

No. A12-0622

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STATE OF MINNESOTA
IN SUPREME COURT

James D. Schowalter, in his capacity as Commissioner of the Minnesota
Department of Management and Budget,

Petitioner,

vs.

The State of Minnesota and the Taxpayers and Citizens of the State of Minnesota,

Respondents.

PETITIONER'S BRIEF IN SUPPORT OF VERIFIED COMPLAINT

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Petitioner James D. Schowalter, in his capacity as Commissioner of the Minnesota Department of Management and Budget (“Petitioner” or “Commissioner”), submits the following in support of the relief sought in his Verified Complaint.

LEGAL ISSUES

- (I) Whether Petitioner is permitted constitutionally to issue the Appropriation Refunding Bonds¹ on behalf of the State of Minnesota in light of the restrictions imposed by Article XI, Sections 4 and 5 of the Minnesota Constitution.

This issue was raised by Petitioner’s Verified Complaint (*see* Agreed Statement of the Record (“ASR”) 7-8), over which this Court has original jurisdiction pursuant to Minnesota Statutes, Section 16A.99, and Article VI, Section 2, of the Minnesota Constitution. Minn. Stat. § 16A.99, subd. 9(c) (2011 Supp.); Minn. Const. art. VI, § 2.

The most apposite cases and constitutional and statutory provisions are: Minn. Stat. § 16A.99; Minn. Const. art. XI, §§ 4, 5; *Minnesota Higher Ed. Facilities Auth. v. Hawk*, 232 N.W.2d 106 (Minn. 1975); *Minnesota Housing Finance Agency v. Hatfield*, 210 N.W.2d 298, 303 (Minn. 1973); *Naftalin v. King*, 102 N.W.2d 301 (Minn. 1960); and *Application of Oklahoma Capitol Improvement Auth.*, 958 P.2d 759 (Okla. 1998), *cert denied*, 525 U.S. 874 (1998).

- (II) Whether Petitioner has taken all action necessary and sufficient for the valid issuance of the General Fund Appropriation Refunding Bonds in accordance with law.

¹ Defined *infra* at page 5.

This issue also was raised by Petitioner's Verified Complaint. (*See* ASR 7-8.) "The Attorney General does not dispute that Petitioner has complied with the provisions of applicable Minnesota statutes in proposing the issuance of the General Fund Appropriation Refunding Bonds, if the Court determines that Petitioner has the authority under the Minnesota Constitution to issue the bonds." (Joint Submission of Petitioner and Attorney General Pursuant to the Court's April 16, 2012 Order ("Joint Submission") 17.)

The most apposite statutory provisions are: Minn. Stat. § 16A.99, subs. 3, 4; Minn. Stat. § 16A.672 (2011 Supp.).

STATEMENT OF THE CASE AND THE FACTS

I. STATEMENT OF THE CASE.

Petitioner asserts he has taken, and will continue to take, if the Court validates the bonds, all necessary and proper steps to authorize and effect the issuance of the Appropriation Refunding Bonds. (Joint Submission at Background and Statement of Undisputed Material Facts ("Joint Statement of Facts" or "JSOF") ¶ 29.)² The Attorney General does not dispute that Petitioner has complied with the provisions of applicable Minnesota statutes in proposing the issuance of the Appropriation Refunding Bonds, if the Court determines that Petitioner has the authority under the Minnesota Constitution to issue the bonds. (Joint Submission at 17.)

² As noted in the Joint Submission, Petitioner and the Attorney General agree that the statements in the Joint Statement of Facts are true and accurate, but reserve the right to dispute the materiality of any statements contained therein to the ultimate decision to be made by the Court. (Joint Submission at 3.)

On April 5, 2012, Petitioner filed a Verified Complaint seeking an order of this Court confirming and validating the Appropriation Refunding Bonds as provided pursuant to Subdivision 9 of Section 16A.99. (JSOF ¶ 30.)

II. **THE OUTSTANDING TOBACCO SETTLEMENT REVENUE BONDS ISSUED UNDER SECTION 16A.98.**

The State of Minnesota (“State”) entered into a tobacco settlement agreement, dated May 8, 1998 and amended June 1, 2001, pursuant to which certain tobacco companies agreed to make annual tobacco settlement payments to the State in perpetuity. (JSOF ¶ 18.) As part of the resolution of the 2011 state government shutdown, and to address a then-projected deficit in the 2012-13 biennial budget of approximately \$800 million, on July 20, 2011, the Minnesota Legislature (“Legislature”) enacted Minnesota Statutes sections 16A.98 and 16A.99. (JSOF ¶14.)³

Minnesota Statutes, Section 16A.98 (“Section 16A.98”), entitled “Tobacco Securitization Bonds,” authorized the Tobacco Securitization Authority (“Authority”),

³ Minnesota Statutes, Section 16A.011, defines certain terms used herein, including “appropriation,” which “means an authorization by law to expend or encumber an amount in the treasury.” Minn. Stat. § 16A.011, subd. 4 (2011 Supp.). “‘Fiscal year’ means the period beginning at midnight between June 30 and July 1 and ending 12 months later.” Minn. Stat. § 16A.011, subd. 14. “‘Biennium’ means a period of two consecutive fiscal years beginning in an odd-numbered calendar year and ending in the next odd-numbered calendar year.” Minn. Stat. § 16A.011, subd. 6. In addition, Minnesota Statutes, Section 16A.011, explains:

A statutory appropriation is one which sets apart a specified or unspecified and open amount of public money or funds of the state general fund for expenditure for a purpose and makes the amount, or a part of it, available for use continuously for a period of time beyond the end of the second fiscal year after the session of the legislature at which the appropriation is made. Every appropriation stated to be an ‘annual appropriation,’ . . . [or] described by equivalent terms or language is a statutory appropriation as defined in this subdivision.

Minn. Stat. § 16A.011, subd. 14a.

which is chaired by Petitioner, to issue revenue bonds in the aggregate amount of no greater than \$900 million secured by payments under Minnesota's tobacco settlement agreement, to generate net proceeds to the State of no more than \$640 million. (JSOF ¶¶ 15, 18 (citing Minn. Stat. § 16A.98, subd. 5 (2011 Supp.)).) Minnesota Statutes, Section 16A.99 ("Section 16A.99"), entitled "Tobacco Appropriation Bonds," authorizes Petitioner to issue appropriation bonds "for the purpose of refunding any . . . tobacco securitization bonds authorized under section 16A.98 then outstanding" (JSOF ¶ 16 (quoting Minn. Stat. § 16A.99, subd. 4 (2011 Supp.)).)

The Tobacco Settlement Revenue Bonds were issued by the Authority on November 29, 2011 in the par amount of \$756,955,000. The bonds consist of two series—the 2011A taxable series and the 2011B tax-exempt series. The Tobacco Settlement Revenue Bonds are secured by and payable from the tobacco settlement payment revenues. (JSOF ¶ 18.) In connection with the issuance of the Tobacco Settlement Revenue Bonds, the State sold its future tobacco settlement payments to the Authority. (See Ex. 5, Official Statement for the Tobacco Settlement Revenue Bonds, at ASR 151) (cited in JSOF ¶ 18).) The State netted a total of \$640 million from the transaction, which proceeds were used to refund certain outstanding state debt obligations by paying the debt service obligations (i.e., principal and interest payments) of the State that became due or were to become due during the 2012-13 biennium. (JSOF ¶ 19.) By paying such principal and interest obligations, the proceeds of the Tobacco Settlement Revenue Bonds reduced overall debt service expenditures for the 2012-2013 biennium, thereby directly addressing the projected deficit in the 2012-13 biennial budget. (See JSOF ¶¶ 14, 19.)

The Tobacco Settlement Revenue Bonds are revenue bonds. By their terms, if the pledged tobacco settlement payments are insufficient to satisfy the principal and interest payments on those bonds, the bondholders may not look to the State's general fund or other assets to satisfy the obligation. (*See* JSOF ¶ 7.)

As described by the Official Statement for the Tobacco Settlement Revenue Bonds, the Tax-Exempt Series 2011B Tobacco Settlement Revenue Bonds are subject to extraordinary optional redemption in advance of maturity (i.e., early repayment of the principal amount to the bondholders), but only until December 1, 2012, and *only* with proceeds of the proposed Appropriation Refunding Bonds at issue in this case. (Ex. 5, Official Statement for the Tobacco Settlement Revenue Bonds, at ASR 166 (providing for "extraordinary optional redemption . . . on or prior to December 1, 2012").) If the proposed Appropriation Refunding Bonds for any reason are not issued on or before December 1, 2012, the opportunity for the extraordinary optional redemption no longer will exist. (*Id.*)

III. THE PROPOSED APPROPRIATION REFUNDING BONDS TO BE ISSUED UNDER SECTION 16A.99.

Petitioner proposes to issue appropriation bonds pursuant to Section 16A.99, formally referred to as "State General Fund Appropriation Refunding Bonds" ("Appropriation Refunding Bonds"),⁴ in a maximum amount of \$800 million, to refund in advance of maturity the outstanding Tobacco Settlement Revenue Bonds. (JSOF ¶ 21.) Accordingly, on April 5, 2012, Petitioner issued an Order of the Commissioner of

⁴ Such bonds are referred to in the Verified Complaint and this Court's April 16 and June 5, 2012 Orders as the "Appropriation Refunding Bonds" and in the Joint Submission as "General Fund Appropriation Refunding Bonds."

Management and Budget for the Issuance and Sale of State General Fund Appropriation Refunding Bonds, Taxable Series 2012A and Tax-Exempt Series 2012B (the "Order"). (A true and correct copy of the Order is contained in the ASR as Exhibit 1, at ASR 11-37.⁵ (JSOF ¶ 22.) In addition, the Appropriation Refunding Bonds will be offered for sale pursuant to a Preliminary Official Statement for the General Fund Appropriation Refunding Bonds ("Preliminary Official Statement"). A true and correct copy of the draft Preliminary Official Statement is contained in the ASR as Exhibit 2, at ASR 38-133. (JSOF ¶ 26.)

The proposed Appropriation Refunding Bonds will contain the following statement:

THE BONDS ARE NOT PUBLIC DEBT OF THE STATE, AND THE FULL FAITH, CREDIT, AND TAXING POWERS OF THE STATE ARE NOT PLEDGED TO THE PAYMENT OF THE BONDS OR TO ANY PAYMENT THAT THE STATE AGREES TO MAKE UNDER MINNESOTA STATUTES, SECTION 16A.99, AND THE ORDER. THE BONDS SHALL NOT BE OBLIGATIONS PAID DIRECTLY, IN WHOLE OR IN PART, FROM A TAX OF STATEWIDE APPLICATION ON ANY CLASS OF PROPERTY, INCOME, TRANSACTION, OR PRIVILEGE. THE BONDS SHALL BE PAYABLE IN EACH FISCAL YEAR ONLY FROM AMOUNTS THAT THE LEGISLATURE MAY APPROPRIATE FOR DEBT SERVICE FOR ANY FISCAL YEAR, PROVIDED THAT NOTHING IN MINNESOTA STATUTES, SECTION 16A.99, AND THE ORDER SHALL BE CONSTRUED TO REQUIRE THE STATE TO APPROPRIATE FUNDS SUFFICIENT TO MAKE DEBT SERVICE PAYMENTS WITH RESPECT TO THE BONDS IN ANY FISCAL YEAR. THE BONDS SHALL BE CANCELED AND SHALL NO LONGER BE OUTSTANDING ON THE EARLIER OF (A) THE FIRST DAY OF A FISCAL YEAR FOR WHICH THE LEGISLATURE SHALL NOT HAVE APPROPRIATED AMOUNTS

⁵ Petitioner intends, if the Court validates the bonds, to supplement the Order on the date of sale of the Appropriation Refunding Bonds to fix the final terms of the issuance, sale, and delivery of the Appropriation Refunding Bonds as expressly provided and within the parameters established by the Order. (JSOF ¶ 22.)

SUFFICIENT FOR DEBT SERVICE, OR (B) THE DATE OF FINAL PAYMENT OF THE PRINCIPAL OF AND INTEREST ON THE BONDS.

(JSOF ¶ 28 (citing Ex. 1, Order, at ASR 16; Ex. 2, Preliminary Official Statement, at ASR 38, 42, 47; Minn. Stat. § 16A.99, subds. 3(b), 6).)

This statement—which is required by Section 16A.99, will appear on the face of the Appropriation Refunding Bonds pursuant to the Petitioner’s Order and will be expressly disclosed to potential investors in the Preliminary Official Statement—describes three key features of the Appropriation Refunding Bonds to be issued under Section 16A.99:

- (a) the full faith and credit of the State is not pledged to the payment of the bonds;
- (b) the taxing powers of the State are not pledged, and the bonds shall not be obligations paid directly from a tax of statewide application; and
- (c) the bonds shall be payable in each fiscal year only from amounts that the Legislature may appropriate for principal and interest payments for any such fiscal year and shall be canceled if the Legislature does not appropriate amounts sufficient for principal and interest payments for such fiscal year.

(See JSOF ¶ 28 (citing Ex. 1, Order, at ASR 16; Ex. 2, Preliminary Official Statement, at ASR 38, 42, 47; Minn. Stat. § 16A.99, subds. 3(b), 6).)

The Appropriation Refunding Bonds are “appropriation bonds,” meaning any obligation to pay the principal of and interest on the bonds for a particular fiscal year is contingent upon the appropriation for such payments in the State’s general fund budgets

for such fiscal year. (JSOF ¶ 8.) That is, the payment of principal of and interest on the bonds is dependent upon a sufficient appropriation each biennium from the Legislature. (*Id.*) The bonds are payable each fiscal year from the State's general fund, subject to the Legislature's discretionary appropriation authority, including the authority to repeal a standing appropriation, as well as the Governor's unallotment authority. (*Id.*) If the Legislature does not appropriate sufficient funds to pay the principal of and interest on the bonds, the bondholders may not look to the State's general fund or other assets to satisfy the obligation. (*Id.*)

According to the Preliminary Official Statement, the Appropriation Refunding Bonds will be "payable in whole or in part from tobacco settlement revenues and from money appropriated by law in any biennium for payment of principal and interest on the Bonds." (JSOF ¶ 27 (citing Ex. 2, Preliminary Official Statement, at ASR 47; Minn. Stat. § 16A.99, subd. 1(b)).) However, neither the tobacco settlement payments nor any other revenues are pledged for the purpose of making payments on the Appropriation Refunding Bonds. Instead, the bonds will be paid, if at all, each fiscal year from the general fund, based on a standing appropriation, but subject to the Legislature's discretionary authority at any time to modify or repeal the standing appropriation and the Governor's unallotment authority. (JSOF ¶ 27.)

Although the Appropriation Refunding Bonds are payable only if and to the extent the Legislature appropriates funds, nonappropriation would adversely affect the State's credit rating and could therefore potentially affect the State's ability to access capital markets in a cost-effective manner. As a result, future legislatures will experience economic and reputational pressure to annually appropriate sufficient funds to pay the

principal and interest on outstanding appropriation bonds, as they become due. (JSOF ¶ 9.)

IV. INTEREST RATES AND RATINGS AND ANTICIPATED SAVINGS.

Bond rating agencies typically rate appropriation bonds one or two gradations below the rating for general obligation bonds (e.g., AA to AA- or A+). Appropriation bonds generally receive higher credit ratings from bond rating agencies than revenue bonds. (JSOF ¶ 11.)

The State most recently issued general obligation bonds in September 2011. These bonds have an all-in true interest rate (meaning the financing cost to the State, including issuance costs) of 2.823%. (JSOF ¶ 4.) The current credit ratings for the State's general obligation bonds are "Aa1" (Moody's), "AA+" (Standard & Poor's), and "AA+" (Fitch). (JSOF ¶ 5.)

Because the Tobacco Settlement Revenue Bonds bondholders cannot look to the State's general fund or other assets to satisfy the obligation, those bonds were issued at a higher interest rate and have a lower credit rating than general obligation bonds. (See JSOF ¶ 7.) The Tobacco Settlement Revenue Bonds have an all-in true interest rate of 4.79%. The Tobacco Settlement Revenue Bonds received an A/A- rating from Standard & Poor's and a BBB+ rating from Fitch. (JSOF ¶ 20.)

As with holders of the Tobacco Settlement Revenue Bonds, holders of the Appropriation Refunding Bonds may not look to the State's general fund or other assets beyond the limited pool of monies—in this case, any amount appropriated by the Legislature for the current fiscal year—to satisfy principal and interest payments on the bonds. (See JSOF ¶¶ 7, 9.) Accordingly, the Appropriation Refunding Bonds also will

have a lower credit rating and be issued at a higher interest rate than general obligation bonds. (*See* JSOF ¶¶ 7, 9.) The all-in true interest rate of the proposed Appropriation Refunding Bonds has not yet been established, but it is anticipated to be substantially lower than the 4.79% all-in true interest rate of the Tobacco Settlement Revenue Bonds and higher than the 2.823% all-in true interest rate on the State's most recent issuance of general obligation bonds. (JSOF ¶¶ 4, 24.) Petitioner estimates the all-in true interest rate of the Appropriation Refunding Bonds will be approximately 3.27%, assuming prevailing interest rates will be unchanged since the date of the Order. (JSOF ¶ 24.) The reason for the lower interest rate relative to the Tobacco Settlement Revenue Bonds, and the higher interest rate relative to the general obligation bonds, is that the anticipated ratings on the Appropriation Refunding Bonds will be in the "A+" to "AA" range. (JSOF ¶¶ 5, 20, 24.)

Petitioner anticipates that, by refunding the outstanding Tobacco Settlement Revenue Bonds with the proceeds of the Appropriation Refunding Bonds, the State will achieve a "substantial present value principal and interest savings of at least 3% of the present value of the remaining principal and interest requirements of the Outstanding Tobacco Settlement Bonds." *See* Ex. 1, Order, at ASR 36. Petitioner estimates the lower interest rate would result in present-value savings to the State on principal and interest payments of \$65,466,217. (JSOF ¶ 25.)

V. THE STATE'S OTHER USE OF APPROPRIATION-CONTINGENT FINANCING.

Although the State previously has not issued "appropriation bonds" of the precise type authorized by Section 16A.99, the State and certain State agencies previously have

undertaken financings involving annually appropriated payments from the general fund. (JSOF ¶ 31 (citing Ex. 2, Preliminary Official Statement, at ASR 128-29).)

Minnesota Statutes, Section 16A.85 (“Section 16A.85”) authorizes a master lease equipment financing program. Minn. Stat. § 16A.85 (2011 Supp.). Since 1985 the State has borrowed a total of \$296,780,158 under the master lease equipment financing program, of which \$17,368,480 is outstanding. The average outstanding annual balance pursuant to the master lease equipment financing program has been approximately \$23,145,683. (JSOF ¶ 31.)

In addition, State certificates of participation (“COPs”) are authorized under Minnesota Statutes, Section 16A.81 (“Section 16A.81”). Minn. Stat. § 16A.81 (2011 Supp.). There are \$66,135,000 of the COPs outstanding. (Ex. 2, Preliminary Official Statement, at ASR 128.)

Further, the Legislature has appropriated annually monies from the general fund for the payment of \$137,250,000 of revenue bonds issued by the University of Minnesota (“U of M”) to finance a football stadium. Minn. Stat. § 137.54(a) (2011 Supp.) (“Up to \$10,250,000 is appropriated annually from the general fund for the purpose of this section . . . for no more than 25 years.”). \$118,490,000 of these bonds are still outstanding. (Ex. 2, Preliminary Official Statement, at ASR 128.)

The Legislature similarly has appropriated annually monies from the general fund for the payment of revenue bonds issued by the U of M to finance biomedical science research facilities. Minn. Stat. § 137.64, subd. 3 (2011 Supp.) (“Annual appropriations are made from the general fund” in maximum amounts ranging from \$850,000 in 2010 to \$15,550,000 in 2015 and thereafter). The U of M is authorized to issue revenue bonds up

to \$219 million, Minn. Stat. § 137.64, subd. 2, and \$163,190,000 of these bonds are still outstanding. (Ex. 2, Preliminary Official Statement, at ASR 128.)

Finally, the Legislature annually appropriated monies from the general fund to the Minnesota Housing Finance Agency (“MHFA”) for the payment of bonds issued by MHFA for affordable housing. Minn. Stat. § 462A.36 subd. 4(b) (authorizing appropriations from the general fund not to exceed \$2,400,000 annually). \$31,980,000 of these bonds are still outstanding. (Ex. 2, Preliminary Official Statement, at ASR 128.) *See also* Act of May 11, 2012, ch. 293, § 36, 2012 Minn. Laws (H.F. 1752) (authorizing additional appropriations for MHFA up to \$30,000,000 in aggregate or \$2,200,000 annually).

In addition to previous financings payable from annual appropriations, recently enacted laws provide for appropriation bonds similar to those authorized under Section 16A.99 in connection with the financing of a professional football stadium and “pay for performance” bonds. (*See* JSOF ¶ 32 (citing Act of May 10, 2012, ch. 299, 2012 Minn. Laws (H.F. 2958); Act of May 9, 2012, ch. 293, 2012 Minn. Laws (H.F. 1752)).) Both of these laws provide for a validation proceeding in the Minnesota Supreme Court before the bonds may be issued. (JSOF ¶ 32 (citing Act of May 10, 2012, ch. 299, 2012 Minn. Laws (H.F. 2958) subd. 10, § 1 art. 2; Act of May 9, 2012, ch. 293, 2012 Minn. Laws (H.F. 1752) § 31).)

ARGUMENT

I. THE APPROPRIATION REFUNDING BONDS ARE NOT “PUBLIC DEBT” SUBJECT TO THE RESTRICTIONS OF ARTICLE XI OF THE MINNESOTA CONSTITUTION.

The Appropriation Refunding Bonds are not “public debt” under Section 4 of Article XI of the Minnesota Constitution, and, because the Appropriation Refunding Bonds are not “public debt,” they are not subject to the limitations of Section 5 of Article XI of the Minnesota Constitution.

A. Standard of Review.

The Legislature authorized the issuance of the Appropriation Refunding Bonds pursuant to Section 16A.99. *See* Laws 2011, 1st Sp., c. 7, art. 11 § 4, eff. July 21, 2011. This Court “presume[s] statutes to be constitutional and exercise[s] the power to declare a statute unconstitutional with extreme caution and only when absolutely necessary.” *Irongate Enters., Inc. v. Cnty. of St. Louis*, 736 N.W.2d 326, 332 (Minn. 2007) (citing *ILHC of Eagan, LLC v. Cnty. of Dakota*, 693 N.W.2d 412, 421 (Minn. 2005) (internal quotation marks omitted)). “The party challenging a statute’s constitutionality bears the burden of establishing that the statute is unconstitutional beyond a reasonable doubt.” *Id.*

Because, as described below, Section 16A.99 cannot be proved unconstitutional beyond a reasonable doubt, Petitioner respectfully requests this Court find Section 16A.99, and the Appropriation Refunding Bonds to be issued thereunder, to be constitutional and enter an order of validation.

B. The Appropriation Refunding Bonds Are Not “Public Debt” Under Section 4 of Article XI of the Minnesota Constitution.

1. Bond “Obligations” Contingent Upon Future Legislative Appropriations Do Not Implicate Minnesota’s Constitutional Limitations on the Incurrence of Public Debt.

The Minnesota Constitution places limitations on “public debt” that may be incurred by the State: “The state may contract public debts for which its full faith, credit and taxing powers may be pledged at the times and in the manner authorized by law, but only for the purposes and subject to the conditions stated in section 5.” *See* Minn. Const. art. XI, § 4 (West 2012). Article XI, Section 4 of the Minnesota Constitution defines “public debt” to include “any obligation payable directly in whole or in part from a tax of state wide application on any class of property, income, transaction or privilege, but does not include any obligation which is payable from revenues other than taxes.” *Id.*

By its plain language, Article XI, Section 4 limits only the State’s incurrence of “public debts for which its full faith, credit and taxing powers may be pledged.” The question, therefore, is whether the issuance of the Appropriation Refunding Bonds involves a pledge by the State of its “full faith, credit and taxing powers.” This is not at all the case.

The Appropriation Refunding Bonds at issue are not “public debt” of the State within the meaning of Section 4, because under Section 16A.99 the State’s full faith and credit expressly may not be and, in fact, are not pledged to the payment of the bonds. *See* Minn. Stat. § 16A.99, subd. 6 (“The appropriation bonds are not public debt of the state, and the full faith, credit and taxing powers of the state are not pledged to the payment of the appropriation bonds or to any payment that the state agrees to make under this section.”); *see also* Minn. Stat. § 16A.99, subd. 3(b) (“Every appropriation bond shall

include a conspicuous statement of the limitation established in subdivision 6”).

Subdivision 6 of Section 16A.99 provides:

Appropriation bonds shall be payable in each fiscal year only from amounts that the legislature may appropriate for debt service for any fiscal year, provided that nothing in this section shall be construed to require the state to appropriate funds sufficient to make debt service payments with respect to the bonds in any fiscal year. Appropriation bonds shall be canceled and shall no longer be outstanding on the earlier of (1) the first day of a fiscal year for which the legislature shall not have appropriated amounts sufficient for debt service, or (2) the date of final payment of the principal of and interest on the appropriations bonds.

Minn. Stat. § 16A.99, subd. 6. Neither the State nor the Legislature has any statutory or contractual obligation to appropriate funds to pay amounts due on the Appropriation Refunding Bonds in any future fiscal year. Instead, there is only the prospect, not the promise, of future payment, based on the sole discretion of the Legislature to appropriate future funds to repay the bonds.⁶ As such, because the State’s full faith, credit and taxing powers are not pledged toward the repayment of the Appropriation Refunding Bonds, and because any repayment of such bonds is at the discretion of the Legislature, the Appropriation Refunding Bonds are not “public debt” within the meaning of Article XI, Section 4 of the Minnesota Constitution, and thus do not violate constitutional restrictions on the incurrence of debt.

⁶ See *First Trust Co., Inc. v. State*, 449 N.W.2d 491, 496-97 (Minn. Ct. App. 1989) (where continuation of energy services agreement between the State and a corporation was “contingent upon continued legislative appropriation of funds,” holding “the state’s obligation ended when the appropriation was not made”).

2. *Section 16A.99 Is Consistent With Minnesota Precedent Recognizing “Public Debt” Involves an Irrevocable Pledge of the Credit of the State.*

Section 16A.99 is consistent with this Court’s precedent, which indicates the key feature of “debt” limited under the Minnesota Constitution is an irrevocable pledge of the credit of the State. Bonds issued under Section 16A.99 are not subject to any such pledge, and the Appropriation Refunding Bonds in fact expressly disclaim any such pledge. Accordingly, bonds issued under Section 16A.99 are not public debt for purposes of the Minnesota Constitution.

In *Fleckten v. Lamberton*, 72 N.W. 65, 65-66 (Minn. 1897), this Court held a law appropriating for a 10-year period the surplus revenues in the State treasury to defray the cost of building a new State capitol did not create a State “debt” for purposes of the Minnesota Constitution.⁷ Expanding on *Fleckten*, in *Brown v. Ringdahl*, 122 N.W. 469, 470 (Minn. 1909), this Court held certain tax anticipation certificates of indebtedness were constitutional. The certificates of indebtedness were issued to defray the cost of building a new State prison, and were payable from a special building fund with proceeds of a tax levied on all taxable property in the State over a 10-year period.

In *Naftalin v. King*, 90 N.W.2d 185 (Minn. 1958) (“*Naftalin I*”), this Court examined whether certain tax anticipation certificates were a constitutional special fund financing under Article 9 of the Minnesota Constitution.⁸ Specifically, financing of State

⁷ At the time of the *Fleckten*, *Brown*, and *Naftalin I* and *II* decisions discussed herein, the Minnesota Constitution addressed limitations on “public debts” in Article 9, Sections 5 through 7. See *Naftalin v. King*, 102 N.W.2d 301, 312 (Minn. 1960) (“*Naftalin II*”) (J. Knutson, dissenting).

⁸ See note 7, *supra*.

buildings projects was to be accomplished by selling certificates of indebtedness payable by the State building fund. A tax then was levied on all taxable property in the State, and the proceeds were appropriated to the State building fund for the payment of tax anticipation certificates. *Id.* at 188-89. Although this Court indicated it might well find the financing scheme unconstitutional “if the present court were passing on the issue for the first time,” in light of *Brown* and *Fleckten* this Court ultimately held “the issuance of the tax anticipation certificates will not create a state debt within the meaning of Minn. Const. art. 9, ss 5, 6, and 7 [.]” *Id.* at 190.

Naftalin I also held that once the State “entered upon a contract, as it does when it issues either bonds or certificates of indebtedness under a statute providing for tax levies to be paid into a special fund for their repayment,” the State “is bound to carry out [that contract’s] terms without repealing . . . or otherwise impairing the tax levies” *Id.* at 192.

The *Naftalin I* Court went on to state, however:

Although, largely because of our prior decisions of long standing, we definitely hold that the building certificates of indebtedness authorized by the 1955 and 1957 acts do not contravene Minn. Const. art. 9, ss 5, 6, and 7, it is the opinion of all members of the court that a word of caution as to future state financing is in order. As forcefully pointed out in *Brunk v. City of Des Moines*, [291 N.W.2d 395 (Iowa 1940)], the special-fund type financing may be so abused that it becomes merely a subterfuge for evading the purpose of constitutional state debt limitations. A constitutional provision which has become so outmoded that only an ever-increasing application of legal ingenuity makes it workable in meeting the modern needs of state finance should be amended. The abuse of the special-fund doctrine has become apparent to many authorities.

Id. at 190 n.6. This Court’s “word of caution” in *Naftalin I* is dictum, and it focused on the need to *amend* a constitutional provision that had become “outmoded,” reflecting a strong aversion to striking down a mode of financing authorized by the Legislature.

Even in the subsequent case of *Naftalin v. King*, 102 N.W.2d 301 (Minn. 1960) (“*Naftalin II*”), when the Legislature passed another special financing law of the same type despite the fact the Minnesota Constitution had not been amended, this Court was unwilling to strike down the statute as unconstitutional in light of *stare decisis*. *Id.* at 499-500. Faced again with “certificates of indebtedness . . . exclusively payable from a special fund . . . derived from the levy and collection of a tax authorized for that particular purpose,” this Court found the *Naftalin I* and *Brown* cases to be “decided upon fallacious reasoning,” *Id.* at 302, 303. This Court explained:

The *Naftalin* case, although relying on the *Brown* case, established a proposition relative to certificates of indebtedness which are to be retired from a state building fund, to which fund is appropriated moneys derived from a levy upon all the taxable property in the state. It established that such certificates when *once issued are irrevocable obligations of the state and, until paid, pledge the credit of the state toward their repayment* out of general ad valorem taxes levied against all the property of the state.

It follows logically from this that the issuance of such certificates creates a debt within the meaning of Minn. Const. art. 9, s 5

Id. at 303 (emphasis added); *see also id.* at 316 (J. Knutson, dissenting) (dissenting from holding that law at issue was constitutional: “Putting it bluntly, these certificates of indebtedness constitute an *irrevocable obligation of the state*, payable out of ad valorem taxes levied generally against all the property of the state, and, as such, it can be nothing but a state debt.”) (emphasis added).

Nevertheless, this Court held the particular funds at issue in *Naftalin II* were not debt subject to constitutional limitations based on *stare decisis*, recognizing:

If we failed to follow [*Naftalin I*] . . . at this time, the construction, alterations, repairs, and rehabilitation of the various state buildings . . . would be curtailed and chaos, delay, hardship, and confusion might well result. To tie up the state building program by declaring that the \$52,994,612 cannot be made available will create a problem which in our opinion would be far more serious than is now recognized by the public After all, a majority of both houses of the 1959 legislature passed [the law] now under consideration, even though the house and senate did not get together on the matter of submitting the constitutional amendment.

Id. at 303. Instead this Court stated, “To the extent that dicta may be binding . . . it is our opinion now that if this court is again presented with the issue in connection with future laws *pledging the credit of the state as security* such laws should be declared in violation of Minn. Const. [debt limitation provisions].” *Id.* at 304 (emphasis added).⁹

This Court’s analysis of the *Naftalin II* certificates identified the key feature of “debt” for purposes of the Minnesota Constitution: an irrevocable pledge of the credit of the State. *See Naftalin II*, 102 N.W.2d at 303, 304; *see also id.* at 316 (dissent); *Naftalin I*, 90 N.W.2d at 191 (finding the State had been “bound to carry out [the certificate’s] terms without repealing . . . or otherwise impairing the tax levies”); *see also Minnesota Energy & Econ. Dev. Auth. v. Printy*, 351 N.W.2d 319, 347 (Minn. 1984) (adopting lower court’s opinion that issuance of bond insurance funded from money already appropriated was not public debt under Minnesota Constitution because “the evil of pledging the future credit of the state [wa]s simply not present”).

⁹ Following the advice of *Naftalin II*, in 1962 the Minnesota Constitution was amended to permit the State to incur debt for purposes of financing state buildings and capital improvements, and removed the maximum limit on state debt, as now reflected in Article XI, Section 5 of the Minnesota Constitution. *See* Minn. Const. art. XI, § 5; Laws 1961, Ex. Sess. c. 99, § 1.

In the case of Section 16A.99 and the Appropriation Refunding Bonds, however, there is no such irrevocable pledge. To the contrary, Subdivision 6 of Section 16A.99 explicitly states “the full faith, credit, and taxing powers of the state are not pledged to the payment of the appropriation bonds” Minn. Stat. § 16A.99, subd. 6. Subdivision 6 further states: “Appropriation bonds shall be payable in each fiscal year *only* from amounts that the legislature may appropriate for debt service for any fiscal year” and that “nothing in this section shall be construed to require the state to appropriate funds sufficient to make debt service payments with respect to the bonds in any fiscal year.” *Id.* (emphasis added). In addition, Subdivision 8 of Section 16A.99 specifically provides the appropriations for the amount needed to pay principal and interest on appropriation bonds are “subject to the repeal, unallotment under section 16A.152, or cancellation otherwise pursuant to subdivision 6.” Minn. Stat. § 16A.99, subd. 8. The Appropriation Refunding Bonds will include a conspicuous statement of these limitations on their face, as required by Subdivision 3(b) of Section 16A.99. *See* Minn. Stat. § 16A.99, subd. 3(b). (Order § 2.06.) The limitations are explicitly disclosed in the Preliminary Official Statement as well.

Because the State’s full faith and credit are not pledged under Section 16A.99 or the Appropriation Refunding Bonds to be issued thereunder, nor is the so-called obligation “irrevocable,” the bonds are not “public debt” within the meaning of Article XI, Section 4 of the Minnesota Constitution.

3. *Section 16A.99 Is Consistent With Minnesota Precedent Upholding the Constitutionality of Bond Issuances Specifically Stating the Bonds Were Not Debts of the State.*

As previously described, Subdivision 6 of Section 16A.99 provides, and the Appropriation Refunding Bonds and Preliminary Official Statement will explicitly state, the Appropriation Refunding Bonds are “not public debt of the state;” “shall not be obligations paid directly, in whole or in part, from a tax of statewide application” and “shall be payable in each fiscal year only from amounts that the legislature may appropriate for debt service for any fiscal year.” Minn. Stat. § 16A.99, subd. 6. Minnesota law supports the constitutionality of bond issuances where the bonds and authorizing statutes specifically state the bonds are not debts of the State and are payable only from certain revenues or annually appropriated funds.

In *Minnesota Housing Finance Agency v. Hatfield*, 210 N.W.2d 298, 303 (Minn. 1973), this Court upheld a statute authorizing the MHFA to issue tax-exempt revenue bonds to provide loans to construct low-income housing and “specifically stat[ed] that the bonds are not debts or liabilities of the state.” In addressing whether the bonds were “debts” of the State, this Court stated:

This issue can be easily disposed of since the debts created by MHFA, the Housing Development Bonds, are not “payable directly, in whole or in part, from a tax of state-wide application” but solely from the revenues paid by the owners of the projects MHFA finances. The statute sets out detailed requirements for the establishment of bond and loan funds which are to be used to repay the loans and specifically states that the bonds are not debts or liabilities of the state.

210 N.W.2d at 303.

Two years later, in *Minnesota Higher Ed. Facilities Auth. v. Hawk*, 232 N.W.2d 106 (Minn. 1975), this Court affirmed the constitutionality of the proposed issuance of

tax-exempt revenue bonds by the Minnesota Higher Education Facilities Authority (“MHEFA”) to refinance debts incurred by three private Minnesota colleges in the construction of certain facilities used solely for nonsectarian educational purposes. In that case, the authorizing statutes provided the bonds would state “they do not, represent or constitute a debt or pledge of the faith and credit of the state, grant to the owners or holders thereof any right to have the state levy any taxes or appropriate any funds for the payment of the principal thereof or interest thereon;” they were “payable solely from the rentals, revenues, and other income, charges, and moneys as are pledged for their payment” and “no liability shall be incurred by the authority hereunder beyond the extent to which moneys shall have been provided” consistent with the authorizing statutes. *Id.* at 110 (quoting Minn. Stat. §§ 136A.30, 136A.35).

“Despite these apparently clear and unequivocal legislative statements,” the defendant in *Hawk* challenged the issuance on the grounds it involved the expenditure of “public funds” in violation of various provisions of the Minnesota Constitution, including Section 5 of Article XI. *Id.* at 110. The Court rejected these arguments, holding the refinancing scheme was “not an expenditure of ‘public money’” and therefore the “constitutional provisions do not apply in the instant case.” *Id.* at 112. *Cf. Minnesota Pollution Control Agency v. Hatfield*, 200 N.W.2d 572 (Minn. 1957) (holding proposed issuance of bonds did not violate Minnesota Constitution’s prohibition on expenditure of funds for internal improvements where bonds pledged full faith and credit of state but involved the preservation of the public health, not merely internal improvements).

Because the Appropriation Refunding Bonds to be issued under Section 16A.99 (1) are explicitly stated not to be a debt or pledge of the State’s full faith and credit, (2)

do not implicate the State's taxing powers, and (3) are payable only from certain funds (in this case, those funds the Legislature may appropriate for principal and interest payments in any fiscal year), according to Minnesota law, the bonds are not "public debt" within the meaning of Article XI, Section 4 of the Minnesota Constitution.

4. *The Majority of Jurisdictions Have Found Appropriation Bonds and Similar Instruments To Be Permissible Under Constitutional Debt Limitations.*

Although the Minnesota Supreme Court has not had occasion to determine the constitutionality of the Appropriation Refunding Bonds authorized under Section 16A.99, many other jurisdictions have considered the constitutionality of appropriation bonds and similar instruments in light of debt limitations imposed by state constitutions. The overwhelming majority of such jurisdictions have found such instruments to be permissible.

In a particularly apposite and thoughtful opinion, the Supreme Court of Oklahoma determined appropriation bonds similar to the bonds at issue here did not violate state constitutional limitations on the incurrence of public debt. *Application of Oklahoma Capitol Improvement Auth.*, 958 P.2d 759 (Okla. 1998), *cert denied*, 525 U.S. 874 (1998). In *Capitol Improvement*, the court considered the constitutionality of highway improvement bonds issued pursuant to Okla. Stat. tit. 68, § 168.6 (1997), which provided the bonds "shall not at any time be deemed to constitute a debt of the state[.]" and required the bonds contain a statement on their face that "neither the full faith and credit nor the taxing power of the state or any political subdivision is pledged for the payment of the principal and interest of the bonds." 958 P.2d at 775-76. Pursuant to Section 168.6, the Oklahoma Capitol Improvement Authority filed an application with

the court for approval of the issuance of bonds. The court addressed the question of whether the bonds created a prohibited debt within the meaning of Oklahoma Constitution Article 10, Section 23, which states:

The state shall never create or authorize the creation of any debt or obligation, or fund or pay any deficit, against the state, or any department, institution or agency thereof, regardless of its form or the source of money from which it is to be paid, except as may be provided in this section and in Sections 24 and 25 of Article X of the Constitution of the State of Oklahoma.

Okla. Cont. art. 10, §23 (West 2012).

The court determined the highway improvement bonds did not create a prohibited legal debt against the state in violation of the Oklahoma constitution:

Because the statute in question does not bind future Legislatures to make the anticipated appropriations, the highway improvement bonds do not create “debts” within the meaning of the Oklahoma Constitution. The full faith and credit of the state is not pledged, because there is only the prospect, not the promise, of future annual appropriations.

Oklahoma Capitol Improvement Auth., 958 P.2d at 761. Accordingly, the court determined the bonds were constitutional. *Id.* In support of its determination the bonds were constitutional, the court noted “Oklahoma’s statutory and case law . . . clearly recognize a distinction between ‘moral’ and ‘legal’ obligations” and further noted that “the overwhelming majority of decisions in sister states” found such appropriations bonds to be constitutional. *Id.* at 761-62.

The Oklahoma Supreme Court recognized “the correct analysis turns not on the type of instrument involved but, rather, on whether an enforceable obligation is created beyond the fiscal year.” *Id.* at 770; accord *Schulz v. State of New York*, 639 N.E.2d 1140, 1149 (N.Y. 1994) (rejecting argument that moral obligation fell within constitutional definition of “debt,” explaining: “[A] moral obligation does not create ‘debt,’ since it

creates no enforceable right on the part of the one to whom the obligation is owed. Moreover, the Act could not make plainer that the State recognizes no moral obligation on its part to continue appropriations.”).

The Oklahoma Supreme Court’s important holding in *Capitol Improvement* – that appropriation bonds did not violate state constitutional limitations on the incurrence of public debt because “one Legislature cannot bind another” – provides the majority view on the constitutionality of appropriation bonds. 958 P.2d at 762. Support for this proposition in other states is widespread. For example, in *In re Anzai*, 936 P.2d 637 (Haw. 1997), the Hawaii Supreme Court held financing agreements, which included a clause stating that payments were subject to appropriations by the legislature and made clear that no lien or claim was created against the state so that there was no pledge of the full faith and credit of the state, were not bonds that triggered the debt ceiling of the Hawaii Constitution. Similarly, the Kentucky Supreme Court held in *Wilson v. Kentucky Transportation Cabinet*, 884 S.W.2d 641 (Ky. 1994), there was no violation of Kentucky’s constitutional prohibitions on contracting state debt without voter approval where the possibility of future appropriations by the legislature to repay bondholders did not create a legal debt obligation because appropriations could be discontinued, reduced, or changed at the legislature’s pleasure.

Similarly, in *Dieck v. Unified School District of Antigo*, 477 N.W.2d 613 (Wis. 1991), the Wisconsin Supreme Court explained:

the word “indebtedness” as referring to a voluntary and absolute undertaking to pay a sum certain. No indebtedness exists if the municipal body may avoid its obligation or if conditions precedent exist. Indebtedness under this constitutional provision [prohibiting incurrence of certain kinds of debt] thus means, according to our cases, that the municipal body has

assumed “legally enforceable obligations.” The undertaking must be enforceable by the creditor against the municipal body or its assets. The test established in our cases for indebtedness in [the Wisconsin Constitution] is not whether the municipal body unit will probably pay or whether the municipal body would be foolish not to pay. The test is whether the municipal body is under an obligation to pay and the creditor has a right to enforce payment against the municipal body or its assets. No indebtedness is incurred “where payments are to be made solely at the government’s option.”

Id. at 618 (citations omitted).

The Supreme Court of Virginia in *Dykes v. Northern Virginia Transportation District Commission*, 411 S.E.2d 1, 10 (Va. 1991) (citations omitted), also upheld the constitutionality of appropriation financing, noting, “We have specifically rejected the proposition that ‘subject to appropriation’ financing in which the legislative body is not legally obligated to make the appropriation creates state debt for constitutional purposes . . .” and reaffirming that holding. In *Department of Ecology v. State Finance Committee*, 804 P.2d 1241 (Wash. 1991), the Washington Supreme Court reached a similar conclusion, determining the debt limitation provision of its state constitution was not violated where certificates did not constitute a “debt within the meaning of the constitution” because:

An “obligation” is “something . . . that binds or constrains to a course of action . . . a formal and binding agreement or acknowledgment of a liability to pay a specified sum or do a specified thing.” There is nothing in the lease agreement or the financing scheme that binds the State to any future course of action. Therefore, there is no “obligation”, and no “debt”.

Id. at 1245 (internal citations omitted) (alterations in original).

Accord State v. School Board of Sarasota County, 561 So. 2d 549 (Fla. 1990) (no referendum constitutionally required where bondholders had no right to compel payment by judicial action and governmental entities were not compelled to repay the bonds);

State ex rel. Kane v. Goldschmidt, 783 P.2d 988 (Or. 1989) (no violation of constitutional debt limitation where state's promise to repay was conditioned on willingness of future legislative assemblies to appropriate funds); *Opinion of the Justices*, 335 So. 2d 376 (Ala. 1976) (statute providing certain expenses were to be paid annually out of the general operating funds satisfied requirement that obligation be payable out of current revenues and was no debt for purposes of statutory indebtedness limitations); *Caddell v. Lexington County School Dist. No. 1*, 373 S.E.2d 598 (S.C. 1988) (lease purchase agreements were not general obligation debt subject to state constitutional prohibitions on the incurrence of debt without referendum where the agreements were not secured by the full faith and credit of issuing school district); *Municipal Building Authority of Iron County v. Lowder*, 711 P.2d 273 (Utah 1985) (debt of municipal housing authority for which county was not responsible was not subject to debt restrictions of the state constitution requiring approval of taxpayers); *Texas Public Building Authority v. Mattox*, 686 S.W.2d 924 (Tex. 1985) (proposed bond issuance by building authority did not contravene constitutional prohibition against creation of debts by or on behalf of the state where the bonds specifically stated that they created no debt of the state); *Glennon Heights, Inc. v. Central Bank & Trust*, 658 P.2d 872 (Colo. 1983) (lease/purchase agreement between bank and state did not violate constitutional prohibition against state contracting debt, where bank had no legally enforceable right to require the legislature to appropriate sufficient funds for renewal of the lease term every year or to require the state to exercise its option to purchase); *Enourato v. New Jersey Building Authority*, 448 A.2d 449 (N.J. 1982) (because New Jersey Building Authority Act did not authorize creation of any debts by state, debt limitations clause of the state constitution did not apply to state's obligations

under lease agreements with building authority); *St. Charles City-County Library Dist. v. St. Charles Library Building Corp.*, 627 S.W.2d 64 (Mo. Ct. App. 1981) (lease-purchase agreement did not incur indebtedness in violation of constitution where said lease contained successive options to renew for one year and could be terminated by failure of district to renew at end of any year); *Ruge v. State*, 267 N.W.2d 748 (Neb. 1978) (lease with annual rental periods did not violate constitutional provision limiting state indebtedness where state liability was conditioned upon legislative appropriation before each rental period began); *Edgerly v. Honeywell Information Systems, Inc.*, 377 A.2d 104 (Me. 1977) (constitutional prohibition on obligating succeeding legislature to make appropriations not violated by contract for purchase of computer equipment where contract provided state could return equipment to seller and be no longer liable for payments if future legislatures failed to make the necessary appropriations); *McFarland v. Barron*, 164 N.W.2d 607 (S.D. 1969) (statute vesting building authority with power to lease buildings to state agencies under leases providing that rent be payable solely from appropriations to be made by legislature and that, in event of nonpayment of rents by state, property shall be leased to others did not violate debt limitation provisions of state constitution); *Berger v. Howlett*, 182 N.E.2d 673 (Ill. 1962) (statute authorizing building authority to issue bonds and lease property to state did not violate constitutional debt referendum requirement because sale of bonds did not create enforceable debt against state); *Duff v. Jordan*, 311 P.2d 829 (Ariz. 1957) (contract between highway department and a contractor did not create a deficit obligation in violation of the state constitution where contract provided no work was to be done or obligation incurred in excess of funds appropriated for current fiscal year); *State ex rel. Ross v. Donahey*, 113 N.E. 263 (Ohio

1916) (state's rental of quarters for the transaction of state business, for which appropriation was made by the state legislature, is not a 'debt' or liability within the inhibition of the provisions of the state constitution).

Each of these courts have found appropriation bonds and a variety of similar financing approaches not to be "debt" for purposes of their respective constitutions. As noted by the Supreme Court of Oklahoma, the analysis of such issues "turns not on the type of instrument involved but, rather, *on whether an enforceable obligation is created beyond the fiscal year.*" *Oklahoma Capitol Improvement Auth.*, 958 P.2d at 770 (emphasis added).

Under that analysis, appropriation bonds issued pursuant to Section 16A.99 do not violate constitutional restrictions on the incurrence of public debt. Similar to the bonds analyzed in *Capitol Improvement*, the Appropriation Refunding Bonds contain a statement on their face that they "are not public debt of the state[.]" and that the "full faith, credit, and taxing powers of the state are not pledged to the payment of the appropriation bonds." *See* Minn. Stat. § 16A.99, subd. 6; *Oklahoma Capitol Improvement Auth.*, 958 P.2d at 775-76. Moreover, Section 16A.99 expressly permits the Legislature to repeal appropriations for payment of principal and interest on the Appropriation Refunding Bonds. Minn. Stat. § 16A.99, subd. 8. The Minnesota Constitution limits only the incurrence of "public debts for which [the state's] full faith, credit and taxing powers [are] pledged." Minn. Const. art. XI, § 4. No such pledge is made here.

Accordingly, because there is only the prospect and not the promise of future legislative annual appropriations for payment to bondholders pursuant to Section 16A.99,

the issuance of the Appropriation Refunding Bonds do not impose any legal obligation on future Legislatures to appropriate funds for repayment. Rather, future Legislatures are free to independently examine the premise for the bonds and refuse to appropriate funds for the payment of the bonds, and upon such nonappropriation the bonds would be canceled and no longer outstanding. *See* Minn. Stat. § 16A.99, subd. 6. And, similar to Oklahoma, Minnesota recognizes the distinction between “moral obligations” and “legal obligations.” *See Arens v. Village of Rogers*, 61 N.W.2d 508, 520 (Minn. 1953) (“the legislature *may* satisfy an obligation which is not legally binding but which, nevertheless, has a basis in justice and equity.”) (emphasis added). Future Legislatures are not legally bound to provide future funding to pay the bonds, and such Legislatures retain the right and discretion at any time in the future to refuse to appropriate funds to pay the principal of and interest on the bonds. The State assumes no liability for the face value of appropriation bonds, nor is the State subject to suit for the face value of the bonds. Minn. Stat. § 16A.99, subd. 6. Because legal liability is limited to the amount of the annual appropriation, the issuance of the Appropriation Refunding Bonds does not violate Minnesota’s constitutional debt limitation.

5. Section 16A.99 Is Consistent With Minnesota’s History of Financing Mechanisms With Funding Contingent on Future Appropriations.

Although to date the State has not issued “appropriation bonds” of precisely the type authorized by Section 16A.99, multiple Minnesota statutes do authorize financings involving annually appropriated payments from the general fund.

For example, under Section 16A.85, the Commissioner is authorized to establish a master lease equipment financing program. Since 1985 the State has borrowed a total of

\$296,780,158 under the program, of which \$17,368,480 is outstanding. The average outstanding annual balance pursuant to the master lease equipment financing program has been approximately \$23,000,000. Section 16A.85, Subdivision 3 states, among other things:

A master lease does not constitute or create a general or moral obligation or indebtedness of the state in excess of the money from time to time appropriated or otherwise available for the payment of rent coming due under the lease, and the state has no continuing obligation to appropriate money for the payment of rent or other obligations under the lease. Rent due under a master lease during a current lease term for which money has been appropriated is a current expense of the state.

Minn. Stat. § 16A.85, subd. 3.

In addition, State certificates of participation (“COPs”), of which there are \$66,135,000 outstanding, are authorized under Section 16A.81. Minn. Stat. § 16A.81 (2011 Supp.) Specifically, Section 16A.81, subdivision 2, authorizes the State to enter into “a lease-purchase agreement in an amount sufficient to fund a technology system project and authorize the public or private sale and issuance of certificates of participation[.]” Section 16A.81, subdivision 8, notes that “[a] lease-purchase agreement does not constitute or create a general or moral obligation or indebtedness of the state in excess of the money from time to time appropriated or otherwise available for payments or obligations under such agreement.” Minn. Stat. § 16A.81, subd. 8. Minnesota Statutes, Section 16A.82, authorizes specific amounts for appropriation from the general fund to the commissioner to make payments under a lease-purchase agreement pursuant to Section 16A.81 for purposes of replacement of the state’s accounting and procurement systems, “provided that the state is not obligated to continue such appropriation of funds or to make lease payments in any future fiscal year.” Minn. Stat. § 16A.82 (2011 Supp.).

Similarly, Minnesota Statutes, Section 270C.145, authorizes specific amounts for appropriation from the general fund to the commissioner to make payments under a lease-purchase agreement pursuant to Section 16A.81 for completing the purchase and development of an integrated tax software package “provided that the state is not obligated to continue the appropriation of funds or to make lease payments in any future fiscal year.” Minn. Stat. § 270C.145 (2011 Supp.).

The Legislature has appropriated monies from the general fund for the payment of revenue bonds issued by U of M to finance a football stadium, and \$118,490,000 of these bonds are still outstanding. Minn. Stat. § 137.54(a). (Ex. 2, Preliminary Official Statement, at ASR 128.) The Legislature similarly has appropriated monies from the general fund for the payment of revenue bonds issued by the U of M to finance biomedical science research facilities, and \$163,190,000 of these bonds are still outstanding. Minn. Stat. § 137.64, subd. 3. (Ex. 2, Preliminary Official Statement, at ASR 128.)

Further, the Legislature appropriated monies from the general fund to MHFA for the payment of bonds issued by MHFA for affordable housing, \$31,980,000 of which bonds are still outstanding, and recently authorized an additional \$30,000,000 in appropriations. Minn. Stat. § 462A.36 subd. 4(b); Act of May 11, 2012, ch. 293, § 36, 2012 Minn. Laws (H.F. 1752) (authorizing additional appropriations for MHFA up to \$30,000,000 in aggregate or \$2,200,000 annually). (Ex. 2, Preliminary Official Statement, at ASR 128.)

Finally, recently enacted laws provide for appropriation bonds in connection with financing of a professional football stadium and “pay for performance” bonds. *See Act*

of May 10, 2012, ch. 299, 2012 Minn. Laws (H.F. 2958); Act of May 9, 2012, ch. 293, 2012 Minn. Laws (H.F. 1752). Each of these laws provides for a validation proceeding in the Minnesota Supreme Court before the authorized bonds may be issued. *See* Act of May 10, 2012, ch. 299, 2012 Minn. Laws (H.F. 2958) subd. 10, § 1 art. 2; Act of May 9, 2012, ch. 293, 2012 Minn. Laws (H.F. 1752) § 31.

In each of these examples, the legislative appropriation is only for a single fiscal year, and, notwithstanding that the stated maturity of the lease agreement, COPs or bonds may be many years in the future, the Legislature is under no obligation to appropriate for any succeeding fiscal year. The State's established history of financings payable on an annual appropriation basis further supports the conclusion that the Appropriation Refunding Bonds authorized by Section 16A.99 are indeed well within established Minnesota law and practice and constitutionally permissible.

C. Because the Appropriation Refunding Bonds Are Not “Public Debt,” They Are Not Subject to the Restrictions of Section 5 of Article XI of the Minnesota Constitution.

The Attorney General has indicated it is her position that “[a]ppropriation bonds present significant concerns under the Minnesota Constitution, especially where, as here, such bonds are used directly or indirectly to balance the State's biennial budget,” leading her to conclude “[t]he General Fund Appropriation Refunding Bonds are not constitutional in light of the balanced biennial budget requirement embodied in [Article XI, Sections 4 and 5 of] Minnesota's Constitution.” (Joint Submission at 16-17.)

The Attorney General's “concerns” regarding the use of appropriation bonds, even if well-founded, are not constitutionally sufficient to compel the invalidity of the bonds. Article XI, Sections 4 and 5 of the Minnesota Constitution speak to the permissible

incurrence of “public debt,” and for the reasons articulated above the Appropriation Refunding Bonds authorized under Section 16A.99 are not public debt. The Attorney General’s balanced budget argument goes beyond the limitations of the Minnesota law and represents a policy determination best left to the Legislature.

1. Section 5 of Article XI Only Governs “Public Debt.”

Section 5 of Article XI of the Minnesota Constitution (“Section 5”) states: “Public debt may be contracted” for certain enumerated purposes. Because the Appropriation Refunding Bonds are not “public debt” (as discussed in the previous section), the limitations of Section 5 are inapplicable to the General Fund Appropriation Bonds.

2. Section 5 of Article XI Does Not Prohibit Use of Funds Other Than Public Debt To Address Projected Budget Deficits.

The Attorney General relies on *Brayton v. Pawlenty*, 781 N.W.2d 357, 360 (Minn. 2010), for the proposition that “[t]he Minnesota Constitution allows the state to borrow money for limited purposes As a result, the state’s biennial operating budget must be balanced—that is, expenditures cannot exceed revenues for the biennium.” This argument overlooks the plain language of Section 5, which does not speak to expenses in excess of revenues but in terms of contracting “public debt.” Although commonly referred to as a “balanced budget” requirement, Section 5 itself recognizes “[p]ublic debt may be contracted” for limited purposes. *See* Minn. Const. art. XI, § 5. *Brayton* itself identifies one situation in which expenditures may permissibly exceed revenues for the biennium: under Minnesota Statutes, Section 16A.152, Subdivision 4(a), monies in the budget reserve account, rather than current revenues, may be used to address a budget deficit. As implicitly recognized in *Brayton*, although expenditures cannot exceed available monies, those monies may come from sources other than current revenues.

In this case, the State sold an asset, its future tobacco settlement payments, to the Authority, and the State used the proceeds to refund outstanding obligations, which reduced overall debt service expenditures for the 2012-2013 biennium, thereby addressing the projected deficit in the 2012-13 biennial budget. The Authority financed its purchase of the asset by selling revenue bonds, the Tobacco Settlement Revenue Bonds, payable from the tobacco revenue payments it purchased. No argument has been or could be made, to Petitioner's knowledge, that this was an unconstitutional or otherwise impermissible method of addressing the projected deficit in the State's budget.¹⁰

The proposed issuance of Appropriation Refunding Bonds at issue here would refund the Tobacco Settlement Revenue Bonds, thereby saving the State tens of millions of dollars in interest payments. Although these millions in savings will be free for the State to put to uses other than interest payments, the Appropriation Refunding Bonds do not directly address any current projected budget deficit.

3. *The Purpose and Magnitude of the Appropriation Refunding Bond Issuance Are Within the Discretion of the Legislature and Do Not Undermine the Constitutionality of Section 16A.99 Appropriation Bonds.*

The Attorney General's "concerns" regarding the Appropriation Refunding Bonds are in essence a policy argument best left to the Legislature.

¹⁰ It appears to be undisputed that the Tobacco Settlement Revenue Bonds, as revenue bonds, are not "public debt" and therefore are not subject to the limitations of Section 5. Moreover, even if the Tobacco Settlement Revenue Bonds had been general obligation bonds, they would have been constitutionally permissible "to refund outstanding bonds of the state or any of its agencies." Minn. Const. art. XI, § 5.

Notably, none of the decisions cited above for the proposition that appropriation-type financing does not offend state constitutional restrictions against public debt turned on the scope or the purpose or magnitude of the financing. In fact, *Oklahoma Capitol Improvement Auth.* involved a sizable bond issue in the range of \$300,000,000. See 958 P. 2d at 759; see also, e.g., *Oklahoma Capitol Improvement Auth.*, 958 P.2d 759 (Okla. 1998); *In re Anzai*, 936 P.2d 637 (Haw. 1997); *Wilson v. Kentucky Transportation Cabinet*, 884 S.W.2d 641 (Ky. 1994); *Schulz v. State of New York*, 84 N.Y.2d 231, 616 N.Y.S.2d 343, 639 N.E.2d 1140 (N.Y. 1994). Rather, the majority of jurisdictions properly have recognized the issue to be simply whether an enforceable obligation created a debt within the meaning of the respective state constitutions. See *Naftalin II*, 102 N.W.2d at 303 (instruments that create “irrevocable obligations of the state and, until paid, pledge the credit of the state toward their repayment . . . create[] a debt within the meaning of [the Minnesota Constitution]”); see also, e.g., *Schulz v. State*, 639 N.E.2d 1140, 1149 (N.Y. 1994) (“In short, a moral obligation does not create ‘debt,’ since it creates no enforceable right on the part of the one to whom the obligation is owed.”).

The narrow legal issue presented by this case is not whether appropriation bonds create a commitment that, if not honored, would result in a change of bond rating, or some anticipated consequence, but whether the bonds create *any enforceable right beyond the current fiscal year* as against the State and in favor of the bondholders so as to implicate the “public debt” provision of Article XI, Section 4 of the Minnesota Constitution. See *Dieck v. Unified School District of Antigo*, 165 Wis. 2d 458, 477 N.W.2d 613, 618 (Wis. 1991) (“The test established in our cases for indebtedness . . . is

not whether the municipal body unit will probably pay or whether the municipal body would be foolish not to pay. The test is whether the municipal body is under an obligation to pay and the creditor has a right to enforce payment against the municipal body or its assets. No indebtedness is incurred ‘where payments are to be made solely at the government’s option.’”) (citations omitted). Here, as specified by Subdivision 6 of Section 16A.99, the Legislature may refuse to appropriate funds for the repayment of the Appropriation Refunding Bonds, and no enforceable right is created as against the State and in favor of the holders of the Appropriation Refunding Bonds should the Legislature exercise its right to nonappropriation. Minn. Stat. § 16A.99, subd. 6. As such, no public indebtedness is created within the meaning of the Minnesota Constitution.

As the *In re Anzai* court noted, though the minority view occasionally has determined appropriation bonds to be debt, nonappropriation clauses notwithstanding, the better view is that there is not a violation of state constitutional provisions limiting debt where the decision to appropriate or not to appropriate funds is entirely within the discretion of the legislature:

Despite the presence of nonappropriation clauses, some courts have invalidated lease financing. Those courts reasoned that future legislatures will feel compelled to appropriate funds. In *Montano v. Gabaldon*, 108 N.M. 94, 766 P.2d 1328 (1989), for example, the lease purchase agreement was a county’s contract with a private contractor for the construction of a new jail on county land. The agreement contained a provision providing, in case of default, that the contractor would acquire permanent title to the land and the jail facility. Despite a nonappropriation provision allowing for termination of the contract at the end of any fiscal year that the County Commission failed to appropriate sufficient funds, the *Montano* court concluded that the agreement constituted unconstitutional debt We have carefully considered the reasoning of this minority view, and have concluded that it does not apply to [the financing agreements at issue] Hawai’i law provides that each lease must state clearly that the decision to appropriate funds is entirely within the discretion of the legislature. Given

the fact that the Hawai'i legislature requires a nonappropriation clause, future legislatures are not required and should not feel compelled to fund the financing agreements.

In re Anzai, 936 P.2d 637, 641 (Haw. 1997).

Likewise, Section 16A.99 expressly provides for nonappropriation, and both the Preliminary Official Statement and the Appropriation Refunding Bonds themselves will disclose this fact to potential bondholders. The decision to appropriate or not to appropriate is entirely at the sole discretion of the Legislature, and in the event of a decision not to appropriate there would be no judicially enforceable contractual or other obligation to pay bondholders. The holders of the Appropriation Refunding Bonds thus will have no right or ability to compel a future legislature to appropriate funds to pay principal or interest on the Appropriation Refunding Bonds, or any recourse against the State in the event the Legislature were to refuse to appropriate such funds.

Finally, the market's treatment of appropriation bonds conclusively rebuts any suggestion that economic and political realities constructively would compel future Legislatures to appropriate funds to pay principal and interest on the Appropriation Refunding Bonds. The Appropriation Refunding Bonds will go to the market with a rating lower than the rating for contemporaneously-issued State general obligation bonds of like maturities, and the interest rates will be higher. (Ver. Compl. ¶ 23; JSOF ¶ 11.) The lower credit rating and higher interest rates for the Appropriation Refunding Bonds reflect the increased risk associated with the purchase of appropriation bonds relative to general obligation bonds for which the full faith and credit of a state is irrevocably pledged. (Ver. Compl. ¶ 23; *see also* JSOF ¶ 11.) The Appropriation Refunding Bonds would have a credit rating and interest rates identical to general obligation bonds if in fact

the market believed the Legislature was bound in the future to appropriate funds to pay principal and interest on the Appropriation Refunding Bonds, when and as due.

D. Conclusion Regarding the Constitutionality of Section 16A.99.

Article XI, Section 4 of the Minnesota Constitution only restricts the incurrence of public debt backed by the full faith, credit, and taxing powers of the State. Because the State has not pledged its full faith, credit, and taxing powers as defined by Article XI, Section 4 to the repayment of the Appropriation Refunding Bonds, and because Section 16A.99 does not create an enforceable obligation on the State beyond the fiscal biennium for which moneys have been appropriated, such bonds do not create public debt within the meaning of the Minnesota Constitution.

Section 16A.99 is presumed constitutional. The Court must uphold the constitutionality of the statute, and the issuance of the Appropriation Refunding Bonds, unless the statute is proven unconstitutional beyond a reasonable doubt, approaching the analysis with extreme caution. *See Irongate*, 736 N.W.2d at 332. By this standard, Section 16A.99 and the Appropriation Refunding Bonds issued pursuant thereto do not violate Minnesota Constitutional prohibitions on the incurrence of public debt. Minnesota has not pledged its full faith and credit to the repayment of the Appropriation Refunding Bonds and is not contractually obligated to repay the bonds, and any future legislatures may refuse to appropriate funds to pay the principal and interest on the bonds. As such, the Appropriation Refunding Bonds do not constitute “public debt” within the meaning of Article XI, Section 4 of the Minnesota Constitution.

II. PETITIONER HAS TAKEN ACTIONS PROVIDING FOR THE VALID ISSUANCE OF THE APPROPRIATION REFUNDING BONDS IN ACCORDANCE WITH LAW.

Petitioner proposes to issue the Appropriation Refunding Bonds by authority of Subdivision 4 of Section 16A.99 and in the manner provided in Subdivision 3 of Section 16A.99 and Minnesota Statutes Section 16A.672. *See* Minn. Stat. § 16A.99, subs. 3, 4; Minn. Stat. § 16A.672 (2011 Supp.). All necessary requirements as a matter of fact and a matter of law have been met for the Appropriation Refunding Bonds to be validly issued, as set forth in Petitioner's Order, the Preliminary Official Statement and the Verified Complaint.

Among other things, the proceeds of the Appropriation Refunding Bonds will be expended for the purpose of refunding in advance of maturity the Tobacco Settlement Revenue Bonds pursuant to Subdivision 4 of Section 16A.99. (Order § 1.01.) In addition, the Appropriation Refunding Bonds will comply with the requirement under Subdivision 3(b) of Section 16A.99 that every Appropriation Refunding Bond shall include a conspicuous statement of the limitation established in Subdivision 6 of Section 16A.99. Specifically, each bond shall state:

THE BONDS ARE NOT PUBLIC DEBT OF THE STATE, AND THE FULL FAITH, CREDIT, AND TAXING POWERS OF THE STATE ARE NOT PLEDGED TO THE PAYMENT OF THE BONDS OR TO ANY PAYMENT THAT THE STATE AGREES TO MAKE UNDER MINNESOTA STATUTES, SECTION 16A.99, AND THE ORDER. THE BONDS SHALL NOT BE OBLIGATIONS PAID DIRECTLY, IN WHOLE OR IN PART, FROM A TAX OF STATEWIDE APPLICATION ON ANY CLASS OF PROPERTY, INCOME, TRANSACTION, OR PRIVILEGE. THE BONDS SHALL BE PAYABLE IN EACH FISCAL YEAR ONLY FROM AMOUNTS THAT THE LEGISLATURE MAY APPROPRIATE FOR DEBT SERVICE FOR ANY FISCAL YEAR, PROVIDED THAT NOTHING IN MINNESOTA STATUTES, SECTION 16A.99, AND THE ORDER SHALL BE CONSTRUED TO REQUIRE THE STATE TO

APPROPRIATE FUNDS SUFFICIENT TO MAKE DEBT SERVICE PAYMENTS WITH RESPECT TO THE BONDS IN ANY FISCAL YEAR. THE BONDS SHALL BE CANCELED AND SHALL NO LONGER BE OUTSTANDING ON THE EARLIER OF (A) THE FIRST DAY OF A FISCAL YEAR FOR WHICH THE LEGISLATURE SHALL NOT HAVE APPROPRIATED AMOUNTS SUFFICIENT FOR DEBT SERVICE, OR (B) THE DATE OF FINAL PAYMENT OF THE PRINCIPAL OF AND INTEREST ON THE BONDS.

(Order § 2.06.)

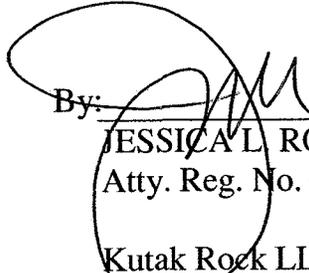
As stated in the Statement of Legal Issues, *supra*, “[t]he Attorney General does not dispute that Petitioner has complied with the provisions of applicable Minnesota statutes in proposing the issuance of the Appropriation Refunding Bonds, if the Court determines that Petitioner has the authority under the Minnesota Constitution to issue the bonds.” (Joint Submission at 17.) Accordingly, this Court should enter judgment validating the Appropriation Refunding Bonds pursuant to Subdivision 9 of Section 16A.99.

CONCLUSION

For the reasons set forth above, Petitioner respectfully submits this Court should enter an Order of judgment validating the Appropriation Refunding Bonds and all actions of Petitioner in connection with the issuance of the Appropriation Refunding Bonds and making such other adjudications as may be proper or necessary in connection with the matters before it.

Dated this 25th day of June, 2012.

JAMES D. SCHOWALTER, IN HIS
CAPACITY AS COMMISSIONER OF THE
MINNESOTA DEPARTMENT OF
MANAGEMENT AND BUDGET,
PETITIONER

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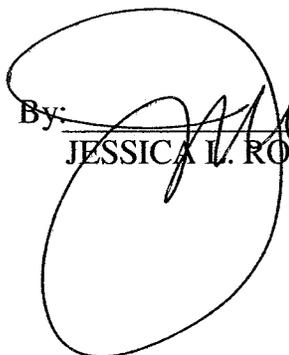
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CERTIFICATION

Pursuant to Minn. R. Civ. App. P. 132.01, subd. 3, the undersigned attorney certifies that this brief complies with the word count limitation of Rule 132.01, subd. 3(a). This brief was prepared using the word processing software Microsoft Word 2010 and contains 11,488 words.

By:  _____
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