# ARIZONA SUPREME COURT

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

## SUPPLEMENTAL 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

The State files this supplemental amicus brief to emphasize two practical points regarding the consideration element of the Gift Clause test. Making these points clear in the Court's opinion will focus lower courts, private parties, and government entities on the economic substance of transactions to ensure that public funds are not being used to make "any donation or grant, by subsidy or otherwise, to any individual, association, or corporation." Ariz. Const. art. IX § 7.[1]

***First***, it is critical that the Court reaffirm that the consideration element requires comparing 1) the objective fair market value ("FMV") of what the government is directly promising to pay or otherwise do with 2) the objective FMV of what the private party is directly promising to pay or otherwise do for a public purpose.

***Second***, when engaging in the above comparison, determining whether the private party's return consideration is "grossly disproportionate," *Turken v.*

[1] The State is not advocating that the Court unwind the present deal, but it is critical that the Court provide guidance.

*Gordon*, 223 Ariz. 342, 345 ¶7 (2010), or, stated differently, "so inequitable and unreasonable that it amounts to an abuse of discretion," *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984), does not mean that the Gift Clause excuses gifts up to a certain amount. That would be fundamentally inconsistent with the Constitution's text, which applies to "*any* donation or grant, by subsidy or otherwise." Ariz. Const. art. IX § 7 (emphasis added). Instead, in line with this Court's recent opinions on presumptions of constitutionality/lawfulness, this language should be understood as requiring the challenging party to clearly show a material divergence between the two FMVs to overcome a presumption that the governmental entity acted lawfully. There is no requirement that the divergence be of a particular magnitude (e.g. twice or ten times) because such requirement would be inconsistent with the Constitution's text.

## ARGUMENT

### I. THE GIFT CLAUSE TEST FOR ADEQUATE CONSIDERATION SHOULD FOCUS ON THE VALUE OF THE DIRECT PUBLIC BENEFIT BEING PROVIDED.

As the Court made clear in *Turken*, "[w]hen public funds are used to purchase something from a private entity, finding a public purpose only begins the constitutional inquiry." 223 Ariz. at 349 ¶30. The Court must also "examine the 'consideration' received from the private entity." *Id.* This is directly required by

the Constitution's text, which outlaws "any donation or grant, by subsidy or otherwise." Ariz. Const. art. IX § 7.

Unlike common law contracts, where the mere existence of consideration is enough to validate their existence, the Gift Clause requires analysis of both the existence and adequacy of consideration. *See Turken*, 223 Ariz. at 349-50 ¶32. Under common law contract principles, adequate consideration exists when one party simply provides performance or gives a promise in return for performance or a promise from the counter party. *See Schade v. Dietrich*, 158 Ariz. 1, 8 (1988) (citing Restatement (Second) of Contracts § 71 (1981)). This is true even where the benefit conferred is indirect because the primary beneficiary of the performance or promise is a third-party. So Party A can promise Party B to pay Party C, and so long as Party B provides a return promise or performance to Party A, there is adequate consideration, even though Party B receives nothing directly in return from the transaction. 13 WILLISTON ON CONTRACTS § 37:28 (4th ed. 2020).

The Gift Clause is different because it outlaws "*any* donation or grant, *by subsidy or otherwise*, to any individual, association, or corporation." Ariz. Const. art. IX § 7 (emphasis added). The Gift Clause "was intended to prevent governmental bodies from depleting the public treasury by giving advantages to special interests." *Wistuber*, 141 Ariz. at 349; *accord City of Tempe v. Pilot*

*Properties, Inc.*, 22 Ariz. App. 356, 362 (1974) ("[I]t is clear that the drafters of this provision intended that government property or funds were not to be given to private industry," and "this intent must be given effect"). A valid contract, therefore, is not enough. Instead, the Gift Clause permits only those contracts where the direct consideration received by the government for a public purpose is roughly equal to the consideration the government provides.

Respecting this important constitutional restriction requires courts to compare, on one side of the ledger, the objective FMV of what the government is directly promising to pay or otherwise do with, on the other side, the objective FMV of what the private party is directly promising to pay or otherwise do for a public purpose. Moreover, courts should not count indirect benefits that the government receives or the value of things that are not for a public purpose. Thus, if the government is "Party B" in the example above, the Gift Clause is not satisfied simply by counting dollar-for-dollar what Party A is paying to Party C. The State explained this at length in its initial amicus brief. *See* State's 5/29/20 Amicus Brief at 10-13.

In addition, this Court has already made clear that certain items do not count as consideration for Gift Clause purposes. The Court has held that indirect welfare or economic benefits do not count in the consideration calculation. *See id.* This is the point the Court made in giving the sewer repair example in *Turken*. *See* 223

Ariz. at 350 ¶ 34 (explaining that the government could not use the indirect value of "saved lives and avoided health care costs" to justify spending $5 million on a sewer repair with a fair market cost of only $5,000).

The Court has also made clear that fiscal impact, such as the payment of sales or property taxes, does not count. This is because fiscal impact exists by exercise of law regardless of whether it is bargained for. *See id.* ¶ 38 ("But the Agreement does not obligate NPP to produce a penny of tax revenue for the City. Rather, the duty of CityNorth and its tenants to pay taxes arises from law applicable to all, not out of contract.").

And the Court has made clear that performance thresholds do not give rise to valid Gift Clause consideration because such thresholds do not *require* that the government's counterparty actually do anything; performance thresholds only specify what the government must do if the counterparty *chooses* performance in the first place. *See id.* ¶ 37 ("To be sure, the City's obligation to make payments under the Agreement does not commence until NPP has developed a specified amount of retail space. However, the Agreement makes plain that NPP has no contractual obligation to build the retail component[.]").

A few examples help to illustrate the proper analysis of consideration for Gift Clause purposes. Start with the example that Judge Morse gave in his thoughtful dissent below. A private company promises to pay $1 million to its

Chief Executive Officer in return for a $1 million payment from the government. According to Respondents, this arrangement would not result in a Gift Clause violation because it is a bargained-for promise to the promisee even if the promise is for the sole benefit of a third party. *See* Respondents' Supp. Br. at 11-12. But Respondents' argument is absurd and would write the Gift Clause out of the Arizona Constitution. Under the proper analysis, the private company is not providing anything of value to the government in furtherance of a public purpose, and therefore the value of the return consideration for Gift Clause purposes is $0.

Consider next the example that Respondents provide in their Supplemental Brief—a municipality partially reimburses a hospital to begin offering COVID-19 tests to patients. *See id.* at 12. So long as the amount of reimbursement is reasonably equivalent to the FMV of the COVID-19 tests (*i.e.*, the market value of the public purpose), the Gift Clause is not violated.[2]

In this case, the consideration analysis is straightforward because Respondents are paying private companies millions of dollars and receiving nothing in return other than a promise that the companies will pay money (perhaps some to third parties like contractors, employees or vendors) to operate their own business and develop their own property. Respondents' arguments in this case are

[2] But as the sewer-repair hypothetical in *Turken* makes clear, it would not be the value of lives saved or additional productivity of workers not contracting COVID-19. *See supra* p. 4-5.

largely a repeat of those this Court rejected in *Turken*. In fact, the consideration calculation here is far easier than in *Turken*, where the government at least received the exclusive use of 200 parking spaces for 45 years. Because the private companies here did not directly promise to pay or otherwise do anything of direct public benefit, the value of the return consideration for Gift Clause purposes appears to be $0, and a violation is easily established.

## II. THE GIFT CLAUSE REQUIRES REASONABLY EQUIVALENT VALUE BETWEEN CONSIDERATION AND RETURN-CONSIDERATION.

In most cases, the consideration question will not be whether the government has received any direct consideration but whether the direct consideration received is sufficient, such that the Government payment does not amount to "any donation or grant, by subsidy or otherwise." Ariz. Const. art. IX § 7.

In so deciding, the courts should use a standard that recognizes that FMV calculations can be somewhat imprecise based on the assumptions made and that government officials should be given some leeway in purchasing goods or services. On the other hand, the standard cannot be so deferential that it renders the Gift Clause a nullity or results in a super presumption of constitutionality.

This Court has recently spoken on the appropriate presumptions that should be afforded to governmental officials, and the Gift Clause jurisprudence should

follow the same reasoning. In *State ex rel. Brnovich v. City of Phoenix*, the Court stated, "we presume the Ordinance complies with [a constitutional requirement] 'unless it clearly [does] not.'" 249 Ariz. 239, 243 ¶17 (2020) (citation omitted). Similarly, when addressing the constitutionality of legislation, the Court recently stated, "[a]n act of the legislature is presumed constitutional, and where there is a reasonable, even though debatable, basis for enactment of the statute, the act will be upheld unless it is clearly unconstitutional." *State v. Arevalo*, 249 Ariz. 370, 373 ¶9 (2020).

The proper balance for the Gift Clause is in accord with the above standards. This requires private parties to provide the government with direct public benefits having an FMV *reasonably equivalent* to the consideration the government provides. This is consistent with the standard that this Court employed in *Wistuber*. *See* 141 Ariz. at 349 ("There must also be consideration which is not so inequitable and unreasonable that it amounts to an abuse of discretion."); *Turken*, 223 Ariz. at 345 ¶7 (explaining the *Wistuber* consideration test).

Importantly, this does ***not*** mean that the government consideration must be multiples of that received to invoke the Gift Clause or, on the other hand, that precise dollar-for-dollar consideration is required.

*Turken* clearly did not overrule *Wistuber*'s language but also injected new "grossly disproportionate" language into the Gift Clause analysis. *See Turken*, 223

Ariz. at 348 ¶22 ("When government payment is grossly disproportionate to what is received in return, the payment violates the Gift Clause."). This "grossly disproportionate" language could be misread to be not just a presumption of constitutionality, but a super presumption. In no other area of law does government need to act grossly unconstitutionally in order to result in judicial oversight. The "grossly disproportionate" language is inconsistent with the constitutional text, which forbids government from providing *any* subsidy to the private sector. The language could even be misconstrued as meaning the government subsidy must be worth ***multiples*** of the return consideration provided to result in an actionable Gift Clause violation. And it has resulted in lower courts rubber stamping the payment of millions of dollars in government funds with little or no showing of direct public consideration received in return, as the court of appeals did below. *See Schires v. Carlat*, 2020 WL 390671, *5 ¶23 (Ariz. Ct. App. Jan. 23, 2020) ("We agree with the trial court's conclusion that Taxpayers have not met their burden of showing that the consideration here is grossly disproportionate.").

The Court should make clear that the "grossly disproportionate" language from *Turken* was merely recognition of the need for judicial restraint rather than a mathematical formula that, contrary to the Constitution's text, excuses donations or grants up to a certain level.

## CONCLUSION

For the foregoing reasons, this Court should vacate the decision of the Court of Appeals and clarify the consideration element of the Gift Clause test.

RESPECTFULLY SUBMITTED this 22nd day of October, 2020.

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