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SUPREME COURT OF TEXAS
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No. 24-0102

In the Supreme Court of Texas

JP Morgan Chase Bank, N.A.,
Petitioner,

v.

City of Corsicana and Navarro County,
Respondents.

On Review from the Court of Appeals
for the Tenth District of Texas

Respondents' Brief on the Merits

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A. The *TML* test governs spending for the public purpose of economic development.

B. The Agreements lacked the controls required by *TML*.

C. When a public purpose fails, the government must stop contributing funds.

STATEMENT OF FACTS

Overview

This case concerns the pledge of taxpayer dollars to build a Gander Mountain store in Corsicana, Texas. 1.CR.4-6. The terms of the Agreements required the City and County to use sales-tax revenues from various stores to repay a $10 million loan that was used to build the Gander Mountain facility. 5.CR.892, 924-25. The deal wasn't conditioned on Gander Mountain ever opening, operating, or generating jobs or taxes; instead, the taxpayers' obligation was "absolute and unconditional." 5.CR.912, 916-17. Years later, Gander Mountain is closed; but its lender Chase—after recouping more than $9 million on the $10 million note—insists that taxpayers remain absolutely and unconditionally on the hook for millions more to pay for the building of a now-defunct business. 3.CR.428; 1.CR.42, 129.

The City and County devote tax dollars for the construction of a Gander Mountain Facility.

In 2004, the City and County each entered into Retail Center Development Agreements ("RCDAs") with the Corsicana Industrial Foundation ("Foundation"). 5.CR.910, 913, 914, 918.[1] In those agreements, the City and County pledged sales-tax funds to "facilitate the development of the Retail Center," which

[1] The RCDAs are identical except that one involves the City and the other the County. Neither Gander Mountain nor Chase signed the RCDAs; nor were Gander Mountain or Chase named as third-party beneficiaries in the RCDAs. 5.CR.918, 923.

was a Gander Mountain store to be located on land the Foundation owned. 5.CR.892-95, 910, 912, 914, 916.

Under the RCDAs, the City granted 1.5% of sales taxes generated from the forthcoming Gander Mountain Facility as well as 1.5% of taxes from the already existing Home Depot store. CR.911. For all other stores in the business park, the City granted .75% of sales tax for construction of the Gander Mountain Facility. *Id.* The County granted .5% and .25% respectively. 5.CR.915.

The RCDAs required the City and County to deposit these funds into a separate "Blocked Account" that the Foundation controlled. 5.CR.912, 916. The Foundation served as an intermediary, facilitating the payment of tax dollars to private parties. *Id.*[2] Because the account was blocked, the City and County could not manage the account other than to deposit funds; only Chase and the Foundation had access to the Blocked Account, which Chase could unilaterally sweep. 4.CR.656, 663; 2.CR.352-53.

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[2] While on appeal, the Foundation assigned its causes of action to J.P. Morgan Chase Bank, N.A., which is in turn now pursuing the appeal on behalf of itself and the Foundation. *See Motion to Substitute Party*, November 9, 2022. Respondents refer to the Petitioner as "Chase" or to all three parties below (including Chase, Gander Mountain, and the Foundation) collectively as "Petitioners," except when the context requires otherwise.

From there, the Foundation would pay the sales tax to Gander Mountain or its lender. 5.CR.895. These funds were to repay debt for incentives offered "solely to Gander Mountain" in connection with its forthcoming "Retail Center." 5.CR.912, 916.[3]

The Agreements give the City and County no control over the venture.

The RCDAs did not give the City or County any discretion or control over the pledged sales-tax funds. 5.CR.911-12, 915-18. Instead, the City and County's obligation to make payments was:

> **absolute and unconditional**…without abatement, diminution or deduction **regardless of any cause or circumstances whatsoever** including, without limitation, any defense, set-off, recoupment or counterclaim . . . the [City/County] may have or assert against the Foundation or any other person.
>
> 5.CR.912, 916-17 (emph. added).

The Agreements contained no cancellation right. *Id.* There was no clawback provision. *Id.* And the burden of paying funds was not tied to any obligation for Gander Mountain to provide anything to the City or County at any time in return for the sales tax revenues paid into the Blocked Account. 5.CR.912, 916-17. In short, the

[3] Chase repeatedly suggests that tax dollars went to "infrastructure." *See Petitioner's Brief*, pp. 26, 47. That is incorrect. Money was "limited to the construction of real property," of the Gander Mountain Facility and could not be used for general infrastructure. 5.CR.911-12; 2.CR.340-41, 354 ("…all the moneys…shall be use[d] to construct the Gander Mountain Facility…").

taxpayer obligation to pay the debt ends only when the debt is repaid (on terms and rates agreed upon by Chase and the Foundation). *See* 5.CR894-95. The City and County were not parties to the loan documents and had no input into their provisions.

<u>Petitioners strike a draft that would have included controls.</u>

As Chase repeatedly notes, an earlier draft of the RCDAs would have included some controls on payment obligations. 2.CR.328-30; *Petitioner's Brief*, p. 20, 33, 53. A prior draft provided that the agreement would terminate on "cessation of operations of Gander Mountain in the City." 5.CR.841, 891.

> Section 3.3 Termination. This agreement shall terminate upon repayment of the debt associated with the incentive package or cessation of operations of Gander Mountain in the City Limits of Corsicana.

But in negotiations, Petitioners insisted on striking the language.

> Section 3.3 Termination. This agreement shall terminate upon repayment of the debt associated with the incentive package.

Petitioner repeatedly touts that the taxpayer-funded obligations were not conditioned on Gander Mountain remaining open or ever doing anything. *Petitioner's Brief*, pp. 20, 33, 53.

An Interlocal Agreement follows.

Shortly after, the City, County, Foundation, and Gander Mountain entered into an Interlocal Agreement to provide "more specific details" about the transaction and to supplement the RCDAs. 5.CR.892, 924-25.

The Interlocal Agreement provided that any lender (here, Chase Bank) was a third-party beneficiary of the Interlocal Agreement. 5.CR.897-98. It also provided that the grant of City and County sales-tax revenues were to be used "for the sole and exclusive purpose" of paying a construction loan (and any subsequent permanent loan) to finance the construction of the Gander Mountain Facility. 5.CR.895, 893.[4]

The Agreements make clear that the sales tax grants were for the "Gander Mountain Facility." 5.CR.892, 894, 893 (noting that the "retail facility" is the Gander Mountain Facility); *see also* CR.894 ("it is in the public interest to promote the economic development of the Gander Mountain Facility," not the entire 132-acre site).[5] Confirming that point, economic development independent of Gander Mountain was already underway on the 132-acre site; the Home Depot store was already under development before Gander Mountain built its store. 5.CR.893.

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[4] The Interlocal Agreement restates many terms found in the RCDAs, including that the purpose was to "develop a retail facility… (the "Gander Mountain Facility"). 5.CR.893-94. One difference, though, is that the Interlocal Agreement provides that the obligations of the City and County are expressly made "subject to existing law." 5.CR.895. To the extent any conflict exists between the Interlocal Agreement and the RCDAs, the Interlocal Agreement controls. 5.CR.895.

[5] As noted below, Petitioner's position on "public purpose" has morphed over time. Sec. I(C)(1).

Neither the City nor the County has any say in the terms of the loan.

To fund the project, the Foundation obtained financing. Both the construction loan and the permanent loan to pay for the Gander Mountain Facility were to be "on such terms as are mutually acceptable to Gander Mountain and the Foundation…" 5.CR.893-94. Although the City and County were funding the deal, they had no say over the provisions of the loan documents, interest rates, terms of the loan, or any other conditions. *See id*. Respondents' job was simply to fund the deal, no questions asked. 5.CR.894-95.

The Foundation enters into a lease with Gander Mountain.

The Foundation and Gander Mountain entered into a twenty-year lease in 2004. 4.CR.369. The Lease provides Gander Mountain with the right to purchase the premises for $1.00 when the loan is fully paid, or on the expiration of the twenty-year lease term. 2.CR.393; 4.CR.793.

Section 8.2 of the Lease also provided:

> [Gander Mountain] **is not required** to continuously operate the Premises or any portion thereof **throughout or during any portion** of the term of this Lease or any renewal thereof and **no provision** hereof may be deemed to impose **any obligations or restrictions** upon Tenant with respect to the operation of the Premises.

2.CR.383 (emph. added).

The City and County are not parties to the Lease and did not participate in its drafting; the governments were unaware of this clause until after Gander Mountain informed the City and County that it would close the Retail Facility. 2.CR.428, 436.

Petitioners draw up loan documents that Respondents must pay.

The Agreements placed no fixed ceiling on the amount of money that the City and County had to contribute. 2.CR.325-48. Instead, the financing documents (none of which Respondents saw or were a party to) were structured so that the Bank could establish a nearly permanent seat at the "all you can eat" taxpayer buffet. 4.CR.652, 660.

The Foundation signed a Promissory Note in the face amount of $10,000,000 on October 3, 2005. CR.652. The Note was a 5-year note with an interest rate of 6.25% but had an amortization period of 20 years. 4.CR.652, 660.

The Foundation had to make quarterly payments of $221,424.85, beginning on January 6, 2006. 4.CR.652. The Foundation had no income or source of income to pay the Note, other than the sales tax payments from the City and County and Gander Mountain's rent. 4.CR.794. To make the deal work, the City and County contributed funds into the Blocked Account until the quarterly payments were due, which the Foundation would then pay. 4.CR.656, 663, 665. Around 2/3 of each payment came from City and County sales tax. The Bank would have received almost

$4.5 million during the first 5-year term of the Note (quarterly payments of $221,424.85 for twenty quarters). 4.CR.799, 801, 835.[6]

Further ensuring they got paid, Chase and the Foundation made the RCDAs and Interlocal Agreement, as well as the sales tax generated by those agreements. collateral for the Note. 4.CR.656, 663; 5.CR.895 (pledging sales tax fund as security also).

Chase and Gander Mountain modify the financing documents.

Chase and Gander Mountain amended the financing documents at least twice, without any notice to or input from the City or County. First, Chase and Gander Mountain amended the documents in 2010. *See* 4.CR.723 (extending Note); 4.CR.729 (amending interest rate); 4.CR.652; 4.CR.729 (amending pre-payment penalty provisions). Chase and Gander Mountain extended the Note for a second five-year term, in which the bank would have received almost $4.4 million in payments during the second 5-year term of the Note. 4.CR.723.

Second, Chase and Gander amended the documents again in 2015. CR.735 (extending maturity date). To obtain the second extension, the Foundation (with

[6] The Note payments were made from the City's and County's combined quarterly sales tax contributions—which typically amounted to $140,000 or so (4.CR.799, 801, 835)—and rent payments made by Gander Mountain. 2.CR.337; 4.CR.663, 665. Gander Mountain's rent payment was equal to the quarterly Note payment minus the quarterly sales tax payments, not to exceed $150,000. 2.CR.377.

City and County funds) had to pay the Bank a mandatory paydown of $218,982.90. 4.CR.736. The extension agreement allowed the Bank simply to remove the money from the Blocked Account. 4.CR.736. Again, the City and County had no say in the matter. 4.CR.741.

After grabbing more than $9 million, the Bank wants millions more.

Although the Bank had been paid more than $9 million on the $10 million Note, the principal balance at the time of maturity was still $6,474,727.85. 5.CR.981. In addition, the Bank had a first lien deed of trust covering the Gander Mountain Facility. 4.CR.687.[7] In the 10+ years of payments, the balance was reduced by only 35%. The term of the Note (with extended 5-year terms), including the extended amortization rate, meant that most of each quarterly payment went to pay interest.

Gander Mountain operates, then closes.

From 2004 to December 2015, the City and County contributed sales tax revenues under the RCDAs and Interlocal Agreement. 3.CR.428-29, 437. In the late summer of 2015, Gander Mountain announced that it was closing the Retail Facility. 3.CR.428. The City and County objected to the closing, and the City Manager

[7] Chase and the Foundation also later asserted a constructive trust against $5 million in insurance proceeds realized from a suit by Gander Mountain against the construction company that built the store. 2.CR.242-48; 4.CR.752-53. And (after this appeal began, though a matter of public record) Chase obtained the underlying property as well. Doc. No. 00004856 in the Real Property Records of Navarro County.

warned Gander Mountain that closing the Retail Facility might result in the inability of the City and County to fund the sales tax grant because the Texas Constitution requires that public money be spent only for public purposes. 2.CR.321-23.

Despite the warning, Gander Mountain closed the Retail Facility on October 22, 2015. 3.CR.428. It remains closed to this day. Gander Mountain filed for bankruptcy, and the Bankruptcy Court eventually rejected the Lease. 6.CR.1052. Since that time, Chase assumed the Foundation's rights and acquired the property. *See* n. 7, above.

<u>The City and County cease payments.</u>

The Agreements contained zero rights, remedies, or controls to address the shuttering of the business with millions still outstanding on the Note. Accordingly, the only remedy the City and County had was to stop paying the sales tax grants into the Blocked Account, which is what happened.[8] On February 2, 2016, the City Council and the County Commissioners Court held a Joint Special Meeting and passed Resolutions making findings that the public purposes of the RCDAs and the Interlocal Agreement were extinguished when Gander Mountain ceased operations

[8] As noted above, the closest the Agreements come to giving Respondents any protection is simply stating that Respondents' obligations to pay are made subject to "existing law." 5.CR.895. In short, the Texas Constitution provides the only protection the City, County, and taxpayers have.

and abandoned the Facility. 3.CR.420, 424. The City and County ceased making payments to the Blocked Account.[9]

The City and County sue.

Respondents, the City of Corsicana and Navarro County, sued Defendants-Petitioners seeking a declaration of their rights, duties, and obligations under the Texas Constitution Article III, § 51, Article III, § 52, Article III, § 52-a, Article XI, § 3 and Article XI, § 5. 1 CR 7-8. Both parties moved for summary judgment. 2.CR.297.

Both lower courts court rule for the City and County.

The trial court granted judgment in the City and County's favor. The trial court declared that:

1. The closing of the Gander Mountain store extinguished the public purposes which authorized the City's and County's grant of public money to repay loans taken out by the Foundation to build the Gander Mountain store.

2. The RCDAs and the Interlocal Agreement ("Agreements"), as well as the other transaction documents including the Lease, failed to place sufficient controls on the transaction to ensure that

[9] To shed light on the timing, sales tax collected at the point of sale is typically paid by the Comptroller to the City and County from one to three months after the tax is collected. 2.CR.428, 437. The City and County continued to fund the sales tax grant for the months in which the Gander Mountain store was open, and for the months in which the City and County received at least some sales tax because the Gander Mountain store was continuing to operate. 2.CR.428-29, 437. Neither the City nor the County has received any sales tax generated by Gander Mountain since December 2015. 2.CR.428, 437.

the public purposes for which the original grant of sales tax was made were carried out.

3. The RCDAs and the Interlocal Agreement are unconstitutional, void and illegal because they allow public funds to be spent without the necessary controls in place to ensure that the public purposes which authorized the public funds are carried out.

4. It is unconstitutional, and a void and illegal act for the City and County to continue to grant sales tax revenues to repay the loan once the Facility was no longer open and no public purpose was being served.

5. The Agreements are unconstitutional, void and illegal to the extent they purport to require the City and County to grant sales tax revenues to pay off the loan when the public purposes supporting the grant are no longer being served. Supp.CR.18.

Petitioners then appealed. Supp.CR.22, 24, 26.

On appeal, the Waco Court of Appeals affirmed, holding that the Agreements "are unconstitutional and therefore not binding on the parties." *Corsicana Indus. Found., Inc. v. City of Corsicana*, 685 S.W.3d 171 (Tex. App.—Waco 2024, pet. filed).

SUMMARY OF ARGUMENT

When private parties contract with their own money, they can typically pursue any lawful purposes, without concern that courts will scrutinize those purposes or whether the deal they struck is likely to achieve those purposes. This freedom of contract allows parties to speculate and gamble with their own money because the dealmaker loses from the bad deal. Petitioners, from the start of this case, have treated this case like a private-party-contract case, proudly championing the "absolute and unconditional" obligations of the taxpayers of Corsicana and Navarro Counties. But deeply woven into Texas law is the principle that public money can only be spent to achieve public purposes. The *TML* test implements that principle to ensure that when taxpayer money is sent to private companies, the government retains sufficient control over the transaction to ensure the public purpose is achieved. The control requirement ensures that private profits, though allowed, are incidental to the achievement of the public purpose, and not vice versa.

In this case, both lower courts correctly invalidated the Agreements for three reasons. First, economic development is not exempt from the *TML* test's taxpayer protections. Second, the Agreements here lacked those controls. And third, Petitioners are on the wrong side of the arguments they make about incentives, public purposes, and the risk of exploitation.

TML Applies

First, economic-development transactions are not exempt from the *TML* test. The *TML* test applies when private parties intervene between public funds and public purposes. Although this Court has not specifically held that *TML* applies to spending for the public purpose of economic development, for three decades the legal community, including every Attorney General from Jim Mattox to Ken Paxton, has agreed that it does. And transactions have been structured accordingly. Nothing about *TML's* origins or economic development suggest otherwise, and Chase's contrary argument is both atextual and dangerous.

Missing Controls

Second, both lower courts correctly concluded that the Agreements lacked the required controls. To satisfy *TML*, the government must retain "sufficient control over the expenditure of funds to ensure that the public purpose is accomplished and to protect the public's investment." For thirty years, members of the legal community have structured CLE courses, created handbooks, and published guides about how to structure economic-development transactions to ensure that the taxpayers' obligation to pay is linked to the development of their economy. The transaction in this case lacked all such provisions; there were no recapture provisions, indexed metrics, termination provisions, or anything similar.

Petitioners insisted on removing the only arguable control from an earlier draft of the Agreements. The result was a transaction that inexorably bound taxpayers to pay a $10 million note for the construction of a new Gander Mountain building. If Gander mountain never opened, employed a person, made a sale, sales-tax revenues from other existing stores would still pay for its building, which Gander Mountain had an option to buy for one dollar in the future. The only provision resembling a *TML* control was a continuous-operations clause in an earlier draft, but Petitioners rejected it. And to make matters worse, taxpayers' repayment obligations extended to whatever amendments and extensions the private parties might (and did) make to the transaction documents note.

Petitioners' Remaining Arguments

Petitioners raise concerns related to the chilling consequences that might follow from this Court striking down what it calls a "conventional" economic agreement. But an agreement that defies all conventions is not a conventional agreement. The conventions it defies were recognized ways to comply with the Texas Constitution's taxpayer protections, and the State of Texas should celebrate the deterrence of those who overreach at taxpayers' expense. As to the consequences of applying the *TML* test to economic-development agreements generally, there is no need to speculate about the consequences of doing so. For the past thirty years, economic-development agreements have been structured to satisfy *TML*, and so the status quo confirms that, as they have in similar government programs, economic development, private profits, and taxpayer protections can, and do, live in harmony.

Next, Petitioners' arguments about "public purpose" are wrong or irrelevant. Petitioners argue at length that economic development is a public purpose. This has never been disputed. The Agreements lacked any controls, however, to measure, ensure, and adjust the payment of a private company's building loan based on its contribution to the development of the economy. The lack of control was highlighted when Gander Mountain shuttered. At that point, the City and County were required to withhold paying tax money because the Texas Constitution does not authorize spending for the purpose of paying a private company's bank loan. Doing so might achieve the public purpose of economic development, but controls are required to link the two.

Finally, Chase's concerns about exploitative and opportunistic governments are unfounded. Chase cites no evidence of such abuse over the past thirty years, perhaps because surrounding equitable principles have been in place for more than a century and prevent the situation Chase asks the Court to fear.

<u>STANDARD OF REVIEW</u>

This Court reviews summary judgment rulings de novo. *Provident Life & Accident Ins. Co. v. Knott*, 128 S.W.3d 211, 215 (Tex. 2003).

ARGUMENT & AUTHORITIES

I. The trial court correctly held that the Agreements violate the Texas Constitution.

The Texas Constitution is "replete with provisions limiting the use of governmental resources" in connection with a private venture. TEX. ATT'Y GEN. OP. JM-1255 (1990), p. 2 (citing TEX. CONST. ART. III, §§ 50, 51, 52(a); ART. VIII, § 3; ART. XI, § 3; ART. XVI, § 6). Those provisions combine to create a central principle—public money can only be spent to achieve public purposes. That principle, of course, would lack usefulness if it could be satisfied merely by a local government's claim that sending money to private parties will achieve the public purpose. The *TML* test exists for this situation, limiting the government's freedom to contract with taxpayer money to circumstances where private profits, though allowed, remain incidental to the achievement of the public purpose. *See Borgelt v. Austin Firefighters Ass'n,* 692 S.W.3d 288, 301 (Tex. 2024) ("We recognize that principles like these are not themselves the constitutional text. They instead usefully reflect how courts can neutrally, predictably, and reliably apply the Constitution's mandate….").

In the trial court, Petitioners conceded that the *TML* test applied, but argued the test was satisfied. In the court of appeals, Petitioners stuck mainly to that argument, despite championing the Agreements as creating "absolute and unconditional" taxpayer obligations that were expressly *independent* of any impact on the development of the economy.

Chase's lead argument now is one made only in passing in the court of appeals, and one that contradicted its trial-court position. Although the *TML* test applies to spending for all *other* public purposes, Chase now argues that Section 52-a of the Texas Constitution singularly exempts economic-development agreements from the taxpayer-protecting controls of the *TML* test. *Petitioner's Brief*, pp. 36-44.

Both lower courts correctly held that the Agreements here failed the *TML* test for three reasons. First, economic-development agreements are not exempt from the *TML* test. Second, the Agreements here lack the taxpayer-protecting controls required by *TML*. And third, Petitioner is wrong about the incentives and precedential impact that will follow a decision here. Not only do those arguments dangerously encourage the unfettered freedom to gamble with taxpayer money, but they also sound false alarms about the perils of upholding the principles courts and practitioners have employed for years.

A. Economic-development spending is not exempt from the *TML* test.

Although public funds can only be spent for public purposes, often those funds must flow through private parties. As a historically justified check on both motives and imprudence, the *TML* test polices those transactions to ensure that private profits remain incidental to the achievement of the public purpose asserted by the government. A transaction satisfies *TML* if:

> (1) The expenditure is not gratuitous but instead brings a public benefit; and
>
> (2) The predominant objective is to accomplish a legitimate public purpose, not to provide a benefit to a private party; **and**
>
> (3) The government retains control over the funds to ensure the public purpose is in fact accomplished.

Borgelt, 692 S.W.3d at 301 (citing *Texas Mun. League Intergovernmental Risk Pool v. Texas Workers' Comp. Comm'n.*, 74 S.W.3d 377, 384 (Tex. 2002) (emph. added).

Chase argues that, unlike spending for all other public purposes, spending for the public purpose of economic development should not be subject to the *TML* test. *Petitioner's Brief*, pp. 36-44. Chase is wrong for three reasons. First, nothing about the origins of the *TML* test removes economic-development spending from the concerns about imprudently committed taxpayer money. Second, there is no need to speculate about potentially chilling consequences of applying the *TML* test to economic-development transactions because—even without an express holding from this Court that economic development is not a singularly exempted public purpose—the *TML* test has been entrenched for decades as the test governing economic-development transactions in Texas. And so, the impact of applying it need not be guessed at; it is the current reality. And third, Chase's remaining arguments run against sound policy and raise concerns that have already been answered by other principles of equity and government law.

1. <u>The *TML* test sprang from a history of abuse.</u>

Texas learned the hard way about the dangers of sending public funds to private businesses. *See* Amici Curiae Brief of Texas Public Policy Foundation and Goldwater Institute, pp. 4-11. In 1871, the Texas Legislature authorized cities and counties to hold bond elections, whose proceeds were pledged to railroads. The bidding frenzy that followed enriched railroads because local governments could not compete if they built prudence into the price. Taxpayers suffered when the bubble burst. *See* TEX. CONST. ART. 3, § 52, Interpretive Commentary; *Outlawing favoritism, The Economics, History and Law of Anti-Aid Provisions in State Constitutions,* (estimating that 20 percent of municipal debt was defaulted during this period), Tab 4. The Constitution of 1876 emerged from this quagmire and banned local governments from lending credit or granting public money to private parties, without regard for any public-purpose objective. TEX. CONST. ART. 3, § 52, Interpretive Commentary.

While the 1876 outright ban on private grants yielded over time to narrow exceptions, the *TML* test and other principles still reflect those hard-learned lessons.[10] Many constitutional provisions unify around a key tenet: public money is for public purposes. TEX. ATT'Y GEN. OP. JM-1255 (1990) (citing TEX. CONST. ART. III, §§ 50, 51, 52(a); ART. VIII, § 3; Art. XI, § 3; ART. XVI, § 6). Built on decades of authority and Texas' unusually robust textual taxpayer protections,[11] the *TML* test recognizes both the inevitably of and risk associated with one reality: to accomplish the public purpose of economic development, public money must often flow through profit-seeking private firms. *Tex. Mun. League*, 74 S.W.3d at 383. When this happens, the *TML* test protects taxpayers by examining the transaction to ensure that private profits remain incidental to the only permissible use of public funds—the accomplishment of a public purpose. *Id.* at 384; *see West River Bridge Co. Dix*, 47 U.S. 507, 537 (1848) (McLean, J. dissenting) ("The public purpose for which the power is exerted must be real, not pretended."); *Borgelt*, 692 S.W.3d at 310 ("The Gift Clause must be obeyed in reality, not just in form …").

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[10] Nor are the perils of such tactics and the threat of wasted tax dollars confined to the past. *See, e.g.*, 5.CR.885 (containing handwritten notes of how Gander Mountain was creating competition among local governments for its store "GO TO OTHER 'COUNTIES,'" "MAKE CITIES COMPETE FOR GANDER…" "FRISCO-FORCE IT WITH THOSE GUYS").

[11] *See Outlawing Favoritism, The Economics, History and Law of Anti-Aid Provisions in State Constitutions,* Mitchell, Riches, Thorson and Philpot, Mercatus Working Paper, Mercatus Center at George Mason University p. 61 (2020), Tab 3 (taxpayer protections are part of the unique fabric of the Texas Constitution; Texas is 1 of only 9 states whose constitutions contain strong textual limitations on government expenditures, extensions of credit, and stock ownership).

The *TML* test's imposition on "freedom of contract," therefore, is not accidental or incidental—it's the entire point, supported by both history and political pragmatism. Courts rarely care about the purposes of private bargains and even less often whether the structure of a deal advances those purposes. But private parties are gambling with their own money. Government grants, on the other hand, commit the money of taxpayers, many of whom will pay long after those who negotiated the transaction are gone. *See Economic Development Incentives must be "Necessary": A Framework for Evaluating the Constitutionality of Public aid for Private Development Projects*, Mulligan, 11 Harv. L. & Pol'y Rev S13 (2017), Tab 6 (explaining that governments find themselves in a "prisoner's dilemma" in which they have little choice but to offer a subsidy to the requesting business).

Under *TML* and other government-spending doctrines, it is not the future taxpayers who are held accountable for the actions of past governments. Nor is there a need for a state oversight agency to ensure that government contracts comply with the Constitution. Instead, the onus has long rested on private firms who wish to profit from taxpayer dollars. *Base-Seal, Inc. v. Jefferson Cnty.*, Texas 901 S.W.2d 783, 788 (Tex. App.–Beaumont 1995, writ denied)(party contracting with a governmental unit is charged by law with notice of the limits of the authority of the governmental unit and are bound, at their peril, to ascertain that the contemplated contract is properly authorized); *see generally State v. Bank of Missouri*, 45 Mo. 528, 538–39 (1870) (explaining how and why the law allocates the risk of loss to private parties when contracting with their government counterparts) (cited by the Supreme Court of Texas in *State v. Ragland Clinic-Hospital*, 138 Tex. 393, 397, 159 S.W.2d 105 (1942)); *see also Nichols v. State*, 11 Tex. Civ. App. 327, 333, 32 S.W. 452, 454 (1895) (rejecting the idea of a government's apparent authority because, to find its actual authority, one must only read the written laws that define its limits).

To be sure, the *TML* test will discourage deals that fail it. That is the point. But as shown in the next section, the test has been entrenched for decades, and the only consequences to fear would come from its elimination.

2. The *TML* test has been applied to economic-development spending for decades, removing any need to speculate about the consequences of applying it.

Chase prophesizes that the lower court's opinion, if undisturbed, will be the end of economic development in Texas. *See Petitioner's Brief*, pp. 14, 18-20. If, the argument goes, economic-development agreements must satisfy the *TML* test, who will partner with local governments? But we already know the answer to the question because the *TML* test *has* been the governing test used for decades by everyone who practices in this area.

Every Attorney General from Jim Mattox to Ken Paxton has agreed that the *TML* test applies to spending for the public purpose of economic development, just as it applies to spending for other public purposes. TEX. ATT'Y GEN. OP. JM-1255 (1990); TEX. ATT'Y GEN. OP. DM-185 (1992); TEX. ATT'Y GEN. OP. LO-96-035 (1996) ("…must retain some degree of control over the performance of the contract."); TEX. ATT'Y GEN. OP. JC-0439 (2001) (noting need for "adequate control") (citing *Key v. Comm'rs Court of Marion Cty.*, 727 S.W.2d 667 (Tex. App.—Texarkana 1987, no writ)); TEX. ATT'Y GEN. OP. GA-0033 (2003) (noting need for "adequate controls"); TEX. ATT'Y GEN. OP. KP-0091 (2016) ("…a contractual agreement outlining the requirements of the receiving entity must comply with in exchange for the funds may provide sufficient control over the funds…"). Again recently, Attorney General Paxton confirmed that Chase's argument (that economic-development agreements are exempt from the *TML* test) lacks any foundation. Tex. ATT'Y GEN OP. KP-0261 (2019) (citing TEX. ATT'Y GEN. OP. JM-1255 at 8-9 (1990) ("[T]here is no language in either Section 52-a nor in the relevant commentary to suggest the amendment was intended to change the requirement [of] sufficient controls to ensure that the public purpose be carried out.")).

Also in lockstep are practitioners and legal thinkers. Across the board, they recognize, and have recognized, the *TML* test as the relevant benchmark by which to judge the investment of tax dollars for economic development. *See* TML Development Handbook, p. 148 (2022), Tab 1;[12] Jeff Moore, Brown & Hoffmeister, LLP, *Chapter 380 of the Texas Local Government Code*, Moore, p.2 (2006), Tab 2 (outlining history and recognizing same); Mary Ann Powell, *The Give and Take of Development Agreements*, 11th Annual Local Government Seminar (January 29, 2015), p. 9, Tab 3 (same).

Volumes have been written about the types of taxpayer-protecting controls required in economic-development agreements under the *TML* test. Agreements "should ensure that the public purpose of economic development will be pursued by the business," with an agreement:

> **that outlines what steps the business will take that justify the provision of public funding** (creation of jobs, expansion of the tax base by construction or enhancement of the physical facilities, etc.). The city should include a recapture provision in the agreement so that if the business does not fulfill its promises, the city will have a right to seek reimbursement of the incentives that were provided. Any such agreement should also include tangible means for measuring whether the industry has met its obligations under the contract. **Without these safeguards and a demonstrable benefit to the municipality, such**

[12] A full copy is available at https://www.tml.org/DocumentCenter/View/1471/2022-Economic-Dev-HDBK- Final?bidId= (last visited June 26, 2024).

> **incentives may not pass constitutional muster for serving a public purpose**

2022 Economic Development Handbook, 148, 162. (emph. added), Tab 1.

Reach back a decade, and the guidance is the same:

> A municipality that institutes a program to promote economic development under Chapter 380 must ensure that it complies with this public purpose requirement. Municipalities, therefore, must include in the economic development agreement sufficient controls to guarantee that it is accomplishing a public purpose with the expenditure of public resources. Particularly, the agreement should: (1) condition the grant or loan incentive on the creation of employment, construction of improvements, continued operations for a stated period of time; and/or other public purpose; (2) contain tangible measures and milestones aligning in municipality to determine whether the public purpose is being served; and (3) require recapture of the grant or loan amount if the recipient does not fulfill the conditions of the grant.

Economic Development Tools, Texas City Attorneys Association, Kimberly Lafferty, (February 21, 2013), Tab 9.

Thus, "whether the *TML* test governs economic-development agreements" is a question of first impression only Court has not faced the issue and so held directly; the affirmative response has been answered by three decades of AG opinions and has literally become the Hornbook law relied upon by practitioners structuring such transactions. *See, e.g.,* Powell, Tab 3; TML Economic Development Handbook p. 148, Tab 1. Deals have been routinely structured to include the controls required by *TML*, and so economic development as we know it *is* economic development governed by the *TML* test. As will be explained in more detail below, because the Agreements so clearly lack the required controls, Chase must do away with the *TML* test if it has any hope of prevailing.

3. Chase's exemption argument is atextual.

Section 52-a's first clause begins with "Notwithstanding any other provision of the Constitution." TEX. CONST. ART. III, § 52-a. Although Petitioners argued otherwise at trial, on appeal Chase reads § 52-a to mean that economic-development spending is exempt from *any* other constitutional restrictions, including the *TML* test. *Petitioner's Brief*, pp. 39-43. Has Chase discovered, with the "Notwithstanding" language, a textualist argument that has been missed by decades of legal thinkers? No. Chase's argument misunderstands the text of Section 52-a, the *TML* test, and how the two interact.

Section 52-a provides:

> Notwithstanding any other provision of this constitution, the legislature may provide for the creation of programs … **for the public purposes** of development and diversification of the economy of the state…

TEX. CONST. ART. III, § 52-a

Before the enactment of § 52-a, "economic development" was not recognized a permissible public purpose for which public funds could be spent. *In re The State of*

Texas, No. 24-0325 (June 14, 2024 Opinion), Tab 5; TEX. ATT'Y GEN. OP. KP-0261; Bill Analysis for H.J.R. 1, 5 (1987) (the Joint Resolution that presented Article III, §52-a for the Legislature's consideration) ("Texas, however, will have difficulty in implementing these models of financing for economic development that have been successful elsewhere, until constitutional language that clarifies economic development as a public purpose is added."). Section 52-a changed that and made economic development one of the public purposes for which public funds could be spent.

But making economic development a "public purpose" does not exempt economic-development spending from the *TML* test. The *TML* test *requires*, as a starting place, that the government articulate a public purpose. Then, the familiar three-prong *TML* test evaluates, among other things, whether the transaction's predominant objective is to accomplish that public purpose *and* whether the government retains control over the funds to ensure that purpose is accomplished. *Borgelt*, 692 S.W.3d at 301, 318 (Busby, J. dissenting in part) ("the government must *require* that the funds serve a public purpose by actually implementing 'adequate contractual or other controls' to '*ensure* its realization'"). Making something a public purpose does not exempt it from a test that polices the predominance of and governmental control over spending for public purposes.

And so economic development is a public purpose under the first prong of the *TML* test. TEX. ATT'Y GEN. OP. KP-0261 (2019).[13] Economic development grants still must "satisfy the other two prongs of the *Texas Municipal League* test…sufficient controls to ensure the accomplishment of a public purpose and receipt of a return benefit." *Id.* at 2. Nothing about economic development suggests that, as compared to other public purposes, its accomplishment was, or should be, unconstrained or elevated above taxpayer protections. Economic development grants aren't exempt from the risk that "corporate greed [will find] local pride and ambition an open way to municipal revenues." *Cleburne v. Gulf, C. & S. F. R. Co.*, 1 S.W. 342 (1886). Similarly, nothing about economic-development agreements would justify the government awarding them based on race or religion in violation of the other Constitutional provisions, which would be a necessary consequence of Chase's faux textual reading of the "notwithstanding" clause.

Based on the constitutional text and its legislative history, historical context, and three decades of consistent interpretations, this Court was right to be skeptical when it addressed but did not decide this issue last year. *In re The State of Texas*, No. 24-0325 (June 14, 2024, Opinion), pp. 9-10, Tab 5 (noting the lack of any real support

[13] Chase spends the first half of its brief establishing that economic development is a public purpose. Of course it is. That was the whole point of Section 52-a.

for treating Section 52-a as a constitutional trump card). As this Court explained, under Chase's reading

> nearly any direct gift of public money that will likely be spent by the recipient could qualify as "economic development"—on the theory that any boost in overall consumer spending is good for the economy. If this is right, then section 52-a comes close to repealing the Gift Clauses' ban on "gratuitous payments to individuals." *Tex. Mun. League*, 74 S.W.3d at 383. Such payments could nearly always be portrayed as good for the economy in some sense.

Instead, the Court reasoned:

> Without resolving the issue, we think it more likely that by authorizing "grants of public money . . . for the public purposes of development and diversification of the economy of the state," section 52-a removed doubt about the constitutionality of conventional economic-development grants, by which governments promote business growth and job creation through grant agreements designed to ensure that the recipient of public funds spends them in a way that has an economic benefit for the wider community. In other words, section 52-a appears designed to clarify that "development and diversification of the economy of the state" qualify as "public purposes."

Id.[14] pp. 9-10.[15]

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[14] Chase argues that the program in *Uplift* "bears no resemblance" to the facts here and tries to distinguish why the Uplift program failed the *TML* test. *Petitioner's Brief*, pp. 63-64. But Chase offers no rehabilitation of its main argument (that *TML* does not apply at all) considering the *Uplift* case.

[15] The legislative history, along with the text, context, and common sense, confirms this Court's reasoning:

Thus, Chase's exemption argument finds no support in text, precedent,[16] history, or policy. Indeed, in the trial court, even Chase and the Foundation agreed that the *TML* test applied.[17] Chase was correct at trial to agree with every existing legal authority. Its about-face, however, is not about sound policy, textual fidelity, or anything other than its own coffers. As shown in the next section, Petitioners insisted on an agreement that lacked all controls and now ask the Court to reward that overreach with taxpayer money and even more costly precedent.

> [Article III, §52-a] is necessary to override certain current constitutional provisions that might be construed as prohibiting economic development investments by the state or local governments that aided individual companies. The court have generally interpreted existing constitutional provisions to permit grants for public purposes…However, to avoid any delay or confusion in the establishment of these proposed new programs, it would be prudent to clarify that public loans and grants for economic development, the elimination of unemployment and the expansion of transportation and commerce are indeed for public purposes and constitutionally acceptable.

Bill Analysis for H.J.R. 1, 5 (1987).

[16] Given the unwavering three-decade consensus of notably diverse Attorneys General, few litigants have even floated Chase's argument to courts; but those weighing in are, not surprisingly, in accord with the AG opinions. *See Ex parte City of Irving*, 343 S.W.3d 850, 854-55 (Tex. App.–Dallas 2011, orig. proc.) (confirming AG opinions, noting that §52-a created an exception to allow programs that foster economic growth serve a public purpose); *see also Borgelt v. Austin Firefighters Ass'n*, *IAFF Loc. 975*, 684 S.W.3d 819, 829 (Tex. App.—Austin 2022) (confirming same) *aff'd in part and reversed in part* 692 S.W.3d 288 (Tex. June 28, 2024).

[17] 4.CR.635-36, 780-81, 820-22. Likewise, the other party, the Foundation, argued the *TML* test was still part of legal analysis under Article 3, §52-a. 4.CR 781, 822.

B. Both lower courts correctly held that the Agreements fail the *TML* test because they lack sufficient controls.

The *TML* test requires the government to show not only that its *target* was a predominantly public purpose but also that the government:

> retains sufficient control over the funds to ensure that the public purpose is accomplished and to protect the public's investment.

Texas Municipal League, 74 S.W.3d at 384; Tex. Att'y Gen. Op. KP-0261; Tex. Att'y Gen. Op. KP-0099; Tex. Att'y Gen. Op. LO-94-008 (gathering authority); *see, e.g.*, *Development Agreements: Basics and Beyond*, Reid C. Wilson (collecting cases and then offering a practitioner's guide to drafting documents that will satisfy constitutional scrutiny), Tab 8.

The lower courts correctly held the Agreements lacked the required controls for three reasons. First, *TML* requires formal controls not mere formalities. *Borgelt*, 692 S.W.3d at 310. Second, the Agreements contain no such controls. And third, Petitioners negotiated Agreements that *removed* from an earlier draft the only arguable taxpayer-protecting control that existed among the layers of protections for the private profits of the Bank and the business.

1. <u>The control prong requires formal controls, not mere formalities.</u>

To survive constitutional scrutiny, there must exist a "retention of formal control" adequate to protect the public's investment. *Key*, 727 S.W.2d at 669; TEX. ATT'Y GEN. OP. JC-0582 (citing *Kordus v.City of Garland*, 561 S.W.2d 260, 261 & n.1 (Tex. Civ. App.-Tyler 1978, writ ref'd n.r.e.)). Although parties may hope or predict a public purpose will be achieved by a transaction, the control prong requires mechanisms to compel, cancel, or modify performance if those predictions fail. *See Borgelt*, 692 S.W.3d at 318; TEX. ATT'Y GEN. OP. JM-1255 *2, 4-5; TEX. ATT'Y GEN. OP. DM-185 *1; s*ee also* TEX. ATT'Y GEN OP LO-94-008 *2 (1994); *see also* TEX. ATT'Y GEN. OP. KP-099.

Just as banks require formal security and enforceable obligations to ensure their private profits, taxpayer-funded transactions must contain controls that ensure the public purpose is achieved. Four examples—a sea wall, a candlelight tour, an ambulance service, and the *Changas* case—illustrate the control test.

Sea walls

A few years ago, a city asked the A.G.'s office whether it could use public funds to construct a seawall on private land. TEX. ATT'Y GEN OP. GA-0528 (2016), Tab 10. Seawalls are public improvements and thus spending for them can achieve a public purpose, even if a private builder, financier, or other business profits from bringing them to the public. But broken, inaccessible, or removed seawalls don't accomplish the public purpose. *Id.* Therefore, though functioning and accessible seawalls were a permissible target, public funds could not be spent without formal controls ensuring that permissible target is achieved. As the opinion explains, to satisfy the *TML* control test, "the City must acquire a sufficient interest in the real property where the seawall will be built to prevent landowners from altering or removing it. In addition, the City would likely need to acquire an interest in the land in order to inspect, maintain, and repair the seawall at various times in the future." *Id.* No matter how "unconditionally" the city might promise to pay the seawall-construction company, *TML* requires controls to ensure that public funds achieve a public purpose. That company's private profits are permissible, after all, only as incidental to the achievement of a public purpose.

Candlelight Tours

Next, the candlelight-tour case illustrates that the prospective optimism of "shared purposes" is as unacceptable as security for taxpayers as it is for banks. *Key*, 727 S.W.2d 667. In *Key*, a citizen challenged the transfer of a public asset, an elaborate Christmas tour, owned by the Marion County Historical Commission, to the (privately owned) Historic Jefferson Foundation. *Id.* Although the private Foundation shared the "same stated goals as the Commission," the Court held the transfer void because the transaction lacked the formal controls needed to ensure the hoped-for result was achieved. *Id.* Unlike private transactions, which can commit money speculatively, the transaction was void because there was no "contractual obligation to ensure that the public's business will in fact be effectuated by the public expenditure." *Id; c.f.* TEX. ATT'Y GEN. OP. JC-0582 *6 (2002)(opinion about a museum, noting "[t]he lease agreement would appear to place sufficient controls on the transaction to ensure that the public purpose—the operation of a museum—is carried out."). *See Outlawing Favoritism*, at 57 (citing *Key* as an exemplary case illustrating transactional controls).

Ambulances

Providing ambulance services is a public purpose for which public money can be spent. But as explained in a recent opinion by Attorney General Paxton, when a local government contracts with a private business who receives those public funds to provide those services, the transaction must contain formal controls to ensure the public benefit is achieved. TEX. ATT'Y GEN OP. KP-0435 (March 7, 2023). Attorney General Paxton was asked to evaluate a transaction that allegedly lacked controls "to ensure the public purpose is achieved and the County receives services equivalent to its expenditures." *Id.*

The ambulance contract, however, contained the ultimate control. As Paxton noted, the contract gave the county the "ability to terminate the Agreements under the terms provided in the Agreements if it determines that a public purpose is no longer being achieved or that the County is not receiving service equivalent to its expenditures." *Id.*; *c.f.* TEX. ATT'Y GEN OP. KP-099 (noting a flat-fee legal-services agreement was suspect because it lacked the controls to ensure the public would receive the services it paid for).

Changas

Finally, in *Changas*,[18] tax revenues were used to reimburse Changas, a private company, for expenses related to water and wastewater services. *City of League, Texas, v. Jimmy Changas, Inc.* 670 S.W.3d 494, 498 (Tex. 2022). The reimbursements, however, could come only from sales tax *generated by Changas*.[19] Thus, if Changas never built, opened, and operated a restaurant, it would never receive any public funds. *Id.* at n. 1 ("The Agreement did not require Jimmy Changas to build and operate the restaurant as projected, but it conditioned the City's incentive payments on its doing so."). If it stopped operating and contributing to the economy, it stopped getting public money. *Id.* Changas was entitled to the promised public funds, not because they were absolutely and unconditionally promised, but

[18] While *Changas* dealt with governmental immunity, Chase cites it as favorable authority. But the facts there reveal how the *TML* test was embodied in the economic development agreement in that case.
[19] For the full contract, see, City of League City, Texas Petition for Review, Texas Supreme Court Cause No. 21-3007, Appendix D, pages 5-6 (filed June 14, 2021).

because they were not. As *Changas* illustrates, controls needn't be complex or burdensome, but they must ensure that public benefits are not subordinated to private profits.

These four examples are illustrative (but surely not exhaustive) of the role played by the control test. History justifies suspicion (of motives or just imprudence) when private profits intervene between public spending and a claimed or potential public benefit. The control test ensures that private profits remain incidental to the public benefit, not vice versa. When an agreement protects private profits but contains no benchmarks, clawbacks, government-termination option, or other assurances that taxpayer money will achieve a public purpose, it is the public purpose that has become incidental. *Borgelt*, 692 S.W.3d at 304 (the Constitution bans transactions "when the public purpose is the caboose rather than the engine.").

2. The Agreements lack those controls.

To contextualize why neither lower court struggled with this issue, consider what a question to the Attorney General would have looked like had it been asked prospectively about this transaction:

> Dear Sir, our government would like to unconditionally pledge sales tax revenues (from multiple sources) for the construction of a building (which will be owned by a retailer) on financing terms decided by others, who also have sole authority to amend those terms. We believe this transaction will bolster our economy, though the

> transaction does not require the building to be used for any particular purpose. Even if the retailer sporadically, or even never, uses that building to generate sales tax, sales-tax revenues from other businesses will be used to pay the absolute and unconditional note. Once the building is constructed, the documents make clear that the taxpayer's obligation to pay the note ends only when the note is paid and is in no way measured or affected by the initial or continuing economic impact of the transaction.

For 30 years, private businesses have known the answer to the question just posed. AG opinions, CLE papers, and seminars have detailed the types of controls that allow private profits while protecting taxpayers, such as performance metrics, performance indexes, clawback provisions, and termination provisions.[20] For example, one source advises that:

> The city should include a recapture provision in the agreement so that if the business does not fulfill its promises, the city will have a right to seek reimbursement of the incentives that were provided. Any such agreement should also include tangible means for measuring whether the industry has met its obligations under the contract. Without these safeguards and a demonstrable benefit to the municipality, such incentives may not pass constitutional muster for serving a public purpose.

TML Economic Development Handbook, 148, 162, Tab 1.

[20] And those contracting with the government know, and have known, that they must *insist* upon the inclusion of the *TML*-required controls because, as with other limits on taxpayer-funded contracts, their exclusion, by design, will doom the one seeking private profits, not the taxpayers whom the rules protect. *See, e.g., Edgewood Indep. Sch. Dist. v. Meno*, 917 S.W.2d 717, 740 (Tex. 1995); *see also* Powell, *The Give and Take of Development Agreements*, Tab 3. Petitioners were represented by counsel during the drafting of the transaction documents and would have been aware of the CLE materials and AG opinions. 4.CR652-742. They aren't without recourse here.

Even the Foundation's own law firm (at the time) published guidance about economic-development agreements, confirming that "any transaction providing public money must contain sufficient controls to ensure that the public purpose is carried out."[21] Jeff Moore, Brown & Hoffmeister, LLP, *Chapter 380 of the Texas Local Government Code, Riley Fletcher Basic Municipal Law Seminar,* Lubbock, Texas, February 24, 2006, at p. 2, Tab 2.

The Texas Municipal League agrees:

> However, a city may not simply write out checks to interested businesses in order to promote economic development. The city should ensure that the public purpose of economic development will be pursued by the business. For example, if a city provides a grant or a loan to an industry, the city should enter into a binding contract with the funded industry that outlines what steps the business will take that justify the provision of public funding (creation of jobs, expansion of the tax base by construction or enhancement of the physical facilities, etc.). The city should include a recapture provision in the agreement so that if the business does not fulfill its promises, the city will have a right to seek reimbursement of the incentives that were provided. Any such agreement should also include tangible means for measuring whether the industry has met its obligations under the contract. Without these safeguards and a demonstrable benefit to the municipality, such incentives may not pass constitutional muster for serving a public purpose....

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[21] Chase succeeded to the Foundation's interest. *See Appellants' Unopposed Motion to Substitute Parties* in the Court of Appeals record at p. 3.

As do other experts:

> Like cities, counties must maintain sufficient control over the way these funds are spent. To ensure such control, a county would be well advised to execute a formal contract between the county and the entity that spends the funds, outlining the respective rights and duties under the agreement. Additionally, the county would want to include a recapture provision outlining how the county would be reimbursed for any incentives it provided if the funded entity is ultimately unable to meet its commitments.

TML Handbook, p. 162, Tab 1.[22]

The Agreements here lack all such controls. The City and County's obligations to grant sales-tax revenues to develop the Gander Mountain Facility are "absolute and unconditional." *See* 5.CR.893-95; 2.CR.427-28, 2435-36. The Agreements don't require Gander Mountain to open or operate a single day, generate a nickel in tax dollars, employ a single person, or pay any ad valorem tax. *Id.* And the Lease between Gander Mountain and the Foundation zealously confirms that fact:

> Tenant is **not** required to continuously operate the Premises or any portion thereof throughout or during any portion of the term of this Lease or any renewal thereof and no provision hereof may be deemed to impose any obligations or restrictions upon Tenant with respect to the operation of the Premises.

2.CR.383, ¶ 8.2 (emph added).

[22] *See also* Outlawing *Favoritism,* Tab 4.

The Agreements contained no metrics, indexes, clawback provisions, or termination options. Instead, the public funds were inexorably committed to pay for Gander Mountain's building loan, whether the store shuttered soon after opening or thrived.

In a sense, the Agreements contained *fewer* than no controls to protect the public's investment because the taxpayers were on the hook to repay a loan that could be, and was, extended and amended without the knowledge, consent, or approval of the City or the County, on terms they had no control over. 5.CR.893-95. 4.CR.652, 660.

Unlike the local government that contracted for ambulance services without ensuring reciprocal value, the Agreement did not give the City or County the right to stop public payments if the payments stopped serving the public. *See* TEX. ATT'Y GEN OP. KP-0435 (March 7, 2023). Stores and seawalls can both advance public purposes, but a dormant or shuttered store serves the economy as well as a damaged seawall protects Texas residents. *See* TEX. ATT'Y GEN OP. GA-0528 (2016). And unlike the contract in *Changas*, the Agreements did not limit the source of payments to sales-tax revenues generated by Gander Mountain. *Changas,* 670 S.W.3d at 498, n. 1 (if Changas never built, opened and operated a restaurant, it would receive no economic-development funds because it did not develop the economy, and when Changas stopped operating, it would likewise stop receiving any public funds).

The lack of any controls protecting Corsicana and Navarro County taxpayers stands in stark contrast to the robust and layered provisions protecting private profits. Gander Mountain kept its flexibility to open a store, or not, and to maximize its profits with absolutely zero of its actions constrained by the fact that ten million taxpayer dollars paid its loan to accomplish economic development. Meanwhile, Chase secured an ironclad "absolute and unconditional" right to be paid on terms it could amend without regard to the use of the building or any economic impact of any aspect of the transaction.

Indeed, it is worth repeating, even if Gander Mountain *never* hired a person or generated a sale, Chase would be repaid from sales-tax revenues generated by other stores. 5.CR.912, 916-17. Meanwhile, taxpayers were on the hook to pay for a building, on whatever terms Chase negotiated (and amended), and their obligation was emphatically disconnected from the only public purpose that justified it. 5.CR. 912, 916-17 (The taxpayers' obligation was "**absolute and unconditional**, and the [Respondents] shall make such payment without abatement, diminution or deduction **regardless of any cause or circumstances whatsoever** including, without limitation, any defense, set-off, recoupment or counterclaim which the

[Respondents] may have or assert against the Foundation or any other person.") (emph. added).

This contrast highlights the essence of the *TML* test, which allows private profits but ensures their collection remains incidental to the achievement of the public purpose. Petitioners insisted on subordinating public purpose by removing the only controls that would have existed.

3. Petitioners insisted on an agreement that protected everyone but taxpayers.

An earlier draft of the RCDAs contained one recognized control protecting taxpayers—a continued-operations clause. 2.CR.328, 330. That clause, which would have terminated payments for Gander Mountain's buildings upon the "cessation of the operation of Gander Mountain," was the only link between the public's economic-development-based obligation and Gander Mountain contributing to the development of the economy.

But even that was too much for Petitioners, who negotiated it away, insisting that taxpayers could stop paying the debt only "upon repayment of the debt," 2. CR.327; 5.CR.841, 891. They instead replaced the continuous-operations clause, a recognized *TML* control, with the opposite:

> Tenant is not required to continuously operate the Premises or any portion thereof throughout or during any portion of the term of this Lease or any renewal thereof and no provision hereof may be deemed to impose any obligations or restrictions upon Tenant with respect to the operation of the Premises.

2 CR 383, ¶ 8.2.[23]

Thus, rather than insisting on a contract containing the required controls to ensure enforceability, Petitioners negotiated away the only control to ensure that private profits in no way depended on the achievement of the public purpose. Indeed, that is why throughout this case, Petitioners have touted the *lack* of any scenario in which taxpayers would be relieved of their obligation to pay. 5.CR.911-12, 916-17, 893-95; 3.CR.427-28, 435-36. *Id.* And yet, Chase still advances as an alternative argument that the Agreements, while creating an absolute and unconditional obligation untied to any economic impact, contain other provisions that qualify as "sufficient controls to ensure that the public purpose [of economic development] is achieved." The Court of Appeals easily disposed of each of these attempts.

First, Chase has suggested, in various forms, that the existence of a contract, regardless of its terms, constitutes sufficient control. If that were the law, the *TML* test would be satisfied if *either* the government entered into any contract *or* retained

[23] The City and County were not parties to the Lease, were not involved in the negotiation of the Lease, and never saw the Lease until after Gander Mountain announced that it was closing its Corsicana store. 2 CR.428, 436.

sufficient control to protect the public's investment. Of course, that is not the law. Contracts function as controls if they contain terms that retain sufficient control. *See, e.g., Borgelt*, 692 S.W.3d at 310 (Busby, J. dissenting in part) ("The Gift Clause must be obeyed in reality, not just in form…any notional government control…has proven woefully inadequate to protect the government's investment of public funds."); *see also* TEX. ATT'Y GEN OP. KP-0435 (March 7, 2023) TEX. ATT'Y GEN. OP. JM-1255 *2,4-5; TEX. ATT'Y GEN. OP. DM-185*1. *See also* TEX. ATT'Y GEN OP LO-94-008 *2 (1994); TEX. ATT'Y GEN. OP. GA-0033 *7 (2003).[24] And if the Agreements had sufficient controls, this lawsuit wouldn't have been necessary. Respondents would have had contractual remedies, not Constitutional ones.

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[24] TEX. ATT'Y GEN. OP. JC-0582 *6 hammers home this point. There, the Opinion considered whether county money could be spent to support the operation of a museum owned and operated by a private party. The Opinion reasoned,

> …[A]lthough the lease agreement between the County and the Museum could have given the County greater control over the Museum's performance of its contractual obligations, **the lease agreement does require the Museum to operate the County's property as a museum**. The lease agreement would appear to place sufficient controls on the transaction to ensure that the public purpose--the operation of a museum--is carried out. *See* Tex. Atty. Gen. Op. JC-0439 (2001) at 2 ("A contract that imposes on the nonprofit organization an obligation to perform a function that benefits the public may provide adequate control.") (citing *Key v.Comm'rs Ct. of Marion County*, 727 S.W.2d 667, 669 (Tex. App.-Texarkana 1987, no writ) (per curiam)).TEX. ATT'Y GEN. OP. JC-0582 *6 (2002) (emph. added).

Depending upon the specific transfer of funds at issue, a contractual agreement outlining the requirements of the receiving entity must comply with in exchange for the funds may provide sufficient control over the funds . . . .TEX. ATT'Y GEN. OP. KP-0091 *2 (2016). The question, of course, is whether the rights and obligations ensure that the public purpose (here, economic development) is achieved.

As another "sufficient control," Chase cites several sections of the RCDAs and the Interlocal Agreement that require the Foundation and Gander Mountain to provide information to the City and County. No matter what information they received, Chase concedes, the City and County's absolute and unconditional obligation is unaffected. Receiving information that the economy is not being developed does not ensure that the economy is developed. Control requires the ability to act on the information received,[25] such as being able to terminate the contract if the public purpose is not being served. *See, e.g.,* TEX. ATT'Y GEN OP. KP-0435 (March 7, 2023) (contracts contain a termination option exercisable by the county), Tab 11.

Next Chase argues that the City and County maintain meaningful control because their unconditional payment must be placed into a certain bank account, called a "blocked account." But neither the City nor County had access to this account or its funds once they complied with their absolute and unconditional obligation to deposit tax revenues into the accounts. 5.CR.894-95, 912, 916-17. The control over the account resided with the Bank, which could unilaterally sweep the

[25] The Public Information Act provides an easy analogy. A government must provide categories of information to almost anyone who asks. *See generally* Public Information Act, Chapter 552 of the Government Code. The fact that the governmental entities must provide the information doesn't mean that those who ask have any control over the entity from whom they request the information. Nor does the City or the County's receipt of information from private businesses create any right to dictate those parties' conduct. That's what a contract with adequate controls is for.

account to make sure it was paid. 4.CR.663. Making unconditional payments into someone else's bank account is not control.[26]

Finally, Chase suggests that constitutionally sufficient control is found in the Agreements because none of the ad valorem taxes of the City or County may be drawn on to pay the bank. That is simply tautology. Of course Petitioners can't take money from ad valorem taxes; it isn't their money and wasn't part of this transaction. The City and County also retain control over retirement funds and paintings hanging in the courthouse, but control over other assets does not matter.

In sum, only one provision resembling a *TML* control has been mentioned, and it was negotiated *out* of the Agreements. Chase has also mentioned another provision[27] in the context of controls, but that argument, addressed below, misunderstands the nature of the required controls.

[26] In fact, the blocked account—which Respondents had no right to control—was then pledged to the Bank as security for the loan and used solely to pay principal and interest on the loan. 5.CR.895. The RCDAs and Interlocal Agreement, and the sales tax generated by those Agreements, were collateral for the Note. 4.CR.656. The Bank also had a security interest in the RCDAs, the Interlocal and the sales tax payments. 4.CR.663. The Bank's absolute control stands in stark contrast with its attempt to find any meaningful protection for taxpayers.

[27] Chase suggests that control might be found because the Agreements limit the use of the sales tax to paying for the construction of the Gander Mountain Facility, which is addressed in Sec. I(C)(1), directly below.

C. Chase's other arguments are unsound.

During this appeal, Chase had advanced various other arguments that can be grouped together in four parts for response. First, Chase argues about whether the "public purpose" was building one store or developing a larger area. Second, Chase parades the horrible consequences of applying the *TML* test to economic-development agreements. Third, Chase builds on this argument by relying on freedom-of-contract principles. And fourth, Chase maintains that it should prevail on public purpose. Each is addressed below.

1. <u>Economic development, not building construction, is the public purpose, and controls are required to link the two.</u>

Chase offers several theories of how the unconditional deal had actual controls to accomplish its intended public purpose. *Petitioner's Brief*, pp. 46-50.

First, Chase declares that "economic development is a legitimate public purpose." *Id.* at 48. But that truism doesn't explain how the deal had adequate controls to accomplish its intended purpose; it is tautology stating a legal point that was never in dispute.

Next, Chase suggests that the public purpose—for which the City and County assumed a $10 million obligation—was to develop the 132-acre business park. *Petitioner's Brief*, p. 49. Because, Petitioner reasons, it built a building—though later abandoned operating any business within it—some economic benefit was conferred and a public purpose was accomplished. *Id.*[28]

And yet, Chase strays from both the Agreements and its own concessions in fashioning this theory. At trial, Chase rightly acknowledged that the "purpose" of the economic development agreement was to entice Gander Mountain to build a store in Corsicana. 4.CR.639.[29] And that's correct. The funds weren't pledged for some general good; they were earmarked exclusively for the Gander Mountain Facility. 5.CR.910, 912, 912-14, 916, 918.

The "economic development" that would theoretically result (though was by no means subject to any controls to ensure it) was that Gander Mountain would operate, generating taxes and jobs, thereby ensuring the accomplishment of the economic development public purpose. Now, on appeal, Chase argues (wrongly) that

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[28] In this same vein, Chase suggests that tax dollars went to infrastructure broadly, not just Gander Mountain, to imply some other public purpose was achieved. *See Petitioner's Brief*, pp. 26, 47. But the money was "limited to the construction of real property," of the Gander Mountain Facility and could not be used for general infrastructure. 5.CR.911-12; 2.CR.340-41, 354 ("...all the moneys...shall be use[d] to construct the Gander Mountain Facility...").

[29] At trial, Chase and Gander Mountain insisted, consistent with the agreements, that the public purpose was the construction of the Gander Mountain Facility. 2.CR.232, 765 (Foundation stating that the "express public purpose" was the construction of the Gander Mountain Facility); *see also* 2.CR.257-58 (Gander Mountain noting same); *see also* 5.CR.837, 847 ("express public purpose of the financial incentives was to construct a store building..."). Having since realized the problem with that reasoning (that is, the documents), Chase has now changed course, arguing that the "public purpose" was the entire 132-acre business park, to suggest that taxpayers are still getting something for their money. *See, e.g.*, *Petitioner's Brief*, pp. 17, 19, 44; *see also Holy Cross Church of God in Christ v. Wolf*, 44 S.W.3d 562, 568 (Tex. 2001) ("Assertions of fact, not pleaded in the alternative, in the live pleadings of a party are regarded as formal judicial admissions...").

the "purpose" was to develop the entire retail area and then attempts to use that purpose inside the *TML* test. But funding a shuttered business on an unconditional obligation comes up short.

Finally, Chase argues that the construction of the building was the ultimate public purpose, and therefore, a deal that requires money to be directed solely to that end contains all the necessary controls by its very nature. *Petitioner's Brief*, p. 55.

But simply stating *what* money can be spent for imposes no controls on *how* a government ensures that public purpose is accomplished. Declaring that money will be funneled towards a sea wall, a business, a restaurant, a law firm, or a building fails to provide any actual controls to see that a public purpose comes from that spending. TEX. ATT'Y GEN OP. GA-0528 (2016) ("…the City must retain enough control over the project to ensure that the public purpose is accomplished and the public interest protected…."); TEX. ATT'Y GEN OP. KP-0435 (March 7, 2023); TEX. ATT'Y GEN OP. KP-099. A privately owned retail building isn't a public purpose. The public purpose is what happens in the building—generation of sales and ad valorem taxes, the creation of jobs, etc. A deal must do more than simply state what money will be spent on; to satisfy the *TML* test, a government must possess adequate controls to ensure the realization of a public purpose. *See Borgelt*, 692 S.W.3d at 318. When the government seeks to advance economic development by doing something, the public purpose does not *become* that something. Chase's rationale is another variant of the "we had a contract, so we had controls" argument. But the Constitution requires more than some notional recitation of purpose or control; both must exist in reality. Here, the Agreements do neither.

In short, simply funding the construction of a private building does not meet these requirements without enforceable mechanisms linking the expenditure to measurable economic outcomes. Instead, controls are required to ensure the achievement of the *public purpose* (economic development) that justified the public spending. That is how clawbacks, benchmarks, and the like work—they measure things like number of residents employed, sales-tax generated, ad valorem tax generated and other measures of whether the chosen means are advancing economic development.

Here, the Agreements fail to include even basic safeguards. The obligation to fund the Gander Mountain facility was "absolute and unconditional," regardless of whether the business ever generated sales, created jobs, or contributed to economic development. Thus, whether the goal of the transaction was to develop a retail center or build a store, the transaction was required to retain for the government enough control to ensure that paying millions of dollars for a private business achieved the only purpose for which such payment could be made—economic development.

2. <u>Other legal principles prevent the government from exploiting the *TML* test.</u>

Chase's concerns about windfalls and government exploitation are also assuaged by the law that has developed over hundreds of years to prevent just such opportunism.

Private parties have long been on notice that governmental contracts are void if they violate limits on what the government can do with taxpayers' money. *Base-Seal, Inc.*, 901 S.W.2d at 788 . And it must be that way. If such illegal agreements were enforceable against the government, taxpayer protections would become empty gestures. *See Borgelt*, 692 S.W.3d at 310 (taxpayer protections must be protected in reality not merely formality). Government officials could sidestep constitutional spending safeguards simply by making a contract with a willing private entity, leaving taxpayers to foot the bill for unauthorized spending. That would force taxpayers to fund exactly the kinds of imprudent projects the Constitution was designed to prevent. Restatement (Third) of Restitution and Unjust Enrichment §§ 33, cmt. d. It would also incentivize private parties to ignore red flags, since they could still collect on deals that should never have existed.

But the void status of a contract does not, as Chase argues, create opportunities for windfalls and exploitation from governments. When a government contract is void, it of course removes the government's obligation to *continue* performing under the agreement. *Id.* cmt. d. That is, no prospective performance is due under a void contract. But that does not mean the government can retain a public benefit and get a refund of its money, or otherwise stop performing at a time when doing so would leave it unjustly enriched. Restatement (Third) of Restitution and Unjust Enrichment §§ 33, 16. As the comments explain:

> *a. General principles and scope; relation to § 16.* *** Rules governing the enforceability of an executory contract are not part of the law of restitution. By contrast, a restitution issue is presented whenever there has been performance on either side of a contract that is determined to be unenforceable because of the incapacity of either of the parties. Performance may have been rendered by the incapacitated party, by the other party, or by both. When an incapacitated party repudiates a contract on the basis of incapacity, a claim to recover property transferred or the value of a performance already rendered is governed by § 16. Section 33 describes the converse claim in restitution: the claim to recover the value of a contractual performance rendered to a party who is excused, by reason of incapacity, from rendering the promised counterperformance—or who is permitted to reclaim it under § 16.

The solution to Chase's concerns is not to make taxpayers pay for contracts entered into in violation of the laws meant to protect them:

> The obligation to do justice rests upon all persons, natural and artificial, and if a county obtains the money or property of others without authority, the law, independent of any statute, will compel restitution or compensation. But this is a very different thing from enforcing an obligation attempted to be created in one way, when the statute declares that it shall only be created in another and different way.

Marsh v. Fulton Cnty., 77 U.S. 676, 684, 19 L. Ed. 1040 (1870); *accord City of Houston v. Finn*, 139 Tex. 111, 114–15, 161 S.W.2d 776, 777–78 (1942); *Hayward v. City of Corpus Christi*, 195 S.W.2d 995, 1004–05 (Tex. Civ. App. 1946, writ ref. n.r.e.); *Penn v. City of Laredo,* 26 S.W. 636, 636 (Tex. Civ. App. 1894).[30]

Thus, while a private party cannot enforce a void contract against the government to obtain the benefit of an illegal contract, the party *can* prevent the types of opportunism Chase imagines. *See, e.g.*, *City of San Antonio v. French*, 16 S.W. 440, 441 (1891). Equity, of course, will consider benefits conferred, the good faith of those involved, and the purpose of the legal protections violated. Restatement § 33 (3) &

[30] *See also United States v. Walker*, No. 1:11-CR-67, 2011 WL 6181468, at *3 (E.D. Tex. Dec. 13, 2011) (The law presumes that such a contractor knew that his "contracts," or agreements to work, on the projects in question violated the law. This may seem harsh, but history teaches that local officials frequently can not resist the temptation of sweetheart contracts, kickbacks, and awards to friends and family. This relatively light burden on contractors, combined with quantum meruit recovery, as discussed below fairly balances public policy concerns."). Modern courts often use the term "implied contracts" to explain the same. *Richmond Printing v. Port of Houston Auth.*, 996 S.W.2d 220, 224 (Tex. App. 1999) ("Where a governmental entity receives benefits under a void contract because it was not made in conformity with the Constitution or a state statute, it will be liable on an implied contract for the reasonable value of benefits." (citing *Harris Cnty. v. Emmite*, 554 S.W.2d 203, 204–05 (Tex. Civ. App. 1977), dismissed (Nov. 16, 1977)).

cmt. c (explaining that recovery must be measured by value conferred, not cost to the other party, because equity cannot hold taxpayers liable for a contract that violates a law designed to protect against those very risks (of imprudent borrowing and expenditure)); *Sluder v. City of San Antonio,* 2 S.W.2d 841, 845 (Tex. Comm'n App. 1928). Equity will neither allow exploitation nor prioritize those who seek to profit from illegal contracts.

Chase has already collected more than nine million dollars of taxpayer money after negotiating an agreement that violated three decades' worth of precedent. When Gander Mountain closed, then-current local officials stopped performing prospectively. 2.CR.321. Taxpayers don't have to send millions more to fund Chase's unconditioned expectations.

To go just one step further for clarity, on determining the Agreements were void, local officials could not rely on the contractual obligation to continue sending taxpayer money to Chase. *Moore v. City of Beaumont*, 195 S.W.2d 968, 985 (Tex. App.—Beaumont 1946), aff'd, 146 Tex. 46, 202 S.W.2d 448 (1947) ("It is ordinarily the duty of city officers to repudiate such ultra vires agreements, and it is always the business of one who deals with the city to ascertain what agreements city officers can, and cannot make and be governed accordingly."). At that point—and only because the contract failed—the local government could *not* send the public money unless it found doing so would achieve a public purpose and it retained sufficient controls.[31] The City and County did so and stopped performing, but did not seek a refund of their money.[32]

In summary, taxpayer protections protect taxpayers over the private profits of those who contract in violation of those protections. But equity has long policed this exact scenario and prevents the exploitative opportunities Chase fears. Instead, Chase disguises its quest for profits as a concern about others being exploited. Its fears are unfounded, and, as explained below, Chase is on the wrong side of the incentives argument.

3. The only dangerous or disruptive precedent that could emerge from this case would come from accepting Chase's freedom-of-contract arguments.

Chase has loudly sounded the alarm, predicting the demise of economic development if this Court affirms both lower courts and strikes down what Chase describes as a "conventional economic agreement." *Petitioner's Brief*, p. 65.[33] Although Chase does not define that phrase, even its colloquial use seems misplaced

[31] They decided, for obvious reasons, that sending the money would not achieve the public purpose of economic development. That decision is entitled to deference, as noted further below. Sec. I(C)(4).
[32] In line with this reasoning, the "implied finding" Chase complains about is relevant only if the City or County had tried to seek a repayment of past funds, which they did not.
[33] Chase repeatedly accuses the courts below of rewriting the agreements. *Petitioner's Brief*, pp. 15, 17, 19, 26, 44, 52, 56. The courts didn't rewrite them; they applied them as written then invalidated them.

because, for starters, these Agreements followed none of the conventions that, for decades, have been included in such agreements because of a shared recognition that their inclusion was constitutionally required.

To be sure, Chase would like this Court to view the Agreements as "conventional," to frame this case as holding the fate of "conventional economic agreements." *See, e.g.*, *In re The State of Texas*, No. 24-0325 (June 14, 2024, Opinion) ("…section 52-a removed doubt about the constitutionality of *conventional* economic-development grants…") (emph. added). But such a framing is impossible to reconcile with Chase's pivot to explaining *why* these Agreements, though *not* conventional, are still okay. *Response*, p. 65 (Suggesting the [missing] standard conventions protecting taxpayers are "best practices" not constitutionally compelled).

Petitioner's predicament is one made by defying convention while the rest of the economic-development universe has been complying with the *TML* test. Before Chase's overreach, there was no body of contrary law or commentary suggesting problems with the test. The lower courts here simply applied CLE-level basic principles to a situation that arises infrequently because most businesses do not negotiate the recognized controls out of agreements.

The *TML* test presents no threat to economic development, except in those transactions where taxpayer protections are a deal-breaker for profit seekers. The *TML* test is already built into the Texas Enterprise Fund, administered by the Governor's Office, which awards economic development grants.[34] Consistent with constitutional safeguards, the program places significant conditions on participants. The rules mimic the TML test factors and provide:

> …all TEF awardees must sign a grant contract with the state which legally obligates the company to fulfill, among other things, projected job creation and average wage commitments. No TEF funds are disbursed until after grantees sign a grant contract and meet their respective job and wage targets for each individual period (typically annually). Grantees are required to maintain these job and wage figures throughout the term of the contract. In the event a grantee fails to do so or fails to meet other terms of the grant contract, certain contract provisions allow the Governor's Office to demand repayment of previously disbursed grant funds in the form of clawbacks.

Similarly, tax abatement agreements—perhaps the most commonly used economic development tool—incorporate the *TML* control requirement. A municipality may enter into an agreement to abate taxes when the owner of the property agrees to make certain improvements or repairs, typically in connection with a larger economic-development initiative; but the agreement must contain

[34] *Texas Enterprise Fund,* Texas Economic Development & Tourism, https://gov.texas.gov/business/page/texas-enterprise-fund (last visited June 12, 2024).

certain provisions to protect the public's investment. TEX. TAX CODE §312.204; TEX. TAX CODE § 312.205 (requiring agreements to "provide for recapturing property tax revenue lost").

While the opinion below disrupts nothing, Chase's argument about elevating "freedom of contract" is dangerous. *Petition*, p. 31. It misunderstands the reason for the *TML* test and, candidly, is not even a superficially workable approach to government contracting.

When private parties contractually gamble with their own money, courts rightly ignore (with some limits not at issue here) what protections one side negotiated for, what purpose the contract serves, or whether one party negotiated a bad deal. Parties obligating themselves need not worry, generally speaking, about courts supervising their bargains.

But the *TML* test—along with countless other principles in every jurisdiction—exists because government officials aren't risking their own money. They are committing the money of, not only present taxpayers and constituents, but also future taxpayers who end up paying for benefits never experienced on terms negotiated by past officials.[35] Mulligan, 11 Harv. L. & Pol'y Rev S13 (2017), Tab 6

[35] So important are these protections that it is one of the few instances in which Texas law affords standing to individual taxpayers to enjoin unconstitutional deals spending their money. *See, e.g. Jones v. Turner*, 646 SW 3d 319, 323 (Tex. 2022) (Taxpayer has standing if a plaintiff can show that the plaintiff is a taxpayer and that public funds are being expended on an allegedly illegal activity).

(explaining that governments find themselves in a "prisoners dilemma" in which they have little choice but to offer a subsidy to the requesting business); *Outlawing Favoritism*, Tab 4.

Accordingly, the *TML* test's imposition on "freedom of contract," is not accidental, or even incidental. It's the entire point. The *TML* test is an established and welcome deterrent against those who seek to impose absolute and unconditional obligations on taxpayers. While principles of equity prevent the government from seeking windfalls or bad-faith recoveries, Chase is simply on the wrong side of the incentives argument. As between an overreaching company and taxpayers, the law always has, should, and hopefully will, continue to send messages like the 10th Court of Appeals did in this case. Businesses should know that, while the *TML* test has not proven burdensome over thirty years, its modest taxpayer protections have teeth, and they will not find among Texas courts a receptive audience when they seek to enforce bargains against Texas taxpayers forbidden by the Texas Constitution.

4. The City and County's determination that the public purpose ceased is entitled to deference.[36]

In determining whether a public purpose exists, a local government's legislative determinations are entitled to deference. *See Davis v. City of Lubbock*, 326 S.W.2d 699, 704, 709, 713 (Tex. 1959); *Housing Auth. of City of Dallas v. Higginbotham*, 143 S.W.2d 79, 85 (Tex. 1940) (a determination of public purpose by a legislative body, like the City Council or Commissioners Court, is entitled to great weight and is highly persuasive).

Unless the City and County acted capriciously, arbitrarily, fraudulently, or illegally, their findings that the public purpose has ceased should stand. *Higginbotham*, 143 S.W.2d at 85; *see also Wagoner v. City of Arlington*, 345 S.W.2d 759, 763 (Tex.Civ.App.–Fort Worth 1961, writ ref'd n.r.e). An action is not arbitrary or capricious when exercised honestly and upon due consideration, no matter how strongly a party believes that an erroneous conclusion was reached. *Ludewig v. Houston Pipeline Co.*, 773 S.W.2d 610, 614 (Tex.App.–Corpus Christi 1989, writ denied); s*ee also City of Austin v. Whittington*, 384 S.W.3d 766, 782 (Tex. 2012).

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[36] The Bank argues that "the City and County have never challenged or attempted to discredit their initial 2004 determination that the grant served a public purpose." *Petitioner's Brief,* at p. 50-51. The City and County have repeatedly pointed out that the original public purpose justifying the payment of public funds to the Bank ceased when Gander Mountain closed. The City and County's determination that the public purpose had ceased, and the consequential decision to stop paying public funds, was in the Motion for Partial Summary Judgment, 2.CR.308-09, and in the briefs in below. In any event, the determination that the public purpose had ceased reflected reality, which justified the City's and County's second set of resolutions.

After the shuttering of Gander Mountain, Gander Mountain not only ceased fulfilling the public purposes for which it received sales taxes, but the bankruptcy and rejection of its lease (and ability to operate) made it impossible to ever do so in the future. 6.CR.1052. Given this reality, the Corsicana City Council and Navarro County Commissioners Court properly convened a Joint Special Meeting on February 2, 2016, and determined that the requisite public purpose of the RCDAs and the Interlocal Agreement was no longer being fulfilled as required by the Texas Constitution. See 2.CR 418-425, 430-33. Respondents had no choice but to stop funding the sales tax grants. *See Turken v. Gordon*, 224 P.2d 158, 167 (Sup. Ct. Arizona 2010) (viewing failing to achieve a sufficient public purpose as a failure of consideration). *See also* State Constitutions: Freedom's Frontier, Cato Supreme Court Review, Bolick p.15 (November/December 2016). Tab 12.

On this backdrop, the lower courts correctly held that the Agreements failed a public purpose analysis. *Corsicana Indus. Found., Inc.*, 685 S.W.3d at 185. As both law and facts bear out, the failure to include adequate controls can reshape an intended public purpose to an exclusively private benefit when the public purpose is no longer being fulfilled. *See Borgelt*, 692 S.W.3d at 318 (Busby, J. dissenting in part) ("the government must *require* that the funds serve a public purpose by actually implementing 'adequate contractual or other controls' to '*ensure* its realization'") (emphasis added in opinion). And Respondents determination, which is entitled to deference, tracks that reality.

While Chase repeatedly emphasizes that the *initial* determination of public purpose should be afforded great weight, it affords far less deference to the later determination that the public purpose ceased. *Petitioner's Brief*, pp. 50-51. But both carry the same weight and are entitled to deference.

In short, this Court can affirm the lower court's conclusion that the Agreement failed the public purpose analysis but can also affirm by limiting the scope of review to whether Respondents properly exercised their power in determining whether the public purpose that authorized the transaction had ceased. Both approaches are supported by the law and facts and lead to the same place. *See Davis*, 326 S.W.2d at 712. In either circumstance, affirming the lower court is proper.

CONCLUSION AND PRAYER

Denying this Petition sends exactly the right message to those who insist on structuring transactions to absolutely and unconditionally protect everyone but the taxpayers. After all, it is their money. Respondents ask this Court to deny review, as the taxpayers have paid enough already for a shuttered store. Alternatively, if the Court grants review, Respondents ask the Court to affirm the taxpayer protections of the *TML* test and affirm the lower court's decisions.

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CERTIFICATE OF COMPLIANCE

In compliance with the Texas Rule of Appellate Procedure 9.4(i)(2)(D), the undersigned certifies that the number of words in this brief, including footnotes and text boxes, and excluding those matters listed in Rule 9.4(i)(1), is 14,874. This brief also complies with the typeface requirements of Tex. R. App. P. 9.4(e) because it has been prepared in a proportionately spaced typeface using Microsoft Word 360 in 14-point font for the body and 12-point font for the footnotes.

/s/ Tyler Talbert
Tyler Talbert

APPENDIX

Tab 1

Texas Municipal League
Economic Development Handbook

2022 Editor

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A home rule city may grant public money from authorized sources to a Type A or Type B economic development corporation under a contract authorized by Section 380.002 of the Local Government Code. The Type A or Type B economic development corporation is required to use the money for "the development and diversification of the economy of the state, elimination of unemployment or underemployment in the state, and development and expansion of commerce in the state."[967]

To establish a loan or grant, or to offer discounted or free city services, a city must meet the requirements contained in the Texas Constitution and in applicable Texas statutes. Additionally, a city must review its city charter and any other local provisions that may limit the city's ability to provide such a grant or loan. A discussion of these issues follows.

Ensuring that a Public Purpose is Served by the Incentive

First, any expenditure in the form of a grant, loan or provision of city services at less than fair market value involves a donation of public property. Article III, Section 52-a of the Texas Constitution sets up the constitutional framework for public funding of economic development efforts. It provides that economic development is a public purpose. However, a city may not simply write out checks to interested businesses in order to promote economic development. The city should ensure that the public purpose of economic development will be pursued by the business. For example, if a city provides a grant or a loan to an industry, the city should enter into a binding contract with the funded industry that outlines what steps the business will take that justify the provision of public funding (creation of jobs, expansion of the tax base by construction or enhancement of the physical facilities, etc.). The city should include a recapture provision in the agreement so that if the business does not fulfill its promises, the city will have a right to seek reimbursement of the incentives that were provided. Any such agreement should also include tangible means for measuring whether the industry has met its obligations under the contract. Without these safeguards and a demonstrable benefit to the municipality, such incentives may not pass constitutional muster for serving a public purpose.[968]

Requirements Under the Local Government Code

Any grant or loan must also meet certain statutory requirements. Chapter 380 of the Local Government Code requires that in order for a city to provide a grant or a loan, it must "establish a program" to implement the incentive. The program may be administered by city personnel, by contract with the federal government, the state, or a political subdivision or by contract with any other entity. The applicable statutes do not indicate specifically how such a program is to be administered. It is safe to expect that the program should be planned and outlined in a written document that includes, at a minimum, the safeguards discussed above.

Additionally, any such grant or loan must meet the requirements under the budget law contained in Chapter 102 of the Local Government Code. Specifically, any economic development-related

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967 Tex. Loc. Gov't Code § 380.002(b).

968 *See* Tex. Att'y Gen. Op. No. GA-529 (2007) (City may fund housing project if it finds the project will promote economic development). *See also* Tex. Att'y Gen. LO-94-037 at 3, LO-97-061 at 4 (These two opinions do not concern the establishment of economic development programs under the authority of Local Government Code Chapter 380. However, their reasoning applies to any grant or loan of public money for economic development, regardless of the authority under which such a grant or loan is made.).

resources.[1043] It should be noted that the County Purchasing Act allows the county to exempt these program contracts from competitive bidding requirements.[1044]

The attorney general has concluded that Section 381.004 does not authorize a county to simply provide funds to existing non-county programs, even if those programs are directed at economic development. Rather, any program funded under this section must be initiated by the county and must be administered either by the county or by an entity under contract with the county.[1045] The commissioners court is authorized to make loans, grant public money, or provide county personnel and services to permissible Chapter 381 economic development programs.[1046]

Also, counties may form a county alliance corporation under state law through the Development Corporation Act.[1047] A county alliance corporation is simply a nonprofit corporation formed by a county alliance of two or more counties to pursue economic development.[1048] The corporation is governed by a board of directors who are appointed by and serve at the pleasure of the commissioners court of each county in the alliance.[1049] Unlike cities with economic development corporations, counties do not have the authority to levy a sales tax for economic development for the corporation's use.

County Ability to Provide Loans or Grants

Counties are constitutionally prohibited from granting "public money or anything of value in aid of, or to any individual, association or corporation whatsoever"[1050], unless the Legislature authorizes a county to undertake programs to provide for loans and grants of public money.[1051] The purpose of these programs can be for the: development and diversification of the state's economy, elimination of unemployment, stimulation of agricultural innovation, and development of transportation or commerce.

Chapter 381 of the Local Government Code allows counties to make loans or grant public monies for permissible Chapter 381 economic development programs.[1052] Like cities, counties must maintain sufficient control over the way these funds are spent. To ensure such control, a county would be well advised to execute a formal contract between the county and the entity that spends the funds, outlining the respective rights and duties under the agreement. Additionally, the county would want to include a recapture provision outlining how the county would be reimbursed for any incentives it provided if the funded entity is ultimately unable to meet its commitments.

1043 *Id.* § 381.004(c)(4).
1044 *Id.* § 262.024(a)(10).
1045 Tex. Att'y Gen. LO-98-007 (1998).
1046 Tex. Loc. Gov't Code § 381.004(h).
1047 *See id.* §§ 506.001 *et seq*.
1048 *Id*. §§ 506.001, .002.
1049 *Id.* §§ 506.051, .053.
1050 Tex. Const. art. III, § 52(a).
1051 Tex. Const. art. III, § 52-a.
1052 Tex. Loc. Gov't Code § 381.004(h).

Tab 2

Chapter 380 of the Texas Local Government Code

Texas City Attorneys Association
Riley Fletcher Basic Municipal Law Seminar
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Prepared and Presented by:

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What are chapter 380 grants?

Chapter 380 is a reference to chapter 380 of the Texas Local Government Code. This chapter of the Texas Local Government Code authorizes Texas municipalities, both home-rule and general law municipalities to provide assistance for economic development. Texas cities may provide monies, loans, city personnel, and city services for promotion and encouragement of economic development.

What type of assistance may a city provide under chapter 380 of the Local Government Code for economic development?

Cities are authorized to "provide for the administration of one or more programs, including programs for making loans and grants of public money and providing personnel and services of the municipality." Nonetheless, the programs must serve the purpose of promoting state or local economic development by stimulating business and commercial activity within the city, within the extraterritorial jurisdiction (or "ETJ") of the city, or an area annexed by the city for limited purposes.[1]

What constitutes serving a public purpose?

The Texas Constitutional requires all expenditures of municipal funds serve a "public purpose."[2] Accordingly, expenditures pursuant to chapter 380 programs must also serve a public purpose. Prior to 1987, Texas cities did not have constitutional authorization to provide economic assistance to businesses for economic development. In 1987, the Texas voters approved a constitutional amendment which provided that grants of monies for economic development may serve a "public purpose." Article III, section 52-a of the Texas Constitution authorizes "the making of loans and grants of public money . . . for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state . . . or the development or expansion of transportation or commerce in the state."[3] Further, any transaction providing public monies must contain sufficient controls "to insure that the public purpose [is] carried out."[4]

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[1] TEX. LOC. GOV'T CODE ANN. § 380.001(a) (as amended by Texas House Bill 918, 79th Legislature, Regular Session (2005) (effective date May 17, 2005)).

[2] TEX. CONST. art. III, § 52(a). *See also, Texas Mun. League Intergovernmental Risk Pool v. Tex. Workers' Comp. Comm'n,* 74 S.W.3d 377, 384 (Tex. 2002) ("A political subdivision's paying public money is not gratuitous, within meaning of state constitutional provision prohibiting gratuitous payments to individuals, associations, or corporations, if the political subdivision receives return consideration.").

[3] TEX. CONST. art. III, § 52-a.

[4] Tex. Att'y Gen. Op. No. JM-1255 (1990) at 8-9.

Is there a durational limitation on economic assistance provided under chapter 380 of the Texas Local Government Code?

Unlike tax abatements which are limited to ten (10) years,[5] chapter 380 of the Local Government Code does not contain a durational limitation. Consequently, some Texas cities have entered into 380 agreements which extend beyond ten (10) years. Whether your particular city has a durational limitation may be controlled by a home-rule city charter or other local provision.

Can you abate delinquent taxes under chapter 380 of the Local Government Code?

Article III, section 55 of the Texas Constitution provides that the legislature "shall have no power to release or extinguish, or to authorize the releasing or extinguishing, in whole or in part, the indebtedness, liability or obligation of any corporation or individual, to this State or to any country or defined subdivision thereof." Consequently, in a Texas Attorney General opinion, the Attorney General concluded "section 380.001(a) of the Local Government Code does not authorize a municipality, as part of an economic development program, to agree to abate a taxpayer's delinquent taxes."[6]

Can a City provide a municipal sales tax rebate as a form of chapter 380 grant?

Many cities may condition the grant or loan of public monies based upon estimated sales tax revenue generated by the business prospect. In a recent Texas Attorney General opinion, the Attorney General considered whether recent legislative changes prevented Texas cities from providing chapter 380 grants in the form of a sales tax rebate.[7] The Attorney General concluded the "Local Government Code authorizes municipalities to refund or rebate municipal sales taxes and otherwise expend public funds for certain economic development purposes."[8] Further, the recent legislative change "does not invalidate existing tax rebate contracts, nor does it prohibit municipalities from executing new ones."[9]

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[5] TEX. TAX CODE ANN. § 312.204(a) (Vernon Supp. 2004-05).

[6] Tex. Att'y Gen. Op. No. LO-95-090 (1995).

[7] Tex. Att'y Gen. Op. No. GA-0071 (2003).

[8] Tex. Att'y Gen. Op. No. GA-0137 (2004) at 1.

[9] *Id.* at 4.

Can a City provide section 4A or 4B economic development corporations city funds for economic development?

A home-rule municipality may provide public money to a section 4A or section 4B corporation.[10] Nonetheless, the grant of public monies must be pursuant to a contract. Further, the development corporation must use the grant money for the "development and diversification of the economy of the state, elimination of unemployment or underemployment in the state, and development and expansion of commerce in the state."[11]

[10] TEX. LOC. GOV'T CODE ANN. § 380.002(b).

[11] *Id.*

Chapter 380 of the Texas Local Government Code

✵ Section 380.001(a) as amended by Texas House Bill 918, 79th Legislature, Regular Session (2005) (effective date May 17, 2005)

§ 380.001. ECONOMIC DEVELOPMENT PROGRAMS.

(a) The governing body of a municipality may establish and provide for the administration of one or more programs, including programs for making loans and grants of public money and providing personnel and services of the municipality, to promote state or local economic development and to stimulate business and commercial activity in the municipality. <u>For purposes of this subsection, a municipality includes an area that:</u>

<u>(1) has been annexed by the municipality for limited purposes; or</u>

<u>(2) is in the extraterritorial jurisdiction of the municipality.</u>

(b) The governing body may:

(1) administer a program by the use of municipal personnel;

(2) contract with the federal government, the state, a political subdivision of the state, a nonprofit organization, or any other entity for the administration of a program; and

(3) accept contributions, gifts, or other resources to develop and administer a program.

(c) Any city along the Texas-Mexico border with a population of more than 500,000 may establish not-for-profit corporations and cooperative associations for the purpose of creating and developing an intermodal transportation hub to stimulate economic development. Such intermodal hub may also function as an international intermodal transportation center and may be collocated with or near local, state, or federal facilities and facilities of Mexico in order to fulfill its purpose.

Added by Acts 1989, 71st Leg., ch. 555, § 1, eff. June 14, 1989. Amended by Acts 1999, 76th Leg., ch. 593, § 1, eff. Sept. 1, 1999.

§ 380.002. ECONOMIC DEVELOPMENT GRANTS BY CERTAIN MUNICIPALITIES.

(a) A home-rule municipality with a population of more than 100,000 may create programs for the grant of public money to any organization exempt from taxation under Section 501(a) of the Internal Revenue Code of 1986 as an organization described in Section 501(c)(3) of that code for the public purposes of development and diversification of the economy of the state, elimination of unemployment or underemployment in the state, and development or expansion of commerce in the state. The grants must be in furtherance of those public purposes and shall be used by the recipient as determined by the recipient's governing board for programs found by the municipality to be in furtherance of this section and under conditions prescribed by the municipality.

(b) A home-rule municipality may, under a contract with a development corporation created by the municipality under the Development Corporation Act of 1979 (Article 5190.6, Vernon's Texas Civil Statutes), grant public money to the corporation. The development corporation shall use the grant money for the development and diversification of the economy of the state, elimination of unemployment or underemployment in the state, and development and expansion of commerce in the state.

(c) The funds granted by the municipality under this section shall be derived from any source lawfully available to the municipality under its charter or other law, other than from the proceeds of bonds or other obligations of the municipality payable from ad valorem taxes.

Added by Acts 1991, 72nd Leg., ch. 16, § 13.06(a), eff. Aug. 26, 1991. Amended by Acts 1991, 72nd Leg., 1st C.S., ch. 4, § 25.02, eff. Aug. 22, 1991; Acts 2001, 77th Leg., ch. 56, § 1, eff. Sept. 1, 2001.

§ 380.003. APPLICATION FOR MATCHING FUNDS FROM FEDERAL GOVERNMENT.

A municipality may, as an agency of the state, provide matching funds for a federal program that requires local matching funds from a state agency to the extent state agencies that are eligible decline to participate or do not fully participate in the program.

Added by Acts 1995, 74th Leg., ch. 1051, § 1, eff. June 17, 1995.

Article III, Section 52-a of the Texas Constitution (as amended November 8, 2005)

Sec. 52-a. Notwithstanding any other provision of this constitution, the legislature may provide for the creation of programs and the making of loans and grants of public money, other than money otherwise dedicated by this constitution to use for a different purpose, for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state, the stimulation of agricultural innovation, the fostering of the growth of enterprises based on agriculture, or the development or expansion of transportation or commerce in the state. Any bonds or other obligations of a county, municipality, or other political subdivision of the state that are issued for the purpose of making loans or grants in connection with a program authorized by the legislature under this section and that are payable from ad valorem taxes must be approved by a vote of the majority of the registered voters of the county, municipality, or political subdivision voting on the issue. A program created or a loan or grant made as provided by this section that is not secured by a pledge of ad valorem taxes or financed by the issuance of any bonds or other obligations payable from ad valorem taxes of the political subdivision does not constitute or create a debt for the purpose of any provision of this constitution. An enabling law enacted by the legislature in anticipation of the adoption of this amendment is not void because of its anticipatory character.

Tab 3

THE GIVE AND TAKE OF DEVELOPMENT AGREEMENTS

Olson & Olson LLP

11th Annual Local Government Seminar

January 29, 2015

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The Give and Take of Development Agreements

The purpose of this paper is to outline some of the ways local governments partner with the private sector. Many matters mentioned here are complex and may require detailed analysis in a given situation. The following is to assist local officials determine how best to proceed with the decision making process when dealing with a developer, business owner or landowner and when considering entering into a contractual relationship with them.

I. Development Agreements - Generally.

Development Agreement can mean any contract entered into between a governmental entity and a private one. Most often, development agreements are entered into by a local governmental entity and the landowner, developer or prospective business. Development agreements can create a mechanism for a community to ensure development occurs in a manner consistent with good planning and maximizes the benefits of a development in situations and in ways that the local entity would not otherwise be able to do, such as controlling the type and rate of growth in a city's extra territorial jurisdiction. Such an agreement can incent by rewarding certain types of development or the rate of a development, and at other times a development agreement can regulate or limit the type and way in which development occurs. Sometimes development agreements can do a combination of these.

Below are a few of the many statutory authorizations for development agreements available to local entities. Each has its own scope of authority. The listing is not exhaustive and is intended as a sampling. Sometimes a development agreement may be coupled with one or more other mechanisms to optimize the desired results of both parties, depending on the circumstances and complexity:

1. Subchapter G. Section 212.171 et seq Texas Local Government Code: Agreements under this subchapter are sometimes referred to as "Non-Annexation Agreements" or "ETJ Agreements."
2. Chapter 380 Texas Government Code: This is the statute adopted specifically to implement Texas Constitution Article III Section 52a[1] and is arguably the broadest and most flexible.

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[1] *See generally* testimony of Representative McCollugh, author of House Bill 3192, before the House Committee on Urban Affiars, 71st Leg. (May 15, 1989).

3. Section 43.0751 Texas Local Government Code: These are strategic partnership agreements entered into between a city and a conservation and reclamation district operating under Chapter 49 Texas Water Code, such as with a municipal utility district.

4. 212.071 Texas Local Government Code: Also sometimes known as development participation agreements, this section is an exception from following the competitive sealed bidding procedure for the construction of certain improvements constructed by a developer depending on the percentage paid by the city and the developer, and whether the improvement relates to oversizing.

5. Chapters 311 & 312 Tax Increment/Tax Abatement agreements. These create incentives to landowners directly tied to performance and can be combined with other types of development agreements.

6. Chapters 501-507 Texas Local Government Code: Economic development corporations may enter into performance agreements in accordance with the provisions of these statutes and pursuant to a corporation's articles, bylaws and election order.

7. Chapter 552 Texas Local Government Code: Utility systems agreements to provide water, sewer, gas, or electric service outside a city's boundaries.

8. Chapter 395 Texas Local Government Code: Impact fee agreements providing for the time and method of payment of impact fees.

9. 42.046 Texas Local Government Code: Planned unit development district agreements for territory that has been disannexed by a city previously annexed for limited purposes may designate an area within its extraterritorial jurisdiction as a planned unit development district.

10. Chapters 2267 and 2268 Texas Government Code: Created by the Texas legislature in 2011, these chapters create methods for public and private partnerships to form to provide "qualified facilities" for public use.

11. Chapter 431, subchapter D, Texas Transportation Code: Through formation of a local government corporation allows various transactions and agreements to occur with more flexibility.

12. Chapter 2303.5055 Texas Government Code: Through creation of an enterprise zone agreements can be entered into relating to refund, rebate or payment of tax proceeds for hotel projects.

13. Chapter 43 Texas Local Government Code: Annexation agreements.

II. Preparation.

a. Be prepared. Being prepared before an opportunity presents itself can be of great help. Before negotiating a development agreement, cities and other local entities should assess the needs of their community. This means understanding what they have to offer a prospective private partner, and also what they have that may detract a prospective private partner from developing, expanding or locating within its borders. The more prepared a community is, the bigger the role it will have in shaping its future and in controlling how a future developer or business will impact them. A business may be knowledgeable about its industry, but a local entity will know how to make it blend with an existing community in a way that can maximize the strengths of both parties.

How do you do this? Cities can prepare by doing one or more of the following:

- Comprehensive plans. Create or update comprehensive plans or elements of comprehensive plans such as thoroughfare plans, drainage plans, park plans, trail plans, etc.
- Market and other studies. Perform market studies or needs assessments, including those provided by outside vendors.
- Workshop. Have city council or assign a committee to identify priorities and opportunities. Even without going through the cost of adopting or updating formal plans and studies, cities can identify and prioritize their strengths and weaknesses. This helps a local community know what to offer and what its needs are when talking with a prospective private partner.
- Establish policies. Adopting policies or guidelines setting forth the criteria that should be met before a city enters into a particular type of development agreement can be helpful. For example, a policy may require a minimum increased value a business must bring to a city before the city will consider entering into a tax abatement agreement.

b. Cooperation. Since the late 1980s, many cities and economic development corporations have negotiated private-public partnerships. Competition for economic development can be fierce. Cities are committed to its citizens. So, too, are its neighbors with respect to their own citizenry. Ideally, communities should work together to create a holistic, complimentary approach to economic development for a "win win" result. The more cohesive and supportive the greater community is towards economic development, the better the result. Combined studies to better understand the relative advantages of each locale can be of tremendous value for all. This can be organized through umbrella organizations such as chambers of commerce, council of governments and similar regional organizations. For example, one community may have vast expanses of undeveloped property while another boasts a workforce that's in high demand.

c. Research. It may be recommended to research different opportunities and even hire or consult with a third party about the viability of a certain type of business or public amenity. If outsourcing, using someone who is familiar with your community, with current trends and who will respect your priorities and maintain open lines of communication is ideal. With respect to specific opportunities, incentives and desired outcomes, it may be beneficial to perform a cost benefit analysis.

d. Resources. Understanding the resources available to a local community beforehand is of great help. If city funds are involved, it will be necessary to identify which funds on hand to use and how much is available for the intended purpose. If not setting aside funds, the legal ability and feasibility of issuing debt needs to be addressed.[2] For example, home rule charters need to be reviewed, statutory authority of general law cities researched, necessity of election examined, etc. When issuing debt, certain loans of public funds may be unconstitutional without a sinking fund if secured by taxes. Avoiding double pledging of revenues or other funds vis a vis current debt obligations is important. Also, understanding the proper use of available funding sources such as hotel occupancy taxes, increased sales or ad valorem taxes attributable to development, enterprise zone funds and so on is necessary.

The Texas State Comptroller's office maintains a website found at www.texasahead.org that has useful information about various types of development agreements and their uses.

III. Negotiating the Development Agreement

a. Equal but different. There are lots of moving pieces to the puzzle when public entities partner with the private sector. Some of them are discussed below. It's important to understand that while equal, the negotiating strengths of a public-private partnership will be different from one involving

[2] *See* Op. Tex. Att'y Gen. No. DM-185 (1992).

only private parties. It may be recommended to go over the ground rules and expectations early so that later on in the negotiations a private party better understands what are some of the "non-negotiable" tenets. For example, accountability of public funds is a necessity to ensure the proper expenditure of public funds in a development agreement as discussed in more detail below. This is also when having an adopted policy to share with a prospective private partner can be helpful.

b. Terms of the Agreement. Understanding what a local community wants and has to offer, and understanding what the private entity wants and has to offer is paramount. Below are some of the most common considerations.

The City/Local entity potential wants:

-infill development
-construction of public improvements to previously undevelopable property
-creation or diversification of jobs
-higher end development from what would otherwise have been developed
-revitalizing a previously depressed area
- tax dollars into local economy
-implementation or furthering implementation of a master plan, such as a thoroughfare plan or master drainage plan
-community amenities, such as a park, convention center or entertainment district.

The Landowner/Developer/Business potential wants:

- land, such as within a business park
-consistency of local regulation of development
-reimbursement of permitting fees, or amounts representing certain collection of taxes.
-money (grant or loan)
-regulatory relief
-deferral of annexation
-infrastructure improvements

Understanding the perspective of the private partner is helpful. For example, when talking to a developer interested in infill development in an older established part of town, regulatory relief may be requested. The City cannot waive its regulatory requirements without legislative enactment. However, creation of overlay districts, planned developments and other approaches can also be discussed. In contrast, when talking to a developer interested in building on an outlying tract of land, presence of utilities may be a source of discussions for cost sharing arrangements addressing both current developer needs as well as oversizing for future development.

c. Additional Considerations. Most development agreements are of long duration spanning typically anywhere from five, ten even 45 years. Once negotiated, the implementation phase may last for years.

It's important for a local entity to choose a private partner carefully when entering into a long term relationship. Factors to take into consideration include the following:

1. Commitment to the Community. Does the business have a commitment to the community? Has the business joined the local chamber? Will its employees be living locally? Will this include upper management? Has the business expressed interest in sponsoring local causes? Does it matter in this instance?
2. Financial and Management Stability. Has the business entity demonstrated financial strength to the satisfaction of the city? Are certain precautions in place commensurate with the level of risk the city is undertaking to ensure proper expenditure of public funds? Is the entity stable or is it undergoing a significant change in management or corporate structure? Will it impact the local project? Can the agreement adequately address the possible scenarios?
3. Communication/Chemistry. Have the negotiations gone smoothly? Have conversations been friendly? difficult? honest? heated yet productive? Have the people with whom the city been dealing been reliable? Have the people on behalf of the private entity been given adequate authority to negotiate? Does the city get along well with its private partner? Is the private partner litigious?
4. History. What is the track record of the prospective private partner? Have they developed something similar elsewhere? Was it successful? By whose standards?

Virtually all private-public partnerships have their own unique makeup including particular strengths and weaknesses. It is not realistic to expect to get everything a local entity wants in a private partner or in the agreement itself. Nonetheless, it is important to understand what the strengths and weaknesses are and to determine the importance of each.

IV. Chapter 380 Texas Local Government Code.

a. Background. Historically cities have enjoyed relationships with private entities ranging from regulator to public partner. When talking about this paper's title "The Give and Take of Development Agreements," perhaps the most common "give" can be found in Chapter 380 Texas Local Government Code. It is under this chapter that cities are able to incent developers, landowners and businesses to perform in a way that is of most benefit to a community.

While the Texas Constitution generally prohibits granting public funds or lending public credit to private parties,[3] the parameters of the relationship was altered beginning in 1987 when Section 52a of Article III was added to read as follows:

§ 52-a. Assistance to encourage state economic development

Sec. 52-a. Notwithstanding any other provision of this constitution, the legislature may provide for the creation of programs and the making of loans and grants of public money, other than money otherwise dedicated by this constitution to use for a different purpose, for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state, the stimulation of agricultural innovation, the fostering of the growth of enterprises based on agriculture, or the development or expansion of transportation or commerce in the state. Any bonds or other obligations of a county, municipality, or other political subdivision of the state that are issued for the purpose of making loans or grants in connection with a program authorized by the legislature under this section and that are payable from ad valorem taxes must be approved by a vote of the majority of the registered voters of the county, municipality, or political subdivision voting on the issue. A program created or a loan or grant made as provided by this section that is not secured by a pledge of ad valorem taxes or financed by the issuance of any bonds or other obligations payable from ad valorem taxes of the political subdivision does not constitute or create a debt for the purpose of any provision of this constitution [added in 2005]. An enabling law enacted by the legislature in anticipation of the adoption of this amendment is not void because of its anticipatory character.

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[3] *See* Texas Constitution, Article III, Section 51, "The Legislature shall have no power to make any grant or authorize the making of any grant of public moneys to any individual, association of individuals, municipal or other corporations whatsoever. . . "

Considered by itself, this constitutional amendment alone did not enable cities to lend credit or make grants to private entities. Rather, it authorized the Texas legislature to enact laws to enable cities to create their own economic development programs.

In the following legislative session, Chapter 380 of the Texas Local Government Code was adopted. This was the enabling legislation needed for Texas cities to develop their own economic development programs.[4] There is no laundry list of acceptable programs and acceptable forms of incentives. Rather, the Texas constitutional prohibition from making grants of monies to private corporations remains but through the above-described amendment economic development became a recognized public purpose.

Forms of acceptable incentives referenced generally in the statute include programs that grant or loan public funds and provide city personnel and services.

b. <u>Public Purpose.</u> Consistent with the Texas Constitutional provisions discussed above is the requirement that the expenditure of public funds be for a public purpose. The Texas Supreme Court set forth a public purpose test as follows:

(1) is the intent to accomplish a public purpose, rather than to benefit a private party;

(2) is there public control over the funds or property to ensure the public purpose is accomplished and to protect the public's investment; and

(3) will the City receive a sufficient return for the funds or property?[5]

In order to maintain the public purpose, controls over the use of public funds or resources must be addressed in a 380 agreement. For example, accounting for how public funds are spent is a requirement. For agreements spanning several years, annual certifications or other proof of performance may be required. Proof of employment levels or caliber of jobs created may be required. Most importantly, in the event a private partner does not meet its obligations to which the grant or loan of public funds relates, there must be recapture of such public funds. These contract provisions are commonly referred to as "clawbacks." As the Texas

[4] *See generally* Texas Attorney General Op. DM-185 (1992).
[5] *Tex. Mun. League v. Tex. Workers' Comp. Comm'n*, 74 S.W.3d 377, 383-384 (Tex 2002).

Attorney General has noted, requiring "a contract or other arrangement sufficient to ensure that the funds are used for the purposes authorized, consistent with the constitutional restrictions on the expenditure of public funds"[6] is a requirement for any 380 agreement.

c. Incentives. The premise of a 380 agreement is that if the private entity performs in a certain manner, the local entity may provide incentives of public funds or resources, such as grants of money, loans, securing of loans, sale or lease of real property and so on. The program may provide for payments up front or for reimbursement upon performance.

Where use of public resources is provided in advance of performance on the part of the private partner, more and more stringent clawback provisions in the agreement may be required. If guaranteeing a loan of a developer, when and how to secure payment to avoid a scenario of developer default, city pays and city gets nothing out of the arrangement needs to be adequately addressed.

The statute does not specify the type of economic development program a city may adopt. However, there are limitations in place regarding the proper expenditure of public funds generally as discussed above from a Texas constitutional perspective, as well as other statutory limitations to consider. For example, Chapter 1502 Texas Government Code generally prohibits providing free utility services except to public schools and building and institutions operated by a city. There can be no abatement of ad valorem taxes outside of the statutory process under Chapter 312 Texas Tax Code. However, due to the flexibility of an agreement under Chapter 380, payments equal to the amount of ad valorem taxes can be negotiated.

There can be local restrictions as well regarding the ability of cities to enter into 380 agreements. Home rule cities need to check charter provisions for limitations, and general law cities may need to look at statutory authorization before adopting a 380 program or before entering into a particular agreement.

d. Flexibility. Compared to other development agreements, agreements under chapter 380 are comparatively flexible. For example, 380 agreements can be coupled with interlocal agreements to achieve a

[6] Tex. Att'y Gen. Op. No. JC-0362 (2001) at 6.

"synthetic TIRZ". Using a 380 agreement approach instead can sometimes achieve similar results with less process and less cost. Also, 380 agreements may be used in conjunction with other economic development tools and at other governmental levels such as in conjunction with the state's Enterprise Zone Program under Chapter 2303 Texas Government Code or in conjunction with an economic development sales tax 4A or 4B program. There are rules and requirements to be met with all such tools, and care should be given to consult with professionals when needed.

e. Considerations. As flexible as 380 agreements can be, there are still factors to consider when working out such an agreement. Below is a sampling, some of which has been mentioned earlier:

i. Necessity to maintain public use and purpose of public funds.
ii. Necessity of establishing a program for the making of loans or grants or use of public services.
iii. Necessity of accountability of public resources.
iv. Necessity of clawback provisions.
v. Prohibition against using public funds to pay undocumented workers and necessity of stating this contractually pursuant to Chapter 2264 Texas Government Code.
vi. Understanding funding sources, including from current funds versus debt.
vii. Understanding authority and limitations placed on authority to enter into agreement, whether for home rule cities or general law cities.
viii. Reimbursement versus immediate availability of public funds.
ix. Grant or loan.
x. Roughly proportional legal concepts vis a vis the 380 agreement.
xi. Public procurement requirements vis a vis the 380 agreement.
xii. Whether to use a 380 agreement in conjunction with other local development and economic development tools to achieve certain results.
xiii. Whether and if a city is able to partner with other public authorities.

V. Implementation of Project.

a. Generally. Once a development agreement has been approved by all the parties, the implementation phase starts. Understandably, there is a great sense of achievement upon final negotiation of a development agreement.

Implementation is the next phase. As mentioned earlier, private-public partnerships often last for many years, making the selection, negotiating and ongoing relationship important. How all phases of this relationship play out should be taken into consideration. Depending on the length of the agreement and the priorities of the respective parties, the specificity with which various topics are discussed will vary.

b. Enforcement. To ensure success, communities may want to consider designating staff or hiring outside services to manage a development agreement or project involving a development agreement. Depending on the complexity, it may be worthwhile to have both a contract manager and a construction manager to ensure adequate oversight and to address issues before problems arise.

There can be times, however, when you may have to deal with a 380 agreement that is not progressing to the satisfaction of one or both parties. For example, a company was to have completed public infrastructure by a certain timeframe or in a certain manner but failed to properly perform. What to do?

As a political subdivision tied to its geographical location, it may be in the best interests of the public partner to first attempt to mutually resolve such problems. For example, a delay because of unforeseen supply shortages may be fleeting. However, the pulling out of an equity partner associated with the landowner or developer may be quite serious. A failing project is not going to move and what happens in a community stays there.

Although neither party likes to think about problems with performance, a public entity should prepare for this possibility by having in place as many protections as is reasonable. Sometimes an escrow fund may be appropriate. Depending on the amount of risk, it may be necessary to have extensive provisions for recapture of public funds. What safeguards are available depends on the situation. When constructing public infrastructure there may be limitations on what can be required in certain situations. [7] Also, the private partner could respond by asserting a takings claim, estoppel or waiver of governmental immunity.

[7] *See* e.g. Tex. Letter Opinion 90-180 interpreting 212.901 Texas Local Government Code requiring surety to guarantee development does not also authorize requiring performance or payment bonds.

It is important to maintain good communications, conduct periodic checks and to perform periodic cost benefit analysis or outside audits to measure and keep abreast of a public-private agreement.

VI. **Conclusion.** There are many types of development agreements. It is outside the scope of this paper to discuss all facets of such agreements. Rather, it is designed to make the reader aware of some of the considerations, attributes and limitations of development agreements generally and specifically with respect to those under Chapter 380 of the Texas Local Government Code.

With adequate preparation, meaningful negotiations and a thoughtfully prepared agreement tailored for the situation at hand, the likelihood of a successful outcome is maximized. Great partnerships can bring great things to both the city and the private partner.

https://www.galvnews.com/news/article_14a1587d-2440-5d05-b3b3-e12822342e44.html

Cities often fail to oversee development agreements, expert says

By MATT DEGROOD The Daily News
Apr 2, 2021

A section of Pinnacle Park in League City is under construction Monday, March 5, 2018. The city and developer Pinnacle Fund Alliance struck a 380 agreement for the 100-acre Pinnacle Park, which is anchored by Cabela's.
JENNIFER REYNOLDS/ The Daily News

Some Galveston County experts still swear by an economic incentive called a 380 agreement, despite such deals generating controversy recently in both Hitchcock and League City,

Done correctly, 380 agreements are simple tools to recruit businesses to town that don't require handing out taxpayer money upfront and pay out only if businesses live up to their end of the deal, they argue.

Others, however, contend that in most cases such agreements go to companies that would have moved in anyway and that cities often don't ensure the firms meet terms beneficial to the public.

"I think the 10,000-foot view is that academics are starting to view incentives in general as not good economic development policy," said Nathan Jensen, a professor of government at the Universit Texas in Austin who studies economic development strategies.

Jensen, in a review of several 380 agreements signed in communities across Galveston County, found most were flawed — overly focused on drawing retail business, lacking in means to verify information from companies and vague about how companies were supposed to report financial numbers.

WELL-INTENDED

The 380 agreement is named after Chapter 380 of the Texas Local Government Code, according to the Texas Comptroller's Office. It provides cities the opportunity to offer businesses loans and grants to promote economic development and stimulate business or commercial activity.

It's among several tools city officials across Texas have to promote economic development, said David Hoover, League City's director of planning and development. Others include tax abatements, actual cash payments and reinvestment zones.

"There's nothing wrong with the tool itself," Hoover said. "The 380 is my favorite. But the tool is not what makes the deal. It is the people."

And in League City, several 380 agreements have stirred controversy in recent months.

"The road to hell is paved with good intentions," Mayor Pat Hallisey said about several of the recent agreements. "The 380 agreements have worked out to be one of those that started with good intentions but didn't work out."

SLOW GROWTH

The first of those League City agreements was for Pinnacle Park, a 100-acre mixed-use town center at Interstate 45 and Big League Dreams Parkway, which some city leaders said was not meeting performance expectations.

Developers behind Pinnacle Park and the city in 2015 reached an agreement wherein the city would reimburse Pinnacle Financial Fund with sales taxes collected based on square footage of the commercial center, which is anchored by outdoor gear retailer Cabela's.

Last year, city leaders complained Pinnacle Park was only about 90 percent developed, which was short of where they thought it would be by then, officials said.

A November review found the city has been making smaller payments to the developer because of slowed growth at Pinnacle Park.

Some residents took the fact that the developer was running behind schedule as evidence that the agreement was never good to begin with, they said.

Despite the slowdown, city officials fully support the project and believe freeway construction and other economic factors made it difficult to develop, officials said at the time.

LITIGATION

And a state appeals court in February sided against the city in a longstanding lawsuit over another 380 agreement it reached with a Mexican food restaurant, ruling sovereign immunity doesn't shield the city from litigation.

City leaders in December 2012 signed a 380 agreement with La Porte-based Jimmy Changas Inc., which stipulated the city would reimburse some percentage of sales tax revenues to the restaurant if the business met set conditions, according to records. The specific amount varied between 15 percent and 35 percent of sales tax revenues.

The rebates are tied to how much the restaurant makes. If the company generates $3 million to $4.5 million a year in revenues, it will receive a 15 percent rebate on its city sales tax. That would increase up to a 35 percent rebate if the restaurant generates more than $6 million in revenues.

The agreement was set to run from 2013 to 2017, according to a lawsuit the restaurant filed against the city in 2018.

Attorneys for Jimmy Changas first brought a lawsuit against the city in the 10th District Court in 2018, asserting city leaders reneged on the 380 agreement and hadn't made any reimbursement payments, despite the business meeting all the requirements laid out in the paperwork, court records show.

The filing sought between $200,000 and $1 million from the city for damages, according to court records.

But lawyers for the city argued the business hadn't met all conditions, and they filed a counterclaim against Jimmy Changas, records show.

Attorneys then tried to end Jimmy Changas' case by filing a plea to the jurisdiction, seeking for a judge to dismiss the case.

AND MORE LITIGATION

Elsewhere in the county, Hitchcock administrators recently sued an Addison-based company over a 380 agreement after learning the community would have to repay more than $3 million over 29 years for it.

The deal was typical of those cities ink in pursuit of economic development. The company's investment would generate more sales tax and maybe some jobs for the city, and the city would kick back some of the increased tax revenue to offset the firm's expenses. A win-win.

Except the warehouse never was built, no jobs ever created or increased sales tax ever generated, the city and state of Texas assert. Yet company officials filed for reimbursements anyway and received them for years after the agreement was signed, court documents assert.

The city now owes the Texas Comptroller's Office more than $3 million, an amount equal to more than 57 percent of its entire annual budget that will take 29 years to pay off, City Manager Marie Gelles said.

OVER THEIR HEADS

The issue with such agreements across Texas is that most cities lack the wherewithal and knowledge to enforce the specific terms, Jensen said.

"Lots of cities don't have a rigorous process," Jensen said. "And usually big companies are good at negotiating."

Jensen reviewed paperwork for 380 agreements signed in the past five years in League City, Santa Fe, La Marque and Galveston.

"The Cabela's one is especially problematic," Jensen said. "This is signed with a developer, not with the company. There are estimates of jobs, but there seems to be no job reporting or clawbacks if they don't make these jobs. These could be minimum- wage jobs."

Hoover argued that Pinnacle Park, or Cabela's agreement, was actually an example of a 380 agreement done relatively well.

It stipulated how many buildings and how much construction had to occur over a specific period, as well as the amount of sales tax it had to generate, Hoover said. If it didn't hit all of those, then the developer wouldn't get 100 percent of the agreement, but a percentage.

Jensen also criticized the 380 agreement to bring a Walmart to La Marque, arguing it wasn't a smart idea to use them to entice retail, he said. Those are typically businesses that would come regardless, and retail is running into economic issues with more people opting to use online retailers, like Amazon, rather than shop in-person.

Officials with La Marque didn't respond to a request for comment about 380 agreements by Thursday afternoon.

A good 380 agreement should also allow a city to perform an independent audit to verify information provided by a developer or business, such as how many jobs were created, Jensen said. The agreements Jensen reviewed didn't do that, he said.

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Matt deGrood

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Sunnyvale 4B Development Corporation

Business Incentive Plan

Policy Statement

Sunnyvale 4B Development Corporation is committed to the promotion and retention of high quality and unique business development in all areas of Sunnyvale, and to an ongoing improvement in the quality of life for its citizens. Insofar as the enhancement and expansion of the local economy generally serve these objectives, the 4B Corporation will, on a case-by-case basis, consider providing business incentives to stimulate economic development in Sunnyvale. The 4B Corporation will consider providing business incentives in accordance with the procedures and criteria outlined in this document and as permitted by and in accordance with state law. Incentive agreements will be considered for new businesses, for the expansion of existing businesses, and for the modernization of existing facilities and structures. Nothing herein shall imply or suggest that the 4B Corporation is obligated to provide a business incentive to any applicant. Applications for incentives shall be filed with the 4B Corporation and copies will be coordinated with the Town Manager, appropriate Town Departments, and the 4B Board of Directors. The 4B Corporation will consider applications on a case-by-case basis. This policy establishes that all business incentives and agreements shall be governed by applicable state statutes relating to economic development. All economic incentives approved under this policy shall be reviewed at least every two years for compliance with the conditions of the incentive program.

Scope

The Town and the 4B Corporation are authorized to offer economic development incentives under various state laws, including chapter 380 of the Texas Local Government Code and the Texas Development Corporation Act (the "Act"), now codified in Title 12 of the Texas Occupations Code. A variety of other economic development tools may also be available through the Town.

Chapter 380 permits Texas municipalities to create programs that promote local economic development. This legislation permits, on a case by case basis, the Town to evaluate and, where appropriate, to offer certain economic development incentives. Incentives may include loans or grants of public money, as well as other Town services, to businesses and entities that the Town determines will promote local economic development and stimulate business and commercial activity in the Town in return for specific and verifiable commitments and results from such businesses or entities to cause specific infrastructure or other public benefits or amenities to be made or invested in the Town.

The Act allows municipalities to create nonprofit development corporations, and fund them with a special sales tax. Sunnyvale 4B Development Corporation was created under the Act. These corporations promote the creation of new and expanded industry and manufacturing activity within the municipality and its vicinity. The Town receives and distributes sales tax proceeds to the 4B Corporation, which uses the money for economic development projects as defined by the Act. Any activities of a development corporation must always be in furtherance of and attributable to a "project."

Except in certain specific instances, 4B Corporation projects involving incentives to business enterprises must result in the "creation or retention of primary jobs." The term primary job means a job that is:

1. available at a company for which a majority of the company's products or services are ultimately exported to regional, statewide, national or international markets infusing new dollars into the local economy; and

2. included in one of the North American Industry Classification System (NAICS) sector codes recognized by the Act. These include:

NAICS Sector	**Number Description**
221	Utilities
331-339	Manufacturing
42	Wholesale Trade
48-49	Transportation and Warehousing
51 (excluding 512131 and 512132)	Information (excluding movie theaters and drive-in theaters)
523-525	Securities, Commodity Contracts, and Other Financial Investments and Related Activities; Insurance Carriers and Related Activities; Funds, Trusts, and Other Financial Vehicles
5413, 5415, 5416, 5417, 5419	Scientific Research and Development Services
551	Management of Companies and Enterprises
56142	Telephone Call Centers

Eligible Section 4B Projects

The 4B Corporation will consider spending sales tax proceeds on land, buildings, equipment, facilities, expenditures, targeted infrastructure, or improvements for the creation or retention of primary jobs, which are found by the 4B Board of Directors to be required or suitable for the development, retention, or expansion of:

- manufacturing and industrial facilities
- research and development facilities
- transportation facilities (including airports, ports, mass commuting facilities and parking facilities)
- distribution centers
- sewage or solid waste disposal facilities
- recycling facilities
- air or water pollution control facilities
- facilities for furnishing water to the public
- distribution centers
- small warehouse facilities capable of serving as decentralized storage and distribution centers
- primary job training facilities for use by institutions of higher education
- regional or national corporate headquarters facilities; and
- projects which promote or develop new or expanded business enterprises including projects that provide public safety facilities, streets and roads, drainage and related improvements, demolition of existing structures, or generally municipally-owned improvements

Additionally, the 4B Corporation may fund the acquisition of land, buildings, equipment, facilities, and improvements found by the board of directors to promote or develop new or expanded business enterprises that create or retain primary jobs, including projects that provide:

- Public safety facilities
- Streets and roads
- Drainage and related improvements
- Demolition of existing substandard or inefficient structures
- General municipally-owned improvements

The 4B Corporation will consider any improvements or facilities that are related to any of those projects and any other projects that the board, in its discretion, determines will promote or develop new or expanded business enterprises or will create or retain primary jobs.

Eligible Projects Which Are Not Required to Create or Retain Primary Jobs

The 4B Corporation of the Town of Sunnyvale will consider funding projects that do not create or retain primary jobs if the project is related to:

- Job training - Certain job training required or suitable for the promotion or development and expansion of business enterprises;
- Certain targeted infrastructure improvements which promote or develop new or expanded business enterprises - limited to streets and roads, rail spurs, water and sewer utilities and electric utilities, gas utilities, drainage, site improvements and related improvements, and telecommunications and internet improvements;
- Land, buildings, equipment facilities, improvements and expenditures required or suitable for a career center, provided the area benefited is not located in the taxing jurisdiction of a junior college district;
- Professional and amateur sports and athletic facilities; entertainment, tourist, convention facilities; public parks and related open space improvements; and related store, restaurant, concession, automobile parking facilities, roads, streets, and water and sewer facilities;
- Affordable housing;
- Water supply facility or water conservation program (this use must be approved by a majority of the City's voters in an election held for that purpose);
- Development, improvement, expansion or maintenance of facilities relating to the operation of commuter rail, light rail or motor buses; and
- Certain airport facilities

Definitions

Clawback- That provision in a Performance Agreement which states how and to what extent any incentive payments from public funds must be repaid if the stated Performance Standards are not met.

Current Payroll- The company's total expenditure for all employees for the month immediately preceding this application multiplied by 12.

Employee Benefit- Incentives offered to employees and paid for by the employer such as hospitalization, vacation, etc. If an employee pays 30% of the cost, or more, it should not be considered a "benefit" for purposes of this application.

Full Time Job- The employment of a person for a minimum of 35 hours per week and offering that person all those benefits adopted by company policy for Full Time Employees. Major stockholders or immediate family members should not be included in this number when considering "New Full-Time Jobs Created."

Hourly Wage- The gross amount paid to the employee for each hour worked not including the Employer's portion of FICA or FWH. Benefits should not be included in this figure, but should be listed separately under the compensation per employee section of the application.

Job Classification Code- The North American Industry Classification System (NAICS) classifies all jobs in all industries. Those job classification codes which are acceptable under state law for assistance are listed under the scope section of this document.

Part-Time Job – A person working less than 35 hours per week. Major stockholders or immediate family members should not be included in this category when completing the application under New Part-Time Jobs Created.

Performance Agreement- a written document designed to protect the interest of local taxpayers by putting a businesses' job creation or capital investment commitments in writing and by linking the payment of any financial incentive to the business fulfilling its written commitments (i.e. clawbacks).

Project- means land, building, equipment, facilities, expenditures, and improvements included in the definition of "project" under the Act.

Primary Job- A job that is (1) available at a company for which a majority of the products or services of that company are ultimately exported to regional, statewide, national, or international markets, infusing new dollars into the local economy; and (2)included in an acceptable sector of the North American Industry Classification System (NAICS).

Ineligible Types of Businesses

The 4B Corporation may determine on a case-by-case basis to exclude business activities that they do not believe benefit the health, safety, and welfare of the community or do not meet the 4B Corporation's objectives .

Application Procedure

1. Applicant shall submit a completed application form and provide documentation required by the application. Information submitted to the 4B Corporation may be considered public information and subject to disclosure under the Public Information Act.
2. Submit 10 copies to the Town of Sunnyvale.
3. Copies will be distributed within 5 business days by the Town of Sunnyvale to the 4B Board, Town Manager, to appropriate Town of Sunnyvale department heads for review and comments.

4. The applicant will come before the 4B Board's regular meeting to present the plan and answer questions. The 4B Board will publish notice and hold a public hearing, if appropriate.
5. 4B will review the application and approve the request in whole or in part, or as modified, deny the request or request additional information.
6. 4B will make a recommendation to the Town Council.
7. Council will review application, applicant may appear before the council for a presentation and questions, council will call public hearings if required by law, and council will have final approval.
8. After council approval the applicant will be required to enter into a performance agreement between the applicant and the 4B Corporation as provided by the 4B Corporation.

Criteria for Approving Incentive Requests

In determining whether to offer an incentive using 4B Corporation funds, the project should demonstrate one or more of the following for the benefit of the town:
1. An increase in the Town's Sales Tax revenues
2. An increase in the Town's Ad Valorem Tax revenues or overall appraised valuation
3. An increase in employment in the Town of Sunnyvale.
4. An increase in the Town of Sunnyvale's overall quality of life that will promote economic development.
5. Improvements to the Town's streets, drainage, water, and/or wastewater infrastructure that will facilitate economic growth.

If a project has a direct, positive effect on those items discussed in the guidelines above, the 4B Corporation board will evaluate each project on a number of differing criteria to determine the level of investment, if any. These guidelines are not retroactive to any project. Criteria to be considered may include:

1. Total capital investment in the project including acquisitions, site improvements, building cost and equipment;
2. Number, type, quality, and wage level of jobs created;
3. Other site-specific issues which may have ancillary benefits to the Town of Sunnyvale;
4. Grants provided by other local, regional, or economic development entities;
5. The economic and financial feasibility of the project, including the financial strength and viability of the applicant;
6. Other factors deemed relevant by the 4B Corporation Board of the Town of Sunnyvale.

Key to determining the amount of the incentive is of course the anticipated economic development benefit to the Town of Sunnyvale.

Tab 4

Outlawing Favoritism

The Economics, History, and Law of Anti-Aid Provisions in State Constitutions

Matthew D. Mitchell,
Jonathan Riches, Veronica Thorson,
and Anne Philpot

MERCATUS WORKING PAPER

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Abstract

Since the early days of the republic, state and local governments have periodically embarked on widespread, large-scale attempts to spur economic growth through targeted economic development subsidies. Interestingly, the constitutions of nearly every state in the union contain provisions that, on plain reading, make these sorts of subsidies illegal. In this paper, we review the economics, history, and law of targeted economic development subsidies in the United States, focusing on these constitutional anti-aid provisions. This review demonstrates four things. First, subsidies do not work as advertised. In fact, the best evidence suggests that they undermine economic development, fiscal health, and good governance. Second, constitutional anti-aid provisions may be able to affect the size and scope of subsidies, reducing these negative effects. Third, the details matter; not all anti-aid provisions are effective. And fourth, as special interests work to undermine the effectiveness of anti-aid provisions, such provisions must be renewed and strengthened from time to time. We conclude with suggestions for strong constitutional anti-aid provisions.

JEL codes: H2, H7, K3, N0, N9

Keywords: gift clauses, anti-aid clauses, targeted economic development subsidies

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Outlawing Favoritism

The Economics, History, and Law of Anti-Aid Provisions in State Constitutions

Matthew D. Mitchell, Jonathan Riches, Veronica Thorson, and Anne Philpot

I. Introduction

Policymakers are keenly interested in promoting economic growth, and targeted economic development incentives are an especially popular strategy.[1] These selective privileges are offered to particular firms or industries and can include targeted tax relief, targeted regulatory relief, cash subsidies, loans and loan guarantees, in-kind donations of land and other valuable goods and services, or some combination of the above. Governments can target particular firms in different ways. One tactic is to favor an entire industry through an industry-wide privilege. (An industry-wide tax privilege is particularly common.) Another approach is to favor firms that locate in certain regions or zones or even to create a zone specifically for the benefit of a particular firm. Another tactic is to target specific firms through discretionary funds, often called *deal-closing funds*, administered by governors or other policymakers. Finally, governments might target a firm by rewarding specific behaviors—for example, if the firm undertakes a certain size or variety of investment or hires a certain number of employees.

While targeted subsidies have a long history, recent high-profile cases have renewed debate about their efficacy.[2] In July 2017, for example, Wisconsin announced a 15-year \$1.2 billion to \$3.6 billion subsidy to Foxconn Technology Group to build a liquid crystal display plant in southeast Wisconsin. And in September of that year, Amazon announced plans for a second headquarters

[1] This is not the only strategy. Another tactic is to create an environment that is conducive to growth by, for example, ensuring some degree of economic freedom.

[2] David E. Pinsky, "State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach," *University of Pennsylvania Law Review* 111, no. 3 (1963): 266n4. Virginia subsidized woolen cloth producers with bounties of tobacco in 1661.

(HQ2), setting off a 238-city bidding war that culminated in the selection of New York City and Arlington, Virginia, and—ultimately—in the abandonment of the New York site.

Most policymakers believe that subsidies work. One recent survey of 110 mayors found that 84 percent of them believe that targeted incentives are good policy.[3] By one estimate, states and localities spend about $49 billion per year on targeted economic development subsidies.[4] This is about 30 percent of average state and local business tax collections. Moreover, as a share of industry contributions to GDP, incentives have tripled since 1990.[5]

The history of targeted subsidies suggests that they fail as an economic development strategy. Indeed, they seem more likely to invite corruption and government fiscal crisis than to promote sustainable growth. When these problems inevitably arise, state constitutional framers have responded with constitutional anti-aid provisions. By their plain language, these measures would seem to outlaw many of the subsidies that take place today. But as they are repeatedly challenged, these provisions tend to weaken and must periodically be renewed and strengthened.[6]

When properly structured, these provisions do seem to have an effect on the size and scope of subsidies. But the details matter. The most effective anti-aid provisions apply to both state and local governments and restrict aid in all its forms. Anti-aid provisions are also more

[3] Richard Florida, "Analysis: Why Mayors Keep Trying to Woo Business with Tax Breaks," *MSN*, February 12, 2019.

[4] Timothy Bartik estimates that state and local business incentives totaled $45 billion in 2015. Assuming that this figure has not grown in real terms over the past four years, this is $48.95 billion in 2019 dollars. We may regard this number as somewhat speculative. States are not transparent about subsidies, and researchers do not always agree on what counts as a subsidy. Others have estimated that the amount may be about $32 billion a year (Thomas) or $70 billion (Good Jobs First). Bartik's estimate is not only the median but close to the average. Timothy Bartik, "A New Panel Database on Business Incentives for Economic Development Offered by State and Local Governments in the United States" (W. E. Upjohn Institute for Employment Research, Kalamazoo, MI, 2017); Kenneth P. Thomas, "The State of State and Local Subsidies to Business" (Mercatus Policy Brief, Mercatus Center at George Mason University, Arlington, VA, October 21, 2019); Good Jobs First, "GASB Statement No. 77," accessed October 11, 2017, https://www.goodjobsfirst.org/gasb-statement-no-77.

[5] Bartik, "New Panel Database," 2–3.

[6] It is possible that the provisions were intentionally designed to break down. The late political economist Anthony de Jasay expresses this skeptical view succinctly: "Putting it at its simplest, majorities choose legislation that maximizes their gains from politics, and they learn to choose a constitution that maximizes the scope for such legislation." Anthony de Jasay, *Justice and Its Surroundings* (Indianapolis: Liberty Fund, 2002), 117.

effective if courts apply a number of important tests. The case law suggests that these provisions are strongest where courts require three conditions for public spending. First, expenditures must serve a broad public purpose with direct and nonspeculative public benefits. Second, the government must exercise sufficient and continuing control over all public expenditures. Third, the government must obtain valid consideration for its outlays. In this case, valid consideration is direct, ascertainable, contractually obligatory, and proportional.

In the next section, we show that, despite their longstanding popularity among public officials, the economic case for targeted subsidies is weak. In section III we review the history of targeted state and local subsidies in the United States, concentrating on constitutional efforts to limit them. In section IV, we present an overview of the current legal landscape for anti-aid provisions. In section V we offer recommendations for sound and effective provisions, and in section VI we discuss possible legislation and litigation strategies. In section VII we offer concluding remarks.

II. The Economics of a Targeted Subsidy

It is straightforward to identify the benefits of a targeted economic development subsidy. We can visit new and expanded facilities, count the number of employees they hire, and calculate their contributions to local GDP. Economists may even be able to estimate the multiplier effects associated with the subsidized activity, though this estimation is a rough science. That is, they can estimate the new demand for other products and services that is generated in an area when a new facility and its employees locate there. The economic development offices that dispense subsidies and the firms that receive them are wont to point to these sorts of benefits, and public debates over subsidies often center on these factors. Upon scrutiny, however, subsidies entail benefits that are much smaller than the boosters' oft-quoted estimates suggest. They also entail significant costs that the boosters often ignore. In this section, we briefly discuss why the benefits of subsidies are typically overstated and why the costs of subsidies are understated. We also discuss several difficult-to-measure costs that often go ignored. We conclude that, on net, a subsidy is more likely to undermine economic development than enhance it.[7]

A. The Overstated Benefits of Subsidies

When, in 2017, the state of Wisconsin offered up to $3.46 billion to Foxconn Technology Group to locate a plant in southeast Wisconsin, the company commissioned a study that concluded that the plant would add more than $62 billion to Wisconsin GDP over 15 years.[8] This would seem to be an extraordinary return on the taxpayers' investment. The $62 billion figure included about $39.9 billion in direct impact from the plant's production, as well as an additional $22.5 billion in indirect and induced economic impact, attributable to a multiplier effect. There is nothing wrong in assuming a multiplier effect: any new economic activity tends to create further activity. A new plant will create new demand for inputs, and its workers will create new demand for housing and other goods. However, this framing ignores the opportunity cost of the subsidy. At best, it should be viewed as an estimate of the gross benefits of the subsidy, not as an estimate of the net benefits. Even as an estimate of gross benefits, however, this figure is overstated.

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[7] For a longer discussion of the economics of a subsidy, see Matthew D. Mitchell, Michael D. Farren, Jeremy Horpedahl, and Olivia J. Gonzalez, "The Economics of a Targeted Economic Development Subsidy" (Mercatus Special Study, Mercatus Center at George Mason University, Arlington, VA, 2019). For a review of the empirical literature, see Matthew D. Mitchell, Jeremy Horpedahl, and Olivia J. Gonzalez, "Do Targeted Economic Development Incentives Work as Advertised?" (Mercatus Working Paper, Mercatus Center at George Mason University, Arlington, VA, forthcoming).

[8] EY Quantitative Economics and Statistics, "Quantifying Project Flying Eagle's Potential Economic Impacts in Wisconsin," *EY*, July 2017.

This is because the estimate implicitly assumes that the subsidy is the determinative factor when a subsidized firm decides where to locate. It rarely is. Consider that when multiple jurisdictions bid for a facility, companies often fail to pick the highest bidder. For example, when Foxconn chose Wisconsin, it was forgoing a larger subsidy from Michigan.[9] And when Amazon chose New York and Virginia for its HQ2 sites, it was forgoing larger offers from Dallas–Fort Worth, Maryland, New Jersey, and Ohio.[10] Firms are willing to forgo even very large incentives because other factors, such as labor costs, business logistics, and access to location-specific resources, tend to have a bigger effect on profit. For example, the costs of locally supplied labor are typically about 14 times larger than state and local business tax costs.[11] A mere 2 percent difference in wages can offset as much as a 40 percent difference in taxes.[12]

A recent review of 34 academic studies concluded that subsidies "probably tip somewhere between 2 percent and 25 percent of incented firms toward making a decision favoring the location providing the incentives."[13] These estimates are derived from past experiences, and it is possible that larger subsidies may increase the probability of tipping the balance. But the implicit assumption that a subsidy is decisive with 100 percent certainty is

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[9] Jason Stein, "Michigan Offered Foxconn $3.8B, Still Lost to Wisconsin," *Milwaukee Journal Sentinel*, October 19, 2017.
[10] The site in Arlington, Virginia, entailed $1.05 billion in subsidies, and the New York City site entailed $3 billion. The Cleveland, Ohio, location would have entailed $3.5 billion; Newark, New Jersey, $7 billion; and Maryland $8.5 billion.
[11] Timothy Bartik, *Who Benefits from State and Local Economic Development Policies?* (Kalamazoo, MI: W. E. Upjohn Institute, 1991), 61. These figures likely vary by sector. See James Papke, "Interjurisdictional Business Tax Cost Differentials: Convergence, Divergence and Significance," *Tax Notes* 9, no. 4 (1995): 1701–11.
[12] It is important to note that the local cost of living can vary by as much as a factor of two across the United States. Leah Beth Curran, Harold Wolman, Edward W. Hill, and Kimberly Furdell, "Economic Wellbeing and Where We Live: Accounting for Geographical Cost-of-Living Differences in the US," *Urban Studies* 43, no. 13 (December 1, 2006): 2443–66; G. Cornia, W. Testa, and F. Stocker, "State-Local Fiscal Incentives and Economic Development" (Urban and Regional Development Series Number 4, Academy of Contemporary Problems, Columbus, OH, 1978).
[13] Timothy J. Bartik, "'But For' Percentages for Economic Development Incentives: What Percentage Estimates Are Plausible Based on the Research Literature?" (working paper, W. E. Upjohn Institute for Employment Research, Kalamazoo, MI, 2018). For two other studies with similar results, see Dennis A. Rondinelli and William J. Burpitt, "Do Government Incentives Attract and Retain International Investment? A Study of Foreign-Owned Firms in North Carolina," *Policy Sciences* 33, no. 2 (2000): 181–205; Nathan Jensen, "Bargaining and the Effectiveness of Economic Development Incentives: An Evaluation of the Texas Chapter 313 Program," *Public Choice* 177, no. 1 (2018): 29–51.

simply not realistic. This should cause us to radically revise downward the expected gross benefits attributed to any given subsidy. If a bet pays $100 with a 25 percent probability of winning, it is only worth $25. Similarly, if a subsidized factory is expected to add, say, $1.5 billion to Wisconsin's economy over 15 years and if we believe that there is a 25 percent chance that the subsidy was decisive, then the expected value of the subsidy is $375 million, not $1.5 billion.[14]

B. The Often-Ignored Costs of Subsidies

While the gross benefits of a targeted economic development subsidy are typically overstated, the gross costs are typically ignored. In fact, the gross benefits are often presented as if they were the *net* benefits. Consider, again, the example of a subsidized plant that is expected to add $1.5 billion to Wisconsin's GDP over 15 years. Assume that the state offered this plant $150 million in subsidies. To obtain the net benefits of the subsidy, we must account for the economic cost of removing this $150 million from the economy in order to fund the subsidy. And just as the plant can be expected to have multiplier effects that spur other economic activity, so too would the money that funds the subsidy, if left in the hands of taxpayers. Worse, because taxes discourage the economic activities to which they apply, taxation entails additional costs that economists call deadweight losses.[15]

According to the range of estimates, if a state raises its taxes by 10 percent, then over the long run, economic activity will tend to decline by about 5 percent, with a plausible range

[14] $375 million is 25 percent of $1.5 billion. Note that we are not saying that the plant itself is worth $375 million. We are taking as given that it will add $1.5 billion to state GDP. Instead, we are saying that the expected gross contribution of the subsidy to that $1.5 billion is only $375 million. By way of analogy, if recovery from a certain disease is worth $150,000 to a patient but if there is only a 25 percent chance that a certain treatment caused the recovery to come about, then in an expectational sense, the treatment is worth $37,500, not $150,000.
[15] The exception is a "head tax," which is not applied to economic activity but is instead applied to all people, regardless of their economic activities.

between 1.5 percent and 8.5 percent.[16] If we apply this range to the higher taxes implied by a $150 million subsidy from the state of Wisconsin, the 15-year gross costs of the subsidy are likely to be about $1.25 billion, with a plausible range between $375 million and $2.1 billion.[17] In table 1, we combine the range of gross benefits and gross costs to yield a range of expected *net* benefits from such a subsidy. The range of gross costs encompasses low, average, and high deadweight losses. The range of gross benefits encompasses scenarios in which the subsidy determined the plant location with 2 percent, 25 percent, 50 percent, and 100 percent certainty. We regard the 100-percent-certainty scenario as unrealistic but present it for the sake of comparison.

The 12 numbers in the lower-right corner of the table indicate the wide range of possible net economic effects. Under the best scenario, the subsidy was decisive with 100 percent certainty and the deadweight loss from taxation is low. In this case, we estimate the subsidy will result in a net gain to the Wisconsin economy of $1.125 billion over 15 years. The worst scenario occurs when the subsidy was only decisive with 2 percent certainty and the deadweight loss from taxation is on the high end of the spectrum. In this case, we estimate the subsidy will result in a net loss of $2 billion over 15 years. In public debates over subsidies, the wide range of scenarios and the possibility of downside risk are rarely acknowledged.

Which of these scenarios is the most realistic? On the cost side, it is reasonable to use the best estimate of a $1.249 billion gross loss over 15 years. On the benefit side, we may never know whether a given subsidy was decisive. But, as we have already noted, the idea that a

[16] Timothy Bartik, *Who Benefits from Economic Development Incentives? How Incentive Effects on Local Incomes and the Income Distribution Vary with Different Assumptions about Incentive Policy and the Local Economy* (Kalamazoo, MI: W. E. Upjohn Institute for Employment Research, 2018), 10.
[17] A $150 million subsidy over 15 years implies that Wisconsin state taxes will be about 0.05 percent higher than otherwise. Applying the deadweight loss estimate implies that the Wisconsin economy will be about 0.023 percent smaller than otherwise. We assume that the full costs of taxation do not materialize for 7 years. Given the size of the Wisconsin economy, the cumulative effect over 15 years is about $1.25 billion. For more details on this calculation with application to the Foxconn subsidy, see Mitchell et al., "Targeted Economic Development Subsidy."

subsidy is decisive with 100 percent certainty is simply not realistic. And though the peer-reviewed evidence suggests that most subsidies are decisive with 2 to 25 percent probability, a 50 percent chance of decisiveness is not out of the question with larger subsidies. Thus, it seems reasonable to regard the highlighted cells of the table as the most realistic scenarios. Under none of these scenarios would this hypothetical subsidy be expected to yield net positive effects for the Wisconsin economy over the long run.

Table 1. Net Expected Value of Subsidies to a Project That Will Add $1.5 Billion to GDP

			Range of Expected Gross Benefits ($ millions)			
			100% Decisive 1,500	50% Decisive 750	25% Decisive 375	2% Decisive 30
	Low DWL of Taxation	−375	1,125	375	0	−345
Range of Expected Gross Costs	Best Estimate of DWL of Taxation	−1,249	251	−499	−874	−1,219
	High DWL of Taxation	−2,123	−623	−1,373	−1,748	−2,093

Notes: The shaded values represent the most realistic range of estimates of the average net subsidy effect. The net subsidy equals the estimated gain from the subsidy minus the estimated loss from taxation. For details on methodology, see Matthew D. Mitchell, Michael D. Farren, Jeremy Horpedahl, and Olivia J. Gonzalez, "The Economics of a Targeted Economic Development Subsidy" (Mercatus Special Study, Mercatus Center at George Mason University, Arlington, VA, 2019).

C. The Difficult-to-Measure Costs of Subsidies

The range of scenarios reported in table 1 excludes additional difficult-to-quantify costs that can arise with a subsidy. For instance, subsidies may encourage too much of the subsidized activity. There is an optimal size to a factory floor, an optimal number of salespeople, and an optimal location for any plant.[18] With a subsidy, however, a firm externalizes some of its costs onto taxpayers, which can lead it to build a factory that is larger than optimal, to hire more salespeople than it should, or to build in a suboptimal location. Indeed, economists have long emphasized that communities prosper when they specialize based on their comparative advantage. That is, they should specialize in producing those products and services that they can produce at a lower opportunity cost than others.[19] But if a firm would not locate a certain facility in a location *but for* a subsidy, that is a strong indication that the firm *should not* locate the facility there. Adam Smith once noted that with enough greenhouses Scotland could produce wine, though only at 30 times the cost of comparable wine produced elsewhere.[20] By the same logic, Wisconsin could induce Dole to locate pineapple production on the shores of Lake Michigan. This, for obvious reasons, would not be a wise investment.

To compound the problem, a firm that would not locate in a certain area but for a subsidy is also likely to be especially sensitive to future subsidies offered by other jurisdictions that might lure it away.[21]

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[18] To put it in technical terms, the optimal scale is that at which marginal cost just equals marginal benefit. Any units of production beyond that point consume more value than they create.
[19] David Ricardo, *On the Principles of Political Economy, and Taxation* (n.p.: J. Murray, 1817).
[20] Adam Smith, *The Wealth of Nations* (n.p.: Simon & Brown, 1776), book 4, chap. 2, para. 15.
[21] Terry F. Buss, "The Case against Targeted Industry Strategies," *Economic Development Quarterly* 13 (July 25, 2016): 350.

Subsidies can also give a firm an anticompetitive advantage, allowing it to ignore customers or to be lax with cost containment, a phenomenon known as x-inefficiency.[22] Furthermore, subsidies tend to lock in inefficient technologies and business practices, making markets and workers less adaptable to change. When governments dispense subsidies, firms expend resources seeking these privileges, a socially wasteful phenomenon known as rent-seeking.[23] Subsidies can also lead to the misallocation of talent as they encourage entrepreneurs to develop new and different ways of obtaining privilege rather than new and different ways of pleasing customers and economizing on resources.[24]

Beyond these economic concerns, there are philosophical and social problems with subsidies. They tend to favor the wealthy and well connected at the expense of the poor and unknown.[25] Moreover, they may be associated with perverse cultural attitudes toward markets. Recent research, for example, finds that leaders of privileged firms are more likely to think the US market is too free, that government should have a more active role in the economy, that favoritism is compatible with free markets, and that government privilege or knowledge of influential policymakers is the most important factor in business success.[26]

Even if a subsidy did not entail any of the problems we have discussed, it would still at best be a zero-sum game—that is, when one state lures a firm with a subsidy, its gain is offset by

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[22] Harvey Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review* 56, no. 3 (June 1, 1966): 392–415; Matthew Mitchell, *The Pathology of Privilege: The Economic Consequences of Government Favoritism* (Arlington, VA: Mercatus Center at George Mason University, 2012).
[23] Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies, and Theft," *Economic Inquiry* 5, no. 3 (June 1, 1967): 224–32; Matthew D. Mitchell, "Rent Seeking at 52: An Introduction to a Special Issue of *Public Choice*," *Public Choice* 181, no. 1 (October 1, 2019): 1–4.
[24] William J. Baumol, "Entrepreneurship: Productive, Unproductive, and Destructive," *Journal of Political Economy* 98, no. 5 (October 1, 1990): 893–921; Kevin M. Murphy, Andrei Shleifer, and Robert W. Vishny, "The Allocation of Talent: Implications for Growth," *Quarterly Journal of Economics* 106, no. 2 (May 1, 1991): 503–30.
[25] Daniel Aobdia, Allison Koester, and Reining Petacchi, "Political Connections and Government Subsidies: State-Level Evidence," *SSRN Electronic Journal*, March 2018, available at https://www.bsg.ox.ac.uk/sites/default/files/inline-files/Petacchi_0.pdf.
[26] Matthew D. Mitchell with Scott Eastman and Tamara Winter, "A Culture of Favoritism" (Mercatus Special Study, Mercatus Center at George Mason University, Arlington, VA, March 27, 2019).

another's loss. This has led many to conclude that state subsidies are akin to a mutually destructive arms race or to a prisoner's dilemma (a term borrowed from game theory). In these sorts of situations, it is individually rational for people to pursue certain actions even though they lead to outcomes that make everyone—including themselves—worse off.[27]

The theoretical case against subsidies is supported by the empirical record. Since 1990 there have been more than 100 academic studies of targeted subsidies.[28] Most of these studies evaluate subsidies in light of their effects on the privileged firms, regions, or industries. But subsidies are rarely sold as a means to boost the well-being of these narrowly targeted interest groups. Instead, subsidies are typically sold as a means to benefit the communities that pay for them.[29] Among those studies that evaluate subsidies in light of their effects on these broader communities, the vast majority find little to no support for subsidies.[30]

[27] Chris Farrell, "The Economic War among the States: An Overview," *The Region*, June 1, 1996; Melvin L. Burstein and Arthur J. Rolnick, "Congress Should End the Economic War among the States," *The Region*, January 1, 1995, 3–20; Matthew Schaefer, "State Investment Attraction Subsidy Wars Resulting from a Prisoner's Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response," *New Mexico Law Review* 28, no. 2 (1998): 303–42; Stephen Ellis and Cynthia Rogers, "Local Economic Development as a Prisoners' Dilemma: The Role of Business Climate," *Review of Regional Studies* 30, no. 3 (2000): 315–30; Daniel J. Wilson, "Beggar Thy Neighbor? The In-State, Out-of-State, and Aggregate Effects of R&D Tax Credits," *Review of Economics and Statistics* 91, no. 2 (May 2009): 431–36; Nathan M. Jensen, Edmund Malesky, Mariana Medina, and Ugur Ozdemir, "Pass the Bucks: Credit, Blame, and the Global Competition for Investment," *International Studies Quarterly* 58, no. 3 (September 1, 2014): 433–47; Nathan M. Jensen, Edmund J. Malesky, and Matthew Walsh, "Competing for Global Capital or Local Voters? The Politics of Business Location Incentives," *Public Choice* 164, no. 3–4 (September 1, 2015): 331–56; Nathan Jensen and Edmund J. Malesky, *Incentives to Pander: How Politicians Use Corporate Welfare for Political Gain* (New York: Cambridge University Press, 2018).
[28] Mitchell, Horpedahl, and Gonzalez, "Work as Advertised."
[29] See Mitchell, Horpedahl, and Gonzalez, "Work as Advertised," for more details. But note that from Alexander Hamilton to Donald Trump, policymakers who advocate for subsidies almost universally speak of the benefits to the broader community.
[30] Again, see Mitchell, Horpedahl, and Gonzalez, "Work as Advertised." Among those studies that evaluate subsidies for their effects on the broader community, about two-thirds find either mixed or insignificant effects. Just 16 percent find positive effects, while 20 percent find negative effects for the broader community.

Yet despite the economic case against subsidies, they persist. Public choice models explain why.[31] Subsidies confer highly visible benefits on concentrated, politically organized special interests, while their costs are less obvious and spread across diffuse, politically unorganized taxpayers, consumers, and small businesses.[32] This pattern of concentrated benefits and diffuse costs explains the persistence of many inefficient policies.[33] The problem is compounded by the fact that voters are often ignorant or confused about the technical aspects of economic development policy.[34] As a result, political leaders may misclassify costs as benefits and believe that a project is more valuable because it involves a large investment or requires a large workforce.[35]

Given the persistence and prevalence of targeted subsidies despite the economic case against them, institutional constraints—such as state anti-aid provisions—are needed to limit their use.

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[31] Public choice is the economic study of political markets. For an overview, see Randy T. Simmons, *Beyond Politics: The Roots of Government Failure* (Oakland, CA: Independent Institute, 2011); Matthew D. Mitchell and Peter J. Boettke, *Applied Mainline Economics: Bridging the Gap between Theory and Public Policy*, 1st ed. (Arlington, VA: Mercatus Center at George Mason University, 2017).

[32] As the economists Robert Ekelund and Robert Tollison have put it, "The undergirding principle of the interest-group approach is nonetheless organizational costs. The theory begins and ends with this principle. Organized groups gain political wealth transfers at the expense of unorganized or less-well-organized groups." Robert B. Ekelund Jr. and Robert D. Tollison, "The Interest-Group Theory of Government," in *The Elgar Companion to Public Choice*, ed. William F. Shughart Jr. and Laura Razzolini, 357–78 (Cheltenham, UK: Edward Elgar, 2001).

[33] Mancur Olson, *The Logic of Collective Action: Public Goods and the Theory of Groups*, 2nd ed. (Cambridge, MA: Harvard University Press, 1965); Theodore J. Lowi, *The End of Liberalism: The Second Republic of the United States*, 40th anniv. ed. (New York: W. W. Norton, 1969); Peter Schuck, *Why Government Fails So Often: And How It Can Do Better* (Princeton, NJ: Princeton University Press, 2014).

[34] Because their votes are unlikely to make a difference in any election, voters tend to be rationally ignorant about policy and its effects. Worse, they have little incentive to spend time thinking about public policy, causing irrational notions to persist. Anthony Downs, *An Economic Theory of Democracy* (New York: Harper & Row, 1957); Bryan Caplan, *The Myth of the Rational Voter: Why Democracies Choose Bad Policies*, new ed. (Princeton, NJ: Princeton University Press, 2008).

[35] Barry R. Weingast, Kenneth A. Shepsle, and Christopher Johnsen, "The Political Economy of Benefits and Costs: A Neoclassical Approach to Distributive Politics," *Journal of Political Economy* 89, no. 4 (August 1, 1981): 642–64.

III. The History of Subsidies and Anti-Aid Provisions in State Constitutions

The history of subsidies and the evolution of public aid restrictions in state constitutions demonstrate that subsidies pose a threat to economic development, fiscal health, and good governance. They also show that anti-aid provisions can restrain the size and scope of subsidies, but the details matter, and periodically these provisions must be strengthened.

The first wave of restraints emerged in the 1840s. Ill-conceived and mismanaged infrastructure projects created large state debts in the 1830s, and following the panic of 1837, these burdens became unsustainable, sending eight states and one territory into default.[36] The states requested a federal bailout but were denied. In the years that followed, many states adopted constitutional fiscal reforms, including restrictions on public spending for private projects. These reforms worked for a time. But as the panic faded from memory in the Reconstruction era, localities—which were often not restrained by constitutional limits—boosted their own funding for railroads and other private projects.[37] After another fiscal crisis in 1873, a second wave of anti-aid reforms closed the locality loophole.[38] Then, starting in the Great Depression, both courts and legislatures began once again to permit public spending for private projects so long as lawmakers or judges could construct some semiplausible rationale that spending would eventually benefit the public at large.[39]

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[36] Jonathan Rodden, *Hamilton's Paradox: The Promise and Peril of Fiscal Federalism* (Cambridge: Cambridge University Press, 2006), 72–74; John Joseph Wallis, "American Government Finance in the Long Run: 1790 to 1990," *Journal of Economic Perspectives* 14, no. 1 (2000): 61–62.
[37] G. Alan Tarr, *Understanding State Constitutions* (Princeton, NJ: Princeton University Press, 1998), 114.
[38] Tarr, *Understanding State Constitutions*, 114.
[39] See, generally, James T. Bennett, *Corporate Welfare: Crony Capitalism That Enriches the Rich* (New Brunswick, NJ: Transaction, 2015), 79–121.

A. The Long History of Favoritism

Governments have favored particular firms, industries, and interests for centuries. And for almost as long, economists have been critical of the practice.[40] At the time of the American founding, what Adam Smith dubbed "mercantilism" had dominated European economic policy for nearly three centuries. Like modern-day economic development strategies, mercantilism aimed to promote certain firms or industries through subsidies, tax privileges, and regulatory protections, and this European practice had been transplanted into the colonies. In 1661, for example, Virginia began subsidizing woolen cloth producers with bounties of tobacco.[41] And during the Washington administration, Secretary of the Treasury Alexander Hamilton famously called for the systematic promotion of manufacturing through tariffs and subsidies.[42]

Yet despite its long and entrenched practice, early US policymakers showed ambivalence toward mercantilism, especially at the national level. Hamilton's plan was rejected by Congress in 1791, and when it later resurfaced as Henry Clay's "American system," that too was largely rejected. Thus, for the first several decades of the republic, neither the states nor the federal government was active in promoting particular firms or industries.[43]

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[40] For an early critique, see Adam Smith's *Wealth of Nations*. For more recent critiques, see Douglass C. North, John Joseph Wallis, and Barry R. Weingast, *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History*, 1st ed. (Cambridge: Cambridge University Press, 2009); Daron Acemoglu and James Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*, 1st ed. (New York: Crown Business, 2012).

[41] Pinsky, "State Constitutional Limitations," 266n4.

[42] Alexander Hamilton, "Report on the Subject of Manufactures," in *The Industrial and Commercial Correspondence of Alexander Hamilton Anticipating His Report on Manufactures* (Chicago: A. W. Shaw, 1928 [1791]).

[43] Some of this opposition likely arose from the unique circumstances of the American founding. The much-reviled Tea Act of 1773, for example, was a mercantilist tax privilege for the East India Tea Company, a British government-chartered firm that already enjoyed several regulatory privileges. The founding era also coincided with the birth of classical economics, which rejected the earlier mercantilist theories.

B. Public Spending on Private Ventures

Beginning in the 1820s, state spending changed in both size and scope. First, states—especially those in the South—began to invest in private banks.[44] Then, following the rejection at the national level of John Quincy Adams's proposals to spend heavily on "internal improvements" (a plan modeled after Henry Clay's proposed American system), a number of states began to take it upon themselves to fund infrastructure projects.

The success of the publicly funded Erie Canal, which was completed in 1825, provided further impetus. It inspired two decades of state-supported railroads, turnpikes, and canals across the nation.[45] State governments hoped to stimulate their economies through investment in private firms, especially as interstate competition for economic development escalated.[46] During this era, "railroad promoters encouraged towns to bid against each other for influence in locating the railroads."[47] And towns obliged because railroads were believed to have "great potential for public benefit"[48] and to be "critical for economic development since the existence of the railroad would attract other economic enterprise."[49] Given the Jacksonian era's disdain for national spending on such projects, it was the states that took the lead.[50] But, as Columbia Law School's Richard Briffault has put it, "Many of these projects blurred public and private lines, with states investing in private firms, or providing grants, loans and loan guarantees to private companies."[51]

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[44] Wallis, "American Government Finance," 67; Rodden, *Hamilton's Paradox*, 58.
[45] Richard Briffault, "Disfavored Constitution: State Fiscal Limits and State Constitutional Law," *Rutgers Law Journal* 34, no. 4 (Summer 2003): 911.
[46] Briffault, "Disfavored Constitution, " 911.
[47] Brian Libgober, "The Death of Public Purpose (And How to Prevent It)" (Harvard Law School Discussion Paper, Cambridge, MA, March 2016), 13.
[48] Nicholas J. Houpt, "Shopping for State Constitutions: Gift Clauses as Obstacles to State Encouragement of Carbon Sequestration," *Columbia Journal of Environmental Law* 36 (2011): 381.
[49] Schaefer, "State Investment Attraction," 342.
[50] See, for example, Jackson's famous veto of the Maysville Road. The president not only noted that the project was "purely local" but also warned of "artful expedients to shift upon the Government the losses of unsuccessful private speculation." Andrew Jackson, "Veto Message," American Presidency Project (website), May 27, 1830.
[51] Briffault, "Disfavored Constitution," 911.

Though the political appetite for locally funded infrastructure spending was high, the appetite for taxes to pay for this spending was low. Early on, states had relied on property taxes.[52] As they began earning income on private projects, however, confidence in infrastructure investments grew, and some states reduced or eliminated their property taxes. By 1835, Alabama, Georgia, Maryland, Massachusetts, New York, Rhode Island, Pennsylvania, and South Carolina had all eliminated their state property taxes.[53] Direct taxation—including property, poll, and income taxation—had all but disappeared.[54] In its place, the main sources of state revenue became sales of public lands, returns on private investments, and proceeds from issuing bank charters.[55] The economic historian John Joseph Wallis has termed this the era of "taxless finance."[56] Reminiscent of modern loan guarantees, under taxless finance, taxpayers took a loss on such a project as a canal, a road, or a bank only if it failed.[57] And evidently, policymakers everywhere convinced themselves that failure was impossible. As a delegate to the Maryland Reform Convention reflected two decades later, "Every man dreamed he was about to reach a new *El Dorado*. Taxation was to exist no longer—public debt was to become an obsolete idea."[58]

State debt did not become an obsolete idea. In fact, it grew substantially. At the beginning of the 1820s, most states had little or no debt.[59] But between 1836 and 1839, the states incurred more debt than they had in their entire previous history.[60] Between 1810 and 1840, state debt per

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[52] Wallis, "American Government Finance," 67.
[53] Wallis, 67.
[54] Rodden, *Hamilton's Paradox*, 57.
[55] Rodden, 57.
[56] John Joseph Wallis, "Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842 to 1852," *Journal of Economic History* 65, no. 1 (2005): 213.
[57] Wallis, "Constitutions, Corporations, and Corruption," 213.
[58] Quoted in Carter Goodrich, "The Revulsion against Internal Improvements," *Journal of Economic History* 10, no. 2 (1950): 153.
[59] Rodden, *Hamilton's Paradox*, 57.
[60] Rodden, 58.

capita rose 144 percent.[61] Since the federal government paid off its debts entirely in 1835 (a feat that would never again be repeated) and thus stopped issuing bonds, foreign investors eagerly snatched up state bonds, not always recognizing the distinction between the federal and state governments.[62] By the late 1830s, state debt had soared to eight times all federal and local debts combined.[63] In 1830, Arkansas, Florida, Illinois, Indiana, Michigan, and Mississippi had no debt at all. But a decade later, their combined general obligation debt was more than $44 million (in current dollars).[64] As collateral against these debts, the states relied on the safety net provided by the federal government's implied support and the option of resuming property tax collection.[65]

Because these ventures permitted private actors to gamble with public money—in other words, they privatized gains and socialized losses—there was a strong incentive to pursue risky projects. As the Rutgers University law professor David Pinsky has put it,

> There was practically no public control over the planning of the railroad project[s] or over the actual expenditures of publicly contributed funds. These functions were completely delegated to private corporate officials. To phrase it more dramatically, but no less accurately, there was a total abdication of public responsibility. Not infrequently, railroad planning was so speculatively conceived and incompetently executed that the proposed line was never completed. Waste and dishonesty in the expenditure of funds led to corporate insolvency and abandonment of routes.[66]

The unsustainable nature of these public investments in private ventures was laid bare by the panic of 1837 and the significant recession that lasted from 1839 to 1843.[67] As the economy contracted, infrastructure projects across the country—marked, as Richard Briffault has put it,

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[61] Wallis, "American Government Finance," 61, 65.
[62] Horace Secrist, "An Economic Analysis of the Constitutional Restrictions upon Public Indebtedness in the United States," *Bulletin of the University of Wisconsin, Economics and Political Science Series* 8, no. 1 (1914): 17.
[63] Wallis, "American Government Finance," 62.
[64] Dale F. Rubin, "Constitutional Aid Limitation Provisions and the Public Purpose Doctrine," *Saint Louis University Public Law Review* 12 (1993): 156.
[65] The federal government had bailed out state Revolutionary War debts in 1790 and again repaid some state debts following the War of 1812. Then, in 1836, Congress agreed to pay $1.5 million in debts incurred by the District of Columbia. Many believe that these actions caused creditors to assume that the federal government would always bail out state governments. Rodden, *Hamilton's Paradox*, 55–60; Thomas J. Sargent, "Nobel Lecture: United States Then, Europe Now," *Journal of Political Economy* 120, no. 1 (February 2012): 15.
[66] Pinsky, "State Constitutional Limitations," 280.
[67] Rodden, *Hamilton's Paradox*, 58.

"by waste, overbuilding, and mismanagement"—failed to generate expected revenues.[68] By 1842, eight states and one territory had defaulted.[69] Four states—Arkansas, Florida, Michigan, and Mississippi—repudiated nearly $14 million in debt.[70] Out of these circumstances, the first wave of state constitutional anti-aid provisions was born.

C. First Wave of Anti-Aid Clauses: Restraining the States

As state fiscal positions eroded, support for federal assumption of state debts grew, especially among politicians representing the most heavily indebted states. The appropriately named William Cost Johnson, a representative from Maryland, headed a committee that ultimately recommended federal assumption of the state debts.[71] First and foremost, the committee argued, a bailout was justified by the precedents set in the federal bailouts following the Revolutionary War, the War of 1812, and the bailout of the District of Columbia in 1836.[72] The committee's proposal, however, was met with stiff resistance, especially among representatives from the handful of states that had not incurred massive debts. Ultimately, the assumption proposal was tabled.

Unable to shift their debts onto federal taxpayers, states were left to clean up their own messes. And one important consequence was that citizens and local leaders mobilized to prevent future messes. One approach, spearheaded by Rhode Island in 1842, was to adopt a

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[68] Briffault, "Disfavored Constitution," 911.
[69] The defaulting states were Arkansas, Illinois, Indiana, Louisiana, Maryland, Michigan, Mississippi, Pennsylvania, and the territory of Florida. Rodden, *Hamilton's Paradox*, 59.
[70] Benjamin Ulysses Ratchford, *American State Debts* (Durham, NC: Duke University Press, 1941), 114. As Joshua Bates, the umpire of the Anglo-American claims convention of 1853, put it, "It is to be hoped that sooner or later the people of Florida will discover that honesty is the best policy; and that no State can be called respectable that does not honorably fulfill its engagements" (111).
[71] Rodden, *Hamilton's Paradox*, 60.
[72] Rodden, 60.

constitutional amendment limiting debt accumulation.[73] By 1857, almost every state in the union had such a provision.[74] Another approach was to limit internal improvements.[75]

Since the state debt crisis was brought on by government-granted privileges to private companies, a number of these reforms specifically targeted such privileges. Many states, for example, adopted general incorporation clauses. These forbade the special incorporation of individual firms by government charters, which often entailed privileges and incentives.[76] Others sought to curb corruption by forbidding bank employees to serve in the legislature.[77] Several states adopted antimonopoly clauses, forbidding government-created monopolies.[78] And some adopted equality guarantees, which eliminated grants of special privilege.[79] All of these reforms were meant to realize the aspirations for impartial government that were already a part of 18th-century state constitutions.[80] Pennsylvania's 1776 constitution, for example, had already asserted that "government is, or ought to be, instituted for the common benefit, protection and security of the people, nation or community; and not for the particular emolument or advantage of any single man, family, or set of men."[81]

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[73] Rubin, "Constitutional Aid Limitation Provisions," 156.
[74] Secrist, "Economic Analysis," 54.
[75] These provisions are beyond the scope of this article. For those interested, see Pinsky, "State Constitutional Limitations," 281; Goodrich, "Revulsion against Internal Improvements."
[76] Tarr, *Understanding State Constitutions*, 112.
[77] See the Virginia Constitution of 1851, for example. Tarr, 112.
[78] Tarr, 111; Steven G. Calabresi and Larissa C. Leibowitz, "Monopolies and the Constitution: A History of Crony Capitalism," *Harvard Journal of Law and Public Policy* 36, no. 3 (June 22, 2013): 1067.
[79] Tarr, *Understanding State Constitutions*, 111; Robert F. Williams, "Equality Guarantees in State Constitutional Law (Symposium: The Emergence of State Constitutional Law)," *Texas Law Review* 62, no. 6 & 7 (March/April 1985): 1195.
[80] Tarr, *Understanding State Constitutions*, 111.
[81] Pennsylvania Constitution of 1776, Declaration of Rights, art. 5, 1776.

A particularly important strategy—the focus of this study—was to adopt constitutional limitations on public aid to private entities.[82] As the law professor Dale Rubin has put it, "The impetus for the adoption of both state and local constitutional aid limitation provisions was the untrammeled and indiscriminate borrowing by governmental entities and the ruthless profiteering by private corporations and individuals."[83]

Moreover, the aim of public aid limitations was, as one delegate to the Ohio conventions of 1850 and 1851 put it, "to see the State Government brought back to its simple and appropriate functions, [leaving] railroad, canal, turnpike and other corporate associations, to get along on their own credit, without any connection or partnership with the State whatever."[84] And as Josiah Scott of the Ohio Supreme Court put it, these provisions aimed to prohibit the union of public and private capital: "The mischief which this section interdicts is a business partnership between a municipality or subdivision of the State, and individuals or private corporations or associations. It forbids the union of public and private capital or credit in any enterprise whatever."[85]

Despite their early adoption by a few states in the 1840s, it took more than a decade for a majority of states to adopt anti-aid provisions.[86] These provisions generally took three forms. The most common was a *credit clause*. It forbade the government to loan its credit to a private individual, association, or corporation. A variant of this clause first appeared in the Rhode Island Constitution of 1842, requiring electoral approval for such deals. Shortly thereafter, New Jersey (1844) and New York (1846) adopted their own credit clauses, but these forbade the lending of

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[82] These approaches were not mutually exclusive. Rhode Island's debt clause read, "The general assembly shall have no power hereafter, without the express consent of the people, to incur state debt to an amount exceeding 50,000 dollars, except in time of war, or in case of insurrection; Nor shall they in any case, without such consent, pledge the faith of the state for the payment of the obligations of others." Rhode Island Constitution of 1842, art. 4, sec. 13, 1842.
[83] Rubin, "Constitutional Aid Limitation Provisions," 156.
[84] Quoted in Kermit L. Hall and Peter Karsten, *The Magic Mirror: Law in American History*, 2nd ed. (New York: Oxford University Press, 2008), 103–4.
[85] Josiah Scott, Walker v. City of Cincinnati, 21 Ohio St. 14 (1871).
[86] Rubin, "Constitutional Aid Limitation Provisions," 144n5.

credit with or without electoral approval.[87] The second type of anti-aid provision was a *stock clause*, which forbade the government from becoming a stockholder in any corporation. This was pioneered by Iowa in 1846.[88] The final provision was a *gift clause*, which forbade the government from granting loans or donations to any individual, association, or corporation. This provision first appeared in Pennsylvania's 1873 constitution.[89]

The spread of anti-aid provisions was by no means uniform. Some states adopted just one provision, some two, and others all three. Moreover, especially in their earliest iterations, public anti-aid provisions did not necessarily apply to substate governments, such as counties, cities, or school districts.[90] Despite these variations, however, by 1900 some form of public aid limitation had been adopted by a large majority of states.[91] Even those that had withstood the panic of 1837 without defaulting adopted these provisions to avoid the fate of their neighbors.[92]

The case for anti-aid provisions was both moral and practical. During the 1850 and 1851 debates at Indiana's constitutional convention, Representative A. F. Morrison offered both types of arguments. On moral grounds, he asserted, "There is no justice in the principle that the property or the money of the people should be taken to make profits for corporations." And on the practical side, he articulated the public choice concerns as well as any modern economist might. Publicly supported internal improvements, he said, were "a system of oppression inflicted by the representatives of the people . . . by means of a regular system of log rolling. . . . It is well known how these schemes are got along in the Legislature. Corporations are always well

[87] Pinsky, "State Constitutional Limitations," 278n70.
[88] Pinsky, 278n71.
[89] Pinsky, 279n77.
[90] Pinsky, "State Constitutional Limitations," 280.
[91] Pinsky, 280.
[92] Tarr, *Understanding State Constitutions*, 112.

represented there, and the people have no knowledge of what is going on until they are entrapped by them."[93]

In the decades following the advent of these anti-aid provisions, state aid to private corporations did not end altogether, but it was sharply curtailed.[94] As Wallis has put it, "The tide of events had turned against state activity."[95] Following the adoption of these provisions, there was a dramatic change in state and local fiscal policy; states reduced their reliance on debt finance, and more activity shifted from state to local governments.[96] In 1841, the states' share of all government debt was 86.4 percent, but by 1902, it was 7.0 percent.[97]

D. Second Wave: Restraining Localities

The first wave of anti-aid provisions did not always apply to localities.[98] Consequently, as states curtailed their direct support of private interests, localities ramped it up. In many cases local governments began to take on the sorts of risks that states had once assumed. Sometimes states abetted this local circumvention of anti-aid provisions. The constitutional scholar Alan Tarr writes, "From 1866 to 1873, legislatures approved over eight hundred proposals to grant local aid to railroad companies. New York, Illinois, and Missouri together authorized over $70 million worth of aid."[99]

As with the state aid that had preceded it, much of this local aid was financed through government borrowing or government guarantees of private debt. Thus, as the states' share of all government debt was declining, localities' share rose, going from 11.4 percent in 1841 to

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[93] *Report of the Debates and Proceedings of the Convention for the Revision of the Constitution of the State of Indiana, 1850–1851* (Indianapolis: A. H. Brown, 1850), 651–52.
[94] Wallis, "American Government Finance," 70.
[95] Wallis, 70.
[96] Wallis, 66–70.
[97] Wallis, 66.
[98] Houpt, "Shopping for State Constitutions," 381; Pinsky, "State Constitutional Limitations," 278–80.
[99] Tarr, *Understanding State Constitutions*, 114.

57.1 percent in 1902.[100] Similarly, while local government revenue per capita had been about 40 percent greater than state revenue per capita in 1840, by 1902 it was 260 percent greater.[101]

As before, the precarious fiscal position of governments—this time, local governments—was laid bare by a national economic contraction. As the panic of 1873 gave way to a deep and lasting economic depression, property values plummeted, and railroads began to default on their debts. By 1874, about 25 percent of all railroad bonds were in default.[102] Next, the municipalities that had guaranteed many of these debts began to default on their own obligations en masse. It is estimated that roughly 20 percent of all municipal debt obligations were defaulted on in the 1870s.[103]

These defaults prompted a second wave of constitutional reforms, this one extending anti-aid provisions to local governments.[104] While a few states (Indiana in 1851, Nevada in 1864, Georgia in 1868, and Illinois in 1870) had already extended their anti-aid provisions to localities, the municipal debt crisis of the 1870s prompted more than a dozen more states to do so over the course of the next decade and a half.[105]

As Colorado acquired statehood in the midst of this economic crisis, its 1876 constitution and its convention are worth noting.[106] In their Address to the People, the delegates there asserted that no other issue had caused "more anxiety and concern than the troublesome and

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[100] Wallis, "American Government Finance," 66.
[101] Wallis, 70.
[102] John A. Dove, "Financial Markets, Fiscal Constraints, and Municipal Debt: Lessons and Evidence from the Panic of 1873," *Journal of Institutional Economics* 10, no. 1 (2014): 76.
[103] C. H. Chatters, *Municipal Debt Defaults: Their Prevention and Adjustment* (Chicago: Public Administration Service, 1933); A. M. Hillhouse, *Municipal Bonds: A Century of Experience* (New York: Prentice-Hall, 1936); Dove, "Financial Markets, Fiscal Constraints."
[104] Tarr, *Understanding State Constitutions*, 114; Briffault, "Disfavored Constitution," 912.
[105] Credit and stock clauses were applied to local governments by Arkansas, New York, and Pennsylvania in 1874; Alabama, Florida, and Missouri in 1875; Colorado and Texas in 1876; Connecticut and New Hampshire in 1877; Maine in 1878; California in 1879; and Montana and Washington in 1889. Dove, "Financial Markets, Fiscal Constraints," 77.
[106] See, generally, Dale A. Oesterle, "Lessons on the Limits of Constitutional Language from Colorado: The Erosion of the Constitution's Ban on Business Subsidies," *University of Colorado Law Review* 73, no. 2 (2002): 587–617.

vexed question pertaining to corporations."[107] On the one hand, the territory had little internal capital or infrastructure, and the delegates were eager to encourage economic development. On the other hand, they were acutely aware of the corruption and fiscal ruin that had plagued those states that encouraged development through subsidies. They were also aware that several of their own territorial cities had grown insolvent through bad deals with railroads.[108] Writing in the Address to the People, the delegates worried that "the Legislatures of other States have, in most cases, been found unequal to the task of preventing abuses and protecting the people from the grasping and monopolizing tendencies of railroads and other corporations."[109]

The delegates considered a number of proposals to directly rein in corporations. For example, they considered granting the general assembly the authority to set railroad rates, to abolish limited liability, to regulate banking, to require annual reporting, and to require the publication of shareholder lists.[110] Each of these proposals was rejected. Dale Oesterle, a professor at the University of Colorado School of Law, writes, "Instead of a long list of specific regulations and minute requirements, the delegates decided they could encourage businesses to locate in the state by offering those businesses what was at the time substantial organizational and operating freedom. To nullify the incentives for bribery and corruption of the state legislature, the delegates relied on restrictions on the state legislature itself."[111]

As the delegates asserted in their address, "Experience has shown that positive restrictions on the powers of the Legislature in relation to these matters are necessary."[112] With that, they adopted credit and stock clauses and extended these provisions to local

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[107] Timothy O'Connor, "The Address to the People Issued by the Convention," in *Proceedings of the Constitutional Convention Held in Denver, December 20, 1875 to Frame a Constitution for the State of Colorado* (Denver: Colorado Secretary of State, 1907), 728.
[108] Oesterle, "Lessons on the Limits," 594.
[109] O'Connor, "Address to the People," 728.
[110] Oesterle, "Lessons on the Limits," 594–95.
[111] Oesterle, 595.
[112] O'Connor, "Address to the People," 728.

governments.[113] Various other provisions of the constitution strengthened these provisions. Laws, for example, had to be general in their application and could not target specific groups for special treatment.[114] In support of these safeguards, the delegates wrote, "The evils of local and special legislation being enormous, the passage of any law not general in its provisions is prohibited—thus saving the State from expenses usually incurred in passing and publishing laws secured by combinations to advance private interests and to create dangerous monopolies."[115]

The second wave of anti-aid provisions was more successful than the first wave, adopted after state defaults in the early 1840s. With the municipal fiscal crisis fresh in mind and with the framers' intentions abundantly clear, courts were active over the next half century in policing governments that overstepped the bounds established by anti-aid clauses, certainly more active than they would come to be as the 20th century wore on. Importantly, early courts understood that the framers of these provisions intended them to limit public aid to private interests regardless of the aid's purpose.[116]

Colorado provides an illustrative example. The first case to consider that state's anti-aid provision was *Colorado Central R.R. v. Lea* in 1879.[117] There, the court—three members of which were delegates to the Colorado Constitutional Convention—was asked to decide whether

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113 Oesterle, "Lessons on the Limits," 595n47.
114 Oesterle, 591n23.
115 O'Connor, "Address to the People," 725.
116 See, for example, Adams v. Jackson Elec. Ry., Light & Power Co., 30 So. 58, 59 (Miss. 1901) (invalidating expenditure with no discussion of public purpose); State ex rel. Bd. of Control of St. Louis Sch. & Museum of Fine Arts v. City of St. Louis, 115 S.W. 534, 548 (Mo. 1908) (invalidating expenditure despite claim of public purpose and discussing history of provisions); Wyscaver v. Adkins, 37 Ohio St. 80 (1881) (striking down a statute authorizing a township to raise $20,000 to make a private railway and finding that the state's anti-aid clause "forbids the union of public and private capital or credit in any enterprise whatever"); Counterman v. Dublin Township, 38 Ohio St. 515 (1882); Taylor v. Comm'rs of Ross County, 23 Ohio St. 22 (1872); Pleasant Township v. Aetna Life Ins. Co., 138 U.S. 67, 11 S. Ct. 215, 34 U.S. (L. ed.) 864 (1891); Alter v. Cincinnati, 56 Ohio St. 47 (1897); State v. City of St. Louis, 115 S.W. 534 (1908) (invalidating a statute that permitted St. Louis to levy a tax that benefited a private corporation, the St. Louis School and Museum of Fine Arts); Garland v. Board of Revenue of Montgomery County, 6 So. 402 (1889) (invalidating a municipal proposal to build a bridge for a railroad); Mayor of Jersey City v. North Jersey St. Ry. Co., 73 A. 609 (1909) (holding that failure to collect licensing fee from railroad for 30 years was a violation of the state's anti-aid clause).
117 Colorado Central R.R. v. Lea, 5 Colo. 192 (1879).

Boulder County commissioners violated the state's anti-aid clause when they called an election asking voters to subscribe $200,000 to the capital stock of the Colorado Central Railroad. The county maintained that this was permitted since it believed the subscription to be in the public's interest. In ruling the county's actions invalid, the court asserted, "If the existence of a public benefit is to give such an agreement the character of a sale of the stock and take it out of the constitutional provision, then the prohibition is utterly nugatory and valueless; as such consideration would exist in every probable case."[118] The court further asserted that the intention of the anti-aid provision was clear:

> It was undoubtedly the intention of the framers of the Constitution, whether wisely or not, to prohibit, by the fundamental law of the new State, all public aid to railroad companies, whether by donation, grant or subscription, *no matter what might be the public benefit and advantages flowing from the construction of such roads*. I understand the framers of the Constitution and the people who adopted it, to have intended by this provision the declaration of *a broad policy of prohibition*, forbidding State, county and municipal aid to railroad *and other companies* in any of the modes specified.[119]

As we showed in section II, targeted economic development incentives are generally not, in fact, in the public interest. Nevertheless, the policymakers that craft these policies are almost universally under the impression that they are.

Courts were, however, by no means universally rigorous in policing state and local violations of anti-aid provisions.[120] Over time, legislatures devised ways to circumvent these rules while courts invented new doctrines that have in many places vitiated these provisions. Nevertheless, the case history of this period shows that—for a time—in geographically and

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[118] *Colorado Central R. R.*, 5 Colo. 192.

[119] *Colorado Central R. R.*, 5 Colo. 192, 196 (emphasis added). See also Lord v. City & County of Denver, 58 Colo. 1, 16 (1914) ("Indeed, it would seem that language could not make plainer the intent of the framers of the [Colorado] Constitution to utterly prohibit the mingling of public moneys with those of private persons, either directly or indirectly, or in any manner whatsoever.").

[120] Rubin, "Constitutional Aid Limitation Provisions," 161.

politically diverse regions of the country, courts were willing to stop the elected branches when they transgressed constitutional anti-aid provisions.[121]

What was the result? While it is impossible to determine a causal relationship or to disentangle the effects of these provisions from those of other reforms adopted at this time, the adoption of anti-aid provisions did coincide with improved policy. First, the financial footing of government grew stronger. Figure 1 shows state, local, and combined state and local debt as a share of national income from 1838 through 1913. Immediately following the first wave of reforms, state debts as a share of national income began to fall. Given the local loophole, however, local debt as a share of income rose. Following the second wave of reforms, local debt as a share of GDP also began to fall and then leveled off. By the end of the 19th century, combined state and local debt stood as a smaller share of national income than at any previous point since the crisis of the early 1840s. Second, as their fiscal positions improved, municipalities found themselves facing lower borrowing costs. The economist John Dove analyzed the prices of bonds issued by dozens of US cities in the latter decades of the 19th century.[122] He found that among those cities that had defaulted in the crisis of the 1870s, those that subsequently adopted either a credit or a stock clause faced borrowing costs that were between 170 and 249 basis points lower.[123] Finally, as state and local governments curtailed their use of targeted economic development subsidies, the US economy entered a period of prolonged and robust economic expansion.[124]

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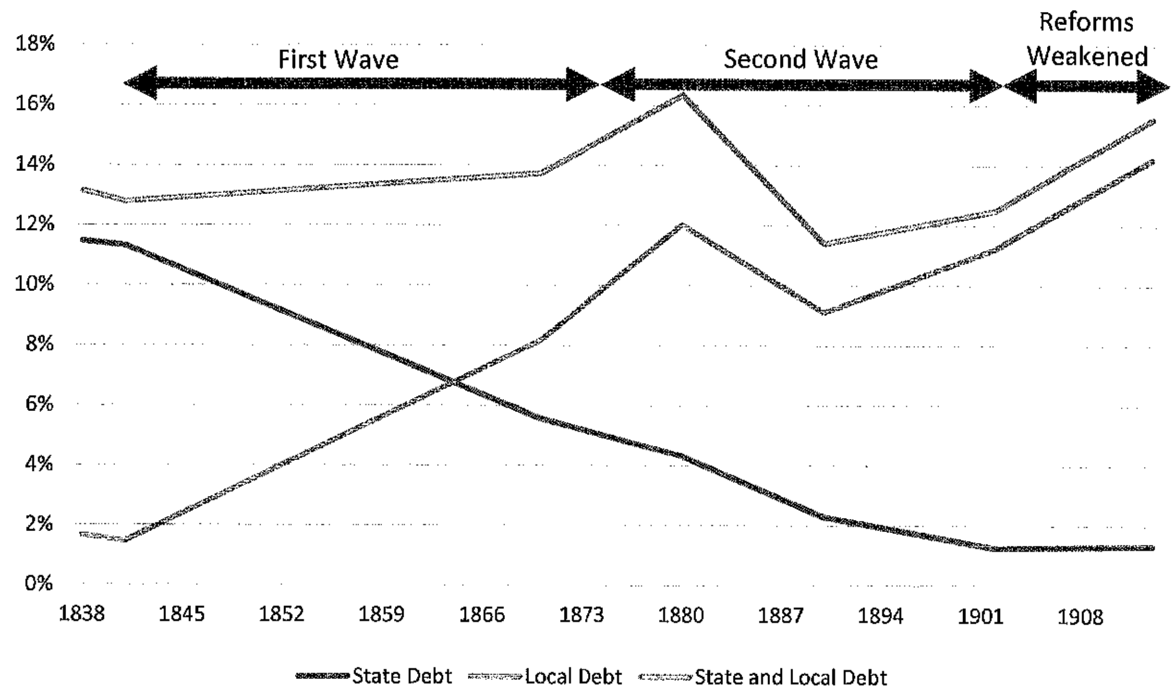
[121] Rubin, 161.
[122] Dove, "Financial Markets, Fiscal Constraints."
[123] His analysis is based on an ordinary least squares (OLS) regression that includes a large set of control variables that account for other socioeconomic factors that might affect borrowing costs. Dove, 92.
[124] Christina D. Romer, "Is the Stabilization of the Postwar Economy a Figment of the Data?," *American Economic Review* 76, no. 3 (1986): 314–34.

Figure 1. Government Debt as a Share of National Income



Sources: Debt figures are reported in John Joseph Wallis, "American Government Finance in the Long Run: 1790 to 1990," *Journal of Economic Perspectives* 14, no. 1 (2000). National income figures are from US Department of Commerce, Bureau of the Census, *Historical Statistics of the United States 1789–1945: A Supplement to the Statistical Abstract of the United States*, Washington, DC, June 1949, 14. National income figures are not available for every year, and some data are interpolated.

In the next section we will discuss the ways in which these clauses have been weakened, distorted, or ignored. Even so, empirical research suggests that these laws continue to affect the size and scope of subsidies and have a positive effect on state economies. Well into the latter half of the 20th century, for example, researchers were finding that these constitutional prohibitions were having an influence on the types of incentives offered by governments, making gifts of land and money the least-used varieties of subsidy.[125] More recently, the economist Carlianne Patrick

[125] John C. Gray and Dean A. Spina, "State and Local Industrial Location Incentives—a Well-Stocked Candy Store," *Journal of Corporate Law* 5 (1980): 528.

has developed an index measuring the strength of constitutional aid limits.[126] She finds that those places with weaker limits—and therefore more subsidies to private businesses—experience significantly lower levels of rural employment in the medium term. In subsequent work, she has found that states with weaker anti-aid provisions tend to subsidize capital, causing firms to substitute such capital as computers and robots for labor. She finds that this decreases employment density and causes an employment shift from labor-intensive to capital-intensive industries.[127]

E. The Weakening of Anti-Aid Provisions

Courts have weakened constitutional anti-aid provisions over the past century.[128] They did so, in large measure, by turning the judicially created Public Purpose Doctrine on its head. The doctrine dates back to an 1853 case called *Sharpless v. Mayor of Philadelphia*,[129] which was decided two decades before an anti-aid provision restricting municipalities' abilities to offer subsidies was added to the Pennsylvania Constitution.[130] In the 1840s and 1850s, the Pennsylvania legislature had authorized the city of Philadelphia to use borrowed money to buy

[126] Carlianne Patrick, "Does Increasing Available Non-Tax Economic Development Incentives Result in More Jobs?," *National Tax Journal* 67, no. 2 (June 2014): 351–86.
[127] Carlianne Patrick, "Jobless Capital? The Role of Capital Subsidies" (working paper, W. E. Upjohn Institute for Employment Research, Kalamazoo, MI, January 1, 2015).
[128] State legislatures have also done much to circumvent constitutional restrictions and provide public resources for private purposes. Though it is beyond the scope of the current analysis, state legislatures frequently circumvent anti-aid clauses through the creation of revenue bonds, moral obligation bonds, and special districts. Governments typically issue revenue bonds to finance the purchase of property that they then lease to private firms. Unlike a general obligation bond, a revenue bond is not backed by government credit or taxing authority; the bond is only secured by the property and by the rental payments from the firm, sparing taxpayers the risk and making it similar in function to a private bond. Because of this, these bonds have not been found to run afoul of state credit clauses. Federal taxpayers do bear a cost, however, because the interest on revenue bonds is exempt from federal income taxation. Moreover, many states exempt the projects financed through these bonds from state and local property taxes because they deem the property to be owned by the public and not by the private entity that occupies it. See Rubin, "Constitutional Aid Limitation Provisions," 161; Gray and Spina, "State and Local," 533–37.
[129] Sharpless v. Mayor of Philadelphia, 21 Pa. 147 (1853).
[130] Dove, "Financial Markets, Fiscal Constraints," 77.

shares in two private railroads.[131] A Philadelphia taxpayer named William P. Sharpless brought suit claiming that the state had no authority to use the public taxing power to support a private interest.

At least in principle, the Pennsylvania Supreme Court agreed. The court asserted, "It is said that this is a taking of *private* property for *private* use. If this be so, it is palpably unconstitutional." Though the constitution had no "express inhibition" against such legislation, the court concluded that the assembly had no authority "to take one man's property and give it to another."[132] Thus was born the Public Purpose Doctrine: the state may only tax to fund projects that are in the public interest; projects that benefit private interests are forbidden. In 1874, the US Supreme Court issued its first ruling regarding the Public Purpose Doctrine, finding that state legislatures may confer to municipalities the right to levy taxes, but only if those taxes serve a public purpose.[133] By 1917, the Court had incorporated the doctrine into the 14th Amendment.[134]

On its face, the Public Purpose Doctrine would seem to complement state constitutional anti-aid provisions. Like these provisions, it prohibits the expenditure of public resources in service of private interests. In practice, however, it has come to thwart anti-aid provisions for two reasons. First, from the beginning, courts have shown an extraordinary tendency to construe "public purpose" in as broad a light as possible. Even in *Sharpless* itself, the court did *not* side with the taxpayer. Instead, the court concluded that, even though the railroad was private, the railroad subsidy nevertheless served a public purpose: "It cannot be denied that a railroad company is a private corporation. But the right to tax depends on the ultimate use, purpose, and

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[131] Howard Gillman, Mark A. Graber, and Keith E. Whittington, *American Constitutionalism*, vol. 1, *Structures of Government, Supplementary Material* (New York: Oxford University Press, 2013), 1.
[132] *Sharpless*, 21 Pa. at 167.
[133] Loan Association v. Topeka, 87 U.S. (20 Wall.) (1874).
[134] Jones v. City of Portland, 245 U.S. 217 (1917).

object for which the fund is raised, and not on the nature or character of the person or corporation whose intermediate agency is to be used in applying it."[135]

In other words, the court concluded that the government could buy shares in a private corporation so long as the goal was to serve a public purpose. Second, decades later, courts would come to see the Public Purpose Doctrine as an *exception* to anti-aid provisions rather than as a *complement* to them. In the 1918 case of *Georgia v. Cincinnati Southern Railway*, for example, the US Supreme Court held that Georgia could grant a right-of-way to a railroad despite the state constitution's bar against "any donation or gratuity in favor of any person, corporation or association."[136] As the Court put it, "A conveyance in aid of a public purpose from which great benefits are expected is not within the class of evils that the constitution intended to prevent."[137] Similar conclusions were reached in a number of state court decisions.[138]

In all of these cases, courts found that the judicially created Public Purpose Doctrine was an exception to the rules stated in constitutional anti-aid provisions.[139] They saw the Public Purpose Doctrine as a justification to provide public aid to private enterprise so long as the expenditure served some public or quasi-public purpose. This interpretation is at odds with the doctrine's initial articulation as a *restraint* on government expenditures, requiring all public projects to serve purely public purposes. It is also at odds with the plain language of anti-aid provisions, which forbid government aid to private firms or individuals regardless of the aid's purpose.

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[135] *Sharpless*, 21 Pa. at 169.
[136] Georgia v. Cincinnati Southern Railway, 248 U.S. 26 (1874).
[137] *Cincinnati Southern Railway*, 248 U.S. at 30.
[138] City of Oakland v. Garrison, 228 P. 433 (Cal. 1924); Alameda County v. Janssen, 106 P.2d 11 (Cal. 1940); Brazoria County v. Perry, 537 S.W.2d 89 (Tex. 1976); City of Charlottesville v. Dehaan, 323 S.E.2d 131 (Va. 1984); Hayes v. State Property and Buildings Comm'n, 731 S.W.2d 797 (Ky. 1987); City of Aurora v. Public Utilities Comm'n, 785 P.2d 1280 (Colo. 1990).
[139] For a fuller discussion, see Rubin, "Constitutional Aid Limitation Provisions."

Another problem with this interpretation is that the Public Purpose Doctrine was first adumbrated in *Sharpless* in 1853, decades before most states adopted their constitutional anti-aid provisions. As Rubin puts it, "Since most of the aid limitation provisions were adopted *after* the Public Purpose Doctrine was judicially enunciated, the courts could not have conceived the doctrine either as an exception or as a doctrine devised to preempt such limitations."[140]

In the landmark *Munn* decision of 1876, the US Supreme Court held that the government could regulate economic arrangements that were "affected with a public interest."[141] Following this decision, state constitutions written in the decades that followed, and legislation enacted during this period, began using "public interest" phraseology.[142]

Government involvement with and regulation of private enterprise increased dramatically during the crisis of the Great Depression. Economists, legal theorists, and policymakers challenged long-held beliefs about the proper role of government in the private economy.[143] This sea change was supported by several US Supreme Court cases during the New Deal era. For example, in *Nebbia v. People of New York*, the Court upheld price-fixing for milk and articulated for the first time the "rational basis" test, which provides extraordinary deference to government involvement in private economic activity.[144] These decisions illustrate the changing dynamic between the state and the private market, and they provided judicial blessing for government decision-making involving private enterprise.

Aware that courts saw the Public Purpose Doctrine as an exception to anti-aid provisions, state legislatures were careful to include the words "public purpose" in their subsidy legislation.

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[140] Rubin, "Constitutional Aid Limitation Provisions," 166 (emphasis in original).
[141] Munn v. People of State of Illinois, 94 U.S. 113, 126, 24 L. Ed. 77 (1876).
[142] Timothy Sandefur, "A Natural Rights Perspective on Eminent Domain in California: A Rationale for Meaningful Judicial Scrutiny of 'Public Use,'" *Southwestern University Law Review* 32 (2003): 648–51.
[143] Robert Higgs, *Crisis and Leviathan: Critical Episodes in the Growth of American Government*, 25th anniv. ed. (Oakland, CA: Independent Institute, 1987); Price Fishback, *Government and the American Economy: A New History* (Chicago: University Of Chicago Press, 2007).
[144] 291 U.S. 502, 525; 54 S. Ct. 505, 511; 78 L. Ed. 940 (1934).

This practice dates back to Mississippi's famous 1936 Balance Agriculture with Industry (BAWI) program, which is widely considered to mark the beginning of the modern era of targeted economic development subsidies. The BAWI program permitted local governments to hold bond elections to purchase land, build factories, and rent these facilities to private manufactuers at low cost.[145] In the preamble to the act, legislators wrote that the "general welfare of its citizens demand, as a public purpose, the development within Mississippi of industrial and manufacturing enterprises."[146] As the economist James Bennet has put it, "By invoking those magic words, those constitutional talismans *general welfare* and *public purpose*, this act, which plainly violated the state charter of the Magnolia State, became kosher."[147] When the BAWI program came before the Mississippi Supreme Court, a majority of justices found it did not violate the state's anti-aid provision, because "in all its parts it contemplates that the proposed industry shall be operated for the accomplishment of the purposes outlined therein."[148] In his blistering dissent, Justice Anderson said the decision "drove a steam shovel through our constitution."[149] The US Supreme Court dismissed an appeal of the case and thus, in the words of two scholars, "closed the door on federal court review of the basic principles underlying industrial development bond financing."[150]

The evolution of anti-aid provisions in many states progressed from strict enforcement of the provisions after they were first adopted to subsequent approval of subsidies for low-income housing (or "slum clearance") programs and other support for the poor, then to approval of

[145] Peter K. Eisinger, *Rise of the Entrepreneurial State*, La Follette Public Policy Series: State and Local Economic Development Policy in the United States (Madison: University of Wisconsin Press, 1989); Bennett, *Corporate Welfare*, 80.
[146] Quoted in James C. Cobb, *The Selling of the South: The Southern Crusade for Industrial Development, 1936–1980* (Baton Rouge: Louisiana State University Press, 1982), 14.
[147] Bennett, *Corporate Welfare*, 83.
[148] Albritton v. City of Winona, 178 So. 799 (Miss. 1938).
[149] 178 So. at 812 (Anderson, J., dissenting).
[150] Gray and Spina, "State and Local," 538.

industrial manufacturing projects, and finally to approval of all manner of economic development schemes.[151]

In time, courts came to take what Richard Briffault has described as "a posture of extreme deference to state legislatures, finding that a broad range of goals fall under the rubric of public purpose, and that legislative determinations that a spending, loan, or tax incentive program will promote the public purpose are to be accepted as long as they are 'not . . . irrational.'"[152]

In so doing, they forgot or ignored the initial aim of the provisions—namely, as the Arizona Supreme Court put it, "to prevent governmental bodies from depleting the public treasury by giving advantages to special interests or by engaging in non-public enterprises." [153] The purpose of these provisions is no less relevant today, especially in the context of prolific public aid to private businesses for the so-called public purpose of economic development (despite the fact that the public is no better off for it).[154]

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[151] See, for example, Humphrey v. City of Phoenix, 55 Ariz. 374 (1940) (upholding revenue bonds to finance a slum clearance project); In re Constitutionality of ORS 456.720, 272 Or. 398 (1975) (same); Opinion to the Governor, 112 R.I. 151, 155–56 (1973) ("The elimination of overcrowded, unsanitary and dangerous dwelling accommodations and the assisting in making available decent, safe and sanitary housing for people whose income would make such an acquisition impossible unquestionably serves a public purpose."); Utah Hous. Fin. Agency v. Smart, 561 P.2d 1052, 1054 (Utah 1977) ("It cannot be said that the finding of the legislature that a public purpose is served by increasing the availability of financing for construction, purchase, and rehabilitation of low and moderate income housing, is incorrect or unreasonable on its face."); Suber v. Alaska State Bond Comm., 414 P.2d 546, 552 (Alaska 1966) (public purpose for relief and support of the poor); Wright v. City of Palmer, 468 P.2d 326, 330–31 (Alaska 1985) (public purpose for improvement program to encourage industrial development); Carruthers v. Port of Astoria, 249 Or. 329, 336 (1968) (listing several cases in which revenue bonds for industrial development were upheld as a public purpose); Maready v. City of Winston-Salem, 342 N.C. 708, 725 (1996) (listing 46 states that have upheld economic development as a public purpose).

[152] Briffault, "Disfavored Constitution," 914, quoting Delogu v. State, 720 A.2d 1153 (Me. 1998).

[153] Wistuber v. Paradise Valley Unified Sch. Dist., 141 Ariz. 346, 349 (1984). See also Bannon v. Port of Palm Beach District, 246 So. 2d 737, 741 (Fla. 1971) (to "protect public funds and resources from being exploited in assisting or promoting private ventures when the public would be at most only incidentally benefited"); Idaho Falls Consolidated Hospitals v. Bingham County Board of Commissioners, 102 Idaho 838 (1982) (apparent that framers "were primarily concerned about private interests gaining advantage at the expense of the taxpayer"); Lawrence v. Schellstede, 348 P.2d 1078, 1081–82 (Okla. 1960) (to prevent the investment of public funds in private enterprises).

[154] See section II above.

Following the BAWI program and the courts' acceptance of it, other southern states initiated their own targeted economic development programs, and in the years following World War II, the practice became all but universal. Figure 2 shows the proliferation of such programs in the 1960s and 1970s. Even when courts did not defer to legislative judgments and did find subsidies unconstitutional, state legislators reacted by amending their constitutions in order to once again permit subsidies. For example, in 1987, Texas amended its constitution to read as follows: "Notwithstanding any other provision of this constitution, the legislature may provide for the creation of programs and the making of loans and grants of public money . . . for the public purposes of development and diversification of the economy of the state."[155] In some cases, courts appealed to such extraconstitutional considerations as interstate economic competition as a rationale for upholding subsidies.[156] As North Carolina's Justice Robert Orr stated in a 1996 dissent, the judicial philosophy in these cases seems to boil down to "everybody's doing it."[157]

Briffault reports, "By the end of the [20th] century virtually every state supreme court had upheld at least some economic development programs that involved direct assistance—including cash grants, low-interest loans, and tax breaks—to individual firms."[158] Nevertheless, there remains some variation in the strength of anti-aid provisions and in the extent to which they are honored. (It is because of this variation that economists have been able to estimate the effects of these provisions.) Moreover, recent legal developments suggest that some courts may be beginning to take these provisions seriously again.

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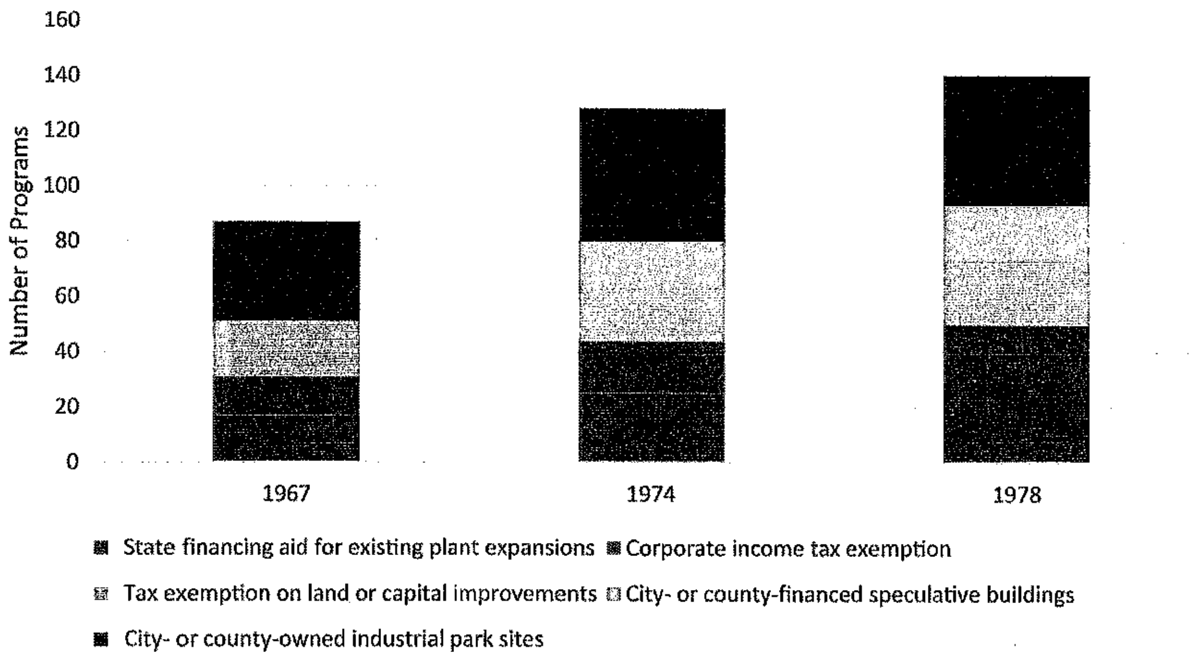
[155] Tex. Const. art. 3, sec. 52-a (1987).
[156] For a thorough discussion of this and citations, see Schaefer, *State Investment Attraction.*
[157] *Maready*, 342 N.C. at 739 (Orr, J., dissenting).
[158] Briffault, "Disfavored Constitution," 913.

Figure 2. Growth in the Number of States Offering Incentives



Source: "The Fifty Legislative Climates," an annual survey of the states published in the November–December issue of *Industrial Development* for the years 1967, 1974, and 1978, reprinted in H. McKinley Conway, *Legislative Climates for Economic Development* (Atlanta: Conway Publications, 1979), A-3 to A-5, A-99 to A-101, A-255 to A-257.

IV. The Current State of Anti-Aid Provisions

Currently 49 state constitutions place some type of limit on government use of public funds to promote private interests.[159] In 45 states, these measures take the form of traditional anti-aid provisions, or clauses, that prohibit public financing of private entities.[160]

A. Three Varieties of Anti-Aid Provisions

These anti-aid provisions take three forms: (1) loans and credit, or credit clauses; (2) stock subscriptions and joint ownership, or stock clauses; or (3) appropriations, donations, grants,

159 Kansas is the only state that does not have a public aid limitation anywhere in its constitution.

160 The exceptions are Alaska, Connecticut, Illinois, Kansas, and Vermont. South Dakota has a state credit clause, but it permits lending of credit with a supermajority of the legislature.

gifts, and subsidies, or gift clauses.[161] Figure 3 shows the present status. Currently 44 states have some variety of credit clause, prohibiting government bodies from lending money or credit for nonpublic uses; 32 states currently have a stock clause prohibiting stock subscription in and joint ownership of private ventures. And 29 states have a gift clause, generally prohibiting expenditures of public money for which the government body fails to receive anything valuable (i.e., consideration) in exchange, rendering the expenditure a mere gratuity.

Because individual anti-aid provisions are, as Pinsky puts it, a product of "specific evils which had manifested themselves" in the different states during the industrial expansion of the 19th century, some state constitutions forbid only one form of public aid, while others forbid two or all three.[162] Likewise, some anti-aid provisions apply to the state, others apply to political subdivisions of the state, and some provisions apply to both levels of government. In addition, some anti-aid limitations are contained within a single clause, while others are found in two or more separate clauses. For a list of states and their respective anti-aid provisions, see table A1 in the appendix.

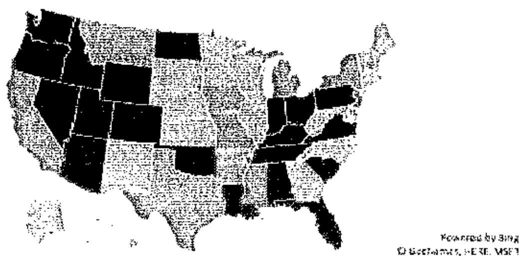
[161] In his seminal law review article on the history of anti-aid provisions, David E. Pinsky uses the term "current appropriations" clause rather than "gift clause" to describe this category of anti-aid provisions. Pinsky, "State Constitutional Limitations," 265–327, 280. While Pinsky's term is more accurate because it encompasses states that prohibit "appropriating money" or "raising money" for private entities in addition to those that prohibit donations, grants, gifts, and subsidies, this paper uses the latter term.

[162] Pinsky, "State Constitutional Limitations," 280.

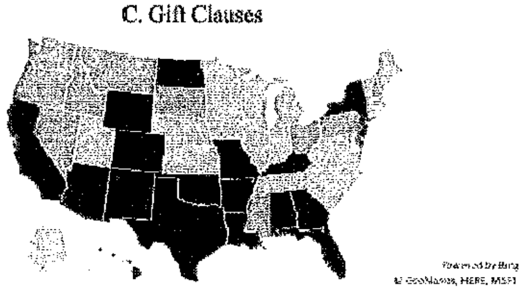
Figure 3. The Current State of Anti-Aid Provisions

A. Credit Clauses

B. Stock Clauses



C. Gift Clauses



■ Both Levels of Government ▩ One Level of Government ░ None

Source: Authors' research. See appendix for details.

Nine state constitutions expressly prohibit both levels of government from aiding private entities in any of the three forms discussed above.[163] For example, Arizona's anti-aid provision says the following:

> Neither the state, nor any county, city, town, municipality, or other subdivision of the state shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation, or become a subscriber to, or a shareholder in, any company or corporation, or become a joint owner with any person, company, or corporation, except as to such ownerships as may accrue to the state by operation or provision of law or as authorized by law solely for investment of the monies in the various funds of the state.[164]

Arizona's anti-aid clause is textually stronger than provisions in most other states because it applies to both levels of government, prohibits all three forms of aid, and allows only two exceptions, both related to legitimate government functions.[165] Most of the other nine constitutions that apply to both levels of government and prohibit all three forms of aid also contain textual exceptions (e.g., Oklahoma and Wyoming permit support for economic development).[166]

In comparison, anti-aid provisions in 36 states also have various textual exceptions and either fail to address both levels of government or fail to limit all three forms of public aid. Other provisions contain few exceptions, apply to both levels of government, and prohibit more than one form of public aid. Logically, those that contain fewer textual exceptions, address more varieties of aid, and apply to both levels of government tend to be stronger. Most anti-aid provisions fall somewhere in between. For example, New Mexico's anti-aid provision states,

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[163] These are Arizona, Colorado, Florida, Kentucky, Louisiana, Montana, North Dakota, Oklahoma, and Wyoming.
[164] Ariz. Const. art. 9, § 7. The exception at the end of the clause is meant to permit state investment of public funds, such as pension funds or rainy day funds. Ideally, these funds will have their own statutory restraints that require the fund managers to be fiduciaries so that investments are made in the public's interest and not in anyone's private interest.
[165] However, Arizona amended its constitution in 1940 to exempt "irrigation, power, electrical, agricultural improvement, drainage, and flood control districts, and tax levying public improvement districts" from the anti-aid provision. See Ariz. Const. art. 13, § 7.
[166] Okla. Const. art. 10, § 15(B); Wyo. Const. art. 16, § 12.

"Neither the state nor any county, school district or municipality, except as otherwise provided in this constitution, shall directly or indirectly lend or pledge its credit or make any donation to or in aid of any person, association or public or private corporation or in aid of any private enterprise for the construction of any railroad except as provided in Subsections A through G of this section."[167]

Subsections A through G contain several exceptions, including the care and maintenance of sick and indigent persons, scholarships for Vietnam veterans who attend public universities, loans for students of the healing arts, support of new or expanding businesses for job creation, affordable housing, and scholarships for war veterans who have exhausted federal aid and who attend public universities. Consequently, although New Mexico's anti-aid provision applies to both levels of government and prohibits both loans and donations (but not stocks or joint ownership), the provision is weakened by textual exceptions. Nevertheless, New Mexico's provision is relatively strong compared to states with bare-bones provisions.

For example, the anti-aid provisions in seven states merely prohibit state loans, presumably allowing public aid in the form of donations or stock subscriptions at the state level and public aid in any form at the municipal level.[168] Thus, textual exceptions aside, bare-bones provisions tend to be weaker because they leave the door open for alternate forms of public aid. Wisconsin's anti-aid provision is illustrative; it provides that "the credit of the state shall never be given, or loaned, in aid of any individual, association, or corporation."[169] Because it only applies to credit, direct subsidies and grants do not implicate Wisconsin's anti-aid clause, and

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[167] N.M. Const. art. 9, § 14.
[168] Maine, Massachusetts, Minnesota, Nebraska, Rhode Island, West Virginia, and Wisconsin. However, in Nebraska, courts have extended the provision to political subdivisions. State ex rel. Beck v. City of York, 164 Neb. 223, 224–25, 82 N.W.2d 269, 271 (1957).
[169] Wis. Const. art. 8, § 3.

concluding otherwise, as the Wisconsin Supreme Court has noted, "would put in jeopardy many of [its] current state subsidies."[170]

B. Public Purpose Clauses

In addition to the 45 state constitutions with traditional anti-aid provisions, 17 state constitutions have *public purpose* provisions and four have *private emolument* provisions that theoretically restrict the use of public aid for private purposes.[171] The public purpose provisions typically appear in the section of a given constitution that governs taxation and, among other limitations, usually restrict taxation for public purposes only. These provisions (*public purpose clauses* or *tax clauses*) do not expressly apply to government expenditures in aid of private entities, but they nevertheless indirectly forbid the use of taxation for such purposes.[172] We list these in the right-hand column of table A1 in the appendix, calling them public purpose clauses.

Alaska, Connecticut, Illinois, and Vermont only have public purpose and private emoluments provisions and have no traditional anti-aid clauses.[173] For example, the Alaska Constitution provides that "no tax shall be levied, or appropriation of public money made, or public property transferred, nor shall the public credit be used, except for a public purpose."[174] Similarly, the Illinois Constitution provides that "public funds, property or credit shall be used

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[170] Libertarian Party of Wisconsin v. State, 199 Wis. 2d 790, 821–22 (1996). Other courts may interpret their state credit clauses to encompass gifts, however. Compare Oxnard Beet Sugar Co. v. State, 73 Neb. 57 (1905) (gifts held to be within scope of credit clause) with Melvin v. Board of County Comm'rs, 199 Md. 402 (1952) (local unit may use its credit to obtain funds which are then given to private institutions). The text of a given anti-aid provision does not necessarily correspond to its judicial interpretation.
[171] See table A1 in the appendix.
[172] See, for example, Ariz. Const. art. 9, § 1 (stating that "all taxes . . . shall be levied and collected for public purposes only"). These are the same types of provisions discussed above in reference to the Alaska and Illinois Constitutions.
[173] As previously noted, South Dakota's credit clause is not like most anti-aid provisions in that it can be overridden by two-thirds of the legislature.
[174] Alaska Const. art. 9, § 6.

only for public purposes."[175] Vermont's constitution provides that "government is, or ought to be, instituted for the common benefit, protection, and security of the people . . . and not for the particular emolument or advantage of any single person."[176] A related provision states that "previous to any law being made to raise a tax, the purpose for which it is to be raised ought to appear evident to the Legislature to be of more service to community than the money would be if not collected."[177] Although Vermont courts have construed both provisions as a general prohibition on the use of public funds for nonpublic purposes, there have been no successful legal challenges to public subsidies in that state.[178]

Not surprisingly, the public purpose and private emoluments provisions are among the weakest limitations on public aid, both textually and as interpreted by courts. This is generally true because the vague language of these provisions invites government officials to test and expand the boundaries of the text while simultaneously providing no definable borders for courts to enforce. The public purpose limitation is especially emblematic of this problem for a few reasons. First, because courts have declared that *public purpose* cannot be defined precisely and evolves to meet changing societal needs,[179] they have upheld a variety of expenditures for

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[175] Ill. Const. § 20. Similar "public purpose" limitations also appear in the constitutions of states with traditional anti-aid provisions (e.g., Arizona, Kentucky, Louisiana, Montana, North Carolina, Ohio, Texas, and Washington).
[176] Vt. Const. chap. 1, art. 7.
[177] Vt. Const. chap. 1, art. 9.
[178] See Bennington v. Park, 50 Vt. 178, 192–93 (1877).
[179] In a seminal Alaska case, for example, the court stated that public purpose "represents a concept which is not capable of precise definition . . . and will change as changing conditions create changing public needs." Dearmond v. Alaska State Dev. Corp., 376 P.2d 717, 721 (Alaska 1962). Yet in a later opinion, the court stated that the test to determine public purpose "should be whether the expenditure confers a direct public benefit of a reasonably general character, that is to say, to a significant portion of the public, as distinguished from a remote and theoretical benefit." Opinion of the Justices, 348 So.2d 1051, 1053 (Alaska 1980). See also note 193, providing examples of the many other courts that cite the evolutionary nature of public purpose as a justification for broad interpretation.

questionable purposes.[180] Of course, it *is* possible to precisely define *public purpose*, and many courts have done so.[181] And while society and technology do change and advance, the principles that spurred anti-aid provisions are immutable and ever applicable.

Second, courts generally defer to government officials' determination that a given expenditure serves a public purpose and often refuse to overturn an expenditure unless officials have unquestionably abused their discretion.[182] Because the "abuse of discretion" legal standard is such a high bar, however, government officials can merely state that an expenditure serves the public—even in the face of evidence to the contrary—to circumvent a public purpose or private emoluments provision.[183] And since officials naturally seek to expand rather than limit their own powers, deferring to their discretion means that judicial interpretation of public purpose will always be expanding, in turn creating a legal universe in which upholding public aid becomes the general rule rather than the exception. In fact, this is precisely what has happened in states with public purpose and private emolument provisions. For example, in South Dakota, courts invalidated three government acts in the early 20th century but have upheld all other acts challenged since 1932.[184] Unfortunately, this has also happened, to varying degrees, in the 45

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[180] See, for example, Lake Otis Clinic, Inc. v. State, 650 P.2d 388, 394 (Alaska 1982) (public purpose for state reimbursement to guarantor who paid off construction loan of private hospital); Wright v. City of Palmer, 468 P.2d 326, 330–31 (Alaska 1985) (public purpose for general obligation bonds to construct facility for lease to private corporation because it would help boost the city's failing economy); Empress Casino Joliet Corp. v. Giannoulias, 231 Ill. 2d 62, 65 (2008) (public purpose for tax on riverboat casinos, the proceeds of which were given to horseracing tracks, because tax was meant to stimulate economic activity).

[181] See, for example, Idaho Water Resources Bd. v. Kramer, 97 Idaho 535 (1976) (defining public purpose as "an activity that serves to benefit the community as a whole and which is directly related to the functions of government"); City of Tombstone v. Macia, 30 Ariz. 218, 224 (1926) (stating that true test for public purpose is "that the work should be *essentially* public, and for the general good of *all the inhabitants* of the city . . . undertaken [not] merely for gain or for private objects . . . but the purpose must be *primarily* to satisfy the need, or contribute to the convenience, of the people of the city at large") (emphasis added).

[182] See, for example, Clem v. City of Yakton, 160 N.W.2d 125,131 (S.D. 1968).

[183] See, for example, *Empress Casino Joliet Corp.*, 231 Ill. 2d at 65 (upholding tax on riverboat casinos to be given to horseracing tracks).

[184] Mackey v. Reeves, 175 N.W.2d 359 (S.D. 1919); White Eagle Oil & Ref. Co. v. Gunderson, 205 N.W. 614 (S.D. 1925); In re Opinion of the Justices, 240 N.W. 600 (S.D. 1932).

states with traditional anti-aid provisions, even though only a few of these contain textual public purpose exceptions within the anti-aid provisions themselves.[185]

As discussed above, many state constitutions have public purpose provisions in addition to their anti-aid provisions. Arizona's public purpose clause provides that "all taxes . . . shall be levied and collected for public purposes only."[186] Because litigants in Arizona often challenged subsidies under both the public purpose provision and the anti-aid provision, the public purpose requirement of the former was gradually grafted onto the latter. This combination took the form of a judicially created two-prong test to evaluate the legality of expenditures that benefit private entities.[187] Thus, to satisfy Arizona's gift clause today, an expenditure of taxpayer money that benefits a private entity must (1) serve a public purpose *and* (2) garner adequate return consideration for the public.

Consequently, in Arizona, public purpose became a requirement of the anti-aid provision (the weaker of the two elements) rather than an exception to it. But in other states, public purpose works the opposite way: courts view it as an *exception* to the prohibition on public aid, which means that an expenditure will be upheld if it is said to serve a public purpose, even if it otherwise violates the anti-aid provision. In these states, the constitutional public purpose requirement has been turned on its head, in much the same way as the judicially created Public Purpose Doctrine was turned on its head. States that treat public purpose as a constitutional requirement rather than as an exception will necessarily have stronger anti-aid jurisprudence. Moreover, in states that lack any public purpose clauses in their constitutions, courts may have

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[185] See, for example, Haw. Const. art. 7, § 4; N.C. Const. art. 5, §§ 3–4.
[186] Ariz. Const. art. 9, § 1.
[187] Turken v. Gordon, 223 Ariz. 342, 346 (2010).

adopted the public purpose exception to anti-aid restrictions based on the doctrine first articulated in *Sharpless v. Mayor of Pennsylvania.*[188]

Anti-aid provisions were intended to protect the public fisc regardless of whatever benefits might result from aid to private ventures, that is, regardless of the perceived purpose of the aid—public or otherwise. And yet, by one court's estimation, "Forty-six states have upheld the constitutionality of governmental expenditures and related assistance for economic development incentives" on the basis of public purpose.[189] Of course, public aid for the purpose of economic development is exactly what states sought to prohibit when they adopted anti-aid provisions in the first place. It is ironic that courts have used the notion of public purpose to eviscerate these provisions when, in fact, states enacted these very same provisions to prohibit public aid *despite their perceived public purpose.*

The future efficacy of anti-aid provisions appears least promising in states that have public purpose exceptions. When public purpose is treated as an exception to an anti-aid provision rather than as a requirement, courts regard expenditures as constitutional on the sole basis that government officials deem them to benefit the public in some manner. Of course, that

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[188] 21 Pa. 147 (1853). Regardless of how the Public Purpose Doctrine entered anti-aid jurisprudence in each state, its analysis evolved similarly. That is, courts declared that (1) public purpose is incapable of definition and changes to meet changing societal needs and that (2) courts will defer to the discretion of government officials and will not invalidate an expenditure unless government officials have abused their discretion. See, for example, City of Glendale v. White, 67 Ariz. 231, 236, 194 P.2d 435, 439 (1948) ("The question of what is a public purpose is a changing question, changing to suit industrial inventions and developments and to meet new social conditions.") (internal citation omitted); Cheatham v. DiCiccio, 240 Ariz. 314, 320, 321, 379 P.3d 211, 217 (2016) ("For Gift Clause purposes, a public purpose is lacking only in those rare cases in which the governmental body's discretion has been unquestionably abused.") (internal quotation marks and citations omitted); Visina v. Freeman, 252 Minn. 177, 184 (1958) (public purpose "not capable of a precise definition"); R.E. Short Co. v. City of Minneapolis, 269 N.W.2d 331, 337 (Minn. 1978) (legislative determination of public purpose entitled to deference and overruled only if "manifestly arbitrary or unreasonable"); McClure v. Hagerman, 155 Ohio St. 320, 98 N.E.2d 835, 838 (1951) ("What is a public use is not capable of absolute definition. A public use changes with changing conditions of society. . . ."); Bazell v. City of Cincinnati, 13 Ohio St.2d 63, 68 (1968) (legislative determination of public purpose "will not be overruled by the courts except in instances where that determination is manifestly arbitrary or unreasonable"); Opinion to the Governor, 112 R.I. 151, 155, 308 A.2d 809, 811 (1973) ("There is no fixed static definition of 'public purpose.' It is a concept which expands with the march of time. It changes with the changing conditions of our society.").

[189] *Maready*, 342 N.C. at 725.

renders the provision essentially nugatory, since officials can virtually always be expected to claim that their decisions are intended to benefit the public.[190] Given the history of anti-aid provisions, whether public aid is thought to serve a public purpose should not determine its constitutionality. Because courts have ignored or misunderstood this basic principle, however, there are few limitations on public aid in states where the assertion of a public purpose alone satisfies the anti-aid provision. Compounding the expanding definition of public purpose is judicial deference to the discretion of government officials, who are constantly finding new ways to appropriate taxpayer money for private interests.

C. A Recent Revival of Anti-Aid Provisions

Despite being weakened by textual exceptions and gutted by judicial interpretation, anti-aid provisions have recovered some of their former strength in a few states, and this jurisprudence provides hope for resuscitating failed provisions in other states. For example, Arizona's seminal gift clause case, *Turken v. Gordon*, clarified that the assertion of public purpose alone cannot justify an expenditure of public money that benefits private interests; instead, the government must receive something sufficiently valuable in return for the expenditure (i.e., it

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[190] As the antifederalist Brutus articulated in his sixth essay,

> It is as absurd to say, that the power of Congress is limited by these general expressions, "to provide for the common safety, and general welfare," as it would be to say, that it would be limited, had the constitution said they should have power to lay taxes, &c. at will and pleasure. Were this authority given, it might be said, that under it the legislature could not do injustice, or pursue any measures, but such as were calculated to promote the public good, and happiness. For every man, rulers as well as others, are bound by the immutable laws of God and reason, always to will what is right. It is certainly right and fit, that the governors of every people should provide for the common defence and general welfare; every government, therefore, in the world, even the greatest despot, is limited in the exercise of his power. But however just this reasoning may be, it would be found, in practice, a most pitiful restriction. The government would always say, their measures were designed and calculated to promote the public good; and there being no judge between them and the people, the rulers themselves must, and would always, judge for themselves.

Herbert J. Storing, ed, *The Complete Anti-Federalist*, 7 vols. (Chicago: University of Chicago Press, 1981), document 8.

must obtain consideration).[191] If the government receives consideration that is "grossly disproportionate" to what it spent, the expenditure is an illegal subsidy. In other words, if the government spends a lot of money but gets very little (or nothing) in return, the expenditure is illegal.

Even better, the court found that *indirect* benefits—such as anticipated tax revenue and employment opportunities for city residents—are not valid consideration if private entities are not contractually required to provide these benefits.[192] Thus, in Arizona, public expenditures for economic development are unconstitutional unless the government receives valuable and direct (arising from the private entity's obligation) consideration in return for the expenditure. Before the *Turken* case, government bodies had successfully argued that indirect public benefits resulting from an expenditure suffice to justify public aid to private interests.[193] As discussed in section II above, this argument is especially problematic given the tendency of policymakers to rely on the indirect gross multipliers associated with new economic activity, which they often overestimate, while ignoring the negative effects of the taxes that pay for these subsidies. *Turken*'s rejection of that overly lax theory illustrates that it is possible—with strategically litigated cases—to realign anti-aid jurisprudence with the intended purpose of these provisions. In short, it is possible to prevent the application of public money to private purposes.

Other states with relatively strong anti-aid provisions also require that government bodies receive a fair return for an expenditure of public funds. In Oklahoma, economic development is considered a public purpose only if the government receives adequate consideration for the

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[191] Turken v. Gordon, 223 Ariz. 342, 348 (2010) (holding that consideration cannot be "grossly disproportionate to what is received in return").
[192] *Turken*, 350.
[193] *Turken*, 351–52.

expenditure and there is accountability or control over the expenditure.[194] And in Mississippi, the state supreme court recently, and without discussing public purpose, held that a city cannot lawfully pay the attorney fees of a mayoral candidate in an election contest because the expenditure lacked consideration and was therefore a donation or gratuity to the candidate.[195]

These examples, together with other strategies, may pave a path toward resuscitating anti-aid provisions in states with weaker jurisprudence. States with anti-aid provisions that include gift clauses offer the greatest protections against economic development subsidies—especially those in which public purpose is one of several requirements rather than an exception. Still, much work is required to realize the potential of such provisions. For a list of states that require (or except) public purpose and consideration, see table A1.

V. Toward a Model Anti-Aid Clause

The framers of the states' anti-aid provisions understood basic principles that are axiomatic in our republic: public dollars should be spent only for public purposes, and when public dollars *are* spent, the government should maintain control over those expenditures and receive adequate consideration for them. Absent these requirements, public expenditures can easily result in the allocation of taxpayer funds to private, special interests. Despite this near-universal recognition by the framers of the state constitutions, courts throughout the country have drained these clauses of their efficacy by disregarding their plain language and their well-documented intent. Courts have also read exceptions into them.

In this section we review various tests laid out by state courts to identify criteria that should be satisfied for anti-aid jurisprudence to achieve its purpose. In so doing, we provide a

[194] Burkhardt v. City of Enid, 771 P.2d 608, 611 (Okla. 1989).
[195] McAdams v. Perkins, 204 So. 3d 1257, 1265 (Miss. 2016).

road map for an ideal anti-aid policy. In those states where courts have not already adopted these tests, state legislatures can strengthen their anti-aid clauses by explicitly requiring courts to do so. To prevent the enrichment of private interests at public expense, three criteria should be satisfied for every expenditure of public funds:

1) The public expenditure should be primarily for a public purpose.
2) The government should maintain sufficient control over the expenditure to ensure its public purpose is accomplished.
3) The public should receive direct, ascertainable, obligatory, and proportional consideration for every outlay of public resources.

As noted, these requirements should apply to both the state government and political subdivisions and should apply to all three varieties of aid (gifts, stock purchases, and extensions of credit). Additional safeguards can also be put in place to, for example, ensure that the provisions are as widely applicable as possible by applying to revenue bonds, industrial development bonds, and special districts.

A. The Primary Purpose of Every Government Expenditure Should Be to Serve a Public Purpose, Not to Benefit a Private Entity or Individual

Because the primary purpose of an anti-aid clause is to avoid the application of public resources for private purposes, a reasonable test for any government expenditure is that it *primarily* serves the public interest rather than the particular private interests of any individual, association, or corporation. As the Arizona Supreme Court has observed, it is "a core Gift Clause principle" that "public funds are to be expended only for 'public purposes' and cannot be used to foster or promote the purely private or personal interests of any individual."[196] Indeed, that is the entire purpose of the anti-aid clause. Or, as the Florida Supreme Court has put it, the clause serves "to protect public monies . . . [and] to keep the State out of private business."[197]

This is true of an expenditure that *primarily* benefits private interests, even if that expenditure also serves *some* public purpose. This is important because *any* expenditure might be said to serve a public purpose in *some* plausible way. Indeed, public choice research has found that successful special interest pleading frequently coincides with some semiplausible public interest story.[198] As the Arizona Supreme Court recognized, the anti-aid clause "was designed primarily to prevent the use of public funds raised by general taxation in aid of enterprises apparently devoted to *quasi-public purposes*, but actually engaged in private business."[199] An anti-aid clause "may be violated by a transaction even though th[e] transaction has *surface indicia* of public purpose" but in reality does not serve the public. What should matter is "the reality of the transaction," not its mere appearance or the government's unsubstantiated assertions.[200]

Accordingly, the first test under the anti-aid clause is whether the expenditure carries out a legitimate government purpose.[201] That means all public expenditures must serve a "benefit to the community as a whole" and "at the same time be directly related to the function of

[196] *Turken*, 223 Ariz. at 347–48, para. 19–20 (citing Kromko v. Arizona Bd. of Regents, 149 Ariz. 319, 321 [1986]). See also Proctor v. Hunt, 43 Ariz. 198, 201 (1934): It is "axiomatic" that "money raised by public taxation is to be collected for public purposes only, and can only legally be spent for such purposes and not for the private or personal benefit of any individual."
[197] Brautigam v. White, 64 So. 2d 781 (1953).
[198] Bruce Yandle, "Bootleggers and Baptists: The Education of a Regulatory Economist," *AEI Journal on Government and Society*, May/June 1983, 12–16; Adam Smith and Bruce Yandle, *Bootleggers and Baptists: How Economic Forces and Moral Persuasion Interact to Shape Regulatory Politics* (Washington, DC: Cato Institute, 2014); Matthew D. Mitchell and Peter J. Boettke, *Applied Mainline Economics: Bridging the Gap between Theory and Public Policy* (Arlington, VA: Mercatus Center at George Mason University, 2017), 76–77.
[199] *Turken*, 223 Ariz. 342, 346, para. 10 (citations omitted) (emphasis added).
[200] *Wistuber*, 141 Ariz. at 349 (emphasis added).
[201] See City of Tacoma v. Tacoma Taxpayers, 108 Wash. 2d 679, 695 (1987).

government."[202] Expenditures on genuine public goods or on generally accessible private goods would be permitted.[203] Thus, among other things, the state would be free to spend on the court system, public safety, public roads, public buildings, and parks (all public goods), as well as on education and social safety net programs (generally accessible private goods). Expenditures on private goods that are exclusively available to narrow beneficiaries, however, would not be permitted. The state would not be allowed to spend public money on private firms.

One paramount consideration should be whether, as the Alabama Supreme Court has put it, the expenditure "confers a direct public benefit of a reasonably general character, that is to say, to a significant part of the public, as distinguished from a remote and theoretical benefit."[204] For example, since the primary and overwhelming beneficiaries of subsidized jobs are the workers themselves, and since subsidized workers are a small minority of the public, subsidized employment should not count as a public benefit. On the other hand, because anyone who qualifies for public assistance may obtain it and because large numbers of citizens do qualify, social safety net programs may well be evaluated differently by the courts.

Second, public expenditures must serve direct public purposes, not speculative purposes. Some have argued that economic development subsidies advance a public purpose. But as we noted in section II above, the possibility that government aid to private business will produce net beneficial results for the communities that pay for these subsidies is speculative at best. In most cases, it seems that the investment would have been made without the subsidy.[205] Moreover, while subsidy proponents point to the indirect benefits of subsidies, they almost never

[202] Davidson Bros. v. D. Katz & Sons, Inc., 121 N.J. 196, 217 (1990) (internal quotations omitted).
[203] In economics, a public good has two characteristics. First, it is "nonrivalrous," which means that one person's use of the good does not diminish another's. Second, it is "nonexcludable," which means that once the good is provided, others cannot be denied its use. Paul Samuelson, "The Pure Theory of Public Expenditure," *Review of Economics and Statistics* 36, no. 4 (November 1954): 387–89; James M. Buchanan, "An Economic Theory of Clubs," *Economica* 32, no. 125 (1965): 1–14.
[204] In re Opinion of the Justices, 348 So. 2d 1051, 1053 (Ala. 1980) (internal citations omitted).
[205] Bartik, "'But For' Percentages."

acknowledge the economic costs of the taxes that fund those subsidies. Nor do they consider the other "unseen" costs, such as rent-seeking losses and anticompetitive effects.[206] Government entities, therefore, should not engage in expenditures that *primarily* rather than *incidentally* benefit a private entity.

B. The Government Must Exercise Sufficient and Continuing Control over All Government Expenditures

Like the framers of the US Constitution, the framers of the various anti-aid clauses recognized that internal and external controls were indispensable to establishing sound government that respects the integrity of the public fisc and the taxpaying public.[207] As the New Jersey Supreme Court recognized in that state's seminal gift clause case, "When the State once enters upon business of subsidies, we shall not fail to discover that the strong and powerful interests are those most likely to control legislation, and that the weaker will be taxed to enhance the profits of the stronger."[208] One way to mitigate the danger of such special interest abuse is to enforce the constitutional requirement that government control the expenditure of public funds. Government control over public expenditures is necessary because the government cannot ensure that a public purpose is accomplished for an outlay of resources unless it exercises sufficient oversight.

Some courts have sought to clarify what precisely the control requirement means. In *Kromko v. Arizona Bd. of Regents*, the Arizona Supreme Court carefully examined a lease contract between the governing board of the state's public universities and a nonprofit

[206] Frédéric Bastiat, "That Which Is Seen, and That Which Is Not Seen," in *The Bastiat Collection*, 2nd ed. (Auburn, AL: Ludwig von Mises Institute, 1850), 1–48.
[207] "A dependence on the people is, no doubt, the primary control on the government; but experience has taught mankind the necessity of auxiliary precautions." James Madison, "Federalist No. 51," in *The Federalist Papers*, ed. Charles R. Kesler (New York: Signet Classics, 2003), 51.
[208] Roe v. Kervick, 42 N.J. 191, 207 (1964) (citation omitted).

corporation that had agreed to operate a university hospital.[209] The court found that the private entity was a functional alter ego of the university's governing board, because the board retained significant and continuing control over the entity's operations. Among other things, the internal organization of the nonprofit required approval of the governing board, the board retained the right to approve any business transactions the nonprofit made, and the nonprofit was required to make financial and other status reports to the board. Most significantly, no earnings of the nonprofit could be distributed to its members, directors, or officers. This, according to the court, meant that the nonprofit corporation's activities were "subject to the control and supervision of public officials. Hence, we believe the fear of private gain or exploitation of public funds envisioned by the drafters of our constitution is absent."[210]

Likewise, in *Hutcheson v. Atherton*, the New Mexico Supreme Court struck down a county's issuance of $250,000 worth of bonds on behalf of a nonprofit because the organization was "not a subordinate governmental agency."[211] It held that New Mexico's gift clause prohibits any appropriation of funds "to any person, corporation, association, institution, or community not under the absolute control of the state."[212] Thus, public money that is spent for or lent to a private entity must be "assigned to bringing the public purpose to fruition," and the private entity's "business activity" must be "*so strictly pointed* in that direction, that for practical purposes [the private entity] represents the *controlled means* by which the government accomplishes a proper objective."[213] *Kromko* and *Atherton* thus make clear that the type of "control" required means the

[209] *Kromko*, 149 Ariz. 319, 321 (1986).
[210] *Kromko*, 149 Ariz. at 321.
[211] Hutcheson v. Atherton, 99 P.2d 462 (N.M. 1940).
[212] Harrington v. Atteberry, 153 P.2d 1041, 1042 (N.M. 1915).
[213] New Jersey Citizen Action, Inc. v. County of Bergen, 391 N.J. Super. 596, 604 (2007) (citations omitted) (emphasis added).

government must maintain sufficient authority over public expenditures to ensure they are used for a public rather than private purpose.

C. Government Expenditures Must Be Supported by Consideration That Is Direct, Ascertainable, Contractually Obligatory, and Proportionate to the Cost

Government expenditures must also be in exchange for valid consideration—meaning a fair exchange of public money for some benefit enjoyed by the state or the public. This requirement is supported by common sense. By definition, a *gift* is a gratuity that is not given in exchange for return consideration. Moreover, it would be easy to disguise an unconstitutional gift as a constitutional appropriation by distributing funds in exchange for illusory or purely abstract consideration (e.g., the government could pay a company in "exchange" for doing nothing at all). As the Arizona Supreme Court explained in *Turken*, "When a public entity purchases something from a private entity, the most objective and reliable way to determine whether the private party has received a forbidden subsidy is to compare the public expenditure to what the government receives under the contract."[214]

Gift clause jurisprudence in several states uses four essential factors in weighing consideration. Consideration received by the government in exchange for public money should be (1) direct, (2) ascertainable, (3) contractually obligatory, and (4) proportional.

First, consideration must be direct and not speculative.[215] The advocates of subsidies often claim that expenditures will yield many purported indirect public benefits. But this

[214] *Turken*, 223 Ariz. at 348. See also Avery v. State, 295 Ga. 630, 633 (2014) (there is no gift clause violation "when the state receives a substantial benefit in exchange for the use of public property"); Hawks v. Bland, 156 Okla. 48 (1932) (defining an unlawful gift as a "gratuitous transfer of property of the state voluntarily and without consideration").

[215] See, for example, *Turken*, 223 Ariz. at 350, para. 33 ("anticipated indirect benefits . . . when not bargained for as part of the contracting party's promised performance . . . are not consideration under contract law" or the gift clause).

argument ignores the evidence that most subsidized investments would have occurred without the subsidy.[216] The indirect-benefit justification also ignores the significant costs associated with the taxation that funds subsidies.[217] Subsidies take from people who would have otherwise invested that money somewhere else, so that the apparent economic activity spurred by subsidies is really just transferred economic activity—transferred from what consumers want to what they have been forced to buy.[218] What is more, if the consideration is not direct, or *obligatory*, nothing will ensure that any public benefits are ever realized.

Second, courts have also required that consideration be *ascertainable*, meaning that it "must be unimagined, substantive and verifiable."[219] In other words, there must be clear obligations imposed on the recipient of public aid that can be measured and readily evaluated. If, for example, a government entity purchases a product or procures a service, it should measure the fair market value of those expenditures, through the procurement process or otherwise, to ensure taxpayers receive proportional value that is not speculative.

Third, anti-aid clauses should require contractual *obligation* to ensure that the public's business will in fact be effectuated by the public expenditure. That is, a recipient of public expenditures must contractually obligate itself to perform a duty to the public.[220] Absent obligation on the part of the private party, there is nothing to ensure that the public's business will be done or that the private entity will not receive a gratuity. As the Arizona Supreme Court

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[216] Bartik, "'But For' Percentages"; Dennis A. Rondinelli and William J. Burpitt, "Do Government Incentives Attract and Retain International Investment? A Study of Foreign-Owned Firms in North Carolina," *Policy Sciences* 33, no. 2 (2000): 181–205; Nathan Jensen, "Bargaining and the Effectiveness of Economic Development Incentives: An Evaluation of the Texas Chapter 313 Program," *Public Choice* 177, no. 1 (2018): 29–51.
[217] Again, see section II above, especially table 1 and the discussion surrounding it.
[218] Gordon Tullock, "The Welfare Costs of Tariffs, Monopolies, and Theft," *Economic Inquiry* 5, no. 3 (June 1, 1967): 224–32; Matthew D. Mitchell, "Rent Seeking at 52: An Introduction to a Special Issue of *Public Choice*," *Public Choice* 181, no. 1 (October 1, 2019): 1–4.
[219] Wilentz v. Hendrickson, 133 N.J. Eq. 447, 33 A.2d 366 (Ch. 1943); City of E. Orange v. Bd. of Water Comm'rs, 79 N.J. Super. 363, 372, 191 A.2d 749, 754 (App. Div.), aff'd, 41 N.J. 6, 194 A.2d 459 (1963).
[220] Key v. Comm'rs Ct. of Marion Co., 727 S.W.2d 667, 669 (Tex. App. 1987) (emphasis added).

put it, only what a party "*obligates* itself to do (or to forebear from doing) in return for the promise of the other contracting party" can count as consideration.[221]

The contractual obligation principle is in this regard directly in line with general principles of contract law. All contracts, to be enforceable, must represent some genuine exchange of consideration. The reason for requiring contractual obligation is straightforward: absent obligation, there is no guarantee the public will receive anything for its expenditure. This is true even if the public entity and a private party share the same purpose.

A Texas case illustrates the point well. In *Key v. Commissioners Court of Marion County*,[222] a citizen challenged the transfer of a "Christmas Candlelight Tour," a winding path of Christmas light Nativity and holiday scenes, from the Marion County Historical Commission (a public entity) to the Historic Jefferson Foundation (a private organization) as a subsidy in violation of the gift clause. The commission argued that the transfer did not amount to a gift because the private nonprofit organization shared "the same stated goals as the commission," including historical preservation.[223] The court rejected that argument, holding instead that "contractual obligation" was necessary to establish consideration. Or, as the court wrote, "Had the Historic Jefferson Foundation *obligated* itself contractually to perform a function beneficial to the public, this obligation might be deemed consideration."[224] But because no such obligation existed in the contract itself, the transfer was not an exchange but a gratuity to the private organization.

In other words, even if a public agency shares a common interest, custom, or practice or has the best intentions, those things are not consideration in the absence of contractual

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[221] Turken v. Gordon, 224 P.3d 158, 165, para. 31 (Ariz. 2010) (emphasis added).
[222] *Key*, 727 S.W.2d 667.
[223] *Key*, 727 S.W.2d at 669.
[224] *Key*, 727 S.W.2d at 669.

obligation. They are, instead, illusory promises. To ensure the public's business is done, and to prevent a private party from discontinuing performance at will, contractual obligation is a necessary requirement for valid consideration under the anti-aid clause.

Fourth, anti-aid clauses should require propotional consideration. In this regard, consideration analysis under anti-aid provisions is different from judicial analysis under traditional contract law. Namely, under contract law, courts rarely, if ever, question the proportionality of consideration. A private contracting party is free to offer anything, no matter how small, as valid consideration because the private parties are "free to contract as they [please]," so the agreement reached "establishe[s] what [is] 'fair' and 'just' inter se."[225] In other words, value is subjective, so the only way to know that one has obtained a just and fair exchange is to allow the exchange to take place on terms that are acceptable to both private parties. In the public context, however, taxpayers have no genuine choice in the contract, so the only way to ensure that they obtain value in excess of their financial sacrifice is to require proportionality.

Thus, consideration in anti-aid cases requires an examination of the proportionality of what is exchanged. Proportionality means there must be a balanced exchange of value for value. As the Arizona Supreme Court explained, "When a public entity purchases something from a private entity, the most objective and reliable way to determine whether the private party has received a forbidden subsidy is to compare the public expenditure to what the government receives under the contract."[226] This, of course, makes sense. If we are trying to ascertain whether the public has given an unlawful subsidy, we must evaluate what was given and what was received.

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[225] Aerojet-Gen. Corp. v. Transp. Indem. Co., 17 Cal. 4th 38, 75 (1997).
[226] *Turken*, 223 Ariz. at 348, para. 22.

When the city of Phoenix, for example, gave $94.7 million dollars to a private developer of a mixed-use development for the exclusive use of 200 parking spaces for drivers participating in a municipal commuting program, the government payment was "grossly disproportionate" to what was received in return, thus violating Arizona's anti-aid provision.[227] Thus, if what the public entity gives is disproportionate to what it receives in return, there is insufficient consideration and the anti-aid provision has been violated.

VI. Litigation and Legislative Solutions in Moving Toward a Model Anti-Aid Clause

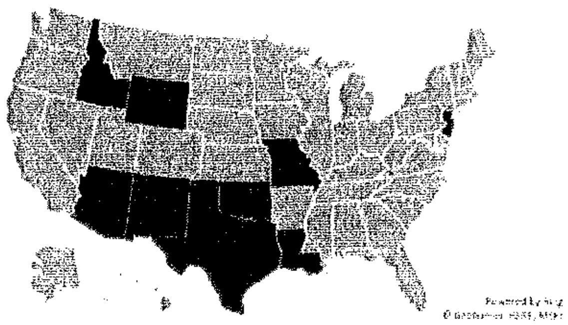
It is possible to move toward an effective anti-aid climate through strategic litigation, legislative reforms, or a combination of both. A successful strategy will depend on a particular state's anti-aid clause jurisprudence, judicial climate, and legislative composition.

Litigation is most viable when it is based on the strength of a given state's anti-aid clause language, the case law interpreting it, and the composition of its courts. Anti-aid clause challenges are most likely to be successful in states with plain language that is strong and direct and in which the courts have shown some willingness to enforce its protections. Challeneges are more likely to be successful when courts use multifactor tests, such as a primary public purpose test, a requirement for continuing government control, and an adequate consideration analysis. The appendix summarizes the current state of anti-aid clause jurisprudence in the states. States in which both a public purpose and a consideration requirement exist, and for which there is no blanket exception for expenditures that alone serve a public purpose, are the most viable

[227] *Turken*, 223 Ariz. at 348.

candidates for legal challenges.[228] Figure 4 shows the legal environment for anti-aid clause challenges based on these factors.

Figure 4. The Legal Environment for Anti-Aid Challenges



Notes: "Strong" indicates these states have anti-aid clauses with strong textual limitations that apply to government expenditures, extensions of credit, and stock ownership at the state and local level. The case law also requires a public purpose for all expenditures and adequate consideration for them with few, if any, exemptions or limitations. "Intermediate" indicates these states have anti-aid clauses with good textual limitations on government expenditures, extensions of credit, and stock ownership. But they may not apply to all levels of government, or they may have certain exceptions that would affect an anti-aid challenge. The case law suggests that challenges to some government expenditures would be feasible."Weak" indicates these states have no anti-aid clauses, have anti-aid clauses that lack textual limitations on government aid to private parties, have clauses with numerous exceptions, have clauses that apply only to one level of government, or have case law that fails to require a public purpose and adequate consideration for all aid.

Source: Authors' research. See appendix for details.

Litigants will be more successful if they identify cases in which one or more of these requirements is demonstrably lacking. For example, when a particular government expenditure is significantly disproportionate to the value received in return, an anti-aid clause challenge is more likely to succeed. As outlined above, taxpayers in Phoenix, Arizona, successfully challenged a nearly $100 million subsidy to a private developer in exchange for 200 parking spots for a

[228] Litigants should also be cognizant of procedural and standing issues in each state. Some states have broad taxpayer standing for taxpayers to challenge unlawful government expenditures. See, for example, Ethington v. Wright, 66 Ariz. 382, 386, 189 P.2d 209, 212 (1948) ("It is now the almost universal rule that taxpayers of a municipality may enjoin the illegal expenditure of municipal funds."). Other states may have more limited forms of taxpayer standing, in which case, litigation may be brought only by a party that is otherwise harmed by the subsidy.

municipal transit program. At $500,000 per parking spot, it was simply impossible for the government to justify its claim that the city was receiving proportional consideration for the public expenditure.[229] (Of course, the government had claimed that the indirect benefits of the project—for example, increased tax revenue and employment opportunities—were also consideration, not just the parking spaces in isolation. The court, however, rejected this claim.) Likewise, when the government transfers nearly all control over government resources to a private entity, a challenge is viable. Loans and direct subsidies for large, private infrastructure projects and donations to nonprofit entities serving quasi-public purposes have resulted in successful anti-aid clause challenges. Of course, there will be other factors to weigh when considering whether an anti-aid clause challenge is likely to be successful, such as state standing doctrines and the composition of the courts.

Legislative reforms can also be pursued separate from or concurrent with judicial challenges. Although government subsidies and economic development projects often find bipartisan support, some legislative reforms, particularly in circumstances in which large subsidies have created negative press, are possible. Ideal legislative reforms should not target specific industries or individual expenditures. Broad-based anti-aid measures are more efficient and equitable. Counterintuitively, broad-based reforms may be more likely to succeed because if many privileges can be eliminated at once, it will be possible to substantially lower tax rates.[230] Ideally, these reforms will ensure that anti-aid provisions apply to all levels of government and all three varieties of aid. Moreover, they will require courts to apply the three tests outlined in the previous section.

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[229] *Turken*, 223 Ariz. at 348.

[230] Matthew Mitchell, "Overcoming the Special Interests That Have Ruined Our Tax Code," in *For Your Own Good: Taxes, Paternalism, and Fiscal Discrimination in the Twenty-First Century*, ed. Adam Hoffer and Todd Nesbit (Arlington, VA: Mercatus Center at George Mason University, 2018), 327–50.

VII. Conclusion

Economic development subsidies do not work as advertised. Both economic theory and experience suggest that, on net, subsidies are more likely to undermine a region's economic development than to enhance it. There are a number of reasons for this outcome. Among other things, firms tend to collect subsidies for doing what they would have done anyway, subsidies involve significant opportunity costs, and subsidies invite a host of economic problems including rent-seeking losses and anticompetitive effects. Time and again, state and local governments have experimented with economic development subsidies only to find that they undermine fiscal health and good governance.

Despite the problems with subsidies, the incentive for policymakers to dispense them is strong. As a result, state policymakers have periodically attempted to bind their own hands by outlawing subsidies through various constitutional anti-aid provisions. We have endeavored to describe the history and current state of these provisions. Our review shows that anti-aid provisions can affect the size and scope of subsidies, reducing their negative economic and social effects. But the details matter, and some varieties of these provisions are stronger than others. Moreover, these provisions must be strengthened periodically.

The strongest anti-aid provisions apply to both state and local governments and restrict government extensions of credit, stock puchases, and gifts. These provisions will be more effective if the courts apply three tests. First, they should require public expenditures to primarly serve public purposes. Second, they should require the government to maintain sufficient control over expenditures to ensure their public purpose is accomplished. And third, they should ensure that the public has received direct, ascertainable, obligatory, and proportional consideration in return for its expense. Anti-aid clause litigation is most likely to be successful in states where these tests, or some portions of them, are applied. And in states where courts do not currently apply these tests, legislators can strengthen statutory restraints by requiring that all public expenditures satisfy these criteria.

Appendix. The Current State of Anti-Aid Clauses

Table A1. Anti-Aid Clauses in US State Constitutions, 2019

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation[231]
AL	Ala. Const. art. 4, §§ 93, 94	State Local	State[232] Local	State Local	*Slawson v. Alabama Forestry Comm'n*, 631 So. 2d 953, 956 (Ala. 1994)	—	*Bd. of Revenue & Rd. Comm'rs of Mobile County v. Puckett*, 227 Ala. 374, 376, 149 So. 850, 851 (1933)	Economic development[233]	—
AK	—	—	—	—	*Dearmond v. Alaska State Dev. Corp.*, 376 P.2d 717, 722 (Alaska 1962)	—	—	—	Public Purpose Alaska Const. art. IX, § 6
AZ	Ariz. Const. art. 9, § 7	State Local	State Local	State Local	—	*Turken v. Gordon*, 223 Ariz. 342, 348 para. 21–22, 224 P.3d 158, 164 (2010)	*Turken v. Gordon*, 223 Ariz. 342, 348 para. 22, 224 P.3d 158, 164 (2010)	Improvement districts[234]	Public Purpose art. IX, § 1
AR	Ark. Const. art. 12, § 5; art. 16, § 1	Local	Local	State Local	*Chapman v. Bevilacqua*, 344 Ark. 262, 271–73, 42 S.W.3d 378, 384–85 (2001); *65th Ctr., Inc. v. Copeland*, 308 Ark. 456, 467, 825 S.W.2d 574, 580 (1992)	—	*City of Fort Smith v. Bates*, 260 Ark. 777, 781, 544 S.W.2d 525, 527 (1976)	Economic development	—

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[231] Provisions that limit the purposes for which taxes may be levied but that do not use the phrase "public purpose" are not included here.
[232] That the state shall not "be interested in any private or corporate enterprise" may imply both a stock and gift clause. Ala. Const. art. 4, § 93.
[233] Ala. Const. art. 4, § 94.01.
[234] Ariz. Const. art. 13, § 7.

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
CA	Calif. Const. art. 16, §§ 6, 17	State Local	State	State Local	*Page v. MiraCosta Cmty. Coll. Dist.*, 180 Cal. App. 4th 471, 495, 102 Cal. Rptr. 3d 902, 921 (2009)	—	*California Sch. Employees Assn. v. Sunnyvale Elementary Sch. Dist.*, 36 Cal. App. 3d 46, 59, 111 Cal. Rptr. 433, 441 (Ct. App. 1973)	Aid to US war veterans	—
CO	Colo. Const. art. 11, §§ 1–2a	State Local	State Local	State Local	*McNichols v. City & County of Denver*, 131 Colo. 246, 252, 280 P.2d 1096, 1099 (1955)	—	*Save Cheyenne v. City of Colorado Springs*, 425 P.3d 1174, 1182, cert. denied, 18SC199, 2018 WL 4561381 (Colo. Sept. 24, 2018)	Student loan program	—
CT	—	—	—	—	*Chotkowski v. State*, 240 Conn. 246, 263–64, 690 A.2d 368, 378 (1997)	—	—	—	Emoluments Conn. Const. art. I, § 1
DE	Del. Const. art. 8, §§ 4, 8	State Local	Local	State Local	*Opinion of the Justices*, 54 Del. 366, 177 A.2d 205 (1962)	—	—	State exception with ¾ legislature	—
FL	Fla. Const. art. 7, § 10	State Local	State Local	State Local	*Miccosukee Tribe of Indians of Florida v. S. Florida Water Mgmt. Dist.*, 48 So. 3d 811, 822 (Fla. 2010)	—	—	Local revenue bonds for industrial or manufacturing plants	—
GA	Ga. Const. art. 3, § 6, para. 6; art. 9, § 2, para. 8	Local	—	State Local	*Avery v. State*, 295 Ga. 630, 633–34, 761 S.E.2d 56, 60 (2014)	—	*Haggard v. Bd. of Regents of Univ. Sys. of Georgia*, 257 Ga. 524, 526, 360 S.E.2d 566, 567 (1987)	Compensation for innocent victims of crime	Public Purpose art. VII, § 1, ¶ III
HI	Haw. Const. art. 7, § 4	State Local	—	State Local	Textual exception	—	—	Public purpose	Public Purpose within anti-aid provision[235]

(continued on next page)

[235] The anti-aid provision and public purpose limitation are combined in one clause: "No tax shall be levied or appropriation of public money or property made, nor shall the public credit be used, directly or indirectly, except for a public purpose." Haw. Const. art. 7, § 4.

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
ID	Idaho Const. art. 8, §§ 2, 4; art. 12, § 4	State Local	State Local	Local	—	*Utah Power & Light Co. v. Campbell*, 108 Idaho 950, 955, 703 P.2d 714, 719 (1985)	*Utah Power & Light Co. v. Campbell*, 108 Idaho 950, 703 P.2d 714 (1985)	Environmental pollution control[236]	—
IL	—	—	—	—	—	Textual requirement	*Vill. of Oak Lawn v. Faber*, 378 Ill. App. 3d 458, 468, 880 N.E.2d 659, 668 (2007)	—	Public Purpose Ill. Const. art. VIII, § 1[237]
IN	Ind. Const. art. 10, § 6; art. 11, § 12	State Local	State Local	—	—	—	—	Public employee retirement fund	—
IA	Iowa Const. art. 3, § 31; art. 7, § 1; art. 8, § 3	State	State	—	—	*Star Equip., Ltd. v. State, Iowa Dept. of Transp.*, 843 N.W.2d 446, 459–60 (Iowa 2014)	—[238]	2/3 vote of legislature to authorize expenditure for private purpose	—[239]
KS	—[240]	—	—	—	—	—	—	—	—

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[236] Idaho Const. art. 8, § 3A.
[237] "Public funds, property or credit shall be used only for public purposes." Ill. Const. art. 8, § 1.
[238] A requirement of consideration usually pertains to gift clauses, and the Iowa Constitution does not have a gift clause. Nevertheless, the Iowa Supreme Court has clarified that a public purpose alone will not satisfy the anti-aid provisions. Star Equip., Ltd. v. State, Iowa Dept. of Transp., 843 N.W.2d 446, 459–60 (Iowa 2014).
[239] But see Iowa Const. art. 3, § 31 ("No public money or property shall be appropriated for local, or private purposes, unless such appropriation, compensation, or claim, be allowed by two thirds of the members elected to each branch of the general assembly.").
[240] Even though the Kansas Constitution does not have an anti-aid provision or a public purpose limitation, "the general proposition of law recognized by [Kansas] cases is that the transfer of public property cannot be made without compensation when no public benefit would result from the gift." Ullrich v. Bd. of County Comm'rs of Thomas County, 234 Kan. 782, 788, 676 P.2d 127, 132 (1984).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
KY	Ky. Const. §§ 177, 179	State Local	State Local	State Local	*Dannheiser v. City of Henderson*, 4 S.W.3d 542, 545 (Ky. 1999)	—	—	Local exception for constructing or maintaining bridges, turnpike roads, or gravel roads	Public Purpose § 171
LA	La. Const. art. 7, pt. 1, § 14	State Local	State Local	State Local	—[241]	La. Atty. Gen. Op. No. 15-0137 (Dec. 28, 2015)	La. Atty. Gen. Op. No. 15-0137 (Dec. 28, 2015); *Bd. of Directors of Indus. Dev. Bd. of City of Gonzales, Louisiana, Inc. v. All Taxpayers, Prop. Owners, Citizens of City of Gonzales*, 2005–2298 (La. 9/6/06), 938 So. 2d 11[242]	14 exceptions listed in section 14(b)	Public Purpose art. VII, pt. I, § 1
ME	Me. Const. art. 9, § 14	State	—	—	—	*Common Cause v. State*, 455 A.2d 1, 27 (Me. 1983)	—	4 exceptions listed in sections 14-A through 14-D	—
MD	Md. Const. art. 3, §§ 34, 54	State County	—	—	*City of Frostburg v. Jenkins*, 215 Md. 9, 15, 136 A.2d 852, 855 (1957)	—	—	Local exception when authorized by legislature	—
MA	Mass. Const. amend. art. 52, § 1	State	—	—	—	*Opinion of the Justices*, 359 Mass. 769, 268 N.E.2d 149 (1971)	—	2/3 vote of legislature	—

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[241] Section 14(c) of the anti-aid provision permits cooperative endeavors with private parties for "a public purpose," but this is not construed as a textual exception. La. Const. art. 7, pt. 1, § 14(C); La. Atty. Gen. Op. No. 09-0212 (Dec. 22, 2009).

[242] The court does not use the term "consideration," but the constitution "is violated when public funds or property are gratuitously alienated." Bd. of Directors of Indus. Dev. Bd. of City of Gonzales, Louisiana, Inc. v. All Taxpayers, Prop. Owners, Citizens of City of Gonzales, 2005–2298 (La. 9/6/06), 938 So. 2d 11, 23–24. See also Jurisich v. Hopson Marine Serv. Co., Inc., 619 So. 2d 1111, 1115 (La. Ct. App. 1993). Moreover, there must be "a demonstrable, objective, and reasonable expectation of receiving at least equivalent value in exchange for [an] expenditure or transfer of public funds." La. Atty. Gen. Op. No. 15-0137 (Dec. 28, 2015).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
MI	Mich. Const. art. 4, § 30; art. 7, § 26; art. 9, §§ 18–19	State City	State	—	City textual exception for credit when authorized by law for a public purpose	*Sch. Dist. of City of Pontiac v. City of Auburn Hills*, 185 Mich. App. 25, 27–28, 460 N.W.2d 258, 259 (1990)	*Kaplan v. City of Huntington Woods*, 357 Mich. 612, 99 N.W.2d 514 (1959)[243]	2/3 vote of legislature to appropriate money for private purpose	—[244]
MN	Minn. Const. art. 11, § 2	State	—	—	*Minnesota Energy & Econ. Dev. Auth. v. Printy*, 351 N.W.2d 319 (Minn. 1984)	—	—	—	Public Purpose art. X, § 1
MS	Miss. Const. art. 4 § 66; art. 7, § 183; art. 14, § 258	State Local	Local	State	—[245]	—	*Tunica County v. Town of Tunica*, 227 So. 3d 1007, 1018 (Miss. 2017)	2/3 vote of legislature to authorize a gratuity	—
MO	Mo. Const. art. 3, §§ 38(a), 39; art. 6, §§ 23, 25	State Local	Local	State Local	*Fust v. Attorney Gen. for the State of Mo.*, 947 S.W.2d 424, 429–30 (Mo. 1997)[246]	*Curchin v. Missouri Indus. Dev. Bd.*, 722 S.W.2d 930, 934–35 (Mo. 1987)	*St. Charles City-County Library Dist. v. St. Charles Library Bldg. Corp.*, 627 S.W.2d 64, 70 (Mo. Ct. App. 1981)	Aid in public calamity and 8 other exceptions	Public Purpose art. X, § 3

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[243] Construing article 10, section 12, of the 1908 constitution, which is identical to article 9, section 18 of the current constitution.
[244] Although the Michigan Constitution does not have a general public purpose clause, it does provide that cities and villages may "levy other [than ad valorem] taxes for public purposes, subject to limitations and prohibitions provided by this constitution or by law." Mich. Const. art. 7, § 21.
[245] Although the courts have occasionally implied that public purpose is an exception, public purpose is not consistently cited as an element of anti-aid jurisprudence. See, for example, Craig v. Mercy Hosp.-St. Mem'l, 209 Miss. 427, 448–49, 45 So. 2d 809, 818, error overruled, 209 Miss. 427, 47 So. 2d 867 (1950).
[246] But see Curchin v. Missouri Indus. Dev. Bd., 722 S.W.2d 930, 934–35 (Mo. 1987) (stating that grants with a primarily private effect have been held unconstitutional "despite the possible beneficial impact upon the economy of the locality and of the state").

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
MT	Mont. Const. art. 5, § 11; art. 8, § 13	State	State	State[247]	—	*Hollow v. State*, 222 Mont. 478, 485, 723 P.2d 227, 232 (1986); *White v. State*, 233 Mont. 81, 93, 759 P.2d 971, 978 (1988)	—[248]	Entities under control of the state	Public Purpose art. VIII, § 1
NE	Neb. Const. art. 13, § 3	State Local[249]	—	—	—	—[250]	*Haman v. Marsh*, 237 Neb. 699, 720–21, 467 N.W.2d 836, 851 (1991)	Residents seeking adult or post–high school education	—
NV	Nev. Const. art. 8, §§ 9–10	State Local	State Local	State	*Employers Ins. Co. of Nevada v. State Bd. of Examiners*, 117 Nev. 249, 259, 21 P.3d 628, 634 (2001)	1995 Nev. Op. Atty. Gen. 25 (1995); *Lawrence v. Clark County*, 127 Nev. 390, 399, 254 P.3d 606, 612 (2011)[251]	Maybe[252]	Corporations formed for educational or charitable purposes; local exception for railroads	—
NH	N.H. Const. pt. 2, art. 5	Town	Town	Town	*Anderson v. McCann*, 124 N.H. 249, 251, 469 A.2d 1311, 1313 (1983)	*Anderson v. McCann*, 124 N.H. 249, 251, 469 A.2d 1311, 1313 (1983)	Maybe[253]	—	Emoluments Pt. 1, art. X

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[247] "Because the Montana courts had construed that state's gift clause to permit any expenditures made for a public purpose, the framers of the revised Montana Constitution omitted the clause as unnecessary in light of other constitutional provisions limiting public expenditures to public purposes. Montana Legislature, Montana Constitutional Convention 1971–1972, at 583 (1979)." *Turken*, 223 Ariz. at 347.
[248] But the courts strictly construe the requirement of government "control."
[249] Extended to political subdivisions by court. State ex rel. Beck v. City of York, 164 Neb. 223, 224–25, 82 N.W.2d 269, 271 (1957).
[250] Public purpose is not "required" because the "prohibition against the pledge of the state's credit does not hinge on whether the legislation achieves a 'public purpose,' when the pledge benefits a private individual, association, or corporation." Haman v. Marsh, 237 Neb. 699, 722, 467 N.W.2d 836, 852 (1991).
[251] Implies that public purpose is required.
[252] See Lawrence v. Clark County, 127 Nev. 390, 254 P.3d 606 (2011) (inferring that Nevada courts ensure the state receives a valuable benefit and holding that consideration is required for disposal of property under both the gift clause and the public trust doctrine).
[253] In re Opinion of the Justices, 88 N.H. 484, 190 A. 425, 428 (1937).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
NJ	N.J. Const. art. 8, §§ 2, para. 1, 3, para. 2–3	State Local	Local	State Local	—	*Roe v. Kervick*, 42 N.J. 191, 199 A.2d 834 (1964)	*Roe v. Kervick*, 42 N.J. 191, 199 A.2d 834 (1964); *City of E. Orange v. Bd. of Water Comm'rs*, 79 N.J. Super. 363, 371, 191 A.2d 749, 753 (App. Div.), aff'd, 41 N.J. 6, 194 A.2d 459 (1963)	—	—
NM	N.M. Const. art. 9, § 14	State Local	—	State Local	—	—	*State ex rel. Office of State Eng'r v. Lewis*, 2007-NMCA-008, para. 48–51, 141 N.M. 1, 15–16, 150 P.3d 375, 389–90	7 exceptions listed in sections 14(A) through 14(D), including "creating new job opportunities"	—
NY	N.Y. Const. art. 7, § 8; art. 8, § 1	State Local	Local	State Local	*Bordeleau v. State*, 18 N.Y.3d 305, 317, 960 N.E.2d 917 (2011)	*People ex rel. Spitzer v. Grasso*, 54 A.D.3d 180, 195–97, 861 N.Y.S.2d 627, 640–41 (2008)	*Grand Realty Co. v. City of White Plains*, 125 A.D.2d 639, 639–40, 510 N.Y.S.2d 172 (1986); *Inc. Vill. of Sag Harbor v. Chelberg & Battle Post #388 of the Am. Legion, Inc.*, 12 A.D.2d 520, 521, 207 N.Y.S.2d 464, 465 (1960)	Several	—
NC	N.C. Const. art. 5, §§ 3–4	State Local	—	—	Local textual exception but only if approved by voter majority	—	*N.C. State Ports Auth. v. First-Citizens Bank & Tr. Co.*, 242 N.C. 416, 424, 88 S.E.2d 109, 114 (1955)	State and local exception for credit approved by voter majority	<u>Public Purpose</u> art. V, § 2

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State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
ND	N.D. Const. art. 10, § 18	State Local	State Local	State Local	*Paving Dist. 476 Group v. City of Minot*, 2017 ND 176, para. 26, 898 N.W.2d 418, 426; *Haugland v. City of Bismarck*, 818 N.W.2d 660 (N.D. 2012)	*Paving Dist. 476 Group v. City of Minot*, 2017 ND 176, para. 26, 898 N.W.2d 418, 426; *Haugland v. City of Bismarck*, 818 N.W.2d 660 (N.D. 2012)	—	Engagement in any industry, enterprise or business	—
OH	Ohio Const. art. 8, §§ 4, 6	State Local	State Local	Local	1999 Ohio Op. Atty. Gen. No. 99-049, 1999 WL 75668[254]	—	1999 Ohio Op. Atty. Gen. No. 99-049, 1999 WL 75668[255]	Economic development[256]	—
OK	Okla. Const. art. 10, §§ 15, 17	State Local	State Local	State Local	—	*In re Oklahoma Development Finance Authority*, 89 P.3d 1075 (Okla. 2004)[257]	*Orthopedic Hosp. of Oklahoma v. Oklahoma State Dept. of Health*, 118 P.3d 216, 222, 2005 OK CIV APP 43, para. 10–12 (Okla. Civ. App. Div. 1, 2005)	State exception for economic development[258]	Public Purpose art. 10, § 14
OR	Or. Const. art. 11, §§ 5–7, 9	State Local	State Local	Local	*Miles v. City of Eugene*, 451 P.2d 59, 61–62, 252 Or. 528, 532–33 (1969); *Carruthers v. Port of Astoria*, 438 P.2d 725, 730–31, 249 Or. 329, 341 (1968)	*Miles v. City of Eugene*, 451 P.2d 59, 61–62, 252 Or. 528, 532–33 (1969); *Carruthers v. Port of Astoria*, 438 P.2d 725, 730–31, 249 Or. 329, 341 (1968)	—	Local exception for affordable housing	—

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[254] Accord State ex rel. Taft v. Campanella, 368 N.E.2d 76, 84–85 (Ohio App. 1977).
[255] Accord C.I.V.I.C. Group v. Warren, 723 N.E.2d 106, 109–10 (Ohio 2000); Citizens Word v. Canfield Twp., 787 N.E.2d 104, 108 (Ohio App. 7 Dist., 2003).
[256] Ohio Const. art. 8, § 13. Article 8 also includes several other exceptions to section 13.
[257] The public purpose requirement appears to stem from the public purpose clause rather than from the anti-aid provision.
[258] Via the Oklahoma Center for the Advancement of Science and Technology. Okla. Const. art. 10, § 15(B).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
PA	Pa. Const. art. 8, § 8; art. 9 § 9	State Local	State Local	Local	*Tosto v. Pennsylvania Nursing Home Loan Agency*, 331 A.2d 198, 205, 460 Pa. 1, 15–16 (1975)	*Tosto v. Pennsylvania Nursing Home Loan Agency*, 331 A.2d 198, 205, 460 Pa. 1, 15–16 (1975)	—[259]	Public service, industrial, or commercial enterprises necessary to the health, safety or welfare of the Commonwealth	—
RI	R.I. Const. art. 6, §§ 11,[260] 16	State	—	—[261]	—	*In re Advisory Opinion to Governor (DEPCO)*, 593 A.2d 943 (R.I. 1991)	—[262]	2/3 vote of legislature to appropriate money for a private purpose	—

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[259] But see Harbold v. City of Reading, 49 A.2d 817, 820–21 (Pa. 1946) (observing that unconstitutional expenditure lacked consideration and public purpose).
[260] Section 11 requires a two-thirds vote by the legislature to appropriate money for a private purpose.
[261] Article 6, section 11, requires a two-thirds vote by the legislature to appropriate money for a private purpose and therefore may be construed as a state and local gift clause. R.I. Const. art. 6, § 11.
[262] Even though there is no consideration requirement, courts examine whether there is a pledge of credit based on criteria other than public purpose alone. See, for example, Opinion to the Governor, 308 A.2d 809, 812 (R.I. 1973) (whether legislation was an unconstitutional pledge of credit turned on whether corporate bonds were an obligation of the state rather than on public purpose alone); Kennedy v. State, 654 A.2d 708, 713 (R.I. 1995) (deciding that legislation required a two-thirds vote for private appropriations even though it was rationally related to a legitimate public purpose for equal protection purposes).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
SC	S.C. Const. art. 10, § 11	State Local	State Local	—	—	—[263]	—[264]	Public pensions	—[265]
SD	S.D. Const. art. 13, § 1[266]	—[267]	—[268]	State	—[269]	—	—[270]	Extension of credit to the people upon real estate security	Public Purpose art. XI, § 2

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[263] Litigants have challenged government actions as lacking a public purpose in addition to pledging the state's credit, but the latter does not turn on whether a public purpose exists. Therefore, public purpose does not appear to be a requirement of or an exception to the credit and stock clauses. See, for example, State ex rel. Medlock v. South Carolina State Family Farm Development Authority, 306 S.E.2d 605, 608–09 (S.C. 1983) (deciding credit issue apart from public purpose question); Carll v. South Carolina Jobs-Economic Development Authority, 327 S.E.2d 331, 334–35 (S.C. 1985) (same); Brashier v. South Carolina Dept. of Transp., 490 S.E.2d 8, 12–13 (S.C. 1997) (deciding credit issue with no analysis of public purpose whatsoever); South Carolina Farm Bureau Marketing Ass'n v. South Carolina State Ports Authority, 293 S.E.2d 854, 856–57 (S.C. 1982) (deciding credit issue even after plaintiff conceded public purpose).

[264] Although there does not appear to be a consideration requirement, courts consider other criteria. See, for example, South Carolina Farm Bureau Marketing Ass'n v. South Carolina State Ports Authority, 293 S.E.2d 854, 857 (S.C. 1982) (credit clause holding based on whether challenged action was primarily for the benefit of the state and farmers rather than the private association); Carll v. South Carolina Jobs-Economic Development Authority, 327 S.E.2d 331, 335 (S.C. 1985) (credit clause holding based on whether the act imposed any pecuniary liability on the state).

[265] Article 10, section 5, provides that "any tax which shall be levied shall distinctly state the public purpose to which the proceeds of the tax shall be applied" and therefore may be construed as a public purpose clause. S.C. Const. art. 10, § 5.

[266] This section permits the state to lend its credit for "developing the resources and improving the economic facilities" of the state, but only when subject to control by the state. Further, it disallows the appropriation of money for these purposes except by a two-thirds vote of the legislature. S.D. Const. art. 13, § 1. This section originally forbade the state from making any "donations to or in aid of any individual, association, or corporation, except for the necessary support of the poor." Cutting v. Taylor, 51 N.W. 949, 950 (S.D. 1892). The original version was more typical of an anti-aid provision. The current version permits aid under certain circumstances and therefore does not fit the typical mold of an anti-aid provision. Nevertheless, because it limits appropriations by requiring a two-thirds vote, it should be construed as an anti-aid provision.

[267] But see S.D. Const. art. 13, § 1. State credit only permitted upon 2/3 vote of legislature.

[268] But see Matter of Advisory Opinion Concerning the Const. of H.B. 1255, H.B. 1132, and H.J.R. 1004, 456 N.W.2d 546, 550 (S.D. 1990) (stating that "the people of South Dakota have explicitly withdrawn the state's authority to be an owner of capital stock of corporations").

[269] But separately required under public purpose clause. See Matter of Advisory Opinion Concerning the Const. of H.B. 1255, H.B. 1132, and H.J.R. 1004, 456 N.W.2d 546, 547–48 (S.D. 1990).

[270] But four other criteria must be met. 456 N.W.2d at 548.

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
TN	Tenn. Const. art. 2, §§ 29, 31	State Local	State Local [271]	—	*West v. Tennessee Housing Development Agency*, 512 S.W.2d 275, 283–84 (Tenn. 1974)	*West v. Tennessee Housing Development Agency*, 512 S.W.2d 275, 283–84 (Tenn. 1974)	—	3/4 voter majority	—
TX	Tex. Const. art. 3, §§ 50–52; art. 11, § 3; art. 16, § 6	State Local	Local	State Local	—	*Edgewood Independent School Dist. v. Meno*, 917 S.W.2d 717, 740 (Tex. 1995)	*Pasadena Police Officers Ass'n v. City of Pasadena*, 497 S.W.2d 388, 392–93 (Tex. Civ. App. 1973); Tex. Atty. Gen. Op. JM-551 (Tex. A.G.), 1986 WL 219397	Economic development,[272] among many others	Public Purpose art. VIII, § 3
UT	Utah Const. art. 6, § 29	State Local	State Local	—	—	*Utah Housing Finance Agency v. Smart*, 561 P.2d 1052 (1977)	—	Equity interest as consideration for intellectual property	—
VT	—	—	—	—	—	*Gross v. Gates*, 109 Vt. 156 (1937)	—	—	Public Purpose Vt. Const. chap. I, art. 9 Emoluments chap. I, art. 7
VA	Va. Const. art. 10, § 10	State Local	State Local	—	—	*City of Charlottesville v. DeHaan*, 323 S.E.2d 131, 138 (Va. 1984)	—[273]	Industrial development	Emoluments art. 1, § 4

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[271] With a three-quarters vote.
[272] Tex. Const. art. 3, § 52-a.
[273] But the transaction must be for the benefit of the government in some manner, and the presence of public purpose alone does not render certain transactions constitutional. City of Charlottesville v. DeHaan, 323 S.E.2d 131, 137–38 (Va. 1984) (citing Button v. Day, 208 Va. 494, 158 S.E.2d 735 (1968) and listing the benefits to be received by the government).

State	Anti-Aid Provision	Credit Clause	Stock Clause	Gift Clause	Public Purpose Exception	Public Purpose Requirement	Consideration Requirement	Sample Textual Exceptions	Other Limitation
WA	Wash. Const. art. 8, §§ 5, 7; art. 12, § 9	State Local	State Local	Local	*Peterson v. Department of Revenue*, 443 P.3d 818 (Wash. App. Div. 1, 2019)[274]	—	*King County v. Taxpayers of King County*, 949 P.2d 1260, 1267	Necessary support of the poor and infirm	Public Purpose art 7, § 1
WV	W.Va. Const. art. 10, § 6	State	—	—	Textual exception;[275] *State ex rel. WV Citizens Actions Group v. EV Econ. Dev. Grant Comm.*, 213 W. Va. 255 (2003)	—	—[276]	Public purposes[277]	—
WI	Wisc. Const. art. 13, § 3	State	—	—	Textual exception[278]	*Libertarian Party of Wisconsin v. State*, 546 N.W.2d 424, 438 (Wis. 1996)	—[279]	Veterans' housing loans[280]	—
WY	Wyo. Const. art. 16, § 6[281]	State Local	State Local	State Local	—	Honorable Philip A. Nicholas Honorable Frank Philp, 2007 WL 1748388, at *8	*Frank v. City of Cody*, 572 P.2d 1106, 1114 (Wyo. 1977)	Economic development[282]	Local Public Purpose art. 13, § 3

[274] Courts use the term "fundamental government purpose." Peterson v. Department of Revenue, 443 P.3d 818 (Wash. App. Div. 1, 2019).
[275] W.V. Const. art. 10, § 6a (allowing appropriations for public purposes).
[276] But see State ex rel. State Bldg. Commission v. Casey, 160 W.Va. 50 (1977) (holding that providing space to corporation in a government building to be used without cost is a grant of credit in violation of the constitution).
[277] 160 W.Va. 50.
[278] Wisc. Const. art. 8, § 7.
[279] But see Libertarian Party of Wisconsin v. State, 546 N.W.2d 424, 439 (Wis. 1996) ("It is our conclusion that the giving or loaning of the credit of the state which it was intended to prohibit . . . occurs only when such giving or loaning results in the creation by the state of a legally enforceable obligation on its part to pay to one party an obligation incurred or to be incurred in favor of that party by another party.") (citation omitted).
[280] Wisc. Const. art. 13, §7.
[281] See also Wyo. Const. art. 3, § 36 ("No appropriation shall be made for charitable, industrial, educational or benevolent purposes to any person, corporation or community not under the absolute control of the state, nor to any denominational or sectarian institution or association.").
[282] Wyo. Const. art. 16, § 12.

Tab 5

Supreme Court of Texas

No. 24-0325

In re The State of Texas,
Relator

On Petition for Writ of Mandamus

JUSTICE BLACKLOCK delivered the opinion of the Court.

Harris County intends to use federal funds to "provide no-strings-attached $500 monthly cash payments to 1,928 Harris County residents for 18 months."[1] Recipients would be chosen by lottery from among applicants with income below 200% of the federal poverty line who live in certain zip codes, among other criteria. Harris County has identified roughly 55,000 eligible applicants, which means the likelihood of any particular entrant succeeding in the lottery is roughly 3.5%.

The State of Texas contends this arrangement is unconstitutional in multiple ways, including that it violates the Texas Constitution's bar on "gratuitous payments to individuals." *Tex. Mun. League*

[1] *Frequently Asked Questions*, UPLIFT HARRIS, https://uplift.harriscountytx.gov/FAQs (as of May 22, 2024). A screenshot of this statement appears in the record, but the website has since been altered.

Intergovernmental Risk Pool v. Tex. Workers' Comp. Comm'n, 74 S.W.3d 377, 383 (Tex. 2002); TEX. CONST. art. III, § 52(a). The State sued the County, seeking an injunction blocking implementation of the proposed program, which the County calls "Uplift Harris." The State immediately sought a temporary injunction, which the district court denied. The State appealed the denial of the temporary injunction and asked the court of appeals for a Rule 29.3 order staying payments under the Uplift Harris program while its temporary-injunction appeal proceeds. *See* TEX. R. APP. P. 29.3 (authorizing "temporary orders necessary to preserve the parties' rights"). The court of appeals denied that request, and the State sought mandamus relief in this Court.

The State's mandamus petition asks this Court to require the court of appeals to issue a Rule 29.3 order staying all Uplift Harris payments while the State's temporary-injunction appeal proceeds. Together with its mandamus petition, the State filed a motion for temporary relief pursuant to Rule 52.10, seeking an immediate stay of Uplift-Harris payments. *See id.* 52.10(b) (authorizing an appellate court to "grant any just relief pending the court's action on the [mandamus] petition"). We administratively stayed[2] the payments, without regard to the merits, pending our consideration of the State's

[2] "Administrative stays do not typically reflect the court's consideration of the merits of the stay application. Rather, they 'freeze legal proceedings until the court can rule on a party's request for expedited relief.'" *United States v. Texas*, 144 S. Ct. 797, 798 (2024) (Barrett, J., concurring in denial of applications to vacate stay) (quoting Rachel Bayefsky, *Administrative Stays: Power and Procedure*, 97 NOTRE DAME L. REV. 1941, 1942 (2022)).

motion for temporary relief. *See id.* That motion, which Harris County opposes, is now before this Court. For the following reasons, the motion is granted, and all payments under the Uplift Harris program are prohibited pending further order of this Court.

The State's appeal of the denial of a temporary injunction remains pending in the court of appeals, which we expect will proceed expeditiously to a decision. That decision can, if desired, be appealed to this Court. The State's mandamus petition will remain pending in this Court while its appeal proceeds below.

* * *

In a mandamus proceeding in the Supreme Court or a court of appeals, "[t]he relator may file a motion to stay any underlying proceeding or for any other temporary relief pending the court's action on the petition." TEX. R. APP. P. 52.10(a). Whether in response to such a motion by the relator, in response to a motion by any other party, or "on its own initiative," the court may "grant any just relief pending the court's action on the petition." *Id.* 52.10(b). Absent a contrary order, relief ordered under Rule 52.10 remains in effect "until the case is finally decided." *Id.*

In an appeal—as opposed to a mandamus proceeding—the closest analogue to Rule 52.10 is Rule 29.3, which authorizes a court of appeals to "make any temporary orders necessary to preserve the parties' rights until disposition of the appeal." *Id.* 29.3. When a court of appeals grants or denies a motion for temporary relief under Rule 29.3, the rules provide no direct mechanism for immediate appeal of that ruling to this Court. As we have recognized in past cases, however, a party may seek mandamus relief in this Court challenging a court of appeals' decision on Rule 29.3 temporary relief. *See, e.g.*, *In re State*, No. 21-0873, 2021 WL 4785741 (Tex. Oct. 14, 2021). In so doing, the party may request immediate temporary relief under Rule 52.10. *Id.* In this way, when time is of the essence, a party may ask this Court to intervene to determine the parties' rights during the pendency of the underlying appeal.

When considering such a request in the past, we have described our exercise of authority under Rule 52.10 as a way to "preserve the status quo" while the appeal proceeds. *Id.* at *1. While "preservation of the status quo" has long been a valid consideration when courts are asked to issue temporary relief, the terminology is not without its drawbacks. Identifying the status quo is not always a straightforward undertaking, after all. In this case, for instance, Harris County claims the status quo is its previously unchallenged freedom to implement the Uplift Harris program as it sees fit. From that perspective, the State's motion seeks to alter the status quo. On the other hand, the State claims the status quo is that the funds have not yet been disbursed. If that is right, then the State's motion seeks to preserve the status quo. Such debates about how to define the status quo can descend quickly into lawyerly word-play, offering little help to a court tasked with providing "just relief." TEX. R. APP. P. 52.10(b).

Rather than describe the purpose of relief under Rule 52.10 as "preservation of the status quo," we find Rule 29.3's analogous formulation more helpful. An appellate court asked to decide whether to stay a lower court's ruling pending appeal or to stay a party's actions while an appeal proceeds should seek "to preserve the parties' rights until disposition of the appeal." *Id.* 29.3. The equitable authority we exercise today, under Rule 52.10, serves the same purpose—preservation of the parties' rights while the appeal proceeds. A stay pending appeal is, of course, a kind of injunction, so the familiar considerations governing injunctive relief in other contexts will generally apply in this context as well. *See, e.g.*, TEX. CIV. PRAC. & REM. CODE § 65.011 (listing requisites for writs of injunction); *Pike v. Tex. EMC Mgmt., LLC*, 610 S.W.3d 763, 792 (Tex. 2020) (listing requisites for permanent injunctive relief).

To begin with, an appellate court can hardly endeavor to preserve the parties' rights pending appeal without making a preliminary inquiry into what those rights are. Thus, the likely merits of the parties' respective legal positions are always an important consideration when a court is asked to issue an order determining the parties' legal rights pending appeal. There is little justice in allowing a party who will very likely lose on the merits to interfere with the legal rights of the opposing party during the appeal, if this can be avoided. Likewise, it may often be unjust to require a party who is very likely to succeed on the merits to wait for the lengthy appellate process to play out before exercising his legal rights.

Consideration of the merits of the parties' legal positions commonly informs a court's assessment of the advisability of injunctive relief. *See* TEX. CIV. PRAC. & REM. CODE § 65.011(1) (asking whether "the applicant is entitled to the relief demanded"); *Pike*, 610 S.W.3d at 792 (requiring showing of "a wrongful act"). The relevance of the merits to requests for injunctive relief does not vanish when courts must rule expeditiously. To the contrary, trial courts asked to issue temporary injunctions or temporary restraining orders commonly must consider the likely merits of the parties' positions. *See Abbott v. Harris County*, 672 S.W.3d 1, 8 (Tex. 2023) (temporary injunction); *In re Abbott*, 628 S.W.3d 288, 291 (Tex. 2021) (temporary restraining order). In a similar way, appellate courts asked to issue temporary relief pending appeal should make a preliminary inquiry into the likely merits of the parties' legal positions. The merits need not—and often should not—be definitively determined at this preliminary stage, but "just relief" that "preserve[s] the parties' rights" cannot be afforded without some consideration of the merits.

Another essential consideration attendant on any request for injunctive relief, including in this posture, is the injury that will befall either party depending on the court's decision. As in the underlying temporary-injunction context, the applicant for a stay pending appeal should be expected to show that he will suffer irreparable harm if relief is not granted. Courts must likewise consider the harm that other parties or the public will suffer if relief is granted—as well as any potential injury to non-parties caused by granting or denying relief. The equitable balancing of these harms is a required aspect of a court's effort to preserve the parties' rights pending appeal. *See Huynh v. Blanchard*, ___ S.W.3d ___, 2024 WL 2869423, at *24–25 (Tex. June 7, 2024).

While the likely merits and the balance of harms are two required considerations in every case in this posture, we do not foreclose consideration of other matters, depending on the circumstances. A stay pending appeal is a creature of equity, and a court asked to issue one may take into account other case-specific equitable considerations that bear on its exercise of discretion.[3]

* * *

Applying this standard here, we conclude that the State's motion for temporary relief should be granted. Although we make no definitive statement about the merits, the State has raised serious doubt about the constitutionality of the Uplift Harris program, and this potential violation of the Texas Constitution could not be remedied or undone if payments were to commence while the underlying appeal proceeds.

Article III, section 52(a) of the Texas Constitution provides that "the Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association or corporation whatsoever." The Constitution contains other similar statements. *See* TEX. CONST. art. III, §§ 50 (prohibiting the giving or lending of credit of the State to persons and entities), 51 (prohibiting grants of public money to individuals and others); *id.* art. XI, § 3 (prohibiting local governments from making "any appropriation or donation" to private entities); *id.* art. XVI, § 6(a) (prohibiting any "appropriation for private or individual purposes").

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[3] "The principles governing courts of equity govern injunction proceedings if not in conflict with this chapter or other law." TEX. CIV. PRAC. & REM. CODE § 65.001; *see also In re Prudential Ins. Co. of Am.*, 148 S.W.3d 124, 136, 138 (Tex. 2004) (noting that mandamus review is "largely controlled by equitable principles" and hence it "resists categorization," requires "flexibility that is the remedy's principal virtue," and includes considerations that "implicate both public and private interests"); *In re Gamble*, 71 S.W.3d 313, 317 (Tex. 2002) (noting that courts exercising equity jurisdiction must "among other things, balance competing equities").

Under this Court's precedent interpreting these provisions, a government in Texas that desires to dole out public funds must, among other things, "retain public control over the funds to ensure that the public purpose is accomplished and to protect the public's investment." *Tex. Mun. League*, 74 S.W.3d at 384.

The record indicates that Uplift Harris has advertised a "no strings attached" stipend to those lucky enough to win its lottery. It appears there will be no public control over the funds after they are disbursed. It likewise appears there will be no monitoring of the recipients' day-to-day purchases, so it is unlikely the County will know how recipients spend the money and whether any legitimate public purpose was achieved thereby. The application states that funds must not be used for terrorism, fraud, or other nefarious activities, but we are given no indication that the County intends to, or even could, meaningfully enforce these restrictions or truly monitor the recipients' expenditures. Indeed, a County official testified that the program is not designed "to monitor what people do with the things they buy."

This is quite unlike a food-stamp program, a housing voucher, or a medical-care program, in which the public funds can only be directed to their intended purpose. It appears that, for all practical purposes, there truly are "no strings attached," and we are directed to no precedent indicating that a government in Texas may make such payments without running afoul of our Constitution's restrictions. At this preliminary stage, the State has raised serious doubt that the Uplift

Harris program can satisfy the "public control" requirement of this Court's Gift Clause precedent.

The County argues, in the alternative, that the Uplift Harris program qualifies as "economic development" and is therefore separately authorized by article III, section 52-a of the Texas Constitution—even if the program otherwise violates the Gift Clauses. Under section 52-a, "the legislature may provide for the creation of programs and the making of loans and grants of public money . . . for the public purposes of development and diversification of the economy of the state." TEX. CONST. art. III, § 52-a. We have not previously decided a case involving section 52-a. Without foreclosing further development of the County's argument, we are skeptical of the County's position at this preliminary stage.

Under the County's permissive reading of section 52-a, nearly any direct gift of public money that will likely be spent by the recipient could qualify as "economic development"—on the theory that any boost in overall consumer spending is good for the economy. If this is right, then section 52-a comes close to repealing the Gift Clauses' ban on "gratuitous payments to individuals." *Tex. Mun. League*, 74 S.W.3d at 383. Such payments could nearly always be portrayed as good for the economy in some sense.

Without resolving the issue, we think it more likely that by authorizing "grants of public money . . . for the public purposes of development and diversification of the economy of the state," section 52-a removed doubt about the constitutionality of conventional economic-development grants, by which governments promote business growth and job creation through grant agreements designed to ensure that the recipient of public funds spends them in a way that has an economic benefit for the wider community. In other words, section 52-a appears designed to clarify that "development and diversification of the economy of the state" qualify as "public purposes." We remain skeptical of the County's argument that a program of unmonitored, "no strings attached" cash payments to individuals serves "the public purposes of development and diversification of the economy of the state" as envisioned by section 52-a.

Turning to the balance of harms, we have recognized that "*ultra vires* conduct" by local officials "automatically results in harm to the sovereign as a matter of law." *State v. Hollins*, 620 S.W.3d 400, 410 (Tex. 2020). Indeed, the violation of duly enacted state law by local government officials "clearly inflicts irreparable harm on the State." *Tex. Ass'n of Bus. v. City of Austin*, 565 S.W.3d 425, 441 (Tex. App.—Austin 2018, pet. denied) (quoting *Abbott v. Perez*, 585 U.S. 579, 602 n.17 (2018)). We have likewise recognized that the State has a "justiciable interest in its sovereign capacity in the maintenance and operation of its municipal corporations in accordance with law," and that "[a]s a sovereign entity, the State has an intrinsic right to . . . enforce its own laws." *Hollins*, 620 S.W.3d at 410 (quoting *Yett v. Cook*, 281 S.W. 837, 842 (Tex. 1926) and *State v. Naylor*, 466 S.W.3d 783, 790 (Tex. 2015)).[4]

The harm alleged here is irreparable in an additional sense as well. Once the funds are distributed to individuals, they cannot feasibly

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[4] To the extent the County challenges the State's standing to bring this suit, our recognition in *Hollins* and elsewhere that the State has a justiciable

be recouped if it is later determined they were paid in violation of the Texas Constitution. The parties do not seem to disagree on this reality.

As for injury to other parties, the County itself will suffer no cognizable injury unless its legal rights are incorrectly circumscribed during the pendency of the appeal. The County is not harmed by being required to follow the Texas Constitution. Again, it remains possible the County will ultimately succeed on the merits. But we must judge the likely harm to the County's legal rights in light of our preliminary assessment of the merits, which does not favor the County.

As for harm to the public, in general the citizens of Harris County are not harmed by requiring the County to abide by the Texas Constitution. A very small percentage of Harris County citizens will temporarily be denied receipt of the disputed payments if a stay is granted. But if those payments would have been illegal, then the temporary denial of them is not a harm that can tip the scales in the County's favor. Requiring the government to follow the law benefits everyone. Temporarily preventing expenditure of these funds while the State's appeal proceeds ensures public funds are not irrecoverably spent in violation of the Texas Constitution. Whether Harris County's proposal would actually violate the Texas Constitution remains an open question at this early stage of the litigation.

* * *

For these reasons, the State's Rule 52.10 motion is granted. Harris County is ordered to refrain from distributing funds under the

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interest in assuring that its political subdivisions comply with Texas law sufficiently establishes the State's standing at this juncture.

Uplift Harris program until further order of this Court.[5] The court of appeals should proceed to decide the temporary-injunction appeal now pending before it. The State's petition for writ of mandamus remains pending in this Court.

James D. Blacklock
Justice

OPINION DELIVERED: June 14, 2024

[5] The County states that, under federal requirements, it must spend the funds by September 30, 2026, but it must "commit" funds to Uplift Harris by December 31, 2024. The precise nature of what constitutes "committing" funds is not entirely clear, but the State does not ask us to prevent the County from earmarking or assigning federal funds to the program. Today's stay prevents the County from disbursing the funds to individual recipients or to third-party intermediaries until further order of this Court.

Tab 6

ARTICLE: Economic Development Incentives Must Be "Necessary": A Framework for Evaluating the Constitutionality of Public Aid for Private Development Projects

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Text

[*13] A familiar scene unfolds in communities across the country. A for-profit company approaches a local government and seeks a discretionary [1] economic development incentive--often in the form of a direct subsidy such as a cash grant--for the company's proposed development project in the community. The project may involve redevelopment of a historic building on Main Street; perhaps construction of a new retail center off the highway; or maybe job creation at a manufacturing facility. When the company requests a direct public subsidy for the project, a crucial constitutional question must be answered: Would the subsidy be an unlawful gift under the state constitution?

A potentially overlooked factor in determining whether a public subsidy for private enterprise amounts to an unconstitutional gift is the concept of "necessity." [2] In other words, is the subsidy "necessary" to achieve the desired public end? If the subsidy is not necessary to achieve the public's objective, then the public is probably not receiving valid consideration for its subsidy payment. [3] In that case, the subsidy essentially amounts to an unconstitutional gift to the recipient. But how can courts and legislative bodies determine whether "necessity" exists when a private enterprise requests public aid, in the form of an economic development incentive or subsidy, for construction of a facility?

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[1] The incentive is discretionary because it must be approved as an exclusive benefit to that company alone, as opposed to an incentive that is provided automatically to all companies within a certain class. As examples of the latter, a local government might provide small business counseling services to all small businesses in the community, or a reduced water rate might be available to all business customers that use a certain volume of water. Those benefits are offered on a general basis, not exclusively to one company on a discretionary basis. General benefits available to all businesses are not the focus of this article.

[2] *See infra* Part II; *see also* C. Tyler Mulligan, *Economic Development Incentives and North Carolina Local Governments: A Framework for Analysis*, 91 N.C. L. REV. 2021, 2050-52 (2013) (describing the "necessity" or "but for" determination undertaken for economic development subsidies in North Carolina).

[3] *Id.*

[*14] A threshold determination is whether jurisdictions are competing with each other over the location of the facility. Businesses have become proficient in using competitive facility location decisions to extract subsidies from state and local governments. [4] In these competitive situations, necessity is a foregone conclusion. Governments find themselves in a "prisoner's dilemma" in which they have little choice but to offer a subsidy to the requesting business, and the causation between the provision of public aid and the resultant location decision is easily demonstrated. [5] In such *competitive* scenarios, the presence of "necessity" or "but for" causation cannot seriously be questioned. Case law pertaining to business location subsidies has, for the most part, involved competitive situations like these; thus courts have generally assumed necessity exists and have deferred to legislative decisions about the appropriateness of subsidies. [6] In this permissive legal environment, business location subsidies have proliferated. Nationwide, state and local governments pour upwards of $ 70 billion annually into this effort. [7]

However, business location subsidies have become so ubiquitous that businesses are requesting subsidies even when location competition is absent and the subsidies arguably are not "necessary." Examples of these *noncompetitive* scenarios include commercial and residential development projects in which the financial feasibility of a project is based upon local market demand and other local conditions. [8] When local conditions are important to feasibility, the project owner cannot reasonably claim that [*15] locations are interchangeable such that the project could be relocated to any one of several jurisdictions without altering feasibility. In these noncompetitive situations, any court that takes constitutional gift analysis seriously should scrutinize the necessity of the requested subsidy.

To that end, this article proposes an analytical framework for conducting an evaluation of necessity as a component of constitutional gift analysis. Part I provides an overview of state constitutional law pertaining to gifts and public aid to private enterprises. It highlights the distinction in case law between competitive and noncompetitive scenarios and concludes that more robust judicial scrutiny of necessity is required in noncompetitive situations.

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[4] Richard Briffault, *Foreword: The Disfavored Constitution: State Fiscal Limits and State Constitutional Law*, *34 RUTGERS L.J. 907, 947 (2003)* ("Moreover, corporations have proven adept at playing competing localities against each other in order to extract government payments or tax exemptions."); *see, e.g.*, Jeff Bennett & Cameron McWhirter, *Volvo to Build First U.S. Car Plant in South Carolina*, WALL ST. J., May 11, 2015, *http://www.wsj.com/articles/volvo-car-corp-to-build-plant-inberkeley-county-sc-1431340237* [*https://perma.cc/GBG7-UF75*].

[5] Matthew Schaefer, *State Investment Attraction Subsidy Wars Resulting from a Prisoner's Dilemma: The Inadequacy of State Constitutional Solutions and the Appropriateness of a Federal Legislative Response*, *28 N.M. L. REV. 303, 311-12 (1998)* ("The prisoner's dilemma is typically described as follows: Two prisoners are separately interrogated by the authorities, who attempt to extract confessions from each implicating the other. If both are silent, each will go free. If both confess, each will get a moderate sentence. If one confesses and the other does not, the former will get a light sentence and the latter a heavy sentence. Accordingly, both prisoners would be best off if each remains silent, but each fears the other will confess. To avoid the danger of the heavy sentence that would follow from the other's confession, each confesses and incurs a moderate sentence. The prisoners are unable to reach their preferred outcome (total silence) because they are unable to communicate and reach a binding agreement. How does the prisoner's dilemma apply to the situation of state subsidy wars? . . . A state that idly sits by while other states offer investment attraction subsidies will have a heavy sentence placed upon it as mobile capital and tax revenues accompanying the capital flow to those other states."); *see also* Mulligan, *supra* note 2, at 2090 (comparing competitive incentives to a "prisoner's dilemma").

[6] *See infra* Part I.

[7] Marcia Clemmit, *Attracting Jobs: Do Tax Breaks for Business Spur Employment*?, CQ RESEARCHER, Mar. 2, 2012, *http://library.cqpress.com/cqresearcher/document.php?id=cqresrre2012030200&type=hitlist&num=0* [*https://perma.cc/KP4X-NC4U*].

[8] Bert Caldwell, *Cabela's Baits the Hook, and States Are Biting*, THE SPOKESMAN REV., Sept. 10, 2006, http://www.spokesman.com/stories/2006/sep/10/cabelas-baits-the-hook-and-states-are-biting/[https://perma.cc/2GSA-98TG] ("What sets Cabela's apart from other businesses is the way it has wrapped its whole approach to brick-and-mortar retailing around its ability to get site concessions.").

Part II proposes an analytical framework that divides subsidy-seeking projects into two categories, competitive and noncompetitive, and treats each category differently. Section A of Part II deals with competitive scenarios and acknowledges that, in case law, the necessity of a subsidy is taken for granted when competition is present. In other words, necessity for public aid to a project can be assumed when the project involves a legitimate location competition. [9] However, competition should be verified, so a disclosure rule is recommended that would compel subsidy-seeking businesses to make disclosures about project financials and reveal all competing locations under consideration. Section B addresses noncompetitive contexts where the necessity of public aid cannot be presumed. It proposes a simple framework, based on principles found in real estate development literature, for courts to employ in determining necessity in noncompetitive situations.

The article concludes by describing how the proposed framework has already been applied by the author for development projects and has proven to be both practical and effective. Courts are advised to enforce constitutional public aid provisions by implementing the proposed necessity framework when evaluating the constitutionality of public aid in noncompetitive situations.

Part I: A Distinction in Gift Clause Case Law--Competitive versus Noncompetitive

Most state gift clauses (also referred to as public purpose clauses and aid limitation clauses) across the nation are over a century old and tend to be variations on a theme. [10] In general, these constitutional clauses require government "spending or lending [*16] [to] be for a public purpose"; "bar the gift or loan of state credit except for a public purpose"; and "ban direct state investment in business corporation obligations." [11] The clauses were designed to prohibit governments from assuming financial risks flowing from private decision making--in other words, from placing public funds under private control. [12]

However, over the past century, courts have chipped away at these gift clauses by allowing exceptions when public aid to private enterprise promotes certain public purposes. [13] Court-approved public purpose exceptions include redevelopment in blighted areas, affordable housing for low-income persons, and incentives for competitive

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[9] *See, e.g.*, Common Cause v. State, 455 A.2d 1, 19 n.23 (Me. 1983) ("Getting [the company] to locate … in Portland was a prime objective of the state and city in the negotiations. We cannot say that provision for a subsidy was unnecessary in order to achieve that objective.").

[10] David E. Pinsky, *State Constitutional Limitations on Public Industrial Financing: An Historical and Economic Approach*, 111 U. PA. L. REV. 265, 280 (1963) ("At the turn of the century, some form of public aid limitation had been incorporated in the constitutions of a large majority of the states. For better or for worse, they are still with us, virtually unchanged . . . . The constitutional movement of the nineteenth century was an extremely pragmatic one; each change in each state was a direct reaction to the specific evils which had manifested themselves in that and perhaps neighboring jurisdictions. Some constitutions therefore contain only a credit clause, others join to it a stock clause, and still others have all three. The potential for diversity is further intensified by the fact that any or all of these restrictions may apply only to the state, to counties, to cities and towns, or to a specified combination of these."); Briffault, *supra* note 4, at 912 ("Initially, these provisions applied only to the activities of state governments. As a result, they were sometimes circumvented by state legislation authorizing local governments to provide assistance to private firms . . . and in the late nineteenth century, many states amended their constitutions to apply the public purpose and aid limitations to local governments.").

[11] Briffault, *supra* note 4, at 911-12.

[12] Pinsky, *supra* note 10, at 283-84.

[13] Briffault, *supra* note 4, at 914-15 ("Today, state constitutional 'public purpose' requirements are largely rhetorical. State legislatures define what public purposes are and receive great deference when they determine that a particular program promotes the public purpose. State constitutional provisions articulate the truism that public spending must be for a public purpose. But they do not provide a judicially enforceable constraint on state or local government.").

business location decisions. [14] When a public purpose exception applies, courts have generally deferred to legislative determinations about whether sufficient public benefit is obtained in consideration for public aid.

Many commentators have focused on the public purpose exception for business location decisions, claiming that it exemplifies the hollowing out of gift clause provisions to the point that gift clauses no longer impose meaningful limits on public purpose. [15] Such critiques of the exception for business location incentives tend to focus on one particular component of gift analysis that courts have ceded to legislative bodies: the evaluation of whether the public benefit received in consideration for a subsidy is adequate. [16] Some courts have set a startlingly low bar, verifying only that the legislature's articulated public benefit rationale is not irrational. [17] These permissive courts may be hesitant to wade into "arcane" agreements [18] and to review economic [*17] analysis [19] that is "often misunderstood and used inappropriately." [20] With such complexity and subjectivity involved in determinations of public benefit, it is perhaps understandable why some state courts have concluded that such public benefit review is "beyond their capacity, and that the means for pursuing economic development as well as the determination that economic development is a legitimate public end is a political question, not a judicial one." [21]

However, there are countervailing considerations that suggest courts should take a more active role in public benefit analysis. Courts may be better than legislative bodies at conducting evaluations of public benefit considering the "weakness of the state legislative institution." [22] At least one commentator has articulated a more active role for courts in weighing public benefits. [23] The Arizona Supreme Court, en banc, asserted its authority in this area

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[14] *See, e.g.*, Mulligan, *supra* note 2, at 2104-05.

[15] *See supra* note 13.

[16] Briffault, *supra* note 4, at 946 ("With many economic development programs little more than giveaways of tax breaks or low-interest loans to private firms, courts could more strictly scrutinize the fit between the public end and the means chosen, or the balance between the public and private benefits, particularly for measures that provide significant private gains but only speculative public ones. But this would involve difficult empirical questions of assessing the benefits from a program and calculating how likely they are to occur. In many cases a more difficult question would be deciding whether to classify a particular benefit as public or private, or what is the proper balance between public and private benefits.").

[17] *Id.* at 914 (characterizing some courts as deferring to legislative determinations "that a spending, loan, or tax incentive program will promote the public purpose are to be accepted as long as they are 'not . . . irrational.'")

[18] *Id.* at 940.

[19] One commentator discussed the application of economic multipliers and suggested that a reasonable distinction could be made by courts between basic activities that produce "an inflow of income from the export of goods to other areas," such as manufacturing, and derivative activities that result in "a net flow of income away from the area." Pinsky, *supra* note 10, at 308-09.

[20] Jonathan Q. Morgan, *Analyzing the Benefits and Costs of Economic Development Projects*, 7 COMMUNITY & ECON. DEV. BULL. 6 (2010), *http://sogpubs.unc.edu//electronicversions/pdfs/cedb7.pdf* [*https://perma.cc/6ZXQ-JHQ9*] ("One of the major concerns about economic impact analysis is that multipliers are often misunderstood and used inappropriately.").

[21] Briffault, *supra* note 4, at 946-47.

[22] *See* Pinsky, *supra* note 10, at 309; *see also* Dale A. Oesterle, *Lessons on the Limits of Constitutional Language from Colorado: The Erosion of the Constitution's Ban on Business Subsidies*, *73 U. COLO. L. REV. 587, 617 (2002)* ("One can doubt the financial expertise and judgment of elected officials to make risk/return calculations.").

[23] Briffault, *supra* note 4, at 946 ("Even with judicial deference to the legislative definition of economic development as public purpose, courts could in theory play a role in determining whether a particular economic development program actually advances its stated public purpose . . . [and] could strictly scrutinize the fit between the public end and the means chosen, or the

by forbidding legislative bodies from considering one particular form of public benefit. The court explicitly rejected the notion that paying taxes to a jurisdiction is sufficient consideration for receiving a subsidy from that jurisdiction, thereby altering the calculus for future legislative determinations of public benefit. [24] Although public benefit determinations are not the focus of this article, it is helpful to understand that assessment of public benefit--rather than assessment of necessity--has been a central theme in the debate over public aid for private enterprise. [25]

Arguments over the judiciary's role in assessing the public benefit of location subsidies reflect a general pessimism about the ability of either legislative or judicial institutions to undertake the evaluation. However, that pessimism rests on an assumption that is true only in a limited subset of cases. That is, it assumes that the difficulty in [*18] evaluating the public benefit of location subsidies is due to the presence of interstate competition. [26] Indeed, in case law where courts have deferred to the legislature on public aid to private enterprise, opinions have pointed to interstate competition as an important reason for carving out a business location exception and giving legislatures more latitude. [27]

Thus, the assumed context for deferring to the legislature is one of competition between governments, in which the "but for" causation or "necessity" of the public aid can readily be assumed because governments find themselves in a "prisoner's dilemma." [28] In these competitive situations, it is unlikely that a location subsidy is wholly unnecessary or reliant on invalid past consideration [29] (an example of the latter is a business that seeks a subsidy

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balance between the public and private benefits, particularly for measures that provide significant private gains but only speculative public ones.").

[24] Turken v. Gordon, 224 P.3d 158, 166 (Ariz. 2010) (opining that the duty "to pay taxes arises from law applicable to all, not out of contract," and therefore tax payments could not serve as consideration flowing to the City under a parking agreement with developer).

[25] Even if one rejects the notion that courts should take a more active role in assessing public benefit, that conclusion has no bearing on whether courts should nonetheless evaluate the *necessity* of business subsidies, as this article proposes.

[26] *See* Pinsky, *supra* note 10, at 275 ("However, since state programs are initiated and implemented in a context of interstate competition to attract new industries, it is difficult for any state to objectively draw a line between adequate and excessive allocation of public funds and credit for industrial financing.").

[27] In a leading state supreme court case, the majority expressed concern about capturing economic development "which might otherwise be lost to other states." Maready v. City of Winston-Salem, 467 S.E.2d 615, 627 (N.C. 1996). A lower court picked up on the treatment of interstate competition and addressed it as a factual determination--it is either present or it is not. *See* Haugh v. Cty. of Durham, 702 S.E.2d 814, 823 (N.C. Ct. App. 2010); *see also* Linscott v. Orange Cty. Indus. Dev. Auth., 443 So. 2d 97, 99-100 (Fla. 1983) (noting that the state's posture on revenue bonds placed it "at a competitive disadvantage with other states"); Hayes v. State Prop. & Bldgs. Comm'n, 731 S.W.2d 797, 798 (Ky. 1987) (noting that "Kentucky was involved in a fierce competition with many of the other states of this nation regarding the location of a major automotive manufacturing plant"); Basehore v. Hampden Indus. Dev. Auth., 248 A.2d 212, 218 (Pa. 1968) ("There is another important factor to consider. Industrial development authorities are so prevelant [sic] throughout the country that Pennsylvania is at a competitive disadvantage in attracting industry to this state should we declare this act unconstitutional."); Mayor & Members of City Council v. Indus. Dev. Auth., 275 S.E.2d 888, 890 (Va. 1981) ("The General Assembly has rejected these arguments and determined that this type [of] authority is necessary to promote the economy of the Commonwealth, and enable it to compete with other states which utilize this 'tool' to attract industry and promote their economic growth."); State ex rel. Hammermill Paper Co. v. La Plante, 205 N.W.2d 784, 798-99 (Wis. 1973) ("The development of such programs will also place Wisconsin upon a competitive basis with neighboring states that heretofore have approved similar legislation." (footnotes omitted)).

[28] *See supra* notes 2-5 and accompanying text.

[29] The generally accepted rule in contract law is that past consideration is not valid consideration. *See, e.g.*, Lantec, Inc. v. Novell, Inc., 306 F.3d 1003, 1012 (10th Cir. 2002) (applying Utah law, which says that "[g]enerally, past services cannot serve as consideration for a subsequent promise"); Smith v. Recrion Corp., 541 P.2d 663, 665 (Nev. 1975) ("Past consideration is the legal equivalent to no consideration."); *see also* ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 9.1 ("Happenings of the

but has already decided where it will locate). [30] It may therefore be rational for courts to defer to legislative bodies in a competitive context, [*19] where courts can be reasonably confident that subsidies are exchanged for valid consideration, because the business would not have located in the jurisdiction "but for" the subsidy. [31] The fact that necessity is clear in these situations may help explain why, today, virtually all state courts have upheld some form of business location subsidies. [32]

However, not all subsidy cases involve location competition, and in those noncompetitive situations, the rationale for judicial deference to legislative bodies evaporates. Noncompetitive scenarios are different from competitive scenarios in important ways and should not be treated the same under the law. A typical noncompetitive situation involves a developer (or redeveloper) of buildings designed for commercial or residential purposes (or both), with arguably no element of location competition, who nonetheless requests direct subsidies. Absent competition, necessity cannot be assumed. Indeed, as Part II demonstrates, the necessity of public aid in a noncompetitive scenario is both debatable and highly contextual. Accordingly, in noncompetitive situations, courts (and legislative bodies) should presume that necessity and "but for" causation are questionable, [33] and should proceed to undertake the necessity analysis proposed in this article. [34]

On what basis can courts raise the issue of necessity in situations in which competition is disputable or lacking? The emphasis on competition within the body of case law and legal scholarship provides courts with the opening they need. By recognizing the role of location competition in justifying public purpose exceptions to gift clauses, [35] the absence of such competition in a particular case can provide the rationale for imposing greater judicial oversight.

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past, not bargained for by a promisor, are far less likely to be held to make an informal promise enforceable than are those for which the promisor bargains.").

[30] Mulligan, *supra* note 2, at 2050 ("An example where consideration would be absent is a company seeking incentives to locate in a local government's jurisdiction after the company has already committed to locate there. Following such a commitment, the local government cannot accept the company's promise to locate in the jurisdiction as valid consideration for an incentive payment, because the company has already committed to locate in the jurisdiction. Such an incentive would amount to a constitutionally impermissible gift: the constitution does not allow the government to pay an entity to do something that the entity has already committed to do.").

[31] Mulligan, *supra* note 2, at 2098 ("The company has stated explicitly that the incentives package will be a determinative factor in its location decision. A company making [this] incentive request will have no difficulty certifying that 'but for' the incentive, the company would not have located its facility in the local government's jurisdiction.").

[32] Briffault, *supra* note 4, at 913 ("During the closing decades of the twentieth century, state courts increasingly expanded the scope of permissible public purposes, so that by the end of the century virtually every state supreme court had upheld at least some economic development programs that involved direct assistance--including cash grants, low-interest loans, and tax breaks--to individual firms.").

[33] Mulligan, *supra* note 2, at 2098-99 ("The developer has selected the location, expended resources on pre-development of the project (such as site assemblage, market research, and design, among others), and courted investors for the project based on the characteristics of the local population--not on the basis of incentives . . . . The best that the developer in [a noncompetitive] scenario could say is that 'but for' the incentive that subsidizes the purchase of land and construction of the commercial buildings, the project could not go forward *in its proposed form*. That is a weak, if not entirely ineffectual, 'but for' argument, and it is fundamentally different from the 'but for' determination [in a competitive context] where the incentives were offered to induce companies to locate in one jurisdiction rather than another."); *see also* Briffault, *supra* note 4, at 913-14 ("Some courts have continued to police economic development programs, invalidating some--such as those aimed at aiding non-industrial activities like hotels and restaurants.").

[34] *See infra* Part II.B.

[35] *See supra* note 27.

[*20] Fortunately, competition tests are not unprecedented in law. [36] Legislatively enacted business location subsidy programs have long mandated such a determination. [37] Even better, no arcane or complex tests are required in order to determine the existence of competition, though greater transparency would be helpful, as discussed in Part II.

It is reasonable to conclude that courts are capable of distinguishing between competitive and noncompetitive scenarios and establishing different analytical frameworks for each. A bifurcated approach to gift analysis is therefore possible: state courts can defer to legislative bodies in competitive situations, but take a more active role when competition is absent. In the latter noncompetitive scenarios, a different analytical framework should be applied, with necessity playing a central role as explained in the next Part.

Part II: A Bifurcated Approach -- The Role of Necessity in Competitive and Noncompetitive Scenarios

Part I reviewed gift clause case law and explained that interstate competition was an important reason given by courts for creating a public purpose exception for business location subsidies. The presence of genuine competition served as a proxy for necessity, and in such competitive scenarios, courts were comfortable deferring to legislative determinations about public benefit. When competition is absent, however, the rationale for the public purpose exception is weakened, and courts can no longer assume that public aid to the enterprise is necessary. If necessity is absent, then a subsidy likely amounts to a gift. Accordingly, to give effect to constitutional gift clauses, courts should make a necessity determination for all discretionary development subsidies, but the test may look different depending on whether the context is competitive or noncompetitive.

In its simplest form, a necessity determination involves a public body determining whether the requested subsidy is necessary to cause the project to go forward in the community. Necessity determinations are not new to the arena of business location subsidies. These determinations have appeared in case law, legislation, and executive branch regulations. [38]

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[36] *See, e.g.,* Haugh, 702 S.E.2d at 823 (finding that interstate competition was present because the company's "consideration was relocating to and outfitting a partially completed facility in Durham or moving to readily available facilities with readily available equipment in California").

[37] *See, e.g.*, NEV. REV. STAT. ANN. § 704.7876 (requiring an attestation "that but for the incentive provided pursuant to the Program, the applicant would not have located or intended to locate the business in this State").

[38] For example, in North Carolina, "necessity" determinations are found in all three: case law, statutes, and executive branch regulations. *See* Maready v. City of Winston-Salem, 467 S.E.2d 615, 619 (N.C. 1996) (describing typical procedures for approval of incentives to include a determination that "participation by local government is necessary to cause a project to go forward in the community"); N.C. GEN. STAT. § 143B-437.52(a)(4) (2011) (requiring that any grant issued through the Job Development Investment Grant program be "necessary for the completion of the project in this State"); *id*. § 143B-437.02(h)(5)(F) (requiring that site development performed using funds from the Site Infrastructure Development Fund be "necessary for the completion of the project in this State"); N.C. DEPT. OF COMMERCE, GUIDELINES AND PROCEDURES FOR COMMITMENT OF FUNDS FROM THE ONE NORTH CAROLINA FUND § 6.1 (2004) http://www.thrivenc.com/node/985/one-north-carolina-fund-guidelines [https://perma.cc/BS3X-FWJN] (establishing the "Threshold Statutory Criteria for Awarding Funds" in Section 6.1 as being "used in connection with projects for which participation by the state government is needed for the project to go forward or be undertaken in the state"). For examples of legislation in other states, see MASS. GEN. LAWS ANN. ch. 23A, § 3C (requiring coordinating council to find, among other things, that "a duly authorized representative of the controlling business has certified to the [council] that the controlling business would not have undertaken the proposed project but for the EDIP tax credits and local tax incentives available to it pursuant to this chapter"); N.J. STAT. ANN. § 52:27D-489d (providing that in deciding whether to approve a local incentive grant agreement, the Local Finance Board shall consider, among other factors, "the need for the redevelopment incentive grant agreement to the viability of the redevelopment project").*But cf.* Common Cause v. State, 455 A.2d 1, 19 n.23 (Me. 1983) (rejecting party's argument based in contract law that public subsidy to induce a shipbuilder to locate a new operation in the state and invest in port facility was a fictitious contract because the facility improvements would have been undertaken by any good manager; finding that locating the operation in the State was a "prime objective" of the State and therefore court "cannot say that provision for a subsidy was unnecessary in order to achieve that objective"); *see also* Delogu v. State, 720 A.2d 1153, 1155 (Me. 1998)

[*21] This Part explores how necessity can be evaluated depending on whether a project involves location competition. Section A addresses necessity in a competitive context and reveals the importance of transparency in conducting effective evaluations of necessity. A disclosure rule is proposed to facilitate an accurate determination. As already noted, necessity can largely be assumed in competitive situations, but a more probing approach must be used when competition is absent. To that end, Section B sets forth a framework, based on principles found in real estate development literature, for testing necessity of development subsidies in a noncompetitive context.

Section A: Testing Necessity in a Competitive Context--and a Disclosure Rule

Part I's review of constitutional gift law explored the role of necessity in the context of location competition. As Part I explained, much of the case law pertaining to public aid of private enterprises deals with competitive situations. In those cases, necessity can practically be assumed away, [39] because as courts have noted, governments have little choice but to provide the requested subsidy or lose the project "to other [*22] states." [40] As a result, the chance that a competitive location subsidy is unnecessary or relies on invalid past consideration is low. [41]

Courts make the final determination on whether competition is present, [42] but they are informed by initial determinations by executive or legislative bodies. One court, for example, referred to determinations made by local governments that subsidies were necessary to make the projects at issue go forward in the community [43]--an uncontroversial presumption in the face of interstate competition. [44]

However, courts should not defer to determinations by other public bodies about the presence or absence of competition unless there is a reasonable basis for the conclusion. In order to accurately assess whether a business subsidy involves a competitive situation or not--and ultimately, whether a subsidy is necessary--courts (and executive or legislative bodies making initial determinations) need information about the project to be subsidized. The need for this information forms the basis for implementing a disclosure rule.

As an example of a possible disclosure rule, any company requesting a discretionary subsidy could be required to provide pertinent information publicly to every solicited government unit in advance of approval of any incentive, including: (a) important details about the amount of the company's proposed investment in the facility and how the project will be financed, (b) the anticipated timing of the company's investment in the facility and associated job

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(citing *Common Cause* for the proposition that "public purpose is not determined . . . by the economic need of the recipient of the aid"). Such "necessity" or "but for" determinations are also common preconditions for approval of tax increment financing (TIF) arrangements. *See* Craig L. Johnson & Kennith A. Kiriz, *A Review of State Tax Increment Financing Laws, in* TAX INCREMENT FINANCING AND ECONOMIC DEVELOPMENT: USES, STRUCTURES, AND IMPACT 39 (Craig L. Johnson & Joyce Y. Man eds., 2001) (indicating at the time of writing that 14 states had a "but for" test and that some other states had a related test for tax increment financing and stating that "determining whether development would have occurred is an extremely difficult matter"); Richard Briffault, *The Most Popular Tool: Tax Increment Financing and the Political Economy of Local Government*, *77 U. CHI. L. REV. 65, 77 (2010)* (citing cases where courts have rejected TIF proposals but suggesting that "but for" test rarely presents meaningful obstacle for projects). TIF programs are legislatively enacted and provide financing for publicly owned projects (see Option 3 in the proposed framework, *infra*) but typically do not provide direct subsidy to private enterprise.

[39] *See supra* notes 27-29 and accompanying text.

[40] *Maready, 467 S.E.2d at 627.*

[41] This conclusions assumes, as case law does, that a promise by a business to locate its jobs and capital investment in one state rather than another is valid consideration for payment of a location subsidy. *See supra* notes 16-21 and accompanying text.

[42] *See supra* note 36.

[43] *Maready, 467 S.E.2d at 619* ("[a] determination is made that participation by local government is necessary to cause a project to go forward in the community").

[44] *Id. at 627.*

creation, (c) the company's internal location selection process and criteria, and (d) the specific location of every site under consideration for the project. [45]

Disclosure of this kind would allow a court (or executive or legislative body) to check the validity of the location competition. For example, officials could review the different locations being considered by a subsidy-seeking business and could compare those locations with the business' internal selection process and criteria to determine whether the other locations were legitimate competitors. Due to the fact that business location decisions often involve interstate competition, an effective disclosure rule would need to be enacted at the federal level and enforced nationwide. Legal standing could be granted to affected governments and taxpayers to file suit in federal court to ensure that disclosure occurs.

[*23] This would, of course, represent a significant shift in practice, since most incentive negotiations today occur under a cloak of secrecy. [46] Establishing a disclosure requirement is justified on the basis that a company seeking public resources should accept a public process. If a company wants its site-selection process to remain proprietary and confidential (not public), then it should forego publicly funded incentives. In addition, transparency would enable each government unit to assess competitor governments and contemplate intergovernmental cooperative arrangements, which would be enforceable thanks to the disclosure requirement.

Importantly for this article's framework, a disclosure rule would help governments distinguish between competitive and noncompetitive situations. Faced with a questionable claim that a project involves location competition, a disclosure rule would ensure that governments receive information to support (or refute) the claim. Courts, likewise, should delve into evidence about competition and establish a precedent for extensive discovery as part of any constitutional review by the judiciary, regardless of whether a disclosure rule is enacted legislatively. [47]

Section B: Testing the Necessity of Public Aid in a Noncompetitive Context

Recall that noncompetitive scenarios involve developers (or redevelopers) of buildings designed for commercial or residential purposes that are seeking incentives for development projects, even though no reasonable claim can be made about location competition. In the absence of competition, as explained in this Section, a subsidy probably is not "necessary"--and to the extent that a subsidy for private enterprise is unnecessary, it amounts to an unconstitutional gift regardless of the public benefit. [48] This Section provides a framework for evaluating the necessity of public aid for private enterprise in noncompetitive situations.

To set the stage for this Section, an example is helpful. Suppose a developer proposes to construct a mixed use project that will include residential and commercial components. Assume that, *without* a subsidy, the developer can obtain sufficient financing to construct the project one half mile away from the town's most central and desirable location, Main Street. However, *with* a subsidy, the developer could afford to construct the project directly on Main Street by acquiring more desirable and expensive land and applying interior and exterior finishes that would make the project more appealing as compared to other residential and commercial space in the community. In this scenario, the project can go forward in the community without subsidy, but it cannot [*24] go forward in the more

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[45] The name of the company is one piece of information that would not be necessary to reveal and has been intentionally omitted from this listing. The company could remain anonymous and communicate to governments through a third party.

[46] Jonathan Q. Morgan, *Using Economic Development Incentives: For Better or for Worse*, POPULAR GOV'T, Winter 2009, at 16 (noting the "secretive nature" of incentive negotiations and explaining that companies require confidentiality "to protect trade secrets and avoid tipping their hand to competitors").

[47] *See, e.g., Haugh, 702 S.E.2d at 821-23 (N.C. Ct. App. 2010)* (closely examining the factual circumstances pertaining to competition and then upholding the location incentives at bar because they were consistent with case law on interstate competition); *see also* Mulligan, *supra* note 2, at 2068.

[48] *See* *Turken v. Gordon, 224 P.3d 158, 164 (Ariz. 2010)* ("When government payment is grossly disproportionate to what is received in return, the payment violates the Gift Clause.").

exceptional form proposed by the developer unless some subsidy is provided. As described, the project does not involve location competition (between jurisdictions) nor is it being pursued for some other public purpose, so the rationale for public aid is weak or nonexistent. [49]

Recall, however, that a project in a noncompetitive context might still be eligible for public aid in pursuit of public purposes such as elimination of blight or construction of affordable housing for low-income persons. [50] In these situations, even though the project context is not competitive, a subsidy may nonetheless be necessary and permissible in order to accomplish the desired public purpose. Taking the example of the mixed use project described above, a public subsidy might be necessary to induce the developer to locate the project in a government-designated blighted area (where lower rents strain the project's feasibility) rather than on a prime piece of real estate on Main Street (where rents are higher). Or a subsidy may be required to enable the developer to construct residential units that are affordable to low-income members of the community. The constitutional question is whether the subsidy provided is unnecessary and therefore amounts to an unconstitutional gift.

An effective necessity test will help governments to minimize the amount of public subsidy required to accomplish the desired end. In the case of a development project in a noncompetitive context, basic methods of real estate development finance can be applied to determine the effect of a subsidy on the project's financial feasibility. A project achieves financial feasibility, as that term is used by development professionals, when the project earns adequate returns to support the minimum investment of private capital needed to finance construction of the project. [51] As a financial and practical matter, feasibility--and therefore necessity--is knowable.

Exactly how might a court employ principles of real estate development finance to test an assertion that a subsidy is "necessary" in a noncompetitive context? Trial courts would need to ask probing questions about the financial feasibility of the project, and [*25] appellate courts would require detailed findings from lower courts to substantiate any determination of necessity. The disclosure rule proposed earlier should be helpful in this regard. Fortunately, there is no need to invent a new analytical framework--courts should simply mirror the analysis that would be conducted by a reasonable development professional faced with the same question. [52]

What does that analysis look like? Some public officials employ a crude "gap" analysis. This method makes basic assumptions about the availability of private debt and equity to finance a development project and then calculates

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[49] In this situation, a determination that a subsidy is unconstitutional would be expected in a state such as North Carolina where competition and necessity are incorporated into the constitutional rationale for business subsidies. *See supra* notes 27 and 47. However, the subsidy might survive a challenge in a state where the judiciary has largely abdicated its role in enforcing public aid clauses. *See, e.g.*, State *ex rel. Brown v. City of Warr Acres, 946 P.2d 1140, 1145 (1997)* (applying public purpose exception to public aid clauses without questioning legislative determination of public benefit and without requiring competitive conditions or necessity).

[50] *See supra* note 14 and accompanying text. Even in the context of affordable housing, necessity plays a role. *See In re Housing Bonds, 296 S.E.2d 281, 285-87 (N.C. 1982)* (finding a public purpose in issuance of bonds for affordable housing that occurs "*only*" when decent housing is not otherwise available because "private enterprise is unable to meet the need").

[51] To attract sufficient private investment to allow a project to proceed, a development project's pro forma financials must demonstrate that the project can achieve a minimum rate of return. RICHARD B. PEISER & DAVID HAMILTON, PROFESSIONAL REAL ESTATE DEVELOPMENT: THE ULI GUIDE TO THE BUSINESS 168 (3d ed. 2012) (describing feasibility analysis as "the one lenders require to ensure that the project will live up to its performance expectations"). Typical return expectations for private real estate development projects are regularly reported in publications such as the quarterly Real Estate Research Corporation (RERC) Report.

[52] This article's proposed framework could be viewed as similar to a "prudent investor" standard. *See* Neb. Const. art. XI, § 1 (requiring municipalities to invest public endowment funds "in the manner required of a prudent investor who shall act with care, skill, and diligence under the prevailing circumstance").

the difference between the total project costs and the assumed availability of private capital. The difference is then presented as a static financing "gap" that must be filled by a public sector contribution. [53]

There are at least two problems with utilizing a static "gap" to evaluate necessity. First, it fails to capture what is actually a dynamic and fluid analysis of interdependent capital sources such as equity and debt. Each assumption about a particular capital source affects the other sources and, ultimately, affects investor returns on a project. [54] In reality, gaps are not static, and it is misleading to represent them as such. Thus, gap analysis is wholly inadequate in approximating the analysis of a prudent investor. Second, even if the existence of a so-called "gap" is assumed, it does not help a local government evaluate and compare different legal means of addressing that gap. After all, a gap can be addressed through options ranging from leases to loans to grants, but gap analysis fails to help governments determine the appropriateness or necessity of each of the available options.

This article provides a more effective framework than gap analysis for constitutional gift determinations. The proposed analytical framework takes a project through a staged, sequential analysis of six general public aid options: (1) analysis and verification of assumptions; (2) public lease of space for public use in the private project; (3) construction or acquisition of public facilities on the site of the private project; (4) market rate public loan to private project with adequate security and risk-adjusted interest rate; (5) subsidized public loan to private project, which could involve inadequate security or an interest rate that fails to fully reflect the public's risk; and (6) equity investment or grant. The options were categorized and ordered by integrating a key legal principle with real estate development finance principles.

The key legal principle is that greater public control over public funds and facilities is favored in constitutional gift analysis. Accordingly, any legal framework for [*26] evaluating aid to a noncompetitive project should consider the level of public control. [55] In the framework proposed here, options that retain greater public control over funds and facilities are prioritized over options that surrender public control.

There are two development finance principles in operation in the framework. The first finance principle is that financial feasibility of a private project can be improved by arranging for prelease or presale of some portion of the private project. [56] In the context of public aid, the public could enter into a presale arrangement in which the government agrees to buy a portion of the private project at a reasonable price (no subsidy) to be used as a publicly owned and operated facility for a public use. A typical example of this sort of public-private partnership is development of a hotel and convention center, in which the private developer constructs the hotel and convention center together, and the public sector agrees to purchase the convention center (but not the hotel) from the developer when construction is complete. In the example, the public would exercise control over the convention center through ownership, which is more control than the public would exercise if it subsidized the convention center and left it in private hands. Another option would leave the convention center under private ownership, but the public would exercise control through a long term lease for space. Under the framework proposed in this article, public ownership or a long term lease would be favored over a scenario in which a public subsidy was provided without public control over the facility.

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[53] MIKE E. MILES ET AL., REAL ESTATE DEVELOPMENT: PRINCIPLES AND PROCESS 340 (4th ed. 2007).

[54] PEISER & HAMILTON, *supra* note 51, at 22 (explaining that feasibility analysis involves an "iterative process in which the developer obtains more and more precise information in each iteration" through five stages of analysis).

[55] This framework compares different degrees of public control of facilities and financing in much the same way as Pinsky describes in his analysis of different forms of public aid for private enterprise. *See generally* Pinsky, *supra* note 10, at 280-89 (describing the evolution of case law regarding public aid of private enterprises and concluding that a key principle in determining whether public purposes are served is the degree of public control over projects and financing).

[56] STEPHEN P. PECA, REAL ESTATE DEVELOPMENT AND INVESTMENT: A COMPREHENSIVE APPROACH 120-21 (2009) (explaining that arranging for presale of a portion of a project can satisfy common preconditions for debt financing).

The second finance principle is that developers, when arranging financing for a development project, typically seek to replace expensive investor equity with less expensive debt whenever possible. [57] Applying this principle in the context of public aid, governments should consider offering loans, which improve project feasibility by reducing the amount of expensive investor equity required for the project, before considering a grant of any kind. In addition, when public aid takes the form of a loan, it provides more public control than a grant (a loan is secured and paid back with interest) and therefore is favored in the proposed framework.

The principles described above were applied to the six options, which were prioritized and then split into two stages: Stage 1 contains the first four options, none of which involves a direct subsidy to the private project, and Stage 2 contains the final two options, each of which involves some direct subsidy to the private project. Table 1 summarizes the framework and the level of public control over facilities and funds.

[*27] Table 1. Framework for determining necessity of public aid in a noncompetitive context

Stage 1: No direct public subsidy, greater public control	
Options (in sequence)	**Public control--facility**
1. Analysis and verification of assumptions	Not applicable
2. Public lease of space in project	High: Public lease and control over space, private ownership
3. Construction or acquisition of public facility on the site of the private project	High: Private construction but public ownership/ control of the public facility
4. Market-rate public loan to private project, adequate security and risk-adjusted interest rate	Low: Privately owned project; public granted security interest in the project
Stage 2: Direct public subsidy provided, less public control	
Options (in sequence)	Public control--facility
1. Subsidized public loan to private project, security inadequate and/or interest rate fails to reflect public's risk	Low: Privately owned project; public granted security interest in the project
2. Equity investment or grant	Minimal: Little or no public control over facility (perhaps some contractual restrictions on development or use)

[57] MILES ET AL., *supra* note 53, at 227 (using an example to illustrate how an investor group sought to "maximize" permanent debt financing because doing so would "provide the cheapest overall financing").

Stage 1: No direct public subsidy, greater public control

Options (in sequence)	**Public control--financial**
1. Analysis and verification of assumptions	Full: Analysis directed by public and conducted for public benefit
2. Public lease of space in project	High: Public funds pay rent for public space only as needed
3. Construction or acquisition of public facility on the of the private project	High: Public funds used only to acquire publicly owned and controlled facility
4. Market-rate public loan to private project, adequate security and risk-adjusted interest rate	Medium: Public funds loaned to private project but terms include adequate security and risk-adjusted interest rate
Stage 2: Direct public subsidy provided, less public control	
Options (in sequence)	Public control--financial
1. Subsidized public loan to private project, security inadequate and/or interest rate fails to reflect public's risk	Low: Public funds loaned to private project but loan is not backed by adequate security and/or fails to earn risk-adjusted return
2. Equity investment or grant	Minimal: No public control over public funds (perhaps some contractual restrictions on development and reporting). Risk-adjusted return may or may not be earned.

Putting the framework into practice is straightforward. For any particular project, the court or other public body tests each option in sequential order before proceeding to the next one. Thus, options described in Stage 1 are tested in sequential order to determine the effect on feasibility of the private project. If any of those options, individually or in combination, make the project financially feasible, then Stage 2 is not even attempted because Stage 2 options cannot be "necessary" to make the project go forward in the community and are therefore unconstitutional gifts. If no Stage 1 option or combination of Stage 1 options makes the project feasible, then Stage 2 options are attempted in sequential order: a subsidized loan is attempted before making an outright grant, because a grant cannot be "necessary" if a loan--which retains more public control over public funds than a grant--would achieve project feasibility. Thus, as noted previously, the necessity of any subsidy is knowable because feasibility is knowable.

Each stage and its sequentially ordered options are described in greater detail below.

Stage 1: Improve Project Feasibility without Direct Subsidy

In Stage 1, the government initially completes its own financial feasibility analysis of the project to determine independently whether the project is feasible for [*28] private investors without any direct subsidies. [58] This action benefits the private developer as well, because it validates (or corrects) the developer's assumptions and

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[58] *See supra* notes 51-54 and accompanying text regarding financial feasibility analysis.

sets expectations for negotiating any future public-private partnership related to the project. The government entity expends minimal resources in conducting this analysis and retains control over its funds and facilities, so it is the most obvious first step.

If feasibility analysis reveals that the project is not feasible on its own to achieve legitimate public purposes, then it would be appropriate to test other Stage 1 options that involve no direct subsidy to the developer. It is important for government officials to recognize that public aid to private enterprises need not take the form of a direct subsidy. As illustrated by the options in Stage 1, there are a number of meaningful ways for public participation to enhance project feasibility without directly subsidizing the project. Sometimes mere government cooperation can improve feasibility for a development project. [59] To the extent that any exchange with the private sector is contemplated in Stage 1--such as a lease or a loan--the exchange occurs at fair market value. However, each subsequent option within Stage 1 represents less public control over public facilities and funds, thereby increasing the public's exposure to private risk and decision-making. [60]

A court need only evaluate whether the options described in Stage 1 were attempted, preferably in sequence. Evidence of compliance with this staged analysis could be submitted by the private developer and tested by experts who could support or refute any claims about the effect of Stage 1 options on project feasibility.

Stage 1 options are described in greater detail below.

1. Project Analysis and Verification of Assumptions. Are the assumptions being made by the developer or retailer reasonable? Key assumptions include the cost of capital provided by lenders and investors, the cost of construction, the strength of demand for the project in the market, and the net operating income of the project upon completion. [61] In the author's experience assisting government officials, there have been several instances in which for-profit developers have made overly conservative assumptions in their pro forma financials and then used those overly conservative assumptions to argue (mistakenly) that the project requires local government subsidy to be financially feasible. Assumptions can be verified by neutral third-party development experts. [62]

[*29] **2. Public Lease of Space in the Private Project**. Could the government lease space in the private development project for government use at an objectively fair price, without a subsidy or gift? [63] With a

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[59] Examples of government cooperation include making public streetscape improvements or timing the construction of nearby public parking to coincide with private development.

[60] Pinsky, *supra* note 10, at 281 ("Adequate protection of the public financial interest necessitates public control consonant with public financial risk.").

[61] For a detailed description of how to perform feasibility analysis, *see* MILES ET AL., *supra* note 53, at 177-187.

[62] If assistance from a third party development expert is not available or affordable, then governments should review the *pro forma* financials that were provided to prospective lenders and investors by the developer. Financials provided to lenders and investors tend to contain more optimistic assumptions about project feasibility, because developers use them to "sell" investors and lenders on the project in order to secure debt or equity investments. Development experts can assist legislative bodies (or reviewing courts) with evaluating financial documents. The author launched a program called the Development Finance Initiative (DFI) at the University of North Carolina to provide such development and finance expertise to local governments. *See* Practical Considerations and Conclusions, *infra*.

[63] Ampt v. City of Cincinnati, 1896 WL 541, at *4 (Ohio Cir. Ct. July 1896), *modified sub nom*. Alter v. City of Cincinnati, 46 N.E. 69 (Ohio 1897) ("While if a constructing party would build the works, it would have to furnish the money until such favorable time as the city might find in which to buy the plant. Whatever aid the constructing party would derive from this arrangement would only be such as it might derive from its profits, if any, from the building and leasing of the works. There could be no more aid in this than is given to every party who constructs a street or any other improvement for the city."). *But cf*. Gallo v. Twp. Comm. of Weehawken, 437 A.2d 738, 742 (Law. Div. 1981) ("Under settled principles, therefore, the guarantee of the bonds by Weehawken under the guise of a lease is declared illegal.").

government pre-lease in hand, the project will look more appealing to banks [64] and may be able to secure a greater amount of low-cost debt as compared to high-cost equity, [65] thus improving the project's feasibility without the need for any direct subsidy. [66] This assumes that the government can put the leased space to good use for legitimate public purposes. [67]

3. Construction or Co-location of Public Facilities on the Site. Could the government turn some portion of the private project into a publicly owned facility? [68] For example, a government could acquire some of the undeveloped land around a project and own it as a public park. The acquisition of unused land from the private project at fair market value (no subsidy) injects capital into the private project, eliminates some of the private owner's capital expenditures and ongoing operating expenses associated with the land--and, importantly, does not [*30] involve a gift. In another example, public parking could be constructed and parking spaces leased to the private project at the fair market rate, [69] thereby reducing the amount of expensive up-front capital required for the private developer to construct its own private parking. [70] Again, this improves the financial feasibility of the project without providing a direct subsidy or gift. [71] An additional benefit to this approach is that the government retains the property it owns and can sell or reuse it for other purposes at the conclusion of the useful life of the project.

4. Market-Rate Loan (Adequate Security and Risk-adjusted Interest Rate). Developers typically seek to maximize the amount of low-cost debt capital in development projects, because loans--even loans with relatively high interest rates--are still less expensive than equity, thereby reducing the overall cost of capital for

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[64] MILES ET AL., *supra* note 53, at 206 (explaining the value of creditworthy tenants to developers but also noting that "creditworthy tenants know the value they bring to a real estate development and they negotiate lower rents"); PECA, *supra* note 56, at 120 ("A common condition precedent [for a construction loan] is the prelease or presale of space in the building."); *cf. id*. at 126 (indicating that pre-leasing requirements are relaxed when markets are at or near their peak and banks are competing to make loans to projects).

[65] PEISER & HAMILTON, *supra* note 51, at 202 ("Equity is the most expensive source of funding because equity investors receive returns only after other lenders have been repaid."). Equity investors can demand risk-adjusted annual returns in excess of 10% over the interest rate of a standard bank loan depending on the level of risk associated with a particular equity investment.

[66] *Turken v. Gordon, 224 P.3d 158, 167 (Ariz. 2010)* (articulating the principle that payment for lease or purchase of public space, if it far exceeds the value of the leased or purchased space, "quite likely violates the Gift Clause").

[67] *Id. at 164* ("No party questions that payments by the City under the Parking Agreement would serve a public purpose. The parties agree that providing parking is a legitimate public purpose and that the City could have erected a parking structure of its own without violating the Gift Clause.").

[68] *Citizens Word v. Canfield Twp., 787 N.E.2d 104, 108 (Ohio Ct. App. 2003)* ("We hold that a governmental entity can improve its own property regardless of whether it will benefit a private developer."); *Wilmington Parking Auth. v. Ranken, 105 A.2d 614, 628 (Del. 1954)* ("The evil forbidden by the Constitution is not the investment of municipal funds in a public project operated solely by the municipality or other public body. 'It forbids the union of public and private capital or credit in any enterprise whatever.' And the history of the adoption of these or similar constitutional provisions in the various states, following widespread default on railroad securities guaranteed by municipalities, shows that the provision was not intended to prevent a municipality from devoting funds to its own public improvements." (citations omitted)).

[69] *Chun King Sales, Inc. v. St. Louis Cty., 98 N.W.2d 194 (Minn. 1959)* (analyzing tax exemption of public property leased to a private entity).

[70] PEISER & HAMILTON, *supra* note 51, at 195 (explaining that, for private developers, "[r]ecovering the full cost of parking can be challenging").

[71] PECA, *supra* note 56, at 120-21 (explaining that arranging for presale of a portion of a project can satisfy common preconditions for debt financing).

the project. [72] Thus, a government can improve the feasibility of a development project simply by providing a loan at an appropriate risk-adjusted rate of interest. [73] The meaning of "appropriate risk-adjusted" interest rate is that the loan carries terms that would be expected for comparable loans in the market, including a market rate of interest and appropriate security in the form of a deed of trust or lien on the project. [74] The interest rate can be high, as appropriate, to compensate for the level of risk accepted by the government in providing the loan. [75] In the author's experience, a loan from a foundation or local government--even at a relatively high interest rate--can be sufficient to make a development project feasible. [76] If feasibility can be achieved through an unsubsidized loan, then an outright grant cannot be "necessary." Thus, so long as making a loan is a [*31] legally permissible activity for governments, [77] a loan can provide an elegant solution for project feasibility without passing along an unnecessary subsidy to the private enterprise.

Stage 2: Minimize Any Subsidy to a "Necessary" Level (If No Feasibility after Stage 1)

If any of the options provided in Stage 1, alone or in combination, make a project feasible, then a grant or direct subsidy cannot be "necessary"--that is, direct subsidy above what is necessary for feasibility must be an unconstitutional gift regardless of the project's perceived benefit. [78] However, after employing all of the options in the first stage, the most challenging projects may still require some direct subsidy in order to achieve feasibility.

In such cases, some governments consider offering direct subsidies to make projects feasible in noncompetitive situations. If such subsidies are authorized in pursuit of a public purpose, [79] the level of subsidy nonetheless should

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[72] MILES ET AL., *supra* note 53, at 227 (using an example to illustrate how an investor group sought to "maximize" permanent debt financing because doing so would "provide the cheapest overall financing").

[73] *Id.* at 222 (noting that when the internal rate of return (return for an equity investor) of a project exceeds the interest rate on debt, the use of debt reduces the amount of equity required and magnifies investment returns to the equity investor).

[74] MILES ET AL., *supra* note 53, at 204-05 (explaining that lenders and equity investors consider the "riskiness" of any loans or investments they make and "price" the expected return accordingly).

[75] *Id.* If the borrower provides security to the government lender that is anything other than the primary (or first) lien on the project--for example, if the government lien is subordinated to some other lender's lien--then the government is accepting higher risk than the primary lender, and the government's higher risk should translate into a higher interest rate for the government-provided loan.

[76] *See* MILES ET AL., *supra* note 53, at 227-228 (describing how one project maximized debt to improve returns); Andrew Trump, *How a Local Government Loan Can Make a Revitalization Project Possible*, UNC SCH. OF GOV'T, COMMUNITY AND ECONOMIC DEVELOPMENT IN NORTH CAROLINA AND BEYOND (Sept. 4, 2015), http://ced.sog.unc.edu/how-a-local-government-loan-can-make-a-revitalizationproject-possible/ [https://perma.cc/P8H9-EFJA] (describing how a mezzanine loan improved project feasibility).

[77] Port of Longview v. Taxpayers of Port of Longview, Cowlitz Cty., 527 P.2d 263, 271 (Wash. 1974) ("The loan of money or credit by a municipality to a private corporation is a violation of our state constitution regardless of whether or not it serves a laudable public purpose.").

[78] *See supra* notes 1622-31 and accompanying explanation in Part I about the difference between public benefit analysis and necessity; *see also* Turken v. Gordon, 224 P.3d 158, 167 (Ariz. 2010) ("We find it difficult to believe that the 3,180 parking places have a value anywhere near the payment potentially required under the Agreement. The Agreement therefore quite likely violates the Gift Clause.").

[79] *See supra* note 14 and accompany text.

be minimized [80] and should be roughly proportional to the public benefit received [81] from the project in order to avoid making an unconstitutional gift. To that end, the following options should be evaluated in sequential order.

1. **Subsidized Loan (Security Inadequate and/or Interest Rate Does Not Reflect Level of Risk)**. A subsidized loan typically involves a lower-than-market interest rate or deferred interest and principal payments with a balloon payment upon sale. Such loans contain an implicit grant--the grant component buys down the interest rate or reduces the debt service payments during the term of the loan. Ideally, the grant component of the loan should be treated as a form of equity investment in the project, entitling the government to some additional risk-adjusted return in the event the project achieves profitability. There are two important points related to a subsidized loan. First, governments should be wary of lowering the cost of their capital (such as a low interest rate on a government-provided loan). When a government offers capital at a subsidized rate, the rational developer will elect to replace expensive private capital with the subsidized public capital, even if reliance on public capital is not necessary. The government should instead make its capital more expensive, in order to motivate the developer to seek alternative (private) sources of capital and to reduce its reliance on public sources. Second, it [*32] should be obvious that courts and legislative bodies should only rarely, if ever, find it necessary to move beyond this option. After all, one can envision an extremely developer-favorable loan that defers all interest and principal payments to a balloon payment due when the project is sold or refinanced. Such a loan will, in most cases, make a project feasible, because it not only replaces expensive equity, but it also involves no payments during the term of the loan, so it behaves nearly identically to a grant in that it does no harm to the project's operating income nor to the project's ability to obtain other financing.

2. **Equity Investment (or Grant as a Last Resort)**. Finally, if all of the above measures have been applied and none achieves feasibility for a private project, then perhaps a direct equity investment is indeed "necessary" to make the project go forward as proposed. A number of state constitutions explicitly prohibit equity investments, [82] but if permitted, such investments (or grants) should be made on the same basis as other investors; that is, the investment in the project should earn a return if the project is profitable. As a leading real estate development text notes, "Investment of public dollars requires a return for risk taking *apart from increased collection of property taxes*, based on some form of . . . profit participation in future project revenues." [83] Indeed, this notion of public return apart from tax revenue is reflected in case law. Arizona's

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[80] *See* Turken, 224 P.3d at 166 ("The potential for a subsidy is heightened when, as occurred here, a public entity enters into the contract without the benefit of competitive proposals.").

[81] Id. at 164 ("When government payment is grossly disproportionate to what is received in return, the payment violates the Gift Clause."); *see also supra* note 78 and accompanying text.

[82] *See, e.g.*, S.C. Const. art. X, § 11 ("Neither the State nor any of its political subdivisions shall become joint owner of or stockholder in any company, association, or corporation."); Nebraska League of Sav. & Loan Ass'ns v. Mathes, 266 N.W.2d 720, 721-22 (1978) ("Article XI, section 1, of the Nebraska Constitution, provides: 'No city, county, town, precinct, municipality, or other sub-division of the state, shall ever become a subscriber to the capital stock, or owner of such stock, or any portion or interest therein of any railroad, or private corporation, or association.' That section of the Constitution was adopted in 1875 and has remained unchanged since that date. Approximately 40 states have similar constitutional provisions. In general, such provisions were designed to prevent the use of public funds to aid in the construction of railways, canals, and similar undertakings. The intent was to keep states and political subdivisions out of private business."); *see also* Briffault, *supra* note 4, at 915 n. 42 ("One nineteenth-century restriction that may have survived the twentieth-century expansion of public purpose is the prohibition on state investment in business corporations."). *But cf*. 2008 Neb. Laws 6 (amending Article XI to authorize investment of public endowment funds).

[83] MILES ET AL., *supra* note 53, at 340 (emphasis added).

Supreme Court, en banc, explicitly rejected the notion that payment of taxes alone could serve as consideration for a subsidy. [84]

Practical Considerations and Conclusion

In general, each successive option outlined in the framework above involves a deeper level of public participation--that is, subsidy or risk or both--than is required for the preceding option. If one of the first options makes a private project feasible, then consideration of subsequent options is neither appropriate nor "necessary." Courts could use the framework to determine the necessity of any form of public aid to private enterprise in a noncompetitive situation. So, for example, a grant would not be deemed [*33] necessary unless it could be shown that each of the preceding options was employed, sequentially, before resorting to the grant.

If a government attempts all of the options and nonetheless arrives at the final one--using public funds to make a grant or to invest directly in a private development project--then officials should begin to question whether the project makes sense to pursue at all. If a project requires direct public subsidy, then is it truly feasible and self-sustaining? This last question is more a policy issue than a legal matter, but the process leading to the policy answer is the same as that needed to answer the legal question.

Finally, the necessity framework proposed in this article is not merely a theoretical concept. This approach has already been tested and employed for projects seeking public aid from state and local governments. At the School of Government at the University of North Carolina at Chapel Hill, [85] students in a graduate level course taught by the author apply this legal framework when helping local governments understand their options for improving the feasibility of development projects. In one project in a rural area, for example, a graduate student team applied the framework to the redevelopment of a historic landmark and found that feasibility could be achieved through a market rate loan (Option 4 in Stage 1 of the framework). [86]

Similarly, in a university program launched by the author called the Development Finance Initiative (DFI), development professionals apply the same framework to test public aid options for state and local governments on larger, more complicated development projects. [87] In one successfully financed project, DFI proposed the development program and conducted financial feasibility analysis for a public-private partnership for construction of public parking as part of a larger private mixed use development in an urban downtown. DFI applied the framework and found that feasibility for the project could be achieved simply through the acquisition of public parking from the developer. Thus, the project was shown to be feasible using Option 3 of Stage 1 of the framework. [88] In that case, Stage 2 subsidies would have been unnecessary, constitutionally questionable forms of public aid.

In an even more complex project involving the master development of an 800-acre site in a rural region, DFI applied the framework to a project where some officials believed that private development would be possible only if it were

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[84] *Turken v. Gordon, 224 P.3d 158, 166 (Ariz. 2010)* (opining that the duty "to pay taxes arises from law applicable to all, not out of contract," and therefore tax payments could not serve as consideration flowing to the City under a parking agreement with developer).

[85] Visit the school's website at *https://www.sog.unc.edu/* [*https://perma.cc/V4Y2-3BSB*].

[86] *See, e.g.*, Trump, *supra* note 76 (describing how a graduate student team used the framework to identify local government options for improving feasibility of a key development project in a small town).

[87] *See Development Finance Initiative*, UNC SCH. OF GOV'T, COMMUNITY AND ECONOMIC DEVELOPMENT IN NORTH CAROLINA AND BEYOND (2009), *http://ced.sog.unc.edu/category/developmentfinance-initiative/* [*https://perma.cc/8H5M-DP52*].

[88] Information about this project, which was located in Wilmington, North Carolina, along with other DFI project examples, is available at *https://www.sog.unc.edu/resources/microsites/developmentfinance-initiative/wilmington-north-carolina-water-street-parking-deck* [*https://perma.cc/H78H-C6A9*].

subsidized. However, DFI conducted feasibility analysis (Option 1) and determined that financial feasibility for private development was achieved through a combination of public leases (Option 2), [*34] acquisition of public facilities (Option 3), and market-rate loans (Option 4)--all within Stage 1 of the framework where no direct subsidy is provided to private enterprise. [89] Once again, the framework proved to be practical and effective in recognizing that Stage 2 subsidies would have been unnecessary and therefore constitutionally suspect forms of public aid.

If the straightforward legal framework proposed in this article can be employed by students and development professionals alike, it should be possible for courts to employ it as well. Courts would not be required to perform the financial analysis themselves. They would simply ensure that executive or legislative bodies followed the framework in any particular instance of public aid to private enterprise and that the determination of necessity was credible.

Courts could exercise some flexibility in how they implement the framework. For example, the framework could be boiled down to a more simplistic formulation: (1) necessity must be present for discretionary public aid to private enterprises, and a determination of public benefit has no bearing on the determination of necessity; (2) so long as public aid is limited to Stage 1 (unsubsidized) options, courts could (and arguably should) defer to the executive or legislative body regarding which Stage 1 options are utilized, how they are combined, and the precise parameters of each; and (3) regardless of public benefit, public aid in the form of a grant cannot be necessary if a loan can be offered instead, and as already explained, a loan almost always achieves feasibility for a project. Accordingly, it is highly unlikely that grants are necessary in a noncompetitive context. Consistent application of this framework by courts should, in turn, impose some discipline on for-profit companies and government officials engaged in public aid negotiations for development projects.

Of course, this article's approach requires some astuteness on the part of state courts, which must ask the right questions and make appropriate findings to support the determination of necessity. Are state courts willing to play this important role? In many states, that question is as yet unanswered.

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[89] For an example of the framework being employed for an 800-acre master development project for the State of North Carolina, *see* C. Tyler Mulligan et al., [RE]IMAGINING BROUGHTON: A REUSE STUDY OF HISTORIC BROUGHTON CAMPUS 20 (2016), *http://sog.unc.edu/dfi/broughton* [*https://perma.cc/839NV7EV*] (applying a protocol for evaluating public aid options based on the framework proposed in this article).

Tab 7

FOREWORD: THE DISFAVORED CONSTITUTION: STATE FISCAL LIMITS AND STATE CONSTITUTIONAL LAW

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Text

[*907]

I. Introduction

The dominant theme in the resurgent state constitutional jurisprudence of the last quarter-century has been the effort of many scholars and jurists to find in state constitutions a progressive alternative to the conservative turn federal constitutional doctrine has taken in the Burger and Rehnquist eras. Following the tone set by Justice William Brennan's path-breaking 1977 article in the Harvard Law Review, [1] the state constitutional law literature has sought a more expansive protection of civil liberties through state constitutional provisions dealing with criminal law and procedure, [2] freedom of expression, [3] and equality, [4] and to ground positive rights to public services in state constitutional measures dealing with such affirmative governmental duties as education, [5] welfare, [6] and housing. [7] [*908]

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[1] William J. Brennan, Jr., State Constitutions and the Protection of Individual Rights, 90 Harv. L. Rev. 489 (1977); see also William J. Brennan, Jr., The Bill of Rights and the States: The Revival of State Constitutions as Guardians of Individual Rights, 61 N.Y.U. L. Rev. 535 (1986).

[2] See Shirley S. Abrahamson, Criminal Law and State Constitutions: The Emergence of State Constitutional Law, 63 Tex. L. Rev. 1141 (1985); Robert M. Pitler, Independent State Search and Seizure Constitutionalism: The New York State Court of Appeals' Quest for Principled Decision-Making, 62 Brook. L. Rev. 1 (1996); Note, Developments in the Law - The Interpretation of State Constitutional Rights, 95 Harv. L. Rev. 1324, 1367-98 (1982) [hereinafter Developments].

[3] See, e.g., Developments, supra note 2, at 1398-1429.

[4] See, e.g., Robert F. Williams, Equality Guarantees in State Constitutional Law, 63 Tex. L. Rev. 1195 (1985).

[5] See Developments, supra note 2, at 1444-59; Michael Heise, State Constitutions, School Finance Litigation, and the "Third Wave:" From Equity to Adequacy, 68 Temp. L. Rev. 1151 (1995); Allen W. Hubsch, The Emerging Right to Education Under State Constitutional Law, 65 Temp. L. Rev. 1325 (1992); Molly McUsic, The Use of Education Clauses in School Finance Reform Litigation, 28 Harv. J. Legis. 307 (1991); William E. Thro, The Role of Language of the State Education Clauses in

With much of the analysis of state constitutional law focused on the failings of federal constitutional law, [8] far less attention has been paid to a distinctive feature of state constitutions that has little to do with civil liberties or positive rights - the many provisions that seek to protect taxpayers by limiting the activities and costs of government. The Federal Constitution says next to nothing about public finance, and when it does so, it either provides authority for congressional action [9] or sets procedures for raising and spending money. [10] It places just a handful of substantive constraints on federal taxation [11] and no restrictions on federal borrowing at all. By contrast, state constitutions accord extensive consideration to state and local spending, borrowing, and taxing. State constitutions limit the purposes for which states and localities can spend or lend their funds, and expressly address specific spending techniques. [12] These "public purpose" [*909] provisions narrow the range of government action and limit public sector support for private sector activities. Nearly all state constitutions impose significant substantive or procedural restrictions on state and local borrowing. [13] A considerable number also limit state and local taxation. [14] These provisions may be said to constitutionalize a norm of taxpayer protection.

Fiscal limits, as well as positive rights, thus characterize state constitutional law. Indeed, the states' fiscal constitutional provisions may offset the more widely heralded positive rights provisions. By giving priority to taxpayers over service recipients, these provisions can make it more difficult for states and localities to raise funds to finance public services.

But the real significance of fiscal limits in understanding state constitutional law is neither the barriers they create for the financing of public programs called for by positive rights advocates, nor the challenge they pose to the progressive image of state constitutional law that has dominated contemporary scholarly writing in the field. Rather, the most important lesson they provide grows out of the uncertain effect these provisions have had in actually

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School Finance Litigation, 79 Educ. L. Rep. 19 (1993); Paul L. Tractenberg, The Evolution and Implementation of Educational Rights Under the New Jersey Constitution of 1947, 29 Rutgers L.J. 827 (1998).

[6] See Helen Hershkoff, Foreword: Positive Rights and the Evolution of State Constitutions, 33 Rutgers L.J. 799 (2002); Helen Hershkoff, Positive Rights and State Constitutions: The Limits of Federal Rationality Review, 112 Harv. L. Rev. 1131 (1999) [hereinafter Hershkoff, Positive Rights]; Helen Hershkoff, Welfare Devolution and State Constitutions, 67 Ford. L. Rev. 1043 (1999); Burt Neuborne, Foreword: State Constitutions and the Evolution of Positive Rights, 20 Rutgers L.J. 881 (1989).

[7] See, e.g., Norma Rotunno, Note, State Constitutional Social Welfare Provisions and the Right to Housing, 1 Hofstra L. & Pol'y Symp. 111 (1996).

[8] See, e.g., Paul W. Kahn, Interpretation and Authority in State Constitutionalism, 106 Harv. L. Rev. 1147, 1153 (1993) (citing "the changed character of the federal bench" as a critical reason for the turn to state constitutional law). The focus on federal constitutional law is equally true of state constitutionalism's leading critic. See James A. Gardner, The Failed Discourse of State Constitutionalism, 90 Mich. L. Rev. 761, 780-98 (1992) (examples of state courts' limited use of state constitutions all involve due process, criminal procedure, or freedom of expression).

[9] See U.S. Const. art. I, § 8, cl. 1 (authorizing Congress to "lay and collect Taxes, Duties, Imposts and Excises"); id. § 8, cl. 2 (authorizing Congress "to borrow Money on the credit of the United States"); id. amend. XVI (authorizing imposition of the income tax).

[10] See id. art. I, § 7, cl. 1 (providing that "all bills for raising Revenue shall originate in the House of Representatives"); id. § 9, cl. 7 (providing that "no Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law").

[11] Id. § 8, cl. 1 (providing that "all Duties, Imposts and Excises shall be uniform throughout the United States"); id. § 9, cl. 4 (providing that "no Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken"); id. § 9, cl. 5 ("No Tax or Duty shall be laid on Articles exported from any State.").

[12] See, e.g., Dale F. Rubin, Constitutional Aid Limitation Provisions and the Public Purpose Doctrine, 12 St. Louis U. Pub. L. Rev. 143, 143 n. 1 (1993) (finding that forty-six out of fifty state constitutions contain some limits on spending).

[13] See, e.g., Stewart E. Sterk & Elizabeth S. Goldman, Controlling Legislative Shortsightedness: The Effectiveness of Constitutional Debt Limitations, 1991 Wis. L. Rev. 1301, 1315-16 (finding that more than three-quarters of the states have debt limitations in their constitutions).

[14] See, e.g., U.S. Advisory Comm'n on Intergovernmental Relations, Significant Features of Fiscal Federalism 18 (1992) (noting that all but seven states place some restrictions on local property taxation).

controlling state and local finances. There is an enormous gap between the written provisions of state constitutions and actual practice. State legislatures and local governments have repeatedly sought to expand the scope of "public purpose" and to slip the restraints of the tax and debt limits. [15] Increasingly, these efforts have won the approval of state courts.

Judicial interpretations have effectively nullified the public purpose requirements that ostensibly prevent state and local spending, lending, and borrowing in aid of private endeavors. Supreme court decisions in many states have also held that a host of financial instruments are beyond the scope of the constitutional debt limitations. As a result, although debt limits have altered the forms of state and local borrowing, they probably have had only a modest effect on aggregate state and local debt. The constitutional constraints on state and local taxation have been more effective, but their [*910] impact has been cushioned by judicial determinations that certain revenue-raising devices are not taxes subject to constitutional limitation.

This Article examines these fiscal limits and their significance for state constitutional law. I refer to these limits as the "disfavored constitution" for two reasons. First, they have been disfavored by state constitutional law scholars, who have largely ignored the state fiscal constitution in favor of other state constitutional provisions. Second, to a considerable degree, they have been disfavored by state courts, who frequently read the fiscal provisions narrowly, technically, and formalistically - often more like bond indentures than statements of important constitutional norms. [16]

Parts II, III, and IV of this Article will sketch out the principal provisions that form the states' fiscal constitution, and examine their contemporary judicial interpretation. In Part V, I will consider why these provisions have often been read so unsympathetically. In Part VI, I will briefly assess whether state constitutions ought to be used to constrain state and local finances. Finally, I will conclude in Part VII by considering the implications of the judicial treatment of state fiscal limits for the study of state constitutional law.

II. Public Purpose Requirements: Their Rise and Fall

By one recent count, forty-six state constitutions contain provisions, known collectively as "public purpose" requirements, that expressly limit the authority of their state and/or local governments to provide financial assistance to private enterprises. [17] The New York Constitution is typical in providing that "the money of the state shall not be given or loaned to or in [*911] aid of any private corporation or association, or private undertaking" [18] and that no "county, city, town, village or school district shall give or loan any money or property or in aid of any individual, or public or private corporation or association or private undertaking." [19] Many state constitutions supplement this general public purpose requirement with further restrictions on specific forms of assistance. [20]

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[15] See infra Parts II-IV.

[16] The few state constitutional law scholars who have referred to the fiscal limits have tended to treat them dismissively, too. See, e.g., James Gray Pope, An Approach to State Constitutional Interpretation, 24 Rutgers L.J. 985, 985 (1993) (referring to the difficulty of developing a state constitutional jurisprudence "on a textual foundation that . . . obsesses in excruciating detail over pecuniary matters").

[17] See Rubin, supra note 12, at 143 n.1. The remaining states appear to rely on judicial doctrines that similarly require that state or local taxpayer funds be spent only for public purposes. See Ullrich v. Bd. of County Comm'rs of Thomas County, 676 P.2d 127, 132-33 (Kan. 1984) (noting that expenditure of public money must be for a public purpose); Common Cause v. State, 455 A.2d 1, 15-16 (Me. 1983) (public purpose doctrine implicit in the Maine Constitution); Clem v. City of Yankton, 160 N.W.2d 125, 130-31 (S.D. 1968) (applying public purpose doctrine not based on specific state constitutional provision); State ex rel. Hammermill Paper Co. v. LaPlante, 205 N.W.2d 784, 793 (Wis. 1973) ("No specific clause in the constitution establishes the public purpose doctrine. However, it is a well-established constitutional tenet.").

[18] N.Y. Const. art. VII, § 8.

[19] Id. art. VIII, § 1.

[20] These may include a prohibition on the state or local government giving or lending its credit to private firms, or a ban on the state or local government becoming a shareholder in a public or private corporation. See Colo. Const. art. XI, § § 1, 2; N.Y.

These public purpose limitations date back to the mid-nineteenth century, and reflect the disastrous consequences of the states' extensive investments in and assistance to private firms in the 1820s and 1830s. The enormous success of the Erie Canal, which opened in 1825, in energizing New York's economy inspired a massive program of state governmental support for turnpikes, canals, and railroads over the next two decades. Many of these projects blurred public and private lines, with states investing in private firms, or providing grants, loans and loan guarantees to private companies. The states frequently obtained the funds they used to aid private firms by borrowing. Fueled by the intense interstate competition for economic development, this era of statesupported infrastructure finance was marked by waste, overbuilding, and mismanagement. The Panic of 1837 led to a contraction in economic activity, and eventually to an economic crisis. Many firms that had borrowed from the states were unable to repay their loans, and many infrastructure projects failed to generate projected revenues. The states had great difficulties meeting their obligations to their creditors; nine defaulted on interest payments and four states - Arkansas, Florida, Michigan, and Minnesota - repudiated all or part of their debts. [21]

In reaction, the states engaged in a wave of constitutional revision. [22] State constitutions were amended to require that state spending or lending be [*912] for a public purpose; to bar the gift or loan of state credit except for a public purpose; and to ban direct state investment in business corporation obligations. Initially, these provisions applied only to the activities of state governments. As a result, they were sometimes circumvented by state legislation authorizing local governments to provide assistance to private firms. Another round of waste, overbuilding, and economic crisis resulted, and in the late nineteenth century, many states amended their constitutions to apply the public purpose and aid limitations to local governments. [23]

The public purpose requirement was never a complete bar to government financial assistance to the private sector. In the leading midnineteenth century case of Sharpless v. Mayor of Philadelphia, [24] the Pennsylvania Supreme Court held that aid to a privately owned railroad could serve a public purpose. "The public has an interest in such a road," even if privately owned, because a railroad provides "comfort, convenience, increase of trade, opening of markets, and other means of rewarding labor and promoting wealth." [25] Railroads aside, most nineteenth century courts, however, treated their state's public purpose requirements as significant barriers to programs that would provide state or local assistance to private firms or individuals. Public purpose requirements constitutionalized the public/private divide with the goal of protecting the public fisc, and thus, the taxpayers, from private demands. During its heyday, the public purpose requirement operated to constrain the scope of state and local government, resulting in the invalidation of a host of economic development and social welfare programs that state courts found benefitted private, not public, interests. [26]

Const. art. VII, § 8; id. art. VIII, § 1. In addition, public purpose requirements typically apply to state and local borrowing, so that debts may be incurred only to support public purpose projects. Robert S. Amdursky & Clayton P. Gillette, Municipal Debt Finance Law: Theory and Practice 84 (1992).

[21] See B.U. Ratchford, American State Debts 105-14 (1941); Alberta M. Sbragia, Debt Wish: Entrepreneurial Cities, U.S. Federalism, and Economic Development 19-43 (1996).

[22] See, e.g., G. Alan Tarr, Understanding State Constitutions 111-12 (1998); see also Dale A. Oesterle, Lessons on the Limits of Constitutional Language from Colorado: The Erosion of the Constitution's Ban on Business Subsidies, 73 U. Colo. L. Rev. 587, 589, 594 & n.38 (2002) (noting that several Colorado cities had become insolvent due to their assistance to railroads, thereby contributing to the inclusion in the Colorado Constitution of 1876 of a ban on state and municipal aid to businesses).

[23] Tarr, supra note 22, at 114.

[24] 21 Pa. 147 (1853).

[25] Id. at 169.

[26] See Allen v. Inhabitants of Jay, 60 Me. 124 (1872) (invalidating government aid to factories); In re Opinion of the Justices, 195 N.E. 897 (Mass. 1935) (holding use of tax revenues to insure banks against loss on home mortgages not within "public purpose" limitations); Lowell v. City of Boston, 111 Mass. 454 (1873) (holding financial assistance to private residential housing development violated public purpose requirement).

Starting in the 1930s, state courts, faced with an array of state efforts to counteract the economic effects of the Great Depression, began to widen the definition of public purpose. In 1938, the Mississippi Supreme Court upheld a state program of issuing bonds to finance the construction of factories and the acquisition of machinery and equipment for long-term lease to private firms willing to relocate to the state; such an industrial development program [*913] was held to serve a public purpose. [27] Over time, as state industrial and economic development initiatives spread, courts came to broaden the notion of public purpose to include increased employment and tax base growth, and to approve programs that provided assistance to individual firms. Initially, many of these programs were funded by revenue bonds, [28] that is, bonds backed solely by the new revenues to be generated by the firms receiving assistance, so that courts could find that taxpayer dollars were not at risk. [29] Other courts did not distinguish between programs financed by revenue bonds and programs backed by general treasury funds. [30] Some courts resisted the trend and continued to invalidate public financial assistance to private businesses. [31] In some states where courts were reluctant to permit direct state assistance to private firms, the state constitutions were amended to permit some forms of industrial development assistance.

During the closing decades of the twentieth century, state courts increasingly expanded the scope of permissible public purposes, so that by the end of the century virtually every state supreme court had upheld at least some economic development programs that involved direct assistance - including cash grants, low-interest loans, and tax breaks to individual firms. [32] Landmark decisions include Common Cause v. State, [33] in which the Maine Supreme Court upheld the state's plan to commit $ 15 million in taxpayer funds to improve the facilities of the Bath Iron Works in order to persuade the company to remain in the state, and Hayes v. State Property & Buildings Commission, [34] in which a closely divided Kentucky Supreme Court upheld a package of inducements - with direct costs estimated at between $ 125 and $ 268 million - to persuade the Toyota Motor Corporation to open a plant in the state. Some courts have continued to police economic [*914] development programs, invalidating some - such as those aimed at aiding non-industrial activities like hotels and restaurants. [35] More generally, courts have taken a posture of extreme deference to state legislatures, finding that a broad range of goals fall under the rubric of public purpose, and that legislative determinations that a spending, loan, or tax incentive program will promote the public purpose are to be accepted as long as they are "not . . . irrational." [36] Even if much of the benefit of an economic development program consists of profits to private firms or individuals, the program may still serve the public purpose of attracting business or promoting growth. [37] Even if the public benefits of aid to the private sector are

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[27] See Albritton v. City of Winona, 178 So. 799, 804 (Miss. 1938).

[28] For an explanation of the difference between revenue bonds and general obligation bonds, see infra pp. 918-19.

[29] See, e.g., Basehore v. Hampden Indus. Dev. Auth., 248 A.2d 212, 223-24 (Pa. 1968).

[30] See, e.g., State ex rel Beck v. City of York, 82 N.W.2d 269 (Neb. 1957).

[31] See Vill. of Moyie Springs v. Aurora Mfg. Co., 353 P.2d 767 (Idaho 1960); Mitchell v. N.C. Indus. Dev. Fin. Auth., 159 S.E.2d 745 (N.C. 1968); State ex rel. McLeod v. Riley, 278 S.E.2d 612 (S.C. 1981).

[32] See Maready v. City of Winston-Salem, 467 S.E.2d 615, 627 n.1 (N.C. 1996) (noting that "courts in forty-six states in addition to North Carolina have upheld the constitutionality of governmental expenditures and related assistance for economic development incentives").

[33] 455 A.2d 1 (Me. 1983).

[34] 731 S.W.2d 797 (Ky. 1987).

[35] See Purvis v. City of Little Rock, 667 S.W.2d 936 (Ark. 1984) (finding no public purpose in financing private hotel); Holding's Little America v. Bd. of County Comm'rs, 712 P.2d 331 (Wyo. 1985) (finding no public purpose in providing aid to hotel and restaurant). But see Hucks v. Riley, 357 S.E.2d 458 (S.C. 1987) (finding public interest in tourism development provides public purpose justifying use of state funds to finance privately owned and operated lodging and restaurant facilities).

[36] Delogu v. State, 720 A.2d 1153, 1155 (Me. 1998).

[37] See Ward v. Commonwealth, 685 A.2d 1061 (Pa. Commw. Ct. 1996); WDW Props., Inc. v. City of Sumter, 535 S.E.2d 631, 636 (S.C. 2000); King County v. Taxpayers of King County, 949 P.2d 1260, 1266 (Wash. 1997); Libertarian Party of Wis. v. State, 546 N.W.2d 424, 434 (Wis. 1996).

acknowledged to be "speculative," while the private benefits are more immediate, courts are still likely to find that the measure satisfies the constitutional public purpose requirement. [38] Such a program will be rejected by the courts "only if it is 'clear and palpable' that there can be no benefit to the public." [39] As one dissenting North Carolina justice observed, lamenting the state supreme court's 1996 decision to uphold an economic development program which would permit public funds to be used, inter alia, to pay for spousal relocation assistance when private firms move to the state, [40] under the court's decision a state or locality could use public funds to pay for country club memberships for corporate executives if that would entice firms to relocate to the state. [41]

Today, state constitutional "public purpose" requirements are largely rhetorical. State legislatures define what public purposes are and receive great deference when they determine that a particular program promotes the public purpose. State constitutional provisions articulate the truism that [*915] public spending must be for a public purpose. But they do not provide a judicially enforceable constraint on state or local government. [42]

III. Debt Limitations: From Restriction to Evasion

A. Substantive and Procedural Restrictions on Borrowing

The vast majority of state constitutions impose some limitation on the ability of their state and local governments to incur debt. [43] These constitutional limitations take a variety of forms. Some bar state debt [*916] outright. [44]

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[38] See WDW Props., Inc., 535 S.E.2d at 635-36.

[39] Jackson v. Benson, 578 N.W.2d 602, 628 (Wis. 1998).

[40] See Maready v. City of Winston-Salem, 467 S.E.2d 615, 633 (N.C. 1996) (Orr, J., dissenting).

[41] Id. at 636 (Orr, J., dissenting).

[42] The decline of the public purpose doctrine as a limit on state spending has had some impact on other state constitutional restrictions on public aid to the private sector. In some states, the restriction on lending of credit does not apply if the assistance is provided for a public purpose. See Alaska Const. art IX, § 6; Ill. Const. art. VIII, § 1. In those states, the expansion of public purposes simultaneously erodes the ban on lending of credit. See also Brower v. State, 969 P.2d 42, 53 (Wash. 1998) (lending of credit restriction does not apply if loan advances a "fundamental purpose" of government).

In other states, however, lending of credit remains an additional restriction. Even if a program constitutes a public purpose, the technique of lending the state or local government's credit may still be proscribed. Most state courts find that a lending of credit has occurred when a state serves as a surety or guarantees a loan made by another lender. See, e.g., Barnhart v. City of Fayetteville, 900 S.W.2d 539 (Ark. 1995). The constitutional provision, thus, protects against the tendency of legislators to discount the risks posed by standing as surety when the state is not required to directly commit any funds at the time the suretyship obligation is assumed. A few state courts have gone further and found that a proscribed lending of credit occurs when a state borrows money and provides the proceeds to another entity. See, e.g., Wash. Higher Educ. Facilities v. Gardner, 699 P.2d 1240 (Wash. 1985). For the most part, however, state courts have distinguished lending of credit from borrowing followed by the provision of public funds to a private recipient, and have limited the lending of credit ban to the former situation. See, e.g., State v. Inland Prot. Fin. Corp., 699 So. 2d 1352 (Fla. 1997).

One nineteenth-century restriction that may have survived the twentieth-century expansion of public purpose is the prohibition on state investment in business corporations. This provision, in the constitution of a number of states, appears to be a direct response to the nineteenth century practice of state subscriptions to canal or railroad company stock. See David E. Pinsky, State Constitutional Limitations on Public Industrial Financing: An Historic and Economic Approach, 111 U. Pa. L. Rev. 265, 278-79 (1963). Two state supreme courts have indicated that this ban may apply even if the investment is for an economic development purpose. See Utah Tech. Fin. Corp. v. Wilkinson, 723 P.2d 406 (Utah 1986); W. Va. Trust Fund, Inc. v. Bailey, 485 S.E.2d 407 (W. Va. 1997). One arguably paradoxical result is that a state may be able to give or lend money to a private firm on a public purpose theory, but may be barred from taking an equity position in the firm, which would enable it to share in any appreciation in the firm's value.

[43] See Sterk & Goldman, supra note 13, at 1315.

[44] See Ind. Const. art. X, § 5 (prohibiting state debt except "to meet casual deficits in revenue," repel invasion, suppress insurrection or provide for state defense); accord W. Va. Const. art. X, § 4.

Others impose very low limits on the amount of debt a state may incur. [45] Some cap state or local debt or debt service at a specified fraction of state or local taxable wealth or revenues. [46] Tying the debt limit to a fraction of property wealth or revenue is a particularly widespread way of limiting local government debt. [47] This approach suggests an attempt to limit debt to the "carrying capacity" of the state or locality, so that new borrowing does not result in burdensome taxation or cuts in existing services.

Most commonly, state constitutions rely on a procedural restriction: Debt may not be incurred without the approval of a supermajority in the legislature, of voters in a referendum, or both. [48] This legislative supermajority or voter approval requirement may stand on its own or may be combined with a substantive cap on the amount of state or local debt. [49] For the states, the procedural requirements are often the real restrictions on debt. [*917] As state constitutions can be relatively easily amended, an absolute prohibition on debt or a low dollar limit on debt can be circumvented by a constitutional amendment authorizing a specific bond issue. As a result, the legal requirements for a constitutional amendment typically, a combination of a legislative supermajority and voter approval - also become the requirements for issuance of debt. Thus, although the Alabama Constitution flatly bars state debt, as of the early 1990s, it contained thirty-three amendments authorizing specific bond issues. [50]

Like the public purpose requirements, the "constitutional moment" [51] for the birth of debt limitation was the turnpike, canal, and railroad boom of the 1820s and 1830s, the Panic of 1837, and the resulting wave of tax increases adopted to pay off the state debts blithely assumed during the boom. [52] The first constitutional limits were adopted in the 1840s, and by 1860, nineteen states had constitutional debt limitations. [53] Most of the Reconstructed southern states and western states admitted to the Union after the Civil War included debt limitations

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[45] See Ariz. Const. art. IX, § 5 (limiting total state debt to $ 350,000); Ohio Const. art. VIII, § 1 (providing state debt limit of $ 750,000); Ky. Const. § 49 (state debt limited to $ 500,000); R.I. Const. art. VI, § 16 (limiting total state debt to $ 50,000).

[46] See Ga. Const. art. VII, § IV, P II (limiting debt service on state debt to 10% of state revenue); Haw. Const. art. VII, § 13 (providing that debt service on state debt is limited to 18.5% of the average state general fund revenues in the three prior fiscal years; local government debts limited to 15% of total assessed value of real property in each political subdivision); Nev. Const. art. IX, § 3 (limiting aggregate state debt to 2% of assessed valuation of property in state); Wash. Const. art. VIII, § 1 (limiting debt service on aggregate state debt to 9% of average of state revenues over the three prior fiscal years).

[47] See Ind. Const. art. XIII, § 1 (capping municipal debt at 2% of assessed valuation); Ky. Const. § 158 (setting permissible local government debt between 2% and 10% of local assessed valuation, with debt limit varying according to population of city; county and taxing district limits set at 2% of assessed valuation); Mich. Const. art. VII, § 11 (setting county debt limit at 10% of assessed valuation); N.Y. Const. art. VIII, § 2-a (setting debt limits for New York City and Nassau County at 10% of assessed valuation; debt limit for other large cities is 9% of assessed valuation; debt limit for other cities and counties and for towns and villages is 7% of assessed valuation).

[48] See Cal. Const. art. VI, § 18 (providing that local government debts require approval of two-thirds of local electorate); Mich. Const. art. IX, § 15 (providing that state long-term debt requires approval of two-thirds of members of each house of the legislature and a majority of state voters in referendum); S.C. Const. art. X, § 13 (providing that new state general obligation debt requires approval of either two-thirds of each legislative house or popular referendum).

[49] See Ga. Const. art. X, § V, P I (limiting county and municipal debt to 10% of assessed valuation; voter approval required); Wash. Const. art. VIII, § 1 (limiting state debt service to 9% of average of state revenues for past three years; three-fifths majority vote in each house of the legislature required before debt may be incurred).

[50] See William H. Stewart, The Alabama Constitution: A Reference Guide 115-16 (G. Alan Tarr ed., 1994); see also James H. White, III, Constitutional Authority to Issue Debt, 33 Cumb. L. Rev. 561, 565 (2002) (noting that Alabama state debt issued "numerous times" by constitutional amendment).

[51] Cf. Bruce A. Ackerman, The Storrs Lectures: Discovering the Constitution, 93 Yale L.J. 1013, 1022 (1984) (presenting theory of "constitutional moments").

[52] See Ratchford, supra note 21, at 73-104.

[53] Id. at 122.

in their constitutions. [54] By the early twentieth century nearly all state constitutions limited the borrowing authority of their local governments as well. [55]

Apart from the specific historical background, constitutional restrictions on debt may be justified as a means of reconciling the conflict between short-term and long-term interests that debt generates. When a government finances a capital project with long-term benefits such as a bridge, school building, or prison - it is appropriate to spread the costs of the project over its useful life. Borrowing the money and repaying the debt over a period of decades spreads the cost to the future generations who will benefit from the project. However, the ability to shift the costs forward may also induce elected officials to incur too much debt. The benefits of the project financed by the debt will be received immediately, while the costs of paying off the debt are deferred into the future. As a result, current elected officials may be [*918] tempted to approve projects that are not fully cost-justified. After all, they can get the credit for the new project immediately, while the blame for the additional taxes needed to pay off the debt will be borne by their successors. A central justification of constitutional limits on debt is to offset the temptations that can cause elected officials to burden future generations with unnecessary debt. Constitutional control can provide a constraint likely to be missing from the ordinary political process.

B. Legislative Evasion and Judicial Ratification

1. The Revenue Bond

Like the public purpose requirements, the state debt limitations have not had quite the effect their terms suggest. State constitutions typically require the state or locality to pledge its "full faith and credit" in support of its debt. This means that such a debt is a "general obligation" of the state or locality, backed not by a particular revenue source, but by the full revenue-raising capacity of the borrowing government. [56] Constitutional debt limitations apply to such debt. However, stimulated in part by the desire to avoid the substantive caps and voter approval requirements of the state constitutions, states and localities have developed financial instruments, what I refer to as "nondebt debts," [57] that enable them to borrow without pledging their full faith and credit. Instead, the debt is backed only by a specific revenue source. As a result of state judicial interpretation, or, in some states, constitutional amendment, these "non-guaranteed" or "revenue bond" debts are typically not subject to the constitutional limitations that apply to general obligation debt. Today, most state and local borrowing does not involve general obligation debt, but instead uses non-debt debts that avoid the pledge of full faith and credit and thus escape the constitutional debt limitations.

Initially, the only revenue bonds exempt from the debt limitations were project finance bonds, e.g., bonds issued to finance a project whose revenues would be used to pay off the debt incurred to finance the project. For example, to build a bridge, the state might issue a bond, promise the bond buyers to impose a toll on the bridge financed by the bond, and pledge the revenues generated by the bridge toll to repay the bonds. [58] State courts found that as long as the state limited its debt service payment obligation to [*919] the "special fund" generated by the project, such a revenue bond was not debt subject to the debt limit. [59]

Over time, the special fund concept spread well beyond debts backed solely by charges imposed on facilities financed by the borrowing. Courts found that bonds to finance highway construction were exempt from debt limitations if they were backed by taxes on motor fuels and vehicle license fees. This was based on the theory that

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[54] Id. at 122, 167-68.

[55] By 1938, forty-five of the forty-eight states had some limitations on state borrowing; the only exceptions were the three New England states of Connecticut, New Hampshire and Vermont. See id. at 430-31.

[56] See, e.g., Flushing Nat'l Bank v. Mun. Assistance Corp., 358 N.E.2d 848 (N.Y. 1976).

[57] See discussion infra Part III.C.

[58] See Ratchford, supra note 21, at 498, 503-06.

[59] Id. at 446-66.

new highways would generate additional auto usage and additional fuel tax and fee revenues and, thus, the costs of repaying the debt would not be borne by the taxpayers. [60] Similarly, a bond issued to finance a convention center might not be "debt" within the meaning of the constitutional constraint if it was backed by a new tax on hotel occupancy. This was done on the theory that the convention center would promote hotel use, generate the necessary new hotel tax revenues, and thus not threaten future taxpayers. [61] The cases are not always consistent, [62] but the trend has been to loosen the nexus required between the project financed by the bond and the revenues committed to paying off the obligation in order to justify avoidance of the debt limitations. [63]

2. Lease-Financing

Another important technique for avoiding debt limitations has been lease financing. Lease financing extends the revenue bond concept - and the attendant exemption from debt restrictions - from the creation of new revenue-generating infrastructure to the construction of new government facilities. In a lease-financing scenario, a private firm or a public authority issues the necessary bonds and builds the facility. Private debts are not subject to constitutional debt limits, and virtually all state courts have held that the debts of public authorities are not debts in the constitutional sense because the authorities lack the capacity to impose taxes or pledge the full faith and credit of the state or local government. [64] To finance the bond, the [*920] state or local government enters into an arrangement with a private firm or public authority bond issuer to lease the bond-financed facility for a period of time, with the government's lease payments covering the annual debt service. In theory, the state or local debt payment is rental for the use of the bond-financed facility. Courts have long held that long-term contracts for the purchase of basic operating goods and services, such as electricity, water, solid waste disposal or space for government offices, are not subject to constitutional debt limitations. [65] Although such a contract raises a danger of long-term commitment akin to that posed by debt, these longterm contracts have been held not to be debt so long as the government's duty to pay is tied to the receipt of service when the payment is made. [66] Thus, a long-term rental agreement does not create "debt" in the constitutional sense.

In most contemporary lease-financings the state or local "rent" payment is based not on the market value of the lease but on the private firm's or public authority's debt service requirements. Nevertheless, as long as the government's commitment to make payments is contingent on its use of the facility and is subject to annual legislative appropriation, most courts have found that the commitment is not "debt" in the constitutional sense. [67]

3. Subject-to-Appropriation Debt

Subject-to-appropriation debt, which emerged in the closing decades of the twentieth century, dramatically expands the opportunities for evasion. Subject-to-appropriation debt - also known as "contract debt" - takes the

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[60] See, e.g., In re Okla. Capitol Improvement Auth., 958 P.2d 759 (Okla. 1998).

[61] See, e.g., Convention Ctr. Auth. v. Anzai, 890 P.2d 1197 (Haw. 1995).

[62] See, e.g., Eakin v. State ex rel. Capital Improvement Bd., 474 N.E.2d 62, 67 (Ind. 1985) (holding that bond used to finance a convention center and backed by taxes on hotels, motels, and retail food business is "debt" within the meaning of debt limit).

[63] The special fund exemption may not be available if the state is dedicating a pre-existing revenue source to pay off a bond, rather than creating a new tax or increasing the amount to be paid under an existing tax. See Opinion of the Justices, 665 So. 2d 1357, 1362-63 (Ala. 1995); State ex rel. Marockie v. Wagoner, 438 S.E.2d 810 (W. Va. 1993).

[64] See Train Unlimited Corp. v. Iowa Ry. Fin. Auth., 362 N.W.2d 489 (Iowa 1985); Schulz v. State, 639 N.E.2d 1140 (N.Y. 1994); Dykes v. N. Va. Trans. Dist. Comm'n, 411 S.E.2d 1 (Va. 1991).

[65] See, e.g., Crowder v. Town of Sullivan, 28 N.E. 94 (Ind. 1891); Struble v. Nelson, 15 N.W.2d 101, 104 (Minn. 1944); Bd. of Supervisors of Fairfax Co. v. Massey, 169 S.E.2d 556, 559 (Va. 1969); State ex rel. City of Charleston v. Hall, 441 S.E.2d 386, 389 (W. Va. 1994).

[66] Hall, 441 S.E.2d at 389.

[67] See Bulman v. McCrane, 312 A.2d 857 (N.J. 1973); Dep't of Ecology v. State Fin. Comm., 804 P.2d 1241 (Wash. 1991); Dieck v. Unified Sch. Dist. of Antigo, 477 N.W.2d 613 (Wis. 1991). But see Montano v. Gabaldon, 766 P.2d 1328 (N.M. 1989).

lease-financing model of public authority issuance backed by state or local contract payments one step further by dispensing with the need for the government backing the debt to obtain anything of value from the issuer. Rather, a public authority, special district, or other entity not subject to constitutional restriction issues a bond, uses the borrowed funds to undertake a project for the state or local government, and then enters into a contract with the state or local government in which that government agrees to make [*921] an annual payment to the authority equal to the annual debt service on the authority's bond. So long as the state's or local government's p ayment to the authority is subject to annual appropriation, and any duty to make an annual appropriation is specifically disclaimed, most state courts which have considered this device have concluded that the state or local contractual commitment to cover the authority's debt service is not a "debt" subject to state constitutional constraint. [68] In other words, by nominally limiting its liability, the state or local government avoids creating "debt." [69]

Subject-to-appropriation borrowing resembles moral obligation debt, which loomed large in municipal finance in the 1960s and 1970s. [70] Under the moral obligation scenario, a public authority issued a bond, which would be backed by authority revenues, typically revenues to be generated by the facility to be financed by the bond. When the authority, or the potential investor, was uncertain whether the facility so financed would be able to produce the necessary revenues, the state would make a non-binding commitment of state funds to cover debt service in the event that revenues from the bond-financed project fell short. The state's moral obligation provided a psychologically significant safety net for public authority bond issues for moderate-income housing, hospitals, universities, and mental [*922] institutions. [71] State courts generally concluded that the legislature's mere "moral" obligation to appropriate debt service did not constitute a debt triggering the constitutional debt limitations. [72] The moral obligation device, however, came under a cloud in the mid-1970s when New York State had to come to the rescue of its Urban Development Corporation (UDC) and make good on its moral obligation to support the UDC. [73]

In one sense, subject-to-appropriation debt is less troubling that moral obligation debt since states typically did not make any initial appropriation to the authority issuing the moral obligation bond but rather acted on the hopeful assumption that they would never have to spend state funds to make good on their "obligation." That may have created the illusion that moral obligation debt was cost-free to the state, and may have led states to take on such obligations too easily. By contrast, contemporary subject-to-appropriation obligations assume the regular appropriation of public funds to the authority issuing the debt, and thus can be factored into budget projections and

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68 See Carr-Gottstein Props. v. State, 899 P.2d 136 (Alaska 1995); In re Anzai, 936 P.2d 637 (Haw. 1997); Wilson v. Ky. Transp. Cabinet, 884 S.W.2d 641 (Ky. 1994); Employers Ins. Co. of Nev. v. State Bd. of Exam'rs, 21 P.3d 628 (Nev. 2001); Schulz v. State, 639 N.E.2d 1140 (N.Y. 1994); Fent v. Okla. Capitol Improvement Auth., 984 P.2d 200 (Okla. 1999); Dykes v. N. Va. Transp. Dist. Comm'n, 411 S.E.2d 1 (Va. 1991).

69 In one very recent case, even the arguable absence of such a disclaimer was unnecessary as the court proved willing to read one into the authorizing legislation. In the summer of 2003, the New York state legislature created a complex financing scheme that would permit the use of state sales tax receipts to back bonds that would be issued to refinance the debt of the Municipal Assistance Corporation (MAC), and thus reduce New York City's current fiscal year MAC interest obligation, and thereby enable the City to close its annual budget deficit. The legislature, however, may have failed to make it clear that the sales tax payments were subject to annual appropriation; indeed, one provision of the law appeared to make the "subject to appropriation" language inapplicable to this arrangement. See N.Y. Pub. Auth. Law § § 3238-a, 3240(5) (McKinney 2003). When the arrangement was challenged, the trial court noted the "poor draftsmanship," but observed that if the "subject to appropriation" language did not apply that would lead to "the absurd result of attributing the intent of enacting a statute that is facially unconstitutional, thus, negating the very payments the Legislature sought to establish . . . .A poorly drafted provision should not overcome the overriding purpose of the statute" - that is, use of a constitutionally acceptable financing device to circumvent the debt limitation. Local Government Assistance Corp. v. Sales Tax Asset Receivable Corp., 230 N.Y. L.J. 17, 17 (2003).

70 See Janice C. Griffith, "Moral Obligation" Bonds: Illusion or Security?, 8 Urb. Law. 54 (1976).

71 Id. at 57-60.

72 See Steup v. Ind. Hous. Fin. Auth., 402 N.E.2d 1215 (Ind. 1980); Utah Hous. Fin. Agency v. Smart, 561 P.2d 1052 (Utah 1977); State ex rel. Warren v. Nusbaum, 208 N.W.2d 780 (Wis. 1973).

73 See generally N.Y. State Moreland Act Comm'n, Restoring Credit and Confidence: A Report to the Governor on the Urban Development Corporation and Other State Financing Authorities (1976).

counted as part of regularly recurring government costs. The fiscal illusion inherent in the moral obligation bond is thus avoided. Yet, by treating subject-toappropriation obligations as part of baseline expenses, the states have only underscored the degree to which this device exists solely to evade the debt limits. These bonds do not involve using the state to provide extra security for public authority bonds; instead, their only purpose is to enable the state to use a public authority to circumvent the state constitution.

Subject-to-appropriation debt has become increasingly widespread. According to a 2001 statement issued by Standard & Poor's, a leading bond rating agency, "this type of debt issuance is now common in at least 33 states." [74] One recent court decision found that courts in thirty-two states had upheld some form of subject-to-appropriation debt. [75] Default levels have been comparable to those of full faith and credit general obligation bonds. "While appropriation-backed bonds are not considered debt under a strict legal definition, Standard & Poor's considers all appropriation-backed bonds of an issuer to be an obligation of that issuer and a failure to appropriate will [*923] result in a considerable credit deterioration for all types of debt issued by the defaulting government." [76]

Indeed, even as they have held that subject-to-appropriation agreements are beyond the scope of constitutional debt limitations, many state courts have candidly acknowledged that the state or locality behind the obligation will do its best to assure that the annual appropriations are made, since failure to make the appropriation would surely have a dramatically negative impact on the state's or locality's own bond rating and interest rates. As the California Supreme Court has stated, "We are not naive about the character of this transaction." [77] Yet, these "practical consequences" have usually not been enough to trigger the application of state constitutional debt constraints. [78] Instead, courts have relied on the state's or local government's formal disclaimer of legal obligation to pay debt service as conclusively eliminating the central threat of state or local debt - the danger to future taxpayers of long-term financial commitments. As a result, state debt limitations need not and do not apply to subject-to-appropriation debt. [79]

Not all state judges have been happy with this development. Many of the cases in which state supreme courts have found subject-toappropriation agreements are not debt have been marked by close votes and sharp dissents, with the dissenters decrying the evisceration of the constitutional debt limitations and calling for a "common sense" or realistic interpretation that would recognize that these borrowings are binding in practice. [80] Yet, the steady trend has been to exempt these agreements from debt limitations. [*924]

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[74] Richard J. Marino & Colleen Waddell, Revised Lease and Appropriation-Backed Debt, Standard & Poor's Rating Services, June 13, 2001.

[75] Lonegan v. State, 819 A.2d 395, 404 n.2 (N.J. 2003) [hereinafter Lonegan II].

[76] Marino & Waddell, supra note 74.

[77] Rider v. City of San Diego, 959 P.2d 347, 358 (Cal. 1998).

[78] See Wilson v. Ky. Transp. Cabinet, 884 S.W.2d 641, 644 (Ky. 1994) ("The argument that the practical consequences [of subject-to-appropriation debt] produce some kind of constitutional general obligation is without merit . . . . Practical, moral or righteous claims do not pass the test of contract or constitutional law."); Employers Ins. Co. of Nev. v. State Bd. of Exam'rs, 21 P.3d 628, 632 (Nev. 2001) (rejecting argument from "realism"). A handful of state courts have given greater weight to practical effects in assessing whether an obligation is "debt" within the meaning of a state's constitution. See State ex rel. Ohio Funds Mgmt. Bd. v. Walker, 561 N.E.2d 927, 932 (Ohio 1990) (noting obligation to be considered "not only for what it purports to be, but what it actually is"); Winkler v. Sch. Bldg. Auth., 434 S.E.2d 420, 433, 435 (W. Va. 1993) (noting that the court was unwilling to "abandon . . . logic and common sense" and finding that "where the only source of funds for revenue bonds was general appropriations, it defied logic to say that the legislature had no obligation to fund such bonds.").

[79] See Wilson, 884 S.W.2d at 644; Enourato v. N.J. Bldg. Auth., 448 A.2d 449, 456 (N.J. 1982); Dep't of Ecology v. State Fin. Comm., 804 P.2d 1241, 1246 (Wash. 1991).

[80] See Wilson, 884 S.W.2d at 646-67 (Stumbo, J., dissenting) ("Through smoke and mirrors we have allowed debt to be labelled something else for too long. The economic reality is that these bonds are debts of the Commonwealth."); Fent v. Okla. Capital Improvement Auth., 984 P.2d 200, 211-15 (Okla. 1999) (Lavender, J., concurring in part and dissenting in part) ("no amount of legal semantics, word-massaging or linguistic subterfuge can turn this express commitment into some non-enforceable moral

In 2002, the New Jersey Supreme Court appeared to signal a shift to a more critical review of subject-to-appropriation debt. [81] In Lonegan I, the court considered a challenge to $ 8.6 billion in bonds for repairing and constructing new public schools - the "largest, most comprehensive school construction program in the nation." [82] The bonds were to be issued by a state authority, and backed by a contract pursuant to which the state committed, subject to annual appropriation, to pay the authority an amount each year that would cover the costs of debt service. As the state's obligation was subject-to-appropriation, the voter approval the New Jersey Constitution requires for new state debt was neither sought nor obtained. The state supreme court expressed serious doubt about the propriety of the appropriation contract device, but ultimately concluded that as the school construction program involved the "provision of constitutionally required" [83] educational facilities and was a direct response to the court's own orders in New Jersey's longstanding school funding litigation, the financing plan did not violate the state's debt limitation provision. [84] The court, however, intimated that subjectto-appropriation debts outside the shelter of the state's education finance requirements might be subject to challenge. [85] Noting that New Jersey's growing use of subject-to-appropriation debt raised the "troubling question" of whether the state's debt limitation "retains its purpose and vitality" and warning that "a literal interpretation of the Debt Limitation Clause that eviscerates the strictures the Clause expressly contains cannot serve the constitutional mandate," [86] the court set down for reargument the question of whether subject-to-appropriation debt outside the school facilities setting is "debt" in the constitutional sense. [87] [*925]

Ultimately, however, the court drew back from the brink and nine months later sustained the general exemption of subject-to-appropriation debt from the state's constitutional debt restriction. [88] The court held that the constitutional limits apply only to "debt that is legally enforceable against the State . . . ." [89] Because "the State is not legally bound" to pay debt service on subject-to-appropriation debt "and can opt not to do so," subject-to-appropriation debt is not subject to constitutional limitation. [90] To be sure, "the State acknowledged that payments on appropriation debt are 'highly likely'" [91] as "non-payment would adversely affect the State's credit rating." [92] Yet, the state's nominal freedom not to pay debt service was doctrinally decisive.

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obligation to repay"); Dep't of Ecology v. State Fin. Comm., 804 P.2d 1241, 1246 (Dore, J., dissenting) (arrangement "violates both the letter and spirit" of the Washington debt limit); id. at 1255 (a "commonsense interpretation" of the debt limit requires that subjectto-appropriation debt be treated as debt); id. at 1257 (the "escape hatch" provided by the non-appropriation clause "is really an illusory one").

[81] Lonegan v. State, 809 A.2d 91 (N.J. 2002) [hereinafter Lonegan I].

[82] Id. at 104.

[83] Id. at 105.

[84] Id. at 104-07.

[85] See generally id.

[86] Id. at 93.

[87] See id. at 109. The plaintiffs had attacked a number of state financing schemes, in addition to the school-funding program, that combined authority-issued debt and state debt service contracts to avoid the state's constitutional debt restriction. Id.

[88] Lonegan II, 819 A.2d 395 (N.J. 2002). The Lonegan I decision, directing that the question of subject-to-appropriation debt be set down for re-argument, was decided by a vote of 6 to 1, with the dissenter voting to invalidate all future subject-toappropriation debt arrangements, other than the school facilities financing scheme, without need for re-argument. Lonegan I, 809 A.2d at 132 (Stein, J., dissenting). Lonegan II sustained the constitutionality of subject-to-appropriation debt by a vote of 4 to 3. 819 A.2d at 407. Chief Justice Poritz wrote the opinions for the court in both cases. Id. at 397; Lonegan I, 809 A.2d at 93.

[89] Lonegan II, 819 A.2d at 402.

[90] Id. at 405.

[91] Id. at 406.

[92] Id.

C. Consequences of Evasion

As a result of the rise of revenue bonds, lease-financing arrangements, subject-to-appropriation debt, and other various evasive techniques, nearly three-quarters of all state debt and two-thirds of city and county debt are "non-debt debts" exempt from the panoply of substantive limitations on and procedural requirements for debt found in state constitutions. [93] Debt limits have affected the form of state and local debt, but they do not appear to have significantly affected the total amount of debt. [94] [*926]

The debt limitations, however, are not without consequences. Evading state constitutions has costs. In order to avoid falling into the category of constitutional debt, these instruments avoid pledging the full faith and credit of the state or locality, and they limit the recourse of lenders seeking principal and interest payments to certain funds. As a result they present a slightly greater risk to investors, and thus usually carry a slightly higher interest rate than general obligation bonds. [95] They also involve greater administrative and legal costs than general obligation debt since issuers not pledging full faith and credit have to provide lenders with other forms of security. Over time, as the bond market has grown familiar and comfortable with these debts, the interest rate differential between the guaranteed and non-guaranteed obligations of the same jurisdiction has narrowed. However, some distinction usually continues, and the higher administrative costs of issuing these bonds remains.

Debt limitations, or the state and local efforts at avoiding them, have also contributed to the baroque structure of state and local government, and to the major role played by un-elected public authorities and similar agencies that are technically independent of the state or of general purpose local governments. [96] Unless the state constitution specifically provides otherwise, state courts have generally found that because public authorities lack the power to impose taxes or to pledge the full faith and credit of their states, public authority debt is not subject to constitutional debt limits. [97] As a result, in many states, public authorities have become conduits for the [*927] "backdoor financing" of appropriation-backed debt. [98] The evasion of debt limits has been an important stimulus to the creation of public authorities, particularly those controlling public infrastructure. These authorities have been

[93] See William D. Valente et al., Cases and Materials on State and Local Government Law 647 (William D. Valente ed., 5th ed. 2001) (reporting debt figures for 1996).

[94] James C. Clingermayer & B. Dan Wood, Disentangling Patterns of State Debt Financing, 89 Am. Pol. Sci. Rev. 108, 116 (1995) (stating that debt limitations "have no statistically significant impact on net increases in state debt"). To be sure, as Professor Stewart Sterk has pointed out to me, it is unlikely that debt limitations have no impact on the overall level of state and local borrowing. Some debts may not be capable of shifting to revenue bond form, and the costs of evading debt limitations may discourage some avoidance efforts. Nevertheless, it is doubtful that debt limitations have had a significant effect on debt levels. As Professor Clayton Gillette has recently written, even when local officials have sought to comply with debt restrictions by submitting bond issues to voter approval, if the voters do reject the debt proposal, officials may still be able to finance the same project through an alternative borrowing mechanism not subject to the voter approval requirement. See Clayton P. Gillette, Direct Democracy and Debt, XXX J. Contemp. Legal Issues (forthcoming 2004) (New York University Public Law and Legal Theory Research Paper Series, Research Paper No. 69, at 13-17) [hereinafter Gillette, Direct Democracy]. However, Professor Gillette concludes that voter approval requirements may have some effect in constraining local officials from overinvesting in capital spending. See id. at 42-53.

[95] This has long been the case. See Ratchford, supra note 21, at 514 (noting that "the most definite and tangible disadvantage of revenue bonds in comparison with general state obligations is their greater interest cost").

[96] See, e.g., Beverly S. Bunch, The Effect of Constitutional Debt Limits on State Governments' Use of Public Authorities, 68 Pub. Choice 57 (1991).

[97] See Rider v. City of San Diego, 959 P.2d 347 (Cal. 1998); Albuquerque Metro Arroyo Flood Control Auth. v. Swinburne, 394 P.2d 998 (N.M. 1964); Ragsdale v. City of Memphis, 70 S.W.2d 56, 68 (Tenn. Ct. App. 2001).

[98] See Rider, 959 P.2d at 359; Schulz v. State, 639 N.E.2d 1140 (N.Y. 1994); Fent v. Okla. Capitol Improvement Auth., 984 P.2d 200, 210 (Okla. 1999); Dykes v. N. Va. Transp. Dist. Comm'n, 411 S.E.2d 1, 5 (Va. 1991).

repeatedly criticized for their lack of accountability to state and local voters and for the resulting fragmentation of state and local infrastructure policies and management. [99]

IV. Tax and Expenditure Limitations: Proposition 13 and the State Fiscal Constitution

State constitutional provisions dealing with taxation and expenditure levels are both less widespread and more diverse than public purpose requirements and debt limitation provisions. Some state constitutions are silent on the subject; in others, the tax provisions, like those in the Federal Constitution, are primarily facilitative or structural rather than restrictive. They authorize certain kinds of taxation, determine which level of government shall levy what kind of tax, or establish the basic ground rules for taxation, such as the requirement of uniformity of assessments and rates, [100] the classification of different categories of property or activity for different rates of taxation, or the provision of exemptions from taxation. These provisions may have some effect on state and local tax policy and may indirectly limit overall revenues, [101] but their thrust is to define and assure the equal treatment of taxpayers rather than to limit tax levels per se. [*928]

Tax limitation, however, is an important theme in the state fiscal constitution, and one of growing significance. More than half the state constitutions include some substantive or procedural limitation on the level of state or local taxing or the level of spending funded by ownsource revenues. Although some constitutional measures are addressed to the sales tax, [102] the income tax, [103] or taxation generally, [104] most limitations are focused on the property tax - historically the most important form of subnational taxation and still the single most important form of local own-source revenue. [105]

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[99] For critical appraisals of the role of public authorities in state and local governance, see Diana B. Henriques, The Machinery of Greed: Public Authority Abuse and What to Do About It (1986); Annmarie Hauck Walsh, The Public's Business: The Politics And Practices of Government Corporations (1980). For a more balanced assessment, see Public Authorities and Public Policy: The Business of Government (Jerry Mitchell ed., 1992).

[100] Almost all state constitutions contain some provisions for equal or uniform taxes. See, e.g., Jerome R. Hellerstein & Walter Hellerstein, State and Local Taxation: Cases & Materials 34 (6th ed. 1997). In some states this applies to all taxes. See Ga. Const. art. VII, § 1 ("all taxation shall be uniform upon the same class of subject within the territorial limits of the authority levying the tax"). In other states, the uniformity or equality requirement is focused on the property tax. See Ind. Const. art. X, § 1 ("uniform and equal rate of property assessment and taxation"); Me. Const. art. IX, § 8 ("all taxes upon real and personal estate . . . shall be apportioned and assessed equally").

[101] By requiring equal levels of taxation for all taxpayers, the uniformity clause makes it more difficult for state and localities to tax commercial property owners or corporations at a higher rate than residential property owners or individuals. Many states have addressed this problem by amending their constitutions to permit the classification of taxpayers into different groups - such as commercial and residential property owners - and then requiring uniformity of treatment only within the designated classes. Uniformity also poses an obstacle to the graduated income tax. "A graduated income tax by its very nature lacks the uniformity of taxation typically required by state constitutional restrictions. A controversy which raged throughout the country, as states enacted income tax levies, was whether the income tax constituted a property tax that violated the uniformity provisions." See Hellerstein & Hellerstein, supra note 100, at 36.

[102] See Mich. Const. art. IX, § 8 (capping the sales tax rate); accord Mont. Const. art. VII, § 16.

[103] See Fla. Const. art. V, § 5 (prohibiting personal income tax); Mich. Const. art. IX, § 7 (prohibiting graduated income tax); N.C. Const. art. V, § 6 (limiting income tax); Tex. Const. art. VIII, § 9 (prohibiting personal income tax without voter approval).

[104] See Cal. Const. art. XIIIA, § 3 (requiring state legislative supermajorities in order to increase state taxes); id. art. XIIID (making voter approval a requirement for all tax increases); Del. Const. art. VIII, § § 10, 11 (requiring legislative supermajorities for imposing or increasing a tax or a fee); Mich. Const. art. IX, § 25 (requiring voter approval as condition for new or increased state or local taxes); Mo. Const. art. X, § § 18, 22 (setting tax limits and conditioning new or increased taxes and fees on voter approval); S.D. Const. art. XI, § § 13, 14 (requiring either legislative supermajority or voter approval in order to increase state taxes or the property tax).

[105] See Valente et al., supra note 93, at 489.

Like the debt limitations, tax limits take many forms: limits on the property tax rate; [106] limits on the increase in assessed valuation and thus on the year-to-year change in the tax liability of the property owner; [107] limits on the rate of increase in state expenditures and in the revenues needed to [*929] fund them; [108] and requirements that new or increased taxes be subject to either a legislative supermajority or voter approval (sometimes with popular supermajorities). [109]

1. Proposition 13 and Its Aftermath

The earliest tax limitations appeared in state statutes during the 1870s and 1880s and were later incorporated in many state constitutions. [110] These statutes capped property tax rates at a fraction of property values. A "second round of constitutional tax limitations appeared during the Depression of the 1930s. They were aimed at forcing tax reductions, thereby stemming the tide of tax delinquencies and tax foreclosures of residential property." [111] But the most important event in the development of tax limitations - the "constitutional moment" for tax limitation comparable to the Panic of 1837 and its aftermath for public purpose and debt limitations - was in June 1978 when California adopted Proposition 13. [112]

Proposition 13 was a response to soaring property taxes in California, a surge attributable to housing price inflation, which was "translated automatically into higher assessed valuations." [113] When local governments failed to lower property tax rates and the state legislature failed to provide tax relief, Howard Jarvis, "a longtime opponent of government spending and ardent champion of lower taxes, organized a campaign" to get a tax relief constitutional amendment on the ballot and enacted by the voters. [114]

Although it built on popular concern about the property tax, Proposition 13's reach swept well beyond that tax. Its initial provision was a relatively [*930] traditional cap on the property tax rate as a percentage of property value; [115] other provisions broke new constitutional ground. Section 2 rolled back property assessments, [116] but more significantly, limited future reassessments, except upon change in ownership, to the lesser of 2% per year or the rate of inflation. [117] This measure, which has been emulated by six other state constitutions, [118] secures property

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[106] See Ariz. Const. art. IX, § 18; Cal. Const. art. XIIIA, § 2; Fla. Const. art. VII, § 9; La. Const. art. VI, § 6; Mo. Const. art. X, § 11; Neb. Const. art. VIII, § 5; Nev. Const. art. X, § 2; N.Y. Const. art. VIII, § 10; Ohio Const. art. XII, § 2; Wash. Const. art. VII, § 2; W. Va. Const. art. X, § 1; Wyo. Const. art. XV, § § 5-7.

[107] See Ariz. Const. art. IX, § 19; Cal. Const. art. XIIIA, § 2; Fla. Const. art. VII, § 4; La. Const. art. VI, § 3; Mich. Const. art. IX, § 3; Okla. Const. art. IX, § 8B; Or. Const. art. XI, § 11(1)(b).

[108] See Ariz. Const. art. IX, § 17; Cal. Const. XIIIB, § 1; Colo. Const. art. X, § 20; Conn. Const. art. III, § 18; Fla. Const. VII, § 1; Haw. Const. art. VII, § 9; La. Const. art. VII, § 10; Mich. Const. art. IX, § 26; Mo. Const. art. X, § § 18, 20; S.C. Const. art. X, § 7.

[109] See Ariz. Const. art. IX, § 22; Cal. Const. arts. XIIIA, XIIIC, XIIID; Colo. Const. art. X, § 20; Del. Const. art. VIII, § § 6, 10, 11; Ga. Const. art. VIII, § 6, P II; Haw. Const. art. VII, § 9; La. Const. art. VI, § 25; id. art. VII, § 2; Mich. Const. art. IX, § 25; Mo. Const. art. X, § § 18, 22; S.C. Const. art. X, § 7.

[110] M. David Gelfand et al., State and Local Taxation and Finance in a Nutshell 38 (2d ed. 2000).

[111] Id.

[112] Cal. Const. art. XIIIA; see Kirk J. Stark, The Right to Vote on Taxes, 96 Nw. U. L. Rev. 191, 192 (2001) ("Proposition 13 marked a watershed moment in the evolution of American attitudes toward government and taxation.")

[113] Stark, supra note 112, at 197.

[114] Id. at 198.

[115] Cal. Const. art. XIIIA, § 1.

[116] Id. § 2.

[117] Id.

[118] See supra note 107 and accompanying text.

owners against inflation, while producing significantly different tax liabilities for owners of identically valued parcels, depending on when they were purchased. [119] Section 3 went beyond the property tax by requiring that any increase in any state tax must first be adopted by a two-thirds vote in each house of the legislature. [120] Section 4 provided that a city, county, or special district may impose a "special tax" in addition to the now-restricted property tax only with the approval of two-thirds of local voters. [121]

Proposition 13 had a catalytic effect, sparking tax revolts and anti-tax constitutional amendments around the country. [122] Some of these focused on the property tax, while others, like Proposition 13 itself, were far more ambitious.

Just a few months after California acted, Michigan voters adopted an amendment which conditioned local tax increases on voter approval, imposed legislative supermajority requirements for increases in state taxes, and limited future increases in state revenues. [123] The measure required that a state revenue limit be

equal to the product of the ratio of Total State Revenues in fiscal year 1978-79 divided by the Personal Income of Michigan in calendar year 1977 [*931] multiplied by the Personal Income of Michigan in either the prior calendar year or the average of Personal Income of Michigan in the previous three calendar years, whichever is greater. [124]

The amendment prohibited the state legislature from imposing "taxes of any kind which, together with all other revenues of the state, federal aid excluded, exceed the revenue limit." [125] This limit can be exceeded only if the governor's declaration of emergency is confirmed by the vote of two-thirds of each house of the legislature. [126] Missouri quickly followed suit with its Hancock Amendment, which imposed a similar set of restrictions on Missouri's state and local governments. [127] In 1979, California voters adopted a second initiative, which followed Headlee and Hancock by imposing limits on the growth of state spending. [128]

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119 Proposition 13's imposition of "acquisition value" assessment and the resulting disparities in the tax treatment of comparably valued properties has been sustained against arguments that it violates the Federal Equal Protection Clause. See Nordlinger v. Hahn, 505 U.S. 1, 10-18 (1992); Amador Valley Joint Union High Sch. Dist. v. State Bd. of Equalization, 583 P.2d 1281, 129294 (Cal. 1978).

120 Cal. Const. art. XIIIA, § 3.

121 Id. § 4.

122 Over the next dozen years, fourteen states imposed limitations on the growth of state taxes and expenditures, and twenty-three imposed limits on local property tax revenue growth, including ten that adopted new or more restrictive tax rate limits. See Mark Skidmore, Tax and Expenditure Limitations and the Fiscal Relationships Between State and Local Governments, 99 Pub. Choice 77, 83, 88 (1999).

123 Mich. Const. art. IX, § § 25-32.

124 Id. § 26.

125 In any fiscal year in which total state revenues exceed the revenue limit by 1% or more, the constitution requires:

The excess revenues shall be refunded pro rata based on the liability reported on the Michigan income tax and single business tax (or its successor tax or taxes) annual returns filed following the close of such fiscal year. If the excess is less than 1%, this excess may be transferred to the State Budget Stabilization Fund.

Id.

126 Id. § 27.

127 Mo. Const. art. X, § § 16-22.

128 Cal. Const. art. XIIIB.

In the years that followed, at least eight additional states Alaska, [129] Arizona, [130] Connecticut, [131] Delaware, [132] Florida, [133] Hawai'i, [134] Louisiana, [135] and South Carolina [136] - adopted constitutional measures that impose, or require the state legislature to impose, state revenue or expenditure limitations based on the growth in state population, the cost of living, or some combination of these measures relative to a baseline year, and also require legislative supermajorities before the legislature can alter or [*932] exceed these limits. [137] Similarly, a number of states have followed California, Michigan, and Missouri in making voter approval a prerequisite for new or increased local taxes. [138]

2. Tax Limitations and the Rise of Non-Tax Revenues

Modern tax and expenditure limitations appear to have had a real impact on state and local finances. Property tax levels, as well as the role of the property tax in financing local government, have dropped sharply across the United States, particularly in the states that adopted the most stringent property tax limitations. [139] The effects of the comprehensive state revenue or expenditure limitations on state government are more uncertain, however, with some researchers finding they have had little effect, [140] while others conclude that they have slowed government revenue growth. [141]

The effect of the tax limits in holding down the property tax, however, have been offset to some degree by increases in other local taxes and, especially, by the dramatic growth in the local use of fees, user charges, and special assessments. [142] The rise in these "non-tax taxes" has had multiple policy, ideological, and political causes - but surely evasion of the tax limits is one of them. [*933]

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[129] Alaska Const. art. IX, § 16 (limiting increases in state appropriations according to population growth and the rate of inflation, using 1981 as a baseline year).

[130] Ariz. Const. art. IX, § 17 (providing for state spending limit, which may be exceeded only by two-thirds vote in each house).

[131] Conn. Const. art. III, § 18 (limiting increases in state spending).

[132] Del. Const. art. VIII, § 6 (requiring legislative supermajority for increase in state expenditure level).

[133] Fla. Const. art. VII, § 1 (limiting increase in state revenue).

[134] Haw. Const. art. VII, § 9 (providing for limit on increases in state expenditures).

[135] La. Const. art. VII, § 10 (setting state spending limit).

[136] S.C. Const. art. X, § 7 (requiring legislature to limit growth in state spending; limit can be changed only be twothirds legislative vote).

[137] See supra notes 129-36.

[138] See Colo. Const. art. X, § 20; Wash. Const. art. VII, § 2 (noting that ad valorem taxation of property at a rate greater than 1% of full cash value requires approval by a supermajority of voters); see also Stark, supra note 112, at 203-06 (discussing efforts to add voter approval requirements in Montana, Washington, Arizona, Oregon, and Florida). The Louisiana Constitution requires both houses of its legislature to approve new or increased local taxes before they can take effect. La. Const. art. VII, § 2.

[139] See Terri A. Sexton et al., Proposition 13: Unintended Effects and Feasible Reforms, 52 Nat'l Tax J. 99, 107 (1999) (finding that in California, the share of county revenue from the property tax dropped from 33.2% in 1977-78 to 11.6% in 199596).

[140] See, e.g., Ronald J. Shadbegian, Do Tax and Expenditure Limitations Affect the Size and Growth of State Government?, 14 Contemp. Econ. Pol'y 22 (1996) (finding that tax and expenditure limitations are little more than "political cover for state legislatures").

[141] See Skidmore, supra note 122, at 95.

[142] See Gary M. Galles & Robert L. Sexton, A Tale of Two Tax Jurisdictions: The Surprising Effects of California's Proposition 13 and Massachusetts' Proposition 2 1/2 , 57 Am. J. Econ. & Soc. 123 (1998) (finding that local governments made up lost property tax revenues through increased non-tax fees and charges); Sexton et al., supra note 139, at 107 (noting that in California cities, the percentage of current revenue from service charges rose from 25% in 1997-78 to 41% in 1995-96). In 1992, fees and

There are many reasons, apart from the proliferation of tax limitations, for the increased utilization of special assessments, fees, and charges. Fees can promote efficiency by requiring the user of a municipal service to internalize the costs of her use. So, too, it can be argued that it is more equitable for the principal beneficiaries of a public service or neighborhood improvement to pay for it through a special assessment or fee than to have the community as a whole finance it through the property tax. User charges, which are earmarked for funding the service for which the charge is imposed, may provide a more certain source of revenue than general taxation. The rise of a particular fee - the development impact fee - reflects a new ambivalence about growth and the desire to make newcomers to a community pay for the additional services and infrastructure that their presence necessitates. [143] The move from broad-based taxes to special charges is clearly tied to a more general turn against redistributive taxation and a growing preference to link taxes paid to services received. [144] More generally, with "no new taxes" the dominant mantra of contemporary public finance, it is not surprising that state and local politicians prefer to raise revenue through means other than broad-based taxes.

Yet the explosion in special taxes, fees, charges, and assessments at the state and local level in recent decades is due at least in part to the desire to evade the legal constraints on taxation resulting from Proposition 13 and its aftermath. Where the property tax is tightly limited, other taxes and non-tax revenue sources become far more legally and politically appealing. This has been facilitated by judicial decisions narrowing the scope of constitutional restrictions. For example, shortly after Proposition 13's adoption, the California Supreme Court undermined the amendment's restriction on local revenue sources other than the property tax. [145] Section 4 of the amendment provides that a city, county, or "special district" may impose or increase a "special tax" only with the approval of two-thirds of local voters. [146] One reading of this provision might be that it conditions all local taxes other than the property tax, which is restricted by the amendment's other provisions, on local voter approval. But the court concluded that "special tax" refers only to [*934] taxes whose proceeds are specially earmarked for a specific program. [147] Taxes that produce revenue for the local general fund were deemed not "special" and therefore not subject to restriction. [148] Similarly, while the voters might have thought that "special district" was an omnibus term for the many types of local governments other than cities and counties, the California court held that the term applies only to local governments with the power to impose the property tax. [149] As a result, local governments without power to impose a property tax could adopt other new local taxes without obtaining supermajority approval from local voters. [150]

More generally, state courts have exempted a host of special assessments, fees, and charges from tax limitations. These decisions grow out of, but often expand, the longstanding judicial determination that fees, charges, and assessments are not taxes because they lack the hallmarks of taxation - coercion and potential for retribution. Special assessments are charges to property to finance new public infrastructure directly adjacent or connecting to the payer's property, such as street or sidewalk paving, electric lighting, or connections to water and sewer lines. Special assessments are coercive; the payer must pay and receive the benefit whether she wants to or not, but

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charges accounted for 14.6% of total local revenues and 23% of local own-source revenues. See U.S. Advisory Comm'n on Intergovernmental Relations, Significant Features of Fiscal Federalism 112-13 (1994).

[143] See Valente et al., supra note 93, at 596-616; see generally Alan A. Alschuler & Jose Gomez-Ibanez, Regulation for Revenue: The Political Economy of Land Use Exactions 77-96 (1993).

[144] For a description and sharp criticism of this trend, see Laurie Reynolds, Taxes, Fees, Assessments, Dues, and the "Get What You Pay For" Model of Local Government, 56 Fla. L. Rev. (forthcoming 2004).

[145] City & County of San Francisco v. Farrell, 648 P.2d 935 (Cal. 1982).

[146] Cal. Const. art. XIIIA, § 4.

[147] Farrell, 648 P.2d at 940.

[148] Id.

[149] Id. at 937.

[150] L.A. County Transp. Comm'n v. Richmond, 643 P.2d 941, 947 (Cal. 1982). But see Rider v. County of San Diego, 820 P.2d 1000, 1002-09 (Cal. 1991) (questioning Richmond and narrowing the scope of the Richmond exemption).

they are not redistributive as the payer must be provided with a benefit worth at least as much as the assessment paid. Consequently, a special assessment is considered not to be a tax. [151] User charges are not coercive because the obligation to pay the charge is incurred only when someone chooses to use the service subject to the charge. Similarly, for a regulatory fee intended to offset the cost of regulating a fee payer whose activity imposes some costs on the community, the fee is nominally voluntary since the duty to pay arises from the payer's decision to undertake the activity subject to regulation. By not consuming the service or avoiding the activity, the payer could avoid the charge or fee. So, too, by reducing the amount of service consumed or the amount of activity subject to regulation, [*935] the payer can reduce her liability. [152] Lacking the coerciveness that is the hallmark of a tax, user charges and regulatory fees have traditionally been treated as not subject to many of the rules applicable to taxes.

State courts have not only regularly applied the non-tax treatment of special assessments, fees, and charges to the new state tax limitations, [153] they have also frequently accepted state and local government efforts to widen the scope of what may be accomplished by these non-tax taxes. With the acquiescence of state courts, special assessments have been expanded to finance a broad array of programs and services that provide diffuse benefits to relatively large neighborhoods, not just the properties adjacent or connected to new infrastructure. [154] This has often involved exemption from a tax limitation. [155] Similarly, some state courts have validated regulatory fees even when a particular firm's fee is not a result of the costs attributable to that firm - thereby reducing the ability of the firm to use changes in its behavior to control its fee liability and thus undermining the voluntary nature of the fee. [156] This has permitted governments to avoid the special [*936] voting rules required by tax limitation amendments. [157] Other courts have permitted localities to charge landowners "fees" for traditional municipal services, such as fire protection and flood control. [158] Combining the assessment and fee concepts, many state courts have upheld development impact fees, which require developers to pay in advance for a host of municipal services and

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151 See, e.g., McNally v. Township of Teaneck, 379 A.2d 446, 451 (N.J. 1977) (finding a special assessment not a tax subject to certain constitutional requirements because the purpose of the assessment was to reimburse the municipality for its expenditure); Lakewood Park Cemetery Ass'n v. Metro. St. Louis Sewer Dist., 530 S.W.2d 240, 245-46 (Mo. 1975) (finding that charitable property constitutionally exempt from taxation may be required to pay a special assessment).

152 Fees and charges are arguably non-redistributive as well. Since the determination of whether or not to pay, or how much to pay, is up to the payer, it can be assumed that she will pay only if the benefit to her from the service or the permit or license to engage in the regulated activity is greater than the fee charged.

153 See Knox v. City of Orland, 841 P.2d 144, 152 (Cal. 1992) (holding that Proposition 13 does not apply to special assessments); Russ Bldg. Partnership v. City & County of San Francisco, 234 Cal. Rptr. 1 (Ct. App. 1987) (holding transit development impact fee not subject to Proposition 13); Trent Meredith, Inc. v. City of Oxnard, 170 Cal. Rptr. 685, 687-91 (Ct. App. 1981) (finding that Proposition 13 does not apply to fee for issuance of a building permit); Mills v. County of Trinity, 166 Cal. Rptr. 674, 675-78 (Ct. App. 1980) (holding that Proposition 13 does not apply to fees for processing subdivision, zoning, and land use applications); Zahner v. City of Perryville, 813 S.W.2d 855, 857-60 (Mo. 1991) (finding that Hancock Amendment does not apply to special assessments); City of Huntington v. Bacon, 473 S.E.2d 743, 751-54 (W. Va. 1996) (fire protection and flood control fees exempt from tax limitation amendment).

154 See Knox, 841 P.2d at 151 (allowing special assessment for parks); City of Boca Raton v. State, 595 So. 2d 25 (Fla. 1992); 2d Roc-Jersey Assocs. v. Town of Morristown, 731 A.2d 1 (N.J. 1999) (allowing assessment for business improvement district).

155 See Knox, 841 P.2d at 151; Evans v. City of San Jose, 4 Cal. Rptr. 2d 601 (Ct. App. 1992).

156 See Sinclair Paint Co. v. State Bd. of Equalization, 937 P.2d 1350 (Cal. 1997); Cal. Ass'n of Prof'l Scientists v. Dep't of Fish & Game, 94 Cal. Rptr. 2d 535 (Ct. App. 2000) (holding that regulatory fee is not subject to legislative supermajority requirement even when individual's payment is not tied to the costs of regulating that individual, so long as total fees collected do not surpass the costs of regulatory programs they support); Nuclear Metals, Inc. v. Low-Level Radioactive Waste Mgmt. Bd., 656 N.E.2d 563 (Mass. 1995).

157 See Sinclair Paint Co., 937 P.2d at 1352-53.

158 See City of Huntington v. Bacon, 473 S.E.2d 743 (W. Va. 1996) (sustaining a municipal fee imposed on all building owners to cover costs of fire and flood protection services); see also St. Johns County v. N.E. Fla. Builders Ass'n, 583 So. 2d 635 (Fla. 1991) (sustaining development impact fee to finance school construction). But see Covel v. City of Seattle, 905 P.2d 324 (Wash. 1995) (rejecting "residential street utility charge" for maintaining, repairing, and improving city streets).

improvements, including new roads, new schools, and expansions of water supply and sewage systems, required by the population growth attributable to their developments. These charges pay for traditional municipal services, are based on property values, and may be passed along to new homebuyers. But when treated as assessments or fees, they are not subject to state constitutional constraints on taxation. [159]

To be sure, some courts police the fee/tax line more closely and require that to avoid treatment as a tax, a fee must be truly voluntary and calibrated according to the payer's use or the cost the payer imposes. [160] Indeed, in a recent case, the Michigan Supreme Court, expressed its concern that "the imposition of mandatory 'user fees' by local units of government has been characterized as one of the most frequent abridgements 'of the spirit, if not the letter,'" of that state's anti-tax amendment. [161] As a result, the Michigan court indicated it would take a more narrow, traditional approach to the determination of what is a service charge lest "municipalities supplement existing revenues by redefining various government activities as 'services' and enacting a myriad of 'fees' for those services." [162]

Moreover, some state constitutions have sought to deal with the proliferation of assessments, fees, and charges by regulating these as well. Missouri's Hancock Amendment subjects increases in fees and licenses as [*937] well as local taxes to voter approval. [163] Similarly, in response to the California Supreme Court's exemption of many special taxes, special assessments, fees and charges from Proposition 13, California voters in 1996 adopted Proposition 218, which extended the voter approval requirement to nearly all revenue-raising devices and narrowed the definition of the special assessments exempt from tax limitations. [164]

Yet, even these provisions have been trimmed by courts. The Missouri Supreme Court determined that, despite the broad reach of the Hancock Amendment's text, not all fees are actually subject to the constitution's voter approval requirement. [165] Instead, the court adopted a complicated five-part test for determining which fees are "tax-fees" subject to the Amendment and which are true user fees and, thus, exempt from constitutional restriction. [166] Missouri's courts have since divided over whether a range of license fees and user charges are restricted quasi-taxes or protected fees. [167] The application of Proposition 218's restrictions has also been uneven; although a host of local fees are now subject to the requirement of local voter approval, [168] the California courts have found that many local fees and assessments remain beyond the scope of the new constitutional limitation. [169] [*938]

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159 See Home Builders Ass'n of Cent. Ariz. v. City of Scottsdale, 930 P.2d 993 (Ariz. 1997); N.E. Fla. Builders Ass'n, 583 So. 2d at 640-41; Home Builders Ass'n of Dayton v. City of Beavercreek, 729 N.E.2d 349 (Ohio 2000); Holmdel Builders Ass'n v. Township of Holmdel, 583 A.2d 277 (N.J. 1990).

160 See Emerson Coll. v. City of Boston, 462 N.E.2d 1098 (Mass. 1984); Bolt v. City of Lansing, 587 N.W.2d 264 (Mich. 1998).

161 Bolt, 587 N.W.2d at 273.

162 Id. at 272.

163 Mo. Const. art. X, § 22(a).

164 Cal. Const. art. XIIIC; id. art. XIIID.

165 Keller v. Marion County Ambulance Dist., 820 S.W.2d 301, 304-05 n.10 (Mo. 1991).

166 Id. at 304.

167 Compare Beatty v. Metro. St. Louis Sewer Dist., 867 S.W.2d 217 (Mo. 1993) (holding sewer charge subject to Hancock Amendment's voter approval requirement), and Avanti Petroleum, Inc. v. St. Louis Co., 974 S.W.2d 506 (Mo. Ct. App. 1998) (holding that retail tobacco vendor's license fee was subject to voter approval requirement), with Ashworth v. City of Moberly, 53 S.W.2d 564 (Mo. Ct. App. 2001) (holding that permit and inspection fee needed to obtain a rental permit is not subject to voter approval requirement), and Mo. Growth Ass'n v. Metro. St. Louis Sewer Dist., 941 S.W.2d 615 (Mo. Ct. App. 1997) (holding sewer charge not subject to voter approval requirement).

168 See Howard Jarvis Taxpayers Ass'n v. City of Salinas, 121 Cal. Rptr. 2d 228 (Ct. App. 2002) (subjecting storm drainage fee to voter approval); Howard Jarvis Taxpayers Ass'n v. City of Roseville, 119 Cal. Rptr. 2d 91 (Ct. App. 2002) (subjecting in-lieu franchise fee for municipal water, sewer, and refuse collection services).

3. Consequences of Limitation and Evasion

State judicial treatment of constitutional tax limitations defies easy characterization. Certainly the tax limits seem to have had far more bite than the public purpose requirements or the debt limits. Nevertheless, it appears that much as the debt limitations stimulated the proliferation of new forms of public borrowing that avoid the constitutional "debt" label, the tax limitations have also spawned a host of revenue-raising devices that avoid the constitutional "tax" label. As with debt, a significant share of state and local revenue is now raised by devices not subject to tax limits. However, unlike debt, most state and local revenue is still raised by constitutional taxes.

As with debt, the shift to alternate methods of raising revenue has had consequences other than circumventing tax limitations. With many local tax limitations targeting specific categories of local government, such as cities and counties, states and localities have an incentive to create special districts and other new forms of local governments not expressly subject to constitutional limitation. [170] These entities may be given some revenue-raising authority, yet so long as they cannot levy the property tax they may be deemed to be exempt from constitutional restrictions. So, too, the imposition of assessments or fees has often been accompanied by the creation of a special purpose government - such as a municipal utility district or a business improvement district - which collects and spends the assessment or fee revenue. The creation of a separate, limited purpose government providing a particular service to the payers will bolster the argument that the charge in question is an assessment or fee and not a tax. Thus, the tax limits can add to the complex nature of local governance and may ultimately make local government less accountable to local residents probably not the outcome that proponents of tax limitation were seeking. [171] [*939]

The turn to non-tax revenue sources also tends to reduce the ability of states and local governments to engage in redistributive programs. The key to the exemption of fees, charges, and special assessments from the label of "tax" is that they provide the payers with a benefit at least equal to their payments (or to the social costs imposed by the payer's behavior). By definition, this precludes the use of fees and assessments to finance broadly redistributive activities. Assessments and fees enable those willing and able to pay for higher levels of service for themselves to do so, but services for the poor must be funded out of general, redistributive taxation, and those taxes are more likely to be subject to constitutional restrictions. This, however, may well be consistent with the goals of those who favor tax limitation.

V. Explaining the Disfavored Constitution

Why have so many state courts given state fiscal limits, particularly the public purpose requirements and the debt restrictions, a crabbed and unsympathetic interpretation, tied to a narrow reading of the specific text rather than a broader approach building on the constitutional spirit of limitation and control? It is difficult to say. The judges in

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[169] See Apartment Ass'n of L.A. County, Inc. v. City of Los Angeles, 14 P.3d 930 (Cal. 2001) (finding apartment inspection fee imposed on private landowners to be outside Proposition 218); Howard Jarvis Taxpayers Ass'n v. City of Riverside, 86 Cal. Rptr. 2d 592 (Ct. App. 1999) (finding assessments for street lighting not subject to Proposition 218); Howard Jarvis Taxpayers Ass'n v. City of San Diego, 84 Cal. Rptr. 2d 592 (Ct. App. 1999) (holding business improvement district assessment not subject to Proposition 218).

[170] See, e.g., L.A. Co. Transp. Comm. v. Richmond, 643 P.2d 941 (Cal. 1982); see also Kathryn A. Foster, The Political Economy of Special Purpose Government 17-18 (1997) (finding that older tax limitations were a "significant motivation for formation of municipally coterminous" special districts); John J. Kirlin, The Impact of Fiscal Limits on Governance, 25 Hastings Const. L.Q. 197, 206-08 (1998) (noting that local adaptations to Proposition 13 have included the creation of new governmental entities that contribute to governmental fragmentation and reduce the popular visibility of government). But cf. Rider v. County of San Diego, 820 P.2d 1000 (Cal. 1991) (holding agency created in order to circumvent Proposition 13's limits was a "special district" within the meaning of Proposition 13).

[171] There are two other consequences that flow from local government tax limits. Local tax limits cause a shift in political power from local governments to the states. See Skidmore, supra note 122, at 95-98; Alvin D. Sokolow, The Changing Property Tax and State-Local Relations, 28 Publius J. Fed. 165 (1998). Moreover, local tax limits provide incentives to local governments to promote and compete for commercial development. See Jonathan Schwartz, Prisoners of Proposition 13: Sales Taxes, Property Taxes, and the Fiscalization of Municipal Land Use Decisions, 71 So. Cal. L. Rev. 183 (1997) (labeling such incentives as the "fiscalization of municipal land use decisions").

these cases rarely explain their motives or even acknowledge that they are engaged in narrowing interpretations. Still, several interrelated factors appear to play a significant role.

First, courts tend to treat fiscal limits not as issues of fundamental rights - like speech, religion, or privacy - or as matters fundamental to government structure - like separation of powers, bicameralism, or federalism - but rather as ordinary legislation. As the California Supreme Court observed in a case narrowing the scope of Proposition 13's requirement that new local "special taxes" receive the approval of two-thirds of local voters, "we are not here concerned with a measure that affects those fundamental rights of individuals which might be endangered in the hands of a majority." [172] Decisions concerning how the state will raise or spend money, whether to [*940] invest in projects that aid the private sector, to authorize an arcane appropriation-clause debt deal, or to impose a "broad-based tax on consumers" [173] to pay for local public services are seen as matters of policy and politics, not matters of rights and law, and therefore, as "best resolved by the people's elected representatives in the Legislature" [174] rather than by the courts. [175]

As the Oklahoma Supreme Court observed in a 1999 decision validating a subject-to-appropriation debt arrangement, "respect for the integrity of the tripartite scheme for distribution of governmental powers commands that the judiciary abstain from intrusion into legislative policymaking because the legislature has the right and responsibility to declare Oklahoma's fiscal policy. . . ." [176] Similarly, the Kentucky Supreme Court, in a 1994 case authorizing the use of a public authority as a conduit for the issuance of debt for the state's transportation program, found that "there is a special deference to the legislature in regard to matters of fiscal policy and taxation." [177]

Indeed, the debt provisions are often treated as little more than technical shoals to be navigated by clever lawyering rather than as embodiments of substantively valuable principles. As the New Jersey Supreme Court observed in New Jersey Sports & Exposition Authority v. McCrane, [178] "the modern science of government has found a method of avoiding [the debt] clause, and the courts have approved it." [179] Conduit financing through an independent public authority is "the constitutionally acceptable device of modern day progressive government" and may be used for "the expeditious accomplishment of public purpose projects." [180] More recently, in affirming the constitutionality of "subject-to-appropriation" debt, the court implicitly praised the "sophisticated means now used to finance" [181] state and local [*941] activities. Noting the important role that debt avoidance has come to play in state finance, the court stressed the "need to maintain stability in respect of the variety of financial instruments authorized by the Legislature." [182]

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172 Richmond, 643 P.2d at 945; see also City & County of San Francisco v. Farrell, 648 P.2d 935, 938 (Cal. 1982) (stating that "the two-thirds vote requirement in section 4 [of Proposition 13] is inherently undemocratic").

173 Richmond, 643 P.2d at 945.

174 CLEAN v. State, 928 P.2d 1054, 1061 (Wash. 1996).

175 Id. ("Public purpose is not a static concept. Rather, it is a concept that must necessarily evolve and change to meet changing public attitudes . . . . The Legislature with its staff and committees is the branch of government better suited to monitor and assess contemporary attitudes than are the courts."); see also id. at 1068 ("Of the three branches of government, the Legislature is best able to consider what measures promote the general welfare.").

176 Fent v. Okla. Capitol Improvement Auth., 984 P.2d 200, 204 (Okla. 1999).

177 Wilson v. Ky. Transp. Cabinet, 884 S.W.2d 641, 646 (Ky. 1994).

178 292 A.2d 545 (N.J. 1972).

179 Id. at 557.

180 Id. at 559.

181 Lonegan II, 819 A.2d 395, 403 (N.J. 2003).

182 Id. at 397.

Contemporary judicial approaches to the public purpose and debt limitation provisions may have been influenced by the United States Supreme Court's post-New Deal jurisprudence treating economic and social issues as political matters for legislative determination, rather than as constitutional issues for the courts. But the Federal Constitution is largely silent on fiscal questions, whereas state constitutions have a long history of regulating state and local finance. By treating public finance as largely political, with little role for the courts, state judges have caused state constitutional law in this area to resemble federal constitutional law despite the significant differences between the state and federal constitutional texts.

Second, the state courts often appear quite sympathetic to the goals of the programs that would be curbed by the fiscal limits. State judges, most of whom are elected, [183] appear to share with state governors and legislators a belief in the legitimacy of the modern activist state and the many projects - roads, dams, schools, power plants, convention centers, stadiums, and aid to targeted industries and firms that contemporary state and local governments undertake. As the New Jersey Supreme Court asserted in a case dealing with the financing of a sports complex in that state's Meadowlands area, "under our democratic form of government public projects are not confined to the barebones of political life." [184] This may be another aspect of the acceptance of the expanded post-New Deal public sector, not only at the federal level, but at the state and local levels as well. The political branches have assumed a responsibility for promoting jobs and growth - it is, after all, "the economy, stupid," that makes and unmakes governments - and the courts appear to agree that politicians are right, or at least reasonable, in doing so. [185] Virtually all public spending programs can be defined as [*942] promoting economic growth, as in some Keynesian sense they all do. Consequently, public purpose requirements impose little constraint on government action.

By the same token, as the notion of public purpose has grown, the definition of debt has narrowed. Some courts acknowledge that they treat debt limitations as disfavored provisions, to be gotten around if at all possible. As the Nevada Supreme Court recently observed, "the public interest is likely promoted" if an agreement that could be treated as either debt or not debt is held not to be debt. Modern financing arrangements, the court noted, provide government agencies with the "flexibility" they need. [186] Similarly, both the New Jersey and Wisconsin Supreme Courts, in almost identical language, have made the point that "it is never an illegal evasion of a constitutional provision or prohibition to accomplish a desired result, which is lawful in itself, by discovering or following a legal way to do it." [187] In other words, leasepurchase financing, appropriation clause financing, or moral obligation debt are not so much gimmicks challenging a desirable constitutional norm of limited government as legitimate measures enabling states and local governments to fund needed projects. In the absence of an outright conflict between a financing instrument and the constitutional text, "the debt clause of the Constitution must be construed . . . to the end that public progress and development will not be stifled and that public problems with their ever increasing complexity may be met and solved." [188] The New Jersey Supreme Court put it most candidly when it proclaimed a

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183 See, e.g., Steven P. Croley, The Majoritarian Difficulty: Elective Judiciaries and the Rule of Law, 62 U. Chi. L. Rev. 689, 725-26 (1995) (noting that in thirty-eight states, most or all judges are elected).

184 McCrane, 292 A.2d at 552.

185 See Delogu v. State, 720 A.2d 1153, 1155 (Me. 1998) (noting that "employment is one of the government's principal concerns . . . indirect economic benefits, such as job creation and retention, may qualify as valid public purposes"); WDW Props., Inc. v. City of Sumter, 535 S.E.2d 631, 635-36 (S.C. 2000) (finding that "economic welfare is one of the main concerns of the city, state, and the federal government"); Libertarian Party of Wis. v. State, 546 N.W.2d 424, 434 (Wis. 1996) (stating that economic development, tourism, and reducing unemployment are "clearly public purposes").

186 Employers Ins. Co. of Nev. v. State Bd. of Exam'rs, 21 P.3d 628, 633 (Nev. 2001).

187 See McCrane, 292 A.2d at 557 (quoting Clayton v. Kervick, 244 A.2d 281, 288 (N.J. 1968)); Dieck v. Unified Sch. Dist. of Antigo, 477 N.W.2d 613, 619-20 (Wis. 1991); see also In re Okla. Improvement Auth., 958 P.2d 759, 763 (Okla. 1998) (holding that "it is not unconstitutional to accomplish a desired result, lawful in itself, by innovative legal measures").

188 McCrane, 292 A.2d at 559-60.

position of "broad tolerance to permit public financing devices of needed facilities not constituting on their face present, interest-bearing obligations of the State itself." [189]

State courts are at times critical of these evasions of the state constitutional text. But their perception that these are matters of ordinary politics, not constitutional principle, makes them reluctant to strike down a creative financing scheme. As Chief Judge Judith Kaye of the New York Court of Appeals observed: "Modern ingenuity, even gimmickry" may have [*943] "stretched the words of the [New York] Constitution beyond the point of prudence . . . ." [190] But fiscal imprudence is not a matter for the courts. According to Chief Judge Kaye, "that plea for reform in state borrowing practices and policy is appropriately directed to the public arena." [191]

Third - and this may help explain some of the difference in treatment between the public purpose requirements and debt limits on the one hand and the tax limits on the other - is the question of whether government measures that evade these restrictions are seen as imposing any burdens or creating any harms. In public purpose and debt cases, individual taxpayers often do not appear before the court and are effectively invisible. Even when they do appear, the connection between a particular spending or borrowing program and any particular taxpayer is highly attenuated. As a result, in public purpose cases, new types of government programs do not seem to have any negative effects on individuals at all, while the only individuals affected by innovative schemes are those who buy government bonds. So long as the financial instruments plainly disclaim the commitment of the state's full faith and credit or any state obligation to pay, they give notice to the bond buyer that they are not "debt," and the bond buyers' interests are thereby protected. The potential impact on current or future taxpayers is either not seen or not treated as significant.

By contrast, in cases involving tax limitations, plaintiffs are frequently the individuals or firms subject to tax, or associations of taxpayers, who can make a convincing claim that they are directly and negatively affected by the asserted tax. Moreover, although courts have expanded the category of non-tax revenue-raising devices, there will still be some payers who can argue that a particular fee, charge or assessment is sufficiently redistributive or coercive that it ought to be treated as a tax. It may, thus, be easier to see that these measures are taxes in tension with constitutional constraints on taxation and that these measures infringe the very interests that the constitutional measures were intended to protect. Still, although courts have trimmed tax limitations at the margins - at times reflecting an awareness that tax limitations affect the ability of governments to fund their programs [192] - the central provisions of such limitations have been enforced.

Finally, and this too may explain some of the difference in treatment between public purpose and debt restrictions on the one hand and the tax and expenditure limitations on the other, courts may be influenced by the degree [*944] to which the provisions reflect current political values and enjoy contemporary political support. The public purpose and debt limits tend to be quite old, typically dating back to the midnineteenth century, or, for the younger states, to their admission to the Union. There is little evidence that they enjoy much active current support. Broad trends in government lasting more than a half-century have included both expansions of the scope of public responsibilities and an increase in public-private partnerships. These developments are at odds with the limited definition of public purpose and the desire for the sharp separation of public and private that animated the mid-nineteenth century public purpose requirements. Moreover, there has been an enormous growth in government borrowing and debt-financed public investment.

By contrast, many tax and expenditure limitations, including all the more restrictive ones, were adopted relatively recently. Many are the products of grass-roots activism and were enacted by voter initiative. There are anti-tax and taxpayer rights organizations committed to their defense. In at least one instance - California's Proposition 218 -

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[189] Bulman v. McCrane, 312 A.2d 857, 861 (N.J. 1973).

[190] Schulz v. State, 639 N.E.2d 1140, 1150 (N.Y. 1994).

[191] Id.

[192] See, e.g., City & County of San Francisco v. Farrell, 648 P.2d 935, 938 (Cal. 1982); Guinn v. Legislature of Nev., 71 P.3d 1269 (Nev. 2003).

voters responded to a state supreme court's narrow reading of constitutional tax restrictions by enacting a new measure intended to undo some of the court's actions. [193] Where public purpose requirements and debt limitations appear to be unsupported by, if not at odds with, contemporary politics, tax and expenditure limitations continue to embody the active political current that brought them to life.

VI. Of Debt and Taxes: The Place for Fiscal Limits in State Constitutions

What does the history of state fiscal limits, and the current relatively disfavored status of the public purpose requirement and debt limits, tell us about the project of constitutionalizing constraints on state and local finance? Are these desirable provisions which have suffered from mistaken judicial decisions? Or do the court decisions suggest deeper problems with constitutionalizing fiscal limits?

Two initial considerations ought to shape the general question of whether public finance restrictions ought to be in state constitutions. First, does a matter need to be constitutionalized, that is, placed beyond the day-to-day control of the political process and instead entrenched in the [*945] fundamental structure of the states? Second, even if in theory a rule or principle ought to constrain ordinary politics and be protected from politics rather than subject to politics, is constitutionalization an effective means of obtaining that goal?

A. Public Purpose

The first consideration suggests that there is something to be said for a public purpose requirement. The fundamental purpose of government, justifying the coercive taxation that enables government to pursue its spending and lending programs, is the promotion of the public good. Public purpose is essential to all government action. Moreover, it would be desirable to adopt a constitutional rule limiting the ability of the states and local governments to dedicate public funds to private ends. State and local spending presents the classic problem of concentrated benefits of the politically influential few at the expense of the broad polity of taxpayers. Special interest groups have the incentive to lobby and the means to reward legislators who provide them with benefits. But the general public is unlikely to be sharply affected by any one interest group giveaway and lacks both the incentive and the means to closely police spending programs. Thus, there is a case for a public purpose limit on government spending.

Yet, for reasons suggested by the second general consideration, the public purpose requirement as a constraint on legislative action is a dead letter today. [194]

While it may be generally agreed that all government spending should promote a public purpose, there is no generally agreed-upon standard for defining the public purpose. The courts have essentially concluded that the meaning of public purpose is to be politically, not judicially, determined, so that the public purpose is defined by the results of the pulling and hauling, [*946] the conflicts and compromises, and the deliberations and maneuvers that mark the political process. [195] More specifically, state judges have largely deferred to the decisions of governors

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[193] See Cal. Const. art. XIIID, § 6(c); Stark, supra note 112, at 200-03 (describing Proposition 218 and another ballot initiative, Proposition 62, as responses to California Supreme Court decisions narrowing Proposition 13).

[194] Two specific constitutional limitations on aid to the private sector - the bans on the lending of credit, and the limits on public subscriptions of private stock - have fared better. The ban on the lending of credit makes sense. Lending credit in the sense of suretyship generates the fiscal illusion that it is cost-free. Government officials may persuade themselves that the contingent liability will never come due. Given that there is no initial out-ofpocket cost, voters may have little incentive to police these arrangements either. For that very reason, constitutional restriction is appropriate. On the other hand, the stock subscription ban seems to make little sense. Today, the principal effect of the ban is to preclude the government from taking an equity interest in the firms it is assisting, thus eliminating the possibility that the public might gain directly from its investment. See, e.g., Utah Tech. Fin. Corp. v. Wilkinson, 723 P.2d 406 (Utah 1986). It is difficult to see why it is permissible for the government to give public money away but not to get some of it back.

[195] State judicial treatment of public purpose is, thus, similar to the federal and state judicial treatment of "public use" in eminent domain cases. See, e.g., Haw. Hous. Auth. v. Midkiff, 467 U.S. 229 (1984); Berman v. Parker, 348 U.S. 26 (1954); Poletown Neighborhood Council v. City of Detroit, 304 N.W.2d 455 (Mich. 1981).

and legislatures throughout the country that economic development, jobs, and expansion of the tax base are public purposes justifying the gift or loan of public funds. Given the broad public assumption of governmental responsibility for the economy, and given the dependence of state and local governments on the well-being of state and local economies and on the sufficiency of their particular tax bases, the emergence of economic development as the ultimate public purpose is not surprising. It is certainly difficult to see courts - particularly state courts composed of elected state judges - challenging the legislature's declaration of the public importance of economic growth, more jobs, and expanding the tax base.

Even with judicial deference to the legislative definition of economic development as public purpose, courts could in theory play a role in determining whether a particular economic development program actually advances its stated public purpose. With many economic development programs little more than giveaways of tax breaks or lowinterest loans to private firms, courts could more strictly scrutinize the fit between the public end and the means chosen, or the balance between the public and private benefits, particularly for measures that provide significant private gains but only speculative public ones. But this would involve difficult empirical questions of assessing the benefits from a program and calculating how likely they are to occur. In many cases a more difficult question would be deciding whether to classify a particular benefit as public or private, or what is the proper balance between public and private benefits. Given that the theory of economic-development-aspublic-purpose assumes a public interest in individuals getting jobs or in persuading a business to remain in a jurisdiction, then most benefits of these programs are simultaneously public and private. Requiring a court to disentangle the two may be an impossible job. Moreover, even if the public and private elements can be distinguished, determining how much public benefit is enough to justify a program that also provides significant private benefits is just as problematic. The state courts may well be wise in concluding that such review is beyond their capacity, and that the means for pursuing economic development as well as [*947] the determination that economic development is a legitimate public end is a political question, not a judicial one.

This is not to deny that many contemporary economic development strategies present serious questions about the diversion of public resources to private ends. Most studies indicate that government financial assistance and tax breaks are relatively minor factors in corporate location decisions. [196] Moreover, corporations have proven adept at playing competing localities against each other in order to extract government payments or tax exemptions. [197] Even when companies do create new jobs in response to a government incentive, the payments may be short-term and the firm may pull up stakes a few years later. [198] In these situations, the public benefits are dubious at best and the opportunities for special interest abuse are clear. Yet, given the difficulties of judicial policing of constitutional limits on economic development programs, a better strategy for protecting the public fisc from economic development programs that unduly benefit private firms might be statutory reforms that provide for better record keeping and public disclosure of the benefits that economic development programs produce, as well as closer legislative and media scrutiny of the asserted benefits of these programs. [199] Contemporary economic development programs raise political issues that require political solutions, not judicial resuscitation of the public purpose doctrine.

B. Debt Limitations

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[196] See Peter K. Eisinger, The Rise of the Entrepreneurial State: State and Local Economic Development Policy in the United States 200-24 (1988); Rachel Weber, Why Local Economic Development Incentives Don't Create Jobs: The Role of Corporate Governance, 32 Urb. Law. 97 (2000).

[197] See, e.g., Bryan D. Jones & Lynn W. Bachelor, Local Policy Discretion and the Corporate Surplus, in Urban Economic Development 223-44 (Richard D. Bingham & John P. Blair eds., 1984)

[198] See Charter Township of Ypsilanti v. Gen. Motors Corp., 506 N.W.2d 556 (Mich. Ct. App. 1993) (finding a company's receipt of a long-term tax abatement for a new plant does not estop the company from closing the plant during the abatement period); City of Yonkers v. Otis Elevator Corp., 649 F. Supp. 716 (S.D.N.Y. 1986) (dismissing breach of contract and equitable estoppel claims against company that accepted economic development benefits and subsequently closed its plant).

[199] See, e.g., Michael LaFave, Taking Back the Giveaways: Minnesota's Corporate Welfare Legislation and the Search for Accountability, 80 Minn. L. Rev. 1579 (1996).

There is also a plausible case for the constitutionalization of debt limitations. Debt promises gains in terms of new facilities or programs that [*948] come on line immediately, with the associated costs deferred into the future. With easy access to debt, current elected officials may be tempted to approve projects that are not cost-justified. They can get the credit for the new project, [200] but the blame for the additional taxes needed to pay off the debt will be borne by their successors. With future debts unlikely to become a present campaign issue, ordinary politics may fail to provide effective checks on the decision to incur debt. Thus, constitutional debt limitations may be justified by the lack of effective political controls over the borrowing decision.

Yet, like public purpose requirements, debt limitations are increasingly ineffective, and courts are complicit in the widespread evasion of constitutional restrictions. [201] Like legislators and governors, state judges seem quite sympathetic to the programmatic spending goals that the debt limits would thwart. In the era of the modern activist state, state judges, like other state elected officials, appear to believe that debt limits are more likely to get in the way of good government than to promote it.

One reason for this lack of judicial sympathy for debt limitation may be the archaic nature of many of the constitutional debt provisions. Many state constitutions either prohibit long-term debt outright, or impose laughably low dollar limits that date back to the nineteenth century. Such provisions, inspire, if they do not justify, evasion. Debt limitations might be more defensible, and might receive more effective judicial enforcement, if they were increased to levels consistent with current capital needs and with the revenue-raising capacities of contemporary state and local governments. Hawai'i's relatively modern debt limit, which caps state debt service to 18.5% of the average of state general fund revenues over the preceding three fiscal years, suggests one possible formulation. [202] [*949]

But a carrying capacity approach also opens new issues. One difficulty is determining the appropriate base for calculating carrying capacity. As previously noted, many limits on local debt actually take a carrying capacity approach by making permissible debt levels a fraction of local assessed valuation. Yet today many localities rely significantly on sources of revenue other than the property tax so that property valuation may well understate local resources for debt service. Even if the denominator for calculating carrying capacity were modernized to take into account the role of sales and income taxes and other contemporary revenue sources, the numerator would still be problematic. Constitutional debt limits have been set at widely varying levels. As two municipal finance experts have noted, the enormous difference in state and local debt limits "belies the notion that there is some consensus about the optimal level of debt." [203] Thus, although the carrying capacity concept is appealing in principle it may be difficult to implement in practice. In any event, there has been little effort generally to modernize limits along these lines, as evasion has provided legislators with an acceptable and more readily available alternative to constitutional reform.

Moreover, it could be argued that the real issue with state and local debt is not the adequacy of taxable resources to pay debt service, but the adequacy of state and local debt to meet future capital needs. Debt can play a crucial role in providing the physical infrastructure vital to the future economic and social health of a community, particularly schools, hospitals, roads, and mass transit facilities. Low levels of debt and the resulting low levels of capital

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[200] That credit may involve not simply the appreciation of the voters for new facilities and services, but also the special gratitude of campaign donors and interest groups with a specific stake in building and financing facilities, such as construction contractors, construction workers and municipal finance lenders and lawyers.

[201] But see Sterk & Goldman, supra note 13, at 1365. Sterk and Goldman contend that public purpose and debt limitations have in fact been effective, arguing that although courts have liberalized the constitutional restrictions the courts still use the limitations to police public borrowing decisions. Id. Part of the difference between their evaluation and mine may be a matter of timing. They published their article more than a dozen years ago, when some state courts continued to enforce public purpose requirements and before the subject-to-appropriation device had received widespread state judicial ratification.

[202] Haw. Const. art. VII, § 13; see also Wash. Const. art. VIII, § 1 (limiting debt service on state debt to 9% of average of state revenues over three prior fiscal years).

[203] Amdursky & Gillette, supra note 20, at 171.

investment can be as harmful to a state or locality as excessive debt. A constitutional debt limitation ought to take into account future capital needs as well as ability to pay. But there is no obvious metric for assessing future needs or for incorporating a concern about capital needs into the constitutional standard. As a result, constitutional debt limitations are likely to fail to address the question of future capital needs or to balance the competing concerns of future capital investment and future taxpayer liability.

Thus, much like the public purpose requirement, a constitutional debt limit seems attractive in theory but it has proven extremely difficult to operationalize in practice. [204] [*950] SHP C. Tax and Expenditure Limitations

Unlike public purpose requirements and debt limitations, there is not even much of a theoretical case to be made for constitutional tax and expenditure limitations. Whereas debt has binding long-term consequences, and the decision whether or not to incur debt may receive inadequate public scrutiny, tax rates may be easily changed, and taxation is typically an extremely salient political issue. New taxes and tax increases trigger an immediate burden on current voters, and anti-tax forces are well-represented in the political process. Politicians who enact high taxes may be punished by the voters in the next election, and few politicians are likely to doubt the political significance of anti-tax sentiment. It is not clear why further constitutional protection needs to be superimposed on the protections provided by the ability of the voters to vote out of office elected officials who raise taxes.

State constitutional limitations on local taxation seem particularly inappropriate. Local government actions may be more transparent than state decisions, and many local governments are subject to effective monitoring, participation, and political control by grassroots taxpayers. Local taxation is further constrained by the vigorous inter-local competition for mobile taxpayers. [205] Given the existence of both significant exit and significant voice opportunities at the local level it is unclear what constitutional need state tax limits on localities serve. Rather, substantive constitutional limits on local taxation interfere with local autonomy since they preclude localities whose people are willing to support tax increases from taking such action. Holding all local governments in a state to the same limit fails to recognize the inter-local variations in needs, circumstances, and preferences that animate home rule. [206] [*951]

Moreover, because the property tax has long been a central focus of the tax limitations movement, tax limitations often bind local governments far more tightly than they bind the states. Although localities have proved inventive in expanding the range of non-tax taxes, the property tax is still central to local finances and in many states property tax limits have really constrained local revenues. As a result, localities have become more dependent on state aid, and states generally account for a greater share of the total of state and local spending. It is unlikely that tax limit proponents desired such a centralization of power from localities to the states but that has often been the result.

Of course, states as well as local governments have also been targeted by the most recent tax limitation efforts, with a number of state constitutions now requiring either voter approval or legislative supermajorities to increase tax rates or impose new taxes. Not much is known empirically about the effect of these requirements, but one study of California - which requires a two-thirds vote in each legislative house to pass a new tax or tax increase - found that

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[204] Professor Clayton Gillette has suggested that if the principal concern about debt is the ability of state taxpayers to repay their obligation, then creditors may be very good representatives of the taxpayers' interest. Clayton P. Gillette, Municipal Creditors as Municipal Monitors (Sept. 6, 2001) (unpublished manuscript, on file with author). Creditors have the incentive to monitor the finances of state and local borrowers, and their interests in state and municipal solvency to some degree overlap those of state and local taxpayers. Id. Gillette suggests that certain subconstitutional changes in municipal finance law could improve the capacity of creditors to stand as surrogates for taxpayer interests. Id.

[205] For the classic authority on the significance of interlocal mobility for local decision-making, see Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956).

[206] City & County of San Francisco v. Farrell, 648 P.2d 935, 938 (Cal. 1982) (noting that Proposition 13 "was imposed by a simple majority of the voters throughout the state upon a local entity to prohibit a majority (but less than two-thirds) of the voters of that entity from taxing themselves for programs or services which would benefit largely local residents"). Indeed, local tax limits appear to have made local governments more fiscally dependent on their states and to have resulted in a loss in local power. See Skidmore, supra note 122, at 95-96; Sokolow, supra note 171, at 178-86.

"gridlock and irresponsibility can be observed much more frequently . . . than mature compromise." [207] Certainly the two-thirds rule contributed to California's fiscal and political problems in 2003.

The consequences for Governor Gray Davis are by now internationally known, but a less heralded, although comparably interesting, development illustrating the effects of a recently adopted constitutional provision requiring a supermajority for tax increases played itself out in neighboring Nevada in the summer of 2003. There, due to a two-thirds requirement for tax increases, the Nevada legislature failed to reach agreement on the budget for public education during its regular session, then failed again in two extra sessions. In the second session, the necessary tax increases passed the upper house but failed twice in the lower house, by votes of 27 to 15, or one vote shy of the constitutionally mandated supermajority. The governor then petitioned the Nevada Supreme Court for a writ of mandamus directing the legislature to pass a budget. Faced with this constitutionally provoked impasse and noting the state's constitutional obligation to provide for the "support and maintenance" of the public schools, the court took the extraordinary step of suspending the two-thirds requirement and then directed the legislature to consider the education budget under a simple [*952] majority rule. [208] Like many of the state courts in the debt limit cases, the Nevada Supreme Court simply concluded that the two-thirds rule a mere "procedural requirement" - was less important than the "basic, substantive right" to an adequately funded education. [209]

Yet, despite the theoretical difficulties with tax and expenditure limitations, they have done much better in the state courts than the theoretically more defensible public purpose and debt provisions - this summer's extraordinary Nevada decision to the contrary notwithstanding. This may be due to their recent nature and continuing popular support. It is no surprise that a constitutional provision that reflects strongly held current political values is more likely to be effectively enforced than measures that are seen as archaic and arcane. So, too, the success of these limits may be due to the fact that, unlike the public purpose requirements, their meaning is relatively clear; and, unlike the debt limitations, state and local legislators have not come up with revenueraising devices that do the work of broad-based taxes as successfully as contemporary revenue bonds have substituted for general obligation debt.

D. Voter Approval Requirements

Many state fiscal limits take the form of voter approval requirements. Voter approval has long been an important component of debt limitations. So, too, as Professor Kirk Stark has recently written, voter approval requirements are an important theme in contemporary tax and expenditure limitations, particularly at the local level. [210] Voter approval is certainly a more flexible means of controlling taxes than a specific limit carved into the constitution. Moreover, for local governments, a requirement that the local electorate approve new taxes or debts is more consistent with home rule than a statewide provision capping local taxes or debt. Professor Stark has also argued that by bringing voters into the process of raising taxes these limits can promote democracy by assuring that new taxes have obtained the consent of those affected, [211] and by enabling the voters to participate directly in an important question of governance. [212] [*953]

Whether conditioning new taxes or new debts on voter approval is desirable is inevitably linked to the more general debate over direct democracy. [213] To be sure, most of the discussion of direct democracy has concerned the voter

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[207] Matthew D. McCubbins, Putting the State Back into State Government: The Constitution and the Budget, in Constitutional Reform in California: Making State Government More Effective and Responsive 366 (Bruce E. Cain & Roger Noll eds., 1995).

[208] Guinn v. Legislature of Nev., 71 P.3d 1269 (Nev. 2003). The legislature did ultimately pass the necessary revenueraising legislation by a two-thirds majority. See Guinn v. Legislature of Nev., 76 P.3d 22, 25 (Nev. 2003).

[209] 71 P.3d at 1275.

[210] See Stark, supra note 112, at 207.

[211] Id. at 207-16.

[212] Id. at 236-50.

[213] For criticisms of direct democracy, see generally David Magleby, Direct Legislation: Voting on Ballot Propositions in the United States (1984); Sherman Clark, A Populist Critique of Direct Democracy, 112 Harv. L. Rev. 434 (1998); Philip Frickey, The

initiative - that is, the ability of individuals and interest groups to sidestep the legislature and bring constitutional amendments and legislative proposals directly to the electorate for enactment - whereas voter approval requirements for new taxes or debts involve referenda following legislative action, with voter approval an additional requirement, not a substitute for legislative approval. As a result, one important argument for direct democracy, that it enables voters to act on popular measures bottled up in the legislature by political gridlock or hostile interest groups, [214] is inapplicable since voter approval requirements apply only to measures that have already emerged from the legislature. On the other hand, some of the concerns about the voter initiative - that it can enable majority groups to ride roughshod over minorities or that the lack of legislative deliberation can lead to the adoption of ill-considered and poorly drafted laws [215] - is equally inapposite since protection for minority rights and opportunities for deliberation are still provided by the legislature. Still many of the concerns raised about direct democracy, including whether the voters are competent enough and sufficiently informed to address complex questions of public policy [216] and whether the fraction of voters that actually votes on ballot propositions is actually representative of the full electorate, [217] continue to apply to voter approval requirements for new taxes or debts.

Professor Stark argues that the possibility that voter approval requirements will "stimulate greater public deliberation regarding . . . tax [*954] burdens" [218] is an important benefit of the new tax limitation amendments. As he notes, "it is hard to imagine a public policy issue more suitable for community deliberation, especially at the local level." [219] Yet, the very high level of voter interest in questions of taxation calls into question the need for voter approval requirements to spark public dialogue. Taxes are typically a major issue even when only elected officials and not the tax increases themselves are on the ballot. Moreover, whatever public dialogue results from a voter approval requirement is likely to be impoverished if the only question the voters are asked is whether to approve a new tax or a tax increase, not which services to cut if the tax is not approved, which of two or more different taxes with different impacts on different payers to approve, or how to combine a range of tax and service packages. [220]

Voter approval requirements take us beyond the eighteenth century concern with "no taxation without representation" to a twentyfirst century doctrine of "no taxation, even with representation, without direct voter consent." It is not clear that this is necessary to correct political process failures or to promote deliberation concerning levels of taxation given the intense public concern with these questions already. Indeed, whatever benefits they may have in promoting civic engagement or assuring that tax increases reflect the "consent of the governed," voter approval requirements, like the substantive tax and expenditure limitations, appear to be driven primarily by the desire to make it more difficult to enact or increase taxes than to adopt nearly all other forms of legislation. Thus, the case for including such a voter approval requirement in a state constitution must ultimately rest on hostility to taxation. Surely, only such an anti-tax principle, rather than a commitment to democracy or popular deliberation, can explain such provisions as Proposition 13's mandate of a local supermajority popular vote

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Communion of Strangers: Representative Government, Direct Democracy, and the Privatization of the Public Sphere, 34 Willamette L. Rev. 421 (1998). For more sympathetic treatments, see David Schmidt, Citizen Lawmakers: The Ballot Initiative Revolution (1989); Clayton Gillette, Is Direct Democracy Anti-Democratic?, 34 Willamette L. Rev. 609 (1998). For a particularly negative account of the effect of direct democracy concerning fiscal matters in California, see Peter Schrag, Paradise Lost: California's Experience, America's Future (1998).

[214] See, e.g., Richard Briffault, Distrust of Democracy, 63 Tex. L. Rev. 1347, 1348 (1985).

[215] Id. at 1360-64.

[216] See Thomas Cronin, Direct Democracy: The Politics of Initiative, Referendum, and Recall 60-90 (1989); Magleby, supra note 213, at 122-44.

[217] Magleby, supra note 213, at 77-99.

[218] Stark, supra note 122, at 237.

[219] Id. at 240.

[220] Professor Stark acknowledges this when he observes that "simply requiring voter approval for new or increased taxes is unlikely to ignite substantive democratic dialogue regarding the allocation of tax burdens." Id. at 241; see also Clark, supra note 213 (criticizing direct democracy for limiting voters to simple yes-or-no choices and not enabling them to express their priorities over a range of issues).

for new local taxes. Such a rule does not empower local majorities; it thwarts them. However, even rules requiring local simple majorities for tax increases seem as much concerned with erecting new hurdles to taxation as assuring that tax decisions reflect the local popular will. Thus, whether new or increased taxes ought to be contingent on voter approval ultimately turns on whether substantive [*955] hostility to taxation ought to be a constitutional norm, not on the need to reform the state and local political processes for addressing tax questions.

Voter approval requirements for bond issues present a slightly different question. New debt, with its binding long-term nature, bears some resemblance to a constitutional amendment. Both commit future generations to a long-term course of action. Indeed, a new bond issue may be more binding than a new state constitutional provision since a constitution may be amended and a new provision repealed while debt creates debt service commitments protected by the Federal Contracts Clause from subsequent state impairment. [221] Moreover, in the absence of a referendum vote, questions about the level of state and local debt and the worthiness of debt-funded projects are less likely to be the subject of public debate than questions about taxation, even though debt levels ultimately affect taxes. Thus, there may be something to be said for a constitutional requirement that makes debt harder to incur, even as many questions about voter information, voter competence, and the representative nature of the electorate in bond-issue elections make it unclear whether voter approval is the right test for determining the appropriateness of new debt. [222]

VII. Conclusion: Fiscal Limits and State Constitutional Law

Finally, what does the uncertain fate of state constitutional fiscal limits tell us about the project of state constitutional law generally? Certainly, it would be wrong to overstate the meaning or to predicate the analysis of state constitutional law on a specific and relatively discrete set of issues. The state judicial treatment of state fiscal limits may have only limited relevance to the interpretation of the civil liberties or positive rights guarantees of state constitutions. Yet, several implications emerge which may be a little unsettling to the vision of state constitutions as an independent, and progressive, alternative to a conservative Federal Constitution.

First, state constitutions are by no means simply "progressive," if progressive is used to mean more supportive of activist, redistributive government. Even as they impose affirmative duties on their governments, state constitutions are also strongly marked by limited-government,taxpayer -protective principles that are entirely absent from the Federal [*956] Constitution. The rise of tax and expenditure limitations over the past three decades has underscored this facet of state constitutional law. Although in a rare case like the recent Nevada decision nullifying the requirement that tax increases requires legislative supermajority approval, [223] positive rights can prevail over taxpayer protection, state fiscal limits, particularly tax limits, generally if subtly constrain government activism at the state and local level. [224]

Second, turning from constitutional texts to constitutional doctrine, state constitutional law often operates in the shadow of the Federal Constitution. Even where state courts deal with state constitutional provisions that have no federal analogues, and where the United States Supreme Court cannot review their judgments, state courts may still be deeply influenced by federal constitutional jurisprudence. The state courts' many references to state fiscal limits as matters of state economic policy, and the repeated calls for deference to the legislature on fiscal questions, indicate that state courts accept the Supreme Court's Carolene Products settlement - the determination that economic and social matters that do not affect fundamental rights or involve discrimination against discrete and

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[221] See, e.g., U.S. Trust Co. v. New Jersey, 431 U.S. 1, 32 (1977).

[222] See, e.g., Gillette, Direct Democracy, supra note 94, at 21-28 (discussing the low turnout in bond issue elections, the unrepresentativeness of bond issue voters of the broader electorate, and the concern that voters' aversion to change will lead to inadequate support for financing necessary public facilities).

[223] See Guinn v. Legislature of Nev., 71 P.3d 1269 (Nev. 2003).

[224] See Schrag, supra note 213, at 154-57.

insular minorities are for the legislatures and not the courts. [225] This appears to be the case even though state constitutions give extensive consideration to these matters while the federal document is largely silent about them.

Finally, state constitutional law is closely intertwined with state politics. The fiscal limits with the strongest contemporary political support do best; those limits that lack current political backing are virtually unenforced. The Nevada case might seem less extraordinary once we notice that the Nevada Supreme Court was not acting on its own but responding to a petition from the governor and that the court's decision effectively empowered the state legislature's majority over the objection of a recalcitrant minority. [226] That politics matters should not be news to students of state constitutional law. [*957] The combination of greater ease in amending state constitutions; [227] the existence of the voter initiative in half the states; extensive state constitutional textual attention to the nitty-gritty of government operations; and a judiciary that is either elected [228] or appointed for limited, renewable terms rather than for life all make some significant interplay between state politics and state constitutional law inevitable. [229] Still, the example of the fiscal limits challenges and unsettles the notion of a state constitution as something fundamental, separate from, and constraining ordinary state politics. The fiscal limits suggest that at least for some features of state constitutions - those with direct bearing on the operations of state and local government - the constitution is constrained by politics rather than the other way around.

I suppose none of these lessons is surprising. Constitutional law is not autonomous. It is shaped by broader jurisprudential currents, the political beliefs of the judges and justices, and the politics of the surrounding society. Nor is it irrelevant. State fiscal limits have contributed to the proliferation of new forms of borrowing and revenueraising, held down the property tax, weakened local governments, and promoted the growth of public authorities and special purpose local units. However, the example of the fiscal limits and their disfavored treatment by many state courts may be helpful in reminding us of the need for modesty in considering the potential for the emergence of state constitutional law as a source of alternative constitutional norms in the American federal system.

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[225] U.S. v. Carolene Prods. Co., 304 U.S. 144, 152 (1938); accord Ferguson v. Skrupa, 376 U.S. 726, 730 (1963) ("courts do not substitute their economic and social beliefs for the judgment of the legislative bodies").

[226] The legislature had previously rejected a proposal to amend the state constitution to add the two-thirds rule; the rule was imposed by voter initiative over legislative opposition. As the court dryly noted in apparently giving weight to the legislature's action, "the voters were not privy to the Assembly's concerns that culminated in the requirement's legislative rejection." Guinn v. Legislature of Nev., 76 P.3d 22, 30 (Nev. 2003).

[227] The United States has operated under the same constitution since 1787, and that document has been amended twenty-seven times. See Council of State Governments, The Book of the States 2000-01, at 3 (2000). By contrast, the fifty states have had 146 constitutions, or nearly three per state. Id. Eighteen states have had four or more constitutions. Id. Only nineteen of the states have operated under just one constitution. Id. Moreover, these constitutions are frequently amended. At the start of 2000, the current constitutions of the states had been amended over 6500 times. Id. Alabama led the way with 664 amendments, and California and South Carolina trailed closely behind with 500 and 480 amendments respectively. Id. Even the newest state constitution, the Georgia Constitution of 1982, has been amended fifty-one times as of the start of 2000. Id.

[228] See Croley, supra note 183, at 725-26 (noting that in thirty-eight states, most or all judges are elected).

[229] Helen Hershkoff has suggested that some of these factors, particularly voter initiative, the ease of state constitutional amendment and the elective state judiciary, eliminate some of the separation-of-powers and political legitimacy objections to more aggressive judicial review at the state level and to state judicial enforcement of the positive rights provisions of state constitutions. See Hershkoff, Positive Rights, supra note 6, at 1157-63; Helen Hershkoff, State Courts and the "Passive Virtues:" Rethinking the Judicial Function, 114 Harv. L. Rev. 1833, 1886-87 (2001).

Tab 8

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Development Agreements:
Basics and Beyond

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DEVELOPMENT AGREEMENTS: BASICS AND BEYOND

I. INTRODUCTION

Development Agreements are in increasingly frequent use in Texas. Since Development Agreements meld private real property law (based upon contract law principles) with local government law (based upon public law principles), they present unique issues a lawyer might not otherwise encounter. This paper addresses important issues in structuring, negotiating, and drafting Development Agreements.

II. WHAT ARE DEVELOPMENT AGREEMENTS?

In this paper, a "Development Agreement" is any contractual agreement between a municipality (city, town or village)[1] and the owner of real property relating to development or redevelopment of that property. The scope could cover "land development" (planning, platting, zoning, engineering, and infrastructure), "vertical" improvements (buildings and other structures for human occupancy), or both. Vvertical improvements could include not only new construction but also renovation, remodeling or adaptive reuse of existing improvements.

Benefits often sought by land owners:

- Money (including reimbursements for development costs)
- Land (or removal of encumbrances like public easements or rights of way)
- Public infrastructure (or related reimbursement), *e.g.*, water, sewer, drainage, streets, etc.
- Regulatory relief (or stability)
- Deferral of annexation (where applicable)

Benefits often sought by municipalities:

- Increased tax base – property and sales tax
- Economic development: additional jobs and/or diversification of job base
- Community amenities: entertainment, shopping, work force housing, etc.
- Public infrastructure: installed and paid for by developer (sometimes reimbursed by the city)
- Higher-quality development

A key purpose of almost any Development Agreement is to encourage and support the type of development described in the agreement. A core principle is the concept that "but for" the agreement, the development would either not occur at all or would occur with a different form, quality or timing. For example, the City of Austin has entered "Planned Development Area Agreements" (or "PDA Agreements") to recruit major employers, especially in "high-tech"

[1] Similar contracts can be made with other local government units, *e.g.*, a county or any of the proliferating types of special districts such as municipal utility districts, tax increment reinvestment zones, municipal management districts, etc. The governing laws will vary depending upon the type of unit.

industries. Typically, such agreements would involve large tracts of land, designate industrial districts and provide. . .

> . . . for the extension of city water and wastewater services to the property (generally financed with substantial funds paid by the city for the cost of such extensions). These agreements have also placed a restriction on the ability of the city to annex the property. In exchange for obtaining city services and avoiding city ad valorem taxes for a period of years, the city has been able to include provisions in the PDA Agreements that limit the uses of the property to specific "clean" industrial or research and development uses generally consistent with a general land use plan. These provisions impose "performance standards" related to noise, smoke, emissions, the handling and use of hazardous materials, and other city zoning ordinances otherwise applicable only to properties within the city limits, such as height, setback, parking, building coverage, landscaping, sign, and lighting limitations. The provisions in the PDA Agreements also address issues related to providing access, traffic regulation, subdivision, drainage, and water quality facilities. R. Alan Haywood & David Hartman, *Legal Basics for Development Agreements*, 32 Texas Tech Law Review 955, 959 (2001)("*Haywood & Hartman"*).

Traditional land-use regulations---platting, zoning and building codes---restrict and control development. Development Agreements can permit local governments to support, entice and encourage development, and they sometimes attempt to limit traditional land-use regulations. This is a new world for many local governments, profoundly different from the traditional model of local land-use regulation. One academic commentator has observed that a contract-based model "fundamentally alters the foundational principles of land use regulation." Daniel P. Selmi, *The Contract Transformation in Land Use Regulation*, 63 STAN. LAW REV. 591, 595 (2011)("*Selmi*"). As more fully discussed in this paper, legal doctrines developed over the years for the traditional model of land-use regulation are difficult to reconcile with contract-based regulation---and this creates an atmosphere of uncertainly about the validity and enforceability of Development Agreements. That uncertainty is anathema to the private sector, which often seeks to use Development Agreements to reduce risk and to provide material economic benefits critical to a planned project.

III. STATE-LAW AUTHORITY FOR DEVELOPMENT AGREEMENTS

A. Common Law Agreements & General Statutes

In general, cities have the power to enter into contracts as part of their authority to operate and perform municipal functions. *See, for example*: TEX. LOC. GOV'T CODE §51.014 (Type A general-law cities may "contract with other persons"); TEX. LOC. GOV'T CODE §51.053 (Type B general law cities generally have same authority as Type A general law cities); TEX. LOC. GOV'T CODE §51.051(b)(Type C general law cities with 201 to 500 inhabitants generally have same authority as Type B general law cities). TEX. LOC. GOV'T CODE §51.072(a) (home-rule cities have "full power of local self-government"). *See, also, Haywood & Hartman*.[2]

A statute may authorize the "municipality" to enter into agreements. Another statute may authorize the "governing body," usually the city council. Regardless of the wording of the statute, it is wise to obtain specific approving action *by express vote of the governing body*. An

[2] The *Haywood & Hartman* article focuses on enforceability of a "common law" development agreement (*i.e.*, one that does not have a basis under any of the many statutory provisions supporting development agreements). Key issues covered are: (1) whether a city is legally contracting away its legislative authority or (2) scope of municipal authority within extraterritorial jurisdiction---whether cities have only the powers expressly granted by the legislature. *See, City of Austin v. Jamail*, 662 S.W.2d 777, 782 (Tex. Civ. App.—Austin 1983, writ dism'd), *City of West Lake Hills v. Westwood Legal Defense Fund*, 598 S.W.2d 681, 683 (Tex. Civ. App.—Waco 1980, no writ).

ordinance may be required by statute or charter, but even if not: (i) an ordinance bestows a higher dignity of approval than a motion or resolution, and (ii) an ordinance can repeal all ordinances, motions and resolutions in conflict.[3] Applicable procedural rules (*e.g.*, notice, quorum, number of votes, minutes, possible vetoes and referenda) and execution formalities (signatures, attestations, seals) should be checked carefully.[4]

A critical procedural detail is the description of a proposed agreement in required meeting notices and agendas. Rulings under the Texas Open Meetings Act, TEX. GOV'T CODE, Chapter 551, indicate that a generally-worded notice may not be sufficient, particularly for agenda items "of special interest to the public." *See, for example, Cox Enterprises, Inc. v. Board of Trustees*, 706 S.W.2d 956, 958 (Tex. 1986). A Development Agreement, especially for a large-scale development or for a long term, could easily be considered "of special interest to the public." Therefore, some detail about the agreement would usually be required to be shown in each meeting notice, to avoid violating Chapter 551.[5]

In addition to the general contracting authority of cities, there are countless statutes authorizing municipal agreements. Examples of statutes particularly applicable to Development Agreements are listed and described below.

B. Economic Development or "380" Agreements (TEX. LOC. GOV'T CODE Chapter 380)

In 1989, cities[6] were granted specific statutory authority for "economic development programs." The Development Agreements based upon these statutory provisions have become commonly known as "380 Agreements." These provisions provide broad authority for Development Agreements by cities if a proposed project is within the city's limits or extraterritorial jurisdiction. The purpose of the program is broadly stated as "to promote state or local economic development and to stimulate business and commercial activity in the

[3] This is a common provision in ordinances. It might repeal "to the extent of the conflict only."

[4] *See City of Bonham v. Southwest Sanitation*, 871 S.W.2d 765, 767 (Tex. App.--Texarkana 1994) where the court wrote: "A city or county may contract only upon express authorization of the city council or commissioners court by vote of that body reflected in the minutes. Hill Farm, inc. v. Hill County, 425 S.W.2d 414 (Tex. 1968); City of Bryan v. Page, 51 Tex. 532 (1879); Corpus Christi v. Bayfront Associates, 814 S.W.2d 98 (Tex. App.--Corpus Christi 1991, writ denied); Stirman v. City of Tyler, 443 S.W.2d 354 (Tex. Civ. App.--Tyler 1969, writ ref'd n.r.e.); First Nat'l Bank of Marlin v. Dupuy, 133 S.W.2d 238 (Tex. Civ. App.--Waco 1939, writ dism'd judgm't cor.); 52 TEX. JUR. 3D Municipalities § 360, at 426-27 (1987). Statements or acts of the mayor or other officers or governing body members are ineffectual. Canales v. Laughlin, 147 Tex. 169, 214 S.W.2d 451 (1948); Alamo Carriage v. City of San Antonio, 768 S.W.2d 937 (Tex. App.--San Antonio 1989, no writ). Persons or entities contracting with the governmental unit are charged by law with notice of the limits of their authority and are bound at their peril to ascertain if the contemplated contract is properly authorized. State v. Ragland Clinic-Hospital, 138 Tex. 393, 159 S.W.2d 105, 107 (1942). Proof of the governing body's acts may only be supplied by the authenticated minutes of the meeting at which the action occurred, unless the minutes have been lost or destroyed. Wagner v. Porter, 56 S.W. 560 (Tex. Civ. App. 1900); 52 TEX. JUR. 3D Municipalities § 360, at 427. A plaintiff suing to establish a contract with a city has the burden to both plead and prove that the minutes show the council's act in authorizing or ratifying the contract. Wagner v. Porter, 56 S.W. at 561." *See, also,* the requirements for establishing a waiver of immunity from suit for breach of contract under TEX. LOC. GOV'T CODE §271.152.

[5] See TEX. GOV'T CODE § 551.141: "An action taken by a governmental body in violation of this chapter is voidable." In *Save Our Springs Alliance, Inc. v. City of Dripping Springs,* 304 S.W.3d 871, 888 (Tex. App. Austin 2010), the following description in a meeting notice was held sufficient: "Consider Approving a Development Agreement with Cypress-Hays, L.P., including adopting Ordinance No. 1280.1 Designating a District under Section 42.044 of the Texas Local Government Code."

[6] TEX. LOC. GOV'T CODE Chapter 381 is a similar statute for counties.

municipality." The city may make "loans and grants of public money" and provide "personnel and services of the municipality."

Home rule cities with populations over 100,000 may make grants to certain tax exempt non-profits for "development and diversification of the economy of the state, elimination of unemployment or underemployment in the state and development or expansion of commerce in the state." Any home rule city may contract with a development corporation created under the Development Corporation Act, TEX. LOC. GOV'T CODE Chapter 501, *et. seq.* (originally adopted in 1979) and grant funding for "development and diversification of the economy of the state, elimination of unemployment or any employment of the state and development and expansion of commerce in this state." The specific grant authority referenced in the prior sentences may <u>not</u> be funded by bond proceeds or other municipal obligations payable from ad valorem taxes.

Because of the broad statutory authority, 380 Agreements have become the preferred type of Development Agreement when a local government desires to financially incentivize development. Some cities use 380 Agreements in lieu of the creation of special districts such as tax increment reinvestment zones, which have burdensome statutory requirements for creation and cumbersome (and expensive) bureaucracies. A 380 Agreement can be structured to become the financial equivalent of a tax increment reinvestment zone.

C. Development Participation Agreements (TEX. LOC. GOV'T CODE §212.071)

In 1989, cities with populations of 5,000 or more were authorized to make developer participation contracts without following the competitive sealed bidding procedure. Such contracts can be made "with a developer of a subdivision or land *in the municipality* to construct public improvements, *not including a building*, related to the development." (emphasis added). Under this statute, the developer would typically construct the improvements and the city would participate in their costs. The city's cost participation is limited by its population and the type of development.

City participation permitted	City population limitation
Up to 30 %	less than 1.8 million
Up to 70%	1.8 million or more
Up to 100% (for drainage improvements for affordable housing*)	1.8 million or more-
Up to 100% (for over-sizing of improvements)	No limit

*defined as "housing which is equal to or less than the median sales prices, as determined by the Real Estate Center at Texas A&M University, of a home in the Metropolitan Statistical Area (MSA) in which the municipality is located"

However, a 2005 statute now codified as TEX. LOC. GOV'T CODE §212.904, could impose an overlapping restriction on developer participation, in some cases. If a city, "as a condition of approval for a property development project," requires a developer to bear costs of "municipal infrastructure improvements," the developer's share may not exceed an amount that is "roughly proportionate" to the proposed development. The statute requires an engineer retained by the city to determine that amount. The statute sets up appeal procedures---including an appeal to district or county court---and prohibits a city from requiring a developer to waive the right of appeal.

The developer must provide a performance bond and make records available for city inspection. A city, by ordinance, may require additional safeguards against "undue loading of cost, collusion, or fraud."

Development Participation Agreements can resemble municipal utility district reimbursement agreements typically used outside city limits.

D. ETJ Development Agreements (TEX. LOC. GOV'T CODE §212.172)

In 2003, cities smaller than 1.9 million population were authorized to enter into Development Agreements with a land owner *in their extraterritorial jurisdiction.* Although this statute is the most comprehensive legislative authorization for Development Agreements, *it does not apply within the city limits of any city.*

Statutory requirements/limitations:

- In writing
- Legal description of the affected land
- Approved by the governing body
- Recorded in the real property records
- Maximum 45-year term

Specific language about binding nature:

- "Binding on the municipality and the land owner and on their successive successors and assigns for the term of the agreement"
- "Not binding on, and does not create any encumbrances to title as to, any in-buyer of a fully developed and improved lot within the development, except for land use and development regulations which may apply to a specific lot."

Authorized subject matter:

- Agreement not to annex, and/or plan for annexation and the terms thereof
- City planning authority under a "development plan … under which certain general uses and development of the land are authorized"
- City's current land use and development regulations enforced by the city
- Additional land use and development regulations enforced by the city
- "Provide for infrastructure for the land including (a) streets and roads; (b) street and road drainage; (c) land drainage; and (d) water, wastewater and other utility systems"
- Environmental regulations enforced by the city
- "Specify the uses and development of the land"
- "Other lawful terms and consideration the parties consider appropriate"

An ETJ Development Agreement is specifically deemed a "permit" under TEX. LOC. GOV'T CODE Chapter 245 (sometimes called the "vested rights" law). Prior agreements which meet the requirements of this section are validated. A city may not require such an agreement as a condition for providing utility service.

The breadth of authority for ETJ Development Agreements should be sufficient for any Development Agreement in the extraterritorial jurisdiction of any city *other than Houston* (only city with over 1.9 million population).

E. Industrial District Agreements (TEX. LOC. GOV'T CODE §§42.044, 43.136)

In 1987, cities were authorized to designate any parts of their extraterritorial jurisdictions as "industrial districts" and to enter into agreements with land owners in those districts.

An "industrial district" was not specially defined, but the section states it "has the meaning customarily given to the term but also includes any area in which tourist-related businesses and facilities are located."

The definition of "industrial" includes: "of or resulting to industry;" and "a company engaged in industrial production or service;" and "a company engaged in industrial enterprises." *See, e.g.*, Merriam-Webster's Dictionary, *available at* http://www.merriam-webster.com; *Wall Street Words*. Houghton Mifflin Company; Dictionary.com http://dictionary.reference.com/browse/industrial>).

The definition of "industry" includes "any general business activity or commercial enterprise. *See, e.g., Dictionary.com Unabridged (v 1.1)*; Random House, Inc.; Dictionary.com http://dictionary.reference.com/browse/industry).

Industrial uses typically include manufacturing, distribution, warehouse, and storage, as well as uses related thereto. In a zoned city, the zoning ordinance may contain a definition of "industrial" use as an indication of what that city might consider appropriate in an industrial district. Case law implies a broad meaning. *See SWEPI LP v. Railroad Commission of Texas*, 314 S.W.3d 253 (Tex. App.--Austin 2010, pet. denied), which relied on zoning authorities to conclude that the term "industrial use" could include "landfill." *See, also, Florida v. Jacksonville Port Authority*, 305 So.2d 166 (1974), which dealt with the issue of whether particular capital projects constituted an "industrial plant" within the meaning of the Florida Constitution, which did not define this term. *Id.* at 167. The projects included a proposed food distribution center and a commercial laundry facility. *Id.* The court held that the term "industry" has a broad definition in common usage. Both uses were held within the definition of "industrial plant." *Id.* at 168-69.

An agreement under §42.044 may include the following provisions:

- Agreement not to annex for up to 15 years
- "Other lawful terms and considerations that the parties agree to be reasonable, appropriate and not unduly restrictive of business activities"
- Renewal for successive periods not to exceed 15 years each (no limit on renewals); All owners within an industrial district must be given the opportunity for renewal

An older statute, now codified as TEX. LOC. GOV'T CODE §43.136, was originally adopted to allow the City of Houston to annex territory around the Houston Ship Channel and the Port of Houston---but only for limited purposes like navigation, transportation and wharves. The statute actually applies to any "special law municipality located along or on a navigable stream," and it allows the annexing city to designate "industrial districts" in such limited-purpose annexation areas. In a designated industrial district, the city may enter into contracts with land owners including: (i) guarantees of immunity from general-purpose annexation, and (ii) "other terms considered appropriate by the parties." This statute is the likely basis for TEX. LOC. GOV'T. CODE §42.044, which has similar wording. The City of Houston has entered many such agreements along the Houston Ship Channel.

F. Planned Unit Development District Agreement (TEX. LOC. GOV'T CODE §42.046)

Effective in 1989, if a city dis-annexes land previously annexed for limited purposes, the city may enter into a Planned Unit Development District Agreement with the land owner.

Requirements:

- Written agreement
- Minimum 250 acres
- Maximum 4 land owners
- Recorded where the land is located

Subject matter:

- Agreement not to annex for up to 15 years
- "Authorize certain land uses and development"
- Extension of "certain municipal land use and development regulations to the land and enforced by the city"
- "Vary any watershed protection regulations"
- "Authorize or restrict the creation of political subdivisions on the land"
- "Other terms and considerations the parties deem appropriate"

Binding character:

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- The agreement is "binding upon all subsequent governing bodies of the municipality and subsequent owners of the land … ."

An ETJ Development Agreement can have similar provisions, but a Planned Unit Development District Agreement can theoretically be used in the extraterritorial jurisdiction of Houston, where an ETJ Development Agreement cannot.

G. Neighborhood Empowerment Zone Agreement (TEX. LOC. GOV'T CODE CHAPTER 378)

In 1999, cities were authorized to create, by resolution, one or more "Neighborhood Empowerment Zones" to promote (i) affordable housing, (ii) economic development, or (iii) social services, education or public safety. The agreements may:

- Waive construction, inspection and impact fees
- Refund sales tax (max. 10 years)
- Abate property taxes (subject to limits in TEX. TAX. CODE §312.204)
- Set baseline performance standards (such as Energy Star)

H. Utility System Agreements (TEX. LOC. GOV'T CODE CHAPTER 552)

Cities have longstanding, broad authority to provide utility systems, including water, sewer, gas, and electricity systems. Any city may "purchase, construct, or operate a utility system *inside or outside the municipal boundaries.*" TEX. LOC. GOV'T CODE § 552.001(emphasis added). The statute includes special authority for a municipality "to contract with persons outside its boundaries to permit them to connect with those utility systems on terms the municipality considers to be in its best interest."

I. Impact Fee Agreements (TEX. LOC. GOV'T CODE CHAPTER 395)

In 1989, municipal impact fees (sometimes called "capital recovery fees" or "subsequent user fees") were restricted by an intricate regulatory scheme under Chapter 345. Chapter 345 also:

- authorizes cities to enter into agreements with landowners of platted land regarding "time and method of payment"
- recognizes that developers may agree to construct improvements or expansions of facilities covered by impact fees, but requires that the city either:
  (i) credit the costs incurred by the developer against the developer's impact fees, or
  (ii) reimburse the developer from other impact fees.

J. Economic Development Corporations, Public Improvement Districts, Etc. (TEX. LOC. GOV'T CODE Chapters 372, 501, ET SEQ.)

Financing and other support for Development Agreements can sometimes be obtained through agreements involving economic development corporations (*see* TEX. LOC. GOV'T CODE, Chapters 501, et seq.), public improvement districts (*see* TEX. LOC. GOV'T CODE

Chapters 501, *et seq*.) and other special districts and financing vehicles. For more information, see materials listed in Exhibit C of this paper (Additional Resources, Forms & Materials).

K. Tax Increment/Tax Abatement Agreements (TEX. TAX CODE CHAPTERS 311 & 312)

Since 1981, cities have been authorized to enter into special tax agreements. Under TEX. TAX. CODE Chapter 311, a city can create a "tax-increment reinvestment zone" or "TIRZ," for a development area. The city can apply the increase in property tax revenues that results from a development to support the development, typically by paying for public infrastructure. Since 1983, the "Property Redevelopment and Tax Abatement Act" (now codified in TEX. TAX. CODE Chapter 312) has allowed cities to adopt guidelines for tax abatements and enter into agreements with individual owners and lessees to abate taxes on specific properties, typically for a term of years. Although TIRZ agreements or tax abatement agreements, by themselves, are not usually thought-of as Development Agreements, they can be combined with other types of Development Agreements. For more information, see materials listed in Exhibit C of this paper (Additional Resources, Forms & Materials).

L. Public-Private Partnership Agreement (Tex. Gov't Code Chapters 2267 and 2268)

In 2011, the Legislature adopted a comprehensive public-private partnership statute, codified in TEX. GOV'T CODE Chapters 2267 and 2268. It authorizes cities (and other governmental entities) to join with private entities to provide "qualified facilities" for public use, which may include:

(i) water supply and waste treatment facilities,
(ii) other public facilities, such as hospitals, schools, recreational facilities, public buildings, some transportation facilities (but not highways), and
(iii) "any improvements necessary or desirable" to publicly-owned "unimproved real estate."

Clearly intended to encourage private investment in public facilities, the new law:

- Requires adoption of guidelines for analyzing proposed projects
- Allows solicitation of proposals or bids
- *Authorizes dedications and conveyances of public property and grants or loans of public funds*
- Allows private entities to own, lease, use and operate projects (and set "user fees")
- Requires submission of proposed agreements to the "Partnership Advisory Commission (composed of eight Legislative-branch members plus three appointed by the Governor)
- *Requires a "comprehensive agreement"* with a governmental entity, for each project
- Requires performance and payment bonds for construction, remodeling, etc.
- Requires private entities to pay costs of eminent domain and relocation of utilities
- Allows private entities to "design and construct" projects, if they generally follow public procurement laws.
- Requires public notice of proposed projects

A city or other governmental entity must adopt a resolution to “elect” to operate under Chapter 2267. In the context of Development Agreements, the new law would apply best to projects focused on facilities for “public use” (even if they are privately owned and operated).

IV. VALIDITY AND ENFORCABILITY

A. Private vs. Public Parties

If the parties to a Development Agreement were all private persons and entities, there might be little concern about validity and enforceability, but Development Agreements involve local governments. Local governments can raise unique and potent legal defenses, even in the face of an unambiguous contract.

Concerns about validity or enforceability can undermine the effectiveness of Development Agreements to incentivize worthy projects. For example, if a Development Agreement requires the city to reimburse the developer for infrastructure, the developer may pledge the expected reimbursements as collateral for a development loan. In effect, the developer will try to convince a lender that the reimbursement funds are the equivalent of “equity” contributed by the developer. In the current lending environment, development loans receive close scrutiny, both in underwriting and documentation. Lenders and their counsel will closely review Development Agreements for conditional language and are aware of validity and enforcement issues. Lenders often ask for legal opinions from the developer’s counsel relating to validity and enforceability and may request an opinion on a Development Agreement. Serious doubts about validity or enforceability can scuttle a loan, sinking the financing for an otherwise-worthy project.

B. Constitutional Restrictions

1. <u>Granting public funds or lending credit</u>

The Texas Constitution generally forbids granting public funds or lending public credit to private parties. Article III, Section 51 proclaims: “ The Legislature shall have no power to make any grant or authorize the making of any grant of public moneys to any individual, association of individuals, municipal or other corporations whatsoever; . . .” Section 52 echoes the same rule: “Except as otherwise provided by this section, the Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association or corporation whatsoever, or to become a stockholder in such corporation, association or company. [. . .]”

However, courts have interpreted these sections to allow some payments to private parties. In *Tex. Mun. League v. Tex. Workers' Comp. Comm'n*, 74 S.W.3d 377, 383-384 (Tex. 2002), the Supreme Court wrote:

> . . . [S]ection 52(a) does not prohibit payments to individuals, corporations, or associations so long as the statute requiring such payments: (1) serves a legitimate public purpose; and (2) affords a clear public benefit received in return. See Edgewood IV, 917 S.W.2d at 740; Bullock v. Calvert, 480 S.W.2d 367, 370 (Tex. 1972)(citing Davis v.

City of Lubbock, 160 Tex. 38, 326 S.W.2d 699 (Tex. 1959)); Brazos River Auth. v. Carr, 405 S.W.2d 689, 694 (Tex. 1966); Byrd, 6 S.W.2d at 740. A three-part test determines if a statute accomplishes a public purpose consistent with section 52(a). Specifically, the Legislature must: (1) ensure that the statute's predominant purpose is to accomplish a public purpose, not to benefit private parties; (2) retain public control over the funds to ensure that the public purpose is accomplished and to protect the public's investment; and (3) ensure that the political subdivision receives a return benefit. See Atkinson v. City of Dallas, 353 S.W.2d 275, 279 (Tex. Civ. App.-Dallas 1961, writ ref'd n.r.e.); Gillham v. City of Dallas, 207 S.W.2d 978, 983 (Tex. Civ. App.-Dallas 1948, writ ref'd n.r.e.). See generally Mike Willatt, Constitutional Restrictions on Use of Public Money and Public Credit, 38 TEX. B.J. 413, 421 (1975).

A 1987 decision indicated that a public agency must retain "some form of continuing public control" to ensure that it "receives its consideration: accomplishment of the public purpose." *Key v. Commissioners Court of Marion County*, 727 S.W.2d 667, 669 (Tex. App.--Texarkana 1987, no writ). The opinion noted that a contract could be the means of exerting such continuing control and satisfying the constitution.

Also in 1987, a constitutional amendment expressly authorized loans or grants to attract to promote economic development. Article III, Section 52-a of the Texas Constitution, which was further amended in 2005, now reads as follows:

> Sec. 52-a. LOAN OR GRANT OF PUBLIC MONEY FOR ECONOMIC DEVELOPMENT. Notwithstanding any other provision of this constitution, *the legislature may provide for* the creation of programs and the making of loans and grants of public money, other than money otherwise dedicated by this constitution to use for a different purpose, for the public purposes of development and diversification of the economy of the state, the elimination of unemployment or underemployment in the state, the stimulation of agricultural innovation, the fostering of the growth of enterprises based on agriculture, or the development or expansion of transportation or commerce in the state. Any bonds or other obligations of a county, municipality, or other political subdivision of the state that are issued for the purpose of making loans or grants in connection with a program authorized by the legislature under this section and that are payable from ad valorem taxes must be approved by a vote of the majority of the registered voters of the county, municipality, or political subdivision voting on the issue. A program created or a loan or grant made as provided by this section that is not secured by a pledge of ad valorem taxes or financed by the issuance of any bonds or other obligations payable from ad valorem taxes of the political subdivision does not constitute or create a debt for the purpose of any provision of this constitution. An enabling law enacted by the legislature in anticipation of the adoption of this amendment is not void because of its anticipatory character.(emphasis added)

Section 52-a requires legislative authorization. It is cited as authority for Chapter 380, TEX. LOC. GOV'T CODE, and much of the language is repeated in that Chapter. Texas Attorney General Opinion No. DM-185 (1992) concluded that Chapter 380 implements Section 52-a. As a result, a Development Agreement that closely tracks Section 52-a and Chapter 380 should avoid constitutional difficulties under the public grant or loan restrictions of Sections 51 and 52.

2. <u>Creating unfunded debts</u>

In matters of municipal finance, Texas is a "pay-as-you-go" state. Sections 5 and 7 of the Texas Constitution prohibit a city from incurring any "debt" without simultaneously levying a tax to cover interest and create a sinking fund to repay principal. The term "debt" covers more than a bond or note. The term covers "any pecuniary obligation imposed by contract." *Texas & N.O.R.R. Co. v. Galveston County*, 169 S.W.2d 713, 715 (1943). That case recognized a "current funds" exception to the unfunded-debt rule, if an obligation was . . .

> . . . at the time of the agreement, within the lawful and reasonable contemplation of the parties, to be satisfied out of the current revenues for the year or out of some fund then within the immediate control of the county. In other words, if the obligation does not arise as an item of ordinary expenditure in the daily functioning of the county government or if it is not to be paid out of funds then in the county treasury legally applicable thereto, it is a debt and falls under the

> condemnation of the Constitution, unless the required provision for its payment is made at the time the obligation is incurred. McNeal v. City of Waco, 89 Texas 83, 33 S.W., 322; Stevenson v. Blake, 131 Texas, 103, 113 S.W. (2d) 525. *Id.*

Courts have sometimes recognized a "special fund" exception to the unfunded-debt rule. *City of Brownsville v. Mun. Admin. Servs.*, 1998 Tex. App. LEXIS 3559, 9-11 (Tex. App. Corpus Christi June 11, 1998)(no pub.) upheld a contingency fee contract in which the city promised to pay only from revenues it might gain as a result of a franchise audit. The court wrote: "Contracts may be made without incurring a debt when the debt is made payable out of a special fund raised or to be raised," citing *City of Laredo v. Frishmuth*, 196 S.W. 190, 193 (Tex. Civ. App.--San Antonio 1917, writ dism'd). *But see, City of Bonham v. Southwest Sanitation*, 871 S.W.2d 765, 769 (Tex. App. Texarkana 1994), which did not recognize future revenues or funds:

> Southwest contended that the City could have and should have increased the fee for nonresidents' use of the landfill to \$2.50 per cubic yard and then it would have had sufficient revenues to pay its alleged contract. Such an action, however, would not have satisfied the constitutional requirement unless it was lawfully in force and dedicated at the time the alleged contract with Southwest was negotiated.

The Supreme Court has ruled that a city's obligation to pay, if carefully limited to non-tax sources, is not necessarily a "debt." In a 1934 case, the court upheld the validity of a city's bonds that were expressly made payable only from non-tax revenues. The court wrote: "In other words the holder of these bonds merely has a claim against the sewer system, its franchise, and the revenues of such system, and the water system. *He can never have any claim against tax funds*. It is settled that such an obligation does not [c]ome within the term debt as used in the above quoted constitutional provision." *Dayton v. Allred*, 123 Tex. 60, 71-72, 68 S.W.2d 172 (1934)(emphasis added). A later case, *Nederland v. Callihan*, 299 S.W.2d 380, 382 (Tex. App.--Beaumont1957, writ ref. n.r.e.) followed the *Dayton* case and upheld a contract calling for a developer to construct water and sewer lines and requiring the city to reimburse from water and sewer revenues.

In the context of real estate acquisitions and leases by local governments, TEX. LOC. GOV'T CODE §271.903 addresses the unfunded-debt problem. Under that stature, a contract may be held valid, but only as to "current revenues," so it may not provide long-term stability for a seller or lessor. It reads as follows:

> If a contract for the acquisition, including lease, of real or personal property retains to the governing body of a local government the continuing right to terminate at the expiration of each budget period of the local government during the term of the contract, is conditioned on a best efforts attempt by the governing body to obtain and appropriate funds for payment of the contract, or contains both the continuing right to terminate and the best efforts conditions, the contract is a commitment of the local government's current revenues only.

This provision authorizes contracts which are "subject to annual appropriation". If the payment for the contract is not appropriated in each year's budget, then the local government may terminate the contract.

3. <u>Contracting away governmental power</u>

In a leading case, the Commission of Appeals invalidated an agreement between the City of Taylor and a railroad company. *Bowers v. City of Taylor*, 16 S.W.2d 520, 522 (Tex. Comm'n App. 1929, holding approved). The agreement was embraced in an ordinance calling for the City to close a public street for 15 years for the exclusive use of the railroad. The Commission reviewed both federal and out-of-state authorities and announced, as a general rule, that "the legislative power vested in municipal bodies is something which cannot be bartered away in such manner as to disable them from the performance of their public functions."

This general rule has been applied to invalidate: (i) a city's agreement allowing a free connection to its sewer system; *see Fidelity Land & Trust Co. v. West University Place*, 496 S.W.2d 116 (Tex. Civ. App.--Houston [14th Dist] 1973, writ ref'd n.r.e.), (ii) a water authority's perpetual agreement to meet all of the water and sewage needs of another utility; *see Clear Lake City Water Authority v. Clear Lake Util.*, 549 S.W.2d 385, 392 (Tex.1977), and (iii) an agreement apparently inhibiting a municipal water authority from collecting revenues from its system; *see Cibolo Creek Municipal Authority. v. City of Universal City*, 568 S.W.2d 699 (Tex.Civ.App.-- San Antonio 1978, no writ). The court in *Pittman v. Amarillo*, 598 S.W.2d 941, 945 (Tex. Civ. App. Amarillo 1980, writ ref'd n.r.e.) summed-up the rule this way: "In short, a municipality cannot, by contract or otherwise, transfer control of its governmental functions to another entity, *absent specific constitutional authorization."* (emphasis added). *See* TEX. CONST. ART. I, §2 (reserving the people's "inalienable right to alter, reform or abolish government") and §17(forbidding "irrevocable or uncontrollable grant of special privileges or immunities") and *Texas Boll Weevil Eradication Found. v. Lewellen*, 952 S.W.2d 454, 469 (Tex. 1997)(delegation of governmental authority to private parties).

Courts have made exceptions, especially when a City has received benefits under an agreement. In *Pitzer v. Abilene*, 323 S.W.2d 623, 627 (Tex. Civ. App. Eastland 1959), the City of Abilene was held to have received "substantial benefit and advantage in consideration of its promise not to annex East Abilene for a period of three years," and therefore the City was estopped from annexing that area (in violation of its promise not to annex). *See, also, Austin v. Garza***,** 124 S.W.3d 867 (Tex. App. – Austin 2003, no pet.)(City bound to agreement in plat note due to having accepted the right of way dedicated by the plat).

However, the general rule remains in use, especially in the context of zoning. In *City of Pharr v. Pena*, 853 S.W.2d 56, 62 (Tex. App. Corpus Christi 1993), the court wrote: "The passage of a zoning ordinance or amendments thereto is an exercise of legislative power, and a city may not by contract or otherwise barter or surrender its governmental or legislative functions or its police power." *2800 La Frontera No. 1A, Ltd. v. City of Round Rock*, 2010 Tex. App. LEXIS 243 (Tex.App.—Austin 2010)(mem.op.) involved a Development Agreement that was claimed to inhibit the City from amending the zoning for a 194-acre planned unit development. The court held the agreement "unenforceable."

C. Governmental Immunity

1. <u>Types of Governmental Immunity</u>

According to the Supreme Court, governmental immunity in Texas has two components: (i) "immunity from liability, which bars enforcement of a judgment against a governmental entity," and (ii) "immunity from suit, which bars suit against the entity altogether." *See Tooke v. City of Mexia*, 197 S.W.3d 325, 332-333 (Tex. 2006). A city can waive the first component (immunity from liability) by entering into a contract. *Id.* However, the Supreme Court has ruled that *only the Legislature* can waive the second component (immunity from suit), and such a waiver must be "clear and unambiguous." *Id.*

2. Waiver of Immunity From Suit

The legislative waiver (of immunity from suit) that relates most directly to Development Agreements is contained in TEX. LOC. GOV'T CODE §271.152. That statute waives a local government's immunity from suit when it enters into a contract for "providing goods or services." In *City of North Richland Hills v. Hometown Urban Partners Ltd. 25*, 340 S.W.3d 900 (Tex. Civ. App.—Ft. Worth 2011, no pet.) the court applied the statute to a Development Agreement for a substantial mixed-use project. The agreement covered a broad array of issues relating to the design, construction and city acceptance of public improvements in the context of a large, long term mixed use project. The developer conveyed land to the city for a recreation center and granted the city an easement for 400 parking spaces (to be constructed by the city) adjacent to the recreation center. A city library was built within the project, and zoning, platting and other approvals consistent with the original development intent occurred. However, the recreation center was never constructed because the city decided to move it to another site. Additionally, the city amended the zoning ordinance to require "specific use permits" for multi-family uses within the project. Allegedly, the amendment occurred without the developer's knowledge, and when the developer sought a specific use permit, the city allegedly imposed "impossible conditions" and eventually denied the permit. The developer invested substantial sums in land development, park improvements, land dedicated to the city for public improvements and private building and structures.

The City did not deny it executed the agreement, or that it was authorized to enter into the agreement, or that it was liable thereunder, but instead asserted immunity from suit. Among other duties, the agreement required the developer to:

- prepare "all plans and designs" for public and private use improvements;
- provide public bidding for any third-party contracts;
- "supervise and oversee all such contracts";
- "exercise due diligence and good faith efforts to insure compliance" with city requirements;
- use "reasonable efforts to guard against any defects or deficiencies in the work of contractors or subcontractors";
- "reject any work or materials" that do not conform to the contract documents";
- obtain lien waivers or "bills paid affidavits" from contractors;
- "establish and maintain a central file for all design, construction, and related contractual documents";
- "coordinate with the appropriate contractors the performance and completion of any unfinished items,"
- "follow the good faith recommendations of the engineer . . . ."

The City argued that the Development Agreement was "ultimately a contract for the conveyance of real property," not for goods or services. Nevertheless, the court held that §271.152 "waives the City's immunity from suit with regard to the Development Agreement because the Development Agreement is a contract for the provision of services to the City within the meaning of that statute." The court relied upon two Supreme Court cases, *Kirby Lake Dev., Ltd. v. Clear Lake City Water Auth.*, 320 S.W.3d 829 (Tex.2010))(agreement requiring developers to provide for construction of water and sewer facilities held to be an agreement for provision of services under §271.152) and *Ben Bolt–Palito Blanco Consol. Indep. Sch. Dist. v. Tex. Political Subdiv. Prop./Cas. Joint Self-Ins. Fund*, 212 S.W.3d 320 (Tex.2006)(agreement requiring members to provide some limited services to insurance fund held to be an agreement for services under §271.152).

Other recent cases finding waiver of immunity from suit: *Clear Lake City Water Auth. v. Friendswood Dev. Co.,* 256 S.W.3d 735 (Tex. App.-Houston [14th Dist.] 2008, pet. dism'd) and *Town of Flower Mound v. Rembert Enterprises, Inc.*, 2011 WL 6141584 (Tex. App.--Fort Worth, December 8, 2011, no pet.) (immunity dispute over Development Agreement). *But see SE Ranch Holdings, Ltd. v. City of Del Rio,* No. 04–06–00640–CV, 2007 WL 2428081 (Tex. App.-San Antonio Aug. 29, 2007, pet. den.) (mem. op.) (immunity from suit not waived in dispute over Development Agreement) and *East Houston Estate Apartments, L.L.C. v. City of Houston*, 294 S.W.3d 723 (Tex. App.-Houston [1st Dist.] 2009, no pet.) (immunity from suit not waived in dispute over low-income housing agreement).

The *City of North Richland Hills* opinion included other rulings that could be important in any litigation involving Development Agreements. The court ruled that money-damage limitations in TEX. LOC. GOV'T CODE SEC. §271.153 (limiting claims to "the balance due" and excluding "consequential damages") do not affect or limit jurisdiction, but they could still limit the amount of a money judgment against a municipality. Also, the court ruled that the developer's request for a declaratory judgment was an improper "recasting" of a breach-of-contract claim, apparently an attempt to collect attorneys' fees (which failed). However, the court went on to rule that the developer could maintain a takings claim---independent of the contract claim---even though the alleged taking was based, in part, upon the City's alleged breach of the contract. The court wrote:

> . . . Appellees allege that the City deprived them of their reasonable investment-backed expectations, and they contend that they had a reasonable expectation—based on seventy-percent of the development being constructed in accordance with the zoning, plats, building permits, Development Agreement, and TIF financing documents and all of which having been in place for several years—that the recreation center and parking spaces would be developed in accordance with those documents. These allegations are sufficient to allege a regulatory taking that unreasonably interfered with Appellees' investment-backed expectations. See El Dorado, 195 S.W.3d at 246-47; McPhee, 2009 Tex. App. LEXIS 6625, 2009 WL 2596145, at *2. While the City's alleged breach of the Development Agreement, standing alone, cannot form the basis of an inverse condemnation claim because it would be nothing more than a recasting of Appellees' breach of contract claim, see Holland, 221 S.W.3d at 643-44, Appellees *reference the Development Agreement as only one evidentiary factor to consider in determining whether the City's actions as a whole constitute a regulatory taking*. See El Dorado, 195 S.W.3d at 246-47; McPhee, 2009 Tex. App. LEXIS 6625, 2009 WL 2596145, at *2. We therefore overrule the City's seventh issue. *Id.* at p. 916 (emphasis added).

3. <u>Estoppel</u>

*City of Austin v. Garza***,** 124 S.W.3d 867 (Tex. App. – Austin 2003, no pet.) applied the doctrine of equitable estoppel in the context of a development dispute over the enforceability of plat notes. In *Garza,* the city approved a plat for a new development. Subsequently, the owner sought to develop in accordance with the plat, including specific plat notes granting certain benefits to the property. The city sued to invalidate the plat previously approved by the city.

The court held that the city was estopped to deny the validity of the plat since it had accepted the benefits of the plat, including dedicated streets and easements.

An earlier case, *Pitzer v. City of Abilene*, 323 S.W.2[nd] 623 (Tex. App.- Eastland 1959, no writ), dealt with an non-annexation agreement breached by the city. The court ignored the city's defenses to enforceability of the agreement and applied estoppel despite the city's assertion that the city had abrogated its governmental power of annexation, rendering the contract unenforceable. The court enforced the contract and held that the city's annexation was void, since the city acquired substantial benefits under the contract, and it would be unjust and inequitable to repudiate the agreement.

However, the general rule is that municipalities are not subject to estoppel, except in extraordinary circumstances. *See City of White Settlement v. Super Wash, Inc.*, 198 S.W.3[rd] 770 (Tex. 2006).

4. Takings

No legislative waiver of immunity is necessary to maintain a claim, like a takings claim, directly authorized by the constitution. *City of N. Richland Hills v. Home Town Urban Partners, Ltd.*, 340 S.W.3d 900, 916 (Tex. App.--Fort Worth 2011, no pet.) held that a takings claim can be based in part upon breach of a Development Agreement. *See* discussion and excerpt, *infra*. However, another court has ruled that a developer waived potential takings claims by entering into a Development Agreement. In *Rischon Dev. Corp v. City of Keller*, 242 S.W.3d 161, 169 (Tex. App. 2007, pet. denied), the developer urged a taking claim based upon City requirements for sidewalks, fire sprinklers, hike and bike trails and a perimeter fence, apparently all covered by the agreement with the City. The developer did not object to the requirements until late in development process, long after the agreement was signed. The court rejected the developer's taking claim because the developer consented to the City's requirements:

> We hold that by proposing, adopting without objection, or agreeing in the Developer's Agreement without objection to all of the Rolling Wood "requirements," Rischon consented to those requirements. Therefore, the trial court did not err by rendering a take-nothing judgment on Rischon's claims. *Id.*

See, also, Selmi, at pp. 624-627, for a discussion of governmental exactions, takings and development agreements.

V. NEGOTIATION OF DEVELOPMENT AGREEMENTS

A. Basic Approach

Approaching negotiation of a Development Agreement, it is important to recognize that the "world view" of local government is fundamentally different from that of a typical private land owner. In the normal real estate transaction, all parties are profit motivated. No so in a Development Agreement. Although the land owner may have a purely profit orientation, the local government does not. The local government is working for the "public" and is engaged in the effort to cause development which is "in the best interests of the public". Further, the attorney for the local government may be on staff: under paid, over worked and not necessarily a real estate law or business specialist.

The land owner view of the world:

- Need it done NOW
- It's all about maximizing financial return
- Let's be practical
- Everyone for themselves
- Push for the most

The local government view of the world:

- Better to delay and let there be more process
- Money isn't everything; the "Public Interest" is.
- CYA (cover your aspects)
- Don't try to take advantage of us
- Let's be fair

Recognizing these differences will help private parties understand how a public-sector lawyer (and a municipality) handles a Development Agreement. Much frustration can be avoided if the private sector parties put themselves in the position of the public sector parties to understand their view of the world.

B. Money and Land

1. Land

Some local governments, particularly cities or their economic development corporations, are willing to convey land, either free or at bargain price, to support economic development activities, particularly those generating good jobs. The conveyance of land is not typically a problematic transaction since the conveyance occurs immediately.[7] The local government may wish to impose restrictive covenants regarding the use, which would typically be acceptable to the recipient. However, conditional conveyances may not be acceptable to the recipients, as they impair the finance-ability of the project.

2. Money

a. How much to ask for?

The developer must usually prove to the local government that the amount of incentives requested is necessary to "plug a gap" in the pro forma for the project. The developer's argument is often that "but for" the monetary incentives, either the project would not go forward or would go forward in a diminished or delayed manner.

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[7] *See* TEX.LOC.GOV'T CODE Chapter 272, which restricts some conveyances by cities. *See also*, discussion *infra* regarding constitutional restrictions on granting public funds, which could apply to transfers of public property.

Cities typically prefer to reimburse for the cost of specific items. Sometimes the cost is estimated, based upon actual bids. Alternatively, the actual cost of a particular item of infrastructure can be reimbursed by a local government to the developer, often with a cap (based upon a bid, and perhaps some variance factor). Specific items typically included within a developer list for reimbursement are as follows:

(1) Public infrastructure (on and off site)
- Roads
- Water and sewer
- Drainage
- Sidewalks
- Lighting
- Landscaping
- Monument project
- Monument signage,
- Traffic facilities (signalized intersections, etc.)
- Oversizing the foregoing

(2) Quasi-public amenities
- Plazas and other gathering places
- Greenspace / parks
- Trails

(3) Subsidy for desired tenants
- Entertainment venue
- Convention center / facilities
- Specific retailers

(4) Design upgrades
- Architectural/materials
- landscaping

(5) Site development costs
- unusual site costs – cut/fill, drainage, etc.

(6) Reduced Density

b. Sources of Funding

There are a number of sources for funding to a developer in a Development Agreement. See discussion, *infra*, above regarding economic development statutes, tax increment financing, public improvement districts, etc. Regarding payments from municipal tax funds and other revenues, see discussion, *infra*, regarding "debts" and exceptions to the constitutional limitations.

VI. DRAFTING POINTS

A. Forms and Checklist

Many complete forms for Development Agreements as well as supporting documents and specialized checklists are available within the materials listed in Exhibit C (Additional Resources, Forms and Materials), attached. Most are available online. See, especially, contract forms and clauses in these individual papers (referred to by author and date):

BOJOUQUEZ 2005 (includes ETJ agreements)

DAHLSTROM 2011 (economic development)

McDONALD 2008 (master development agreement for mixed-use, guaranty, etc.)

SMITH 2010 (Chapter 380, economic development, sample clauses, etc.).

See Exhibit A for a general checklist. More-specialized checklists are included in the materials listed in Exhibit C (Additional Resources, Forms and Materials).

B. Risk Issues; Drafting Approaches

See Exhibit B, attached, for a list of risk issues and drafting approaches to address them.

Exhibit A
General Checklist For Development Agreements

This checklist contemplates a traditional type of agreement calling for a "Developer" to undertake a project that may include facilities to be constructed by the Developer for the City and reimbursed by the City (at least in part). Many of the papers listed in Exhibit C contain discussion of relevant issues, and they are referred in this checklist by author last name and date, e.g., "BOJOUQUEZ 2005."

Item	Note or Comment
Parties	State full names and types of business organizations, states of organization, etc. State type of municipality and governing laws. Identify all guarantors, escrow agents and parties to related agreements.
Authority	Cite key authorizing statutes, especially for economic development projects. TEX. LOC. GOV'T CODE Ch. 380 has the broadest authority and strongest constitutional basis.
Property	Include full legal description, maps and drawings. Many Development Agreements say that they "run with the land" and should be recorded.
Project	Describe fully. Include drawings, land plan, tables, renderings, etc. Include key data, *e.g.*, capacities, sizes and service areas of utility and drainage facilities. Identify any agreed-upon phases.
Other documents	Identify and link to all related documents, *e.g.*, PUD/PDD ordinances, financing documents, separate/related agreements (economic development, tax abatement, financing), etc.
Plats, plans, Etc.	State who will prepare plats, plans, etc., who has the right to review and approve, etc., and require all construction to comply with plans as approved. Provide for plan changes including field changes.
Land and ROW	State who will be responsible for acquiring (or providing, dedicating, etc.) all land and ROW, how it will be paid for, etc. If street or utility abandonments are required, state who will be responsible and whether any special payments are required; s*ee* TEX. LOC. GOV'T CODE Ch. 272. *See* "Risk Issue Chart" in this paper regarding TEX. LOC. GOV'T CODE §212.904.
Regulatory approvals	Identify all regulatory approvals and say who is responsible for obtaining them, when they must be obtained and the consequences of not obtaining them. If zoning, platting or discretionary City approvals are required, state who will apply and provide time for hearings and decisions. *See* "Risk Issue Chart" in this paper. State consequences of an unfavorable outcome.
Competitive bidding	Provide for bids, except for items clearly exempt. *See McDONALD 2008.*
Deliverables and timetable	Specify deliverable items, *e.g.*, studies, appraisals, plats, plans, specifications, facilities, reports, certifications, audits, etc. Provide a timetable, including any

	agreed-upon phasing. Provide for timetable changes and updates. Consider catchall time of performance clauses ("within a reasonable time, taking into account . . . " or "as soon as reasonably practicable").
Project halts, cleanup; force majeure	If project is halted, provide for orderly shut-down and site clean-up. *See McDONALD 2008.* Provide for "force majeure".
Construction	State who will handle construction, how inspections and reports will be handled, etc. Require surety bonds. Provide for construction close-out items, like "as-built" plans, "bills paid" affidavits, certificates of completion, warranties, consents of sureties, etc. Provide for conveyances of facilities to city, as appropriate.
Payments by City (*providing other things of value)*	Identify amounts and "triggers" precisely. Consider escrows, guarantors, tax levies, special funds, and other risk-reduction measures. *See* "Risk Issue Chart" in this paper.
Costs	State who will bear costs such as engineering, audit, appraisals, legal, surveying, permits, advertising, etc. Provide for cost-shifting, deposits, security.
"Goods and Services"	To qualify under TEX. LOC. GOV'T CODE §271.152 for legislative waiver of sovereign immunity from suit, include delivery of "goods and services" to City. Tie the goods and services to a core aspect of the agreement, so it can't easily be dismissed as "ancillary" or immaterial.
Approved Consultants	Where approval of consultants is necessary, consider listing at least one pre-approved consultant, in each area.
Payments by Developer	Identify amounts and "triggers" precisely. Consider escrows, guarantors, bonds, etc. *See* "Risk Issue Chart" in this paper regarding TEX. LOC. GOV'T CODE §212.904 .
Performance security	Consider surety bonds, letters of credit, etc. State circumstances when City can take over and finish the project. Provide for access, equipment, funds, etc. *See McDONALD 2008.*
Chapter 245 "vesting," etc.	Identify any existing ordinances and regulations that are agreed to be "frozen." Tie the issues to TEX. LOC. GOV'T CODE §§245.002 and 245.004, particularly (2) & (3), which list items which may be "frozen" under zoning regulations or non-zoning land use regulations. (*Note*: "Property classification" and "building size" have promise for broad vesting.) State any agreements regarding non-conforming uses. *See* "Risk Issue Chart" in this paper.
Subject to laws, etc.	Include broad clause and state an intention to comply with all laws, rules, regulations, etc. Consider reserving the City's full powers to regulate, legislate, etc. *See* "Risk Issue Chart" in this paper.
Severability	Consider special "non-severability" language for any doubtful clauses that, if

	stricken, could harm one party severely. Consider severability clauses allowing reformation. *See, e.g.* sample clauses in *SMITH 2010*. *See* "Risk Issue Chart" in this paper.
Special waivers	Consider waivers of confidentiality (trade secrets, sales tax) and waivers of takings impact assessments required by TEX. GOV'T CODE Ch. 2007 (if any). *See SMITH 2010* and *BOJOURQUEZ 2005*.
ETJ, annexation, etc.	Provide for annexation, non-annexation, payments in lieu of taxes, etc. as may be agreed upon. Check all special provisions listed in TEX. LOC. GOV'T CODE §212.171 *et. seq.* Check TEX. GOV'T CODE Ch. 2007(takings impacts).
Remedies; estoppels letters, etc.	Consider limitations of remedies customized for the project, *e.g.*, limiting of money claims, consequential or punitive damages, allowing specific performance (or not). *See* TEX. LOC. GOV'T CODE §271.153 (limits on city liability-"balance due", no consequential damages). Consider stabilization provisions like notice and opportunity to cure (in case of breach) and mediation prior to litigation (all claims). Provide for recoupment and "clawback" of public funds, as appropriate. Provide for "estoppel letters" or "comfort letters" from the city for the benefit of lenders or buyers relating to the project regarding the status of performance from time to time.
Recording, etc.	State whether the agreement will be recorded (sometimes recording is required, *e.g.*, TEX. LOC. GOV'T CODE §212.172) or if another document will be recorded. Require acknowledgments by all parties.
Illegal aliens	*See* TEX. GOV'T CODE Ch. 2264. Statement or certification may be required.
Attorneys fees	Check TEX. GOV'T CODE §2252.904 ("two-way" requirement) and TEX. GOV'T CODE §271.l53.
Successors and assignments	*Generally:* Address the procedure and discretion for assignments. *Partial Assignments:* Consider whether and to what extent rights can be bifurcated, taking into consideration the expected development of the project and the likelihood of separate ownership. Consider limiting assignments to just owners of substantial holdings. Be wary of allowing agreements to run too freely with ownership; it could result in too many parties (but certain benefits should run with ownership). *Collateral Assignments:* Permit the right to payments to be collaterally assigned to a lender. Lender will likely not assume any liabilities, except after foreclosure and then only for ongoing issues. New owners and assignees should expressly assume all obligations relating to ongoing operations, but beware of liability relating to development activities which a passive investor won't accept. Consider limiting liability to the term of ownership. *Specific Provisions for ETJ Development Agmts:* TEX. LOC. GOV'T CODE §212.172(f) states that ETJ Development Agreements are "binding on the municipality and the landowner and on their respective successors and assigns for the term of the agreement" but frees an "end-buyer of a fully developed and improved lot" from any burdens except "land use and development regulations".

Term, survival	Check and follow governing statutes carefully for maximum terms, *e.g.*, TEX. LOC. GOV'T CODE §212.172(limits terms for ETJ development agreements). Consider having some covenants survive termination, or even "run with the land" for the life of the structures. *But see* TEX. LOC. GOV'T CODE §212.172(f). Be careful not to knock out any "trailing" duty (*e.g.*, the duty to make a payment that accrues during the last year of the term---as a practical matter, the payment may have to be made after the term expires).
Approvals	Consider identifying an agreed approval authority for the City, such as the City Manager or Planning Director, for discretionary approvals provided in the agreement. Consider a general standard such as "All approvals shall not be unreasonably withheld, conditioned or delayed". A time for approval after which a requested approval is deemed approved is unlikely to be acceptable to a city, but there may be ministerial approvals where it is appropriate.
Variations (substantial compliance)	Sometimes, an agreement has detailed drawings, renderings, specifications and the like. It may be appropriate to allow a City staff member, usually the City Manager, to make an administrative determination that offered facilities or equipment or variations (or even substitutions) "substantially comply" with the agreement or are "substantially equivalent" to what the agreement requires. Usually, this authority will be limited to specified matters, such as color, type of material and the like.
Other	Include other necessary or useful contract clauses. See, also, approaches to risk issues mentioned in the "Risk Issue Chart" in this paper.

Exhibit B
Risk Issue Chart

In this chart, "LGC" means Texas Local Government Code. For potential risk estimates, ♦ = low,♦♦♦♦♦ = high.

Type of covenant	**Potential risk (est.)***	**Drafting ideas to mitigate potential risk**	**Comment**
City and Developer agree . . .	♦♦	Recite the authorizing constitutional provisions and statutes. Use statutory words and phrases in the agreement.	Especially important for general-law cities, which have only those powers granted by the Legislature.
City shall--- ---make a grant or gift. . . ---lend money . . . ---assist [private business] . . .	♦♦♦	(1) Link covenant tightly to LGC Ch. 380 or other economic development statute. (2) State the public purpose to be achieved---and achieve it. (3) State real consideration; make it substantial and proportionate. (4) Identify points at which city can exercise "control" over the project, and include a general residual right of public control.	Chapter 380 has broad, undefined authority, while most other statutes have specific authority.
City shall--- ---pay money . . ---obtain [thing of value] . . .. ---provide [thing of value]. . .	♦♦♦♦	Recite that sufficient funds are on hand and appropriated for the agreement, *but see Brodhead v. Forney*, 538 S.W.2d 873, 875 (Tex. Civ. App.--Waco 1976, writ ref'd n.r.e), where an ordinance ratifying a Development Agreement recited that the City had set aside sufficient money, but the City actually had "no money on hand to meet the terms of the contract and did not assess a tax for that purpose." Developer took nothing.	*Brodhead* opinion put the burden upon developer to "plead and prove" compliance with constitutional requirements for validity of debt.
		Recite that sufficient funds are on hand, appropriated, etc. *and* put them on deposit with an escrow agent for purposes of the agreement	Escrow with a third party like a title co, with a clear process for release of funds based on progress in the project.
		In ordinance authorizing agreement, levy a tax in an amount sufficient---and refer to it in the agreement. *See*	Tax levy reduces risk if funds are not actually on hand.

		Brown v. Jefferson County, 406 S.W.2d 185 (Tex. 1966)(upholding unfunded contract supported by tax levy)	*Brown* opinion quotes actual tax levy language.
		Delegate payment obligations to a third-party (or get a guaranty or letter of credit)	The payment obligation may be supported by a "standby" letter of credit (very limited defenses to payment of drafts) or by a guaranty from third party like an Economic Development Corporation.
		Make the obligation payable only from a non-tax source of revenues, identify the source and include covenants to assess and collect those revenues.	Check bonds and other senior pledges; add waivers and subordinations, if necessary.
		Link the payment to a duty of the Developer (so that they are performed simultaneously) or make a duty of the Developer contingent upon payment.	
City shall--- ---re-zone . . . ---grant variances . . . ---amend ordinances . . .	♦♦♦♦½	Beware! (1) Take all legislative and regulatory action *before* the agreement is signed. (2) The agreement would adopt the regulations in effect at the time of the agreement and acknowledge that LGC Ch. 245 "freezes" them. Consider listing key Developer duties as conditions in a PUD or other discretionary regulatory approval, i.e., use conditional zoning.** A different approach, suggested in *Haywood & Hartman* at 32 Tex. Tech L. Rev. 955, 977: (1) "reflect specific land uses as part of the development or preliminary plan that is approved as part of the	Same problem with promises ***not*** to re-zone, ***not*** to grant variances, etc. Legislative acts are unlikely to be restrained.

		development agreement, (2) declare developer's agreements to be covenants running with the land "required by the city to assure compliance," and (3) record the agreement.	
City may zone, rezone or not, but--- ---existing uses are "grandfathered" ---proposed uses are "grandfathered"	♦♦♦	(1) Amend ordinance to grant prior non-conforming status (to existing or proposed uses) *before* the agreement is signed. (2) Agreement would refer to the prior non-conforming regulations and acknowledge that LGC Ch. 245 "freezes" them. Consider listing key developer duties as conditions in a PUD or other discretionary regulatory approval, *i.e.,* use conditional zoning.**	A different approach suggested in *Haywood & Hartman*, at 32 Tex. Tech L. Rev. 955: Agree that uses in the approved development plan or preliminary plan should be allowed to continue as legal, non-conforming uses.
City shall--- ---review/approve plans . . . ---approve permits . . .	♦♦	Limit the duty to ministerial, non-discretionary acts, *i.e.*, duty only applies if permits clearly comply with applicable regulations Recite that City may refuse to approve discretionary permits, also that third parties may appeal the granting of permits and administrative bodies may reverse, modify, revoke, etc. (and this is not a breach of the agreement)	
Developer shall--- ---build a library . . . ---re-pave asphalt road using concrete . . . ---provide [something else that exceeds a roughly proportionate share of infrastructure] . . .	♦	*See* anti-waiver clause in LGC §212.904. Get engineer's determination of rough proportionality *before* the agreement, then recite in the agreement that everyone agrees with the engineer's determination, developer does not want to appeal, etc. List developer duties as conditions in a PUD or other discretionary regulatory approval, *i.e.,* use conditional zoning.**	Probably OK, if developer agrees., even though unilateral imposition of the same obligation by the city might be a taking or violate LGC §212.904. *See*, *Rischon, infra*, and *Selmi.*
City waives sovereign and governmental immunities	♦	Restrict this clause to the waivers allowed by law, and tie any waiver of *immunity from suit* to a specific,	Consider backing-up non-monetary promises to perform

		cited statute. If LGC §271.152 and §271.153 are cited for the waiver, the agreement should identify--- ---all the "goods and services" to be provided ---the "balance due" and how to compute it.	with contingent promises to pay money, *i.e.*, City shall either perform, or else pay a liquidated sum of money as the "balance due.". *But see* discussions, *infra*, regarding unfunded debt.

** Estimates of potential risk are not intended to show that a particular covenant will be invalid, but to show that it should be addressed with care due to the state of the law as of January 2012.*

*** See Super Wash, Inc. v. City of White Settlement, 131 S.W.3d 249, 257 (Tex. App.--Fort Worth 2004), rev'd in part by City of White Settlement v. Super Wash, Inc., 198 S.W.3d 770 (Tex. 2006):* "Conditional zoning, however, occurs when the city unilaterally requires a landowner to accept certain restrictions on his land without a prior commitment to rezone the land as requested. Because conditional zoning does not involve a promise to rezone that bypasses any procedure required by the Local Government Code, the Texas Constitution, or the United States Constitution, conditional zoning is not invalid per se. Therefore, conditional zoning is valid if it is not arbitrary or capricious and if it reasonably relates to the public welfare."

Exhibit C
Additional Resources, Forms & Materials

Note: Many of the following are available either at the website for the Real Estate, Probate & Trust Law Section of the State Bar of Texas www.reptl.org, or the State Bar CLE website www.statebarcle.org.

Institutions

Texas Municipal League. A large number of development agreement/economic incentive articles and example documents are on the website of the Texas Municipal League. http://www.tml.org/legal_topics/legal_finance.asp. It also has links to the Comptroller' and Attorney General's website materials on economic incentives.

Attorney General of Texas, ECONOMIC DEVELOPMENT HANDBOOK 2008. Available on the Attorney General's website. https://www.oag.state.tx.us/newspubs/publications.shtml

Papers, Presentations, Etc.

Bojorquez, "Development Agreements," UT Law Land Use Conference 2005 (Topics: Tex. Loc. Gov't Code §212.071 Developer Participation Agreements: Authority and Negotiation – Forms: Checklist for §212.071 Developer Participation Agreement)("*BOJORQUEZ 2005*")

Dahlstrom, "Drafting Guidelines for Economic Development Agreements," St. Bar Advanced Real Estate Drafting Course 2011 (Topics: 380 Agreements, Tax Abatements, dealing with economic development corporations and tax increment financing and drafting considerations – Forms: (i) 380 Agreement, (ii) Tax Abatement Agreement, (iii) Pre-Annexation Agreement and (iv) Checklist for drafting considerations (Sec. A of article))("*DAHLSTROM 2011*")

Fort, "Annexation Development Agreements," UT Land Use Conference 2010 (Topics: Tex. Loc. Gov't Code §212.172 Developer Participation Agreements, Tex. Loc. Gov't Code §43.035 Development Agreements – Forms: (i) §43.035 Notice Letter to property owner, and (ii) §43.035 Development Agreement)

Green, "380 Development Agreement," State Bar Advanced Real Estate Drafting 2009 (Topics: Tex. Loc. Gov't Code §380 Economic Development Agreements – History: AG Opinions and negotiations – Forms: Municipal Economic Development Program and 3 different 380 Agreement forms)

Haywood, "Development Agreements from Landowner/Developer Perspective," UT Law Land Use Conference 2005 (Topics: Tex. Loc. Gov't Code §212.071 Development Participation Agreements – Authority, Drafting and Negotiation – Forms: §212.071 Development Participation Agreement)

McDonald, "Development Agreements," UT Law Land Use Conference 2008 (Topics: Negotiating tips for development agreements, proposed "compromising" language on several important issues – Forms: (i) Letter of Intent, (ii) Master Development Agreement for large mixed use project including tax increment financing, 380 payments, parking garage lease to the city, public improvement district, (iii) Parking Garage Lease to city, (iv) Developer Completion Guaranty, (v) Tax Increment Financing District Developer Reimbursement Agreement)("*McDONALD 2008*")

Moore, "Chapter 380," http://www.bhlaw.net/articles (Topic: Chapter 380 programs – Forms: none)

Smith, Peter, "Economic Development Incentives," St. Bar Advanced Real Estate Law 2004 http://www.njdhs.com/CM/Articles (Topics: Broad review of Economic Development Agreements – Forms: Tax Abatement Checklist, Tax Abatement Agreement – TTC Sec. 313.027 with School District). Also available at the same website are 3 Development Agreements used by the cities of De Soto (High Star project), Prosper (Blue Star project) and Allen (Village at Allen project).

Smith, Peter, "Economic Development." UT Law Land Use Conference 2005 (Topics: Tex. Loc. Gov't Code §212.071 Developer Participation Agreements: Authority and Negotiation – Forms: Checklist for §212.071 Developer Participation Agreement)

Smith, Peter, "The Municipal/Governmental Perspective of Economic Development Incentive Agreement Provisions." UT Law Land Use Conference 2010 (Forms: sample clauses, Chapter 380 agreement, tax abatement, etc.)("*SMITH 2010*").

Smith, Peter, "ECONOMIC DEVELOPMENT TOOLS IN THE NEW NORMAL, PART I: Understanding the role of special districts and alternatives to special districts, including TIFs and 380 agreements." UT Law Land Use Planning Conference 2011(Topics: Broad review of Economic Development incentives including hotel occupancy taxes – Forms: none) ("*SMITH 2011*").

Welch and Brown, "Economic Development," http://www.bhlaw.net/articles (Topics: Tax increment financing, 380 Agreements, tax abatements and dealing with 4A and 4B corporation – Forms: none)

Zech, "Development Agreements," UT Law Land Use Conference 2008 (Topics: Broad review of Development Agreements of all types – Forms: (i) Infrastructure Reimbursement Agreement, (ii) Tex. Loc. Gov't Code §42.044 Industrial District Agreement, (iii) Tex. Loc. Gov't Code §212.172 Development Agreement, and (iv) Tex. Loc. Gov't Code §43.035 Non-Annexation Development Agreement)

Tab 9

ECONOMIC DEVELOPMENT TOOLS

Kimberly R. Lafferty

Lafferty Law Firm, PLLC

The Fourteenth Annual Riley Fletcher Basic Municipal Law Seminar

Texas City Attorneys Association

February 21, 2013

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Kimberly R. Lafferty is a partner in the Lafferty Law Firm, PLLC, and has provided general legal counsel, transactional support, and trial and appellate representation to governmental entities for over fourteen years. She understands the intricacies of the laws applying to governmental entities, and provides innovative solutions to complex legal concerns.

Ms. Lafferty has represented clients on a variety of issues, including disputes involving annexation, contracts, constitutional law, employment law, land use and the Texas Tort Claims and Civil Service Acts. Ms. Lafferty also regularly assists municipalities and development corporations with economic development projects. Most recently, Ms. Lafferty assisted the City of Gunter, Texas with establishing a Tax Increment Reinvestment Zone for an area composed of a bankrupt residential development, in which the City had not seen any construction in over five years.

Ms. Lafferty obtained her *Juris Doctorate* degree from Southern Methodist University School of Law in 1996, and was honored with fellowship from the Maguire Center for Ethics and Public Responsibility. She obtained her Bachelors of Science degree with honors from the University of Texas at Austin.

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III. Property Tax Incentives

IV. Public Improvement Districts: Ch. 372 of the Texas Local Government Code

ECONOMIC DEVELOPMENT TOOLS

Article III Section 52-a of the Texas Constitution, adopted November 3, 1987, and entitled "Assistance to Encourage State Economic Development," declared as public purposes the development and diversification of the economy, the elimination of unemployment or underemployment, the stimulation of agricultural innovation, the fostering of the growth of enterprises based on agriculture, and the development or expansion of transportation or commerce, thereby authorizing the use of public money for economic development purposes. The Texas Legislature thereafter developed various economic development statutes, providing for retention or expansion of primary employment and the development, retention, and expansion of local business. This paper addresses several of the economic development tools available to municipalities.[1] Ultimately, a municipality should structure its economic development incentives in a way as to successfully achieve one or more of the goals stated in the applicable statute.

LOANS AND GRANTS OF PUBLIC FUNDS: CH. 380 OF THE TEX. LOCAL GOV'T CODE

Chapter 380 of the Texas Local Government Code grants municipalities broad discretion to make loans and grants of public funds or provision of public services (with or without cost) to promote local industrial, commercial, and retail business development.[2] Specifically, the statute authorizes a governing body to establish and provide for the administration of one or more programs to promote state or local economic development, and to stimulate business and commercial activity in the municipality.[3] A municipality may extend its economic development incentive program to its extra territorial jurisdiction and areas annexed by the municipality for a limited purpose.[4]

A municipality and a business prospect may tailor an economic development incentive agreement to address their unique needs. The Legislature intended Chapter 380 to authorize a municipality to implement any range of programs designed to promote economic development. Basically, the types of incentives offered are wholly discretionary with the municipality, provided: (1) the program serves a public purpose; (2) the projects are funded by current revenue or authorized debt; and (3) the municipality complies with its Charter and applicable statutes.

1. Public Purpose. Art. III, Section 52(a) of the Texas Constitution generally prohibits a municipality from lending its credit or granting public money or thing of value in aid of or to an individual or corporation.[5] Section 52-a, however, provides an exception to this general rule. The provision adopted in 1987 and amended in 2005, provided for the creation of programs and making of loans and grants of public money for the public purposes of:

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[1] The discussion of economic development tools in this paper does not address all the state and federal economic development programs available to municipalities. For further information regarding the programs addressed herein as well as the programs not discussed in this paper, see the Texas Attorney General Economic Development Handbook for Texas Cities at www.oag.state.tx.us/AG_Publications/pdfs/econdevhb2013.pdf.
[2] TEX. LOCAL GOV'T CODE § 380.001.
[3] TEX. LOCAL GOV'T CODE § 380.001.
[4] TEX. LOCAL GOV'T CODE § 380.001(a)(1) and (2).
[5] TEX. CONSTIT. art. III, § 52(a).

- Development and diversification of the economy of the state;
- The elimination of unemployment or underemployment in the state;
- The stimulation of agricultural innovation;
- The fostering of the growth of enterprises based on agriculture; or
- The development or expansion of transportation or commerce.[6]

A municipality that institutes a program to promote economic development under Chapter 380 must ensure that it complies with this public purpose requirement.[7] Municipalities, therefore, must include in the economic development agreement sufficient controls to guarantee that it is accomplishing a public purpose with the expenditure of public resources. Particularly, the agreement should: (1) condition the grant or loan incentive on the creation of employment, construction of improvements, continued operations for a stated period of time, and/or other public purpose; (2) contain tangible measures and milestones allowing the municipality to determine whether the public purpose is being served; and (3) require recapture of the grant or loan amount if the recipient does not fulfill the conditions of the grant.

2. Lawfully Available Funds. To fund grants or loans, the municipality may use funds derived from any source lawfully available to the municipality under its charter or other law, other than from the proceeds of bonds or other obligations of the municipality payable from ad valorem taxes.[8] City Council must approve all grants and loans made pursuant to Chapter 380, and should include the amount in the city budget or fund it through other authorized proceeds. Some municipalities include a specific allocation in their budgets for Chapter 380 grants.

Chapter 380 does not expressly authorize a municipality to finance an economic development incentive through the issuance of debt or bonds; however, a home-rule city can derive such authority from its charter. A home-rule city may issue bonds to the extent provided in the city charter *assuming that the bonds have been first authorized by voters in election held on the issue*. If the city charter is silent, a home-rule city must find other statutory authority that allows the issuance of bonds or debt to finance the economic development incentive.

A general law municipality may not issue debt without specific statutory authority. Without specific legislative authority contrary to Section 380.002(c) of the Texas Local Government Code, a general law municipality may only fund economic development programs through current city funds and revenues.

3. Compliance with Charter and Applicable Laws. A home rule municipality should review its charter for provisions that might restrict its ability to enter into an incentive agreement. While home-rule cities are authorized to take any action not prohibited by the Texas Constitution or statutes, the City Charter may limit such programs. General law municipalities, on the other hand, are only limited by state law, and must rely on a specific statute authorizing their action. Section 380.001 provides authority to create economic development incentive programs;

[6] TEX. CONSTIT. art. III, § 52-a.
[7] *See* Atty. Gen. Op. JM-1255 (1990)(Section 52-a did not change the requirements that public resources and powers be used for "the direct accomplishment of a public purpose" and that transactions using such resources and powers contain sufficient controls "to insure that the public purpose be carried out.")
[8] TEX. LOCAL GOV'T CODE § 380.002(c).

accordingly, if the municipality has available funds, it may provide a grant or loan to fulfill a public purpose.

Economic Development Incentive Program

Chapter 380 requires that, in order for a municipality to provide a loan or grant, it must establish a program.[9] A city may elect to have its program administered by use of municipal personnel or through contract with another entity, such as the federal government, a Type A or Type B Economic Development Corporation, or the Chamber of Commerce.[10] The statute does not provide any specific requirements for administration of the program; nevertheless, a municipality should adopt a written plan setting forth guidelines and policies, and describing the available economic development incentives and the criteria for eligibility. These guidelines and policies provide a framework for negotiating the agreement with the business prospect, and ensure that the project meets constitutional requirements.

In establishing its program(s), a municipality may provide for general incentives and criteria that allows for flexibility in the type of development eligible for consideration, or may set forth specifics that limit the types of incentives available and provide for strict eligibility criteria. Factors a municipality may want to consider addressing in its program include:

- the duration/number of years condition applies;
- maximum amount or limits on incentive;
- geographical limitations on restrictions based on zoning district;
- generation of certain levels of sales tax revenue;
- creation of a certain number and type of jobs;
- employment of local residents;
- restrict to certain types of industry or commercial activity;
- environmental restrictions;
- provision for required capital or infrastructure improvements;
- provision for required level of investment; and/or
- provision for required development standards.

A municipality would have to comply with any self-imposed limitations or restrictions included in its program.

Incentives

Neither Chapter 380 nor Article III, Section 52-a specifies the type of incentives that a municipality may include in a program to promote state or local economic development. The incentives offered are limitless, unless otherwise addressed in the law.[11] Incentives used by municipalities under Chapter 380 have included the following:

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[9] TEX. LOCAL GOV'T CODE § 380.001(a).
[10] *See* TEX. LOCAL GOV'T CODE § 380.001(b).
[11] For example, Chapter 1502 of the Government Code generally prohibits city-owned utilities from providing free utility services. *See* TEX. GOV'T CODE ANN. § 1502.057(b).

1. Funding for the renovation of shopping center or other business facilities conditioned on the generation of a certain level of sales tax revenue with the use of the sales tax revenue to fund the grant.
2. Use or loan of city personnel, equipment, and facilities for economic development projects.
3. Lease of city owned land or buildings to business.
4. Grant equivalent to refund/rebate of sales tax or property taxes to offset the absence of Freeport Exemption or tax abatement, or to provide more than 10 years of abatement.
5. Construction of roads, sewers, site or building improvements, or infrastructure improvements or funding for the same.
6. Waiver, reduction or credit against impact fees, parkland dedication fees, or other fees associated with construction and development.
7. Funding for business acquisition of real property, improvements, equipment, and fixtures.
8. Rent subsidies;
9. Funding for relocation expenses, landscaping or other amenities.
10. Acquisition of land, improvements, equipment or fixtures for business.
11. Funding for advertising, promotion, marketing, travel, travel expenses, billboards, or advertisements for business.
12. Providing or funding training and education for specific business or companies.
13. Sale of real property and improvements for less than fair market value through credit/ funding of purchase price for business.

CONTRACTUAL TERMS

Providing Chapter 380 economic development incentives through contracts allows a municipality to regulate growth and ensure quality construction and development in the community. A city may condition the incentive upon the creation of employment, construction of improvements, continued operations in a city for a stated period, or other public consideration. The agreement should, at a minimum, contain the following terms:[12]

1. Reference to Chapter 380, Texas Local Government Code;
2. Reference to Texas Constitution Article VIII, Section 52-a;
3. Reference to Economic Development guidelines;
4. Reference to job creation or retention, sales tax generation, added tax base, construction or development of specific project or other public consideration for the incentive;

[12] Following the 2005 amendment to Section 52-a of the Texas Constitution, the financial commitment by a municipality under a Chapter 380 agreement that does not contain a pledge of property taxes or financing through bonds is not a debt under art. VII, Section 5 of the Texas Constitution, thereby forgoing the necessity of an appropriations clause in the contract.

5. Condition the payment of the incentives on achieving milestones or performance standards;
6. Identify method of payment – loan, grant, or grant equivalent to tax abatement, Freeport or percentage of sales tax;
7. Contain one or more of the following:
    a. The kind, number and location of proposed improvements;
    b. Limit, control or restrict the use of the property to a specific development goal;
    c. Minimum taxable values of sales tax;
    d. Minimum term of occupancy or continued operations within a city;
    e. Occupancy by specific tenant, business, or activity or type thereof;
    f. Creation and maintenance of employment positions; and
    g. Required deed restrictions or land use controls.
8. Provide access to and authorize inspection of the property to ensure compliance with the agreement;
9. Require annual written certification that recipient is in compliance with the agreement;
10. Authorize the municipality to terminate or modify the agreement if recipient fails to comply with the agreement; and
11. Provide for the recapture of the grant or incentive, if recipient breaches the agreement.[13]

Cities throughout Texas have utilized Chapter 380 to attract businesses and jobs to their communities. The statute allows for implementation of progressive and innovative approaches to promote economic development in a community. Often, Chapter 380 Agreements are an effective tool for competing for new business or expansion of existing facilities when tax abatement and other economic incentive tools are not available.

ECONOMIC DEVELOPMENT SALES TAX: CH 501-505 OF THE TEX. LOCAL GOV'T CODE

The Development Corporation Act (the "Act") authorizes municipalities to create a nonprofit corporation funded by local sales tax revenue to promote and develop new and expanded business enterprises and job training. A municipality may adopt one-eighth, one-fourth, three-eighths or one-half of one percent sales tax for economic development.[14] Two options are available to a municipality to adopt this tax—Type A and Type B.

[13] Chapter 380 agreements provide for a variety of recapture provisions in the event of default. The city should have the right to seek reimbursement of the incentives that were provided if the business does not fulfill its obligations. The recapture of incentives for a breach must be significant enough to deter the recipient from breaching its contractual obligations and/or relocating to another jurisdiction that has offered greater incentives. In the absence of significant liquidated damages there is no incentive for business to continue to comply with the terms of the agreement and fulfill its obligations to promote economic development.

[14] TEX. LOCAL GOV'T CODE §§ 504.252(b), 505.252(b) (West Supp. 2011).

Most incorporated municipalities may impose a Type A sales tax, which an economic development corporation acting on behalf of a municipality may use to implement programs related to industrial development, business infrastructure, and the promotion of new and expanded business enterprises that create or retain primary jobs. All incorporated municipalities, however, may impose a Type B sales tax, which the economic development corporation may use on a wide variety of projects, including public parks and business development. Chapters 501 through 505 of the Texas Local Government Code govern the initiation of an economic development sales tax, the creation of economic development corporations, and the use of the economic development sales tax proceeds.

ADOPTION AND USE OF ECONOMIC SALES TAX

1. ***Eligibility***. The Development Corporation Act sets forth eligibility requirements for adopting an Economic Development Sales Tax.

a. *Eligibility to Adopt a Type A Sales Tax*. A municipality is eligible to adopt a Type A tax with voter approval if the new combined local sales tax would not exceed two percent and:[15]

- the municipality is located in a county with a population of fewer than 500,000; or
- the municipality has a population of less than 50,000 and is located within two or more counties, one of which has a population of 500,000 or more (Bexar, Dallas, El Paso, Harris, Hildago, Tarrant, or Travis); or
- the municipality has a population of less than 50,000 and has not elected to become part of the transit authority.[16]

b. *Eligibility to adopt a Type B Sales Tax*. A municipality may impose a Type B sales tax with voter approval if the new combined local sales tax rate would not exceed two percent and one of the following applies to the municipality:[17]

- the municipality is eligible to adopt a Type A sales tax;
- the municipality is located in a county with a population of 500,000 or more and the current combined state and local sales tax rate does not exceed 8.25 percent at the time the Type B sales tax is proposed;
- the municipality has a population of 400,00 or more and is located in more than one county, and the combined state and local sales tax rate does not exceed 8.25 percent.

By statute, every Texas municipality appears eligible to adopt a Type B sales tax, provided the city's combined local sales tax rate does not exceed two percent.

[15] *See* TEX. LOCAL GOV'T CODE §§ 504.002, 504.251, and 504.254(a).
[16] Participation in a rapid transit authority does not invalidate a municipality's ability to adopt a Type A tax if adoption of the tax would not place the municipality above its statutory cap for the local sales tax rate. TEX. LOCAL GOV'T CODE § 504.259; *see also* TEX. TRANSP. CODE ANN. § 452.6025 (West Supp. 2011)(authorizing the reduction of a Type A sales tax "to the highest rate that will not impair the imposition of the [regional transportation] authority's sales and use tax," if a majority of voters adopt a regional transportation authority proposition.)
[17] TEX. LOCAL GOV'T CODE §§ 505.002, 505.251.

2. ***Election to Adopt a Type A or Type B Sales Tax***. The initiation of an election to adopt a Type A or Type B economic development sales tax may occur either by city council approval of an ordinance calling for an election on the imposition of the tax, or by a petition signed by a number of qualified voters that equals at least 20 percent of the voters who voted in the most recent regular city election.[18] If the governing body receives a petition meeting the requirements, it must pass an ordinance to call an election on the imposition of the tax.[19] Generally, a municipality passes an ordinance calling for a Type A or Type B sales tax election on its own motion.

A municipality that orders an election for an economic development sales tax must follow all the applicable requirements in the Texas Election Code, the Municipal Sales and Use Tax Act (Chapter 321 of the Tax Code), and any other Texas statutes relating to elections.[20] The ballot for a Type A sales tax proposition must provide for or against the proposition, and use the following specific wording:[21]

> The adoption of a sales and use tax for the promotion and development of new and expanded enterprises at the rate of *(insert one-eighth, one-fourth, three-eighths, or one-half, as appropriate)* of one percent.

The ballot for a Type B sales tax proposition does not require any specific wording, but must specify the rate of tax to be adopted.[22]

Other considerations for inclusion on the ballot proposing an economic sales tax include the following:

a. *Limitation on duration of tax*. A municipality may include in the wording of the ballot proposition a limitation on the length of time in years that the municipality will impose the economic sales tax.[23] Once the voters approve a proposition with such a limit, the municipality may only extend the economic sales tax beyond the time limit if the municipality has an election and a majority of the qualified voters of the city voting in the election approve the extension or re-imposition of the economic sales tax.[24]

b. *Election to reduce or increase tax rate*. A municipality that has adopted a Type A sales tax may, in the same manner and by the same procedure for imposition of the tax, reduce

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[18] TEX. LOCAL GOV'T CODE §§ 504.255, 505.256 (West Supp. 2011); TEX. TAX CODE § 321.401(a) and (c) (West 2008).
[19] *Id.*
[20] TEX. LOCAL GOV'T CODE §§ 504.255, 505.256 (West Supp. 2011)(providing that Chapter 321 of the Texas Tax Code governs elections under Chapters 504 and 505 of the Texas Local Government Code); TEX. TAX CODE § 321.403 (West 2008)(providing that an election held under Chapter 321 of the Tax Code must be held on the next available uniform election date).
[21] TEX. LOCAL GOV'T CODE § 504.256.
[22] TEX. LOCAL GOV'T CODE § 505.254.
[23] *See* TEX. LOCAL GOV'T CODE §§ 504.257, 505.2565.
[24] TEX. LOCAL GOV'T CODE §§ 504.257(e), 505.2565(b).

or increase the tax rate.[25] The tax rate may be modified in increments of one-eighth of one percent, but cannot be reduced below one-eighth of one percent or increased more than one-half of one percent.[26] A municipality that holds an election to reduce or abolish a Type A sales tax at the same election may adopt a Type B sales tax.[27] The statute does not provide for the modification of a Type B sales tax after its initial adoption.

c. *Limiting Sales and Use Tax for Specific Project*. A municipality may limit the use of an economic sales tax to a specific project.[28] If voters approve such a limitation, the City may not broaden the purposes for which the economic development sales tax may be used unless it holds another election.[29] Generally, municipalities seek to broaden the uses for the economic sales tax, and this proposition is never used.

3. ***Creation of a Type A or Type B Economic Development Corporation***. Either the municipality or a group of citizens may initiate the creation of a Type A or Type B economic development corporation.[30] The initiation by citizens requires a group of three or more individuals who are qualified voters of the municipality to file a written application with the City requesting approval of an economic development corporation.[31] The municipality may not charge a fee for consideration of the application.[32] If the governing body determines that the creation of the corporation is advisable and approves the certificate of formation proposed for organizing the corporation, the municipality may create the corporation by resolution.[33] The certificate of formation must state either that the corporation is governed by Chapter 504 of the Local Government Code (Type A),[34] or Chapter 505 of the Texas Local Government Code (Type B),[35] and contain the following information:[36]

- the name of the corporation
- that the corporation is a nonprofit corporation;
- the duration of the corporation, which may be perpetual;
- the specific purpose for which the corporation is organized and may issue bonds on behalf of the unit;
- that the corporation has no members and is a nonstock corporation;
- any provision consistent with law for the regulation of the corporation's internal affairs, including any provision required or permitted by the statute to be stated in the bylaws;

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[25] TEX. LOCAL GOV'T CODE § 504.258(a); *but see* Tex. Atty Gen. Op. DM-137 (1992)(stating that if a reduction or limitation on an economic sales tax is approved in an election, the reduction or limitation may not apply to any bonds issued prior to the date of the election).
[26] TEX. LOCAL GOV'T CODE § 504.258(c).
[27] TEX. LOCAL GOV'T CODE § 505.255.
[28] *See* TEX. LOCAL GOV'T CODE §§ 504.260, 505.2575.
[29] *Id.*
[30] TEX. LOCAL GOV'T CODE §§ 501.051(a); 504.003(a); 505.003(a).
[31] TEX. LOCAL GOV'T CODE § 501.051(a).
[32] *Id.*
[33] TEX. LOCAL GOV'T CODE § 501.051(b).
[34] TEX. LOCAL GOV'T CODE § 504.004.
[35] TEX. LOCAL GOV'T CODE § 505.004
[36] TEX. LOCAL GOV'T CODE § 501.056.

- the street address of the corporation's initial registered office and the name of the corporation's initial registered agent;
- the number of directors of the initial board of directors, and the name and address of each;
- the name and street address of the organizer; and
- that the municipality has by resolution specifically authorized the corporation to act on the municipality's behalf to further the public purpose stated in the resolution and certificate of formation and approved the certificate of formation.

The municipality must file the certificate of incorporation with the Secretary of State as required by Section 501.057 of the Texas Local Government Code.[37] After issuance of a certificate establishing the filing of the certificate of incorporation, the board of directors must hold an organizational meeting to adopt the bylaws of the corporation and to elect officers.[38] The municipality must approve the bylaws by resolution.[39]

a. <u>*Board of Directors*</u>.

(1) *Type A*. At least a five-member board of directors governs a Type A corporation.[40] The city council appoints the directors by a majority vote at an open meeting for a term not to exceed six years.[41] The Act does not set forth any requirements or qualifications to serve as a director; however, the director serves without compensation and is only reimbursed for actual expenses incurred for handling corporation business.[42] The directors serve at the pleasure of the City Council, and may be removed prior to the end of their term without cause.[43]

(2) *Type B*. A Type B corporation is governed by a seven-member board of directors, who are appointed for a two-year term by a majority vote of the city council at an open meeting.[44] A Type B director must meet certain qualifications to serve as a director; a director of a Type B corporation created in a municipality with a population of 20,000 or more must be a resident of the city, and a director of a Type B corporation created in a municipality with a population of less than 20,000 must (1) be a resident of the city; (2) be a resident of the county in which a majority of the municipality is located; or (3) reside within 10 miles of the municipality and in a county that borders the county in which a majority of the municipality is located.[45] State law also provides that city officials or city employees cannot fill three of the seven positions.[46] Like a Type A corporation, the director serves without compensation, and is only reimbursed for actual expenses.[47] The

[37] TEX. LOCAL GOV'T CODE § 501.057.
[38] *See* TEX. LOCAL GOV'T CODE § 501.063. This section also requires that the directors receive notice of the first meeting by mail at least three days prior to the meeting.
[39] TEX. LOCAL GOV'T CODE §§ 501.064.
[40] TEX. LOCAL GOV'T CODE § 504.051(a).
[41] TEX. LOCAL GOV'T CODE § 504.051(c).
[42] TEX. LOCAL GOV'T CODE § 501.062(d).
[43] TEX. LOCAL GOV'T CODE §§ 501.062(c), 504.051(b).
[44] TEX. LOCAL GOV'T CODE § 505.051(a).
[45] TEX. LOCAL GOV'T CODE § 505.052.
[46] TEX. LOCAL GOV'T CODE § 505.052(c).
[47] TEX. LOCAL GOV'T CODE § 501.062(d).

directors serve at the pleasure of the City Council, and may be removed prior to the end of their term without cause.[48]

b. General provisions.

(1) A majority of the board constitutes a quorum.[49]

(2) The board of directors is subject to both the Open Meetings Act and the Public Information Act.[50]

(3) The Board must conduct all of its meetings within the municipality's corporate limits, unless the municipality is located in a county with a population of less than 30,000.[51] If the economic development corporation is located in a county with a population of less than 30,000, then the board may conduct its meetings within the county.[52]

(4) The Board is required to elect a president, a secretary, and any other officers that the governing body of the municipality considers necessary.[53]

(5) The corporation's registered agent must be a resident of Texas, and the corporation's registered office must be within the boundaries of the municipality.[54]

(6) The executive director of the economic development corporation, or other person who is responsible for the daily administration of the corporation, and either the city attorney, city administration, or city clerk must attend a training seminar once every 24-months.[55] The corporation may use Type A or Type B funds to pay for the costs of attending a seminar.[56] Failure to comply with this provision could result in an administrative penalty in an amount not to exceed $1,000.[57]

c. Powers and Duties of Type A and Type B Economic Development Corporations.

(1) *Power of Non-profit corporation*. The corporation has all the powers, privileges, and functions of a non-profit corporation under the Texas Non-Profit Corporation Act (Chapter 22 of the Texas Business Organizations Code), except to the extent such powers would conflict with or be inconsistent with the Development Corporations Act.[58]

(2) *Power to expend tax proceeds*. The economic development corporation may expend the proceeds of the economic development sales tax for purposes authorized by the Act,

[48] TEX. LOCAL GOV'T CODE §§ 501.062(c), 505.051(c).
[49] TEX. LOCAL GOV'T CODE §§ 504.053, 505.054.
[50] TEX. LOCAL GOV'T CODE §§ 501.072, 505.054.
[51] TEX. LOCAL GOV'T CODE §§ 504.054, 505.055.
[52] *Id.*
[53] TEX. LOCAL GOV'T CODE §§ 504.052, 505.053.
[54] TEX. LOCAL GOV'T CODE §§ 504.003(b), 505.003(b).
[55] TEX. LOCAL GOV'T CODE § 502.101(a).
[56] TEX. LOCAL GOV'T CODE § 502.101(d).
[57] TEX. LOCAL GOV'T CODE § 502.103(b).
[58] TEX. LOCAL GOV'T CODE § 501.054(a).

provided that a majority of both the Board of Directors and the City Council approves the expenditure.[59]

(3) *Financial Transaction Powers*. The corporation has the power to contract,[60] purchase property,[61] finance projects,[62] issue bonds,[63] lease or sell a project,[64] and make secured and unsecured loans.[65]

(4) *Limited Power to Own or Operate a Project*. An economic development corporation may not own or operate a project as a business, other than as a lessor, seller, or lender, or according to the requirements of any trust agreement securing a credit transaction.[66] This limitation, however, does not apply where the project is a military installation or military facility that has been closed or realigned.[67]

(5) *Eminent Domain Power*. A Type A corporation does not have authority to exercise the power of eminent domain, except by the action of City Council.[68] A Type B Corporation, on the other hand, may exercise eminent domain with approval of the action by the municipality and in accordance with and subject to the laws applicable to the municipality.[69]

(6) *Tort Claims Act Protection*. The economic development corporation directors and employees are not liable for damages arising out of the performance of governmental functions of the corporation.[70]

d. Limitation on financial obligations. An economic development corporation may not incur debt that cannot be paid from:[71]

(1) bond proceeds;

(2) revenue realized from the sale or lease of a project;

(3) revenue realized from a loan; or

(4) money granted from a municipality under a contract

e. Limitation on sales tax funds for promotional expenses. The Act limits Type A and Type B corporation spending for promotion purposes to no more than 10% of its current annual revenues in any given year.[72] However, unexpended revenues specifically set aside for promotional purposes in past years may be expended along with 10% of current revenues

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[59] TEX. LOCAL GOV'T CODE § 501.054(b)(2); *see also* Tex. Atty Gen. Op. JC-0488 (2002)(sales tax proceeds expended by board of directors subject to city council approval).
[60] TEX. LOCAL GOV'T CODE § 501.158.
[61] TEX. LOCAL GOV'T CODE § 501.101.
[62] TEX. LOCAL GOV'T CODE § 501.151.
[63] TEX. LOCAL GOV'T CODE § 501.201.
[64] TEX. LOCAL GOV'T CODE § 501.153.
[65] TEX. LOCAL GOV'T CODE § 501.155.
[66] TEX. LOCAL GOV'T CODE § 501.160(a).
[67] TEX. LOCAL GOV'T CODE § 501.160(d).
[68] TEX. LOCAL GOV'T CODE § 504.106.
[69] TEX. LOCAL GOV'T CODE § 505.105.
[70] TEX. LOCAL GOV'T CODE §§ 504.107, 505.106.
[71] TEX. LOCAL GOV'T CODE § 501.008.
[72] TEX. LOCAL GOV'T CODE §§ 504.105, 505.103.

without violating the cap.[73] The Act does not define "promotional purposes"; the Texas Attorney General, however, has determined that a promotional expenditure "must advertise or publicize the city for the purpose of developing new and expanded business enterprises."[74]

4. ***Economic Development Corporation Projects***. The Development Corporation Act provides a wide variety of "authorized projects" for which an economic development corporation may expend economic sales tax proceeds.

a. *Projects related to creation or retention of primary jobs*[75]. The Act specifically allows funding for land, buildings, equipment, facilities, expenditures, targeted infrastructure, and improvements that are for creation or retention of primary jobs and found by the Board of Directors to be required or suitable for the development, retention, or expansion of:[76]

- Manufacturing and Industrial Facilities
- Research and Development Facilities
- Military Facilities
- Transportation Facilities
- Sewage or Solid Waste Disposal Facilities
- Recycling Facilities
- Air or Water Pollution Control Facilities
- Facilities for Furnishing Water to the Public
- Distribution Centers
- Small Warehouse Facilities
- Primary Job Training Facilities
- Regional or National Corporate Headquarters

Type B corporations only may also provide land, buildings, equipment, facilities, and improvements found by the Board of Directors to promote or develop new or expanded business enterprises that create or retain primary jobs, including projects to provide public safety facilities, streets and roads, drainage and related improvements, demolition of existing structures, general municipally owned improvements, and any improvements or facilities related to a project described above or that the board in its discretion determines promotes or develops new or expanded business enterprises that create or retain primary jobs.[77]

b. *Projects without requirement of creating or retaining primary jobs*. The Act authorizes the following projects without the condition of creating or retaining primary jobs:

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[73] *See* Tex. Atty. Gen. Op. GA-0086 (2003).
[74] *Id.*
[75] "Primary job" means a job that is available at a company for which a majority of the company's products or services are ultimately exported to regional, statewide, national, or international markets, infusing money into the local economy, and are included in one of the North American Industry Classification Sectors set forth in Section 501.002(12)(A)(iii) or (B). *See* TEX. LOCAL GOV'T CODE § 501.002(12).
[76] TEX. LOCAL GOV'T CODE § 501.101.
[77] TEX. LOCAL GOV'T CODE § 505.155.

(1) *Projects related to certain job training*. Project includes job training required or suitable for the promotion of development and expansion of business enterprises.[78]

(2) *Certain Infrastructure Improvement Projects*. Project includes expenditures that are found by the Board of Directors to be required or suitable for infrastructure necessary to promote or develop new or expanded business enterprises, limited to:[79]

- Streets and roads, rail spurs, water and sewer utilities, electric utilities, or gas utilities, drainage, site improvements, and related improvements;
- Telecommunications and Internet improvements; or
- Beach remediation along the Gulf of Mexico.

(3) *Career Center Projects Outside of Junior College District*. Project includes the land, buildings, equipment, facilities, improvements, and expenditures found by the Board of Directors to be required or suitable for use for a career center, if the area to be benefitted by the career center is not located in the taxing jurisdiction of a junior college district.[80]

(4) *Mass Transit-Related Facilities*. As authorized by the Board of Directors, a Type A or Type B corporation may expend tax revenue received under the Act for the development, improvement, expansion or maintenance of facilities relating to the operation of commuter rail, light rail, or motor buses.[81]

(5) *Airport Facilities or Other Projects Authorized by Certain Border Municipalities*. A Type A or Type B corporation authorized by a municipality, any part of which is located within 25 miles of an international border, may fund a project that includes land, buildings, facilities, infrastructure, and improvements that:[82]

(a) the Board of Directors finds are required or suitable for the development or expansion of airport facilities, or

(b) are undertaken by the corporation where the municipality at the time the corporation approves the project has a population of less than 50,000 or an average rate of unemployment greater than the state average for unemployment during the most recent 12-month period.

In addition to these projects, a Type A corporation only may also undertake projects concerning business airports and port-related facilities without the requirement of creating or retaining primary jobs.[83]

c. *Projects authorized for Type B Corporations only that do not require the creation or retention of primary jobs*. Sections 505.152 through Section 505.154 of the Texas Local Government Code specifically authorizes expenditures of Type B sales tax proceeds for land, buildings, equipment, expenditures and improvements required or suitable for the following projects:

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[78] TEX. LOCAL GOV'T CODE § 501.102; *see also* TEX. LOCAL GOV'T CODE § 501.162.
[79] TEX. LOCAL GOV'T CODE § 501.103.
[80] TEX. LOCAL GOV'T CODE § 501.105.
[81] TEX. LOCAL GOV'T CODE § 502.052.
[82] TEX. LOCAL GOV'T CODE § 501.106.
[83] TEX. LOCAL GOV'T CODE § 504.103.

(1) *Recreational or Community Facilities*. Projects include:[84]

- professional and amateur sports facilities, including stadiums and ballparks
- entertainment, tourist, and convention facilities, including auditoriums, amphitheaters, concert halls, museums and exhibition facilities
- parks, park facility, and open space improvements

(2) *Affordable Housing*. Projects for promotion of development and expansion of affordable housing.[85]

(3) *Water Supply Facilities and Water Conservation Programs*. Projects for:[86]

- Development or improvement of water supply facilities, including dams, transmission lines, well field developments, and other water supply alternatives; or
- Development and institution of water conservation programs, including incentives to install water-saving plumbing fixtures, educational programs, brush control programs, and programs to replace malfunctioning or leaking water lines and other water facilities.

Note: A project for water supply facilities or water conservation requires a majority of the qualified voters of the municipality voting in an election called for the purpose to approve the project.[87]

(4) *Airport Facilities*. Projects related to development or expansion of airport or railport facilities, including hangars, maintenance and repair facilities, cargo facilities, and related infrastructure located on or adjacent to an airport or railport facility, provided the corporation:[88]

a. Enters into a development agreement with an entity in which the entity acquires a leasehold or other possessory interest from the corporation and is authorized to sublease the entity's interest for other projects authorized by this section; and

b. The municipal governing body has authorized the development agreement by adopting a resolution at a meeting called as authorized by law.

(5) *Business Enterprises in Certain Municipalities*. Projects for development, retention, or expansion of business enterprises in municipalities that have not generated more than $50,000 in sales and use tax revenues in the preceding two fiscal years, and that city council authorizes the project by adopting a resolution following two separate readings conducted at least one week apart.[89]

(6) *Business enterprises in Landlocked Communities*. Projects for development of manufacturing or industrial facilities for a municipality wholly or partly located in a county with a population of two million or more and has within its municipal limits and extraterritorial jurisdiction less than 100 acres that can be used for the development of

[84] TEX. LOCAL GOV'T CODE § 505.152.
[85] TEX. LOCAL GOV'T CODE § 505.153.
[86] TEX. LOCAL GOV'T CODE § 505.154.
[87] TEX. LOCAL GOV'T CODE § 505.304.
[88] TEX. LOCAL GOV'T CODE § 505.1561.
[89] TEX. LOCAL GOV'T CODE § 505.156.

manufacturing or industrial facilities in accordance with zoning laws or land use restrictions of the municipality. Projects may also include expenditures related to the promotion of new or expanded business enterprises within the landlocked community.[90]

(7) *Business Development in Certain Small Municipalities*. Projects for promotion of new or expanded business development in a municipality with a population of 20,000 or less, provided that, for projects which require an expenditure of more than $10,000, the city council authorizes by adopting a resolution following two separate readings.[91]

d. *Use of Type A Tax for Type B projects*. By an election, voters of an area may approve the use of Type A economic development sales tax funds for a project authorized under Chapter 505 of the Texas Local Government Code. The municipality must conduct a public hearing on the issue prior to the election, at which the municipality's residents must receive information regarding the estimated cost and impact of the proposed project or category of projects. The municipality must publish notice in a newspaper of general circulation in the municipality at least 30 days before the date set for the hearing. In the election, the municipality must identify on separate ballot propositions the particular Type B project(s) or category of Type B projects for voter approval. Additionally, if the Type A funds will pay maintenance and operating costs, and not just initial construction costs, then the ballot proposition for the Type B project must state that fact.

e. *Projects for Sports Venue Facilities*. Type A and Type B funds may fund "sports venue" projects, provided the project meets certain requirements and the development corporation follows certain procedures. The requirements for a "sports venue" project are set forth in Sections 504.151, *et seq.* and 505.201, *et seq*. of the Texas Local Government Code.

5. ***Performance Agreement.*** An economic development corporation may not provide a direct incentive to or make an expenditure on behalf of a business under a project provided for by the Act, unless the corporation enters into a performance agreement with the business enterprise.[92] A performance agreement between a corporation and business enterprise must:[93]

a. provide, at a minimum, for a schedule of additional payroll or jobs to be created or retained and capital investment to be made as consideration for any direct incentives provided or expenditures made by the corporation under the agreement; and
b. specify the terms under which repayment must be made if the business enterprise does not meet the performance requirements specified in the agreement.

The Act does not establish any minimum payroll or job requirements (other than being a primary job), nor does the Act require the repayment of the incentive in the event the business does not meet the performance standards. Additionally, in regard to the repayment of the incentive there are no statutorily imposed conditions under which the development corporation must require repayment of the incentive.

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[90] TEX. LOCAL GOV'T CODE § 505.157.
[91] TEX. LOCAL GOV'T CODE § 505.158.
[92] TEX. LOCAL GOV'T CODE § 501.158.
[93] *Id.*

6. ***Specific Requirements for a Type B Corporation to Expend Type B Tax Proceeds***.

   a. *Hearing required*. A Type B corporation shall hold at least one public hearing on a proposed project before spending money to undertake the project.[94] This requirement does not apply to a Type B corporation whose authorizing municipality has a population of less than 20,000 and the proposed project is defined by Subchapter C, Chapter 501.[95]

   b. *Election Requirement*. A Type B corporation may undertake a project unless, not later than the 60th day after the date of notice of the specific project or general type of project is first published, the governing body receives a petition from more than 10% of the registered voters of the municipality requesting an election before the specific project or general project is undertaken.[96] The municipality is not required to hold an election if the voters of the municipality previously approved the undertaking of the specific project or general type of project.[97]

7. ***Annual Report***. Not later than February 1st of each year, the Board of Directors of an economic development corporation must submit a report to the Texas Comptroller, which includes a statement of the corporations primary economic development objectives; the corporation's total revenue during the preceding fiscal year; the corporation's total expenditures during the preceding fiscal year; and the corporation's total expenditures during the preceding fiscal year in the categories of administration, personnel, marketing or promotion, direct business incentives, job training, debt service, capital costs, affordable housing, and payments to taxing units; a list of the corporation's capital assets; and any other information the comptroller requires to determine the use of the sales and use tax imposed under Chapter 504 or Chapter 505.[98]

III.
PROPERTY TAX INCENTIVES

A.
TAX ABATEMENT

A tax abatement is an agreement between a taxing unit and a property owner that exempts all or part of an increase in the value of real property and/or tangible personal property from taxation for a period not to exceed 10 years. Municipalities often use this traditional economic tool to attract new business and encourage the retention and expansion of existing businesses. The Texas Legislature in 2009 re-authorized the continued use by local governments of tax abatements until September 1, 2019.[99] Chapter 312 of the Texas Tax Code, the *Property Redevelopment and Tax Abatement Act*, governs tax abatements.

[94] TEX. LOCAL GOV'T CODE § 505.159(a).
[95] TEX. LOCAL GOV'T CODE § 505.159(b).
[96] TEX. LOCAL GOV'T CODE § 505.160(a).
[97] TEX. LOCAL GOV'T CODE § 505.160(b).
[98] TEX. LOCAL GOV'T CODE § 502.151.
[99] TEX. TAX. CODE ANN. § 312.006 (West Supp. 2011).

Incorporated municipalities, counties, and special districts may enter into a tax abatement agreement under Chapter 312 of the Texas Tax Code; school districts, however, may not enter into tax abatement under the chapter.[100] Each taxing unit[101] that wants to consider tax abatement agreements must first establish guidelines and criteria governing tax abatement agreements and adopt a resolution stating that the taxing unit intends to participate in tax abatement agreements.[102] The taxing unit may not enter into tax abatement under Chapter 312 unless it finds that the terms of the agreement and the property subject to the agreement meet the applicable guidelines and criteria adopted by the governing body.

PROCESS TO PARTICIPATE IN A TAX ABATEMENT AGREEMENT

1. ***Approve a resolution stating intent to participate in tax abatement***. A municipality may not enter into a tax abatement agreement and a municipality's governing body may not designate an area as a reinvestment zone unless the governing body has passed a resolution stating that the taxing unit elects to become eligible to participate in tax abatement.[103] The resolution need merely indicate the municipality's intent to consider providing tax abatements. By adopting the resolution, the governing body does not bind the municipality to grant approval of any proposed agreement.

2. ***Adopt guidelines and criteria governing tax abatement agreements***. A municipality must also adopt guidelines and criteria setting forth the conditions under which property is eligible for tax abatement and terms for tax abatement.[104] The guidelines and criteria must provide for the availability of tax abatement for both new facilities and structures and for the expansion or modernization of existing facilities and structures.[105] The guidelines and criteria are effective for two years from the date of adoption.[106] During that period, a governing body may only amend or repeal the guidelines and criteria by a vote of three-fourths of the members of the governing body.[107]

The adoption of guidelines and criteria by the governing body does not limit the discretion of the governing body to decide whether to enter into a specific tax abatement agreement.[108] This action also does not create any property, contract, or other legal right in any person to have the governing body consider or grant a particular application or request for tax abatement.[109] Rather, it merely sets forth the conditions under which the governing body may consider tax abatement.

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[100] TEX. TAX. CODE ANN. § 312.002(f) (West 2008). Instead, a school district may limit appraised values and provide tax credits under Chapter 313 of the Texas Tax Code, the *Texas Economic Development Act*. *See* TEX. TAX CODE ANN. Ch. 313 (West 2008 and West Supp. 2011).
[101] For purposes of Chapter 312, "taxing Unit" means a county, an incorporated city or town (including a home-rule city), a special district or authority or other political unit of the state, except a school district, that is authorized to impose and imposes ad valorem taxes on property. *See* TEX. TAX. CODE ANN. § 312.002(g) (West 2008).
[102] TEX. TAX. CODE ANN. § 312.002(a) (West 2008).

[103] TEX. TAX. CODE ANN. § 312.002(a) (West 2008).
[104] TEX. TAX. CODE ANN. § 312.002(b) (West 2008).
[105] TEX. TAX. CODE ANN. § 312.002(a) (West 2008).
[106] TEX. TAX. CODE ANN. § 312.002(c) (West 2008).
[107] TEX. TAX. CODE ANN. § 312.002(c) (West 2008).
[108] TEX. TAX. CODE ANN. § 312.002(d)(1) (West 2008).
[109] TEX. TAX. CODE ANN. § 312.002(d)(3) (West 2008).

The criteria and guidelines usually address the following:

- the duration tax abatement is available;
- the percentage of taxes or value subject to abatement;
- the maximum amount or limit of tax abatement;
- the geographical areas or zoning districts subject to tax abatement;
- the types of industry or development subject to tax abatement;
- a minimum capital investment;
- minimum sales tax revenue generation requirements:
- creation or maintenance of a certain number and types of jobs;
- the employment of local residents;
- requirement to contract with minority or woman-owned businesses and/or local merchants;
- requirement for certain infrastructure improvements;
- imposition of environmental restrictions;
- the imposition of landscaping or other development upgrades; and
- a minimum occupancy or presence in the taxing unit

Additionally, the guidelines and criteria generally require the submission of a formal application for tax abatement, along with supporting information, including but not limited to: (a) a legal description of the land; (b) sales tax impact; (c) projected number of jobs created and/or maintained; (d) projected capital investment; (e) financial information; (f) applicant's experience and credentials; (g) a description of the proposed project; and (h) an explanation of how the applicant meets and satisfies the guidelines and criteria for tax abatement.[110]

3. ***Designate a Reinvestment Zone for Tax Abatement***. A municipality by ordinance may designate as a reinvestment zone an area within its territorial jurisdiction or extraterritorial jurisdiction that satisfies one of the following criteria:[111]

(1) Area in its present condition and use that substantially arrests or impairs the sound growth of the municipality, retards the provision of housing accommodations, or constitutes an economic or social liability and menace to the public health, safety, morale, or welfare because of the presence of:

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[110] The applicant should ensure that any information provided to the taxing unit does not contain any trade secrets or other confidential information. The taxing units are subject to the Public Information Act, Texas Government Code, Chapter 552; and may not be able to maintain the confidentiality of the applicant's information indefinitely. *See* TEX. TAX. CODE ANN. § 312.003 (West 2008).
[111] TEX. TAX. CODE ANN. § 312.202(a)(West 2008).

a) a substantial number of substandard, slum, deteriorated, or deteriorating structures;

b) predominance of defective or inadequate sidewalks or streets;

c) faulty size, adequacy, accessibility, or usefulness of lots;

d) unsanitary or unsafe conditions;

e) deterioration of site or other improvements;

f) tax or special assessment delinquency exceeding the fair value of the land;

g) defective or unusual conditions of title;

h) conditions that endanger life or property by fire or other cause; or

i) any combination of these factors.

(2) Area is predominantly open and, because of obsolete platting, deterioration of structures or site improvements, or other factors, substantially impair or arrest the sound growth of the municipality.

(3) Area is within or adjacent to a federally assisted new community located in a home-rule city, or the entire area meets the requirements for federal assistance under Section 119 of the Housing and Community Development Act of 1974;

(4) Area encompasses signs, billboards, or other outdoor advertising structures designated by the governing body of the municipality for relocation, reconstruction, or removal for purpose of enhancing the physical environment of the municipality;

(5) Area reasonably likely as a result of the designation to contribute to the retention or expansion of primary employment or to attract major investment in the zone that would benefit the property and contribute to the economic development of the municipality.

The ordinance must describe the boundaries of the zone and the eligibility of the zone for residential tax abatement or commercial-industrial tax abatement or tax increment financing (discussed in Section B).[112] The zone may include multiple tracts of land or be limited to the specific property for which the applicant has requested abatement.[113] Large zones usually target particular areas for development.

The statute does not prescribe any shape or size for a reinvestment zone. The Texas Attorney General, however, has opined that the area for a reinvestment zone must be contiguous and

[112] *See* TEX. TAX. CODE ANN. § 312.201(b)

[113] If a reinvestment zone includes several properties, each tax abatement agreement between a taxing unit and owners of property in the same tax abatement reinvestment zone must contain identical terms relating to the duration and amount of value that is to be exempt. *See* TEX. TAX. CODE ANN. § 312.204(b). Please note that the taxing unit is not obligated to grant a tax abatement to the property owner. Also, tax abatement agreements between a property owner and other taxing units for property in the same tax abatement reinvestment zone do not have to contain the identical terms relating to the duration and the amount of value that is to be exempt.

include the underlying land.[114] Once a reinvestment zone is officially designated, there is no authority to modify its boundaries.

The designation of a reinvestment zone for residential or commercial-industrial tax abatement expires five years after the date of the designation, and is renewable for periods not to exceed five years.[115] The term of a tax abatement agreement may continue up to 10 years, even if the reinvestment zone is not renewed after the initial five-year term.[116]

The designation of an area as an enterprise zone under Texas Government Code Chapter 2303, the *Texas Enterprise Zone Act*, also constitutes a designation of an area as a reinvestment zone.[117] Reinvestment zones that are enterprise zones are effective for the seven-year duration of the enterprise zone. An applicant receiving tax abatement in an enterprise zone must meet the administrative requirements for a tax abatement agreement under Chapter 312 of the Texas Tax Code.

a. *Notification of public hearing regarding reinvestment zone*. Before the governing body may adopt an ordinance designating a reinvestment zone, it must hold a public hearing.[118] The municipality at least seven days before the hearing must send written notice to the presiding officer of each of the other taxing units that has taxing jurisdiction over real property within the zone.[119] The municipality at least seven days before the hearing must also publish notice of the hearing in a newspaper of general circulation in the municipality.[120] There is not statutorily required wording for either of these notices.

b. *Public hearing on reinvestment zone*. During the public hearing on the reinvestment zone, the governing body should consider whether the improvements sought are feasible and practical, and would benefit the zone after the expiration of the tax abatement. The governing body should also determine whether the zone meets one of the applicable criteria for reinvestment zones. The criterion most often cited is that the reinvestment zone's designation is reasonably likely to contribute to the retention or expansion of primary employment or would attract major investment to the zone. At the hearing, interested persons are entitled to speak and present evidence for or against the designation.[121]

c. *Approve Reinvestment Zone*. The governing body prior to designating a reinvestment zone by ordinance must first make and approve findings that: (a) the improvements sought are feasible and practical, and would benefit the reinvestment zone after the expiration of the tax abatement agreement, and (b) the area meets one of the applicable

[114] Tex. Atty Gen. Op. DM-456 (1997)(a reinvestment zone under Chapter 312 must be contiguous and may not consist of only a portion of a building.)
[115] TEX. TAX. CODE ANN. § 312.203.
[116] TEX. TAX. CODE ANN. §§ 312.203, 312.204(a) and (c)(West 2008).
[117] TEX. TAX. CODE ANN. § 312.2011 (West 2008).
[118] TEX. TAX. CODE ANN. § 312.201(d).
[119] TEX. TAX. CODE ANN. § 312.201(d).
[120] TEX. TAX. CODE ANN. § 312.201(d)(West 2008).
[121] TEX. TAX. CODE ANN. § 312.201(d)(West 2008).

criteria for reinvestment zones.[122] The governing body should have the findings noted in the meeting minutes.

4. ***Written notice of intent to grant tax abatement***. At least seven days before a municipality enters into a tax abatement agreement, the governing body shall deliver to the presiding officer of the governing body of each other taxing unit in which the property subject to the agreement is located, written notice that the municipality intends to enter into the agreement.[123] The notice must include a copy of the proposed agreement.[124]

5. ***Approve tax abatement agreement at regularly scheduled meeting***. To be effective, a majority of the members of the governing body of a municipality must approve the tax abatement agreement by an affirmative vote at a regularly scheduled meeting. [125] The governing body, therefore, may not consider the agreement at a specially called or emergency meeting.

During the meeting in which the tax abatement agreement is considered, the governing body must make a finding that the terms of the agreement and the property subject to the agreement meet the applicable guidelines and criteria.[126] The governing body after approval of the agreement will execute the tax abatement agreement in the same manner as other contracts entered into by the applicable taxing unit.[127]

Property within the reinvestment zone owned or leased by a member of the municipality's governing body or planning and zoning board or commission is not eligible for tax abatement.[128] If the owner or lessee of the property has entered into a tax abatement agreement and subsequently becomes a member of the governing body or planning and zoning board or commission, the property owner does not lose the benefit of the tax abatement agreement.[129]

6. ***Other taxing units may elect to enter into an abatement agreement***. If a municipality executes a tax abatement agreement for property located within the municipality, the other taxing units may also execute a written tax abatement agreement.[130] Each taxing unit may adopt a tax abatement agreement with terms that differ from the agreement adopted by the municipality.[131] The other taxing units do not have a deadline to execute their agreements, and may elect not to enter into an agreement.[132]

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[122] TEX. TAX. CODE ANN. § 312.201(d)(West 2008).
[123] TEX. TAX. CODE ANN. § 312.2041.
[124] TEX. TAX. CODE ANN. § 312.2041.
[125] TAX. CODE ANN. § 312.207.
[126] TAX. CODE ANN. § 312.002(b).
[127] TAX. CODE ANN. § 312.207(b).
[128] TAX. CODE ANN. § 312.204(d).
[129] TAX. CODE ANN. § 312.204(d).
[130] TAX. CODE ANN. § 312.206(a).
[131] TAX. CODE ANN. § 312.206(a).
[132] TAX. CODE ANN. § 312.206(a).

TAX ABATEMENT AGREEMENT

A tax abatement agreement may exempt from taxation all or part of the *increase* in the value of the real property, leasehold interest, or fixture for each year covered by the agreement, provided the property owner makes specific improvements or repairs to the property.[133] The exemption only applies to the extent that the property's value for the year exceeds its value for the year in which the agreement was executed ("Base Value"); the real property's Base Value may not be exempted from taxation.[134] The Base Value is the taxable value of the real property and any fixed improvements as of January 1st of the year of the tax abatement agreement.[135]

A tax abatement may not exceed a period of 10 years.[136] The statute, however, permits a property owner to defer the beginning of the abatement period until a date in the future other than the January following execution of the agreement.[137]

Section 312.205(a) of the Texas Tax Code sets forth certain mandatory provisions for a tax abatement agreement. A tax abatement agreement must:[138]

(1) List the kind, number, and location of all proposed improvements of the property;

(2) Provide access to and authorize inspection of the property by municipal employees to ensure that the improvements or repairs are made according to the specifications and conditions of the agreement;

(3) Limit the uses of the property consistent with the general purpose of encouraging development or redevelopment of the zone during the period that the property tax exemptions are in effect;

(4) Provide for recapturing property tax revenue lost as a result of the agreement if the owner of the property fails to make the improvements or repairs as provided by the agreement;

(5) Contain each term agreed to by the owner of the property;

(6) Require the owner of the property to certify annually to the governing body of each taxing unit that the owner is in compliance with each applicable term of the agreement; and

(7) Provide that the governing body of the municipality may cancel or modify the agreement if the property owner fails to comply with the agreement.

Section 312.205(b) of the Texas Tax Code provides a list of optional provisions that a municipality may include in the tax abatement agreement, which include provisions for:

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[133] TAX. CODE ANN. § 312.204(a) (West 2008).
[134] *See* TAX. CODE ANN. § 312.204(a).
[135] Accordingly, if at the time of execution of the contract, the Base Value for the property was $100,000, and in subsequent years the property increased in value to $500,000 due to improvements and repairs made by the property owner, the property owner would be entitled to an abatement on $400,000—the amount that exceeds the Base Value.
[136] TAX. CODE ANN. § 312.204(a) (West 2008).
[137] TAX. CODE ANN. § 312.007(b) (West Supp. 2011).
[138] TAX. CODE ANN. § 312.205(a).

(1) Improvements or repairs by the municipality to streets, sidewalks, and utility services or facilities associated with the property, except that the agreement may not provide for lower charges or rates than are made for other services or properties of similar character;

(2) An economic feasibility study, including a detailed list of estimated improvements costs, a description of the methods of financing all estimated costs, and the time when related costs or monetary obligations are to be incurred;

(3) A map showing existing uses and conditions of real property in the reinvestment zone;

(4) A map showing proposed improvements and uses in the reinvestment zone;

(5) Proposed changes of zoning ordinances, the master plan, the map, building codes, and city ordinances; and

(6) The recapture of all or a portion of property tax revenue lost as a result of the agreement if the owner of the property fails to create all or a portion of the number of new jobs provided by the agreement, if the appraised value of the property subject to the agreement does not attain a value specified in the agreement, or if the owner fails to meet any other performance criteria provided by the agreement, and payment of a penalty or interest, or both, on that recaptured property tax revenue.

Although the tax abatement reinvestment zone may not be altered, a tax abatement agreement may be amended during the term of the agreement to include any term or condition that could have originally been included.[139] However, the amendment may not be retroactive.[140]

What types of property are eligible for tax abatement?

Land, buildings, improvements, tangible personal property (machinery, equipment, furniture, fixtures, vehicles, inventory, and supplies) and leasehold interests in exempt and non-exempt property.

May a city abate property taxes for more than 10 years?

The maximum time period for abatement of taxes for property is 10 years. A municipality may not grant tax abatement for property that was the subject of a previous ten-year tax abatement agreement.[141] A city may, however, effectively grant additional years of tax abatement by providing annual economic development grants equivalent to the amount of taxes that would have been abated through a Section 380 agreement.[142]

Who may qualify for tax abatement?

Certain eligible taxing units may enter into a tax abatement agreement with the owner of taxable real property, the owner of a leasehold interest on tax-exempt real property, or lessees of taxable

[139] *See* TEXAS TAX CODE § 312.208.
[140] *See* Tex. Atty Gen. Op. GA-0134 (2004).

[141] *See* Tex. Atty. Gen. Op. JC-0133 (1999).
[142] *See* TEX. LOCAL GOVT. CODE §380.001.

real property.[143] The tax exemption may include a portion of the real property's value, the tangible personal property's value that is located on the real property, or both.[144]

B.
TAX INCREMENT FINANCING

Tax increment financing ("TIF") is an economic development tool that a municipality may use to publicly finance needed structural improvements and enhanced infrastructure within a reinvestment zone. The improvements constructed in a TIF zone are intended to stimulate growth and development in the area, attract new business to the area, and to promote and encourage the development, redevelopment and expansion of existing business in the area. The cost of the improvements is repaid by the contribution of future tax revenues. Chapter 311 of the Texas Tax Code governs tax increment financing.

Only a municipality or a county may establish tax increment financing.[145] Each taxing unit may chose to dedicate all, a portion of, or none of the tax revenue attributable to the increase in property value resulting from the improvements for repayment of the cost of financing the public improvements.

Similar to a tax abatement agreement, TIF establishes a base tax value for property in the reinvestment zone,[146] and the tax revenue generated from property in the zone in excess of the base value is considered the "tax increment."[147] The costs of the improvements in the reinvestment zone are paid from a specific allocated portion of the tax increment. Basically, the taxing unit projects ad valorem tax revenue will increase in the reinvestment zone as a result of the added improvements and enhanced infrastructure, and dedicates a portion of this increase in tax revenue from the property within the reinvestment zone for repayment of the costs for the improvements and infrastructure. By using TIF, the costs for improvements in the reinvestment zone are financed by an increase in the taxable value of real property in the zone rather than property taxes of property owners and taxpayers outside the tax increment zone who did not directly benefit from the improvements.

CREATING A TIF

1. ***Designate reinvestment zone***. The governing body of a municipality by ordinance may designate a contiguous or noncontiguous geographic area that is in the municipality's corporate limits, the municipality's extraterritorial jurisdiction, or both as a reinvestment zone to promote development or redevelopment of the area if the governing body determines that development or redevelopment would not occur solely through private investment in the reasonably foreseeable future.[148]

[143] *See* TEX. TAX CODE ANN. §312.204(a); *see also*, Tex. Atty Gen. Op. GA-0600 (2008).
[144] TEX. TAX CODE ANN. §312.204(a).
[145] TEX. TAX CODE ANN. §311.003 (West Supp. 2011).
[146] A municipality may, but is not required to contribute municipal sales tax to the TIF fund.
[147] TEX. TAX CODE ANN. §311.012.
[148] TEX. TAX CODE ANN. §311.003.

a. *Criteria for reinvestment zone*. To be designated as a reinvestment zone, an area must:[149]

(1) substantially arrest or impair the sound growth of the municipality designating the zone, retard the provision of housing accommodations, or constitute an economic or social liability and menace to the public health, safety, morale, or welfare because of the presence of:

   (a) a substantial number of substandard, slum, deteriorated, or deteriorating structures;

   (b) the predominance of defective or inadequate sidewalk or street layout;

   (c) faulty lot layout in relation to size, adequacy, accessibility, or usefulness of lots;

   (d) unsanitary or unsafe conditions;

   (e) the deterioration of the site or other improvements;

   (f) tax or special assessment delinquency exceeding the fair value of the land;

   (g) defective or unusual conditions of title;

   (h) conditions that endanger life or property by fire or other cause; or

   (i) structures, other than single-family residential structures, less than 10 percent of the square footage of which has been used for commercial, industrial, or residential purposes during the preceding 12 years, if the municipality has a population of 100,000 or more.

(2) Be predominantly open or undeveloped and, because of obsolete platting, deterioration of structures or site improvements, or other factors, substantially impair or arrest the sound growth of the municipality.

(3) Be a federally assisted new community located in the municipality or in an area immediately adjacent to a federally assisted new community; or

(4) Be an area described in a petition requesting that the area be designated as a reinvestment zone, if the petition is submitted to the governing body of the municipality by the owners of property constituting at least 50 percent of the appraised value of the property in the area according to the most recent certified appraisal roll for the county in which the area is located.

The governing body of a municipality may also designate as a reinvestment zone an area in which the proposed project plan for a potential area includes the use of land in the zone in connection with the operation of an existing or proposed regional commuter or mass transit rail system, or for a structure or facility that is necessary, useful, or beneficial to such a regional rail system.[150]

A court will give deference to a governing body's decision to create a reinvestment zone under the first or second criteria listed above should a challenge to the creation of the zone occur. Unless the decision is arbitrary or capricious, willful and unreasoned, or taken without

[149] TEX. TAX CODE ANN. §311.005(a).

[150] TEX. TAX CODE ANN. §311.005(a-1).

consideration and in disregard of the facts and circumstances, the Court will uphold the governing body's decision.[151]

b. *Restrictions on Composition of Reinvestment Zone*. A municipality may not create a reinvestment zone if:[152]

(1) More than 30% of the property in the proposed zone, excluding property that is publically owned, is used for residential purposes (*this provision does not apply to a reinvestment zone created by petition of the owners of property in the zone[153]);

(2) The total appraised value of taxable property in the proposed zone and in existing reinvestment zones exceeds:

(a) 25% of the total appraised value of taxable real property in the municipality and in the industrial districts created by the municipality, if the municipality has a population of 100,000 or more; or

(b) 50% of the total appraised value of taxable real property in the municipality and in the industrial districts created by the municipality, if the municipality has a population of less than 100,000.

Subject to these limitations, a municipality by ordinance or resolution may reduce or enlarge the boundaries of an existing reinvestment zone.[154] The governing body may also extend the term of all or a portion of the zone after notice and hearing.[155] A taxing unit other than the municipality that created the zone is not required to participate in the zone for portion of the zone for the extended term unless the taxing unit enters into a written agreement to do so.[156]

2. ***Prepare a preliminary reinvestment zone financing plan*.** Before adopting an ordinance designating a reinvestment zone, the governing body must prepare a preliminary reinvestment zone financing plan.[157] Section 311.003(b) of the Texas Tax Code does not specify the contents of the preliminary plan; best practices, however, suggest should contain the following:[158]

- Detailed description of estimated project costs[159]

[151] *See Hardwicke v. City of Lubbock*, 150 S.W.3d 708, 716-17 (Tex. App.—Amarillo 2004, no pet.).
[152] TEX. TAX CODE ANN. §311.006(a).
[153] TEX. TAX CODE ANN. §311.006(e).
[154] TEX. TAX CODE ANN. §311.007(a).
[155] TEX. TAX CODE ANN. §311.007(c).
[156] *Id.*
[157] TEX. TAX CODE ANN. §311.003(b)
[158] *See* TEX. TAX CODE ANN. §311.011.
[159] "Project costs" means the expenditures made or estimated to be made and monetary obligations incurred or estimated to be incurred by the municipality designating a reinvestment zone that are listed in the project plan as costs of public works, public improvements, programs, or other projects benefiting the zone, plus other costs incidental to those expenditures and obligations. *See* TEX. TAX CODE ANN. §311.002(1). This amount includes: capital costs; financing costs; real property assembly costs; professional service costs; imputed administrative costs; relocation costs; organizational costs; interest before and during construction and for one year after completion of construction; cost of operating the reinvestment zone and project facilities; the amount of any contribution made by the municipality from general revenue for implementation of the project plan; costs of school buildings or other educational buildings or facilities; and payments made at the discretion of the governing body that it found necessary or convenient to the creation of the zone or to the implementation of projects in the zone. *See* TEX. TAX CODE ANN. §311.002(1)(A-L).

- List of proposed kind, number, and location of public works and public improvements to be financed (including programs for economic development grants)
- An economic feasibility study
- Estimated amount of bond indebtedness to be incurred
- Estimated time when costs or monetary obligations are to be incurred
- Methods of financing project costs and expected sources of revenue to finance or pay project costs, including the percentage of tax increment from property taxes
- Current appraised value of taxable real property in the zone
- Estimate captured appraisal value during each year of its existence
- Duration of the zone

The municipality at this time should also prepare a proposed project plan, which should include: (a) a map showing existing uses of real property within the zone and any proposed improvements; (b) any proposed changes to zoning ordinances, the master plan of the City, building codes, or other municipal ordinances; (c) a list of estimated non-project costs; and (d) a statement of the method for relocating persons who will be displaced as a result of implementation of the plan.[160]

3. ***Public hearing***. Before the governing body may adopt an ordinance designating a reinvestment zone, it must hold a public hearing on the creation of the zone and its benefits to the municipality and to property in the proposed zone.[161] The municipality at least seven days before the hearing must publish notice of the hearing in a newspaper of general circulation in the municipality.[162] At the hearing a person may speak for or against the creation of the zone, its boundaries, or the concept of tax increment financing.[163] The municipality must provide a reasonable opportunity for the owner of property to protest the inclusion of the property in a proposed reinvestment zone.[164]

4. ***Ordinance adopting TIF and establishing TIF board***. After public hearing, the governing body by ordinance may designate an area within the municipality, its extraterritorial jurisdiction, or both as a reinvestment zone for tax increment financing purposes.[165] A governing body may adopt the ordinance by a simple majority vote at an open meeting, unless the city's charter requires a larger majority. The adopted ordinance must include a finding that development in the area would not occur in the foreseeable future solely through private investment.[166] The ordinance must also comply with Section 311.004 of the Texas Tax Code, and contain the following:[167]

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[160] TEX. TAX. CODE ANN. §§ 311.008(b)(1), 311.011(b).
[161] TEX. TAX. CODE ANN. § 311.003(c).
[162] *Id.*
[163] *Id.*
[164] TEX. TAX. CODE ANN. § 311.003(d).
[165] TEX. TAX. CODE ANN. § 311.003(a).
[166] *Id.*
[167] TEX. TAX. CODE ANN. § 311.004(a).

(1) A description of the boundaries of the zone with sufficient definiteness to identify with ordinary and reasonable certainty the territory included in the zone;

(2) Creation of a board of directors for the zone and specify the number of directors of the board as required by law;

(3) A provision that the zone take effect immediately upon passage of the ordinance or order;

(4) A provision identifying the date for the termination of the zone;

(5) A name for the zone for identification, with the first zone created as by a municipality designated as "Reinvestment Zone Number One, City (or Town if applicable) of (name of municipality)," and subsequently created zones assigned names in the same form numbered consecutively in order of their creation;

(6) A provision establishing a tax increment fund for the zone;

(7) Findings that: (A) improvements in the zone with significantly enhance the value of all the taxable real property in the zone and will be of general benefit to the City; and (B) the area meets the requirements of Section 311.005. This finding does not have to identify the specific parcels of real property.[168]

If a municipality designates a reinvestment zone on the petition of property owners, the municipality must also specify in its ordinance that the reinvestment zone is designated pursuant to Section 311.005(a)(4) of the Texas Tax Code.[169]

BOARD OF DIRECTORS

The size, composition and qualifications of the board of directors depend on whether the reinvestment zone was initiated by the municipality or by a petition of property owners.

a. *Board of Directors for TIF zone initiated by Governing Body*. [170]

- Consists of five members, but no more than 15 members
- Appointments:
  - Each taxing unit that approves the payment of all or part of its tax increment into the tax increment fund is entitled to appoint a number of members to the board in proportion to the taxing unit's pro rata share of the total anticipated tax increment to be deposited
  - A taxing unit may waive its right to appoint a director
  - Municipality creating the zone cannot appoint more than 10 directors to the board
  - Members are appointed for two year terms, which may be staggered
- To be eligible for appointment:
  - Must be at least 18 years of age;

[168] TEX. TAX. CODE ANN. § 311.004(b).
[169] TEX. TAX. CODE ANN. § 311.004(c).
[170] TEX. TAX. CODE ANN. § 311.009(a), (c)-(e)(1).

- A resident of the county in which the zone is located or a county adjacent to that county OR
- Own real property in the zone, whether or not the individual resides in the county in which the zone is located or a county adjacent to that county or be an employee or agent of a person that owns real property in the zone

➢ Vacancy on the board is filled for the unexpired term by appointment of the governing body of the taxing unit that appointed the director who served in the vacant position

b. *Board of Directors for TIF zone initiated by Petition of Property Owners*.

➢ Consists of nine members, but no more than 15 members

➢ Appointments:
- Each taxing unit that approves the payment of all or part of its tax increment into the tax increment fund is entitled to appoint a number of members to the board in proportion to the taxing unit's pro rata share of the total anticipated tax increment to be deposited[171]
- A taxing unit may waive its right to appoint a director
- The member of the State Senate in whose district the zone is located is a member of the board[172]
- The member of the State House of Representatives in whose district the zone is located is a member of the board[173]
- Members are appointed for two year terms, which may be staggered

➢ To be eligible for appointment:
- Must be at least 18 years of age
- Own real property in the zone or be an employee or agent of a person that owns real property in the zone

➢ Vacancy on the board is filled for the unexpired term by appointment of the governing body of the taxing unit that appointed the director who served in the vacant position

Each year, the governing body of the municipality creating the zone appoints one member of the board to serve as chairman.[174] The chairman serves for a term of one year that begins on

[171] If fewer than seven taxing units, other than the municipality that designated the zone, are eligible to appoint members of the board of directors, the municipality may appoint a number of board members so that the board comprises nine members; otherwise, the municipality may only appoint one member. *See* TEX. TAX. CODE ANN. § 311.009(b).
[172] If the zone is located in more than one senate district, then the senator in whose district a larger portion of the zone is located is the member of the zone's board. *See* TEX. TAX. CODE ANN. § 311.009(b).
[173] If the zone is located in more than one house district, then the representative in whose district a larger portion of the zone is located is the member of the zone's board. *See* TEX. TAX. CODE ANN. § 311.009(b).
[174] TEX. TAX. CODE ANN. § 311.009(c).

January 1st of the following year.[175] The board of directors may elect a vice-chairman to preside in the absence of the chairman, and other officers the board deems appropriate.[176]

The statute specifies that a member of a TIF board of directors is not a public official by virtue of position on the board.[177] Accordingly, a person appointed to the board of directors is not subject to the Texas Constitutional prohibition of dual office holding, thereby permitting city council members or other public officials to serve as directors.[178]

5. ***Board of Directors prepares project plan and reinvestment zone financing plan***. The board of directors shall prepare and adopt a project plan and a reinvestment zone financing plan for the zone, and submit the plans to the governing body of the municipality that designated the zone.[179]

- *Project Plan must include*:[180]
  (1) Map showing existing uses of real property within the zone and any proposed improvements;
  (2) Any proposed changes to zoning ordinances, the master plan of the City, building codes, or other municipal ordinances;
  (3) A list of estimated non-project costs; and
  (4) A statement of the method for relocating persons who will be displaced as a result of implementation of the plan.
- *The reinvestment zone financing plan must include*:[181]
  (1) A detailed list of the estimated project costs of the zone, including administrative expenses;
  (2) A list of the kind, number and location of all proposed public works or public improvements within the zone;
  (3) An economic feasibility study;
  (4) The estimated amount of bonded indebtedness to be incurred (Note: all bonds must mature within 20 years of the date of issue);
  (5) The timing for incurring costs or monetary obligations;
  (6) The methods for financing all estimated project costs and the expected sources of revenues, including the percentage of the tax increment to be derived from the property taxes of each taxing unit that levies taxes on real property within the zone;
  (7) The current total appraised value of taxable real property in the zone;

[175] *Id.*
[176] *Id.*
[177] TEX. TAX. CODE ANN. § 311.009(g).
[178] *See* Tex. Atty Gen Op. GA-0169 (2004).
[179] TEX. TAX. CODE ANN. § 311.011(a).
[180] TEX. TAX. CODE ANN. § 311.011(b).
[181] TEX. TAX. CODE ANN. § 311.011(c).

(8) The estimated captured appraised value of the zone during each year of its existence; and

(9) The duration of the zone—a tax increment financing reinvestment zone terminates on the earlier of: the termination date designated in the original or amended ordinance creating the zone, or the date on which all project costs, tax increment bonds, and interest on those bonds have been paid in full.

The board of directors of the zone shall make recommendations to the governing body of the municipality that created the zone regarding the administration of the TIF.[182] At any time after the TIF is adopted, the board of directors may adopt an amendment to the project plan.[183] The amendment takes effect on the approval of the change by ordinance of the municipality's governing body that created the TIF.[184] If an amendment reduces or increases the geographic area of the zone, increases the amount of bond indebtedness to be incurred, increases or decreases the percentage of tax increment contributed by a taxing entity, increases the total estimated project costs, or designates additional property in the zone to be acquired by the municipality, then the governing body must hold a public hearing before adoption of the amendment by ordinance.[185]

6. ***Governing body of municipality approves by ordinance the project plan and reinvestment zone financing plan***.[186] The governing body of the municipality that designated the zone must approve a project plan and reinvestment zone financing plan after its adoption by the board.[187] The plans are approved by ordinance, which must include a finding that the plan is feasible.[188] The governing body either at the time it establishes the reinvestment zone or when it approves the project and reinvestment zone financing plans must determine the portion of the tax increment that the municipality must pay into the tax increment fund for the zone.[189] If the municipality does not determine the portion for payment in the fund, then the municipality must pay the entire tax increment produced by the municipality in the zone.[190]

The governing body of the municipality by ordinance or resolution may authorize the board to exercise any of the municipality's powers[191] with respect to the administration,

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[182] TEX. TAX. CODE ANN. § 311.010(a).
[183] TEX. TAX. CODE ANN. § 311.011(e).
[184] *Id.*
[185] *Id.*
[186] TEX. TAX. CODE ANN. § 311.011(d).
[187] *Id.*
[188] *Id.*
[189] TEX. TAX. CODE ANN. § 311.013(l); *see also* TEX. TAX. CODE ANN. § 311.013(m) (providing special rules related to tax increment in populous areas).
[190] *Id.*
[191] TEX. TAX. CODE ANN. § 311.008(b) provides that the municipality may exercise any power necessary and convenient to carry out Chapter 311 of the Texas Tax Code, including the power to:

(1) Cause project plans to be prepared, approve and implement the plans, and otherwise achieve the purposes of the plan;

(2) Acquire real property by purchase, condemnation, or other means and sell real property, on the terms and conditions and in the manner it considers advisable, to implement project plans;

management, or operation of the zone or the implementation of the project plan for the zone, except the issuance of bonds, imposition of taxes or fees, exercise of eminent domain power, final approval of the project plan (or amendments thereto).[192] Further, the governing body must approve any acquisition or sale of real property by the board of directors.[193] The municipality by ordinance or resolution also may choose to restrict any power granted to the board of directors under Chapter 311.[194]

Once the municipality approves a project plan and reinvestment zone financing plan, it must by April 1st of the year following the year the zone is designated deliver to the Texas Comptroller's Office a report containing a general description of the reinvestment zone, a copy of each project plan or reinvestment zone financing plan adopted, and any other information required by the Comptroller that helps in the administration of the central registry and tax refund for economic development.[195]

7. ***Other taxing entities with property in the zone may contract with governing body to contribute to tax increment financing fund***.[196] Other taxing entities may contribute to the tax increment fund. The decision as to what percentage of the increased tax revenues to contribute is entirely discretionary with the governing body of each taxing unit.[197] A taxing unit may decide to retain all the tax increment for itself and not contribute to the tax increment fund.[198]

An agreement by a taxing unit to contribute to a tax increment fund must identify the portion of the tax increment dedicated to the fund, as well as the number of years the taxing unit will contribute the portion of its tax increment.[199] The agreement may also specify the projects to be paid by the taxing units tax increment, and identify the base year later than the original

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(3) Enter into agreements, including agreements with bondholders, determined by the governing body of the municipality to be necessary or convenient to implement project plans and achieve their purposes, which agreements may include conditions, restrictions, or covenants that run with the land or that by other means regulate or restrict the use of land; and

(4) Consistent with the project plan for the zone:
   a. Acquire blighted, deteriorated, deteriorating, undeveloped, or inappropriately developed real property or other property in a blighted are or in a federally assisted new community in the zone for the preservation or restoration of historic sites, beautification or conservation, the provision of public works or public facilities, or other public purposes;

   b. Acquire, construct, reconstruct, or install public works, facilities, o r sites or other public improvements, including utilities, streets, street lights, water and sewer facilities, pedestrian malls and walkways, parks, flood and drainage facilities, or parking facilities, but not including educational facilities; or

   c. In a reinvestment zone created on or before September 1, 1999, acquire, construct, or reconstruct educational facilities in the municipality.

192 TEX. TAX. CODE ANN. § 311.010(a).
193 TEX. TAX. CODE ANN. §§ 311.008(b)(2), and 311.010(d)(2).
194 TEX. TAX. CODE ANN. § 311.010(d)(1).
195 TEX. TAX. CODE ANN. § 311.019(b).
196 TEX. TAX. CODE ANN. § 311.013.
197 *See* TEX. TAX. CODE ANN. § 311.013(f).
198 *Id.*
199 *Id.*

agreement for computation of the tax increment.[200] The agreement may contain other conditions for payment.[201] The agreements and conditions in the agreement are binding on the taxing unit.[202]

The participating taxing units' contributions of the portion of their increased tax revenues that are collected each year under the plan make up the tax increment fund.[203] The taxing units may determine the amount of their tax increment for a year by one of two methods—either the amount of property tax levied and *assessed*, or the amount of property taxes levied and *collected*.[204]

Unless otherwise specified by an agreement between the taxing unit and the municipality that created the zone, payment of the taxing unit's increment into the fund is due by the 90th day after the later of: (1) the delinquency date for the unit's property taxes; or (2) the date the municipality that created the zone submits to the taxing unit an invoice specifying the amount of the tax increment produced by the taxing unit that is owed.[205] A delinquent payment incurs a penalty of 5% the amount unpaid and accrues interest at an annual rate of 10%.[206] The taxing unit, however, is not required to pay into the tax increment fund the portion of a tax increment attributable to delinquent taxes until those taxes are actually collected.[207]

8. ***Once the reinvestment zone is established, the Board of Directors must make recommendations to the City Council on implementation of the tax increment financing***. Either the Board or the City may enter into agreements that are necessary or convenient to implement the project plan or reinvestment zone financing plan.[208] Such agreements may pledge or provide for the use of revenue from the tax increment fund, and provide for the regulation or restriction of land use.[209] If the reinvestment zone was created by petition, the board with the approval of the municipality may impose certain zoning restrictions within the zone.[210]

With the approval of the municipality creating the reinvestment zone, the board of directors may establish and provide for the administration of programs for a public purpose of developing and diversifying the economy, eliminating unemployment and underemployment, and developing business and commercial activity in the zone.[211] This power includes programs to make grants or loans from the tax increment fund.[212]

[200] *Id.*
[201] *Id.*
[202] *Id.*
[203] TEX. TAX. CODE ANN. §§ 311.013, 313.014.
[204] TEX. TAX. CODE ANN. § 311.012(a).
[205] TEX. TAX. CODE ANN. § 311.013(c).
[206] TEX. TAX. CODE ANN. §§ 311.013(c-1).
[207] TEX. TAX. CODE ANN. §§ 311.013(i).
[208] TEX. TAX. CODE ANN. § 311.010(b).
[209] *Id.*
[210] TEX. TAX. CODE ANN. § 311.010(c).
[211] TEX. TAX. CODE ANN. § 311.010(h).
[212] TEX. TAX. CODE ANN. § 311.010(h).

Sales Tax Increment

The governing body of a municipality may determine either in the ordinance designating an area as a reinvestment zone or in an ordinance adopted subsequent to the designation of the zone that a portion or amount of increased tax increment generated from municipal sales and use taxes attributable to the zone may be deposited into the tax increment fund.[213] A municipality, however, is not required to contribute sales tax increments into the tax increment fund.[214]

Tax Abatement Agreements

A taxing unit (other than a school district) may enter into a tax abatement agreement with an owner of real or personal property in a reinvestment zone, regardless of whether the taxing unit deposits or agrees to deposit any portion of its tax increment into the tax increment fund.[215] An agreement to abate taxes on real property in a reinvestment zone is only effective if approved by: (1) the board of directors of the reinvestment zone; and (2) the governing body of each taxing unit that imposes taxes on real property in the reinvestment zone and deposits or agrees to deposit any of its tax increment into the tax increment fund for the zone.[216] If a taxing unit enters into a tax abatement agreement, taxes that are abated are not considered taxes imposed or produced by the taxing unit in calculating the amount of the tax increment for the taxing unit or the amount of the taxing unit's deposit into the tax increment fund.[217]

Tax Increment Bonds and Notes

A municipality designating a reinvestment zone may issue tax increment bonds or notes, and use the proceeds to: (a) make payments pursuant to agreements made under Section 311.010(b); (b) to pay project costs for the reinvestment zone on behalf of which the bonds and notes were issued; or (c) to satisfy claims of holders of the bods or notes.[218] Tax increment bonds are issued by ordinance without any additional approval other than that of the attorney general.[219] Tax increment bonds and notes are payable, as to both principal and interest, solely from the tax increment fund established for the reinvestment zone.[220] The requirements for tax increment bonds or notes are set forth in Section 311.015 of the Texas Tax Code.

9. ***Annual report***. The City must submit an annual report to the Chief Executive Officer of each taxing unit that levies taxes on property within the zone, and provide a copy to (1) the Public Finance Division in the Office of the Attorney General and (2) the Texas State Comptroller's Office.[221] The report must be provided within 150 days of the end of the city's fiscal year, and include the following:[222]

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[213] TEX. TAX. CODE ANN. § 311.0123(b).
[214] *Id.*
[215] TEX. TAX. CODE ANN. § 311.0125(a).
[216] TEX. TAX. CODE ANN. § 311.0125(b).
[217] TEX. TAX. CODE ANN. § 311.0125(d).
[218] TEX. TAX. CODE ANN. § 311.015(a).
[219] TEX. TAX. CODE ANN. § 311.015(c).
[220] TEX. TAX. CODE ANN. § 311.015(b).
[221] TEX. TAX. CODE ANN. § 311.016(a) and (b).
[222] TEX. TAX. CODE ANN. § 311.016(a).

- Amount and source of revenue in the tax increment fund established for the zone
- The amount of purpose of expenditures from the fund
- Amount of principal and interest due on outstanding bond indebtedness
- Tax increment base and current captured appraised value retained by zone
- The captured appraised value shared by the city and other taxing units
- Total amount of tax increments received
- Any additional information necessary to demonstrate compliance with the tax increment financing plan adopted by the municipality.

IV. PUBLIC IMPROVEMENT DISTRICTS: CH. 372 OF THE TEX. LOCAL GOV'T CODE

The Public Improvement District Assessment Act allows any municipality to levy and collect special assessment on property that is within the municipality or its extraterritorial jurisdiction.[223] A municipality may use this tool to make certain improvements in their infrastructure to facilitate economic growth in an area by providing adequate streets, utility services, or other public facilities and services. Chapter 372 of the Texas Local Government Code provides the authority for a Public Improvement District ("PID").

A public improvement project under Chapter 372 may include:[224]

(1) landscaping;
(2) erection of fountains, distinctive lighting, and signs;
(3) acquiring, constructing, improving, widening, narrowing, closing or rerouting of sidewalks, streets or any other roadways, or their rights-of-way;
(4) construction or improvement of pedestrian malls;
(5) acquisition and installation of pieces of art;
(6) acquisition, construction or improvement of libraries;
(7) acquisition, construction or improvement of off-street parking facilities;
(8) acquisition, construction, improvement or rerouting of mass transportation facilities;
(9) acquisition, construction, or improvements of water, wastewater or drainage improvements;
(10) the establishment or improvement of parks;
(11) projects similar to those listed as 1 through 10 above;
(12) acquisition, by purchase or otherwise, of real property in connection with an authorized improvement;
(13) special supplemental services for improvement and promotion of the district, including services relating to advertising, promotion, health and sanitation, water and wastewater, public safety, security, business recruitment, development, recreation, and cultural enhancement;
(14) payment of expenses incurred in the establishment, administration, and operation of the district; and
(15) the development, rehabilitation, or expansion of affordable housing.

[223] TEX. LOCAL GOV'T CODE § 372.003(a).
[224] TEX. LOCAL GOV'T CODE § 372.003(b).

CREATING A PID

1. ***Define an area as a Public Improvement District***. The governing body of a municipality or a group of affected property owners may initiate a petition that calls for designation of a defined area of the municipality as a PID.[225] The petition must state:[226]

(1) the general nature of the proposed improvements;

(2) the estimated cost of the improvements;

(3) the boundaries of the proposed assessment district;

(4) the proposed method of assessment, which may specify included or excluded classes of property subject to the assessment;

(5) the proposed appropriation of costs between the public improvement district and the municipality as a whole;

(6) designate management of the district by the municipality, by the private sector, or by a partnership of the two;

(7) that the persons signing the petition request or concur with the establishment of the district; and

(8) that an advisory board may be established to develop and recommend an improvement plan to the governing body of the municipality.

The petition is sufficient if signed by: (1) owners of taxable real property representing more than 50 percent of the appraised value of taxable real property liable for assessment under the proposal, as determined by the current roll of the appraisal district; and (2) by record owners of real property who constitute more than 50 percent of all record owners of property liable for assessment under the proposal, or own taxable real property that constitutes more than 50 percent of the area of all taxable real property liable for assessment under the proposal.[227] The petition must meet both requirements, and be filed with the municipal secretary.[228]

2. ***Municipality may appoint advisory board to develop and recommend improvement plan for PID***. After receipt of the petition, the city council may appoint an advisory board to develop an improvement plan for the public improvement district.[229] The membership of the board must be composed of:[230]

(1) owners of taxable real property representing more than 50 percent of the appraised value of taxable real property liable for assessment under the proposal, as determined by the current roll of the appraisal district; and

(2) record owners of real property who constitute more than 50 percent of all record owners of property liable for assessment under the proposal, or own taxable real property that

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[225] TEX. LOCAL GOV'T CODE § 372.005.
[226] TEX. LOCAL GOV'T CODE § 372.005(a).
[227] TEX. LOCAL GOV'T CODE § 372.005(b).
[228] TEX. LOCAL GOV'T CODE § 372.005(c).
[229] TEX. LOCAL GOV'T CODE § 372.008(a).
[230] TEX. LOCAL GOV'T CODE § 372.008(b).

constitutes more than 50 percent of the area of all taxable real property liable for assessment under the proposal

3. ***Municipality prepares feasibility report***. After receiving a petition, the governing body causes the preparation of a feasibility report to determine whether the proposed improvements should be made as set forth in the petition, or in combination with other improvements as authorized by Chapter 372.[231] Municipal employees or outside consultants may prepare the report.

4. ***Public hearing on advisability of the improvements***. After completion of the feasibility study, the governing body must hold a public hearing to determine the advisability of the proposed improvements.[232] Notice of the public hearing must be published more than 15 days prior to the hearing in a newspaper of general circulation in the city and the area in the extraterritorial jurisdiction proposed for inclusion in the PID.[233] The municipality must also sent written notification via first class mail to the owners of property within the proposed PID more than 15 days prior to the hearing.[234] The notice must state the time and place of the hearing; the general nature of the proposed improvements; the estimated cost of the improvements; the boundaries of the proposed assessment district; the proposed method of assessment, and the proposed apportionment of cost between the PID and the municipality as a whole.[235] The municipality must make findings by resolution regarding the advisability of the proposed improvements, including their costs and the assessments, based on the public hearing.[236]

5. ***Adopt resolution authorizing creation of PID***. The governing body of the municipality must adopt a resolution by majority vote authorizing the creation of the PID within six months of the public hearing.[237] The authorization is effective once notice of the resolution is published in a newspaper of general circulation in the municipality or municipality's extraterritorial jurisdiction where the district is located.[238]

6. ***Municipality may begin construction of improvements twenty days after authorization of PID takes effect***. The municipality can begin construction of the improvements twenty days after authorization of the public improvement district unless presented within twenty days with a protest petition, signed by owners representing at least two-thirds of the total area of the district, or by two-thirds of all the landowners in the district.[239] The statute does not address the procedure for a municipality to address a protest petition. Nonetheless, after receiving the protest, the city council may elect to assess only part or none of the district.

7. ***Municipality must develop a five-year on-going service and assessment plan***. The advisory board or other entity in the absence of an advisory board shall prepare an ongoing service plan

[231] TEX. LOCAL GOV'T CODE § 372.007(a).
[232] TEX. LOCAL GOV'T CODE § 372.009.
[233] TEX. LOCAL GOV'T CODE § 372.009(c).
[234] TEX. LOCAL GOV'T CODE § 372.009(d).
[235] TEX. LOCAL GOV'T CODE § 372.009(c).
[236] TEX. LOCAL GOV'T CODE § 372.009(b).
[237] TEX. LOCAL GOV'T CODE § 372.010(a).
[238] TEX. LOCAL GOV'T CODE § 372.010(b).
[239] TEX. LOCAL GOV'T CODE § 372.010(c).

and present the plan to the city council for review and approval.[240] The plan must cover a period of at least five years and define the annual indebtedness and projected costs for improvements.[241] The service plan must be reviewed and updated annually for purposes of determining an annual budget for improvements.[242]

An assessment plan must be included in the annual service plan.[243] The governing body of the municipality shall apportion the cost of an improvement to be assessed against property in a PID based on the special benefits accruing to the property because of the improvement.[244] The municipality may assess the costs of improvements: (a) equally per front foot or square foot; (b) according to the value of the property as determined by the governing body, with or without regard to improvements on the property; or (c) in any other manner that results in imposing equal shares of the cost on property similarly benefitted.[245]

The governing body may establish by ordinance the reasonable classifications and formulas for the apportionment of the cost between the municipality and the area to be assessed, and the methods of assessing the special benefits for various classes of improvements.[246] Assessments may be adjusted annually upon review of the service plan.[247]

8. ***<u>Prepare proposed assessment roll, and provide public hearing on proposal</u>***. After a municipality forms a district, a copy of the proposed assessment roll must be filed with the city secretary.[248] The municipality must publish notice of a public hearing on the proposed assessment roll in a newspaper of general circulation at least 10 days before the date of the hearing.[249] The notice must state the time and place of the hearing; the general nature of the improvements; the cost of the improvements; the boundaries of the assessment district; and that written or oral objections will be considered at the hearing.[250]

Notice of the public hearing on the assessment roll must also be mailed to affected property owners.[251] At the public hearing, the governing body must hear and rule on any objections raised.[252] The governing body may amend a proposed assessment on any parcel.[253]

9. ***<u>Levy by ordinance the special assessment against the taxable property within the district</u>***. Once the governing body has heard and considered all the objections, it may levy by ordinance a special assessment against property in the PID.[254] The ordinance shall specify the method of

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[240] TEX. LOCAL GOV'T CODE § 372.013(a).
[241] TEX. LOCAL GOV'T CODE § 372.013(b).
[242] *Id.*
[243] TEX. LOCAL GOV'T CODE § 372.014(a).
[244] TEX. LOCAL GOV'T CODE § 372.015(a).
[245] TEX. LOCAL GOV'T CODE § 372.015(b)
[246] TEX. LOCAL GOV'T CODE § 372.015(c).
[247] TEX. LOCAL GOV'T CODE § 372.015(d).
[248] TEX. LOCAL GOV'T CODE § 372.016.
[249] TEX. LOCAL GOV'T CODE § 372.016(b).
[250] *Id.*
[251] TEX. LOCAL GOV'T CODE § 372.016(c).
[252] TEX. LOCAL GOV'T CODE § 372.017(a).
[253] *Id.*
[254] TEX. LOCAL GOV'T CODE § 372.017(b).

payment of the assessment.[255] The municipality may defer an assessment until a date specified in the ordinance.[256] Additionally, the municipality may contract with another taxing unit or the Board of Directors of the appraisal district to collect special assessments.[257]

a. *Installment payments*. The governing body may provide for payment of assessments in periodic installments, at an interest rate and period of time approved by the governing body.[258] The amount of installments must be in amounts necessary to meet annual costs for improvements and must continue for the period necessary to retire the indebtedness on the improvements or the period approved by the governing body for installment payments.[259]

b. *Limitation on interest rate for installment payment and liens*. Should the municipality issue general obligation bonds, revenue bonds, time warrants, or temporary notes to finance the improvements, the interest rate identified in the assessment ordinance may not exceed a rate that is one-half of one percent higher than the actual rate paid on the debt.[260] Further, the interest that accrues between the effective date of the assessment ordinance and the first installment payment must be added to the first installment payment.[261]

c. *Lien*. The assessment is a first and prior lien against the property, superior to all other liens and claims except liens for state, county, school district, or city ad valorem taxes.[262] The lien is also a personal liability charge against the owners of the property, regardless of whether they are named.[263] An assessment lien is effective from the date of the assessment ordinance until the assessment is paid.[264] Further, the assessment runs with the land, and a foreclosure purchaser of the property is subject to the assessment lien and any associated obligations.[265] The municipality may enforce the lien in the same manner as it enforces an ad valorem tax lien against real property.[266]

d. *Delinquent payment of assessment installments*. Delinquent payment of assessment installments shall incur interest, penalties and attorney's fees in the same manner as delinquent ad valorem taxes.[267] The interest on any delinquent installment shall be added to each subsequent installment until all delinquent installments are paid.[268] Unless a property held a homestead exemption prior to the assessment, the property is subject to foreclosure and forced sale for nonpayment.[269]

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255 *Id.*
256 *Id.*; see also TEX. LOCAL GOV'T CODE § 372.0055.
257 TEX. LOCAL GOV'T CODE § 372.0175.
258 TEX. LOCAL GOV'T CODE § 372.017(b).
259 *Id.*
260 TEX. LOCAL GOV'T CODE § 372.018(a).
261 *Id.*
262 TEX. LOCAL GOV'T CODE § 372.018(b).
263 *Id.*
264 TEX. LOCAL GOV'T CODE § 372.018(c).
265 TEX. LOCAL GOV'T CODE § 372.018(d).
266 TEX. LOCAL GOV'T CODE § 372.018(e).
267 TEX. LOCAL GOV'T CODE § 372.018(f).
268 TEX. LOCAL GOV'T CODE § 372.018(a).
269 *See* Tex. Atty Gen. Op. GA-237 (2004).

10. ***Municipality may make additional assessments against property within district to correct omissions or mistakes regarding costs of improvements***. After notice and hearing, the governing body of a municipality may make supplemental assessments to correct omissions or mistakes in the assessment related to the total cost of the improvements.[270] Notice must be given and hearing held as required for the original levy of assessments.[271]

11. ***Payment of Costs***. Costs of improvements are payable or reimbursable in any combination of methods described in Section 372.023.[272] A municipality may pay a cost payable wholly by itself from general funds available for the purpose or other available general funds.[273] A cost payable from a special assessment that is paid in full shall be paid from that assessment.[274] A cost payable from a special assessment that is payable in installments may be paid by any combination of the following methods:[275]

a. under an installment sales contract or a reimbursement agreement between the municipality and person who acquires, installs, or constructs the improvements;

b. as provided by a temporary note or time warrant issued by the municipality or county and payable to the person who acquires, installs, or constructs the improvements; or

c. by the issuance and sale of bonds.

The payee without consent of the municipality may assign an installment sales contract, reimbursement agreement, temporary note, or time warrant.[276]

The cost of more than one improvement may be paid from: (1) a single issue and sale of bonds without other consolidation proceedings before the bond issue, or (2) under a single installment sales contract reimbursement agreement, temporary note, or time warrant.[277] If bonds are issued, the municipality must create a separate fund in the treasury to which the proceeds from the sale of bonds, temporary notes, time warrants or other sums appropriated are credited.[278] The fund may only pay the costs incurred in making an improvement.[279] Once the improvement is completed, the balance of the assessment for the improvement must be transferred to the fund established for retirement of bonds.[280]

[270] TEX. LOCAL GOV'T CODE § 372.019.
[271] *Id.*
[272] TEX. LOCAL GOV'T CODE § 372.023.
[273] TEX. LOCAL GOV'T CODE § 372.023(b).
[274] TEX. LOCAL GOV'T CODE § 372.023(c).
[275] TEX. LOCAL GOV'T CODE § 372.023(d).
[276] TEX. LOCAL GOV'T CODE § 372.023(d-1).
[277] TEX. LOCAL GOV'T CODE § 372.023(g).
[278] TEX. LOCAL GOV'T CODE § 372.022.
[279] *Id.*
[280] *Id.*

Tab 10

ATTORNEY GENERAL OF TEXAS
GREG ABBOTT

March 8, 2007

The Honorable Eddie Lucio, Jr.
Chair, Committee on International Relations and Trade
Texas State Senate
Post Office Box 12068
Austin, Texas 78711

Opinion No. GA-0528

Re: Whether a seawall funded from assessments levied pursuant to Local Government Code, chapter 372, subchapter A or B, may be built on privately-owned land (RQ-0528-GA)

Dear Senator Lucio:

You ask whether a seawall located on privately-owned property may be funded from assessments levied under Local Government Code chapter 372, subchapter A or B.[1] *See* TEX. LOC. GOV'T CODE ANN. §§ 372.001–.030 (Vernon 2005) (subchapter A, entitled the Public Improvement District Assessment Act), 372.041 (subchapter B, concerning the authority of improvement districts in home-rule municipalities). A "seawall" is "a wall or embankment to protect the shore from erosion or to act as a breakwater." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 1054 (10th ed. 1993).

The City of Port Isabel ("the City"), a home-rule municipality, is considering the creation of a public improvement district pursuant to Local Government Code chapter 372 to finance various improvements. *See* Request Letter, *supra* note 1, at 2. The contemplated improvements include street paving, sidewalks, storm drainage, water and sewer lines, street lights, a seawall, and dredging and backfill, and most of these will be located on public property. *See id.* "The City believes the seawall is a public necessity that will both protect the City's territory and prevent soil erosion from harming the body of water." *Id.* The proposed seawall, however, "would be built on private property along a body of water." *Id.* You wish to know whether improvements authorized by chapter 372 must be located on public property, either real property owned in fee or an easement[2] in privately-owned real property. *See id.*

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[1]*See* Letter from Honorable Eddie Lucio, Jr., Chair, Committee on International Relations and Trade, Texas State Senate, to Honorable Greg Abbott, Attorney General of Texas, at 1 (Sept. 6, 2006) (on file with the Opinion Committee, *also available at* http://www.oag.state.tx.us) [hereinafter Request Letter].

[2]An easement is a nonpossessory interest in land that authorizes the holder to use the property for particular purposes. *See Marcus Cable Assocs., L.P. v. Krohn*, 90 S.W.3d 697, 700 (Tex. 2002). It confers upon the dominant estate holder the right to use the land of the servient estate holder for a specific purpose. *See Bickler v. Bickler*, 403 S.W.2d 354, 359 (Tex. 1966).

Subchapters A and B provide for funding certain public improvements by assessment. An assessment, or special assessment, is a special imposition on property in the vicinity of municipal improvements to provide funding for the improvements. *See City of Wichita Falls v. Williams*, 26 S.W.2d 910, 911–12 (Tex. 1930); *see also* BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE 868 (2d ed. 1995). Although special assessments are levied under the taxing power, they differ from a general property tax that is imposed throughout the taxing jurisdiction for the general support of its government. *See City of Wichita Falls*, 26 S.W.2d at 912; *Henry v. Kaufman County Dev. Dist.*, 150 S.W.3d 498, 504–05 (Tex. App.—Austin 2004, pet. dism'd by agr.). An assessment is imposed only upon the property that is specially benefitted by the improvement, and its amount is based on the special benefits accruing to the property. *See City of Wichita Falls*, 26 S.W.2d at 911; *Henry*, 150 S.W.3d at 505; *see also City of Houston v. Blackbird*, 394 S.W.2d 159, 162 (Tex. 1965) (assessment for paving improvements).

It appears, and for purposes of this opinion we assume, that the proposed seawall can be an authorized public improvement under chapter 372, subchapters A and B. *See* TEX. LOC. GOV'T CODE ANN. §§ 372.003(b) (Vernon 2005) (authorized improvements under subchapter A), 372.041(a) (authorized improvements under subchapter B).

To determine whether improvements authorized by chapter 372 must be located on public property, either real property owned in fee or an easement in privately-owned real property, we first consider a private owner's rights in his real property. A property owner may exclude others from his property, although he may choose to relinquish a portion of the right to exclude by granting an easement. *See Marcus Cable Assocs., L.P. v. Krohn*, 90 S.W.3d 697, 700 (Tex. 2002). A city may not use private property for public purposes unless the landowner consents to the use or the city otherwise secures an appropriate interest in the land. In *MGJ Corp. v. City of Houston*, for example, the plaintiff who held an easement in a private parking lot sued the City of Houston to prevent city police officers from parking in the lot. *See MGJ Corp. v. City of Houston*, 544 S.W.2d 171, 173–74 (Tex. Civ. App.—Houston [1st Dist.] 1976, writ ref'd n.r.e.). Because the City of Houston had "no valid claim of right to use the parking area jointly with the plaintiff, it [was] in the position of a trespasser," and an injunction against Houston was a proper remedy to restrain the trespasses. *Id.* at 175. Accordingly, the City of Port Isabel has no right to build a seawall on private real property. The City must first acquire an appropriate interest in the real property.

Next, we consider a constitutional provision governing the expenditure of public funds. Texas Constitution, article III, section 52(a) provides in part:

> Except as otherwise provided by this section, the Legislature shall have no power to authorize any county, city, town or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association or corporation whatsoever, or to become a stockholder in such corporation, association or company.

TEX. CONST. art. III, § 52(a).

The purpose of article III, section 52(a) is to prevent the use of public funds for private purposes and to prevent the gratuitous grant of such funds or other public assets to individuals or corporations. *See Byrd v. City of Dallas*, 6 S.W.2d 738, 740 (Tex. 1928). A municipal expenditure to accomplish an authorized municipal purpose is not, however, rendered unlawful because it incidentally benefits a private person. *See Brazos River Auth. v. Carr*, 405 S.W.2d 689, 693–94 (Tex. 1966). For a municipal expenditure to comply with article III, section 52(a), it must meet three requirements: its predominant purpose must be to accomplish a public purpose and not to benefit private parties; the city must retain sufficient control over the transaction to ensure that the public purpose is accomplished and to protect the public's investment in it; and the public must receive a return benefit. *See Tex. Mun. League Intergovernmental Risk Pool v. Tex. Workers' Comp. Comm'n.*, 74 S.W.3d 377, 384 (Tex. 2002). The City may spend public funds and allocate other resources to building a seawall that incidentally benefits private parties if the project complies with these requirements.

Because the City must retain enough control over the project to ensure that the public purpose is accomplished and the public interest protected, the City must acquire a sufficient interest in the real property where the seawall will be built to prevent land owners from altering or removing it. In addition, the City would likely need to acquire an interest in the land in order to inspect, maintain, and repair the seawall at various times in the future.[3]

We conclude that the City may not build and fund a seawall under Local Government Code chapter 372, subchapter A or B, on privately-owned property without obtaining an interest in the property sufficient to enable the city to protect the public interest in the seawall.

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[3]Several provisions of the Local Government Code could enable the City to acquire an interest in the seawall to protect the public interest and ensure that the public purpose is accomplished. Chapter 372, subchapter A authorizes a city to acquire real property in connection with a public improvement project under that subchapter. *See* TEX. LOC. GOV'T CODE ANN. § 372.003(b)(12) (Vernon 2005). Furthermore, Local Government Code chapter 421, which authorizes cities and counties on the Gulf Coast to build seawalls and impose a tax to pay for them, provides that the city or county "may acquire property that is necessary for the establishment, construction, and maintenance of a seawall, breakwater, levee, floodway, or drainway." *Id.* § 421.004(a). Gulf Coast cities and counties may exercise the power of eminent domain to acquire an easement or fee simple interest in real property. *See id.* § 421.004(c). Finally, landowners may donate real property or an interest in real property to a city for a public use. *See Copeland v. City of Dallas*, 454 S.W.2d 279, 282–83 (Tex. Civ. App.—Dallas 1970, writ ref'd n.r.e.).

SUMMARY

Texas Constitution article III, section 52(a) requires a city that builds a seawall on privately-owned land to maintain sufficient control over it to ensure that the public purpose is accomplished and to protect the public's interest in it. To carry out this duty, a city must have an appropriate interest in the land on which a seawall funded from assessments levied pursuant to Local Government Code, chapter 372, subchapter A or B will be located.

Very truly yours,

GREG ABBOTT
Attorney General of Texas

KENT C. SULLIVAN
First Assistant Attorney General

ELLEN L. WITT
Deputy Attorney General for Legal Counsel

NANCY S. FULLER
Chair, Opinion Committee

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Tab 11

KEN PAXTON
ATTORNEY GENERAL OF TEXAS

March 7, 2023

Ms. Nichole Mock
Wheeler County Auditor
Post Office Box 69
Wheeler, Texas 79096

Opinion No. KP-0435

Re: Authority of a county to use tax revenue to pay a supplement to a hospital district in the county (RQ-0474-KP)

Dear Ms. Mock:

You ask several questions about agreements for emergency medical services—also referred to as "ambulance services"—between Wheeler County ("County") and two hospital districts.[1] You explain that both the North Wheeler County Hospital District and South Wheeler County Hospital District (collectively, "Hospital Districts") are located within the County and "[e]ach hospital district operates its own emergency medical service providing EMS/ambulance services to residents in either the NWCHD or SWCHD."[2] Request Letter at 1. You further explain that "[t]he County has previously entered into Interlocal Agreements" under which the County pays "a $300,000.00 lump sum payment" to assist each hospital district in "the operation of their respective EMS departments" (collectively, "Agreements"). *Id.* at 1–2 (referring to agreements authorized by the Interlocal Cooperation Act, Government Code, chapter 791). You tell us that the funds used to make the contractual payments come "primarily from Wheeler County tax revenue received from property owners throughout the [C]ounty." *Id.* at 2.

As an initial matter, we note that your questions ask us to opine about the nature of the Agreements. *See id.* at 1–3. This office does not construe contracts in the opinion process and thus, will not be opining about the nature of a particular contract. *See* Tex. Att'y Gen. Op. Nos. KP-0391 (2021) at 2 (explaining "this office does not approve or construe specific contracts in the

[1]*See* Letter and Attachments from Ms. Nichole Mock, Wheeler Cnty. Auditor, to Off. of the Att'y Gen., Op. Comm. at 1–3 (Aug. 18, 2022), https://texasattorneygeneral.gov/sites/default/files/request-files/request/2022/RQ0474KP.pdf ("Request Letter" and "Attachments"); *see also* Tex. Att'y Gen. Op. No. JC-0420 (2001) at 1 (explaining that "emergency medical services" were formerly known more commonly as "ambulance services").

[2]The Hospital Districts were both "created under the authority of Section 9, Article IX, Texas Constitution[.]" TEX. SPEC. DIST. CODE §§ 1083.002, 1097.002.

opinion process"), KP-0366 (2021) at 1 . Nevertheless, we can advise you generally as to legal principles pertinent to your questions.

Expenditure of County Revenue

Two of your questions concern the expenditure of county revenue. *See* Request Letter at 1–3. You first ask whether the County may use tax revenue to make the payments to the Hospital Districts "regardless of the hospital district residency of the taxpayers who fund" the payments. *Id.* at 1. You question whether it is permissible to send "taxpayer funds to another taxing entity for which the taxpayer has no representation/vote" as to the use of the funds.[3] *Id.* at 2.

When it comes to the expenditure of *county* tax revenue, the hospital district in which the taxpayer resides is of no legal concern. *See generally* TEX. TAX CODE §§ 26.01–.18 (setting forth the procedure the county commissioners court uses to set the ad valorem tax rate); TEX. LOC. GOV'T CODE §§ 111.001–.096 (providing the procedures the commissioners court uses to adopt a budget).

You also ask about the requirement to expend County funds in compliance with article III, subsection 52(a) of the Texas Constitution. *See* Request Letter at 2–3. Article III, subsection 52(a) provides that "the Legislature shall have no power to authorize any county, city, town, or other political corporation or subdivision of the State to lend its credit or to grant public money or thing of value in aid of, or to any individual, association, or corporation whatsoever[.]" TEX. CONST. art. III, § 52(a). Subsection 52(a) is construed to prohibit a political subdivision, like a county, from gratuitously granting its funds to other political subdivisions, like hospital districts. *See, e.g.*, *Fort Worth Indep. Sch. Dist. v. City of Fort Worth*, 22 S.W.3d 831, 842–43 (Tex. 2000) (involving payment of city funds to a school district); Tex. Att'y Gen. Op. Nos. KP-0237 (2019) at 1 (involving payment of county funds to a school district), GA-0721 (2009) at 2 (involving payment of hospital district funds to a city).

A political subdivision's payment of funds to another political subdivision is not gratuitous if it meets a three-part test promulgated by the Texas Supreme Court. *See Tex. Mun. League Intergov'tl Risk Pool v. Tex. Workers' Comp. Comm'n*, 74 S.W.3d 377, 384 (Tex. 2002). The test requires that: (1) the predominant purpose of the expenditure be to accomplish a public purpose, not benefit a private party; (2) the public entity retain sufficient control over the expenditure to ensure the public purpose is accomplished; and (3) the public entity receive a return benefit. *See id.*

As to the first prong, the use of county funds to fulfill a statutory function of the county generally serves a public purpose of the county. *See* Tex. Att'y Gen. Op. No. KP-0237 (2019) at 2. A county may meet the second prong and retain public control over the funds by entering into an agreement that imposes upon a recipient of public funds the obligation to accomplish the public

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[3]You describe, "[a]s an example, a taxpayer living in and paying property taxes to NWCHD also pays County taxes, with a portion of the taxpayer's County taxes being paid to both" Hospital Districts via the Agreements, "even though the taxpayer does not reside in SWCDHD. The taxpayer does not have the right to vote in the elections for the governing board of directors for SWCHD and has no representative voice on that board as to how the [County payments] are used by SWCHD." Request Letter at 2.

purpose. *See id.* Such an agreement may also serve to ensure the county receives a return benefit in satisfaction of the third prong. *See id.* An agreement could, as you suggest, provide for an "annual accounting" of the funds to satisfy the second and third prongs of the test. *See* Request Letter at 3. But there might also be some other way an agreement could satisfy those prongs.

Applying the three-part test here, we observe that state law authorizes a county to provide ambulance service. *See, e.g.*, TEX. HEALTH & SAFETY CODE § 774.003 (authorizing the commissioners court of a county to provide for emergency ambulance service in the county and expressly authorizing a county to contract with a hospital district for such service); *see also* Tex. Att'y Gen. Op. Nos. GA-0472 (2006) at 2 (concluding a hospital district may, but is not generally required to, provide ambulance service), JC-0420 (2001) at 4 (concluding a municipality may expend tax funds to provide ambulance service within an article IX, section 9 hospital district). And, as you tell us, the County has entered into Agreements with each of the Hospital Districts regarding the responsibilities of the Hospital Districts in exchange for the payment of funds. *See* Request Letter at 1–2; Attachments at 1–2.

But you assert that neither of the Agreements contain sufficient controls to ensure that the public purpose is achieved and that the County receives services equivalent to its expenditures. *See* Request Letter at 2–3. It is for the county commissioners court to determine in the first instance whether a proposed expenditure satisfies the three-part test, subject to judicial review. *See* Tex. Att'y Gen. Op. No. KP-0338 (2020) at 3. Accordingly, we note that the county commissioners court has the ability to terminate the Agreements under the terms provided in the Agreements if it determines that a public purpose is no longer being achieved or that the County is not receiving service equivalent to its expenditures.

County Debt

Your remaining question asks whether the Agreements create "a debt obligation that would require the County to calculate a debt rate on Line 42 of the Tax Rate Calculation Worksheet[.]"[4] Request Letter at 2. Line 42 of the Worksheet refers to "debt" as defined in Tax Code section 26.012. *See* Worksheet at 6.

Chapter 26 of the Tax Code sets forth the method by which a taxing unit must calculate and the procedures that a taxing unit must follow in adopting property tax rates (i.e., ad valorem tax rates). *See generally* TEX. TAX CODE §§ 26.01–.18. Section 26.012 defines "debt" to mean:

> (A) a bond, warrant, certificate of obligation, or other evidence of indebtedness owed by a taxing unit that:
>
> (i) is *payable* from property taxes *in installments over a period of more than one year*, not budgeted for payment from

[4]*See 2022 Tax Rate Calculation Worksheet Taxing Units Other than School Districts or Water Districts*, TEX. COMPTROLLER OF PUB. ACCOUNTS, *available at* https://comptroller.texas.gov/forms/50-856.pdf ("Worksheet").

> maintenance and operations funds, and secured by a pledge of property taxes; and
>
> (ii) meets one of the following requirements:
>
> > (a) has been approved at an election;
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> > (b) includes self-supporting debt;
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> > (c) evidences a loan under a state or federal financial assistance program;
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> > (d) is issued for designated infrastructure;
> >
> > (e) is a refunding bond;
> >
> > (f) is issued in response to an emergency under Section 1431.015, Government Code;
> >
> > (g) is issued for renovating, improving, or equipping existing buildings or facilities;
> >
> > (h) is issued for vehicles or equipment; or
> >
> > (i) is issued for a project under Chapter 311, Tax Code, or Chapter 222, Transportation Code, that is located in a reinvestment zone created under one of those chapters; or
>
> (B) a payment made under contract to secure indebtedness of a similar nature issued by another political subdivision on behalf of the taxing unit.

Id. § 26.012(7) (emphasis added).[5] Because it appears to be the focus of your question, we examine only one portion of the definition of "debt"—indebtedness owed by a taxing unit that is payable "in installments over a period of more than one year[.]" *See* Request Letter at 2; TEX. TAX CODE § 26.012(7)(A)(i).

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[5]The Comptroller's Worksheet distills this definition into a four-part test, indicating that "[d]ebt means the interest and principal that will be paid on debts that: (1) are paid by property taxes, (2) are secured by property taxes, (3) are scheduled for payment over a period longer than one year, and (4) are not classified in the taxing unit's budget as M&O expenses." Worksheet at 6. The Worksheet instructs that "[d]ebt also includes contractual payments to other taxing units that have incurred debts on behalf of th[e] taxing unit, if those debts meet the four conditions above." *Id.*

The Legislature has, in some instances, mandated that indebtedness be treated as "debt" for purposes of Tax Code subsection 26.012(7). *See, e.g.*, TEX. EDUC. CODE § 45.108(a) (instructing school districts borrowing money for current maintenance expenses that "[n]otes issued for a term longer than one year must be treated as 'debt' as defined in Section 26.012(7), Tax Code").

While not defined in chapter 26, the common meaning of the term "installment" indicates a payment for less than the total amount owed. *See* BLACK'S LAW DICTIONARY 916 (10th ed. 2014) (defining "installment" to mean "a periodic partial payment of a debt" and contrasting it with a lump sum payment); *cf. also* TEX. TAX CODE §§ 31.032, 33.02 (allowing installment payment of property taxes in certain instances). This stands in contrast to a "lump sum" which commonly means "[a] single payment made once, usu[ally] at a particular time, as opposed to a series of smaller payments." BLACK'S LAW DICTIONARY 1664 (10th ed. 2014). Relying on this common meaning, a court would likely conclude that an indebtedness payable in installments is one payable in periodic partial payments. *See Maxim Crane Works, L.P. v. Zurich Am. Ins. Co.*, 642 S.W.3d 551, 557 (Tex. 2022) (providing that when a statute is clear and unambiguous, a court will apply its words according to their common meaning). And, thus, an indebtedness payable in one lump sum over a period of one year or less does not constitute a debt as defined in subsection 26.012(7).

S U M M A R Y

The hospital district in which a county taxpayer resides and votes is of no legal consequence when it comes to the expenditure of county property tax revenue.

A county entering into an agreement with a hospital district to provide ambulance services in the county will not violate article III, subsection 52(a) of the Texas Constitution as long as the county: (1) ensures that the transfer of funds is to accomplish a public purpose of the county, not to benefit private parties; (2) retains public control over the funds to ensure that the public purpose is accomplished and to protect the public's investment; and (3) ensures that the county receives a return benefit. Whether an agreement satisfies the three-part test is for the county commissioners court to determine in the first instance, subject to judicial review.

A "debt" as defined by Tax Code subsection 26.012(7) requires, among other things, that the indebtedness be "payable from property taxes in installments over a period of more than one year[.]" A court would likely conclude that an indebtedness payable in installments is one payable in periodic partial payments and, thus, an indebtedness payable in a lump sum over a period of one year or less does not constitute a debt as defined in subsection 26.012(7).

Very truly yours,

K E N P A X T O N
Attorney General of Texas

BRENT E. WEBSTER
First Assistant Attorney General

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AUSTIN KINGHORN
Chair, Opinion Committee

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Assistant Attorney General, Opinion Committee

Tab 12

State Constitutions: Freedom's Frontier

*Clint Bolick**

We gather today to celebrate the 229th anniversary of the signing of the most magnificent national freedom charter every created—appropriately enough in an institution dedicated to the eternal preservation of the Constitution and the principles on which it rests.

And yet, when we speak of *the* Constitution, no matter how much we properly revere it, we often overstate its intended importance in the American legal order. For in our federal system, we have not one but 51 constitutions. It is part of the masterpiece of federalism that each of us in the 50 states can look for the protection of our rights not to one constitution but two. Indeed, state constitutions were intended to be primary, not secondary. Early Americans looked mainly to their state constitutions to protect their rights. Only after the Fourteenth Amendment was ratified in 1868 could they look to the national constitution for protection against most state violations of their rights.

But even as the national constitution moved to the fore—particularly the rights protected in the Bill of Rights, plus equal protection and due process—many essential liberties were protected either by state constitutions or not at all. Freedom of enterprise, for instance, was left unprotected by the U.S. Supreme Court, even though many state courts applied their own constitutions to strike down excessive economic regulations.[1]

Yet today, state constitutions are relegated to an afterthought. Constitutional law classes rarely mention them. Litigators rarely invoke

*Justice, Arizona Supreme Court. This is a slightly revised version of the 15th annual B. Kenneth Simon Lecture in Constitutional Thought, delivered at the Cato Institute on September 15, 2016.

[1] See, e.g., Clint Bolick, Death Grip: Loosening the Law's Stranglehold Over Economic Liberty (2011) (discussing the failure to protect freedom of enterprise under the national constitution starting with *The Slaughter-House Cases*, 83 U.S. 36 (1873)).

them. State courts often interpret them as if they were mere appendages of the national constitution.

Moreover, despite their professed commitment to federalism, many conservative and libertarian litigation groups focus almost exclusively on the national constitution, except when they have no other choice. That emphasis is profoundly unfortunate, for two reasons. First, it overlooks the vast untapped potential of state constitutions as bulwarks for freedom. Second, it concentrates resources in judicial terrain that may grow increasingly hostile to freedom in the years to come. So even as we pause to celebrate the remarkable resiliency of our nation's constitutional charter, so should we look anew to the state constitutions that were intended to provide the first line of defense against overreaching government.

I. The Advantages of State Constitutions

For freedom advocates, state constitutions provide significant advantages over their national counterpart. Indeed, if this talk had a subtitle, it would be "if only," as in, "if only the United States Constitution had so many of these features." Although the national constitution has many nifty qualities from a freedom perspective, many individual rights and constraints on government power in the U.S. Constitution have been winnowed by federal courts. And they pale in comparison to provisions for freedom available in state constitutions.

I call these superior features of state constitutions the Fabulous Five. Foremost among them is that all state constitutions provide protections of individual rights and constraints on government power that are completely unknown to the U.S. Constitution. I will discuss some of those provisions later on, but among those that are common to many state constitutions are explicit rights to privacy, debt limits, and prohibitions against gifts of public funds. For freedom advocates, exploring state constitutions is akin to being a kid in a candy store. And like the proverbial unseen tree falling silently, the freedom provisions of state constitutions are equally silent when they are unlitigated.

Second, many state freedom provisions that are similar to provisions in the U.S. Constitution are written more broadly. Even when such provisions are identical to those in the U.S. Constitution, state courts are free to interpret them differently than federal courts, but only in one direction: state courts may apply state constitutional provisions as more protective of freedom than their federal counterparts, but not less. I call this the freedom ratchet: the U.S. Constitution provides the floor beneath individual rights, while state constitutions can provide greater but not lesser protection.

Third, state courts have the final word on state constitutional interpretation. In other words, if you prevail on a state constitutional issue, the other side has no recourse to the U.S. Supreme Court, unless of course the state court interpretation violates the U.S. Constitution or valid federal laws. That is reason enough for freedom advocates to always consider filing constitutional cases in state courts and to always assert independent state constitutional grounds in addition to federal constitutional grounds when doing so.

Fourth, state constitutions often provide greater access to the courts than does the national constitution, at least as interpreted by the U.S. Supreme Court. For instance, many state constitutions do not contain "case or controversy" requirements. Perhaps most important, unlike federal courts, most state courts recognize taxpayer standing to challenge unconstitutional government spending.

Finally, state constitutions often are far more easily amended than the national constitution. If you've ever aspired to constitutional authorship, I suggest you look at amending state constitutions rather than attempt the Sisyphean task of amending the U.S. Constitution. Arizonans have added several freedom provisions to our Constitution in recent years, including a prohibition against racial preferences in government employment, education, and contracting; provisions protecting rights to healthcare autonomy and rights of terminally ill patients to use experimental drugs; and a provision authorizing the legislature or the people to forbid the use of state funds to implement federal laws or programs they believe exceed constitutional boundaries.

State constitutions, like the national constitution, were intended to protect individual rights and restrain government power. Their potential to do so is vast and largely unrealized, yet hardly unrealizable.

II. Learning from Justice Brennan

The earliest clarion call for freedom advocates to repair to state constitutions came not from the right but the left, in a pair of penetrating law review articles by U.S. Supreme Court Justice William

H. Brennan. Justice Brennan was not only a highly effective jurist but a brilliant legal strategist. By 1977, the Warren Court with Brennan as its chief architect had experienced a very successful run, fundamentally reshaping American jurisprudence in a wide array of areas, most notably the rights of criminal defendants. But Brennan correctly sensed that change was coming. With President Richard Nixon's appointment to the Court of so-called law-and-order strict constructionists, the jurisprudential tide was turning. Writing in the *Harvard Law Review*, Brennan declared that "[t]he legal revolution which has brought federal law to the fore must not be allowed to inhibit the independent protective force of state law—for without it, the full realization of our liberties cannot be guaranteed."[2] Where federal courts retreated from judicial frontiers, Brennan urged liberal advocates to turn instead to state courts.

They did, and with gusto. Only nine years later, when Brennan wrote his second article on the subject, he could report at least 250 state court decisions that had interpreted their state constitutional rights more broadly than their national counterparts.[3] Most of the decisions were in the realm of criminal procedure, but others encompassed free-speech guarantees and educational equity. In this second article, Brennan's call to arms was even more urgent, and grounded in decidedly different rhetoric addressed to liberals and conservatives alike. He applauded state courts for "construing state constitutional counterparts of provisions of the Bill of Rights as guaranteeing citizens of their own states even more protection than the federal provisions, even those identically phrased."[4] Brennan declared, "Every believer in our concept of federalism, and I am a devout believer, must salute this development in our state courts."[5]

Fast forward 30 years to today. I submit that we conservatives and libertarians may find ourselves in a "Brennan moment." For the past quarter-century, since the confirmation of Justice Clarence Thomas in 1991, we have enjoyed a renaissance in the jurisprudence of original meaning. I know that many will argue about whether the glass is

[2] William J. Brennan Jr., "State Constitutions and the Protection of Individual Rights," 90 Harv. L. Rev. 489, 489 (1977).

[3] William J. Brennan Jr., "The Bill of Rights and the States: The Revival of State Constitutions as Guardians of Individual Rights," 61 N.Y.U. L. Rev. 535, 548 (1986).

[4] *Id.* at 495.

[5] *Id.* at 502.

half-empty or half-full, and all of us would quibble over doctrinal details. But none of us would trade the federal jurisprudence of today for that of 1991. We have made significant progress for liberty in areas as diverse as freedom of speech, religion, and association; federalism; private property rights; Second Amendment rights; racial classifications; school choice; and the limits of federal power under the Commerce Clause.

But prospects for future freedom gains are uncertain. Justice Antonin Scalia's intellect and his role as an ardent proponent of constitutional textualism will be sorely missed. Justice Anthony Kennedy's pivotal vote is increasingly uncertain, as evidenced by his 2016 decision to uphold racial preferences at the University of Texas, after decades of voting to strike such preferences down. Chief Justice John Roberts disappointed freedom advocates by voting to uphold Obamacare. And of course we cannot be certain of President Donald Trump's commitment to appoint justices and judges dedicated to the rule of law.[6]

So the time has come for freedom advocates to devote greater attention to state constitutions. Some of the issues on which we have experienced great success in the federal courts cannot, of course, be equally advanced in state courts. But many, such as freedom of speech and religion, private property rights, and equal protection can be. And as I noted earlier, largely unexplored state constitutional frontiers abound in other areas, including economic liberty and taxpayer protections. Brennan's epiphany about the independent vitality of state constitutions is as relevant and resonant for today's freedom advocates as it was nearly four decades ago.

III. My Own Experience and Beyond

My own epiphany about state constitutions occurred early in my career. Like most lawyers, I never took a course in state constitutional law and hadn't a clue what treasures those mysterious documents contained. But I was about to be schooled on them in what was to be the most important case of my young career.

I went to law school in large part to advance educational freedom, especially through school vouchers, and was determined to defend voucher programs against inevitable legal challenges

[6] But the appointment of Justice Neil Gorsuch is a promising start!

by those invested in the status quo. Trouble was, there were no voucher programs to defend.

That changed in 1990 with the enactment of the Milwaukee Parental Choice Program. Initially it was tiny, limited to one percent of the school district's students who could use a fraction of their state education funds to attend nonsectarian private schools. Still, we knew a legal challenge was imminent. But what would be the grounds for attack? For years we had prepared for a challenge under the First Amendment's Establishment Clause, but the program excluded religious schools. So the challengers had to look not to the U.S. Constitution but to the Wisconsin Constitution.

There they found three causes of action: the educational-uniformity clause, the so-called public purpose doctrine, and the "private or local bill" clause, which the challengers asserted the program violated because it was passed as part of the state budget rather than as a stand-alone bill. I had never heard of any of these provisions, and I had all of a couple of weeks to fathom and argue them.

For the next two years, we battled over those provisions, winning in the trial court, losing in the court of appeals. The private or local bill clause, in particular, became the bane of my existence. Ultimately, in 1992, we prevailed in the Wisconsin Supreme Court by the resounding vote of 4-3,[7] which marked the start of a vibrant national movement to expand precious educational opportunities for children who desperately needed them.

In the midst of that grueling struggle, an odd thing happened: I fell in love with my *bête noire*, the private or local bill clause. Once I allowed myself to get past my adversarial disdain and see it in its natural splendor, I found the stuff of which libertarian dreams are made, a constitutional provision aimed at one of the most odious yet ubiquitous legislative practices: logrolling. Properly applied, the local or private bill clause, contained in numerous state constitutions, requires narrow-interest bills to stand on their own and be voted on separately, in the light of day. No more bridges to nowhere. No more larded up appropriations bills. No more earmarks. If only the U.S. Constitution contained such a provision! Having grasped the potential of the private or local bill clause, I made a mental vow

[7] Davis v. Grover, 480 N.W.2d 460 (Wis. 1992).

to one day wield it to good effect in litigation—a promise my colleagues eventually kept.

But that was not for many years. A far more pressing issue emerged requiring recourse to state constitutional protections, with results that illustrate perhaps better than any other the importance and potential for state constitutional guarantees. That issue was eminent domain. Under the guise of economic development, local governments around the country were using eminent domain in reverse-Robin Hood fashion, taking property from less well-connected owners and giving it often to developers tight with local officials.

The Fifth Amendment, of course, forbids that practice, limiting eminent domain to "public use." But a body of thought has emerged from the Supreme Court holding that the Constitution is self-amending, and that the justices' role is to discover and announce when that happens. Sure enough, the Court discovered that the Fifth Amendment's "public use" limitation had transmuted into the far more forgiving "public benefit." So when my colleagues challenged the taking of Suzette Kelo's little pink house in New London, Connecticut, under the Fifth Amendment, they faced a decidedly uphill task. And we all know the outcome: the neighborhood was bulldozed, the supposed public benefit never materialized, and we all suffered an erosion of our precious liberties.[8]

But at the same time the fight against eminent domain was being fought and lost in federal courts, my former colleagues and I were waging a similar battle in Arizona state courts on behalf of Randy Bailey, who owned Bailey's Brake Service in Mesa. Randy inherited the business from his dad and wanted to pass it along to his son. But the city had other ideas: it wanted to take Randy's shop and several homes so that the owner of a hardware store could expand his business. Under the *Kelo* decision, Randy surely would have come away empty-handed in federal court. But in state court, Randy had a powerful weapon: Article II, § 17 of the Arizona Constitution.

That provision states, "Private property shall not be taken for private use." Not only that, but it states, "Whenever an attempt is made to take private property for a use alleged to be public, the question whether the contemplated use be really public shall be a judicial question, and determined as such without regard to any legislative assertion that

[8] Kelo v. City of New London, 545 U.S. 469 (2005).

the use is public." Although the courts previously had not vigorously applied that standard, in Randy's case they did.[9] So while Suzette and her neighbors tragically lost their homes, you can still buy brakes at Bailey's Brake Service at Country Club and Main in Mesa.

That decision, in my view, illustrates what federalism and state constitutionalism are all about. And it's the kind of decision that can be contagious; indeed, several other state courts have applied their eminent domain provisions more broadly than the U.S. Supreme Court to protect private property rights.[10]

In other areas too, state court decisions have expanded the boundaries for freedom. In Arizona, my former colleagues and I dusted off the Gift Clause of the state constitution, which forbids gifts of public funds to private individuals, corporations, or associations by subsidy or otherwise.[11] At the time, Arizona cities were competing for sales tax revenues by subsidizing retail shopping centers. A Chicago developer landed a nearly $100 million taxpayer subsidy to construct a Phoenix mall that was supposed to be so grandiose that we dubbed it the "Taj Mah-Mall." In its 2010 decision in *Turken v. Gordon*, the Arizona Supreme Court ruled that payments to private companies are unconstitutional unless supported by tangible, enforceable consideration, thus bringing the costly subsidy wars to an end.[12] Dozens of other states have gift clauses in their constitutions, which are rarely deployed despite a plethora of state and local subsidies.

A recent decision by the Texas Supreme Court has special meaning for me because it involves a right to which I devoted much of my

[9] Bailey v. Myers, 76 P.3d 898 (Ariz. App. 2003).

[10] See, e.g., Mt. Valley Pipeline, LLC v. McCurdy, 793 S.E.2d 850 (W. Va. 2016) (holding that a natural gas pipeline did not constitute a public use because defendant was "unable to identify even a single West Virginia consumer, or a West Virginia natural gas producer who is not affiliated with [defendant], who [would] benefit"); Kirby v. N.C. DOT, 786 S.E.2d 919 (N.C. 2016) (holding that the state's designation of private property as part of a highway corridor, heavily restricting owners' right to develop, constituted a taking requiring just compensation); City of Norwood v. Horney, 853 N.E.2d 1115 (Ohio 2006) (In the first state supreme court case addressing the use of eminent domain for private development after *Kelo*, the court unanimously held that economic benefit to the government and community alone was not enough to constitute public use, that eminent-domain cases require heightened scrutiny, and that the use of the term "deteriorating area" as a taking standard was void for vagueness).

[11] Ariz. Const. Art. IX, § 7.

[12] 224 P.3d 158 (Ariz. 2010).

litigating career, but a right that the federal courts have almost completely buried: freedom of enterprise. Even though economic liberty was meant to be a foundational freedom protected by the Fourteenth Amendment's Privileges or Immunities Clause, federal courts have largely abdicated their responsibility to protect it, no matter how sweeping, destructive, or protectionist the regulation.[13]

In *Patel v. Texas Department of Licensing and Regulation*, the Court independently interpreted the state constitution to require greater justification for professional licensing, striking down regulations on eyebrow threading.[14] In a concurring opinion, Justice Don Willett articulated perfectly the necessity of state constitutionalism:

> Today's case arises under the Texas Constitution, over which we have final interpretive authority, and nothing in its 60,000-plus words requires judges to turn a blind eye to transparent rent-seeking that bends government power to private gain, thus robbing people of their innate right—antecedent to government—to earn an honest living. Indeed, even if the Texas Due Course of Law Clause mirrored perfectly the federal Due Process Clause, that in no way binds Texas courts to cut-and-paste federal rational-basis jurisprudence that long post-dates enactment of our own constitutional provision, one more inclined to freedom.[15]

Those stirring words are both an exposition of the boundless realm of the possible as well as a call to action.

What then are the frontiers for freedom advocacy under state constitutions? They depend, of course, on the particulars of specific state constitutions and the opportunities they afford to protect freedom. They also depend on how much erosion our rights sustain under the federal constitution, and whether state constitutions can fill the void. The possibilities run the gamut from rights protections—in such areas as free speech, religious liberty, criminal procedure, privacy, freedom of association, private property rights, economic liberty, gun ownership, due process, and equal protection—to structural limits on government power, such as separation of powers, spending limits, gift clauses, and anti-monopoly provisions.

[13] See, e.g., Clint Bolick, Death Grip: Loosening the Law's Stranglehold Over Economic Liberty (2011).

[14] 469 S.W.3d 69 (Tex. 2015).

[15] *Id.* at 98.

IV. The Judge's Role

Thus far I have emphasized the role of freedom advocates in bringing state constitutional actions. I will conclude by briefly discussing the role of judges in that context, a subject to which I hope to return in greater depth soon.

Judges are (or ought to be) bound by the rule of law. Even in my short time on the Arizona Supreme Court, I can attest that taking the rule of law seriously means departing frequently from personal policy preferences. We are not policymakers. That role is played by the political branches, within their constitutional boundaries.

But as state court judges, we swear oaths to two constitutions, and we ought to take each seriously. When a state constitutional issue is presented to us, that oath, in my view, requires us to interpret what the words of our state constitution say and mean—not what the federal courts have interpreted national constitutional provisions to mean. Unless our state constitutional provisions derive from the national constitution, what similar provisions of the national constitution mean is largely irrelevant to our task, and federal court interpretations even more so. In particular, while federal courts have determined that provisions of the U.S. Constitution have "evolved"—that is, have amended themselves to permit greater government power or protect fewer individual rights—there is no reason to assume that state constitutional provisions have experienced similar metamorphosis.

Each state has developed its organic law to reflect its own values and aspirations. The meaning of that law often is evident from its text and its history, but rarely from reference to federal jurisprudence. That is what is meant by independent interpretation of state law. As state judges, we are oath-bound to determine what our state constitutions mean. Quite often, they mean to protect freedom.

As a justice, I draw inspiration, and take my marching orders, from Article II, Section 1 of our Arizona Constitution: "A frequent recurrence to fundamental principles is essential to the security of individual rights and the perpetuity of free government." If we take those words seriously, and strive to give them their intended meaning, we will, despite all odds, leave to our children and grandchildren a nation more free than the one we inherited.

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