

STATE OF MINNESOTA

Office of the Attorney General

TO : PETER SAUSEN
Assistant Commissioner
Department of Finance

DATE : December 2, 1997

FROM : CHRISTIE B. ELLER CBE
Assistant Attorney General
Manager, Public Finance/Opinions Division

PHONE : 296-9421 (Voice)
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SUBJECT : **Use Of General Obligation Bonds For Biomass Energy Projects**

You have asked me to discuss whether general obligation bonds¹ could be issued by the State of Minnesota for biomass energy projects as described in Minn. Laws 1997, ch. 176. For the reasons discussed in this memorandum, it is unlikely general obligation bonds could be issued for biomass projects without court case, or “test case” establishing the authority of the State of Minnesota to issue such debt.² For the purpose of this discussion you have asked me to consider biomass energy projects to be farm-grown closed loop biomass as defined in Minn. Stat. § 216C.051, subd. 7(g).

The Minnesota Constitution provides that general obligation bonds may only be issued for those purposes set forth in Minn. Const. art. XI, § 5. Most eligible purposes are for publicly owned projects. However, general obligation bonds may be issued “to develop the state’s agricultural resources by extending credit on real estate security in the manner and on the terms and conditions prescribed by law[.]” Minn. Const. art. X, § 5(h). While there is not a public ownership requirement in clause h the provision leaves many unanswered questions. It is my understanding that a closed end farm biomass project is likely to be an energy production facility. When interpreting constitutional provisions one looks to the plain meaning of the language. Historical interpretation of the clause can also provide guidance. Unfortunately, in this case the language is ambiguous. What does “develop agricultural resources” mean? Is it limited to farmland and improvements to farm property? Does “develop” include to provide a market for,

¹ In view of the discussion as to the likely need for a best case before the state could issue general obligation bonds, issues as to whether such bonds would be taxable or tax-exempt have not been addressed.

² A similar opinion was expressed by Thomas S. Hay, bond counsel to the State of Minnesota with respect to ethanol financing in a letter to you dated May 4, 1992. A copy of that letter is attached.

or to process agricultural products? Other phrases are also ambiguous. Does the clause "extending credit on real estate security" mean the security must be related to the agricultural purposes or will any real estate security be sufficient? Must the security be a first lien and must it be for more than the amount of the loan? Historically the section has been used to provide loans to farmers to acquire land and finance improvements directly used to farm secured by first mortgages. It has not been used to issue public debt to finance manufacturing facilities even those which directly processed agricultural products.

In order to issue general obligation bonds, it is necessary to obtain an unqualified opinion from recognized bond counsel. The standard for issuance of such an opinion is that there is no reasonable doubt as to the legal authority of the State to issue bonds. Given ambiguity of the constitutional provision as to the meaning of "develop agricultural resources," it would be unlikely that an unqualified opinion from bond counsel would be available for the type of biomass projects that I understand are under consideration unless the ambiguity in the constitutional provision was resolved in the affirmative by a court case.

Enclosure

cc: Thomas S. Hay

CBE/dsc
AG:39287 v1

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May 4, 1992

Mr. Peter Sausen
Assistant Commissioner of Finance
Minnesota Department of Finance
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658 Cedar Street
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Re: Laws 1992, Chapter 602
Sections 8, 9 and 12 ("Chapter 602")

Dear Peter:

You have asked for our opinion as to whether the state general obligation bonds authorized by Chapter 602 assuming it was properly enacted, could legally be issued under the Minnesota Constitution without a Minnesota Supreme Court ruling as to their legality ("Test Case"); and, if so, what conditions would have to be met in their issuance. After reviewing relevant matters we have concluded that Chapter 602 authorizes the issuance of bonds which may lawfully be issued under the Minnesota Constitution, Article XI, Section 5, clause (h), without a Test Case, provided certain conditions discussed below are met on their issuance. Bonds might legally be issued under Chapter 602 and under other conditions, but may well require a Test Case before they could be issued.

Article XI, Section 5, clause (h) provides as follows:

"Sec. 5. Public debt and works of internal improvement: purposes. Public debt may be contracted and works of internal improvements carried on for the following purposes:

...

(h) to develop the state's agricultural resources by extending credit on real estate security in the manner and on the terms and conditions prescribed by law;"

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The meaning of these words and their application to various circumstances which might be proposed is uncertain. For example: (1) what does "develop" include?; (2) what are the state's "agricultural resources"?; (3) can credit be extended for purposes other than improvements to real estate?; (4) is a connection between the extension of credit and the real estate security required?; (5) does the real estate security requirement necessitate a determination that security value equals or exceeds the loan amount?; (6) does the real estate security requirement require a first mortgage?

Some of these questions are rendered moot by Chapter 602 which: (1) limits loans to the financing of "agricultural improvements", which it defines in effect, to mean improvements to farm real estate which are useful for and intended to be useful for farming; (2) requires that loans be secured by a mortgage on all or part of the farm on which the improvements are made; and (3) does not expressly allow second mortgages or authorize the refinancing of first mortgages or the use of moneys to retire first mortgages in order to realize upon the value of real estate subject to a second mortgage.

In approving state bonds bond counsel must determine that there is no reasonable doubt as to their legality in order to issue an approving opinion; as of the date of their issuance; there cannot exist any reasonable chance that a suit to enjoin the issuance of the bonds could be commenced and successfully maintained. Given the unresolved issues surrounding Article XI, Section 5, clause (h) of the Constitution, the words of the statute, and the bond counsel opinion standard set forth above, we as bond counsel are willing to issue an unqualified opinion on bonds issued pursuant to Chapter 602 only to: (1) finance improvements to real property which is used or to be used directly for agricultural purposes (i.e. farm property used to grow crops, fruit etc., or to raise livestock, or to produce milk or other food elements, not for manufacturing or processing plants using agricultural products as raw materials); (2) the loan must be secured by a mortgage on the agricultural property on which the improvements are made; (3) the loan amount must be less than the appraised value of the mortgaged agricultural property as determined by an independent appraisal or other suitable means; and (4) upon default by the borrower the mortgage must be enforceable under state law and upon enforcement give the state the ability to realize upon its real estate collateral without the payment of additional moneys to eliminate any third party's rights (i.e. it must be a first mortgage).

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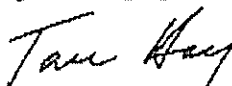
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It is possible that the state could lawfully authorize and issue bonds pursuant to Article XI, Section 5, clause (h), to make loans for other purposes which are secured differently, but without certain changes in the law and, in all probability, a Test Case which clearly establishes the authority of the state to issue the bonds, we could not render the necessary unqualified bond counsel opinion with respect to such bonds.

While these comments do not cover all circumstances which might be considered for financing under Chapter 602, I hope they give you some insight as to our opinion as to what may, and what may not, be financed under Chapter 602.

We should probably meet with Minnesota Rural Finance Authority officials to discuss this matter in the near future.

Very truly yours,


Thomas S. Hay

TSH/sd

cc:LaVonne Nicolai