ARIZONA SUPREME COURT

DARCIE SCHIRES, *et al.* Appellants/Petitioners, v. CATHY CARLAT, *et al.*, Appellees/Respondents.	CV-20-0027-PR Court of Appeals No. 1 CA-CV 18-0379 Maricopa County Superior Court No. CV2016-013699

AMICUS CURIAE BRIEF OF STATE OF ARIZONA IN SUPPORT OF APPELLANTS/PETITIONERS

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The State files this as-of-right amicus brief under ARCAP 16(b)(1)(B) because this case presents recurring issues of statewide importance concerning compliance with the Arizona Constitution when spending substantial public funds.

INTRODUCTION

It is critical that this Court grant review here. As an initial matter, this case presents a novel issue because it involves the legal analysis for Gift Clause claims where a private party, in return for payment of public monies, promises to perform certain actions for third parties (rather than provide direct services back to the government itself as in *Wistuber v. PVUSD*, 141 Ariz. 346 (1984), *Turken v. Gordon*, 223 Ariz. 342 (2010), and *Cheatham v. DiCiccio*, 240 Ariz. 314 (2016)). But, on top of this, when confronting that factual wrinkle, the majority below articulated an analysis so erroneous that it actually threatens to render the Gift Clause a nullity in virtually all situations—something that Judge Morse recognized in his well-reasoned dissent (*e.g.*, at *7 ¶33).

The Gift Clause's plain language prohibits the State and local governments from "mak[ing] any donation or grant, by subsidy or otherwise, to any individual, association, or corporation." *See* Ariz. Const. art. IX, § 7. Courts apply this provision using a two-part test: government payments or other transfers involving private entities will be upheld if they are 1) for a public purpose ("Public-Purpose

Requirement") and 2) not grossly disproportionate to the fair market value ("FMV") of what the private entity directly promises to pay or do in furtherance of a public purpose ("Consideration Requirement"). *See Wistuber*, 141 Ariz. at 349.[1]

In granting review, this Court should reaffirm fundamental principles regarding the Consideration Requirement that are derived directly from not only the constitutional text itself, but also this Court's recent cases of *Turken* and *Cheatham*. ***First***, the Court should confirm that the Consideration Requirement analysis must focus on the FMV of what is directly promised by the contracting parties, not indirect benefits. ***Second***, the Court should confirm that the analysis must be based on the FMV of what the private party agrees to do for or on behalf of the government payor for a public purpose, not what it agrees to do for its own private benefit. ***Third***, the "grossly disproportionate" language from the Court's prior opinions must be recognized as a presumption of judicial restraint (akin to a presumption of constitutionality for legislation) rather than a mathematical formula that excuses private gifts and subsidies up to a certain level.

In sum, the correct analysis under the Consideration Requirement must look, on the one hand, at the FMV of what the government is directly promising to pay

[1] "[N]on-contractual public expenditures, such as direct assistance to the needy" is beyond the scope and thus not barred by the above test; this test is focused instead on when the government pays a private company monies to perform services or provide goods, or transfers something of value. *See Turken*, 223 Ariz. at 348 n.4.

or otherwise do and, on the other, at the FMV of what the private party is directly promising to pay or otherwise do in furtherance of a public purpose. It must then compare those FMVs to determine whether there is a "donation or grant, by subsidy or otherwise." Ariz. Const. art. IX, § 7.

This Court should take this case to clarify what distinguishes proper public payments from improper gifts and subsidies. This sorely needed guidance will aid both the government and private parties in understanding the government's obligations to safeguard public monies under the Arizona Constitution.

ARGUMENT

I. The Issues Presented Are Recurring, Purely Legal Questions Of Statewide Importance, And This Is An Ideal Vehicle For Resolving Them

A. In The Few Years Since *Cheatham v. DiCiccio*, There Have Been At Least Four Other Appeals In Which The Gift Clause Has Been Asserted During The Litigation

The legal test for Gift Clause violations—and the Consideration Requirement in particular—is an important issue that continues to confront the lower courts and private and governmental parties. There have been (in addition to this case) at least four other appeals since *Cheatham* in 2016, in which the Gift Clause has been raised during the litigation. And importantly, it is not just private parties that have asserted the Gift Clause but also governmental entities.

In *City of Glendale v. Vieste SPE LLC*, Glendale asserted the Gift Clause in a contract action involving Glendale agreeing to provide a private company with municipal waste as part of a "waste-energy initiative." No. 1 CA-CV 18-0572, 2020 WL 428652, at *1 ¶2, *8 ¶38 (Ariz. Ct. App. Jan. 28, 2020), *petition for review pending on other grounds* No. CV 20-0045-PR. And there, Glendale specifically recognized that "[a]nticipated 'indirect benefits' … 'do not satisfy the "consideration" prong of the Gift Clause analysis.'" Glendale's Answering Brief/Contingent Cross-Appeal Opening Brief, 2019 WL 2373839, at *70 (May 2, 2019) (citation omitted).

In *Rodgers v. Huckelberry*, taxpayers challenged a lease-purchase agreement in which Pima County agreed to construct a facility on county-owned land to accommodate a private company's near-space-exploration operations. 243 Ariz. 427, 428 (App. 2017), *review denied* No. CV 18-0015-PR (Aug. 29, 2018). As part of that litigation, the taxpayers asserted a Gift Clause claim. *Id.* at 429 n.1; *see also* Taxpayer's Answering Brief, 2017 WL 4018133, at *13 (Sept. 5, 2017).

In *Stuart v. Lane*, a taxpayer challenged an amendment to an agreement whereby, in connection with making improvements to a clubhouse at a golf course, the City of Scottsdale allegedly "received insufficient consideration in exchange for" payments to a private party. *Stuart v. Lane*, No. 1 CA-CV 15-0746, 2017 WL

3765499, at *4 ¶22 (Ariz. Ct. App. Aug. 31, 2017), *review denied* No. CV 17-0311-PR (Aug. 29, 2018).

And in *State of Arizona ex rel. Brnovich v. Arizona Board of Regents*, the State is challenging whether ABOR will receive sufficient consideration as part of a transaction for a private developer to develop a private hotel and conference center near the ASU Tempe Campus. No. 1 CA-TX 20-0003.[2]

These cases only represent the small fraction of matters that reach the appellate courts; there are countless more instances where government officials and private parties must evaluate transactions for Gift Clause compliance and would benefit tremendously from this Court addressing the important issues presented here. This Court should therefore grant review. *See, e.g.*, *Sandra R. v. DCS*, 248 Ariz. 224, 227 ¶11 (2020) (granting review "to clarify the appropriate inquiry under [statute], a recurring issue of statewide importance"); *Turken*, 223 Ariz. at 345 ¶9 ("We granted review because interpretation of the Gift Clause is an issue of statewide importance.").

B. Neither Mootness Nor A.R.S. § 12-1841 Presents A Barrier To Granting Review

Contrary to the Response (at 21), mootness is not a barrier to accepting review here. The declaratory and injunctive relief sought is not moot, as the

[2] The Tax Court dismissed the Gift Clause claim on statute-of-limitation grounds, but if the Court of Appeals reverses, then any guidance from this Court will greatly assist the Superior Court and parties on remand.

parties still have a live dispute about the lawfulness of these type of "economic development" payments to private parties, which Peoria is likely to engage in in the future given its position in this litigation. As such, this Court (or the trial court on remand) retains discretion to declare rights and determine whether injunctive relief is also warranted beyond the particular transaction challenged. *See, e.g.*, *Prutch v. Town of Quartzsite*, 231 Ariz. 431, 435 ¶11 (App. 2013) (claims remain justiciable when a remedy is still available); *Bank of New York Mellon v. DeMeo*, 227 Ariz. 192, 193-94 ¶8 (App. 2011) (mootness arises when "action by the reviewing court would have no effect on the parties"). And even if Peoria were to swear-off such deals in the future—which it has not done—voluntary cessation, particularly *after* suit is filed, does not automatically moot possible injunctive relief. *See State ex rel. Babbitt v. Goodyear Tire & Rubber Co.*, 128 Ariz. 483, 486 (App. 1981).

Moreover, even if this case were moot, which it is not, Arizona courts may decide a moot issue when it is "of great public importance" and "likely to recur"—separate from whether the issue "evade[s] review." *Sears v. Hull*, 192 Ariz. 65, 72 n.9 (1998); *see supra* Part I(A) (showing the recurrence of the issues here). And Courts have considered moot issues that involve public contracts. *See Big D Construction Corp. v. Court of Appeals*, 163 Ariz. 560, 562-63 (1990) (deciding constitutionality of bid preference statute, even though parties had settled). And

this approach is particularly relevant in the context of Gift Clause claims, where the Court has previously applied its ruling prospectively, meaning it was providing guidance only for future transactions (the same scenario as when it retains jurisdiction after a case becomes moot). *See Turken*, 223 Ariz. at 351-52 ¶45, ¶49.

Finally, there is no § 12-1841 issue. Section 9-500.11 has no bearing here and does not need to be held unconstitutional in connection with resolution of this case. *Contra Response to PR* at 13. Section 9-500.11(A) merely authorizes a city to "appropriate and spend public monies for and in connection with economic development activities." Nothing in that statute's plain language purports to overrule the Gift Clause, and Petitioner is not arguing that *all* economic development activities violate the Gift Clause; there are thus no grounds to declare the statute unconstitutional here. *See Turken*, 223 Ariz. at 351 ¶41 (concluding that § 9-500.11 was not determinative).

II. The Majority's Analysis Under The Consideration Requirement Contradicts Both The Constitution's Text And Case Law And Could Render The Gift Clause A Dead Letter

A. The Proper Gift Clause Analysis Must Focus On The FMV Of What Is Directly Promised By The Contracting Parties, Not Indirect Economic Impacts

Judge Morse in his dissent correctly recognized that "[t]he Superior Court erred when it considered indirect economic impact to determine adequate consideration under the Gift Clause," and this "Court has held that potential

economic impact is not consideration for purposes of the Gift Clause." Op. at *6 ¶27, *7 ¶31 (Morse, J., dissenting).

Indirect economic impact or potential economic impact does not count in determining whether the government has received adequate consideration for payments to a private contractor to perform a task or otherwise engage in quasi-public purposes. *See Turken*, 223 Ariz. at 350 ¶33. If it did, then the whole purpose of the Gift Clause would be thwarted.

Instead, *Turken* recognizes that it is permissible only to count the value of the direct benefits that are bargained-for and provided to the State directly or directly on the State's behalf. *Id*. The Court in *Turken* gave a hypothetical wherein it concluded that a city could not pay $5 million to a contractor to fix a sewer line simply because the fix might result in $5 million of indirect benefits such as saved lives or avoided health care costs. *Id.* ¶¶34-35.[3]

But contrary to this Court's case law, the majority below labeled the indirect economic benefit of $11.3 million as "direct benefits" because the economic impact is a "direct result of the promises made in the agreements." Ct. App. Opinion at ¶¶21-22. It relied on Peoria's expert's opinion "that the appropriate

[3] Similarly, in *Cheatham* and *Wistuber*, the Court looked at the direct benefit of the activities promised by the union as part of the collective bargaining agreements. Regardless of whether those should be considered public benefits, they were indisputably direct.

way to measure the fair market value Peoria received from the agreements was to measure the economic impact of the campus within Peoria's limits." *Id*. at ¶22.

This flatly contradicts *Turken*; if economic impact is a direct benefit simply because it is a "direct result" of the agreement, then any result of an agreement may be classified as a direct benefit and *Turken* would have come out differently. The saved lives and avoided healthcare costs from *Turken*'s sewer-repair hypothetical were also a direct result of the agreement to have the sewer line repaired. Yet those benefits do not count because they were not reflective of the FMV of what the government was actually purchasing (sewer repair services). Secondary economic impacts are simply not cognizable for purposes of the Consideration Requirement under the appropriate Gift Clause analysis.

In sum, the correct analysis under the Consideration Requirement must look, on the one hand, at the FMV of what the government is directly promising to pay or otherwise do and, on the other, at the FMV of what the private party is directly promising to pay or otherwise do in furtherance of a public purpose. It must then compare those FMVs to determine whether there is a "donation or grant, by subsidy or otherwise."

B. The Analysis Must Be Based On The FMV Of What The Private Party Agrees To Do For Or On Behalf Of The Government Payor For A *Public* Purpose, Not What It Agrees To Do For Its Own *Private* Benefit

The majority also erred when it failed to apply *Turken* and other well-established Gift Clause case law to the novel factual situation here: rather than a government entity purchasing services or goods for itself (*e.g.*, sewer repair or parking spaces), Peoria here is paying a private entity to provide public services or goods to the citizenry that the government could otherwise provide. Perhaps intuitively fearing that literal application of existing case law to this new fact pattern would result in outlawing all privatization of public services, the majority below erred in the opposite direction and adopted a test that simply counts "the amount expended by [the private parties] as the value of [the] consideration [to the government] for Gift Clause purposes." *See* Op. at *7 ¶32 (Morse, J., dissenting); *id.* at 5 ¶23 (majority).

But the case law ***is*** applicable to such a situation, and its application does not result in government entities never being able to use private parties to provide public goods or otherwise engage in public-private partnerships. Indeed, it is sometimes more financially efficient for the government to use private parties to provide government services, and that is completely *consistent* with the purposes and text of the Gift Clause.

Instead of the misguided approach below, proper application of the case law must focus on whether the government is paying FMV for the *public* goods or services the third party is contractually promising to provide. The way to do this is straightforward: the analysis must be based on the FMV of what the private party agrees to do for or on behalf of the government payor for a public purpose, not what it agrees to do for its own private benefit. Even if the overall contract has an arguably public purpose (the first requirement of the test, *see supra* 1), the Consideration Requirement still requires inquiring into whether the FMV of the promise *to the government* is equal to the amount of the government payment. *See Wistuber*, 141 Ariz. at 351 ("The reality of the transaction both in terms of purpose and consideration must be considered. A panoptic view of the facts of each transaction is required."); *accord Turken*, 223 Ariz. 348 ¶21 ("In *Wistuber,* … this Court rejected [the primary/incidental benefit] approach in favor of a simpler question: Does the expenditure, even if for a public purpose, amount to a subsidy because '[t]he public benefit to be obtained from the private entity as consideration... is far exceeded by the consideration being paid by the public'?").

Judge Morse's dissent illustrates this distinction perfectly. He hypothesizes a contractual promise by a private party to a government to pay the private party's C.E.O. $1,000,000 in return for a $1,000,000 payment from the government. Op. at *7 ¶33 (Morse, J., dissenting). If, per the majority's analysis, the "value" of the

return promise to the government party is the amount paid by the private party to its C.E.O., then there is no gift; but this example is the prototypical example of an illegal gift, which shows that the majority's analysis is fatally flawed.[4]

In contrast, if the government agrees to pay a private organization $5,000 per student and the organization agrees to provide free K-12 education to such students, then the proper analysis would be if the FMV of the education provided is equal to the $5,000 government payment.[5] Similarly, if the government agrees to provide a community organization with a $1,000,000 grant for homeless services, and the organization contractually agrees to provide services to the homeless, then the proper inquiry is whether the FMV of the services the organization is promising to provide equals ~$1,000,000, in which case there is no gift or subsidy.

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[4] Arizona courts have not hesitated to strike down Gift Clause violations based on illegal gifts. *See Arizona Ctr. For Law In Pub. Interest v. Hassell*, 172 Ariz. 356, 369–70 (App. 1991) (invalidating the State's attempted "wholesale relinquishment" to riverbed lands); *Puterbaugh v. Gila Cty.*, 45 Ariz. 557, 564 (1935) (invalidating county's attempted reimbursement to supervisor for unauthorized expenses as "clearly a donation"); *Duke v. Yavapai Cty.*, 24 Ariz. 567, 573 (1923) (invalidating attempted reimbursement to purchaser of cattle at a tax sale as a "mere donation").

[5] When applying this straightforward legal test, courts will have to properly take a "panoptic" view of the transaction and look at the <u>net</u> value of what is being provided. For example, if the school agreed to provide the education but still charge $2,000 to each student, then that $2,000 would have to be subtracted from the FMV of the pertinent services the organization is providing when comparing the FMV to the payment from the government. But these are factual inquires that the trial courts are well equipped to make if armed with the proper legal test.

As the latter two examples illustrate, applying the Gift Clause case law does not result in outlawing all government use of private parties to provide public goods and services. Instead, it properly focuses the analysis to the text and purpose of the Gift Clause: prohibiting gifts and subsidies of public monies to private businesses. And it is critical to make this inquiry because one of the primary functions of the Gift Clause is "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." *City of Tempe v. Pilot Properties, Inc.*, 22 Ariz. App. 356, 360 (1974); *see also* Ariz. Const. art. IX, § 1 ("[A]ll taxes … shall be levied and collected for public purposes only.").

C. The "Grossly Disproportionate" Limit Must Be Recognized As An Presumption of Judicial Restraint Rather Than A Formula That Excuses Private Gifts And Subsidies Up To A Certain Level

The "grossly disproportionate" language originated in this Court's jurisprudence in *Turken* as part of its gloss on the *Wistuber* test, *see Turken*, 223 Ariz. at ¶22, and must be recognized as an presumption of judicial restraint (akin to a presumption of constitutionality for legislation) rather than a mathematical formula that excuses private gifts and subsidies up to a certain level.

This concept serves an important role—Courts should not be called on to second-guess every transaction entered into by the duly elected leadership of the State and its various local government entities, or to decide Gift Clause cases based

on the most fleeting of disparities between the amount paid and the value provided. Instead, the judiciary should only intervene when the evidence establishes that the government entity engaged in an "abuse of discretion." *Wistuber*, 141 Ariz. at 349 (quoting *City of Tempe*, 22 Ariz. App. at 363).

That said, the Court must not completely defer to the government entities' fact-finding. Compliance with the Gift Clause must ultimately be a legal question.[6] The courts should evaluate the facts independently. But, based on those judicially evaluated facts, courts should not declare a transaction unconstitutional unless it is clear that the government entity was providing a gift based on a material divergence in value between what was paid and received/provided (irrespective of whether the transaction itself involved a small or large dollar value). It is the legal conclusion as to the gift or non-gift nature of the payment and not any mathematical multiplier that determines lawfulness. *See* Ariz. Const. art. IX, § 7 (prohibiting State and local governments from "mak[ing] <u>*any*</u> donation or grant, by subsidy or otherwise, to any individual, association, or corporation" (emphasis added)). In granting review, this Court should make that clear.

[6] Just like compliance with the First and Fourth Amendments is ultimately a legal question, even if it involves facts. *E.g.*, *State v. Woods*, 236 Ariz. 527, 530 ¶10 (App. 2015) (appellate courts review *de novo* mixed questions of law and fact and the superior court's ultimate legal conclusions about whether the totality of the circumstances warranted an investigative detention and whether its duration was reasonable) (citing *Ornelas v. United States,* 517 U.S. 690, 699 (1996)).

CONCLUSION

For the foregoing reasons, this Court should grant review.

RESPECTFULLY SUBMITTED this 29th day of May, 2020.

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