

STATE OF NORTH CAROLINA
COUNTY OF WAKE

IN THE GENERAL COURT OF JUSTICE
SUPERIOR COURT DIVISION
05 CVS 17197

CHARLES HEATHERLY; THOMAS
SPAMPINATO; W. EDWARD
GOODALL, JR.; PAUL STAM; WAKE
COUNTY TAXPAYERS ASSOCIATION;
and THE NORTH CAROLINA FAMILY
POLICY COUNCIL

Plaintiffs,

WILLIS WILLIAMS; NORTH
CAROLINA FIAR SHARE; and NORTH
CAROLINA COMMON SENSE
FOUNDATION,

Proposed Plaintiff-Intervenors

v.

STATE OF NORTH CAROLINA;
CHARLES A. SANDERS, BRYAN E.
BEATTY, LINDA CARLISLE, ROBERT
A. FARRIS, JR., JOHN R. MCARTHUR,
JIM WOODWARD, and ROBERT W.
APPLETON, Members of the North
Carolina Lottery Commission, in their
official capacity; NORTH CAROLINA
LOTTERY COMMISSION; THOMAS N.
SHAHEEN, Executive Director of the
North Carolina Education Lottery, in his
official capacity; MICHAEL F. EASLEY,
Governor of the State of North Carolina, in
his official capacity; RICHARD H.
MOORE, Treasurer of the State of North
Carolina, in his official capacity,

Defendants.

PLAINTIFFS' BRIEF IN SUPPORT
OF MOTION FOR PRELIMINARY
INJUNCTION

This matter is before the Court on a matter of the utmost urgency: whether \$10 million of the state budget will be spent creating a lottery, the constitutionality of which is in grave doubt.

This action is brought pursuant to the Uniform Declaratory Judgment Act, N.C. Gen. Stat. § 1-253 to challenge the constitutionality of North Carolina's HB 1023, as ultimately amended by section 31.1 of SB 622, titled "AN ACT TO ESTABLISH A STATE LOTTERY TO GENERATE FUNDS TO FURTHER THE GOAL OF PROVIDING ENHANCED EDUCATIONAL OPPORTUNITIES SO THAT ALL STUDENTS IN THE PUBLIC SCHOOLS CAN ACHIEVE THEIR FULL POTENTIAL, TO SUPPORT SCHOOL CONSTRUCTION, TO FUND COLLEGE AND UNIVERSITY SCHOLARSHIPS, AND TO MAKE CONFORMING CHANGES TO THE GENERAL STATUTES" ("the Lottery Act") and to seek a judgment finding null, void and unenforceable the same on the grounds that passage of the same did not satisfy requirements of the North Carolina Constitution. (A copy of HB 1023 as amended by section 31.1 of SB 622 is attached to the Complaint as Exhibit A.).

Plaintiffs seek a preliminary injunction and submit this brief in support thereof.

I. STATEMENT OF FACTS

A. Legislative History

The following chronology details the purported enactment of the Lottery Act:

March 30, 2005:

- HB 1023 was filed in the House of Representatives was read for the first time and referred to committee the following day.

April 6, 2005:

- *First vote:* HB 1023 (Committee Substitute) was placed on the calendar for that day for immediate consideration, (A copy of HB 1023 (Committee Substitute) is attached to the Complaint as Exhibit B), and was called for a second reading and vote that same day. The bill passed its second reading, by electronic vote, 62-58. The yeas and nays of the vote on the second reading were recorded in the House Journal. The vote total was adjusted to 61-59 after one representative (Representative Harrison) asked permission for and was granted permission to change her vote from "aye" to "no."

- *Second vote*: Immediately after the vote on the second reading, HB 1023 (Committee Substitute) passed on a purported third reading by voice vote, as reflected in the House of Representatives Journal for that day. (A copy of the House Journal for April 6, 2005, is attached to the Complaint as Exhibit C). The yeas and nays were not recorded in the House Journal.
- That same day, after purportedly passing HB 1023 (Committee Substitute) on a vote following a third reading, the House sent HB 1023 (Committee Substitute) to the Senate.

April 7, 2005:

- HB 1023 (Committee Substitute) was received by the Senate, was read for the first time and was referred to the Committee on Rules and Operations of the Senate that same day.

May 5, 2005:

- SB 622 (the “Budget Bill”) was passed in the Senate. The Budget Bill contained provisions at section 31.1 which related to a State Lottery.

June 16, 2005:

- The House passed the Budget Bill on June 16, 2005, without the Lottery provisions in the bill. However, after being sent to Conference Committee, SB 622 emerged with the Lottery provisions of section 31.1 included. These provisions were dependant for enactment upon the passage of HB 1023 (Committee Substitute) and would amend HB 1023 (Committee Substitute) *if* it (HB 1023 (Committee Substitute)) became law.

August 16, 2005:

- SB 622 passed both houses, and was signed into law by the Governor on August 13, 2005. (A copy of section 31.1 of SB 622 is attached to the Complaint as Exhibit D.)

August 24, 2005:

- After approximately 20 hours of debate, Marc Basnight as Senate President Pro Tempore announced that the Senate had concluded its business for the session, would not be taking any additional votes, and would return the following week to take up a resolution for adjournment.

August 26, 2005:

- Members of the Senate were supposedly notified that the Senate would be in session on August 30, 2005, to consider any eligible legislation.

August 30, 2005:

- The Committee on Rules and Operations of the Senate reported HB 1023 (Committee Substitute) favorably to the Senate and it was placed on the calendar for that day.
- *First vote:* HB 1023 (Committee Substitute) was passed by the North Carolina Senate on a purported second reading on August 30, 2005 by electronic vote. The yeas and nays of the vote on the second reading were recorded in the Senate Journal. The vote after the second reading in the Senate was tied at 24 yeas and 24 nays, and a tie breaking “yea” vote was cast by Lieutenant Governor Beverly Perdue, presiding in her official capacity. (A copy of the Senate Journal from August 30, 2005 is attached to the Complaint as Exhibit E).
- *Second Vote:* The same day as the second reading and vote, HB 1023 (Committee Substitute) passed by voice vote after a purported third reading. The yeas and nays of the vote on third reading were not recorded in the Senate Journal.

August 31, 2005

- HB 1023 (Committee Substitute) having purportedly passed the House and Senate and been signed by the presiding officers of each, and by the Governor became law on August 31, 2005 (See Exhibit A), and HB 1023 (Committee Substitute) was thus amended by section 31.1 of SB 622 and the final manifestation of the Lottery Act was complete.

B. Provisions of the Lottery Act

A review of the provisions of the Lottery Act is essential to understanding how and why it is unconstitutional. The Lottery Act states that its purpose is “to establish a State-operated lottery to generate funds for the public purposes” described in the bill, i.e., public education. The substantive provisions of the bill are as follows:

North Carolina State Lottery Fund

Pursuant to Article 7 of HB 1023 as amended by section 31.1 of SB 622

- *Enterprise fund:* The Lottery Act created an enterprise fund within the State treasury, to be known as the North Carolina State Lottery Fund, the purpose of which is to generate revenue to be used for the educational welfare of all North Carolina citizens and residents.

- *Purpose:* The North Carolina State Lottery Fund will be the repository for all proceeds from the sale of lottery tickets, public funds for initial start-up costs provided by the State, all other funds credited or appropriated to the Lottery Commission, and interest earned by the North Carolina State Lottery Fund.

Revenues from the Sale of Lottery Tickets

- The Lottery Act directs the Lottery Commission, to the extent practicable, to allocate revenues from the sale of lottery tickets in the following manner:
 - a. At least 50% of the total annual revenues for prizes;
 - b. At least 35% of the total annual revenues to be transferred to the Education Lottery Fund as directed by §18C-164 of HB 1023;
 - c. No more than 8% of the total annual revenues for payment of expenses of the lottery; and
 - d. No more than 7% of the total annual revenues for compensation paid to lottery game retailers.

Allocation of Net Revenue

- The Lottery Act directs the Lottery Commission to distribute the net revenue of the North Carolina State Lottery Fund annually as follows:
 - a. **5%** shall be transferred to the Education Lottery Reserve Fund to be used for purposes of conforming the General Assembly's appropriation of net revenue (which is based on estimates) to the actual net revenues for any given year.
 - b. the remaining net revenues shall be distributed as follows:
 - * **50%** shall be transferred to the Education Lottery Fund to support reduction of class size in early grades of public schools;
 - * **40%** shall be transferred to the Public School Building Capital Fund created in Article 38A of Chapter 115C of the General Statutes and appropriated for expenditure in accordance with that Article;
 - * **10%** shall be transferred to the State Educational Assistance Authority and appropriated to fund scholarships pursuant to Article 35A of Chapter 115C of the General Statutes.

Appropriation by General Assembly

- Pursuant to §18C-164(d) of HB 1023 as amended by section 31.1 of SB 622, the Education Lottery Fund, the Public School Building Capital Fund, and the State Educational Assistance Authority shall be subject to appropriation by the General Assembly and shall be used to further the goal of providing enhanced educational opportunities so that all students in the public schools can achieve their full potential.

Income Tax on Lottery Winnings

- Section 10.2(a) of the Lottery Act directs the Lottery Commission to deduct and withhold state income taxes from the payment of winnings that are reportable to the Internal Revenue Service.
- The amount of taxes to be withheld is seven percent of the winnings.
- Section 10.3 of the Lottery Act rewrites in part N.C. Gen. Stat. § 105-134 to impose a tax on every nonresident of North Carolina who derives income from gambling activities in the State, including the lottery.

Loan to Fund Start-Up Costs

Pursuant to Section 15 of the Lottery Act:

- The State Treasurer is directed to lend to the North Carolina State Lottery Commission, at a rate of interest comparable to short-term rates in the private capital market and with repayment terms satisfactory to both parties, sufficient State funds to cover initial operating expenses of the Lottery Commission, except that the total amount of borrowed funds shall not exceed \$10 million.
- The borrowed funds are to be deposited in the North Carolina State Lottery Fund and are to be available for expenditure as set forth in the Lottery Act without further action by the General Assembly.

II. ARGUMENT

A. Standard for Issuance of a Preliminary Injunction

Under North Carolina law, a preliminary injunction will issue if the movants can show a likelihood of success on the merits and that an injunction is necessary to protect them from irreparable harm during the litigation either because a remedy at law is insufficient or for the

protection of their rights during the course of the litigation. See A.E.P. Industries, Inc. v. McClure, 308 N.C. 393, 405, 302 S.E.2d 754, 762 (1983). The Court must also consider the equities of the situation: "The judge in exercising his or [her] discretion should engage in a balancing process, weighing potential harm to the plaintiff if the injunction is not issued against the potential harm to the defendant if injunctive relief is granted." Williams v. Greene, 36 N.C. App. 80, 86, 243 S.E.2d 160 (1978) disc. rev. denied, appeal dismissed, 295 N.C. 471, 246 S.E.2d 12 (1978) (citing Huggins v. Board of Education, 272 N.C. 33, 157 S.E.2d 703 (1967)).

Plaintiffs meet the requirements for a preliminary injunction because 1) they demonstrate their likelihood of success on the merits, 2) irreparable harm will ensue absent a preliminary injunction, and 3) the equities favor issuance of the injunction.

B. Plaintiffs Demonstrate A Likelihood of Success on the Merits

Passage of the Lottery Act was not in accordance with the requirements mandated in Art. II, Sec. 23 of the North Carolina Constitution and was thus improperly and unconstitutionally enacted. The only conclusion this Court can reach is that Defendants failed to follow constitutional procedure in the passing the Lottery Act. During the course of this litigation, Plaintiffs will present serious questions concerning deprivation of their constitutional rights.

The Lottery Act purports to provide the sole legal authority for creating a lottery. Thus, the validity of the contracts and past and future expenditure of public funds necessarily relies on the validity of the Lottery Act. Absent the authority of the Lottery Act, Defendants would have no authority to enter contracts or expend public funds to implement the Lottery Act. Since an unconstitutional law is void, "it imposes no duties, confers no rights, creates no office, bestows no power or authority on anyone, affords no protection, and justifies no acts performed under it .