**LETTER OPINION**
**97-L-108**

July 25, 1997

Honorable Robert R. Peterson
State Auditor
600 East Boulevard Avenue
Bismarck, ND 58505

Dear Mr. Peterson:

Thank you for your letter asking several questions about what you describe as long-term financing by state agencies that may extend the term of any specific agreement beyond the biennium in which the agreement is made, typically through automatic successive renewals of the agreement if sufficient funds are appropriated to fund the renewals.

In a recent opinion, I stated:

> Article X, Section 13 of the North Dakota Constitution establishes a limit on the general obligation indebtedness that may be incurred by the state and conditions under which such debt may be incurred. The Supreme Court of North Dakota has determined that the terms constitutional "debt" or "indebtedness" as used in the North Dakota Constitution do not apply to obligations that are to be paid out of current revenues. See, e.g., Schieber v. City of Mohall, 268 N.W. 445, 449 (N.D. 1936) (the term "debt" in the state constitution is a general obligation for which there is a pledge to pay in the future; unless the obligation is to be satisfied out of current revenue); Jones v. Brightwood Ind. Sch. Dist. No. 1, 247 N.W. 884, 887 (N.D. 1933) ("the term 'indebtedness' as used in section 183 [now set forth as N.D. Const. art. X, § 15] means the amount of debts less currently collectible taxes and other funds"). When there is no general obligation of the taxing power of an entity, the debt limit does not apply. See Schieber v City of Mohall, 268 N.W. 445, 447 (N.D. 1936). ("'[D]ebt' and 'indebtedness' as used in Section 183 of the Constitution . . . [now Art. X, § 15], refer to pecuniary obligations imposed by contract, except the obligations to be satisfied out of current revenue.") A lease with a nonappropriation clause also does not involve the debt limit because the nonappropriation clause authorizes the government entity to cancel the lease if

> the Legislature does not appropriate sufficient funds to make the lease payments. See Red River Human Services Found. v. North Dakota Dep't of Human Services, 477 N.W.2d 225, 227-28 (N.D. 1991). When a lease-purchase agreement specifically says that it does not œonstitute a general obligation of the government, that the government's taxing powers are not pledged for payment of the lease payments, and that the government is only liable for lease payments for the current fiscal year (or period) for which it has appropriated funds, the agreement does not create debt as contemplated by the constitution. See Marks v City of Mandan, 296 N.W. 39, 47 (N.D. 1941) ("Payment of the obligations having been provided without resort to general taxation, they are not such obligations as are contemplated by [the constitution.]"). The duty owed to the bondholders when a bond issue is a revenue obligation includes a duty to exercise due diligence to collect sufficient revenues to pay the lease payments; however, that duty does not give rise to a debt in the constitutional sense. Id.
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> Although the cases discussing the debt limit involved political subdivisions and not the state, the conclusion pertaining to what constitutes "debt" for political subdivisions under Article X, Sections 15 and 17 is equally applicable to the state under Article X, Section 13. See State ex rel. Lesmeister v. Olson, 354 N.W.2d 690, 695 (N.D. 1984); State ex rel. Syvertson v. Jones, 23 N.W.2d 54 (N.D. 1946). Thus, a pledge by the state to pay an obligation out of current revenues which is not a general obligation of the state and which contains a nonappropriation clause does not constitute state debt proscribed by the constitution.

Letter from Attorney General Heidi Heitkamp to Lieutenant Governor Rosemarie Myrdal (July 2, 1997). See also 1977 N.D. Op. Att'y Gen. 1.

Thus, if an agency is authorized to enter into the contract in question and the contract does not actually pledge to pay an obligation out of any but currently available appropriations, the contract is not "debt" under the North Dakota Constitution.

It is common knowledge that extension of "credit" has the indirect effect of enhancing resource availability because more goods and

services can be obtained by spreading payments over a period of time. However, if an agreement by a state agency does not legally obligate appropriations beyond those currently available, the extension of this "credit" does not constitute debt in the constitutional sense.

In the software development industry, including maintenance and support services for purchased or developed computer software, it has apparently become an industry practice for maintenance and support services to be provided for assistance to software purchasers in the use and development of software programs as well as the agreed receipt of new or upgraded releases of software programs or modifications (fixes) to existing software to make it operable as intended. Such agreements, if they do not actually obligate the state to payments beyond current appropriations, are not unlawful.

In your letter you indicate a concern because interest costs are assessed and paid by state agencies as part of the agreements over a period of years. You question the propriety of payment of such "borrowing" costs. The term "borrow" is defined as:

> To solicit and receive from another any article of property, money or thing of value with the intention and promise to repay or return it or its equivalent. If the item borrowed is money, there normally exists an agreement to pay interest for its use. In a broad sense the term means a contract for the use of money. . . .

Black's Law Dictionary (6th ed. 1990), p. 185. Thus, when a state agency enters into a contract for goods or services and pays for them over a period of time, it is effectively obtaining credit or "borrowing" the use of the money. Naturally, such a process entails the payment of interest to, inter alia, compensate the seller or other party financing the transaction for the risk and the time value of the money involved. Even shorter term agreements for periods of one to two years carry interest charges, hidden or not, unless the contract price is paid as an up-front lump sum payment. Therefore, as noted above, if the state is not actually obligated to make payments beyond its current appropriation authority, then agencies authorized to enter into contracts may include in those contracts payment for goods and services over a period of years, including software development and maintenance and support services connected therewith, and the payment of interest. If the Legislature were to exercise its authority to not appropriate sufficient funds for funding of any particular agreement, the requirement to make any interest payment under the agreement would also cease. The fact that

interest charges may be assessed and paid does not change the analysis that contract payments from current revenues are not debt within the meaning of the constitutional debt limit, particularly when accompanied by a nonappropriation clause.

It is apparent that the Legislature is fully aware of the financing arrangements used by agencies that include nonappropriation or, as you say, a standard "out" clause for the agency to employ if appropriations are not forthcoming as anticipated. In fact, in 1975, the Legislature enacted N.D.C.C. § 54-06-17 which specifically authorized lease-purchase of office equipment if the arrangement produced a financial advantage to the state and did not commit the state beyond the biennium for which funds were available. Furthermore, if the Legislature believes the issue is of serious import, it can pass legislation such as 1991 Senate Bill 2442 or 1997 House Bill 1187. The 52nd Legislative Assembly considered 1991 Senate Bill 2442 which would have prohibited the state and any of its political subdivisions from entering into any sale and leaseback agreement or any other means of financing acquisition of property or capital construction except through cash purchase from available funds or the issuance of bonded indebtedness approved by law. The 55th Legislative Assembly considered 1997 House Bill 1187 which would have prohibited a state agency or institution from acquiring the use of an asset through a lease arrangement that involved payments beyond one biennial period unless the proposed lease had been separately identified in the agency's budget request and funds had been appropriated for it by the Legislative Assembly or identified to it from appropriated funds or approved by the budget section. The bill would also have required inclusion of a nonappropriation clause if lease payments were to be made in more than one biennium -- something that is already being done in such leases and agreements. Both of these pieces of legislation failed to pass their respective legislative assemblies. The Legislature is fully capable of controlling such future financing arrangements.

Sincerely,

Heidi Heitkamp
ATTORNEY GENERAL

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