

ALASKA LEGISLATURE COMMITTEE FILES 2007-2008

SJUD

125

“The right of a state government through its Legislature, when not restricted by constitutional provisions, by contract to limit its power of taxation, is a doctrine too firmly established to admit of discussion at this time.”

State v. Great Northern Railroad Co., 119 N.W. at 202 (Minn. 1908)

A provision that has come into increasing use in recent years is the clause stating that “the power of taxation shall never be surrendered, suspended, or contracted away.” This provision is the only provision dealing with taxation that is included in the Model State Constitution of the National Municipal League. Its object is to prevent the state from exempting, particularly by contract, individuals and corporations from taxation.

Constitutional Studies, Chapter IX at pp. 4-5

Arizona, California, Florida, Georgia, Kentucky, Maine, Minnesota, Missouri, New York, and Oklahoma are states with constitutions that include a clause stating that “The power of taxation shall never be surrendered, suspended, or contracted away.”

Constitutional Studies, Chapter IX at p. 4 n.11

The states of Arkansas, Louisiana, Idaho, Montana, North Dakota, Pennsylvania, Texas, Virginia, Washington, and South Dakota have the same provision, but limit its application to corporations.

Constitutional Studies, Chapter IX at p. 5 n.12

“The issue today is not one of conferring taxing power as such, but rather it is a question of under what conditions and in what circumstances should the state limit itself in the use of its taxing power. There are various cases in which states have limited or surrendered taxing authority over particular individuals, institutions, corporations, or industries in an effort to favor some particular class of people, use of property, or to induce investment or construction of a particular type or in a specific jurisdiction or locality.”

Constitutional Studies, Chapter IX at p. 9

[S]uch a provision does not prohibit tax exemptions; it serves another rather technical purpose in limiting the nature of exemptions granted by the legislature.

Constitutional Studies, Chapter IX at pp.10-11

[S]uch a provision does not prohibit tax exemptions; it serves another rather technical purpose in limiting the nature of exemptions granted by the legislature.

Constitutional Studies, Chapter IX at pp.10-11

Industrial Exemptions are a “violation of the first principles of a sound tax program.”

Constitutional Studies, Chapter IX at pp.11-12 n.26, citing Tax Exemptions (Tax Policy League, 1939).

“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 power.”

Constitutional Studies, Chapter IX at p. 15

“The power to tax is not considered inalienable, however. In granting exemptions, one legislature may bind another and there lose for the state its power to tax.”

Constitutional Studies, Chapter IX at p. 15

“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.”

Constitutional Studies, Chapter IX at pp. 15-16

“To avoid such difficulties, a considerable number of states have constitutionally prohibited the surrendering or contracting away of the taxing power. It is deemed that with such a provision in the constitution, a state enactment intended to give contract status to a tax exemption would be void ab initio.”

Constitutional Studies, Chapter IX at p. 16

And, most importantly, “[a]ny general exemption act would be read as not capable of establishing a contracted exemption.”

Constitutional Studies, Chapter IX at p. 16

“Exemptions are to be narrowly construed. They are more likely to be considered contracts if contained in a corporate charter, or if they arise from a special rather than a general law.”

Constitutional Studies, Chapter IX at p. 16 n.31

PROPOSAL NO. 3

RESOLVED, that the following be agreed upon as part of the Alaska State Constitution.

1. The power of taxation shall never be surrendered, suspended, given or contracted away.

Constitutional Convention,
Referred to Committee on Finance,
November 15, 1955

“Mr. Cooper asked what consideration the committee had given tax incentives for Alaska.

At the request of the chairman, the secretary read the sections tentatively adopted which bear on this subject, and explained that the committee intended to make it possible for the legislature to grant tax incentives, while not specifying any in the constitution.”

**Constitutional Convention,
XI/Finance & Taxation/17,
December 3, 1955**

Section 1. The power of taxation shall never be surrendered; and shall never be suspended or contracted away, except as provided herein.

**Constitutional Convention Committee Proposal/9,
December 16, 1955**

(Sec. 1 Taxing Power)

The 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.

Constitutional Convention Committee Proposal/9,
Commentary on the Article on Finance and Taxation,
December 16, 1955

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 the thought there and the addition of the words, "except as provided herein" is to remove doubt as to what we might mean later on down in the article by providing exceptions.

Minutes of the Alaska Constitutional Convention,
December 19, 1955

“Section 4 deals with exemptions from taxation, most of it is pretty standard. . . .

The exemption given to religious, charitable, cemetery, or educational purposes is pretty standard. These are the only ones we have attempted to spell out here. 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.”

Minutes of the Alaska Constitutional Convention,
December 19, 1955

“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.”

Minutes of the Alaska Constitutional Convention, January 16, 1956

“The Committee felt that definitely the power of taxation should never be surrendered so we inserted a semicolon, 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.”

Minutes of the Alaska Constitutional Convention, January 16, 1956

“In construing and interpreting contracts of this class, the courts are guided by a set of principles that have now become fundamental. . . .These in brief, are, chiefly

- [1] that taxation is the rule, and exemption the exception;**
- [2] the power of taxation is an essential attribute of sovereignty, necessary and vital to the very existence of the government;**

***State v. Great Northern Railroad Co.*, 119 N.W. at 202 (Minn. 1908)**

- [3] the whole community is interested in its maintenance unimpaired;
- [4] it is presumed never to have been surrendered; and
- [5] the intention to surrender it must be expressed in language so clear and free from ambiguity as to admit of no reasonable doubt.”

State v. Great Northern Railroad Co., 119 N.W. at 202 (Minn. 1908)

- [6] “An exemption never arises by implication;
- [7] it is always restricted to its lowest possible terms;
- [8] every doubt must be resolved in favor of the government and against the claimant.”

State v. Great Northern Railroad Co., 119 N.W. at 202 (Minn. 1908)

If the exemption clause of the charter was void in its irrevocable feature, it created no obligation, and hence its repeal impaired nothing. So long as the exemption remained in force and unrepealed, it was valid.

Phillips Exeter Academy v. Exeter, 27 A.2d at 578

[P]ublic agents have no power to bind the state or any of its subdivisions by an apparent authority in excess of their actual authority. The grantee of an exemption is chargeable with notice of the constitution and limitations of legislative power, and he may not in reasonable justice rely on the legislative assumption of power merely because the legislature assumes it or the executive department of government acts pursuant to it or the unofficial public do not question it.

Phillips Exeter Academy v. Exeter, 27 A.2d at 586

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MEMORANDUM

March 30, 1998

SUBJECT: Alaska Stranded Gas Act (CSHB 393(RES))

TO: Representative Scott Ogan
Attn: David Stanchiff

FROM: Richard A. Glover *RAG*
Legislative Counsel

Enclosed is the CS you requested.

AS 43.S2.220 limits the scope of this bill to gas royalties only. A specific statement regarding this appears in AS 43.S2.220(d), prohibiting modification of oil royalty under the provisions of the bill.

I would also like to bring to your attention that the bill as introduced does not seem to comply with Art. IX, sec. 1 of the state constitution which states:

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

Under AS 43.S2.210 of the bill, or as negotiated by the legislature as contemplated by the new AS 43.S2.650, a contract may contain terms that substitute periodic payments in lieu of taxes. These contract terms will, I suppose, be expected to prevent the state from later changing the law and imposing those taxes as a result of the federal and state prohibitions on the impairment of contracts. (Art. I, sec. 15, Constitution of the State of Alaska) The problem is that this is exactly the kind of contract that is prohibited under Art. IX, sec. 1. While 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.

If I may be of further assistance, please advise.

RAG:dr,gle
9S-202:jdr

Enclosure

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MEMORANDUM

March 11, 1998

SUBJECT: Gas projects (CSHB 393(O&G))

TO: Representative Mark Hodgins, Chair
House Special Committee on Oil and Gas

FROM: Tamara Brandt Cook
Director *TBC*

Here is a draft committee substitute you requested of a bill originally introduced by the governor. I have some comments.

(1) The bill as introduced does not seem to comply with Art. IX, sec. 1 of the state constitution which states:

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

Under AS 43.82.210 in the bill, a contract will contain terms that substitute periodic payments in lieu of taxes. These contract terms will, I suppose, be expected to prevent the state from later changing the law and imposing those taxes as a result of the federal and state prohibitions on the impairment of contracts. (Art. I, sec. 15, Constitution of the State of Alaska) The problem is that this is exactly the kind of contract that is prohibited under Art. IX, sec. 1. While 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.

(2) AS 43.82.230(a) requires the commissioner of revenue to include in a contract a term requiring contracting with and employment of state residents, "within the constraints of law..." As a practical matter, there is little chance that such a term could ever be included. (Hicklin v. Orbeck, 565 P.2d 159 (Alaska 1977), rev'd on other grounds, 437 U.S. 518 (1978)) To the extent that the change made in this CS to the definition of "Alaska resident" adds a durational residency requirement of one year or longer, it is likely to be constitutionally invalid.

(3) The requirement added in AS 43.82.435 of this CS that the authority to enter into a contract be authorized by the legislature may violate the separation of powers doctrine. While the legislature may enact standards for the exercise of an executive power, it may generally not reserve the power to approve or authorize a particular action. For example,

Representative Mark Hodgins
March 11, 1998
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former AS 37.05.280, requiring legislative approval of certain leases of state office space, was held to violate the principle of separation of powers. (Marine View Chapter Juneau Tenants Association v. Alaska State Housing Authority, Superior Court, First Judicial District, 1JU-80-1037 Civ., Nov. 3, 1981) Currently the Procurement Code contains a similar lease approval requirement in AS 36.30.080, but at the time of the Code rewrite, a representative of the Attorney General's office testified that the provision was invalid. Likewise, the executive branch has, for many years, taken the position that the requirement for legislative approval of royalty oil contracts is unconstitutional (See Governor's transmittal letter for SB 164 dated April 22, 1995, Senate Journal, pages 1190-1191) Note, however, that while the executive branch has consistently, and, in my view, correctly, asserted that legislative approval provisions are unconstitutional, it has often conformed to them to accommodate the legislative desire for oversight.

(4) AS 43.82.400 uses the term "public revenue." I don't know what that means.

(5) The definition of "uneconomic or uncompetitive" added in paragraph 12 of AS 43.-82.900 in this CS is not useful. That phrase is not used in the bill at all except in the paragraph (11) of the same section. Taken together the net result of both the definitions is to define "stranded gas" as follows: (11) "stranded gas" means gas that is not being marketed due to prevailing cost or price conditions as determined by an economic analysis by the commissioner. Is that a good definition for your purpose? If so, I suggest you substitute it for paragraphs (11) and (12).

(6) In AS 43.82.510 added by this CS it is presumed that more than one municipality will be affected and so several members will be appointed to the group. What if only one municipality is affected?

(7) In AS 43.82.200(2)(A) and (B) are mutually exclusive. Does this make sense?

(8) AS 43.82.300 is unclear to me. Upon approval of an application, a commissioner can request certain information, but, if the information is not provided, the commissioner is prohibited from continuing to review the application. Hasn't the application already been approved? What, then, is left to review?

TBC:lmb
98-035.lmb

Enclosure

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fishing and trapping license and voter registration. In order to make those changes on page 15, line 5, an "and" would need to be added at the end of the line and strike the language on lines 8 and 9.

Number 1967

COMMISSIONER CONDON addressed the issue of gas to communities. He stated that requiring project sponsors to subsidize local gas consumption would increase the project costs and have a dependency of pushing project economics in the wrong direction. He stated that they are trying to increase the likelihood that the project is going to come into being. He stated that they are going to be requiring a reasonable provision of gas to communities and they need to figure out ways to reduce the uncertainty regarding the quantity of gas that the project is going to be required to deliver to local users. This is so that requiring Alaska deliveries is not a disincentive to the project.

Number 2016

COMMISSIONER CONDON stated that the third area is municipal revenue sharing. Clearly, the single step that both state and local governments can take to improve economics of this project is to relieve the project of the tax burden of a local property tax before the project goes into operation. He stated that the state and local governments will feel the largest negative impact from the project in terms of providing social services and the social disruption that occurs with a large project. He pointed out that the question is whether or not it is worth it. He stated that there is the question of how municipalities should share in the revenues generated by a fiscal contract. Whether municipal governments should be at the table, is a question that the legislature needs to address. He pointed out that the bill does not provide for that now and if it were made to include them, negotiations would be more cumbersome.

Number 2107

COMMISSIONER CONDON addressed the area of confidentiality, trade secrets would be held in confidence by the state. That information would be shared among the pertinent executive branch agencies and the legislature, but would be kept confidential as long as they truly were trade secrets. The memorandum and documents generated during the negotiation process would remain confidential during the negotiation process but would be entirely open and available for review once the review of the contract began. He stated that it is stated in AS 43.82.310(f).

Number 2171

COMMISSIONER CONDON addressed the issue of legislative approval of the contract. Formal legislative approval of any fiscal contract involving the taxation of stranded gas is important for both policy and legal reasons. The Governor strongly supports formal legislative approval and has pledged to require it even if a legislature enacts legislation without legislatively inserting that requirement. He stated that the bill did not include this requirement because he was advised against it due to technical constitutional reasons.

2/19/88

Number 2276

COMMISSIONER CONDON stated that the final issue is, can one legislature bind future legislatures with respect to the tax liability of a project. He stated that the Department of Law has concluded that it is not possible to bind future legislatures. He stated that it could be done with a properly written fiscal contract which raises the issue of if the legislature wants to test that authority. The considerations are what the legislature believes its power ought to be and what effect litigation would have on this project. He stated that he thought it would be wiser to avoid litigation and the exploration of the issue of what the extent of legislative power is.

Number 2372

CHAIRMAN HODGINS stated that he would like to have a presentation by the producers and that the majority of the work be done in this committee.

Number 2417

REPRESENTATIVE JOE RYAN stated that the bill requires a deep leap of faith on the part of the legislature. He stated that it is time to get to the serious negotiations of what the resources are worth to state of Alaska and how far Alaska is willing to go to sell the project. He stated that there has not been any testimony as to the potential of the project.

TAPE 98-11, SIDE B
Number 0033

REPRESENTATIVE RYAN stated that the commissioner of revenue through the bill is given a lot of power and he questioned if that was wise.

CHAIRMAN HODGINS stated that at a earlier meeting Dr. Pedro van Meurs' testified that he thought there was approximately \$150 billion worth of revenues. He stated that Dr. van Meurs would be back at a later date to answer those questions.

Number 0064

REPRESENTATIVE KEMPLIN asked that on page 7, line 5 "proximity of the project" if the definition could be nailed down better than as stated. He questioned if it was just within 10 miles or does it extend to a pipeline that goes out to Southcentral Alaska.

Number 0099

CHAIRMAN HODGINS stated that it is his hope that committee members will pick the bill apart and make sure that there are no unanswered questions. He stated that HB 393 will be held over for further consideration.

House SPECIAL COMMITTEE ON OIL & GAS Minute**Feb 26, 1998**

HB 393 - DEVELOP STRANDED GAS RESOURCES

Number 1069

CHAIRMAN HODGINS announced the committee would hear HB 393 "An Act relating to contracts with the state establishing payments in lieu of other taxes by a qualified sponsor or qualified sponsor group for projects to develop stranded gas resources in the state; providing for the inclusion in such contracts of terms making certain adjustments regarding royalty value and the timing and notice of the state's right to take royalty in kind or in value from such projects; relating to the effect of such contracts on municipal taxation; and providing for an effective date." He stated that he asked his colleagues to present their concerns and suggestions regarding the bill.

Number 1080

REPRESENTATIVE TERRY MARTIN, stated that he has concerns about this issue. He referred to the history of the issue of financing a gas pipeline. He stated that he had voted against the bill that had initiated this because the legislature was giving too much up to the executive branch. He referred to Title 9 of the constitution that stated the power of taxation should never be surrendered. He stated that legislators should not force the economy one way or another. He stated that the free market should be allowed to work and the legislature should not be in the way.

Number 1282

REPRESENTATIVE MARTIN stated that as legislators they should look at what is being done with the gas. He stated that recycling of gas is producing more oil resulting in an estimated 2 billion barrels of excess oil received. He stated that if the pipeline is forced the oil will decrease because once gas is taken out the oil reserves will be depleted. He asked how much this will cost the state of Alaska in oil royalties.

Number 1401

REPRESENTATIVE MARTIN stated that the incentive programs should make the participants, "run like mad". He referred to Section 2, "The legislature further intends, however, that any fiscal terms agreed to in a contract under this Act in lieu of other taxes will fully and fairly compensate the people of the state of Alaska for the severance, production, and sale of natural resources belonging to the people" and "The value of the infrastructure that may be provided by the state to a project, including all the advantages of civilized society that may be provided by the state to the sponsors of a project." He stated that clause should cause any investor to not participate in the project. He stated that at the most investors would receive 3 percent of what they invested even with

3/12/98

Number 1509

REPRESENTATIVE OGAN referred to Ms. Cook's memo and asked if we are binding further legislatures from changing the terms of the contract.

Number 1559

COMMISSIONER CONDON replied that the answer to that question is unknown. At some point in time the legislature will have the option of saying that they want to bind a future legislature, once contested the answer will be known. There are differing views on how far the legislature can go in binding future legislatures.

Number 1650

REPRESENTATIVE OGAN asked that in order to avoid legislation, it would be prudent to make sure the law is not ambiguous.

Number 1669

COMMISSIONER CONDON replied that he agreed with that but in respect to this issue, litigation would be wanted to find out the extent of the legislature's authority.

Number 1689

REPRESENTATIVE OGAN referred to Article 9, Section 1, and asked if he could explain what is provided in the article.

Number 1735

COMMISSIONER CONDON replied that the question of binding future legislatures would not arise now but when dealing with a proposed contract.

CHAIRMAN HODGINS asked Representative Ryan to present his committee substitute.

Number 1783

REPRESENTATIVE RYAN stated that there were a number of changes that he requested that are not reflected in the draft. He stated that he would not ask the committee to introduce his committee substitute until it includes what he intended it to. He stated that he was going to talk with the legislative legal department.

Number 2366

REPRESENTATIVE ROKEBERG made a motion to adopt CS HB 393(O&G). 0-GH2006, version B, 3/11/98.

TAPE 98-24, SIDE A

Number 0006

CHAIRMAN HODGINS asked if there was an objection. Hearing none, CS HB 393(O&G) 0-GH2006, version B, 3/11/98 was adopted.

Number 0076

3/12/98

and stated that the legislature has taken the position that they will prevent the executive branch from acting unless there is specific legislative authorization. Any time the administration wants to build something with revenue bonds there needs to be specific legislative authority to do so. However, there is general authority to build roads etc. He stated that this bill would not give the administration the authority to do so, it gives the command to the administration to develop a proposal for legislative authorization. He stated that without legislative authorization there can not be a separation of power problem.

Number 1090

REPRESENTATIVE BRICE stated that he believed the legislature has been clear in its support of the gas line. He stated that HB 393 gives the administration the authority to break down the terms and negotiate the contract. He stated that he is hearing that Commissioner Condon wants more authority to negotiate fiscal terms and then come back to the legislature and ask for specific statute changes to meet those fiscal terms. He had hoped in the event that there was a contract, the legislature would either sign off through resolution or not. He stated that his confusion is that instead, the administration is going to come back with further changes to the state's fiscal system.

Number 1216

COMMISSIONER CONDON stated that what the bill would do is ask the legislature for the authority to enter into the contract. In order to do so a bill would have to be passed.

Number 1253

REPRESENTATIVE BRICE replied "The difference between HB 393 and HJR 12 in general terms, are two specific different animals." He stated that the administration asks for legislative approval submitted in House bill form, but to say that the legislature can not go into that contract and make changes is absolutely foreign. He stated that to say that the legislature will approve by resolution, the difference is in the discretion.

Number 1324

COMMISSIONER CONDON stated that if there is a contract they will have no discretion unless it is agreed to.

REPRESENTATIVE BRICE asked if he wanted a resolution.

COMMISSIONER CONDON replied that it in fact has to be done in the form of a bill.

Number 1357

REPRESENTATIVE ALAN KEMPLER stated that there would be further discussions of this. The notion of fiscal certainty has been reinforced enough to move forward with the project. He stated that the process is building a case for a long term commitment to the terms of the contract. He stated that he believed this to be a good approach.

2/6/03

MR. MARKS explained that once a contract was negotiated, preliminary findings would be submitted to the governor; if the governor chose to proceed, those findings would be given to the legislature and the public for a 30-day review period. After that, the commissioner of revenue would modify the contractual terms as appropriate, and if acceptable to the sponsor; a final contract would be submitted to the governor; the governor would transmit the contract to the legislature with the request for authorization to execute the contract; and the legislature would vote on it.

MR. MARKS addressed other provisions. Calling the property tax the bread and butter for municipalities, he explained that municipalities were concerned about their interests' not being represented in a negotiation. As part of the Act, therefore, a municipal advisory group was set up to participate in developing the contract terms. In addition, there are provisions in the Act for making gas available to communities; for local hire; and for dealing with confidential information provided by the sponsors.

Number 1208

MR. MARKS also pointed out that there was a question of the constitutionality of the Act as a whole, and whether this switching to a contract [basis] by one legislature is binding a future legislature. Noting that Article IX [Section 1] of the state constitution says that the power of taxation shall never be surrendered, suspended, or contracted away, Mr. Marks reported that it was the Department of Law's judgment that [the Act] was constitutional because it was simply putting fiscal terms into a contractual form. Certainly, he said, a future legislature would be able to add tax terms after the contract was in place, but the contract itself would be "a solemn pledge or a moral commitment by the state that once it agrees to this contract, it would not change it." Likening it to "a message to the future from one legislature to another," Mr. Marks said it was the administration's position that it wasn't airtight but was "a strong moral message."

Number 1101

MR. MARKS informed the committee that the Department of Revenue generally supports HB 16. He added that possibly the administration would submit some amendments, although he wasn't aware of what they would be.

Number 1070

MR. MARKS, in response to a question from Representative Rokeberg, said he'd only had [Version H] for about one-half hour and hadn't had time to study it.

REPRESENTATIVE ROKEBERG referred to [Section 1], the proposed amendments to AS 43.82.100 under the heading "Qualified project." He asked whether the new language in subparagraphs (A), (B), and (C) would affect the department's fiscal note.

MR. MARKS said he didn't believe so.

Number 1023

REPRESENTATIVE KERTTULA offered her understanding that part of the intent with the Act was to "try to get the gas going." She asked Mr. Marks whether the lack of an expiration date [in the

DOL_006095

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ALASKA NORTH SLOPE GAS COMMERCIALIZATION TEAM

REPORT TO THE GOVERNOR

December 15, 1997

**Wilson L. Condon, Commissioner
Department of Revenue
John T. Shively, Commissioner
Department of Natural Resources
Bruce M. Botelho, Attorney General**

DOL_006081

PART I

FISCAL CERTAINTY

Fiscal certainty is an important element in risk reduction. The goal of the Fiscal Certainty working group was to analyze, develop and propose a statutory and contractual mechanism for providing fiscal certainty for an Alaska North Slope natural gas project.

I. CONSTITUTIONAL ISSUE RAISED BY THE USE OF A CONTRACT TO DEFINE TAX LIABILITY

The use of a contract to define tax liability raises the constitutional issue of whether a future legislature is prohibited under the U. S. Constitution from altering that liability. The relevant provision is Article I, Section 10 of the U.S. Constitution that says "No state shall . . . pass any . . . law impairing the obligation of contracts."

The Department of Law's position is that the state is constitutionally incapable, under Article IX, Section 1 of the Alaska Constitution, of entering into a contract that would prohibit a future legislature from exercising its power of taxation over a signer to the contract. Any contract purporting to set an individual's tax liability into the future would be subject to an implied term, if not an expressed one, reflecting this constitutional limitation.

Article I, Section 10 of the U.S. Constitution, the impairments of contracts clause, would not be violated by a subsequent legislative enactment changing a signer's tax obligation because no binding contractual obligation existed over the legislature's authority to pass new tax laws that apply to the signer. Therefore, the contract would not be impaired by the enactment of such a new law. The state may set by contract a person's tax liability, so long as it is understood that the contract does not limit the ability of a future legislature to revoke that contract and change that person's tax liability through the enactment of a general law. Viewed another way, Sections 1 and 4 of Article IX of the Alaska Constitution allow a contract to stand in the stead of a general law imposing a tax. This means that a future legislature may amend the tax liability imposed by the contract just as it may amend any general tax law.

There is a contrary interpretation of Article IX. Section 1 does not clearly state that the power of taxation may never be contracted away. Instead, it states "[t]his power shall not be suspended or contracted away, except as provided in this article." But nowhere else in Article IX is the suspension or contracting away of the taxing power explicitly discussed. The minutes of the Constitutional Convention reveal, however, that what the framers had in mind was the provision in Section 4 empowering the legislature to create tax exemptions by general law.

The framers' choice of language creates an ambiguity, if not an outright conflict, between Sections 1 and 4, because a general law tax exemption as a rule is not considered a "suspension" or a "contracting away" of the taxing power, but rather an exercise of it. This ambiguity leaves open the argument that the framers' intent was to allow the legislature to authorize by general law the state to enter into contracts exempting persons from certain taxes and that such contracts would be binding on future legislatures--i.e., future legislatures could not impose new or different tax obligations on the signatories to the contracts without running afoul of the Impairment of Contracts Clause of the U.S. Constitution.

A. Implications of the Department of Law's Position

A contract with the state does not provide potential project sponsors with absolute certainty regarding the fiscal regime that a stranded gas project will be subject to over its life. This may discourage some potential investors, or perhaps increase the rate of return that the project needs to attract investors to compensate for the increased risk associated with the legislature's unilateral power to alter fiscal terms applicable to the project.

If the Department of Law is correct, the most that potential project sponsors can expect is a solemn pledge--a moral commitment--by the state that once it agrees to the fiscal terms, it will not change them.

B. Implications of the Contrary Interpretation

If the contrary interpretation is correct, greater certainty for project sponsors could be possible. It is unlikely, however, that the sort of absolute certainty that potential investors might desire is achievable within any reasonable time frame relevant to a decision to invest in the project given the Department of Law's interpretation and the unlikelihood of an advisory opinion on the issue from the Alaska Supreme Court.

II. CONCLUSION

The fact that the contrary interpretation is not frivolous, and could prevail in future litigation, suggests that the administration should not endeavor to reflect the tax regime applicable to a gas project in a contract, and the legislature should not in any way ratify such a contract unless both are convinced that the contract's terms are in the state's best interests and both are willing to abide by those terms throughout the stipulated life of the contract.

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**Contractually Limiting the State's
Taxing Power:**

The Constitutional Framers' Intent

April 3, 2003

Contractually Limiting the State's Taxing Power

There are Three Parts to this Presentation

Part I. The purpose of the presentation

Part II. The case in support of constitutional authority for the State to suspend or temporarily contract away its taxing power as a means to encourage industry

Part III. Discussion of the argument that “grant[ing tax exemptions] by general law” under Article IX, Section 4 implies an ability for subsequent legislatures to amend that “law” and thereby unilaterally alter the terms of those exemptions

Contractually Limiting the State's Taxing Power

Part I. The Purpose of this Presentation

April 3, 2003

Contractually Limiting the State's Taxing Power

Purpose of this presentation

- To make a plausible case that the State has authority under its constitution to enter into “tax contracts” that are legally binding and enforceable
- Not to prove definitively that the State has such authority
 - Only the Alaska Supreme Court can provide a definitive answer
 - To get such an answer, the Alaska Stranded Gas Development Act (AS 43.82) specifically calls for front-end judicial review of any natural gas “tax contract” made under it

Contractually Limiting the State's Taxing Power

Part II. The Case in Support of Constitutional Authority for the State to Suspend or Temporarily Contract Away its Taxing Power as a Means to Encourage Industry

April 3, 2003