LETTER OPINION
2005-L-02

January 13, 2005

The Honorable Ken Svedjan
Chairman, Budget Section
Legislative Council
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Representative Svedjan:

Thank you for your letter questioning the constitutionality of the proposal contained in Senate Bill No. 2018 that would allow the Department of Commerce to borrow up to $50,000,000 from the Bank of North Dakota as a source of funding for the proposed centers of excellence. In essence, you are asking whether this plan would violate the state's constitutional debt limit found in N.D. Const. art. X, § 13. For the reasons indicated below, it is my opinion that the proposal contained in Senate Bill No. 2018 permitting the Department of Commerce to borrow up to $50,000,000 from the Bank of North Dakota to finance the proposed centers of excellence and to be repaid by contingent future biennial appropriations by the Legislative Assembly does not violate the state constitutional debt limit found in N.D. Const. art. X, § 13.

ANALYSIS

Section 7 of Senate Bill No. 2018 provides, in part, that "the department of commerce on behalf of the centers of excellence commission, may request additional funds of up to $50,000,000 from the Bank of North Dakota, as financing to be repaid in whole or in part by subsequent department of commerce biennial appropriations as provided by the legislative assembly."

Section 9 of Senate Bill No. 2018 would amend N.D.C.C. § 15-10-41 to provide as follows:

> The Bank of North Dakota may loan up to fifty million dollars to the department of commerce to provide matching funds to recipients of funds awarded under this section. The debt service due under the loan must not exceed five million dollars per biennium. The loan may be entered into upon the terms, conditions, and payment provisions as the parties deem to be in the best interest of the state. Repayment of each loan by the department of commerce is contingent upon receipt of sufficient biennial appropriations by the legislative assembly for that purpose.

Id. (Emphasis added.)

The state's constitutional debt limit is contained in N.D. Const. art. X, § 13, which provides, in part:

> The state may issue or guarantee the payment of bonds, provided that all bonds in excess of two million dollars shall be secured by first mortgage upon real estate in amounts not to exceed sixty-five percent of its value; or upon real and personal property of state-owned utilities, enterprises, or industries, in amounts not exceeding its value, and provided further, that the state shall not issue or guarantee bonds upon property of state-owned utilities, enterprises, or industries in excess of ten million dollars.
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> No further indebtedness shall be incurred by the state unless evidenced by a bond issue, which shall be authorized by law for certain purposes, to be clearly defined.

You are correct in noting that any attempt to borrow in violation of the constitution would be invalid. See State ex rel. Lesmeister v. Olson, 354 N.W.2d 690 (N.D. 1984) (holding that bonds funded by any general state tax constitutes a debt of the state within the meaning of the constitutional debt limitation). While it would appear at first glance that the appropriations to the Department of Commerce to repay Bank of North Dakota borrowings would be funded by the general fund and implicate the state debt limit, it is noteworthy that the borrowing proposed in Senate Bill No. 2018 differs in two significant respects from the circumstances present in the Lesmeister case. In Lesmeister, the North Dakota Supreme Court determined that the bond issuance scheme contained in former N.D.C.C. ch. 61-24.4 violated the debt limit, in part, because the bonds were to be repaid from the oil extraction tax and also because under former N.D.C.C. § 61-24.4-10,[1] the appropriations to pay for the bonds were stated to be irrepealable. Lesmeister at 699-700. In addition, the proposed bonds in Lesmeister were to be sold to the investing public. Id. at 700. In Lesmeister, the court noted that the appropriation "in this case cannot be repealed once the bonds are issued without threat of a breach of contract action by the bond holders until the bonds and interest are paid in full." Id.

[1] Former N.D.C.C. § 61-24.4-10 provided as follows:

> All taxes levied, appropriations, and transfers provided to pay bonds issued under the provisions of this chapter and interest thereon shall not be repealed until such bonds and interest are fully paid. The state pledges and agrees with the holders of any obligations issued pursuant to this chapter that the state will not limit or alter the authorities vested in the commission to fulfill the terms of any agreements made with the holders thereof, or in any way impair the rights and remedies of the holders until the bonds, together with the interest thereon, with interest on any unpaid installments of interest, and all costs and expenses in connection with any action or proceeding by or on behalf of such holders are fully met and discharged. The commission is authorized to include this pledge and agreement of the state in any agreement with the holders of such bonds.

There is no similar provision in Senate Bill No. 2018.

The borrowing proposal contained in Senate Bill No. 2018 differs in that the appropriation to repay the Bank of North Dakota loan is not irrepealable; rather, repayment of any loan by the Department of Commerce is "contingent upon receipt of sufficient biennial appropriations by the legislative assembly for that purpose." Senate Bill No. 2018, § 9. Also, the proposal in Senate Bill No. 2018 is to borrow from the Bank of North Dakota, a state entity, rather than from the investing public.

> No state debt is created in the sense contemplated by a constitutional inhibition unless the state itself is under a legally enforceable obligation. Accordingly, no debt is created where there is neither debtor nor creditor, as where the state uses a fund of one of its own departments, bureaus, or commissions, or where payment of state funds is to be made solely at the state's option.

81A C.J.S. States § 365 (2004) (emphasis added).

A number of courts have considered the issue of whether unconstitutional debt is created when a borrowing is to be repaid from future annual or biennial appropriations by the Legislature. In State ex rel. Warren v. Nusbaum, 208 N.W.2d 780, 803-804 (Wis. 1973), the court noted:

> This court has heretofore consistently held that no state debt is created unless the state itself is under a legally enforceable obligation.
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> . . . No absolute obligation is created to be satisfied or discharged out of future appropriations. . . .
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> Future legislative approval is necessary before appropriations are to be made into the Authority's capital reserve fund. Thus, [the statute] creates no presently binding legal obligation on the part of the state but merely constitutes an expression of future intention or aspiration.
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> No enforceable legal obligation is created on the part of the state to subsidize the debts of the Authority even though good judgment may dictate that it do so voluntarily. No state debt can be created where payment of state funds is to be made solely at the state's option.

(Citations omitted.)

The Nusbaum court noted that even if the financing statute "evidences a moral obligation on the part of the state to insure the Authority's debts," "[t]he term 'moral obligations'

recognizes the absence of any legally enforceable claim." Further, "[i]t is generally held that the state is not compelled to recognize moral obligations, but it is free, through appropriate legislation, to satisfy that which it recognizes as its moral debt." 208 N.W.2d at 804.

Similarly, in State ex rel. Kane v. Goldschmidt, 783 P.2d 988 (1990), the court had occasion to rule on the constitutionality of a statute authorizing state officials to enter into certain financing agreements. The court noted:

> The state does not promise that future legislatures will appropriate any funds. The lenders take the risk of nonpayment. . . . As noted in Walsh Const. Co. v. Smith, supra, 272 Or. at 404, 537 P.2d 542, if the legislature makes an unenforceable promise to replenish the source from which repayments are made, "it is at most based upon a moral obligation which the members of future legislatures might feel to meet the deficiency. We do not interpret [the constitutional debt limit provision] as prohibiting such a moral and therefore unenforceable pledge."
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> Nor does the fact that the legislature may feel compelled to make payments in a future biennium out of the fiscal concern to protect its credit rating convert the state's "obligation" into a legal one subject to [the constitutional debt limit]. The economic and fiscal consequences of either continuing the agreements or allowing them to terminate by failing to appropriate money merely becomes a factor in the public policy calculus of a political system that automatically "subjects the economic wisdom of such projects to [biennial] review by future taxpayers and their elected representatives.". . . These consequences are of no constitutional significance.
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> . . . Though decisions of other states are not binding, most sister courts considering the effect of nonappropriation clauses have upheld financing mechanisms such as this because the nonappropriation mechanism prevents the transaction from being a "debt" under state law.

Id. at 995-96 (citations omitted).

In In Re Oklahoma Capitol Improvement Authority, 958 P.2d 759 (Okla. 1998), the court was determining the constitutionality of a proposed $300 million highway improvement bond issue to be funded by annual appropriations. The court noted:

> Here, the highway bond program is also subject to an annual review by current members of the legislative body. The Legislature will determine on a year-by-year basis in the appropriation process whether road improvements should be funded through the appropriations to the Highway

> Department. . . . The fact that the Legislature might, under the highway program, feel some moral obligation to continue the agreement or to ensure that highways are provided for all citizens of this state does not mean that it is legally obligated, and therefore, the [constitutional debt limit provisions] are neither implicated nor applicable -- the bonds . . . are constitutional.

Id. at 769. The court further noted that "this Court said the matter had been settled -- multi-year commitments expressly made contingent on future legislative appropriations did not violate constitutional debt limitation provisions." Id. at 770. Finally,

> [T]he majority of jurisdictions considering the effect of financing mechanisms comparable to the one mandated by [the state statute], the obligations created are not "debts" within the meaning of constitutional and statutory provisions similar to [Oklahoma's constitutional debt limit provisions]. Under these cases, the financing procedures are not "debts" either because the enacting body is not bound legally to make future appropriations or because it is clear that the legislators did not intend them to be obligations of the states or their subdivisions.

Id. at 773-774 (citing, e.g., In re Anzai, 936 P.2d 637, 642 (Haw. 1997); Wilson v. Kentucky Trans. Cabinet, 884 S.W.2d 641, 644-45 (Ky. 1994); Schulz v. State, 639 N.E.2d 1140, 1148 (N.Y. 1994); Dieck v. Unified School Dist. of Antigo, 477 N.W.2d 613, 618 (Wis. 1991); Dykes v. Northern Virginia Transportation Dist. Comm'n, 411 S.E.2d 1, 4 (Va. 1991), cert. denied, 504 U.S. 941, 942, 112 S. Ct. 2275, 2277, 119 L. Ed.2d 201, 203; Department of Ecology v. State Finance Committee, 804 P.2d 1241, 1246 (Wash. 1991); State v. School Bd. of Sarasota County, 561 So.2d 549, 552 (Fla. 1990)).

Although the North Dakota Supreme Court has not ruled on the precise issue presented in your letter, it has similarly recognized that a state agency's obligation to pay rent that is conditioned on the North Dakota Legislature appropriating sufficient funds for the purpose of paying the rent was legally sufficient to permit the agency to escape its lease obligation when the Legislature failed to appropriate sufficient funds. Red River Human Services Foundation v. Department of Human Services, 477 N.W.2d 225 (N.D. 1991). See also Haugland v. City of Bismarck, 429 N.W.2d 449 (N.D. 1988).

In addition, the borrowing proposal contained in Senate Bill No. 2018 is similar to the financing mechanism for the North Dakota Building Authority contained in N.D.C.C. ch. 54-17.2. Under that chapter, state buildings and other projects authorized by the Legislature are paid for by issuing bonds which are ultimately repayable from the general fund, but only to the extent the Legislature provides biennial appropriations for payment of lease rentals, which in turn pay for debt service on the Building Authority bonds. See N.D.C.C. § 54-17.2-10 ("The lease must provide that rents are payable solely from appropriations to be made by the legislative assembly for the payment of the lease . . . .").

The constitutionality of N.D.C.C. ch. 54-17.2 has never been challenged and, indeed, that chapter is entitled to a strong presumption of constitutionality. See, e.g., Traynor v. Leclerc, 561 N.W.2d 644, 647 (N.D. 1997); Menz v. Coyle, 117 N.W.2d 290 (N.D. 1962). Similar financing arrangements have been upheld against constitutional debt limit challenges in other states.[2] The Building Authority bonds are successfully marketed even though bondholders are aware that the building rentals which support debt service payments are payable only to the extent biennial appropriations by the North Dakota Legislature are made. See, e.g., Official Statement, North Dakota Building Authority Lease Revenue Bonds, 2003 Series B ("The obligation of the agencies to pay any rent, as herein defined, under its lease is subject to biennial appropriations by the North Dakota Legislature as provided in such lease. . . . The issuance of the bonds does not directly or contingently obligate the agencies to pay any rent beyond that appropriated for the current biennium of the state."). In the case of Senate Bill No. 2018, there are no outside bondholders; rather, the Bank of North Dakota holds the debt. Should the Legislature fail to appropriate sufficient moneys to permit the Department of Commerce to make loan payments in any biennium, the Bank of North Dakota would be in the same position as would North Dakota Building Authority bondholders should the Legislature ever determine to not appropriate debt service payments for those bonds. In the case of the Building Authority bonds, the bondholders are taking the risk of nonappropriation. In the case of Senate Bill No. 2018, the Bank of North Dakota is taking the risk of nonappropriation and, should that occur, would have to deal with the defaulting Department of Commerce loan like any other defaulting loan it encounters.

Based on the foregoing, it is my opinion that the proposal contained in Senate Bill No. 2018 permitting the Department of Commerce to borrow up to $50,000,000 from the Bank of North Dakota to finance the proposed centers of excellence and to be repaid by contingent future biennial appropriations by the Legislative Assembly does not violate the state constitutional debt limit found in N.D. Const. art. X, § 13.

Sincerely,

Wayne Stenehjem
Attorney General

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This opinion is issued pursuant to N.D.C.C. § 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts. See State ex rel. Johnson v. Baker, 21 N.W.2d 355 (N.D. 1946).

[2] E.g., Barkley v. City of Rome, 381 S.E.2d 34 (Ga. 1989); State v. Brevard County, 539 So.2d 461 (Fla. 1989); Caddell v. Lexington County School Dist., 373 S.E.2d 598 (S.C. 1988).