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Honorable Alex DeCroce
101 Gibraltar Drive, Suite 1-A
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Dear Assemblyman DeCroce:

You have asked through Tom Neff and Rick Wright of the Assembly Republican Office for our opinion as to whether the use of \$150 million of the proceeds of a proposed issuance of New Jersey Tobacco Settlement Financing Corporation advance refunding bonds as anticipated State General Fund revenue that will fund or balance a portion of the Fiscal Year 2006 State budget is constitutional in light of the decision of the New Jersey Supreme Court in Lance v. McGreevey, 180 N.J. 590 (2004). The advance refunding bond issuance is described in a Preliminary Offering Circular dated July 25, 2005, offering Tobacco Settlement Asset-Backed Bonds in excess of \$2 billion. The circular indicates that a portion of the advance refunding bond proceeds will be paid to the State. It is the understanding of the Legislative Budget and Finance Officer that this payment is reflected in the Governor's revenue certification for the Fiscal Year 2006 State appropriations act, P.L.2005, c.132, as a miscellaneous Department of Treasury General Fund revenue item of \$150 million described as "Bond Refinancing/Restructuring Proceeds." For the reasons stated below, we are of the opinion that the \$150 million in Tobacco Settlement Corporation bond proceeds used to balance a portion of the State annual budget and fund State general expenses payable from the General Fund is violative of the holding in Lance that the State may not rely on bond proceeds as revenue to fund general expenses of State government as set forth in annual appropriation acts.

The New Jersey Tobacco Settlement Financing Corporation is established by the "Tobacco Settlement Financing Corporation Act," P.L.2002, c.32 (C.52:18B-1 et seq.) for the purpose of acquiring from the State all or a portion of the State's Master Settlement Agreement¹ "State

¹ The Master Settlement Agreement was entered into on November 23, 1998 among the attorneys general of 46 states (including New Jersey) and the four largest cigarette manufacturers in settlement of certain smoking litigation claims made by the states. Annual payments are made

tobacco receipts," to issue securities payable solely from and secured solely by the State's tobacco receipts, to hold and invest the net proceeds of the sale of the securities pending direction by the State, which are not pledged to secure securities of the corporation, and to manage such portion of the net proceeds of the sale of the securities pending direction by the State. N.J.S.A. 52:18B-2. "Tobacco receipts" are defined in the act as "a) all tobacco settlement payments that are received by the State that are required to be made, pursuant to the terms of the master settlement agreement, by tobacco manufacturers to the State, and b) the State's rights to receive such tobacco settlement payments." N.J.S.A. 52:18B-4. The corporation is established in, but not of, the Department of Treasury as a public body corporate and politic, with corporate succession and is constituted as an instrumentality of the State exercising public and essential governmental functions of the State. However, its assets, liabilities and funds are not to be consolidated or commingled with those of the State. N.J.S.A. 52:18B-3. Its bonds are not a debt or liability of the State or any agency or instrumentality thereof (other than the corporation as set forth in this act), either legal, moral or otherwise. N.J.S.A. 52:18B-8.

In 2002 the corporation issued bonds that involved the transfer of 50% of the State's tobacco receipts to the corporation for the corporation to pay the interest and principal and costs of issuance of the corporation's bonds. In the State fiscal year 2003 annual appropriations act, P.L.2002, c.138, the amount of \$1,351,706,000 was certified as a General Fund revenue through an interfund transfer designated "Tobacco Settlement Fund." This amount was from the proceeds of the corporation's 2002 bonds. See section 49 of P.L.2002, c.38 appropriating ". . . an aggregate amount not to exceed \$1,075,000,000 from funds paid to the State from any net proceeds, earnings thereon or residual interests from the sale of tobacco settlement revenues as authorized pursuant to P.L.2002, c.32 (C.52:18B-1 et seq.)."

In 2003 the corporation issued bonds that involved the transfer of the remaining 50% of the State's tobacco receipts to the corporation for the corporation to pay the interest and principal costs of issuance of the corporation's bonds. In the State fiscal year 2004 annual appropriations act, P.L.2003, c.122, the amount of \$1,612,022,000 was certified as a General Fund revenue through an interfund transfer designated "Tobacco Settlement Fund." Most of this amount was from the proceeds of the corporation's 2003 bonds. See section 49 of P.L.2003, c.122 appropriating ". . . an aggregate amount not to exceed \$1,487,247,000 from funds paid to the

(¹ con't.)

by the settling manufacturer to the settling states for perpetuity. The amount of the annual payments are subject to annual adjustments. The actual payment for New Jersey's share of the Master Settlement Agreement in Fiscal Year 2005 was approximately \$243 million which was transferred to the corporation as part of the previous bond indentures of the corporation.

State from any net proceeds, earnings thereon or residual interests from the sale of tobacco settlement revenues as authorized pursuant to P.L.2002, c.32 (C.52:18B-1 et seq.)."

The proposed advance refunding issue will use the newly obtained bond proceeds of over \$2 billion to purchase a Refunding Escrow which will be pledged to advance refund the corporation's outstanding 2003 bonds.² The amount of the Refunding Escrow is not specified in the Preliminary Offering Circular. That use and the other uses of the bond proceeds are noted therein as subject to change. These amounts are usually made available on or shortly before the date of the bond sale. The circular further provides that "[e]xcept to the extent that the proceeds of the Series 2005 Bonds are deposited in the Debt Service Reserve Account, the Debt Service Account, the Operating Account and the Cost of Issuance Account, the proceeds of the Series 2005 Bonds will be, on the Closing Date, irrevocably dedicated to (i) the funding of an escrow for the advance refunding of all Outstanding Series 2003 Bonds and (ii) a payment of the balance to the holder of the Residual Certificate." Preliminary Offering Circular dated July 25, 2005, at 13-14. The owner of the residual certificate under the 2003 bond issuance is the State.

The State is thus scheduled to receive an amount from the net proceeds of the issuance. "Net proceeds" as defined in N.J.S.A. 52:18B-4 "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." Subsection d. of N.J.S.A. 52:18B-5 provides in part:

The net proceeds, any earnings thereon . . . shall be applied, transferred, or paid to, and upon the order of, the State, as directed by the State representative, and shall be used by the State for any bona fide governmental purposes as determined by the State, including without limitation for capital expenditures, debt service on outstanding bonds of the State, working capital expenditures or operating deficit needs of the State, endowments, or grants or aid to political subdivisions, including without limitation school districts, of the State. Pending such direction by the State representative, the corporation shall invest such moneys such that

² An advance refunding in the context of municipal bonds is described as a financing structure under which new bonds are issued to repay an outstanding bond issue prior to its first call date. The refunding issue usually specifies an interest rate lower than the issue to be refunded. Generally, the proceeds of the new issue are invested in government securities, which are placed in escrow. The interest and principal repayments on these securities are then used to repay the old issue, usually on the first call date.

funds will be available at such times as the State representative shall deem necessary for the expenditure thereof. The State is authorized and may arrange for the availability of the net proceeds . . . from the corporation on such terms and conditions as the State representative deems appropriate and may include in the sale agreement provisions for interfund transactions with respect thereto between the State and the corporation.

It is anticipated that net proceeds in the amount of \$150 million will be transferred from the corporation to the State. This transfer will provide the actual revenue certified by the Governor as anticipated to be received as "Bond Refinancing/Restructuring Proceeds" upon enacting the Fiscal Year 2006 State appropriations act, P.L.2005, c.132, on July 2, 2005. To the extent the advance refunding generates net proceeds in the current year, a conscience decision is made to borrow more funds in this proposed issuance than are necessary to meet the other purposes of the advance refunding.

In Lance v. McGreevey, 180 N.J. 590 (2004), the plaintiffs sought to enjoin the issuance of bonds under two enactments, the proceeds from which were to be used to balance the Fiscal Year 2005 annual appropriations act. The two enactments, the "Cigarette Tax Securitization Act of 2004," P.L.2004, c.68 (34:1B-21,16 et seq.), and the "Motor Vehicle Surcharges Securitization Act of 2004," P.L.2004, c.70 (C.34:1B-21.23 et seq.), made available bond proceeds in excess of \$1.9 billion to be appropriated by the Legislature for any lawful purpose including the operating expenditures of State government. The appropriations clause of the New Jersey Constitution, N.J. Const., Article. VIII, Section 2, paragraph 2, requires the State to have a balanced budget each fiscal year. The case required the court " . . . to determine whether the State properly can rely on borrowed funds to balance its annual budget and fund general expenses, an issue of first impression." Lance, at 590.

The Appropriations Clause provides:

No money shall be drawn from the State treasury but for appropriations made by law. All moneys for the support of the State government and for all other State purposes as far as can be ascertained or reasonably foreseen, shall be provided for in one general appropriation law covering one and the same fiscal year; except that when a change in the fiscal year is made, necessary

provision may be made to effect the transition. No general appropriation law or other law appropriating money for any State purpose shall be enacted if the appropriation contained therein, together with all prior appropriations made for the same fiscal period, shall exceed the total amount of revenue on hand and anticipated which will be available to meet such appropriations during such fiscal period, as certified by the Governor. [N.J. Const., Art. VII, Sec.II, para. 2.]

The court noted that the Appropriations Clause "reflects a 'constitutional command that the State's finances be conducted on the basis of a single fiscal year covered by a single balanced budget.' City of Camden v. Byrne, 82 N.J. 133, 151, . . . (1980). The requirement that the State enact a balanced budget each fiscal year 'cannot in any sense be regarded as merely providing governmental housekeeping details, necessary and important but not truly vital.' Id. at 146 . . . Rather, the Clause 'must . . . be given full and complete effect in accordance with [its] clear and obvious intent.'" Lance, at 596.

The court agreed with the plaintiffs, reasoning in Lance that relying on bond proceeds as revenue ". . . belies the common-sense notion of a balanced budget and is contrary to the framers' original intent in drafting the Appropriations Clause." Id. at 596-597. The court considered its prior observation in another context, "that bond proceeds scarcely resemble 'State revenue.'" Id. at 597, citing State v. Trump Hotels & Casino Resorts, Inc., 160 N.J. 505, 536 (1999). The court also noted that "[a]t least one other court . . . has defined the term broadly . . . without including borrowed monies within the meaning of revenue." Lance, at 597 referring to Pub. Mkt. Co. of Portland v. City of Portland, 171 Ore. 522 (1942), supplemented on reh'g by, 138 P.2d 916 (1943).

Further, considering dictionary definitions of "revenue" and the consistent use of the concept of governmental income within those definitions, the court recognized

. . . that after revenues are defined, disputes can then arise over the definition of income as that concept appears in the definitions we have reviewed. In such circumstances, we do well to remember Learned Hand's observation that "it is one of the surest indexes of a mature and developed jurisprudence not to make a fortress out of the dictionary." Cabell v. Markham, 148 F.2d 737, 739 (2d Cir.),

aff'd, 326 U.S. 404, 66 S. Ct. 193, 90 L. Ed. 165 (1945). We recall, also, this Court's prior teaching that "the Constitution was written to be understood by the voters; its words and phrases were used in their normal and ordinary as distinguished from technical meaning." Vreeland v. Byrne, 72 N.J. 292, 302, 370 A.2d 825 (1977) (internal quotation marks and citation omitted). That teaching supports the straightforward notion that borrowed 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, at 598.]

The court noted that the holding in Lance "will apply only in connection with the next fiscal year's budget and thereafter." Id., at 593. Thus on the important constitutional issue presented in that case, the court held that beginning in State fiscal year 2005 and thereafter, ". . . bond proceeds used to fund general expenses in the State budget do not constitute 'revenue' for the 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 bond issues under the two bond acts in Lance were structured as appropriations bonds which rely upon a repayment pledge based upon future annual State appropriations from certain revenues to the New Jersey Economic Development Authority. 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 which have been transferred by the State to a trustee on behalf of the corporation's bondholders in consideration for transfer of the bond proceeds to the State. However, we do not believe that the court's holding in Lance relies in any way upon a distinction in pledged method of repayment for the borrowed monies. In neither the reasoning found in Lance or in any other New Jersey case is there to be found any common sense distinction for the purpose of the Appropriations Clause between the technical difference in the pledge of future appropriations or the pledge of the transfer of future State revenue. The Clause "must . . . be given full and complete effect in accordance with [its] clear and obvious intent . . . ," Id. at 596, and should not be limited in its meaning because of the latest financing devices that may evolve in the municipal bond marketplace.

In conclusion, for the reasons stated above, we are of the opinion that the annual appropriations act for State Fiscal Year 2006 relies on \$150 million in borrowed funds from the

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proposed Tobacco Settlement Financing Corporation advance refunding bonds that under the holding in Lance may not be used for the purpose of funding or balancing any portion of the budget pertaining to general costs without violating the Appropriations Clause of the State Constitution.

Very truly yours,

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Legislative Counsel

By:



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