UNIVERSITY OF NORTH DAKOTA RESEARCH ENTERPRISE AND COMMERCIALIZATION BUILDING LOAN AGREEMENT

This memorandum is in response to a request for information regarding whether the loan agreement between the University of North Dakota (UND) and Bremer Bank to purchase the Research Enterprise and Commercialization (REAC) building was in compliance with the legislative authorization under 2013 Senate Bill No. 2003 and whether the agreement would be considered void or voidable if not in compliance with the legislative authorization.

AUTHORITY TO PURCHASE REAC BUILDING

In January 2013 UND requested the State Board of Higher Education to seek authorization for UND to purchase the REAC building and enter a financing arrangement for the purchase. The board granted the request and the board and UND requested the Senate Appropriations Committee to amend Senate Bill No. 2003 to authorize the purchase. The Senate amended the bill to include a provision authorizing the purchase and financing of the building. During deliberations in the House of Representatives, that provision was removed from the bill. However, the conference committee again considered the request, and the bill was adopted with the following authorization:

> **SECTION 23. UNIVERSITY OF NORTH DAKOTA - RESEARCH ENTERPRISE AND COMMERCIALIZATION BUILDING PURCHASE - BUDGET SECTION REPORT.** During the period beginning with the effective date of this Act and ending June 30, 2015, the state board of higher education may enter a purchase and financing agreement or agreements with a private entity and do all things necessary and proper to authorize the purchase of the research enterprise and commercialization building on the campus of the university of North Dakota **using donations, gifts, or other funds**. The state board of higher education shall provide a report to the budget section if the research enterprise and commercialization building is purchased as provided under this section. (**emphasis supplied**)

SOURCE OF FUNDS FOR PURCHASE

Under Section 23 of Senate Bill No. 2003, the board was authorized to enter a purchase and financing agreement using donations, gifts, or other funds. There is no clear guidance as to what "other funds" includes. However, a review of the minutes and testimony from the Appropriations Committees and the conference committee on Senate Bill No. 2003 suggests the phrase was intended to mean funds other than appropriated general funds. On a number of occasions, representatives of UND, committee members, and staff commented that the financing agreement for the purchase would use revenue generated from the facility and would not require an appropriation. The statement provided to the Senate Appropriations Committee by Ms. Alice Brekke, Vice President for Finance and Operations, University of North Dakota, stated "[p]lease let me emphasize as we make this request that we are not asking for money--simply the authority to purchase the building and enter into a financing arrangement for that purpose . . . The primary source of funds for the repayment will be the revenue generated by the facility."

It appears the only reference to the use of appropriated funds was included in the request UND made to the board and submitted to the Senate Appropriations Committee in which document UND indicated "[t]he primary source of funds for the repayment of the financing will be the rent and operating revenue generated by the facility. If necessary, other land lease revenue, local funds, grant funding and/or appropriated funding may be used." Although it appears quite clear that there was no intent to use general fund appropriations to finance the purchase of the building, it could be argued that the reference to "appropriated funding" was intended to include non-general fund money. In Section 34 of Senate Bill No. 2003, the Legislative Assembly appropriated to the various institutions under the control of the board all funds derived from federal, private, and other sources, including tuition revenue. Thus, although there would be no need to appropriate general funds or other funds specifically for the purchase and financing of the building, UND could presumably use the appropriation authority under Section 33 during the 2013-15 biennium and similar authority in future bienniums for payments on the loan used to purchase the building. It is important to keep in mind Article X, Section 12, of the Constitution of North Dakota, provides that public moneys may be "disbursed only pursuant to appropriation first made by the legislature."

FINANCING OF THE REAC BUILDING

On June 28, 2013, the Acting Chancellor of the North Dakota University System, Dr. Larry Skogen, sent a letter to the president of UND indicating his approval of the purchase terms and financing agreement for the REAC building. On July 2, 2013, UND issued a request for proposals (RFP) for a loan of $9.8 million to the board and UND for the financing and acquisition of the REAC building. In the RFP, UND specified the source of payment of the loan as follows:

> Payments due on the loan are a special obligation of UND payable from all available unrestricted current funds, **appropriations to UND** and other revenues generated by UND from the use of the Facility. The loan will not be secured by any real or personal property including the Facility. The loan will not be a general obligation of UND, the State Board of Higher Education of the State of North Dakota or the State of North Dakota. (**emphasis supplied**)

On July 29, 2013, UND received notice of the acceptance of its offer to purchase the REAC building from the UND Research Foundation. Four lenders responded to UND's RFP, and on August 15, 2013, UND notified Bremer Bank of acceptance of Bremer's proposal. On September 12, 2013, Bremer Bank and UND executed the financing documents, and the proceeds of the loan were transferred to UND. The University of North Dakota and the UND Research Foundation completed the purchase agreement on September 16, 2013.

The loan agreement executed by UND and Bremer Bank did not address the issue of the source of funds to repay the loan. The agreement included provisions in which UND certified that as the borrower, UND had the authority to execute the agreement and perform its obligations under the agreement. The University of North Dakota further certified that the carrying out of the transactions under the agreement will not violate any law. The agreement includes within the definition of an "event of default" any representation by the borrower in the agreement or any statement made in connection with the agreement that is proven to be incorrect in any material respect when made.

CONTRACTS - VOID AND VOIDABLE

In general, a contract that is void is an agreement that is null or does not exist and has no legal effect. The legal treatise *Restatement (Second) of the Law of Contracts* explains that no contract exists if a party, due to misrepresentation, does not know or have reasonable opportunity to know of the character or essential terms of the proposed contract. [*Restatement Second, Contracts §163*]. Another example of a void contract is when a contract is entered under duress or physical force.

A contract that is voidable is an agreement that a party to the agreement can elect to avoid the terms of the agreement. The *Restatement* explains typical instances of voidable contracts include contracts "induced by fraud, mistake, or duress, or where breach of a warranty or other promise justifies the aggrieved party in putting an end to the contract. [*Restatement Second, Contracts §7*]. More specifically, Section 164 of the *Restatement* provides that if a party agrees to a contract due to fraud or a material misrepresentation by the other party, the contract is voidable by the party that was subject to the fraud or misrepresentation. However, a voidable contract remains valid until a party that has the ability to avoid it does so.

Beyond the question of whether a contract is void or voidable, there is also the question of enforceability of a contract. Under North Dakota Century Code Section 9-08-01, a provision of a contract is unlawful if it is contrary to an express provision of law. The North Dakota Supreme Court has interpreted that section to mean that an illegal contract is void. In a 1932 decision, *Mees v. Matt,* 63 N.D. 74, the court determined that the conduct of a party to an agreement amounted to a breach of faith under the contract with his employer and violated his duty and obligation to the employer. Therefore, the transaction in question was inconsistent with fair and honorable dealing, contrary to sound policy, and offensive to good morals. Although the court indicated such a contract would be void due to illegality, ultimately the court determined the agreement was not enforceable and did allow the employee to collect under the contract.

Chapter 9-08 specifies a variety of types of contracts or contractual provisions that are void. Section 9-08-02.1 states that a provision in a construction contract which would make the contractor liable for the errors or omissions of the owner or the owner's agents in the plans and specifications of the contract is against public policy and void. Section 9-08-03 states penalties imposed by contract for any nonperformance thereof are void. Section 9-08-04 states that a contract by which the amount of damages to be paid, or other compensation to be made, for a breach of an obligation is determined in anticipation thereof is to that extent void, except that the parties may agree therein upon an amount presumed to be the damage sustained by a breach in cases in which it would be impracticable or extremely difficult to fix the actual damage. Section 9-08-05 provides that unless otherwise allowed by law, a stipulation or condition in a contract by which any party thereto is restricted from enforcing that party's rights under the contract by the usual legal proceedings in the ordinary tribunals or which limits the time within which that party thus may enforce that party's rights is void. Section 9-08-06 declares certain contracts by which anyone is restrained from exercising a lawful profession, trade, or business is void. Section 9-08-07 provides that a contract in restraint of the marriage of any person, other than a minor, is void.

Section 9-08-08 addresses a type of contract that is voidable. That section provides that every settlement or adjustment of any claim for relief for damages on account of any personal injuries received and every contract of retainer or employment to prosecute such an action, is voidable if made within 30 days after the injury or if made while the person so injured is under disability from the effect of the injury so received and within six months after the date of the injury.

SUMMARY

Although it appears clear there was no intention to use appropriated general funds to finance the purchase of the REAC building, the language of the statutory provision authorizing the purchase and financing of the REAC building is not entirely clear with respect to the source of the funds to repay the loan because there is no clear definition of "other funds." Furthermore, the language of the RFP indicating that appropriated funds may be used to repay the loan is legally accurate in that all funds expended by a state institution must be appropriated by the Legislative Assembly, and the Legislative Assembly appropriated to the institutions of higher education, including UND, all funds derived from federal, private, and other sources, including tuition revenue.

Could the contract between UND and Bremer Bank be determined to be void? There do not appear to exist any of the circumstances under which the *Restatement* on contracts would suggest a contract would be void. Although Section 9-08-01 states that a contract is unlawful if it is contrary to an express provision of law, it may be difficult to conclude that the contract is contrary to an express provision of law.

Is the contract between UND and Bremer Bank voidable? There does not appear to be any circumstance under which the state could void the contract. If Bremer Bank were to attempt to desire to void the contract, it could attempt to claim that UND misrepresented the repayment provisions in the RFP. However, so long as UND continues to make repayment provisions under the contract, there would seem to be little desire to void the contract.