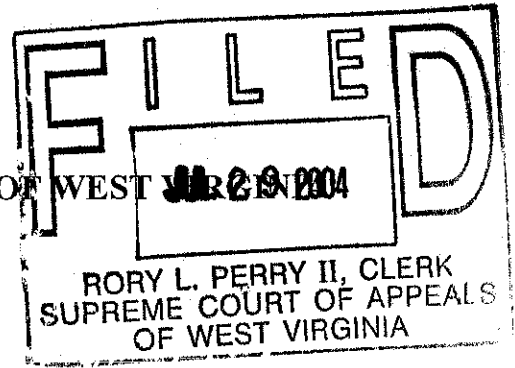


NO. 31749

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.

CIVIL ACTION NO. 03-C-1651
(The Honorable Irene C. Berger, Judge)

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.*

APPELLANT'S REPLY BRIEF

DARRELL V. McGRAW, JR.
ATTORNEY GENERAL

SILAS B. TAYLOR
SENIOR DEPUTY ATTORNEY GENERAL
State Bar No. 3712
State Capitol, Room E-26
Charleston, West Virginia 25305
(304) 558-2021

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*Appellees,
Defendants below.*

APPELLANT'S REPLY BRIEF

I.

**PENSION OBLIGATION BONDS VIOLATE THE DEBT CLAUSE
(Art. X, § 4) AND THE PROHIBITION AGAINST PLEDGING THE
CREDIT OF THE STATE (Art. X, § 6)**

A. Do The Ends Justify The Means?

The Brief of Appellees (at 8-10) suggests that "Appellants have asked this Court to believe that no crisis exists . . ." and that the Legislature's decision to issue bonds deserves

support “because of all that is at stake.” (Brief at 8,9.) These, and many other comments, are calculated to persuade this Court that the Constitutional limitations on legislative power should be overlooked to accommodate the Legislature’s “bold” and “rigorous” effort to “ameliorate the adverse consequences” of its own past underfunding of the pension systems at issue. (*Id.*)

In various contexts, legislation which tackles a difficult issue is entitled to deference, but the Act in question doesn’t do that. Rather than tackling the issue of whether pension bonds are legal and good policy, it delegates those questions to a “review committee” empowered, without legislative guidance, to decide whether the bonds should be issued at all, and reserves to itself the power to veto the committee, by resolution, if need be. The Act does not constitute an exercise in responsible democracy, but an abdication thereof.¹

In any event, although the courts usually apply a presumption of validity in favor of an act of the Legislature, no statute can authorize an unconstitutional practice. Wherever a statute and the constitution come into conflict, the statute must give way. *State ex rel. West*

¹Appellees criticize Appellants’ “withering cynicism” regarding Legislative motivations, but are guilty of the same speculative venture when they ascribe lofty motives to a Legislature that was woefully misinformed. Legislators were told that pension bonds would result in savings at no risk to the State, and were apparently ignorant of the substantial likelihood that the bonds would actually *increase* the cost of funding pensions. Given the information they had, and the “escape clauses” provided in the Act, they could hardly be expected to struggle with their decision to pass it. What else could they do? (Indeed, “respect for the legislative purpose” of minimizing the cost of pensions might best be served by striking the Act as unconstitutional!)

Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee,
213 W. Va. 255, 580 S.E.2d 869 (2003).

**B. A Special Revenue Debt May Not Be Redeemed by Pledging General Revenues,
Nor May the Credit of the State be Pledged to County Boards of Education.**

Appellees' backdrop of "crisis" and "respect for the Legislature" sets the scene for their invitation to this Court to abandon its role as guardian of the restrictions imposed by the Constitution on legislative power. Appellants' Opening Brief made two dispositive legal points that Appellees, to their credit, do not dispute. Instead, however, they ask this Court to overlook them.

First, Appellees apparently concede that pensions create lawful debt only because they are to be paid from a "special fund," and are therefore not a "contract for State debt" within the meaning of Constitution Article X, Section 4. Appellees' Brief admits that this Court, in *Booth v. Sims*, 193 W. Va. 323, 456 S.E.2d 167 (1995), relied on the special fund doctrine in holding that "the State's pensions do not violate the constitutional debt limit because pension plans are expected to generate their own money . . ." (Appellees' Brief at 13, fn. 4.) However, Appellees ask the Court to ignore this holding because "the unfortunate reality is that the 'special funds' of the Pension Systems have not generated enough money to satisfy their future obligations." (*Id.*) Note that the phrase "their future obligations" correctly refers back to the "the Pension Systems," not "the State." Appellees blithely ask this Court to allow that *special*-fund obligation to be transferred to the State via a bond issue pledging future *general* revenues, thereby ignoring the Debt Clause. Only

tautological rhetoric is offered to justify such an errant course: “If the State may constitutionally subsidize the Pension Systems using appropriations from general revenue, then it should follow that the State may similarly dedicate its general revenue toward repaying its pension debt obligations.” (*Id.*)

The quoted statement conveniently ignores the Constitution’s differing treatment of current and future revenues, only the first of which is subject to legislative appropriation; and of special and general revenue debts, only the first of which may be incurred without voter approval. (Const. Art. VI, § 51 and Art. X, § 4.) The Legislature *may* Constitutionally “subsidize” the Pension Systems, but only from *this year’s* general revenues. That is why pension plans are constitutional. *Booth v. Sims*, 193 W. Va. 323, 456 S.E.2d 167, 177 (1995); *see, State ex rel. West Virginia Resource Recovery-Solid Waste Disposal Authority v. Gill*, 174 W.Va. 109, 113, 323 S.E.2d 590, 595 (1984) (approving the use of current appropriations for steam as a means of funding debt service, provided that future general revenues were not pledged).

Appellees’ unspoken premise is that there is no functional difference between annual appropriations to the Retirement Systems and a bond indenture binding the State for 25 to thirty years. This premise is false. The Legislature may *amend* the funding formulas of the Pension Systems, within the bounds allowed by the Contract Clause, but may *not* amend a bond indenture. Consequently, only the latter constitutes a “contract for debt” within the meaning of Article X, Section 4.

This same misconception infects Appellees' argument that the bonds do not pledge the credit of the State to county school boards in violation of Article X, Section 6. At present, the county school boards are the beneficiary of the State's annual contributions to the School Aid formula, which in turn allows the counties to pay employer contributions to the TRS employers' contribution fund. Appellees, relying on *dicta* in *West Virginia Education Association v. Consolidated Public Retirement Board*, 194 W. Va. 501, 460 S.E.2d 747 (1995), argue that this involvement of the State renders the TRS pensions a responsibility of the State, thus justifying the bonds even though the county boards are "ancillary" beneficiaries. (Appellees' Brief at 37.) But the *dicta* on which Appellees rely is an "impairment of contract" discussion, which imposes restrictions on the Legislature's ability to "impair" any public employees' contractual rights, whether employed by the counties or the State. As earlier noted, the Contract Clause does not preclude all amendments of this current relationship, but a bond indenture would. Consequently, a bond indenture would constitute a pledge of the credit of the State whereas the existing statutory subsidies do not.

That past Legislatures failed to make the statutorily required "normal" contributions to the retirement systems does not justify ignoring the Debt Clause. Such failures may warrant corrective judicial intervention, as in *Dadisman v. Moore*, 181 W. Va. 779, 385 S.E.2d 816 (1988) and *WVEA, supra*, but neither this Court nor the Legislature can fashion a remedy that itself violates the Constitution. Two "wrongs" don't make a "right." If they

did, other recurring obligations could be similarly neglected and thereby converted into general revenue debt. The possibilities are nearly endless.² What purpose, then, would the Debt Clause serve?

C. **The State's Pension Obligations Will Not Be "Redeemed" by the Infusion of Borrowed Funds.**

The other obvious example of an "ends justifies the means" argument, again tautological and again requesting this Court to ignore the Debt Clause, occurs when Appellees' Brief concedes that a reduction in the UAAL does not extinguish any pension liability -- i.e., no "redemption" occurs.

Admittedly, the sale of bonds under the Act will not "extinguish" the State's obligation to make future benefit payments. However, the infusion of monies from the contemplated bond issuance would fund the shortfall measured by the UAAL and help to eliminate the State's corresponding obligation to make annual debt payments to amortize this shortfall. By eliminating this deficit, the State's contributions to the Pension Systems could thereafter be limited to the "normal cost" employer contributions - - and no amortization debt payments would be required. [Citations omitted.]

²A few immediately come to mind. The State could fail to fund State agency PEIA premiums until all available PEIA reserves were consumed, creating a "funding crisis," at which time the State would issue general obligation bonds to "redeem" the delinquent premiums. The same technique could be used with workers' compensation premiums, medicaid appropriations, payments to regional jails for State prisoners, appropriations for appointed public defenders, rental payments to the Building Commission (which fund special revenue bonds), or any other recurring transaction where the payee has sufficient flexibility to maintain the system in the short-term, and insufficient resolve to resist the "necessity" arguments justifying the "refinancing" scheme. Unfortunately, it is exactly such scenarios that explain much of the shortfalls in the past funding of the TRS and the PERS. See, *Dadisman*, and *WVEA v. CPRB*, *supra*.

Simply put, the proceeds of the proposed bonds are designed to help the State meet its future pension obligations by supplanting the current amortization debt payments and reducing the total cost of satisfying this liability. Appellants' dogmatic insistence that "redemption" may be accomplished only by payment of the final pension check would subvert the purpose of this constitutional exception and should therefore be rejected. [Citation omitted.]

(Appellees' Brief at 19-10.) Other than the first sentence, these two paragraphs contain virtually every misconception upon which the bonds have historically been promoted, and are worthy of careful analysis.

First, Appellees again ignore the distinction between current and future general revenues, only the first of which is subject to legislative control. That the statutory funding formula contemplates annual appropriations (employer contributions) from each year's *current* general revenues does not authorize the Legislature to pledge *future* general revenues to bondholders. (*See*, W. Va. Code § 18-9A-6a.)

The second misconception evident in Appellees' "redemption" discussion is the notion that the "supplemental" payments dedicated to "amortizing" the UAAL can be characterized as debt-service, whereas "normal" contributions cannot. As indicated above, all agree that the underlying "debt" is the State's obligation, as an employer (or as a funding source for county school boards), to pay the pensions promised by statute. ("The cynosure of an employee's W. Va. Const. art. III, § 4 contract right to a pension is *not* the employee's or even the government's contribution to the fund; rather, it is the government's promise to pay." *Booth v. Sims*, 193 W. Va. 323, 339, 456 S.E.2d 167, 184 (1995) (emphasis supplied).

The establishment of a pension fund into which regular contributions are made is a *mechanism* to fund a reserve from which that eventual debt may be paid. The amounts which should have been contributed to the reserve via the statutorily prescribed “normal cost” payments are thus debt-service. Indeed, the Accrued Actuarial Liability (AAL) is equal to those payments, *even if made*. (App. 109.) That a retirement system is “fully-funded” simply means that all debt-service payments required by the current funding plan have been made (and have earned the expected interest). (App. 53.)

Thus, to the extent that the promised pensions constitute a “debt,” *normal cost payments are debt service payments* to amortize that debt. Consequently, if appellants are correct in their assertion that pensions constitute a “previous liability of the State” which may be “redeemed” by fully funding the AAL, *all* contributions to the system to “fund” the AAL, including “normal” contributions, may be supplanted with bond issues pledging general revenues. If Appellees prevail, such bonds could be issued every year, or at other regular intervals, to completely replace the State’s obligation to make contributions of any kind, whether “normal” or otherwise.

The distinction made by Appellees between “normal costs” and “supplemental contributions” is illusory for another reason. Because the amount of annual “normal cost” payments is dictated by the particular funding plan in use (and *not* by the additional pension obligations accruing in a single year) the distinction between “normal cost” payments and

“supplemental payments” is, to use Scott Dennison’s word, “arbitrary.” (App. at 10, fn. 3; 51, 58, and 64-65.)

Appellants’ assertion that “redeeming” the UAAL (e.g. “fully funding” the AAL) will “limit the State’s annual contribution to normal costs” is wrong for two reasons. First, it ignores the large debt-service payments the State would then be making to amortize the debt owed to the bond-holders, a debt that will be \$63 Million *larger than* the UAAL supposedly “redeemed.”³ Second, the supposedly “redeemed” UAAL will magically reappear unless the invested assets of the Retirement Systems achieve a 7.5% rate of return, and will also reappear when other actuarial assumptions prove to be incorrect, or when the funding methodology is changed. (See Appellant’s Opening Brief at pp. 30-31.) In any such case, “supplemental” debt-service contributions to the Retirement Systems will have to begin again, in addition to the payments made to service the bonds. If a debt has been “redeemed,” how can it thus reappear? It can’t. How can new supplemental debt-service payments arise if the debt has been “redeemed?” They can’t. Consequently, fully funding the UAAL redeems nothing, and does not mean that “future payments will be limited to normal costs.”⁴

³(App. 207, 335.) This won’t stop lobbyists from requesting larger pension benefits given the high level of funding in the system, even if that funding is borrowed. God help us if the source of that funding is forgotten by future Legislators.

⁴Appellees’ Brief frequently observes that the Act was calculated to reduce the cost of funding pensions. This is certainly true, but only in the sense that the Legislature was misled into believing that savings would result from issuing pension bonds. However, it has since become apparent that the prediction of “savings” was pure speculation premised on an optimistic view of the future performance of the stock market, a view not borne out by its actual performance since the Act was passed, and not likely to be realized in the

The above discussion obliquely reveals the otherwise obvious observation that the function of pension bonds is *not* to redeem a debt, but to engage in speculative risk arbitrage, hoping that the return on the invested bond proceeds, when invested in stocks, will more than compensate for the cost of debt service on the bonds. The Constitution does not permit borrowing to create funds for investments.⁵ The Act is therefor unconstitutional.

foreseeable future. “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, quoting Craig Slaughter, Executive Director of the Investment Management Board, available on Westlaw at 2004 WL 59634117).

Further, an unusual feature of the Act precludes any realization of such savings (if they occur) until the bonds are fully redeemed, which even the optimists predict will not occur for 20 or more years. (See Appellants’ Opening Brief at pp. 16-17). In the meantime, any arbitrage losses incurred will impose additional burdens on our general revenues, while any gains cannot be used to reduce them. (*Id.*) Such a lose-lose venture could only be the result of the intensive salesmanship of those with an economic interest in the bonds that is independent of the likelihood of success of the scheme.

⁵Appellees’ Brief repeatedly asserts that the people have authorized investment of the bond proceeds in stock via the 1997 amendment of Constitution Article X, Section 6. That would certainly be true if they had authorized issuing the bonds to begin with, but they haven’t. Likewise, Appellees assert that the 1997 amendment gave the Legislature the authority to determine the wisdom of such investments. True again, but it did *not* grant authority to borrow money for that purpose. Appellees’ observations are thus “red herrings” calculated to avoid the issue actually raised by Appellants -- Whether the Act authorize a contract for State debt that is prohibited by Article X, Section 4.

II.

THE ACT VIOLATES THE DIVISION OF POWERS CLAUSE (ART. V, § 1)

A. Standards? What Standards?

Every word in the entire Act that relates to the “review committee” is quoted below (note the total absence of legislative standards for the committee to apply in approving the bonds):

§ 12-8-4(c). The costs of issuance, excluding fees for bond insurance credit enhancements and liquidity facilities, plus underwriter's discount and any other costs associated with the issuance shall not exceed, in the aggregate, the sum of one percent of the aggregate principal amount of bonds issued. All such costs shall be subject to the review and approval of a majority of the members of a review committee. The review committee shall consist of the state treasurer and four persons having skill and experience in bond issuance, appointed by the governor.

§ 12-8-4(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.

§ 12-8-5(f). Notwithstanding any other provision of this code, and subject to the approval of the review committee, the department of administration, in the department's discretion: (i) Shall select, employ and compensate one or more persons or firms to serve as bond counsel or cobond counsel . . . , one or more persons or firms to serve as underwriter or counderwriter . . . , and one or more fiduciaries, financial advisors and experts, other legal counsel, placement agents, appraisers, actuaries and such other advisors, consultants and agents as may be necessary to effectuate the purposes of this article.

§ 12-8-5(g) Notwithstanding any other provision of this code, and subject to the approval of the review committee, the state treasurer, in the state treasurer's discretion shall select, employ and compensate an independent person or firm to serve as special counsel to the state treasurer to advise the

state treasurer with respect to the state treasurer's duties pursuant to this article.

As indicated in Appellants' Opening Brief, none of the so-called "standards" relied upon by the Court below and by Appellees on appeal relate to the committee; all were enacted in 2000, two years before the committee was ever given the authority to "authorize" the bonds; all expressly govern the actions of the Governor, the CPRB, and the Department of Administration – not the committee; and most could not possibly be applied by the committee because they relate exclusively to events which take place *after* the committee has already approved the bonds. (See Appellants' Brief at 33-37.) Nor is there any indication in the record (which includes a complete set of minutes of the review committee) that any standards were ever considered or applied by the review committee in "authorizing the bonds." (See Deposition Exhibit 2.)

Other than conclusory assertions that these inapplicable provisions constitute standards for the committee -- assertions contradicted by the plain language of the statute -- Appellees offer no arguments to counter Appellants' observation that the review committees' authority to approve or disapprove of the bonds is a standardless delegation of unbridled legislative authority to an executive committee.

B. Emergency? What Emergency?

The only justification offered by Appellees to explain the review committees' hastily conducted meeting, which was noticed in the State Register days *after* it had already occurred, was the "emergency" occasioned by the statutory requirement that "bonds may be

issued by the governor upon resolution adopted by the Legislature authorizing the same.” W. Va. Code § 12-8-5(d). Appellants had argued that, because this statutory requirement was unconstitutional, it could not justify an “emergency meeting” of the review committee.

Appellees appear to recognize that the requirement of a legislative resolution, if construed to give the legislature authority to informally determine whether the bonds should issue, would violate the constitutional procedures for enacting laws and encroach upon executive authority, as described in *Barker v. Manchin*, 167 W. Va. 1155, 279 S.E.2d 622(1981). As Appellees note, citing *Barker*: “Having caused a law to be made, the Legislature may only amend or repeal it through the formal action of the entire body. Acting via committee or by informal resolution is insufficient.” (Appellees’ Brief at 29.)

Appellees therefor ask this Court to construe the Act as *requiring* the Legislature to *approve* the bonds, thereby rendering the requirement of a legislative resolution meaningless. “Once the Legislature receives the Governor’s request, it is virtually compelled to adopt a resolution authorizing the bonds.” (Appellees’ Brief at 30.) This is so, say Appellees, in part because “the Legislature may not, consistent with *Barker*, undo what it has already done absent formal repeal.” (*Id.*) Nothing in the statute suggests such a pointless construction, however, so those Legislators who may have been comforted by the notion that they could later veto the bonds by resolution would be betrayed by Appellees’ interpretation which, if known at the time, might have resulted in the defeat of the Act itself.

That is why statutes must be read to mean what is apparent from the plain language thereof, as that is what is relied upon by the legislators who voted for it.

Appellees note that the Act contains language allowing the Legislature to include in the resolution “certain terms of issuance” proposed by the Governor, and that the resolution “need not authorize the maximum amount” requested by the Governor, thus promoting the idea that these, rather than complete repeal, are the functions of the resolution. (Appellees’ Brief at 30.) But their argument is self-defeating, as any such “terms” would either constitute an amendment of the Act by resolution (prohibited by *Barker*) or an encroachment on the executive authority of the Governor (prohibited by *Barker* and *Citizens Action Group v. West Virginia Economic Development Authority*, 213 W. Va. 255, 580 S.E.2d 869 (2003)).

Thus, no matter how it is construed, the requirement of a legislative resolution was unconstitutional, and could not provide justification for the emergency meeting of the review committee.

III.

CONCLUSION

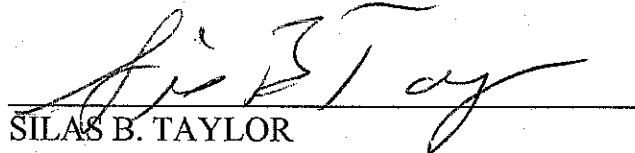
For the reasons stated, Appellants pray that the ruling below be reversed.

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,

DARRELL V. McGRAW, JR.
ATTORNEY GENERAL

A handwritten signature in cursive script, appearing to read "S. B. Taylor", is written over a horizontal line.

SILAS B. TAYLOR
SENIOR DEPUTY ATTORNEY GENERAL

State Bar No. 3712

State Capitol, Room E-26

Charleston, West Virginia 25305

(304) 558-2021

CERTIFICATE OF SERVICE

I, Silas B. Taylor, Senior Deputy Attorney General for the State of West Virginia, do hereby certify that a copy of "Appellant's Reply Brief" was served by depositing the same, postage paid, in the United States mail on the 29th day of July, 2004, addressed to:

Stephen P. Goodwin, Esquire
Goodwin & Goodwin, LLP
300 Summers Street, Suite 1500
Charleston, WV 25328-2107



SILAS TAYLOR /STATE BAR NO. 3712