

# **R-E-S-P-E-C-T the voters, D-E-F-E-A-S-E the bonds**

By Thomas Heller

October 30, 2003, by a 6-3 vote, the Washington State Supreme Court ruled that Tim Eyman's second "\$30 car tabs" measure, Initiative 776, passed constitutional muster. The justices found, as required by Article II, section 19 of the state constitution, that I-776 contained only one subject (repeal of local motor vehicle fees and excise taxes) and that it was sufficiently expressed in the measure's title. The court ruled that the initiative's mention of putting light rail to a new vote (and its exhortations that public officials be held to their word) were merely expressions of motive for the measure, not substantive legislation which would have constituted a second subject -- and voided the initiative.

The immediate consequence of the court's ruling was the cessation of \$15 fees being levied by King and Pierce County on vehicle license renewals. Soon thereafter, King County began processing refunds for fees car owners paid after the measure was approved in the November 2002 election.

But another consequence still hangs in the balance. It relates to the 0.3% motor vehicle excise tax (MVET) currently levied and collected for the benefit of Sound Transit.

When voters in 1996 approved a proposed 21-mile light rail line along with commuter rail service to Seattle from Tacoma and Everett, and new express bus routes throughout the region, Sound Transit was granted authority to collect a 0.4% retail sales tax and a 0.3% MVET as their principal local source of financing. Within a couple years, confident they would soon begin construction --and anxious to take advantage of historically low interest rates-- Sound Transit floated a \$350 million bond issue backed by these two taxes.

In the bond agreement, Sound Transit pledged to their bondholders that ST's sales tax and its MVET would be maintained at 0.4% and 0.3% respectively "so long as any bonds remain outstanding". This pledge is a central feature of the contract Sound Transit entered with its bondholders. Because these bonds are not scheduled to be fully repaid until the year 2028, Sound Transit assured its bondholders that those taxes would not be reduced for the next thirty years.

Fast forward a few years. The Supreme Court has now ruled that Initiative 776 repealed all local MVET taxes, including the MVET Sound Transit has been collecting. The initiative is now law (more precisely, it has been law since the voters approved it.) Its provisions take their place among the ninety-one volumes ("Titles") of state laws that are the Revised Code of Washington (RCW), volumes covering crimes and punishments, businesses and professions, common schools, elections, cities and towns, public utility districts, public assistance, fish and wildlife, mental illness, flood control and --last but not least of course-- taxes. These are the laws that the people and their representatives have passed; each and every one of them is entitled to be enforced by state and local officials. This includes the judiciary.

There is a clear conflict, however, between the contract that Sound Transit entered into with its bondholders and the provisions of Initiative 776. The bond contract pledges that ST's MVET will not be reduced as long as any bonds remain outstanding. But I-776 repealed ST's MVET. What now?

The Supreme Court did not address this conflict (the issue was not placed before it by the parties, who simply sought judgment as to whether I-776 violated the constitution by containing more than one subject.) With the court's decision, the conflict between the bond contract and I-776 was passed back down to the trial court, remanded to King County Superior Court Judge Mary Yu for resolution.

What are the choices available to Judge Yu, now that she has been informed that I-776 indeed is constitutional? Confined by past Supreme Court decisions, the judge will have little latitude for creativity. The most confining past decision, it seems, would force the judge to take one of two polar positions, each defensible but widely different in effect.

Tyropak v. Daniels (124 Wn 2d 146) established the notion that no law could alter, in any degree, the "financial framework" of a public contract (indeed, a bond contract). In Tyropak, the court ruled that a law allowing port district A to annex land within port district B altered the financial framework that port district B's bondholders had relied upon when they bought the port's bonds. The very small loss of tax revenue the annexation would cause to port district B was immaterial; the law was unconstitutional because it allowed the financial framework of the port's existing bonds to be altered.

On first impression, it appears that Tyropak would lead Judge Yu to find that Sound Transit's full 0.3% MVET cannot be altered, as the bond contract pledged that the tax would be maintained as long as any bonds remained outstanding.

This position, though, would produce a distinctly preposterous result: Sound Transit would continue collecting its 0.3% MVET through the year 2028, by which time they would have amassed an estimated three billion MVET dollars, while retiring a total of only \$350 million in bonds. Such a decision would also mean that enforcement of I-776, a law passed by a vote of the people in 2002, would be deferred for a quarter of a century until 2028. Not since an asterisk overshadowed Roger Maris' record-breaking feat of 61 home runs would such an undeserved outcome result.

Can Judge Yu avoid such a preposterous result? It has been suggested that she could direct ST to create a special MVET account from which the bonds would be repaid. Because this account would only need to repay the existing bonds, it would not need to collect three billion dollars and hence the MVET could be reduced to around 0.1%. Neat and simple. But unilaterally altering the bond contract would fly in the face of Tyropak's prohibition of any alteration in the contract's "financial framework". It is not an option available to Judge Yu; it would be reversed upon appeal.

Then how does Judge Yu resolve this conflict? There's one way out that recognizes both bondholder's rights to the security pledged in their bond contract and the rights of voters to have their laws enforced.

Judge Yu must direct Sound Transit to execute the provisions of Section 10 of the bond contract. This section sets forth how the bonds can be "defeased" (i.e. made no longer outstanding.) Once the bonds are no longer outstanding, Sound Transit's pledge to maintain their 0.3% MVET tax until 2028 or "so long as any bonds remain outstanding" is satisfied. And once that pledge is satisfied, Sound Transit's MVET can be eliminated, consistent with I-776's repeal of local MVET taxes.

This option is the only choice that balances the interest of bondholders with the interest of voters. It doesn't require almost a quarter century to pass before I-776 takes effect, while Sound Transit collects three billion dollars just to pay off \$350 million in bonds. Further, it is not a unilaterally-imposed alteration of the financial framework of the bond contract. Indeed, it *enforces* a feature of that contract's financial framework. The bondholders are held harmless by defeasance and voters will see their new law enforced, not kicked like a can down the street.

So what might this mean to Sound Transit? What is its interest in the issue? Thus far, the agency's attorneys have only asserted that its bond contract's "maintenance of MVET" pledge trumps I-776 and precludes any reduction in its 0.3% MVET. But this stance is more designed to protect ST's ability to finance its light rail project than a stance rooted in jurisprudence. With unfailing zeal (and large public relations budgets) ST asserts that the entire universe revolves around it -- that the work they've embarked upon is an essential public purpose, an inviolable contract with the people of the Puget Sound region.

But after I-776, the only legal claim that ST has with regard to maintaining its MVET is the pledge they made to bondholders to maintain the 0.3% rate "so long as any bonds remain outstanding." But that pledge can be satisfied, entirely within the financial framework of their bond contract, by defeasing the bonds.

This is not a result that Sound Transit desires, however, as it would cause a loss of financial capacity almost twice as large as the agency has represented as the "worst-case scenario" should I-776 be ruled constitutional. The agency assured the Federal Transit Administration that they could still complete construction of its light rail project even if I-776 were found lawful. This was based on the assumption that ST's MVET would be trimmed to 0.1% and would be directed solely to retire the bond issue. ST's assurance prompted the release a \$500 million federal grant that, until then, had been held back.

Now that the state Supreme Court has ruled I-776 constitutional, the legality of that assumed "worst-case" scenario will be put to the test. Judge Yu will likely have to decide whether that scenario violates Tyrpak's strict "altered financial framework" standard. Tyrpak is a very high hurdle. We will watch her deliberations with great interest, but we're confident bondholders' interest can be balanced with voters interests without tinkering with ST's MVET and delaying the enforcement of I-776 as new law. Defeasance is a word we expect to hear a lot more of.