPhillips, BP, and ExxonMobil – who require oil and gas tax certainty as a part of their application to build a gas pipeline. The other potential candidates to build the line – TransCanada and AGPA – have not made this requirement central to their proposals.

II. The Constitutional Issue is Whether a Long Term Freeze of Tax Rates is Permissible Under 'General Law.'

The issue of a long term freeze on tax rates is a question of constitutional law. Our state constitution, like many others, has a clause which restricts law-makers' ability to grant tax exemptions. A brief history of these clauses is necessary to set them in context.

Tax exemptions granted to businesses by state governments are not a new economic phenomenon. Banks and railroads were frequent recipients of these incentives in the nineteenth century. The exemptions were usually put into effect for long periods of time.[1] The effect of these exemptions was to reduce the power of state governments to raise the necessary funds to pay for basic goods and services. This issue was discussed extensively in states across the country. This, for example, is from the constitutional history of the state of Georgia:

> The drafters [of the 1877 Georgia Constitution] were concerned with the General Assembly's practice of granting tax immunity to corporations, especially railroads. They wanted to stop the practice so that there would be money in the treasury to benefit those who benefited the State.
>
> During the convention, Mr. Toombs, one of the drafters said: "You have virtually taken away so much of the life of the state and given it to these corporations for their support. Without taxation and full control over the power of taxation, the state cannot support her militia, hold her courts of justice, defend the people, and *preserve the rights of society*. You cannot administer your laws or *legislate for the benefit of the people*, or do anything else connected with the government. When this power of taxation is gone and when you say that the legislature can give this power away to them, you then and there put yourself in the power of these corporations. [2]

Often the state government that granted the exemption would later try to modify it in order to begin to collect revenue from the now-established business. Early cases decided by the United States Supreme Court set out the rule that these tax exemptions amounted to contracts that were not subject to being tampered with.[3]

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[1] See Sterk & Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 Wis. L. Rev. 1301, 1319 (1991) and Simpson, *Choosing Fairness over Fundamentals: How Bailey v. North Carolina Undermines the Constitutional Prohibition Against the State Contracting Away its Power of Taxation*, 77 N.C.L.Rev. 2217-2219 (1999).

[2] *Parrish v. Employees Retirement System*, 398 S.E.2d 353, 356 (Ga. 1990)(emphasis in the original).

[3] *New Jersey v. Wilson*, 11 U.S. (7 Cranch) 164, 166-7 (1812).

The reaction to this problem in many states was to adopt a constitutional amendment prohibiting the legislature from making long term tax exemptions in the first place.[4]

Our constitution's version of this provision says, **"The power of taxation shall never be surrendered. It shall not be suspended or contracted away, except as provided in this article."** [5]

I'll refer to this as the "no surrender" clause.

Thus we can see that there is no executive or legislative power to contract away the state's taxing authority, "except as provided in this article."

All observers agree that the exceptions are found in one place, which is in the same article, Article IX, section 4. The exceptions read as follows:

> Exemptions. The real and personal property of the State or its political subdivisions shall be exempt from taxation under conditions and exceptions which may be provided by law. All, or any portion of, property used exclusively for non-profit religious, charitable, cemetery, or educational purposes, as defined by law, shall be exempt from taxation. *Other exemptions of like or different kind may be granted by general law.* All valid existing exemptions shall be retained until otherwise provided by law.[6]

The third sentence, the one italicized here for emphasis, is the only potential legal authority for a long term tax deal. Period. There is no other source. If this sentence does not provide the legal basis for a tax freeze, then it does not exist in Alaska law.

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[4] Some nineteen states have a version of this amendment. See, e.g., Ariz. Const. art. IX, 1 ("The power of taxation shall never be surrendered, suspended, or contracted away."); Ga. Const. art. VII, 1(1) ("The state may not suspend or irrevocably give, grant, limit, or restrain the right of taxation and all laws, grants, contracts, and other acts to effect any of these purposes are null and void."); Me. Const. art. 9, 9 ("The Legislature shall never, in any manner, suspend or surrender the power of taxation."); Mont. Const. art. VIII, 2 ("The power of taxation shall never be surrendered, suspended, or contracted away."); N.C. Const. art. V, 2(1) ("The power of taxation ... shall never be surrendered, suspended, or contracted away.

[5] Alaska Const., art. IX, § 1.

[6] Alaska Const., art. IX, § 4 (emphasis supplied).

There are some tax exemptions that have been authorized by this part of the constitution. For example, this section has been used by the legislature to allow the extension of tax-exempt status to hospitals, and to allow for the senior citizen property tax exemption.[7] It has also been used to give municipalities the authority to grant additional tax exemptions under local ordinances.[8]

These 'general law' exemptions, set out in our statutes, may all be changed or eliminated by any future legislature. The proposed long term tax freeze is not of this nature, however. As proposed, the long term tax rates would be set into a contract, whose term would extend for a decade or more. Thus the relevant question is whether this is a 'general law' exception to the 'no surrender' clause.

A. 'General law' means those laws that are passed by each successive legislature. One legislature cannot, consistent with the Alaska Constitution, stop another legislature from changing a statute.

1. A general law is a statute by definition and by case law.

The foregoing raises the question: What is 'general law'?

'General law' can mean several things.[9] Basically, the term refers to the bulk of statutes that make up a jurisdiction's laws. Our state supreme court has used the term in this, its most universal sense, as follows: "The basis for a home rule charter may be either a constitutional grant of authority, a general law enacted by the state legislature, or a combination of both."[10]

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[7] See AS 29.45.030.

[8] See AS 29.45.050.

[9] "General Law: A law that affects the community at large. A general law as contradistinguished from one that is special or local, is a law that embraces a class of subjects or places, and does not omit any subject or place naturally belonging to such class. A law, framed in general terms, restricted to no locality, and operating equally upon all of a group of objects, which, having regard to the purposes of the legislation, are distinguished by characteristics sufficiently marked and important to make themselves a class by themselves, is not a special or local law, but a general law. A law that relates to a subject of a general nature, or that affects all people of state, or all of a particular class." Black's Law Dictionary, sixth ed., p. 684.

[10] Chugach Elec. Ass'n v. Anchorage, 476 P.2d 115, 122 (Alaska 1970) (internal citations omitted).

In another case the court noted the difference between constitutional law and general law by way of defining the word "charity": "Recognizing that neither the constitution nor the general laws of this state defined the term, we resorted to the broad common law definition of 'charity.'"[11]

If nothing else, these two cases make it clear that a 'general law' is a statute, and not a constitutional amendment.

The term 'general law' probably first appeared in Alaska's legal history in 1884, when Congress put the territory of Alaska under the jurisdiction of a set of laws from Oregon: "In 1884, Congress enacted the Alaska Organic Act, establishing for the first time a civil government for the District of Alaska. The Organic Act, with unusual economy, enacted an entire criminal and civil code for Alaska by adopting the laws of Oregon ...Section 7 of the Act provided that: 'The general laws of the State of Oregon now in force are hereby declared to be the law in said district, so far as the same may be applicable and not in conflict with the provisions of this Act or the laws of the United States.'"[12]

These three references to the term 'general law' by our supreme court all point to the same basic definition: 'general law' means a statute. And statutes are subject to change.

2. Our constitution uses the term 'general law' to mean 'statute.'

Our state constitution uses the term 'general law' in three places.

For example, the phrase appears in the public education section of article VII : "The legislature shall by general law establish and maintain a system of public schools open to all children of the State, and may provide for other public educational institutions."[13] No case discussing this section has elaborated on the precise meaning of 'general law' in the context of public education.

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[11] Nome v. Catholic Bishop, 707 P.2d 870, 887 (Alaska 1985).

[12] Native Village of Stevens v. Alaska Management & Planning, 757 P.2d 32, 37-38 (Alaska 1988) (internal citations omitted).

[13] Alaska Const., art VII, § 1.

The term also appears in two sections dealing with paying state officials. The first is: "The compensation of the governor and the lieutenant governor shall be prescribed by law and shall not be diminished during their term of office, unless by general law applying to all salaried officers of the State."[14] The second is: "Justices, judges, and members of the judicial council and the Commission on Judicial Qualifications shall receive compensation as prescribed by law. Compensation of justices and judges shall not be diminished during their terms of office, unless by general law applying to all salaried officers of the State." [15]

While the immediate reading of these two sections may suggest that there is a difference between most laws and general laws, and there certainly are legal theories about how those two terms are different[16], the difference in terms may not

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[14] Alaska Const., art III, § 15.

[15] Alaska Const., art IV, § 13.

[16] This distinction received its most thorough examination in Alaska law in a case which asked whether teachers who have been fired from their jobs after an administrative hearing have the right to a new trial in superior court. The difficulty for the Supreme Court was that many different statutes could be brought to bear on the issue. Part of the case turned on the clash of "general" and "special" statutes. The Court looked to other states and to scholarly treatises for help:

> The role of special statutes was treated by the Montana Supreme Court in *Teamsters Local 45 v. Montana Liquor Control Bd.*, 155 Mont. 300, 471 P.2d 541, 543 (1970). There the court said: 'Where one statute deals with a subject in general and comprehensive terms and another deals with a part of the same subject in a more minute and definite way, to the extent of any necessary repugnancy between them the special will prevail over the general.'
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> In addition, facially conflicting special statutes may simply establish exceptions to a general rule. Thus the Oregon Supreme Court has stated that where a 'later special or local statute is not irreconcilable with the general statute to the degree that both statutes cannot have coterminous operation, the general statute will not be repealed, but the special or local statute will exist as an exception to its terms.' *Andersen v. Heltzel*, 197 Or. 23, 251 P.2d 482, 483-84 (1952).

Matanuska-Susitna Borough v. Lum, 538 P.2d 994, 999-1000 (Alaska 1975)

While this distinction may have some interest for scholars and supreme court law clerks, its application to the tax question confronting the state appears to be minimal.

amount to any real significance, due to another constitutional provision. "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 Article XI."[17]

After reviewing our constitution, and prior cases defining the term, it is clear that any Alaskan court reviewing a 'general law' exception to the power of taxation would decide that general laws are those proposed and passed by each successive legislature.

The conclusion to be drawn from this analysis is that any change in tax law that purported to extend beyond the duration of a legislature would not be deemed a 'general law' exception, and would be unconstitutional. Under this analysis, whether the tax exemption is for three, five, ten, or thirty years, doesn't matter. Our state constitution forbids the granting of a tax exemption that can't be tampered with by the next legislature. In other words, this legislature could decide that it was necessary to eliminate all production taxes for all oil companies operating in the state, and make the exemption last to the end of this year. But the same legislature could not make the law effective beyond the termination of its own life span, which comes to an end in January, 2007.

B. Historical and Legal Analysis Shows that a Long Term Tax Freeze is Unconstitutional.

1. A drafter of the Alaska Constitution declares a long term tax freeze unconstitutional.

This analysis comports with that of Vic Fischer, one of the few surviving drafters of our state constitution. In remarks delivered at a public hearing on the proposed gas line contract in Anchorage on June 3, 2006, the former state senator stated as follows:

> Given the constitution's history, it is totally inconceivable that the framers of Alaska's constitution would have meant the ['no surrender' clause] to include surrender of its power of taxation over a petroleum industry that already exists and is so established that it provides 80-90% of general fund revenues. Industrial incentives of that scale and scope just didn't exist and would defy logic.'

[17] Alaska Const., art XII, § 11 (emphasis supplied).

> . . . An exemption under the ['no surrender' clause] may only be 'granted by general law.' . . . Thus, even an action to exempt a new industry from taxes must be granted by general law. It can not be done through a contract authorized by the legislature and signed by the Governor, as contemplated under the Stranded Gas Act.[18]

2. The Department of Law that first analyzed the SGDA declared a long term tax freeze unconstitutional.

a. Assistant Attorney General Jack Griffin testified that one Legislature can't bind the next.

Before the Stranded Gas Development Act ("SGDA") was introduced to the Legislature in January, 1998, there were hearings to familiarize legislators with the provisions of the bill. Assistant Attorney General Jack Griffin, who is now an executive with ConocoPhillips, told the House Oil and Gas Committee at a November 12, 1997 hearing that while there is some constitutional ambiguity as to whether a future legislature would be bound by a long term tax promise, "the better view is that a future Legislature cannot be bound."[19] The presentation made by Mr. Griffin relied significantly on the definition of 'general law."[20]

In a series of powerpoint slides, Mr. Griffin asked and answered the following question:

> Issue: May the legislature pass a general law that empowers the executive to enter a contract setting the tax obligations of a participant in a particular industry for a definite period, such that, under Article I, § 10 of the U.S. Constitution,[21] future legislatures cannot impair that contract, either by repeal or amendment of the

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[18] Vic Fischer Testimony (Rev) submitted at June 3, 2006 Alaska Gas Pipeline Public Hearing, Anchorage, pp 4-5.

[19] Quoted in the November 19, 1997 edition of the Alaska Budget Report, p. 10 (used with permission).

[20] Jack Griffin, Presentation to the Alaska Legislature (1997) as referenced in Assistant Attorney General Alan Birnbaum's letter of June 1, 2006 in response to a records request for the Stranded Gas Development Act bill file.

[21] This is the federal 'Contracts Clause', which reads in relevant part "No State shall..pass any...Law impairing the Obligation of Contracts . .." The state counterpart to this provision is found in Article I, section 15.

general law, or by imposition of additional tax obligations under a new law?

Answer: No. Article IX, Section 4 empowers the legislature to establish exemptions only by general law; although the legislature may allow the executive to reflect those exemptions in a "contract," that "contract," like the general law upon which it is based, will be subject to an implied condition that future legislatures may amend or repeal it.

Reason: A contract that prohibits future legislatures from amending or repealing tax exemptions or from imposing new taxes upon an individual or corporation, is a surrender of the taxing power that is prohibited by Article IX, Section 1 of the Alaska Constitution. *To the extent the legislature may "contract away" the taxing power, it may do so only by general law, which is to say that the "contract" is subject to repeal or modification by any future legislature.*[22]

This analysis is consistent with the plain language of the constitutional provisions that bear on this question.

b. Attorney General Bruce Botelho's analysis strongly suggests that a long term tax freeze is unconstitutional.

Two of Alaska's attorneys general have weighed in on this issue. The first, Bruce Botelho, issued a formal opinion in 1998 about the SGDA's long term tax provisions, in which he wrote that

> There are a number of other important issues raised by this legislation. First, art. IX, sec. 1 of the Alaska Constitution provides that "the 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

[22] Jack Griffin, Presentation to the Alaska Legislature (1997), slides DOL_005965-67 (emphasis supplied).

> 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.[23]

This passage is certainly less than a ringing endorsement of the SGDA's long term tax deal concept, particularly if the reader keeps in mind that this was written by the attorney general then employed by the governor who introduced the SGDA. Indeed, the reasoning is a bit curious. The attorney general is pointing out that since the SGDA itself does not bind future legislatures, it is not unconstitutional. It is difficult to avoid the conclusion that the opinion of the then-attorney general was that the SGDA *would* have been unconstitutional *if it had* purported to bind future legislatures. The attorney general simply punted the constitutional question to today, when the legislature is deciding "whether, and if so under what terms, it will allow execution of a contract at all."

3. The Director of the Division of Legal and Research Services, as well as other attorneys in that Division, declare a long term tax freeze unconstitutional.

When the SGDA was formally filed as a bill in 1998 it sparked renewed interest in the legality of setting tax rates in place through a long term contract. When asked about the apparent conflict between the state constitution and the possibility of a long term tax deal under the SGDA, Tam Cook, the Director of the Division of Legal and Research Services for the Legislative Affairs Agency, wrote in March 1998 that "[w]hile the state may certainly provide for a tax exemption, I do not think it is possible for the state to give up its power to repeal the exemption and impose the tax in the future. Any contract that has that effect will probably be void as against public policy."[24]

The view of the attorneys at Legal Services has not changed in the intervening years. In a May 18, 2006 memo, Don Bullock declared that "[i]n my

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[23] 1998 Alas. AG LEXIS 7 (May 29, 1998).

[24] Memoradum from Tamara Brandt Cook, March 11, 1998, p. 1.

opinion a contract provision limiting the level of a tax is more likely than not contrary to art IX, sec. 1 and is not within the exceptions in art. IX, sec. 4."[25]

In a second memo, dated May 25, 2006, Mr. Bullock answered the question of whether locking up tax rates for a shorter term of years or the presence of a "reopener clause" in the contract would make a difference in his analysis. Mr. Bullock wrote that "[c]ontracting away is contracting away, regardless of the length of the contract and regardless of a provision that allows for revisiting the tax-related terms some time in the future."

C. Alaska Case Law Strongly Suggests that a Long Term Tax Freeze is Unconstitutional.

There have not been any Alaskan cases involving this exact question decided by our Supreme Court. There are a few cases which raise the issue of the surrender or contracting away of the power of taxation in a tangential way. They are discussed below.

In *Atlantic Richfield Company v. State*[26] the issue was whether the state's new form of "separate accounting" oil taxation was constitutional. One of the arguments advanced by the North Slope oil producers – ARCO, BP, and Exxon – was that the new tax amounted to a change in the terms of the leases that the state had entered into with the producers. The court found that the lease terms had not been impaired and noted that "the state could not, and did not, contract away its power as a sovereign to tax income earned in the state."[27]

While the case did not hinge on this observation, the phrase used by the Court – that "the state could not, and did not, contract away its power as a sovereign to tax" -- is not helpful to those who wish to enter into a long term tax deal. It is also the clearest expression in any case of our Supreme Court's view of this subject.

In *DeArmond v. State Dev. Corp.*[28] the Legislature had created a development corporation that was, among other things, exempted from any and all state taxes. The constitutionality of the law creating the corporation was

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[25] Memorandum from Don Bullock, May 18, 2006, p.1.
[26] 705 P.2d 418 (Alaska 1985).

[27] *Id.* at 438.

[28] 376 P.2d 717 (Alaska 1962).

challenged on several grounds. The court found the exemption from taxes allowable under the "[o]ther exemptions of a like or different kind may be granted by general law" clause.[29]

The reason that this ruling doesn't offer much support for a long term tax promise is that the development corporation was a creation of general law. It was put into place through the passage of several statutes. Had the next Legislature wanted to eliminate the corporation, or its tax-free status, it was perfectly free to do so.

In *Alascom v. North Slope Borough*[30] the North Slope Borough discovered in an audit that Alascom had underpaid its property taxes for several years. When Alascom challenged the updated assessment, the case went to court. One issue was whether a two or six year statute of limitations should apply to the collection of overdue taxes. The North Slope Borough took the position that ***any*** statute of limitations was unconstitutional. They argued that "applying a statute of limitations to tax assessments and collections would constitute an unconstitutional surrender or suspension of the taxing power."[31]

The Court disagreed, finding that a statute of limitations was one of the "different" tax exemptions envisioned by article IX, section 4.[32] Like the *DeArmond* case, this is an example of a general law exemption. The important point is that the Legislature did not give up the power to change the law.[33]

III. The Opinion of the Current Attorney General Overlooks the Plain Meaning of the Term 'General Law.'

A legal opinion on the subject of a long term tax freeze was issued on May 10, 2006, by Attorney General David Marquez. It should be noted that General Marquez admitted in his remarks to the group of legislators attending the Administration's gas line contract presentations at Centennial Hall in Juneau that his analysis was not a balanced view of the question of the constitutionality of a

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[29] *Id.* at 725.

[30] 659 P.2d 1175 (Alaska 1983),

[31] *Id.* at 1179.

[32] *Id.*

[33] *See* Department of Revenue v. Alaska Pulp Am., 674 P.2d 268, 272 (Alaska 1983)

long term tax deal, but rather was essentially a defense of the Administration's point of view.

Much of the legal analysis in General Marquez' memo consists of a noncontroversial recitation of federal law regarding the Contracts Clause[34] and a summary of how Alaska's constitutional convention drafted and debated the "no surrender" clause.[35]

Regarding the history of these sections, there is little doubt that the convention delegates intended to allow some exemptions from taxation. For example, Delegate Nerland said about article IX, section 4 that "this is the provision that allows for some exemption or inducement to industries or similar things." Furthermore, the official commentary to the "no surrender" clause stated that "[t]he power to tax is never to be surrendered, but under terms that may be established by the legislature, in may be suspended or temporarily contracted away. This could include industrial incentives, for example."[36]

The constitutional record suggests strongly that the focus of the delegates was on attracting *new* industries to Alaska. For example:

> Section 1 is a rather routine statement that the power of taxation shall never be surrendered or contracted away. The reason for the division of thought there and the addition of the words "except as provided herein" is to remove doubt as to what we mean later down in the article by providing exceptions.....and then in the last paragraph of that section it provides that other exemptions may be provided by general law. **This would allow for, among other things, for a granting of tax incentives to new industries.**[37]

> "The Committee felt that definitely the power of taxation should never be surrended so we inserted a semi-colon, but **we did feel that there would possibly be occasion and good justification in the future for such things as allowing an industry-wide exemption to**

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[34] Memorandum on the Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms, at pp. 7-13.

[35] *Id.* at pp. 16-21.

[36] Commentary on the Article on Finance and Taxation (Dec. 16, 1955).

[37] Minutes of the Constitutional Convention at 1109 and 1100.

> **encourage new industry to come in** and that is the reason for the particular wording there. That is later provided for under Section 4.[38]

General Marquez' memo overlooks this distinction, and pushes beyond the historical record when he argues that "the framers deliberately rejected putting parameters around what would constitute a temporary tax incentive"[39] and that "the committee chose not to adopt a specific durational limit for tax exemptions."[40] Those statements ignore the plain meaning of the term "general law" in article IX, section 4, and the time limits imposed by that term. The memo does not at any place discuss the meaning of the term "general law," despite implicitly acknowledging the fact that "general law" is the operative term.[41]

A. Any court reviewing this issue would not fail to focus on the term 'general law.'

A reviewing court will certainly begin its analysis with a review of the basic terms involved. It is necessary therefore to consider how that review will be conducted.

The basic process that the Alaska Supreme Court uses to interpret any constitutional provision is easily described. "We interpret the constitution and Alaska law according to reason, practicality, and common sense, taking into account the plain meaning and purpose of the law as well as the intent of the drafters."[42]

The procedure is set out with more detail as follows:

> 'Questions concerning the constitutionality of a statute are questions of law and are reviewed de novo.' We must first determine what the constitution actually means. The proper interpretation of a

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[38] Minutes of the Constitutional Convention at 2301.

[39] Memorandum on the Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms, at 19.

[40] *Id.* at 20.

[41] "Because sections 1 and 4 [in Article IX] were adopted simultaneously and the convention history links them together, section 1 can reasonably be read to refer to the legislature's power to authorize tax exemptions and other incentives by general law." *Id.* at 27.

[42] Sampson v. State, 31 P.3d 88, 91 (Alaska 2001)

> constitutional provision is a question of law to which this court applies its independent judgment. We then examine the statute to see whether it conflicts with the constitutional requirement. 'Statutes should be construed if reasonably possible to avoid the conclusion that they are unconstitutional.'
>
> The appropriate approach to interpreting language in the Alaska Constitution is well established. 'Constitutional provisions should be given a reasonable and practical interpretation in accordance with common sense. The court should look to the plain meaning and purpose of the provision and the intent of the framers.'
>
> Because of our concern for interpreting the constitution as the people ratified it, we generally are reluctant to construe abstrusely any constitutional term that has a plain ordinary meaning. Rather, absent some signs that the term at issue has acquired a peculiar meaning by statutory definition or judicial construction, we defer to the meaning the people themselves probably placed on the provision. Normally, such deference to the intent of the people requires 'adherence to the common understanding of words.'[43]

If the Supreme Court adheres to the common understanding of the words of the drafters, then it will focus on the term 'general law.' That focus will very likely force a conclusion that no one legislature can bind another and remain consistent with our constitution.

B. The only post-constitutional example of a long term tax exemption was never tested in court.

It must be noted that since Statehood, there has been one example of the legislature granting a type of tax exemptions that were given a period of effectiveness beyond the term implied by the words "general law."[44] The 1968

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[43] Hickel v. Cowper, 874 P.2d 922, 926 (Alaska 1994)(internal citations omitted).

[44] There were two instances of this type of legislation enacted by the Territorial Legislature. The first was the Alaska Property Tax Act of 1949 which exempted new industries from most taxes for a period of up to ten years. Ch. 10, SLA 1949. The other was the Alaska Industrial Incentive Act of 1957 which, though it used a more sophisticated methodology, amounted to the same general type of tax exemption, also offered for a period of up to ten years. Former AS 23.26.010. General Marquez uses both of these as supporting examples in his memo on pages 21-22. The obvious distinction is that they were enacted prior to the ratification of our state constitution, which contains the "no surrender" clause.

Alaska Industrial Incentive Tax Credits Act allowed for the granting of tax credits that could be used for a period of up to ten years.[45] There are no reported cases interpreting this act. While the act certainly stands as evidence that the Legislature is willing to adopt a long term tax promise, there is no evidence on either side that what the Legislature did in 1968 was constitutional.

C. Adopting the phrase 'payment in lieu of taxes' does not alter the analysis.

General Marquez notes in his memo the fact that the proposed SGDA contract "requires continuous payments in lieu of taxes, not a complete exemption from payment of taxes."[46] There is no argument presented as to why this would make a difference in a court's analysis of the constitutionality of the proposed contract. One might argue on behalf of the Administration that because the proposed contract provides for the payment of taxes (or, more accurately, for payments in lieu of taxes) then the power of taxation has not been "contracted away." The rebuttal to that argument is that the issue is not whether the state collects any monies from taxpayers under a contract, but rather whether the state has retained the *power* to tax. Setting tax rates in place for five, ten, or thirty years means that the state has "contracted away" the power of taxation for that period, something our constitution does not allow.

The argument might be made that a "payment in lieu of taxes," being a different legal creation from a straight tax, is somehow entitled to a different constitutional analysis. The exact difference between a 'tax' and a 'payment in lieu of a tax' has not been articulated by the Administration. No help is provided by the proposed contract either, for it does not provide a definition of 'payment in lieu of taxes.'[47]

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[45] Former AS 43.26 et seq., repealed in 1986.

[46] Memorandum on the Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms, at 23.

[47] The difference has eluded legal minds from other jurisdictions. The Supreme Court of New Hampshire noted that their state's department of revenue ("DRA") was unaware of a general definition for the term, abbreviated in this decision by the acronym "PILOT. "The statute does not provide a definition of PILOTs, however, and the DRA concedes that there "is no general definition for 'payment in lieu of taxes.'" Appeal of the City of Portsmouth (N.H. Bd. of Tax & Land Appeals), 151 N.H. 170, 172 (N.H. 2004)

D. The four cases cited by the Attorney General do not support a long term tax freeze.

1. Three of the cases are clearly not on point.

General Marquez does cite to four out-of-state court decisions as examples of "[r]elevant cases significant in upholding a fiscal certainty guarantee under a power of taxation clause."[48] The memo does not supply any of the facts from these cases. The bulk of the cases do not hold up to close examination.

In the case of *In re Opinion of the Justices (Mass.)*[49] the Massachusetts Legislature sought an advisory opinion from their state Supreme Court on the legality of an urb. edevelopment bill pending before the legislature. The legislature posed eleven questions to the court, the first of which asked whether it was constitutional, under the Massachusetts Constitution, to exempt from most taxation "projects...to be constructed in blighted, open areas, decadent areas, and substandard areas." The exemption was for forty years.

The Massachusetts court had to balance the loss of tax revenue as well as the use and possible gain accruing to private interests from a completed private project against the public advantages of (1) the encouragement of prompt action unlikely to be undertaken by private enterprise in the foreseeable future; (2) stimulation of other facilities made available for public use and (3) removing doubts as to the future use of the area, "now largely vacant or occupied by an .. unsightly railroad freight yard." The Court held that the exemption was constitutional, as long as each project exempted was found to have a public purpose.

The Attorney General should have pointed out in his memo that the Alaska Supreme Court does not supply advisory opinions. (He did acknowledge this fact in his remarks at Centennial Hall.)

More damaging to the attorney general's position is the fact that the Massachusetts Constitution does not have a 'no surrender' provision similar to Alaska's. The Attorney General also should have pointed out this obvious and critical difference in his memo.

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[48] Memorandum on the Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms, at 27, fn. 120.

[49] 168 N.E.2d 858 (1960).

The next case cited by General Marquez is a case titled *Valencia Energy Co. v. Arizona Dep't of Revenue*[50] in which a company known as Valencia Energy was under contract to deliver coal to power plants. In response to an inquiry, the company was told in a letter from an Arizona state tax analyst that its transportation charges were not subject to state tax. During a subsequent audit, the state Department of Revenue concluded that the analyst was in error and that taxes should be paid on the transportation charges. Valencia argued that the state was "estopped[51]" from collecting the taxes (meaning that the tax analyst's letter trumped the Department's audit). The state in turn asserted the "no surrender" provision in its constitution, meaning that to raise the analyst's letter over the Department's ruling would constitute a surrender of the state's taxing power.

The Arizona Supreme Court ruled that "[a]n estoppel from collecting revenue from a single taxpayer for a single event is not the kind of permanent capitulation with which the framers were concerned." The difference between this case and the situation facing our state is that the state of Arizona was trying to correct an error by one of its employees. General Marquez cites the case for this proposition: "power of taxation clauses do not preclude some contracting away of taxing authority."[52] It is entirely unclear where in the opinion that assertion is made.

Another case cited by General Marquez is *Gruen v. State Tax Commission*[53], in which the Washington State Legislature passed a law providing for the payment of a bonus to veterans of World War II. The money for the veterans was to be raised through the sale of state bonds. The bonds were to be financed through an excise tax on cigarettes. A cigarette distributor sued the state, claiming that "the legislature, in effect, entered into a contract with the bond buyers that a tax would be levied upon the sale of cigarettes for the purpose of retiring the

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[50] 959 P.2d 1256 (Ariz. 1998).

[51] Estoppel, according to Black's Law Dictionary, means "that party is prevented by his own acts from claiming a right to the detriment of the other party who was entitled to rely on such conduct and has acted accordingly." Any parent is familiar with estoppel. Your child asks, "Can I go to the movies?" and you say, "No, you have homework." Your child says, "But Mom said I could, and I already told my friend I could go!" Your child is asserting that you and your spouse constitute a single 'party' and are estopped from denying the trip to the movies.

[52] Memorandum on the Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms, at 27, fn. 120.

[53] 211 P.2d 651 (Wash. 1949).

bonds and paying the interest, and that "contract" cannot be limited in any way or voided by subsequent legislatures."

The Washington Supreme Court handled the "no surrender" issue by breaking it into two parts: (1) did the Legislature "contract away" its taxing authority?[54] And (2) could the Legislature bind future legislatures through a long term bond issue?[55] With respect to the first question, the Court held that the State neither surrendered, suspended, nor contracted away its taxing authority through the bond sale.[56]

The Washington Court answered the second question in the affirmative, stating that the "legislature acted within its authority when it provided that the funds raised by the tax imposed on cigarettes...should be used to redeem the bonds."[57]

The reason this case offers no support for a long term tax deal is that the court held that the Washington legislature had not contracted away its power. Moreover, there are many examples of the same type of bonding arrangement being used here in Alaska.

2. The case which does support the Attorney General is easily distinguished.

The last case cited by General Marquez, and the only one that legitimately supported his position, is *Bailey v. State.*[58] The facts are as follows. Beginning in 1939, state employees in North Carolina enjoyed retirement accounts that were free of any state taxation. The tax exemption was altered in 1989 in response to a United States Supreme Court decision[59]. The alteration placed a $4000 cap on the amount of annual benefits that would be exempt from state taxes.

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[54] *Id.* at 680.

[55] *id.*

[56] *Id.*

[57] 211 P.2d at 686.

[58] 500 S.E.2d 54 (N.C. 1998).

[59] The case was *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 109 S.Ct. 1500 (1989). In that case the Supreme Court held that "if a state taxes state and local government employees differently than it taxes federal employees, the state violates the

When State employees sued the state, the issue was whether the state employees had an enforceable contract right that had been impaired by the change in state law. In defending the suit, the State argued that the exemption was illegal from its inception, as it conflicted with their constitution's 'no surrender' provision.

The North Carolina Supreme Court held that the state could not in fairness change the benefits of its employees after fifty years of promises. "The state's action here in changing the taxability of vested retirement benefits is no different than if the State issued tax-free bonds, collected millions of dollars for their purchase, and then retrospectively repealed investors' tax-free interest and capital gain advantages."[60] The Court noted that the North Carolina state constitution expressly provided for exemptions from income taxes.[61] The Court's resort to basic notions of fairness, while laudable, has been criticized as undermining that state's 'no surrender' clause.[62]

There are obvious differences between the North Carolina case and the situation facing Alaska. The court in North Carolina was trying to avoid a result

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constitutional doctrine of intergovernmental tax immunity as well as federal statutory law." 500 S.E.2d at 59.

[60] *Id.* at 65.

[61] "Subsection (6) [of the North Carolina constitution] provides that, regarding income taxes, 'there shall be allowed....exemptions.'" *Id.* at 64.

[62] *See* Simpson, *Choosing Fairness over Fundamentals: How Bailey v. North Carolina Undermines the Constitutional Prohibition Against the State Contracting Away its Power of Taxation*, 77 N.C.L.Rev, 2244-45: "As a matter of fairness, the court was correct in preventing the state from reneging on its agreement to exempt state employee retirement benefits from state income taxation. The court, however, could have legitimately reached this 'fair' result without undermining the intent of Article V, section 2(1)[the 'no surrender' clause]. Instead of creating a convoluted constitutional interpretation, the court could have simply ruled that the state was estopped from questioning the constitutionality of the statutory tax exemption since the state had willingly accepted the benefits created by this statute for fifty years. This common-sense alternative to the court's action could have eliminated the need for the court to adopt its questionable constitutional interpretation of Article V, section 2(1) and thus, would have prevented the potentially troublesome impact of this interpretation on North Carolina public policy. In its rush to help state retirees in Bailey, the North Carolina Supreme Court may have inadvertently cleared the way for the return of the tax policy problems that plagued the state in the nineteenth century."

that would impose a fundamental unfairness to fifty years' worth of state employees. The case was essentially looking backwards.

Here, the issue is forward looking – that is, how should Alaska approach its rates of oil and gas taxation for the next fifty years? While *Bailey* offers some support for the Attorney General's position, the support is slender, and it is not likely to be relied upon by our Supreme Court. It is one thing to issue an opinion that avoids injustice, and quite another to knowingly enter into a tax regime that is forbidden by our constitution.

Furthermore, three other states that confronted the collision between tax free benefits and a 'no surrender' clause came to a conclusion opposite that of the *Bailey* court. These cases are discussed below.

E. The Attorney General failed to mention several relevant cases.

1. Three states have ruled that their 'no surrender' clauses allow for changes to tax-free retirement benefits.

General Marquez did not address several other cases involving the issue of long-term tax exemptions from jurisdictions that have 'no surrender' clauses in their state constitutions. To the extent that the state or any other litigant attempts to use *Bailey* as authority, our Supreme Court will undoubtedly refer to these three other cases, as they reach an opposite result. A full examination of the issue requires their consideration.

A suit brought by state employees in Montana, similar to the one brought in North Carolina, resulted in a ruling quite different from the North Carolina Supreme Court's ruling in *Bailey*. The Montana Supreme Court held that the "statute creating the tax exemption in question did not create a contractual right because the state constitution prohibited the state from surrendering or contracting away its power of taxation."[63] True, Montana's "no surrender" provision is worded more strongly than Alaska's: "The power of taxation shall never be surrendered, suspended, or contracted away."[64] Nevertheless, the analysis is essentially the same.

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[63] *Id.* at 2233 (citing *Sheehy v. Public Employees Retirement Division.* 864 P.2d 762, 765 (Mont. 1993).

[64] Mont. Const. art. VIII, § 2.

In the same vein, the Supreme Court of Maine dismissed a lawsuit challenging the repeal of tax-exempt retirement benefits for state employees, holding that because the state constitution forbids the legislature from suspending the power of taxation, state employees who receive retirement benefits have no contractual entitlement to tax-exempt benefits.[65]

A third case dealing with tax-free retirement benefits was decided in conformity with the two cases referenced above. The court in *Parrish v. Employees Retirement* System[66] found that the Georgia 'no surrender' clause trumped the claims of state employees who argued that an alteration to their tax-free retirement benefits amounted to a violation of that state constitution's prohibition on impairments-of-contracts clause.

2. Arizona's Supreme Court upholds its state's 'no surrender' clause.

Other tax cases are in agreement with this analysis. In *Switzer v. City of Phoenix,*[67] a 1959 case decided by the Supreme Court of Arizona, the court decided whether the issuance of a street and highway improvement bond amounted to a violation of that state constitution's 'no surrender' clause. The Court took note of and ruled in accordance with the Washington State court's ruling in *Gruen v. State Tax Commission.*[68] However, the Arizona court used a slightly different rationale in reaching its decision. After undertaking a thorough examination of that state's Constitutional Convention, the Arizona court noted that their convention delegates relied on excerpts from this letter from a national tax expert in structuring their state's 'no surrender' clause:

> The right to impose taxes is a legislative power, inherent in organized government. In the absence of constitutional limitations, a legislature may enact such tax laws as it sees fit, subject only to the restrictions contained in the constitution of the United States. Everything over which the authority of the state reaches may be the subject of taxation, whether it be person, property, or occupation.
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[65] *Blair v. State Tax Assessor*, 485 A.2d 957, 960 (Me. 1984).

[66] 398 S.E.2d 353 354 (Ga. 1990).

[67] 341 P.2d 427 (Ariz. 1959).

[68] 211 P.2d 651 (Wash. 1949).

> There are certain safeguards, however, that should be provided: *First; The legislature should be prohibited from contracting away the right to tax anything or person whatsoever, or from making any irrepealable grant of exemption.*[69]

The Arizona court ultimately ruled that issuing a bond is not a surrender of the taxing authority.[70]

3. Minnesota refused to cede taxing authority under its 'no surrender' clause, *even in the face of a contrary constitutional amendment.*

Like Alaska, the state of Minnesota depends upon mineral revenues for much of its tax base. Like Alaska, Minnesota also has a 'no surrender' clause in its state constitution. Like Alaska, resource development industries have tried to find a way to get tax certainty in order to further their financial objectives.

In 1963 the legislature, with subsequent approval of the state voters, enacted a constitutional amendment that fixed the tax rates on a mineral called taconite in place for some twenty-six years.[71] In reliance on that tax certainty, Reserve Mining Company spent $350 million[72] and employed 3,300 workers to extract taconite.[73]

Despite the tax certainty amendment, the Minnesota legislature enacted by statute a 'tailings tax' on taconite in 1977, a tax which only applied to Reserve

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[69] 341 P.2d at 430 (emphasis in the original).

[70] *Id.* at 431.

[71] *Reserve Mining Company v. State of Minnesota*, 310 N.W.2d 487, 493 (Minn. 1981). The relevant portion of the amendment reads as follows:

> Laws of Minnesota 1963, Chapter 81, relating to the taxation of taconite and semi-taconite, and facilities for the mining, production and beneficiation thereof shall not be repealed, modified or amended, nor shall any laws in conflict therewith be valid until November 4, 1989.

[72] $350 million spent in 1964 has the value of over $2 billion today. Westegg Inflation Calculator: http://www.westegg.com/inflation/infl.cgi, last accessed June 6, 2006.

[73] *Reserve Mining Company v. State of Minnesota*, 310 N.W.2d 487 (Minn. 1981).

Mining.[74] On the effective date of the act Reserve Mining brought suit to challenge the constitutionality of the new 'tailings tax.'

On the issue of the tax-certainty amendment, Reserve argued that the amendment amounted to a contract between the state and Reserve, and that tampering with the contract was in violation of both federal and state Contracts clauses.[75]

The Minnesota Supreme Court agreed that the constitutional amendment was a contract, but did not agree that there was any impairment of the contract. "Reserve would have us interpret the taconite amendment to mean that the legislature cannot impose any other taxes on taconite companies. We do not agree. In enacting the taconite amendment, the state did not contract away the legislature's right to tax. ***It is precluded from doing so.*** The amendment only accorded taconite producers favorable tax status by making taxation of taconite production subject to a statutory limit."[76]

While the court eventually ruled that the taconite tailings tax was subject to the fiscal limits imposed by the tax-certainty amendment,[77] this case stands as a cautionary fable to proponents of the long term ***statutory*** tax promise envisioned by the proposed gas line contract. The Minnesota court ruled that a constitutional amendment holding taxes in place was insufficient to overcome the state's 'no surrender' clause. Our supreme court will eventually review this Minnesota case, and it will draw an obvious legal conclusion: no statute fixing oil taxes in place can trump a constitutional 'no surrender' clause.

IV. The Appropriate Approach to this Issue is to Amend the State Constitution.

When Minnesota confronted the difficult issue of providing tax certainty under a state constitution that contains a 'no surrender' clause, the solution was an amendment to their constitution fixing the rate of taxation in place.

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[74] *Id.* at 489.

[75] *Id.* at 493.

[76] *Id.*(emphasis supplied). In a footnote to the highlighted sentence, the court cited to Minnesota's 'no surrender' clause: "The power of taxation shall never be surrendered, suspended, or contracted away." Minn. Const. art. X, § 1.

[77] *Id.* at 495.

The state of New York took a similar approach. During their 1938 constitutional convention, a 'no surrender' clause was adopted. The drafters recognized the limitations imposed by such a clause, however, and modified it by allowing for 'general law' exemptions, with the caveat that those 'general law' exemptions could be "altered or repealed" by a subsequent legislature. The only exception to the power to repeal was for property tax exemptions granted to religious, charitable, or educational groups.[78]

The state of New Jersey followed suit when their state constitution was revised in 1947. The drafters adopted 'general law' language similar to that of New York.[79] When the need later arose to allow for tax exemptions for urban renewal projects, the New Jersey constitution was modified to allow municipalities to grant general law exemptions that would last for a period not greater than five years. [80] The fact that New Jersey specifically amended their

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[78] See Sterk & Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 Wis. L. Rev. 1301, 1319 fn. 108 (1991): "In 1938, the Constitutional Convention added to the state constitution article XVI, § 1, which provides in relevant part:

> The power of taxation shall never be surrendered, suspended or contracted away, except as to securities issued for public purposes pursuant to law. . . .
>
> Exemptions from taxation may be granted only by general laws. Exemptions may be altered or repealed except those exempting real or personal property used exclusively for religious, educational or charitable purposes as defined by law and owned by any corporation or association organized or conducted exclusively for one or more of such purposes and not operating for profit."

[79] N.J. Const. art VII, § 1, P2:

> Exemption from taxation may be granted only by general laws. Until otherwise provided by law all exemptions from taxation validly granted and now in existence shall be continued. Exemptions from taxation may be altered or repealed, except those exempting real and personal property used exclusively for religious, educational, charitable or cemetery purposes, as defined by law, and owned by any corporation or association organized and conducted exclusively for one or more of such purposes and not operating for profit."

[80] N.J. Const. art VII, § 1, P6:

> The Legislature may enact general laws under which municipalities may adopt ordinances granting exemptions or abatements from taxation on buildings and structures in areas declared in need of rehabilitation in accordance with statutory criteria, within such municipalities and to the

constitution to make their 'general law' exemptions last beyond the life of any given legislature gives additional support to the principle that 'general law' exemptions are easily altered.

The experience of Minnestota, New York, and New Jersey should not be overlooked. Absent clear authority in a state's constitution, the majority rule is that 'no surrender' clauses do not allow long term tax exemptions.

VI. Conclusion

The 'no surrender' clause of the Alaska Constitution will not allow for long term tax exemptions. Put more formally, the power of taxation may not be contracted away for more than two years, consistent with Article IX, sections 1 and 4. Any 'general law' exemption must, by definition, only last during the life of any given legislature. Attempts to do otherwise will be struck down by our state Supreme Court.

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land comprising the premises upon which such buildings or structures are erected and which is necessary for the fair enjoyment thereof. Such exemptions shall be for limited periods of time as specified by law, but not in excess of 5 years.

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MEMORANDUM May 26, 2006

SUBJECT: Contracting away is contracting away (CSSB 2001(FIN); Work Order No. 24-GS2094\F)

TO: Representative Les Gara

FROM: Donald M. Bullock Jr.
Legislative Counsel

After you received the memorandum dated May 18, 2006, concerning whether the power of taxation may be suspended or contracted away, you asked whether the power may be contracted away for a number of years so long as the contract had a provision for reopening and amending any contract provision that relates to tax.

I stated in the May 18, 2006 that, "In my opinion a contract provision limiting the level of a tax is more likely than not contrary to art. IX, sec. 1 and is not within the exceptions in art. IX, sec. 4 [of the Alaska Constitution]." I did not qualify that statement by writing that contracting away the power of taxation for a shorter rather than longer period may be compatible with art. IX, secs. 1 and 4 and do not qualify that statement in this memorandum. Contracting away is contracting away, regardless of the length of the contract and regardless of a provision that allows for revisiting the tax-related terms some time in the future.

Since my memo to you on May 18, Dennis Bailey, legislative counsel, looked at this issue and found constitutional restrictions similar to ours in the State of New York.

The New York Court of Appeals discussed that state's constitutional prohibition against contracting away the taxing power in *Roosevelt Raceway v. Monaghan.*[1] A 1956 New York statute had reduced the state tax on a racetrack betting pool and allowed a racetrack to put part of the tax in a "construction account." After receiving the approval from the Harness Racing Commission for making capital improvements, a racetrack could withdraw money from the construction account for the cost of construction and for

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[1] 9 N.Y.2d 293; 174 N.E.2d 71; 213 N.Y.S.2d 729 (1961), *motion den* 9 NY2d 966, 218 NYS2d 48, 176 NE2d 502, *app dismd* 368 US 12, 7 L Ed 2d 75, 82 S Ct 123 (no substantial federal question).

federal income taxes paid on that amount. In 1959, the law was changed to bar reimbursement from the "construction account" for federal income taxes paid.[2]

Roosevelt Raceway insisted that the state was powerless to stop the reimbursement because ending the state's obligation represented an unconstitutional impairment of a contractual obligation under art I, sec. 10, of the United States Constitution. In response, the court of appeals wrote:

> It is not entirely clear what Roosevelt claims to be the content of the contract which it asserts the State made with it.
>
> . . .
>
> But, if we accept this position for the purposes of the present litigation, involving solely reimbursement of Federal income taxes, the only contract which may be said to have been made is a contract for tax relief -- a promise by the State to keep the reduction enacted in the 1956 tax formula intact and unchanged until the track has been made whole, under that formula, out of revenues that would otherwise go to the State as taxes. Such a contract, if not indeed void in its inception -- and this is a question as to which we express no opinion -- is at all times revocable by the State. This was proclaimed and established, beyond the power of the Legislature to alter, by section 1 of article XVI of our present Constitution; in so many words, it declares:
>
> > "The power of taxation shall never be surrendered, suspended or contracted away, except as to securities issued for public purposes pursuant to law. * * *
> >
> > "Exemptions from taxation may be granted only by general laws. Exemptions may be altered or repealed except those exempting real or personal property used exclusively for religious, education or charitable purposes".
>
> Just as the "reserved power" to amend corporate charters, found in section 1 of article X of our Constitution, "prevents the charter from becoming a contract between State and corporation protected from impairment by the [Federal] Constitution" so section 1 of article XVI of our Constitution "prevents" the 1956 legislative promise to reduce the harness track's taxes "from becoming a contract between State and corporation protected from impairment by the [Federal] Constitution." In other words, in view of the first sentence of section 1 of article XVI, the State may not be said to have breached any contract or agreement with Roosevelt to maintain its State tax at the level provided for in 1956 for the

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[2] 174 N.E.2d at 73-74 (citations omitted; bracketing in original).

> reason that no one was empowered to enter into such an agreement on behalf of the State.
>
> . . .
>
> In the present case, Roosevelt would not be aided even if we were to accept its concept of tax exemption. Section 1 of article XVI separately prohibits any attempt to contract away the power of taxation unless sanctioned by the people themselves. A contract for a pre-established limit on tax liability, whether it be considered as conferring "tax exemption" or "tax savings", or tax relief by any other label, is clearly barred by this sweeping prohibition. The 1959 Legislature was, therefore, free to increase the tax obligations of the harness tracks either by raising the rates of existing taxes or by imposing new taxes. There are limits on, as well as qualifications of, the power to tax, but these have not been disregarded. The asserted limit based on a contract with the State does not exist.[3]

This New York appellate decision based on a state constitutional provision prohibiting the contracting away of the power to tax would be helpful to an Alaska court interpreting art. IX, secs. 1 and 4 of the Alaska Constitution. I would expect a similar outcome by an Alaska court.

Finally, for your information, the full citation to *Ohio Life Ins. and Trust Co.* decision on page 3 of my memorandum to you dated May 18, 2006, is *Ohio Life Ins. and Trust Co. v. De Bolt*, 57 U.S. 416; 14 L. Ed. 997; 1850 U.S. LEXIS 1559; 16 HOW 416 (1854). The quotation discussed the prohibition against one legislature depriving a future legislature of the power to impose a tax the future legislature finds necessary, absent a constitutional provision providing for such a restriction.

If I may be of further assistance, please advise.

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[3] 174 N.E.2d at 76-78 (citations omitted).

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MEMORANDUM May 18, 2006

SUBJECT: Contracting away the power of taxation
(Work Order No. 24-LS1938)

TO: Representative Les Gara

FROM: Donald M. Bullock Jr.
Legislative Counsel

With reference to the draft "Alaska Stranded Gas Fiscal Contract" under review by the legislature, you asked whether the power of taxation could be surrendered or contracted away and whether one legislature could bind a future legislature or an initiative from enacting different tax rules.

The questions you ask present issues under three specific sections of the state constitution -- art. IX, sec. 1, art. IX, sec. 4, and art. I, sec. 15. In my opinion a contract provision limiting the level of a tax is more likely than not contrary to art. IX, sec. 1 and is not within the exceptions in art. IX, sec. 4. However, if a tax-limiting provision were to be included in a contract and the provision was not voided based on art. IX, secs. 1 and 4, art. I, sec. 15 would prohibit the legislature or a future initiative from "impairing the obligation of [the] contract[]" by making a change in the tax.

Article IX, sec. 1

Article IX, sec. 1, Constitution of the State of Alaska reads as follows:

> **Taxing Power.** The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article.

This section has been discussed only twice by the Alaska Supreme Court and both discussions were published in 1983 decisions. In *Alascom, Inc. v. North Slope Borough*,[1] the North Slope Borough claimed that any statute of limitations applied to bar supplemental assessments would contravene art. IX, sec. 1. The Borough argued, "that applying a statute of limitations to tax assessments and collections would constitute an unconstitutional surrender or suspension of the taxing power." The court rejected this argument by writing:

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[1] 659 P.2d 1175 (Alaska 1983).

> We believe that the response to the Borough's contention is provided by Article [IX], section 4, of the Alaska Constitution, the provision addressing exemptions from taxation. After setting forth specific exemptions this provision states that "other exemptions of like *or different* kind may be granted by general law" (emphasis supplied). In our view this constitutional grant of power to except encompasses the power to require that taxes be assessed and collected within a certain period of time or be forever barred.[2]

In other words, the legislature had enacted a statute limiting the period in which a borough could make assessments and such an enactment was consistent with art. IX, sec. 4. If property was not assessed within the limited period, the property was effectively exempt for the period in which the assessment was not timely made.

The second case discussing the art. IX sections is not helpful in analyzing the issues you raise. In *Cogan v. State, Dep't of Revenue*,[3] the court merely referred to art IX, secs. 1 and 4 as authority for deciding that paying taxes is an obligation of a person to the people and to the State should the legislature impose them.[4]

Attorney General Bruce Botelho discussed art. IX, sec. 1 in an opinion discussing the Alaska Stranded Gas Development Act, SCS CSHB 393(FIN) (1998). In that opinion, addressed to Governor Tony Knowles, the Attorney General wrote:

> There are a number of other important issues raised by this legislation. First, art. IX, sec. 1, of the Alaska Constitution provides that "the 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

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[2] 659 P.2d at 1179 (footnote omitted).

[3] 657 P.2d 396 (Alaska 1983).

[4] 657 P.2d at 398.

> 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.[5]

The Attorney General's opinion offers that the contracting away issue could be avoided by having the contract recognize that future legislatures may make changes to the tax. However, if the contract precludes future legislative action, the art. IX, sec. 1 prohibition against contracting away the taxation power would need to be resolved.

During my research, I found a short discussion relevant to the issue of surrendering the power to tax by contract. An 1862 decision of the California Supreme Court quoted an Ohio court case that discussed the surrender by contract of the taxing power. In *Fall v. The County of Sutter*,[6] the California Supreme Court wrote:

> A series of cases arose under a general Banking Law of the State of Ohio, wherein it was claimed that the Legislature had authority to surrender by contract the taxing power on bank capital; and having the power, had so exercised it. The first is the case of the *Ohio Life Ins. and Trust Co.* v. *De Bolt* (16 How.) In this case Chief Justice Taney, in delivering the opinion of the Court, held as follows:
>
> > The powers of sovereignty confided to a legislative body are undoubtedly a *trust* committed to them, to be executed to the best of their judgment for the public good, and no one Legislature can by its own act disarm their successors of any of the powers or rights of sovereignty confided to the legislative body, *unless they are authorized to do so by the Constitution under which they are elected.* They cannot, therefore, by contract deprive a future Legislature of the power of imposing any tax they may deem necessary for the public service, or of exercising any other act of sovereignty confided to the legislative body, *unless the power to make such contract is conferred upon them by the Constitution of the State;* and in every controversy on this subject the question must depend upon the Constitution of the State, and the extent of the power thereby conferred on the legislative body." [Emphasis in original.]

Article IX, sec. 4

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[5] 1998 Alas. AG LEXIS 7 (May 29, 1998).

[6] 21 Cal. 237 (1862).

As the court noted in *Alascom, supra*, the Constitution of the State of Alaska identified art IX, sec. 4 as authority for providing exemptions from tax. That section reads as follows:

> **Exemptions.** The real and personal property of the State or its political subdivisions shall be exempt from taxation under conditions and exceptions which may be provided by law. All, or any portion of, property used exclusively for non-profit religious, charitable, cemetery, or educational purposes, as defined by law, shall be exempt from taxation. Other exemptions of like or different kind may be granted by general law. All valid existing exemptions shall be retained until otherwise provided by law.

Reporting for the finance committee to the Alaska Constitutional Convention on January 16, 1955, Leslie Nerland explained the reasoning behind the wording that ultimately became art. IX, sec. 1 and the relationship between that section and what would become art IX, sec. 4, Constitution of the State of Alaska:

> Section 1 of this proposal has been altered slightly from the usual wording of a number of state constitutions and also the model state constitution in that which, as some of you perhaps might have noticed, generally reads, "The power of taxation shall never be surrendered, suspended or contracted away." The Committee felt that definitely the power of taxation should never be surrendered so we inserted a semicolon,[7] but we did feel that there would possibly be occasion and good justification in the future for such things as allowing an industry-wide exemption to encourage new industry to come in and that is the reason for the particular wording there. That is later provided for under Section 4."

Article IX, sec. 4, provides for exemptions from tax provided by law. In other words, exemptions may be enacted by the legislature (and repealed or amended by a subsequent legislature), but there is no authority in the Constitution of the State of Alaska to suspend the power of the state to tax in a contract between the state and a taxpayer.[8]

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[7] In its final form, art. IX, sec. 1 has a period, rather than a semicolon, following the clause prohibiting the surrender of the power to tax.

[8] Two instances of the state suspending or reducing a tax for a limited period are found in AS 43.55.011(b) and AS 43.65.010. AS 43.55.011(b) provides that the severance tax on oil production is 12.25 percent for the first five years after the start of production occurring after June 30, 1981, and 15 percent thereafter. Under AS 43.65.010(a), "all new mining operations are exempt from the [mining license tax] for three and one-half years after production begins."

Article I, sec. 15

While an exemption may be repealed or amended by the legislature, enacting a law that impairs a contract violates art I, sec. 15, Constitution of the State of Alaska. Should the contract include a provision that fixes the tax or payment in lieu of tax, and the provision is not void under art. IX, sec. 1 or as a matter of public policy, a future legislature or initiative would be precluded from changing the that provision. Article I, sec. 15 reads as follows:

> **Prohibited State Action.** No bill of attainder or ex post facto law shall be passed. *No law impairing the obligation of contracts, and no law making any irrevocable grant of special privileges or immunities shall be passed.* No conviction shall work corruption of blood or forfeiture of estate. [Emphasis added.]

The United States Constitution has a similar provision in art. I, sec. 10. That section bars any state from passing a law "impairing the obligation of contracts." In *State of New Jersey v. Wilson*,[9] the United States Supreme Court considered a situation in which New Jersey had exempted land from tax and the exemption had been made part of a contract. A contract that transferred land to an Indian tribe stated "that the lands to be purchased for the Indians aforesaid shall not hereafter be subject to any tax, any law usage or custom to the contrary thereof, in any wise notwithstanding."[10] Another part of the agreement provided that the land could not be sold. Sometime after the transfer, the tribe asked the legislature to amend the agreement to allow the sale of the land so that the tribe could relocate. The legislature enacted a law allowing the transfer, but did not modify the shield from taxation that applied to the land. The following year, the legislature repealed the tax-shield provision that had been included in the original law that transferred the land to the Indian tribe. The purchasers of the land from the Indians brought suit against the state on the ground that the repeal of the tax-shield provision had harmed them and had the effect of impairing their contract for purchasing land not subject to tax.[11] Although successful in the New Jersey courts, the United States Supreme Court found that the legislature's repeal of the tax-shield provision violated art. I, sec. 10, Constitution of the United States.[12]

The Supreme Court provided an alternative that would have removed the tax-shield in return for allowing the Indians to sell the land:

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[9] 11 U.S. 164; 3 L. Ed. 303 (1812).

[10] 11 U.S. at 165, 3 L. Ed. at 304.

[11] 11 U.S. at 166, 3 L. Ed. 304.

[12] 11 U.S. at 167, 3 L. Ed. 304.

> It is not doubted but that the state of New Jersey might have insisted on a surrender of this privilege as the sole condition on which a sale of the property should be allowed. But this condition has not been insisted on. The land has been sold, with the assent of the state, with all its privileges and immunities The purchaser succeeds, with the assent of the state, to all the rights of the Indians. He stands, with respect to this land, in their place and claims the benefit of their contract. This contract is certainly impaired by a law which would annul this essential part of it.[13]

In short, the State of New Jersey had the opportunity to remove the tax-shield from the land at the time it amended the agreement with the tribe. The State removed the covenant that prevented the tribe from selling the land, but did not remove the covenant that made the land free of any future tax. When the land was subsequently sold with the covenant attached, the legislature was prohibited from repealing the covenant.

Conclusion

Article IX, sec. 1, Constitution of the State of Alaska, prohibits the state from contracting away the power to tax, but art. IX, sec. 4 allows the legislature to suspend a tax or provide for tax exemptions. A suspension or exemption may be amended or repealed by a subsequent legislature or an initiative under the power to tax. However, art. I, sec. 15, Constitution of the State of Alaska, and art. I, sec. 10, Constitution of the United States, prohibit a subsequent legislature from passing a law that impairs the obligations in a contract.

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[13] 11 U.S. at 167, 3 L. Ed. 304.

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MEMORANDUM

State of Alaska

Department of Law

To: William Corbus, Commissioner
Department of Revenue

Date: May 10, 2006

File No: 661-03-0485

Tel. No.: (907) 465-2133

Fax: (907) 465-2075

From: David W. Márquez
Attorney General

Subject: Effect of Article IX, Sections 1 and 4 of the Alaska Constitution on Proposed Stranded Gas Development Act Contract Terms

I. INTRODUCTION

The purpose of this opinion is to provide analysis and advice on the question of whether sections 1 and 4 of article IX of Alaska's Constitution permit the state to enter into a long-term fiscal contract under the Stranded Gas Development Act ("SGDA"), AS 43.82.010 *et seq.* The proposed contract would exempt the sponsors of the Gas Pipeline Project from paying certain taxes associated with oil and gas production and transportation, and would replace those taxes with specified payments in lieu of those taxes. The provisions in the contract that would incorporate a Petroleum Production Tax ("PPT") similar to that considered by the legislature (HCS CSSB 305 FIN AM H, S Fld CONCUR H(AM)) have not been finalized at this time. However, it is expected that the contract will generally provide for 30 years of fiscal certainty for payments in lieu of certain taxes on oil and up to 45 years for payments in lieu of all other taxes. Other key provisions of the proposed contract include state commitments to finance and own 20 percent of the Gas Pipeline Project and to take in-kind and market the royalty and production tax shares of the gas.

II. SUMMARY OF ADVICE

Article IX, section 1 of Alaska's constitution prohibits the legislature from surrendering the power of taxation, but permits the legislature to suspend or contract

away the tax power as provided in article IX.[1] Section 4 of article IX provides the permissive authority for the legislature to grant tax exemptions by general law.[2] Thus, while Alaska's constitution restricts the legislature's authority from surrendering its power of taxation, it does not prohibit the legislature from suspending or contracting away its power to tax by granting tax exemptions.

The SGDA authorizes the Commissioner of Revenue ("Commissioner") to negotiate fiscal terms for inclusion in a proposed SGDA contract, including periodic payments in lieu of taxes that otherwise would be imposed by the state or a municipality on the sponsor of a gas pipeline project.[3] The fiscal terms may be "tailored to the particular economic conditions of the project and . . . [established] in advance with as much certainty as the Constitution of the State of Alaska allows."[4] The term of the proposed contract "may be for no longer than is necessary to develop the stranded gas that is subject to the contract . . . ; however, the term of the contract may not exceed 35 years from the commencement of commercial operations of the approved qualified project."[5] The proposed SGDA contract must be approved by the legislature before it is binding on the state.[6]

While the SGDA is not the first time the state has authorized contractual tax incentives to encourage development of Alaska's resources, the Alaska Supreme Court

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1 Alaska Const. art. IX, § 1: "[t]he power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article."

2 Alaska Const. art. IX, § 4:

> Exemptions. The real and personal property of the State or its political subdivisions shall be exempt from taxation under conditions and exceptions which may be provided by law. All, or any portion of, property used exclusively for non-profit religious, charitable, cemetery, or educational purposes, as defined by law, shall be exempt from taxation. Other exemptions of like or different kind may be granted by general law. All valid existing exemptions shall be retained until otherwise provided by law.

3 AS 43.82.020(1).

4 AS 43.82.010(2).

5 AS 43.82.250. The administration proposes to amend this and other provisions of the SGDA. In this memorandum, we assume there is statutory authority for the contract terms.

6 AS 43.82.435.

has not addressed the extent of the state's authority under section 1 of article IX to enter into such agreements or whether a future legislature may amend or repeal the terms of such a fiscal certainty contract. However, the United States Supreme Court has held that state legislatures may agree to long-term, binding tax arrangements to the extent permitted under individual state constitutions.

In accordance with the SGDA, the Commissioner has issued comprehensive preliminary findings which conclude that the proposed fiscal certainty terms are necessary to encourage investment in the Project. The fiscal certainty provided is also expected to slow the decline in oil production by encouraging further investment in Alaska's oil fields, particularly its marginal fields.

We believe that a reviewing court will defer to the findings of the Commissioner and the legislature. The provision of tax incentives to develop Alaska's resources to benefit all Alaskans was expressly contemplated by the delegates to the constitutional convention and deliberately embodied in sections 1 and 4 of article IX as well as sections 1 and 2 of article VIII. Additionally, Congress provided unprecedented amounts of land to Alaska under the Statehood Act so that the state could support itself through development of its resources. Therefore, we believe that the proposed SGDA Contract is constitutional under sections 1 and 4 of article IX. The next sections of this memorandum explore this conclusion in greater detail.[7]

III. SUMMARY OF THE FISCAL CERTAINTY TERMS IN THE PROPOSED CONTRACT

The state legislature has enacted the SGDA and has considered legislation providing for a new PPT. In accordance with the authority provided to it in the SGDA, the state administration has negotiated the proposed SGDA Contract with Exxon, ConocoPhillips and BP (collectively, the "Sponsor Group"). The proposed terms would exempt the Sponsor Group, as well as any other producers that enter into an upstream fiscal certainty contract and commit to ship North Slope gas on the Project (collectively, "Participants"), from certain state and municipal taxes that would otherwise be imposed as a consequence of the commercialization of North Slope gas (e.g., oil and gas production, property and corporate income taxes, as well as other state and local taxes).

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[7] This memorandum addresses only the effects of sections 1 and 4 of article IX on the proposed contract terms; it does not address other sections of article IX or other provisions of the constitution that do not directly relate to sections 1 and 4. Similarly, we have analyzed the question of whether the state may contract away certain aspects of the power of taxation, thus requiring a federal Contract Clause analysis, but we have not considered the impact of other provisions of the federal constitution on the proposed contract.

In lieu of exemption from certain taxes, Participants would make specified payments to the state and affected municipalities.

Generally speaking, total state oil and gas revenues under the SGDA Contract are comparable to those the state would receive if the 2005 fiscal regime remained in place.[8] The Commissioner has also determined that oil and gas revenues could increase under the proposed SGDA Contract.[9] In the words of the Commissioner, "the contract provides inducement through stability, not by materially reducing the present day tax burden on the project."[10] The state will receive its tax payments in gas instead of cash and commit to ship the gas on the pipeline.[11]

The Commissioner's Findings indicate that North Slope gas could be one of the most expensive resources in the world to bring to market, and that building the gas line may turn out to be one of the most expensive private construction projects ever undertaken.[12] Fiscal certainty improves the Project's internal rate of return, making it more likely that it will go forward.[13] Moreover, the combination of fiscal stability, state equity participation, and the state agreeing to take its gas in-kind and ship it on the pipeline, "provide[s] commercially reasonable inducements to influence a timely and favorable decision to commence the feasibility and regulatory work obligations . . . and create a higher probability that the required investment in the project will be made on the

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8 Commissioner's Preliminary Findings and Determination as required by the Stranded Gas Development Act (May 10, 2006) (hereafter "Commissioner's Findings") at FIF-246. Revenues under the SGDA Contract are expected to approximate or be higher than total state oil and gas revenues that would have been received under the fiscal system as it existed in 2005. *Id.* at ES-2 ($35 billion under the proposed Contract versus $34 billion under the 2005 fiscal structure); FIF-73 (Table 6, Comparison of Total State Oil and Gas Revenues).

9 Commissioner's Findings at ES-2. The Commissioner expects a gain in gas-related revenues of $12 billion in net present value and an increase of oil-related revenues of $2 billion in net present value for a total gain of $14 billion. *Id.* Additionally, Table 6 at FIF-73 indicates higher revenues than those expected under the 2005 fiscal system for $5.50/MMBtu (million British thermal units) of gas and higher and $35 per barrel of WTI (West Texas Intermediate) oil.

10 *Id.* at FIF-246.

11 *Id.* at ES-11, FIF-47, FIF-50-51.

12 *Id.* at FIF-48, FIF-115.

13 *Id.* at FIF 142-43; FIF-165.

project sanction date."[14] Therefore, the Commissioner has found that the fiscal stability the SGDA Contract would bring is intended to raise the Project higher on the investment priority list for projects in the producers' portfolio of potential projects worldwide.[15]

Furthermore, the provision of fiscal certainty for gas developed in the future under other state leases will encourage all North Slope producers to provide additional gas to the Project needed to completely fill the pipeline to capacity for the term of the contract.[16] In short, the Commissioner has determined that fiscal certainty is necessary to establish a significant long-term gas industry in Alaska.[17] Additionally, he has found that the fiscal certainty arrangement is also expected to have the added benefit of encouraging investment in smaller oil fields in Alaska, which may slow the otherwise predicted decline in oil production.[18] Providing fiscal certainty for oil as well as gas will make the Project more attractive since the Participants' overall oil and gas business in Alaska will benefit from fiscal stability under the Contract.[19]

With respect to the proposed terms of fiscal certainty, the Commissioner has determined that the long-term fiscal interests of the state will be served by providing fiscal certainty for up to 45 years for gas.[20] This term is required to allow the pipeline owners (including the state) to recover pipeline investment costs as well as provide assurance to Project lenders that a stable fiscal environment will prevail.[21] Additionally, the Commissioner's Findings state that such certainty is required to locate the additional reserves that will be needed to fill the gas line to capacity for its useful life.[22] In other

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14 *Id.* at FIF-243. *See also* ES-9, ES-12, FIF-107.

15 *Id.* at FIF-103, FIF-244.

16 *Id.* at ES-11, FIF-48, FIF-115. Legislation will be proposed to provide fiscal certainty to all ANS state leases, as well as to any party that makes firm transportation commitments. *Id.* at ES-5, ES 8-9, FIF-98, FIF-115.

17 *Id.* at ES-1.

18 *Id.* at ES-1, FIF-118, FIF-246.

19 *Id.* at FIF-117-18.

20 *Id.* at ES-2, FIF-115-17.

21 *Id.* at ES-5, FIF-115-17, FIF-245.

22 *Id.* at ES-5, FIF-115-17, FIF-246. Alaska's 35 trillion cubic feet of known proven reserves of gas is likely not enough to fill the line for the entire 35-year useful life and therefore, (continued)

words, because the state, as an equity owner in the Project, will receive revenues from the sale of gas shipped through the pipeline, fiscal certainty not only provides the state with a steady flow of tax revenues, but also encourages maximum Project success, thus further enhancing the state's revenue sources from monetizing its gas in this fashion.[23]

It is expected that the Contract will generally provide for 30 years of fiscal certainty for oil taxes, which will enhance the likelihood of Project success.[24] First, gas exploration expenses are deductible from the proposed PPT, thereby encouraging exploration for the gas needed to fill the gas line to capacity.[25] Since this gas will be needed in the midpoint of the 35-year useful life, providing fiscal certainty for oil up until that time instead of for up to 45 years is appropriate.[26] As noted above, the PPT will encourage investment in smaller oil fields as well. Additionally, the Project is less likely to be built unless oil fiscal certainty is provided since the Sponsor Group has indicated that it will not enter into an SGDA contract without oil fiscal certainty.[27] Without certainty on both oil and gas taxes, the state could increase oil taxes to capture additional value and thus change the fiscal stability of the gas tax structure.[28]

Finally, to assure the terms of fiscal stability, the proposed SGDA Contract requires the state to reimburse Participants for tax payments they might be required to make under any subsequently enacted tax that is the same or similar to a tax from which they are exempt under the Contract. The Sponsor Group maintains that the reimbursement provisions are required to insulate them from future legislation or ordinances providing for new or additional taxes after they have undertaken the investment necessary to develop the Project.

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the Project's success will depend in part on providing the proper investment climate to find that gas. *Id.* at FIF-117.

23 *Id.* at FIF-105.

24 *Id.* at FIF-246.

25 *Id.* at FIF-118.

26 *Id.* at FIF-118, FIF-246.

27 *Id.* at FIF-117.

28 *Id.* at FIF-117-18.

IV. LEGAL ANALYSIS

The question of whether the proposed SGDA Contract is enforceable raises questions of federal and state law. First, may a state, which is sovereign, enter into a fiscal contract that is enforceable? Second, even if a state may enter into a fiscal contract that would be enforceable under the U.S. Constitution, does the Alaska Constitution provide the legislature with the authority to do that?

A. States May Enter into Fiscal Contracts Subject to Limitations Contained in Individual State Constitutions

The Supreme Court of the United States has determined that a state legislature may alienate its taxing powers, at least to some degree, if not prohibited by the state's constitution and if done in an unmistakable manner. Once the tax power is properly alienated, a state's contractual promise is binding through application of the Contract Clause of the Constitution of the United States.

The legal maxim that one legislature has the ability to overrule its predecessors was firmly embedded in English common law.[29] However, in American jurisprudence the doctrine underwent significant limitation with the adoption of the federal Contract Clause, which establishes that, "[n]o State shall . . . pass any . . . Law impairing the Obligation of Contracts."[30] In 1810, the Supreme Court began defining the contours of the Contract Clause in *Fletcher v. Peck*.[31] The Court recognized that the clause imposes limitations on the states, established requirements for its enforcement, and developed an analytical framework for alleged violations.

The Contract Clause was adopted by the federal framers for several reasons. First, they were aware of the abuses of the English Parliament, especially during the reign of Charles II, when lands were blatantly confiscated and contractual rights extinguished by

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29 "Acts of parliament derogatory from the power of subsequent parliaments bind not . . . . Because the legislature, being in truth the sovereign power, is always of equal, always of absolute authority: it acknowledges no superior upon earth, which the prior legislature must have been, if its ordinances could bind the present parliament." 1 W. Blackstone, *Commentaries on the Laws of England* 90 (1765).

30 U.S. Const. art. I, § 10.

31 10 U.S. 87 (1810).

parliamentary enactments.[32] Second, they were aware of the abuses of local legislatures in interfering with debtor-creditor relationships.[33] They wished to prevent this from happening in the republic. Third, after the American Revolution, the newly emerging country was in substantial economic crisis and the federal framers felt that fiscal instability that did not promote economic investment would hamper the success of the new republic.[34] They hoped that a constitutional provision enshrining contractual rights and limiting state rights would promote economic growth in the nation.[35]

The fundamental and governing principles established by the United States Supreme Court can be stated as follows: a state's power of taxation is not a police or regulatory power, but is a power fully capable of alienation by a sovereign; it can be bargained away by the sovereign for consideration; once it is bargained away, the promise concerning it is fully protected by the Contract Clause, which is binding on states through application of the Supremacy Clause.[36] For the Contract Clause to have any meaning, the promise of the state has to be binding on the state's future legislatures.[37] If it were not binding on the legislatures, states would be free to void contractual obligations by enacting nullifying laws.

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32 *See Trustees of Dartmouth College v. Woodward*, 17 U.S. 518, 559 (1819) (argument of Daniel Webster).

33 The Contract Clause "was made part of the Constitution to remedy a particular social evil — the state legislative practice of enacting laws to relieve individuals of their obligations under certain contracts . . . ." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 256 (1978). James Madison explained that the people were "weary of the fluctuating policy" of state legislatures and wanted it made clear that under the new government men could safely rely on states to keep faith with those who justifiably relied on their promises. *The Federalist No. 44*, at 301 (J. Cooke ed. 1961).

34 *The Federalist No. 7*, at 42-43 (A. Hamilton) (J. Cooke ed. 1961).

35 B. Wright, *The Contract Clause of the Constitution* 4-5, 15 (1938).

36 U.S. Const. art. VI, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.").

37 *See* Eule, *Temporal Limits on the Legislative Mandate: Entrenchment and Retroactivity*, 1987 Am. B. Found. Res. J. 379, 392-93 (observing that the English rationale for precluding a legislature from binding its successors does not apply in America).

(continued)

With respect to certain state rights, however, sweeping application of the Contract Clause is undesirable, and limited by three principles. First, the states still retain some authority to define what is a legal contract under their state laws, and therefore enforceable under the Contract Clause. The states may enact constitutional provisions defining what contracts are enforceable that will be recognized as a threshold matter by the Supreme Court in Contract Clause analysis.

Second, there are certain essential attributes of state sovereign authority that are incapable of alienation. They are called the "reserved powers." A state can never alienate those powers so that the alienation will be binding on future legislatures and enforceable under the Contract Clause. The reserved power is the residuum of state sovereignty that inheres in all of the state's contracts. Under United States Supreme Court precedent, taxation power is not a reserved power.

Third, before a promise of alienation of sovereign power will be enforceable under the Contract Clause, the promise must be so clearly expressed, and unmistakably detailed, that it is capable of no other interpretation but of the sovereign's unequivocal intent to alienate the power. This is called the "unmistakability doctrine" of Contract Clause law.

The purpose of the federal Contract Clause is to promote economic certainty through the enforcement of contractual obligations. The purpose of the reserved powers doctrine is to prevent a sovereign from selling off critical powers essential to governance. The purpose of the unmistakability doctrine is to avoid unnecessarily trammeling on state sovereign rights unless it is clear beyond any debate that the state meant to give up that right.

As recognized by the Supreme Court many times, there is an inescapable tension between, on the one hand, the Contract Clause, and, on the other hand, the three limitations. From nearly the birth of this country to present day, the Court has struggled to develop its framework balancing all principles. The question of whether the proposed SGDA Contract violates article IX, section 1 or is enforceable under the Contract Clause calls into play all these complex principles.

In *Fletcher v. Peck*, the U.S. Supreme Court considered whether the federal Contract Clause precluded the Georgia legislature from enacting a law voiding an earlier sale of certain lands conveyed by Peck to Fletcher in 1803.[38] The seller argued the

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[38] 10 U.S. 87 (1810).

familiar English maxim that one legislature was always competent to repeal any act which a former legislature had passed.[39] In interpreting the meaning of the federal guarantee against impairment of contract in the context of the Georgia legislature's attempt to void the sale, the Court invalidated the Georgia act.

In a similar case, in 1845 the Ohio legislature granted a corporate charter to a bank that provided for a six-percent tax on the profits of the bank. In 1851, the legislature passed another law imposing a different tax structure on the bank. The U.S. Supreme Court considered whether a promise to maintain a certain tax structure was enforceable under the Contract Clause.[40] The county treasurer seeking to uphold the 1851 Act argued that the state could not have alienated its taxation powers in the 1845 charter. The Court held that the state could have alienated such power.

Again, in *Ohio Life Ins. & Trust Co. v. Debolt*,[41] the U.S. Supreme Court upheld the right of an Ohio life insurance company to enforce an 1834 corporate charter stating it would pay no more than five percent of its dividends on net profits as tax to the state notwithstanding the fact that, in 1851, the Ohio legislature enacted a law modifying the arrangement. The Court held the taxation agreement in the 1834 charter enforceable under the Contract Clause:

> [I]f the contract was within the scope of the authority conferred by the constitution of the State, it is like any other contract made by competent authority, binding upon the parties. Nor can the people or their representatives, by any act of theirs afterwards, impair its obligation. When the contract is made, the Constitution of the United States acts upon it, and declares that it shall not be impaired, and makes it the duty of this court to carry it into execution.[42]

The Court made clear that a threshold inquiry must be made to determine if the alienation of taxation power was authorized under a state constitution: "[N]o one legislature can, by its own act, disarm their successors of any of the powers or rights of sovereignty confided by the people to the legislative body, unless they are authorized to do so by the constitution under which they are elected."[43]

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39 *Id.* at 135.

40 *Piqua Branch v. Knoop*, 57 U.S. 369 (1853).

41 57 U.S. 416 (1853).

42 *Id.* at 429.

43 *Id.* at 431.

(continued)

Because the Court concluded the Ohio constitution had no such prohibition, the Ohio legislature had power to enter into such a tax contract. Therefore, the 1834 agreement was enforceable under the Contract Clause.

In *Stone v. Mississippi*, the Court delivered its clearest explanation of the limits on the alienability of powers of taxation and the reserved powers doctrine up to that point.[44] In 1867 the State of Mississippi granted a corporation a charter to conduct a lottery for 25 years. An 1868 constitutional provision prohibited all lotteries.

The Court found that, while the legislature could not bargain away the public morals with regard to lotteries, no such prohibition existed with respect to taxing power:

> While taxation is in general necessary for the support of government, it is not part of the government itself. Government was not organized for the purposes of taxation, but taxation may be necessary for the purposes of government. As such, taxation becomes an incident to the exercise of the legitimate functions of government, but nothing more. No government dependent on taxation for support can bargain away its whole power of taxation, for that would be substantially abdication. All that has been determined thus far is, that for a consideration it may, in the exercise of a reasonable discretion, and for the public good, surrender a part of its powers in this particular.[45]

In *United States Trust Co. of New York v. New Jersey*, the United States Supreme Court held that the New Jersey legislature could not enact legislation modifying an earlier enacted bondholder covenant, and that limited deference would be given to the sovereign's stated need for the later legislation since the state was perceived to have a self-interest in repudiating its debt.[46] The Court concluded that when a state entered into a debt contract that included terms upon which investors rely, the state cannot avoid its financial obligations by seeking refuge in the reserved powers doctrine. One legislature can bind another with regard to such obligations. The Court did state, however, that the Contract Clause "is not an absolute bar to subsequent modification of a State's own

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44 101 U.S. 814 (1879).

45 *Id.* at 820.

46 431 U.S. 1 (1977).

financial obligations."[47]

In *United States v. Winstar Corp.*, the Court's most recent pronouncement on the enforceability of a sovereign's contractual promises to adhere to financial obligations, the Court embraced Contract Clause analysis in considering the binding nature of a contractual promise by two federal agencies.[48] The Court concluded that the agreement by federal agencies to hold harmless a private party against future regulatory changes did not impede the exercise of any sovereign power.[49]

In *Simpson v. Murkowski*, a case in which the Alaska Supreme Court was evaluating, not a tax exemption issue, but rather the discontinuance of the longevity bonus, the court applied a two-part test to determine whether the law violated the federal Contract Clause.[50] First, the court examines whether the law operates as a substantial impairment of a contractual relationship. To make that determination, the court considers (1) whether there is a contractual relationship; (2) whether the law impairs that relationship; and (3) whether the impairment is substantial. Second, if the court finds that the law substantially impairs a contractual relationship, the court examines whether the impairment is "reasonable and necessary to serve an important public purpose."[51]

To determine whether a statute creates a contractual relationship, the court looks primarily to the statute's language. "In general, [the court] will look for language specifically creating a contract or expressly prohibiting future amendments that would reduce benefits."[52] By using "language evincing a clear and unequivocal intent to create a binding contract," the legislature may create a contract entitled to Contract Clause protection.[53]

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47 *Id.* at 25 (citing *City of El Paso v. Simmons*, 379 U.S. 497 (1965)). In *El Paso*, the Court held that a statute that put a limit on the amount of time that buyers of public land had to pay off delinquent interest in order to get their land back was not an unconstitutional impairment of contract. It stated further that a state's "economic interest" could justify contract impairment. 379 U.S. at 508.

48 518 U.S. 839 (1996).

49 *Id.* at 883.

50 129 P.3d 435, 444 (Alaska 2006).

51 *Id.* (quoting *U.S. Trust Co.*, 431 U.S. 1, 25 (1977)).

52 *Id.* at 445.

53 *Id.* at 446.

(continued)

The cases cited above suggest that, if permitted by their individual constitutions, states may, in the exercise of reasonable discretion, surrender a portion of their taxing powers. They must, however, do so unmistakably and unequivocally. Courts will not infer a contracting away of taxing power.[54]

We believe that the proposed SGDA Contract and the act of the legislature in authorizing the governor to sign it constitute a contract under applicable Contract Clause analysis. The Contract Clause analysis asks if the fiscal certainty guarantee requires the alienation of a reserved power. As discussed, the United States Supreme Court has found taxation powers to be fully alienable in various contexts. We believe that a reviewing court is likely to find that the power of taxation provided for in section 1 of article IX is fully alienable.

The next question will be whether the SGDA Contract and the act of the legislature in authorizing the governor to enter into it are unequivocally clear and capable of no other interpretation but that Alaska intended to alienate its taxation powers for the terms established in the SGDA Contract. We believe that the SGDA Contract does unequivocally indicate that the state intends to alienate its power to change taxes from the terms established in the Contract.[55] Therefore, assuming the legislature authorizes the governor to enter into the Contract, the federal Contract Clause is likely to permit Participants who have relied on the fiscal certainty guarantee to bring a successful constitutional claim if a future legislature alters the fiscal certainty terms in a manner that substantially impairs the Contract and is not otherwise justified as reasonable and necessary to serve an important public purpose.

B. The Alaska Constitution Provides Authority for the Legislature to Contract Away or Suspend Taxing Authority Through General Law

1. In response to the United States Supreme Court's interpretation of a state's power of taxation, many states restricted their inherent power to contract away taxes through state constitutional taxation clauses -- but not Alaska

In the nineteenth century many states, in order to attract certain businesses such as

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[54] *See Covington v. Kentucky* 173 U.S. 231 (1899) (The Court established that a sovereign's intent to enact an irrevocable law must be unmistakable).

[55] *See* Art. 11.1 of the proposed SGDA Contract.

railroads to their states, began conferring permanent, total tax exemptions to those corporations in their charters.[56] When the fiscal uncertainties of later times rendered the continuing grant of permanent tax exemptions ill-advised, many states attempted to impose taxes on the corporations.[57] However, the Supreme Court refused to impose the taxes and instead upheld the corporations' permanent tax exemptions under the federal Contract Clause.[58] As far back as 1810, in *Fletcher v. Peck*, the United States Supreme Court determined that a state could alienate the power to tax if done in a clear and unmistakable way.[59]

Several states were displeased with the Supreme Court's construction of the federal Contract Clause.[60] Some states therefore enacted state constitutional prohibitions against the surrender of taxation power.[61] The National Municipal League (NML) Model State Constitution included a power of taxation clause which stated that "[t]he power of taxation shall never be surrendered, suspended or contracted away."[62] The wording of these provisions varies slightly among states, but the most common language is that used by the NML.[63] As we discuss in further detail in a subsequent section of this memorandum, Alaska did not adopt the language used by the NML. Instead, its representatives at the constitutional convention considered the wording of the model provision, and adopted instead the unique clause in article IX giving the Alaska legislature authority to suspend or contract away taxing power by providing tax exemptions by general law.

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56 *See generally* Sterk & Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 Wis. L. Rev. 1301, 1319 (1991).

57 *E.g.*, *Home of the Friendless v. Rouse*, 75 U.S. 430 (1869).

58 *See generally id.*; *Ohio Life Ins. & Trust Co. v. Debolt*, 57 U.S. 416 (1853); *Piqua Branch v. Knoop*, 57 U.S. 369 (1853).

59 *Fletcher v. Peck*, 10 U.S. 87 (1810).

60 *Gulf & S.I.R. Co. v. Hewes*, 183 U.S. 66 (1901); *Williams v. Mayor of Baltimore*, 289 U.S. 36 (1933); *Home of the Friendless v. Rouse*, 75 U.S. 430 (1869).

61 *See generally* Sterk & Goldman, *Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations*, 1991 Wis. L. Rev. 1301, 1319 (1991). Such provisions are known as "power of taxation clauses" or "alienation clauses."

62 Model State Constitution art. VII, § 700 (Nat'l Mun. League, 5th ed. 1948).

63 *See, e.g.*, Ariz. Const. art. IX, § 1.

It is well established that state legislatures possess plenary powers, except as the powers are limited by federal or state constitutions. A state legislature's plenary powers extend to everything within the sphere of the legislature's power, except as restricted by the federal or state constitutions.[64] In other words, "the [state] Legislature possesses every power not delegated to some other department or to the federal government, or not denied to it by the Constitution of the state or of the United States."[65] In contrast, the power of the federal government is one of only "delegated powers."[66]

It is also well established that a state legislature may not contract away certain reserved powers, such as its police power. Some light is shed on Alaska's reserved powers by considering how the Alaska Supreme Court has defined "police powers," since police powers are regarded as inalienable.[67] The court has described Alaska's police powers as "broad and comprehensive."[68] The court has previously found many challenged state actions to be legitimate exercises of the police powers.[69] But the court

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64 *Pine Grove v. Talcott*, 86 U.S. 666 (1873).

65 *People ex rel. Chicago v. Barrett*, 26 N.E.2d 478, 482 (Ill. 1940). *See also Smith v. Penta*, 405 A.2d 350 (N.J. 1979) (as the repository for the reserved powers of the government, the state legislature is free to act except in respect of the powers delegated to the federal government by the Constitution of the United States and except as such exercise may be limited by the state constitution; there are no other restraints on state legislative power); *Com v. Henry*, 65 S.E. 570 (Va. 1909) (the power of the legislature of the state is supreme except so far as it is restrained by the state or federal constitution, and even in case of doubt as to the power, all doubts are to be resolved in favor of the existence of the power).

66 *Carter v. Carter Coal Co.*, 298 U.S. 238, 291 (1936) ("the powers which the general government may exercise are only those specifically enumerated in the Constitution, and such implied powers as are necessary and proper to carry into effect the enumerated powers.").

67 *See Stepanov v. Homer Elec. Ass'n*, 814 P.2d 731 (Alaska 1991) (public utility contract between developer and public authority was subject to the reserved authority of the state, under the police power, to modify the contract in the interest of the public welfare).

68 *State v. Enserch*, 787 P.2d 624 (Alaska 1990) (resident hiring preference not within police power).

69 The following exercises of power have been found to be within the state's police powers: regulation of a food distribution center, *O'Callaghan v. Anchorage*, 2002 WL 1293001 (Alaska 2002); utility regulation, *Tlingit-Haida Reg'l Elec. Auth. v. State*, 15 P.3d 754 (Alaska 2001); hazardous substances releases, *Kodiak v. Exxon*, 991 P.2d 757 (Alaska 1999); regulation of hunting, *Totemoff v. State*, 905 P.2d 954 (Alaska 1995); tariff ratemaking for intrastate oil shipments, *Cook Inlet Pipeline Co. v. Alaska Pub. Util. Comm'n*, 836 P.2d 343 (Alaska 1992); and use of confidential well data by the state in order to maximize state revenues from leased (continued)

has also indicated, in dicta, in one case that it views "taxation power" as separate and apart from Alaska's "police powers."[70] A review of United States Supreme Court cases indicates that state taxation powers are not generally considered police powers and may be subject to being contracted away if permitted under individual state constitutions.

The determination of whether the Alaska legislature has authority to alienate its taxing powers begins by analysis of article IX, section 1, the "power of taxation clause," to ascertain whether Alaska's constitutional framers deprived the legislature of all authority to alienate its power of taxation. Based on the text of article IX, section 1 and section 4, and the constitutional history of the provisions, the framers of Alaska's constitution chose to limit, but not preclude, the state's legislature from alienating its power of taxation through tax exemptions to provide incentives for economic development of Alaska's resources.[71]

Based on the debate that occurred among the delegates at the Alaska Constitutional Convention, and on the familiar principle that constitutional and legislative provisions should be harmonized so that none of the words are rendered superfluous, we believe that the framers intended to leave the legislature with the authority to suspend or contract away the power to tax as part of its power to grant tax exemptions by general law.[72] Indeed, immediately before and after the constitutional convention, both the Alaska territorial and state legislatures adopted industrial incentive acts providing tax

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lands, *Dep't of Natural Res. v. Arctic Slope Reg'l Corp.*, 834 P.2d 134 (Alaska 1992). *Cf. Matthews v. Quinton*, 362 P.2d 932 (Alaska 1961) (transportation of schoolchildren to nonpublic schools not within police powers).

[70] In *Waiste v. State*, 10 P.3d 1141 (Alaska 2000) (Takings Clause challenge to seizure of boat for suspected fishing law violations), the court in enumerating different sources and types of state power, listed "taxation power" separately from "police power" and separately from "the power to purchase property." *Id.* at 1155. Arguably, if taxation power were already subsumed within "police power," there would have been no need for the court to separately identify the power.

[71] Very little case law directly interprets the pertinent article IX provisions. The Alaska Supreme Court has considered other issues arising out of tax contracts without addressing the constitutionality of the underlying contracts. Case law from other states is mixed, and is highly dependent on the particular language of other states' constitutions and the particular facts. It is difficult to draw firm conclusions from these cases that are applicable to Alaska in view of the framers' discussions concerning the unique language of Alaska's power of taxation clause.

[72] *Park v. State*, 528 P.2d 785 (Alaska 1974). This reading of the taxation clause is enhanced by article VIII of the state constitution, which provides for development of the state's resources "for the maximum benefit of the people." *See* Section IV-B-3, *infra*.

exemptions and other incentives to businesses investing in Alaska that were considered contractual in nature. Several delegates to the convention were members of the legislature when these acts were enacted.[73]

Much direct archival evidence exists of the intent of the framers of Alaska's constitution to permit legislators to alienate a portion of taxation powers through tax incentives to encourage development of Alaska's resources. When members of the Committee on Finance and Taxation met to begin crafting article IX, they had already reviewed a paper concerning the NML Model State Constitution provisions that was prepared by consultants from the Public Administration Service (PAS).[74] Committee minutes reflect the discussion.[75]

The PAS paper considered the origins of the Model State Constitution power of taxation clause, the ability of a sovereign to alienate its taxation powers through exemptions and incentives, and the negative view of tax incentives held by some economists.[76] The paper expressly cautioned delegates that tax exemptions could result in binding contractual obligations:

> Whatever may be the merits of [the tax exemptions'] use, business and industrial tax exemptions have occasionally given rise to a significant constitutional problem. By granting such inducements in legislation, states have been held on occasion to have contracted away the taxing power. It is a settled principle of public law that one legislature cannot bind another and that the government of a state cannot contract away its police powers. The power to tax is not considered inalienable, however. *In granting exemptions, one legislature may bind another and thereby lose for the state its power*

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73 These acts are discussed in greater detail in section IV-B-3, *infra.*

74 3 Constitutional Studies, PAS Staff Paper 9, Vol. 3, State Finances (1955). The Alaska Supreme Court has recognized the importance of PAS papers in interpreting the framers' intent. See *State v. Alex*, 646 P.2d 203, 209 n.5 (Alaska 1982).

75 "There followed a general discussion of the material PAS Paper #9 -Finance- and finance provisions in the Model State Constitution, Hawaii and Puerto Rico Constitutions, and those of various states. The discussion included . . . alienation clauses as they may affect tax incentives and other matters . . . ." Minutes of the Finance Committee, Alaska Constitutional Convention (Nov. 16, 1955). In fact, the Finance Committee unanimously decided that the outline of PAS Paper No. IX be followed in committee deliberations.

76 PAS Staff Paper, State Finance, at 15-16 ("tax specialists frown darkly on such devices").

> *to tax.* The exemption may, under certain conditions, result in a contract relationship that legislatures may not abrogate without violating the federal constitutional guarantee against state legislation impairing the obligation of contracts.[77]

Another PAS paper studied by all delegates advised that state constitutional limitations on legislative power, such as a power of taxation clause, could retard growth.[78] Nonetheless, it is clear from the convention history that the delegates consciously rejected the PAS' advice.

2. Alaska's constitutional delegates carved out an exception for suspending or contracting away the power to tax, as provided in section 1 of article IX

It is evident from the minutes of committee meetings and the transcripts of convention debate that the framers had a unique design and purpose for Alaska's taxation clause. They modified the NML Model State Constitution taxation clause into a preliminary draft of article IX, section 1 that read: "[t]he power of taxation shall never be surrendered; and shall never be suspended or contracted away, except as provided herein."

In committee meetings, when delegates asked if incentives might be viewed differently by experts in light of Alaska's unusual position, the committee's financial consultant, Dr. Weldon Cooper, replied, "yes, but that it should be part of an overall picture."[79]

The committee's summary progress report noted that, "[t]he Finance and Taxation Committee is still considering tax incentive measures, which may be affected by classification, and related problems, *including a time limit on any incentive program.* The Committee has tentatively adopted certain secs. of the preliminary draft, and is preparing a Proposed article for submission soon."[80] At the first reading, Delegate White

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77 *Id.* (emphasis added).

78 PAS Constitutional Studies, Vol. 2, "The Legislative Department," at 5-6 stated: "if, on the one hand, the restrictions [on legislative power in state constitutions] are highly specific and well-defined, there is always the danger that they may rapidly become out-moded and develop into barriers to necessary reform. This is well illustrated, for example, by state constitutional restrictions upon the power to tax."

79 Minutes of Finance Committee (Dec. 5, 1955).

(continued)

indicated that the semicolon and division of thought, and the addition of the words, "except as provided herein," were to remove doubt as to what the framers meant in the exemptions provision of article IX, the proposed section 4.[81] White described section 4 as allowing for the "granting of tax incentives to new industries."[82]

Delegate Nerland, chairman of the committee, explained this modified version of the section 1 taxation clause at second reading. He stated that the proposal "has been altered slightly from the usual wording of a number of state constitutions . . . ."[83] He continued, "[b]ut we did feel that there would possibly be occasion and good justification in the future for such things as allowing an industry-wide exemption to encourage new industry to come in and that is the reason for the particular wording there."[84] As to the section 4 exemptions, he continued: "this is the provision that allows for some exemption or inducement to industries or similar things."[85] The committee's official commentary to section 1 explained that "[t]he power to tax is never to be surrendered, but under terms that may be established by the legislature, it may be suspended or temporarily contracted away. This could include industrial incentives, for example."[86]

Section 4 delineated a number of tax exemptions, and then followed with, "other exemptions of like or different kind may be granted by general law . . . ."[87] Official commentary to section 4 explained that "the legislature is authorized to make further tax

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80 Convention Committee's Summary Progress Report No. 3, at 5 (Dec. 10, 1955) (emphasis added).

81 *Proceedings of the Alaska Constitutional Convention* (Dec. 19, 1955).

82 *Id.*

83 *Id.* (Jan. 16, 1956).

84 *Id.*

85 *Id.* This evidence demonstrates that framers considered industrial exemptions to be one type of tax incentive, and authorized under section 4. The phrase "inducement to industries" is arguably broader than the term "exemption," and allows for inducement schemes like the SGDA Contract that involve exemptions and other inducements.

86 Commentary on the Article on Finance and Taxation (Dec. 16, 1955).

87 Alaska Const. art. IX, § 4. Section 4 contains express tax exemptions for nonprofit, religious, charitable, cemetery, or educational purposes, but permits "other exemptions of like or different kind."

exemptions to encourage, among other purposes, new industry . . . ."[88]

Such archival history demonstrates that although the prohibition against surrendering taxation power may be absolute, the prohibition against suspending or contracting away taxing power is not absolute, but is qualified by the permissible exemption provisions in section 4. Thus, in Alaska the language governing suspending or contracting away taxing authority is permissive under certain conditions, whereas in other state constitutions the language is absolutely prohibitory. In Alaska, the framers deliberately rejected putting parameters around what would constitute a temporary tax incentive and specifying exactly what kinds of incentives could be provided.

The convention made no alterations to the committee's final proposed language. The Committee on Style and Drafting, however, made nonsubstantive grammatical changes, adopting the current article IX, section 1: "[T]he power of taxation shall never be surrendered. This power shall not be suspended or contracted away, except as provided in this article."

The final version of section 4's tax exemption provision stated, in relevant part, "other exemptions of like or different kind may be granted by general law." Chairman Nerland explained to the delegates that one purpose of the power of taxation clause was to prohibit forgiveness of already-delinquent or back taxes.[89] No floor debate on sections 1 and 4 voiced the framers' concern with potential corporate overreaching, the impetus behind other states' adoption of taxation clauses, although in discussions of other sections of the constitution the delegates were generally interested in making sure that Outside industries (the focus at the time was on the salmon industry) did not control Alaska's resources or commandeer Alaska's resource wealth.

With respect to the "like or different" language, Mr. Smith asked: "Isn't that, in effect, saying that exemptions of any kind may be granted?" Mr. Nerland responded: "Yes, that was the purpose of it."[90]

Dr. Cooper repeatedly reminded the committee members that tax exemptions were highly disfavored.[91] Nevertheless, the committee and entire convention manifested their

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88 Commentary on the Article on Finance and Taxation (Dec. 16, 1955).

89 *Proceedings of the Alaska Constitutional Convention* (Jan. 11, 1956).

90 *Id.* (Jan. 16, 1956).

(continued)

strong belief that in Alaska tax incentives should be encouraged under section 4. As Delegate Marston explained with regard to incentives, "to get outside capital coming here we've got to be liberal."[92] In spite of Dr. Cooper's urging, the committee chose not to adopt a specific durational limit for tax exemptions for the express purpose of avoiding constitutional questions.[93]

Of additional significance is "A Report to the People of Alaska from the Alaska Constitutional Convention, February 1956."[94] This report simply stated: "Save for exempted property used for non-profit, religious, charitable, cemetery or education purposes, the legislature may determine the kinds and subjects of taxation and prescribe standards for appraisal of property for state or local purposes."[95] This language informed the voters that the legislature had broad powers to determine the specifics of any tax regime. Moreover, the court expressly held in *DeArmond v. Alaska State Dev. Corp.* (which is discussed in greater detail in a subsequent section of this memorandum) that exemptions different from the charitable and other exemptions could be provided.[96]

The broad authority over tax exemptions conferred in the constitution and described to Alaska voters at ratification continued historical precedent. As discussed below, the framers and their contemporaries in the territorial and first state legislatures were well aware of — and approved of — industrial incentives in the nature of tax contracts.

3. Constitutional history and principles of constitutional construction link together sections 1 and 4 of article IX

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91 Minutes of Finance Committee (Dec. 5, 1955) ("Mr. Cooper also pointed out that experts generally viewed tax exemptions, beyond those traditionally granted, as a poor practice.").

92 *Proceedings of the Alaska Constitutional Convention* (Jan. 18, 1956).

93 Minutes of Finance Committee (Dec. 5, 1955).

94 *See, e.g., State v. Lewis*, 559 P.2d 630, 637-38 (Alaska 1977) (footnote omitted) (citing directly to this report, the court stated: "While voters were probably not privy to the comments of the delegates in adopting the provision, they were made aware of its purpose in unambiguous language by A Report to the People of Alaska from the Alaskan Constitutional Convention which was widely distributed.").

95 Proposed Constitution of the State of Alaska, A Report to the People of Alaska from the Alaska Constitutional Convention, February 1956, at 1.

96 376 P.2d 717 (Alaska 1983).

Even before statehood, the legislature of the Territory of Alaska had enacted the Alaska Property Tax Act of 1949.[97] This Act authorized the tax commissioner to exempt "new industry" and "new industrial enterprises" from "license fees, excises or other taxes levied by the state or a political subdivision of the state" for up to ten years.[98] Factors influencing eligibility for the exemption included: permanence of the industry, amount of capital invested, whether the operation was seasonal or continuous, whether the operation was likely to be marginal because of the distance from principal markets, and the number of Alaskan workmen employed.[99] The Act constituted "a contract between the [local] taxing unit, and the owner of the property."[100] It provided that the "exemptions shall remain in full force and effect for the periods granted and are binding."[101] Several of the delegates had been legislators when this Act was passed, bringing their experience to the convention. Thus, at the time the framers met in 1955, Alaska had a tax exemption act in place that by its own terms was considered contractual in nature.

The Alaska Industrial Incentive Act of 1957, a territorial statute enacted shortly after the convention but before ratification, established a graduated taxation exemption related to the amount of investment.[102] Businesses could apply for a ten-year tax exemption certificate which, if granted, was deemed to be binding and in full force and effect upon the terms set forth for the period granted.[103] It provided for exemptions and

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97 Ch. 10, SLA 1949.

98 *Id.* sec. 6(h)(1).

99 *Id.* sec. 6(h)(2).

100 H.B. 43, § 2, approved March 16, 1953.

101 *Id.* § 3.

102 *See* former AS 43.25.010 *et seq.*

103 *Id.* The Alaska Supreme Court has considered provisions of this Act several times. In *Union Oil Co. of Cal. v. State*, 677 P.2d 1256 (Alaska 1984) (*Union I*), the court held that under the Act the incentives operated to reduce the state income tax liability of a subsidiary only, and not of an entire consolidated group. In *Union Oil Co. of Cal. v. State*, 804 P.2d 62 (Alaska 1990) (*Union II*), the court found the Department of Revenue's interpretation of a tax exemption certificate reasonable. In *K & L Distribs., Inc. v. Murkowski*, 486 P.2d 351 (Alaska 1971), the court found that an industrial incentive tax credit of up to 75 percent of the value of an investment for seven years could be applied against a tax liability due under an excise tax. In none of these cases did the court opine, even in dicta, that the existence of such a tax incentive contract under the Act violated Alaska's power of taxation clause. In fact, in *K&L Distribs.*, the (continued)

credits from a wide array of taxes, including income and property taxes as well as "license fees, excises or other taxes levied by the Territory or any political subdivision thereof."[104] Moreover, an individual exemption could be tailored with terms and conditions needed to further the industrial development in question.[105] At least one major project on the Kenai Peninsula benefited directly from the provisions of the Industrial Incentive Act, and might never have come to fruition without its contractual terms.[106] Several members of the 1957 legislature had been convention delegates, and presumably brought their understanding of article IX's provisions to the 1957 Act.

Following statehood, in 1968 the legislature enacted the Alaska Industrial Incentive Tax Credits Act.[107] Under this Act the grant of a tax credit was "effective for a period . . . not to exceed 10 years from the date of grant . . . ."[108] It offered tax credits rather than the exemption available in the 1957 Act.[109]

In sum, the convention record indicates that the delegates were familiar with tax exemptions and credits, and the Acts discussed above suggest that they considered such incentives to be contractual in nature. Significantly, several members of the constitutional convention, including members of the Committee on Finance and Taxation, were also members of the 1949, 1957 or 1968 legislature. None of these members questioned the constitutionality of such Acts under article IX. In our view then, it is reasonable to conclude that the delegates did not view the Acts as violating article IX and intended that the "other exemptions" in section 4 relate to section 1.[110]

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court found that the grant of tax relief provided for in the Act was "in the broadest possible form and that the legislature intended that a credit could be provided for almost any tax within the State of Alaska." *Id.* at 358.

104 *Id.*

105 *Id.*

106 The liquefied gas plant, gas pipeline, and related facilities project on the Kenai Peninsula provided substantial development to the young state and utilized the benefits of the Act. 1998 Inf. Op. Att'y. Gen. (May 29; 883-98-0083), 1999 WL 638618, at * 4.

107 Former AS 43.26 et seq., repealed in 1986.

108 Former AS 43.26.010(a). Another provision, AS 43.26.050, set forth a few limited grounds for revoking the tax credit, but included no provision for allowing revocation based on a change in the law.

109 Former AS 43.26.010(a).

(continued)

Moreover, unlike the earlier Incentive Acts, the proposed SGDA Contract requires continuous payments in lieu of taxes, not a complete exemption from payment of taxes. Additionally, as previously noted, taken as a whole, the payments are not expected to materially reduce the present-day tax burden on the project.

The length of fiscal certainty provided for in the SGDA Contract is much longer than the period of exemption provided for under the earlier Incentive Acts. However, as noted above, the framers rejected time limits for complete exemptions under section 4. If complete exemptions for taxes could be provided for any amount of time, it follows that continuous payments for a long period of time are not prohibited by sections 1 and 4. As previously noted, the Commissioner has found that the periods of fiscal certainty that will be provided for in the proposed SGDA Contract are necessary to convince the Sponsor Group to (1) build one of the largest and most expensive projects ever built; (2) invest in the Project in Alaska now as opposed to investing in numerous other gas projects around the world; (3) ensure that the vast amounts of gas needed to fill the pipeline to capacity are both discovered and committed to the Project; (4) allow recovery of the cost of building the pipeline; and (5) provide assurance to the parties' potential lenders. The Commissioner has also found that the fiscal certainty provided for in the Contract will encourage investment in oil fields to combat declining oil production. In short, it is reasonable to conclude that the proposed SGDA Contract is within the parameters established by the framers in sections 1 and 4 to use the state's tax structure to encourage development for the maximum benefit of the people.

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[110] With respect to the weight that the earlier Incentive Acts may have in interpreting these constitutional provisions, the court in *Juneau v. Hixson*, 373 P.2d 743 (Alaska 1962), considered post-constitutional legislation affecting "capital improvements" in determining that a home rule city's bond issue was not an unauthorized "capital improvement" within the meaning of article IX, section 9. On the other hand, the court held more recently in *Hickel v. Cowper*, 874 P.2d 922, 936 n.7 (Alaska 1994), that "the applicable degree of deference is lessened by the fact that at issue is the meaning of a constitutional amendment for which the legislature is not the ultimate adopting authority." The people are the ultimate adopting authority. *See, e.g., State v. Lewis*, 559 P.2d 630, 637-38 (footnote omitted) ("While we believe there can be no serious question as to the intent of the delegates in drafting Art. VIII, Sec. 9, we are cognizant [of the fact that a] constitutional provision . . . must be ratified by the voters, and it is therefore also necessary to look to the meaning that the voters would have placed on its provisions. While voters were probably not privy to the comments of the delegates in adopting the provision, they were made aware of its purpose in unambiguous language by A Report to the People of Alaska from the Alaskan Constitutional Convention which was widely distributed.") As noted above, the people were made aware of sections 1 and 4 in the Report to the People.

Article VIII, section 1 of the Alaska Constitution provides that it is "the policy of the State to encourage . . . development of its resources by making them available for maximum use consistent with public interest." Further, article VIII, section 2 states that the "legislature shall provide for the . . . development . . . of all natural resources . . . for the maximum benefit of the people." The constitution thus provides the legislature with broad powers to take actions to utilize and develop the natural resources of the state.

The proposed SGDA Contract is consistent with article VIII's mandate to develop the state's gas for the maximum benefit of Alaska citizens and fits within the parameters of sections 1 and 4 of article IX. Commentary by the delegates regarding article VIII makes it clear that all saw it as allowing for development of the state's vast resources to benefit future Alaskans. For example, Delegate Rivers stated: "It seems to me that here we have the foundation and the framework for a real orderly development and utilization of our resources, and I, for one, feel we have laid the foundation here for the future success and well-being of all of our citizens [and for] the great success of the future state."[111] The framers recognized that developing Alaska's resources according to the mandate of article VIII might require an innovative tax regime, and this is reflected in their rejection of the highly restrictive NML model for article IX, the finance and taxation clause.

The need to develop natural resources for the people's benefit was a continuing concern expressed not only at the convention but also in the Statehood Act debates that occurred simultaneously with the adoption of Alaska's constitution. As the Alaska Supreme Court has noted, "[t]he primary purpose of the statehood land grants contained in section 6(a) and (b) of the Statehood Act was to ensure the economic and social well-being of the new state."[112] The court explained in *Trustees* that even congressmen who supported statehood conceded that there would be difficult financial burdens without some special consideration of Alaska's unique circumstances. To address the need for an economic base, Congress granted 103 million acres of federal land to Alaska as an endowment that would yield income for Alaska to meet the costs of statehood. The statehood land grant was considered "the foundation upon which Alaska can and will build to the enormous benefit of the national economy shared by her sister States."[113]

The Supreme Court of Alaska first considered the section 4 exemptions clause in *DeArmond v. Alaska State Dev. Corp.*, a declaratory judgment action challenging

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111 *Proceedings of the Alaska Constitutional Convention* (Jan. 31, 1956).

112 *Trustees for Alaska v. State*, 736 P.2d 324, 335 (Alaska 1987) (citations omitted).

113 *Id.* at 336 (citations omitted).

creation of the Alaska State Development Corporation.[114] Taxpayers contended that the act creating the corporation, which exempted the Alaska State Development Corporation from all taxes and assessments, violated article IX, section 4, the exemptions clause.

The taxpayers argued that the phrase "other exemptions of like or different kind" limited the exemptions to only those types of exemptions previously named, and therefore, no residual exemption should be recognized for a state development corporation. The court rejected such a narrow construction of section 4. It concluded that the legislature may grant exemptions beyond those specifically listed in section 4:

> We believe the word 'like' refers to the named exemptions in the preceding sentence and that 'different' was intended to clearly indicate that the legislature was not to be bound by the rule of *ejusdem generis* and was free to grant other exemptions even though they may not be of the same kind or character as those named.[115]

In *Alascom, Inc. v. North Slope Borough,* the court held that the prohibition against surrender or suspension of taxation power did not preclude application of a six-year statute of limitations to tax collections.[116] The court stated:

> We believe that the response to the Borough's contention is provided by Article 9, section 4, of the Alaska Constitution, the provision addressing exemptions from taxation. After setting forth specific exemptions this provision states that "[o]ther exemptions of like *or different* kind may be granted by general law." In our view this constitutional grant of power to except encompasses the power to require that taxes be assessed and collected within a certain period of time or be forever barred.[117]

The court in *Alascom* thus viewed a statute of limitations as a "different kind" of "exemption" under section 4. *Alascom* illustrates that the court will not consider sections 1 and 4 of article IX in isolation, but will attempt to harmonize their reading.

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[114] 376 P.2d 717 (Alaska 1962).

[115] *Id.* at 725.

[116] 659 P.2d 1175 (Alaska 1983).

[117] *Id.* at 1179 (emphasis in original).

Additionally, although sections 1 and 4 of article IX were not discussed, the court held in *K&L Distribs., Inc. v. Murkowski* that the grant of tax relief provided for in the Industrial Incentive Tax Credits Act was "in the broadest possible form and that the legislature intended that a credit could be provided for almost any tax within the State of Alaska."[118]

In *Atlantic Richfield Co. v. State,* oil and gas production companies raised numerous challenges to the constitutionality of the oil and gas corporate income tax.[119] They claimed the tax deprived them of due process and equal protection, and violated the Commerce Clause. In addition, the companies contended that the income tax increased the state's share under various leases, and thus violated the federal Contract Clause.

The court noted in dicta that, in entering into leases, the state could not contract away its power as a sovereign to tax income earned in the state, and the court then specifically observed that a government's power to tax remains unless it has been specifically surrendered.[120] In *Atlantic Richfield*, the state's power of taxation had not been specifically and unambiguously altered by the legislature and thus, *in entering the leases*, the state had no authority to contract away its taxing powers. The holding does not deal with a fact situation similar to the proposed contract at issue here in which the state unequivocally states its intent to alienate its power to change taxes for the terms established in the contract.

Finally, given the significant number of state constitutions with taxation clauses, it is surprising that relatively few cases exist that challenge tax incentives under power of taxation clauses. Even fewer cases address the precise points at issue in the proposed SGDA Contract.[121]

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118 486 P.2d 351, 358 (Alaska 1971).

119 705 P.2d 418 (Alaska 1985).

120 *Id.* at 438 (emphasis added) (citing *St. Louis v. United R. Co.*, 210 U.S. 266 (1908)); *See also Exxon v. Eagerton*, 462 U.S. 176, 187-94 (1983).

121 Relevant cases significant in upholding a fiscal certainty guarantee under a power of taxation clause include: *Valencia Energy Co. v. Arizona Dep't of Revenue*, 959 P.2d 1256 (Ariz. 1998) (power of taxation clauses do not preclude some contracting away of taxing authority); *Gruen v. Tax Comm'n*, 211 P.2d 651 (Wash. 1949) (power of taxation clauses do not prohibit a legislature from contracting for a term longer than the life of the current legislature), *overruled in part on other grounds*, 384 P.2d 833 (Wash. 1963); *In re Opinion of the Justices (Mass.)*, 168 N.E.2d 858 (Mass. 1960) (a 40-year tax contract for urban renewal purposes is not a surrender of (continued)

In summary, the words of article IX, section 1, "except as provided in this article" would be superfluous and meaningless if there were no other provision in article IX allowing a suspension or contracting away of taxing power. Because sections 1 and 4 were adopted simultaneously and the convention history links them together, section 1 can reasonably be read to refer to the legislature's power to authorize tax exemptions and other incentives by general law.[122]

Further, the Alaska Supreme Court recognizes that the state constitution must be considered a "living document adaptable to a change in the conditions and circumstances unanticipated at the time it was written."[123] Framers 50 years ago could hardly foresee the dramatically increased international competitiveness in energy development arising from the commercialization of former East Bloc nations, China, and other relatively undeveloped nations. Nevertheless, the framers' intent to maintain an attractive industrial climate in Alaska is abundantly clear in the archival history, as is their intent to refrain from imposing arbitrary time limits for tax incentives.[124]

Based on the significant constitutional and legislative histories discussed above, it is our conclusion that the framers intended to leave relatively unfettered the legislature's authority to approve tax incentive contracts. Moreover, this conclusion is enhanced with respect to the current proposed SGDA Contract because of article VIII's mandate to develop state resources and the Statehood Act's provision of vast acreage to Alaska to develop an economic base to support all Alaskans.

V. CONCLUSION

As noted above, the words of article IX, section 1, "except as provided in this article" would be superfluous and meaningless if there was no other provision in article IX allowing a suspension or contracting away of taxing power. Because sections 1 and 4 were adopted simultaneously and the convention history links them together,

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a sovereign's taxing power); and *Bailey v. State*, 500 S.E.2d 54 (N.C. 1998) (irrevocable tax exemption did not violate North Carolina's power of taxation clause).

122 *Proceedings of the Alaska Constitutional Convention* (Dec. 19, 1955) (comments of Delegate White regarding sections 1 and 4); *id.* (Jan. 16, 1956) (comments of Chairman Nerland regarding sections 1 and 4).

123 *Warwick v. State ex rel. Chance*, 548 P.2d 384 (Alaska 1976).

124 Industrial tax incentives in the oil and gas industry in the United States are widespread.

section 1 refers to the legislature's power to authorize tax exemptions and other incentives by general law.

Further, it is reasonable to conclude that the state will receive adequate consideration for the fiscal certainty provided for in the SGDA Contract in the form of the various benefits that will result to the state from building the Project. To summarize, in order to develop the state's vast gas resources now when oil production is declining rapidly, the Commissioner has determined that the fiscal certainty provided for in the proposed SGDA Contract is necessary. The Commissioner has found that certainty will encourage the Sponsor Group to (1) build one of the largest and most expensive gas lines ever built; (2) invest in the Project in Alaska now as opposed to investing in numerous other gas projects around the world; (3) ensure that the vast amounts of gas needed to fill the pipeline to capacity are both discovered and committed to the Project; (4) allow recovery of the cost of building the pipeline; and (5) provide assurance to the parties' potential lenders. The Commissioner has also found that the fiscal certainty provided for in the Contract will encourage new investment in oil fields to combat declining oil production.

Finally, if the proposed SGDA Contract is approved by the legislature, the Contract Clause of the U.S. Constitution may well prohibit future legislatures from changing its fiscal terms. For the reasons discussed above, we believe that the powers of taxation set forth in the Alaska Constitution are alienable. Therefore a fiscal contract of the type contemplated in the SGDA will likely be enforceable by the parties to the contract.

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STATE OF ALASKA

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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 it. The North Slope Gas Commercialization Team's Report to the Governor of December 15, 1997, in fact identifies an LNG project as the "most promising" alternative for commercializing North Slope 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, however, 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

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