

**May 10, 2006 Attorney
General's Opinion on the
Authority to Provide Fiscal
Certainty Under Article IX,
Sections 1 And 4 Of The Alaska
Constitution**

**The Piqua Branch of the State Bank of Ohio v. Knoop,
Treasurer of Miami County, 578 U.S. 369, 384, 389
(1853)**

“The assumption that a State, in exempting certain property from taxation, relinquishes a part of its sovereign power, is unfounded. The taxing power may select its objects of taxation; and this is generally regulated by the amount necessary to answer the purposes of the State. ... To establish such institutions as shall meet the public wants and secure the public confidence, inducements must be held out to capitalists to invest their funds. ... **There is no constitutional objection to the exercise of the power to make a binding contract by a State. It necessarily exists in sovereignty,** and it has been so held by all the courts in this country. **A denial of this is a denial of State sovereignty.** It takes from the State a power essential to the discharge of its functions as a sovereign. If it do not possess this attribute, it could not communicate it to others. **There is no power possessed by it more essential than this.”**

THE QUESTION PRESENTED:

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.?

Can states enter into binding fiscal contracts that cannot be modified by subsequent legislative enactments?

- The federal contract clause (Art. I, § 10) provides that no state shall pass any law impairing the obligation of contracts.
- In a series of cases, starting in the 1800s, the United States Supreme Court held that the contract clause applied to contracts in which state legislatures agreed to specific tax obligations.

- Although the Court found that there are certain inherent and essential elements of sovereignty – referred to as “reserved powers” – that can never be contracted away, the Court also held that the power of taxation is not a reserved power.
- Rather, the taxation power is “alienable” and can be bargained away for consideration because it is incidental to the exercise of governmental functions and exists to facilitate inherent and legitimate governmental functions.
- Any such alienation must be allowable under the state’s constitution and must be expressed in a clear and unequivocal manner, i.e. it must be unmistakable.
- A state can therefore be held to a contract despite subsequent state legislation that alters the fiscal terms in a manner that substantially impairs the contract and is not otherwise justified as reasonable and necessary to serve an important public purpose.

- Therefore, the state can enter into a fiscal contract to facilitate the development of our gas.
- The contract will be binding on future legislatures who seek to impair the contract unless the impairment is justified by an important public purpose.
- The Court will look hard at a future legislature's reasoning for changing the tax structure and will not simply defer to the legislature's findings.

Sections 1 and 4 of Article IX of the Alaska Constitution read together provide the authority to enter into a fiscal contract that would be enforceable under the federal contract clause.

- Art. IX, § 1 provides: “The power of taxation shall never be surrendered. This power shall not be suspended or contracted away, *except as provided in this article.*”
- Art. IX, § 4 provides for specific exemptions from taxes – such as for properties owned by state and local governments and nonprofits – and also provides: “*Other exemptions of like or different kind may be granted by general law.*”

The history of §§ 1 and 4 shows that the Framers chose to give the Legislature the flexibility to provide for tax exemptions by general law to develop industries in Alaska.

- The Framers rejected stricter language.
- The Framers endorsed economic development incentives.
- The Framers were familiar with contemporaneous industrial incentive acts.

- The Framers specifically considered and rejected a Model Provision put forward by the National Municipal League that stated that “[t]he power of taxation shall never be surrendered, suspended or contracted away.”
- Instead, the Framers adopted the language in Art. IX, § 1 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.”
- The Model Provision arose from concerns that some states had restricted their power to tax businesses through approval of long term tax rates in corporate charters which were later upheld by the U.S. Supreme Court under the contracts clause.
- Consultants to the Framers noted that, without the Model Provision, Alaska could be bound by the types of fiscal contracts other states had authorized.
- Nonetheless, the Framers rejected the Model Provision in light of Alaska’s unique circumstances as a resource-rich but sparsely populated state without the local capital available to develop its resources.

What did the Framers mean in § 1 when they stated that the power of taxation “shall not be suspended or contracted away, *except as provided in this article*”?

- The Official Commentary about § 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.”
- The Convention history demonstrates that the Framers were referencing the tax exemption power provided in § 4 of Article IX, which states that “*Other exemptions of like or different kind may be granted by general law. ...*”
- The Official Commentary to § 4 explained that “the legislature is authorized to make further tax exemptions to encourage, among other purposes, new industry....”

- Delegate White stated: “And then in the last paragraph of that section [4] 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.”
- Delegate Nerland stated “...this is the provision that allows for some exemption or inducement to industries or similar things.”

- Delegate Smith asked: “Isn’t that, in effect, saying that exemptions of any kind may be granted? Delegate Nerland responded: “Yes, that was the purpose of it.”
- 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 provision in § 4.

Consistent with the Framers' intent, the SGDA provides fiscal certainty for the length of the Project in order to realize the State's long term goal of an ANS gas line necessary to monetize our vast gas resources.

- The Finance and Taxation Committee expressly considered but chose not to include any time limit on tax exemptions provided for in § 4.

- The Commissioner's Findings indicate that the length of certainty provided in the SGDA Contract is necessary to get the gas line built, find enough gas to fill the line, and encourage investment in new oil fields to combat declining oil production.
 - Up to 45 years for gas and other taxes is required to allow the state and other pipeline owners to recover pipeline investment costs, assure lenders, and discover the gas reserves necessary to fill the pipeline to capacity.
 - 30 years for oil taxes further enhances the likelihood of Project success because gas exploration expenses are deductible from the proposed PPT thereby further encouraging additional gas exploration.
 - Since this gas is needed in the midpoint of the expected project life, 30 years is more appropriate than 45 years.
 - Oil fiscal certainty also encourages oil exploration in smaller fields.
 - 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.

- If tax liability could constitutionally be entirely extinguished by granting an exemption for a particular industry, it follows that tax liability could also constitutionally be extinguished in favor of fixed payments in lieu of those taxes for a set term.
- In short, the proposed SGDA Contract is within the parameters established by the Framers in §§ 1 and 4 to use the State's tax structure to encourage development for the maximum benefit of the people.

Section 1 of Article VIII, the natural resources article of the Alaska Constitution, provides that “[i]t is the policy of the state to encourage the settlement of its land and development of its resources by making them available for maximum use consistent with the public interest.”

- The need to develop natural resources and bring in new industries was a continuing concern expressed in both the Statehood Act debates in Congress as well as at the Constitutional Convention.

- To address the need for an economic base, Congress granted 103 million acres of federal land to Alaska – including land containing the North Slope oil and gas fields – as an endowment that would yield income to meet the costs associated with becoming a State.
- The Framers recognized that developing Alaska’s resources according to the mandate of Article VIII might require an innovative tax regime, as reflected in their rejection of the highly restrictive Model Provision in favor of § 1 of Article IX and the adoption of the “like or different” exemption language in § 4 of Article IX.

Finally, it is significant that fiscal contracts have been employed in Alaska to attract new industries since Territorial days.

- In 1949, the Territory authorized the tax commissioner to enter into fiscal contracts for new industrial enterprises.
- In 1957, after the Alaska Constitution was ratified, the Territory enacted an industrial incentive act that permitted businesses to apply for fiscal contracts to encourage new investments in Alaska.

- In 1968, the Legislature enacted the Alaska Industrial Incentive Tax Credits Act.
 - In 1971, the Alaska Supreme Court held that the grant of tax relief provided for in the 1968 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.”
- The proposed SGDA Contract is more favorable to the State than the tax exemptions previously required to attract industry to Alaska.
 - It is not a complete exemption from payment of taxes.
 - It requires continuous payments in lieu of taxes.
 - It will provide a steady source of revenue to Alaska at the same time that it provides an incentive to the Sponsor Group to build a gas line in order to develop Alaska’s gas resources.

IN CONCLUSION:

- There is always a degree of uncertainty in trying to anticipate what action a future legislature might take and how a court might rule on that action.
- The proposed SGDA Contract is within the parameters established by the Framers in §§ 1 and 4 to use the State's tax structure to encourage development for the maximum benefit of the people.
- Additionally, Article 11.1 of the proposed contract coupled with a legislative act authorizing the Governor to sign the contract will constitute a clear and unequivocal statement of intent to alienate the power to change taxes for the terms established in the contract, and thus, the contract will be enforceable under the contracts clause.

SOVEREIGN IMMUNITY

THE QUESTION PRESENTED:

Can the State waive its sovereign immunity in the SGDA contract for purposes of arbitration and for purposes of enforcing arbitration awards in courts outside of Alaska?

- The proposed SGDA Contract provides in Art. 26.2 that all parties waive any defenses based on immunity for purposes of arbitration and enforcement of awards.
- The proposed SGDA Contract provides that an award may be entered and enforced in any superior court in Alaska and thereafter, the judgment entered in Alaska may be entered in any state court in the United States that has jurisdiction.
 - If the Alaska Superior Court does not enter a final judgment within a year, the award may be entered and enforced in any other state court.
- Article 26.2 is constitutional.

ALASKA CONSTITUTION

- Art. II, §21 of the Alaska Constitution provides that “[t]he Legislature shall establish procedures for suits against the State.”
- The Framers expressed their clear intent that this provision authorized lawsuits against the State and that the role of the Legislature was only to establish procedures for those lawsuits.
- Delegate McLaughlin explained that the committee that drafted the language “wanted to direct that the sovereign state could be sued and that the legislature couldn’t prevent it.”
- Delegate Rivers noted that “the state [could] be sued at all times ...”

- The Alaska Supreme Court has held that the Legislature must expressly waive the State's sovereign immunity.
- The Legislature has waived the State's sovereign immunity for contract claims in Alaska courts in AS 09.50.250, but has not waived sovereign immunity for claims brought in courts outside of Alaska.
- The Legislature can waive the State's sovereign immunity as proposed in Art. 26.2 by an act approving the proposed SGDA contract.

U.S. CONSTITUTION

- Neither The Eleventh Amendment, the Full Faith and Credit Clause or the common law doctrine of “comity” prevent a state from waiving its sovereign immunity to suit brought in a sister state court.
- Therefore, Alaska may consent to suit in any of its sister states’ courts as long as it is expressly authorized by the Legislature to do so.

**FISCAL CONTRACT'S
EFFECT ON TAX LAWS
ENACTED BY
INITIATIVE**

Whether an SGDA Fiscal Contract can exempt taxpayers from pending or future changes to the tax laws enacted by initiative?

- Pursuant to Article XI, § 1, the “people” have the authority to “propose and enact laws by the initiative, and approve or reject acts of the legislature by the referendum.”
- The power of initiative is no greater than the power of the legislature to enact laws and therefore if the legislature can bind future legislatures it can provide exemptions from tax laws enacted by initiative.
- The Alaska Supreme Court has held that the “people’s power to enact legislation by initiative is no greater than that of the legislature. Thus, any law that would be invalid if enacted by the legislature would also be invalid if enacted by initiative.” *Alaskans for Legislative Reform v. State*, 887 P.2d 960 (Alaska 1994) (*per curiam*) “Only the law-making powers assigned to the legislature are to be liberally construed as within the people’ power to legislate by initiative.” *Citizens Coalition*, 810 P. 2d at 168 (emphasis in original).

CONCLUSION

- If a tax law enacted by initiative has no greater dignity than a measure passed by the legislature, then the constitutional authority to contract away the tax power of the State contained in Article IX, §§1 and 4 would apply equally to both types of tax laws.
- Thus, an exemption provision in a fiscal contract adopted by law prior to the enactment of any pending or future initiated tax law will be enforceable and does not violate the people's constitutional power of the initiative. § 7.