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

KARL HIRSHMAN; RICHARD RODGERS; and BRUCE ASH,

Plaintiffs,

vs.

JONATHAN ROTHSCHILD, in his official capacity as Mayor of the City of Tucson; REGINA ROMERO, in her official capacity as member of the Tucson City Council; PAUL CUNNINGHAM, in his official capacity as member of the Tucson City Council; KARIN UHLICH, in her official capacity as member of the Tucson City Council; SHIRLEY SCOTT, in her official capacity as member of the Tucson City Council; RICHARD FIMBRES, in his official capacity as member of the Tucson City Council; STEVE KOZACHIK; RICHARD MIRANDA, in his official capacity as City Manager of the City of Tucson; and CITY OF TUCSON,

Defendants.

Case No.: C2014-0690

PLAINTIFFS' REPLY TO DEFENDANT'S RESPONSE TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

(Assigned to the Honorable Gus Aragon)

Pursuant to Rule 56, Ariz. R. Civ. P., Plaintiffs Karl Hirshman, Richard Rodgers, and Bruce Ash, who are Tucson taxpayers ("Taxpayers"), hereby Reply to Defendant City of Tucson's ("City") Response to Taxpayers' Motion for Summary Judgment.

PRELIMINARY STATEMENT

Perhaps recognizing the constitutional infirmities with TC § 28-39, the City now tries to save that ordinance by arguing that it must be interpreted differently from the manner in which it has been implemented and in a way that a fair reading of the law does not support. The evidence in this case confirms a different conclusion. Like the state bid preference statute that was struck down by the Arizona Supreme Court 25 years ago, the financial burden imposed by TC § 28-39, the discrimination it effects, and the privileges it confers, are not rationally related to any legitimate government purpose. *Big D Const. Corp. v. Ct.App. of Ariz.*, 163 Ariz. 560, 570, 789 P.2d 1061, 1071 (1990). Additionally, since there is no substantial reason for the blatant residential discrimination under TC § 28-39(c), that provision violates the U.S. Constitution's Article IV Privileges and Immunities Clause. Finally, because the City does not receive lawful consideration for public expenditures made pursuant to TC § 28-39, those expenditures are unconstitutional gifts. TC § 28-39 is unconstitutional as enacted and as implemented, and has resulted in the unlawful expenditure of Taxpayer funds. As a result, the ordinance *as a whole* must fall.

I. THE LOCAL PREFERENCE PROVISIONS UNDER SECTION 28-39 ARE NOT RATIONALLY RELATED TO THE CITY'S STATED PURPOSE.

A. The Definition of "Principal Place of Business" as Implemented by the City Ensures that TC § 28-39 Does Not Advance Its Stated Purpose.

Defining "local" companies under TC § 28-39 as those with a "principal place of business" within Pima County does not advance that ordinance's stated purpose. The City asserts that Taxpayers' objections to the ordinance are "based on mistaken facts and hypotheticals" (Defendants' Response to Plaintiffs' Motion for Summary Judgment ("Resp. to PMSJ") at 2). In doing so, the City has placed itself in an odd, and at times, unintelligible predicament. Namely, there is nothing hypothetical about the fact that the City has specifically defined "principal place of business" as the domestic address a company maintains with the Arizona Corporation Commission ("ACC") (Plaintiff's Separate Statement

of Facts ("PSOF") ¶ 24). The City has admitted this in a wide variety of contexts, including in its own statement of facts, and at every stage of this litigation. *See, e.g.,* Defendants' Supplemental Facts ("DSF") ¶ 12; PSOF ¶ 24. However, perhaps sensing that the City's own definition of "local" companies does not, and cannot, advance the purpose of TC § 28-39, the City appears to retreat from its definition, and relies instead on some heretofore unknown definition of "principal place of business" that the City asserts can somehow be discerned from the text of TC § 28-39 itself and "the law." *See, e.g.,* (Defendant's Motion for Summary Judgment ("DMSJ") at 9) ("The LPP requires that the business getting a 5% preference as local to Tucson must *in fact* have its principal place of business in Tucson) (emphasis added); (*id.* at 9, n. 4) ("Principal place of business is well recognized in the law as a basis for differentiating between entities"); (Resp. to PMSJ at 3) ("[T]he law and the other materials provided to bidders . . . plainly identify the local preference as applying to a firm based on its principal place of business"); (*id.*) ("[T]here is absolutely no evidence that the preference has in fact been applied where there was no *real* 'principal place of business'") (emphasis added). But the City does not state what "principal place of business" means "in fact" or what this "real" or actual definition of "principal place of business" is. This is as if Congress mandated payment of taxes based on "income," failed to define income in statute, delegated authority to the Internal Revenue Service to define income, and then required taxpayers to divine a separate definition of income from the one the IRS specifically implemented.

The City cannot have it both ways. Having enacted an ordinance that seeks to promote an unconstitutional purpose and that delegated authority to a department that implemented the ordinance in a manner that does not rationally advance that unconstitutional purpose, the City cannot now claim that it is powerless to "change the law" (Resp. to PMSJ at 2). Likewise, the City cannot legitimately argue that the criterion it has specifically applied in defining "principal place of business" under TC § 28-39 is somehow different from other yet-to-be-identified, actual criteria for "principal place of business" (*id.*). In this case, bidders, Taxpayers, and this Court alike have no other option but to rely on the definition the City itself has actually applied to the phrase "principal place of business" in implementing TC § 28-39. Indeed, the City asserts that the text of TC § 28-39 mandates discretion for the Procurement Department to implement the ordinance (Defendant's Statement of Stipulated Facts ("SF") ¶ 11). That

definition, as Taxpayers argued in their Motion for Summary Judgment (PMSJ at 8-11), fails as a matter of law. Moreover, reference to some other "well recognized" definition of "principal place of business" in "the law" does not save TC § 28-39 (DMSJ at 9, n. 4). As asserted in Taxpayers' Response to Defendant's Motion for Summary Judgment ("Resp. to DMSJ at 8-12), the law provides no intelligible definition of the phrase "principal place of business." Indeed, the definition settled on by the U.S. Supreme Court in the context of federal diversity jurisdiction does not advance, but undermines, the City's stated purpose in enacting TC § 28-39. *See Hertz Corp. v. Friend*, 559 U.S. 77 (2010).

The City's haphazard, contradictory, and ambiguous definition of "principal place of business" produces precisely the arbitrary and whimsical results that were ruled unconstitutional in *Big D.* 163 Ariz. at 568, 80 P.2d at 1069. Municipalities across this State have retreated from bid preferences for over 25 years because, if Arizona law does not directly prohibit them, it certainly disfavors them. The City's latest attempt to resurrect a practice that has long been held unconstitutional fails even more spectacularly than its predecessor statute that was struck down in *Big D* because it does not advance the government's purported interest, producing instead "whimsical, arbitrary, and capricious results." *Id.*

B. The Evidence in this Case Supports a Finding that Local Preferences Awarded Pursuant to TC § 28-39 May or May Not Have Anything to Do with the Actual Business Location of the Company Awarded the Preference.

The City argues that Taxpayers "do not cite any evidentiary basis" for the observation that Local Preferences under TC § 28-39 may be awarded to a company regardless of the actual location of the company's business activities (Resp. to PMSJ at 5). The record on this point is abundantly clear. Specifically, the City expressly admits that "principal place of business" under TC § 28-39 is defined as the address on record with the ACC. (DSF ¶ 12). This was placed in a declaration by the current director of the City Procurement Department and acknowledged by both the former and current directors of the City Procurement Department during depositions. (PSOF ¶¶ 24-25). The City then created an Affidavit that reiterates this definition of "principal place of business" and requires bidders to attest, under penalty of perjury, that they meet the definition of principal place of business as implemented by the City and indicated on the Affidavit in order to qualify for a Local Preference. (PSOF ¶ 20). In turn, the Director of the Corporation Division of the ACC attested that, "The only criterion the ACC uses . . . for 'known place of business' address…is that it must be a street address or other physical address in

Arizona." (PSOF ¶ 27). Despite the City's assertions to the contrary, the evidence is indisputable: In implementing TC § 28-39, and defining "local" businesses as those with a "principal place of business" in Pima County, the City has settled on a criterion that may or may not have anything whatsoever to do with the actual location of a company (or its business activities) that qualifies for the preference.

The City next attempts to attack the evidentiary value of Taxpayers' expert, Michael Purdy, claiming that "it is possible to find economists who think local preference is a bad idea just as there are others who believe it is a good idea" (Resp. to PMSJ at 5). Taxpayers wonder whether the City reviewed the expert report. Taxpayers' expert is not an "economist" (though Taxpayers do not dispute that the vast majority of economists would agree that a local preference policy is not a "good idea"), but rather a public procurement professional with over 30 years of experience, including as the Contracting Manager for the City of Seattle. (PSOF ¶ 54). In forming an expert opinion in this case, among other items, Mr. Purdy reviewed TC § 28-39, the declaration of the City's Procurement Director, Marcheta Gillespie, and the declaration of the director of the ACC's Corporations Division, Patricia Barfield. (Plaintiffs' Second Supplemental Statement of Facts ("2nd PSSOF") ¶ 1). Based on his review of these materials and his extensive experience in public procurement, Mr. Purdy concluded: "The City has applied a very loose and ineffective standard to determine when the preference percentages should be applied, thus undermining the stated objective of the ordinance." (2nd PSSOF ¶ 2). Although Mr. Purdy roundly rejects the "economic" studies the City purportedly relied on when enacting TC § 28-39 (Plaintiffs' Supplemental Statement of Facts ("PSSOF") ¶ 2), his analysis was not that of a "competing economic stud[y]." (Resp. to PMSJ at 5). Rather, as a public procurement professional, and in accordance with the opinion of the public procurement community as a whole, Mr. Purdy believes not only that local preferences are matters of poor public policy generally (PSOF ¶¶ 54, 62-69), but TC § 28-39 is specifically ineffective, if not counterproductive, in achieving the City's purported aims. (2nd PSSOF ¶ 3).

II. THE CITY MISREADS THE HOLDING IN *BIG D* AND CONFUSES THE ANALYSIS UNDER THE U.S. CONSTITUTION'S ARTICLE IV PRIVILEGES AND IMMUNITIES CLAUSE, WHICH SUPPORTS COUNT SIX OF TAXPAYERS' COMPLAINT.

The City argues (Resp. to PMSJ at 4) that TC § 28-39 is rationally related to a legitimate state purpose because the ordinance purportedly supports actual, "local" firms, citing footnote 7 in *Big D* as

support. *Big D*, 163 Ariz. at 567, 789 P.2d at 1068. The footnote cited by the City specifically pertains to the application of the Privileges and Immunities Clause under Article IV of the U.S. Constitution, not the Equal Privileges and Immunities and Special Law provisions of the Arizona Constitution. *Id.* Although footnote 7 is inapplicable to an Equal Privileges and Immunities and Special Law analysis under the Arizona Constitution, that reference supports, rather than undermines, Taxpayers' claim that TC § 28-39(c) violates the U.S. Constitution's Article IV Privileges and Immunities Clause.[1]

In *Big D*, 163 Ariz. at 567, 789 P.2d at 1068, the Arizona Supreme Court reiterates the state of the U.S. Constitution's Article IV Privileges and Immunities jurisprudence in the context of residential discrimination on public works projects following the U.S. Supreme Court's decision in *United Bldg. and Const. Trades of Camden v. City of Camden*, 465 U.S. 208, 221-22 (1984). In *City of Camden*, the Court held that in order to survive scrutiny under the Article IV Privileges and Immunities Clause, there must be a "substantial reason" for disparate treatment between residents and non-residents, and nonresidents must be shown to "constitute a peculiar source of the evil at which the statute is aimed." *Id.* at 222 (internal citations omitted). In footnote 7 in *Big D*, the Arizona Supreme Court simply reiterates and adopts the "substantial reason" test laid out in *City of Camden*. *Big D*, 163 Ariz. at 567, 789 P.2d at 1068 ("This suggests that where an opportunity *can* be attributed to state programs or revenues, *and there is a substantial reason to justify it*, the state may discriminate against non-residents") (second emphasis added). As described in Taxpayers' Motion for Summary Judgment (at 14-15), the City has not, and cannot, make a showing that there is a substantial reason for discriminatory treatment between residents and non-residents and that non-residents constitute "a peculiar source of the evil at which the [discriminatory] statute is aimed." *City of Camden*, 465 U.S. at 221-22; *Big D*, 163 Ariz. at 567, n. 7, 789 P.2d at 1068.

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[1] In any event, the present version of TC § 28-39, like the state bid preference statute that was struck down in *Big D*, "does not favor Arizona firms, those with a substantial presence in Arizona, nor those that have made significant contributions to the public fisc." *Big D*, 163 Ariz. at 567 n. 7, 789 P.2d at 1068. On the contrary, among other irrational applications, as implemented by the City, under TC § 28-39 a preference may be awarded to a firm that maintains only a statutory agent within Pima County. PSOF ¶ 28. This would include any firm that has registered an address with the ACC in Pima County, regardless of the company's actual business contacts in Tucson. Of course, this undermines, rather than advances, the City's purported interest in enacting TC § 28-39.

Moreover, the City argues that the U.S. Constitution's Equal Protection Clause and Article IV Privileges and Immunities Clause "apply the same standard as the state constitutional claims" (Resp. to PMSJ at 9). The City goes on to write that "[t]his case is not about residency" (*id.*). In fact, the U.S. Constitution's Privileges and Immunities Clause does not apply the same constitutional standard as either the U.S. Constitution's Equal Protection Clause or the state constitutional claims. While the U.S Constitution's Equal Protection Clause and the Arizona Constitution's Equal Privileges and Immunities and Special Law provisions require discriminatory classifications to be rationally related to a legitimate government purpose, the U.S. Constitution's Article IV Privileges and Immunities Clause recognizes certain "fundamental rights" that are protected and any regulations that discriminate against those rights will be unconstitutional unless the government can show a substantial reason for the disparate treatment. *City of Camden*, 465 U.S. 221-22. The U.S. Supreme Court has recognized employment on public works projects as a fundamental right protected by Article IV's Privileges and Immunities Clause. *Id.* As indicated *supra*, if laws discriminate against that right, the burden is on the government to show there is "something to indicate that non-citizens constitute a peculiar source of the evil at which the statute is aimed." *Hicklin v. Orbeck*, 437 U.S. 518, 525-26 (1978). Even in those cases where a substantial reason for discriminatory treatment exists, the inquiry "must be concerned with whether . . . the degree of discrimination bears a close relation" to the reasons for disparate treatment. *Toomer v. Witsell*, 334 U.S. 385, 396 (1948).

In this case, TC § 28-39(c) permits a 1.5 percent preference for "a locally owned" franchise. PSOF ¶ 34. Although the City admits that it does not have any established criteria for determining what constitutes a "locally owned franchise," the Bidder's Affidavit, which is prepared by the City Procurement Department, appears to define a "locally-owned franchise" as one that is "majority owned" by a "local resident." PSOF ¶¶ 35-36. Therefore, the ordinance indisputably discriminates in favor of residents against non-residents. The City has made no findings that there is a "substantial reason" for the discriminatory treatment of non-residents under any portion of TC § 28-39, including TC § 28-39(c). Similarly, there is no support in the record that non-residents constitute a "peculiar source of evil" at which TC § 28-39(c) aims to remedy. On the contrary, the record clearly establishes that residents are at an *advantage* vis-à-vis their non-resident competitors. Specifically, the City already grants a 2.7 percent

tax-offset to Tucson-based companies that non-Tucson-based firms do not enjoy. PSOF ¶ 13. Additionally, resident bidders enjoy greater flexibility to respond to City needs as well as reduced travel time, costs, and other overhead expenses as a result of close proximity compared to non-resident competitors. In fact, at the time TC § 28-39 was adopted, the large majority of City contracts were already going to businesses located in Tucson and Arizona: 55 percent and 81 percent, respectively. PSOF ¶ 8. This suggests, of course, that rather than constituting a "peculiar source of evil," non-residents are already at a significant disadvantage when bidding on public contracts. There is, therefore, no "substantial reason" for their discriminatory treatment under TC § 28-39. TC § 28-39(c) fails under Article IV's Privileges and Immunities Clause constitutional because it facially discriminates against non-residents without *any*, let alone a *substantial*, reason.

The City argues, both unconvincingly and bafflingly, that despite the residential discrimination effected under TC § 28-39(c), the law is constitutional because "the implementation of the preference is discretionary with the City and thus it cannot be said with certainty that the franchisee preference will be denied to someone who is operating a local franchise but technically a non-resident" (Resp. to PMSJ at 9). As a threshold matter, TC § 28-39(c) requires that any company receiving a franchise preference must be "locally owned." This vague and arbitrary definition raises its own constitutional problems under our state constitution. *See* PMSJ at 9-10; *see also State v. Singer*, 190 Ariz. 48, 50, 945 P.2d 359, 361 (App. 1997) ("A legislative enactment must 'provide explicit standards for those who will apply it.'") (internal citations omitted). More significantly, however, the City *itself* created the residential discrimination in both the language of TC § 28-39 and in the Bidder's Affidavit, the mechanism used to implement that ordinance. Is the City now suggesting that it will not apply its own standards? If so, TC § 28-39(c) must be repealed or amended. If not, that provision clearly violates the U.S. Constitution's Privileges and Immunities Clause of Article IV, and, therefore, must be struck down.

III. SUBSIDIES PROVIDED TO PRIVATE ENTERPRISE UNDER SECTION 28-39 VIOLATE THE GIFT CLAUSE BECAUSE THE CITY DOES PAY MARKET PRICE AND DOES NOT RECEIVE CONSIDERATION FOR THE PUBLIC EXPENDITURE.

The requirements for a public expenditure to satisfy the Arizona Constitution's Gift Clause are clear and unequivocal: There must be a public purpose for the expenditure and the government must receive adequate consideration in return. *Wistuber v. Paradise Valley Unified Sch. Dist.*, 141 Ariz. 346,

349, 687 P.2d 354, 357 (1984). "Although anticipated indirect benefits may well be relevant in evaluating whether spending serves a public purpose, when not bargained for as part of the contracting party's promised performance, such benefits are not consideration under contract law . . . or the *Wistuber* test." *Turken v. Gordon*, 223 Ariz. 342, 350, 224 P.3d 158, 166 (2010) (citation omitted). In the City's Response, the City continues its analytical confusion regarding the requirements that must be satisfied for public expenditures under the Gift Clause. The City argues that expenditures made pursuant to the Local Preferences under TC § 28-39 do not violate the Gift Clause because "[t]he local bidder is getting exactly the price that he believed was the *fair market price* for those goods and services" (Resp. to PMSJ at 7) (emphasis added). The City misunderstands the definition of "fair market price" generally and in Gift Clause analysis specifically. The bidder's own *belief* about what fair market price is or ought to be is entirely irrelevant for Gift Clause purposes. Indeed, the bidder on a public contract does not determine fair market price, even if the City acquiesces to the bidder's offer. "[A]nalysis of adequacy of consideration for Gift Clause purposes focuses instead on the *objective* fair market value of what the private party has promised to provide in return for the public entity's payment." *Turken*, 223 Ariz. at 350, 224 P.3d at 166 (emphasis added). By the City's own admission, the *only* benefits it receives by providing a preference under TC § 28-39 are *indirect* benefits, such as projected tax revenues or increased employment. (PSOF ¶¶ 7, 18-19). Since indirect benefits are not consideration under the Gift Clause, the City is not paying objective fair market value when it awards a contract to a bidder who qualifies for the preference. *Turken*, 223 Ariz. at 350, 224 P.3d at 166. Rather, the City is providing an unconstitutional gift of Taxpayer funds to that bidder.

The City goes on to argue that even if an expenditure made pursuant to a Local Preference under TC § 28-39 is a subsidy, that expenditure does not violate the Gift Clause because it is not "close to the millions of dollars involved in Gift Clause cases" and therefore is not "grossly disproportionate" (Resp. to PMSJ at 8). Again the City misunderstands the constitutional analysis. Adequacy of consideration cannot be tested based on the dollar amount of the public expenditure alone. Rather, an analysis of what is received in return for that expenditure is necessary. Because indirect benefits are not consideration under the Gift Clause, when the City makes a public expenditure for which it receives only indirect benefits as consideration, the City is receiving *no consideration at all*. *Turken*, 223 Ariz. at 350, 224

P.3d at 166. If the public receives nothing for something, regardless of the dollar amount involved, the government payment is grossly disproportionate to what is received in return. And the entity receiving that payment is receiving a gift. Under any other arrangement, the City could provide a gift of $100 dollars to its favorite charity for the purpose of spreading good will and not run afoul of the Gift Clause because the expenditure was not "close to the millions of dollars involved in Gift Clause cases." That is, of course, not the test under the Gift Clause. When, as here, no consideration is received for the public expenditure, the expenditure is a gift.

Lastly, the City contends that if indirect benefits do not count as consideration under the Gift Clause, then the City's request for proposal ("RFP") contract process, which allows the City to select bids the City deems most advantageous rather than simply those that are lowest, is also a violation of the Gift Clause. The City writes: "Determining what may be most advantageous [to the City] obviously will include the same type of 'indirect' benefits that Plaintiffs argue cannot be included" (Resp. to PMSJ at 8). This, of course, may or may not be true. To determine whether a certain contract made pursuant to the RFP process is constitutional would require an analysis about the specific public expenditure made and the consideration received for that expenditure. In most cases, the City is probably deriving value (and consideration) from evaluation criteria it applies to a RFP, such as the bidder's ability to meet outlined project priorities or the bidder's experience and capacity to provide the services requested. In other cases, the evaluation criteria may be gratuitous. In either case, evaluation criteria in the RFP process are entirely irrelevant to the challenged practice of providing subsidies under TC § 28-39. Under the ordinance challenged here, the City systemically provides subsidies to private businesses without requiring any additional value and *no* consideration under the Gift Clause. As a result, expenditures made pursuant to TC § 28-39 are unlawful and must be enjoined.

IV. CONCLUSION

The City's retreat from its own unconstitutional implementation of TC § 28-39 is telling. Unfortunately for the City, neither the evidence in this case, nor a plain reading of TC § 28-39 can save that ordinance. TC § 28-39 was enacted for an unconstitutional purpose, and as implemented by the City, the ordinance does not advance that purpose. Moreover, TC § 28-39(c) blatantly discriminates against non-residents for no substantial purpose in violation of the U.S. Constitution's Article IV

Privileges and Immunities Clause. Because the City does not receive consideration for public expenditures made pursuant to TC § 28-39, that ordinance also results in unconstitutional gifts to bidders enjoying a preference. For all of these reasons, as well as those set out in Taxpayers' Motion for Summary Judgment and Response to the City's Motion for Summary Judgment, Taxpayers respectfully request that Taxpayers' Motion for Summary Judgment be GRANTED, the City's Motion for Summary Judgment be DENIED, and that this Court declare TC § 28-39 unconstitutional and enjoin its further effect.

RESPECTFULLY SUBMITTED this 31st day of October, 2014 by:

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