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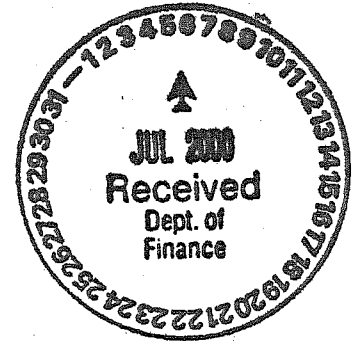
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July 5, 2000

Mr. Peter Sausen
Minnesota Department of Finance
400 Centennial Office Building
658 Cedar Street
St. Paul, MN 55155



Re: Permitted Uses of State General Obligation Bonds;
Department of Administration Technology Projects

Dear Mr. Sausen:

The Department of Finance has received an inquiry from the Department of Administration regarding the possible use of state general obligation bonds to fund a series of technology projects (working description, **Attachment 1**). You have asked us to consider the legality thereof.

State general obligation bonds constitute "public debt" within the meaning of Article XI, Section 4 of the Constitution, and therefore are subject to the limitations of Article XI, Section 5 and Section 7. We have previously provided guidance concerning the interpretation of these constitutional provisions in a letter to you dated April 24, 1989, a memorandum entitled "Expenditures Eligible for State General Obligation Bond Financing," and a letter to you dated March 15, 1990 and accompanying memorandum entitled "What Expenditures Qualify as Capital Expenditures Financeable From State Bond Proceeds." The principles discussed therein are relevant to technology acquisition and we have briefly summarized them, as well as additional considerations applicable to general obligation bond financing for technology, in **Attachment 2** hereto, a memorandum entitled "Summary of Constitutional Principles Applicable to State General Obligation Bond Financing for Technology."

DORSEY & WHITNEY LLP

Mr. Peter Sausen

July 5, 2000

Page 2

In applying the constitutional requirements to the proposed technology programs, we note that bond counsel is held to a high opinion standard. In order to render an approving opinion, we must be able to conclude that it would be unreasonable for a court to hold to the contrary. While the opinion standard is stringent, it serves to assure the investing public that the general obligation bonds of the State of Minnesota are of the highest quality and that there is no reasonable likelihood that such bonds suffer any legal infirmity.

Proposed Technology Projects Department of Administration

At the outset, we assume that the Department of Administration technology projects meet the "public purpose" test because the projects achieve legitimate public benefits and because title to technology improvements is to remain with the State. We further believe that many of the infrastructure enhancements generally described in these technology proposals may be financed with the proceeds of general obligation bonds if such infrastructure changes constitute capital betterments of public buildings within the meaning of the constitutional language. While individual projects and bonding bill language would need to be analyzed for compliance with constitutional principles, the following guidance, which is keyed to the various elements of the proposal, should be kept in mind:

A. Network Infrastructure

1. State offices are located either in state-owned buildings or in leased facilities; facilities leases tend to be short term (i.e., less than five years, but some are as long as ten years).

The type of State office is relevant to meeting the "public building" test; State-owned buildings obviously comply, but short-term leases are problematic. In the absence of a clarification of the law, we would be unable to render an approving opinion on bonds used to finance betterments of leaseholds of less than ten years; the ten-year standard (which has been used by the State in the past) helps to ensure, in conjunction with other factors, that the "public" interest is substantial. We have previously concluded that "to acquire" means acquisition by purchase; thus, the ten-year test does not authorize general obligation bonding for build-outs made upon initial leasing of space.

2. Such offices have need for infrastructure changes to accommodate technology; such changes will vary from site to site, but may include:

DORSEY & WHITNEY LLP

Mr. Peter Sausen

July 5, 2000

Page 3

- a) installation of coaxial cable ("cable") and/or fiber-optic wire ("fiber") for internal transmission; cable or fiber may be run through walls, under floors, above drop ceilings and the permanence of installation will vary; may include installation in ground and connector devices (jacks, hubs, terminals) - cable and fiber installation typically is building-wide and remains beyond ten years, most often for the life of the building;

Installation of coaxial cable and/or fiber-optic wire may constitute a betterment and not mere maintenance if accomplished as part of a program of substantial technological upgrade to a building. A betterment must renovate, improve or expand, i.e., change the character or function, not merely repair or replace; typically cannot be removed without difficulty or damage to the building; must result in an increase in value and/or useful life; and must not be recurring or predictable. In-ground installation and connector devices may be included in appropriate cases as long as they are located on the public building site.

- b) changes to utility systems, i.e., electrical, cooling, ventilation, etc., necessary to support technology; may include fire suppression, wall and structural alterations and is often permanent;

Changes to utility systems necessary to support technology comprising betterments as defined in 2(a) may be financed in appropriate circumstances; mere maintenance is neither a betterment nor capital and would not be eligible for debt financing.

- c) creation of technology centers within office space to facilitate technological support; technology centers include computer or server rooms and related wiring closets within buildings; alteration to building with increased electrical service and/or conduit to separate cable or fiber from other utilities;

Technology centers, including computer or service rooms and related wiring closets may constitute part of a betterment program in appropriate circumstances; increased electrical service and/or conduits to cable or fiber from other utilities may also be financeable, as described in 2(a) and (b) above.

- d) creation of "clean" rooms to prevent contamination of systems when certain functions are performed; some "clean" rooms today, but more

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Mr. Peter Sausen

July 5, 2000

Page 4

often secure server rooms with specialized design, floor plan, utilities, and added security modifications;

"Clean" rooms and/or secure service rooms, installed as part of a betterment program for a particular building, may be paid for with general obligation bond proceeds.

- e) acquisition of routers, switches, transmitters, repeaters or similar devices as part of technology infrastructure; these items have a relatively short useful life (i.e., less than five years), and are either replaced or upgraded; such devices may be installed on racks or bolted down but are able to be removed physically with little damage to the building (although removal in some cases would result in disruption of technology service and require significant rewiring, etc.) trays, racks, closet structures are long-lived (beyond ten years) and many devices within the server room and wiring closets last beyond five years;

Routers, switches, transmitters, trays, racks, closet structures and other similar devices may not be financed with general obligation bonds on an individual or repair/replacement basis; however, if these items are part of technology infrastructure (not, for example, items such as personal computers that do not comprise an integral part of the building's technology system), they may be acquired as a component part of a general program that comprises a capital betterment.

- f) technology infrastructure installed in leased office space will remain the property of the State.

As described above, the retention of legal title by the State is necessary to meet the "public" building test.

3. Data are transmitted to and from State offices either through cable and fiber or by wireless transmission.
 - a) cable/fiber systems require running of cable/fiber between office locations as well as supporting equipment; would be installed on land owned, leased or acquired through easements by the State or government units; includes cable and fiber to/from state office buildings and nearest service point of presence at street or pole;

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Mr. Peter Sausen

July 5, 2000

Page 5

Cable/fiber systems that are a component part of the betterment of a particular building and its site may be financed with general obligation bonds, as described in 2(a) above. Cable/fiber that is located on public land that is not the site of a bettered building is not part of a building's betterment program. Such cable or fiber can be removed from its location relatively easily, might not even be incorporated into the land, and does not improve the value of the land; thus, mere stringing or burying of cable or fiber on public land does not constitute a betterment of such land and may not be financed with general obligation bonds.

- b) wireless systems require reception-transmission facilities at the office location, which equipment is attached to the building and in some cases may not be removable without damage to building; such systems for public safety utilize microwave networks and the physical characteristics of microwave equipment are generally similar to other wireless systems; wireless systems require the installation of tower facilities constituting substantial structures not easily or cheaply removed from their locations on property owned, leased or acquired through easement by the State or government units. This includes transmission within the wireless system.

Wireless system infrastructure located at state buildings may be financed if part of a betterment program; transmission facilities located at separate locations would need to be reviewed on a case-by-case basis. It may be possible that such towers will, in particular cases, constitute "improvements" as described in the Constitution.

B. Major Statewide Applications

1. Development of customized software logic and processes to implement various statewide system applications; costs are people-intensive (i.e., systems analysts, programmers etc.).
2. Systems include but are not limited to: criminal and juvenile justice systems; electronic filing systems; integrated web service delivery systems; optical scanners; geographic positioning systems; electronic voting systems; automated fingerprint ID systems; kiosks; electronic security systems; water/air/feedlot quality monitoring systems; environmental data sharing systems.

Many of these systems have costs measured in tens of millions of dollars and expected lives of twenty or more years. Intellectual property (licenses and code) is purchased and

DORSEY & WHITNEY LLP

Mr. Peter Sausen
July 5, 2000
Page 6

created. The largest share of expense is in the building phase and may be spent over two or more biennia.

C. Data Management

1. Generally similar to production management technology described in B above, but with recognition that data are an "asset" of the State and investments in data management tools will result in enhanced value and prolonged life of the data asset. Examples of enhanced value are transformation of data from production systems into data for complex analysis or historical preservation.
2. Expenses related to management, transformation, manipulation and transfer movement of data from environment to environment; costs are people-intensive, but will include acquisition of certain equipment as described in A(2)(e) above. Expenses will also include development of metadata dictionaries and repositories and data warehouses.

The development and acquisition of the systems described in B. and C. above, while expensive and undeniably important, do not constitute the acquisition or betterment of land or buildings. The word "improvements" as commonly used in the legal sense means enhancements to real property, not equipment or software. Moreover, certain of the costs associated with the described programs may not be "capital" expenses. Even assuming that financing is sought only for capital items, a court might reasonably conclude that the word "improvements" should be interpreted in historical fashion. Thus, under current law the bond counsel opinion standard would prevent us from approving the use of general obligation bonds for these purposes. To the extent that these systems include either equipment or software embedded in mainframes acquired and installed during a betterment program, such applications could potentially be financed with bond proceeds.

Bonding Bill Language

We reiterate the constitutional requirement contained in Article XI, Section 7 that any bonding bill "distinctly specify" the purposes for the issuance of bonds and the amount of bonds authorized for each purpose. Because most of the technology proposals are just in the planning stage, it may be particularly difficult to meet the constitutional requirements without the statutory creation of a State program authorizing the related capital projects. If such a program were created, then the bonding bill could cross-reference that statute for purposes of meeting the requirements of Article XI, Section 7.

DORSEY & WHITNEY LLP

Mr. Peter Sausen

July 5, 2000

Page 7

Lease-Purchase Alternative

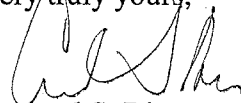
While the language of the Constitution does not authorize the issuance of general obligation bonds for all elements of the technology programs (the Constitution authorizes the issuance of long-term debt only for capital building projects because historically such projects were the only long-term assets acquired by the State), the use of lease-purchase financing may be available to State officials considering how to pay for technology programs. This relatively new method of acquiring short-term financing for equipment needs is already used by the Department of Finance to fund equipment acquisitions for which general obligation bond debt is inappropriate. Such contracts do not constitute "public debt" and are outside the limitations of Article XI, Section 5 and Section 7. Often lease-purchase financing may be undertaken on a tax-exempt basis similar to general obligation bonds.

Other States

We have been advised that there are at least five states (Connecticut, Massachusetts, Montana, Tennessee and Vermont) that have issued debt for technology purposes. Three of these states (Connecticut, Tennessee and Vermont) have no constitutional limitations on the issuance of debt. In each of these jurisdictions, then, the legislature is free to authorize the issuance of bonds for any legitimate public purpose. The remaining two states (Massachusetts and Montana) have very limited constitutional restrictions on the issuance of debt, none of which is applicable to technology. Thus, these states do not provide useful precedent.

We hope that this analysis is helpful in determining which technology projects are appropriate for general obligation bond financing. The problem is obviously complex and we look forward to working with you and others in determining how the State should proceed.

Very truly yours,



Leonard S. Rice

LSR/pmh

Enclosures

cc: Christie Eller, Esq.

Attachment 1

Proposed Technology Projects Department of Administration

A. Network Infrastructure

1. State offices are located either in state-owned buildings or in leased facilities; facilities leases tend to be short term (i.e., less than five years, but some are as long as ten years).
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 - b) changes to utility systems, i.e., electrical, cooling, ventilation, etc., necessary to support technology; may include fire suppression, wall and structural alterations and is often permanent;
 - c) creation of technology centers within office space to facilitate technological support; technology centers include computer or server rooms and related wiring closets within buildings; alteration to building with increased electrical service and/or conduit to separate cable or fiber from other utilities;
 - d) creation of "clean" rooms to prevent contamination of systems when certain functions are performed; some "clean" rooms today, but more often secure server rooms with specialized design, floor plan, utilities, and added security modifications;
 - e) acquisition of routers, switches, transmitters, repeaters or similar devices as part of technology infrastructure; these items have a relatively short useful life (i.e., less than five years), and are either replaced or upgraded; such devices may be installed on racks or bolted down but are able to be removed physically with little damage to the building (although removal in some cases would result in disruption of

technology service and require significant rewiring, etc.) trays, racks, closet structures are long-lived (beyond ten years) and many devices within the server room and wiring closets last beyond five years;

- f) technology infrastructure installed in leased office space will remain the property of the State.
3. Data are transmitted to and from State offices either through cable and fiber or by wireless transmission.
- a) cable/fiber systems require running of cable/fiber between office locations as well as supporting equipment; would be installed on land owned, leased or acquired through easements by the State or government units; includes cable and fiber to/from state office buildings and nearest service point of presence at street or pole;
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Attachment 2

SUMMARY OF CONSTITUTIONAL PRINCIPLES APPLICABLE TO STATE GENERAL OBLIGATION BOND FINANCING FOR TECHNOLOGY July 5, 2000

State general obligation bonds constitute "public debt" within the meaning of Article XI, Section 4 of the Constitution, and therefore are subject to the limitations of Article XI, Section 5 and Article XI, Section 7. We have previously provided guidance concerning the interpretation of these constitutional provision in a letter to Peter Sausen dated April 24, 1989 (Exhibit A), a memorandum entitled "Expenditures Eligible for State General Obligation Bond Financing" (Exhibit B), and a letter to Peter Sausen dated March 15, 1990 and accompanying memorandum entitled "What Expenditures Qualify as Capital Expenditures Financeable From State Bond Proceeds" (Exhibit C). The principles discussed therein are relevant to technology acquisition and a brief summary of them, as well as additional considerations applicable to general obligation bond financing for technology, follow.

All expenditures of State money, including the proceeds of State general obligation bonds, must be for a public purpose. Additionally, the Constitution provides that:

Public debt may be contracted and works of internal improvements carried on for the following purposes:

(a) to acquire and to better public land and buildings and other public improvements of a capital nature and to provide money to be appropriated or loaned to any agency or political subdivision of the state for such purposes if the law authorizing the debt is adopted by the vote of at least three-fifths of the members of each house of the legislature;

Minnesota Constitution, Article XI, §5. Article XI, Section 7 further states that ". . . each law authorizing the issuance of bonds shall distinctly specify the purposes thereof and the maximum amount of the proceeds authorized to be expended for each purpose." Therefore, all expenditures of bond proceeds must be (1) for a public purpose, (2) to acquire and to better (3) public land and buildings (4) and other public improvements (5) of a capital nature, and (6) distinctly specified by law in purpose and amount.

Public Purpose

A public purpose exists where an expenditure can reasonably be expected to achieve a legitimate public goal or benefit, even though some benefit may result to non-public interests. A determination of public purpose depends upon the nature of the expenditure and the extent to which the public goal or benefit is accomplished, and the extent to which it is the dominant benefit to be derived

from the expenditure. Private benefit may result, but it should not be the dominant or overriding benefit of the expenditure. The nature of the expenditure as public is affected by whether, by both historical and contemporary standards, the expenditure is to be made with respect to a subject matter which is proper for government action; or instead is made with respect to a subject reserved for the private sector. The legislature is given great deference in its determination of public purpose.

To Acquire and To Better

"To acquire" is generally understood to mean acquisition by purchase. "To better" typically means to substantially renovate, to improve or to expand, to change the character or function, not merely to repair or to replace; betterments cannot be removed without substantial difficulty or damage to the original; and property that has been bettered typically will have an increase in value and/or useful life. Betterments are not recurring or predictable.

Public Land and Buildings

Article XI, Section 5 uses the word "public" to characterize the land, buildings and other improvements which may be financed with State bonds. "Public" is not defined, but we have previously concluded that the word refers to ownership of a substantial interest in the subject property, as well as its use for a public purpose. State bonds cannot be issued to fund a project to be owned by a person or entity other than the State, either directly or through its agencies and instrumentalities or a political subdivision of the State, or where the State's interest in the affected building or land is insubstantial, i.e., less than ten years in length.

Projects of the Minnesota Historical Society have been determined to be public and have been financed with State bonds. However, projects of the following entities or for the following purposes are not so clearly publicly owned that State general obligation bonds could be issued to finance them under present law: (a) Indian tribes, (b) Minnesota public radio, (c) Minnesota public television, (d) grants to private property owners to build or improve on-site sewage disposal systems, and (e) grants to private corporations to build or improve sewage treatment works which will serve the public. These projects probably involve a public purpose but must be financed with appropriations or local government unit bonds as part of a local government program of some sort.

Improvements

The word "improvement" is used in law to describe a permanent addition to real property (and not equipment or other personal property) that increases the value of the real property, involves the expenditure of time and money, and makes the real property more useful or valuable, as distinguished from mere replacement or repairs.

Expenditures of a Capital Nature

Projects financed with State bond proceeds are limited to expenditures for land, buildings and other public improvements of a "capital nature." Operating costs cannot be financed with State bonds. The definition of "capital expenditure" under generally accepted accounting principles applicable to governmental entities is as follows:

Capital Expenditures. Expenditures resulting in the acquisition of or addition to the government's fixed assets which are long-lived tangible assets obtained or controlled as a result of past transaction, events or circumstances. Fixed assets include buildings, equipment, improvements other than buildings, and land.

We have previously summarized the criteria to be used in determining whether an expenditure is a "capital expenditure" as follows:

- (a) an expenditure for acquisition or improvement of property must be made with respect to a "fixed asset" such as land, buildings, improvements to land other than buildings or equipment;
- (b) a fixed asset being acquired must be "long-lived"; an interest in land of ten years duration has been determined to qualify, and it is suggested that only other fixed assets with an actual useful life of at least ten years should qualify;
- (c) an expenditure to improve a fixed asset already owned must (i) comprise a substantial improvement or expansion of the fixed asset, (ii) extend the useful life or substantially increase the value of the fixed asset, and (iii) not be predictable or recurring; and
- (d) an expenditure must be project specific.

For example, expenditures for studies to determine the need for a project, for educational, information or lobbying for a project which has not been sited, and expenditures for computer models and financial information with respect to a project not yet sited are not properly categorized as capital expenditures.

Expenditures for equipment acquired independently of an acquisition or betterment project which has a useful life of less than ten years are not eligible capital expenditure. Expenditures for repairs and replacement of existing structures and equipment typically do not qualify as capital expenditures.

Distinct Specification of Purpose and Amount

Article XI, Section 7 requires that any law authorizing State general obligation bonds "distinctly specify" the purposes for which such bonds are issued and the maximum amount of proceeds authorized to be expended for such purpose. Thus, in the law authorizing general obligation bonds, either the specific project to be financed must be identified or there must be a specific reference to a statute establishing a specific governmental program which authorizes public projects of a capital nature to be financed. In the past bonding bills have not met this requirement because: (a) the description of the purpose for which the bonds are to be issued was so brief or vague as to be unintelligible, or (b) the description authorized expenditures for projects not identified or even presently identifiable, and did not "distinctly specify" the purpose by reference to a State program set forth in the statutes.

- Exhibit A Letter to Peter Sausen, April 24, 1989
- Exhibit B Memorandum - "Expenditures Eligible for State General Obligation Bond Financing"
- Exhibit C Letter to Peter Sausen, March 15, 1990 and Memorandum - "What Expenditures Qualify as Capital Expenditures Financeable from State Bond Proceeds"