R15-022

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DISTRICT 13

Arizona House of Representatives
Phoenix, Arizona 85007

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JOINT COMMITTEE ON CAPITAL REVIEW

October 8, 2015

Mark Brnovich
ARIZONA ATTORNEY GENERAL
1275 W. Washington
Phoenix, Arizona 85007
Attention: Michael Bailey

RECEIVED
OCT 13 2015
ATTORNEY GENERAL
EXECUTIVE OFFICE

Re: Request for Attorney General Opinion

Dear Mr. Brnovich:

Pursuant to A.R.S. § 41-193(7), in my capacity as State Representative for Legislative District 13, I write to request a formal opinion from the Attorney General on the following question:

QUESTION PRESENTED

Does Arizona's conflict of interest 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?

STATUTE AT ISSUE

A.R.S. § 38-511. Cancellation of political subdivision and state contracts; definition.

A. 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.

B. Leases of state trust land for terms longer than ten years cancelled under this section shall respect those rights given to mortgagees of the lessee by section 37-289 and other lawful provisions of the lease.

C. The cancellation under this section by the state or its political subdivisions shall be effective when written notice from the governor or the chief executive officer or governing body of the political subdivision is received by all other parties to the contract unless the notice specifies a later time.

D. The cancellation under this section by any department or agency of the state or its political subdivisions shall be effective when written notice from such party is received by all other parties to the contract unless the notice specifies a later time.

E. In addition to the right to cancel a contract as provided in subsection A of this section, the state, its political subdivisions or any department or agency of either may recoup any fee or commission paid or due to any person significantly involved in initiating, negotiating, securing, drafting or creating the contract on behalf of the state, its political subdivisions or any department or agency of either from any other party to the contract arising as the result of the contract.

F. Notice of this section shall be included in every contract to which the state, its political subdivisions, or any of the departments or agencies of either is a party.

G. For purposes of this section, "political subdivisions" do not include entities formed or operating under title 48, chapter 11, 12, 13, 17, 18, 19 or 22.

FACTUAL OVERVIEW

As you may know, a conservation easement is an interest in specified real property that a private landowner voluntarily grants to and is vested in a qualified non-profit organization or governmental (municipal, county, state or federal) entity and that restricts the private landowner's rights to the property in order to protect resources such as productive agricultural land, ground and surface water, wildlife habitat, historic sites or scenic views. The ability of governmental entities to receive donations of conservation easements is a critical factor in the government's ability to preserve open space and promote conservation interests. According to the National Conservation Easement Database, in Arizona alone, governmental entities at the local, state and federal levels hold nearly 52,000 acres of conservation easement property. Across the United States, qualified non-profit organizations and governmental entities hold over 23 million acres of conservation easement land.

While conservation easements can be sold, it is my understanding that these real property interests are most often gratuitously granted by a private landowner through a donative instrument known as a conservation easement deed. For instance, in my legislative district, certain real estate developers have on several occasions consciously planned and developed communities to offer substantial preserved open space dedicated for the scenic enjoyment of the general public, for educational purposes, and for the protection and preservation of natural

habitat for the wildlife and vegetation indigenous to the area. These landowners' donations of conservation easements to the City of Buckeye ("Buckeye") were granted by gratuitous deeds through which Buckeye received an immediately vested interest in specific real property dedicated in perpetuity for conservation purposes without providing the landowner any consideration in return. These donations therefore allow governmental entities to provide a significant benefit to the public at essentially no cost to the government.

Although the landowner receives no consideration from the governmental entity in exchange for its donation of the conservation easement, the landowner is entitled to receive a federal income tax deduction based on its charitable contribution. The Internal Revenue Code provides that a qualified conservation contribution must transfer to the donee a "qualified real property interest." Code § 170(h)(1)(A). One type of qualified real property interest is a conservation easement, which requires a restriction, granted and enforceable in perpetuity, on the use that can be made of real property. Code §§ 170(h)(2)(C), 170(h)(5)(A); Treasury Regulation §§ 1.170A-14(b)(2), 1.170A-14(g)(1).

It is my understanding that the Internal Revenue Service has taken the position that Arizona's conflict of interest statute, A.R.S. § 38-511, applies in the conservation easement donation setting. Specifically, the IRS's seems to have the opinion that A.R.S. § 38-511 applies to a donative deed through which a taxpayer granted Buckeye a conservation easement. I understand the IRS's position is that Buckeye's ability to cancel the transaction within three years of its execution pursuant to the statute (even though this did not occur) renders the taxpayer's grant conditional and not perpetual and therefore disqualifies the donation from eligibility for a federal income tax deduction. If that position were correct, no conservation easement to a political subdivision of the State could result in a federal income tax deduction for the donor. That outcome would have a chilling effect on these important donations of conservation lands for the public good.

LEGAL OVERVIEW

A.R.S. § 38-511 permits the State as well as its political subdivisions, departments, and agencies to cancel "any contract" within three years of its execution where a conflict of interest exists (i.e., where any person involved in negotiating the contract on behalf of the State becomes an employee or agent of the other party to the contract). A.R.S. § 38-511(A) (emphasis added). According to the IRS, conservation easement deeds must be effective in perpetuity for the donor to receive a federal income tax deduction for its charitable contribution. A.R.S. § 38-511, if applicable, would theoretically allow a conservation easement to be terminated during the applicable three-year period if a conflict of interest arose, thereby depriving the conservation easement of the required perpetuity. However, neither the statute nor Arizona case law define the term "contract" as it is used in A.R.S. § 38-511. Statutory construction is therefore necessary to determine whether a gratuitous deed creating a conservation easement must be considered a "contract" within the scope of A.R.S. § 38-511 and may be subject to cancellation.

The primary goal in interpreting a statute is to determine and give effect to the legislature's intent. See Morgan v. Carillon Invs. Inc., 207 Ariz. 547, 549, 88 P.3d 1159, 1161 (App. 2004); see also A.R.S. § 1-211(B) ("Statutes shall be liberally construed to effect their objects and to

promote justice."). Where statutory language is ambiguous, traditional rules of statutory construction require consideration of "the statute's context, its spirit and purpose, its historical background, its effects and consequences, its language, and its subject matter." Homebuilders Ass'n of Central Ariz. v. City of Scottsdale, 186 Ariz. 642, 648–49, 925 P.2d 1359, 1365–66 (App. 1996).

In the context of gratuitous grants of conservation easement deeds, the language of A.R.S. § 38-511(A) is ambiguous because courts do not uniformly classify deeds as "contracts." And, as detailed below, the legislative history of A.R.S. § 38-511 suggests that the statute was not intended to apply to non-competitive transactions in which the governmental entity involved does not incur affirmative obligations. Further, Arizona law supports the conclusion that a donative instrument such as a deed gratuitously granting a governmental entity an interest in real property for conservation purposes cannot be deemed a "contract" where the deed does not impose affirmative obligations on the governmental entity or require any consideration in exchange for the donation.

A.R.S. § 38-511's Legislative History Suggests that the Statute was not Intended to Apply to Deeds Gratuitously Granting a Real Property Interest to a Governmental Entity

A.R.S. § 38-511 was enacted as a part of Arizona's conflict of interest rules regulating government employees. H.R. Comm. on Commerce, Statement of R. Corpstein (Minutes Feb. 6, 1978) (explaining that H.B. 2185—now A.R.S. § 38-511—would supplement current conflict of interest laws). The primary purpose of the law was to give the government a means of avoiding contracts tainted by conflicts of interest and employee kickbacks. S. Comm. on Gov't, 33d Leg., Statement of S. Lindeman (Minutes May 10, 1978) (explaining that passage of H.B. 2185—now A.R.S. 38-511—would "protect the state against a person dealing in a contract for their own personal benefit and then going to work for the company that got the contract"); H.R. Comm. on Pub. Inst., 38th Leg., 2d Reg. Sess., Statement of Attorney Robert Lynch (Minutes May 10, 1988) (explaining his work with sponsor of bill amending A.R.S. § 38-511 to permit state to recoup commission in event of conflict and recognizing that the purpose of the amendment is to clarify "the remedies available" where a conflict of interest is involved).

While the legislative history of A.R.S. § 38-511 does not specifically discuss the definition of "contract" as the term is used in the statute, the legislative history does provide several examples of the type of situation the statute was intended to remedy. In 1988, A.R.S. § 38-511 was amended to give political subdivisions the power to cancel a contract under the statute's provisions. Fact Sheet, S.B. 1067, 38th Leg., 2d Reg. Sess. (Ariz. 1988). When discussing the bill, several committees commented on recent events that prompted the amendment and the need to extend the statute to include political subdivisions. S. Comm. on Gov't, 38th Leg., 2d Reg. Sess. (Minutes Feb. 10, 1988); H.R. Comm. on Pub. Inst., 38th Leg., 2d Reg. Sess. (Minutes May 10, 1988). For example, the Senate Committee on Government explained that the bill amending A.R.S. § 38-511, would "apply to political subdivision contracts where an employee receives 'kickbacks.'" S. Comm. on Gov't, 38th Leg., 2d Reg. Sess. (Minutes Feb. 10, 1988); see also H.R. Comm. on Pub. Inst., 38th Leg., 2d Reg. Sess. (Minutes May 10, 1988).

Further, A.R.S. § 38-511(C) and (D) explicitly provide that a cancellation made pursuant to the provision is effective when written notice of cancellation is given by the appropriate governmental official, body, or agency to all other parties to the contract unless the notice specifies a later time. However, a donee cannot "cancel" a properly recorded deed of conservation easement upon written notice to the donor. Rather, pursuant to A.R.S. § 33-272(B), a conservation easement deed must be amended and properly recorded before any desired changes can take effect, which further illustrates that the legislature did not contemplate the application of A.R.S. § 38-511 to such deeds when it adopted the statute. Instead, this language indicates that the legislature intended for the provision to apply only to contracts the legal effect of which can be terminated by one party upon proper notice to the other.

While the statutory language broadly provides that the State or its political subdivisions, departments, or agencies can cancel "any contract," the legislative history of A.R.S. § 38-511 indicates that it was enacted specifically to target situations in which government employees or consultants could promote their own financial gain at the expense of the state. Indeed, the legislative history specifically demonstrates that the statute is directed at instances involving competitive bidding for a specific government contract where government employees might accept kickbacks or promises of future employment in exchange for tipping the scales in favor of one bidder over another or might otherwise deal for financial gain on both sides of the transaction.

Based on its legislative history, it is clear that A.R.S § 38-511 was intended to deter government employees from seeking to personally benefit from the competitive bid process for government contracts. This concern is not applicable in the conservation easement setting where a landowner receives no consideration from a governmental entity in exchange for its donation. Therefore, A.R.S. § 38-511 should not be interpreted to apply to donative deeds granting a governmental entity a conservation easement over specified real property that require the donor to retain all associated costs of the property and thereby grant the governmental entity rights free of affirmative obligations and costs.

A Gratuitous Deed Granting a Conservation Easement is a Restricted Gift not Supported by Consideration and is not a "Contract" Under Arizona Law

A valid contract requires mutual assent supported by valuable consideration. Alexander v. O'Neil, 77 Ariz. 91, 97, 267 P.2d 730, 734 (1954) ("The fundamental requisites of such a contract are an offer, an acceptance, a meeting of the minds, and a quid pro quo."). "Mutuality of obligation is indeed an essential element of every enforceable agreement and is absent when only one of the contracting parties is bound to perform." Nickerson v. Green Valley Recreation, Inc., 228 Ariz. 309, 321, 265 P.3d 1108, 1120 (App. 2011) (rejecting petitioners' argument that no mutuality of obligation existed and finding enforceable contract where respondent was obligated under instrument to perform for the benefit of its members); see also Carroll v. Lee, 148 Ariz. 10, 13, 712 P.2d 923, 926 (1986) (recognizing that mutuality of obligation was a requirement for contract formation and finding promises to exchange monetary support for household services was sufficient to support finding of contract even though promises exchanged were not necessarily of like kind). Because gifts are supported by donative intent rather than bargained-for consideration and generally do not impose mutual obligations, donative

instruments typically do not create enforceable contracts. See Alexander, 77 Ariz. at 97, 267 P.2d at 734 (finding evidence insufficient to support finding of enforceable contract where facts were equally consistent with finding of reciprocal gifts).

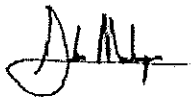
My understanding is that the deeds through which landowners in my legislative district have donated conservation easements to Buckeye do not impose affirmative obligations on Buckeye, but instead simply list specific intended uses for the donated real property. Thus, these donative instruments do not affirmatively obligate the City of Buckeye to perform any action. It appears therefore that Arizona law supports the conclusion that a gratuitous deed granting a conservation easement is a restricted gift and not a "contract" subject to A.R.S. § 38-511.

CONCLUSION

If A.R.S. § 38-511 were interpreted to apply to a deed gratuitously granting a conservation easement, then landowners in my legislative district and throughout the State would be discouraged from making future grants of real property interests for conservation purposes to Buckeye and other qualified entities. Therefore, I respectfully request that the Attorney General issue an opinion that A.R.S. § 38-511 does not apply to a landowner's donation by deed of a conservation easement to "the state, its political subdivisions or any department or agency of either."

I appreciate your prompt and thoughtful attention to this request. Please let me know if there is any additional information that I can provide.

Sincerely,



Steve Montenegro
Majority Leader

Rep. Montenegro

House of Representatives

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