

**03/13/15**  
**BRIEFING:**  
**KETCHIKAN**  
**GATEWAY BOROUGH**  
**LAWSUIT**

<TARGET><BILL></BILL><SUBJECT>03-13-15 BRIEFING ON THE  
KETCHIKAN GATEWAY BOROUGH  
LAWSUIT</SUBJECT><COMM>HEDC29</COMM></TARGET>

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### Friday, March 13, 2015

#### House Education Committee

[Link to Video](#)

Link to Audio not available (there are no documents associated with this hearing)

#### Update: Ketchikan Gateway Borough Lawsuit on Required Local Contribution

Friday morning the House Education Committee heard a briefing on the Ketchikan Gateway Borough's lawsuit on the required local contribution to education. Reviewing the information were Assistant Attorneys General Rebecca Hatton and Kathryn Vogel, Dept. of Law.

Committee members in attendance were Chair Keller, and Representatives Kreiss-Tomkins, Drummond, and Seaton. Also attending were two legislators not on the committee: Representatives Kito and Ortiz. The committee first heard a brief presentation from the Dept. of Law, and then took questions.

Ms. Hatton said the lawsuit was filed in January 2014. In February and March of 2014, both parties, the State of Alaska and the Ketchikan Gateway Borough, asked for a summary judgment, which means there's no issue of material fact – that there are no contested facts in the lawsuit and it's just a question of law. A final judgment on the case from the Superior Court was issued in January 2015.

Ms. Hatton said Judge William Carey's decision found in favor of Ketchikan on one constitutional clause, and in favor of the state on two. The state requested a stay on the

ruling, and then appealed to the Supreme Court when Judge Carey denied the stay. The Supreme Court then gave a stay until the state had an opportunity to make their case.

Ms. Hatton reviewed the lawsuit. Municipalities pay about 16 percent of basic need in their school districts. For the Ketchikan Gateway Borough that was about \$4.2 million in FY16, out of a total of \$22.5 million in basic need for Ketchikan.

Ms. Hatton said the lawsuit argued that required local contributions violate three provisions in the [Alaska Constitution](#): provisions for dedicated funds, the right of the legislature to appropriate, and the right of the governor to veto. The constitutional framers' intent on a ban on dedicated funds was to not allow earmarks and to maximize the legislature's ability to make appropriations. Alaska courts use a two-part test to determine whether something is a dedicated fund, one of which is dedication to a specific purpose. The state's position is that the required local contribution is not a specific tax and not state revenue. Judge Carey ruled that it was a dedicated tax.

Ms. Hatton said state's argument was that the governor is able to veto the line item. Required local contributions are appropriated by a borough's treasury, so it doesn't violate the governor's veto or the legislative appropriation clauses of the Alaska Constitution.

Ms. Hatton said Ketchikan asked for recovery of damages, which is basically the same as asking for a refund. Judge Carey denied that argument, and said state was not unjustly enriched because required local contributions don't ever come to the state treasury. The required local contribution was found unconstitutional as violating dedicated funds, but not the governor's right to veto or the legislature's right to appropriate. Refund of fees to Ketchikan was denied. The state can continue to enforce the required local contribution statute because the Supreme Court issued a stay in the case.

Ms. Hatton said the state is confident in its legal arguments, but if the Supreme Court rules in favor of Ketchikan, it would have to be addressed by the legislature.

Rep. Seaton said he's confused – if the judge decided it is a tax, and dedicated to a special purpose, it seems that it wouldn't be a state tax. Ms. Hatton said the state's arguments were that the money didn't come within the power of state's treasury, but Judge Carey saw it differently. Ms Vogel added that Judge Carey's decision did not find it significant that the money was locally raised and allocated. She thinks that part of the decision will be held up. Judge Carey also found that that distinction didn't matter.

Rep. Kito said if there's not a requirement that the funding the local government pays comes from a tax or license, in that case it would not be considered a local tax. Ms.

Vogel said yes; the state made that argument: that while the statute gives an amount, and states it be the equivalent of a mill rate, nothing states how the money be raised. Judge Carey didn't accept that argument, but that was the state's position.

In response to a previous question from Chair Keller, Rep. Kito said he believes the total state amount of local contribution currently is about \$220 million.

Rep. Kreiss-Tomkins asked if the Supreme Court will take up the case and rule on it. Ms. Hatton said yes, both sides have appealed. There is a conference this afternoon to determine due dates. She expects the Supreme Court to deal with the case in an expedited manner.

Rep. Kreiss-Tomkins asked if there's any sense of what the timeline will be. Ms. Hatton said she wouldn't speculate. They will keep the House Education Committee updated. The Supreme Court can take any amount of time they deem necessary.

Chair Keller asked if local school districts will be short money if the Supreme Court decides in their favor. Ms. Hatton said she won't speculate on the ruling. But though Ketchikan didn't clearly challenge the required local contribution under the education clause of the constitution, they did include arguments that the state didn't clearly fund education. She said Judge Carey said the state did not have an obligation to fully fund education.

Chair Keller asked if impact aid will be affected. Ms. Hatton said that's an area of concern. Alaska has an equalized formula for impact aid. So the state can take 90 percent of impact aid for basic need, which offsets about \$69 to \$70 million annually. It would be speculation to say whether a revised formula would be considered an equalized formula. So that's an open question.

Rep. Kito asked if the ruling could impact other payments beyond education that the legislature requires, such as PERS or matching funds for capital projects. Ms. Vogel said yes. A dedicated fund decision from the Supreme Court, particularly if it adopts a similar decision of the Superior Court, could have implications for other requirements for local matches to state funds. That would be an expansion of how the dedicated fund clause has been interpreted in the past. The impact would depend on how the Supreme Court words its decision, so it's somewhat unknown. There are a lot of implications beyond education. The state's position has been to highlight to the court all the implications.

Rep. Seaton asked if they are talking about something like the 70/30 reimbursement for bond debt. Ms. Hatton said that's an area of concern. Other joint municipal/state

participation programs could be in danger with an expansive interpretation of the issue.

Rep. Seaton asked if all three constitutional issues being appealed. Ms. Hatton said it's the whole lawsuit. The state initially appealed the dedicated funds, but Ketchikan appealed all three.

Rep. Drummond said this has interesting implications. Has the state considered what other states do on education funding? Alaska school districts are dependent school districts, through local government and state government. Many states have independent school districts that have the power to tax. She can see this turning Alaska into a different sort of structure. She said she's looking far forward, but if the state loses and school districts have to find other sources of revenues, they could turn them into local school districts [with taxing authority], which is what happens in other states.

Chair Keller asked if that's part of court's considerations. Ms. Hatton said the state's focus is limited to defending the current system. The legislature has the plenary power to decide what education looks like in the state through the constitution. The state's goal is to legally defend the current situation.

Ms. Vogel said one other consideration is that before statehood, school districts had independent taxing authority, and then they sought refunds from the territory. But the constitution doesn't give school districts taxing authority. Only municipalities and the state have taxing authority. Alaska schools are funded by municipal, state, and federal aid. The state is aware of how much state aid Alaska schools receive, and presented evidence to the court on where Alaska falls in relation to other states. But the focus of the litigation is on the legality of local contributions in light of the dedicated funds clause.

Rep. Drummond said it sounds like it would take a constitutional amendment to change the funding source for schools. Ms. Vogel agreed.

Rep. Seaton said they require all boroughs to use fair market assessed value, and the legislature has the authority to do that. Could the state impose an assessed tax on valuations, put the money in the general fund, and then the legislature could appropriate that directly? Would that be a logical response to a required local contributions being ruled a dedicated fund? Ms. Hatton said that is an available solution. In their briefing to the court, they discussed the benefit that the money isn't put in the general fund, but goes directly from municipalities to school districts.

Rep. Seaton said what he's asking is if there is nothing prohibiting the state from having a property tax based on fair market valuation. Ms. Hatton said there's nothing she's

aware of that would prevent that. Ms. Vogel agreed that's a possible solution to a ruling that the required local contribution is a dedicated fund. A state imposed tax, deposited in the general fund and not dedicated specifically to schools, seems like it would not be unconstitutional.

Rep. Ortiz asked if the Ketchikan Gateway Borough argued the issue of equitability between organized boroughs and unorganized borough. Ms. Hatton said that argument was not made.

Rep. Seaton said he thinks the current system is better and works well, though it got a little messed up when they went from 4 mills, to only 50 percent of the increase in assessment. That gave them a problem with equity across the state. They don't have a huge problem with a direct state property tax, other than the will to go ahead with a state property tax across the state, which is basically what currently occurs with the required local contribution. So the legislature isn't in too much of a box on the issue. Although he's worried about the case and having to redo things, there seem to be mechanisms to deal with it, without have to completely revamp it. There's a fairly simple solution.

Chair Keller said they won't go there right now, since the Supreme Court hasn't ruled on the case.

Rep. Kito thanked Chair Keller for bringing the issue forward, and allowing them to participate.