MEMORANDUM

September 7, 2018

SUBJECT: Deposits into the constitutional budget reserve fund
(Work Order No. 31-LS0077)

TO: Kris Curtis
Legislative Auditor

FROM: Megan A. Wallace
Director

You have asked for further legal analysis regarding the opinions issued by the Department of Law\(^1\) and the Department of Revenue\(^2\) about the deposit of additional production taxes or royalties received by the state due to the adjustment of the value of oil following the settlement of pipeline tariff disputes into the general fund, as opposed to the constitutional budget reserve fund (CBR) under art. IX, sec. 17(a), Constitution of the State of Alaska. The Department of Revenue advised that these additional revenues "must be deposited into the general fund"\(^3\) and that it intends to "prospectively comply" with the advice of the Department of Law,\(^4\) which will result in a reduction of the amounts owed to the CBR under art. IX, sec. 17(d), Constitution of the State of Alaska, by $1,173,302,043.89 for tax years 1997 through 2017.

Article IX, sec. 17(a), Constitution of the State of Alaska, provides:

(a) There is established as a separate fund in the State treasury the budget reserve fund. Except for money deposited into the permanent fund under Section 15 of this article, all money received by the State after July 1, 1990, as a result of the termination, through settlement or otherwise, of an administrative proceeding or of litigation in a State or federal court

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\(^1\) See February 14, 2018, letter from William E. Milks and Mary H. Gramling, Assistant Attorney Generals, to Senators MacKinnon and Giessel, a copy of which you provided.

\(^2\) See February 27, 2018, letter from Sheldon Fisher, Department of Revenue Commissioner, to you, a copy of which you provided.

\(^3\) This opinion seems to contradict earlier opinions from the Department of Law. See, e.g., 1995 Inf. Op. Att'y Gen. (May 18; 663-95-0475; 663-95-0474).

\(^4\) While the Department of Revenue states that it will apply the advice "prospectively," it goes on to explain that it is actually applying the advice retroactively.
involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property, shall be deposited in the budget reserve fund. Money in the budget reserve fund shall be invested so as to yield competitive market rates to the fund. Income of the fund shall be retained in the fund. Section 7 of this article does not apply to deposits made to the fund under this subsection. Money may be appropriated from the fund only as authorized under (b) or (c) of this section.

Emphasis added.

Consequently, to determine whether the additional production taxes or royalties received by the state due to the adjustment of the pipeline tariff disputes should be deposited into the CBR, we must examine whether the settlement is (1) "of an administrative proceeding or of litigation in a State or federal court", and (2) "involv[es] mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property." 5

Administrative Proceeding or Litigation

According to a Department of Law press release, in December 2017, the state "agreed to settle dozens of cases involving Trans Alaska Pipeline System (TAPS) tariff rates for the years 2009-2015. In these cases, the State asserted that TAPS tariff rates were too high, resulting in reduced royalty and tax obligations by the shippers who utilize TAPS." 6 It goes on to summarize that:

The 2009-2015 TAPS tariff cases primarily focused on two questions: (1) whether the TAPS owners improperly capitalized (and placed into TAPS tariff rates) over $600 million of costs related to "strategic reconfiguration"; and (2) whether the carriers could recover prior year TAPS property taxes (ad valorem taxes) in later years. As a result of litigating these questions, the State already collected approximately $224 million of additional revenue. However, these matters were under review by two appellate courts. This settlement would bring those matters to a close. 7

5 Art. IX, sec. 17(a), Constitution of the State of Alaska.


7 Id.
The overall settlement includes the settlement of litigation before both the Federal Energy Regulatory Commission (FERC) and the Regulatory Commission of Alaska (RCA).\(^8\) The state was a signor of both the FERC and RCA settlement agreements.\(^9\)

While the litigation regarding the pipeline tariff disputes commenced before FERC and RCA, as noted by the Department of Law, the "matters were under review by two appellate courts," including the United States Court of Appeals for the District of Columbia Circuit.\(^10\) Because the settlements resolved active litigation in federal court,\(^11\) there can be no dispute that the December 2017 TAPS tariff settlement was "of an administrative proceeding or of litigation in a State or federal court" under art. IX, sec. 17(a).\(^12\)

\(^8\) Id.


\(^11\) Id; see also Joint Status Report, Document No. 1731158, May 16, 2018; Voluntary Dismissal, Document No. 17358924, June 14, 2018 (attached hereto). Even if the TAPS tariff settlement were not being actively litigated in federal court, it would likely meet the criteria described in Hickel v. Halford, 872 P.2d 171, 175 (Alaska 1994), which is that:

1. A dispute must exist.
2. A document reflecting the fact of the dispute which serves a function similar to that of a complaint in a civil action, or an accusation or statement of issues under the Administrative Procedure Act, AS 44.62.360, 370, must be served by one party on the other party.
3. The document must set in motion mechanisms prescribed by statute or regulation under which the dispute will ultimately be resolved.

\(^12\) The Department of Revenue has advised that it intends to prospectively apply the advice of the Department of Law to settlements for tax years 1997 through 2017. I have not seen a list or description of the prior settlements to which the Department of Revenue is prospectively applying the advice of the Department of Law. Without knowing the nature of each settlement, I cannot provide analysis as to whether other settlements are (1) "of an administrative proceeding or of litigation in a State or federal court", and (2) "involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property."
Involving Taxes or Royalties

Relying on the opinion of the Department of Law, the Department of Revenue has concluded that the additional production taxes or royalties received following the TAPS tariff disputes settlement "must be deposited into the general fund." The Department of Law states:

The FERC has no jurisdiction over state production taxes or state royalties. Instead, the dispute in a FERC case is about the tariffs charged by pipeline owners to those shipping oil in a particular pipeline. Accordingly, a FERC case is not an administrative proceeding or litigation involving production tax or royalty for the purposes of the CBR fund amendment.

In essence, the Department of Law appears to reason that the pipeline tariff disputes are not "involving mineral lease bonuses, rentals, royalties, royalty sale proceeds, federal mineral revenue sharing payments or bonuses, or involving taxes imposed on mineral income, production, or property," which would otherwise require deposit into the CBR under art. IX, sec. 17(a). The Alaska Supreme Court, however, has not decided this issue.

In my opinion, there is a strong argument that the December 2017 TAPS tariff settlement is a settlement "involving" production taxes or royalties. Because this question has not been decided, the action taken by the Department of Revenue in response to the Department of Law opinion may risk legal challenge.

A previous attorney general opinion from 1995 advises that:

*Any [ ] lump-sum settlements agreed to as a result of the termination of an administrative proceeding that fixed liability for unassessed years should also be deposited in the budget reserved fund.* Revenues received for unassessed years that were affected by a settlement of an administrative

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13 February 27, 2018, letter from Sheldon Fisher, Department of Revenue Commissioner at p. 1.

14 February 14, 2018, letter from William E. Milks and Mary H. Gramling, Assistant Attorney Generals, to Senators MacKinnon and Giessel, at p. 2 (emphasis added).

15 While the Department of Law argues that "[t]he FERC has no jurisdiction over state production taxes or state royalties," art. IX, sec. 17(a) does not require that the administrative proceeding or state or federal court have "jurisdiction" over the state production taxes or royalties for the proceeds to be deposited into the CBR, it merely requires that the settlement or other termination of the administrative proceeding or litigation "involve" state production taxes or royalties.
proceeding, but for which the tax liability had not been finally determined at the proceeding, however, are not subject to deposit in the budget reserve fund.\textsuperscript{16}

*Webster's New World Dictionary* defines "involving" as "to relate to or affect."\textsuperscript{17} There is an argument that while the merits of FERC and RCA litigation did not center on mineral production taxes or royalties, the December 2017 TAPS tariff settlement did "involve" or "relate to or affect" production taxes or royalties. Indeed, the "Settlement Agreement Regarding 2009-2015 Interstate Rates for the Trans Alaska Pipeline System" specifically contains a provision dictating how the use of the FERC tariff settlement rates are to be applied for purposes of adjusting state production taxes and royalties.\textsuperscript{18} Given that the issue of calculation of state production taxes and royalties was made an integral part of the December 2017 TAPS tariff settlement, a court may determine that for purposes of art. IX, sec. 17, the settlement did "involve" production taxes or royalties. In fact, according to the Department of Law, the December 2017 TAPS tariff settlement directly resulted in the collection of $225 million of additional revenue, with at least $165 million more of additional revenue to be collected by the state in the future.\textsuperscript{19}

The Department of Law opinion is based on the recent Alaska Supreme Court decision in *Wielechowski v. State*\textsuperscript{20} regarding interpretation of the language in art. IX, sec. 17. There, the Court reaffirmed the framework for interpreting the Alaska Constitution as set forth in *Hickel v. Cowper*,\textsuperscript{21} explaining:

"Our analysis of a constitutional provision begins with, and remains grounded in, the words of the provision itself. We are not vested with the authority to add missing terms or hypothesize differently worded

\textsuperscript{16} 1995 Inf. Op. Att'y Gen. (May 18; 663-95-0475; 663-95-0474) (concluding that the money received from a 1993 BP settlement that had been allocated to the general fund should be transferred to the budget reserve fund) (emphasis added).

\textsuperscript{17} Second College Ed. 1972.

\textsuperscript{18} http://law.alaska.gov/pdf/press/171214-SettlementAgreement.pdf at 7 - 8. The State of Alaska was a party to the settlement agreement, and it was executed by the Attorney General.


\textsuperscript{20} 403 P.3d 1141 (Alaska 2017).

\textsuperscript{21} 874 P.2d 922, 926-28 (Alaska 1994).
provisions . . . to reach a particular result." We instead "look to the plain meaning and purpose of the provision and the intent of the framers."

"Because of our concern for interpreting the constitution as the people ratified it, we generally are reluctant to construe abstrusely any constitutional term that has a plain ordinary meaning." "Constitutional provisions should be given a reasonable and practical interpretation in accordance with common sense." "[A]bsent some signs that the term at issue has acquired a peculiar meaning by statutory definition or judicial construction, we defer to the meaning the people themselves probably placed on the provision" without "add[ing] 'missing terms' to the Constitution or . . . interpret[ing] existing constitutional language more broadly than intended by . . . the voters." "Legislative history and the historical context, including events preceding ratification, help define the constitution." 22

In my opinion, since the decision in Wielechowski v. State does not establish a new precedent for constitutional interpretation, that decision does not seem to justify, by itself, a departure from prior department conclusions regarding deposit of settlement revenue into the CBR.

The additional revenue received by the state as a consequence of the December 2017 TAPS tariff settlement seems to fit within the category of "windfall revenue" the supporters of the CBR amendment intended and described to the voters were to be deposited into the CBR. The view that the CBR was designed to receive "windfall revenue" also appears to have historical support from the Department of Law. 23 A January 23, 1992, memorandum by assistant attorney general James L. Baldwin examined the voting materials published by the state concerning the budget reserve proposition,

The ballot summary described the revenue source for the budget reserve fund as consisting of "money the state receives from mineral revenue lawsuits or administrative actions . . . ." Supporters of the initiative, Senator Faiks, and Representatives Brown and Phillips authored a statement in support of the initiative in which they argued as follows:

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22 Wielechowski, 403 P.3d at 1146-47.

23 1992 Inf. Op. Att'y Gen. (January 23; 663-91-0298; 663-92-0189; 663-92-0256; 663-92-0107) (internal citations omitted) (also noting that supporters of the budget reserve amendment argued in an authored statement that "[i]f approved, the Budget Reserve Fund will help hold down spending by removing from the table the oil and gas revenue 'windfalls' that result from pending litigation and tax disputes.").
If approved, the Budget Reserve Fund will help hold down spending by removing from the table the oil and gas revenue 'windfalls' that result from pending litigation and tax disputes.

Mr. Baldwin concluded that:

From the foregoing, it appears that the voters understood that the [proposed budget reserve] amendment was addressing the need to remove large unanticipated recoveries from the normal budget process. 24

The additional revenue at issue here resulted from litigation, is from prior tax years, and was recovered outside the normal budget process. For these and the above reasons, the Department of Revenue’s decision to deposit the additional revenue into the general fund as opposed to the CBR may be at risk for challenge. A court may determine that "the plain meaning and purpose of the provision" requires deposit of settlement revenues that "involve" or "relate to or affect" state production taxes and royalties, even if the taxes and royalties were not the center of the dispute – particularly where those state production taxes and royalties are an integral part of the settlement.

Retroactive application

While the Department of Revenue states that it is applying the advice "prospectively," it has also advised that it is actually applying the advice of the Department of Law retroactively and that the "amounts deposited to the CBR for the time period of 1997 to 2017 that would have been deposited to the general fund under the Department of Law’s analysis, will reduce the current [CBR] repayment obligation" by $1,173,302,043.89. 25

In Hickel v. Halford, 26 the Alaska Supreme Court noted that:

1) the holding is one of first impression, or overrules prior law, and was not foreshadowed in earlier decisions; 2) there has been justifiable reliance on an alternative interpretation of the law; 3) undue hardship would result from retroactive application; and 4) the purpose and intended effect of the holding is best accomplished by prospective application.

24 Id.
25 February 27, 2018, letter from Sheldon Fisher, Department of Revenue Commissioner at pp. 1-2. The letter, however, does not provide an accounting or any details regarding the prior settlements to which the advice is being applied.
While difficult to predict, a court might also find that when applying the above conditions, only prospective, rather than retroactive application is appropriate.

Conclusion

While the Alaska Supreme Court has not specifically decided whether TAPS tariff disputes "involve" production taxes or royalties, in my opinion, the additional revenue received by the state as a consequence of December 2017 TAPS tariff settlement seems to fit within the category of "windfall revenue" the framers of the CBR amendment intended to be deposited into the CBR. More specifically, the December 2017 TAPS tariff settlement was a settlement of federal litigation, to which the state was a party, that resulted in more than $225 million in "windfall revenue" from state production taxes and royalties. Had the state not participated in or been a party to the December 2017 TAPS tariff settlement, there is no question that the state would have sought collection of underpaid state production taxes and royalties from the producers who were parties to the December 2017 TAPS tariff settlement based on the terms of the settlement - and any additional revenue received by settlement or otherwise would undeniably be deposited into the CBR.

The conclusions reached by the Department of Revenue and Department of Law in this instance appear inconsistent with art. IX, sec. 17(a) and within the Department of Law's own prior opinions, do not include any discussion of the Alaska Supreme Court's decision in Hickel v. Halford analyzing art. IX, sec. 17(a), and do not take into account the legislative history, meaning, or purpose of the CBR amendment. For these reasons, the conclusions reached by the Department of Revenue and Department of Law may be at risk to legal challenge, because the collection of revenue that resulted from the December 2017 TAPS tariff settlement appears to be the type of revenue the framers of the CBR amendment intended to be deposited into the CBR.

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Attachments