IN THE COURT OF APPEALS FOR THE STATE OF ARIZONA
DIVISION ONE

CAVE CREEK UNIFIED SCHOOL DISTRICT #93, DEBBI BURDICK, in her official capacity as Superintendent for Cave Creek Unified School District; DAVID SCHAEFER, MARK WARREN, SUSAN CLANCY, CASEY PERKINS, and STEPHANIE REESE, in their official capacities as members of Cave Creek Unified School District Governing Board; and KATHIE AMABISCA, in her official capacity as Director of Finance for Cave Creek Unified School District, Defendants/Appellants, vs. JAYNE FRIEDMAN and RICHARD BAIL, Plaintiffs/Appellees.	Court of Appeals, Division One Case No. 1 CA-CV 11-0828 Maricopa County Superior Court Case No. CV2011-007925

APPELLEES' RESPONSE TO APPELLANTS' OPENING BRIEF

Clint Bolick (021684)
Carrie Ann Sitren (025760)
Christina Sandefur (027983)
Scharf-Norton Center for Constitutional Litigation
at the GOLDWATER INSTITUTE
500 E. Coronado Rd.
Phoenix, AZ 85004
(602) 462-5000
litigation@goldwaterinstitute.org
Attorneys for Plaintiffs-Appellees

Table of Contents

Table of Authorities iii

Introduction 1

Statement of the Case 2

Statement of the Facts 3

I. Arizona school districts must seek voter approval to obtain money for additional capital projects 3

II. Cave Creek Unified School District contracts with the body politic to provide new schools, buses and grounds improvements 4

III. Cave Creek Unified School District diverts bond money from its approved purposes 6

IV. Cave Creek taxpayers file lawsuit to enjoin unconstitutional expenditures 7

Issues Presented 9

Standard of Review 10

Argument 10

I. Section 34 bestows special favors on a select few districts in violation of Arizona's Special Law Clause 12

a. Section 34 does not rationally further a legitimate objective 13

i. Section 34 does not have a legitimate objective 14

ii. Section 34's narrow class is not rationally related to its avowed purposes 15

b. Section 34 does not encompass all members of the relevant class 16

i. Smaller classes are subject to more searching scrutiny 16

ii. Section 34's conditions do not save the class membership 18

c. Section 34 creates an inelastic class 20

II. The District impaired its contract with its body politic in violation of the U.S. and Arizona contract clauses 23

a. The bond election created a contract between the District and body politic 27

b. The District impaired its contract with the body politic 33

c. The District's impairment was not made pursuant to a significant and legitimate public purpose 39

d. The impairment was not reasonable and appropriate 40

III. Attorney's Fees 44

Conclusion 45

Table of Authorities

Federal Cases

Allied Structural Steel Co. v. Spannaus, 438 U.S. 234 (1978) 39, 42

Bank of Augusta v. Earle, 38 U.S. (13 Pet.) 519 (1839) 32

Cass County v. Johnston, 95 U.S. 360 (1877) 32

Energy Reserves Group, Inc. v. Kansas Power & Light Co., 459 U.S. 400 (1983) .... *passim*

Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502 (1942) 41

Fletcher v. Peck, 10 U.S. (6 Cranch) 87 (1810) 36

Freeland v. Williams, 131 U.S. 405 (1889) 31

Home Building & Loan Assn. v. Blaisdell, 290 U.S. 398 (1934) 25, 26, 39

In re Seltzer, 104 F.3d 234 (9th Cir. 1996) 41

Louisiana v. City of New Orleans, 109 U.S. 285 (1883) 31, 32

RUI One Corp. v. City of Berkeley, 371 F.3d 1137 (9th Cir. 2004) 8

State of Nev. Employees Ass'n, Inc. v. Keating, 903 F.2d 1223 (9th Cir. 1990) 26

Stewart v. Blackwell, 444 F.3d 843 (6th Cir. 2006) 14

Univ. of Hawai'i Prof'l Assembly v. Cayetano, 183 F.3d 1096 (9th Cir. 1999) 10

U.S. Trust Co. of New York v. New Jersey, 431 U.S. 1 (1977) .... *passim*

U.S. v. Winstar Corp., 518 U.S. 839 (1996) 35, 36

State Cases

Arizona Downs v. Arizona Horseman's Foundation, 130 Ariz. 550, 637 P.2d 1053 (1981) 20

Arizona State Highway Commission v. Nelson, 105 Ariz. 76, 459 P.2d 509, (1969) 27

Arnold v. Ariz. Dep't of Health Servs., 160 Ariz. 593, 775 P.2d 521 (1989) 10, 45

Associated Students of N. Peralta Cmty. Coll. v. Bd of Trustees, 92 Cal. App. 3d 672 (Cal. Ct. App. 1979) 29, 35

Baker v. Ariz. Dept. of Revenue, 209 Ariz. 561, 105 P.3d 1180 (App. 2005) 8, 24, 25, 40

Best v. Miranda, __ Ariz. __, 2012 WL 868774 (App. March 15, 2012) 10

Big D Constr. Corp. v. Ct. of Appeals, 163 Ariz. 560, 789 P.2d 1061 (1990) 13

Carson v. City of Fort Lauderdale, 244 So.2d 485 (Fla. Dist. Ct. App. 1971) 30

City of Tucson v. Woods, 191 Ariz. 523, 9559 P.2d 394 (App. 1007) 12, 22

County of San Bernardino v. Way, 18 Cal. 2d 647, 117 P.2d 354 (1941) 28

County of San Diego v. Perrigo, 318 P.2d 542 (Cal. App. 1957) 28, 37

David v. Timon, 183 S.W. 88 (Tex. Civ. App. 1916) 32, 37

Earthworks Contracting Ltd. v. Mendel-Allison Const. of California, Inc., 167 Ariz. 102, 804 P.2d 831 (App. 1990) 26, 44

El Paso Natural Gas Co. v. Arizona Dep't of Revenue, 174 Ariz. 470, 851 P.2d 95 (App. 1992) 16, 21

Fletcher v. Ely, 53 S.W. 2d 817 (Tex. App. 1932) 28, 35, 38

Fort Lauderdale v. Kraft, 21 So. 2d 461 (Fla. 1945) 29, 30

Gallagher Headquarters Ranch Dev., Ltd. v. City of San Antonio, 269 S.W.3d 628 (Tex. App. 2008) 38

Jarrell v. Bd. Of Ed. of Raleigh County, 50 S.E.2d 442 (W. Va. 1948) 29, 30

Johnson v. Earnhardt's Gilbert Dodge, Inc., 212 Ariz. 381, 132 P.3d 825 (2006) 31

Kadish v. Arizona State Land Dept, 177 Ariz. 322, 868 P.2d 339 (App. 1993) 10, 45

Long v. Napolitano, 203 Ariz. 247, 53 P.3d 172 (App. 2002) 22

Matter of Estate of Dobert, 192 Ariz. 248, 963 P.2d 327 (App. 1998) 25, 33

Maricopa County v. State, 187 Ariz. 275, 928 P.2d 699 (App. 1996) 8, 35

Martin v. Reinstein, 195 Ariz. 293, 987 P.2d 779 (App. 1999) 23

Medina v. Bd. Of Ret., 112 Cal. App. 4th 864 (App. 2003) 31

Mountain States Tel. & Telegraph Co. v. Arizona Corp. Comm'n, 160 Ariz. 350, 773 P.2d 455 (1989) 23

Peery v. City of Los Angeles, 203 P. 992 (Cal. 1922) 35

Phelps Dodge Corp. v. Arizona Elec. Power Co-op, Inc., 207 Ariz. 95, 83 P.3d 573 (App. 2004) 24

Putnam v. City of Irving, 331 S.W.3d 869 (Tex. App. 2011) 27, 28

Republic Inv. Fund I v. Town of Surprise, 166 Ariz. 143, 800 P.2d 1251 (1990) .... *passim*

Roane County Court v. O'Brien, 122 S.E. 352 (W.Va. 1923) 28, 35

San Saba County v. McCraw, 108 S.W. 2d 200 (Tex. 1937) 28, 29

Schade v. Diethrich, 158 Ariz. 1, 760 P.2d 1050 (1988) 31

Smith v. City of Tucson, 153 Ariz. 372, 736 P.2d 1184 (App. 1987) 13

State Compensation Fund v. Symington, 174 Ariz. 188, 848 P.2d 273 (1993) 13

State v. Wolfe, 137 Ariz. 133, 669 P.2d 111 (App. 1983) 10

Town of Gilbert v. Maricopa County, 213 Ariz. 241, 141 P.3d 416 (App. 2006) .... *passim*

Tucson Electric Power Co. v. Apache County, 185 Ariz. 5, 912 P.2d 9 (App. 1995) 13, 15, 16, 20

Verma v. Stuhr, 223 Ariz. 144, 221 P.3d 23 (App. 2009) 33

Ward v. Chevron U.S.A. Inc., 123 Ariz. 208, 598 P.2d 1027 (App. 1979) 26, 39

Federal Constitutional Provisions

U.S. Const. Art. I § 10 .... 9, 23, 24

State Constitutional Provisions

Ariz. Const. Art. II § 25 23

Ariz. Const. Art. IV § 19 .... 9, 12, 19

Ariz. Const. Art. VII § 13 .... 3, 29, 34

Statutes

A.R.S. § 15-491 .... *passim*

A.R.S. § 15-1022 3

A.R.S. § 15-1024 .... 6, 37, 38

2010 Ariz. Sess. Laws 332 § 34 .... 2, 7

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The Federalist No. 44 23

The Federalist No. 78 13

INTRODUCTION

"I have altered the deal; pray I do not alter it any further."

—Darth Vader, *The Empire Strikes Back.*

Darth Vader's authoritarian declaration easily could have been uttered by officials of the Cave Creek Unified School District ("the District") after they voted to renege on a decade-old agreement with district voters. Ten years ago, the District promised its citizenry new schools in exchange for bond authorization in excess of $40 million, with the understanding that any leftover funds would revert to the taxpayers. Now, the District wants to spend over a quarter of those funds on a catalog of unapproved projects that District officials think are a better use of the taxpayers' money. Thankfully for taxpayers, Arizonans are not subject to the whims of the Galactic Empire, but instead are protected by state and federal constitutions. These constitutions prohibit governments from evading their obligations.

In November 2000, Cave Creek District voters approved a bond program: in exchange for $41.6 million beyond their general tax obligations, they would receive new schools, buses, and school grounds improvements. After building two elementary schools, District officials decided to spend the remaining $13 million

on projects they preferred. But they faced an obstacle: spending bond money on unauthorized purposes violates state law. To overcome this legal hurdle, in 2010, the state Legislature passed 2010 Ariz. Sess. Laws 332 § 34 ("Section 34"), giving the District and a select few others permission to ignore the conditions of their bond agreements.

But legislative favoritism cannot circumvent the constitutional ban on impairing contracts. Because Section 34 was designed for the benefit of the Cave Creek District and creates an underinclusive class, it violates the Arizona Constitution's prohibition of special laws. And because it impairs a contract with the Cave Creek voters, the District's abrogation pursuant to Section 34 violates the federal and state constitutional bans on impairing contracts. The trial court's well-reasoned decision holding exactly that should be affirmed.

STATEMENT OF THE CASE

Appellee Jayne Friedman, a Cave Creek Unified School District taxpayer, filed a lawsuit in Maricopa County Superior Court on April 5, 2011, against Appellants Cave Creek Unified School District and its Superintendent, President, Vice President, Governing Board Members, and Director of Finance, sued only in their official capacities, seeking declaratory and injunctive relief plus costs and attorney fees. (Index of Record ("I.R.") 1.) The parties filed cross motions for summary judgment. (I.R. 24 and 38.) Following oral argument, on September 12,

2011, the trial court granted Plaintiffs' Motion for Summary Judgment on all counts and denied Defendants' Motion for Summary Judgment on all counts. (I.R. 72 at 2, 3.) The court awarded Plaintiffs' attorney's fees on October 20, 2011, and entered final judgment on October 28, 2011. (I.R. 81, 84.) Defendants appealed to this Court on November 23, 2011 (I.R. 85) , and filed their opening brief on February 15, 2011. (Appellants' Opening Brief ("Br.")).

STATEMENT OF THE FACTS

I. Arizona school districts must seek voter approval to obtain money for additional capital projects

When school districts wish to finance capital projects beyond the state and local funds they already receive, they can sell bonds to raise additional money. *See* A.R.S. § 15-491(A)(3). But when school districts borrow money by issuing bonds, they put district property taxpayers on the line to repay the funds. *See* § 15-1022 (requiring a district to repay its bonds by levying a tax on the taxable property within the district to pay both the interest and the portion of the principal due). That is why Arizona's Constitution requires voters to decide whether the specific projects are worth the extra tax burden. *See* Ariz. Const. art. 7, § 13 ("Questions upon bond issues or special assessments shall be submitted to the vote of real property tax payers, who shall also in all respects be qualified electors of this state, and of the political subdivisions thereof affected by such question"). Furthermore, Arizona law requires school districts seeking voter approval for bond measures to

inform voters of the exact purposes of that money. To this end, state law requires districts to mail a publicity pamphlet to each voting household, containing a "complete list of each proposed capital improvement that will be funded with the proceeds of the bonds." § 15-491(H)(6). And if voters approve bond measures, Arizona law requires districts to adhere to the projects that induced the voters' consent. Section 15-491(J) states:

> If the voters approve the issuance of school district class B bonds . . . , the school district shall not use the bond proceeds for any purposes other than the proposed capital improvements listed in the publicity pamphlet, except that up to ten per cent of the bond proceeds may be used for general capital expenses, including cost overruns of proposed capital improvements.

This is the legal framework that was in place in 2000 when the District presented the voters with the bond measure.

II. Cave Creek Unified School District contracts with the body politic to provide new schools, buses and grounds improvements

On November 7, 2000, the District held a Special Election, offering to voters new schools, buses and school grounds improvements in exchange for their approval of a $41.6 million class B bond measure. (I.R. 41, App. 1.) Pursuant to § 15-491(H)(6), the District sent out a Publicity Pamphlet, which included the purposes of the bond measure:[1]

[1] Any references herein to bond expenditures being limited to the purpose set forth in the Publicity Pamphlet are qualified by § 15-491(J), permitting "up to ten percent of the bond proceeds [to] be used for general capital expenses, including

- Acquiring by purchase or lease school lots;
- Constructing new school buildings including but not limited to two new elementary schools, one new middle school and one new high school;
- Acquiring pupil transportation vehicles;
- Improving school grounds, including adjacent ways thereto;
- Liquidating indebtedness incurred for the purposes set forth above;
- Providing all utilities and other capital items necessary for the construction of school buildings and for improving school grounds;
- Paying all architectural, design, engineering, project and construction management and other costs incurred in connection with the purposes set forth above; and
- Paying all legal, financial and other costs in connection with issuance of the bonds

(I.R. 41, App. 1.) Voters agreed to the bond measure and the District issued the bonds. (I.R. 72 at 2.)

At the time of the agreement, Arizona law specifically prohibited government from using bond proceeds for purposes other than those approved by voters. *See* § 15-491(J).[2] Thus, voters reasonably expected that the District would spend the bond money on new schools and the related projects identified in the Publicity Pamphlet. Had they known that the District could spend the money on unapproved projects, they might have voted differently.

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cost overruns of proposed capital improvements." Section 15-491(J) was law during the 2000 bond election and thus was part of the parties' expectations.

[2] Notwithstanding the special exception carved out by Section 34 (the subject of this lawsuit), the law still prohibits government from using bond proceeds for unapproved purposes.

III. Cave Creek Unified School District diverts bond money from its approved purposes

After voters agreed to the bond measure for new schools, buses and grounds improvements, the District used the bond money to build two new schools. (I.R. 42 at 14, App. 2.) But after 2008, the District was no longer seeing the growth in enrollment that it had projected when it held the bond election in 2000. Thus, it determined that it did not need to use the remaining bond money on the construction of new schools. (I.R. 56, ¶ 4, 6; I.R. 25, ¶ 4, 6, App. 3.) Consequently, about $13 million in proceeds from the 2000 bond measure remain unspent. (I.R. 42 at 14, App. 2.)

When the District issued its 2010 Annual Report, the District still owed $17.9 million on the bonds, which will take taxpayers about 13 more years to pay back. (*Id.*) According to Arizona law and the terms of the Publicity Pamphlet, the District must use leftover money to pay down the bond debt. *See* § 15-1024(B)(1); (I.R. 41; App. 1.)

Over the next few years, a series of attempts to pass legislation exempting the Cave Creek District from its obligation to the voters ensued. One of those bills was vetoed in July 2009 (I.R. 45, App. 4; I.R. 46, App. 5), and the District did not use the other because, according to District meeting minutes, it was special legislation in violation of law. (I.R. 49, App. 6; I.R. 50, App. 7; I.R. 52 at 3, App. 8)

On May 11, 2010, Governor Brewer signed into law 2010 Ariz. Sess. Laws. 332, the subject of this lawsuit. (I.R. 53, App. 9.) Section 34 allows school board members to divert bond funds from voter-approved projects to capital improvements that have not been sanctioned by voters as follows:

> Notwithstanding section 15-491, subsection J, Arizona Revised Statutes, when nine years or more have passed since an election that authorized a school district to issue bonds, the school district may choose to use the proceeds of any bonds authorized at that election for any necessary capital improvement, provided that the school district's governing board votes to authorize the proposed use of the bond proceeds prior to June 30, 2013.

Pursuant to Section 34, District Board Members voted to authorize the remaining 2000 bond money for the improvement of existing school facilities. (I.R. 57 at 7-8, App. 10.) The District then commenced planning and designing a variety of projects that were not listed in the Publicity Pamphlet. (I.R. 55, No. 2, App. 11.)

IV. <u>Cave Creek taxpayers file lawsuit to enjoin unconstitutional expenditures</u>

On April 5, 2011, Taxpayer Jayne Friedman filed a lawsuit in Maricopa County Superior Court to enjoin the District from unlawfully expending the remaining bond money on unapproved purposes in violation of the state special law clause and the state and federal contract clauses. (I.R. 1.)

The District filed a motion for summary judgment which, *inter alia*, challenged Ms. Friedman's standing to sue despite her status as a taxpayer because she did not vote in the 2000 election. (I.R. 24 at 7.) Although Plaintiff Friedman

had taxpayer standing to assert her right 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), to conserve judicial resources and focus on the merits of the case, Plaintiff Friedman amended her Complaint to add Plaintiff Richard Bail, a District taxpayer who voted in the 2000 bond election, as a plaintiff. (I.R. 35, ¶¶ 2, 4.) Taxpayers then moved for summary judgment. (I.R. 38.)

The trial court granted Taxpayers' Motion for Summary Judgment on all counts, holding that the District's abrogation of its contract and Section 34 violate the state and federal contract clauses and the state special law clause. (I.R. 72 at 2, 3.) The court held that "[t]he 2000 Bond Election was an agreement between the District and the people, the terms of which were expressly stated in the Publicity Pamphlet." (*Id.* at 2.) Section 34 is invalid under the contract clauses because it "impermissibly relieves the District of its obligation to the detriment of the people," and "essentially abrogates the voters' rights existing at the time of their bond vote, and by so doing, strikes a blow to the election process . . . by retroactively impairing the reasonable expectations of the body politic within the District." (*Id.*) The court found that "[n]o significant, legitimate public purpose exists which justifies the Government's retroactive taking. *Baker v. Ariz. Dept. of Revenue*, 209 Ariz. 561, 105 P.3d 1180 (App. 2005); *RUI One Corp. v. City of Berkeley*, 371 F.3d 1137 (9th Cir. 2004)." (*Id.* at 2-3.) Additionally, the court held

that "Section 34 constitutes a special law and as such also violates Article IV, Part 2, § 19 of the Arizona Constitution. *See Town of Gilbert v. Maricopa County*, 213 Ariz. 241, 141 P.3d 416 (App. 2006). . . . Section 34 fails the three prong test set forth in *Town of Gilbert v. Maricopa County*." (*Id.* at 3.)

The trial court entered judgment for Plaintiffs and awarded Plaintiffs' attorney's fees in the amount of $31,867. (I.R. 81, 84.) Defendants appealed the trial court's decision and award of attorney's fees. (I.R. 85.)

ISSUES PRESENTED

1. Does Section 34, which allows select school districts to spend bond money on unapproved purposes in direct conflict with the agreement between a district and its body politic, violate the Arizona Constitution's prohibition on special laws (Ariz. Const. art. 4, pt. 2, § 19)?

2. Did the District's decision to spend bond money on unapproved purposes pursuant to Section 34, in direct conflict with the agreement between the District and its body politic, violate the United States and Arizona contract clauses (U.S. Const. art. 1, § 10, cl. 1; Ariz. Const. art. II, § 25)?

3. Did the trial court err in awarding Plaintiffs Taxpayers, who were the successful parties, their reasonable attorney's fees pursuant to Arizona's private attorney general doctrine?

STANDARD OF REVIEW

"In reviewing a motion for summary judgment, [appellate courts] determine *de novo* whether . . . the superior court properly applied the law." *Best v. Miranda*, __Ariz. __, 2012 WL 868774 (App. Mar. 15, 2012). 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, 26 (1977).

This Court reviews a trial court's award of attorneys' fees for an abuse of discretion. *Arnold v. Ariz. Dep't of Health Servs.*, 160 Ariz. 593, 609, 775 P.2d 521, 537 (1989); *Kadish v. Arizona State Land Dept.*, 177 Ariz. 322, 326, 868 P.2d 335, 339 (App. 1993).

ARGUMENT

Contracts are the building blocks of a free society — they are the vehicles through which people voluntarily exchange goods and services. A society without

reliable and enforceable contracts cannot prosper. To safeguard this important freedom, the state and federal constitutions prohibit governments from interfering with valid agreements.

People enter into contracts for a variety of purposes. For example, a family might contract with a builder to add a new kitchen to their home. Typically, the family would approve the specific plans, agree to a price and sign a contract. At the end of the construction period, the family would expect to have a new kitchen. But what if the builder decided that the family did not need a new kitchen, and instead determined that their money would be better spent building a garage? The family would sue the builder for violating the contract, and they would win. The District behaved the same way when it broke its contract with its body politic. That this conduct was sanctioned by the state legislature only worsens the situation. Special legislative privileges cannot overcome constitutional proscriptions, and themselves violate the Constitution under the circumstances presented here.

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 reasons set forth below, this Court should affirm the trial court's holding that the District's abrogation of its

contract and the legislature's enactment of Section 34 violate the state and federal contract clauses and the state special law clause.

I. <u>Section 34 bestows special favors on a select few districts in violation of Arizona's special law clause</u>

Section 34 was specifically crafted to relieve the Cave Creek School District of its obligations, and as such, it is a quintessential unconstitutional special law. *See* Ariz. Const. art. IV, part 2, § 19.[3] "The fundamental intent of [Arizona's] prohibitions on local or special laws is to prevent the enactment of statutes bestowing special favors on preferred groups or localities." *City of Tucson v. Woods*, 191 Ariz. 523, 529, 959 P.2d 394, 400 (App. 2007). Because it carves out a special exception that allows a select few districts to spend bond money on unapproved purposes, the trial court properly held that Section 34 is an unconstitutional special law. (I.R. 72 at 3.)

In determining whether a law is unconstitutionally special, Arizona courts do not stop at the rational basis test, but rather conduct a more searching inquiry. A law is general and not special only if it satisfies *all three* prongs of the special law test: (1) the classification is rationally related to a legitimate governmental objective; (2) the classification encompasses all members of the relevant class; and (3) the class is elastic, allowing members to move in and out of it. *Town of Gilbert*

[3] Article IV, part 2, § 19 of the Arizona Constitution provides, "No local or special laws shall be enacted in any of the following cases," including "(20) When a general law can be made applicable."

v. Maricopa County, 213 Ariz. 241, 246, 141 P.3d 416, 421 (App. 2006). Section 34 fails all three prongs, although failing any one is sufficient to render it unconstitutional and affirm the trial court's ruling.

a. <u>Section 34 does not rationally further a legitimate objective</u>

Challenges under the special law clause succeed if a law lacks a rational basis to further a legitimate government purpose. *Smith v. City of Tucson*, 153 Ariz. 372, 373, 736 P.2d 1184, 1185 (App. 1987). The rational basis test in the special law context has been more rigorously asserted than the rational basis test under the federal equal protection clause. Several Arizona cases have invalidated laws under that prong. *See, e.g., State Compensation Fund v. Symington*, 174 Ariz. 188, 194, 848 P.2d 273, 279 (1993) (invalidating tax statutes applicable to the State Compensation Fund under rational basis scrutiny); *Big D Constr. Corp. v. Ct. of Appeals*, 163 Ariz. 560, 566, 789 P.2d 1061, 1067 (1990) (applying rational basis standard to strike down a bid preference statute); *Tucson Elec. Power Co. v. Apache County*, 185 Ariz. 5, 12, 912 P.2d 9, 16 (App. 1995) (striking down differential tax treatment under rational basis test). Despite that, the District disposes of the rational basis inquiry with one sentence. (*See* Br. at 27) (noting only that Section 34 "seeks to make use of already available funds to support education in a time of fiscal crisis"). But arbitrary laws are not insulated from

judicial scrutiny merely because the legislature says they are "legitimate."[4] Indeed, Section 34 lacks both a legitimate purpose and a rational means to further that purpose. A law whose specific purpose is to permit school districts to break their agreements with the electorate does not have a legitimate aim, and a law that arbitrarily relieves a select few districts of their obligation to spend bond proceeds on voter-approved projects is not a rational means of obtaining this objective.

i. <u>Section 34 does not have a legitimate objective</u>

Section 34's objective is to allow certain school districts to divert bond money to unapproved purposes. A law whose specific purpose is to permit districts to break their agreements does not have a legitimate aim. *See U.S. Trust*, 431 U.S. at 30-1 ("[A] State is not completely free to consider impairing the obligations of its own contracts on a par with other policy alternatives"). A state has no legitimate interest in defying constitutionally-protected rights. *Cf. Stewart v. Blackwell*, 444 F.3d 843, 873 (6th Cir. 2006), *vacated as moot*, 473 F.3d 692 (2007) ("[W]e find it difficult to conjure up what the State's legitimate interest is by the use of technology that dilutes the right to vote").

[4] While this prong leaves room for legislative discretion, "where the will of the legislature, declared in its statutes, stands in opposition to that of the people, declared in the Constitution, the judges ought to be governed by the latter rather than the former." The Federalist No. 78 at 404 (Alexander Hamilton) (G. Carey & J. McClellan eds., 2001).

The District asserts that Section 34's purpose is "mak[ing] use of already available funds to support education in a time of fiscal crisis." (Br. at 27.) But this description is misleading, for the funds were not "already available" for anything besides the purposes stated in the Publicity Pamphlet. Thus, while the District may exercise discretion when spending *general* funds, it may not undermine the integrity of the election process and circumvent its agreement with the body politic by spending money on unapproved purposes. This is especially illegitimate in light of the legal framework in place at the time of the agreement.

ii. <u>Section 34's narrow class is not rationally related to its avowed purposes</u>

Assuming *arguendo* that Section 34's purpose is to remedy statewide funding shortages and this purpose is legitimate, the resulting class is not properly related to this objective. The "fiscal crisis" that Defendants point to (*Id.* at 27) is pervasive throughout the state and nation. The District has made no claim that the economic slump has affected the Cave Creek district or the handful of other districts poised to take advantage of Section 34's benefits. Since the state's economy affects *all* districts, it is arbitrary to grant *some* districts access to restricted funds but not others. *See Town of Gilbert*, 213 Ariz. at 246, 141 P.3d at 421 (no circumstances, no matter how "exigent," justified a law providing emergency services to *some* county islands while excluding other similarly-situated islands); *Tucson Electric Power Co.*, 185 Ariz. at 14, 912 P.2d at 18 (the purpose

of equalizing tax rates across a district did not justify taxing certain properties higher than others).

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

Section 34 also violates the special law clause because it creates an underinclusive class. If the purpose of the law is "to support education in a time of fiscal crisis," the class is far too limited. This is because the class is not designed with regard to a district's financial need, but rather with regard to when voters approved a district's bond measures. This impermissibly excludes other districts that could benefit from exemptions from their obligations.

i. Smaller classes are subject to more searching scrutiny

In determining whether a law comprises all relevant class members, courts subject smaller classes to a more exacting scrutiny. *See, e.g., El Paso Natural Gas Co. v. Arizona Dep't of Revenue*, 174 Ariz. 470, 478, 851 P.2d 95, 103 (App. 1992) ("Although the number in the class is not determinative, as that number decreases in size, courts are more likely to find the classification invalid"); *Republic Inv. Fund I v. Town of Surprise*, 166 Ariz. 143, 151, 800 P.2d 1251, 1259 (1990). Thus, Appellants' claim that "[t]he legitimacy of a classification does not depend on whether there are many members in the class" is untrue. (*See* Br. at 28.) Where a class is arbitrarily defined and exceptionally small, as it is here, "there

must be a rational reason why the scope of its application is limited." *Town of Gilbert*, 213 Ariz. at 246, 141 P.3d at 421.

In this case, just as in *Town of Gilbert*, no such reason exists. If Section 34 was, as Appellants contend, passed "to support education in a time of fiscal crisis" (Br. at 27), the class should apply to all districts affected by the economic downturn. *See Town of Gilbert*, 213 Ariz. at 246, 141 P.3d at 421 ("Although Appellants argue that exigent circumstances exist in Gilbert, they did not articulate why it is rational that the legislation does not include other similarly situated county islands"). Notwithstanding the contract clause implications raised by the law's retroactive impairments, for special law purposes, the Legislature could have tied the class directly to the districts' financial need. Instead, the statute carves out special privileges for very few school districts. A survey of 90% of Arizona school districts revealed that only 3% are included in the class.[5] (I.R. 62; App. 12.) This is unduly restrictive for a law aimed at "support[ing] education in a time of fiscal crisis." (Br. at 27.)

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[5] Appellants received responses from 218 of 242 Arizona school districts besides Cave Creek and determined that only 3% have funds remaining from bond elections held prior to June 30, 2004. (I.R. 62; App. 12.) Even if every remaining district belonged to the class, which is highly unlikely, no more than 12% of all districts would be included in the class.

ii. <u>Section 34's conditions do not save the class membership</u>

The District's declaration that Section 34 "applies to every school district in the state that has bond proceeds nine or more years old, and applies equally to each school district in that classification" (*Id.* at 28) begs the question by addressing membership in the class in a way that renders the second prong meaningless. By defining the class as "every school district in the state that has bond proceeds nine or more years old" and attempting to prove the class's constitutionality because it includes "every school district in the state that has bond proceeds nine or more years old," the District asserts a circular argument that cannot survive the second prong.

The District attempts to compensate for the unduly narrow class by asserting the legitimacy of the law's individual conditions. (*See* Br. at 28-29.) They claim that the nine-year-old bond condition is legitimate because "some holding requirement was necessary to ensure that HB 2725 did not provide an incentive for manipulation." (*Id.* at 28.) But justifying the nine-year condition as discouraging gamesmanship is unpersuasive when the law's very purpose is to impair obligations, and its effect to provide a windfall for a select few school districts.

Likewise, the 2013 deadline is speculative at best. It is doubtful that the legislature could foretell that June 2013 will be the "end date of the fiscal crisis" as the District claims. (*See Id.* at 29.) To bolster that prediction, the District explains

that June 2013 was selected because it is also "the date on which a voter-approved temporary sales tax to fund education programs would expire." (*Id.* at 29.) But this actually undermines the legitimacy of the 2013 deadline because running these provisions simultaneously means the District at once gets a double influx of funds. In other words, Section 34 relieves select districts of their obligations while they also are receiving funds from the temporary sales tax.

As it stands, the class containing fewer than three percent of all districts bears no relationship to the economic need of the districts within the state and thus does not justify such a limited class. Stating that "some holding requirement was necessary" (*id.* at 28), does not give the legislature license to craft any "holding requirement" it wishes, especially when it excludes similarly-situated members from a class. Article IV, part 2, § 19 (20) of the Arizona Constitution forbids special laws "when a general law can be made applicable," not "when a general law is not desirable to the Legislature."

Laws must treat consistently all similarly-situated entities that meet the legislative purpose for implementing the law. *See Republic Inv. Fund I*, 166 Ariz. 143, 800 P.2d 1251 (invalidating a deannexation statute that only applied to twelve small cities when more were affected by annexation abuse); *Town of Gilbert*, 213 Ariz. 241, 141 P.3d 416 (striking down a population-based law for creating emergency service districts that excluded other county islands similarly in need of

emergency services); *Tucson Electric Power Co.*, 185 Ariz. 5, 912 P.2d 9 (invalidating 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). Legislators specifically could have targeted districts that have special financial needs. Instead, they created a tortured classification designed to benefit a specific school district, which is exactly what the special law clause is designed to prevent. The District argues that the nine-year condition and 2013 deadline were "necessary to defend against a contract clause claim, should one be actionable." (Br. at 29.) But even if these conditions could somehow avoid the contract clause violation, the antidote for one constitutional infirmity (contract clause violation) cannot be justified when it is the poison for another constitutional provision (special law prohibition).

c. **Section 34 creates an inelastic class**

Section 34 creates an inelastic class, and for that additional and independent reason is thus is an unconstitutional special law. A law is elastic if members of a class are able to enter and exit the class. Section 34 is inelastic because while members of the class are able to exit when they spend their remaining bond money, they cannot do anything to enter the class.

"A law is special or local if it is plainly intended for a particular case and looks to no broader application in the future." *Arizona Downs v. Arizona Horseman's Foundation*, 130 Ariz. 550, 637 P.2d 1053 (1981). Section 34 created

a class that was closed from its inception because it applies only to past bond elections. *See El Paso Natural Gas Co.*, 174 Ariz. at 478, 851 P.2d at 103 (law was special because "[n]o future change of circumstance could possibly cause . . . any current nonmember of the class to come within [it]"). By its own terms, Section 34 only applies "when nine years or more have passed since an election that authorized a school district to issue bonds," and the school board must "authorize the proposed use of the bond proceeds prior to June 30, 2013." In other words, Section 34 can only be used by a district with unspent bond money that was approved by voters on or before June 30, 2004. Thus, the class was already closed when the Section 34 became law, and at that time, all the districts in the class were determined.[6] Section 34 is structured in such a way that potential members can do nothing to join the class after it became law. *See Republic Inv. Fund I*, 166 Ariz. 143, 800 P.2d 1251 (striking down a statute that applied to cities of certain populations based on a past census, so the cities could do nothing to enter the class); *El Paso Natural Gas Co.*, 174 Ariz. 470, 851 P.2d 95 (invalidating a tax law that applied only to hospital districts existing in a certain fiscal year). A class that is closed from its formation is evidence that the legislature crafted the law with specific members in mind, as Section 34's legislative history clearly reflects. *Cf.*

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[6] The District inaptly invokes the Taxpayers' survey in contending that districts can enter the class. But the survey identifies the small number of districts that are *already* in the class. That is the very opposite of elasticity.

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").

The special law test was designed to determine whether "the class formation was separate from consideration of particular persons, places, or things and, thus, not intended as special or local in operation." *Republic Inv. Fund I*, 166 Ariz. at 151, 800 P.2d at 1258-59. Not only does Section 34 fail each prong of the explicit test, but the legislative history surrounding the law "strongly suggests that the provision was the product of the very evil that the constitution was intended to guard against." *See Woods*, 191 Ariz. at 529, 959 P.2d at 400. Legislative summaries of Section 34's predecessors expose the legislature's true intentions to "[a]llow[] the *Cave Creek Unified School District* to expend remaining proceeds from a bond election conducted in November of 2000 to make modifications to an existing school rather than build a new school facility." (I.R. 47 at 5, App. 13; I.R. 51 at 3, App. 14) (emphasis added.) Attempting to mask its constitutional deficiencies, the legislature created the fig-leaf of a broader classification and passed Section 34. *See Republic Inv. Fund I*, 166 Ariz. at 147, 800 P.2d at 1256 (comparing an original proposal to the challenged legislation). Nevertheless, the legislative summary still reflects that the law was intended to "[a]llow[] *Cave Creek Unified*, with governing board approval, to use bond proceeds authorized in

November 2000 for any capital purpose until June 30, 2013." (I.R. 54, App. 15) (emphasis added.) This is akin to a criminal hiding his tracks yet confessing to the crime. The legislature quite obviously designed Section 34 for Cave Creek and not "separate[ly] from consideration of particular persons, places, or things." *Republic Inv. Fund I*, 166 Ariz. at 150-51, 800 P.2d at 1258-9. In fact, then-Representative Nancy Barto, who introduced Section 34 as a floor amendment, represented Legislative District 7, the district encompassing Cave Creek School District. As such, Section 34 embodies the very favoritism the special law clause seeks to prohibit.

II. **The District impaired its contract with its body politic in violation of the U.S. and Arizona contract clauses**

"[L]aws impairing the obligation of contracts[] are contrary to the first principles of the social compact, and to every principle of sound legislation." The Federalist No. 44 at 232 (James Madison) (G. Carey & J. McClellan eds., 2001). Both the federal and state constitutions prevent governments from impairing contracts.[7] U.S. Const. art. 1, § 10, cl. 1 ("No State shall . . . pass any . . . Law

[7] Arizona's contract clause is at least as protective as, but may be more robust than, its federal counterpart. *Cf. Mountain States Tel. & Telegraph Co. v. Arizona Corp. Comm'n*, 160 Ariz. 350, 356, 773 P.2d 455, 461 (1989) ("[O]ur framers and people must have intended the Arizona declaration of rights to be the main formulations of rights and privileges conferred on Arizonans"); *see also Martin v. Reinstein*, 195 Ariz. 293, 987 P.2d 779 (App.1999) (acknowledging that, in some circumstances, the Arizona Constitution provides greater protection than the federal constitution). Most of the federal cases that the District uses to justify its contractual impairment

impairing the Obligation of Contracts"); Ariz. Const. Art. II, § 25 ("No . . . law impairing the obligation of a contract, shall ever be enacted"). To bring a successful claim against a government for violating the contract clauses, a plaintiff must show: (1) the existence of a contract, and (2) an unconstitutional impairment of that contract. *Baker*, 209 Ariz. at 564, 105 P.3d at 1183. A government may not substantially impair a contract unless (1) there is a significant and legitimate public purpose, and (2) the impairment is appropriate to the public purpose. *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*, 459 U.S. 400, 411-13 (1983).

A law impairs a contract when it enlarges or reduces an obligation in favor of one party against another. *Phelps Dodge Corp. v. Arizona Elec. Power Co-op, Inc.*, 207 Ariz. 95, 122, 83 P.3d 573, 600 (App. 2004). The reasonable

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were decided during and after the New Deal era, when the Supreme Court greatly diluted the Contract Clause's protection against governments' impairing contracts. *See, e.g.*, James W. Ely Jr., *Whatever Happened to the Contract Clause?*, 4 Charleston L. Rev. 371, 391 (2010) ("The advent of New Deal constitutionalism completed the effective destruction of Contract Clause jurisprudence"); Richard H. Fallon, Jr., *Reflections on Dworkin and the Two Faces of Law*, 67 Notre Dame L. Rev. 553, 585 (1992) ("[B]eginning in 1937, the Supreme Court . . . effectively rewr[ote] the commerce and contracts clauses"). But in the era when Arizona's Constitution was drafted, federal courts demonstrated a much more robust application of the contract clause. *See* Abraham Bell & Gideon Parchomovsky, *The Uselessness of Public Use*, 106 Colum. L. Rev. 1412, 1428 (2006) ("Particularly during the end of the nineteenth century and the early twentieth century, courts developed a robust jurisprudence of the Contracts Clause"). It is in this light that Arizona's contract clause should be interpreted and applied, as a stronger protection of contract rights.

expectations of the parties play an important role in determining whether a contract is impaired. *Matter of Estate of Dobert*, 192 Ariz. 248, 253, 963 P.2d 327, 332 (App. 1998); *Energy Reserves*, 459 U.S. at 416.

Courts will invalidate the government's substantial impairment of a contract, except under limited circumstances where the impairment is appropriately tailored to a significant and legitimate public purpose. *See Energy Reserves*, 459 U.S. at 411-13. These circumstances typically involve *incidental* impairments to contracts under general laws passed pursuant to the state's police powers to give broad relief. *See, e.g., Home Building & Loan Assn. v. Blaisdell*, 290 U.S. 398 (1934) (upholding a mortgage moratorium extending the redemption period for foreclosure sales that applied uniformly throughout the state during the Great Depression); *Energy Reserves*, 459 U.S. 400 (upholding a cap on gas prices affecting contracts with escalation clauses, because it applied broadly and the parties anticipated price changes); *Baker*, 209 Ariz. 561, 105 P.3d 1180 (upholding repeal of a vehicle tax credit from a general law that did not create rights and did not impair a government's specific agreements). Only particular, essential government objectives will pass as significant and legitimate public purposes. The problem the government seeks to relieve "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).

In evaluating whether an impairment is appropriate to the public purpose, courts are particularly suspicious when governments extricate themselves from their own contracts. *See, e.g., U.S. Trust*, 431 U.S. 1 (striking down efforts of the Port Authority of New York and New Jersey to nullify bond covenants that prohibited it from using bond proceeds to support mass transit); *State of Nev. Employees Ass'n, Inc. v. Keating*, 903 F.2d 1223, 1226 (9th Cir. 1990). In those cases, courts apply heightened scrutiny because the government's "self-interest is at stake." *U.S. Trust*, 431 U.S. at 26. But even under less exacting scrutiny, impairments must be "of a character appropriate to [the] emergency," *Blaisdell*, 290 U.S. at 445, and consist of "reasonable conditions tailored to the emergency." *Ward v. Chevron U.S.A., Inc.*, 123 Ariz. 208, 210, 598 P.2d 1027, 1029 (App. 1979).

The bond agreement at issue in this case is a constitutionally-protected contract between the District and the body politic, and the terms are contained in the publicity pamphlet. The District extended an offer to the voters – new schools, buses, and grounds improvements – in exchange for permission to issue bonds, which taxpayers would pay back with interest. The voters accepted this offer, agreeing to its specific terms. Because the District's impairment of its contract

was not appropriately tailored to a significant and legitimate public purpose, the trial court properly held that the District's abrogation pursuant to Section 34 violated the contract clauses (I.R. 72 at 3), and this Court should affirm.

a. The bond election created a contract between the District and body politic

Voter approval of a bond measure for specific, enumerated purposes establishes a contractual relationship between the government and its body politic, obligating the government to abide by the terms of the contract.[8] While Arizona appellate courts have not yet had the opportunity to opine on the contractual relationship between a school district and its citizenry, other courts consistently have held that state constitutions protect bond agreements between the government and the body politic from government impairment. Courts have recently 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"). Arizona's regime of putting voters in charge of bond authorizations strongly supports this doctrine.

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[8] Note that Arizona courts have found that the purchase of bonds creates a contractual relationship between bondholders and the governmental entity selling the bonds. *See, e.g., Arizona State Highway Commission v. Nelson*, 105 Ariz. 76, 81, 459 P.2d 509, 514 (1969) ("It is a well established principle of Constitutional Law that bondholders are protected against subsequent legislation that will impair the contractual obligation evidenced by the bond").

Every court that has considered the issue has recognized that bond elections create contracts between the government and the body politic that are protected by federal and state contract clauses. Thus, if Arizona were to reject this doctrine, it would be the outlier. A California appellate court held with regard to a bond election, "Without question the election created a contractual relation between the electors and the supervisors. The terms of the contract are contained in the ballot proposal approved by the electors." *County of San Diego v. Perrigo*, 318 P.2d 542, 545 (Cal. App. 1957). *See also County of San Bernardino v. Way*, 18 Cal. 2d 647, 665, 117 P.2d 354, 365 (1941) ("It is the settled doctrine in California that upon the voting of bonds . . . there arises between the state or its agency and the taxpayers certain contractual obligations which must be respected by any subsequent legislation or by any action on the part of public officials"); *Roane County Court v. O'Brien*, 122 S.E. 352, 355 (W. Va. 1923) (recognizing that a "referendum by the people of the district constituted a contract or quasi-contract between the voters of the district and the county court"). Laws that "impair and destroy [the voters'] rights existing at the time of the vote" violate the contract clauses. *San Saba County v. McCraw*, 108 S.W. 2d 200, 202-203 (Tex. 1937). *See also Fletcher v. Ely*, 53 S.W. 2d 817, 818 (Tex. App. 1932) (the result of a bond election "has been referred to as having the binding effect and force of a contract"); *Putnam*, 331 S.W.3d at 878 ("A city violates its 'contract' with the voters if it uses

proceeds from taxes approved by the voters in a way that the voters did not approve"); *Fort Lauderdale v. Kraft*, 21 So. 2d 461, 462 (Fla. 1945) (denying cert) ("The first plan for financing the sewer improvements became a contract between the municipality and the taxpayers when approved by the latter and that [the new statute] was void as an impairment of this contract").[9]

School districts have no power to force taxpayers to fund capital projects beyond their general capital and operational funds. *See* Ariz. Const. art. VII, § 13 ("Questions upon bond issues or special assessments shall be submitted to the vote of real property tax payers"). The need for consent of the body politic is key, as there is a "difference in the character of the rights of taxpayers in connection with . . . funds raised by levies which can be created *only by their consent* and of their rights with respect to . . . levies imposed by a political subdivision." *See Jarrell v.*

[9] The District's comparison of the Arizona Constitution's bond provision to the California Constitution's bond provision is inapposite. (*See* Br. at 17.) Plaintiffs brought some cases under California's constitutional provision requiring that districts name specific bond expenditures, others under the contract clause, and some under both, and courts treated all as legitimate causes of action. *See Associated Students of N. Peralta Cmty. Coll. v. Bd. of Trustees*, 92 Cal. App. 3d 672, 677 (1979) (noting that California cases have classified bond elections both "contractual" and "*analogous* to a contract"). The Texas case the District cites is irrelevant to this point because it also invokes the state contract clause. *See, e.g.*, *McCraw*, 108 S.W. 2d at 203 (emphasis added) ("[A]fter such tax is voted, the Legislature, without the consent of the voters, has attempted to impair and destroy their rights existing at the time of the vote. To our minds, such a legislative act not only violates the very constitutional provision authorizing the tax to be voted, but *violates section 16 of article 1 [the contract clause] of our State Constitution as well*").

Bd. of Ed. of Raleigh County, 50 S.E.2d 442, 445 (W. Va. 1948) (emphasis added). Courts that have considered this issue have found contractual relationships between a municipality and its citizenry when voters were required to approve special levies, *Kraft*, 21 So.2d 461 (finding a contractual relationship between a municipality and the taxpayers when taxpayers were required by law to approve a special assessment levy, and holding that the contract was impaired when the city subsequently tried to alter the plan), but in other cases have not found a contractual relationship when the law did *not* require public approval to levy a tax. *Carson v. City of Fort Lauderdale*, 244 So.2d 485 (Fla. Dist. Ct. App. 1971).

The contract Taxpayers seek to enforce has all the elements of a typical contract: the obligation was created when the District extended an offer, the terms of which were precise and specific, which the citizenry accepted – forming a classic contract secure from government impairment. However, the District strains to characterize the bond agreement as something other than contractual. It cites several cases for the proposition that "[t]he Contracts Clauses use the term 'contract' in its ordinary sense." (Br. at 16, 15.) But none of these cases supports the District's contention that the 2000 bond agreement is not contractual in the "ordinary sense"; rather, these cases strengthen *the Taxpayers'* position.

The District's cases illustrate the distinction between assent to the specific terms of the 2000 bond measure, which formed a contract between the District and

the body politic, and non-contractual duties arising out of general law. *See Freeland v. Williams*, 131 U.S. 405 (1889) (court judgment founded on a tort committed as an act of public war is not protected by the contracts clause); *Medina v. Bd. of Ret.*, 112 Cal. App. 4th 864 (App. 2003) (protection of the contracts clauses does not extend to invalid contracts).[10] In *Louisiana v. City of New Orleans*, 109 U.S. 285 (1883), for example, the Court held that the word "contract" does not extend to court judgments. Indeed, judgments are not the product of agreement, but rather "are usually the result of violent contests." *Id.* at 288. Thus, a contract "in its ordinary sense" is an agreement formed by "[m]utual assent to its terms," such as the 2000 bond agreement, and not an obligation "imposed upon the losing party by a higher authority against his will and protest," such as a court judgment. *See id.*[11] Thus, while the *Louisiana* Court upheld a law that *incidentally* delayed enforcement of *non-contractual* court judgments, it observed that "state legislation . . . shall not operate *directly* upon *contracts* of the [municipal]

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[10] It is curious that Appellants would cite to *Medina*, a California case, to support their contention that constitutional protection does not extend to contracts with the voters, when the contracts with the voter doctrine is alive and well in that jurisdiction. *Medina* simply stands for the proposition that the contract clause will not apply to an *estoppel* theory, since by definition estoppel is only used when there is no valid contract but equity nevertheless demands recovery. *Id.* at 871.

[11] The District's citation to *Johnson v. Earnhardt's Gilbert Dodge, Inc.*, 212 Ariz. 381, 384, 132 P.3d 825, 828 (2006) and *Schade v. Diethrich*, 158 Ariz. 1, 9, 760 P.2d 1050, 1058 (1988) for the proposition that contracts require mutual assent is consistent with Taxpayers' position. (Br. at 16.)

corporation, so as to impair their obligation." *Id.* at 290 (emphasis added). Here, Section 34 and the District's diversion of bond money are clearly of the latter, prohibited type: they operate directly upon the District's contracts, impairing the District's obligations.

It is quite simple to understand the mutual assent in the bond agreement once one understands the parties to be bound – something the District continues to misconstrue. (Br. at 16-17.) The contract is not between the District and any individual voter; rather, it is between the District and the *body politic*, much like corporations, themselves single entities composed of individuals, enter into contracts. *See, e.g., Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519, 541 (1839). Indeed, the District acknowledges that when the required number of individual voters approved the terms of the bond measure, *all* taxpayers were bound by the results, regardless of whether or not they assented *individually*. (*See* Br. at 16) ("[T]he resulting bonds and the tax assessments necessary to repay them will bind every single property owner in the district for the duration of the bond term, regardless of whether they participated in the election or even lived in the district at the time"). *Accord Cass County v. Johnston*, 95 U.S. 360, 369 (1877) ("All qualified voters who absent themselves from an election duly called are presumed to assent to the expressed will of the majority of those voting"). This is the nature of representative government. If the majority of voters could not bind the body

politic, absent or "no" voters would not be bound to repay the bond. But this is not so – every property taxpayer of the District is liable to repay the bond's principal and interest, because every property taxpayer is bound by the decision of the body politic.

b. <u>The District impaired its contract with the body politic</u>

When the District decided to spend the remaining bond money on unapproved renovations instead of the agreed-upon projects, it substantially impaired its contract with the body politic. The laws in force at the time of the election helped shape the voters' expectations when they accepted the District's offer, but the District's abrogation is established by the terms of the contract alone. To the extent that Section 34 purports to authorize this abrogation, it is invalid.

The reasonable expectations of the parties play an important role in determining whether a contract is impaired, *Matter of Estate of Dobert*, 192 Ariz. at 253, 963 P.2d at 332, and Cave Creek voters certainly had clear expectations that the bond money would be used only toward approved purposes. The laws in force at the time a contract is executed shape the parties' expectations and are highly relevant in determining whether those expectations were reasonable. *See Verma v. Stuhr*, 223 Ariz. 144, 152, 221 P.3d 23, 31 (App. 2009) ("[T]he parties are presumed to know the law"). The statutes in effect at the time that bonds were approved were "a part of the consideration for the authorization of their issue."

David v. Timon, 183 S.W. 88, 91 (Tex. Civ. App. 1916). In other words, a court will not assume that voters were aware of an imminent or probable change in legislation.

When voters agreed to the 2000 bond measure, the law at the time clearly prohibited the District from using the bond proceeds for any purpose other than those specifically listed in the Publicity Pamphlet. § 15-491(J).[12] Thus, it is both perfectly reasonable for Taxpayers 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. The District's citation to *Energy Reserves*, for the proposition that taxpayers should have anticipated Section 34, is inapposite. (*See* Br. at 23) (citing 459 U.S. at 416.) In *Energy Reserves*, a case involving *private* contracts (and thus subject to a lesser scrutiny),[13] the Supreme Court held that the parties lacked a reasonable expectation that the state would not impose price controls in part because "the contracts expressly recognize the existence of extensive regulation by providing that any contractual terms are

[12] Indeed, § 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 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.

[13] See *Infra* Part II(d).

subject to relevant present and future state and federal law." *Id.* at 416. The Taxpayers' case is distinguishable from *Energy Reserves* because the District's *own* contract is at issue, and the voters had no such warning that the terms of their agreement could change. Allowing Defendants to spend the bond money on unauthorized projects "work[s], in effect, a fraud upon the electors through securing their votes for the approval of these bond issues upon terms and conditions which will not be kept." *Peery v. City of Los Angeles*, 203 P. 992, 998 (Cal. 1922).

Taxpayers do not claim any interest in a statute's permanency – their interest is simply in having their specific agreement enforced.[14] The contract clauses do not prohibit states from repealing or amending statutes *generally*. *Cf. U.S. Trust*, 431 U.S. at 17. But if the clauses are to have any real meaning, the government must abide by its specific agreements. *See, e.g., U.S. v. Winstar Corp.*, 518 U.S.

[14] Contrary to the District's baseless assertion (*see* Br. at 21), the Taxpayers need not assert any other interest besides the interest in having their agreement enforced in order to bring this lawsuit. Appellees have a right as taxpayers not to have their tax dollars spent on unlawful purposes. *See Maricopa County v. State*, 187 Ariz. 275, 279, 928 P.2d 699, 703 n.7 (App. 1996). Plaintiffs in the cases the District cites asserted interests in *particular* schools or roads because they were seeking enforcement of *specific* projects that were not enumerated in the agreement. *See Fletcher*, 53 S.W. 2d 817 (description of road was ambiguous, so precise path was at issue); *O'Brien*, 122 S.E. 352 (same); *Associated Students*, 92 Cal. App. 3d 672 (agreement did not require school board to build any *particular* campus, just a campus). Taxpayers in this case, by contrast, simply seek to enforce the agreement as written – whether the District uses the money for schools, buses, grounds, or to pay down the debt (I.R. 1.)

839, 874 (1996) (citing *Fletcher v. Peck*, 10 U.S. (6 Cranch) 87, 135-36 (1810)) ("[L]egislative sovereignty [is] limited by the federal Constitution's bar against laws impairing the obligation of contracts").

Despite the District's persistent and clearly erroneous attempts to mischaracterize the nature of the bond agreement (*See* Br. at 10, 15, 18, 19), the trial court did not hold, nor do taxpayers claim, that the contract's terms include statutes.[15] Appellants set up a straw man in admonishing the undesirable results that would occur "if every statute was [sic] potentially a contract." (*Id.* at 18.) But the Court need not concern itself with this scenario, because the statutes governing bond elections are neither necessary to upholding, nor terms of, the bond contract. The statutes merely weigh heavily in taxpayers' favor when assessing the parties' reasonable expectations.

Although the law at the time of the contract shaped voters' reasonable expectations, the District's abrogation is established by the specific terms of the

[15] The trial court's opinion does not state that any statute became part of the contract, but rather explicitly notes that the Publicity Pamphlet provided the contract's terms. (*See* I.R. 72 at 2 ("The 2000 Bond Election was an agreement between the District and the people, the terms of which were expressly stated in the Publicity Pamphlet").) Throughout their trial court briefs, taxpayers made it very clear that they were not asserting that statutes created contract rights or became contract terms. (*See, e.g.*, I.R. 39 at 5 ("Plaintiffs do not claim that § 15-491(J) *created* a contract right. . . . Indeed, the election would have created a contract between the voters and the District *regardless* of whether § 15-491(J) was in effect"); I.R. 68 at 4 ("Plaintiffs do not . . . claim that statutes created contract rights or became terms of the contract").)

contract. These terms are wholly contained in the Publicity Pamphlet.[16] *See, e.g.*, *Perrigo*, 318 P.2d at 545 ("Without question the election created a contractual relation between the electors and the supervisors. The terms of the contract are contained in the ballot proposal approved by the electors"); § 15-491(H)(6) (requiring districts wishing to issue class B bonds to mail to each voting household a publicity pamphlet with a "complete list of each proposed capital improvement that will be funded with the process of the bonds"). Before the District voted to spend the bond money on unapproved projects, Taxpayers expected to get new schools, buses, and school grounds improvements in exchange for agreeing to repay bonds worth $41.6 million.[17] After the abrogation, Taxpayers would receive entirely different products but remain bound by the same burden. This certainly does not put Taxpayers "in a somewhat better position," as the District claims. (Br. at 22.) If the District no longer has a need for the approved items, per the contract terms and the law in place at the time of the agreement, *see* § 15-1024(B),

[16] The District is correct that the Publicity Pamphlet did not list "the then-existing statutory provision permitting up to ten percent of bond proceeds to be used for items *not* included in the listed purposes." (Br. at 19-20 (citing § 15-491(J).) But taxpayers do not claim that the ten percent requirement in § 15-491(J) was a contract term – that is merely a statutory requirement that existed at the time of the contract and thus deemed "a part of the consideration for [its] authorization." *David*, 183 S.W. at 91.

[17] Contrary to the District's assertions, Taxpayers' argument is not about lowering their property taxes. (*See* Br. at 21.) Appellee taxpayers simply want the District to abide by its agreement with the voters by spending the bond money only in an authorized manner.

it can use the remaining bond money to retire the bond debt.[18] But if it wishes to deviate from its agreement, it must present the question to the voters.[19] *See, e.g.*, *Fletcher*, 53 S.W. 2d at 818 ("[W]hen the voters thus speak, the proceeds of the bond issue are 'earmarked' with the character of a trust fund which may not be diverted to another purpose or project").

To the extent that Section 34 permitted the District and other school districts to abrogate their contractual obligations, that law is invalid.[20] Section 34 would not offend the contract clauses if it applied prospectively, to future bond agreements. In that case, voters would be on notice that when they authorize their

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[18] The District is incorrect that the remaining bond money would have to be held on deposit indefinitely. § 15-1024(B)(1) requires Districts to use excess bond money to pay down the bond debt when the projects are "completed." If the District has no use for a third school (*see* I.R. 57, ¶ 4; I.R. 25, ¶ 4, App. 3), additional buses, or grounds improvements, then the projects are completed. And the Publicity Pamphlet itself includes "[l]iquidating indebtedness incurred" as a proper use of the bond funds. (I.R. 41, App. 1.)

[19] Indeed, it sought approval in 2007 for a bond initiative for additional capital funds, but voters rejected the proposal. (I.R. 42 at 14, App. 2.)

[20] The District's citation to *Gallagher Headquarters Ranch Dev., Ltd. v. City of San Antonio*, an anomalous Texas case, does not repudiate this point. (*See* Br. at 18 (citing 269 S.W.3d 628 (Tex. App. 2008)).) In *Gallagher*, voters approved funds for a city to acquire land for open-space parks. The city fulfilled that promise, but later granted an easement for the placement of power lines, which the court upheld. But the decision in *Gallagher* was vacated due to a settlement agreement. 2010 Tex. LEXIS 468 (Tex. June 18, 2010). Nonetheless, it is distinguishable from the present case because while the District abrogated its agreement to use money for approved purposes, the city in *Gallagher* fulfilled its contractual promise to purchase land for parks. *See* 269 S.W.3d 628, 631 (Tex. App. 2008).

school district to issue bonds for certain purposes, district officials would be permitted to use the money for other purposes. This knowledge would reasonably factor into the voters' decision-making processes.

c. The District's impairment was not made pursuant to a significant and legitimate public purpose

The text of the contract clauses is clear – governments may not impair contracts. That is the rule. Permitting governments to impair contracts under certain, limited circumstances is the exception. *See Energy Reserves*, 459 U.S. at 411-13 (state may not impair contracts if there is not a "significant and legitimate public purpose"). But these limited exceptions, typically involving general laws that give broad relief and only incidentally affect private contracts, do not give the District license to ignore its specific agreements. *Cf. U.S. Trust*, 431 U.S. 1 (governments cannot nullify their own bond covenants).

Experiencing an economic downturn is not an appropriate purpose justifying the District's abrogation under either the U.S. or Arizona constitutions. The exception allowing contractual impairment applies to legislation to remedy "a broad, generalized economic or social problem." *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 235 (1978). The emergency must be severe enough to threaten a basic social interest. *Ward*, 123 Ariz. at 210, 598 P.2d at 1029. And the legislature's declaration that an adequate emergency exists is not conclusive. *Blaisdell*, 290 U.S. at 442.

The District's citation to *Baker v. Ariz. Dept. of Revenue*, which upheld an amendment capping a tax credit for persons who converted vehicles to alternative fuel, does not support its contention that a sufficient "fiscal exigency" existed to justify the District's abrogation. (*See* Br. at 24 (citing 209 Ariz. at 566-67, 105 P.2d at 1185-86)). The original law in *Baker* was not modified in light of an unrelated financial crisis; rather, the law *itself* was mistakenly drafted and "riddled with loopholes" with a "potential cost [that] mushroomed to hundreds of millions of dollars." The legislature merely amended general statutory benefits so that it could continue to provide the tax credits; it did not alter the specific terms of voter-approved bonds. *See Baker*, 209 Ariz. at 563, 566, 105 P.3d at 1182, 1185.

Furthermore, the District cannot justify its contract violations by claiming it is "maximizing" the use of funds. (Br. at 26.) Undoubtedly the District believes it is more efficient to use bond proceeds for unapproved purposes, because this maximizes the District's flexibility without the inconvenience of having to ask the voters for permission. But this reallocation is not an effective use of funds from the perspective of the body politic, who were induced to relinquish their money in exchange for specific projects.

d. <u>The impairment was not reasonable and appropriate</u>

Assuming *arguendo* that the District had a legitimate purpose for impairing its contract with the voters, the abrogation is not reasonably and appropriately

tailored to a "fiscal crisis." A higher scrutiny applies when governmental entities abrogate 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*, 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.[21]

"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*, 431 U.S. at 24, 27 (*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

[21] The District attempts to dodge heightened scrutiny by asserting that "the State of Arizona . . . has no self-interest in the outcome of this dispute." (Br. at 24 n.5.) But the District clearly has self-interest in avoiding its obligations.

as originally planned or use the money to repay the debt. If the District desires additional funds 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.

The District's abrogation fails even under less exacting scrutiny. Even where the government has a legitimate interest in exercising a police power, "complete deference to a legislative assessment of reasonableness and necessity is not appropriate." *U.S. Trust*, 431 U.S. at 25-26. Breaching an agreement without even attempting to obtain voters' permission to use the money for other purposes is not an appropriate way to address a funding shortage. 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*, 431 U.S. at 30-31; *see Allied Structural Steel Co.*, 438 U.S. at 235 (striking down a law imposing a pension funding fee if businesses close a state office because it was too narrow to solve the state's general plant closure problem). 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]." *U.S. Trust*, 431 U.S. at 29.

Under either level of scrutiny, the District's funding shortage does not rise to the level of an emergency that justifies breaking an agreement and undermining the election process. The District concedes it 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. (I.R. 58 at 7: 9-16; App. 16.) 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. (*Id.* at 13: 20-25, 14: 1-21.) Yet the projects the District planned to divert the bond money to include painting entire schools regardless of damage (*id.* at 26: 24-25, 27: 1-7), painting projects intended to create "an aesthetically pleasing classroom environment" (*id.* at 41: 8-14), expanding a high school cafeteria (*id.* at 28: 18-25, 29: 1-17), replacing a scratched skylight that still provides light in the classrooms (*id.* at 37: 21-25, 38: 1-25, 39: 1-2), and modernizing the stage and theater lighting in the Fine Arts Center. (*Id.* at 49: 15-25, 50: 1-25, 51: 1-12.) Some of these projects were by the District's own admission not even related to safety or learning. (*Id.* at 48: 6-20.) One project was to renovate a school that had been closed and had no students attending it. (*Id.* at 31: 15-25, 32: 1-19.) In fact, according to the latest plan, the District planned to spend $2,047,286 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." (I.R. 60, projects designated "2" or "3," App. 17; I.R. 61, App. 18.) Thus, 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. *Cf. 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).

The District's tortuous attempts to avoid heightened scrutiny and justify its self-serving defiance of its contractual obligations to the body politic do not comport with even the broadest and most deferential interpretations of the state and federal contract clauses. Because the District, pursuant to Section 34, violated its own contract without a permissible, significant objective, on contract clause grounds alone, this Court should affirm the trial court's ruling to enjoin the District from spending bond money on unapproved projects.

III. <u>Attorney's Fees</u>

Appellants do not appear to contest the validity of the trial court's award of attorney's fees, but simply note that "[i]f this Court finds that the trial court erred as a matter of law in granting summary judgment to plaintiffs, it should also vacate

the fee award, as plaintiffs would no longer be the prevailing parties." (Br. at 31.) This Court reviews a trial court's award of attorneys' fees for an abuse of discretion. *Arnold*, 160 Ariz. at 609, 775 P.2d at 537; *Kadish*, 177 Ariz. at 326, 868 P.2d at 339. Because appellate courts defer to the trial court's exercise of discretion regarding fee awards, if this Court affirms the trial court's grant of summary judgment to Taxpayers on any ground, it should also affirm Taxpayers' fee award.

CONCLUSION

Section 34 was passed as a special favor to permit the Cave Creek School District to renege on its agreement with the body politic. But the federal and state constitutions do not permit the state to make a rule that authorizes a privileged few school districts to break another rule. The District has other options – if it desires money for different purposes, it is free to ask its citizenry for permission in a new bond election. But it is *not* free to circumvent that process by unilaterally altering the agreement created in a prior election. A statute cannot excuse the District from constitutional compliance, and it certainly cannot do so for only a select few school districts.

Appellees Taxpayers respectfully request that this honorable Court affirm the trial court's ruling.

RESPECTFULLY SUBMITTED this 26th day of March, 2012 by:

/S/ Christina Sandefur
Clint Bolick (021684)
Carrie Ann Sitren (025760)
Christina Sandefur (027983)
Scharf-Norton Center for Constitutional Litigation at the GOLDWATER INSTITUTE
500 East Coronado Rd., Phoenix, AZ 85004
(602) 462-5000
litigation@goldwaterinstitute.org
Attorneys for Plaintiffs/Appellants