

No. 317P06

TENTH JUDICIAL DISTRICT

NORTH CAROLINA SUPREME COURT

CHARLES HEATHERLY, *et al.*,)

Plaintiffs,)

WILLIS WILLIAMS, *et al.*)

Plaintiff-Intervenors,)

v.)

STATE OF NORTH CAROLINA, *et al.*,)

Defendants.)

Wake County
05 CVS 17197

**RESPONSE TO PETITION FOR DISCRETIONARY REVIEW
UNDER G.S. 7A-31(b) AND APPELLATE RULE 15**

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TO THE HONORABLE SUPREME COURT OF NORTH CAROLINA:

NOW COME the defendants-respondents to this action, by and through their undersigned counsel, and respond to plaintiffs-petitioners' Petition for Discretionary Review Under G.S. 7A-31(b) and Appellate Rule 15. Without opposing or supporting the petition, respondents point out to the Court the following matters relevant for its consideration of the petition.

STATEMENT OF THE CASE

Plaintiffs brought this action on 15 December 2005 seeking to have the trial court declare unconstitutional, and enjoin the implementation of, the North Carolina Lottery provisions, Chapter 344 of the 2005 North Carolina Session Laws (hereafter the "Lottery Act"), as amended by Part XXXI of Chapter 276 of the 2005 Session Laws. At that time plaintiffs were three citizens and residents of Wake County, one citizen and resident of Union County, plus two non-profit organizations, the Wake County Taxpayers Association, and the North Carolina Family Policy Council. At that time defendants were the State itself and the North Carolina Lottery Commission, plus seven Lottery Commission members, the Executive Director of the Lottery, the Governor, and the State Treasurer, all sued in their official capacities. Plaintiffs claim the Lottery Act was enacted in violation of Article II, Section 23 of the Constitution of North Carolina, requiring that bills

raising money on the credit of the State, pledging the faith of the State, or imposing a tax, be read in the General Assembly on three separate days. Originally plaintiffs further claimed the Lottery Act violates Article V, Section 7 of the North Carolina Constitution by providing for the drawing of money from the State Treasury without the necessary appropriation having been made by law.

On 14 February 2005 the trial court allowed intervention in this action by three plaintiff-intervenors, then including a citizen and resident of Martin County, plus North Carolina Fair Share and North Carolina Common Sense Foundation, two non-profit organizations. The plaintiff-intervenors' claims are essentially identical to those of plaintiffs.

On 30 December 2005 plaintiffs moved for a preliminary injunction to prevent defendants from transferring money from the State Treasury to the North Carolina State Lottery Fund, disbursing money from the Lottery Fund and entering into contracts under the Lottery Act.

On 18 January 2006 defendants moved to dismiss this action pursuant to N.C.G.S. §12(b)(1), (2), and/or (6) on the grounds that the action is barred by sovereign immunity, that plaintiffs lack standing to bring the action, and that plaintiffs have failed to state a claim upon which relief may be granted.

On 13 February 2006 the trial court heard plaintiffs' motion for a preliminary injunction, defendants' motion to dismiss, and plaintiff-intervenors' motion to intervene. The trial court allowed the intervention, denied plaintiffs' motion for a preliminary injunction (R pp. 276-78), and denied defendants' motion to dismiss as to Counts One, Two, Three, and Six, but granted the motion as to Counts Four and Five (R pp. 279-82). The trial court entered a Scheduling Order directing the defendants to answer the complaints by 3 March 2006, allowing the parties to file briefs no later than 15 March 2006, ordering the parties to file proposed orders no later than 15 March 2006, and scheduling a hearing on the merits for 20 March 2006. Defendants filed their answers to both complaints on 3 March 2006.

On 20 March 2006 the trial court conducted a hearing on the merits. By Order dated 21 March 2006, judgment was entered for defendants on all claims (R pp. 446-57). By that same order the trial court ruled that the organizational plaintiffs and plaintiff-intervenors lacked standing, and assessed costs against plaintiffs and plaintiff-intervenors.

On 29 March 2006 plaintiffs appealed. On 4 April 2006 plaintiff-intervenors Williams and the North Carolina Common Sense Foundation appealed. On 10 April 2006 defendants filed a cross appeal. The record on appeal was

docketed in the North Carolina Court of Appeals on 15 June 2006. Petitioners (plaintiffs-appellants and intervenors-appellants) timely filed their petition for discretionary review with this Court.

STATEMENT OF FACTS

The Lottery Act was proposed in House Bill 1023 of the 2005 General Assembly. A Committee Substitute was given a favorable report in the House of Representatives on 6 April 2005, and it passed its second and third readings in the House on that day. On 11 August 2005 the General Assembly enacted Senate Bill 622, the Current Operations Appropriations Act, Chapter 276 of the 2005 Session Laws; in Part XXXI of Chapter 276 (also referred to as the “Budget Act”), the General Assembly amended House Bill 1023, so that if and when House Bill 1023 was ratified, it would be as amended by Chapter 276. On 30 August 2005 the Senate considered the Committee Substitute of House Bill 1023, and it passed its second and third readings that day. Thus, the ratified House Bill 1023, as amended by Part XXXI of Chapter 276, is the Lottery Act which plaintiffs seek to de-rail in this litigation.

The Lottery Act establishes the North Carolina State Lottery Fund as an enterprise fund within the State Treasury. N.C.G.S. § 18C-160 (2005). Overseeing the Lottery is a Lottery Commission, located within the Department of

Commerce for budgetary purposes, but otherwise functioning as “an independent, self-supporting, and revenue-raising agency of the State.” N.C.G.S. § 18C-110 (2005). The Commission appoints a Director, who operates and administers the Lottery and serves as Secretary to the Commission. N.C.G.S. § 18C-120 (2005). The Commission may choose from a variety of types of lottery games to be used in the North Carolina Lottery, other than ones using certain types of video gaming machines. N.C.G.S. § 18C-130 (2005); *see also* N.C.G.S. § 18C-103(4) (2005). Lottery revenues are to be allocated 50% to prizes, at least 35% to the Education Lottery Fund, no more than 8% to Lottery expenses, and no more than 7% to Lottery retailers. N.C.G.S. § 18C-162 (2005). From the Education Lottery Fund, 5% goes to the Education Lottery Reserve Fund. Of the rest, 50% goes to reduction of class sizes in early grades and pre-kindergarten programs for at-risk four-year-olds, 40% goes to the Public School Building Capital Fund, and 10% goes to the State Educational Assistance Authority for college and university scholarships. N.C.G.S. § 18C-164(b)-(c) (2005). The Lottery Commission is required to withhold for state income tax purposes 7% from winnings reportable to the Internal Revenue Service, and revenue laws have been amended to make it clear that Lottery winnings are taxable income for non-residents winning Lottery prizes in North Carolina. N.C.G.S. §§ 105-134(2), 105-134.5(b), 105-163.2B

(2005). The State Treasurer was directed to lend up to \$10 million to the Lottery Commission for start-up expenses, at an interest rate comparable to private market short-term rates, with all loan money to be repaid within twenty-four months from the effective day of the Act. 2005 N.C. SESS. LAW 344 § 15.

Plaintiffs brought this action contending that the Lottery Act was enacted in violation of Article II, Section 23 of the Constitution of North Carolina. Article II, Section 23 reads as follows:

Sec. 23. Revenue bills.

No law shall be enacted to raise money on the credit of the State, or to pledge the faith of the State directly or indirectly for the payment of any debt, or to impose any tax upon the people of the State, or to allow the counties, cities, or towns to do so, unless the bill for the purpose shall have been read three several times in each house of the General Assembly and passed three several readings, which readings shall have been on three different days, and shall have been agreed to by each house respectively, and unless the yeas and nays on the second and third readings of the bill shall have been entered on the journal.

Specifically, plaintiffs claimed that the Lottery Act raises money on the credit of the State (Count One), pledges the faith of the State for payment of the Lottery debts (Count Two), imposes an “implicit tax” by providing that Lottery funds would be spent 35% for funding education and 15% for operation of the Lottery (Count Three), imposes an express tax on residents by requiring withholding of 7% of Lottery winnings for State income tax (Count Four), and creates an express tax

on nonresidents by requiring them to pay North Carolina income tax on Lottery prizes (Count Five). As to each of these counts, plaintiffs alleged that the Lottery Act is unconstitutional because it was not read on three separate days in each house of the General Assembly as is required for legislative acts that fall within the scope of Article II, Section 23.

Defendants do not contend that the Lottery Act itself was enacted in accordance with the procedural requirements of Article II, Section 23; instead, defendants deny that the Lottery Act is within the scope of Article II, Section 23. Defendants further deny that the Lottery Act itself or any action pursuant to the Lottery Act violates Article II, Section 23. Moreover, in their Answers to plaintiffs' complaint and to plaintiff-intervenors' complaint, defendants noted that the Budget Act was read three separate times on three separate days in each house and that the yeas and nays on the second and third readings were recorded in both journals for the Budget Act. Some of the language which became part of the Lottery Act, such as provisions regarding income tax, were contained only in the Budget Act. *See* §§ 31.1(aa), 31.1(bb), 31.1(dd) of Chapter 276 of the 2005 Session Laws & N.C.G.S. §§ 105-134(2), 105-134.5(b), 105-163.2B. The trial court ultimately rejected all plaintiffs' claims as being without merit.

FACTORS RELEVANT TO DISCRETIONARY REVIEW

Plaintiffs-appellants and intervenors-appellants (hereinafter “petitioners”) contend that this Court should certify three issues for review. *See* Pet. at 16. However, petitioners make an argument in support of review only of the enactment of the Lottery. Indeed, their Petition states clearly that “questions presented in this case relating to interpretation and application of Article II, § 23 of the North Carolina Constitution and interpretation of N.C.G.S. § 18C-101, *et seq.* (the Lottery Act) are questions that meet the criteria for this Court’s discretionary review.” (Pet. at 2) Having made no argument whatsoever that any other issue decided by the trial court merits discretionary review, specifically the trial court’s rulings that (a) the non-profit organizational petitioners lack standing to complain and (b) petitioners are to be taxed with the costs of the action, petitioners have effectively abandoned their nominal quest for discretionary review of those issues.

Petitioners claim to meet three of the criteria for discretionary review under N.C.G.S. § 7A-31(b): (1) significant public interest; (2) legal principles of major significance to the jurisprudence of the State; and (3) delay in final adjudication will cause substantial harm. However, petitioners have brought forward no argument that necessarily compels a departure from the normal appellate process of cases going first to the Court of Appeals and then, as appropriate, to this Court.

I. PUBLIC INTEREST

Petitioners argue that this action involves a matter of significant public interest. The real problem with petitioners' contention is that, surely, this Court's certification of a matter on the grounds of significant public interest is appropriate only when there are also legal issues of a nature that would necessitate the bypassing of the Court of Appeals. While the Lottery may have stimulated public interest, the legal issues are not so difficult as to justify ignoring the regular and orderly procedure of having appeals heard first by the Court of Appeals, and then by this Court if appropriate, regardless of whether the issue is newsworthy.

Petitioners assert that the process of enacting the Lottery has generated much public debate and that there has even been an indictment related to the Lottery. As to the indictment, there is nothing in the record to support petitioners' assertion, and - moreover - the indictment to which petitioners refer has nothing to do with the legal issues plaintiffs raise here. As to public debate, that debate has largely been of a philosophical nature unrelated to the legal issues raised by petitioners.

In an attempt to bolster their contention that this action has significant public interest, petitioners also suggest that somehow the enactment of the Lottery

presents questions under *Leandro v. State*, 346 N.C. 336, 488 S.E.2d 249 (1997).¹ However, contrary to petitioners' suggestion, the Lottery was not enacted to meet the State's obligation under the State Constitution and under the *Leandro* decision to provide an opportunity to all public school students for a sound basic education. In the first place, not every educational expenditure made by the State for public education is an expenditure required to provide the educational opportunity mandated by the Constitution and by *Leandro*. The Lottery Act clearly provides that the funds generated by the Lottery are to be used for scholarships for post-secondary education, for the Public School Building Capital Fund, and in efforts to reduce class size in early grades, each a category of public education spending not directly implicated by *Leandro*. Neither the *Leandro* litigation nor Article IX, § 2(1) of the North Carolina Constitution involves post-secondary educational opportunities or scholarships. Moreover, petitioners' attempts to tie this case to the *Leandro* litigation should not cloud the fact that the Court of Appeals is well-equipped to handle the issues raised by the parties.

¹ Petitioners appear to fail to appreciate the irony of their contention, in that *Leandro* itself, in the first appeal of that case, was deemed not to meet the criteria for discretionary review under N.C.G.S. § 7A-31(b). See *Leandro v. State*, 122 N.C. App. 1, 5, 468 S.E.2d 543, 546 (1996).

II. SIGNIFICANCE TO NORTH CAROLINA JURISPRUDENCE

Petitioners contend that this case merits discretionary review under the criteria of jurisprudential significance, but the only significance they articulate is that the particular issue is allegedly one of first impression before this Court. Regardless of petitioners' characterization of the case, the issue raised by petitioners can be handled initially in the Court of Appeals, based on precedential decisions of this Court addressing the constitutional provision on which petitioners rely. Specifically, this Court has in the past ruled that various statutes providing for the payment of money did not come within Article II, Section 23 or its predecessors.

Nearly 100 years ago this Court rejected the idea that an act providing for the payment of money to an estate in settlement of a claim fell within the scope of what was then Article II, Section 14 of the Constitution. *Battle v. Lacy*, 150 N.C. 573, 64 S.E. 505 (1909). "It is not pledging the faith of the State for the General Assembly to order the State Treasurer to pay a debt with money." *Id.* at 575, 64 S.E. at 506. Similarly, fifty years ago this Court held that "a lease made for an adequate consideration is not a loan of the credit of the state or of the agency making such lease." *N.C. State Ports Auth. v. First-Citizens Bank & Trust Co.*, 242 N.C. 416, 424, 88 S.E.2d 109, 114 (1955).

Significantly, this Court has also addressed the nature of a tax and defined it in ways inconsistent with plaintiffs' claims. *See State ex rel. Utilities Comm'n v. Carolina Util. Customers Ass'n*, 336 N.C. 657, 683, 446 S.E.2d 332, 347 (1994) ("This Court has defined a tax as 'a charge' levied and collected as a contribution to the maintenance of the general government [It is] imposed upon the citizens in common at regularly recurring periods for the purpose of providing a continuous revenue." (citations omitted)). As noted by Professor Orth in his book on the North Carolina Constitution, "[a] tax is a forced contribution to government; it differs from a fee in that it has no necessary immediate relationship to a benefit conferred." JOHN V. ORTH, *THE NORTH CAROLINA STATE CONSTITUTION* 88 (1993). The Lottery Act is not a levy of taxes; nor does it force contributions to the government. No one is required to purchase a lottery ticket for any purpose except personal desire or amusement. If individuals do purchase tickets, they will receive benefits in the form of opportunities to win prizes. It is this receipt of a special benefit, as a *quid pro quo* so to speak, that distinguishes taxes from non-regulatory charges such as the purchase price of lottery tickets.

This Court addressed the distinction between a tax and a payment made in exchange for receipt of a benefit in holding that a toll payment did not come within the scope of Article II, Section 23. "Tolls are not taxes. A person uses a toll road

at his option; if he does not use it, he pays no toll.” *N.C. Turnpike Author. v. Pine Island, Inc.*, 265 N.C. 109, 116-17, 143 S.E.2d 319, 325 (1965). In so doing, it cited to a decision of the Indiana Supreme Court. That court, in holding that its toll road act was not a bill for raising revenue within the meaning of the state constitution, observed that “[t]he payment of a tax is compulsory and not optional, and it entitles the taxpayer to receive nothing in return, other than the rights of government which are enjoyed by all citizens alike.” *Ennis v. State Highway Comm’n*, 231 Ind. 311, 323, 108 N.E.2d 687, 693 (1952). Petitioners miss the point that the Lottery is not a tax, any more than the toll was a tax for constitutional purposes, and this Court’s decisions provide ample authority to reject petitioners’ contention that the Lottery imposes a tax for purposes of Article II, Section 23.

In other words, this Court has recognized that Article II, Section 23 is not merely directed to legislation which provides for the payment of money under certain circumstances, but instead is aimed at legislation providing for the borrowing of money or pledging the State’s liability for payment of debts or the imposition of a tax. The Lottery Act does none of these.

Given the previous cases by this Court addressing Article II, Section 23, as well as decisions of the Court of Appeals, petitioners have shown no reason why

the issues raised in this case must be removed from the consideration of the able jurists at the Court of Appeals.

III. HARM FROM DELAY

Finally, petitioners contend that citizens and taxpayers of North Carolina will be harmed unless discretionary review is granted because they will become dependent on Lottery funds during a lengthy appellate process. Then, according to the argument, when petitioners prevail, Lottery funds will no longer be available to help fund public education and people will suffer. Of course, if respondents prevail, the so-called economic dependency will be wholly harmless. In either case, accelerating appellate review neither precludes nor facilitates the alleged harm to the public.

ADDITIONAL QUESTIONS FOR REVIEW

In the event this Court certifies this case for review, then respondents would seek review of the following additional questions:

1. Did the trial court err in its 15 February 2006 Order on Motion for Dismissal under Rules 12(b)(1), (2), and (6) in failing to dismiss all claims because petitioners lack standing to bring any and all of their claims?
2. Did the trial court err in its 15 February 2006 Order on Motion for Dismissal under Rules 12(b)(1), (2), and (6) in failing to dismiss all claims because it lacked personal and/or subject matter jurisdiction in that petitioners' complaints, and all claims contained therein, are barred by respondents' sovereign immunity?

3. Did the trial court err in its 21 March 2006 Order in failing to dismiss petitioners' complaints under the doctrine of laches?

Respondents have preserved these issues for review through assignments of error and a notice of appeal from the 15 February 2006 Order on Motion for Dismissal under Rules 12(b)(1), (2), and (6). These issues, if resolved in respondents' favor, could avert the need for the appellate courts to reach any of the constitutional questions urged by petitioners. Thus, the fact that respondents have additional, non-constitutional issues that must be addressed may weigh in favor of this case proceeding through the normal appellate process of being addressed first by the Court of Appeals. Thereafter, should this Court deem it appropriate, the remaining issues raised by petitioner could be considered by this Court.

CONCLUSION

WHEREFORE, respondents neither support nor oppose the Petition for Discretionary Review Under G.S. 7A-31(b) and Appellate Rule 15 filed by petitioners before this Court and stand ready to defend the trial court's judgment in whichever Court the appeal is heard.

Respectfully submitted, this the 28th day of June, 2006.

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of the foregoing **RESPONSE TO PETITION FOR DISCRETIONARY REVIEW UNDER G.S. 7A-31(b) AND APPELLATE RULE 15** in the above-captioned action upon all parties by depositing a copy of the same in the United States mail, first-class postage prepaid, addressed as follows:

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This the 28th day of June, 2006.

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