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June 17, 2004

Honorable Leonard Lance
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Dear Senator Lance:

You have asked for our advice whether certain proceeds¹ of long term debt may lawfully be considered "revenue" for the purpose of "balancing" the budget under Article VIII, Section II, paragraph 2 of the New Jersey Constitution. Further, you have asked if this use of long term debt as revenue to arrive at a balanced budget is challenged and the Supreme Court ultimately holds this use is violative of the Constitution, what is the exposure of the State in terms of a court remedy.

It is our opinion that the use of a device to securitize revenues from future years to finance appropriations in the current year is violative both of the balanced budget requirement and the debt limitation clause of Article VIII, Section II of the Constitution, paras. 2 and 3. Our advice relies on the need to read both paragraphs together in a manner which is faithful to the revision made in the 1947 Convention and which seems to have been lost in the case law and legislation enacted since. Our attempt to set forth that understanding follows with acknowledgement of contrary case law and legislation as relevant.

¹ According to the Governor's Budget Message, dated February 24, 2004, the proposed \$26.3 billion budget is balanced in part by revenue enhancements of which \$1.52 billion comes "from the securitization of motor vehicle surcharges and new revenue from a 45 cent increase in the cigarette tax . . ." page B-5. These proceeds are cited again at page C-8 of the Message with some explanation of the motor vehicle surcharges relied on. The \$1.52 billion is then included as anticipated in FY2005 as State revenues in the Department of the Treasury, page C-17.

Honorable Leonard Lance
Page 2
June 17, 2004

The constitution mandates that withdrawals of monies from the State treasury can be accomplished only by legislative appropriation and that there shall be "one general appropriation law covering one and the same fiscal year." Its exact terms in this respect are:

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. (1947), Art. VIII, Sec. II, para. 2.]

The constitutional requirement of a unitary general appropriations law covering but a single fiscal year is the center beam of the state's fiscal structure. It expresses the basic understanding that fiscal soundness and integrity are the foundations for proper governmental operations. The constitutional plan for the expenditure of public revenues for governmental purposes centralizes and simplifies state financial affairs, serving to improve the operations of government, define fiscal commitments, and clarify official responsibility. [Karcher v. Kean, 97 N.J. 483, 488 (1984), citing City of Camden v. Byrne, 82 N.J. 133, 146 (1980)].

It is this constitutional provision that requires that appropriations be incorporated into a single balanced budget in which current expenditures of those appropriations must be met by current revenues.

The payment of an expenditure of a current fiscal year appropriation matched by the proceeds of State borrowing to be paid from revenue from a future fiscal year would likely be viewed under our Constitution as an effort "... to increase state expenditures, which presumably have already been calculated and included in a unitary budget that effectively appropriates revenues sufficient to meet all such expenditures for the fiscal year, [and] would tend to tilt the

Honorable Leonard Lance

Page 3

June 17, 2004

budget toward imbalance. This cannot be done without violating the 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, at 151.

You should be aware that certain revenue collected after the end of a State fiscal year may be considered "revenue on hand and anticipated which will be available to meet" the appropriations made for the previous fiscal year. N.J.S.A. 52:27B-46 provides that "all accounts receivable and payable, all balances of all funds, and such other information as is required for a proper statement of the financial conditions and operations of the State" are to be maintained through "a complete set of double-entry accounts, which shall reflect directly or through proper controlling accounts, on an accrual basis, all assets, liabilities, revenues, and expenditures of the State, and all of its accounting agencies." This statute provides the legislative recognition that funds constructively in the State's treasury during the fiscal year may be treated as actually in the treasury.²

At least since this statute's enactment in its current form under P.L.1944, c.112, the State's revenue and appropriations accounting has been based on the accrual method of accounting. N.J.S.A. 52:27B-46 was enacted as one of the bills proposed by the New Jersey Commission on State Administrative Reorganization, which, in Part 2 of its report of March 1944, recommended streamlining measures involving State fiscal procedures, that were expressed in the Commission's memorandum on the bill, as part of an overall effort "... to provide the facilities . . . [to] the Governor to meet . . . his obligation . . . to provide adequate direction and control of both revenues and expenditures . . . without conflict in authority between the executive and legislative branch . . ." Report of the New Jersey Commission on State Administrative Reorganization, Part 2, March 1944, at 1. This method of accounting is further noted to be applicable to the revenues available to support the State appropriation act in N.J.S.A. 52:27B-46, which in addition to requiring the preparation of the public annual fiscal year comprehensive financial report of the State, provides that the Director of the Division of Budget and Accounting in the Department of the Treasury prepare a "... summarized monthly report of the General State Fund no later than 30 days following the end of each month which shall reflect the accrued revenues as compared with anticipated revenues, itemized by revenue source for major taxes, [and] by department for miscellaneous revenues. . . ." These statutorily established revenue accounting rules, although without specific mention in the convention proceedings, were, along with all other statutory and other law in force at the time, declared to remain in full force unless superseded, altered or repealed by the

²Thus, for example, sales tax revenues which are collected by vendors and accrue to the State during the last part of the current fiscal year, but are not received by the State during the fiscal year because of the statutorily established time lag in the remitting of the collected taxes, are properly allocated to the current fiscal year.

Honorable Leonard Lance
Page 4
June 17, 2004

new Constitution of 1947. Article XI, Section I, paragraph 3. Nothing in our review of the Constitutional Convention proceedings of 1947 and of the changes incorporated in the 1947 Constitution indicates any suspension or alteration of these rules. To our knowledge they have been applied to the annual appropriation act to the present.

Of most importance, the State Constitution's Debt Limitation Clause contains the authority for the State Legislature to address a deficiency in State revenues to match appropriations for a fiscal year by way of borrowed funds through the issuance of State debt without a public referendum. To our knowledge, however, this form of State borrowing has not been previously utilized.

The State Constitution's Debt Limitation Clause is found in Article VIII, Section II, paragraph 3 and reads in relevant part as follows:

The Legislature shall not, in any manner, create in any fiscal year a debt or debts, liability or liabilities of the State, which together with any previous debts or liabilities shall exceed at any time one per centum of the total amount appropriated by the general appropriation law for that fiscal year, unless the same shall be authorized by a law for some single object or work distinctly specified therein. . . . Except as hereinafter provided, no such law shall take effect until it shall have been submitted to the people at a general election and approved by a majority of the legally qualified voters of the State voting thereon. No voter approval shall be required for any such law authorizing the creation of a debt or debts in a specified amount or an amount to be determined in accordance with such law for the refinancing of all or a portion of any outstanding debts or liabilities of the State heretofore or hereafter created, so long as such law shall require that the refinancing provide a debt service savings determined in a manner to be provided in such law and that the proceeds of such debt or debts and any investment income therefrom shall be applied to the payment of the principal of, any redemption premium on, and interest due and to become due on such debts or liabilities being refinanced on or prior to the redemption date or maturity date thereof, together with the costs associated with such refinancing. All money to be raised by the authority of such law shall be applied only to the specific object stated therein, and to the payment of the debt thereby created. This paragraph shall not be construed to refer

Honorable Leonard Lance
Page 5
June 17, 2004

to any money that has been or may be deposited with this State by the government of the United States. Nor shall anything in this paragraph contained apply to the creation of any debts or liabilities for purposes of war, or to repel invasion, or to suppress insurrection or to meet an emergency caused by disaster or act of God. (emphasis added)

The underlined text was the subject of an amendment to this paragraph discussed and adopted at the State constitutional convention of 1947. The amendment to increase the \$100,000 debt limit in the 1844 Constitution to the one percent of annual appropriations was made by Senator Van Alstyne who was a delegate from Bergen County and Chairman of the Joint Appropriations Committee in 1947. The text of the amendment as it appears at pages 1240-1241 of the Convention Proceedings, Volume II, is attached as Appendix A for your reference. The debate during the course of the movement and adoption of the amendment on the floor of the convention is compelling on the subject. It is set forth in its entirety as it appears in the Convention Proceedings, Record, Volume I at pages 701 to 704 in Appendix B which is attached for your reference.

The debate strongly suggests that the one percent debt limitation was intended to create flexibility in the annual appropriation act by allowing the act to be balanced within a "leeway" of one percent of appropriations. In other words, the State's ability to incur debt of up to one percent of appropriations was intended to help the State meet its operating expenses in those years when revenue anticipated in the beginning of the fiscal year fell short of expectations. In opposing the amendment, Frank J. Murray, Vice-Chairman of the Committee on Finance and Taxation for the Constitutional Convention described the State's ability to incur debt as follows:

In addition to \$100,000 and the debt that could be incurred for these excepted purposes which I have read, all other money spent beyond available appropriations, or available monies and revenues which could be appropriated, must be by referendum approved by the voters of the State. Now, it is just a question of policy as to whether we want to preserve a situation where the State should not incur a debt beyond these emergencies except by the vote of the people, or whether we do want to make it a reasonable sum such as the Senator has suggested. [Vol. I, page 702].

This statement expresses Vice-Chairman Murray's concern that Senator Van Alstyne's proposed amendment would permit the Legislature to incur debt up to one percent of appropriations without

Honorable Leonard Lance

Page 6

June 17, 2004

going to the voters for approval.

Another appropriate point of reference for this portion of the Debt Limitation Clause is the monograph on Constitutional Limitation on the creation of State Debt by Amos Tilton. Constitutional Convention of 1947, Convention Proceedings, Volume II, at 1708-1727 (hereinafter cited as "Monograph" and attached as Appendix C for your reference). This and other monographs were prepared at the direction of the Governor and were immediately available to the delegates upon their election. *Id.*, Volume II at 1328. The Monograph provides an excellent overview of the use of debt financing by New Jersey up to the time of the 1947 convention and the historical context which generated the adoption of the debt limitation provision in 1844. Of particular interest is the statement that the "balance of unredeemed³ state bonds on January 1, 1947 was \$72,200,000." Monograph at 1715. Of further interest is the characterization of the then existing \$100,000 limit as "permitted for casual deficiencies," in the summary on page 1724.

Given the discussion on the amendment to this clause and the framework placed on the clause by the Monograph, it seems that the provision limiting to one percent of the total amount appropriated in the fiscal year was understood by the framers to authorize the creation of debt in that amount as a means of balancing an unbalanced budget without the requirement of voter referendum. Further a sensible reading leads to the construction that the phrase "together with previous debt or liabilities" in this clause applies only to this type of deficit financing, and not to obligations approved by the voters. Although there is no New Jersey case that resolves the issue of whether the phrase includes all previous voter-authorized debt, the history of the constitutional convention suggests that general obligation debt should not be included in the definition of previous debt.

The only New Jersey case⁴ that addresses the issue is Bulman v. McCrane, 64 N.J. 105 (1973), wherein the court declined to resolve the issue. In that case, the Attorney General argued that, even if the State's lease with the builder-developer for a records storage center was considered a debt under the Debt Limitation Clause, such debt did not violate the clause because,

³The word "redeemed" is used, but in the context of the tables and discussion we presume that its use is a typographical error.

⁴ In Clayton v. Kervick, 52 N.J. 138, 143-144 (1968), the court accepted a stipulation that the one percent limit was exceeded by existing general obligation bonds but this was not necessary to its rationale and decision. A passing mention of the lost relevance of the debt limitation clause as a check on aggregate State debt was made by Justice Stein in Lonegan v. State, 174 N.J. 435, 498 (2002) (Lonegan I).

Honorable Leonard Lance

Page 7

June 17, 2004

1) the value of the lease was not greater than one percent of the fiscal year 1972-73 State appropriations, and, 2) the State had no previous debt to which the amount of the lease needed to be added. The court ultimately found that the State's sole obligation was for future installments of rent and not a present debt in the constitutional sense. Bulman, at 118.

The court recounted the argument:

The Attorney General points out that the total potential liability of the State under the lease is \$3,644,075, which is less than one percent of the fiscal 1972-1973 legislative appropriation of \$2,047,934,209. His legal contention is that the approximate \$1,200,000,000 in presently outstanding State bonds is not to be included within the text, "any previous debts or liabilities," in the excerpt . . . above, within the true meaning of the Constitution. The implied position is that once the people have voted on specific items of funded debt pursuant to the constitutional mandate the policy underlying the debt limitation provision is met as to such debts and thereafter only new debts aggregating in excess of the one percent limitation are of constitutional concern. [Bulman, at 108.]

Curiously, the court went on to conclude that there was no history of the constitutional framers' intent on this issue.

We think this issue of constitutional interpretation raised by the Attorney General is a substantial one. Unfortunately, however, it was not adequately researched for us by either side. No case on point is cited. Our own independent search of the 1844 and 1947 constitutional proceedings has revealed no significant light as to the framers' intent in the respect under contention. See Proceedings of the New Jersey State Constitutional Convention of 1844 (1942) at 135, 185, 203, 277, 310-311, 340-343, 519-522, 524-527, 595; V Proceedings, Constitutional Convention of 1947, at 543, 590, 600, 601, 602, 844. In these circumstances, and in view of the fact that the instant litigation will be concluded by our determination that the contract for a lease did not create a debt or liability within

Honorable Leonard Lance
Page 8
June 17, 2004

the constitutional proscription, we defer to another day resolution of the issue posed.²

* * *

²It is to be noted that determination of the issue as to whether this transaction is a debt within Art. VIII, Sec. II, Par. 3 is useful even if the Attorney General's alternative position ultimately prevails. In that event the State's fiscal officers would still need to know whether this transaction is to be charged against the quantum of "free" debts up to 1 percent of the appropriation law. [Bulman, at 109-110.]

It appears from the foregoing passage that no reference to Senator Van Alstyne's presentation of the amendment to one percent on the convention floor is made and that the most crucial piece of evidence in favor of the Attorney General's argument on this point was not considered.

We are of the opinion that there is good authority in the record of the 1947 Constitutional Convention for the proposition that debt approved by voter referendum does not count in the aggregation of State debt or liabilities up to the one percent limit. The case law, notably Bulman v. McCrane, is not dispositive of the issue. In the only other case on point, the California Supreme Court, in a decision of some vintage, addressed the issue under a similar debt limitation clause under the California constitution that had a \$300,000 limit on debt created by the Legislature itself. In Bickerdike v. State, 144 Cal. 681 (1904), the court applied the same reasoning later used by the New Jersey Attorney General in Bulman, that the phrase "any previous debts" included only the limited category of debt permitted to be created by the legislature under the limited circumstances of revenue deficiencies, and excluded therefrom the unlimited category of debt that may be created by voter referendum. 144 Cal. at 695-697.

Therefore, we are of the opinion that the Legislature has authority under the State Constitution to create debts up to one percent of the total amount appropriated by the annual appropriation act in the current fiscal year to finance a budget deficit which debt would be subject to repayment in future years if an authorizing act so provided. Further, in a determination of the forms of outstanding debt that would be aggregated in counting up to that limit, outstanding general obligation bonds approved by the voters would not count. While language in paragraph

Honorable Leonard Lance
Page 9
June 17, 2004

3 uses "the total amount appropriated," that language was drafted and adopted at the time of the adoption of the unitary general appropriations requirement in paragraph 2 which predates the creation of the current constitutionally dedicated funds contained within the appropriation act. For example, the Governor's Budget Message at page B-1 shows the recommended budgeted appropriations for the 2004-05 State fiscal year for the General Fund at \$17,865,378,000 and for the Property Tax Relief Fund at \$7,843,000,000 and for the Casino Revenue Fund at \$478,880,000. It may be argued that the one percent limit should be calculated on the \$17,865 billion figure and that dedicated funds were not in the contemplation of the convention delegates. (The Comprehensive Annual Financial Report of the State of New Jersey for the fiscal year ended June 30, 2003, at page 316, would appear to set forth a calculation of the State's legal debt limit under this one percent provision using the same assumption.) Assuming this is the correct understanding, there may be authorized by law State debt of \$178,865,378 in this fiscal year without a referendum on the assumption that no other outstanding debt exists which counts against the limit.

A necessary part of this background is the line of cases placing the Legislature in the ultimate position of responsibility for appropriations recognizing the "significant responsibilities for the State's fiscal affairs" of the Governor. Karcher v. Kean, 97 N.J. 483,489 (1984); City of Camden v. Byrne, 82 N.J. 133,146 (1980). In answering in the negative whether a variety of statutes had the effect of appropriating moneys for the purposes of those statutes, the court relied on 'the constitutional provisions requiring appropriations to be incorporated into a single balanced budget in which current expenditures must be met by current revenues.' City of Camden, *supra*, 82 N.J. at 151.

More particularly focusing on the debt limitation clause is the line of cases culminating in Lonegan v. State, 176 N.J. 2 (2003) (Lonegan II), in which the court ultimately held that "the restrictions of the Debt Limitation Clause do not apply to appropriations-backed debt." *Id.* at 21. Here also, the court recognizes the preeminent role of the Legislature in addressing the concerns of the three dissenting justices. *Ibid.* Deference to the Legislature and Executive Branch permeates the approach of the court. 176 N.J. at 5.

In order to complete the backdrop, the handling of the unfunded pension liabilities in 1997 by means of the "Pension Bond Financing Act of 1997," P.L. 1997, c.114 (N.J.S.A. 34:1B-7:45 et al.) in conjunction with Chapter 115 which revalued the assets of the pension systems was fully discussed by Justice Handler's dissenting part in Spadoro v. Whitman, 150 N.J. 2,4 (1997). The immediate effect of these two laws was to take the pressure off the interdepartmental accounts in the State operations portion of the budget for FY1997-98, in the reliance on \$144.7 million of pension surplus. Governor's Budget Message, page B-4.

Honorable Leonard Lance
Page 10
June 17, 2004

Notable recent examples of innovative means of balancing the State budget occurred with the immediate use of tobacco settlement moneys in the appropriations act for FY 2000, P.L. 1999, c.138, with the recognition of \$92,808,000 from the tobacco settlement fund in the interfund transfer part of the General Fund revenue certification and its charge for various departments and programs in section 53 of Chapter 138. In the FY 2001 appropriations act, P.L. 2000, c.53, \$144,219,000 was certified as available from the tobacco settlement fund and charged for general fund uses in subsection a. of section 56 of Chapter 53. Further off-budget appropriations of \$245,064,000 were made in subsection b. of section 56. In the FY 2002 appropriations act, P.L. 2001, c.130, \$365,204,000 was certified and charged for general fund purposes in section 54 of Chapter 130. In 2002, the "Tobacco Settlement Financing Corporation Act," P.L. 2002, c.32 (N.J.S.A. 52:18B-1 et seq.) established the corporation to manage the proceeds of the tobacco settlement and convert the State's interest into a present value. In section 5 of the act (N.J.S.A. 52:18B-5), subsection d. provides that the net proceeds may be applied . . . "for any bona fide governmental purposes . . . including . . . capital expenditures, debt service . . . or operating deficit needs The FY 2003 appropriations act, P.L. 2002, c.38 certified \$1,351,706,000 in the tobacco settlement fund as revenue and authorized \$1,075,000,000 to be appropriated in section 49 of Chapter 38. In the FY 2004 appropriations act, P.L. 2003, c.122, \$1,612,022,000 was certified as available in the tobacco settlement fund and \$1,487,247,000 was appropriated in section 49 of Chapter 122.

It appears that the tobacco settlement fund received approximately \$205,000,000 more in FY 2003 than set out in the paragraph above, but that no amount is anticipated for FY 2005 in that fund as set out at page C-19 of the Governor's Budget Message, dated February 24, 2004.

While the exact details of the Governor's proposed securitization are unknown as of this writing, it is our opinion that the proposal necessarily requires a commitment of what appear to be ordinary revenue in a stream from future years, to anticipate in the coming fiscal year, an amount that is a significant multiple of what would actually be anticipated in the fiscal year if not securitized. We further are unaware of what means or device by which the securitization would be effected. It is our opinion based on what we believe was the purpose of the changes made in the 1947 Constitutional Convention that the balanced unitary budget requirement of paragraph 2 and the one percent debt limitation of paragraph 3 are flip sides of the same coin. With this view in mind and the obvious difficult history of case law (driven in every case by legislation of various devices subject of the challenge) culminating in Lonegan II, it is our opinion that an attempt to "securitize" ordinary revenue to balance the FY 2005 budget violates the requirement of a unitary budget in one fiscal year in paragraph 2 and goes beyond what the case law has heretofore upheld against a debt limitation challenge under paragraph 3.

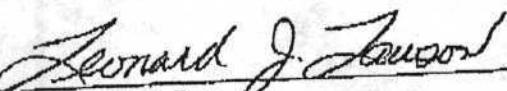
Your second question asks what is the exposure of the State in terms of a remedy by the

Honorable Leonard Lance
Page 11
June 17, 2004

court. Our best assessment is that the court would, if before the fact of securitization, defer to the Legislature and the Governor to restore balance and use those powers already committed by the Constitution and law⁵ most notably as discussed in *Karcher v. Kean, supra*. If the ruling came after the fact of securitization, judicial relief could be "problematic." *Spadoro v. Whitman* 150 N.J. at 14. The court could "grandfather all existing transactions that otherwise might be constitutionally infirm, leaving them undisturbed." *Lonegan v. State*, 176 N.J. at 24 (Justices Long, Verniero and Zazzali, dissenting, citing Justice Stein's dissent in *Lonegan I*, 174 N.J. at 500-504 for prospective application of potentially disruptive judicial decisions). Based on the fact that the proposed securitization is equal to one dollar out of seventeen or slightly less than six percent of the State budget and the impossibility of knowing where the loss would fall and the olive branches offered in the above cases, it is our belief the court would be considerate of the legislative and executive branches, responsibilities in balancing the budget.

Very truly yours,

Albert Porrone
Legislative Counsel

By: 
Leonard J. Lawson
First Assistant Legislative Counsel

AP:L/fa

⁵ For example, the executive power to revise quarterly allotments when revenues have fallen below those anticipated is set forth in N.J.S.A. 52:27B-26.