

IN THE SUPREME COURT  
STATE OF ARIZONA

ARIZONA EARLY CHILDHOOD  
DEVELOPMENT & HEALTH  
Board, a public body,

Petitioner,

v.

JANICE K. BREWER, in her official  
capacity as Governor of the State of  
Arizona; DEAN MARTIN, in his  
official capacity as State Treasurer; and  
D. CLARK PARTRIDGE, in his  
official capacity as State Comptroller,

Respondents.

Supreme Court No. CV09-0078-SA

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BRIEF OF THE SPEAKER OF THE HOUSE OF REPRESENTATIVES AND  
THE PRESIDENT OF THE SENATE  
PURSUANT TO A.R.S. § 12-1841

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## **I. INTRODUCTION**

The Petitioner, the Arizona Early Childhood Development and Health Board (“Board”), filed this special action to challenge the transfer of \$7 million in interest monies from the Arizona Early Childhood Development and Health Fund (“Fund”) to the State general fund. Respondents Janice K. Brewer, Dean Martin and D. Clark Partridge filed their Response to the special action on April 27, 2009. Kirk D. Adams, Speaker of the Arizona House of Representatives, and Robert L. Burns, President of the Arizona Senate, agree with the arguments made in the Respondents’ Response brief. In addition, Speaker Adams and President Burns file this separate brief to urge the Court to enforce article IX, section 23 of the Arizona Constitution<sup>1</sup>.

## **II. STANDING**

If an action alleges that a state law is unconstitutional, the party challenging the law must have the action served on the Speaker of the House of Representatives and the President of the Senate. The Speaker and President are entitled to be heard in the action. A.R.S. § 12-1841.

Petitioner has served Speaker Adams and President Burns with notice that it is challenging the constitutionality of Laws of 2009, First Special Session, chapter

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<sup>1</sup> Hereafter referred to as the “Revenue Source Rule.”

1, section 11. This brief is submitted pursuant to the rights of Speaker Adams and President Burns established by A.R.S. § 12-1841.

### **III. STATEMENT OF FACTS**

#### **A. Arizona's Fiscal Emergency**

In the midst of the greatest economic crisis this nation has faced in over half a century, the Legislature is trying to marshal the State's increasingly scarce resources to meet the wide variety of needs of the citizens of Arizona. Faced with a projected \$1.6 billion budget shortfall for the 2008-2009 fiscal year, the Governor called the Legislature into special session in January, 2009. *Proclamation by Governor Calling a Special Session of the 49<sup>th</sup> Legislature*, (January 28, 2009) available at:

[http://azgovernor.gov/dms/upload/PROC\\_012909\\_SDOC4424.pdf](http://azgovernor.gov/dms/upload/PROC_012909_SDOC4424.pdf) (special session called for "adjustments necessary to address the projected State budget deficit for fiscal year 2008-2009"); *JLBC Monthly Fiscal Highlight*, p. 2 (March 2009) (attached as Appendix E). To make matters worse, the State faces a projected budget shortfall of \$2.93 billion for the 2009-2010 fiscal year. (App. E, p. 2). While the current economic downturn is a nationwide problem, Arizona's

budget deficit is widely recognized as one of the most severe in the country.<sup>2</sup>

During the special session, the Legislature had to balance the various income sources and revenue needs of the State. As part of this process, the Legislature transferred \$7 million in interest earnings from the Arizona Early Childhood Development and Health Fund to the State general fund pursuant to A.R.S. § 8-1181, subsection E. Laws 2009, First Special Session, chapter 1, section 11. Despite all these efforts, the shortfall for fiscal year 2008-2009 could still be as much as \$510 million. (App. E, p.2).

#### **B. The Early Childhood Development and Health Initiative**

The Board and the Fund were created as part of Proposition 203, which was approved at the 2006 general election. See A.R.S. §§ 8-1151, 8-1181 and 8-1191. The Fund consists of monies derived by a special tax on tobacco products, appropriations by the Legislature and any gifts, grants or contributions received. A.R.S. § 8-1181. The monies from these sources are kept in independent accounts. *Id.* Interest and other income from the investment of the monies in any account “shall be credited to that account except as otherwise provided by law.” *Id.*

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<sup>2</sup> “Arizona takes the dubious award of having the largest anticipated budget gap in percentage terms for fiscal year 2010—24.2 percent.” Edward Smith, *A Grim Forecast*, STATE LEGISLATURES, February 2009, at 12, 15 available at [http://www.ncsl.org/magazine/articles/2009/09slfeb09\\_grimforecast.htm](http://www.ncsl.org/magazine/articles/2009/09slfeb09_grimforecast.htm).

Proposition 203 prescribed a new tax on all tobacco products in addition to all other taxes on the product. The new tax on a cigarette is four cents, which equates to eighty cents per pack of cigarettes. A.R.S. § 42-3371. As of January, 2009, the Fund had received \$327.7 million in revenues since the inception of the tax. *Presentation to the Senate Healthcare and Medical Liability Reform Committee*, p. 6 (January 21, 2009) (presented by Richard Stavneak, Director of the Joint Legislative Budget Committee (“JLBC”)) (attached as Appendix A (App. A)). Revenues from the tax are projected to decline 1.4 percent annually. *Id.*

The Board administers the fund. A.R.S. § 8-1181. Fund monies may be used to pay administrative expenses of the Board and for programs and services to enhance the quality of, or access to, early childhood development and health opportunities. *Id.* and A.R.S. § 8-1192 (B). The monies may be used for programs undertaken by the Board, for statewide grants and for regional programs. A.R.S. § 8-1185.

As of January 2009, the Board had spent \$16.6 million on administrative costs and \$176,200 in statewide grants. (App. A, p. 6). The lack of spending on programs resulted from the initial implementation requirements of Proposition 203. Before July 1, 2007, all Fund monies were to be applied first to administrative costs. 2006 General Election Proposition 203, § 4. Also, regional programs cannot be funded until fiscal year 2009-2010. *Id.*

In 2009-2010, Board expenditures will jump. Beginning in fiscal year 2010-2011, the Board believes that expenditures will begin to exceed revenues. *First Things First, The Right System for Bright Futures*, p. 17 (January 21, 2009) (attached as Appendix C (“App. C”). The difference between expenditures and revenues will increase so that the Fund balance will be spent to make up the difference. By 2019, the Fund will have a zero balance. *Id.*

Elliot Hibbs, director for the Board, testified to a Senate committee that the Board was expending monies for programs on a limited basis. The Legislature would have to fund the programs in the long run. *Hearing on the Early Childhood Development and Health Board before the Senate Healthcare and Medical Liability Reform Committee*, pp. 1-2 (January 21, 2009) (Partial testimony of Elliot Hibbs, Director of the Early Childhood Development and Health Board) (attached as Appendix D (“App. D”).

When questioned about the growing difference between expenditures and revenues, Mr. Hibbs stated that the Board would not immediately come to the Legislature to fill this gap. *Id.* However, he explained that the Board would have to seek permanent funding from the Legislature, stating:

What we want to do here is sustain the programs and evaluate the results and then once we've had the opportunity, and you are going to be at least five, six years out before you are going to have enough information back to be able to start saying this is the impact of this investment. Before that, we wouldn't want to ever come back and ask anybody for any more money at the Legislature. After that time has

passed on what you see in this slide, if there is true value in all of this that we would come back to the Legislature and say ok, here is what you get for the investment, here is why you ought to provide more money to take care of the gap that exists at that time.

*Id.* at p. 2.

In addition to these future expenditures from the State general fund, Proposition 203 revenues going into the State general fund have been reduced as a result of Proposition 203. The increase in the tobacco tax has lessened the demand for these products.

As might be expected, immediately before the implementation of the Proposition 203 tax, the sale of tax stamps greatly increased as wholesalers wanted to pay the lower tax rate. Immediately after the tax became effective, the sale of tax stamps dropped dramatically. *ATRA Special Report*, p. 4 (April 2009) (attached as Appendix B (App. B)). However, by March, 2007, the sale of tax stamps began to level out. Since that time the monthly average of tax stamps sold has been reduced from 21 million stamps before implementation of the Proposition 203 tax to 16.6 million after implementation. *Id.*

The drop in tax stamp sales has decreased revenues to the State general fund. Comparing fiscal year 2005-2006 collections to those for fiscal year 2007-2008<sup>3</sup>, State general fund revenues decreased \$7.1 million.

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<sup>3</sup>These years are the last full fiscal year before imposition of the Proposition 203 tax and the first full fiscal year after the tax became effective.

The lower tax stamp sales have also decreased revenues to the Tobacco Tax and Health Care Fund (“TTHCF”) and the Tobacco Products Tax Fund (“TPTF”). Monies in these funds are used for health research, emergency health services, indigent health care services and health education. A.R.S. §§ 36-770 and 36-771. Comparing fiscal year 2005-2006 collections to those for fiscal year 2007-2008, TTHCF revenues decreased \$22.9 million and TPTF revenues decreased \$29.2 million. (App. B, p. 1). Because of the reduction in revenues to these two funds, JLBC estimates that for fiscal year 2008-2009 the State general fund will have to backfill \$43 million in revenues. (App. A, p. 8); *JLBC Staff Report*, p. 1 (April 30, 2009) (attached as Appendix F (“App. F”)).

#### **IV. ARGUMENT**

Voter enacted statutes must meet the requirements of the Arizona Constitution. *See Iman v. Bolin*, 98 Ariz. 358, 365, 404 P.2d 705, 709 (Ariz. 1965) (after enactment, the constitutionality of all statutes may be tested) *Tillotson v. Frohmiller*, 34 Ariz. 394, 271 P. 867 (1928) (voter enacted initiative held unconstitutional). Proposition 203 is constitutionally flawed.

Article IX, section 23, subsection A of the Arizona Constitution provides:

An initiative or referendum measure that proposes a mandatory expenditure of state revenues for any purpose, establishes a fund for any specific purpose or allocates funding for any specific purpose must also provide for an increased source of revenues sufficient to cover the entire immediate and future costs of the proposal. The

increased revenues may not be derived from the state general fund or reduce or cause a reduction in general fund revenues.

If a ballot measure requires an expenditure of State monies, this Revenue Source Rule prescribes two requirements. The measure must provide a revenue source that:

1. Is sufficient to cover the entire immediate and future costs of the measure; and
2. Is not derived from the State general fund or does not cause a reduction in State general fund revenues.

Proposition 203 fails to meet both of these requirements. The proposition does not provide funding to meet its requirements in the future, and the funding source drastically affects State general fund revenues and expenditures.

Setting aside Proposition 203's unconstitutionality, the Legislature has the plenary authority under the Constitution and the specific authority under Proposition 203 to appropriate Fund interest monies.

**A. PROPOSITION 203 VIOLATES ARTICLE IX, SECTION 23 OF THE ARIZONA CONSTITUTION.**

1. **Proposition 203 does not provide funding to cover the entire future costs of the measure.**

The Fund's main source of revenue is an additional tax on tobacco. (App. A, p. 4). It is projected that these revenues will decline by 1.4 percent annually. (*Id.*, p. 6). The Board's own analysis of sustainability shows that the Board's

expenses will begin to exceed its revenues in 2011. (App. C, p. 17). By 2019, the Fund will be depleted. At that point, expenses will be exceeding revenues by about \$60 million annually and the gap will be growing. (App. C, p. 17).

As the Board's Director testified before the Senate Healthcare and Medical Liability Reform Committee, in the future, the Board will not be able to maintain its programs without revenues provided by the Legislature. (App. D, p. 2). In other words, Proposition 203 did not provide sufficient revenues to meet the proposition's future costs as required by the Constitution.

Proposition 203 placed the ultimate burden for its programs on other State resources. This result is clearly what the voters sought to prevent by approving the Revenue Source Rule. One of the proponents of the Revenue Source Rule explained the Rule's purpose as follows:

Put simply, voter approved initiatives have done considerable damage to the Legislature's ability to do comprehensive budgeting. Too often, voters have passed initiatives creating new programs that place demands on the state general fund far exceeding what was sold to the voters on election day. Even when new funding was identified for a program, the costs have often outpaced the revenue, forcing the Legislature to cut funding for other programs like education, health care, and public safety.

*2004 General Election Publicity Pamphlet*, p. 15 (Argument of Arizona Tax Research Association on Proposition 101) (attached as Appendix G)<sup>4</sup>.

At the 1998 general election, the voters adopted Proposition 105, which restricted the authority of the Legislature to use monies created or allocated by an initiative or referendum. Ariz. Const. art. IV, pt. 1, § 1 (6). Proposition 105 prohibits the Legislature from changing a policy adopted through initiative or referendum, no matter how circumstances change or outdated the policy has become. As indicated by the publicity pamphlet argument quoted above, these requirements of Proposition 105 greatly restrict the ability of the Legislature to limit funding to programs approved by the voters in times of a budget crisis. The constitutional Revenue Source Rule was approved by the voters in response to this problem and to make sure that new initiative and referendum measures did not drain the state's resources. It accomplishes this by requiring ballot measures to provide the revenues necessary to meet the total needs of the programs. (App. G, pp. 14-15).

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<sup>4</sup> The fear expressed in this - argument that the promises of ballot proposition proponents are contrary to reality - is evidenced in the arguments for Proposition 203. One proponent stated, "Even better, it will be funded by a dedicated tax on tobacco products and will not be a drain on the existing state budget." *2006 General election Publicity Pamphlet - Proposition 203 (Arguments "For" Proposition 203)*, p. 124 (attached as Appendix H). Most of the arguments for the proposition also stated that the tax would provide \$150 million annually for early childhood programs. *Id.* at 123-130.

By failing to provide sufficient monies to meet the entire immediate and future needs of its programs, Proposition 203 violates Article IX, section 23 of the Arizona Constitution.

**2. The funding mechanism for Proposition 203 has caused a reduction in State general fund revenues.**

The Constitution requires new initiatives to hold the State general fund harmless. Ariz. Const. art. IX, § 23 (A). Far from protecting the State general fund, Proposition 203 gave it an immediate one-two punch. It reduced State general fund revenues and increased expenses to be paid from the State general fund.

Proposition 203 prescribed an additional tax on tobacco at a rate of eighty cents per pack. *See* A.R.S. § 42-3371. This increase in taxes has led to a large drop in demand for tobacco products and a resulting reduction in State general fund revenues.

After the initial implementation of the Proposition 203 tobacco tax, the monthly average of tax stamps sold has been four million less than the monthly average of sales before implementation of the Proposition 203 tax. (App. B, p. 4). The drop in tax stamp sales has decreased revenues to the State general fund by over \$7 million a year. (App. B, p. 1).

The impact on demand for tobacco tax stamps in the future was entirely foreseeable. Indeed, a prior voter-enacted increase in tobacco taxes included as

part of its increase an amount “to compensate for decreases in the corrections fund resulting from lower tobacco tax revenues available . . . as a result of the levy of luxury taxes that are dedicated to the tobacco tax and health care fund . . . .” A.R.S. § 36-775 (added as A.R.S. § 42-1241 by Proposition 200 approved in the 1994 general election).

Revenues to two other funds have also been significantly reduced as a result of Proposition 203. Tobacco tax monies for both the TTHCF and the TPTF have decreased by over twenty percent. (App. B, p. 1). Before the passage of Proposition 203, revenues to these funds were increasing. In fiscal year 2007-2008, the first full year of the new Proposition 203 tobacco taxes, the revenue to these two funds fell to \$52,260,000 below the fiscal year 2005-2006 collections. (App. F, p. 1). Because of the reduction in revenues to these two funds, JLBC estimates that for fiscal year 2008-2009 the State general fund will have to backfill \$43 million in revenues. (App. A, p. 8; App. F, pp. 1-2).

The Proposition 203 tax has clearly caused a reduction in the State general fund, contrary to the Revenue Source Rule. It is irrelevant that Proposition 203 does not require a direct reduction in State general fund revenues. The Revenue Source Rule prohibits increased sources of revenue from causing a reduction to State general fund revenues, whether direct or indirect.

The drafters of Proposition 203 could have elected to avoid this constitutional prohibition. The Revenue Source Rule would not apply if Proposition 203 had included a provision holding the State general fund harmless. For example, it could have stated that money from the new tax could be deposited in the State general fund if collections for the State general fund fell below the level of current tobacco tax collections when Proposition 203 was enacted. *Cf.* A.R.S. § 36-775 (holding the corrections fund harmless from “decreases . . . resulting from lower tobacco tax collections . . . .”) Instead, Proposition 203 causes clear and substantial reductions in State general fund revenues. Under these circumstances, the constitutional Revenue Source Rule’s plain meaning must be given effect. *Cain v. Horne*, 220 Ariz. 77, 202 P.3d 1178, 1181 (Ariz. 2009) (the “plain language of the provision” is the primary inquiry. “Each word, phrase, clause, and sentence must be given meaning . . . .”).

The plain meaning of the Revenue Source Rule stands out when it is contrasted with another section of Article IX. Constitution of Arizona Article IX, section 22 requires a two-thirds vote of the members of each house on measures that include certain provisions that provide for a net increase in State revenues. This requirement does not apply to “[t]he effects of inflation, increasing assessed valuation or any other similar effect that increases state revenue but is not caused

by an affirmative act of the legislature.” Ariz. Const. art. IX § 22(c) (emphasis added).

The drafters of this provision recognized that there are direct and indirect causes of increased State revenues. Article IX § 22 expressly exempts indirect causes from triggering the two-thirds vote requirement. By contrast, the Revenue Source Rule expressly includes any form of causation. Ariz. Const. art IX, § 23(A) (“[I]ncreased revenues may not be directed from the State general fund or reduce or cause a reduction in general fund revenues.”) (emphasis added). Clearly, the Revenue Source Rule could have but intentionally did not contain a similar limitation to that in Article IX, section 22.

The Mississippi Supreme Court gave a similar interpretation to its constitutional requirement for a revenue impact statement in *Stoner v. Mahoney*, 774 So. 2d 397 (Miss. 2000). If an initiative to amend the Mississippi Constitution requires a reduction in any source of government revenue, the initiative must identify any program whose funding must be reduced to implement the initiative. Miss. Const. art. XV, § 273(4).

*Stoner* had proposed an amendment to the constitution to prohibit gambling in the State, but did not identify a funding reduction for any program. *Stoner*, 774 So. 2d at 399. While the initiative did not require a reduction in taxes, the court examined the effect of the elimination of gambling on tax revenues to determine

that the initiative would have a negative impact on State revenues. *Id.* at 401-402. The court concluded that these indirect effects of the proposition on State revenues required the sponsors of the initiative to include a government impact revenue statement as mandated by the constitution. *Id.* at 402. Similarly, the effects of Proposition 203 in causing a reduction in the State general fund revenues constitute a violation of the Revenue Source Rule. The meaning of the Rule is clear – revenue sources of voter created measures may not cause a reduction in general fund revenues.

**3. The Court should strike down Proposition 203 because it does not meet the requirements of Article IX, section 23 of the Arizona Constitution.**

Proposition 203 has not provided sufficient monies to meet the entire immediate and future costs of the proposition. This fact is clear from the initial implementation of Proposition 203. The implementation of the proposition has also shown that its funding mechanism has caused a reduction in the State general fund. Because Proposition 203 has met neither of the requirements of Constitution of Arizona Article IX, section 23, this Court should hold that Proposition 203 is invalid.

Subsection B of section 23 does allow the Legislature to reduce funding for a program subject to the Revenue Source Rule in any year in which a designated revenue source is insufficient. However, Proposition 203 will not lead to

occasional fund shortages. The inability of the tobacco tax to fund Proposition 203 programs is a structural and chronic condition.

A reduction in funding also would not address the negative impact of the additional tobacco tax on the State general fund. The only way to protect the State general fund is to strike down the proposition.

**B. THE LEGISLATURE ACTED WITHIN ITS PLENARY AUTHORITY OVER APPROPRIATIONS.**

Setting aside the constitutional deficiencies of Proposition 203, the Petitioner's arguments fail on their own merits. Laws 2009, First Special Session, chapter 1 is a clear exercise of the Legislature's constitutional authority. The Arizona Constitution vests the "legislative authority of the state" in the Legislature. Ariz. Const. art. IV, pt. 1, § 1. Simply stated, "the Legislature has all power not expressly prohibited or granted to another branch of the government." *Adams v. Bolin*, 74 Ariz. 287, 283, 247 P.2d 617, 626 (1952); *see also State v. Hansen*, 215 Ariz. 287, 289, 160 P.3d 166, 168 (2007). The broad grant of legislative power clearly includes unique authority over the State's finances. *See, e.g., Le Febvre v. Callaghan*, 33 Ariz. 197, 204, 263 P. 589, 591 (1928) ("[A]ll power to appropriate money . . . rests in the Legislature."); *Pacific Fruit Express Co. v. City of Yuma*, 32 Ariz. 601, 604, 261 P. 49, 51 (1927) (the Legislature has "plenary power" over taxation).

The very language of Proposition 203 anticipates the Legislature's constitutional authority. Indeed, the use of the language "except as otherwise provided by law" in Proposition 203 is strikingly similar to the language of Article IX, § 5 of the Arizona Constitution: "No money shall be paid out of the state treasury, except in the manner provided by law." Both provisions clearly paint appropriations scenarios, where "the Legislature is supreme." *Crane v. Frohmiller*, 45 Ariz. 490, 496, 45 P.2d 955, 958 (1935).

Speaker Adams and President Burns join the arguments presented to the Court in the Response brief of Respondents, which was filed with the Court on April 27, 2009. The words "as provided by law" clearly invoke legislative power. The Petitioner cannot demonstrate otherwise.

#### **IV. CONCLUSION**

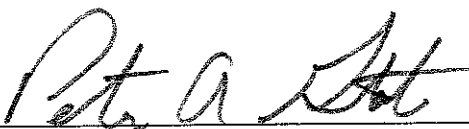
The Revenue Source Rule requires that programs prescribed through ballot measures must be funded from a new revenue source that meets the entire needs of the programs, both at inception and in the future. And, the funding source cannot cause a reduction in State general fund revenues.


Proposition 203 failed to meet both of these requirements, because the tobacco tax it imposed caused an immediate reduction in State general fund revenues. Also, the funding source cannot meet the future needs of the Board's programs.

In addition, Petitioner's arguments ignore the plenary authority of the Legislature and the specific authority to appropriate Fund interest monies provided by Proposition 203.

For these reasons, Speaker Adams and President Burns respectfully request that this Court declare Proposition 203 invalid and deny Petitioner's requested relief.

Dated this 1<sup>st</sup> day of May, 2009.

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**CERTIFICATE OF SERVICE**

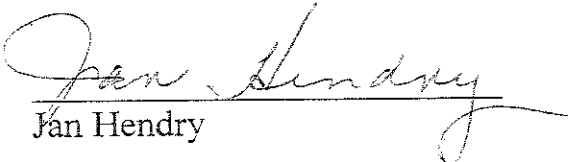
I certify that the original and 7 copies of the foregoing Brief of the Speaker of the House of Representatives and the President of the Senate Pursuant to A.R.S. § 12-1841 were hand-delivered this 1<sup>st</sup> day of May, 2009 to:

Office of the Clerk  
SUPREME COURT OF ARIZONA  
1501 West Washington  
Phoenix, AZ 85007

In addition, I have, on this date, caused two copies of the Brief of the Speaker of the House of Representatives and the President of the Senate Pursuant to A.R.S. § 12-1841 to be mailed to:

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## CERTIFICATE OF COMPLIANCE

Pursuant to Rule 7(e) Rules of Procedure Special Actions, the undersigned certifies that the foregoing Brief of the Speaker of the House of Representatives and the President of the Senate Pursuant to A.R.S. § 12-1841 was prepared using a proportional typeface known as Times New Roman, 14-point, with double line spacing, except for indented quotes and footnotes. The brief contains 3808 words according to the Word software used to create the brief, from the Introduction to the end of the Conclusion.



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Peter Gentala