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IN THE SUPERIOR COURT OF ARIZONA
IN AND FOR THE COUNTY OF MARICOPA

JAYNE FRIEDMAN, et al., Plaintiffs, vs. CAVE CREEK UNIFIED SCHOOL DISTRICT #93, et al., Defendants.	Case No.: CV2011-007925 **PLAINTIFFS' RESPONSE TO DEFENDANTS' MOTION FOR SUMMARY JUDGMENT** *Hon. Eileen S. Willett*

Defendants moved for summary judgment pursuant to Ariz. R. Civ. P. 56(a). For the reasons set forth below in the Memorandum of Points and Authorities and in Plaintiffs" Statement of Facts in Support of Plaintiffs" Motion for Summary Judgment ("SOF"), Defendants" Motion for Summary Judgment should be denied.

MEMORANDUM OF POINTS AND AUTHORITIES

When school districts borrow money for projects by issuing bonds, they put taxpayers on the line to repay the funds. Thus, Arizona law requires voter approval of bond issues, Ariz. Const. art. 7, § 13, and districts to distribute publicity pamphlets that outline the specific improvements the bonds would finance, enabling voters to determine whether the projects are

worth the extra tax burden. *See* A.R.S. § 15-491(H)(6). Until recently, and at the time of the 2000 Cave Creek Unified School District No. 93 ("the District") bond election, Arizona law specifically prohibited governments from using bond proceeds for purposes not approved by the voters. A.R.S. § 15-491(J). A new law, passed ten years after the election, carves out an exception that allows the preferences of school board members to override the constitutionally-protected will of the voters. *See* 2010 Ariz. Sess. Laws 332 § 34. Pursuant to this new law, Defendants Board Members voted to spend money that voters had specifically designated for new school construction on a variety of renovations and improvements, none of which was approved by the voters.

Defendants attempt to deny the relationship the election created between the District and the voters, despite a clear state regime designed to protect taxpayers by constraining how governments may behave when incurring debt at taxpayer expense. They contend the District"s financial difficulties justify the contractual impairment and the law itself, but this does not comport with the degree of the impairment or the arbitrariness of the law"s operation. Although statutes enjoy a strong presumption of constitutionality, they will be struck down if they "infringe[] upon a constitutional guarantee or violate[] some constitutional principle." *See State v. Wolfe*, 137 Ariz. 133, 134, 669 P.2d 111, 112 (App. 1983). Courts are "less deferential to a state's judgment of reasonableness and necessity when a state's legislation is self-serving and impairs the obligations of its own contracts," *Univ. of Hawai'i Prof'l Assembly v. Cayetano*, 183 F.3d 1096, 1107 (9th Cir. 1999), because "a governmental entity can always find a use for extra money, especially when taxes do not have to be raised." *U.S. Trust Co. of New York v. New*

Jersey, 431 U.S. 1, 25-6 (1977). Because § 34 violates the contract clauses of the Arizona and federal constitutions and the Special Law Clause of the Arizona Constitution, and because acting pursuant to § 34 Defendants have violated their obligation to spend the remaining bond money on voter-approved projects, Defendants' Motion for Summary Judgment should be denied.

I. Section 34 and Defendants' actions violate the state and federal contract clauses

a. Plaintiffs have standing to bring their Contracts Clause challenge

Defendants challenge Plaintiff Friedman's standing to bring her contracts clause claim because she did not vote in the 2000 election and therefore "lack[s] standing to assert the rights of those who are parties." (Defs.' Mot. Summ. J. 7.) Defendants misunderstand the right Plaintiff Friedman asserts. She does not assert the rights of third parties, but rather, her *own* right as a taxpayer not to have her tax dollars spent on unlawful purposes. *See Maricopa County v. State*, 187 Ariz. 275, 279, 928 P.2d 699, 703 n.7 (App. 1996). In Arizona, standing "is not a constitutional mandate," but rather a "prudential or judicial restraint." *Armory Park Neighborhood Ass'n v. Episcopal Comm. Services in Ariz.*, 148 Ariz. 1, 6, 712 P.2d 914, 919 (1985). Arizona courts consistently have conferred broad taxpayer standing to challenge unlawful governmental expenditures. *Turken v. Gordon*, 220 Ariz. 456, 461, 207 P.3d 709, 714 (App. 2008), *rev'd on other grounds*, 223 Ariz. 342, 224 P.3d 158 (2010). Indeed, contract-with-the-voters cases in other jurisdictions were usually brought by taxpayers.

Nevertheless, to conserve judicial resources and to focus on the merits of the case, Plaintiff Friedman has amended her Complaint to add Richard Bail as a plaintiff. Plaintiff Bail voted in the 2000 bond election and thus addresses Defendants' concerns. (*See* SOF 5.)

b. The bond election created a contract between the District and voters

Defendants dismiss Plaintiffs‟ contract claim because it "is reflected primarily in some very old court decisions." (Defs.‟ Mot. 3.) But state courts have very recently, indeed mere months before this lawsuit was filed, verified that the doctrine is alive and well. *See, e.g., Putnam v. City of Irving*, 331 S.W.3d 869, 878 (Tex. App. 2011) ("A city violates its „contract‟ with voters if it uses proceeds from taxes approved by the voters in a way that the voters did not approve"). Defendants contend that "[m]ost states and the federal courts have wisely declined to adopt this contract theory of bond elections" (Defs.‟ Mot. 3), but cite no case law for support.

Although Defendants correctly note that California courts have at times classified bond elections as "analogous to" contractual relations instead of actual contracts (Defs.‟ Mot. 6), this distinction amounts to mere semantics, as those decisions nevertheless employed the same contracts law analysis. In fact, a subsequent California case noted, "The logical basis for invalidating such amendments is not that they violate a metaphorical contract; rather, that they clash with the constitutional provision which required popular approval of the bonds in the first place." *State Sch. Bldg. Fin. Comm. v. Bett*s, 216 Cal. App. 2d 685, 693 (Cal. Ct. App. 1963). Likewise, the Arizona Constitution requires school districts to obtain voter approval before issuing bonds. *See* Ariz. Const. Art. 7, § 13.

Defendants devote the bulk of their contracts clause argument to a misguided discussion of parties to the contract, claiming that the District cannot be bound by the election because not every voter voted or voted "yes," and thus not every voter gave consent and intended for the District to be bound. (*See* Defs.‟ Mot. 4-6.) But the contract at issue is with the body politic of

which Plaintiffs are part, and the fact that each and every voter has not *personally* assented to the contract does not in any way weaken Plaintiffs' argument – indeed, this is the very nature of representative democracy. The party intending to be bound is the body politic as a *whole*. To imply that a law that, once implemented, applies differently to "yes" and "no" voters is patently false. After all, even property taxpayers who vote "no" on a bond issue are still liable to repay the debt. Nor are other voters not parties to this lawsuit "indispensible parties" that must be joined. (*See* Defs.' Mot. 5.) Plaintiffs' rights arise out of their status as taxpayers, and Arizona courts have never held that taxpayers must join all other affected taxpayers in order to bring a lawsuit protecting their rights and challenging illegal expenditures.

Finally, Defendants incorrectly submit that, due to a strong presumption that statutes do not create contract rights, Plaintiffs' argument fails because of "the assertion that the terms of A.R.S. § 15-491(J) formed a part of the supposed contract." (Defs.' Mot. 7.) But Plaintiffs do not claim that § 15-491(J) *created* a contract right. The contract right was created by the election itself, the terms of which were contained in the publicity pamphlet. Indeed, the election would have created a contract between the voters and District *regardless* of whether § 15-491(J) was in effect. By authorizing the District to spend the bond money on specific items, the voters prohibited expenditures on other purposes. Section 15-491(J) is relevant because Arizona courts have long recognized that law at the time the contract is formed affects the expectations of the parties. *See Verma v. Stuhr*, 223 Ariz. 144, 152, 221 P.3d 23, 31 (App. 2009) ("[T]he law is made part of the contract"). Because Section 15-491(J) was law during the election, Plaintiffs had no notice that when they voted the District could spend the money on other purposes.

Indeed, Section 15-491(J) is merely one element of an overall regime designed to protect voters by limiting a district's discretion in spending bond money. *See also* Ariz. Const. art. 7, § 13; A.R.S. § 15-491(H)(6). That such extensive protections exist indicate that districts and the legislature do not have the same discretion and "flexibility" here as they would when spending general funds or passing regular legislation. Bond elections are different – they put taxpayers on the line to repay additionally-incurred debt, and the protections afforded by Arizona law recognize this distinction.

c. The impairment effected by § 34 and the District was substantial

In determining whether a law unconstitutionally impairs a contract, courts consider whether there is (1) a substantial impairment, (2) a significant and legitimate public purpose, and (3) an adjustment of rights and responsibilities of the contracting parties based upon reasonable conditions appropriate to the public purpose. *See Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-13 (1983). Section 34 and the District's actions pursuant to it fail all three prongs.

Section 34 substantially impaired the District's agreement with the voters, including, contrary to Defendants' claims, the financial terms. (*See* Defs.' Mot. 9-10.) The statute need not change the interest rate to affect the contract financially. Prior to § 34, Cave Creek taxpayers expected to get certain projects in return for agreeing to sustain additional taxes. Now, they are receiving entirely different products but remain bound by the same burden and continue to pay interest on the debt. Furthermore, as Defendants correctly note, "The reasonable expectations of a complaining party . . . play an important role in deciding whether a law

substantially impairs a contract." (Defs.' Mot. 9.) But this proposition strongly militates in Plaintiffs' *favor*: given the laws governing bond elections, including § 15-491(J), it is both perfectly reasonable for Plaintiffs to expect that the District would limit its expenditures to projects in the publicity pamphlet, and wholly *unreasonable* for them to anticipate that the District would *not* do so.

d. Section 34 was not passed pursuant to a significant and legitimate purpose

i. The purpose does meet the standards of the Arizona Constitution

Under certain very limited circumstances, the Arizona Constitution "allow[s] legislation to impair contracts constitutionally[, but it] must be of such magnitude as to bring to the general consciousness of the public a feeling of urgency and need. Anything less would unduly undermine the constitutional limitation against impairment of contracts." *Earthworks Contracting, Ltd. v. Mendel-Allison Const. of California, Inc.*, 167 Ariz. 102, 107, 804 P.2d 831, 836 (App. 1990). The emergency must be severe enough to threaten a basic social interest. *Ward v. Chevron U. S. A. Inc.*, 123 Ariz. 208, 210, 598 P.2d 1027, 1029 (App. 1979).

Defendants cite *Baker v. Arizona Dept. of Revenue*, 209 Ariz. 561, 105 P.3d 1180 (App. 2005), to support their contention that a significant public purpose existed for § 34 and the District's actions. (Defs.' Mot. 10.) But *Baker* involved modification to a general statute passed by the legislature, not the terms of voter-approved bonds. *See Baker*, 209 Ariz. at 563, 105 P.3d at 1182. Statutes usually do not create contract rights and legislatures generally may amend statutes. But bond measures requiring voter approval are different. As the *Baker* court itself noted, the parties' reasonable expectations "play an 'important role,'" Ariz. 561, 566, 105 P.3d

1180, 1185, and voters and taxpayers may reasonably assume that the terms of a voter-approved bond issue cannot be altered by anyone but the voters. Furthermore, the public purpose at issue in *Baker* was a statewide financial crisis, unlike the instant situation, which is addressed below. *Id.* at 566-67, 105 P.3d at 1185-86.

ii. The purpose does not meet the standards of the federal Constitution

Experiencing an economic downturn is not an appropriate reason to justify § 34 or the District‟s impairing its contract. Federal courts only allow contractual impairment if legislation was enacted to remedy "a broad, generalized economic or social problem." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 235 (1978). Even in cases where courts have been more willing to "defer to the decisions of state legislatures regarding the impairment of *private* contracts," *State of Nev. Employees Ass'n, Inc. v. Keating*, 903 F.2d 1223, 1226 (9th Cir. 1990) (emphasis added), they hold governments impairing their *own* contracts to a higher standard because their "self-interest is at stake." *Id.* (quoting *U.S. Trust Co*, 431 U.S. at 26).

The purpose behind the deference courts sometimes accord legislatures when dealing with private contracts is that the Contracts Clause cannot limit a state‟s legitimate police powers. Indeed, recent decisions that defer to state police powers address powers that "lie[] clearly within a state‟s or a municipality‟s police power." *See, e.g.*, *RUI One Corp. v. City of Berkeley*, 371 F.3d 1137, 1150 (9th Cir. 2004). Thus, laws that incidentally impair contracts when implementing a "generally applicable rule of conduct" are less suspect and are "sharply distinguishable from the [unconstitutional] measures struck down in *United States Trust Co. v.*

New Jersey," *i.e.*, state statutes that retroactively repealed *their own* statutory covenants relied upon by bond purchasers. *Exxon Corp. v. Eagerton*, 462 U.S. 176, 192 (1983).

A law that intentionally, rather than incidentally, provides for breaching contracts is not a legitimate police power. Furthermore, the Arizona Constitution specifically delegates the power to govern whether bonds are issued and how bond proceeds are spent to the people, so it is not a legitimate police power of the state to allow school districts to redesignate these funds.

Under certain circumstances, economic crises can justify general laws that incidentally impair private contracts. For example, laws passed during the Great Depression that capped gas prices, although affecting existing private contracts, were constitutional because the entire nation was facing an economic emergency, and people would be forced to endure winter without heat. *See Energy Reserves*, 459 U.S. at 417. Moreover, the parties were already operating in a highly-regulated industry where government intervention had become commonplace and expected. *Id.* at 413-15. In contrast, Cave Creek voters were in no way on notice that Defendants could spend the bond money on other, unapproved purposes.

Defendants claim that the contractual impairment is justified "to help schools maintain their facilities despite a shortage of funding." (Defs.' Mot. 11.) But "a shortage of funding" does not rise to the level of an emergency that justifies a government's abrogating its own contractual obligations. The District is in "good shape" regarding Maintenance and Operation funds, which it uses to keep the schools open and running and to make repairs, though it has "some deficiencies" in capital funding. (SOF 20.) Although the State has cut funding to school districts, the District is still receiving some money from the state for capital accounts, which the

Governing Board can choose to use for a variety of items, from technology, to skylights, to fire extinguishers. (SOF 22.) The District"s planned projects include painting projects that will cover the entire Cactus Shadows High School, regardless of damage (SOF 27); painting projects intended to create "an aesthetically pleasing classroom environment" (SOF 28); expansions to the cafeteria of Cactus Shadows High School (SOF 29); and converting a classroom to a records storage area, which is unrelated to children"s safety or learning. (SOF 31.) In fact, the District plans to spend over $2 million of the 2000 bond money alone on projects that the District itself has determined "do not pose a significant risk to the building"s occupants if not addressed immediately." (SOF 26.) And the plan for spending the bond money includes renovations to a school that the District closed a year ago.[1] (SOF 33-34.) Indeed, it has already been a year since § 34 became law, and the District has not yet spent money on these projects. Thus, while it is undeniable that these are not times of plenty for Arizona generally and the District in particular, the situation at present is not one that rises to the level of extreme financial crisis that is necessary to justify even the impairment of private contracts. *See Earthworks Contracting*, 167 Ariz. at 108, 804 P.2d at 837 (a retroactive statute requiring contractors to be licensed, although passed pursuant to a valid police power, "was [not] such an urgent social need that it should override a constitutional limitation," since license requirements had fluctuated for years).

Also, while the District may be experiencing some financial pressures, this symptom is not unique to the District. Undoubtedly, taxpayers are experiencing the effects of a difficult economy, but without the funding that government may rely on. If the contract clauses are to

[1] The Governing Board authorized plans to renovate that school even after voting to close it.

mean anything, they must protect taxpayers in tough economic times as well as in the good. It is precisely when governments must pinch pennies that constitutional protections are most needed. Because bonds put taxpayers on the line for additional debt and interest, Arizona law provides additional protections to ensure governments do not abuse their police powers.

Even in situations where deference would otherwise be appropriate, courts apply a much higher level of scrutiny in determining whether a public purpose justifies a substantial contractual impairment when the government itself is a party to the contract. *See State of Nev. Employees Ass'n, Inc.*, 903 F.2d at 1226. Courts are particularly suspicious when governmental entities favorably impair contracts to which they are a party, because government "can always find a use for extra money, especially when taxes do not have to be raised. If [it] could reduce its financial obligations whenever it wanted to spend the money for what it regarded as an important public purpose, the Contract Clause would provide no protection at all." *U.S. Trust Co. of New York*, 431 U.S. at 26. It is certainly easier for the District to spend the bond money on other purposes rather than convincing voters that these purposes are worthy of additional debt. Accordingly, the burden of proving that impairing a contract is constitutional is on the government where the government benefits from impairment. *In re Seltzer*, 104 F.3d 234, 236 (9th Cir. 1996). The District has not met this burden.

b. Section 34 was not reasonable and appropriate

Not only is the purpose impermissible, but neither § 34 nor the District"s impairment of its contract with the voters are reasonable and appropriate actions. Even where the state has a legitimate interest in exercising a police power that interferes with contracts, "complete

deference to a legislative assessment of reasonableness and necessity is not appropriate." *U.S. Trust Co. of New York*, 431 U.S. at 25-26. Even in a genuine emergency, impairments must be "of a character appropriate to that emergency," *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 445 (1934), and consist of "reasonable conditions tailored to the emergency." *Ward*, 123 Ariz. at 210, 598 P.2d at 1029.

The legislation could have been universally applicable so that other similarly-situated school districts could have taken advantage of it. Furthermore, the District did not even attempt to ask voters‟ permission to use the money for other purposes, despite its ability to do so. (SOF 23.) Indeed, government "is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives, . . . or to impose a drastic impairment when an evident and more moderate course would serve its purposes." *U.S. Trust Co. of New York*, 431 U.S. at 30-31. Governments "cannot refuse to meet [their] legitimate financial obligations simply because [they] would prefer to spend the money to promote the public good [invest in other projects] rather than the private welfare of its creditors [the taxpayers]." *Id.* at 29.

"The only time in this century that alteration of a municipal bond contract has been sustained by [the Supreme] Court" was when a change in the contract was necessary in order for the government to fulfill its contractual obligations. *U.S. Trust Co.*, 431 U.S. at 24, 27 (1977) (*discussing Faitoute Iron & Steel Co. v. City of Asbury Park*, 316 U.S. 502 (1942)) (sustaining an alteration when the city could not pay off its creditors under the old terms). The most effective way for the District to fulfill its obligations is not to be released from them, but rather to undertake the projects as originally planned or use the money to repay the debt. If it needs

money for different purposes, it is free to ask permission in a new bond election – but not to circumvent that process by unilaterally altering the contract created in a prior election.

II. Special Law Clause

a. Section 34 is not legitimate

Defendants provide no legal support for their bold assertion that "[i]t is legitimate for the Legislature to attempt to maximize the efficient use of bond proceeds" (*See* Defs.' Mot. 12), perhaps because such an assertion is impossibly vague. Efficient to whom? The District may find it more "efficient" to use bond proceeds for unapproved purposes if its goal is having the greatest flexibility at the least inconvenience to the District. But such a resolution would be equally *inefficient* to taxpayers, whose goals may be to minimize their tax burdens or to spend money for specific purposes. Arizona law has largely resolved this very question by implementing the constitutional and statutory protections that curb district discretion.

b. Section 34 does not encompass all members of the relevant class

Defendants claim that the time limitation in § 34 is rational as "a temporary expedient to help [districts] weather difficult times." (Defs.' Mot. 13.) Even if this were true, it is unclear how the legislature can portend that the economy will rebound in June 2013. Arbitrarily limiting the statute means that it operates *only* retroactively, thus limiting the districts that can take advantage of it. If the purpose of § 34 was to give school districts added flexibility to spend bond proceeds on general capital improvements because of statewide economic woes, there would be no reason to restrict the statute's application to bonds issued nine years ago. Laws must treat consistently all similarly-situated entities that meet the legislative purpose for

implementing the law. *See Republic Inv. Fund I v. Town of Surprise*, 166 Ariz. 143, 151, 800 P.2d 1251, 1259 (1990) (striking down an annexation statute that did not apply to all affected counties); *Tucson Electric Power Co. v. Apache County*, 185 Ariz. 5, 16, 912 P.2d 9, 20 (App. 1995) (invaliding higher tax rates for properties in certain districts when a small minority of properties did not have to pay a tax at the higher rate).

c. The class created by § 34 is not elastic

The purpose of the elasticity prong must hinge on volitional behavior to enter or exit a class, otherwise, the law would not truly be a *general* one. *See, e.g., El Paso Natural Gas Co. v. Arizona Dept. of Revenue*, 174 Ariz. 470, 478 851 P.2d 95, 103 (App. 1992) (striking down a law that applied only to hospital districts existing during a single fiscal year). Defendants claim that § 34 is elastic because in the three years between when it was passed and when it expires (May 2010 – June 2013), new districts theoretically would be able to spend bond money on purposes unauthorized by the voters. But defendants "provide no examples . . . of any [districts] that will fall within the population-based classifications of the legislation." *See Town of Gilbert v. Maricopa County*, 213 Ariz. 241, 247, 141 P.3d 416, 422 (App. 2006). And a smidgen of districts among the hundreds in the state would not suffice. (*See* SOF 35.)

More importantly, these districts would not actually be entering the class. Even if other districts' bond measures pass § 34's time threshold before the cut-off date, this does not create a truly open class because there was never any way for districts to alter their behavior so as to become eligible to take advantage of § 34. Defendants incorrectly limit the inquiry to the districts within the statute's scope, rather than considering the hundreds of districts in the state.

See City of Tucson v. Woods, 191 Ariz. 523, 530, 959 P.2d 394, 401 (App. 1997) ("[T]he relevant geographical area for consideration is the whole state, not just the area to which the statute, by its terms, applies").

Potential members of a class should be able to establish the prerequisites for entry *after* the law is implemented. *Cf. Long v. Napolitano*, 203 Ariz. 247, 258, 53 P.3d 172, 183 (App. 2002) ("A classification limited to a population as of a particular census or date . . . is a form of identification, not of classification"). From the time § 34 was implemented, a fixed population of district bonds that had been passed and would reach the nine-year mark by 2013 already existed. It was immediately possible to identify all of the entities that would be able to take advantage of § 34. Thus, from its inception § 34 created a limited classification that impermissibly identifies instead of classifies.

CONCLUSION

Section 34 contemplates a discrete, particular class, circumvents the constitutionally-protected will of the voters and has permitted the Cave Creek District to elude its contractual obligations. For the above reasons, Defendants" Motion for Summary Judgment should be denied and Plaintiffs should recover their costs and fees.

RESPECTFULLY SUBMITTED this 17th day of June, 2011 by:

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