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## THE DEATH OF PUBLIC PURPOSE (AND HOW TO PREVENT IT)

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# THE DEATH OF PUBLIC PURPOSE (AND HOW TO PREVENT IT)

Brian Libgober<sup>1</sup>

Introduction.....	1
Section I: The Origin and Development of Public Purpose.....	6
Section II: The Death of Public Purpose.....	23
I. The Case Study: Methodology and Results.....	23
II. Representative Case: Board of Directors v. All Taxpayers, Property Owners, Citizens of the City of Gonzales.....	30
III. Representative Case: Empress Casino Joliet Corporation v. Giannoulas.....	35
IV. Representative Case: Turken v. Gordon.....	39
Section III: How to Revive It.....	47
Conclusion.....	56

## Introduction

By some measures, the greatest financial crisis to affect the United States was not the mortgage-backed securities crisis of the late 2000s or the consumer-debt crisis of the 1930s, but rather the public-debt crisis of the late 1830s.<sup>2</sup> In order to support the dramatic expansion of commerce in the antebellum era, state and local governments took to spending lavishly on roads, canals, railroads, and other public-private partnerships. When these endeavors failed to generate the revenues that were promised, states ended up with responsibility for the bill, but no ability to pay. As a result, eight states defaulted on all or part of their debt.<sup>3</sup> The economic, social, and political effects of the crisis were profound.

Unlike the other financial crises in the United States, whose themes seem to repeat every few decades, today the ills that caused the crisis of the 1830s seem cured. One reason is that a legal and institutional technology

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<sup>2</sup> J. ATACK & PETER PASSELL, A NEW ECONOMIC VIEW OF AMERICAN HISTORY FROM COLONIAL TIMES TO 1940, 102 (1994) (noting two measures by which the 1839-1843 downturn was worse than the Great Depression, and another that was not).

<sup>3</sup> John A. Dove, *Credible commitments and constitutional constraints: State debt repudiation and default in nineteenth century America*, 23 CONST. POLIT. ECON. 66, 67 (2012).

was invented in response to the calamity that has proven effective at heading off irresponsible public spending: the public purpose doctrine.<sup>4</sup> In essence, the public purpose doctrine holds that no state government may give funds to private persons unless doing so is for some public end. The doctrine does not forbid private parties from benefiting from transactions with state and local governments, but it does insist that the public benefit be sufficiently high that the transaction is rightly considered in the public interest. This is not a federal requirement, but rather was operationalized independently by constitutional amendment in almost every state, and grafted into constitutional common law by some of America's greatest legal thinkers.

The reasons for the public purpose doctrine's effectiveness are three fold. By amending their constitutions to disallow profligate spending, states sent a costly signal of their commitment not to default again. Second, by giving their courts the power to enforce those provisions and block spending, the states make that commitment credible.<sup>5</sup> Finally, by granting debt-holders and concerned citizens the power to sue, they create a "fire-alarm" that allows for decentralized monitoring of the legislatures actions.<sup>6</sup> Evidence that these mechanisms really worked is found in one recent econometric study, which concluded that the enactment of public purpose provisions in the 19<sup>th</sup> century was associated with significantly higher prices of state bonds.<sup>7</sup> Besides the economic benefit of strengthening the credit of state and local governments, the public purpose doctrine has played a significant role in slowing interstate subsidy competition.<sup>8</sup> A recent paper has reported that \$80.4 billion dollars are spent per year by states trying to convince businesses to relocate, a distortionary policy that might benefit some states in the short term but on the whole causes the nation a great deal

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<sup>4</sup> *Id.*

<sup>5</sup> There is an extensive literature in political economy discussing institutional technologies that prevent excessive public indebtedness and promote economic well-being. See, e.g., Weingast & North, *Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century*, XLIX J. ECON. HIST. 803–832 (1989); J Lawrence Broz, 52 THE ORIGINS OF CENTRAL BANKING: SOLUTIONS TO THE FREE-RIDER PROBLEM International Organization 231–268 (1998).

<sup>6</sup> Mathew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols versus Fire Alarms*, 28 POLIT. SCI. 165–179 (2009).

<sup>7</sup> Dove, *supra* note 3, at 81–90.

<sup>8</sup> In *State ex rel. Ohio County Commission v. Samol*, 165 W. Va., 714 (1980), West Virginia Chief Justice Neely presents a remarkable concurrence that speaks directly to the subsidy issue. Neely states that the business aid measure before him seems to be bad policy and in obvious conflict with the public purpose doctrine, but he upholds it anyway because of the "parochial interest" of West Virginians and the fact that other state and federal courts have "so relaxed their vigilance in this regard that any Congressional scheme to subsidize private enterprise, no matter how predatory, will be sustained." Indeed, it is telling that an informed commentator was already able to recognize how weakened the doctrine had become even so early as 1980.

Fall 2015]

*Death of Public Purpose*

3

of harm, particularly to the income of manufacturers.<sup>9</sup> While in Europe such subsidies are kept on a tight-leash by a centralized European agency, in the United States there is no comparable federal oversight.<sup>10</sup> The public purpose doctrine is among the few institutional constraint preventing local governments from engaging in costly interstate subsidy wars.<sup>11</sup>

Despite the pivotal role the public purpose doctrine has played in promoting well-being within and between the States, in the last few decades the doctrine seems to have fallen on hard-times. Based on an exhaustive survey of the over 200 cases that have considered the doctrine in the last twenty years, this Article concludes that the doctrine is no longer an effective constraint on state and local governments. While the survey contains examples from nearly every state in the country where the Courts say the public purpose doctrine is still good law, not a single state Supreme Court has actually invalidated a public spending measure based on public purpose grounds. If the law is what Courts do and not what they say they do, the public purpose doctrine is no more.<sup>12</sup>

Courts' failure to apply the public purpose doctrine against state and local governments raises questions about this rule's force, yet it is also important to establish that there were opportunities where the rule might have been used. Perhaps state and local governments have not acted in such a way as to clearly violate the doctrine? Unfortunately, a close reading of the cases suggests otherwise. Within the last decade, Courts have validated 42 million dollars to aid construction of a sporting good facility in Louisiana,<sup>13</sup> over 90 million dollars in aid to a private shopping center in Arizona,<sup>14</sup> and the mortgaging of a police headquarters to finance the construction of a private athletic facility in Colorado.<sup>15</sup> The public purpose behind these expenditures is doubtful, and it is likely that they would fail a fair application of the tests the public purpose doctrine provides. If one considers the low incentives that exist to bring such case in the first place, it is not surprising that many of the cases would be strong for the plaintiffs.

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<sup>9</sup> Ralph Ossa, *A Quantitative Analysis of Subsidy Competition in the U.S.* (Nat'l Bureau of Econ. Research, Working Paper No. 20975, 2015).

<sup>10</sup> WILLIAM SCHWEKE, CURBING BUSINESS SUBSIDY COMPETITION: DOES THE EUROPEAN UNION HAVE AN ANSWER 2-3 (2000).

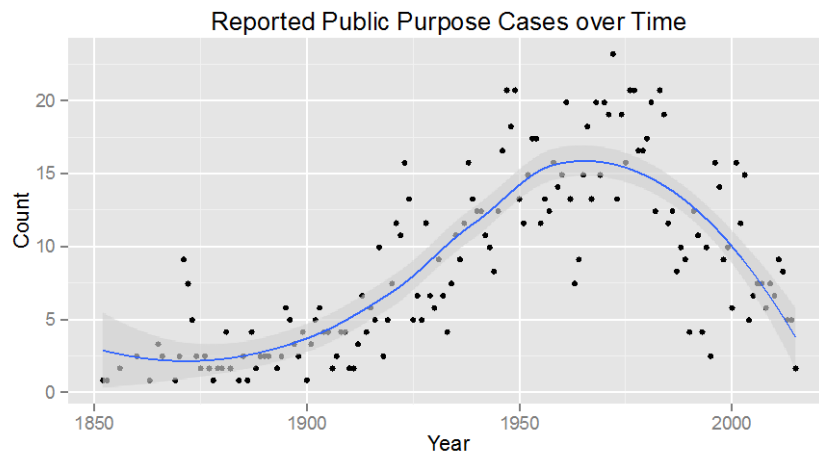
<sup>11</sup> Another, somewhat inconsistently applied institutional defense is the dormant commerce clause doctrine. See, e.g., Organization for Economic Co-operation and Development [OECD], Global Forum on Competition, *Competition, State Aids, and Subsidies*, DAF / COMP / GF / WD 5-10 (2010).

<sup>12</sup> Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 Harv. L. Rev. 457, 461 (1897). For a modern explanation of legal realism, see Brian Leiter, *Rethinking Legal Realism: Toward a Naturalized Jurisprudence*, 76 TEX. LAW REV. 267 (1997).

<sup>13</sup> Board of Directors of Indus. Development Bd. Of City of Gonzales, Louisiana v. All Taxpayers, Property Owners, Citizens of City of Gonzales, 938 So. 2d 11, 14 (La. 2006).

<sup>14</sup> Turken v. Gordon, 223 Ariz. 342 (2010).

<sup>15</sup> Fischer v. City of Colorado Springs, 260 P. 3d 331 (Co. 2010).



**Figure I – Estimated number of cases concerning public purpose aggregated by year since 1850s. The estimate is based on aggregating results to the query “public purpose” that occurred within Westlaw KeyCites dealing with government expenditures.**

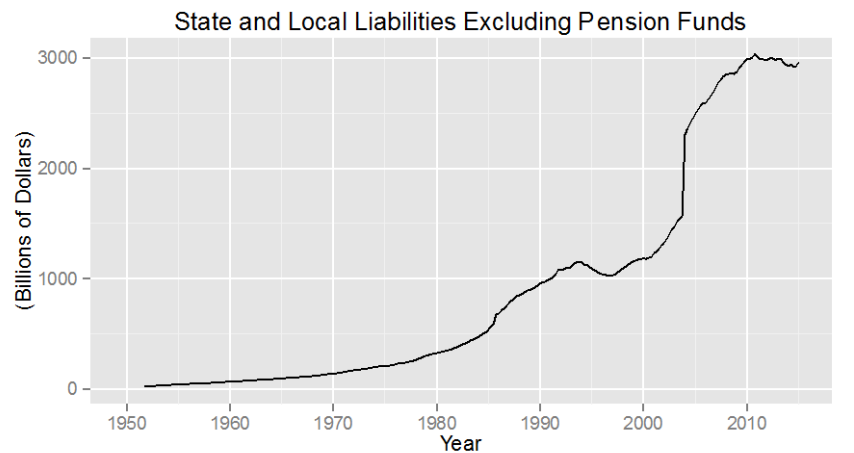
Courts have not lacked for opportunities to use the public purpose doctrine, the problem lies in their willingness to enforce it.<sup>16</sup>

Not surprisingly, given that plaintiffs no longer win public purpose doctrine cases, such challenges are becoming increasingly rare. Figure I provides an estimate of the number of cases involving the public purpose doctrine reported by Westlaw since 1850. While in the 1970s about twenty cases per year or more were reported that involved public purpose, the vast majority reaching state Supreme Courts, the statistical analysis presented in Section II suggests that we can expect about two cases per year in the entire country for the foreseeable future. At the same time as the public purpose doctrine has evaporated, public debt has ballooned. Indeed, even excluding pension liabilities, the state and local debt load has roughly tripled from about one trillion dollars at the beginning of the case survey period to almost three trillion today.<sup>17</sup> Figure II illustrates the growth of state and local government debt since 1950.<sup>18</sup> The precipitous decline in reported public purpose cases that began in the 1980s is strongly correlated with a massive increase in state and local debt. No doubt there are many factors explaining the worrisome increase in public debt over this period. Yet among all these many causes, there are good reasons to think that the erosion of the public purpose doctrine is a significant one. First, the primary driver of this debt increase appears to have been infrastructure and

<sup>16</sup> See, e.g., *State ex rel. Ohio County Commission v. Samol*, 714 W. Va. 714, 722 (1980). (describing many schemes upheld by courts as obviously “predatory”)

<sup>17</sup> St. Louis Federal Reserve, “State and Local Governments, Excluding Employee Retirement Funds; Credit Market Instruments; Liability, Level” (June 11, 2015, 2:01 PM) <https://research.stlouisfed.org/fred2/series/SLGSDODNS>

<sup>18</sup> *Id.*



**Figure II - The amount of state and local debt beginning in 1950.**

economic development initiatives, the exact kind of spending the public purpose doctrine regulates.<sup>19</sup> Second, as is elaborated below, the doctrine was not only created with the intention of curing these specific ills, there is significant evidence that the doctrine's development was historically associated with a real decline in government debt and an increase in government creditworthiness. Finally, the case survey itself documents hundreds of millions of dollars in government expenditures that could not have withstood a forceful public purpose doctrine. If the doctrine had been more powerful, it would have discouraged countless other expenditures that were not subject to constitutional challenge. Although there does not appear to be a good observational setting to prove that the association in Figures I and II is truly causal, there is enough other evidence to substantiate the claim that the decline of the public purpose doctrine may be a significant driver of this spike in public debt.

In my view, the reason the public purpose doctrine is no longer effective is that, as currently understood, it requires Courts to engage in a *substantive* analysis of the measure challenged in a particular case. Yet Courts are reluctant to substitute their judgment about what is fair for those of others, instead using legal doctrine developed in other areas of the law to guide their inquiry. Most often, the Court's default resource is contract law, in particular the distinction contract law develops between "gift" and "contract." Yet contract law, I argue, should not guide Courts' understanding of fairness in this areas, because the concerns driving a contractual understanding of fairness are quite unlike those that should drive an understanding of fairness in the public purpose context. Perhaps the main reason contract law does not inquire into the adequacy of consideration is concerns over paternalism. But in public purpose cases, one of the parties is necessarily *not* an autonomous, self-determining individual. Rather, one of the parties is necessarily a government entity ostensibly acting on behalf of

<sup>19</sup> Penelope Lemov, *Do States Have a Debt Problem?*, GOVERNING.COM (May 30, 2013) <http://www.governing.com/columns/public-finance/col-states-rising-debt-problem.html>

the people. The notion that Courts should analyze public purpose cases substantively, through the lens of Contract Law, inevitably leads to poor protection of the citizens from negligence, incompetence, and maleficence of those entrusted with managing their affairs, and explains why Courts have in recent decades failed to carry out the responsibility they have had accorded to them since the mid-19<sup>th</sup> century. Instead, this Article proposes that State Courts develop the public purpose doctrine with more of an eye toward the law of agency. In particular, I propose that state supreme courts develop the doctrine of “public purpose” as requiring that governments exercise the care, competence, and diligence normally exercised by government agencies in managing transactions of a similar nature, a formulation used by the 3<sup>rd</sup> Restatement of Agency to describe the duty every agent owes to its principal.<sup>20</sup> This kind of understanding of a fair agreement balances Courts’ legitimate concerns with their own limitations against the dangers of inaction, and also leverages Courts’ unique ability to develop standards of conduct incrementally on a case-by-case basis.

In Section I of this article, I consider the origin of the public purpose doctrine and its development. In Section II, I present the methodology and results of the case survey, which I interpret as establishing that the public purpose doctrine is disappearing. In Section III, I analogize the problem of public purpose to the issue of Courts superintending corporate transactions, developing a procedural test that I would propose to balance the interests of Courts in protecting citizens and holders of public-debt, while promoting governmental autonomy to act in the public good.

### Section I: The Origin and Development of Public Purpose

Allusions to something like the public purpose doctrine can be found in the Enlightenment-era philosophy that inspired much of early American political thought. John Locke, in describing the extent and bounds of legislative power, writes that “laws ought to be designed for no end ultimately, but the good of the people.”<sup>21</sup> Burlamaqui claims that “the right of the sovereign with respect to taxes, being founded on the wants of the state, be ought never to raise them but in proportion to those wants, and that he ought never to employ them but with these views.”<sup>22</sup> Montesquieu states that “the real wants of the people ought never to give way to the imaginary wants of the state.”<sup>23</sup>

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<sup>20</sup> RESTATEMENT (THIRD) OF AGENCY § 8.08 (AM. LAW INST. 2006).

<sup>21</sup> JOHN LOCKE, SECOND TREATISE ON GOVERNMENT §142 (1690).

<sup>22</sup> J.J. BURLAMAQUI, THE PRINCIPLES OF POLITIC LAW: BEING A SEQUEL TO THE PRINCIPLES OF NATURAL LAW, XXII (1752).

<sup>23</sup> Montesquieu, THE SPIRIT OF THE LAWS, XIII (1748).

Although these philosophical principles were familiar in the antebellum U.S., as *legal* principles they were not effective.<sup>24</sup> As Thomas Sedgwick's 1857 treatise on constitutional law noted, such "brave" principles as the Enlightenment thinkers propounded were not in fact responsive to the "novel and complex questions which our age has called into being."<sup>25</sup> The more salient question for Sedgwick was whether "the judiciary can arrest the operations of the legislative branch, on the sole ground that they are repugnant to natural justice or morality."<sup>26</sup> To answer this question, Sedgwick sought to understand the boundaries of legislative and judicial power. Unfortunately, turning to the texts of the state constitutions did not provide much help in this endeavor, as he found that the descriptions of legislative and judicial power they provided were "of a very vague and general character."<sup>27</sup> Nonetheless, by exploring some of the leading cases of the time, Sedgwick developed four principles describing when the judiciary can invalidate a legislative act. None of these principles forbade the use of public funds for private purposes.<sup>28</sup>

Although one of the most authoritative statement on state constitutional law at the time, Sedgwick's treatise was completed amidst a groundswell of changes in state constitutional law, which culminated in the eventual recognition of a "public purpose doctrine" that empowered the courts to prevent state legislatures from spending public funds for private ends.<sup>29</sup>

<sup>24</sup> Ellis Leigh Waldron, *The Public Purpose Doctrine of Taxation*, 1 (1952) (also arguing that the doctrine did not become a legal constraint until the mid-nineteenth century); Breck P. McAllister, *Public Purpose in Taxation*, 18 CALIF. LAW REV. 137, 139-140 (1929) (discussing an 1849 Pennsylvania Supreme Court opinion that described legislative power in this area as "unquestioned")

<sup>25</sup> Theodore Sedgwick, *Of the Boundaries of Legislative and Judicial Power*, 1 in A TREATISE ON THE RULES WHICH GOVERN THE INTERPRETATION AND CONSTRUCTION OF STATUTORY AND CONSTITUTIONAL LAW 119, 124 (1874).

<sup>26</sup> Theodore Sedgwick, *Of the Boundaries of Legislative and Judicial Power*, 1 in A TREATISE ON THE RULES WHICH GOVERN THE INTERPRETATION AND CONSTRUCTION OF STATUTORY AND CONSTITUTIONAL LAW 119, 124 (1874).

<sup>27</sup> *Id.* at 133.

<sup>28</sup> *Id.* at 151-152. The closest Sedgwick comes is the last of his four principles, which says that a "statute, without some controlling interest or public necessity and for public objects, seeks to affect or interfere with vested rights of public property, is equally beyond the true limits of legislative power." But from the case he drew this principle from, it is clear that he is discussing the power of eminent domain, which has to do with the *taking* of private property for a public good or purpose, not with the *giving* of public funds for private purposes, which is the activity forbidden by the public purpose doctrine.

<sup>29</sup> Sedgwick was clearly aware of the public-purpose provisions that were sweeping the country, as he discussed one such provision when considering the legal status of a newly enacted constitutional provision that contravenes a previously valid law. *Id.* at 415. His discussion presumes that states could buy stock in private companies, which the later public purpose doctrine squarely disallowed, and indeed he favorably cited precedent allowing a governmental entity to buy stock in private railroads. *Id.* at 434. His discussion of taxation does not mention restrictions on what governments might spend tax revenue on. *Id.* 501-511.



Between 1840 and 1860, twenty states adopted “new constitutional constraints to deal with public indebtedness.”<sup>30</sup> These new provisions came in somewhat different flavors, and any particular state might have enacted more than one.<sup>31</sup> Some states required that the state not lend its credit to a private individual or corporation.<sup>32</sup> Others prohibited state government from purchasing corporate stock or bonds. Another frequent provision was that the state have a special election procedure before the issuance of debt.<sup>33</sup>

The precipitating cause for these changes in state constitutional law was the huge economic upheaval experienced beginning in 1837 and continued until the last quarter of the 19<sup>th</sup> century. Throughout the antebellum period, state governments spent lavishly on internal improvements, including roads, highways, tolls, canals, bridges, harbors, waterworks, schools, libraries.<sup>34</sup> They also established and invested in thousands of corporations, including banks, insurance companies, and manufacturing firms.<sup>35</sup> The scale of these projects is difficult to comprehend: the Erie Canal alone was estimated as costing \$7 million dollars “at a time when the total banking and insurance capital in New York was less than \$21 million.”<sup>36</sup> The tremendous success of the Erie Canal enabled the Bank of the United States to market state bonds to European investors, creating huge capital inflows.<sup>37</sup> State bonds became so valuable that governments were able to subsist primarily off of “asset financing,”<sup>38</sup> the nature of which I shall describe in a moment. One estimate claims that taxes counted for less than 20% of state revenues in 1835, with the rest of the revenues coming from asset-financing schemes.<sup>39</sup>

In a typical asset-financing arrangement, the state or local government would issue bonds and use the funds raised to purchase stocks, fund construction, or provide whatever upfront costs needed to be provided for some project. Assuming that the project was successful, the government would be able to service its bond obligations by receiving back dividends, use-fees, or some other revenue stream originating from the project. In the end, promoters of these ventures were able to plausibly claim that their project “wouldn’t cost direct tax payers anything,”<sup>40</sup> and indeed would

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<sup>30</sup> Dove, *supra* note 3.

<sup>31</sup> Dove, *supra* note 3 at 75.

<sup>32</sup> Dove, *supra* note 3 at 74.

<sup>33</sup> Dove, *supra* note 3.

<sup>34</sup> JJ Wallis, *State Constitutional Reform and the Structure of Government Finance in the Nineteenth Century*, in PUBLIC CHOICE INTERPRETATIONS OF AMERICAN HISTORY 33, 33 (2000).

<sup>35</sup> *Id.*

<sup>36</sup> ROBERT SOBEL, *THE MONEY MANIAS*, 49 (1973).

<sup>37</sup> *Id.* at 60.

<sup>38</sup> Wallis, *supra* note 34, at 36.

<sup>39</sup> Wallis, *supra* note 34, at 36.

<sup>40</sup> Wallis, *supra* note 34, at 36.

“return a handsome profit to the state.”<sup>41</sup> Also importantly, such construction projects were thought to increase property values and were therefore popular.<sup>42</sup> In the seven year period from 1830 to 1837, state governments had gone from owing about twenty-six million dollars to over one-hundred forty-million dollars, which placed total state debt on par with the combined national debt of Russia, Prussia, and the Netherlands, all three of which were major European powers.<sup>43</sup> It is not unfair to say that by the mid 1830s, many states were operating as highly-leveraged financial vehicles.<sup>44</sup>

The first signs of trouble came with the Panic of 1837. In order to facilitate trans-Atlantic trade, it had been common practice for American merchants to establish accounts at English banks, and then pay for purchases made on either side of the Atlantic with notes that allowed the holder of to collect the money at a bank in London. Such contracts, similar to modern checks, were called “bills of exchange.”<sup>45</sup> Few merchants actually traveled to London to collect upon these bills, instead preferring to sell such “checks” to middlemen who would in turn sell these on to still other middlemen.<sup>46</sup> This process of exchanging bills of exchange was called “discounting.” Note that the term was something of a misnomer, because a “discounted” bill of exchange might often sell locally for above its face value, as individuals who needed to make payments in London were often willing to pay for the convenience of avoiding the costs of transporting gold specie.<sup>47</sup>

Fearful of excessive exposure to the US economy and shallow gold reserves, the Bank of England tried to clamp overinvestment in the United States.<sup>48</sup> It announced that it would refuse to discount the paper of any of the British firms that offered commercial credit to American merchants.<sup>49</sup> This measure forced the British banks that were most exposed to the American market to begin calling in their debt. The inability of American merchants to make good on these debts led to the failure of “all those great

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<sup>41</sup> Wallis, *supra* note 34, at 36.

<sup>42</sup> Wallis, *supra* note 34, at 42.

<sup>43</sup> ALASDAIR ROBERTS, AMERICA’S FIRST GREAT DEPRESSION 51-52 (2012).

<sup>44</sup> See *id.* at 49-73 (discussing at length the investing and decision-making strategies of the various defaulting states).

<sup>45</sup> JESSICA M. LEPLER, THE MANY PANICS OF 1837, 17 (2013).

<sup>46</sup> *Id.*

<sup>47</sup> *Id.* at 18.

<sup>48</sup> PETER TEMIN, THE JACKSONIAN ECONOMY 137 (1969).

<sup>49</sup> This explanation was prevalent both at the time of the crisis, Richard Hildreth, *Banks, banking, and paper currencies: in three parts. History of banking and paper money. Argument for open competition in banking. Apology for one-dollar notes*, 220 (1840), [http://books.google.com/books?id=8\\_8pAAAAYAAJ](http://books.google.com/books?id=8_8pAAAAYAAJ), and still prevails LEPLER, *supra* note 45, at 54-55.

cotton brokerage houses in New Orleans,”<sup>50</sup> which led in turn to the failure of many banks throughout America, but especially in New York.<sup>51</sup>

The states were initially able to weather this terrible calamity thanks to an infusion of cash from the federal government. Through the collection of tariffs and the sale of Western lands, the federal government had earned itself a huge surplus in the 1830s, which it presciently decided to disburse to the states starting on January 1, 1837.<sup>52</sup> Although the preemptive federal bailout allowed states to avoid succumbing under the initial panic, the confidence of English and European investors was indelibly shaken by the Panic.<sup>53</sup> In late 1839, banks started to fail once again. The decline in liquidity forced construction to halt in the Western states and land values dropped precipitously. With the bankruptcy of the great cotton merchants in 1837, the market for this pivotal crop “could scarcely have been less hopeful.”<sup>54</sup> Banks in which states owned stocks soon failed; suddenly the bonds that had seemed capable of servicing themselves now required tax revenue. Florida, Mississippi, Louisiana, and Arkansas first defaulted on interest payments in 1841 and finally repudiated their entire debt. Indiana, Illinois, and Michigan spent two years in default and finally renegotiated a serviceable debt load. Maryland and Pennsylvania defaulted on their debts in 1842. “By December 1842, one-third of the Union was refusing to meet obligations to overseas lenders.”<sup>55</sup>

The economic crisis of the late 1830s-early 1840s that resulted was “among the most severe in its history.”<sup>56</sup> Book assets of state banks fell by almost 50%, more than one quarter of all banks that existed in 1837 failed.<sup>57</sup> Railroad, insurance, and bank stocks plummeted.<sup>58</sup> The British ambassador to the United States reported that “the conquest of the land by a foreign power could hardly have produced a more general sense of humiliation and grief.”<sup>59</sup> Anti-government violence broke out across the

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<sup>50</sup> Richard Hildreth, *Banks, banking, and paper currencies: in three parts. History of banking and paper money. Argument for open competition in banking. Apology for one-dollar notes*, 102 (1840), [http://books.google.com/books?id=8\\_8pAAAAYAAJ](http://books.google.com/books?id=8_8pAAAAYAAJ)

<sup>51</sup> TEMIN, *supra* note 48, at 141-144.

<sup>52</sup> ROBERTS, *supra* note 43, at 101-102; TEMIN, *supra* note 48, at 20.

<sup>53</sup> Peter L. Rousseau, *Jacksonian Monetary Policy, Specie Flows, and the Panic of 1837*, 62 J. ECON. HIST. 457, 457 (2002).

<sup>54</sup> TEMIN, *supra* note 48, at 21 (quoting R.C.O. Matthews, *A Study in Trade-Cycle History: Economic Fluctuations in Great Britain, 1833-1842*, at 68 (1954)).

<sup>55</sup> ROBERTS, *supra* note 43, at 53.

<sup>56</sup> ROBERTS, *supra* note 43, at 457; *But see*, TEMIN, *supra* note 48, at 23 (1969) (arguing that although contemporaries saw the crisis as severe, the period was not truly a “depression” as there was no decline in production).

<sup>57</sup> ROBERTS, *supra* note 43, at 457.

<sup>58</sup> ROBERTS, *supra* note 43, at 457.

<sup>59</sup> ROBERTS, *supra* note 43, at 7.

Fall 2015]

*Death of Public Purpose*

11

country, and voter turnout reached an all-time high.<sup>60</sup> Attempts to collect debts were met either with “mob resistance” or the unfortunate realization that the debtor had “G.T.” – that is, gone to Texas.<sup>61</sup> Visiting Cairo, Illinois, which had only a few years earlier been a veritable nexus of international investment, Charles Dickens described an appalling scene:

At the junction of two rivers . . . lies a breeding-place for fever, ague, and death . . . . A dismal swamp, on which the half-built houses rot away; cleared here and there for the space of a few yards; and teeming, then, with rank, unwholesome vegetation, in whose baleful shade the wretched wanderers who are tempted hither drop, and die, and lay their bones; the hateful Mississippi circling and eddying before it, and turning off upon its southern course, a slimy monster hideous to behold; a hotbed of disease, an ugly sepulchre, a grave uncheered by any gleam of promise, a place without one quality, in earth or air or water, to commend it.<sup>62</sup>

Besides leaving in its wake despair and destruction at home, the defaults also took their toll on America’s reputation abroad. All Americans were viewed as responsible for the calamity, regardless of their state citizenship.<sup>63</sup> One prominent English reformer said, “A great nation has been guilty of a fraud as enormous as ever disgraced the worst king of the most degraded nation of Europe . . . [you are] a nation with whom no contact can be made, because none can be kept; unstable in the very foundations of social life, deficient in the elements of good faith, who prefer any load of infamy, however great, to any pressure of taxation, however light.”<sup>64</sup> William Wordsworth, capturing the sentiment of many European investors, dedicated a poem to the *Men of the Western World*:

Think ye your British Ancestors forsook  
Their native Land, for outrage provident;  
From unsubmitive necks the bridle shook  
To give, in their Descendants, freer vent  
And wider range to passions turbulent,  
To mutual tyranny a deadlier look?

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<sup>60</sup> ROBERTS, *supra* note 43, at 8.

<sup>61</sup> ROBERTS, *supra* note 43, at 21.

<sup>62</sup> ROBERTS, *supra* note 43, at 15.

<sup>63</sup> ROBERTS, *supra* note 43, at 67.

<sup>64</sup> ROBERTS, *supra* note 43, at 70.

In response to the financial catastrophe wrought by the public debt boom, the 1840s witnessed a veritable public “revulsion” toward improvement works.<sup>65</sup> Ten states “bound themselves not to make loans to improvement enterprises.”<sup>66</sup> Four prohibited public stock ownership and six either prohibited or abandoned state construction.<sup>67</sup> Even states that had not defaulted took actions to prevent such a calamity from befalling them.<sup>68</sup> Most existing states adopted some kind of aid limitation provisions, and “all states entering the union after 1845 wrote some sort of debt restriction into their constitutions.”<sup>69</sup>

Yet, surprisingly, as vehement as the revulsion towards internal improvement works was, so too was it fickle. “Railroad mania” soon gripped the land.<sup>70</sup> Between 1850 and 1860, American railroads went from comprising 9,000 miles of track to covering over 30,000 miles, at a cost of maybe a billion dollars – about five times as much as was invested in canals.<sup>71</sup> The factors that led to this cloudburst of railroad are still being debated by economic historians, but no doubt one of the most important was the federal land grant program, which gave land to states or sometimes even private companies in order to defray track construction costs.<sup>72</sup> While the primary recipients of federal aid were interstate railroad companies, state and local government became involved by supporting smaller lines that connected their communities to the larger rail network.<sup>73</sup> Indeed, the most thorough scholarly analysis of these projects to date concludes that state and local governments committed at least 400 million dollars to the support of rail construction.<sup>74</sup>

Although the railroads that the federal government supported were profitable,<sup>75</sup> the local government projects met with less success.<sup>76</sup> To take one example, “The New York & Oswego Railroad meandered over the

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<sup>65</sup> See Carter Goodrich, *The Revulsion Against Internal Improvements*, 10 J. ECON. HIST. 145–169, 1950, available at <http://www.jstor.org/stable/2113517>.

<sup>66</sup> *Id.* at 147–148.

<sup>67</sup> *Id.* at 147–148.

<sup>68</sup> GEORGE ALAN TARR, *UNDERSTANDING STATE CONSTITUTIONS* 113 (1998).

<sup>69</sup> *Id.* at 112.

<sup>70</sup> Goodrich, *supra* note 65, at 148.

<sup>71</sup> ATTACK AND PASSELL, *supra* note 2, at 429.

<sup>72</sup> ATTACK AND PASSELL, *supra* note 2, at 436.

<sup>73</sup> MORTON KELLER, *AFFAIRS OF STATE: PUBLIC LIFE IN LATE NINETEENTH CENTURY AMERICA* 165–6 (1977). See also, REGINALD C. MCGRANE, *FOREIGN BONDHOLDERS AND AMERICAN STATE DEBT* 271 (1935).

<sup>74</sup> CARTER GOODRICH, *GOVERNMENT PROMOTION OF AMERICAN CANALS AND RAILROADS 1800–1890* 162–165 (1965).

<sup>75</sup> ATTACK AND PASSELL, *supra* note 2, at 435–444 (discussing whether the profitability was so great as to make the federal land grant program superfluous).

<sup>76</sup> For a very thorough account of which projects succeeded and which did not, see GOODRICH, *supra* note 74, at 121–169.

upstate New York countryside in search of local aid, finally touching (in both senses of the word) some fifty communities with 250 labyrinthine miles of track. The line was finished in 1873, just in time for the financial crisis of that year, and promptly went into bankruptcy.<sup>77</sup> That the railroads were intentionally putting together bogus projects would have surprised no one at the time; chief executives of some of the greatest railroads both in the US and England had committed widely publicized acts of securities fraud, bankrupting companies and towns, and escaped prosecution by running away to jurisdictions beyond the reach of law.<sup>78</sup> Even though railroads were widely viewed with suspicion, America seemed powerless to resist their lure.<sup>79</sup> Railroad promoters encouraged towns to bid against each other for influence in locating the railroads.<sup>80</sup> Towns and counties felt that they had to do whatever it took to be connected to the railroad, lest they be left behind on the path of development.<sup>81</sup>

How was the government-fueled expansion in railroads possible, given the constitutional constraints imposed by the citizens in the 1840s?<sup>82</sup> One explanation is that many of the states that supported this expansion had not even existed at the time of the first public-debt calamity.<sup>83</sup> Although their constitutions may have contained some form of debt restriction, their political leaders had not internalized the lessons that these provisions were meant to enshrine. Secondly, states often chose to enact procedural restrictions, not absolute restrictions.<sup>84</sup> Third, the economic incentives were unchanged, and many no doubt hoped there was a way to have their cake and eat it too. As a case in point, consider Article XI, Section 1 of Wisconsin's 1846 constitution, which states "The state shall encourage internal improvements by individuals, associations, and corporations, but shall not carry on, or be a party in carrying on, any work of internal improvements."<sup>85</sup> Finally, and perhaps most troubling, state courts throughout the country authorized dubious legal loopholes, whereby subsidiaries of a state government such as a county or township were

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<sup>77</sup> KELLER, *supra* note 73, at 166.

<sup>78</sup> CRAIG H. MINER, *A MOST MAGNIFICENT MACHINE* 193–194 (2010).

<sup>79</sup> *Id.* at 192–200.

<sup>80</sup> GOODRICH, *supra* note 74, at 259–260.

<sup>81</sup> ALBERT FISHLOW, *AMERICAN RAILROADS AND THE TRANSFORMATION OF THE ANTE-BELLUM ECONOMY* 194–195 (1965).

<sup>82</sup> See Goodrich, *supra* note 74 (also discussing the question of how improvements were justified after constitutional amendment).

<sup>83</sup> Waldron, *supra* note 24, at 39. CARTER GOODRICH, *GOVERNMENT PROMOTION OF AMERICAN CANALS AND RAILROADS 1800-1890* 147-9 (1965).

<sup>84</sup> JJ Wallis, *Constitutions, Corporations, and Corruption: American States and Constitutional Change, 1842 to 1852*, 65 J. ECON. HIST. 211–256, 230 (2005).

<sup>85</sup> George E. Connor and Christopher W. Hammons, eds., *Wisconsin, in THE CONSTITUTIONALISM OF AMERICAN STATES* (2008).

declared exempt from the constitutional constraints placed on the state as a whole.<sup>86</sup>

Before long, economic crisis once again gripped the nation. The Panic of 1857 started with the failure of a multistate bank that had specialized in loaning credit to railroads.<sup>87</sup> Stocks of all kinds, but especially railroads, soon began to tumble and companies started declaring bankruptcy.<sup>88</sup> Prices for various agricultural products fell 30% in a matter of months.<sup>89</sup> Although banks had been more careful than in the 1830s and were therefore able to avoid, the evaporation of credit soon triggered a severe recession.<sup>90</sup>

The effects of the late 1850s recession were not so great as the crisis of the 1830s and 1840s, but times were nonetheless tough. One Philadelphia statistician described the human reality of this calamity.

“A nightmare broods over society. The City is still as a Sabbath day. The oldest, wealthiest houses are crashing down day by day, as their harvest days come round. Scores of thousands are out of work. Bread riots are dreaded. Winter is coming. God alone foresees the history of the next six months.”<sup>91</sup>

Modern observers tend to think that the main driver of the Panic of 1857 and recession was the unexpected decrease in demand for American agriculture exports following the conclusion of the Crimean war, however at the time the major culprit was thought to be the railroads.<sup>92</sup> Public debate over internal improvements once again resumed. Many drew parallels with the Panic of 1837,<sup>93</sup> and argued that primary the lesson was “that government should not be engaged in economic pursuit of any kind.”<sup>94</sup> Citizens in several states took to amending their constitutions in the hopes of preventing their representatives in government from supporting dubious ventures. By 1860 eighteen states “had adopted provisions “against aiding companies by at least one of the three methods of loan, subscription, or donation, although most did not extend the prohibition to local authorities. Five states, moreover, accepted self denying ordinances, making it unconstitutional for them to construct public improvements.”<sup>95</sup> The Committee on the Sale of Pennsylvania’s State Works report from 1857

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<sup>86</sup> See, e.g., *Robertson v. Rockford*, 21 Ill. 451 (1859); *New Orleans v. Graible* 9 La. Ann. 561 (1854); *Clark v. Janesville*, 10 Wis. 136 (1859).

<sup>87</sup> JAMES L. HUSTON, *THE PANIC OF 1857 AND THE COMING CIVIL WAR* 14-15 (1987).

<sup>88</sup> *Id.* at 15.

<sup>89</sup> *Id.* at 18.

<sup>90</sup> *Id.* at 29.

<sup>91</sup> *Id.* at 25.

<sup>92</sup> *Id.* at 31-32.

<sup>93</sup> MINER, *supra* note 78, at 203-206.

<sup>94</sup> HUSTON, *supra* note 87, at 56-57.

<sup>95</sup> Carter Goodrich ed., *THE GOVERNMENT AND THE ECONOMY, 1783-1861*, at 94 (1967).

Fall 2015]

*Death of Public Purpose*

15

expressed the widespread spirit of revulsion toward government funded public improvements:

The system of public works exercises an influence more powerful upon the morals, and in some respects, upon the interests of the people, than the government itself. The officials and agents of the system, whose name is legion, extend to all parts of the Commonwealth, -- a vast engine of political power, unknown to the Constitution, moved by a common impulse, and operating upon the public mind at any time they are so disposed, in State conventions, and at the ballot box, in solid column and with almost irresistible sway. But it is not as dangerous political machine that it is viewed in its worst aspects, nor as an exhausting drain upon the public purse; its malign influences upon the morals of the community, are even more dreaded than all other evils, and powerfully cooperate in making it a festering disease upon the public.<sup>96</sup>

Despite widespread unease about the railroads and their relation to government, the constitutional revisions made in the aftermath of the 1857 crisis were not quite so widespread as those that followed the 1830s crisis.<sup>97</sup> No doubt one important reason is that constitutional amendment typically takes years and the issue was superseded in importance by the Civil War, during which time rail growth ground to a virtual halt and made the issue moot. Another reason may have been that tighter banking laws enacted in Eastern states in response to the crisis had the effect of making it even harder for Western states to find capital to support necessary transportation infrastructure,<sup>98</sup> making government aid even more important. Generally speaking, these new amendments did not put a halt to government sponsorship of railroads after the conclusion of the Civil War, when development progressed even more quickly than it had in the 1850s.

Despite the imprimatur of constitutional prohibitions and painful lessons of history, by the late 1860s the public purpose doctrine remained relatively inchoate and ineffective at constraining government aid to railroads. Yet in only a few years, its status would be elevated to that of a fundamental constraint implied in the very definition of legislative power. Thomas Cooley's influential treatise on state constitutional law states:

“when, therefore, the legislature directs the levy of a tax for a purpose not public, and which cannot be made public on any of the grounds above indicated . . . we must conclude that they are

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<sup>96</sup> Report of the Select Committee, February 4, 1854, Pennsylvania Senate Journal, 328-337, reprinted in, *THE GOVERNMENT AND THE ECONOMY, 1783-1861*, *supra* note 95, at 94.

<sup>97</sup> Goodrich, *supra* note 74, at 156.

<sup>98</sup> HUSTON, *supra* note 87, at 57.



exercising an authority not conferred in the general grant of legislative power, and which is therefore unconstitutional.”<sup>99</sup>

Cooley’s conclusion that the judiciary did have the power to declare spending not in the public purpose unconstitutional was based on only two important cases: *Brodhead v. City of Milwaukee* 19 Wis 652 and *Sharpless v. Mayor*, 21 Penn St. 168. In *Sharpless*, the mayor and alderman of Philadelphia wanted to issue municipal bonds in order to buy the stock of two railroads.<sup>100</sup> Pennsylvania had not enacted a provision forbidding such actions, so if the justices of the Pennsylvania Supreme Court were going to find this or similar actions unconstitutional they would need to find some other basis for doing so besides explicit prohibition. Moreover, if they declared the provision unconstitutional, it would call into doubt the legal status of many already existent municipal-bond based railroad financing schemes. So it seems that they decided to fire a warning shot. They declared that the requirement of “public purpose” was clearly implied<sup>101</sup> in the very definition of taxation:

Neither has the legislature any constitutional right to create a public debt, or to lay a tax, or to authorize any municipal corporation to do it, in order to raise funds for a mere private purpose. No such authority passed to the Assembly by the general grant of legislative power. This would not be legislation. Taxation is a mode of raising revenue for public purposes. When it is prostituted to objects in no way connected with the public interests or welfare, it ceases to be taxation, and becomes plunder. Transferring money from the owners of it, into the possession of those who have no title to it, though it be done under the name and form of a tax, is unconstitutional for all the reasons which forbid the legislature to usurp any other power not granted to them.<sup>102</sup>

Although not by any means a reading of precedent, the language of the opinion fit with principles that had strong normative appeal and a good basis in the theory of Republican political thought. Moreover, some limit was clearly necessary given the exigencies of the recent past. Although it claimed that economic or policy considerations played no part in its decision, the court nonetheless seemed deeply moved by the “selfish passion” that had “carried the state to the verge of financial ruin,” that had “produced revulsions of trade and currency in every commercial country,” and “is tending now, and here, to the bankruptcy of cities and counties.” It is especially hard to take seriously the court’s claim that policy played no

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<sup>99</sup> THOMAS M. COOLEY, A TREATISE ON THE CONSTITUTIONAL LIMITATIONS WHICH RESTS UPON THE LEGISLATIVE POWER OF THE STATES OF THE AMERICAN UNION, 494 (1972).

<sup>100</sup> McAllister, *supra* note 24, at 140.

<sup>101</sup> McAllister, *supra* note 24, at 141.

<sup>102</sup> *Sharpless v. Mayor of Pennsylvania*, 21 Pa. 147, at 168-169 (1853).

part in its opinion, given its expressed view that “This plan of improving the country, if unchecked by this Court, will probably go on until it results in some startling calamity, to rouse the masses of people.”<sup>103</sup>

Although it is impossible to answer definitively, it is worth posing the question of why the Court chose to view “public purpose” as implied by the very notion of taxation, rather than basing its public purpose discussion on eminent domain law, since application of the doctrine might seem more natural.<sup>104</sup> If eminent domain forbids the taking of private property without a public purpose, and taxing is necessarily a taking of private property, it seems reasonable to think that the principle of eminent domain should forbid taxing individuals without a public purpose. Yet this analogy is too neat.<sup>105</sup> Eminent domain doctrine is extraordinary and involves the taking of property from *specific* individuals, while taxation is ordinary and applies to the whole public.<sup>106</sup> The individual liberty interest is stronger in the former case, and the political process seems more trustworthy in the latter. For this reason the courts’ supervision of public expenditures should indeed be more deferential than the use of eminent domain, and claiming the eminent domain principle applied might have lead to much more supervision of the legislature than was appropriate. Moreover, the right of states to use eminent domain to create rights of way was by this time unquestioned, and basing its decision on eminent domain might have muddled the waters and called such actions into question. For better or worse, the *Sharpless* court decided to chart a different course, and the doctrines have since evolved separately, even if the language used by courts in the two areas often seems to overlap and if courts sometimes conflate the two doctrines.<sup>107</sup>

The reasoning in *Sharpless* was soon endorsed and extended by the Wisconsin Supreme Court in *Brodhead v. City of Milwaukee*. In that case, the city of Milwaukee created a tax to pay “bounties” worth \$200 to individuals who would be drafted to serve in the Civil War. More surprisingly, the bounties would also be paid to those who decided to pay a fine and provide substitutes to be drafted in their place.<sup>108</sup> Judged solely by its effects, it would appear that the true purpose of the bill was to subsidize draft-shirking by Milwaukee citizens.<sup>109</sup> Following *Sharpless*, the Court declared that “the legislature cannot create a public debt, or levy a tax . . .

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<sup>103</sup> *Id.* at 159.

<sup>104</sup> Indeed, two decades later, in *Lowell v. City of Boston*, 111 Mass. 454, 462 (1873), the Supreme Court of Massachusetts would reach this point and conclude that the test of public purpose was the same in eminent domain as in the proper use of tax revenues.

<sup>105</sup> Indeed, Cooley himself discussed how the two were not analogous in *People ex rel. Detroit & H.R. Co. v. Salem Township Bd.*, 20 Mich. 452, 480-481 (1870).

<sup>106</sup> *Sharpless*, *supra* note 97, at 154-155, 157.

<sup>107</sup> *See, e.g.*, *Lowell v. City of Boston*, 111 Mass. 454, 462 (1873).

<sup>108</sup> *Brodhead v. City of Milwaukee et al.*, 19 Wis. 624, 686-9 (1865).

<sup>109</sup> *Id.*

for a mere private purpose.” More importantly, it transformed the *Sharpless* principle into a legally applicable rule:

“To justify the court in arresting the proceedings and declaring the tax void, the absence of all possible public interest in the purposes for which the funds are raised must be clear and palpable -- so clear and palpable as to be perceptible by every mind at the first blush. In addition to these, I understand that it is not denied that claims founded in equity and justice in the largest sense of those terms, or in gratitude or charity, will support a tax.”<sup>110</sup>

The test *Brodhead* announced was extremely deferential. In essence, the question was, “Could anyone think this measure has a public purpose?” As if that were insufficiently deferential, the Court also included a safe harbor for measures based in “equity,” “justice,” “gratitude,” or “charity,” where each term is to be understood as “broadly as possible.” Not surprisingly, given the standard applied, the Court found the subsidy for draft-dodgers to be a public purpose.

Given the weakness of these two precedents, it was aspirational for Cooley to place the public purpose doctrine on such a high pedestal so early as 1868.<sup>111</sup> Yet it seems he was correct to do so, for not long after his treatise a string of cases came down that gave the public purpose doctrine real teeth.<sup>112</sup> Among these, perhaps the most important is the one that Thomas Cooley himself penned, which struck down a municipal railroad-financing scheme similar to the one involved in *Sharpless*. Acknowledging the “considerable number of cases” that had supported the kind of policy at issue, Cooley nonetheless concluded that “[t]he incidental benefit which any enterprise may bring to the public, has never been recognized as sufficient of itself to bring the object within the sphere of taxation.”<sup>113</sup> In 1872, John Dillon, like Cooley an early advocate of the public purpose doctrine, published the first treatise on municipal law, here too laying down as a matter of black letter law that “there can be no legitimate taxation to raise money unless it be destined for the uses or benefit of the government or some of some municipalities, or divisions invested with the power of

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<sup>110</sup> Id. at 686-687

<sup>111</sup> Waldron, *supra* note 24, at 117-118. (arguing that in some sense the public purpose requirement was a minority view that Cooley helped popularize).

<sup>112</sup> See, e.g., *Sweet v. Hulbert*, 51 Barb. 312 (N.Y. 1868) (calling the legislatures railroad aid scheme “legal robbery”); *Hansen*, 27 Iowa 28 (1869); *Whiting v. Sheboygan Railway Co.*, 9 Am. Law Reg. N.S. 156 (1870); *People ex rel. Detroit & H.R. Co. v. Salem Twp. Bd.*, 20 Mich. 452, 488 (1870); *Opinion of the Justices*, 58 Me. 591 (1871).

<sup>113</sup> *People ex rel. Detroit & H.R. Co. v. Salem Twp. Bd.*, 20 Mich. 452, 488 (1870) abrogated by *Advisory Opinion Re 1976 PA 295 & 1976 PA 297*, 401 Mich. 686, 259 N.W.2d 129 (1977)

auxiliary or local administration.”<sup>114</sup> Indeed, even the Supreme Court of the United States jumped in, writing, “Undoubtedly taxes may not be laid for a private use.”<sup>115</sup>

Although the public purpose requirement was secure as a matter of legal principle by the mid 1870s, the precise contours of its application were still much in flux. The 1870s witnessed substantial unfavorable reaction to the innovative doctrine, and “Cooley’s *Salem* decision was the principal target.”<sup>116</sup> Kansas’ Justice Valentine wondered how it was possible that railroads could be considered to have sufficient public benefit to allow for a home to be destroyed, while not have sufficient public benefit to allow the legislature to levy “one cent” in taxes against the same property?<sup>117</sup> The Nebraska Supreme Court found the doctrine Cooley proposed “novel and startling.”<sup>118</sup> Even Dillon admitted in his own treatise that,

“As it is an author’s duty, in a work of this character, to state what the law is, rather than what, in his judgment, it ought to be, he feels constrained to admit that a long and almost unbroken line of judicial decisions in the courts of most of the states have established the principle that, in the absence of special restrictive constitutional provisions, it is competent for the legislature to authorize a municipal or public corporation to aid [by using public debt to purchase stock], the construction of railways.”<sup>119</sup>

How then did the public purpose doctrine become a *universal* constraint on state and local governments, in other words a principle recognized in every state in the country? Although the 1870s witnessed judges repeatedly rejecting challenges to public aid for railroads,<sup>120</sup> these cases did tend to accept Cooley’s fundamental contention that taxation needed a public purpose.<sup>121</sup> Courts simply disagreed with Cooley that railroads had a purely private purpose, especially given the mountain of precedent vindicating the

<sup>114</sup> JOHN FORREST DILLON, §587 TREATISE ON THE LAW OF MUNICIPAL CORPORATIONS 556-557 (1872).

<sup>115</sup> *Olcott v. Supervisors*, 83 U.S. 694 (1872).

<sup>116</sup> Waldron, *supra* note 24, at 171. The identification and discussion of the cases that follows is heavily indebted to Waldron. Among the other cases he cites are *Perry v. Keene*, 56 N.H. 514 (1876); *Bennington v. Park*, 50 Vt. 178 (1877); *Walker v. Cincinnati*, 21 Ohio St. 14 (1871) (finding a public purpose in the city of Cincinnati’s decision to support the construction of a railroad out of state).

<sup>117</sup> *Leavenworth County v. Miller*, 7 Kans. 479 (1871).

<sup>118</sup> *Hallenbeck v. Hahn*, 2 Nebr. 377 (1872).

<sup>119</sup> DILLON, *supra* note 114, at 144.

<sup>120</sup> DILLON, *supra* note 114, at 557 n. 1 (noting that “what is a public purpose sufficient to support this [taxing] power, has been much discussed of late years, particularly in connection with the authority conferred upon municipalities to aid in the building of railways.”)

<sup>121</sup> *Commercial National Bank of Cleveland v. Iola*, 2 Dill. 353, 360.

right of governments to exercise eminent domain for the express purpose of railroad construction, and the express conclusion of the Supreme Court that railroads, canals, and other “highways” constituted a public purpose.<sup>122</sup> The doctrine fared better in application to measures not involving railroads. For instance, the Supreme Court of Maine was asked by the legislature to decide whether towns could be allowed to make gifts to individuals or corporations for the purpose of developing manufacturing. The Court’s answer was a resounding no. “What is this but manifest and undisguised spoliation?”<sup>123</sup> Citing the Declaration of Rights, the Constitution, and even the Magna Carta, the Court said that “it would be simply an act of despotic power to sequester the property of an individual or individuals directly or indirectly by the means of taxation, for the purpose of giving it away against the will of the owner, and to those whom others than he may select.”<sup>124</sup> The very next year, Maine’s legislature, perhaps interested in testing the Court’s resolve, validated the loaning of money by a township to a local firm.<sup>125</sup> The Supreme Court applied its previous opinion and invalidated the law.<sup>126</sup>

A steady drumbeat of cases invalidating policies without insufficient public purpose soon followed. The Supreme Court of Massachusetts, one of the most prestigious court in the country at the time,<sup>127</sup> rejected a plan by the city of Boston to loan money to individuals displaced by a terrible fire in November, 1872. They explained that “incidental advantage to the public, or to the State, which results from the promotion of private interests, and the prosperity of private enterprises or business, does not justify their aid by the use of public money raised by taxation, or for which taxation may become necessary.”<sup>128</sup> Moreover, they proposed that unless “public use or service [is] expressly declared, or implied from the nature of the object of the expenditure, taxation in any form cannot be justified.”<sup>129</sup> The test *Lowell v. Boston* established was very unlike the “not public according to everyone’s first impression” test articulated by the Wisconsin Court in *Brodhead*. As Massachusetts seemed to state it, the government now had to show 1) that the public purpose was either explicit or implied and obvious and 2) not merely incidental.

The Massachusetts holding was almost immediately endorsed by Justice Dillon, now serving as a justice on the federal circuit, in *Commercial*

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<sup>122</sup> *Id.* at 362 (discussing *Olcott v. Supervisors*, 83 U.S. 694 (1872))

<sup>123</sup> *In re Opinion of the Justices*, 58 Me. 590, 594 (1871)

<sup>124</sup> *Id.* at 595-596.

<sup>125</sup> Waldron, *supra* note 24, at 240.

<sup>126</sup> *Allen v. Jay*, 60 Me. 124 (1872).

<sup>127</sup> See Rodney L. Mott, *Judicial Influence*, 30 AM. POLIT. SCI. REV. (1936) (attempting, as no one had yet, to rank the prestige of the state supreme courts, unsurprisingly finding that New York and Massachusetts were atop the list based on a wide variety of measures).

<sup>128</sup> *Lowell v. Boston*, 111 Mass. 454, 461(1873)

<sup>129</sup> *Id.* at 471.

Fall 2015]

*Death of Public Purpose*

21

*National Bank of Cleveland v. Iola* and *Citizens Savings and Loan Association of Cleveland v. Topeka*. The latter of these opinions was appealed to the Supreme Court, which was at last prepared to recognize the public purpose doctrine.<sup>130</sup> Declining to express a view on the question of whether railroads constituted a public purpose, which itself marked something of a step back from dicta involved in *Olcott*, the court stated unequivocally that

“We have established, we think, beyond cavil that there can be no lawful tax which is not laid for a public purpose . . . It may not be easy to draw the line in all cases so as to decide what is a public purpose in this sense and what is not . . . It is undoubtedly the duty of the legislature which imposes or authorizes municipalities to impose a tax to see that it is not to be used for purposes of private interest instead of a public use, and the courts can only be justified in interposing when a violation of this principle is clear.”<sup>131</sup>

This position articulated by the Supreme Court would remain the definitive one for nearly fifty years.<sup>132</sup> Note that the view was a bit more deferential than the articulation of Massachusetts. The burden would not be upon state and local governments to show “obvious” public purpose, as the Massachusetts court seemed to have wanted. Line drawing in public purpose cases would always be messy, the Supreme Court said. Nonetheless, state courts would be justified in blocking transfers of funds if a violation was “clear.” By endorsing *Lowell v. Boston* so strongly, the Court also helped solidify the notion that incidental versus primary public benefit was an important part of discerning whether a public purpose had been satisfied.

Many cases over the following decades witnessed courts clamping down on state and local schemes to attract business through public subsidies. Although one must do more work to justify a causal claim, an examination of state debt levels in the decades that followed suggests that something drastic had to have happened to change the pattern of exploding public debt and questionable economic incentives. Where in 1870 states had 352 million dollars in debt, by 1880 they had *decreased* their debt to 297 million dollars, and by 1890 has reduced it further to 228 million, a rate that was unchanged by the end of the decade 1900.<sup>133</sup> The constitutional debt

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<sup>130</sup> Indeed, the Court notes in its opinion that it went to quite some trouble to find a copy of the Massachusetts opinion in *Lowell v. Boston*, which might be taken as indication of the deliberateness with which they decided to take a stand on an evolving precedent.

<sup>131</sup> *Loan Association v. Topeka* 87 U.S. 662, 664 (1874)

<sup>132</sup> Waldron, *supra* note 24, at 251.

<sup>133</sup> One problem with this argument is that local debt did increase rather drastically during the same period. One can argue that this is inconsistent with the story being told about the real effectiveness of the public purpose doctrine at clamping down spending, however the provision of services from local governments such as streets, sanitation, and education

limitations that were enacted following the crises of the 1850s and 1870s were not of a wholly different kind than the limitations that followed the Panic of 1837, it seems more plausible to think that what *really* did the trick was the process of the public purpose doctrines gradual recognition through opinions, treatises, and change in legal culture.

By the mid-20<sup>th</sup> century the doctrine was widely recognized in treatises along widely similar lines. Despite myriad textual sources and a winding precedential history, one finds judges in the late 20<sup>th</sup> defining the doctrine in extraordinarily similar ways, readily citing the interpretations of the public purpose doctrine described in other states or in secondary sources.<sup>134</sup> Indeed, North Carolina's *Maready* opinion has a footnote that cites cases supporting the doctrine in no less than forty-six states,<sup>135</sup> and there are cases in the four states it does not cite that do recognize the doctrine. For the sake of completeness, I shall now state what seem to be the four essential principles for which the public purpose doctrine stands today.<sup>136</sup> First, Courts say that public purpose cannot be defined precisely, because it is a vague concept that changes with time.<sup>137</sup> Second, Government acts are *presumed* to be in the public purpose.<sup>138</sup> Third, the public benefit must be primary, and not just incidental, although the fact that there is some private benefit does not render the government act a violation of public purpose.<sup>139</sup> Finally, courts will reverse only if it is "manifest" or "clear" that there is no reasonable public purpose, or that the officials "unquestionably abused" their discretion.<sup>140</sup> Some widely recognized public purposes include the promotion of public health, safety, morals, general welfare, or security.<sup>141</sup>

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undoubtedly increased in this period, which prevents us from saying whether at the local level . Increasing expectations for state governments in the same period also makes the flat-lining of state debt more remarkable. Obviously, the argument requires considerably more data to justify a causal interpretation, but the change in trend is obvious and the newfound willingness of courts to enforce the public purpose doctrine seems a plausible explanation.

<sup>134</sup> See, e.g., *Maready v. City of Winston-Salem*, 342 N.C. 708 (1996); *State ex rel. Brown v. City of Warr Acres*, 946 P.2d 1140, 1147 (1997); *Gober v. Stubbs*, 682 So.2d 430, 435 (Ala. 1996); *Wright v. City of Danville*, 174 Ill.2d 391, 400 (1996); *In re Limited Tax General Obligation Bonds of City of Edmonds*, 256 P.3d 1242, 1248 (2011); *Cooper v. Town of Pinedale*, 1 P.3d 1197 (2000).

<sup>135</sup> *Maready v. City of Winston-Salem*, 342 N.C. 725 n.1 (1996);

<sup>136</sup> See 15 MCQUILLIN MUN. CORP. § 39:25 (3d ed). Interestingly enough, several of these principles are already discernible in *Sharpless v. Mayor of Philadelphia*, 21 PA 147 (1853), a case commonly credit as having developed the public purpose doctrine.

<sup>137</sup> *McQuillin Mun. Corp.* § 39:25 (3d ed. 2014)

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*

## Section II: The Death of Public Purpose

This section presents the design and results of a comprehensive case study of all public purpose cases available on WestLaw reported between August 6, 1994 and August 6, 2014. The survey established that there is not a single instance of a Court invalidating economic incentives to private individuals or corporations. I consider and reject the possibility that plaintiffs are simply bringing weak cases by considering a few representative example. Unsurprisingly, given that plaintiffs no longer seem capable of winning a public purpose case, the survey also reveals evidence that such challenges are becoming increasingly rare. That the number of public purpose cases is decreasing as a function of years turns out to be a statistically significant result, robust to regional fixed effects and total volume of litigation going through state courts. This associational result is interpreted as supporting the claim that cases involving the public purpose doctrine are both rare and decreasing over the last twenty years.

### *I. The Case Study: Methodology and Results*

The case study method that this article adopts has grown increasingly popular in empirical legal studies over the years.<sup>142</sup> The most important reason is that case studies offer “a uniquely legal empirical method -- a way of generating objective, falsifiable, and reproducible knowledge about what courts do and how and why they do it.”<sup>143</sup> In essence, what is involved in a case study is collecting a set of judicial opinions on a particular subject and “systematically read[ing] them, recording constituent features of each and drawing inferences about their use and meaning.”<sup>144</sup> In contrast to the more traditional legal scholarship which like literary interpretation relies “on the interpreter’s authoritative expertise to select important cases and draw out noteworthy themes and potential social effects of the decisions,” the persuasiveness of case studies such as this depends on the ability of the researcher “to explain the selection of cases and themes in enough objective detail to allow others to replicate the steps.”<sup>145</sup> The higher credibility of these studies may explain both why the placements of such studies seem to

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<sup>142</sup> MA Hall & RF Wright, *Systematic content analysis of judicial opinions*, 96 CALIF. LAW REV. 70 (2008), <http://www.jstor.org/stable/20439171> (last visited Aug 18, 2014) (noting the increase from less than one such study per year prior to the 1990s, to about six per year in the 1990s and eight per year in the first-half of the 2000s). The discussion that follows is heavily indebted to Hall & Wright’s article. In the author’s view, this is actually a positive aspect of the study, since “methodological innovativeness” tradesoff with reproducibility.

<sup>143</sup> *Id.* at 64.

<sup>144</sup> *Id.* at 64.

<sup>145</sup> *Id.* at 66.



be better on average than other kinds of studies,<sup>146</sup> and why they are more frequently cited after publication. Indeed, one recent study of legal scholarship found that compared with law review articles in general, a full 40% of which are not once cited, case studies produced during the 1990s had on average seventy-seven citations per article, with 71% having at least five citations.<sup>147</sup>

In order to conduct a proper case study, the author must settle the following issues. First, she must establish that content analysis will provide an answer for the kind of question she is interested in answering. If what is desired is an understanding of the potential effects of a specific case, series of cases, or concept on a body of law, a systematic empirical case study “would be either irrelevant or overkill.”<sup>148</sup> Systematic case studies are most useful when seeking “an objective understanding of a large number of decisions where each decision has roughly the same value.”<sup>149</sup> Second, she must decide upon how cases will be selected. The key principles here are that the mechanism be broad enough to be sufficiently comprehensive to answer the question posed, while precise enough that the results be reproducible. For example, Landes’ and Posner read every tenth case citing the *T.J. Hooper* opinion in *The Economic Structure of Tort Law*,<sup>150</sup> while more recent studies may search for all cases under a key number or that respond to a Westlaw search in a given date range.<sup>151</sup> Third, she must decide how features of the cases will be catalogued, recorded or “coded.” A consistent coding scheme forces researchers to maintain objectivity and completeness in their perspective.<sup>152</sup> Finally, she must decide what sort of analysis will be preformed on the cases.

In assessing the ongoing vitality of the public purpose doctrine, a case study is the ideal tool. Most importantly, since the aim of this paper is to prove a negative claim, i.e. that the public purpose requirement is no longer an effective constraint on state and local governments, a comprehensive

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<sup>146</sup>*Id.* at 70–71, n.27 (citing twenty-two case studies that were published in the law reviews of “T14” law schools, out of one-hundred thirty four total case studies the authors found in existence).

<sup>147</sup>*Id.* at 74. It should be noted that these two phenomena are probably not unrelated, since one would expect publications in prominent journals to get more citations on average, however the strength of the citation results seems to indicate that the phenomena are not completely coextensive, and that the higher credibility of case-study methodology on average seems a reasonable explanation for both phenomena.

<sup>148</sup>*Id.* at 78.

<sup>149</sup>*Id.* at 78. For a more aggressive view promoting the use of case studies over traditional legal analysis, see Lee Epstein & Gary King, *The Rules of Inference*, 69 UNIV. CHICAGO LAW REV. 1–133 (2002).

<sup>150</sup> WILLIAM M. LANDES & RICHARD A. POSNER, *THE ECONOMIC STRUCTURE OF TORT LAW* 103 (1987).

<sup>151</sup> Political Scientists Gary King and Lee Epstein do much the same in their own case study on law review articles. See Epstein & King, *supra* note 149, at 16.

<sup>152</sup> Hall and Wright, *supra* note 142, at 80–81.

analysis is clearly required. For example, Douglas Laycock's *The Death of the Irreparable Injury Rule* showed that the rule that courts will not prevent harm if money damages could adequately compensate for the harm is "dead in the practical sense that it almost never affects the results of cases."<sup>153</sup> Moreover, the assumption that each case is roughly as important for the analysis seems warranted. State courts addressing the public purpose doctrine have cited each other quite readily. While there are obviously gradations in the amount of research that went into each opinion, the rigor of legal reasoning involved, and other factors associated with higher or lower opinion quality, the citation patterns show that courts across the country are not united in recognizing a single opinion or series of opinions. Rather, it seems that when confronted with a public purpose case, state supreme courts make an effort to canvas the nation and see what they find pertinent. Since state supreme courts generally regard the opinions of their equivalents in other states as influential but not controlling, there is no reason to think any opinion should count more than any other a priori. In this instance, the assumptions required of a case study are appropriate.

Once an author is sure that her decision to use a systematic case study is reasonable, the next issue to address is how cases will be selected. The critical requirements are that the selection mechanism be so wide-ranging as to be comprehensive, but specific enough to be reproducible. For my study, I searched the All States database on Westlaw for cases decided in the twenty-year period between August 6, 1994 and August 6, 2014 that contain the phrase "public purpose" at least once. August 6, 2014 was the day that I began conducting the survey by downloading all the then published opinions on Westlaw, while August 6, 1994 was chosen so as to cover a twenty-year period from the day of the study beginning. The decision to adopt a twenty-year period was based primarily on balancing the resource available for the study against the concern that the time-horizon be sufficiently large as to be comprehensive.

Besides date and search term, another important aspect of the selection mechanism was the use of West's Key Number system. There are over 10,000 opinions that use the term "public purpose" occurs at least once. Even looking within the last decade still lists over 1,000 opinions. While 1,000 is not an impossible number of opinions for a case study to cover, the term "public purpose" arises frequently in opinions dealing with condemnations, zoning, and other topics that have a low probability of actually involving the public purpose doctrine. To get a better fit with the research topic at hand and more effectively use limited resources, I eliminated all search results in the date range that did not belong to one of several pre-selected "Topics" from Westlaw's Key Number System.<sup>154</sup>

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<sup>153</sup> Laycock, *The Death of the Irreparable Injury Rule*, vii. (1991).

<sup>154</sup> The Topics I selected were 381IV Fiscal Management, Public Debt, Securities, and Taxation; 360IV Fiscal Management, Public Debt, and Securities; 268VIII Municipal

These topics were not selected haphazardly, but rather by carefully working through the key numbering system. A public purpose case *necessarily* involves fiscal management and expenses, so if Westlaw's content were curated with absolute accuracy any case involving public purpose would have to occur underneath a fiscal management and expense headnote. Unfortunately, Westlaw does not have a single "fiscal management and expense" headnote, instead Westlaw has headnotes corresponding to the different types of governmental actors that could be involved in a public purpose case: towns, municipal corporations, counties, or states. Contained within each actor-specific headnote is a particular version of the fiscal management and expenses "topic." The titles for all these topics are quite similar, as one can see from their description in the last paragraph, and deciding which one to select is not difficult.

By adding the assumption that a public purpose case must involve fiscal management and supposing that West always applies a fiscal management headnote to cases actually involving fiscal management issues, I was able to reduce the search results for the two decade period to 211. According to one study of legal scholarship in this vein, 252 is the median number of cases read per project, so the number of cases that resulted from applying this method seemed reasonable as a basis for the study.<sup>155</sup> More importantly, 173 of these actually did turn out to involve the public purpose doctrine, so the fit between all the cases that should be found and all the cases that were found seems strong. As a sanity check, I was able to confirm that the cases cited by a recent law review note on the public purpose doctrine that should have appeared in the search did in fact appear there.<sup>156</sup> On the other hand, the assumption that Westlaw always correctly applies fiscal management headnote to cases that should have them is provably false. *Garden Club I* and *II* were both public purpose cases, for example, but only the last one was properly assigned the fiscal management topic header.<sup>157</sup> While the decision to use KeyCites is reasonable, and since the failure to properly apply the proper headnote is probably an occurrence both rare and independent of any trends this paper seeks to analyze, the potential for incompleteness of the survey is always present. Good scholarship should not seek to hide from threats to its inferential strategy, but rather identify those threats as clearly as possible.

After the set of cases to analyze was fixed, cases were coded as involving the public purpose doctrine, as being about the public purpose doctrine but superseded by another case on appeal, or as being a takings, *ad*

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Expenses and Charges and Statutory Liabilities; 268XIII Fiscal Matters; 104VIII Fiscal Management, Public Debt, and Securities.

<sup>155</sup> *Id.* at 72.

<sup>156</sup> C. Tyler Mulligan, 91 N.C. L. REV. 2021 (2013).

<sup>157</sup> See *Garden Club of Georgia, Inc. v. Shackelford*, 266 Ga. 24 (1995); *Garden Club of Georgia, Inc. v. Shackelford*, 274 Ga. 653 (2002).

*valorem* taxation, or about some other category of case. A one-sentence description of the kind of action allegedly taken by the government, including the kind of actor in question, was recorded for all cases truly involving the public purpose doctrine.<sup>158</sup> Additionally, cases were coded for whether they involved some kind of incentive to a private entity for the purposes of economic development, which is to say dealing with the kind of matters the public purpose doctrine was originally designed to regulate. For example, *Ethics Commission v. Keating*,<sup>159</sup> where the government action challenged was summarized as “Governor uses his transportation service to attend political events,” was coded as involving the public purpose doctrine but *not* involving economic incentives, while *State ex rel. Brown v. City of Warr Acres*, summarized by “City pays current property owner in order to solidify lease agreement with Walmart,” was coded as involving the public purpose doctrine *and* involving economic incentives. Finally, the effect of the judgment was recorded.<sup>160</sup> Possible effects were state action upheld as public purpose, state action considered public purpose but rejected on other grounds, dismissed on procedural grounds, remanded with skepticism, state action considered not public purpose but remanded on other grounds, and state action rejected on public purpose grounds.

Coding cases involves one of the most serious challenges in social science, “the movement between concepts and observations.”<sup>161</sup> Do the tallies derived from coding measure concepts in a valid way? What does it mean to say that one case *involves* the public purpose doctrine or *involves* economic incentives? To a certain extent, these are “background concepts” that have a potentially different meaning for different, and which therefore may result in some kind of systematic disagreement between the coding one researcher does and the coding of another.<sup>162</sup> Clarity and reproducibility is promoted by the use of “systematized” concepts, which facilitate the transformation of observations into measures.<sup>163</sup> Since I am interested in the cases occurring within a precedential tradition, the systematized concept

<sup>158</sup> It was not always possible to summarize cases in this way that were about something besides public purpose, since the defendant was not always a government entity.

<sup>159</sup> *Ethics Com’n v. Keating*, 958 P.2d 1250 (Ok. 1998).

<sup>160</sup> In practice, formation of the coding scheme is a messy process that goes back and forth as the research project develops, with recoding of the cases necessary at perhaps multiple junctures. In this case, the initial plan of this study was to find the legal factors at play in economic development opinions that were important for Courts that struck down government actions as unconstitutional, and then to turn back and see how those factors were or were not considered by courts upholding government action as constitutional. To my surprise, this plan failed, because there were no opinions where a court invalidated an economic development measure based on public purpose grounds, a finding itself worth reporting.

<sup>161</sup> Robert Adcock, *Measurement validity: A shared standard for qualitative and quantitative research*, 95 AM. POLIT. SCI. ASSOC. 529–546 (2001), [http://journals.cambridge.org/abstract\\_S0003055401003100](http://journals.cambridge.org/abstract_S0003055401003100) (last visited Aug 30, 2014).

<sup>162</sup> *Id.*

<sup>163</sup> *Id.*

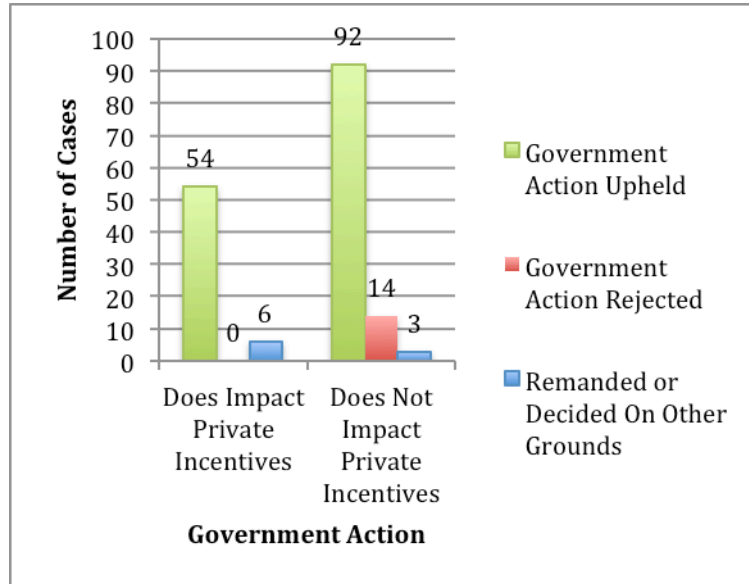
I use is closely connected with this aim. I treat an opinion as “involving” the public purpose doctrine if in developing the legal standard it applies, the opinion relies on sections of secondary source materials explicitly describing the public purpose doctrine or public purpose requirement in public spending, if it cites other cases that do the same, if it cites constitutional amendments that were enacted to enshrine the public purpose requirement, or if the opinion explicitly uses the standards described in the first section of this article as being typical of public purpose doctrine cases. My systematized understanding of what “economic incentives” requires is that a private entity, either for-profit or not-for-profit, real or hypothetical, receive some benefit as inducement for promoting jobs, property values, or some other form of community wealth. This definition allows for the clean separation of issues like the payment of assorted costs for public officials accused of wrong doing, which I do not think one can reasonably consider “economic incentives,” while including plans such as the construction of an athletic facility for the US Olympic Team, which might plausibly be considered part of the promotion of economic development and community wealth. I do not make a sweeping claim about what the background concepts of economic development or public purpose “really” mean, rather my only claim is that these are reasonable approaches given the goal of consistently coding cases.<sup>164</sup>

With these matters decided, what remains is the analysis. Initially, the goal of the study was to determine what factors really determine the outcomes of public purpose doctrine cases today, in the spirit of Borchers demonstration that what really determines outcomes in choice of law questions is whether a jurisdiction follows the First Restatement or not.<sup>165</sup> Yet to my surprise, there was almost no variance in outcomes: the government did not actually lose a single case involving economic development initiatives on public purpose grounds, and almost never loses other kinds of public purpose cases. The closest the government came to losing a public purpose case was *Turken v. Gordon*, discussed below, where the Arizona Supreme Court decided that the measure before it did not have a public purpose, but claimed that its prior articulation of the public purpose doctrine was so unclear that its holding should only apply prospectively. As a result, the measure before them was not declared invalid. Figure 1 illustrates the outcome of the case dependent on whether the action deals with private economic incentives.

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<sup>164</sup> *Id.* at 532.

<sup>165</sup> Borchers, *The Choice of Law Revolution: An Empirical Study*, 49 Wash & Lee L.R. 357 (1992). A number of other similar studies are mentioned in Hall and Wright, *supra* note 142, at 92.

**Figure 1 - Outcome Depending on Kind of Action**

Although the tallies of outcomes are informative, they do not tell us what the outcomes should look like in a world where the public purpose doctrine *were* genuinely effective. Perhaps rare victories for plaintiffs is consistent with an effective public purpose doctrine, since governments only litigate strong cases. Against this view, we can note that the costs to litigating are probably higher for plaintiffs than for defendants in this area, so we would expect the government to litigate even when their case is relatively weak, and the number of victories is really extraordinarily small, to the point of equaling zero in cases involving economic incentives. Moreover, in public purpose cases not involving private economic incentives, the outcome seem consistent with the government receiving substantial, but not total deference. The best argument that we are in a world where the public purpose doctrine is not genuinely effectively is found by actually looking at the measures challenged in the cases and using legal judgment to assess the strength of the cases the plaintiffs were bringing. In particular, I shall describe three cases: *Board of Directors v. All Taxpayers, Property Owners, Citizens of the City of Gonzales*, *Fischer v. City of Colorado Springs*, and *Turken v. Gordon*. Looking forward to the next section, this will also be a good opportunity to compare legal rules.

*II. Representative Case: Board of Directors v. All Taxpayers, Property Owners, Citizens of the City of Gonzales*

In 2005, a special election was held in Gonzales, Louisiana, the purpose of which was to determine whether 1.5% of sales tax revenue could be used for the creation of “economic development” districts.<sup>166</sup> Notwithstanding its renown as “Jambalaya Capital of the World,”<sup>167</sup> the city of Gonzales had around 10,000 individuals at this time, only a little over a thousand of whom actually turned out to vote on this matter. The proposal was carried 625 to 251.<sup>168</sup> Within a matter of weeks, the City had entered into a complex sale-and-leaseback transaction involving itself, several other government entities, and two private corporations, Cabela’s Retail and Carlisle Resort. This agreement was subsequently challenged in *Board of Directors v. All Taxpayers, Property Owners, Citizens of the City of Gonzales*.<sup>169</sup> The decision was notable for the fact that the majority and dissent did not agree with each other about the basic nature of the transaction contemplated: was the city giving away a shopping center or not?

Viewed objectively, and eliding some less relevant details, the contract contemplated the following series of events.<sup>170</sup> First, Cabela’s would buy approximately 50 acres of land from Carlisle and construct upon it an 165,000 square foot retail facility in the style of its other properties around the country. Next, the title to the retail facility would pass into the hands of the Industrial Development Board, who in return would issue bonds to Cabela’s in an amount up to 42 million dollars. These bonds would be paid out of the 1.5% local sales tax revenue, as well as another 1.5% out of state sales tax revenue, so that 3% of every purchase of consumer goods made in Gonzales would not go to the public coffers, but rather to Cabela’s. With the facility built and paid for, Cabela’s would then lease the retail facility from the City so that it could actually operate the store. The lease included an option to purchase at any time for a figure yet to be determined, but which was supposed to be the facility’s fair market value, minus all the rental costs Cabela’s had paid Gonzales, minus \$2,500 times each full time job created at Cabela’s, and minus \$1,900,000 for each year of the lease in operating costs.

Less literally, the agreement amounts to the following. Cabela’s pays the cost of building a property for the city, the city pays Cabela’s back for doing so with future earnings, and then the city leases the property back to the corporation so it can exist as a running business. To execute this agreement, Cabela’s must expend money in two ways: it must fund

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<sup>166</sup> Board of Directors of Indus. Development Bd. Of City of Gonzales, Louisiana v. All Taxpayers, Property Owners, Citizens of City of Gonzales, 938 So. 2d 11, 14 (La. 2006).

<sup>167</sup> “History,” Jambalaya Festival.org (July 17, 2015 12:15 pm).

<http://www.jambalayafestival.org/history.aspx>

<sup>168</sup> *All Taxpayers*, 938 So. 2d at 14 n. 2.

<sup>169</sup> 938 So. 2d 11 (La. 2006).

<sup>170</sup> *See id.* at 14-16.

Fall 2015]

*Death of Public Purpose*

31

construction of the facility, and then it must pay the government to lease the facility it has built. For its part, the governmental entities do not expend money today, but effectively will “pay” for the next thirty years out of sales tax revenues they would have been entitled to.

What has Cabela’s received by agreeing to pay the full upfront cost of construction, and thereafter the cost of leasing the facility it has only just built? The answer depends on the future state of the world. If no sales were made in Gonzales in the future, Cabela’s would receive no income, and the city would have paid nothing to get ownership of a facility which it will likely have difficulty finding a tenant to occupy, and which Cabela’s will likely not choose to buy. Conversely, suppose that 1.4 billion dollars of sales are made in Gonzales over 30 years, which is the amount required to pay off the full balance of the bonds. In such a happy state, the city has essentially bought a property for around 42 million dollars that has earned rental income over time, and which it might sell back to recoup some of its 42 million dollar investment. The Cabela’s will have only bourn the cost of leasing the facility.

If the option to buy the facility is exercised, it slightly changes the picture. Supposing it exercises the option at the end of this period, Cabela’s will not have bourn the cost of leasing the facility, will have not bourn 1.9 million dollars per year in operating costs, will not have bourn some fraction of the burden of making payroll in the facility, but will pay the difference between these costs and the fair market value of the facility. As property values increase, the government stands to recoup more of the 42 million dollar cost it paid out of pocket. If retail facilities suddenly became much more valuable in Gonzales, it would be good for the government and bad for Cabela’s. Cabela’s protection against this possibility is that it can exercise its option to purchase at any time. Conversely, if the fair market value of the property does not exceed 42 million dollars plus the annual operating cost and other deductible expenses, then the city will have lost money on the transaction.

Given this fact pattern, one can readily imagine a victorious public purpose challenge, as it is no exaggeration to say that Gonzales, Louisiana bought a Cabela’s for Cabela’s to operate for themselves. Yet this measure was upheld 7-2 by the Louisiana Supreme Court. An exploration of the reasoning in the dissent and majority in this case gives one a good opportunity to see what is going on in these opinions that has lead to the lopsided tallies that content analysis reveals.

In *All Taxpayers*, the majority opinion chose not to reference the case law developing the public purpose doctrine explicitly. Instead it considered the “plain-language” of the Louisiana Constitution’s Article VII §14(A).<sup>171</sup> The provision forbids state aid using language that mirrors many of the state aid provisions enacted in the 19<sup>th</sup> century to rein in the railroads:

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<sup>171</sup> *Id.* at 20.



Except as otherwise provided by this constitution, the funds, credit, property, or things of value of the state or of any political subdivision shall not be loaned, pledged, or donated to or for any person, association, or corporation, public or private.<sup>172</sup>

In the majority's interpretation, the meaning of this provision was clear and should be applied without need for judicial construction. The key question for the court was whether the government's action had "gratuitously give[n] something to another."<sup>173</sup> As an example of what might count as a gratuitous gift, the Court referred to transcripts of the 1973 Louisiana Constitutional Convention, wherein the delegates had noted that the provision forbids the government from buying land for some industry and "just giv[ing] it to them."<sup>174</sup>

To analyze whether this transaction was forbidden, then, the Court turned to principles of contract law, which are described in the Louisiana Civil Code.<sup>175</sup> Without delving into the nuances of that code, the essential question should be familiar to common law scholars: should the agreement be viewed as a gift or a contract? To answer this question, the Court looked both to the intent of the government, was its conveyances made with "gratuitous intent," and the consideration that Cabela's provided, had the latter obligated itself to a significant degree? The Court thought that the government was plausibly acting in a self-interested fashion, not out of "liberal feelings" toward Cabela's. "If the project is successful, significant sales tax revenues will be generated . . . it appears that 2.50% [of] the sales taxes collected by the State and 0.50% of the sales taxes collected by the City are not pledged to finance the bonds."<sup>176</sup> If sufficiently more sales were made, the governments might actually gain tax revenue. Cabela's obligations were also viewed as significant, as it committed to a significant cash outlay, and would transfer the property and thereafter pay rent as well as operating costs. The Court noted, correctly, that Cabela's faced real financial risk if the project were unsuccessful. The Court did consider whether the exercise of the option might change things, but the fact that the option's exercise was unlikely unless the project were successful for the government as well as Cabela's belied its status as a gratuity.

The dissent did not seem to disagree that the lens of contract law was appropriate for this case, although it took a slightly different tack. The dissent claimed the test was "whether the consideration given to the Board, under this agreement, is sufficient."<sup>177</sup> The difference between the two approaches seemed to be (1) that the majority found governmental intent to be relevant, while the minority did not, and (2) the majority did not seem to

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<sup>172</sup> *Id.*

<sup>173</sup> *Id.*

<sup>174</sup> *Id.* at 20-21

<sup>175</sup> *Id.*

<sup>176</sup> *Id.* at 24.

<sup>177</sup> *Id.* at 32.

think adequacy of consideration was necessary to establishing its sufficiency, so long as there was genuine consideration, while the minority thought assessing the quality of consideration was crucial. The dissent noted that the characterization of the payments to the government as “rent” was deceptive, since these were in fact identical to the amount of property taxes the Cabela’s would have owed were the government not itself the true owner of the property.<sup>178</sup> The other “obligations” were all made to third-parties besides the government.<sup>179</sup> Even the promise of Cabela’s “to make reasonable efforts to employ Gonzales residents” was viewed as illusory by the dissent.<sup>180</sup> The dissent concluded that the government was bearing all the burden of financing a privately owned enterprise.<sup>181</sup> To whatever extent that was an exaggeration, Cabela’s burden was no different from the kind any new business owner must endure.<sup>182</sup> Because the weight of the benefits was so favorable to Cabela’s, the dissent found it “unimaginable how this financing structure amounts to anything other than a loan or donation of public property and funds.”<sup>183</sup>

By choosing to avoid judicial construction of the amendment and analyzing instead the provisions plain meaning, the Court failed to rigorously apply the public purpose doctrine. The outcome of the case turned upon whether Courts should look at the existence of consideration alone or inquire into its adequacy. The tradeoffs from both approaches are fairly clear: less aggressive supervision by Courts with the former rule, possibly resulting in better decisions without “judicial second-guessing”, and more aggressive oversight from the Courts in the latter, possibly preventing ill-advised ventures by legislatures and governmental administrations, perhaps at the cost of preventing some good ideas from getting off the ground.

A traditional public purpose based opinion would have dealt with these same issues, although with more clarity and directness. The Court would have first had to answer whether greater sales tax revenues or “economic improvement” is a constitutionally valid public purpose, since this was the only benefit articulated by the governmental entities. The resolution of this question is not exactly clear. Economic development measures aimed at fighting poverty, blight, urban decay, and other recognized social ills are well accepted in the case law. The land in this case was not blighted, only undeveloped. Measures that directly promise jobs or improvements in the tax base raise entirely different concerns and should be treated separately, but these too are often considered valid public purposes.<sup>184</sup> As the cases

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<sup>178</sup> *Id.* at 33.

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* at 34.

<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *See* Mulligan, *supra* note 156.

make clear, public purpose cannot be defined precisely, as it is a fluid concept that changes with time.<sup>185</sup> The view presented by the majority opinion in *All Taxpayers* betrays the unquestioned assumption throughout that it is appropriate for a government to in its own self-interest seek greater wealth as such. If one views the government as a trustee of the citizens, one must be somewhat circumspect about the value of that trustee's enrichment. In any event, a more traditional public purpose analysis would force the Courts to take a stand on the legitimacy of the goals the government pursues, bringing clarity for future leaders and encouraging democratic response if the citizens or legislature disagrees with the Court's reasoning.

Once the Court narrows the discussion to a specific set of public purposes that the government has tried to achieve, it next considers its presumptions. Government acts are *presumed* to be in the public purpose.<sup>186</sup> Some courts might take this principle as little more than a fact to bear in mind, that governments are usually acting for some public reason. Other courts might discuss this principle in order to determine how searching their review ought to be, akin to the question of whether to apply the rational basis test or strict scrutiny. In *All Taxpayers*, I would argue the review needed to be very searching indeed. Following a special election in which less than one out of ten citizens voted, the leaders of a town comprising 3000 households obligated themselves after only a few months to pay up to 42 million dollars for the next 30 years. There was no inquiry by the Court into the process by which Cabela's was chosen as the retailer, and it seems likely that Cabela's approached Gonzales and not the other way around.<sup>187</sup> There was no discussion in the opinion about what economic development was projected to look like, whether development had happened in other towns in which Cabela's or similar stores had located.<sup>188</sup> In *Board v. Gonzales*, there was no discussion of how significant sales tax revenue from Gonzales was for the citizens of Gonzales or the state in general. The size of the agreement alone, the low turnout in the election, and the speed with which the agreement was entered into following the special election, in my view give substantial reason for the Court to press hard and make sure the government really did its job: the presumption in this case was not deserved. But even if one disagrees, the public purpose doctrine helps make the decision in such cases turn not on the artificial question of adequacy versus

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<sup>185</sup> McQuillin Mun. Corp. § 39:25 (3d ed. 2014)

<sup>186</sup> *Id.*

<sup>187</sup> Bert Caldwell, "Cabela's Baited the Hook, and States Are Biting," *The Spokesman Review* (Sept. 10, 2006). <http://www.spokesman.com/stories/2006/sep/10/cabelas-baits-the-hook-and-states-are-biting/>

<sup>188</sup> Indeed, Cabela's arrival did not bring economic boons in many of its locations, which should have been public knowledge at the time of Gonzales' agreement. *See, e.g.* Dan Uhlinger, *Cabela's Hasn't Fulfilled Dreams: Pennsylvania Store in Rural Isolation*, *HARTFORD COURANT* (Sept. 18, 2005); *see also* State Demands Refund from Cabela's, *AUSTIN BUSINESS JOURNAL* (Aug. 15, 2006).

the existence of consideration, but on the real issue in these cases, how strong should the Court's oversight of the government be?

With a sense of how much deference a government deserves, a Court deciding a public purpose case proceeds to the real heart of the doctrine. The public benefit must be primary, and not just incidental, although the fact that there is some private benefit does not render the government act a violation of public purpose.<sup>189</sup> As one scholar has put it, the inquiry must decide whether the policy brings a "net benefit" to the public.<sup>190</sup> The analysis that should follow is closer to the dissents' reasoning in *All Taxpayers* than the majorities. The Courts must inquire into the quality of the agreement from the *government* side, not from the perspective of the recipient. This is not to say that the public purpose doctrine required the courts to invalidate the measure in *All Taxpayers*, the case is still arguable, but the mere fact that the private party bears some risk should not be dispositive of the outcome. In any event, it is easy to imagine that a Court could have found it "clear" that the officials "abused their discretion" by committing themselves to the degree they did.<sup>191</sup> The skeptics' contention that plaintiffs simply never bring plausible challenges is therefore refuted.

## *II. . Representative Case: Empress Casino Joliet Corporation v. Giannoulas*

Another case that can help address concerns that plaintiffs simply do not bring good cases is *Empress Casino Joliet Corporation v. Giannoulas*.<sup>192</sup> In 2005, the Illinois General Assembly passed "An Act concerning Gaming,"<sup>193</sup> the effect of which was to raise taxes by 3% on the four riverboat casinos in Illinois that had receipts above 200 million dollars per year. The proceeds of this tax were to be given to the five horse racing tracks in Illinois.<sup>194</sup> The Illinois legislature required that 60% of the money go to increasing the size of purses in the races, and the other 40% would go "to improve, maintain, market, and otherwise operate [their] racing facilities to conduct live racing, which shall include backstretch services and capital improvements related to live racing and backstretch."<sup>195</sup> The funds would be distributed to the tracks roughly on the basis of how big each of the horseracing tracks were in total amount of bets taken. The law also included specific findings, the most important of which are as follows:

- (1) riverboat gaming has had a negative impact on horse racing. . .

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<sup>189</sup> *Id.*

<sup>190</sup> See Mulligan, *supra* note 156.

<sup>191</sup> *Id.*

<sup>192</sup> *Empress Casino Joliet Corporation v. Giannoulas*, 231 Ill.2d 62 (2008).

<sup>193</sup> Pub. Act No. 94-0804, *available at*

<http://www.ilga.gov/legislation/publicacts/fulltext.asp?Name=094-0804&GA=94>

<sup>194</sup> *Empress*, 231 Ill.2d at 65.

<sup>195</sup> *Id.* at 66.

(2) this decrease in wagering has negatively impacted purses for Illinois racing, which has hurt the State's breeding industry. . .

(3) That the decline of the Illinois horseracing and breeding program, a \$2.5 billion industry, would be reversed if this amendatory Act of the 94th General Assembly was enacted. By requiring that riverboats agree to pay 3% of their gross revenue into the Horse Racing Equity Trust Fund, total purses in the State may increase by 50%, helping Illinois tracks to better compete with those in other states. Illinois currently ranks thirteenth nationally in terms of its purse size; the change would propel the State to second or third.

(4) That Illinois agriculture and other businesses that support and supply the horse racing industry, already a sector that employs over 37,000 Illinoisans, also stand to substantially benefit and would be much more likely to create additional jobs should Illinois horse racing once again become competitive with other states.

(5) That the 3% of gross revenues this amendatory Act of the 94th General Assembly will contribute to the horse racing industry will benefit that important industry for Illinois farmers, breeders, and fans of horseracing and will begin to address the negative impact riverboat gaming has had on Illinois horseracing.<sup>196</sup>

Unsurprisingly, the riverboat casinos challenged the law on a host of grounds. Represented by attorneys at Mayer Brown and Foley & Lardner,<sup>197</sup> the casinos won at the circuit court level on their allegation that the provision violated Illinois' constitutional requirement that taxes be uniform. The Illinois Supreme Court reversed, and in so doing had opportunity to consider the casinos' contention that the measure violated Article VIII, section 1 of the Illinois constitution.<sup>198</sup> The Illinois Constitution provides that,

"Public funds, property, or credit shall be used only for public purposes."<sup>199</sup>

The unanimous decision of the Court was that the measure satisfied the public purpose requirement. Quoting familiar principles of the public purpose doctrine, the opinion noted that the plaintiffs needed to allege facts "indicating that governmental action has been taken which directly benefits a private interest without a corresponding public benefit."<sup>200</sup> It further noted

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<sup>196</sup> Pub. Act No. 94-0804

<sup>197</sup> *Id.* at 64.

<sup>198</sup> The court also considered whether the federal takings clause might apply, but determined that the takings clause does not constrain the state's taxing ability.

<sup>199</sup> IL. CONST. ART. VIII § 1(a).

<sup>200</sup> *Empress*, 231 Ill.2d at 85.

that “the legislature is vested with a broad discretion, and the judgment of the legislature is to be accepted in the absence of a clear showing that the purported public purpose is but an evasion and that the purpose is, in fact, private.”<sup>201</sup> It reminded that the definition of public purpose changed with time and that some incidental private benefit is acceptable, so long as the overriding purpose is public.

The Court did not consider whether the legislative findings were evasive or deceptive, as the plaintiffs had not alleged that they were. Instead, the analysis primarily focused on whether the intended beneficiary was primarily public or private. The plaintiffs first alleged that the facts spoke for themselves. The only beneficiary of the tax were racetrack owners and there was “no effective control on how the track owners can use the 40% of the surcharge given to them.”<sup>202</sup> How could the primary beneficiary not be private? Essentially, the plaintiff’s were claiming that the state was taking cash from four individuals and giving it to five others with “conditions” that were not actually real. The plaintiffs might as well have said, “Just smell this, it stinks!” The Court did not agree with the plaintiffs that the facts themselves proved the conclusion, and attempted to dispute the plaintiffs’ characterization of the measure as a snatch-and-grab. As the Court said, “the manner in which the owners must utilize the funds is controlled by statute.”<sup>203</sup> The Courts’ meaning seems to be that because the letter of the law required the individuals to spend the funds in a certain way, it did not matter that there were no measures in the bill to actually make sure they did.

While one might have doubts about the seriousness of a requirement not backed by sanction, to a certain extent the plaintiffs were in fact misguided. They hoped to use the quality of the private benefit to show that the public benefit was absent, but as was argued in the previous section, the private benefit is not all that relevant to the determination of whether there is a net public benefit. The private benefit could not be clearer from the Illinois law, but that did not in itself rule out the possibility that genuine public benefit was also present. The Court was required by the doctrine to look at the plaintiffs’ allegations regarding public benefit. The Court concluded that the principal purpose of the act was “to stimulate economic activity, including the creation and maintenance of jobs and attraction and retention of sports and entertainment, particularly betting on horse racing....The surcharge will benefit the general well-being of society and the prosperity of the people of the State of Illinois.” The Court did not consider what if any evidence there was backing the legislatures findings of fact, for the Court it was enough that the legislature had made those determinations.<sup>204</sup>

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<sup>201</sup> *Id.* at 86.

<sup>202</sup> *Id.* at 88.

<sup>203</sup> *Id.*

<sup>204</sup> 90.

The Illinois Court's failure to look beyond the bare assertions of the State and inquire as to how these findings were justified is disappointing, and I would argue a misstep in its application of the public purpose doctrine. The public benefit must be *real and genuine*, it cannot simply be based on bare assertion,<sup>205</sup> or else the public purpose doctrine is reduced to a doctrine only constraining the justifications the government provides, rather than the actual policies it pursues. And indeed, one would be hard pressed to find a more baseless set of predictions. The findings simply recite publicly available industry statistics, without any real attempt to justify a causal prediction of the measures intended effect. The first finding, that riverboat gambling had caused the horseracing decline, is particularly bad. The fact that horseracing has declined since the introduction of riverboat gambling proves nothing about the relationship between the two events, especially given that horseracing was already in decline at the time of the law's passage *nationwide*.<sup>206</sup> Second, and perhaps more importantly, the findings are suspicious in so far as they do not consider *at all* the impact upon the riverboat casino industry from these taxes. It is not difficult to imagine that the successful and growing industry is doing more to create jobs and promote development in the state. Without any understanding of the effect of the tax on the taxed, how can one assess whether it is truly beneficial to the public? At no point did the Court explore whether the legislature had considered other alternatives to dealing with the problem it sought to address, or whether there might be better purposes for using the tax revenues collected from the casinos. Although the Illinois Supreme Court got the words behind the public purpose doctrine right, it did an appalling job actually inquiring into the benefit. No doubt, this failure is at least in part due to aspects of the underlying doctrine.

It did not take long for the plaintiffs to be proven right about the law in question. Following the laws passage the horseracing industry continued to decline, until two of the largest tracks declared bankruptcy in late 2014. Although the commercial demise of the tracks was probably inevitable, it was accelerated by an \$82 million judgment against the track owners, who were caught on FBI wiretaps promising disgraced Illinois governor Rod Blagojevich hundreds of thousands of dollars in campaign funds if he helped to extend the 2004 riverboat casino tax.<sup>207</sup> These same track owners had given several hundred thousand dollars to Mr. Blagojevich's first

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<sup>205</sup> See, e.g., *Wistruber v. paradise Valley Unified School District*, 141 Ariz. 346, 349.

<sup>206</sup> <http://www.chicagobusiness.com/article/20141004/ISSUE01/310049970/horse-tracks-stumble-amid-painful-wait-for-slots>

<sup>207</sup> Katy Stech, *Bankrupt Chicago HorseRacing Tracks Looking for Buyers*, THE WALL STREET JOURNAL (May 8, 2015), <http://blogs.wsj.com/bankruptcy/2015/05/08/bankrupt-chicago-horse-racing-tracks-look-for-buyers/>

campaign for governor, casting further doubt on the real reason the Illinois legislature passed the law in the first place.<sup>208</sup>

### *III. Representative Case: Turken v. Gordon*

One final case to consider in evaluating whether there were able challenges that might have won is *Turken v. Gordon*, the case in the survey that came closest to finding a development measure unconstitutional. “CityNorth” was a 144-acre, mixed-use development project in Phoenix, Arizona. The developers planned on creating a master-planned community that would include places to shop, live, work, and play. Unfortunately, the project ran into difficulties and “CityNorth” informed Phoenix that it needed financial assistance in order to complete the project.<sup>209</sup> Phoenix responded by entering into a parking space development and usage agreement with CityNorth. The terms of the agreement were essentially that the City would pay for the right to use 3,180 parking spaces that CityNorth had built over the next 45 years, at cost dependent upon a formula, but which could not in any event exceed \$97.4 million. The formula was that the cost was equal to 50% of the sales tax revenue collected by the city in the retail portion of CityNorth over the next eleven years and three months. The ability of the city to use the spaces was not exclusive, as guests, customers, vendors, and suppliers of the shopping area might use the spaces.<sup>210</sup>

The law was challenged by concerned taxpayers and business owners in Phoenix on the grounds that the law violated Arizona Constitution Article 9, § 7, the “Gift Clause,” which provides that

Neither the state, nor any county, city, town, municipality, or other subdivision of the state shall ever give or loan its credit in the aid of, or make any donation or grant, by subsidy or otherwise, to any individual, association, or corporation, or become a subscriber to, or a shareholder in, any company or corporation, or become a joint owner with any person, company, or corporation, except as to such ownerships as may accrue to the state by operation or provision of law or as authorized by law solely for investment of the monies in the various funds of the state.<sup>211</sup>

The plaintiffs initial challenge did not succeed, as the superior court determined that the Agreement served many public purposes, including “the creation, retention, and expansion of retail uses and employment in the community; the stimulation of economic development in Phoenix; the generation of substantial additional sales tax revenues; the creation of

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<sup>208</sup> Riverboat Robbery, THE WALL STREET JOURNAL (Mar. 24, 2009), <http://www.wsj.com/articles/SB123785278166719611>

<sup>209</sup> *Turken v. Gordon*, 220 Ariz. 456, 459 (2008).

<sup>210</sup> *Id.* at 459.

<sup>211</sup> Az. Const. Art. 9 § 7.



significant, free public parking, which will encourage the use of public transportation; and the development of an urban core that will reduce congestion, traffic, and pollution.”<sup>212</sup> Yet the agreement fared better on appeal, as the Circuit Court and ultimately the Supreme Court found that the deal was substantially in violation of the gift clause.

Arizona’s intermediate court began its analysis by recounting the purposes of the Gift Clause. Its intent is first “to avoid the depletion of the public treasury or the inflation of public debt by engagement in nonpublic enterprise,”<sup>213</sup> and secondly to ensure that public funds “are to be expended only for ‘public purposes’ and cannot be used to foster or promote the purely private or personal interests of any individual.”<sup>214</sup> The Court noted that the historical reason for the law was a “reaction of public opinion to the orgies of extravagant dissipation of public funds . . . in aid of the construction of railways, canals, and other like undertakings during the half century preceding 1880, and it was designed primarily to prevent the use of public funds raised by general taxation in aid of enterprises apparently devoted to quasi public purposes, but actually engaged in private business.”<sup>215</sup> It then noted that a measure might violate the Arizona constitution even though “surface indicia of public purpose” were present. “The reality of the transaction both in terms of purpose and consideration must be considered.”<sup>216</sup> The Court proceeded to list some kinds of policies that did not violate the Gift Clause, including expenditures to “improve, assist, or define government operations,” to provide for “pension benefits and compensation for services rendered,” to “promote the health and welfare of citizens.” It emphasized that governments are not forbidden to deal with private enterprises, nor to prevent private profit in such transactions, since over-encroachment by the Court would discourage the provision of goods and services necessary for governments.

With these considerations in mind, the Court announced a two-part test for whether an act was constitutionally permissible under the gift clause. First, the Court should inquire into whether there is a public purpose justifying an expenditure. Second, the Court should also look “to the adequacy of the public benefit to be obtained from the private entity as consideration for the payment or conveyance from a public body.”<sup>217</sup> Put differently by the Court, the second part of the test asks whether the consideration given by the public “far exceeds” the benefit to it. In considering the benefit, the Court needed to “give appropriate deference to the findings of the governmental body.”<sup>218</sup>

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<sup>212</sup> *Turken v. Gordon*, 220 Ariz. at 460-461.

<sup>213</sup> *Id.* at 462.

<sup>214</sup> *Id.*

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

<sup>217</sup> *Id.* at 465.

<sup>218</sup> *Id.*

The City argued that what it was receiving was a combination of economic and civic development, sales tax revenue that would otherwise go to neighboring Scottsdale, and the creation of a park and ride facility that would decrease traffic throughout the city.<sup>219</sup> The plaintiffs argued that the payments were “simply a massive subsidy given to private business owners to construct a private shopping center, as well as a parking garage that will serve retail businesses and their patrons.”<sup>220</sup> The plaintiffs conceded that there was some public benefit, but argued it was inadequate to justify the expense.

The Court responded by splitting the deal apart. It acknowledged that “200 parking spaces set aside for park and ride users are for a valid public purpose. The spaces will be used by passengers of a City sponsored public transit system.”<sup>221</sup> As far as the price for these spaces, the plaintiffs had not argued the formula for calculating the market rate was incorrect. As a result, this part of the agreement was upheld.

The Court then turned to the remaining 2,980 parking spaces. The Court noted that these spaces would not be obtained for “direct use” by the City, which is to say by its employees or business partners. The only direct public purpose that might be served by these spaces was “providing free public parking.”<sup>222</sup> But the Court insisted that it must “look at who will actually use the parking spaces and for what reasons.”<sup>223</sup> In other word, the Court thought the analysis had to reach the question of *which* public would use the parking. The answer was obviously customers and employees of CityNorth businesses, which in the Court’s view made this public benefit actually a private one. As for the other benefits, such as economic development and employment, these were indirect benefits of the transaction, and not something that CityNorth was actually providing. The Court was unable to see how such indirect benefits were different from those that the railroads promised to cities in the 19<sup>th</sup> century, which were clearly forbidden in the Court’s view.

On appeal, the City and developers lost on principle, but got the result they were after. As the Arizona Supreme Court said, “Although we conclude that the agreement quite likely violates the Gift Clause, because language in our previous opinions could well have led the City to conclude that the agreement was constitutional, we today clarify our Gift Clause jurisprudence and apply our decision prospectively only.”<sup>224</sup> To put it differently, Arizona Courts had made such a mess of the public purpose doctrine that the government entities were reasonably entitled to believe

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<sup>219</sup> *Id.* at 459.

<sup>220</sup> *Id.* at 468.

<sup>221</sup> *Id.*

<sup>222</sup> *Id.* at 469.

<sup>223</sup> *Id.*

<sup>224</sup> *Turken v. Gordon*, 223 Ariz. 342, 344 (2010).

their agreement was valid, and therefore the Arizona courts were estopped from invalidating an agreement that was probably unconstitutional.

Where had the Court of Appeals gone wrong? Certainly, in the Supreme Court's view, the intermediate court had gotten the historical purpose right.<sup>225</sup> And it had also made no mistake about the vagueness and historical contingency of defining public benefit.<sup>226</sup> The problem in the Supreme Court's view as that the Court of Appeals had used a three-part test that included an examination of whether the benefit was "primary" or "incidental", when the true question was much simpler.<sup>227</sup> Really, what the gift clause required only a two-part test. First, one asked whether there was a public benefit that the government received from the agreement. Next, one asked whether "the public benefit to be obtained from the private entity as consideration . . . is far exceeded by the consideration being paid by the public?"<sup>228</sup> The Court proceeded to explicitly reject the notion that indirect benefits should not count for public purpose analysis.<sup>229</sup>

The Court had no trouble concluding that there was a public benefit the government had pursued in this case. The more challenging issue was whether the consideration provided by the government is "so inequitable and unreasonable that it amounts to an abuse of discretion."<sup>230</sup> The Court used a definition of consideration taken from the Second Restatement of Contracts: "[consideration is] performance or return promise that is bargained for in exchange for the promise of the other party."<sup>231</sup> This definition allowed the Supreme Court to conclude, as the Court of Appeals did, that sales tax revenue did not count as consideration. While the Court of Appeals reached this result because the sales tax was an indirect benefit, the Supreme Court said that the problem was that the sales tax was not bargained over as part of the contracting party's promised performance. Indirect benefits are acceptable consideration for public purpose analysis, in the Court's view, so long as they are bargained for. The analysis of adequacy of consideration for Gift Clause purposes focuses on the objective fair market value of what the private party had promised to provide in return for the public entity's payment."<sup>232</sup>

The subtly of the difference between the two rules should be drawn out. The Court of Appeals says that as a categorical rule indirect benefits are not consideration; consideration has to come out of promised performance. The Supreme Court disagrees with that categorical rule, indirect benefits might still count as consideration, so long as they are bargained over. The problem

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<sup>225</sup> *Id.* at 346.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.* at 348.

<sup>228</sup> *Id.* at 348.

<sup>229</sup> *Id.* at 348-349.

<sup>230</sup> *Id.* at 349.

<sup>231</sup> *Id.* at 349.

<sup>232</sup> *Id.* at 350.

that the Supreme Court may have been concerned with is that sometimes the only real benefit from taking an action is indirect. The Court gives an example of a sewer line break that, if uncorrected, might cause disease and public health expenditures. Paying for the line to be fixed should not violate the gift clause, but paying 1,000 times the market rate clearly would. The Supreme Court thinks that one needs to look at the value of the bargained for service, fixing the line, and assess whether what is paid for far exceeds that. The main accomplishment of both rules is to narrow the scope of public benefits that might possibly justify the measure to those actually being provided by the private party under the terms of the contract.<sup>233</sup> Both approaches reveal that the City is essentially receiving nothing from the developer, as non-exclusive use of parking spaces cannot come close to the 100 million dollars the City potentially would pay for them.

The bizarre conclusion of the Supreme Court opinion was no doubt motivated by concern over damaging the development project. The Court decided that it could not decide the factual question of whether non-exclusive use of parking spaces could be worth nearly 100 million dollars, however strongly it doubted that was the case. The Court therefore declined to remand the case for this determination to be made, but rather applied its rule only prospectively.

The Arizona Court of Appeals and Supreme Court decisions were possibly the most faithful to the public purpose doctrine in the entire survey, however one can note that they suffered from real difficulties. In particular, the Courts both struggled to apply the framework of contract law to the agreement. Both Courts had to come to grips with how to analyze the adequacy of such a flexible concept as “public benefit,” while at the same time engaging with the difficult question of what benefits written on the terms of the agreement should count. These two decisions were the only ones in the survey where a Court explicitly declared that a measure violated the public purpose requirement, and there were several cases whose fact-pattern was quite close to that involved in *Turken v. Gordon*. In sum, a qualitative analysis of a few of the opinions involved in the case survey shows how weak the enforcement of the public purpose requirement has become.

#### *IV. The Death of Public Purpose*

The qualitative and quantitative findings of the case survey have called into question the vitality of the public purpose doctrine. But even if it has no force, there remains a separate question as to whether it is going away, and if so how quickly.<sup>234</sup> The data collected is already sufficient to find that the answer is yes, to a social scientific certainty we can be sure that the public

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<sup>233</sup> *Id.*

<sup>234</sup> Note that the target of inference here is closely tied with the observations actually drawn. For a discussion of why that matters, see Epstein and King, *supra* note 149, at 30–31.

purpose doctrine *is* disappearing. Table I presents the results of regressing the number of case against years according to a wide-variety of model specifications. For a Poisson regression model, which is the kind of model normally prescribed for count data such as these, the result is statistically significant at the 95% confidence level.

For other reasonable specifications, including negative binomial and ordinary least squares with or without regional fixed effects, the sign and size of the coefficient are all about the same, but the statistical significance drops to the 90% or in some cases 85% level. While social scientists generally prefer results with a 95% significance level or higher, that number should not be given talismanic significance. What matters more than whether to apply 85% or 90% or 95% confidence level is careful consideration of model specification issues, since misspecification can result in estimates that are excessively conservative or not conservative enough. That the coefficient's sign remains the same and without statistical significance evaporating across many specifications is good evidence that the doctrine is indeed disappearing. Although the inclusion of regional fixed effects show that public purpose challenges occur with somewhat greater frequency in the South than in other regions, and the inclusion of such fixed effects does push the magnitude and statistical significance of the year coefficient downward, they do not erode the magnitude or significance of the effect very greatly. The strongest remaining concern is that the decreasing number of cases every year is better explained by co-occurring environmental factors than by plaintiffs realizing the doctrine is a loser. For example, if Congress passed a law taxing the filing of lawsuits at an increasing rate over the period in question, we would expect public purpose cases to decrease regardless of the viability of any particular doctrine. To address this concern about the change in "legal environment," I used estimates of incoming case-volume derived from data produced by the National Center for State Courts<sup>235</sup> as a control in a Poisson regression of counts on years. The size of the effect actually became slightly stronger after controlling for how much litigation entered state courts over the same period, albeit with a small loss of statistical significance ( $p$ -value = 0.0593).

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<sup>235</sup> R. LaFountain, R. Schauffler, S. Strickland, K. Holt, & K. Lewis, *Examining the Work of State Courts: An Overview of 2012 State Trial Court Caseloads* (2014); R. Schauffler, R. LaFountain, N. Kauder, & S. Strickland, *Examining the Work of State Courts, 2004: A National Perspective from the Court Statistics Project* (2005). The coarseness of the data comes from the fact that time-series data on state case-loads are not readily available in a reproducible form, so the data had to be read off published charts. The estimates of caseloads obtained (in millions of cases) are consistent with each other and the charts to the nearest significant figure. I also imputed the 2013 value as being equal to the 2012 value, since changes in load are generally stable year to year, and failing to impute a value for this year would have reduced the already small sample size.

Fall 2015]

*Death of Public Purpose*

45

<i>Dependent variable: Count</i>							
	<i>Poisson</i>	<i>Neg. Binomial</i>	<i>OLS</i>	<i>Poisson</i>	<i>Neg. Binomial.</i>	<i>OLS</i>	<i>Poisson</i>
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Year	-0.030** (0.014)	-0.031* (0.018)	-0.256 (0.162)	-0.023 (0.015)	-0.023 (0.015)	-0.062 (0.037)	-0.033* (0.017)
Northeast				-0.551** (0.238)	-0.551** (0.238)	-1.526** (0.578)	
West				-0.403* (0.210)	-0.403* (0.210)	-1.175** (0.538)	
Midwest				-0.275 (0.204)	-0.275 (0.204)	-0.858 (0.545)	
Caseload							0.007 (0.025)
Constant	62.294** (28.878)	64.597* (35.658)	521.884 (325.243)	46.835 (29.579)	46.835 (29.580)	127.279* (74.616)	67.032** (33.483)
Observations	19	19	19	60	60	60	19
Log Likelihood	-51.270	-51.202		-104.467	-105.468		-51.227
Akaike Inf. Crit.	106.540	106.404		218.935	220.935		108.454
<i>Note:</i>				*p<0.1; **p<0.05; ***p<0.01			

Even more important than statistical significance or care in specification is the interpretation that statistical results are given. Even if we do know that public purpose cases are being reported less frequently, we do not know why that is. Although the analysis of the cases and results of the case survey suggest an explanation that is plausible, that the public purpose doctrine is almost always a losing legal strategy, we cannot rule out other explanations for a result that is correlational. Even so, we can still make predictions that are valid under the assumption that the data we would collect in the future will be similar to the data collected in the survey. Under the Poisson Model in I, we would expect on average that there will only be between one and two cases involving public purpose doctrine per year in state appellate courts around the country for the next twenty-five years, and less than one case per year thereafter. The number of cases predicted are similar regardless of the type of model one chooses. Moreover, most of

these cases will not deal with economic incentives, which is the core area the doctrine was evolved to regulate, and where it is arguably most necessary. Given the reasonableness of the assumption that the future will be like the past, there is substantial reason to believe that state courts around the country will not have many more chances to revitalize the public purpose doctrine or encourage plaintiffs to pursue them.

Before turning to the question of how Courts should go about revitalizing the doctrine, it is worth at least speculating about whether state and local governments have changed their behavior in response to the declining force of the public purpose doctrine and the weakening check of state courts. Although a full exploration is clearly beyond the purview of a legal study such as this, one might note that the public indebtedness of state and local governments *has* ballooned over the same period the case study has analyzed. The typical explanation for this fiscal development is increasing pension liabilities due to an aging population, but according to the Federal Reserve public debt has ballooned *even if one excludes pension liabilities*.<sup>236</sup> Experts have noted that the true source of growing public debt is that states and local governments are investing heavily in the improvement of infrastructure and transportation. Yet reports also indicate that American infrastructure is apparently crumbling. How can both phenomena be happening simultaneously? One explanation comes directly from the cases explored in the sample. Indeed, it is clear that many of the economic incentives that local governments have provided to private businesses involve the construction of parking facilities, roads, and other improvements likely to be counted as transportation or infrastructure-related by accountants. While I am not able to make an informed guess at how much spending is happening that is suspect under the public purpose doctrine, the answers seems to be *a lot*. A single company, Cabela's, has been estimated as receiving three-hundred and fifty million dollars in state and local subsidies.<sup>237</sup> Only a single case in the survey involved Cabela's, but we have examples in the case surveys of Walmart, Bass Pro Shop's, and other retailers receiving quite similar aid as the one examined in *All Taxpayers*. The measures at issue in the sixty economic development cases contained in this sample together were altogether worth hundreds of millions of dollars, and one must suspect that these are a small fraction of the private aid initiatives local and state governments have pursued over the same period. Although speculative, given the historically important role public purpose requirements had in constraining local governments, and the size of the aid that we do observe as receiving public purpose review, it is not idle speculation to suspect that the decline of the public purpose doctrine is a significant factor explaining the runaway spending of state and local

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<sup>236</sup> St. Louis Federal Reserve, "State and Local Governments, Excluding Employee Retirement Funds; Credit Market Instruments; Liability, Level" (June 11, 2015, 2:01 PM) <https://research.stlouisfed.org/fred2/series/SLGSDODNS>

<sup>237</sup> Steve Bailey, "Not enough bang for buck", BOSTON GLOBE (Feb. 17, 2006)

governments witnessed in recent decades. If this beneficial institutional technology *is* disappearing, the most pressing question becomes how to revive it.

### Section III: How to Revive It

Earlier in this article, three explanations were proposed for why the public purpose doctrine became an effective constraint on governments in the late 19<sup>th</sup> and early 20<sup>th</sup> century: costly signaling, credible enforcement, and effective monitoring. By enshrining this doctrine in constitutional amendment, governments sent a costly signal of their commitment to spend funds only on certain kinds of matters, that governments made this commitment credible by giving the power to enforce those provisions and block spending to vigorous courts, and that giving debt-holders and concerned citizens the power to sue created a “fire-alarm” which allowed for decentralized monitoring of the government’s actions.<sup>238</sup>

Today, all three mechanisms supporting the doctrine are failing. In most states well over 100 years have passed since the public enshrined these requirements into their constitutions. Courts, perhaps rightly, face doubts about the seriousness of a commitment made so long ago. Indeed the Courts are only nominally enforcing the public purpose requirement, as the case study reveals. Governments around the country are paying attention to what other governments are doing, and when the Courts give silent consent to a type of measure in one location, others take notice. Finally, plaintiffs are understandably uncertain about what it takes to win a public purpose case, which necessarily chills their desire to bring suit and dampens the quality of monitoring. As a result, we have good reason to believe that there may be less than one hundred such cases left to be heard.

What would it take to fix these mechanisms and prevent the doctrine from becoming obsolete? If citizens organized themselves to send a costly signal of renewed commitment, it would no doubt help. Perhaps it is not an accident that Arizona seemed more aggressive about enforcing the public purpose requirement than other states did in the survey, as voters in Arizona rejected an attempt to amend that state’s Gift Clause as recently as 2004.<sup>239</sup> As the discussion of the cases shows, the doctrine would benefit from having more specificity about what ends of government are appropriate and which are not, rather than the current non-exhaustive list that is acknowledged as being subject to change over time. Courts today are concluding that “free public parking” is inherently a public purpose. While it might be more reasonable to suggest that free public parking is a means to some other legitimate public end, such as economic development, Courts

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<sup>238</sup> Mathew D. McCubbins & Thomas Schwartz, *Congressional Oversight Overlooked: Police Patrols versus Fire Alarms*, 28 *POLIT. SCI.* 165–179 (2009).

<sup>239</sup> *Turken v. Gordon*, 220 *Ariz.* 456, 462 (2008).



would have an easier time if citizens enumerated what public purposes should be considered valid. State constitutions are in general much more malleable than the federal constitution,<sup>240</sup> and it is reasonable to imagine that a desirable policy that does not fit with existing approved purposes could drive amendment necessary to make that policy constitutional.

At the same time, the proper aims of government is perhaps not something that will ever be decided, and citizens looking to send a costly signal of their commitment to rein in public officials may seek a more practical proposal. There are roughly speaking six kinds of constitutional amendments around the country that provide a basis for the public purpose doctrine,<sup>241</sup> and most states only have one or two of these. In the past, states have borrowed the language of other states' amendments and enacted them in their own constitution; their doing so could be an effective signal of their renewed commitment to the doctrine. For example, a state that only has a provision forbidding "exclusive emoluments" could also forbid "gifts" to private entities, or forbid the pledging of credit to the support of private individuals without public purpose. Even small changes in the language of the existing amendments could be enough to signal renewed commitment, for example adding different kinds of entities to the list of organizations to which the existing requirements apply. Finally, states could put the repeal of their existing amendment up for vote. If the amendment process fails, it would speak to the ongoing support for the state constitutional principle.

Tempting as it is to wait for citizen action to legitimate the requirement once again, complacency is not legitimate either. Constitutional provisions do not sunset, and it is the obligation of the Courts to vigorously enforce these provisions. For this reason, it makes sense to explore what aspects of the doctrine predispose it toward ineffectiveness. The analysis of *Turken v. Gordan*, *Board of Directors v. All Citizens*, and *Empress Casino v. Giannoulis* cases revealed patterns that explain the doctrine's weakness. First, the principle that "private benefit does not negate the public purpose so long as the public benefit is dominant" forces Courts to engage in a balancing test between the consideration the government gives and the consideration it receives. This balancing test is unlike other balancing tests one finds in federal constitutional law, it is much more like the balancing tests one finds in contract law used to say whether an agreement is a gift or contract. Yet contract law typically inquires into the sufficiency of consideration, and not whether it is good enough to be fair. The public purpose doctrine seems to require an inquiry into the adequacy of

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<sup>240</sup> G. Alan Tarr, ed., *CONSTITUTIONAL POLITICS IN THE STATES* xiv-xv (1996).

<sup>241</sup> See, e.g. Ga. Const. Art. III § 6 ¶ 6 (a "gratuities" clause); Co. Const. Art. 11 § 1 (a "credit" clause); Co. Const. Art. 11 § 2 (an "aid limitation" provision); Ct. Const. Art. 1 § 1 ("exclusive emolument" provision); Mt. Const. Art. 8 § 1 ("tax purposes" clause); Az. Const. Art. 9 § 7. ("gift clause").

consideration, which Courts are not accustomed to doing. Even more troubling, the Courts have understandable difficulty characterizing what is appropriately considered a “benefit” that a government can derive from a contract. In Louisiana, the fact that a private entity brings an increased chance of higher sales tax revenue and economic development count as a benefit that can support the giving of substantial consideration by a government. In Arizona, this increased possibility is not part of the bargained-for performance, so cannot be offered by the private in support of an agreement. In short, as currently understood the public purpose doctrine presents courts with a confusing question of what to put on the scales and how lopsided a balance is problematic, with very few recent examples finding the weight of public benefit so small as to render a policy unconstitutional.

Three solutions to this dilemma seem possible, two that are more closely tied to the common law of public purpose and one that is more innovative, and perhaps more flexible to contemporary needs. The first two options are to pursue the strategies proposed by one or the other Arizona Courts, while the latter is to take a page from agency law and view the public purpose doctrine as requiring government actors to exercise a minimum duty of care in entering into such agreements.

Perhaps the primary advantage of both Arizona approaches is that they are more closely rooted in the current conception of the doctrine. The very things that railroads, canals and other business entities promised in the 19<sup>th</sup> century were the possibility of economic development and better government balance sheets. Such benefits should not count as consideration because the contract does not by its terms obligate the private entity to provide them. Categorical rules that “indirect benefits” or “non-bargained for performance” do not count for the purposes of the public purpose doctrine is simply a reiteration of the basic reason for the public purpose doctrine in the first place. At the same time as these rules are justified by the existing doctrine, more widespread recognition of the rule would do much to make Courts’ decisions easier. Rather than having to decide on the aims of government in a particular case, Courts can simply look at what the private entity has promised to do. Instead of making the analysis philosophical and wide-ranging, calling upon Courts to answer timeless questions of government as they consider every possible justification the government lawyers can possibly advance, the analysis becomes specific and practical. What has the private individual actually provided under the contract? In *Empress Casino*, the private entities are required to improve their race tracks, which is not in itself a very plausible public benefit. In *All Citizens of Gonzales*, the private entity is building a store for the government and running it for itself, neither of which is a very plausible public benefit. By focusing on what the private entities are actually promising to do, public purposes cases become easier to adjudicate, and also easier for Courts to adjudicate in favor of plaintiffs.

The problem with both Arizona approaches is that although they address the problem in some cases, they do little more than shift the problem around in others. Consider *Turken v. Gordon*, which is not actually an easy case even under the Arizona law. The private entity in that case is literally providing use of parking spaces to the government. Although under both Arizona approaches a Court no longer has to consider the sales tax or economic development benefit, in the Court of Appeals view the Court does nonetheless need to decide whether parking spaces are a direct or an indirect benefit. In the Arizona Supreme Court's approach, one needs to make a determination as to what parts of the agreement are bargained for consideration. It is hard to see the analytical basis for line drawing in either case. The Circuit Court decided, for example, that parking for those who will most likely be shoppers is not a direct benefit, but parking for those who are commuters is. While it might make sense that commuters are different than shoppers since commuters will necessarily use a government service, public transportation, it is also true that shoppers will necessarily contribute to government revenues, since all their purchases result in the collection of sales tax. There does not seem to be much reason why using the bus helps the government any more than paying sales tax does. Even if one focuses purely on the goods that the private entity provides, it will often prove challenging for Courts to see whether that good is really a direct benefit or not, or really a bargained for benefit or not.

Moreover, a Court may reasonably worry that the proposed rule is too stringent. Although none of the measures in the cases mentioned here appear to be particularly good policy, it is nonetheless possible to imagine that there are good policies involving "gifts" to private individuals that provide little to no direct benefit in return. Consider, for example, the measure at issue in *State ex rel. West Virginia Citizens Action Group v. West Virginia Economic Development Grant Committee*. In that case, the proposed policy was the creation of a Grant Committee that would consider business ideas and other projects submitted by citizens. The Committee would award funds to those projects that showed the most promise according to a predefined set of criteria. The funding awards from the committee were to be financed by revenue bonds paid out of excess lottery revenues. Although there were serious defects in the appointment mechanism for the Grant Committee, the point is that governments do occasionally experiment with research, development, and arts programs, none of which necessarily guarantee any direct return to the government. The Arizona rule threatens such policy innovations, perhaps to the public detriment.

This article presents the view that Courts should approach the basic questions in these cases somewhat differently. When a Court assesses the adequacy of consideration, or whether the public benefit or private benefit dominated in any particular transaction, the real question being asked is whether the agreement was fair. The current approach to that question involves a direct examination of the agreement. An alternative approach is

to assess the adequacy of representation that the parties had in entering into the agreement. Did the agent do their duty by the principal in entering the agreement that they did? If the agent was loyal, obedient, and careful, then the principal has no right to complain if the agreement proves a bad one. Instead of evaluating the substance of the agreement reached and deciding whether it was good or not, one evaluates the behavior of those as they entered into it. The intent of the public purpose doctrine was to regulate the behavior of government officials. By focusing on the behavior of government officials directly, through the basic principles of agency law, the Courts achieve that goal more directly. Moreover, the agency law approach may also find a basis in the existing judicial language, since Courts applying the doctrine have since time immemorial phrased the doctrine as being about whether the government has clearly “abused its discretion.” This language already suggests that the government is bound by the duty of agents when it forms contracts with the private sector.

What does the law require of agents? Obedience, loyalty, and care.<sup>242</sup> Neither the duty of obedience or loyalty is typically implicated in public purpose cases, since the citizenry rarely gives specific commands to a public body to enter into an agreement, and breaches of loyalty by public officials involve corruption already covered by other areas of law. Rather, the more typical problem in public purpose cases is whether the government has acted with sufficient care in entering into the agreement. The 3<sup>rd</sup> Restatement of Agency already provides a good generic description of an agent’s duty of care:

[A]n agent has a duty to the principal to act with the care, competence, and diligence normally exercised by agents in similar circumstances.

This language is readily adapted to situations where a government entity is making policy that potentially violates the public purpose doctrine. The question for the Court is whether the government entity acted according to the appropriate standard of care for governments taking similar actions. Rather than answer hard questions about the aims of government, Courts can simply ask the parties to a lawsuit what concrete measures were taken to make sure that the deal was genuinely in the public’s interest, and what measures were taken in comparable cases by other similar government entities. The point is not to allow parties to point to bad practices elsewhere as excuses for behavior, but rather to allow Courts to assess what best practices are elsewhere and how far the process deviated in the case before them from that goal. Assuming that the government entity in a particular case acted as a reasonably prudent entity would, the public purpose requirement is satisfied.

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<sup>242</sup> William T. Allen, Reinier Kraakman, and Guhan Subramanian, CASES AND COMMENTARIES ON THE LAW OF BUSINESS ORGANIZATIONS 26-7 (4<sup>th</sup> ed. 2012).

Almost none of the cases in the survey consider the quality of the process that leads up to the decision. Yet one often has the sense in reading these opinions that the plaintiffs only sued because of serious deficiencies in the process. If Courts adopt this approach, it is reasonable to expect that they will become more adept at sorting through good indicia and bad indicia in these cases, similar to the way that the corporate law has evolved to understand what indicia in a fundamental transaction are good or bad. Having said that, it behooves an account such as this to give a few suggestions about where to start. To do so, I shall draw upon the voluminous literature that has analyzed the characteristics separating successful and unsuccessful public private partnerships.<sup>243</sup> A summary of the indicia that an opinion could consider are presented in Table II. Below, I organize the consideration of these indicia around a series of proposed questions, which can help guide the inquiry into whether the behavior of the government was sufficiently careful.

Positive Indicia	Negative Indicia
<b>Transparent Process</b>	<b>Poor Transparency</b>
<b>Competitive Bids</b>	<b>Lack of competition</b>
<b>Technical Capability of Private and Public Entities</b>	<b>Difference in interests and expectations</b>
<b>Appropriate Risk Sharing and Management</b>	<b>Inappropriate feasibility study</b>
<b>Strong Market Needs</b>	<b>Complex decision-making</b>
<b>Favorable Economic Conditions</b>	<b>Poorly defined government objectives</b>
<b>Collaboration among stakeholders</b>	<b>Poor risk sharing and management</b>
<b>Public Acceptance</b>	

Table II.<sup>244</sup>

The first question a Court might ask is how the private party was selected to receive the government aid. Generally speaking, the award process will be the result of competitive bidding or direct negotiation.<sup>245</sup> Competitive bidding is usually characterized by public notification of the intent to make an award, distribution of memoranda and draft contracts to interested parties, a formal screening mechanism to reduce the list of

<sup>243</sup> OECD, Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money, 13, 16-18 (2008) (distinguishing public private partnerships to concessions, privatization, and public procurement, but noting that lessons learned from each field are similar)

<sup>244</sup> This list of factors is adapted from Table II in Patrick X.W. Zou, Shouqing Wang, and Dongping Fang, A Life-cycle Risk Management Framework for PPP Infrastructure Projects, J. FIN. MANAGEMENT OF PROPERTY & CONST'N (Aug. 2008) (defining public private partnerships).

<sup>245</sup> Michel Kerf et al., Concessions for Infrastructure: A guide to their design and award, 107 (World Bank Technical Paper No. 399, 1998).

bidders to those that are actually qualified to provide the service in question, and a public process for the presentation, evaluation, and selection of the awardee. By contrast, direct negotiations often begin with the private sector approaching the government entity about a project, with terms and conditions for performance discussed only between the private and government parties.<sup>246</sup>

Competitive bidding provides the greatest guarantee that the government has exercised due care in authorizing an expenditure.<sup>247</sup> The competitive process requires substantial preparation before the award is made.<sup>248</sup> The transparency of competitive bidding process discourages favoritism.<sup>249</sup> The bidding process itself results in an approximation of the free market, implying that the value of the service provided by the private party is close to the true costs plus fair pair.<sup>250</sup>

Direct negotiations require caution on the part of the government, and generally are only justified in exceptional cases.<sup>251</sup> It is reasonable for a government to directly negotiate with a private entity, for example, where competitive bidding would be too costly to organize, or if the project involves technology that makes it unlikely more than one private entity would be qualified to bid. The government ideally would have specific evidence, for example based on consultation with experts or findings of an independent committee, supporting its decision to use direct negotiations instead of competitive bidding. The government should establish that they used reasonable methods to find a fair valuation of the assets they were giving and receiving, including the hiring of disinterested advisors and consultants. The inquiry should consider how advisors are compensated, to ensure that it is not in the direct financial interest of the experts to reach one outcome or another.

Occasionally the award process may involve features of both competition and direct negotiation. For example, the government could ask for project proposals on a competitive basis, and then select one or two private entities to actually negotiate with.<sup>252</sup> When “competitive negotiations” seem to introduce genuine pressure on the private sector to lower costs or give terms more favorable to the government, then the Courts should treat the process in a light more similar to true competitive bidding. If the project idea comes from one private sector entity and the government eventually chooses a competing entity, concerns about the integrity of the process are clearly less than they would be if the entity that proposes the

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<sup>246</sup> Id. at 109

<sup>247</sup> OECD, Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money, 13, 57 (2008).

<sup>248</sup> Kerf, *supra* note 239.

<sup>249</sup> Kerf, *supra* note 239.

<sup>250</sup> Kerf, *supra* note 239.

<sup>251</sup> Kerf, *supra* note 239.

<sup>252</sup> Kerf, *supra* note 239.

idea is also the one selected. Courts should be wary of governments seeking proposals that only one entity could possibly be qualified to fill.

Another important set of questions concern how the government decided on this particular expenditure and not some other.<sup>253</sup> The analysis here looks to the severity of the civic need, the presence of private sector coercion, which alternatives were considered and how intensively they were explored, and how much study and effort went into investigating the risks and benefits of what was chosen. Phoenix and Gonzales were both challenged for measures involving dubious civic needs, which were committed to with relatively little public discussion, and without any real indication that alternatives were considered. In contrast to Phoenix and Gonzales, one can consider how the city of Rialto, California approached the challenge posed by its contaminated water system.<sup>254</sup> Rialto first made substantial investigation into whether refinancing would allow it to make the investments necessary to fix the system. When it was determined that it could not undertake these expenses, the City decided to privatize its water utility. The City spent two-years developing criteria for the selection of the firm, after ongoing meetings with community stakeholders. Already on these facts, it is clear that the Rialto government did a more careful job than Phoenix or Gonzales did, although their care was not so extraordinary as to be beyond that which one can reasonably of a government entity. Although not relevant to the agency analysis, it is nonetheless worthwhile to note that the substantive outcome reached by Rialto also looks better from a public benefit standpoint than either of the former agreements. In exchange for the city giving to private entities its the right to operate the water utility, the private entities agreed to pay the city \$30 million dollars, which helped the debt-written city's finances, and also promised to make over \$42 million in improvements to the city's water system. Although presumably rates to consumers increased following the agreement, they were capped according to formula. In short, when a city uses a more careful process, the substantive result will usually be fairer to the public.

Another important question the Court should consider is what, if any, steps the government took to determine the value of the consideration they were giving and that which they were receiving.<sup>255</sup> Demonstrating that an agreement is likely to prove favorable to a government requires significant effort at evaluation and revenue projection.<sup>256</sup> Government entities often do not have the in-house expertise to value assets, make revenue projections

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<sup>253</sup> European Commission, Guidelines for Successful Public-Private Partnerships 6 (March 2003).

<sup>254</sup> OECD, Public-Private Partnerships: In Pursuit of Risk Sharing and Value for Money, 42 (detailing the kind of analysis expected of governments in other countries for similar projects). See Patrick Sabol & Robert Puentes, Private Capital, Public Good, BROOKINGS METROPOLITAN INFRASTRUCTURE INITIATIVE 14-15 (Dec. 2014).

<sup>255</sup> *Id.* (noting that over-optimistic projects are the frequent cause of project failure).

<sup>256</sup> See OECD, *supra* note 254, at 42 (describing some kinds of projections that might establish an agreement is favorable).

many years into the future, or assess the legal and economic risks of these projects.<sup>257</sup> Even those with such expertise would do well, particular in large transactions, to seek out independent consultants. Courts should not only evaluate whether consultants were retained and if they were genuinely experts, but also what sort of work-product was produced and how that product was used in decision making.

One final matter the Court should consider is what efforts were made to seek out interested stakeholders in the communities. Failure to understand the public's likely reaction is a frequent shortcoming in government-sponsored projects, and one that otherwise well-thought out proposals.<sup>258</sup> The timeline for the project selection should be revealed as early as possible, and thorough documentation of what the government is doing should be made easily available, for example on a website.<sup>259</sup> By seeking out local business organizations, civic advocacy groups, hospitals, churches, private colleges or universities, unions, and other parties in the community, governments can better understand the needs of their community, and how that proposal will be received.<sup>260</sup> Such groups may be incorporated into the decision-making process by holding public meetings where they are invited to express their view, or by giving such groups seats on an independent committee that can veto the measure.<sup>261</sup> Submitting the proposed measure to approval by the voters is good evidence that the government has sought out the input of relevant stakeholders, although Courts must be sensitive to the fact that the authorization of certain kinds of measures is not the same as authorizing a particular implementation. In *All Taxpayers*, for example, the voters only authorized the addition of economic development to the list of valid uses for TIF funds, which is a far-cry from approving the particular contract that the city ultimately signed. As the distance between the language of the referenda citizens vote on and the measure implemented increases, so too does the decision to submit the measure to the voters becomes less probative of the government exercising proper care.

The agency-based approach has several advantages. First, by replacing questions about substance with questions about process, it makes the results of a judicial opinion easier to reach and more predictable given a specific fact-pattern. Relatedly, the agency-based approach allows Courts to define more specific, interpretable standards than those prescribed by messy balancing tests. Additionally, the factual determination the agency approach requires is much less burdensome on Courts than the contract law approach. Under the Arizona Supreme Court rule, a superior court would have to

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<sup>257</sup> Sabol & Puentes, *supra* note 254, at 20. OECD, *supra* note 254, at 43.

<sup>258</sup> Lawrence J.M. Haas, Leonardo Mazzei, and Donal O'Leary, Setting Standards for Communication and Governance 15 (World Bank Working Paper No. 121, 2007). *See also*, Zou, Wang, & Fang, *supra* note **Error! Bookmark not defined.**, at 128, 130.

<sup>259</sup> Sabol & Puentes, *supra* note 254, at 21.

<sup>260</sup> *Id.*

<sup>261</sup> *Id.*



make a complex determination about the value of assets being traded under an agreement. By contrast, the agency approach will usually not require the Court to go very deeply into the asset evaluation approach. If the government hired an independent expert, the plaintiff would need to have good reasons establishing that the experts' independence as questionable before reaching questions about what the true valuation was. Finally, the agency-based approach allows for governments to have a clearer idea of what they need to do in order to navigate the risk of a public purpose challenge. As the law stands today, plaintiffs with colorable challenges do not actually need to win in Court in order to receive their desired outcome. For example, although the challengers in *Turken v. Gordon* did not succeed in having Phoenix and CityNorth's agreement validated, the legal uncertainty nonetheless caused the failure of the project. A rule that makes it easier for governments to protect themselves from suit is to their benefit, and a rule that makes resolution of a challenge quicker in the end decreases legal risk and prevents the chilling of valuable projects. Finally, the development of the agency law approach is already justified by the existing language of the opinions, since it in a sense is simply an elaboration of what it means for a government to have "abused its discretion" in a public purpose case.

### Conclusion

This article has explored how the public purpose doctrine came into being as a powerful, constitutional constraint on the decision-making of state and local government entities. It has established that the doctrine is no longer an effective constraint on government, both using the quantitative case-study approach and a qualitative analysis of several representative cases. Using a Poisson-regression model, it establishes to a social scientific certainty that the doctrine is vanishing. One should expect no more than 1-2 cases per year for the next 50 years. Most of these cases will not concern inappropriate aid to private firms, the core area the doctrine was designed to regulate. The facts that the doctrine has proved valuable, but has also become toothless and is vanishing, together legitimizes substantial reform of the doctrine. This article has proposed that Courts follow the more rigid contract-based analysis proposed by the Arizona state courts, and has also developed an agency-law based approach that it holds is preferable. Rather than getting tangled in thorny questions about the ends of government and the unusual question of whether consideration is adequate, the agency law approach proscribes that governments entering extraordinary agreements with private parties take the same precautions normally prudent governments do take in entering such agreements. Some of the indicia to consider include what alternatives to the transaction were considered, whether there was a competitive process for choosing the selected private counter-party, how the government decided the value of the assets it was

Fall 2015]

*Death of Public Purpose*

57

giving and receiving, and whether the ultimate decision was made by a disinterested group of relevant stakeholders.