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The Honorable Bill Walker
Governor
State of Alaska
P.O. Box 110001
Juneau, AK 99811-0001

Re: *HB 331/SB 176, Alaska Tax Credit Certificate Bond Corporation Legislation*

Dear Governor Walker:

You have asked for a legal opinion on whether bonds payable subject only to appropriation, such as the tax credit bonds proposed in House Bill 331/Senate Bill 176 ("HB 331"), can be issued consistent with the requirements of article IX of the Alaska Constitution. We believe that subject-to-appropriation financing tools like those proposed in this bill are not prohibited by the Alaska Constitution.[1]

The Alaska Constitution, article IX, section 8, places limits on the power to incur 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.

[1] If the bill passes and the process toward issuing these bonds is initiated, no bonds will be issued without the certification by both the Department of Law and the State's bond counsel that it is the respective belief of each organization that the bonds are permitted by Alaska law.

Yet the Alaska Supreme Court has held that not all financial obligations are "state debt" to which these limits apply. The key question is whether the State incurs an "obligation involving borrowed money where there is a promise to pay sums . . . in the future whether funds are available or not.[2]"

HB 331 bonds do not promise to pay creditors "whether funds are available or not"; instead payment of these bonds is expressly conditioned on appropriation of funds by the Legislature for this purpose. HB 331[3] states that the tax credit 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."[4] The bill further provides that "the legislature *may appropriate*" annually for the debt service on the bonds but that the issuance of the bonds does not create "a debt or liability of the state." [5] It is our understanding that, as is customary with bonds whose debt service is subject to legislative appropriation, the bonds and other disclosure documents such as the preliminary official statement will state clearly to potential purchasers that the bonds are not a general obligation of the State and that payment is "subject to appropriation."

Because payment on these bonds is subject entirely to the legislature's discretion to appropriate funds for that purpose, and the bonds give the bondholders no recourse against the State, these bonds are not "state debt" subject to the limitations of article IX, section 8, and need not be ratified by voter referendum.

A. The Alaska Supreme Court has ruled that financial obligations expressly subject to legislative appropriation are permitted by the Alaska Constitution.

General obligation bonds issued under article IX, section 8 of the Alaska Constitution pledge the State's full faith and credit, and payments on those bonds cannot be avoided because a court can order payment from the state treasury. But the proposed tax credit bonds would be "subject-to-appropriation" bonds, which means that payment on these bonds is contingent on annual legislative appropriation decisions. Thus, by HB 331's express terms, a person holding these bonds has no legal right to force payment if the Legislature does not appropriate funds to service the bonds.

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2 *Carr-Gottstein Props. v. State*, 899 P.2d 136, 142 (Alaska 1995).

3 Citations to HB 331 are to the version of the bill introduced by the House Rules Committee by request of the Governor. HB 331 (version 30-GH2863/A, Feb. 7, 2018).

4 HB 331, page 2, lines 20-21.

5 HB 331, page 4, lines 15-23.

In *Carr-Gottstein Properties v. State*, [6] the Alaska Supreme Court ruled that not all kinds of debt incurred by the State are subject to the limitations of article IX, section 8. Instead, these limitations apply only to "constitutional debt," "a term of art used to describe an obligation involving borrowed money where there is a promise to pay sums such as rents accruing in the future *whether funds are available or not*.[7]" In that case, the Court concluded that a lease-purchase agreement did not create constitutional debt for purposes of article IX, section 8.[8] It reasoned that the agreement did not create impermissible constitutional debt because the State's obligation was subject to appropriation, the agreement limited the debt holder's recourse against the State, and the agreement did not bind future legislatures.[9]

Similarly, HB 331 authorizes an agreement that makes repayment of the bonds expressly subject to appropriation and gives the bondholders no recourse against the State. In fact, HB 331 is explicit in providing that the bonds are not "state debt" and do not constitute a general obligation of the State. Although the lease-purchase agreement in *Carr-Gottstein* is obviously a different financial instrument than the bonds authorized by HB 331, the differences are not material for purposes of determining whether they amount to constitutional debt. The lease purchase agreement, like the bonds in HB 331, was undoubtedly a kind of debt: the State acquired title to a property by promising to pay the purchase price plus interest in routine installments. Yet that alone was not enough to make the agreement a "constitutional debt." The central question in deciding whether a debt is a "constitutional debt" subject to the limits in article IX, section 8 is whether the state enters into "an obligation involving borrowed money where there is a promise to pay sums …*whether funds are available or not."*[10] The bonds proposed in HB 331 are payable only if the legislature decides to make debt service payments in any particular year. There is no commitment to make payments "whether funds are available or not," so the bonds are not subject to article IX, section 8's limitations on "constitutional debt."

B. Neither the text of the constitution nor the deliberations of the delegates to the constitutional convention reveals the intent to prohibit issuance of bonds subject to appropriation.

Article IX, section 8 states that "[n]o state debt shall be contracted" except for certain specific purposes and with voter approval. The Alaska Supreme Court, having looked at "the plain meaning and purpose of the [constitutional] provision and the intent

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6 899 P.2d 136.

7 *Id.* at 142 (emphasis added).

8 *Id.* at 143.

9 *Id*.

10 *Id.* at 142 (emphasis added).

of the framers" to discern its meaning,[11] concluded that not all forms of indebtedness are "state debt" or "constitutional debt" subject to the limitations in article IX, section 8.[12] HB 331 expressly provides that the tax credit bonds "are not state debt" and are not a general obligation of the State, and that the payment on the bonds is subject to annual appropriation. The bill thus does not propose any debt that is prohibited by the plain terms of the Alaska Constitution, as interpreted by the Alaska Supreme Court.

The record of Alaska's constitutional convention shows that the delegates intended to exempt financial obligations that do not pledge the State's full faith and credit from the stringent procedures required when the State's full faith and credit *is* pledged. In drafting article IX, the convention delegates relied on a report by the Public Administration Service, known as the Alaska Statehood Commission studies, which addressed the subject of state finance.[13] That report observed that revenue bonds that do not pledge a state's full faith and credit are generally considered to fall outside of constitutional debt limitations.[14] The delegates were also aware that some state constitutions contain extensive provisions restricting debt, but they ultimately decided to adopt only the limitations expressed in article IX, section 8.[15] This is consistent with the general approach of the delegates' committee on finance, which proposed article IX with the intent to "assure a sound system of finance and taxation" and to "leave as much leeway to the state as possible."[16]

Consistent with that intent, the framers decided to expressly exempt revenue bonds from the procedures required for constitutional debt under article IX, section 8: "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."[17] Although some have suggested that this specific exception implies that no other forms of

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11 *Wielechowski v. State, Alaska Perm. Fund. Corp.*, 403 P.3d 1141, 1146 (Alaska 2017).

12 *Carr-Gottstein Properties,* 899 P.2d at 143.

13 *See State v. Alex,* 646 P.2d 203, 209 (Alaska 1982) (noting delegates' reliance on Alaska Statehood Commission studies in drafting article IX).

14 3 Alaska Statehood Commission, Constitutional Studies pt. IX, at 23 (1955).

15 For example, the finance committee observed that some state constitutions contain limitations on the amount of debt that may be incurred, but the committee declined to include such a provision in article IX of the Alaska Constitution. 3 Proceedings of the Alaska Constitutional Convention 2317 (Jan. 26, 1956).

16 2 Proceedings at 1109 (Dec. 19, 1955).

17 Alaska Const. art. IX, § 11.

debt are exempt from the limitations in article IX, section 8, the *Carr-Gottstein* decision refutes this point. The lease-purchase agreement upheld in that case did not involve a "public enterprise or public corporation of the State"—it involved the Alaska Court System and the Department of Natural Resources.[18] Yet the Alaska Supreme Court ruled that the State's indebtedness was not subject to article IX, section 8 because it was subject to appropriation and gave creditors no recourse against the State. In fact, the Court rejected the argument that only debt issued by an independent state corporation or authority is exempt from the restrictions of article IX, section 8, reasoning that the "relationship of the contracting parties alone is not the dispositive issue."[19] The logical conclusion is that revenue bonds are not the only kinds of indebtedness exempt from the limitations on "constitutional debt."[20] Other forms of debt are also exempt, so long as they share the key characteristic of revenue bonds—they do not pledge the full faith and credit of the State.

Even if revenue bonds issued by a public corporation were the only type of debt exempt from the requirements of article IX, section 8—and the *Carr-Gottstein* decision shows that they are not—the bonds authorized by HB 331 would be lawful because they fall within that exemption. HB 331 provides that the bonds shall be issued by a public corporation created for this purpose called the Alaska Tax Credit Certificate Bond Corporation. The source of the corporation's revenues is legislative appropriation, and these revenues are the security for the bonds. Nothing in the constitutional text precludes considering the revenues of a public corporation that issues bonds under article IX, section 11 to include appropriations. In fact, the framers themselves understood that in some cases, public corporation bond payments would be financed by legislative appropriations. One delegate opposed to the use of public corporation revenue bonds noted that, without pledging the State's full faith and credit, these bonds would force a "higher interest rate on the taxpayers of Alaska,"[21] reflecting an understanding that some public corporation revenue bonds would be financed by taxpayers—*i.e.* through appropriations. As illustrated in detail below, the State has acted on this understanding for decades. Because the bonds authorized by HB 331 are guaranteed only by the

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18 *Carr-Gottstein*, 899 P.2d at 138.

19 *Id.* at 144.

20 *Carr-Gottstein*'s conclusion is supported by the delegates' discussion of article IX, section 11's provisions on public corporation revenue bonds. The delegates recognized that even states with "severe debt restrictions" "wind up with this kind of enterprise any way, and the courts hold that debts incurred by this type of enterprise do not come under the standard debt restrictions." 2 Proceedings at 1111 (Dec. 19, 1955). Accordingly the delegates added this provision simply "to avoid litigation" on this point, not to imply that all other forms of debt are subject to the limitations in article IX, section 8. *Id.*

21 3 Proceedings at 2436 (Jan. 17, 1956).

revenues of a public corporation, which are subject to appropriation by the Legislature, these bonds are permitted by article IX, section 11 of the Alaska Constitution.

C. The majority of states to consider the constitutionality of subject-to-appropriation financing mechanisms have upheld them because the appropriating body retains its power to decide whether or not to make payments on the debt.

Subject-to-appropriation bonds and other financial instruments that do not pledge a state's full faith and credit are common in the United States and have been upheld by the majority of state courts. Most recently, in 2012 the Minnesota Supreme Court rejected the argument that subject-to-appropriation bonds were prohibited by the Minnesota constitution's limits on incurring state debt.[22] Similarly, the New Jersey Supreme Court adopted a clear rule that bonds payable subject to appropriation do not violate that state's debt limitation provision.[23] The New Jersey Court recognized that 32 states permit some kind of subject-to-appropriation debt despite numerous constitutional provisions that limit state debt as a general matter.[24] In fact, the Court specifically cited the Alaska Supreme Court's decision in *Carr-Gottstein* in concluding that subject-to-appropriation debt is widely permitted.[25] Likewise, the Iowa Supreme Court rejected the argument that bonds payable subject to annual appropriations were constitutional debt because the appropriating body retains the authority to decide whether to make debt payments: "If there is no legally enforceable obligation to continue repayments in the future, such debt is not considered constitutional debt."[26] The Iowa Court, like the New Jersey Court, specifically relied on the *Carr-Gottstein* decision as precedent supporting the conclusion that subject-to-appropriation debt is permitted in Alaska.[27]

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22 *Schowalter v. State,* 822 N.W.2d 292, 303 (Minn. 2012).

23 *Lonegan v. State,* 819 A.2d 395, 401-07 (N.J. 2003).

24 *Id.* at 404 n.2.

25 *Id.*

26 *Fults v. City of Coralville,* 666 N.W.2d 548, 556 (Iowa 2003).

27 *Id.* at 559 n.3.

New York's highest court, facing an arrangement largely like the one authorized in HB 331, convincingly explained why these arrangements do not violate constitutional prohibitions on state debt:

> While the legislature might make the appropriations to the [f]unds, to be used in turn to service the [a]uthorities' debt, it is not bound to do so. Should it fail to do so, and the [a]uthority default, the State is not liable to the bondholders under the provisions of the Act. Because the State does not become indebted, the financing subject to appropriation does not constitute the lending of credit or assumption of the liability of a public corporation, or the indebtedness of the State for the purposes of the constitutional limits on such debt.[28]

The same is true of HB 331.

D. Alaska's state and municipal governments have a long history of issuing subject-to-appropriation debt, relying on both the Alaska Supreme Court's decision in *Carr-Gottstein* and on the well-established practices of other jurisdictions.

Since the early days of statehood, the State has acted with the understanding that "state debt" subject to the limitations of article IX, section 8 is a term of art that does not apply to all forms on indebtedness incurred by the State, but only to obligations against the "general credit" of the State.[29] The State and other public entities have long issued or authorized subject-to-appropriation debt in various forms: certificates of participation to fund buildings; public corporation revenue bonds to fund construction; and pension obligation bonds. These financing mechanisms are all subject to, but do not bind, the Legislature's power of appropriation. Some of these arrangements do not involve any revenue pledge other than annual appropriations. The long-held understanding of the Department of Revenue that this debt is permissible and distinct from State constitutional debt is reflected in the Department's annual Alaska Public Debt report.[30] The report defines "state debt" as an obligation in which the full faith and credit of the State has been pledged and distinguishes it from other forms of debt that are based on revenue pledges or subject-to-appropriation pledges.[31]

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28 *Schulz v. New York*, 639 N.E.2d 1140, 1150 (N.Y. 1994).

29 1959 Op. Att'y Gen. No. 39 at 2 (Dec. 30).

30 State of Alaska, Department of Revenue, *Alaska Public Debt 2017 – 2018* (Jan. 2018), available at treasury.dor.alaska.gov/Debt-Management/State-Publications/aspx (last accessed May 1, 2018).

31 *See id.* at 1-2.

There are many examples of subject-to-appropriation debt issued or authorized in Alaska by the State, its public corporations, and municipalities:

- The former Alaska State Housing Authority (ASHA) (absorbed by the Alaska Housing Finance Corporation in 1986) was authorized to construct and acquire public buildings for the lease to the state. ASHA would acquire the buildings by issuing lease revenue bonds secured by the subject-to-appropriation lease payments.

- Since 1984, the State has directly issued certificates of participation for which the State's subject-to-appropriation pledge of lease payments is the only security. Alaska Statute 36.30.085 defines how and when the Department of Administration, the University, the Alaska Supreme Court, and the Legislative Council may enter into a lease-purchase agreement for real property. A recent example of facilities constructed through the use of these certificates of participation in the Alaska Native Tribal Health Consortium's Residential Housing Facility.

- The construction of Goose Creek Correctional Facility, the Anchorage Jail, and the Atwood Building was financed with subject-to-appropriation lease-revenue bonds.

- State entities have also issued revenue bonds that are largely backed by appropriations even as other revenue sources help to fund payment on the bonds. For example, the University of Alaska relies on annual appropriations for a substantial portion of its revenues, and these appropriations are considered in rating analysis and included in investor information.

- In both 2008 and 2016 the State and its bond counsel were prepared to issue and certify pension obligation bonds under AS 37.16 as lawful subject-to-appropriation bonds. The bonds were to be secured by a funding agreement commitment from the Department of Administration that was subject to annual appropriation.

In short, the State has long taken the view that subject-to-appropriation debt is not subject to the restrictions of article IX, section 8 of the Alaska Constitution and has acted accordingly.

E. The State's substantial reliance on the understanding that subject-to-appropriation debt is permissible is an important consideration that should lead Alaska's courts to uphold the practice.

The lengthy history in Alaska of issuing subject-to-appropriation debt reflects a common understanding that this financial arrangement is lawful. This understanding is not unique to Alaska. Many state governments have relied on this understanding to finance important government undertakings, and courts have recognized that reliance as a reason not to overturn decades of practice. For example, the New Jersey Supreme Court rejected a broad challenge to a slew of state statutes authorizing subject-to-appropriation debt in part due to the "the State's reliance on the Court's precedents when crafting complex financing mechanisms responsive to changing market conditions."[32] The Court was "unwilling to disrupt the State's financing mechanisms" and "agree[d] with the majority of state courts interpreting their own constitutions that the restrictions of the Debt Limitation Clause do not apply to appropriations-based debt."[33] If HB 331 were challenged, it is likely that the Alaska Supreme Court would uphold the constitutionality of the bonds, given its decision in *Carr-Gottstein* and the State's significant reliance on its holding that subject-to-appropriation debt is not subject to the restrictions of article IX, section 8.

CONCLUSION

It is the Department of Law's view that HB 331 does not present a constitutional problem because the bill expressly provides that the bonds it authorizes are not a general obligation of the State and are not "state debt" under the Alaska Constitution, and the Legislature retains the authority to decide whether or not to appropriate funds to pay the debt service on the bonds.

Sincerely,

Jahna Lindemuth
Attorney General

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32 *Lonegan,* 819 A.2d at 401.

33 *Id.* at 407.