

No. COA04-593

TENTH JUDICIAL DISTRICT

NORTH CAROLINA COURT OF APPEALS

W.D. GOLDSTON, JR., JAMES E.)
HARRINGTON, and CITIZENS,)
TAXPAYERS, AND BONDHOLDERS)
SIMILARLY SITUATED,)
Plaintiffs-Appellants,)

v.)

STATE OF NORTH CAROLINA and)
MICHAEL F. EASLEY, GOVERNOR,)
INDIVIDUALLY AND IN HIS)
OFFICIAL CAPACITY)
Defendants-Appellees.)

From Wake County
02 CVS 015253

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COURT OF APPEALS

APPELLANTS' BRIEF

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QUESTIONS PRESENTED

1. DOES ARTICLE V, § 5 OF THE NORTH CAROLINA CONSTITUTION AND THE HIGHWAY TRUST FUND FORBID TRANSFERS OF TRUST FUND TAXES TO THE GENERAL FUND FOR CURRENT FISCAL YEAR EXPENDITURES THAT DO NOT RELATE TO THE SPECIFIC OBJECTS OF THE HIGHWAY TRUST FUND?

2. DOES THE EXECUTIVE BRANCH HAVE AUTHORITY UNDER ARTICLE III, § 5(3) OF THE NORTH CAROLINA CONSTITUTION TO BALANCE A FISCAL YEAR BUDGET BY "EFFECTING THE NECESSARY ECONOMIES IN STATE EXPENDITURES" FOR THAT FISCAL PERIOD BY DIVERTING TAXES COLLECTED IN PREVIOUS YEARS FOR SPECIFIC OBJECTS OF THE HIGHWAY TRUST FUND?

STATEMENT OF THE CASE

On 14 November 2002, Plaintiff-Appellants ("Plaintiffs") filed a Declaratory Judgment action in response to the unconstitutional taking of \$205 million from the Highway Trust Fund against Defendants-Appellees ("Defendants"). (R p. 8)

Plaintiffs request judgment declaring the two transfers (\$80 million by the executive branch and \$125 million by the legislative branch) were unconstitutional. Plaintiffs seek no money damages. The State will not have to refund any money to anyone. The legislative and executive branches need guidance regarding appropriate constitutional methods for handling future budgetary shortfalls. Plaintiffs' actions serve this purpose. Once the validity of the State's actions are judicially declared unconstitutional, the legislative and executive branches will be enlightened and correct their actions now and in future State budget crises.

Following a hearing on 25 November 2003, the trial court: (1) denied Plaintiffs' Motion to Consider Additional Evidence, (2) denied Plaintiffs' Motion for Summary Judgment, and (3) granted Defendants' Motion for Summary

Judgment on 29 January 2004. (R p. 53-55) Plaintiffs timely appealed on 4 February 2004. (R p. 58)¹

STATEMENT OF THE FACTS

A. The Plaintiffs and the Highway Trust Fund

During the late 1980's, Plaintiff Bill Goldston, a Democrat, was a State Senator from the 24th Senate District. He served as Chairman of the Senate Transportation Committee and Co-chair of the bipartisan State Highway Study Commission ("Commission"). (R. pp. 8)

Plaintiff Jim Harrington, a Republican, served as North Carolina's Secretary of the Department of Transportation (1985-1989). Harrington initiated the Commission. He provided information and advice on planning, constructing and financing North Carolina's highway system and urban loops. (R pp. 8-9) (E. P. Ex. 19) After numerous public hearings throughout the State, the Commission recommended a plan for building and improving "Intrastate Highways," "Urban Loops," "City Streets," and "Secondary Roads." (R p. 8)

¹ Plaintiffs cite to the printed Record as (R. p. __) and to an Exhibit notebook designated "Designation of Evidentiary Evidence" which consists of both Plaintiffs' and Defendants' evidence submitted during summary judgment hearings. The Evidence Notebook is cited as (E. P. Ex. __) referring to Plaintiffs' evidence in the Notebook and (E. D. Ex. __) referring to Defendants evidence in the Notebook. There is no transcript.

The 1989 Commission proposed creation of a "Trust Fund," designated the North Carolina Highway Trust Fund ("Trust Fund"). The Trust Fund is comprised of "taxes" for the sole objects and purpose of improving and paying for 1,844.2 miles of specific "transportation corridors," completing 205.4 miles of specific urban loops around seven explicitly named cities and secondary roads. (R. P. 8)

The Trust Fund was thereupon created pursuant to Chapter 692 of the 1989 Session Laws ("the Act"), and codified in N.C. Gen. Stat. § 136-175 *et seq.* The Act created a special account within the State Treasury. The Trust Fund consists of taxes from several sources: (1) motor fuel excise tax, N.C. Gen. Stat. § 105-449.125; (2) alternative fuel excise tax, N.C. Gen. Stat. § 105-449.136; (3) excise tax on carriers using fuel purchased outside the State, N.C. Gen. Stat. § 105-449.43; (4) motor vehicle use tax, N.C. Gen. Stat. § 105-187.9; (5) motor vehicle title and registration fees, N.C. Gen. Stat. § 20-85; and (6) interest and income earned by the Trust Fund.

As originally enacted, the Act provides that funds from the Trust Fund are to be used only for the following purposes: (1) expenses to administer the Trust Fund; (2) specific projects of the Intrastate Highway System; (3) specific urban loop highways, designated by number and

location; (4) supplemental appropriations to cities for city streets; and (5) supplemental appropriations for specific secondary road construction identified by a minimum traffic flow. (R. pp. 29-30) In an earlier legal opinion by the Attorney General in 2002, the State contended that N.C. Gen. Stat. § 136-180 restricted the use of Trust Funds for specific road building purposes and declined Durham's request to use the funds for any other purpose.²

Prior to and through 1998, the North Carolina Comprehensive Annual Financial Report listed the Highway Trust Fund as a "Special Revenue Fund." "The special revenue funds are maintained to account for those financial resources which are **restricted** by legal . . . action to **finance particular functions** or activities of the State." See 1998 North Carolina Comprehensive Annual Financial Report, at 115 (emphasis added). (E, P Ex. 18)

Like the preceding annual reports, the 2002 North Carolina Comprehensive Annual Financial Report states:

The State acts as a trustee or fiduciary for its employee pension plans. It is also responsible for other assets that, because of a **trust** arrangement, can be **used only for the trust** beneficiaries The government-wide statements **exclude** fiduciary fund activities and balances because these **assets are restricted** in

² 2002 WL 1128899 N.C.A.G. at 4 (Attorney General Opinion of Senior Deputy Attorney General Clayton H. Polley) (E, P. Ex. 1)

purpose and **cannot be used to support the State's own programs.**

See 2002 North Carolina Comprehensive Annual Financial Report, at 30 (emphasis added). (E, P Ex. 16)

The 2002 North Carolina Comprehensive Annual Financial Report also states that the Trust Fund "was established to provide a **dedicated** funding mechanism to meet highway construction needs for North Carolina." "**Taxes** were increased for the **specific purpose** of improving identified primary transportation corridors within the State and for the completion of urban loops around seven major metropolitan areas." See 2002 North Carolina Comprehensive Annual Financial Report, at 38 (emphasis added) (E. P Ex. 16)

The State Highway Fund and the Highway Trust Fund have multi-year budgets. They are not included in the budgetary statements of the General Fund, nor the "fiscal period" as used in Article III, § 5(3) of the North Carolina Constitution. They are special revenue funds pursuant to Generally Accepted Accounting Principles ("GAAP"). The Highway Trust Fund is budgeted and accounted for on a multi-year project basis, not for each "fiscal period" like the General Fund. (R. pp. 11)

The Act contains no express provision authorizing loans of taxes in the Trust Fund for objects or purposes

other than those stated in the Act. N.C. Gen. Stat. § 136-175 et seq.

Plaintiffs are citizens, taxpayers and residents of the State of North Carolina and the United States and have been for more than forty years. (R p. 8) Since 1989, Plaintiffs and millions of taxpayers and the motoring public similarly situated have paid motor fuels taxes, alternative fuels taxes, highway use taxes, fuel and oil inspection taxes, driver license fees, auto title certificate fees, vehicle registration fees, lease and lien recording fees, and other related taxes and fees from 1989 through today. (R pp. 8-9) Taxpayers pay tax revenue into three separate funds: (1) the General Fund, (2) the Highway Fund, and (3) the Trust Fund. Each fund receives specific tax revenue which is accounted for separately in the State Treasury. (E. P. Ex. 15)

Plaintiffs' have: (1) direct standing (See e.g. Texfi Industries, Inc. v. City of Fayetteville, 44 N.C. App. 268, 270, 261 S.E.2d 21, 23 (1979), affirmed, 301 N.C. 1, 269 S.E.2d 142 (1980); Wynn v. Trustees, 255 N.C. 594, 599, 122 S.E.2d 404, 407-08 (1961); (2) derivative standing(see e.g. Fuller, 145 N.C. App. at 395-96, 553 S.E.2d at 46-47; Guilford County Bd. of Comrs. v. Trogdon, 124 N.C. App. 741, 747, 478 S.E.2d 643, 647 (1996)); and (3)

constitutional standing (see e.g. Lewis, 287 N.C. at 643-44, 216 S.E.2d at 146; Shaw v. City of Asheville, 269 N.C. 90, 95, 152 S.E.2d 139, 143 (1967) (where the governing authorities put public property to an unauthorized use, citizens and taxpayers may seek equitable relief); Wishart v. Lumberton, 254 N.C. 94, 96, 118 S.E.2d 35, 36 (1961).

B. The North Carolina Constitution

The North Carolina Constitution protects North Carolina citizens from the misuse and misapplication of their tax monies: (1) Article V, 5 of the North Carolina Constitution entitled "Acts Levying Taxes to State Objects" provides that: "**Every act of the General Assembly levying a tax shall state the special object to which it is to be applied, and it shall be applied to no other purpose.**" (Emphasis added); (2) Article III, § 5(3) only permits the Governor to "**effect the necessary economies in State expenditures**" when the State is facing a budgetary shortfall (emphasis added); (3) Article VI, § 7 requires the Governor to support and maintain the Constitution; (4) Article V, § 3 of the North Carolina Constitution restricts when and how the General Assembly can borrow money; and (5) Article I, § 6 mandates separation of governmental powers.

C. The Executive Branch's Actions

On February 5, 2002, the Governor issued Executive Order No. 19 ("Order 19"). Section 5 states that "OSBM [the Office of State Budget and Management] may transfer, as necessary, funds from the Highway Trust Fund Account for support of General Fund appropriation expenditures." (E, P Ex. 4 and 19)

The State Budget Officer directed that \$80 million be debited from the Highway Trust Fund and credited to the General Fund pursuant to Order 19. The \$80 million was transferred by the State Controller on 8 February 2002. (R. 34) (E. P. Ex. 4) The Governor issued Executive Order No. 22 ("Order 22") on June 27, 2002, effective July 1, 2002, which extended Order 19 through the 2002-2003 fiscal period. (E, P Ex. 29-A)

The \$80 million transfer during fiscal year 2001-2002 is the **only time** since 1989 that monies were transferred from the Highway Trust Fund to the General Fund by Executive Order. (R. p. 34)

D. The General Assembly's Actions

The General Assembly made a loan to itself of \$125 million from the Trust Fund for use in general appropriations for the 2002-2003 fiscal period pursuant to Section 2.2(g) of Session Law 2002-126 (the Budget Bill). Section 2.2(g)

does not reference or amend the Act (N.C. Gen. Stat. § 136-175 *et seq.*) or any North Carolina General Statute, including taxing act N.C. Gen. Stat. § 105-187.9.

Taxes in the Trust Fund were removed and exhausted by various General Fund expenditures, none of which relate to the special objects and purposes set forth in the Trust Fund Act. The constitutionally protected public funds were diverted and "applied" for "another purpose" other than highway safety, transportation, repair, construction or any other express object and purpose of the Trust Fund.

ARGUMENT

I. SUMMARY OF ARGUMENT

This case involves two unlawful transfers totaling \$205 million in Trust Fund taxes to pay for deficiencies in the budget of the fiscal period appropriations for 2002-2003. First was the 8 February 2002 transfer of \$80 million pursuant to Executive Order 19 by the Governor. The second was the transfer or loan of \$125 million pursuant to Section 2.2(g) of Session Law 2002-126. No genuine issue of material fact exists. Plaintiffs are entitled to judgment under N.C. Gen. Stat. § 1A-1, Rule 56 because: (1) Article V, § 5 and the nature of the Trust Fund forbid the confiscation by the Executive Branch and General Assembly of \$205 million from the Trust Fund for

General Fund appropriations; and (2) the Executive Branch has no constitutional authority to confiscate and transfer \$80 million from the Trust Fund to the General Fund.

II. ARTICLE V, § 5 AND THE NATURE OF THE HIGHWAY TRUST FUND FORBID TRANSFERS OF HIGHWAY TRUST FUND TAXES TO THE GENERAL FUND FOR CURRENT FISCAL YEAR EXPENDITURES.

PLAINTIFFS' ASSIGNMENTS OF ERROR NOS. 1-2. (R p. 58)

Taking of \$205 million from the Trust Fund and applying it to the General Fund was unconstitutional because of (A) the plain language of Article V, § 5 of the North Carolina Constitution, (B) the Highway Trust Fund Act, (C) the North Carolina General Statutes, (D) case law precedent, and (E) legal principles of a trust fund.

A. The Plain Language of Article V, 5 Prohibits Transfer of Highway Trust Fund Taxes to be Applied to General Fund Appropriations.

Article V, § 5 was first approved by the People in 1868 and again in 1971. It is a basic right. The Constitution guarantees that the People will be taxed on the "fruits of their labor" only for a specific purpose which must be disclosed in the law, in advance, before the taxes can be collected. It also guarantees that public monies once collected as taxes can only be spent for the objects and purposes stated in the tax law.

Article V, § 5 provides:

Acts levying taxes to state objects.
Every act of the General Assembly

levying a tax shall state the special object to which it is to be applied, and it shall be applied to no other purpose.

(Emphasis added). This language is simple. It is clear. First, every tax law must state the "special object" for which the revenue is to be collected. The second clause is likewise simple and clear. Once collected, the tax "shall be applied to no other purpose. The Constitution "requires that substance follows form." John V. Orth, The North Carolina State Constitution, 126 (1993) (emphasis added). Defendants violated Article V, § 5 by diverting \$205 million raised for the clearly defined purposes of the Trust Fund and applying it to objects and purposes other than those specifically identified in the Act.

Questions of constitutional construction are governed by the general principles that control the meaning of any law or written instrument. In re Peoples, 296 N.C. 109, 162, 250 S.E.2d 890, 920 (1978). "[W]here one statute deals with a particular subject or situation in specific detail, while another statute deals with the subject in broad, general terms, the particular, specific statute will be construed as controlling, absent a clear legislative intent to the contrary." Nucor Corp. v. Gen. Bearing Corp., 333 N.C. 148, 154-55, 423 S.E. 2d 747, 751 (1992);

Trs. of Rowan Technical Coll. v. Hammond Assocs., et al., 313 N.C. 230, 238, 328 S.E.2d 274, 279 (1985); Nat'l Food Stores v. N.C. Bd. of Alcoholic Control, 268 N.C. 624, 151 S.E.2d 582 (1966).

Here, Article V, § 5 deals directly and specifically with the subject of levying a tax and spending the money. Defendants offer no explanation of collecting a tax for one purpose and applying it to another purpose or object. No other justification can control the plain simply meaning of Article V, § 5. Article V, § 5 circumscribes all other powers related to taxes.

B. The Highway Trust Fund Act itself Prohibits Transfer of Highway Trust Fund Taxes.

The structure of the Trust Fund Act is based on Article V, § 5. One major concern for Goldston (a Democrat) and Harrington (a Republican) was that no future Governor or General Assembly, regardless of political persuasion, would confiscate and divert the highway taxes imposed on the public for purposes other than objects expressly identified. The Constitution guarantees that new taxes raised will be used, without exception, for no purpose other than for special objects specifically listed in the Revenue Act. This was the main reason for creating the Highway Trust Fund as a "trust," as opposed to simply creating an account within the General Fund to pay for

specific highway projects listed within a fiscal period's general revenue appropriations.

Consistent with the Constitution, the Trust Fund was (1) created in a single revenue law; (2) the bill specifically and expressly listed each tax to be collected for Highway Trust Fund "objects and purposes;" and (3) the law specifically and expressly states in detail the special objects to which the taxes deposited into the Trust Fund "shall be applied." The Act is faithful to the Constitution.

1. The Highway Trust Fund Act Identifies Specific Taxes.

The Act expressly and in detail identifies "taxes" and "fees" that shall be collected and deposited in a trust account as "special," not "general," revenue. N.C. Gen. Stat. § 136-175, *et seq.* The Act is purposefully named a "Trust Fund." The Trust account is separately created, funded, accounted for, and maintained. The Trust Fund contains no money from any other general revenue tax.

Specifically identified highway taxes are properly designated "Special Revenue Funds" in the State Treasurer's accounts. According to Generally Accepted Accounting Principles ("GAAP") and the Government Accounting Standards Board ("GASB"), Trust Fund "special revenue" are "funds

maintained to account for those financial resources which are restricted by legal, regulatory or administrative action to finance particular functions or activities of the State." (E. P. Ex. 21)

2. The Highway Trust Fund Act Identifies Specific Objects (Purposes).

Faithful to the Constitution, the Act expressly enumerates special objects to which Trust Fund monies shall be applied: (1) Intrastate Highway System; (2) Urban Loops around seven named cities; (3) City streets; (4) Secondary roads having a specific traffic count; (5) Debt service on highway bonds issued in 1997 and sold; and (6) related DOT administration expenses.

3. The Highway Trust Fund Act Itself Limits how Trust Fund Monies are Spent.

The Trust Fund Act provides: "Funds in the Trust Fund are annually appropriated to the Department of Transportation to be allocated and **used as provided in this subsection.**" N.C. Gen. Stat. § 136-176(b) (Emphasis supplied). The law orders a cap of 4.5% of the fund to be used by the Department of Transportation for expenses to administer the Act, its mandated programs, and its specific projects. "The rest of the funds in the Trust Fund **shall** be allocated and used as follows" N.C. Gen. Stat. § 136-176(b) (emphasis added). The use of the word "shall"

connotes a legal obligation. The Act then painstakingly details how each dollar in the fund shall be spent. Trust taxes are reserved for highway projects, not new or different programs, salaries, general government operations, retirement, education, welfare, law enforcement, etc.

The Act assures strict oversight of expenditures of Trust Fund monies. N.C. Gen. Stat. § 136-184(b) states: "The Department [of Transportation] **shall** provide the [Legislative] Committee with all information needed to determine if funds available under the Trust Fund . . . are being spent in accordance with G.S. 136-17.2A." (Emphasis added)

N.C. Gen. Stat. § 136-17.2A, Distribution Formula for Funds Expended on Intrastate System and Transportation Improvement Program, details further constraints. N.C. Gen. Stat. § 136-185 further restricts how Trust Fund monies are spent.

If the Highway Trust Fund has not terminated but all contracts for the projects of the Intrastate System described in G.S. 136-179 have been let and the amount collected and allocated for the Interstate System is enough to pay the contracts and retire any bonds issued under the State Highway Bond Act of 1996 for projects of the Intrastate System, **all subsequent allocations of revenue** for the Intrastate System shall be credited to a reserve account within the Trust Fund. **Revenue in this reserve may be used only**

to maintain the projects of the Intrastate System.

N.C. Gen. Stat. § 136-185 (Emphasis added).

The Act also contains a "sunset" provision.³ The Trust Fund is unlike the General Fund. It is to be held inviolate until its objects and purposes are completed. Confiscation and diversion of Trust Funds prevents the "sunset" of the Trust Fund.

C. Case Law Precedent Prohibits Transfer of Highway Trust Fund Tax Monies.

Every case decided by North Carolina's appellate courts regarding Article V, § 5 holds that the constitutional mandate and guarantee means exactly what it says. Courts analyze the facts and law to ensure that (1) the tax levied "states a special object" and (2) that the tax is "applied to no other purpose." Bd. of Educ. of Macon County v. Bd. of Comm'rs of Macon County, 137 N.C. 310, 49 S.E. 353 (1904) held that Article V, § 7 required that the special tax levied by Macon County could only be used to improve the public roads. The tax could not be used for general government purposes. "We are of the

³ When all of the roads and highways listed in the Act are completed, or their completion is provided for, and when all of the bonds and notes issued pursuant to the State Highway Bond Act of 1996 are retired or provision for their retirement has been made, the Trust Fund is repealed. Chapter 692, sec 8.4, 1989 N.C. Sess. Laws, as amended by Chapter 590, sec. 10(a), 1995 (Reg. Sess. 1996) N.C. Sess. Laws; Chapter 380, sec. 3, 1999 Sess. Laws.

opinion that, in order to give full force and effect to section 7, the entire tax must be applied to the purpose for which it was levied and collected." ⁴ Id. at 314, 49 S.E. at 354. The Supreme Court added that:

We must construe, and not make, the Constitution. To weaken the very essential safeguard against the abuse of the taxing power found in section 7, art. 5, would expose the property of the citizen to dangers which experience has shown to lurk in every form of government, because of the fact that 'the power to tax involves the power to destroy.' We should be slow to adopt a construction which would carry the capitation tax which must accompany every special tax for necessary purposes into a channel different from that 'stated,' setting at naught the peremptory command, 'It shall not be applied to any other purpose.' To do so would seriously embarrass the counties in meeting the ever-increasing demands of a progressive people for better roads, bridges, and public buildings.

Id. at 316, 49 S.E. at 355.

In State v. Rippy, 80 N.C. App. 232, 341 S.E.2d 98 (1986), this Court concluded that a defendant's argument that a particular tax violated Article V, § 5 of the North Carolina Constitution was without merit because "[t]he special purpose of Subchapter IV, as revealed by its title, is the conservation of marine and estuarine and wildlife resources. **It is evident that the license tax is levied and applied for this purpose.**" Id. at 235, 341 S.E.2d at 100

⁴ Present day Article V., § 5 is identical to Article V., § 7 as cited in these cases. Article V., § 5 was first added to the Constitution in 1868 as Article V., § 8. Sometime in the 1880's Article V., § 8 was renumbered Article V., § 7. In the Amendments to the North Carolina Constitution of the 1970's, Article V., § 7 was renumbered Article V., § 5.

(emphasis added). This Court held that the tax was being properly spent for the purposes for which it was collected. See Also McCless, et al. v. Meekins, et al., 117 N.C. 34, 23 S.E. 99 (1895) ("We are of the opinion that the act of 1895 [an Act that attempted to repeal the Act of 1889] is without effect, because it is against the provisions of article 5, § 7, of the constitution [sic], which is in these words: "Every act of the general assembly levying a tax shall state the special object to which it is to be applied and it shall be applied to no other purpose"); S. Ry. Co. v. Bd. of Comm'rs of Mecklenburg County, 148 N.C. 220, 238, 61 S.E. 690, 696-700 (1908) (The Supreme Court held that a county levying and collecting a tax to pay interest on its bonds cannot apply any part of the tax to another purpose because it would be in direct violation of the express prohibition of Article 5 § 7. "When these well-defined limits are disregarded, taxes become oppressive.").

These cases show that the appellate division axiomatically accepts Article V, Section 5 at face value. Case law precedent controls, and Plaintiffs are entitled to judgment as a matter of law regarding both diversions totaling \$205 million.

D. The Nature of the Highway Trust Fund Itself Prohibits Transfer of Tax Monies.

Not only does the Act conform to the Constitution by stating special objects to which the taxes must be applied, the Act creates a "trust fund."

"Trust fund" has a legal meaning. *Blacks Law*

Dictionary defines "trust fund" as:

A fund held by a trustee for the specific purposes of the trust; in a more general sense, a fund which, legally or equitably, is subject to be devoted to a **particular purpose** and **cannot** or **should not be diverted** therefrom.

Blacks Law Dictionary 1356 (4th ed. 1979); 1513-14 (6th ed. 1990) (emphasis added).

N.C. Gen. Stat. § 147-82, Accounts of Funds Kept Separate, requires that all "Trust Funds" shall be accounted for and maintained separately.

In order to **preserve** and **keep** them **separate**, all funds that are now required by law to be **kept separate . . . or funds handled or maintained as Trust Funds** in any form by such department . . . shall be evidenced in daily reports by distribution sheets, which shall reflect and show an exact copy of the accounts, showing the distribution of said money kept by such collecting departments . . . and the same shall be entered in the records of the office of the State Treasurer, so as to keep and maintain in the office where the same is first collected or received

N.C. Gen. Stat. § 147-82. Tax revenues in the Trust Fund are so administered. It cannot be administered as the law

commands if allowed to be wrongfully and unconstitutionally depleted.

"The State Treasurer's Annual Report from Fiscal Year 1990/1991" ("the Report") early on recognized the constitutional restraints placed on Trust Fund "special revenue." In the section entitled "Summary of Significant Accounting Policies," the Report states the following:

Trust Fund Assets and Equity—Assets of Trust Funds are maintained at cost. The net assets of each Trust Fund are held **solely for the benefit** of the lawful **beneficiaries** of the **Trust Funds**. Net assets of **Trust Funds** are shown in the financial statements as fund balance **reserved** for **trust beneficiaries**.

(E. P. Ex. 8) (Emphasis added)

Defendants' actions violate both the North Carolina Constitution and the legal and equitable principles of a trust fund. In addition, there is a second fund denominated the "Highway Fund" that is not the subject of this lawsuit. The existence of the "Highway Fund" begs the question: why have a separate "Highway Trust Fund" when a "Highway Fund" account exists? The very nature of a trust fund demands the highest protections accorded by principles of law and equity.

Defendants' actions emasculate all notions of "trust" associated with the "Trust Fund." If Defendants' actions are allowed to continue, and the Trust Fund be repeatedly

depleted, the word "trust" has no meaning. The current fiscal dilemma of 2005 lays the stage for repetition of this dangerous precedent set by the Executive Branch and the Legislative Branch. If the government can divert \$205 million from the People's Trust Fund, why can it not divert all of the People's Trust Fund?

III. THE EXECUTIVE BRANCH'S AUTHORITY TO BALANCE A FISCAL YEAR BUDGET BY "EFFECTING THE NECESSARY ECONOMIES IN STATE EXPENDITURES" FOR THE "FISCAL PERIOD" DOES NOT INCLUDE DIVERTING TAXES FROM THE HIGHWAY TRUST FUND COLLECTED FOR SPECIFIC PURPOSES.

PLAINTIFFS' ASSIGNMENTS OF ERROR NOS. 1-2. (R p. 58)

Even if this Court holds that Article V, § 5 countenanced the transfer of \$205 million from the Trust Fund to the General Fund, which it clearly does not, the Governor also had no authority or power to transfer those funds by Executive Order 19.

A. The Executive Branch Powers are Limited

"The Office of Governor has no such prerogative powers but is confined to the exercise of the powers conferred upon it by the constitution and statutes." State ex rel. Martin v. Melott, 320 N.C. 518, 528, 359 S.E.2d 783, 789 (1987). This is a critical distinction between the Governor's powers and those of the General Assembly.

Neither the Constitution nor the General Statutes authorize the Governor to make external changes in

legislative appropriations by diverting taxes from the Trust Fund to the General Fund. The 8 February 2002 transfer of \$80 million of Trust Fund revenue should be declared unconstitutional.

B. Article III, § 5(3) does not Empower the Executive Branch to Apply Taxes for Highway Trust Fund Purposes to General Fund Purposes.

The sole defense to raiding the Trust Fund is that Article III, § 5(3) empowers the Executive Branch to transfer Trust Funds in whatever amount notwithstanding Article V, § 5. Any reasonable reading of Article III, § 5(3) proves the error.

Article III, § 5(3) states in pertinent part:

Budget. The Governor shall prepare and recommend to the General Assembly a comprehensive budget of the anticipated revenue and **proposed expenditures** of the State for the ensuing **fiscal period**. The budget as enacted by the General Assembly shall be administered by the Governor.

The **total expenditures** of the State for the **fiscal period** covered by the budget shall not exceed the total of receipts during **that fiscal period** [W]henever he [sic] determines that receipts during the fiscal period will not be sufficient to meet **budgeted expenditures** the Governor shall **effect the necessary economies in State expenditures.**

(Emphasis added) "The second paragraph of this subsection, requiring a balanced budget, was added by amendment in 1977. It empowers the Governor to make 'necessary

economies in State expenditures,' without consulting the General Assembly, whenever he determines them [State expenditures of a "fiscal period"] to be necessary to avoid a deficit within the budgetary period." John V. Orth, The North Carolina State Constitution 96 (1993).

This provision requires the Governor, as head of the executive branch, to prepare and recommend to the General Assembly a Biennial Budget. Anticipated revenues should equal, or be no greater than, proposed expenditures. The General Assembly thereafter debates and enacts the Biennial Budget on a fiscal year basis. The year of each Biennial Budget is the "fiscal period" designated in the Constitution. After a budget for a specific "fiscal period" is enacted, the Governor administers it, *i.e.*, he is responsible for disbursing tax revenues according to legislative appropriations for the current fiscal period. N.C. Const. Art. III, § 5(3); N.C. Gen. Stat. § 143-2. His responsibility is to keep the Biennial Budget balanced within itself; not to raise revenue from external sources such as the Highway Trust Fund, retirement funds, and local government revenues.

The constitutional duties of the Governor do not extend to his acquisition of special revenue from the Trust Fund. Revenue in the Trust Fund is made up of past,

present and future taxes and fees collected over numerous years, unlike budget revenue collected in a specific fiscal period and deposited in the General Fund for appropriated expenditures during that fiscal period.

Article III, §5(3) is unambiguous and simple: when the actual receipts during a current fiscal period will not meet the State's budgeted expenditures projected for that fiscal period, the Constitution mandates that legislatively appropriated expenditures be reduced, *i.e.* "effect the necessary economies in state expenditures."

Article III, § 5(3) uses the definite article "the" and the pronoun "that." These words denote the current fiscal period in which the revenue shortfall occurs rather than an unlimited period of time, past or future. The phrase "fiscal period" appears four times. The term "expenditures" also appears four times. Article III, § 5(3) limits the Governor to altering "expenditures" of the "fiscal period" in which the actual receipts are "insufficient." Special revenue on deposit in the Trust Fund, by definition, does not include "receipts during the fiscal period." It is money that has been collected over many years from specific taxation to be applied to specific objects.

To "effect the necessary economies in state expenditures" has one meaning: adjust expenses. It cannot mean "increasing revenue" by increasing the General Fund with money from the Highway Trust Fund. There is no Constitutional provision allowing the Executive Branch to "increase revenues" from protected sources outside the budget for that "fiscal period."

Plaintiffs find only one reported appellate decision relating to Article III, § 5(3) "We hold . . . an expenditure occurs only when funds are disbursed." Boneno, et al. v. State, et al., 54 N.C. App. 690, 691, 284 S.E.2d 170, 171 (1981). Revenue that goes directly into the Trust Fund through the collection of specific taxes for special objects is not money that is "disbursed." Transfer of previously collected taxes from one account to another cannot be an "expenditure" nor is it an "appropriation" of the current "fiscal period."

C. The Executive Budget Act is Similar to Article III, § (5) (3) and does not and could not Confer Transfer Power to the Governor.

The Executive Budget Act contains language similar to Article. III, (5)(3). It also describes the procedure to administer the State's budget. The law also requires the Executive Branch to operate government on a balanced budget

during each fiscal period. N.C. Gen. Stat. § 143-25 provides that the Governor

may reduce all of said appropriations, *pro rata* when necessary, to prevent an overdraft or deficit to the fiscal period for which such appropriations are made. The purpose and policy of this Article are to provide and insure that there shall be no overdraft or deficit in the General Fund of the State at the end of the fiscal period, growing out of appropriations for maintenance, and the Director of the Budget is directed and required to so administer this Article as to prevent any such overdraft or deficit.

Id. Balancing of a budget has two elements—receipts of the fiscal period and appropriated expenditures of the fiscal period. The Governor cannot confiscate and divert special revenue from the Highway Trust Fund to the General Fund to increase “fiscal period revenue” when actual receipts of a fiscal period do not meet projected budgeted receipts of “that fiscal period.”

To do otherwise results in an Executive Branch ignoring the lawful budget and executing a personal unauthorized budget of income and expense. The legislative power to tax and spend is reserved solely to the legislative branch under our Constitution.⁵ Article I, § 6 states, “The legislative, executive, and supreme judicial

⁵ Appellants’ brief in County of Cabarrus, et. al. v. Tolston, No. COA04-594 recently was filed with this Court and contains the same issues as this brief. These Plaintiffs request that this Court consider the arguments contained in that brief as supplementary authority relating to Article V, § 5, Article III, § 5(3), and Article I, § 6 as they relate to Executive Order No. 19.

powers of the State government shall be forever separate and distinct from each other." Each distinct branch has its assigned function. One branch cannot invade the powers and duties of the other. State v. Holden, 64 N.C. 829, (1870). Enacting a budget of receipts and appropriating expenditures for a fiscal period is solely a function of the legislative branch. Rewriting and executing a different budget violates the doctrine of the separation of powers. The Governor thus exceeded his limited constitutional authority by creating a completely different budget and transferring monies from the Trust Fund to the General Fund.

D. Executive Order 19 does not Increase the Executive Branch's Power to Transfer Highway Trust Fund Taxes.

Issuance of an executive order does not increase the power and authority of the Governor. Executive Order No. 19, executed February 5, 2002, is titled "Classroom Protection and Orderly Budget Administration Given State of Fiscal Emergency." It states "unless further economies in State expenditures are made, the State's General Fund expenditures will exceed General Fund receipts, for the current fiscal year." Elsewhere, the Order acknowledges that the Governor must "effect the necessary economies in State expenditures" to offset the expected deficit. But

Section 5 of Executive Order No. 19 then provides that: "OSBM may transfer, as necessary, funds from the Highway Trust Fund Account for support of General Fund appropriation expenditures." The State Controller transferred \$80 million on 8 February 2002.

Using school children as cover ("classroom protection") in the title of Order 19 is disingenuous and provides no lawful powers under Article III, § 5(3) to manipulate the Biennial Budget. Putting the tag "emergency" on Executive Order No. 19 was of no legal consequence.

A hurricane, flood, or riot may constitute an emergency. An "emergency" does not occur when projected revenue and actual revenue are unequal. A temporary downturn in revenue collection is not a sudden event. Tax revenues are collected year-round and are reasonably predictable over short periods of time. Recessions are cyclical.

Overspending by government, on the other hand, is an historical, habitual vice. A revenue shortfall that began in 1999 and continues three years in a row is not an "emergency." It is failure to face realistically the slow-moving, evolving, and predictable economic reversal.

This Governor's predecessor, Governor James B. Hunt, also faced a slow-down in tax receipts in 1998. Unlike here, Governor Hunt followed the mandate of Article III, § 5(3) and Article V, § 5. He cut expenditures. He "effected the necessary economies in expenditures." The same thing is happening again in 2005.

E. The Governor has no Statutory Authority to Transfer Highway Trust Fund Tax Monies.

In addition to the Governor's powers and duties listed in Article III, the General Statutes give details for exercise of some additional powers vested in the executive branch. The Governor's powers are: Chapter 147, Article 3, § 147-12, (Powers and Duties of Governor); Chapter 147, Article 3A (Emergency War Powers of Governor); Chapter 166A, Article 1 (North Carolina Emergency Management Act of 1977); Article 36A, Riots and Civil Disorders [causing emergency]; N.C. Gen. Stat. § 147-70 (To Make Short-Term Notes in Emergencies) (the only law related to "fiscal emergency").

If the General Assembly intended for a Governor to have the power to confiscate and divert Trust Fund revenue to the General Fund, it would have defined the "emergency" and granted the power. It did not in 1989; it has not

since.⁶ The trial court erred. Plaintiffs are entitled to judgment as a matter of law regarding the \$80 million transfer.

CONCLUSION

The People in their Constitution do not authorize their tax money to be spent for objects other than those specified in the law levying the tax. When the Legislative Branch's budget for a fiscal period appears unbalanced, the People in their Constitution authorize the Executive Branch to cut spending, that is, "effect the necessary economies in state expenditures" from the expenditure side of the ledger. When the Legislative Branch puts the People's tax money into a "Trust" fund it must be spent only for the purposes and objects of the trust. To spend it otherwise is a violation of trust and the Constitution.

The trial court erred by denying Plaintiffs' motion for summary judgment and allowing Defendants' motion for summary judgment. There was no genuine issue of material fact and Plaintiffs were entitled to judgment as a matter of law based on Defendants' violation of Article V § 5,

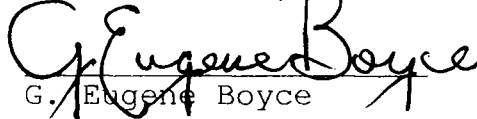
⁶ In 2004 the Legislature was called into special session for the sole purpose of changing tax and revenue laws to give Dell Computers \$250 million in tax benefits. The Governor could have called the General Assembly into special session for it to consider additional taxes or obtain loans as allowed by the Constitution.

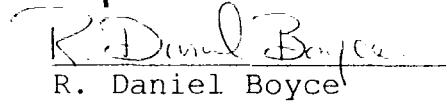
Article III § 5(3), Article I, § 6, and Article V § 3 of the North Carolina Constitution.

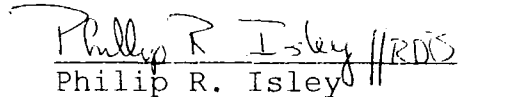
Accordingly, the trial court's order should be reversed.

Respectfully submitted this the ^{2nd} ~~3rd~~ day of ~~January~~ ^{FEBRUARY} 2005.


BOYCE & ISLEY, PLLC


G. Eugene Boyce


R. Daniel Boyce


Philip R. Isley
Post Office Box 1990
Raleigh, NC 27602-1990
Telephone (919) 833-7373

BRANNON STRICKLAND, PLLC


Anthony M. Brannon
Lawyers Weekly Building
107 Fayetteville Street Mall
Suite 201
Raleigh, NC 27601
Telephone (919) 838-5295
Fax (919) 838-5299

Attorneys for Appellants.

CERTIFICATE OF SERVICE

The undersigned attorney hereby certifies that on this day the foregoing **APPELLANTS' BRIEF** was served by placing copies in envelopes addressed to the persons named below, at the place and address stated below, which are their last known address, and by depositing said envelope in the United States Mail at Raleigh, North Carolina.

ADDRESSEE:

ROY COOPER
Attorney General

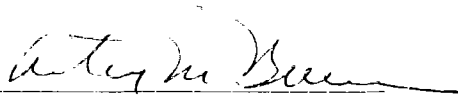
Grayson G. Kelley
Chief Deputy Attorney General

John Maddrey
Special Deputy Attorney General

Norma S. Harrell
Special Deputy Attorney General
North Carolina Department of Justice
Special Litigation Section
Post Office Box 629
Raleigh, North Carolina 27602-0629

This the 2nd of February 2005

BRANNON STRICKLAND, PLLC


Anthony M. Brannon