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HONORABLE LEONARD LANCE, as a citizen of New Jersey and a taxpayer; and HONORABLE ALEX DeCROCE, as a citizen of New Jersey and a taxpayer; Plaintiffs, v. HONORABLE RICHARD J. CODEY, Acting Governor of the State of New Jersey; and HONORABLE JOHN E. McCORMAC, Treasurer of the State of New Jersey; and TOBACCO SETTLEMENT FINANCING CORPORATION; Defendants.	SUPERIOR COURT OF NEW JERSEY LAW DIVISION-MERCER COUNTY DOCKET No.:MER-L-2087-05 CIVIL ACTION OPINION

DECIDED: August 11, 2005

Mark D. Sheridan, for the plaintiffs (Drinker Biddle & Reath, attorneys; Mr. Sheridan and James K. Webber, on the brief).

Peter C. Harvey, Attorney General of the State of New Jersey, for the defendants (Nancy Kaplen, Assistant Attorney General, of counsel and on the brief; Patrick DeAlmeida, Assistant Attorney General, and Susan K. Fischer, Deputy Attorney General, on the brief).

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BACKGROUND

On August 4, 2005, plaintiffs, Hon. Leonard Lance and Hon. Alex DeCroce (collectively "plaintiffs") filed a verified complaint for emergent declaratory and injunctive relief to restrain the proposed sale of the Tobacco Settlement Asset-backed Bonds, Series 2005 (the "Series 2005 Bonds"). Plaintiffs are members of the New Jersey Legislature and taxpayers in the State. The complaint names the Acting Governor of the State, Richard J. Codey, the State Treasurer, John McCormac, and the Tobacco Settlement Financing Corporation ("TSFC") as defendants. TSFC is a public corporation, acting as an "instrumentality" of the State, created by the Tobacco Settlement Financing Act, N.J.S.A. 52:18B-1 et seq. The Treasurer, John McCormac also serves as the Chairperson and President of TSFC, consistent with N.J.S.A. 52:18B-3(d).

Plaintiffs seek an order: (1) declaring that the proceeds of the sale of the Series 2005 Bonds is not "revenue" as the term is used in N.J. Const. art. VIII, § 2, ¶ 2; (2) declaring that the FY06 Appropriations Act, L.2005, c.132, effective July 1, 2005, is unconstitutional because it is "balanced" in part with monies that do not constitute revenue under the ruling in Lance v. McGreevey, 180 N.J. 590 (2004); (3) restraining defendants from undertaking any acts in furtherance of the issuance of bonds, including, but not limited to: (a) signing or approving resolutions or orders approving the sale of bonds; (b) preparing or approving professional contracts or accepting services from bond counsel, financial advisors, and other professionals; and (c) marketing or selling, or causing to be marketed or sold, any bonds; (4) restraining Acting Governor Codey and Treasurer McCormac from expending funds on behalf of the State from the proceeds of bonds; (5) awarding compensatory damages, costs and attorneys' fees to plaintiffs;

(6) awarding punitive damages to plaintiffs; and (7) for such other relief as the court may deem just and equitable.

Defendants oppose the relief sought and have agreed to delay the sale of bonds until this matter is resolved by the court on August 11, 2005.

1. THE TOBACCO SETTLEMENT FINANCING ACT

On June 20, 2003, the Legislature enacted the Tobacco Settlement Financing Act ("Act"), N.J.S.A. 52:18B-1 et seq. The Act establishes the TSFC "as an instrumentality of the State exercising public and essential governmental functions,....[but to] be treated and accounted for as a separate legal entity with its separate corporate purposes as set forth in [the] [A]ct." N.J.S.A. 52:18B-3(a). TSFC was created under the Act to acquire from the State its right, title and interest in the moneys ("Tobacco Receipts") due to the State pursuant to the Master Settlement Agreement (the "MSA"), dated November 23, 1998. The MSA includes the Attorneys General of forty-six states and various other jurisdictions, including New Jersey, and several tobacco products manufacturers. N.J.S.A. 52:18B-2.

The MSA resolved cigarette smoking related litigation and provided for a continuing release of future smoking-related claims, in exchange for certain payments to be made to the states over an indefinite period of time. The payments due under the MSA vary from year to year depending on numerous factors, including: (1) the number of cigarettes sold in the relevant state by the tobacco products manufacturers; (2) changes in the market share; and (3) other variables that can reduce the payments to the states, including the State of New Jersey.

The Act authorizes the sale by the State to TSFC of all or a portion of the State's right to receive the Tobacco Receipts. N.J.S.A. 52:18B-5(a). Pursuant to N.J.S.A. 52:18B-5(b), the sale of any Tobacco Receipts to the TSFC by the State must “be treated as a true sale and absolute transfer of the property ... and not as a pledge or other security interest for any borrowing.” Ibid.

The Act authorizes TSFC to issue securities in such amounts as deemed necessary to provide sufficient funds to purchase all or portion of the Tobacco Receipts from the State. N.J.S.A. 52:18B-7(a)(1). Such “securities shall be special revenue obligations payable from and secured by a pledge of ... tobacco revenues ....” N.J.S.A. 52:18B-7(a)(2). The Act further provides that the securities issued by TSFC are not to be a debt or liability of the State or any agency or instrumentality thereof other than TSFC and TSFC cannot incur any indebtedness on behalf of the State. N.J.S.A. 52:18B-8. A declaration to this effect must appear on all bonds issued by TSFC pursuant to the Act. Ibid. “No appropriation of any moneys by the State to the corporation is authorized [by the] [A]ct.” Ibid. Moreover, TSFC is authorized to “issue securities to refund any securities by the issuance of new securities, whenever it deems such refunding expedient ....” N.J.S.A. 52:18B-7(a)(3).

2. THE SALE OF SETTLEMENT PROCEEDS TO TSFC

On August 28, 2002, the State sold to TSFC, pursuant to a Purchase and Sale Agreement dated as of August 1, 2002, without recourse to the State, all of its right, title and interest of the State in and to the Tobacco Receipts on and after December 1, 2003. (Treasurer McCormac Aff. ¶ 9.) In order to pay for the acquisition, TSFC issued $1,801,455,000 of its Tobacco Settlement Asset-backed Bonds, Series 2002 (the “Series 2002 Bonds”). (Ibid.) TSFC paid to the State the net proceeds from the sale of the Series 2002 Bonds and issued to the State a Residual Certificate. (Ibid.) In accordance with the Residual Certificate, TSFC agreed to pay to the State income of the TSFC and bond proceeds not needed by TSFC to pay the Series 2002 Bonds and any other bonds issued by TSFC secured by the Tobacco Receipts. (Ibid.)

The Series 2002 Bonds were issued pursuant to an Indenture of Trust between TSFC and Wachovia Bank, National Association, as Trustee, dated August 1, 2002, as supplemented. (Ibid.) The proceeds in excess of the amount authorized to be transferred to the State in FY03, which were in the amount of $1,351,706,000, were held by Wachovia Bank, National Association as depository agent (the "Depository Agent") for TSFC to be paid over to the State pursuant to an agreement between TSFC and the Depository Agent dated as of August 1, 2002 (the "Depository Trust Agreement"). The Series 2002 Bonds are paid from and secured by a pledge of 50% of the Tobacco Receipts. (Ibid.)

On March 7, 2003, TSFC issued $1,659,170,000 of its Tobacco Settlement Asset-backed Bonds Series 2003 (the "Series 2003 Bonds"), pursuant to an Indenture of Trust between TSFC and Wachovia Bank, National Association as Trustee, dated March 1, 2003, as supplemented (the "2003 Indenture"). (Treasurer McCormac Aff. ¶ 10.) Net proceeds from the Series 2003 Bonds in the amount of $1,263,270,838.95 were held by the Depository Agent pursuant to the Depository Trust Agreement as they exceeded the amount authorized by the FY03 Appropriations Act and were paid over to the State in Fiscal Year 2004 ("FY04"). The Series 2003 Bonds are paid from and secured by a pledge of the remaining 50% of the Tobacco Receipts. (Ibid.)

3. SERIES 2003 BONDS

The Series 2003 Bonds have a final maturity of June 1, 2043. (Treasurer McCormac Aff. ¶ 10.) However, pursuant to a redemption provision known as the "Turbo Redemption," the Series 2003 Bonds can be redeemed prior to maturity from and to the extent that there are sufficient Tobacco Receipts available for their payment. (Ibid.) At the time of issuance of the

Series 2003 Bonds, the projected Turbo Redemption of the Series 2003 Bonds is June 2023. (Ibid.)

4. SERIES 2005 BONDS

TSFC was advised by its financial advisor that, because of changes in the marketplace, it could restructure the Series 2003 Bonds through the issuance of refunding bonds. (Treasurer McCormac Aff. ¶ 11.) TSFC adopted a resolution on July 25, 2005 (the "Authorizing Resolution"), authorizing the issuance pursuant to the Series 2005 Bonds in an aggregate principal amount not to exceed $2,400,000,000. (Ibid.) It is the Series 2005 Bonds which are the subject of the current challenge.

Treasurer McCormac asserts that the Series 2005 Bonds will be issued pursuant to the 2003 Indenture and the proceeds will be used to: (1) purchase securities (the "Defeasance Collateral") to fund an escrow for the advance refunding of all of the outstanding Series 2003 Bonds; (2) pay certain costs of issuance; (3) fund capitalized interest through December 1, 2005; (4) fund a Debt Service Reserve Account for payments associated with the Series 2005 Bonds; and (5) pay the balance of the bond proceeds to the State as owner of the Residual Certificate. (Ibid.)

The Series 2005 Bonds shall be payable from and secured by Tobacco Receipts previously purchased by TSFC pursuant to the Purchase Agreement. (Ibid.) As a result of the establishment of an escrow, the Series 2003 Bonds will no longer be payable from or secured by the Tobacco Receipts, but instead will be payable solely from the escrow. (Id. ¶ 12.)

The Authorizing Resolution provides for a final maturity of the Series 2005 Bonds of no later than June 1, 2043, which is the same as the final maturity of the Series 2003 Bonds. (Ibid.) The Series 2005 Bonds are structured so that the Turbo Redemption is projected to be completed by June 1, 2027. (Ibid.) The Authorizing Resolution also allows TSFC to solicit bids for the Defeasance Collateral and authorizes execution of an Escrow Deposit Agreement with Wachovia Bank, National Association, as escrow agent (the "Escrow Agreement") to provide for the payment of the Series 2003 Bonds. (Ibid.)

5. FISCAL YEAR 2006 APPROPRIATIONS ACT

The New Jersey Legislature adopted the FY06 Appropriations Act, L.2005, c.132, effective July 1, 2005 (the "FY06 Appropriations Act"). When Acting Governor Codey signed the FY06 Appropriations Act, he certified, pursuant to Article VIII, § 2, ¶ 2 of the State Constitution (the "Appropriations Clause") that anticipated revenues in the FY06 Appropriations Act meet or exceed anticipated expenditures. Included in the revenues anticipated in the Acting Governor's certification is approximately $150 million in funds derived from "Bond Refinancing/Restructuring Proceeds," which were the result of the Series 2005 Bonds. The State Treasurer represents that the FY06 Appropriations Act also reflects a $600 million surplus of anticipated revenues over anticipated expenses. (State Treasurer McCormac Aff. ¶ 6.)

On July 25, 2005, a Preliminary Offering Circular was distributed by TSFC for the issuance and sale of $2,101,930,000 Series 2005 Bonds. (Id. ¶ 13.) At the time of distribution, it was anticipated that TSFC would enter into a bond purchase agreement with the underwriters for the sale of the Series 2005 Bonds on August 4, 2005 and at the same time would accept bids for the Defeasance Collateral. (Ibid.)

On or about July 26, 2005, plaintiff, Alex DeCroce, requested from the Office of Legislature Services ("OLS") an opinion regarding the constitutionality of the State treating the $150 million from the sale of the Series 2005 Bonds as "revenue" for purposes of balancing a portion of the FY06 Appropriations Act. On August 2, 2005, OLS issued an opinion in response to that request. The OLS opinion concluded that the proposed budget is unconstitutional because it violates the Court's opinion in Lance, supra, 180 N.J. 590 and the Appropriations Clause of the New Jersey Constitution, by relying upon proceeds from the sale of bonds as "revenue" to balance a portion of the budget. N.J. Const. art. VIII, § 2, ¶ 2.

ANALYSIS

TSFC proposes to issue approximately $2.1 billion worth of new debt, $1.95 billion of which it will use to retire outstanding debt. Plaintiffs seek to enjoin the sale of $150 million in bonds; not the part of the restructuring of the bonds to be used to reduce the TSFC debt under the 2003 Tobacco Bonds. While plaintiffs acknowledge that retiring the 2003 bonds will realize savings for the State, they object to the characterization of $150 million of these funds as "revenue." The record reflects that the Anticipated Resources by the Department of Treasury for the FY06 Budget includes the sum of $150 million, referred to as Bond Refinancing/Restructuring Proceeds.

Plaintiffs submit that the holding in Lance I[1] does not distinguish between bond proceeds that the State intends to spend, and therefore "balance" the budget, and bond proceeds that are otherwise counted as general revenue. Plaintiffs argue that the $150 million is not necessary to pay off any existing obligations on the original bonds. As such, it represents "surplus borrowing" and not the sale of an asset.

Defendants do not dispute that the FY06 Budget recognizes as "revenue" proceeds from the sale of bonds. They argue, however, that: (1) the $150 million is from the sale of an asset and is properly included as "revenue"; (2) the State has no obligation to pay the debt service on the Series 2005 Bonds; (3) the State's retention of the Residual Certificate in the sale of its rights

[1] Lance I refers to Lance, supra, 180 N.J. 590; Lance II refers to Lance v. Codey, No. MER-L-2087-05 (N.J. Super. Law Div. Aug. 11, 2005) the case pending before the court.

to receive the Tobacco Receipts entitles the State to this enhancement of proceeds from the sale of its asset; and (4) the FY06 Appropriations Act has a surplus of $600 million; therefore, the Appropriations Clause requirement that the State enact a balanced budget each year is in no way implicated by the revenues at issue here. Finally, defendants argue that the proposed transaction is actually a restructuring, not a refunding, and it is designed to maximize to the State, as seller of the asset, the value of the stream of payments from the Tobacco Receipts.

In Lance I, to secure the payment of bonds, the Cigarette Tax Securitization Act of 2004, N.J.S.A. 34:1B-21.16 et seq. (the "Cigarette Tax Act"), and the Motor Vehicle Surcharges Securitization Act of 2004, N.J.S.A. 34:1B-21.23 et seq. (the "Surcharges Act"), authorized the Economic Development Authority ("EDA") and the Treasurer to enter into contracts to repay the proposed bond obligations. Lance, supra, 180 N.J. at 594. The monies originated from unsafe driving surcharges and dedicated cigarette tax revenues. Ibid. Both payments were subject to appropriations by the Legislature. Ibid. The Governor certified the expected bond proceeds as anticipated revenue for purposes of the Appropriations Act. "Absent recognition of the bond proceeds as revenue, the Appropriations had a deficit of approximately $1.5 billion." Id. at 594-95.

Importantly, the Court addressed three issues: to wit, (1) whether borrowed monies constituted income; (2) whether these funds could be used for the purpose of funding or balancing any portion of the budget pertaining to general costs, without violating the Appropriations Clause; and (3) the constitutionality of certain bonding mechanisms enacted by the legislative and executive branches without voter approval. See id. at 593. For purposes of this matter, Lance II, the court will only address the first two issues.

In Lance I, the Court rejected the notion that the State had the authority to rely on borrowed funds to balance its annual budget and fund general expenses. Id. at 593. "We hold that contract bond proceeds used to fund general expenses in the State budget do not constitute 'revenue' for purposes of Article VIII, Section 2, paragraph 2 of the New Jersey Constitution (the Appropriations Clause), and cannot be used to balance the annual budget." Ibid.

The State asserts that the $150 million is not needed to balance the budget, so the limitations in Lance I do not apply. This court disagrees. Irrespective of the "balanced budget" issue, the Court recognized that borrowed funds did not represent income. Id. at 593, 598. In Lance I, the Court noted, "[i]n a different setting, this Court has observed that 'bond proceeds scarcely resemble "State revenue."'" Id. at 597 (quoting State v. Trump Hotels & Casino Resorts, Inc., 160 N.J. 505, 536 (1999)). Furthermore, the Court relied on a case decided by the Supreme Court of Oregon in which, while defining the term broadly, did so without including borrowed monies within the definition or revenue:

> When we refer to the revenues of the state, we usually mean the annual or periodic yield of taxes, excise, customs, etc., which the state collects and receives into the treasury for public use, but the word "revenues" may be much broader than that as it may include rent, yield, as of land, profit. It includes annual and periodical rent, profits, interest, or issues of any species of property, real or personal, income.
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> [Ibid. (quoting Pub. Mkt. Co. of Portland v. City of Portland, 171 Or. 522, 130 P.2d 624, 644 (1942)(internal quotation marks and citation omitted), supplemented on reh'g by, 171 Or. 522, 138 P.2d 916 (1943)).]

While the State cites Myers v. Alaska Housing Finance Corp., 68 P.3d 386 (2003) to support its argument that the restructuring of bonds permits the government to include these sums as "revenue," the state's reliance is misplaced. In Myers, the Supreme Court of Alaska correctly held that the sale of the tobacco settlement revenue stream, while not traditional sources of state revenue, when reduced to present value was constitutional. Supra, 68 P.3d at 387, 394. The Myers decision is consistent with New Jersey's statutory scheme, more specifically N.J.S.A. 52:18B-2, which permits the TSFC to acquire from the State all or portion of the State's tobacco receipts. In fact, the monies from the sale of the Series 2002 and 2003 bonds have already been legitimately transferred to the General Fund of the State of New Jersey. That transfer is not in dispute.

While the State argues that the $150 million will be given to the State without any obligation by the State to refund these monies, this legal fiction creates serious public policy issues. First, the State transferred all of its title and interest in the Tobacco Receipts to the TSFC in 2002 and 2003. While the State reserved an interest, through the Residual Certificate, the $150 million does not represent residual proceeds. Rather, it represents additional borrowing made possible as a result of lower interest rates. In essence, it is "surplus borrowing." Second, while the State may not have an obligation to repay the $150 million, the receipt of these funds by the TSFC creates a corresponding obligation for repayment. While bond holders, by the very nature of the bond issuance, may understand the potential risk involved, N.J.S.A. 52:18B-10 does create certain obligations and responsibilities that can not be undermined.

N.J.S.A. 52:18B-10, entitled State pledge and agreement, in pertinent part, provides:

> The State hereby pledges and agrees with the corporation, and the owners of the securities and benefited parties, that until all securities and ancillary facilities, together with the interest thereon and all costs and expenses in connection with any action or proceedings by or on behalf of owners of securities or benefited parties, are fully paid and discharged the State will ... not limit or alter the rights of the corporation to fulfill the terms of its agreements with such owners or benefited parties ... [and] not in any way impair the rights and remedies of such owners or benefited parties or the security for such securities or ancillary facilities .... The State representative is authorized and directed to include this pledge and agreement in sale agreements and the

> corporation is authorized and directed to include this pledge and agreement in any contract with the owners of the securities and benefited parties.
>
> [Ibid.]

The Act, effective July 1, 2002, N.J.S.A. 52:18B-1 et seq., was created to "authorize, create and establish a corporation empowered to acquire from the State all or a portion of the State's tobacco receipts." N.J.S.A. 52:18B-2. The relationship between TSFC and the State is uncomplicated. N.J.S.A. 52:18B-3(a) states in pertinent part:

> There is hereby established in, but not of, the Department of Treasury a public body corporate and politic, with corporate succession, to be known as the "Tobacco Settlement Financing Corp." The corporation is hereby constituted as an instrumentality of the State exercising public and essential governmental functions, and the exercise by the corporation of the powers conferred by this act shall be deemed and held to be an essential governmental function of the State.
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> [Ibid.]

In addition, N.J.S.A. 52:18B-3(h) states in pertinent part:

> The corporation may be dissolved by act of the Legislature on condition that the corporation has no debts or obligations outstanding or that provision has been made for the payment or retirement of such debts or obligations. Upon any such dissolution of the corporation, all property, funds and assets thereof shall be vested in the State.
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> [Ibid.]

TSFC is an instrumentality of the State and exercises public and essential governmental functions. N.J.S.A. 52:18B-3(a). Moreover, dissolution of TSFC is conditioned upon the payment of all outstanding debts and obligations. N.J.S.A. 52:18B-3(h). Thereafter, any residual value is legally owned by the State. Ibid. Furthermore, the Act requires TSFC to conduct an audit of its books and accounts at least once each year. N.J.S.A. 52:18B-3(i). The audit is to be filed with the Secretary of State and the State Comptroller. Ibid.

The Act permits TSFC to refund securities by the issuance of new securities.[2] N.J.S.A. 52:18b-7. Albeit, the State represents that under federal tax laws, TSFC has only one opportunity to restructure the existing Series 2003 Bonds on a tax-exempt basis. As to restructuring/refunding[3]:

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[2] **ADVANCE REFUNDING** – For purposes of certain tax and securities laws and regulations, a refunding in which the refunded issue remains outstanding for a period of more than 90 days after the issuance of the refunding issue. The proceeds of the refunding issue are generally invested in Treasury securities or federal agency securities (although other instruments are sometimes used), with principal and interest from these investments being used (with limited exceptions) to pay principal and interest on the refunded issue. Bonds are "escrowed to maturity" when the proceeds of the refunding issue are deposited in an escrow account for investment in an amount sufficient to pay the principal of and interest on the issue being refunded on the original interest payment and maturity dates, although in some cases an issuer may expressly reserve its right (pursuant to certain procedures delineated by the SEC) to exercise an early call of bonds that have been escrowed to maturity. The Internal Revenue Code and regulations restrict the yield that may be earned on investment of the proceeds of a refunding issue.

[www.msrb.org/msrb1/glossary/glossary_db.asp?sel=a (last visited Aug. 9, 2005).]

[3] The State asserts that the proposed transaction is actually a restructuring, not a refunding, and is designed to maximize to the State, as seller of the asset, the value of the stream of

> The corporation shall issue securities to refund any securities by the issuance of new securities, whenever it deems such refunding expedient, whether the securities to be refunded have or have not matured, and to issue securities partly to refund securities then outstanding and partly for any of its other authorized purposes. **The refunding securities may be exchanged for the securities to be refunded or sold and the proceeds applied to the purchase, redemption or payment of such securities**.
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> [N.J.S.A. 52:18B-7(a)(3)(emphasis added).]

It is undisputed that the State sold all of its title and interest in the Tobacco Receipts to TSFC. The only entitlement that remains is the State's right under what has been referred to as a "Residual Certificate." While this term has not been defined, the court assumes that these monies represent any excess after the interest and outstanding bonds have been satisfied, if any. N.J.S.A. 52:18B-4 defines both "Net Proceeds" and "Residual Interests:"

> "Net proceeds" means the amount of proceeds remaining following each sale of securities which are not required by the corporation to establish and fund reserve or escrow funds or termination or settlement payments under ancillary facilities and to provide the financing costs and other expenses and fees directly related to the authorization and issuance of securities.
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> ....
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> "Residual interests" means: the unencumbered tobacco revenues; the net proceeds not previously paid to the State; the income of the corporation that is in excess of the corporation's requirements to pay its operating expenses, debt service, sinking fund

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payments of the Tobacco Receipts. While neither the court nor the plaintiffs challenge the propriety of retiring the bonds to capitalize on the lower interest rates available now in the marketplace, it appears that refunding is simply one method of restructuring outstanding debt. The Preliminary Offering Circular dated July 25, 2005, states "**the Corporation is issuing the Series 2005 Bonds under the Indenture for the purpose of restructuring certain of its bonded indebtedness through an advance refunding of the Series 2003 Bonds.**" Ibid. (emphasis added). In fact, term "refunding bond" is used several times elsewhere in the Preliminary Offering Circular. See generally ibid.

> requirements, reserve fund or escrow fund requirements and any other contractual obligations to the owners of the securities of benefited parties, or that may be incurred in connection with the issuance of the securities or the execution of ancillary facilities; and such contractual rights, if any, as shall be provided to the State in accordance with the terms of any sale agreements ....
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> [Ibid.]

Finally, the Act places an obligation on TSFC to pay all outstanding bond obligations until they have been retired or upon maturity.

> On and after the effective date of each sale of TSRs, the State shall have no right, title or interest in or to the TSRs sold, and the TSRs so sold shall be property of the corporation and not the State, and shall be owned, received, held and disbursed by the corporation and not the State....[S]uch TSRs are to be paid directly to the corporation or the trustee under the applicable corporation resolution, trust agreement or trust indenture for the benefit of the owners of the securities and benefitted parties until such securities and ancillary facilities are no longer outstanding.
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> [N.J.S.A. 52:18B-5(c).]

The State argues the bonds issued in Lance I are intrinsically different than the bonds in Lance II. While the court acknowledges the differences, it is a distinction without meaning. The bonds issued in Lance I were structured as appropriate bonds that relied upon a repayment pledge based upon future annual State appropriations from certain revenues to the New Jersey Economic Development Authority ("EDA"). Supra, 180 N.J. at 594. Similarly, the proposed advance refunding bonds, as well as the 2003 and 2004 tobacco settlement financing corporation bonds, rely for their repayment upon a pledge of the State's annual receipt of Master Settlement Agreement payments that have been transferred by the State to a trustee on behalf of the TSFC's bondholders in consideration for transfer of the bond proceeds to the State.

The State submits that the lack of any obligation on the part of the State to repay the bonds differentiates this case from Lance I. "The issuance of securities and the execution of any ancillary facility under the provisions of this act shall not directly, or indirectly or contingently obligate the State or any political subdivision thereof to pay any amounts to the corporation or owner of securities or benefited parties ...." N.J.S.A. 52:18B-8.

Furthermore, the State submits that the legend on the bonds, as well, protects the State from any direct, indirect or contingent liability. The Preliminary Offering Circular dated July 25, 2005, states, "THE ISSUANCE OF THE SERIES 2005 BONDS SHALL NOT DIRECTLY, OR INDIRECTLY OR CONTINGENTLY, OBLIGATE THE STATE OR ANY POLITICAL SUBDIVISION THEREOF TO PAY AY AMOUNTS TO THE CORPORATION OR ANY OWNER OF THE SERIES 2005 BONDS ...." Ibid.

This court does not challenge the protection afforded to the State regarding the repayment of the bonds. Clearly, N.J.S.A. 52:18B-8 insulates the State from the obligation to repay. This protection, however, is not absolute. Clearly, the consequences of nonpayment by TSFC will invariably have an impact on the financial integrity of the State, its ability to borrow in the future and any future bond rating. Significantly, although the alter-ego theory oftentimes applied to the relationship between a TSFC and shareholders does not apply, the nature of the agreement between the State and TSFC, and the position of TSFC in the Department of the Treasury, pursuant to N.J.S.A. 52:18B—3, creates a relationship with several features of an alter-ego relationship.

While the methods of repayment may differ, there is little difference from a public policy perspective, between a pledge of future appropriations, and a pledge of repayment from the receipt of settlement proceeds by TSFC. Importantly, the holding in Lance I does not distinguish between bond proceeds that the State intends to spend, and therefore, "balance the budget," and bond proceeds that are otherwise counted as general revenue. "[B]orrowed monies, which themselves are a form of expenditure when repaid, are not income (i.e., revenues) and cannot be used for the purpose of funding or balancing any portion of the budget pertaining to general costs without violating the Appropriations Clause." Lance I, supra, 180 N.J. at 598.

Undoubtedly, the borrowing of an additional $150 million falls under that prohibition, as it funds at least a portion of the FY06 Budget. As a result, it is unconstitutional to certify the bond proceeds as general revenue. The court rejects the notion that the obligation rests with TSFC and not the State. The State has a significant interest, from a public policy and economic perspective, in the integrity of the bonds and the ultimate repayment. To suggest otherwise, is simply naïve.

While the State argues that the $150 million will not be applied to operating expenses this year, the funds are identified as revenues and are part of the General Fund of the Treasury. As a result, once in the General Fund, these monies are legally available to pay operating and other expenses. Furthermore, as noted by plaintiffs, even if the $150 million is retained as surplus initially, there is nothing to preclude the allocation and application of these funds to future expenses or projects. Finally, the utilization of these funds beyond FY06, as well, represents an attempt to utilize proceeds from bonds to cover future operating expenses. Suffice it to say, this also violates Lance I. See ibid.

The proposed transaction is akin to a homeowner who, after a few years, re-finances their mortgage at a lower interest rate.[4] For example, if a homeowner had an original mortgage in the

[4] Similar to the refinancing of a home mortgage, the pre-refunded municipal bonds are created when municipalities borrow money at lower interest rates to refinance municipal bonds issued when interest rates were higher. Unlike home mortgage, however, the original municipal bond issue remains in existence according to the terms of its

face amount of $300,000 at 8% in 2002 and then re-financed in 2005 and secured a loan in the sum of $400,000 at 5%, the additional $100,000 would not be considered as income. The sum of $100,000 merely reflects the benefits of re-structuring the loan, at a lower interest rate, with the accompanying benefit of qualifying for an additional sum of $100,000. Importantly, the $100,000 would not be considered by a subsequent lender as income inasmuch as that sum is obligated under the mortgage, now in the sum of $400,000, to be repaid. Furthermore, it is extremely unlikely that the homeowner, now vested with $100,000 of extra funds, would offer those monies to the initial seller of the property.

While Lance I recognized that bond proceeds used to purchase an asset may properly be recognized as revenue for budgetary purposes, the present refunding of the 2003 Bonds does not involve the sale of an asset. Quite simply, Lance I prohibits the Acting Governor from counting all proceeds from bonds as "revenues." Supra, 180 N.J. at 593. The complicated funding mechanism created to repay the 2003 Bonds does not change that overriding principle. The court is satisfied that the annual appropriations act for FY06 relies on $150 million in borrowed funds from TSFC advance refunding bonds, and pursuant to the holding in Lance I, defendants may not use this money for the purpose of funding or balancing any portion of the budget.

CONCLUSION

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original issuance. Once the refinancing is completed, the municipality uses the proceeds to buy a portfolio of U.S. Treasury securities; the interest and principal of which are used to retire the original issue to its call or maturity date.

[www.morganstanleyindividual.com/markets/bondcenter/school/prere.pdf (last visited Aug. 9, 2005).]

It is well settled that a party is entitled to injunctive relief where that party demonstrates (1) it has a reasonable probability of success on the merits of its claims; (2) absent such injunctive relief, it is probable the moving party will sustain irreparable harm; and (3) the non-moving party will not suffer any legitimate injury from the issuance of such an injunction. Crowe v. De Gioia, 90 N.J. 126, 133-34 (1982); Zoning Bd. of Adjustment of Township of Sparta v. Service Elec. Cable Television of N.J., Inc., 198 N.J. Super. 370, 379 (App. Div. 1985). The plaintiffs satisfy all three prongs. First, the $150 million in borrowed funds from the TSFC advance refunding bonds may not be used for funding or balancing any portion of the budget without violation of the Appropriation Clause of the State Constitution. Second, absent an injunction the defendants will use the $150 million for an unconstitutional purpose. Finally, the State cannot establish that it will suffer any legitimate injury as a result of an injunction to enjoin the sale of the $150 million in bonds.

The FY06 Budget has been approved by the Legislature and includes the $150 million from the anticipated sale of the 2005 bonds. Based on representations of the Treasurer that the FY06 Budget had a surplus of $600 million, it appears the FY06 Budget will now be left with a net surplus of $450 million. This opinion does not address what steps are required, if any, to modify the budget to reflect the removal of the $150 million.

The court will not enjoin the entire sale of the Series 2005 Bonds. The vast majority of the proceeds from the sale of those bonds will be used to finance the restructuring of debt resulting from the purchase of the Tobacco Receipts. Furthermore, plaintiffs do not contest the use of this portion of the bond proceeds, as those funds will not be deposited in the General Fund or used for general State purposes.

The one remaining issue relates to the proposed issuance of an additional $150 million in bonds. The State suggests that, should the court determine that the transfer from TSFC to the General Fund is inappropriate, then TSFC should be permitted to hold these proceeds until a permissible use can be identified by the Legislature. As noted heretofore, these funds may not be transferred to the State and placed into the General Fund. Clearly, inasmuch as TSFC proposed to issue the $150 million in proposed bonds solely to transfer the proceeds to the State, the sale of these bonds is apparently unnecessary to pay off any existing obligations on the original bonds.

"Surplus borrowing" has a real potential to undermine the integrity of the 2005 Bonds and the likelihood of repayment to the bondholders. N.J.S.A. 52:18B-7, in pertinent part, provides "the refunding securities may be exchanged for the securities to be refunded or sold and the proceeds applied to the purchase, redemption or payment of such securities." Ibid. No other purpose is authorized. Therefore, the court enjoins the additional $150 million in bonds.