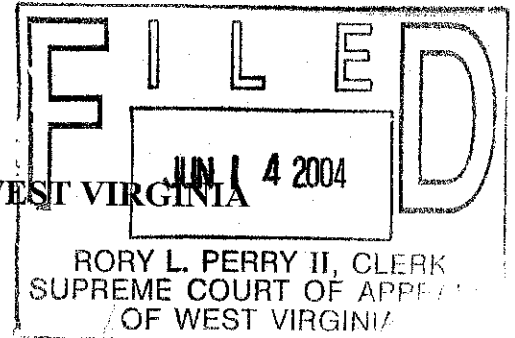


NO. 31749

IN THE SUPREME COURT OF APPEALS OF WEST VIRGINIA



**THE HONORABLE JOHN D. PERDUE,**  
Treasurer of the State of West Virginia, and  
**THE HONORABLE GLEN B. GAINER, III,**  
Auditor of the State of West Virginia,

*Appellants,  
Plaintiffs below,*

v.

**THE HONORABLE BOB WISE,** as  
Governor of the State of West Virginia, and  
**TOM SUSMAN,** as Acting Secretary of the  
Department of Administration of the State  
of West Virginia,

*Appellees,  
Defendants below.*

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**APPELLANT'S BRIEF**

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**TABLE OF CONTENTS**

	<b>Page</b>
<b>I. THE PROCEEDINGS BELOW AND THE RELIEF REQUESTED IN THIS APPEAL</b> .....	1
<b>II. SUMMARY</b> .....	3
<b>III. STATEMENT OF FACTS</b> .....	7
A. The "Pension Obligation Bonds" Authorized by the Act Are Simple Arbitrage Bonds to Obtain Funds to Play the Stock Market. ....	7
B. What Happens When the Stock Market Doesn't Cooperate. ....	12
C. Until the Bonds Are Paid Back, They Cannot Possibly Reduce the Annual Cost of Funding Pensions -- They Can Only Increase It. ....	16
D. Other Jurisdictions Issuing Pension Obligation Bonds Have Tragically Learned That Such Bonds do Not "Redeem" Their Pension Obligations. ....	17
<b>IV. ASSIGNMENTS OF ERROR</b> .....	19
<b>V. LEGAL ARGUMENT</b> .....	20
A. The Act Creates State Debt in Violation of The Debt Clause of The West Virginia Constitution. ....	20
1. This Court Has Never Held That the UAAL Is a "Previous Liability of the State." .....	20
2. Pensions Are Not a Debt of the General Revenue, and Therefor Cannot be "Redeemed" via a Pledge of Future General Revenues. ....	22

3.	Pension Obligation Bonds Do Not “Redeem” any Liability, and Therefor Cannot Extinguish the . Accrued Actuarial Liability. ....	29
B.	The Act Violates the Separation of Powers Clause by Delegating Legislative Power to an Executive Committee Without Supplying any Standards for the Committee to Apply. ....	33
1.	The Review Committee Was Originally Designed as an Unconstitutional Mechanism for the Legislature to Exercise Post-Enactment Control over the Executive. ....	33
2.	The Act Contains No Standards for the Committee to Apply in Any of its Functions. ....	37
C.	A Legislative Resolution Which Purports to Control Executive Action Is an Unconstitutional Encroachment by The Legislature on The Executive. ....	39
D.	The Meeting of The Review Committee Violated The Open Governmental Proceedings Act. ....	42
E.	The Act Pledges The Credit of The State to Local School Boards in Violation of Constitution Article X, Section 6. ....	44
<b>VI.</b>	<b>CONCLUSION</b> .....	<b>45</b>

## TABLE OF AUTHORITIES

CASES:	Page
<i>Berry v. Fox</i> , 114 W. Va. 172, 513 S.E. 896 (1934) .....	32
<i>Booth v. Sims</i> , 193 W. Va. 323, 456 S.E.2d 167 (1995) .....	<i>passim</i>
<i>Dadisman v. Moore</i> , 181 W. Va. 779, 384 S.E.2d 816 (1989) .....	23, 27
<i>Painter v. Peavy</i> , 192 W. Va. 189, 451 S.E.2d 755 (1994) .....	2
<i>Spadoro v. Whitman</i> , 150 N.J. 2, 695 A.2d 654 (1997) .....	27
<i>State ex rel. Barker v. Manchin</i> , 167 W. Va. 155, 279 S.E.2d 622 (1981) .....	40, 41
<i>State ex rel. Cities of Charleston, Huntington and its Counties of Ohio and Kanawha v. West Virginia Economic Development Authority</i> , ___ W. Va. ___, 588 S.E.2d 655 (2003) .....	36
<i>State ex rel. Dadisman v. Caperton</i> , 186 W. Va. 627, 413 S.E.2d 684 (1991) .....	22, 28, 29
<i>State ex rel. Hall v. Taylor</i> , 154 W. Va. 659, 178 S.E.2d 48 (1970) .....	25
<i>State ex rel. School Building Authority of West Virginia v. Marockie</i> , 198 W. Va. 424, 481 S.E.2d 730 (1996) .....	32
<i>State ex rel. State Building Commission v. Moore</i> , 155 W. Va. 212, 184 S.E.2d 94 (1971) .....	25
<i>State ex rel. West Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee</i> , 213 W. Va. 255, 580 S.E.2d 869 (2003) .....	<i>passim</i>
<i>State ex rel. West Virginia Resource Recovery-Solid Waste Disposal Authority v. Gill</i> , 174 W. Va. 109, 323 S.E.2d 590 (1984) .....	20, 25
<i>West Virginia Education Association v. Consolidated Public Retirement Board</i> , 194 W. Va. 501, 460 S.E.2d 747 (1995) .....	16, 22, 44
<i>Winkler v. State School Building Authority</i> , 189 W. Va. 748, 434 S.E.2d 420 (1993) .....	<i>passim</i>

**CONSTITUTIONAL PROVISIONS:**

Pa. Const. art. IX, § 10 ..... 17

W. Va. Const. art. V, § 1 ..... 6, 19, 40

W. Va. Const. art. VI, § 1 ..... 40

W. Va. Const. art. VI, § 29 ..... 40

W. Va. Const. art. VI, § 30 ..... 40

W. Va. Const. art. VII, § 7 ..... 40

W. Va. Const. art. VII, § 14 ..... 40

W. Va. Const. art. VII, § 15 ..... 40

W. Va. Const. art. X, § 4 ..... *passim*

W. Va. Const. art. X, § 6 ..... 44

**STATUTES:**

W. Va. Code §§ 6-9A-1 *et seq.* ..... 7

W. Va. Code § 6-9A-3 ..... 42, 43

W. Va. Code § 12-6-12 ..... 4

W. Va. Code § 12-8-1 *et seq.* ..... 1

W. Va. Code § 12-8-2(d) ..... 29

W. Va. Code § 12-8-2(e) ..... 21

W. Va. Code § 12-8-4(a) ..... 38, 39, 41

W. Va. Code § 12-8-4(b) ..... 4, 38

W. Va. Code § 12-8-4(c) ..... 4, 34, 36, 38

W. Va. Code § 12-8-4(g) .....	6, 33, 34, 38
W. Va. Code § 12-8-5(a) .....	9, 11, 37, 38
W. Va. Code § 12-8-5(d) .....	6
W. Va. Code §12-8-5(f) .....	34
W. Va. Code § 12-8-8(c) .....	16
W. Va. Code § 12-8-8(g) .....	4
W. Va. Code §§ 18-9A-1 .....	44
W. Va. Code §18-9A-6a .....	16

**OTHER:**

Auden, W.H. (Wystan Hugh) (1907-1973), <i>The American Scene</i> .....	12
<i>Black's Law Dictionary</i> , 7th ed. (1999) .....	13
Gabriel, Roeder, Smith & Company, <i>Questions to Consider Before Issuing Pension Obligation Bonds</i> , 2004 GRS Insight, vol. 1, February 2004, available online at <a href="http://www.grsnet.com/pubs/GRSInsight-2004-1F.pdf">http://www.grsnet.com/pubs/GRSInsight-2004-1F.pdf</a> .....	12
Shaw, George Bernard, <i>Everybody's Political What's What?</i> (1944) .....	7

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of West Virginia,

*Appellees,*  
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APPELLANT'S BRIEF

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I.

**THE PROCEEDINGS BELOW AND THE RELIEF  
REQUESTED IN THIS APPEAL**

Your Appellants, the State Treasurer and Auditor, brought the action below to challenge the constitutionality of the euphemistically-named "Pension Liability Redemption Act" (W. Va. Code § 12-8-1 *et seq.*, hereafter "the Act"). The challenged Act authorizes the

Governor to sell \$3.9 *Billion* in general obligation bonds -- \$2,000 worth of debt for every man, woman, and child in this State -- to provide money to invest in stocks and other securities for the benefit of three public retirement systems. (A copy of the Act is included as the last item in the Joint Appendix, at pp. 368 *et seq.*, hereafter "App. \_\_\_\_"). The Act does not provide for an amendment to the Constitution's prohibition against incurring State debt (art. X, § 4), and includes other features (hereafter discussed) calculated to inhibit the vigorous public debate that should have accompanied a proposed bond of this magnitude.<sup>1</sup>

The evidence developed in discovery below included the sworn testimony of the State's present and former pension actuaries (Harry Mandel and Scott Dennison) and was consistent on all material facts, resulting in cross-motions for summary judgment. Appellants' various constitutional challenges were rejected and the Act was upheld in a summary judgment order entered by the Honorable Irene Berger on March 15, 2004. (App. 3-6.) That Order was appealed to this Court for *de novo* review. ("A circuit court's entry of summary judgment is reviewed *de novo*." Syllabus Point 1, *Painter v. Peavy*, 192 W. Va. 189, 451 S.E.2d 755 (1994).) Appellants pray that this Court reverse the Order below and declare the Act to be unconstitutional.

The Complaint below was not a "friendly lawsuit," but was brought to protect the public's right to decide whether it is willing to assume the risks and burdens associated with

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<sup>1</sup>By way of contrast, the largest bond sale ever before made by the State of West Virginia was only \$220 Million, which bonds were issued in 1998 pursuant to a Constitutional Amendment (the Safe Roads Amendment of 1996).

this massive bond issue. Nor are Appellants mere nominal parties. In addition to being the constitutional guardians of the people's treasury, both are members of the Investment Management Board ("IMB"), which will have the untenable responsibility of investing the bond proceeds in a manner that meets the "actuarial expectations" of the Consolidated Public Retirement Board ("CPRB").<sup>2</sup> Both are also trustees of the CPRB, the supposed "creditor" that will be "repaid" with the bond proceeds. In addition, the Treasurer is a member of the statutory "bond review committee," which committee, without notice to the public, and without standards or other legislative guidance, authorized the bonds over the Treasurer's dissent. (App. 203-205.)

## II.

### SUMMARY

Pursuant to the challenged Act, the first \$39 Million in bond proceeds will be used to pay the underwriters, brokers, bankers, and lawyers who will prepare and market the bonds. (App. 207, 335.) Other costs will consume another \$24 Million (App. 335) before the remaining proceeds are credited to one or more of three public retirement systems

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<sup>2</sup>Proponents of the bonds predict that the State will save money by investing the borrowed funds as pension assets, but their predictions *assume* that earnings on the invested bond proceeds will meet or exceed the CPRB's actuarial investment target of 7.5% annually, and that the interest payments on the bonds will be less, the difference representing a net gain, or "savings." (Joint Appendix at 86-87, 180A-183, 189-190, 273-278, 294-299, 314-318, 319-326.) In a recent letter to the Charleston Gazette, the Executive Director of the IMB expressed considerable doubt that such investment returns could be achieved: "Over the next decade, West Virginia's current investment mix of roughly 60 percent stocks and 40 percent bonds has [only] about a 33 percent chance of hitting the 7.5 percent actuarial target." (*Charleston Gazette*, April 12, 2004, available on Westlaw at 2004 WL 59634117).

considered to have been “underfunded” in the past.<sup>3</sup> Importantly, however, all three of these systems are currently “actuarially sound,” meaning that their existing assets, combined with the required future contributions from their various employers and employees, are together sufficient to pay all future obligations of the systems as they become due. (Mandel Deposition at App. 91-93, 158; Dennison Affidavit at ¶ 25, App. 55.)

As pension funds, the net proceeds of the borrowed money will be invested by the IMB in stocks and other securities (Code 12-6-12). *If* the resulting investment gains (less the IMB’s fees) more than offset the considerable cost of borrowing the money (\$63 million in expenses plus over \$2 billion in interest payments), then the resulting profits will be used to retire the bonds early. W. Va. Code § 12-8-8(g). If all goes well, the State’s future taxpayers will thereafter reap the benefit of these profits in the form of reduced appropriations to the pension systems. (App. 336.) Of course, if the State’s investments go sour, or do not earn enough to cover the interest owed to the bondholders and the IMB’s fees, the resulting losses will be borne entirely by the taxpayers, taxpayers already burdened with paying back the original bonds. (Mandel Deposition at App. 142, 147; Dennison Affidavit at ¶¶ 7-12 and Supplemental Affidavit, App. 46-48, 75-77; Smith Deposition at App. 175A-176A.)

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<sup>3</sup>The three systems are the Judges’ Retirement System, with an “unfunded actuarial accrued liability” (“UAAL”) of \$44 Million as of June 30, 2003; the “Troopers Retirement System” [the death, disability and retirement fund of the department of public safety], with a UAAL of \$350 Million; and the Teachers Retirement System, with a UAAL of \$5.05 Billion. (W. Va. Code §§ 12-8-4(b) and (c).) Interestingly, the statute does *not* include the Public Employees Retirement System, although it has a UAAL of \$991 Million -- the second largest UAAL of any of the State’s public retirement systems. (*Id.*) (The numbers recited here are the latest available, and are more current than those in the record below.)

The mathematics of pension bonds are thus exactly the same as mortgaging your house to obtain money to play the stock market. If your investments (less broker commissions) earn enough to pay closing costs and interest payments, you can pay off the mortgage using your investment account and keep any remaining funds. If not, you will either lose your house or make up your losses out of future paychecks. (*Id.*; see Smith Deposition at App. 179-180.) Perhaps we shouldn't worry about that possibility. After all, can't we simply borrow more money to cover such losses, and postpone the impact for yet another generation?

To forestall just such a scenario, our Constitution prohibits the State from contracting for debt to be repaid from future general revenue appropriations, thus requiring that proposals to incur State debt be ratified by the voters. (Const. art. X, § 4.) Because the challenged statute does *not* provide for voter approval and obligates future general revenues, it is unconstitutional.<sup>4</sup> The voters should decide whether they are willing to risk the losses that could befall them should the bonds issue.

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<sup>4</sup>Appellees rely on an exception in Article X, Section 4 allowing the State to incur debt to "redeem a previous liability of the State," and assert that the bonds will simply refinance existing pension obligations. However, the pension obligations at issue are owed by a "special fund" consisting of contributions from local school boards, State agencies, and their employees, and are consequently not a "liability of the State" within the meaning of the Debt Clause. *Booth v. Sims*, 193 W. Va. 323, 456 S.E.2d 167 (1995). Moreover, no "redemption" will occur when the bonds are issued -- the State's pension obligations will remain exactly as they were before -- so the "unfunded actuarial liability" supposedly "redeemed" with bond proceeds can reappear at any time without warning.

The Complaint below (App. 8-33) was not limited to its well-publicized allegation that the proposed bonds were prohibited by the Debt Clause. It also attacked two insidious statutory requirements that were alleged to violate the Division of Powers Clause (art. V, § 1). First, the requirement that an executive-branch “bond review committee” “authorize” the bonds without any standards to guide its discretion (Code 12-8-4(g)) was alleged to be an unconstitutional delegation of legislative power. *See State ex rel. West Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee*, 213 W. Va. 255, 580 S.E.2d 869 (2003) (holding that a statute authorizing an executive committee to award State economic development grants was unconstitutional because it lacked standards for the committee to consider in making its awards).

Second, the statutory prohibition against issuing the bonds unless they are first “authorized” by legislative resolution (Code 12-8-5(d)) was alleged to have allowed the legislature to exercise inappropriate post-enactment control over executive action. *See State ex rel. Barker v. Manchin*, 167 W. Va. 155, 279 S.E.2d 622 (1981) (holding that the Legislature could not ‘overrule’ executive regulations by legislative resolution, but only by formal lawmaking).

Both of these provisions were calculated to minimize debate by encouraging doubtful legislators to vote for the Act, knowing that either the review committee or the legislature (by resolution) could prevent issuance of the bonds for any reason or for no reason. Moreover, the unconstitutional requirement for a legislative resolution caused the “bond

review committee” to suddenly conduct an “emergency meeting,” without notice to the public, on June 13, 2003, in order to allow for a resolution to be passed the following day – the last day of a special legislative session. (App. 201-205.) This “emergency meeting” consequently violated the notice provisions of the Open Governmental Proceedings Act (Code 6-9A-1 *et seq.*), during which meeting the bonds were “authorized” without discussion and without participation by the public, just as they are to be issued without public debate or voter approval.

The legislative resolution also passed (App. 36), making this appeal the only impediment to encumbering our taxpayers with \$3.9 Billion in debt without their consent.

### III.

#### STATEMENT OF FACTS

A. **The “Pension Obligation Bonds” Authorized by the Act Are Simple Arbitrage Bonds to Obtain Funds to Play the Stock Market.**

“A government which robs Peter to pay Paul can always depend on the support of Paul.”

George Bernard Shaw, *Everybody’s Political What’s What?*, chapter 30, p. 256 (1944).

The basic goal of pension obligation bonds is to borrow money in the hopes that it can be invested and earn a rate of return over the life of the bonds sufficient to pay off the indebtedness at no cost to the State -- perhaps even realizing a gain. (App. 249-258; 261-263; 264-267.) Of course, if the State’s investments don’t earn enough to pay off the bonds, there will be net losses on the transaction, potentially enormous, like those burdening the taxpayers

of New Jersey, Pittsburgh, and New Orleans, each of which (among others) suffered substantial losses after investing the proceeds of their pension bonds. (See Section D of this Statement of Facts.)

Since the Constitution does not authorize borrowing money to invest in stocks, we are told by the bonds' proponents that we shouldn't think of pension obligation bonds as a new debt burden. After all, the proceeds will eventually be used to pay future pension benefits, which benefits would otherwise require future employer contributions from general revenue appropriations, so there *should* be a corresponding reduction (if all goes well) in the tax burdens that would otherwise be imposed upon our children. (Of course, the same observation could be made if the bond proceeds were dedicated to *any* future expenses of the State.) It is this "corresponding reduction" that forms the basis of Appellees' position that the bonds "redeem" a previous liability.

Legislators in the 2000 regular session were accordingly persuaded that the bond proceeds would "redeem" "unfunded pension liabilities." (App. 189-190; 294-313.) They were *not* told that the success or failure of the scheme depended solely on the future performance of the stock market. (Dennison Affidavit at ¶¶ 7-12, App. 46-48, 75-76; Mandel Deposition at App. 142, 147; Smith Deposition at App. 175A-176A; 180A-182; App. 188; 189-190; 191-194.) They were not told that issuing bonds would increase the unpredictability of the cost to the taxpayer of funding future pension benefits, and that such costs could be larger, potentially much larger, than the costs which would be incurred under

the current funding plan. (*Id.*; Dennison Affidavit at ¶¶ 7 and 10, App. 46, 47, 75; Mandel Deposition at App. 104-106.)

Rather, they were misinformed that the State was currently “paying interest” on the UAAL that was greater than the interest to be paid on the bonds, and that savings would result from “refinancing” this “debt,” just “like refinancing your home mortgage.”<sup>5</sup> They were told that the statutory requirement that bonds could not be issued unless the bond market was below the actuarial rate guaranteed that the bonds would “create savings.” (App. 189-190; *see* W. Va. Code § 12-8-5(a).) Both the current and former actuaries for the retirement systems at issue stated under oath that *all these assertions were false*. (Mandel Deposition at App. 142-147; Dennison Affidavit at ¶¶ 9-14, 44, App. 46-49, 70.) Attorney Marjorie Martorella, who quit her job with the legislature in protest of the deceptions, wrote a blistering expose’ published on March 16, 2000 (App. 191-194), just after the Act was passed, which has since been proven correct by the testimony taken herein.<sup>6</sup>

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<sup>5</sup>The lobbying materials supplied by Department of Administration Secretary Joe Marcus to the Legislature completely failed to disclose that the bonds represented risk arbitrage (borrowing to invest in potentially higher-yielding stocks). Instead, they repeatedly stated that issuing the bonds would produce savings whenever the interest rate on the bonds was below the “actuarial rate” used to estimate the future rate of return on retirement system assets, and that the bond transaction was “just like refinancing a mortgage” at a lower interest rate. (App. 189-190; 273-278; 294-299; 314-318; 319-322; 323-326, 180A-183.)

<sup>6</sup>Ms. Martorella wrote:

The first time I sifted through all this, I was flooded with something between shame and distaste as it hit me: Dear God, they want to borrow \$4 billion to play the stock market. And once the bonds are issued, it doesn't much matter

(continued...)

Even after the Act was passed, the bonds' proponents would continue to tell the "bond review committee" that making regular general revenue contributions to fund debt service on the bonds instead of regular contributions to the pension funds was merely a "refinancing, similar to refinancing your home mortgage." (App. 329-330; *see* fn. 5.) If this were true, this case would not be before this Court. Unfortunately, however, no "redemption" will occur when the bonds are issued – the obligation to pay pensions will still be there, just as it is today, in exactly the same form, until the last benefit check is written.<sup>7</sup> Unlike a "refinancing," where you realize savings from paying off a higher-interest loan with money borrowed at a lower rate, whether "savings" will result from issuing pension bonds is pure speculation. The only persons certain to benefit from the bond-issue are the underwriters,

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<sup>6</sup>(...continued)

what happens after that; we are well and royally stuck.

(App. 193) Tom Susman, who is now the Secretary of Administration (Appellee herein) characterized his predecessor's optimistic predictions before assuming his duties: "This program sounds like the high school senior who tells his sweetheart 'Just Trust Me.'" (App. 185-187.)

<sup>7</sup>In the words of the State's former actuary, Scott Dennison:

The AAL [Actuarial Accrued Liability] does not "disappear" even if the plan is "fully funded." The "unfunded" portion of the AAL is simply the AAL less existing assets, but the AAL is still there, whether "funded" or not. Until the system's assets are actually applied to pay benefit checks, they cannot extinguish the system's future pension obligations or the AAL.

(App. 53.)

bankers, brokers, insurance companies, and bond lawyers who will get the first \$63 Million of the bond proceeds. (App. 207, 335.)

According to the uncontradicted testimony below, whether the State will ultimately make money by investing borrowed funds depends entirely on one thing and one thing only -- whether the investments earn a greater return than the true interest cost (including expenses) of borrowing the money. (Mandel Deposition at App. 142, 147; Dennison Affidavit at ¶¶ 7-12, App. 46-48; Smith Deposition at App. 175A-176A.) The "Pension Bond Redemption Act" is, in reality, not a "refinancing" at all, but rather is a simple arbitrage scheme. The mathematics are the same as borrowing on your credit card to obtain money to invest in the stock market. *If* you get a better return on your investments than you pay in credit-card interest and fees, you can use your investment account to pay back the credit card company and keep the surplus, without having spent a dime of your own money. (*Id.*; *see* Smith Deposition at App. 179-180.) Of course, this is not a new idea. On October 29, 1929 (Black Tuesday), many people owned stock they had purchased with credit during the bull-market fueled by World War I. After their stock vaporized in the market crash, they still had their debt, but nothing to show for it.

It is easy to lose sight of the forest for the trees when the mechanics of pension bonds and the vagaries of actuarial calculations are injected, but the bonds remain simple arbitrage bonds just the same.<sup>8</sup> ("A rose by any other name . . .") If the State does not earn enough

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<sup>8</sup>The Internal Revenue Service classifies pension obligation bonds as "arbitrage (continued...)"

on its investments to cover the interest costs on the bonds, the State's overall obligations, and the cost of funding them, will increase beyond what they would have been had no bonds issued. The State will not only have to pay back the bonds, but because the supposedly "redeemed" pension obligations will still exist, it will also have to restore out of future general revenues any arbitrage losses suffered by the retirement systems. And with \$3.9 Billion of borrowed funds to play with, the potential for such losses is staggering.

**B. What Happens When the Stock Market Doesn't Cooperate.**

"Sometimes your best investments are the ones you don't make."

W.H. (Wystan Hugh) Auden (1907–1973), *"The American Scene,"* (1962).

Aren't the State's investments safe? Is there really any substantial risk that such an arbitrage scheme will turn sour? Aren't these merely policy questions for the Legislature? Absolutely not. Legally, that there is *any* risk that the scheme will turn sour means that we

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<sup>8</sup>(...continued)

bonds." Consequently, unlike most publicly issued bonds, the yield to the bondholder is taxable. Arbitrage bonds must therefore offer a higher yield to the bondholder to compete with tax-exempt bonds and thus have a higher debt-service cost to the taxpayers, making it harder to achieve investment yields with the borrowed funds that outperform the cost of the bonds. See Gabriel, Roeder, Smith & Company, *Questions to Consider Before Issuing Pension Obligation Bonds*, 2004 GRS Insight Vol. 1, February 2004, available online at <http://www.grsnet.com/pubs/GRSInsight-2004-1F.pdf>.

have not truly “redeemed a previous liability,” in which case the Debt Clause (art. X, Sec. 6) would flatly prohibit the proposed bonds.<sup>9</sup>

As a practical matter, the risk of loss is substantial. One must invest in relatively volatile investments, such as stocks, in order to have any hope of obtaining investment returns greater than the cost of debt-service on the bonds. (Dennison Affidavit at ¶ 8, App. 46.) Since 1997, the Investment Management Board (“IMB”) has, in fact, been investing approximately 60% of the assets of these retirement systems in stocks, with dismal results, causing substantial increases to the Accrued Actuarial Liability (“AAL”) and the UAAL of the pension funds at issue.<sup>10</sup>

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<sup>9</sup>Black’s Law Dictionary, 7th Edition (1999) defines “redemption” as follows:

1. The act or an instance of reclaiming or regaining possession by paying a specific price. 2. *Bankruptcy*. A debtor’s right to repurchase property from a buyer who obtained the property at a forced sale initiated by a creditor. 3. *Securities*. The reacquisition of a security by the issuer.

The above definitions suggest that to “redeem” a previous liability is to buy it back from the creditor, thus extinguishing the preexisting debtor-creditor relationship. Pension bonds don’t do that, since the obligation to pay pension benefits remains the same regardless of how well-funded the system is. That is why investment returns and other contingent events continue to impact the contributions that will be needed to fund future pension benefits. Pension bonds don’t eliminate the uncertainties inherent in predicting future pension costs. Indeed, they exacerbate such uncertainties by exposing more funds to market volatility. (Dennison Affidavit at ¶ 7, App. 46; Mandell Deposition at App. 93-105; Smith Deposition at App. 177-178.)

<sup>10</sup>From 1999 to 2003, investment returns on TRS assets averaged only 2.31%, far less than the interest cost of taxable arbitrage bonds. (Affidavit of Scott Dennison at ¶ 10, App. 47; Supplemental Affidavit at App. 75-77.) Each year that invested pension funds do not achieve returns equal to the 7.5% actuarial target creates an “actuarial loss” and an increased  
(continued...)

In 1999, the Underwood administration, assisted by Salomon Smith Barney (now lead underwriter of the bonds), claimed that the cost of paying back such bonds -- about 7% at the time -- was less than the 8% earnings that the IMB was then expected to earn on pension fund assets. (App. 270.) Thus, if such bonds were sold, the State could expect to pocket about 1% each year in arbitrage gains and apply them to reduce the cost of funding future pension benefits -- all without spending one additional dime. (*Id.*)

But pension fund assets did *not* earn 8%, and we accordingly are very fortunate that pension bonds were not issued. Uncontradicted exhibits were introduced below to show exactly what would have happened had such bonds been issued in 1999. At the time, the UAAL of the Teacher's Retirement System was about \$3.7 Billion, so issuing bonds would have *fully funded* the TRS, creating a UAAL of "zero." Would the UAAL thereby have been "redeemed?" Not hardly.

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<sup>10</sup>(...continued)

UAAL. (Mandel Deposition at App. 104-106.) Such losses are proportional to the amount of money invested. (*Id.*) For instance, in FY 2002, the UAAL of the TRS increased by \$105 Million due solely to investments not meeting actuarial expectations. (App. 200.) Had bond proceeds been invested as TRS assets that year, the UAAL would have increased by about \$500 Million. (*See*, Mandel Deposition at App. 104-106; Dennison Affidavit at ¶¶ 10-12, App. 47-48.) Over the four years from 1999-2003, actuarial losses due to poor investment returns exceeded \$185 Million, and would have approached \$1 Billion had bond proceeds been invested as well. (*Id.*)

Nor does the future look bright. As earlier noted, the Executive Director of the IMB is pessimistic about its ability to achieve the investment returns expected by the State's pension actuary. (See footnote 2 herein.) Thus, if bonds are sold and the proceeds invested as envisioned by the Act, the actuarial losses suggested by the Director's concerns will be nearly five times greater than if no bonds are issued. (see Mandel Deposition at App. 104-106.)

The bond proceeds would not have purchased any pre-existing liability, nor cancelled any obligation to our retirees. They would have instead been invested by the IMB along with other pension assets. The subsequent downturn in the stock market would have caused arbitrage losses consuming \$600 Million of the borrowed funds, *but the requirement to pay them all back would still be there.* (Dennison Affidavit at ¶¶ 10-12, App. 47-48, 76.) The State's actuary, using his current methods, would have required the State to increase its annual employer contributions by amounts sufficient to restore \$100 Million of the losses to the TRS before June 30, 2003, and the remaining \$500 Million would be reflected as an increase in the UAAL, to be amortized with supplemental employer contributions over the remaining life of the system. (*Id.*) During the same period, the legislature would also have to pay debt-service on the bonds. (*Id.*) At the end of four short years (1999-2003), the supposedly "redeemed" UAAL would have mushroomed from zero dollars to \$1.9 Billion,<sup>11</sup> despite the payment of all "normal costs" (plus another \$100 million in supplemental contributions during the interim) *and the State would still owe nearly all of the \$3.7 Billion it had borrowed* to achieve this remarkable result! (*Id.*) Thus, a bond issue to "redeem a previous liability of the State" would, in fact, have dramatically increased the taxpayer's pension burden. Nothing would have been "redeemed."

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<sup>11</sup>About \$500 Million of the \$1.9 Billion UAAL would have been attributable to arbitrage losses from issuing the bonds, the remaining 2/3 representing additional "actuarial losses" and events that would have impacted the UAAL in any event.

C. **Until the Bonds Are Paid Back, They Cannot Possibly Reduce the Annual Cost of Funding Pensions -- They Can Only Increase It.**

The Teachers Retirement System (TRS) represents 93% of the total UAAL of the three systems that could receive bond proceeds. Under the present funding plan, the required payments to the TRS are over \$300 million a year, and are estimated to reach \$600 Million by 2030<sup>12</sup> (App. 328.) It is a common misconception that issuing pension bonds will, at some point in the foreseeable future, reduce the total funding burden imposed upon the State's taxpayers by the current plan for funding the TRS. However, an unusual feature of the Act is its requirement that general revenue payments *may not be reduced* until the bonds are paid off. W. Va. Code § 12-8-8(c). Rather, those sums that would have been contributed under the current plan must still be contributed to either the TRS or to the bond trustee (to enable early retirement of the bonds). (*Id.*) Thus, if there are arbitrage gains, they will be paid to the bondholders' trustee. (*Id.*)

Proponents of the bonds predict that, if investments meet the actuarial target of 7.5% annually, the bonds will be retired early, during the year 2024, *after* which the State will

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<sup>12</sup>The current funding plan, although "actuarially sound," requires annual payments, recalculated each year, sufficient to amortize the TRS UAAL by 2034. (W. Va. Code §18-9A-6a). The payments increase over time because, under the "Entry Age Normal Cost" method for funding pensions, contributions are calculated so as to maintain them at a uniform percentage of payroll over time, and the payroll increases with inflation. (Dennison Affidavit at ¶ 20, App. 52, fn. 3.) Such payments have been made since the cited statute was enacted in 1994, which statute mooted a pending court proceeding challenging the pre-existing failure to properly fund the TRS. *West Virginia Education Association v. Consolidated Public Retirement Board*, 194 W. Va. 501, 460 S.E.2d 747 (1995).

realize savings in the form of reduced contributions to the TRS (App. 336.) Until then, the State and its taxpayers will realize no savings from issuing the bonds.

Thus, for 20 or more years, the only possible financial impact of issuing pension obligation bonds will be the substantial risk that the IMB's investments will *not* meet actuarial expectations, as described in the preceding section, requiring *increased* contributions from general revenue to offset the additional actuarial losses caused by investing the bond proceeds.

**D. Other Jurisdictions Issuing Pension Obligation Bonds Have Tragically Learned That Such Bonds do Not "Redeem" Their Pension Obligations.**

As repeatedly noted by proponents of the Act, pension obligation bonds were common in the 1990s due to the expectation that the bull market would enable arbitrage gains, and were promoted in West Virginia by pointing to the supposed success of New Jersey, which (as of late 1999) had an "overfunded" pension plan due to the infusion of borrowed funds and the resulting investment gains. (App. 261-267.) New Jersey, however, subsequently suffered enormous losses from its investments of the bond proceeds, leading to far greater obligations than it would have had if it had issued no bonds. (Dennison Affidavit at ¶ 42, App. 68.) "Reportedly, the bond brokers and the lawyers made \$53 million in fees for setting up the [New Jersey] pension obligation bond deal. So far, they seem to be the only ones who came out ahead on this." (*Id.*)

The Pennsylvania Constitution authorizes the incurrence of debt by municipalities in Article IX, Section 10, and Pittsburgh made the mistake of issuing POBs:

In 1996 and 1998 the City of Pittsburgh sold \$294 million in bonds to fund its badly underfunded pension plan. Before the sale the city's annual pension contribution was reportedly \$21 million. But then stock prices fell, and now Pittsburgh is paying \$26 million annually into its retirement fund, and is also having to pay debt service on the bonds. . . . "The decision to issue pension bonds for risk arbitrage was a fundamentally risky one, but Pittsburgh had very little margin for taking on increased risk. *In some respects, the decision was analogous to the poker player who decides to borrow from others so he can double his bets, despite the fact that he is already losing money.*"

(Dennison Affidavit at ¶ 43, App. 69, emphasis supplied.)

Scott Dennison makes the following observations regarding New Orleans:

In December of 2000, New Orleans used \$171 million in bonds to finance the pensions of its retired firefighters. Paine Webber, the main underwriter, predicted that the city would probably have to pay about 8.2% for the bonds, but could expect to earn about 10.7% with the bond proceeds after investing it in their pension fund. (Paine Webber, incidentally, collected \$3 million for its services.) The return actually realized through some point in 2003 was negative 3% per year. In a few years the pension fund will run out, and the city will still have to pay about \$17 million a year in pensions – plus another \$16 million in interest on the bonds.

(Dennison Affidavit at ¶ 44, App. 70.)

By the way, there is no jurisdiction that has issued general obligation pension bonds in the face of a constitutional or statutory prohibition against incurring debt. Such bonds have either been authorized by referendum, utilized existing authority to issue debt, or were special, rather than general, revenue bonds.

#### IV.

#### ASSIGNMENTS OF ERROR

1. The lower court erred in its determination that the State's obligation to pay pensions could be "redeemed" by issuing bonds, and consequently erroneously found that the Act did not violate the constitutional prohibition against incurring debt (Const. Art. X, § 4).

2. The lower court erred in its determination that various statutory preconditions for issuing the bonds constituted "standards" for the review committee. These preconditions were not established to guide the review committee, nor did they. They were requirements wholly independent of the committee, which consequently exercised unbridled legislative discretion in violation of the Division of Powers Clause (Const. Art. V, § 1).

3. The lower court erroneously determined that the statutory requirement for a legislative resolution "authorizing" the bonds did not constitute unlawful post-enactment legislative control over executive action, in violation of the Division of Powers Clause (Const. Art. V, § 1).

4. The lower court erroneously held that the unconstitutional requirement for a legislative resolution justified an "emergency meeting" of the review committee, without notice to or participation by the public, thus justifying the committee's failure to abide by the notice provisions of the Open Governmental Proceedings Act.

5. The lower court erred in its determination that pension bonds would not pledge the credit of the State to local school boards in violation of article X, § 6 of the West Virginia Constitution.

V.

**LEGAL ARGUMENT**

**A. The Act Creates State Debt in Violation of The Debt Clause of The West Virginia Constitution.**

1. This Court Has Never Held That the UAAL Is a “Previous Liability of the State.”

West Virginia Constitution, article X, § 4 (hereafter sometimes the “Debt Clause,”) provides:

**Limitation on Contracting of State Debt**

No debt shall be contracted by this State, except to meet casual deficits in the revenue, to redeem a previous liability of the State, to suppress insurrection, repel invasion or defend the State in time of war; but the payment of any liability other than that for the ordinary expenses of the State, shall be equally distributed over a period of at least twenty years.

This provision “is designed to prevent one generation of politicians from helping their friends whilst leaving the next generation of taxpayers to foot the bill.” *Booth v. Sims*, 193 W. Va. 323, 332, 456 S.E.2d 167, 176 (1995). “The clear purpose of [this provision] is to protect the fiscal integrity of the State by prohibiting creation of any present indebtedness that would obligate subsequent legislatures to make appropriations.” *State ex rel. West Virginia Resource Recovery-Solid Waste Disposal Authority v. Gill*, 174 W.Va. 109, 111, 323 S.E.2d 590, 593 (1984). General obligation bonds, like those at issue here, obligate

future legislatures to appropriate debt service payments and consequently constitute a prohibited contract for State indebtedness unless they are issued for one of the specific purposes allowed by the Debt Clause. *Winkler v. State School Bldg. Authority*, 189 W. Va. 748, 754, 434 S.E.2d 420, 426 (1993) (holding that bonds to be repaid from future general revenue appropriations and issued to finance school construction were unconstitutional, despite the constitutional duty of the State to provide a “thorough and efficient system of schools”). Clearly, borrowing to achieve arbitrage gains on the stock market is not one of the specified purposes. Consequently, the Act in question employs a legal fallacy to escape the constitutional prohibition.

Capitalizing on the exception in article X, § 4, which allows the State to incur debt to pay off another debt, the Act contains self-serving findings that defy common sense as well as decisions of this Court. The Act misrepresents this Court by declaring it has ruled that the “unfunded” portion of the “actuarial accrued liability” (hereafter sometimes the “UAAL”) of the three retirement systems is a “*previous liability of the State*” (W. Va. Code § 12-8-2(e)) (emphasis supplied). This Court has never so held, nor can the UAAL be fairly characterized as debt. It is, in reality, an ever-changing and assumption-ridden estimate of the accumulated value (including imputed investment gains) of employee and employer contributions that would, with the benefit of hindsight, have been made to date based on the current funding methodology, less cash on hand. (Dennison Affidavit at ¶¶ 22-34, App. 53-62; Mandel Deposition at App. 103, 109, 112-113, 115-116, 122-127, 133, 135-136,

151-152, 155.) Nor is the UAAL considered a debt in the audited financial statements of the State of West Virginia.<sup>13</sup>

*None* of the three retirement systems at issue is delinquent in making pension benefit payments; *all* are currently funded via existing assets and regular contributions that are together sufficient to pay all pension benefits as they become due; and *all* said systems are “actuarially sound.” (Mandel Deposition at App. 91-93, 158; Dennison Affidavit at ¶ 25, App. 55.) This is exactly what the law requires. *West Virginia Educ. Ass'n v. Consolidated Public Retirement Bd.*, 194 W. Va. 501, 460 S.E.2d 747 (1995) (dismissing Teachers Retirement funding case as moot upon enactment of a 1994 statute creating an actuarially sound funding plan, despite the continued existence of a large unfunded actuarial liability); *State ex rel. Dadisman v. Caperton*, 186 W. Va. 627, 413 S.E.2d 684 (1991) (mandamus petition seeking to require the State agencies to restore delinquent employer contributions, which case was dismissed despite the existence of a UAAL because the system was “actuarially sound”).

2. Pensions Are Not a Debt of the General Revenue, and Therefore Cannot be “Redeemed” via a Pledge of Future General Revenues.

However, there can be no doubt that the existence of a State-sponsored pension system creates enforceable contract rights and imposes corresponding legal duties on the

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<sup>13</sup>The State’s financial statements list “net pension obligations” under “long term debt,” amounting to about \$254 million for all retirement systems combined. (Report of Independent Auditors at 21, available online at <http://www.wvfinance.state.wv.us/FARS/cafr/cafr2003/Financia.pdf>.)

State as a participating employer. “The payment of statutorily promised pension benefits, on maturity, is a general and moral obligation of the State.” Syllabus Point 19, *Dadisman v. Moore*, 181 W. Va. 779, 384 S.E.2d 816 (1989) (*Dadisman I*). So, the question becomes, is the “general and moral” obligation to pay future pension benefits “on maturity” (e.g., the promise to pay benefits that are not yet due or payable), the sort of liability that is contemplated by the phrase, “previous liability of the State,” thus justifying the issuance of \$3.9 Billion in debt? The answer to that question is best-articulated in the decision most relied upon by the Appellees before the trial court -- *Booth v. Sims*, 193 W. Va. 323, 456 S.E.2d 167 (1995).

*Booth* has often been quoted by the bonds’ proponents as holding that “pensions are legitimate debts of the state” (e.g., App. 190, 286), but this quote is incomplete and taken out of context. *Booth* concluded that pensions are “legitimate” debts because they are *not* a general revenue obligation, but rather are payable exclusively from a “special fund.”

In *Winkler [v. School Building Authority]*, 189 W.Va. 748, 434 S.E.2d 420 (1993), we did note that in certain instances the State could issue bonds when the bond proceeds, themselves, were to be used to build projects such as toll bridges, or buildings that generated money to liquidate the bond obligation. 189 W.Va. at 756-758, 434 S.E.2d at 428-430 (discussing funding arrangements that do not violate our constitutional debt limitations). In these instances, a *special fund* derives from the service itself, and, for this reason, lenders, not taxpayers, are the only potential losers if the project does not generate the anticipated returns.

This Court concluded long ago that our pension systems do not involve the creation of an unconstitutional debt. *State ex rel. Board of Governors v. Sims*, 133 W.Va. 239, 244, 55 S.E.2d 505, 508 (1949). Although *Sims* did not discuss the rationale behind its reasoning on this issue, given our decision in

*Winkler* it should now be clear that pension systems are constitutional for the same reasons that special revenue bonds are constitutional: The pledge for the pension fund derives from the actuarially sound contributions of the employees and the Division; that is, *the fund is expected to generate its own money to meet its eventual obligations*. Because money is expected to be put away as a condition precedent to fund the system, pensions are legitimate debts of the state.

*Booth*, at 332-333, 454 S.E.2d at 176-177 (emphasis supplied).

Based on the quoted discussion, and on the discussion in *Winkler* to which it refers, the “special fund” dedicated to paying “eventual” pensions is *not* the general revenue of the State, but rather the accumulated and anticipated revenues of the retirement systems. The obligation of a State-agency employer (or, in the case of the TRS, a county school board) is to pay its share of the contributions to the relevant retirement fund. This obligation arises by virtue of its status as an “employer” under the relevant retirement act, not because of its status as a sovereign, and the only revenues that have accordingly been committed to redeeming pensions are the regular contributions *actually received* by the CPRB from the various employers and employees participating in its pension systems.<sup>14</sup> Hence, pension debts are “legitimate” despite the constitutional prohibition against binding future general revenues. In the decisions discussed in *Winkler*, and again in *Booth*, “special revenue” debt obligations were approved even though *general* revenues were expected to be

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<sup>14</sup>It is perhaps important to note that all three of the retirement systems at issue here are funded, in large part, by employee contributions; that the employer contributions to the Teachers’ Retirement System are funded jointly by the State and local school boards; and that the Public Employees’ Retirement System (not at issue in this case) is funded by city, county, and State employees and their employers.

contributed to the “special fund” from which the debt was to be repaid. Thus, a State office building could be financed by a “special fund” consisting of rents collected from State agencies for office space. *State ex rel. Hall v. Taylor*, 154 W. Va. 659, 178 S.E.2d 48 (1970); *State ex rel. State Bldg. Comm'n v. Moore*, 155 W. Va. 212, 184 S.E.2d 94 (1971). Likewise, a steam-generating plant could be financed by pledging those revenues expected as payments from the State for steam generated by the facility. *State ex rel. West Virginia Resource Recovery-Solid Waste Disposal Authority v. Gill*, 174 W. Va. 109, 323 S.E.2d 590 (1984), *overruled on other grounds, Winkler, supra*. In those decisions, that the “ultimate source” of the “special” revenue pledged to the bonds included general revenues did not render the bonds unconstitutional, because the bondholders were limited in their remedies to the rent payments or utility payments *actually received* by the special fund, and could not enforce the obligation directly against general revenues. “Thus, although there is an expectation of continued appropriations by the legislature [for rent or heat], there is no prohibited state debt or pledge of credit if the legislature is not obligated to act.” *State ex rel. West Virginia Resource Recovery-Solid Waste Disposal Authority v. Gill*, at 114, 323 S.E.2d at 595.

Consequently, *Booth*'s oft-quoted statement that “pensions are legitimate debts of the State” was meant to indicate that the State's pension obligations were *not* a prohibited pledge of the credit of the State, but rather were a pledge of retirement system assets, funded in turn by an “expectation” that State agencies and their employees (or school boards and

their employees) would make regular contributions to a special fund, which fund was responsible for paying pensions. "The pledge for the pension fund derives from the actuarially sound contributions of the employees and the Division [of public safety]; that is, the fund is *expected* to generate its own money to meet its eventual obligations." *Booth*, at 333, 456 S.E.2d at 177 (emphasis supplied).

Based on the above reasoning, the Legislature could have authorized the CPRB to issue special revenue bonds that pledged future employer and employee contributions, but it could *not* pledge the credit of the State. Such legislation would dramatically change the powers of the CPRB, but (if politically feasible and not otherwise unlawful) such legislation could direct that the funding stream currently being used by the CPRB to fund pensions be instead dedicated to repaying special revenue bonds issued for the same purpose. In such a case, however, the CPRB would clearly be "robbing Paul to pay Paul," and would not find pensioners very supportive of the idea due to the risk of loss inherent in the scheme. Only by imposing that risk on future taxpayers does the scheme become politically feasible (and unlawful).

However, should such a special revenue bond be issued, the bondholders could *not* enforce their claim directly against the State, just as the State, as a lessee of office space or a consumer of heat, remains immune from suit by the bondholders whose money built the office space and the steam generating plant. The State, as an employer, can no more issue general obligation bonds to prepay future pension benefits than it could to prepay future rent

payments, utility bills, or salaries. Nor could the State, as the provider of a “thorough and efficient system of free schools,” borrow to build school buildings or to prepay future School Aid subsidies. *Winkler v. State School Bldg. Authority*, 189 W. Va. 748, 754, 434 S.E.2d 420, 426 (1993). Rather, the State is expected to pay for these services, including the services of its employeccs, *contemporaneously out of this year’s appropriations*.<sup>15</sup>

Thus, the “special fund” reasoning in *Booth* and the decisions on which it relies to exempt pensions from the debt clause (art. X, § 4), likewise precludes a finding that such pensions can be “refinanced” as a “previous liability of the State” by pledging future general revenues to bondholders. The only revenues that the Legislature is authorized to dedicate to pensions are those within the revenue estimate of the Governor for a single fiscal year.

This reasoning is not inconsistent with the famous *Dadisman* decision, issued six years earlier than *Booth*. In *Dadisman I, supra*, this Court held that a pensioner has a contractual right to demand that the State, as an employer, have an actuarially sound plan in place to pay his pension, but this Court also held that this contractual right did *not* entitle a pensioner to demand that the State eliminate a UAAL caused by past underfunding relative to that plan, provided that the underfunding did not render the system “actuarially unsound.”

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<sup>15</sup>The New Jersey pension obligation bonds were issued before their opponents prosecuted an appeal to the state’s Supreme Court, and thus the appeal was dismissed as moot. However, two justices opined that, had the case reached them in time, they would have enjoined the bonds as violating the New Jersey Constitution’s “Debt Limitation Clause,” because the proceeds of the bonds “are directed only to defray the ordinary expenses entailed in the operation of government.” *Spadoro v. Whitman*, 150 N.J. 2, 10, 695 A.2d 654, 658 (1997) (J. Handler, concurring and dissenting). (App. 354.)

*State ex rel. Dadisman v. Caperton*, 186 W. Va. 627, 632, 413 S.E.2d 684, 689 (1991) (*Dadisman II*). “According to the actuaries herein, however, most public or private pension plans have unfunded actuarial liabilities amortized over about thirty years.” *Dadisman II* at 633, 413 S.E.2d at 690. This does not mean they are “actuarially unsound”. (*Id.*) Indeed, both actuaries below testified that the TRS was “actuarially sound.” (Mandel Deposition at App. 91-93, 158; Dennison Affidavit at ¶ 25, App. 55.)

Even the *Booth* opinion, in characterizing pensions as “legitimate debts,” does not suggest that the unfunded portion of the actuarial accrued liability is a debt of any kind, but rather that pension benefits must be paid when due and, if *not* paid, constitute a debt recoverable in mandamus. “W. Va. Const. art. VI, § 51B(3)(d) requires the Governor to prepare a yearly budget that allows for *payment of pensions* as constitutionally created debt of the State.” *Booth*, 193 W. Va. at 334, 454 S.E.2d at 177 (emphasis supplied). “Because pensions are a lawful debt of the State, the proper remedy for any *failure to pay a pension* is a mandamus action against the state treasurer and auditor.” *Id.* at 340, 454 S.E.2d at 184 (emphasis supplied). The issue in *Booth* was the lawfulness of changes to the system designed “to meet the state’s *eventual* pension debt.” *Booth* at 333, 454 S.E.2d at 333.

Thus, *Booth* is a critical decision in this case, not only because it makes clear that “pensions are a lawful debt of the state” because they are *not* general revenue obligations, but because of its holding that “eventual pension debts” become actionable only when there

is a "failure to pay," and not when an actuary declares that more money needs to be accumulated to prepay that "eventual" obligation.

Thus, the Act and the Court below were both in error in their suggestion that "the Supreme Court of Appeals has ruled that the unfunded actuarial accrued liability of pension systems is a public debt of the state that must be repaid." W. Va. Code § 12-8-2(d). *Booth* and *Dadisman II* hold exactly to the contrary.

3. Pension Obligation Bonds Do Not "Redeem" any Liability, and Therefor Cannot Extinguish the Accrued Actuarial Liability.

Regardless of whether the Actuarial Accrued Liability ("AAL") is a "previous liability of the State," it is not susceptible of being "redeemed" except by paying pensioners their pensions (or obtaining their release in exchange for adequate consideration). "Fully funding" the AAL does neither, and consequently a supposedly "redeemed" UAAL can suddenly reappear. (Mandel Deposition at App. 131-132; Dennison Affidavit at ¶¶13 and 21-32, App. 48, 53-61; App. 219, 213-233, 243, 250-252.)

The reason that the AAL cannot be extinguished (or "redeemed") by virtue of being "fully funded," and the reason that an unfunded liability can reappear immediately after the AAL becomes fully funded, is that the underlying pension obligations upon which the AAL is calculated are *future* liabilities that are contingent on a number of variables that cannot yet be ascertained, and which remain mercurial until the pension benefits are actually paid to retirees. Instead, the underlying obligations can only be estimated using demographic and inflationary assumptions that change, sometimes dramatically, over time. (Mandel

Deposition at App. 113, 131-133, 152; Dennison Affidavit at ¶¶ 21-32, App. 53-61.) In addition, the calculation of the AAL changes dramatically depending on the funding method used to calculate the regular contributions required of the plan sponsor and membership. (Mandel Deposition at App. 119-127; Dennison Affidavit at ¶¶ 22, 26, App. 53, 55.)

There is no creditor that will be "repaid" by "funding" the AAL. The AAL will remain exactly as it was before. All the benefit obligations that the State CPRB owes or will owe to members of its retirement system will remain exactly as they were before – none will have been extinguished; none will have been "redeemed;" no debt will have been "repaid." (See Mandel Deposition at App. 131, 156B.) In the words of Scott Dennison, who was the State's actuary when Pension Obligation Bonds were first proposed to the State,

The AAL does not "disappear" even if the plan is "fully funded." The "unfunded" portion of the AAL is simply the AAL less existing assets, *but the AAL is still there, whether "funded" or not.* Until the system's assets are actually applied to pay benefit checks, they cannot extinguish the system's future pension obligations or the AAL. Because actuarially expected contributions are based on future pension obligations, which cannot be extinguished until the last benefit check is written, the AAL remains, even if "fully funded", until that last check is written. Consequently, even when "fully funded," the AAL can thereafter grow or shrink for reasons having nothing to do with the assets or liabilities of the system, including revised actuarial assumptions about the future or revisions in the methodology used to define the AAL. In addition, even if "fully funded", the AAL must be revised to reflect subsequent changes in the benefit formula or the demographic characteristics of its membership.

(App. 11, emphasis supplied.)

The moment after the AAL has supposedly been "redeemed" (i.e. "fully funded") via the infusion of borrowed funds, it can instantly reappear simply by revising the underlying

assumptions or methodologies used by the State's actuary. For instance, during the one day period between June 30 and July 1, 2002, the UAAL of the TRS increased by \$448 Million even though its existing assets and pension obligations *had not changed at all*.<sup>16</sup>

Additionally, the UAAL will reappear if the investment returns on retirement system assets (including the borrowed funds) don't meet actuarial expectations.<sup>17</sup> Simply by changing the actuarial method used to calculate "normal contributions," the UAAL can be increased, decreased, or eliminated altogether!<sup>18</sup> The UAAL is a mercurial abstraction

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<sup>16</sup> In 2002, the CPRB decided to change the assumed rate of return on TRS system assets from 8% to 7.5%. This alone caused an increase in the UAAL of \$195 Million on July 1, 2002. (Mandel Deposition at App. 136; App. 200.) In addition, a recently conducted "experience study" resulted in revised estimates and assumptions regarding future inflation and membership demographics, causing an increase of \$253 Million in the UAAL as of July 1, 2002. (Mandel Deposition at App. 139.) Thus, between June 30 and July 1, 2002, the UAAL of the TRS increased by \$448 Million even though its existing assets and pension obligations had not changed at all. Similar changes have occurred several times since 1994.

<sup>17</sup>(Mandel Deposition at App. 156B-156C.) The July 1, 2002, actuarial valuation of the TRS recognized that investments had not met actuarial expectations for the preceding year, requiring an increase in the UAAL of approximately \$105 Million effective July 1, 2002. (App. 200.) Thus, between June 30 and July 1, 2002, the UAAL of the TRS increased by more than \$½ Billion due solely to adjustments to actuarial assumptions, despite that there was no increase in the pension obligations of the system. Such adjustments to the UAAL (either positive or negative) are made *every year*.

<sup>18</sup>For instance, in 1993, the Public Employees Retirement System was "overfunded" (had assets in excess of its AAL) by nearly \$224 Million. That year, however, the CPRB decided to change the plan's funding methodology, resulting in increased normal costs that were projected backwards in time to calculate a new AAL. As a result of this decision, and nothing else, the AAL increased by over \$350 Million, creating an "underfunding" (UAAL) of more than \$130 Million. (Dennison Affidavit at ¶ 28, App. 59.) Thus there was a change of \$350 Million in "actuarial liabilities," creating a UAAL that did not previously exist, even though assets and pension obligations of the system had not changed at all!

(continued...)

which is continuously changing even when the actual assets and liabilities of the system remain constant. While useful for planning purposes, it is subject to all of the ever-changing premises and assumptions which underlie its calculation. It is not, by any stretch of the legal imagination, a redeemable "previous liability of the state," and should not be used as an excuse to engage in a speculative arbitrage scheme with borrowed funds. *Berry v. Fox*, 114 W. Va. 172, 513 S.E. 896 (1934); *Winkler v. State School Bldg. Authority*, 189 W. Va. 748, 434 S.E.2d 420 (1993); *State ex rel. School Bldg. Authority of West Virginia v. Marockie*, 198 W. Va. 424, 481 S.E.2d 730 (1996).<sup>19</sup>

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<sup>18</sup>(...continued)

Indeed, under one funding method (the "Aggregate Cost" method), the TRS would currently have no "unfunded liability" whatsoever! (Mandel Deposition at App. 124-125; Dennison Affidavit at ¶ 26A, App. 56.) In the words of actuary Scott Dennison;

Because the AAL is defined by reference to "Normal Costs" (or normal contributions) the precise meaning of "Actuarial Accrued Liability" for any particular pension plan will depend on the particular "actuarial cost method" or "funding method" (these terms are synonymous) being used by the plan's sponsor to define "Normal Costs." The definition of Normal Costs differs dramatically depending on which funding method is used, causing a dramatic difference in the definition and amount of the AAL, and consequently the UAAL. As will hereafter be shown, the current UAAL of the TRS [Teachers Retirement System] could be as little as \$0 depending on what funding method is being used to define the AAL.

(App. 53, emphasis supplied.)

<sup>19</sup>These decisions hold that the State's constitutional obligation to provide funding for schools does not constitute a "previous liability of the State;" that the State is consequently prohibited from issuing general revenue bonds to redeem previously incurred school building debts or to fund new school buildings; and that savings from refinancing  
(continued...)

One last observation: Under the funding method currently in use for the TRS, the AAL is substantially greater than the estimated present value of the future benefits earned to date by its members. This is because this particular method requires that pension benefits yet to be earned be paid for, in part, by past contributions. (Dennison Affidavit at ¶¶ 27, 37-38, App. 58, 64-65).

**B. The Act Violates the Separation of Powers Clause by Delegating Legislative Power to an Executive Committee Without Supplying any Standards for the Committee to Apply.**

1. The Review Committee Was Originally Designed as an Unconstitutional Mechanism for the Legislature to Exercise Post-Enactment Control over the Executive.

Perhaps because the arbitrage scheme contemplated by the Act is fraught with risk, its promoters tout its “safeguards,” including a “Review Committee” that must “authorize the issuance of the bonds.” W. Va. Code § 12-8-4(g). Unfortunately, the Act provides no guidance or standards for the Review Committee to apply in considering whether the bonds should issue. The committee’s discretion is unrestrained and consequently constitutes an unlawful delegation of Legislative power. *See State ex rel. West Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee*, 213 W. Va. 255, 580 S.E.2d 869 (2003) (holding that a Legislative “statement of purpose” provided insufficient

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<sup>19</sup>(...continued)  
valid school-building debts may not be “realized as cash” and used to fund new school buildings.

standards to adequately guide the discretion of a committee which had been delegated the power to award economic development grants).

Originally, the “review committee” consisted of the Treasurer and eight gubernatorial appointees, four of whom were to be selected from names submitted by the President of the Senate and the Speaker of the House. W. Va. Code § 12-8-4(g) (2000). As originally enacted, the Act gave this committee very limited authority. It was empowered only to “review and approve” the fees, commissions, and other costs to be paid from the bond proceeds, and to “approve” the bond counsel, underwriter(s), advisors and consultants selected by the Department of Administration to receive these fees and commissions. W. Va. Code §§ 12-8-4(c) and 12-8-5(f) (2000). The Act included no standards to be used by the committee for approving these expenses and appointments, thus fostering suspicion that the Legislature sought to retain some control over who would benefit from the \$39 Million in fees and commissions that would be generated by this massive bond issue.<sup>20</sup>

In the Regular Session of 2002, the Act was amended by deleting therefrom the requirement that this Court approve the bonds, and substituting therefor a new subsection, 12-8-4(g), giving that power to the Committee:

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<sup>20</sup>In *Citizens Action Group*, six members of the challenged Grant Committee were appointed from lists submitted by the President and the Speaker, and the Committee was to approve economic development grants without adequate legislative standards, thus leading this Court to hold that “the subject legislation does indeed set in place a device by which the Legislature may assert post-enactment control over executive branch decisions.” 213 W. Va. at \_\_\_, 580 S.E.2d at 881.

(g) Prior to any request of the governor that the Legislature prepare and consider a resolution authorizing the issuance of bonds, the bonds shall be authorized by a majority of the members of the review committee described in subsection (c) of this section.

No standards accompanied this new delegation of power and thus the review committee's authority to generally approve or disapprove the issuance of the bonds was without legislative limitation or guidance (except such "guidance" as might have been injected by the legislatively chosen appointees!).

In March of 2003, after the Review Committee had initially approved the fees, commissions, appointments, and the issuance of the bonds, this Court issued its decision in the highly analogous case of *State ex rel. West Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee*, 213 W. Va. 255, 580 S.E.2d 869 (2003). This decision had two holdings that clearly applied to the Review Committee and invalidated its prior actions. First, this Court held that an "Economic Development Grant Committee" (hereafter "Grant Committee") was unconstitutionally constituted because six of its members were appointed from lists provided by the President and Speaker, thus usurping the Governor's constitutional power of appointment. Second, it held that the delegation of unbridled discretion to the Grant Committee to award grants was an unlawful delegation of Legislative power.

As a general rule the Legislature, in delegating discretionary power to an administrative agency, such as a board or a commission, must prescribe adequate standards expressed in the statute or inherent in its subject matter

and such standards must be sufficient to guide such agency in the exercise of the power conferred upon it.

*Citizens Action Group*, 213 W. Va. at \_\_\_\_, 580 S.E.2d at 886.

In response to this decision, the Legislature immediately convened into its Second Extraordinary Session of 2003 and amended the statutes governing the Grant Committee by eliminating the Legislatively controlled appointments and by enacting 18 specific standards to control the Grant Committee's discretion. *State ex rel. Cities of Charleston, Huntington and its Counties of Ohio and Kanawha v. West Virginia Economic Development Authority*, \_\_ W. Va. \_\_\_\_, 588 S.E.2d 655 (2003).

The Act at issue here was also amended in the same extraordinary session by deleting from the Review Committee's membership the four members selected from lists provided by the Speaker and the President. W. Va. Code § 12-8-4(c) (2003). No other changes were made, however. In stark contrast to the amended standards controlling the Grant Committee, no new standards to control the Review Committee's discretion were enacted. Thus, while the 2003 amendment followed this Court's holding regarding Legislative control over gubernatorial appointments, *it completely ignored the Court's second holding regarding the unconstitutionality of standardless delegations*. The Act therefor remains unconstitutional.

On the day following the passage of the 2003 Amendment, the Governor reappointed the same people to the Review Committee (less those chosen from the lists of the President and the Speaker). Hours later, the newly constituted Committee briefly met in an "emergency meeting;" ratified (without discussion) all acts of the prior Committee; and

authorized issuance of the bonds; all within 24 hours of passage of the Amendment. (App. 201-213.)

2. The Act Contains No Standards for the Committee to Apply in Any of its Functions.

The lower court correctly recognized that *Citizens Action Group* supplied the pertinent legal standards, but nonetheless held that various provisions of the Act constituted standards for the Review Committee. In reality, none of said provisions purports to control or guide the actions of the Review Committee and none can fairly be construed as standards for the Committee's decisions. Moreover, there is no indication in the Minutes of the Committee's meeting that it perceived these provisions as controlling its discretion. (App. 201-213.)

The court below held as follows:

The Act establishes several important limitations on the issuance and sale of the bonds, including: (i) a restriction on the costs of issuance; (ii) a restriction on the aggregate principal amount of bonds that may be issued, W. Va. Code § 12-8-4(b); (iii) a time limit within which the sale of authorized bonds are to be made, W. Va. Code § 12-8-4(a); (iv) a limitation on the true interest costs of the bonds, W. Va. Code § 12-8-5; and (v) a requirement that the bond issuance will not "cause a down grade or reduction in the state's general obligation credit rating," *id.*

(App. 4-5.) Unfortunately, however, none of these "limitations" were written as guidance to the Committee in its decision to approve the bonds, all were written years before the Committee was empowered to approve or disapprove of the bonds, and most cannot even be determined or applied until *after* the committee has already approved the bonds.

It is true that the Committee was originally empowered to “review and approve” the costs of issuance, which could not exceed 1% of the bond proceeds. W. Va. Code §12-8-4(c). But nothing in that section suggested that the bonds themselves could be disapproved on this basis, for the Committee didn’t even have the authority, at that time, to approve the bonds.

The “restriction on the aggregate principal amount of the bonds” is determined by the Consolidated Public Retirement Board (CPRB), not the Review Committee.<sup>21</sup> The “time limit within which the bonds may be sold” is “no later than five years after the date of adoption of the resolution of the Legislature authorizing the issuance of the bonds.” W. Va. Code § 12-8-4(a). Since the Legislature cannot even consider such a resolution until *after* the Review Committee has already approved the bonds, the time limit for issuing the bonds would not even be known at the time the Review Committee approves them! W. Va. Code § 12-8-4(g). Consequently, the Committee could not possibly apply this “standard.”

The same is true for the limitation on the “true interest costs of the bonds” and the requirement that their issuance “will not cause a downgrade or reduction in the state’s general obligation credit rating,” both of which restrictions are set forth in Code § 12-8-5(a). Whether either restriction applies cannot be determined until the bonds are ready for the

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<sup>21</sup>Code § 12-8-4(b) provides that the principal amount of the bonds less expenses shall be no more than the lesser of \$3.9 Billion or “the unfunded actuarial accrued liability [of the three retirement systems], *as certified by the consolidated public retirement board.*” (Emphasis supplied.)

market, and it is consequently the Governor, not the Review Committee, who has the duty to insure that these restrictions are met and who makes that determination *at the time the bonds are issued*, long after the Review Committee has approved them.<sup>22</sup>

Thus, the Act provided the Review Committee with no standards whatsoever to apply in considering whether to approve of the bonds. The Act is consequently an unconstitutional delegation of legislative law-making powers.

C. **A Legislative Resolution Which Purports to Control Executive Action Is an Unconstitutional Encroachment by The Legislature on The Executive.**

After the Review Committee approved the bonds, the Act required them to be “authorized” by a legislative resolution empowering the Governor to issue an executive order “authorizing” the bonds. Code § 12-8-5(a). Such a legislative resolution was passed on June 14, 2003, the day after the Review Committee’s “emergency” meeting. It required, *inter alia*, “that the Governor shall sell the bonds . . . at such prices during the fiscal year as he may determine necessary . . . .” (A copy of the resolution was appended to the Plaintiffs’ Memorandum below.)

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<sup>22</sup>Code 12-8-5(a) provides, in pertinent part:

The governor shall not sign the bonds unless he shall first make a written finding . . . that: (i) The true interest cost of the bonds is at least thirty basis points less than the assumed actuarial interest rate . . .; and (ii) that the issuance of the bonds will not in any manner cause a down grade or reduction in the state’s general obligation credit rating by standard bond rating agencies.

This resolution violated the Division of Powers Clause (art. V, § 1) by exerting post-enactment legislative control over executive implementation of the Act. In *State ex rel. Barker v. Manchin*, 167 W. Va. 155, 279 S.E.2d 622 (1981), this Court held that the executive branch implements laws, not resolutions, and that a legislative resolution is not an exercise of legislative law-making power. Because resolutions are not subject to the numerous constitutional provisions which control how laws may be passed,<sup>23</sup> the use of resolutions to control or dictate executive action is unconstitutional:

These constitutional provisions clearly limit the power of the Legislature to give the binding effect of law to its actions. It may create law only by following the formal enactment process. Where it seeks to give legal force to informal actions, the Legislature exceeds the limits of its constitutional authority. Thus, it has been held from the earliest days of our statehood that the Legislature cannot give a matter the force and effect of law by joint resolution when such matter is properly the subject of the enactment process. *Boyers v. Crane*, 1 W. Va. 176 (1865). *Joint or concurrent resolutions, while they may bind the members of the legislative body, are not statutes and do not have the force and effect of law.*

*State ex rel. Barker v. Manchin*, 167 W. Va. at 171, 279 S.E.2d at 633 (emphasis supplied.)

In the cited case, the Legislature had delegated to executive officials the power to promulgate regulations, but required that such regulations be submitted to a "rule making committee" of the legislature for approval. The actions of the rule making committee, in

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<sup>23</sup>The Court was referring to article VI, § 1 (which requires enactments to be styled, "Be it enacted by the Legislature of West Virginia"), Section 29 of article VI (which prohibits a bill from becoming law "until it has been fully and distinctly read, on three different days, in each house ..."), Section 30 of article VI, ("No act of the Legislature may embrace more than one object"), and the detailed procedures for gubernatorial vetoes (W.Va. Const. art. VII, §§ 7, 14 and 15). None of these restrictions apply to resolutions.

turn, could be revised by legislative resolution. The Court held this process to be an unconstitutional encroachment on executive power.

Such a mechanism for legislative review of executive action may properly be called an "extra-legislative control device" for it permits the Legislature to act as something other than a legislative body to control the actions of the other branches. This is in direct conflict with our constitutional requirement of separation of powers. The power of the Legislature in checking the other branches of government is to legislate.

*State ex rel. Barker v. Manchin*, 167 W. Va. at 173, 279 S.E.2d at 633.

Thus, the Act is unconstitutional insofar as it made the sale of the bonds subject to a resolution authorizing them. (The lower court did not address this issue, other than to say: "The Court finds that Legislature's role under the Act does not infringe upon that of the executive branch in violation of the separation of powers mandated by Article V, Section 1 of the West Virginia Constitution." (App. 5.)

Assuming that the Act's requirement for a resolution was valid, the resolution itself failed to conform to the Act because it attempted to amend the Act by requiring that all bonds be sold within one fiscal year. The Act itself allows five years for this process. (W. Va. Code § 12-8-4(a)). Obviously, the statutory provisions of the Act cannot be amended by resolution. "[I]t has been held from the earliest days of our statehood that the Legislature cannot give a matter the force and effect of law by joint resolution . . . ." *State ex rel. Barker v. Manchin*, 167 W. Va. at 173, 279 S.E.2d at 633.

Nor can the resolution simply be ignored, for it forms an integral part of the "safeguards" built into the Act which may have discouraged debate and encouraged

reluctant legislators to vote for it, knowing that they would have another opportunity to consider the question, by resolution, before the bonds could be issued. Moreover, the unconstitutional requirement for a legislative resolution induced the Review Committee to violate the Open Governmental Proceedings Act.

**D. The Meeting of The Review Committee Violated The Open Governmental Proceedings Act.**

The meeting at which the Review Committee authorized issuance of the bonds was conducted only five hours after notice thereof was delivered to the Secretary of State. (App. 344.) No other notice to the public was given, nor did any member of the public attend. (App. 201-213.) West Virginia Code § 6-9A-3 provides, in pertinent part, as follows:

Except as expressly and specifically otherwise provided by law, . . . all meetings of any governing body shall be open to the public. . . .

*Each governing body shall promulgate rules by which . . . the date, time, place and purpose of all special meetings are made available, in advance, to the public and news media, except in the event of an emergency requiring immediate official action.*

. . . Each notice shall state the date, time, place and purpose of the meeting. Each notice shall be filed in a manner to allow each notice to appear in the state register *at least five days prior to the date of the meeting.*

In the event of an *emergency requiring immediate official action*, any governing body of the executive branch of the state may file an emergency meeting notice at any time prior to the meeting. The emergency meeting

notice shall state the date, time, place and purpose of the meeting and the facts and circumstances of the emergency.

(Emphasis supplied.)

The meeting held by the Review Committee violated this statute in four respects: First, the Committee never issued the required rules by which notice of its meetings will be given to "the public and news media." Second, the meeting was not publicized in the State Register until June 19, 2003, six days *after* it occurred, rather than five days before. (App. 348.) Third, the "emergency notice" of the meeting was filed by Alex Macia (general counsel to the Governor) rather than by the Committee itself, as required by the quoted statute. Mr. Macia had no relationship to the Committee whatsoever, and was not authorized to act on its behalf. Fourth, no "emergency" was implied by the "requirement for a legislative resolution" as described in the emergency notice filed by Mr. Macia, nor could such an unconstitutional requirement constitute a lawful emergency in any event.

The unconstitutional effort of the Legislature to build in a mechanism whereby it could exercise post-enactment control over the executive's implementation of the Act (via a resolution) thus caused the executive to violate the spirit, purpose, and letter of the Open Governmental Proceedings Act, depriving the public of its statutory right to observe the meeting just as the Act itself deprived the public of its constitutional right to vote.

The Act thus operated to exclude the public in every respect imaginable from the decision to issue \$3.9 Billion in debt. Consequently, as provided in W. Va. Code § 6-9A-3,

this Court should “invalidate any action taken at any meeting for which notice did not comply with the requirements of this section.”

**E. The Act Pledges The Credit of The State to Local School Boards in Violation of Constitution Article X, Section 6.**

Unlike State troopers and judges, who are employed directly by the State of West Virginia, county school employees are employed by the local county boards of education. Their salaries and benefits, including their pensions, are funded by both local and State funds via the “School Aid Formula,” which determines the amount of the State subsidy received by each county board. (See, W. Va. Code §§ 18-9A-1.) As noted by the CPRB’s actuary, the annual State appropriations for their pension benefits constitute a “subsidy” for the benefit of the local school boards. (Mandel Deposition at App. 97-99.)

While the Constitution does not prohibit appropriations from the State’s general revenue to subsidize school boards, it does prohibit incurring debt for that purpose: “The credit of the state shall not be granted to, *or in aid of* any county, city, township, corporation or person.” W. Va. Const. art. X, § 6 (emphasis supplied). Clearly, issuing bonds for the purpose of “subsidizing” the county boards would violate this provision.

The court below observed that TRS pensions are an obligation of the State, apparently relying upon this Court’s opinion in *WVEA v. Consolidated Pub. Retirement Bd.*, 194 W. Va. 501, 460 S.E.2d 747 (1995). (App. 5.) That decision held that the statutes creating the Teachers Retirement System created contract rights enforceable against the State officials who administer the fund, including the Governor, who must insure that *current*

appropriations are sufficient to maintain the system on an actuarially sound basis. All this is true, but nothing in that case suggests that the State is therefor authorized to violate article X, Section 6 by borrowing money as a substitute for such annual subsidies.

IV.

CONCLUSION

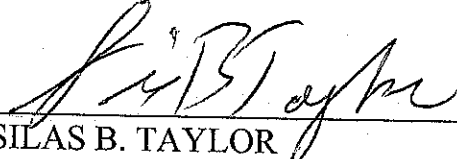
For the reasons stated, Appellants pray that the ruling below be reversed, and that the people's constitutional right to decide whether to incur debt be vindicated.

Respectfully submitted,

THE HONORABLE JOHN D. PERDUE,  
Treasurer of the State of West Virginia, and  
THE HONORABLE GLEN B. GAINER, III,  
Auditor of the State of West Virginia,  
Defendants,

By Counsel,

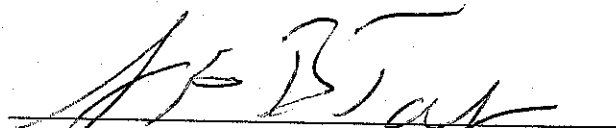
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**CERTIFICATE OF SERVICE**

I, Silas B. Taylor, Senior Deputy Attorney General for the State of West Virginia, do hereby certify that a copy of this Brief and Joint Appendix were served via regular United States mail, postage prepaid on the 14<sup>th</sup> day of June, 2004, to:

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