DATE: September 1, 1993

SUBJECT: Application of the Constitutional Prohibition Regarding Indebtedness, Article XIII, Sec. 1 of the Nebraska Constitution, to Financing Agreements entered into by the State

REQUESTED BY: John Breslow, Auditor of Public Accounts

WRITTEN BY: Don Stenberg, Attorney General
              Fredrick F. Neid, Assistant Attorney General

You have asked the Attorney General certain questions concerning a Master Lease Program of the Department of Administrative Services. A copy of a memorandum of the Department of Administrative Services, distributed to all agencies, boards, and commissions, indicates that a Master Lease Program is being developed which may be utilized to facilitate procurement of personal property through lease-purchase agreements. You inquire whether the constitutional limitation regarding indebtedness of the State is applicable to lease-purchase financing arrangements entered into by the State.

It is our opinion that the debt limit provisions of Article XIII, Sec. 1 of the Nebraska Constitution are applicable to financial agreements and any master lease agreement entered into by the State.

CONSTITUTIONAL DEBT LIMITATION

The section of the Constitution of the State of Nebraska you have referenced is Article XIII, Sec. 1 which in pertinent part states:
The state may, to meet casual deficits, or failures in the revenue, contract debts never to exceed in the aggregate, one hundred thousand dollars, and no greater indebtedness shall be incurred except for the purpose of repelling invasion, suppressing insurrection, or defending the state in war, and provision shall be made for the payment of the interest annually, as it shall accrue, by a tax levied for the purpose, or from other sources of revenue, which law providing for the payment of interest by such tax shall be irrepealable until such debt is paid; . . . .

(Emphasis added).¹

Various legislative enactments and financing plans authorized by those acts have been determined to be violative of Article XIII, Sec. 1 by the Nebraska Supreme Court. The issue is whether the act and the financing arrangements authorized result or may result in the contraction of debt or the incurrence of an indebtedness within the meaning of the constitutional provision. One purpose of the constitutional limitation upon state indebtedness is to prevent the anticipation of revenue by the creation of obligations to be paid from revenue to be received in future fiscal periods. Obligations which are to be paid from revenue subject to appropriation by future legislatures are subject to the state debt limitation provisions.

In State ex rel. Douglas v. Thone, 204 Neb. 836, 286 N.W.2d 249 (1979), a legislative act which provided for the construction of plants and facilities for the manufacture of agricultural ethyl alcohol (gasohol) was found to be unconstitutional. The Nebraska Supreme Court concluded that the constitutional limitation of state indebtedness was violated because the financial arrangements which guaranteed payments of bonds through pledging of state funds was authorized by the act. Similarly, a legislative act to assist in the financing of waste water treatment works was determined to be unconstitutional since fees and charges to be received may be pledged as security for payment of bonds. State ex rel. Meyer v. Duxbury, 183 Neb. 302, 160 N.W.2d 88 (1968). Also see, State ex rel. Meyer v. Steen, 183 Neb. 297, 160 N.W.2d 164 (1968).

¹We point out that, while this Section of the Constitution prohibits indebtedness of the state exceeding one hundred thousand dollars, the issuance of bonds for construction of highways and water retention structures as well as the issuance of bonds by the University of Nebraska and state colleges for described purposes is expressly authorized.
FINANCING AGREEMENTS

Legislative Bill 544 was passed during the first session of the 1993 Legislature and approved by the Governor on May 8, 1993 with the emergency clause. Certain provisions of the Legislative Act, Neb. Rev. Stat. §§ 11-119, 77-2406, 77-2409, 81-106, 81-1101 to 1118, 81-1121, 81-1122, and 84-304 (1987 and Cum. Supp. 1992), which established the Department of Administrative Services, were amended by LB 544. Powers, duties, and responsibilities of the Director of Administrative Services for review and approval of financing agreements were added. Following amendment, Neb. Rev. Stat. § 81-1107 in material part provides:

The Director of Administrative Services is hereby vested with the duties, powers, and responsibilities involved in:

... (3) The review and approval of financing agreements for the purposes of protecting the credit of the state, insuring the most advantageous terms, providing for proper accounting of financial transactions, complying with the approved budget, and promoting sound financial management; ...

LB 544 also added a definition of the term, "financing agreement." Following amendment, Neb. Rev. Stat. § 81-1102 includes the definition:

... (13) Financing agreement shall mean any bond, lease-purchase agreement, obligation, installment sales contract, or similar financial arrangement, for a period greater than one year, which is entered into by the state or any agency, board, or commission thereof, not including the University of Nebraska, or state colleges, in accordance with the Constitution of Nebraska and statutes of this state; ... .

(Emphasis added).

Generally, a financing agreement is any financial arrangement with a term greater than one year entered into by the State. The described financial arrangements for the most part would include a fixed and certain obligation of the State to pay money in the future and the authorizing statute requires that the financial arrangements conform to constitutional provisions. Accordingly, financing agreements constitute debt instruments subject to the constitutional limitation regarding indebtedness of the state.
You have requested that this Office provide you with a definition for "debts" as it is used in the Constitution to facilitate your auditing practices. We believe that the term, "debts," for purposes of the constitutional prohibition means any financial obligations contracted by the State in amounts exceeding one hundred thousand dollars to be repaid in future periods for which a current appropriation of funds has not been made. Whether a particular financing agreement would be violative of the debt limitation provision is a highly factual question dependent on the express terms and conditions of the lease-purchase agreement. For this reason we may only provide you with guidelines concerning whether a particular lease-purchase financing arrangement would be suspect as violative of the constitutional debt limitation.

The Nebraska Supreme Court has reviewed the terms of a particular lease agreement entered into by the State to determine whether the agreement conflicted with debt limitation provisions of the Constitution. In Ruge v. State, 201 Neb. 391, 267 N.W.2d 748 (1978), the Court concluded that a lease agreement entered into between the State and a municipal corporation did not violate the debt limitation provision. The lease agreement included an "appropriation clause" which conditioned the lease upon an annual appropriation for payment of the annual rental amount. The liability of the State was limited to rental periods of twelve months or less for which an appropriation has been made by the appropriation clause. While the Court determined that the lease agreement did not violate the prohibition against indebtedness, a specific lease provision was found to be invalid and therefore unenforceable. The lease agreement included a "liquidated damages provision" which obligated the State to pay costs of reletting the facilities in the event of default. In concluding that the damages provision violated the debt prohibition, the Court observed that "[T]his kind of an open-ended promise violates the spirit and purpose of the constitutional limitation against indebtedness, is beyond the power of the state to assume, and is invalid and unenforceable." Id. at 398, 399; 267 N.W.2d at 752.

In light of the case authorities set out above, we believe that the following guidelines are appropriate for review of a lease-purchase agreement entered into by the state:

FIRST, the annual rental or lease amounts should be subject to an annual appropriation of funds for payment of the amounts; SECOND, the lease agreement should not include a damages provision that exposes the state to an open-ended liability; THIRD, the lease should not purport that the state "guarantees" payment of rental amounts for more than one annual period; FOURTH, if the lease-purchase agreement also involves the issuance of bonds, state funds
from general tax revenues may not be utilized to repay or secure repayment of the bond amounts.\textsuperscript{2} See State ex rel. Douglas, 204 Neb. at 836; State ex rel. Meyer, 183 Neb. at 302.

In summary, the constitutional debt limitation set forth in Article XIII, Sec. 1 is applicable to financing agreements as that term is defined in Section 81-1102. Further, whether a particular financing agreement or arrangement is constitutionally suspect is dependent on the terms and conditions of the agreement entered into by the State.

Sincerely yours,

DON STENBERG
Attorney General

Fredrick F. Neid
Assistant Attorney General

\textsuperscript{2}This Office previously has concluded that legislative acts and agreements that pledge state funds for payment of bond obligations are violative of the constitutional debt limitation provision. See Ops. Att'y Gen. No. 92053, March 31, 1992; No. 89036, April 17, 1989.