STATE OF ARIZONA

OFFICE OF THE ATTORNEY GENERAL

ATTORNEY GENERAL OPINION By MARK BRNOVICH ATTORNEY GENERAL March 24, 2016	No. I16-003 (R15-022) Re: Application of A.R.S § 38-511 to gratuitous grant by deed of a conservation easement

To: Steve B. Montenegro
Arizona House of Representatives

Questions Presented

Does Arizona's conflict of interest statute in Arizona Revised Statute ("A.R.S.") § 38-511, apply to a private landowner's gratuitous grant by deed of a conservation easement to the State, its political subdivisions or any department or agency of either (collectively, the "State")?

Summary Answer

Arizona Revised Statute § 38-511 does not apply to a private landowner's gratuitous donation of a conservation easement—which does not impose affirmative obligations on the State or require any consideration in exchange for the donation—because such a donation does not qualify as a "contract" within the meaning of A.R.S. § 38-511.

Background

Arizona's conflict of interest statutes, A.R.S. §§ 38-501 to -511, set forth those matters presenting conflicts of interest for public officers and employees. Ariz. Att'y Gen. Op. I98-025. Under A.R.S. § 38-511(A) (the "Cancellation Provision"), the State is permitted to cancel "any contract" within three years of its execution provided certain conditions are met:

> The state, its political subdivisions or any department or agency of either may, within three years after its execution, cancel any contract, without penalty or further obligation, made by the state, its political subdivisions, or any of the departments or agencies of either if any person significantly involved in initiating, negotiating, securing, drafting or creating the contract on behalf of the state, its political subdivisions or any of the departments or agencies of either is, at any time while the contract or any extension of the contract is in effect, an employee or agent of any other party to the contract in any capacity or a consultant to any other party of the contract with respect to the subject matter of the contract.

Arizona's statutes permitting and regulating conservation easements are set forth in A.R.S. §§ 33-271 to -276, which are modeled after the Uniform Conservation Easement Act. Under these statutes, a "conservation easement" is defined as "a nonpossessory interest of a holder in real property imposing limitations or affirmative obligations for conservation purposes or to preserve the historical, architectural, archaeological or cultural aspects of real property." A.R.S. § 33-271(1). This Opinion only concerns conservation easements which are gratuitous. As presented in the request for this Opinion, the conservation easements at issue do not impose any affirmative obligations on the State or require any consideration from the State in exchange for the grant of the conservation easement.

Underlying the question presented is a tax issue. The donation of a conservation easement that meets all statutory and regulatory requirements may be claimed as a federal

charitable contribution deduction. *E.g.*, 26 U.S.C. § 170(h). To qualify for this deduction, a conservation easement must (among other things) include "a restriction (granted in perpetuity) on the use which may be made of the real property." *Id.* § 170(h)(2)(C); 26 C.F.R. § 1.170A-14(b)(2).

As recounted in the request for this Opinion, the Internal Revenue Service has taken the position that the State's ability to cancel any contract made by the State within three years of execution applies to all conservation easements. The easement grants are therefore "conditional and not perpetual," and are disqualified from eligibility for a federal income tax deduction. This Opinion does not address the applicability of the federal charitable contribution deduction to conservation easements to the State. Rather, this Opinion analyzes the narrow issue of whether a *gratuitous* deed of a conservation easement to the State may be subject to the Cancellation Provision.

Analysis

No Arizona court has determined whether the Cancellation Provision in A.R.S. § 38-511(A) applies to a gratuitous deed of a conservation easement to the State. "Our task in interpreting the meaning of a statute is to fulfill the intent of the legislature that wrote it." *State v. Williams*, 175 Ariz. 98, 100 (1993). "In determining the legislature's intent, we initially look to the language of the statute itself." *Bilke v. State*, 206 Ariz. 462, 464, ¶ 11 (2003). If the statute's language is clear, we apply it "unless application of the plain meaning would lead to impossible or absurd results." *Id.* The threshold question concerning the applicability of the Cancellation Provision to a gratuitous deed of a conservative easement to the State is whether such a grant qualifies as a "contract" within the meaning of the statute. If such a donation is not a "contract," then the Cancellation Provision has no applicability.

The Arizona Supreme Court, adopting the approach taken in the Restatement (Second) of Contracts, has defined a contract as "a bargain in which there is a manifestation of mutual assent to the exchange and a consideration." *Johnson v. Earnhardt's Gilbert Dodge, Inc.*, 212 Ariz. 381, 384, ¶ 10 (2006) (quoting Restatement (Second) of Contracts § 17(1) (1981)). "The term 'consideration' has a settled meaning in contract law. It is a performance or return promise that is bargained for in exchange for the promise of the other party." *Turken v. Gordon*, 223 Ariz. 342, 349, ¶ 31 (2010) (citing Restatement (Second) of Contracts § 71) (internal quotations and alterations omitted). "In other words, consideration is what one party to a contract obligates itself to do (or to forbear from doing) in return for the promise of the other contracting party." *Id.*

Here, the gratuitous deed of a conservation easement, which does not impose any affirmative obligations on the State or require any consideration from the State in exchange for the grant of the conservation easement, is not a "contract" within the meaning of the Cancellation Provision. Such a donation is not a contract because, as the issue has been presented, it lacks one of the two requisites for the formation of a contract, namely, consideration. *See Schade v. Diethrich*, 158 Ariz. 1, 8 (1988) (stating that the two requisites for the making of a contract are "a bargain, consisting of promises exchanged, and consideration").

In concluding that gratuitous conservation easements are not a "contract" subject to the Cancellation Provision, this Opinion notes that a deed may be considered contractual in other contexts, for example, when determining whether an action "arises out of contract" for purposes of awarding attorneys' fees, *see Pinetop Lakes Ass'n v. Hatch*, 135 Ariz. 196, 198 (App. 1983) (an action to enforce mutual restrictive covenant in a deed "arises out of contract" pursuant to A.R.S. § 12–341.01), or considering whether parole evidence is admissible, *Valento v. Valento*,

225 Ariz. 477, 483, ¶ 22 (App. 2010) ("a deed may be treated as a contractual agreement" for purposes of the parole evidence rule). This Opinion also does not affect the long standing rule in Arizona that the lack of consideration does not, by itself, render a deed inoperative. *See In re McDonnell's Estate*, 65 Ariz. 248, 251 (1947) ("[W]e hold that want of consideration by itself is not enough to make [a deed] inoperative."). Rather, it addresses the narrow issue presented by the request and concludes that a gratuitous deed of a conservation easement is not a contract subject to cancellation under A.R.S. § 38-511(A).

This interpretation—that the Cancellation Provision does not apply to a gratuitous deed of a conservation easement—is consistent with the purpose of Arizona's conservation easement statutes. As set forth in its prefatory notes, the Uniform Conservation Easement Act (the "Uniform Act") "maximizes the freedom of the creators of the transaction to impose restrictions on the use of land and improvements in order to protect them, and it allows a similar latitude to impose affirmative duties for the same purposes." [1] Uniform Act, Refs & Annos. In furtherance of this objective, the Uniform Act enables "the structuring of transactions so as to achieve tax benefits which may be available under the Internal Revenue Code." *Id.* Accordingly, Arizona's conservation easement statutes expressly provide (consistent with the Uniform Act) that "a conservation easement is ***unlimited in duration*** unless the instrument creating it otherwise provides." A.R.S. § 33-272(C) (emphasis added). This language was specifically included, not only to provide parties latitude consistent with the preservation purposes of the Uniform Act, but also to enable parties "to fit within federal tax law requirements that the interest be 'in perpetuity' if certain tax benefits are to be derived." Uniform Act § 2, cmt.

[1] When "a statute is based on a uniform act, we assume that the legislature intended to adopt the construction placed on the act by its drafters, and commentary to such a uniform act is highly persuasive." *May v. Ellis*, 208 Ariz. 229, 232 ¶ 12 (2004) (internal quotations and alterations deleted).

But, if every conservation easement, even if gratuitously granted, is considered a "contract" subject to cancellation under A.R.S. § 38-511(A), then no conservation easement deeded to the State (including its political subdivisions or any department or agency of either) would ever qualify for tax deductions under the requirements of federal tax law as interpreted by the Internal Revenue Service. Such an outcome would thwart an express objective of the Uniform Act to enable parties "to fit within federal tax law requirements," potentially chilling important donations of conservation easements for the public good.

Conclusion

Arizona Revised Statue § 38-511 does not apply to a private landowner's gratuitous donation of a conservation easement—which does not impose affirmative obligations on the State or require any consideration in exchange for the donation—because such a donation does not qualify as a "contract" within the meaning of A.R.S. § 38-511.

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