SUPREME COURT OF ARIZONA

DARCIE SCHIRES; ANDREW AKERS; and GARY WHITMAN, Appellants/Petitioners, v. CATHY CARLAT, et al., Appellees/Respondents.	Arizona Supreme Court No. CV-20-0027-PR Court of Appeals Division One No. 1 CA-CV 18-0379 Maricopa County Superior Court No. CV 2016-013699

RESPONSE TO SUPPLEMENTAL BRIEF OF AMICUS CURIAE STATE OF ARIZONA

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INTRODUCTION

The State's supplemental brief addresses only the second prong of this Court's Gift Clause test, which requires analyzing consideration. The goal of the analysis is to determine whether Peoria promised "far too much" for what HU and Arrowhead promised in return. *Turken v. Gordon*, 223 Ariz. 342, 350 ¶ 32 (2010).

Consideration "has a settled meaning in contract law"—it is what each party "obligates itself to do (or to forbear from doing) in return for the promise of the other contracting party." *Id.* at 349 ¶ 31. Thus, the consideration analysis compares **(1)** the value of what Peoria promised, with **(2)** the value of what HU and Arrowhead promised in return. This Court has never departed from this settled meaning of consideration in its jurisprudence.

The State's formulation, however, asks the Court to modify this analysis for the first time by adding several new restrictions to the meaning of consideration, applicable only to the Gift Clause. *See* State's Suppl. Br. at 1.

First, the State restricts consideration analysis to what HU and Arrowhead promised "for a public purpose." State's Suppl. Br. at 1. But public purpose is a separate inquiry under the Gift Clause. And regardless, the State does not argue that HU's and Arrowhead's promises lack a public purpose in this case.

Second, the State restricts consideration analysis to what HU and Arrowhead "directly" promised Peoria. State's Suppl. Br. at 1. But there are two types of

directness. One is whether *promises were made directly* to Peoria. The other is whether *things being promised were given directly* to Peoria. The first type of directness is satisfied in this case. The second type of directness is not a requirement, nor should it be. And regardless, Peoria received direct benefits in this case.

Third, the State restricts consideration analysis to the "fair market value" of HU's and Arrowhead's promises. State's Suppl. Br. at 1. But, while fair market value is often a reasonable valuation method, this does not mean it is the appropriate valuation method in all cases. Moreover, Petitioners presented no evidence of fair market value below, even though they had the burden.

The State also offers its own gloss on the rule that a challenger must prove a government payment is "grossly disproportionate" to the return promise. *Turken*, 223 Ariz. at 350 ¶ 35. The State interprets this rule as requiring the challenger to "clearly show a material divergence" between the values of promises exchanged, not "that the divergence be of a particular magnitude (e.g. twice or ten times)." State's Suppl. Br. at 1–2. The City agrees that gross disproportionality requires a clear showing of material divergence but not a specific numerical magnitude. Judicial deference is especially important when it comes to evaluating consideration.

The State also notes that it "is not advocating that the Court unwind the present deal." State's Suppl. Br. at 1 n.1. The City agrees that unwinding the present deal would be inappropriate regardless of how the merits are resolved.

I. Consideration analysis focuses on the values of promises exchanged.

The State's new formulation of consideration analysis is unwarranted and adds unnecessary confusion.

A. Public purpose is a separate inquiry (and regardless, HU's and Arrowhead's promises serve a public purpose here).

The State restricts consideration analysis to what HU and Arrowhead promised "for a public purpose." State's Suppl. Br. at 1; *see also id.* at 4, 6. But public purpose is a separate inquiry, aimed at a separate issue.

The "first prong" of Gift Clause analysis is whether the government unquestionably abused its discretion in determining that its contract serves a "public purpose." *Turken*, 223 Ariz. at 349 ¶¶ 28–29. This is the first prong because, if a government contract serves no discernible public purpose, then payments to a private entity under the contract are really a "donation or grant" of public funds. *See* Ariz. Const. art. 9 § 7.

The first prong is therefore a restriction on the *types* of contracts a government may enter into. For example, the City could not pay for an official's private travel expenses, regardless of whether those expenses were paid at a reasonable market rate. *See Valley Bank & Trust Co. v. Proctor*, 47 Ariz. 77, 83–86 (1936) (finding several of the governor's expenditures were for private rather than public purposes).

The second prong plays a more limited role. Even when a government contract serves a public purpose, payments under the contract might still be a

donation or grant if the government pays "far too much" for what the private entity promises in return. *Turken*, 223 Ariz. at 350 ¶ 32. In that situation, the amount of the donation or grant would be the extent of overpayment.

The second prong is therefore a restriction on the *amount* a government may pay under an otherwise appropriate contract. For example, if a contractor offers to repair a sewer line for $5,000 and the municipality instead pays the contractor $5,000,000, the municipality has made a donation or grant of $4,995,000. *Cf. id.* at 350 ¶ 34. For this reason, courts "analyz[e] the adequacy of consideration issue only *after* finding the requisite public purpose." *Id.* at 348 ¶ 21 (emphasis added).

The State, by defining a private entity's consideration in terms of public purpose, conflates these two distinct inquiries. This Court has refrained from defining consideration in terms of public purpose. Rather, this Court has followed the "settled meaning in contract law," defining consideration simply as "what one party to a contract obligates itself to do (or to forbear from doing) in return for the promise of the other contracting party." *Id.* at 349 ¶ 31.

The State's hypothetical about the CEO payment illustrates the distinction between the public purpose inquiry and the consideration inquiry. *See* State's Suppl. Br. at 5–6 (referring to the dissent below). It is true that the City could not pay a private company $1 million in return for the company paying its own CEO $1 million. But the constitutional defect there would be lack of public purpose (prong

one), not overpayment (prong two). In other words, that is not the *type* of contract the City should enter into, regardless of the *amount* of payment. The City could no more pay the private company $5 than it could $1 million.

At best, the State's hybrid approach serves no useful purpose because courts already examine public purpose. At worst, it is likely to cause confusion. This Court should not adopt it.

Moreover, in this case it does not matter. HU's and Arrowhead's promises to Peoria—including the promise to open and operate a specialized undergraduate campus in Peoria and the promise to convert an otherwise underutilized building in an important district to an educational use—serve a variety of public purposes. *See* Respondents' Resp. to Pet. at 12–15; Respondents' Suppl. Br. at 2–6. The State does not argue otherwise.

B. Consideration is not limited to benefits given "directly" to the government (and regardless, Peoria received direct benefits here).

The State also restricts consideration analysis to what HU and Arrowhead "directly" promised Peoria. State's Suppl. Br. at 1; *see also id.* at 3–5, 7. There are two types of directness, however. One involves whether the private entity *directly made the promise* to the government. The other involves whether the private entity *directly gave the thing being promised* to the government.

This distinction is subtle but important. The former is supported by this Court's decision in *Turken* and common sense. The latter is not.

1. Under *Turken*, consideration is limited to what the private entity promised.

In *Turken*, a municipality agreed to pay a developer up to $97.4 million. 223 Ariz. at 350 ¶ 36. In return, the developer promised shockingly little: only "the non-exclusive use of some 2,980 parking garage spaces" and "the exclusive use of 200 park-and-ride spaces" for a period of time. *Id.* The developer "made no other promises." *Id.*; *see also id.* at 345 ¶ 5 (summarizing promises exchanged).

The municipality argued that other items were consideration too, but this Court rejected those arguments because the developer had not promised those items. For example, the municipality expected the developer to build "retail space," but that item was not consideration because the developer had "no contractual obligation" to do so. *Id.* at 350 ¶ 37. Likewise, the municipality expected the development to generate tax revenues, but that item was not consideration because, again, the contract did "not obligate" the developer to do so. *Id.* at 350 ¶ 38.

Turken thus established a simple proposition: For an item to count as consideration to the government, the private entity must actually promise it.[1]

Here, unlike in *Turken*, HU and Arrowhead made a multitude of promises directly to Peoria, including the promise to open and operate a specialized campus

[1] How to value promises is a separate question. *See Turken*, 223 Ariz. at 351 ¶ 42 (describing "the remaining question" as "whether the $97.4 million that the City has promised to pay far exceeds the value of the parking spaces promised in return").

in Peoria and the promise to convert an underutilized building in a key district to an educational use. These promises were bargained for and are therefore consideration. *See* Respondents' Resp. to Pet. at 15–21; Respondents' Suppl. Br. at 7–13.

2. Limiting consideration to benefits given directly to the government is not supported by law or common sense.

Although HU and Arrowhead made their promises directly to Peoria, the State does not count these promises as consideration because they did not involve *giving things directly* to Peoria. The State offers an illustration of its theory:

> If A promises B that it will give a benefit to C, and…
>
> In return, B makes a promise to A, then…

Under contract law, there is adequate consideration; but under the Gift Clause, if B is a government, the State asserts there is no adequate consideration. *See* State's Suppl. Br. at 3–4.

The State's theory is wrong for two reasons. First, the State admits that its theory would require departing from ordinary contract law, which this Court uses. *See Turken*, 223 Ariz. at 349 ¶ 31 (relying on the "settled meaning in contract law"). Second, while governments sometimes enter into contracts to obtain things directly like goods or services, they often enter into contracts to pay a private entity to do something that otherwise benefits members of the public. For example, the State admits that a government may reimburse a hospital to begin offering COVID-19 tests to patients, or pay a private organization to provide education, or pay a

community organization to provide homeless services. *See* State's Initial Br. at 12; State's Suppl. Br. at 6. Yet in each of these examples, the government "receives nothing directly," at least in the State's view. State's Suppl. Br. at 3.[2]

To be sure, consideration does not include "anticipated indirect benefits" that are "not bargained for." *Turken*, 223 Ariz. at 350 ¶ 33. But the underlying bargained-for promise is still consideration. For example, when a contractor promises to repair a sewer line in a way that is expected to save lives, the saving of lives is not consideration, but the promise to do the repair is. *See id.* at 350 ¶ 34.

Similarly, HU's and Arrowhead's promises to Peoria—including opening and operating a specialized campus in Peoria and converting an underutilized building in a key district to an educational use—are consideration to Peoria. *See* Respondents' Resp. to Pet. at 15–21; Respondents' Suppl. Br. at 7–13. The "remaining question" is how to value those promises. *Turken*, 223 Ariz. at 351 ¶ 42.

C. Petitioners failed to present evidence of fair market value (and other valuation methods are also reasonable).

On the valuation question, the State focuses only on the "fair market value" of HU's and Arrowhead's promises. State's Suppl. Br. at 1; *see also id.* at 6. The City agrees that fair market value is a reasonable valuation method in many cases.

[2] In the City's view, the government *does* receive a direct benefit in these examples because governments act on behalf of their constituents. For this reason, Peoria received direct benefits in this case. *See* Respondents' Suppl. Br. at 12.

But, importantly, the burden of establishing fair market value rests on those who challenge a government contract. *See* Respondents' Resp. to Pet. at 20; Respondents' Suppl. Br. at 6–7, 14–15. The State agrees, acknowledging that the consideration test requires "the challenging party to clearly show a material divergence between the two FMVs." State's Suppl. Br. at 2.

Here, however, Petitioners made no attempt to assign a fair market value (or any value) to HU's and Arrowhead's promises. They did not, for example, attempt to show that other competent universities or property owners would have made the same promises at a far lower cost to Peoria. Indeed, the only evidence touching on these points is the opposite. *See* Respondents' Suppl. Br. at 16–17. Petitioners thus failed to present evidence that Peoria paid "far too much" for HU's and Arrowhead's promises, even under the State's theory. *Turken*, 223 Ariz. at 350 ¶ 32.

Moreover, while fair market value is appropriate when "evaluating a contract like the Parking Agreement," *Turken*, 223 Ariz. at 350 ¶ 33, in this case other valuation methods are reasonable too. For example, this Court has also examined "the value to be received by the public." *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346, 349 (1984); *see also Cheatham v. DiCiccio*, 240 Ariz. 314, 322 ¶ 34 (2016) (focusing on "the benefit the public receives"). Accordingly, the City reasonably hired economists to estimate the economic and fiscal impacts of some of HU's and Arrowhead's promises. *See* Respondents' Suppl. Br. at 17–19.

Likewise, consideration can consist of a "loss or detriment" to a contracting party. *Cavanagh v. Kelly*, 80 Ariz. 361, 363 (1956). Thus, another reasonable approach is to examine the dollar amounts that HU and Arrowhead expressly promised to invest in Peoria. *See* Respondents' Suppl. Br. at 20.

And, to the extent it is impossible to assign values to some of HU's and Arrowhead's promises, that does not mean Peoria paid "far too much" for the promises. *Turken*, 223 Ariz. at 350 ¶ 32. Rather, it means Petitioners failed to carry their burden of gross disproportionality. *See* Respondents' Suppl. Br. at 14–15.

One thing is for sure: Petitioners *never* showed that the value of HU's and Arrowhead's promises is $0, as the State baldly asserts. *See* State's Suppl. Br. at 7. Indeed, that conclusion would come as quite a surprise to Peoria's elected officials and staff, who spent substantial time negotiating with HU and Arrowhead and carefully drafting contracts in which HU and Arrowhead made specific promises deemed highly valuable and in furtherance of Peoria's pre-existing policies, and which ultimately caused HU to open and operate a specialized campus in Peoria. *See* Respondents' Suppl. Br. at 2–5, 7–10.

II. Gross disproportionality requires a clear showing of material divergence between values of promises, and judicial deference is especially important.

The State asserts that gross disproportionality requires the challenger to "clearly show a material divergence" between values of promises exchanged, not

"that the divergence be of a particular magnitude (e.g. twice or ten times)." State's Suppl. Br. at 1–2. The City agrees. Indeed, nobody has asserted otherwise. This Court's existing jurisprudence is clear in this respect and need not be altered.

The State goes on to suggest, however, that this Court's unanimous decision in *Turken* should not have used the term "gross disproportionality," because it "could be misread" as a super presumption of constitutionality and has resulted in lower courts "rubber stamping" government expenditures. *See* State's Suppl. Br. at 8–9. This suggestion is unwarranted.

First, the State misunderstands the reasons for the gross disproportionality standard and the corresponding need for judicial deference when evaluating consideration. It is true that, as the State points out, a Gift Clause challenge asks judges to review the constitutionality of government officials' decisions. Deference is required for this reason. *See* State's Suppl. Br. at 7–8.

But when it comes to evaluating consideration, deference is *also* required for prudential reasons. Courts "do not ordinarily examine the proportionality of consideration" between contracting parties at all. *Turken*, 223 Ariz. 349 ¶ 32. This is because "the parties are thought to be better able than others to evaluate the circumstances of particular transactions." Restatement (Second) of Contracts § 79 cmt. c (1981). And "in many situations there is no reliable external standard of value, or the general standard is inappropriate to the precise circumstances of the

parties." *Id.*

Thus, a challenge to adequacy of consideration does not merely ask judges to review the constitutionality of government officials' decisions. It also asks judges to make *value judgments*—even though the contracting parties are often better able to estimate value and even though objective answers may be impossible. Judicial deference is therefore especially important in this area. A challenger *should* be required to prove gross disproportionality before a judge intervenes.

Second, the gross disproportionality standard has not caused judges to "rubber stamp[]" government expenditures. The State's only example of a purported rubber stamp is the concluding sentence of the majority opinion below. *See* State's Suppl. Br. at 9. But that conclusion came at the end of a well-reasoned six-paragraph discussion of consideration. *See* Ct. App. Op. at 7–9 ¶¶ 18–23. And the majority's conclusion was not only well-reasoned, but correct.

III. Regardless of the merits, the Court should not unwind the present deal.

The State notes that it "is not advocating that the Court unwind the present deal." State's Suppl. Br. at 1 n.1. The City agrees that, regardless of how the merits are resolved, the Court should not unwind the contracts with HU and Arrowhead for two reasons.

First, the challenge to Peoria's contract with HU is moot because all payments under that contract have been made. *See* Respondents' Resp. to Pet. at 21. In

addition, some of the payments under Peoria's contract with Arrowhead have also been made. *See* Notice of Corrected Declaration filed 10/07/2020.

Second, this Court has discretion to apply its opinions prospectively only. *See Turken*, 223 Ariz. at 351 ¶ 44. Even if this Court disagrees with the majority below, the Court should apply its opinion prospectively and affirm the trial court's dismissal. *See id.* at 352 ¶ 50 (taking this approach).

CONCLUSION

The Court should affirm the judgment below.

RESPECTFULLY SUBMITTED this 5th day of November, 2020.

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