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MEMORANDUM

April 13, 2018

SUBJECT: Constitutionality of SB 176 (Work Order No. 30-GS2863\A)

TO: Senator Bill Wielechowski
Attn: Sonja Kawasaki

FROM: Emily Nauman
Deputy Director 

Question Presented

You asked if SB 176 is constitutional under art. IX, secs. 8 and 11, Constitution of the State of Alaska.

Brief Answer

There is an absence of case law evaluating the constitutionality of revenue bonds whose debt is serviced solely by independent annual legislative appropriations. Although the outcome is difficult to predict, this office is concerned that a court reviewing SB 176 may find that, for purposes of bonding under art. IX, sec. 11, *revenue of a corporation* does not include appropriations from traditional sources of state income, such as taxes and other receipts received by the general fund. Therefore, there is a substantial risk that a court may determine that SB 176 is unconstitutional.

Discussion

I perceive two potential ways SB 176 could be subject to constitutional attack. Either (1) as a violation of art. IX, secs. 7 and 13, Constitution of the State of Alaska (dedicated funds; expenditures); or (2) as a violation of art. IX, secs. 8 and 11, Constitution of the State of Alaska (state debt; exceptions).

Dedicated Funds; Expenditures

It is possible, although probably unlikely, that the bond release in SB 176 may violate art. IX, secs. 7 and 13, Constitution of the State of Alaska. Those sections provide:

SECTION 7. Dedicated Funds. The proceeds of any state tax or license shall not be dedicated to any special purpose, except as provided in section 15 of this article or when required by the federal government for state participation in federal programs. This provision shall not prohibit the continuance of any dedication for special purposes existing upon the date of ratification of this section by the people of Alaska.

SECTION 13. Expenditures. No money shall be withdrawn from the treasury except in accordance with appropriations made by law. No obligation for the payment of money shall be incurred except as authorized

by law. Unobligated appropriations outstanding at the end of the period of time specified by law shall be void.

Taken together, these sections mean that the state may not allocate future revenues for a particular purpose; money withdrawn from the treasury must be done by annual appropriation. The bill addresses these requirements by making clear that the debt service on the bonds will be contingent upon the legislature making an appropriation. Proposed sec. 37.18.040(g) states:

To assure the maintenance of the required debt service reserve in the reserve fund, *the legislature may appropriate* annually to the corporation for deposit in the fund the sum, certified by the chair of the corporation to the governor and to the legislature, that is necessary to restore the fund to an amount equal to the required debt service reserve. The chair annually, before January 30, shall make and deliver to the governor and to the legislature a certificate stating the sum required to restore the fund to that amount, and *the certified sum may be appropriated* and paid to the corporation during the then current state fiscal year. Nothing in this subsection creates a debt or liability of the state.

Emphasis added. Similar language has been upheld by the Alaska Supreme Court as not infringing on the anti-dedication clause.¹ Although the bonds in SB 176 do depend on appropriations for their repayment, the bill makes clear that the repayment is contingent upon legislative appropriation. The bill does not require the legislature to appropriate money for the purpose of debt service.² Nor does it require that money be allocated to the corporation without an appropriation.³ Given the language of sec. 37.18.040, I think it is

¹ See *Sonneman v. Hickel*, 836 P.2d 936 (Alaska 1992) (although the case ultimately held that an act violated the anti-dedication clause because it limited the ability of a state agency to request funding from revenues produced by another state entity). See also *Carr-Gottstein Properties v. State*, 899 P.2d 136 (Alaska 1995) (upholding a non-appropriation clause in a lease agreement); *State v. Alex*, 646 P.2d 203 (Alaska 1982) (striking down a dedication of the "proceeds of a state tax or license.") However, the Court has also upheld language that may appear to circumvent the anti-dedication clause, where the legislature sold the future income stream of a state asset. *Meyers v. Alaska Hous. Fin. Corp.*, 68 P.3d 386 (Alaska 2003), discussed at length *infra*.

² It may be argued, however, that the bill places future legislatures in an uncomfortable position – either appropriate funds for debt service on the bonds, or possibly risk a downgrade to the state's credit rating.

³ A close read of sec. 37.18.040(b) reveals a movement of funds without an appropriation. That subsection allows money in the reserve fund of the corporation to be disbursed to the commissioner of revenue for purchase or payment of oil and gas tax credits without further appropriation. Similar language also appears in the changes to AS 43.20.046(e), 43.20.047(e), 43.20.053(e), 43.55.028(e) and (j), proposed sec. 43.55.028(k), (l), and (n), and sec. 44.37.230. It would be more appropriate for the funds to be disbursed to the

unlikely that a court would find that the bill violates art. IX, secs. 7 and 13, Constitution of the State of Alaska.

State Debt; Exceptions

More concerning is the form of the bonds themselves. Article IX, sec. 8, Constitution of the State of Alaska, states:

SECTION 8. State Debt. No state debt shall be contracted unless authorized by law for capital improvements or unless authorized by law for housing loans for veterans, and ratified by a majority of the qualified voters of the State who vote on the question. The State may, as provided by law and without ratification, contract debt for the purpose of repelling invasion, suppressing insurrection, defending the State in war, meeting natural disasters, or redeeming indebtedness outstanding at the time this constitution becomes effective.

The bonding debt contemplated in SB 176 does not appear to be of the character of the debt permitted by sec. 8. It is neither debt for capital improvements nor debt for loans for veterans, to be ratified by a majority of voters. Nor is the state defending itself in war or meeting a natural disaster. Indeed, language in the bill distinguishes debt created by the issuance and sale of bonds by the Alaska Tax Credit Certificate Bond Corporation (corporation) from the debt described in sec. 8. Proposed sec. 37.18.030(b) states, in part, "[t]he bonds do not constitute a general obligation of the state and are not state debt within the meaning of art. IX, sec. 8, Constitution of the State of Alaska. Authorization by the voters of the state or the legislature is not required."

Given these facts, it seems likely that the administration (SB 176 is a governor's bill) is instead relying on the exception to art. IX, sec. 8, found in sec. 11. That section states:

SECTION 11. Exceptions. The restrictions on contracting debt do not apply to debt incurred through the issuance of revenue bonds by a public enterprise or public corporation of the State or a political subdivision, when the only security is the revenues of the enterprise or corporation. The restrictions do not apply to indebtedness to be paid from special assessments on the benefited property, nor do they apply to refunding indebtedness of the State or its political subdivisions.

Section 11 has two requirements applicable in this instance. First, debt must be the responsibility of a public corporation. Second, the debt must be in the form of revenue bonds that are secured only by the revenues of the corporation.

The corporation is a public corporation established in the Department of Revenue under sec. 37.18.010. As discussed above, the bill attempts to make clear that the debt is issued

general fund and appropriated to the commissioner. Unlike the other possible constitutional infirmities with the bill, this issue could be resolved by an amendment. Please let me know if you would like me to draft one.

by the corporation. In my opinion, a court would find that the corporation is validly established and that it is the corporation, not the state, issuing the bonds. This likely disposes of the first requirement of art. IX, sec. 11. The larger issue, however, is whether the bonds qualify as "revenue bonds" secured by the "revenues of the enterprise or corporation," since the only "revenue" the corporation will receive under the bill is appropriations from the legislature.

Black's Law Dictionary defines a "revenue bond" as a:

Type of bond issued by a state or local government repayable by the particular unit of government which issues it. Also, a bond issued for a specific public purpose such as the construction or maintenance of a bridge and repayable from income generated by such project. Term is descriptive qualification which indicates that the instruments are payable solely from a revenue producing product.^[4]

Similar to the definition in *Black's*, the exception for revenue bonds in art. IX, sec. 11, Constitution of the State of Alaska, applies to bonds that are payable solely from a revenue producing product of the corporation ("the only security is the revenues of the enterprise or corporation"). Under the current structure of SB 176, it is unclear how the bonds are secured by a revenue-producing product of the corporation. A somewhat similar bond structure has been enacted in the state before. The Alaska Pension Obligation Bond Corporation is authorized to issue bonds to repay unfunded accrued actuarial liability related to the state's retirement system.⁵ However, under AS 37.16.110,

[t]he corporation shall enter into contracts with governmental employers for the purpose of recouping amounts paid as debt service on bonds issued by the corporation for the benefit of governmental employers. The corporation may pledge the revenue of the contracts as security for the bonds issued by the corporation.^[6]

SB 176 contains no similar provision. And of course, simply because a similar structure appears in statute does not guarantee its constitutionality. Although authorized by law, the Alaska Pension Obligation Bond Corporation has never issued bonds nor has the pension obligation bond structure been reviewed by a court.

To that end, there does not appear to be any case law in this state directly on point in this instance. One state case, however, does analyze a similar state bonding structure and may shed light on the issue here. In *Myers v. Alaska Hous. Fin. Corp.*, an anti-tobacco advocate brought action against Alaska Housing Finance Corporation (AHFC) seeking declaration

⁴ 6th ed. 1991.

⁵ AS 37.16.030.

⁶ These proposed contracts, however, may constitute only a limited form of security for the pension obligation bonds because they may include a nonappropriation clause.

that the state's present value sale to AHFC of a future stream of income from settlement of claims against tobacco companies was unconstitutional.⁷ The purchased income stream was used as the "revenue" for purposes of a "revenue bond." Ultimately, the court found that:

Because the legislature sold the tobacco settlement and then appropriated the resulting income, it did not directly violate the anti-dedication clause. Although selling the tobacco settlement revenue stream is an indirect method of producing an effect very similar to the prohibited dedication of those future revenues, the anti-dedication clause clashes with the legislature's appropriation power. We conclude that the sale of the tobacco settlement is constitutional because the legislative appropriation power includes the power to sell state assets, lawsuit settlements are not traditional sources of public revenue, and the legislature has the responsibility to manage the state's risk.^[8]

Although *Myers* was mostly concerned with the dedicated funds provision, the Court did briefly discuss the possibility that the bonds violated art. IX, secs. 8 and 11:

Although Myers asserts in one sentence that the legislature's act effectively circumvented article IX, section 8, which requires voter consent for a general bond issue, he does not develop the point. Accordingly, we consider the issue waived.

Even if Myers had not waived the argument, the state is correct that [AHFC] issued the bonds within the requirements of the constitution. Although article IX, section 8, provides that the state can contract debt only with ratification by a majority of the voters, article IX, section 11, provides an exception for a state agency to issue revenue bonds secured only by the agency's revenues. Because the [AHFC] bonds were secured solely by the tobacco settlement revenues, the bonds are expressly permitted under article IX, section 11.^[9]

While *Myers* demonstrates that the court may accept an unconventional definition of "revenue bonds," it is significant that the revenues involved in *Myers* (settlement proceeds from a lawsuit) were not typical or "traditional sources of state revenue." The Court found that

⁷ 68 P.3d 386 (Alaska 2003).

⁸ *Id.* at 394. Note that the case was closely decided, with two justices joining in a very vigorous dissent.

⁹ *Id.* at 393 - 94. Internal citations omitted. Because the argument was waived, this language is dicta. However, I believe it provides insight into how the Court would analyze the issue at hand. See footnote 10, *infra*.

lawsuits and corresponding settlements have a non-recurring nature unlike other sources of state revenue relied upon in Alaska's annual appropriation process. Lawsuit settlements are not traditional sources of state revenue.^[10]

The settlement proceeds in *Myers* were an asset that the legislature sold to the public corporation that provided the public corporation with revenues (the annual payments under the settlement) to service the bond debt. In this way, *Myers* differs significantly from SB 176. SB 176 does not involve an appropriation of a state asset or some other non-traditional source of state revenues. The corporation created in SB 176 will not have revenues of its own, but will issue bonds that rely upon appropriations of traditional sources of state revenue; revenues that are "relied upon in Alaska's annual appropriation process." Given these facts, it is unclear how the financing structure in SB 176 could meet even the basic definition of a "revenue bond" secured only by the revenues of the corporation.¹¹

It is possible that the administration will argue that an appropriation from the legislature to the corporation constitutes "revenue" for the purposes of art. IX, sec. 11.¹² I do not believe a court would be persuaded by this argument. In *State Ports Auth. v. Arnall*, a Georgia

¹⁰ *Id.* at 392 (the Court agreed with the superior court's reasoning that "lawsuit settlements are more closely comparable to state assets *than to taxes or other traditional sources of state revenue.*" (emphasis added)). It is worth noting that the court in *Myers* primarily examined whether the sale of the future stream of revenues comported with the constitution's restriction on dedicated funds. That is slightly different from the issue here, whether the bonds in SB 176 constitute "revenue bonds." However, the Court seemed to be relying on its analysis of the dedication of funds issue when it went on to raise and dismiss the art. IX, secs. 8 and 11 argument. Therefore, it is reasonable to believe that the court may use a similar analysis in the case at hand. At a minimum, a court would likely identify that the distinction made in *Myers* not only applies in this case, but also indicates that the use of traditional sources of revenue for debt service on bonds requires additional scrutiny, especially for a corporation that has no other revenue stream, like the one envisioned in SB 176.

¹¹ Other provisions of the Constitution of the State of Alaska also reinforce the understanding that public corporations issuing bonds were not intended to rely on appropriations from the general fund. Article IX, sec. 16, Constitution of the State of Alaska, states that "revenues of a public enterprise or public corporation of the State that issues revenue bonds" are not to be included for purposes of the appropriation limit. It is implied in this provision that the revenue bonds were intended to be serviced exclusively by revenues of the public corporation, not by legislative appropriations from traditional revenue sources.

¹² In the February 21, 2018, Senate Resources Committee hearing on SB 176, Revenue Commissioner Sheldon Fisher, when describing the bonds issued by the corporation, stated "it's not a general obligation bond, it's what we would call a subject-to-appropriation bond." I am unaware of any constitutional provision relating to a subject-to-appropriation bond.

Supreme Court case discussed in *Myers* -- and which was based on constitutional provisions similar to the constitutional provisions of this state -- the Court warned:

If the State cannot under constitutional inhibitions increase its bonded indebtedness for the purposes undertaken by the Authority, and this it can not do, then it would be ridiculous to say that it may create a separate corporate entity and under the guise of assistance to it, do that which it may not directly do.^[13]

At least in Georgia, it has been made clear, a public corporation may not be used for the purpose of circumventing the requirements of the constitution.¹⁴ It is not immediately apparent why SB 176 would not face the same scrutiny. The bill appears to establish a corporation solely for the purpose of issuing debt that cannot, because of constitutional limitations, be issued by the state.

In summary, the question of revenue bonds issued by a public corporation secured only by an appropriation by the legislature has not been confronted by a court in this state. Because of the novelty of the concept, predicting an outcome of a constitutional challenge is difficult. However, a close reading of the constitution and similar cases in this jurisdiction and others indicate that there is a substantial risk that the issuance of bonds in accordance with SB 176 will be found by a court to be unconstitutional.

Practical Considerations

Even assuming the structure envisioned in SB 176 passes constitutional muster, repayment of the bonds will be contingent only on legislative appropriation. As a practical matter, this may make the bonds difficult to issue and market and, thus, less useful.¹⁵

If I may be of further assistance, please advise.

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¹³ 41 S.E.2d 246, 254 (Ga. 1947). *See also Witzemberger v. State ex rel. Wyoming Cmty. Dev. Auth.*, 575 P.2d 1100 (Wyo. 1978) (holding that legislation authorizing future tax revenues to be pledged indirectly for the satisfaction of revenue bonds of a state authority that had no independent revenues of its own violated the debt limitations of the Constitution of the State of Wyoming.)

¹⁴ *Id.*

¹⁵ Consider, for example, the fate of the pension obligation bonds.