



# LEGAL ALERT

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February 2009

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## *Turken v. Gordon*

A \$97.4 million economic incentive agreement between the City of Phoenix and NPP CityNorth, L.L.C. was largely overturned by the Arizona Court of Appeals, Division I, in a decision issued on December 23, 2008. The Goldwater Institute, a locally-based think tank, filed a lawsuit after the Phoenix City Council authorized the sharing of 50% of the sales tax proceeds generated by the 144 acre mixed-use CityNorth development, arguing that the agreement violated the Arizona Constitution's "Gift Clause" prohibition against "any donation or grant, by subsidy or otherwise, to any individual, association, or corporation." The agreement provided funding for a garage that contains public parking, including 200 parking spaces set aside exclusively for park and ride users. The Court concluded that only the payments attributable to the park and ride spaces satisfied the requirements of the Gift Clause. Payments attributable to the remaining 2,980 spaces were found to be unconstitutional under the standard adopted by the Court.

Prior to the *CityNorth* decision, most Arizona courts evaluated the constitutionality of economic incentive agreements by focusing on a two-prong test articulated by the Arizona Supreme Court in *Wistuber v. Paradise Valley Unified Sch. District*, which requires such agreements to: (1) satisfy a public purpose, and (2) provide adequate consideration to the public. Applying this test, the Maricopa County Superior Court ruled in favor of the City and CityNorth developer, finding the CityNorth sales tax reimbursement arrangement to be valid. The Court of Appeals, however, found that *Wistuber* did not preclude consideration of a third factor in determining whether a tax sharing agreement violates the Gift Clause: (3) whether the public expenditure to a private party unduly promotes private interests.

The Court of Appeals analyzed several public purposes cited by the City and the CityNorth developer in justifying their tax reimbursement agreement, including creation of retail uses and employment, development of an urban core, stimulation of economic development,



generation of sales tax revenues, and creation of a public parking facility. While the Court of Appeals agreed that the park and ride spaces have a valid public purpose and do not improperly promote a private interest, the Court rejected the argument that the remaining spaces provided a direct benefit to the City since they were not for City employees or persons doing business with the City. Consequently, the Court looked beyond whether there was consideration for the remaining spaces and evaluated whether the City's payments plainly fostered or promoted the purely private or personal interests of the CityNorth developer. Concluding that the parking provisions directly promote the developer's private purposes, the Court was influenced by the fact that the members of the "public" that will use the spaces are actually the private customers of CityNorth, who will be parking their cars so that they can do business with CityNorth's retail tenants.

The Court of Appeals also rejected several other arguments made by the City and the CityNorth developer in support of the validity of the agreement, including (1) that the agreement serves a public purpose simply because it is authorized by a state statute, (2) that since there would have been no violation of the Gift Clause if the City owned the parking garage, the result should not be different simply because the CityNorth transaction is structured as a lease, (3) that the consideration anticipated to be received by the City is so substantial that the Court should assume the Gift Clause is satisfied, and (4) that the transaction is structured in a manner that will prevent the City from losing money.

The *Turken* decision calls into question the use of economic incentive agreements that offer government payments, including sales tax reimbursements,

for transactions involving anything other than construction of public infrastructure or similar direct public uses. Such agreements may be vulnerable to legal challenge in the absence of a clear showing that, under the agreement, the municipality will receive some direct public benefit – such as the park and ride facilities in CityNorth – in return for its payments or expenditures.

In response to the *Turken* decision, at least one municipality has suspended payments under several previously executed economic development agreements, while others have placed negotiation of such agreements on hold. Although the City of Phoenix and the CityNorth developer have indicated their intention to appeal the decision to the Arizona Supreme Court, pending the outcome of that appeal, developers that request economic incentives for indirect benefits alone, such as jobs, economic development, and increased sales tax revenues, risk litigation.

If you have any questions regarding the content of this legal alert, please contact the attorney listed below or consult your legal professional.

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