IN THE SUPREME COURT

STATE OF ARIZONA

DARCIE SCHIRES; ANDREW AKERS; and GARY WHITMAN

Appellants/Petitioners,

v.

CATHY CARLAT, in her official capacity as Mayor of the City of Peoria; VICKI HUNT, in her official capacity as City of Peoria Councilmember for the Acacia District; CARLO LEONE, in his official capacity as City of Peoria Councilmember for the Pine District; MICHAEL FINN, in his official capacity as Councilmember for the City of Peoria for the Palo Verde District; JON EDWARDS, in his official capacity as Councilmember for the City of Peoria for the Willow District; BRIDGET BINSBACHER, in her official capacity as Councilmember for the City of Peoria for the Mesquite District; and BILL PATENA, in his official capacity as Councilmember for the City of Peoria for the Ironwood District; CITY OF PEORIA, a municipal corporation of the State of Arizona,

Appellees/Respondents.

Supreme Court
No. CV-20-0027-PR

Court of Appeals, Division One
Case No. 1 CA-CV 18-0379

Maricopa County Superior Court
Case No. CV2016-013699

PETITION FOR REVIEW

Scharf-Norton Center for Constitutional Litigation at the GOLDWATER INSTITUTE
Christina Sandefur (027983)
Veronica Thorson (030292)
500 E. Coronado Rd.
Phoenix, Arizona 85004
(602) 462-5000
Litigation@goldwaterinstitute.org
Attorneys for Petitioners

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Constitutional Provisions

Statutes

Other Authorities

ISSUES PRESENTED FOR REVIEW

1. Did the Court of Appeals err in holding that a private university's promise to invest in its own business is adequate consideration under article IX, section 7 of the Arizona Constitution (the "Gift Clause") when the City of Peoria ("City") receives no direct and tangible benefits from that promise?

2. Did the Court of Appeals err by holding that a commercial real estate firm's renovation of its own property for its own private profit is adequate consideration under the Gift Clause when the City receives no direct and tangible benefits from that promise, either?

3. Did the Court of Appeals err by concluding, without analysis, that economic development is a public purpose under the Gift Clause?

INTRODUCTION

This case involves the City's payments of taxpayer money to private businesses in exchange for nothing—or, specifically, for agreeing to operate their businesses in Peoria. The court below upheld the payments against a Gift Clause challenge on the theory that the businesses are obligated to invest in their own operations and may therefore stimulate the economy. This extraordinary break with precedent encourages local governments to do what the clause was written to forbid: subsidize private businesses with public money.

FACTS AND PROCEDURAL HISTORY

The Huntington Contract

Huntington University ("Huntington") is a private college based in Indiana. APP.075 ¶¶ 10, 19. On July 7, 2015, the City agreed to pay Huntington $1.875 million of taxpayer money to open a branch campus in Peoria. APP.076 ¶ 30.

Peoria officials exercise no control over the campus; rather, Huntington's Board of Trustees in Indiana makes decisions for the Peoria campus. APP.075–76 ¶¶ 10–11, 27–29.

As a private college, Huntington is not generally open to Peoria residents—unlike a public park or library. *Id.* ¶¶ 12–14. And Peoria residents do not receive admission preference or reduced tuition. *Id.* If they wish to use the campus, Peoria residents—like non-residents—must apply, be accepted, enroll, and pay tuition, or they must pay Huntington to lease space, but even then there is no guarantee Huntington will grant them access. *Id.*

Huntington offers only one field of study at its Peoria campus, Digital Media Arts, which is taught through the "lens of the Christian worldview." *Id.* at ¶¶ 15–16, 23. According to the City's own consultant, Digital Media Arts is a "niche market," which means Huntington will likely enroll most of its students from outside Peoria. APP.075 ¶¶ 17–18.

Under the Huntington contract, the City pays the university simply to operate its business. Specifically, Huntington agreed to complete three "performance thresholds" in exchange for three payments totaling $1.875 million; Huntington's completion of the performance thresholds is the *only* obligation "directly tied" to the payments. APP.076 ¶ 30; APP.023 ¶¶ 17–20; APP.091–96. *See also* APP.039–48.

To receive $900,000 under the first performance threshold, Huntington had to appoint campus leadership, obtain approval for its degree programs, obtain federal approval for student financial aid, submit a marketing and enrollment plan and a list of undergraduate programs to the City, enter a seven-year lease for a facility in Peoria, submit a faculty and staff plan to the City, execute an articulation agreement with Maricopa County Community College District, accept students for the 2016–2017 academic year, and submit expense reports to the City. APP.077 ¶ 33; APP.023–24 ¶¶ 21–22. To receive up to $550,000 under the second performance threshold, Huntington had to offer coursework to 100 students for the 2017–2018 academic year and submit expense reports to the City. APP.077–78 ¶ 38; APP.024 ¶¶ 23–24. To receive up to $425,000 under the third performance threshold, Huntington had to offer coursework to 150 students for the 2018–2019 academic year and submit expense reports to the City. APP.078 ¶ 42; APP.024 ¶¶ 26–27.

The contract also provides that Huntington will participate in "economic development activities" with the City—a term which is not defined—and invest $2.5 million into its own campus. APP.079–81 ¶¶ 59, 68–69; APP.024–25 ¶ 30. Unlike the performance thresholds, however, these two requirements are *not* "directly tied" to the "financial incentive package." APP.186–87 at 16:24–17:5. This means Huntington does *not* receive payments for participating in economic

development activities or investing in its business. It *only* receives payments ($1.875 million) in exchange for operating its business, as measured by the performance thresholds.

The Arrowhead Contract

In December 2015, Huntington leased a building from Arrowhead Equities, LLC ("Arrowhead"), on property located in one of Peoria's "greatest spots" for "vibrancy and activity," to use as its campus. APP.087 ¶ 139; APP.025 ¶ 37. Arrowhead was created solely to acquire and own the Huntington campus; Arrowhead testified that the purpose of its acquisitions is to "make money" for its private investors. APP.025 ¶ 38; APP.086–87 ¶ 136. Arrowhead also testified that its parent company, Glenwood Development, has no trouble raising private funds for its commercial real estate projects, which can and do succeed without subsidies. APP.087 ¶¶ 137–138.

Nevertheless, on March 15, 2016, the City promised to pay Arrowhead $737,596 solely to renovate its own property to suit Huntington's needs, as measured by Arrowhead's completion of "Tenant Improvements," "Program Criteria," and "Performance Criteria." APP.161–62; APP.085 ¶ 122. *See also* APP.048–52.

The Tenant Improvements required Arrowhead to renovate its own property (a former salon and spa) so Huntington could "open for business" no later than

October 15, 2016, and the Program and Performance Criteria merely contained pedestrian requirements, such as passing fire and building inspections and complying with applicable laws. APP.161; APP.085–86 ¶¶ 122–125.

In other words, neither Huntington nor Arrowhead are required to do anything other than operate their businesses, as measured by the performance thresholds under each contract, to receive $2.6 million in payments from the City.

The Litigation

Petitioner Taxpayers challenged both contracts under the Gift Clause because the City did not receive anything of value (i.e., consideration) in return for its payments. *Turken v. Gordon*, 223 Ariz. 342, 348 ¶¶ 21–22 (2010). The City argued below that it receives an operational university within Peoria. Petitioners argued that the City merely pays Huntington and Arrowhead to operate their own businesses without receiving constitutionally adequate consideration in return because the City does not in fact receive a university or any other tangible benefits from the arrangement.

To determine the value of what the City receives under each contract, the City and Petitioner Taxpayers consulted expert witnesses. APP.056 ¶¶ 2–4; APP.032 ¶¶ 1–4.[1] The City's expert testified that he did not analyze the monetary

[1] For Gift Clause purposes, a contract is valued by the goods, materials, property, and services bargained for on the face of the contract. *Turken*, 223 Ariz. at 348 ¶ 22; *Yeazell v. Copins*, 98 Ariz. 109, 112 (1965).

value of the performance thresholds for either contract and did not believe he "or any economist or business valuation analyst" could do so. APP.080 ¶ 65.[2] Instead, he estimated the overall "economic impact" of Huntington's operation, which he predicted to be $11.3 million. APP.034 ¶ 15; APP.056 ¶ 7. He also testified that economic impact is merely an estimate and cannot be guaranteed. APP.106 at 47:17–49:25. "Economic impact" is a "prediction of changes in the local economy." APP.057 ¶ 11. Regardless, neither contract *requires* Huntington or Arrowhead to create economic impact within the City. APP.090–103; APP.159–70.

Taxpayers' expert testified that economic impact is *not* a measure of the value the City receives under the contracts. APP.058 ¶¶ 14, 17. Instead, the *fiscal* impact—$206,630—is a better estimate of value (i.e., economic return) because it represents revenue the City might receive into its coffers because of Huntington's operations. APP.058–59 ¶¶ 16–18.[3] However, neither contract requires Huntington or Arrowhead to generate revenue for the City. APP.090–103; APP.159–70. Because "Huntington and Arrowhead have not promised to give the City any direct

[2] He also testified that he doesn't "think there's a way to realistically do that," and that he that he doesn't "know how that would be done." PSOF 65.
[3] Before executing the contracts, the City hired a consultant to estimate the "fiscal impact" of the Huntington deal. APP.026 ¶ 46. The "fiscal impact," $206,630, is the consultant's estimate of tax revenue the City might receive. APP.058 ¶¶ 15–16. APP.109 at 71:16–21. APP.027 ¶ 49; APP.081 ¶ 77.

economic return," Taxpayers' expert concluded that the value of both contracts is zero. APP.059 ¶¶ 21–22.

According to the City, the ultimate purpose of both contracts is "economic development." APP.012; APP.068–69.

REASONS THE PETITION SHOULD BE GRANTED

This case presents questions of statewide importance and first impression that, if left unaddressed, will result in the misapplication of this Court's Gift Clause jurisprudence and increased confusion at all levels of Arizona government in applying that precedent.

While no Arizona decision expressly controls any of the points of law in question, the decision below profoundly misapplies this Court's seminal decision in *Turken* a decade ago that indirect benefits are not consideration under the Gift Clause. 223 Ariz. at 350 ¶ 33. Namely, the decision below concluded that Huntington's $2.5 million investment into its own campus is sufficient consideration for Gift Clause purposes despite the City's failure to receive any direct and tangible benefits from that investment. The court's valuation is erroneous not only because the City receives absolutely nothing from Huntington's investment into its own property but also because there is simply no proper way to value indirect benefits that, by their nature, are speculative and lack a quantifiable

objective fair market value—such as unspecific benefits that *might* result from a business's investment into its own property or its operation within a given region.

Because Arizona local governments frequently subsidize private businesses in exchange for indirect and intangible benefits in the *hope* of stimulating development, the issues presented here are of statewide importance. Lower courts need guidance regarding whether and to what extent indirect and intangible benefits can serve as consideration under the Gift Clause.

This case also presents issues of first impression regarding both prongs of the Gift Clause test, which requires that expenditures of public money (1) serve a public purpose and (2) garner adequate return consideration. *Turken*, 223 Ariz. at 348 ¶¶ 21–22. No Arizona court has ever decided whether a private business's mere promise to operate within a city's boundaries or to renovate its own property—without any obligation to provide direct and tangible benefits to that city—is adequate consideration under the Gift Clause. And, although the Gift Clause was written specifically to prohibit subsidies to private businesses in hopes of stimulating the economy, no Arizona court has addressed whether economic development alone serves a public purpose under the Gift Clause.

I. The Court should grant review because this matter is of statewide importance, and government entities urgently need guidance.

Economists estimate that state and local governments spend $90 billion per year on economic development incentives for private businesses. 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 Inst. for Emp't Research 6 (2017).[4] In Arizona, local governments frequently subsidize businesses in hopes that these businesses will stimulate the local economy. Such subsidies are so commonplace, in fact, that the Arizona League of Arizona Cities and Towns ("League") declared that this case "is of statewide importance for all of Arizona's cities and towns." League's App. Ct. Amicus Br. at 2.

The League is aware of at least 12 contracts that fall within the scope of this case. *Id.* at APP24–25. And Petitioners are aware of three contracts authorizing subsides to private universities in exchange for their promises to operate within a given city. *See* Mark Flatten, *Economic Dysfunction: Cities Make Risky Bets to Lure Private Universities* (2016).[5] One of these involves Respondents: in addition to Huntington, Peoria also gave taxpayer dollars to Trine University, which closed its doors in 2017 after failing to create the economic development the City hoped for. APP.057–58 ¶ 12.

Additionally, the Gift Clause has been cited in 17 Arizona appellate decisions since this Court decided *Turken*, but only seven decisions are reported, and only one of the reported decisions offers a substantive opinion regarding the

[4] https://research.upjohn.org/cgi/viewcontent.cgi?article=1228&context=reports
[5] https://goldwaterinstitute.org/wp-content/uploads/2017/07/GI_PEORIA_Policy-Paper.pdf

Gift Clause. *See Cheatham v. DiCiccio*, 240 Ariz. 314 (2016), which vacated *Cheatham v. Diciccio*, 238 Ariz. 69 (App. 2015).

Cheatham resulted in a 3-2 opinion in which this Court found it difficult to determine whether the City of Phoenix had received adequate consideration from provisions of a contract with the Phoenix Law Enforcement Association ("PLEA"). "Whether the City receive[d] sufficient consideration turn[ed] on 'the objective fair market value' of what PLEA promised to provide," yet the record did not reflect such a value. 240 Ariz. at 326 ¶ 53 (citation omitted; Timmer, J. dissenting). "Indeed, the City lack[ed] a mechanism to quantify the value of benefits it receive[d] from the release time provisions." *Id.* The same flaw is present here: Peoria could not quantify the value of any benefits it might receive from Huntington's operation of its own business or from Arrowhead's renovation of its own property. Yet the Court of Appeals inexplicably concluded that Huntington's investment of $2.5 million into its own property reflected that value. Op. at 9 ¶ 23. That error alone merits review.

More importantly, as the dissent below recognized, the majority placed a value on the contracts even though the City received *no* quantifiable direct benefits from Huntington or Arrowhead. *Id.* at 11 ¶ 27 (Morse, J. dissenting) (stating that "neither the indirect economic benefits nor the amounts expended by H[untington] or Arrowhead provide evidence of the direct benefits received by Peoria").

As the tension between the majority and dissent demonstrates, the issue of indirect benefits continues to pervade Gift Clause jurisprudence. Lower courts need clarity to make sound decisions, and governments require guidance to avoid making illegal expenditures. Accordingly, this Court should grant review to clarify that intangible and unquantifiable benefits are not consideration under the Gift Clause.

II. The Court should also grant review because this case presents an issue of first impression regarding the consideration prong of the Gift Clause.

Although Gift Clause precedent, if correctly applied, yields the result that a private business's promise to operate within a city's boundaries (including its promise to invest $2.5 million into its *own* property) and a business's promise to renovate its own property for its own financial gain are not adequate consideration under the Gift Clause, confusion persists because no Arizona court has ever decided the issue. This is perhaps because, up until now, Gift Clause cases construing government contracts have involved contracts for tangible "goods, materials, property and services." *Yeazell*, 98 Ariz. at 112.

For example, in *Turken*, the city contracted for public parking spaces, though it *hoped* the larger development project would create substantial indirect benefits as well. 223 Ariz. at 350–51 ¶ 40. In *Cheatham*, the government bargained for police services, though plaintiffs alleged that the larger contract for police services contained within it a gift to police unions as well. 240 Ariz. at 324 ¶ 45

(Timmer, J. dissenting). In *City of Tempe v. Pilot Properties*, as noted by the dissent below, the government contracted to lease property it would own at the conclusion of the lease. Op. at 13 ¶ 33, n.3 (citing 22 Ariz. App. 356, 363 (1974)). And in a more recent Gift Clause case—unreported but also recognized by the dissent below—the government contracted for property improvements. *Id.* (citing *Stuart v. Lane*, 1 CA-CV 15-0746, 2917 WL 3765499 at *4 ¶ 24 (App. 2017)). In all of these cases, regardless of any indirect and speculative benefits the government entities hoped for, they specifically contracted for direct benefits, and those are what the courts focused on.

When government entities contract for goods, materials, property, or services, an adequacy of consideration analysis is straightforward because tangible benefits have a market value and are thus quantifiable, allowing courts to "distinguish between permissible payments made by a government for goods and services…and impermissible donations and subsidies." Op. at 11 ¶ 29 (Morse, J., dissenting).

But here, the City did not contract for *any* tangible or quantifiable benefits. Instead, it paid Huntington to operate its own business and Arrowhead to renovate its own property and then claimed that the secondary economic consequences of those operations—indirect, speculative benefits—were the value of the consideration in both contracts.

The trial court accepted this argument, but the Court of Appeals adopted a different theory. As the dissent points out, "[p]erhaps implicitly recognizing the superior court's error…[the court] attempts to address the problem of indirect benefits by finding….the value of this consideration to be adequate because H[untington] promised to invest $2.5 million to develop and open the new campus and Arrowhead promised to make improvements to its property." *Id.* at 11–12 ¶¶ 27, 32. "However, the value of these promises…cannot be determined based on the amount expended by" the private businesses because "the value of that consideration for Gift Clause purposes is 'what the government receives *under the contract*." *Id.* at 12 ¶ 32 (citing *Turken*, 223 Ariz. at 348 ¶ 22) (emphasis added).

The confusion regarding the value of consideration stems from the fact that no Arizona court has decided this particular issue. Thus, although the majority seems to recognize that economic impact is an *indirect* benefit and therefore cannot be consideration under *Turken*, it nevertheless erred by concluding that a private university's investment into its own campus—a quantifiable number—is consideration even though the City does not receive that investment.

This court should grant review to provide needed guidance on this important Gift Clause question.[6]

[6] The Court should also qualify its decision in *Cheatham*, 240 Ariz. 314, regarding whether and to what extent courts "must give due deference to the decision of […] elected officials in assessing the adequacy of consideration." Op. at 9 ¶ 23 (citing

III. The Court should also grant review because this case presents an issue of first impression regarding the public purpose prong of the Gift Clause.

No Arizona court has ever decided whether economic development is a public purpose under the Gift Clause simply because a statute "permits municipalities to spend public monies 'for and in connection with economic development activities.'" Op. at 7 ¶ 17 (citing A.R.S. § 9-500.11(A)). This Court should grant review to provide guidance on this question of statewide importance. Fortunately, the plain meaning and history of the Gift Clause provide valuable direction as to whether economic development can serve a public purpose when the government attempts *subsidize* private businesses to stimulate economic development.

Arizona's Gift Clause was written to ban subsidies to private businesses for "economic development." In territorial days, governments regularly subsidized railroads and other enterprises because they believed these projects were "critical for economic development." 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*

---

240 Ariz. at 321–22 ¶¶ 30, 35). If courts must defer to officials regarding both consideration *and* public purpose, then officials can override the constitution by simply "determining" that an expenditure garners adequate return consideration and serves a public purpose. *See id*.

Response, 28 N.M. L. Rev. 303, 312 (1998). The resulting calamities are why the constitution prohibits "*any* donation or grant, by *subsidy* or otherwise." Ariz. Const. art. IX, § 7 (emphasis added). A "subsidy" is a "grant of money made by government in aid of the promoters of any enterprise…which is considered a proper subject for state aid, because likely to be of benefit to the public." Subsidy, *Black's Law Dictionary* 1117 (2d ed. 1910).

While the decision below is correct that "Arizona courts have taken an expansive view of public purpose," Op. at 6 ¶ 16, no Arizona court has ever held that secondary, intangible, and indirect benefits—such as economic development—satisfy the public purpose prong of the Gift Clause. On the contrary, economic development is notably different from any other purpose courts have deemed "public" under the Gift Clause. Nevertheless, there is no precedent on this issue of first impression, which ironically points to the very same issue that prompted enactment of the Gift Clause.

CONCLUSION

Petitioners respectfully ask this Court to grant review to decide these important questions of first impression, which—if left unanswered—will render the Gift Clause meaningless by allowing local governments to pay all manner of

private businesses merely for operating themselves (e.g., paying Starbucks to sell coffee).[7]

Respectfully submitted this 9th day of March 2020 by:

/s/ *Veronica Thorson*
Christina Sandefur (027983)
Veronica Thorson (030292)
Scharf-Norton Center for Constitutional Litigation at the GOLDWATER INSTITUTE

[7] Notice Under Rule 21(a): Petitioners request attorney fees and costs pursuant to the private attorney general doctrine. *See Ariz. Ctr. for Law in Pub. Interest v. Hassell*, 172 Ariz. 356, 371 (App. 1991).