

Does Cap and Dividend Policy Violate the Washington State Constitution's Prohibition on the Gift of Public Funds?

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1. OVERVIEW

a. What is Cap and Dividend?

Cap and Dividend is one version of cap and trade. Under a Cap and Dividend program the government auctions carbon emissions permits, which large-scale emitters will be required to obtain in proportion to their annual emissions (one permit required per ton of CO₂-equivalent). The annual supply of permits will decrease steadily, thereby creating an enforceable limit on the total amount of greenhouse gas pollution allowed each year.

The sale of these permits at auction will generate revenue and either a government office or separate entity will be tasked with giving 100 percent of the permit revenues back to the citizens in the form of per capita rebates through either a monthly or yearly payment. There are a number of cap and trade models, but the one described here as Cap and Dividend presupposes that all auction revenue is recycled and redistributed on an equal per capita basis to each Washington state resident, regardless of need.

b. How would Cap and Dividend work?

Cap and Dividend could work at a federal level, and perhaps at the state level under a program such as the Western Climate Initiative (WCI).

There is little consensus as to how to best refund the permit revenues to the people. At least one study cautions against issuing the consumer or taxpayer rebates through utility companies, as much of the burden of rising energy costs, such as gas prices, will be felt outside of the home energy context.¹ Other suggestions for how to administer the rebates include: requiring the Social Security Administration to issue monthly or yearly refunds; expanding the Earned Income Tax Credit (EITC) and Earned Benefit Transfer (EBT) systems; relying on the Low-Income Home Energy Assistance Program; providing grants to states or a new private or quasi-governmental entity to allocate funds to low-income households; creating a payroll tax rebate; or providing a flat income tax credit.

A Washington version of Cap and Dividend would collect all of the Washington revenue generated through the WCI's permit auction and return it to Washington residents on an equal per capita basis. The distribution of auction revenues may prove particularly difficult in Washington due to state constitutional constraints and the lack of a state income tax.

2. ISSUE AND BRIEF ANSWER

Does Cap and Dividend violate the Washington Constitution's prohibition on the gift of public funds?

¹ Robert Greenstein, Sharon Parrott, & Arloc Sherman, "Designing Climate-Change Legislation that Shields Low-Income Households from Increased Poverty and Hardship," Center on Budget and Policy Priorities (2008).

If properly drafted, strong legal arguments exist for upholding Cap and Dividend legislation. There is, however, no precedent for an across-the-board distribution of funds to Washington residents, and courts may be reluctant to validate a program that provides money from the state treasury to individuals regardless of need. Consequently, other legal mechanisms such as a constitutional amendment—an approach taken in other instances—present clearer solutions for avoiding issues related to the gift of public funds.

a. Discussion

Article VIII, Section 5 of the Washington Constitution provides: “The credit of the state shall not, in any manner be given or loaned to, or in aid of, any individual, association, company or corporation.” Article VIII, Section 7 of the Washington Constitution provides: “No county, city, town or other municipal corporation shall hereafter give any money, or property, or loan its money, or credit to or in aid of any individual, association, company or corporation, except for the necessary support of the poor and infirm, or become directly or indirectly the owner of any stock in or bonds of any association, company or corporation.”

Although Section 5 refers to state action and Section 7 refers to the actions of local governments, the Washington Supreme Court has construed the two provisions the same way, applying the same exemptions and prohibitions to each despite their differences in language. The critical exemption for the poor and infirm therefore applies to both sections.²

The provisions share the same manifest purpose, which is to “prevent state funds from being used to benefit private interests where the public interest is not primarily served.”³ The framers wanted to prevent the harmful “effects on the public purse of granting public subsidies to private commercial enterprises, primarily railroads.”⁴ Even though the railroads served a quasi-public purpose, the framers wanted to ban public subsidies to this primarily private entity in order to “protect the weak from the strong within.”⁵

For many reasons, the Washington Supreme Court has been skeptical of gift challenges. In recent years the Washington Supreme Court has adhered strictly to the framers' intent when enforcing the provision, narrowing its application to remedy the types of subsidies the framers' intended to prevent.⁶ Generally, if the public retains any amount of control over the way funds are spent, then the courts are likely to determine that no gift violation has occurred.⁷ Many public gifts to

² *Washington Health Care Facilities Auth. v. Ray*, 93 Wn.2d 1260 (1980) relying on *Morgan v. Department of Social Security*, 14 Wn.2d 156 (1942).

³ *Japan Line Ltd. v. MaCaffree*, 88 Wn.2d 93, 98 (1977).

⁴ *Tacoma v. Taxpayers of Tacoma*, 108 Wn.2d 679 (1987), citing *Marysville v. State*, 101 Wn.2d 50, 55 (1984). See also Jay A. Reich, “Lending of Credit Reinterpreted: New Opportunities for Public and Private Sector Cooperation,” 19 Gonz. L. Rev. 639 (1984).

⁵ Comment, Nick Beermann, “Legal Mechanisms of Public-Private Partnerships: Promoting Economic Development or Benefitting Corporate Welfare?,” 23 Seattle Univ. L. R. 175, 181 (1999), citing comments of delegate Buchanan at the Constitutional Convention of 1889, printed in Colin Kippen, Article VIII, Sections 5 and 7: An Examination of the Provisions, Their Impact and the Prospects for Change, Seattle City Light, April 18, 1979, at I-8.

⁶ *Tacoma*, 108 Wn. 2d at 681.

⁷ *Johnson v. Johnson*, 96 Wn.2d 255, 258 (1981). See also *Clean v. State*, 130 Wn.2d 782, 798–99 (1996).

private entities have survived a Section 5 or Section 7 challenge, including public financing of the Mariner’s baseball stadium.⁸

The burden on challenges is high. To succeed, the challenger must overcome the presumption that the authorizing statute is constitutional.⁹ If any set of facts supports the statute's constitutionality, then the statute is presumed constitutional.¹⁰ By default, the Court will accept the legislative declaration of public purpose, “unless it is arbitrary or unreasonable.”¹¹ The challenger who wants to disprove that the expenditure furthers a public purpose must prove it “beyond a reasonable doubt.”¹²

Overall, however, the Washington Supreme Court’s gift analysis has been inconsistent and confusing. In fact, the Court has noted the “presence of inconsistent analysis or exceptions” and a “checkered approach” to Sections 5 and 7 problems.¹³ Multiple tests and exceptions, sometimes applied and sometimes ignored without any overruling cases to provide explanation, have muddled the case law. Despite the lack of a uniform analytical approach, the Court has stated that, “In as much as this court has never expressly overruled a previous Section 5 case, all ... the approaches remain viable.”¹⁴

Cap and Dividend has increased chance of surviving constitutional scrutiny if enabling legislation expresses the legislature’s intent to pass Cap and Dividend as a nonseverable whole policy. In *Adams v. University of Washington*,¹⁵ the Washington Supreme Court defined a “gift” as a decrease in the state general fund and a gratuitous benefit to a recipient....The key factor...[being] lack of consideration.”¹⁶ It follows that when Cap and Dividend is interpreted as a whole, dividends are best understood as refunds or rebates of the “fee”¹⁷ on carbon imposed on consumers by the cap, and less as “gifts” of money. When people receive their own money back in the form of a dividend, there is no gift, and the gift prohibition would be less likely to apply.¹⁸

⁸ *King County v. Taxpayers of King County*, 133 Wn.2d 584 (1997).

⁹ *Public Employment Relations Commission v. City of Kennewick*, 99 Wn. 2d 832, 836 (1983).

¹⁰ *Johnson*, 96 Wn.2d at 258.

¹¹ *Id.*, citing *Frach v. Schoettler*, 46 Wn.2d 281, 280 (1955).

¹² *Id.*, citing *Bellevue v. State*, 92 Wn.2d 717, 720 (1979) (statute's invalidity must be proven beyond a reasonable doubt). See also *Primeau v. State*, 70 Wn. 2d 109, 11 (1966) (challenger must rebut the presumption that all legally necessary facts exist.)

¹³ *Id.* at 264.

¹⁴ *Id.* at 265.

¹⁵ 106 Wn. 2d 312 (1986) (reflecting the direction of court decisions in Section 5 cases after a period of inconsistent analysis).

¹⁶ *Id.* at 327.

¹⁷ A fee is “enacted principally as an integral part of the regulation of an activity and to cover the cost of regulation.” *Franks & Son, Inc. v. State*, 136 Wn.2d 737, 750 (1998).

¹⁸ Our conclusion would be consistent with the analytical approach formally adopted by the Washington Supreme Court in 1985 in *Higher Education v. Gardner*. This test breaks down the constitutional provision into key elements, taking a plain language approach to interpreting the provision. If any of the key elements are missing, the Court has consistently determined that there is no prohibition or violation. See Hugh Spitzer, “An Analytical View of Recent ‘Lending of Credit’ Decisions in Washington State,” 8 *University of Puget Sound Law Review* 195, 196 n.6 (1984), citing *Louthan v. King County*, 94 Wn. 2d 422 (1980) (gift component missing).

If courts were to instead focus narrowly on the dividend payments alone, then case law might support invalidating aid to those not in need as unconstitutional¹⁹ without some other validating reason.

b. Analysis summary

Washington courts apply a two-prong analysis to gift questions. To be valid Cap and Dividend must survive *either* prong: 1) payments serve a fundamental governmental purpose and are therefore not gifts, *or* 2) donative intent is lacking and consideration for the payments is either sufficient or adequate.²⁰

Cap and Dividend is likely to survive the first prong with properly written legislation. The Washington Supreme Court will defer to the legislature's declaration of what constitutes a fundamental governmental purpose, unless the declaration is “arbitrary or unreasonable.”²¹ Phrased as “entitlement payments,” payments that further a fundamental governmental purpose serve an “overriding public purpose” or satisfy a “moral obligation,” such that the private benefit is “merely incidental” are not considered gifts.²² Because of the high level of judicial deference afforded to the legislature’s declaration of a “fundamental governmental purpose,” Cap and Dividend is likely to survive the first-prong as long as the statute includes language that Cap and Dividend serves a “fundamental governmental purpose” and support for such determination. Survival of the first prong would be sufficient to validate Cap and Dividend as valid under the Washington Constitution.

If, however, Cap and Dividend fails the first prong, then it is possible it could still be valid by surviving the second prong. Under second-prong analysis, courts are generally asking whether the state is giving away money without receiving anything of value in exchange. To determine its answer, courts first look for any evidence of “donative intent,” or intent to give something without the expectation of receiving anything in return. Its findings on donative intent then direct subsequent analysis in one of two ways. Depending on whether donative intent is present or absent, consideration—defined traditionally as a legally bargained-for act or inaction—is either assumed to be “sufficient” with no further inquiry, or it is analyzed for “adequacy.” Consideration is the basic test for determining whether there is an exchange of any kind to justify the payments and declassify dividends as “gifts” because recipients are giving something back to the state in return.

When donative intent is absent, or there is evidence of “a grossly inadequate return,” courts analyze consideration under a “sufficiency” standard.²³ Under a sufficiency standard the court

¹⁹ *Morgan v. Department of Social Security*, 14 Wn.2d 156, 169 (1942). See note 22, *infra*.

²⁰ Furthered in *Tacoma v. Taxpayers of Tacoma*, the two-prong test represented the Court’s updated framework for analyzing Article VIII, Sections 5 and 7 cases, after a period of inconsistent rulings advancing different tests. *Tacoma*, 108 Wn.2d 679.

²¹ *Johnson v. Johnson*, 96 Wn.2d 255, 263 (1981), *citing Frach v. Schoettler*, 46 Wn.2d 281 (1955).

²² *City of Seattle v. State*, 100 Wn.2d 232, 241–44 (1983).

²³ *Tacoma*, 108 Wn.2d at 703 (1987), *citing Adams v. University of Washington*, 106 Wn.2d 312, 327 (1986).

does not conduct a comparative analysis of the exchange. It only inquires into the facts that the parties conducted a legally bargained-for exchange. Sufficient consideration under Cap and Dividend could be found in many ways. For example, the right to pollute the atmosphere—a public resource—is exchanged in return for cash dividend payments to every individual. If courts find evidence of donative intent, then they will analyze consideration under an “adequacy” standard.²⁴

The “adequacy” standard is a more difficult standard to overcome, with the comparative value of the public and private benefit of the exchange figuring into the analysis. The Washington Supreme Court has never found evidence of donative intent, and therefore has never applied the “adequacy” standard to a gift question. As a result it has made no attempt to establish guidelines for what facts constitute “adequate” consideration. Consistent with the Court’s forgiving approach to donative intent, it seems likely that courts would not find donative intent in its analysis of Cap and Dividend and would apply the “sufficiency” rather than the “adequacy” standard to consideration. There are enough plausible ways to configure consideration to meet the sufficiency standard that it is likely that Cap and Dividend would be valid under the second prong. The rarity with which courts scrutinize the adequacy of consideration reserves such inquiry for the most extreme of cases, a category that Cap and Dividend is likely to avoid with proper drafting.

Despite the strong legal arguments in support of Cap and Dividend’s survival, Cap and Dividend is uncharted territory for Washington courts. Case precedent has supported direct financial assistance to the poor or infirm, but not to citizens who are not in need²⁵ outside of spending to further a fundamental governmental purpose. Because historical support for Cap and Dividend is lacking, a list of potential policy prescriptions follow. These proposals deploy alternative legal mechanisms that might help validate otherwise unconstitutional gifts of public funds. Some of the proposals listed—such as constitutional amendments—have been used a number of times by the courts to overcome the gift hurdle.

3. TWO-PRONG ANALYSIS

Determining when spending violates the constitutional gift prohibition

The constitution’s “poor and infirm” exception does not apply to Cap and Dividend because dividends are universally distributed under its policies. If the “poor and infirm” exception did apply, Cap and Dividend would survive and the gift analysis would end. For more on the “poor and infirm” exception, and its triggers, please read the memo on **Cap and Rebate**. Because Cap

²⁴*Tacoma*, 108 Wn.2d at 703.

²⁵*Morgan*, 14 Wn.2d at 169 (holding Social Security Act not unconstitutional because no person who is not in need may be a beneficiary: “In support of the contention that the entire [Social Security] act is void, it is argued that the act purports to benefit private individuals who are not in need. The support of the poor and needy is a recognized public governmental function. If the act by its terms purports to relieve persons not in actual need, it might well be challenged upon constitutional grounds.”)

and Dividend does not trigger the “poor and infirm” exception, it must be analyzed under the two-prong analysis advanced by the Washington Supreme Court in *Tacoma v. Taxpayers of Tacoma* (1987).

a. First Prong: Cap and Dividend will likely survive because it serves a “fundamental governmental purpose”

The Washington Supreme Court has validated otherwise unconstitutional payments when they have furthered a “fundamental governmental purpose”²⁶ and the individual benefit was “merely incidental” to such purpose. The rule established in *Tacoma v. Taxpayers of Tacoma* was that “entitlement payments” furthering a “fundamental governmental purpose” were not gifts.²⁷ This approach was consistent with the framers’ intent, which was to ban aid to primarily private enterprises only. The Washington Supreme Court has repeatedly said that “[a]id to individuals is not absolutely prohibited under our law but is only improper where public money is used solely for private purposes.”²⁸

In *Johnson v. Johnson*, a 1981 case that preceded *Tacoma*, the Court used a different phrase, holding that the gift ban did not apply to “[r]ecognized governmental functions”. The Washington Supreme Court has not made a concerted effort to explain the shift in terminology. “Recognized governmental functions,” similar to “fundamental governmental purposes,” require that any private benefit conferred must be incidental to a primary public purpose.²⁹ Both terms seem to derive their authority from a historical and continual basis in the law.³⁰ For example, the “poor and infirm” exception in the Washington Constitution grew out of the recognized public governmental function of “supporting the poor and the needy.” The Court has said “providing for those in financial and medical need is not a new concept.”³¹

According to the Court in *Johnson*, applying Article VIII, Sections 5 and 7 to “recognized governmental functions” was not what the founders intended, for that “would destroy the efficiency of the agencies established by the constitution to carry out the recognized and essential powers of government. It cannot be conceived that the people who framed and adopted the

²⁶ *Tacoma*, 108 Wn.2d at 702. See also *Johnson*, an earlier case in which the Court used a different phrase, a “recognized [public] governmental function.” *Johnson*, 96 Wn.2d at 263–64. There is some difference between the two phrases, but the Court has not taken pains to distinguish them. Nevertheless, the “entitlements payment” test determines when either a “fundamental governmental purpose” or “recognized governmental function” is being served.

²⁷ *Tacoma*, 108 Wn.2d 679.

²⁸ *State v. Ralph Williams’s Northwest Chrysler Plymouth, Inc.*, 82 Wn. 2d 265 (1973).

²⁹ *Public Employment Relations Commission v. City of Kennewick*, 99 Wn. 2d 832, 838 (1983) (“[p]rivate parties may indeed benefit incidentally as a result of the exercise of that important function; however, as long as the private benefit is incidental to the public purpose served, the legislation is not unconstitutional”). *City of Kennewick* was an Article VIII, Section 5, case despite the “public purpose” language, which if read carefully, would flag this case as an Article VII case even though it is not. This is yet another instance where the Court’s language is confusing.

³⁰ *Johnson*, 96 Wn.2d at 262 (finding public enforcement of child support as a “recognized governmental function,” citing Laws of 1854, 1st Sess., Section 8, and modern grants of statutory authority permitting states the means to protect the interests of minor children).

³¹ *Johnson v. Johnson*, 96 Wn. 2d 255, 271 (1981).

constitution had such consequences in view.”³² This logic applies to spending furthering “fundamental governmental purposes” as well.

In light of unimportant differences in the two terms, this analysis of Cap and Dividend will simplify the terminology and refer solely to “fundamental governmental purpose” in order to be consistent with the language the Court used to write its *Tacoma v. Taxpayers of Tacoma* (1987) opinion. Though no uniform rule can be applied to gift cases, *Tacoma* is the most recent attempt by the Court to solidify a two-prong analysis after a period of confusing analytical approaches. The Washington Supreme Court cites *Tacoma* and its two-prong analytical approach frequently in gift cases.³³ Under the first prong, we consider whether funding constituted an “entitlement payment” furthering a “fundamental governmental purpose.”

1. Entitlement Payments

Under *Tacoma*, the “fundamental governmental purpose” test considers whether spending constituted an “entitlement payment” for a governmental purpose.³⁴ Entitlement payments are defined as “a form of assistance provided to the public, or a segment of the public, as cash or services, in carrying out a program to further an overriding public purpose or satisfy a moral obligation.”³⁵ Because entitlement payments further a fundamental government purpose, they are not gifts and the gift ban does not apply to such expenditures.³⁶ Examples of entitlement payments include free daycare for working mothers, fare-free bus zones, and crime victim compensation.³⁷

Alternately, payments that do not further fundamental governmental purposes are subject to a “gift” analysis under the second prong. The second prong does not apply to funding that furthers fundamental governmental purposes because that money is not considered to be a gift. (See “Two-Prong Gift Test” on page 12 for the analysis.)

Cap and Dividend legislation should explain in its “legislative findings” section that Cap and Dividend payments are “entitlement payments” with an “overriding public purpose,” “moral obligation,” or both.

a. Overriding public purpose

Although entitlement payments benefit private individuals, the “overriding public purpose” makes any private benefit “incidental.”³⁸ The Court has said, “[I]f most of the use is public then a small concomitant of private use may be deemed incidental.”³⁹

³² *Id.* at 262, citing *Rauch v. Chapman*, 16 Wash. 568, 575 (1897).

³³ For example, see *Citizens for Clean Air v. Spokane*, 114 Wn.2d 20, 39 (1990) (“The constitutional prohibition against gifts of public moneys has a 2-prong analysis under *Tacoma v. Taxpayers*, 108 Wn.2d 679 (1987).”)

³⁴ *Tacoma*, 108 Wn.2d at 702. See also *City of Seattle v. State*, 100 Wn.2d 232, 241 (1983), where the Court phrased the same rule differently. In *City of Seattle*, the Court didn’t use the phrase “fundamental governmental purpose” to phrase its rule that “entitlement payments” were not gifts. Instead it referred to “recognized governmental function” and defined payments that furthered a “recognized governmental function” as “entitlements.” Therefore the rule on “entitlement payments” applies to both “recognized governmental functions” and “fundamental governmental purposes.” This may be a result of sloppy drafting.

³⁵ *City of Seattle*, 100 Wn. 2d at 241.

³⁶ *Tacoma*, 108 Wn.2d at 702.

³⁷ *Id.*, quoting *City of Seattle*, 100 Wn.2d at 240–42.

³⁸ *City of Seattle*, 100 Wn.2d at 240–42.

The meaning of “overriding public purpose” can perhaps best be explained by a few concrete examples. In *City of Seattle v. State*,⁴⁰ the Court discussed the meaning of “overriding public purpose” in the context of campaign financing. Private candidates were seen to only “incidentally benefit” from public funds spent to discourage candidates from special interest–group support. The Court concluded that appropriations (by the city of Seattle) toward individual campaigns were spent for public purposes and candidates, by spending the money “only for direct campaign purposes,” were acting as “trustees” of the public purse.⁴¹ Therefore, even though the payments directly benefited candidates and their campaigns, the “overriding public purpose” of protecting the integrity of public elections made the private benefit “merely incidental,” thus validating the constitutionality of aid to persons who wouldn’t otherwise have qualified had need been the only determining factor.

In another case, *United States v. North Bonneville*,⁴² the Court deemed that resale of private property to a municipality conferred “incidental” benefits to the developer. Resale to private parties was thought “incidental” because “[u]nlike financing arrangements struck down under [A]rticle [VIII], [S]ection 7, in this case a large portion of the acquired property would go to undisputedly municipal uses as streets, parks, and service facilities.”⁴³ Even though *North Bonneville*’s analysis of public purpose related to Washington Constitution Article VII, Section 1,⁴⁴ which stipulates that all taxes be levied for a “public purpose,” *North Bonneville* helps define the meaning of “incidental” in a “fundamental governmental purpose context.” In sum, if a “large portion” of the spending furthers a fundamental governmental purpose, then the gift ban does not apply.

Furthermore, there is an important, yet confusing, difference between a “public purpose” (derived from Washington Constitution Article VII, Section 1) and an “overriding public purpose” (derived from Article VIII, Sections 5 and 7). In *Johnson*, the Washington Supreme Court attempted to clarify the distinction: “Mr. Johnson, as did the trial court, seems to confuse Article XII, Section 1 with Article VIII, Section 5. He erroneously believes that [S]ection 1 is violated because substantial private benefits are conferred. He fails to realize only *some* actual public benefit is necessary for Section 1 purposes.”⁴⁵ Following the Court’s reasoning, for a gift to survive the “fundamental governmental purpose” analysis required by Article VIII cases, an “overriding”—not just “some”—public purpose is required.

In *Clean v. State*, a later case on the Mariner’s stadium, the Court emphasized the direct connection between an “overriding public purpose” and a *fundamental* governmental purpose. “Although we have concluded above that a public purpose is served by construction of a baseball stadium, it cannot be seriously contended that the development of a baseball stadium for a major

³⁹ *In re in re Seattle*, 96 Wn.2d 616, 643 (1981).

⁴⁰ *City of Seattle*, 100 Wn.2d 232.

⁴¹ *Id.* at 240–41. See also Hugh Spitzer, “An Analytical View of Recent ‘Lending of Credit’ Decisions in Washington State,” 8 *University of Puget Sound Law Review* 195, 207 n. 77 (1984).

⁴² *United States v. North Bonneville*, 94 Wn.2d 827, 833 (1980).

⁴³ *Id.* at 839.

⁴⁴ See n. 29, *infra*.

⁴⁵ *Johnson v. Johnson*, 96 Wn.2d 255, 260 (1981). Emphasis added.

league team is a ‘fundamental purpose’ of state government.”⁴⁶ Distinguishing between “overriding public purpose” and “public purpose” is consistent with the intent behind the founders’ writing Article VIII, Sections 5 and 7 in 1889. Subsidies to railroads certainly served a governmental purpose, but not a *fundamental* governmental purpose. The railroads were a *primarily private* enterprise after all.

Cap and Dividend is most likely to survive first prong analysis if the legislature takes care to explain why it serves a *fundamental* as opposed to simply any public purpose. Also the legislation should cast payments as “merely incidental” to the “overriding public purpose” of reducing carbon emissions by explaining the direct relationship between the “cap” and “dividend.” To determine the threshold after which payments are no longer “merely incidental,” the legislature should hold hearings and capture its conclusions in the enabling legislation.

b. Moral obligation

In addition to claiming an “overriding public purpose,” Cap and Dividend legislation might declare that the policy serves a moral obligation. Moral obligations tend to fall within the state’s police power. State police powers are inherent to the states and are relatively broad in nature: “[T]here is no doubt that the state, in the exercise of such power, may prescribe laws tending to promote the health, peace, morals, education, good order and welfare of the people. Police power ... exists without express declaration, and the only limitation upon it is that *it must reasonably tend to correct some evil or promote some interest of the state, and not violate any direct or positive mandate of the constitution.*”⁴⁷

In the past, Washington has allowed direct cash payments with a “close nexus” to an “overriding public purpose” or “moral obligation” to qualifying individuals.⁴⁸ Examples of cash payments that have survived constitutional gift scrutiny because they were found to further “moral obligation” include:

- Veterans' bonuses (Former RCW 73.34.040),
- Compensation to victims of a felony or gross misdemeanor under “Victims of Crime—Compensation, Assistance” (RCW 7.68),
- Reimbursement of court costs to those who act in self-defense or in defense of another in imminent danger of injury or death from a serious crime (RCW 9.01.200),
- Attorneys' and expert witnesses' fees to a successful litigant in a condemnation case (RCW 8.25.070 and .075), and
- Relocation assistance payments to people and businesses displaced by a condemnation (RCW 8.26).

The Washington Supreme Court has not developed a metric system for testing “moral obligation.” Much like “overriding public purpose,” “moral obligation” is a question for the legislature.⁴⁹ No mechanical yardstick analysis applies. Therefore, if a “moral obligation” applies

⁴⁶ *Clean v. State*, 130 Wn.2d 782, 798 (1996).

⁴⁷ *Wash. State Highway Com v. Pac. Northwest Bell Tel. Co.*, 59 Wn.2d 216, 236 (1961), quoting *Shea v. Olson*, 185 Wash. 143, 161 (1936).

⁴⁸ *City of Seattle*, 100 Wn.2d at 242.

⁴⁹ 63C Am. Jur 2d Public Funds §79.

to Cap and Dividend, the “moral obligation” served should be unambiguously expressed in enabling legislation in order for the courts to find that Cap and Dividend serves a moral obligation. The legislature should therefore consider including strong moral obligation language to ensure Cap and Dividend has a good chance of surviving. (Please see the Appendix, Section C, for more information on drafting.)

2. Conclusion: First Prong

To conclude, the first prong assesses whether spending furthers a “fundamental governmental purpose.” The constitutional gift ban does not apply to spending that furthers a “fundamental governmental purpose.” Judicial deference to the legislature’s declaration of what constitutes a “fundamental governmental purpose” indicates that Cap and Dividend could survive a gift challenge if legislation was properly worded.

Courts will defer to the legislature over what constitutes an “overriding public purpose” and “moral obligation,” and statutes are presumed constitutional unless they are found to be arbitrary or unreasonable. Therefore Cap and Dividend would likely survive the first prong if the legislature found that Cap and Dividend served a “fundamental governmental purpose.”⁵⁰ Then, if challenged, Cap and Dividend would likely survive the first prong. Courts would not apply the second prong, because the “public benefit” of “fundamental governmental purposes” satisfies the consideration requirement.⁵¹ Cap and Dividend need only survive either the first *or* the second prong to be constitutional.

In the “legislative findings” section of Cap and Dividend legislation, which introduces and explains the purpose behind the bill, the legislature should explain why the policy serves a “fundamental governmental purpose.” The findings should also explain how dividends further the purpose of the cap, perhaps by providing a financial incentive for people to limit their carbon expenditures to no greater than the amount of the dividend payment. Dividends also provide the opportunity for individuals to increase their purchasing power from the dividends by consuming less carbon. With a direct relationship between “cap” and “dividend” clearly defined in the bill’s legislative findings, Cap and Dividend would be more likely to survive the legal tests developed by case law. If the dividends were understood to further emissions reductions, courts would more likely interpret the dividends as “merely incidental” to the “overriding public purpose” of emissions reductions.

To summarize, if Washington were to implement Cap and Dividend, enabling legislation should (or might need to) convey several key points: 1) the state recognizes a cap on carbon would impose financial burdens on residents and that the state is providing a measure of relief in Cap and Dividend; 2) the dividends further the aims of the cap, perhaps because residents can tailor the cost of their climate impact to fit with the amount received by the dividend; and 3) there is a

⁵⁰ Prior legislation indicates that Washington has declared a fundamental role in combating climate change in the past. For example, RCW 80.80.050 (1)(f) (2007) provides that “there is a need to assess the trend of greenhouse gas emissions statewide over the next several decades, and to take sufficient actions so that Washington meets its responsibility to contribute to the global actions needed to reduce the impacts and pace of global warming.” Section (4)(b) states that “[I]t is vital to...reduce Washington consumers’ exposure to costs associated with future regulation of these emissions....”

⁵¹ *Citizens for Clean Air v. Spokane*, 114 Wn.2d 20, 39 (1990). See also Appendix C, and Appendix notes 13–14.

close nexus between the carbon cap and the dividend and a stated belief that an “overriding public purpose” and or “moral obligation” apply to the statute as a whole.

A potential danger of concluding that Cap and Dividend will survive the first prong is that courts will be skeptical of boilerplate language that is unsupported by the facts. It is always possible that courts could rule the legislature’s determinations incorrect if its findings are not well-supported. Therefore committee hearings and testimony should be held to examine whether Cap and Dividend legislation fundamentally passes the legal tests laid out in this analysis, and if so, legislation should be carefully drafted to indicate that the legislature has considered the policy in light of the constitutional gift prohibition. For “[t]he judiciary has the exclusive function of determining the constitution's meaning, and the legislature cannot define what is and is not a proscribed gift or loan under the state constitution.”⁵²

b. Second Prong: Cap and Dividend will likely survive because it lacks donative intent and provides consideration

The second prong, also referred to as the “gift” analysis, is only applied to transactions that fail the first prong, or to which the first prong doesn’t apply, such as spending by government in a proprietary, or private, capacity.⁵³ Outside of exempted expenditures for fundamental governmental purposes,⁵⁴ Washington courts apply the *Adams/Tacoma* “gift” test to determine whether a gift occurs. The “gift” test also has two prongs. To succeed, challengers must prove both 1) presence of donative intent or grossly inadequate return *and* 2) lack of sufficient or adequate consideration.⁵⁵ Under the “gift” test, courts are basically looking to ensure that the government received something of value in return for depleting the state treasury.

1. Two-Prong “Gift” Test

a. Donative intent: No intent to gift under Cap and Dividend

Establishing a gift primarily involves interpreting whether the government had donative intent when it gifted public money.⁵⁶ “If intent to give a gift is lacking the elements of a gift are not present, then [A]rticle [VIII], [S]ection 7 does not apply.”⁵⁷

Donative intent is a question of fact for the courts. The Washington Supreme Court will infer donative intent from narrative evidence and/or “grossly inadequate” return.⁵⁸ Narrative evidence includes correspondence, letters, documents and other evidence that conveys an intention to gift.⁵⁹ The Washington Supreme Court has never found donative intent.⁶⁰

⁵² *Tacoma v. Taxpayers of Tacoma*, 108 Wn.2d 679, 688 (1987), citing *Scott Paper Co. v. Anacortes*, 90 Wn.2d 19, 33 (1978).

⁵³ *Id.*

⁵⁴ In the case of fundamental governmental purposes, the consideration is built-in, because the public benefit constitutes the consideration. *Citizens for Clean Air*, 114 Wn.2d at 39.

⁵⁵ *Gen. Tel. Co. v. City of Bothell*, 105 Wn.2d 579, 588 (1986).

⁵⁶ *Id.* See also *Tacoma*, 108 Wn.2d at 695.

⁵⁷ *Scott Paper Co.*, 90 Wn.2d at 33.

⁵⁸ *King County v. Taxpayers of King County*, 133 Wn.2d 584, 626 (1997).

⁵⁹ *Id.*, referring to an example that supports the inference of donative intent: “the *raison d’etre* for the stadium project is to aid the Mariners by making it more profitable for them to stay in Seattle than to go elsewhere.”)

⁶⁰ Comment, David D. Martin, “Washington State Constitutional Limitations on Gifting of Funds to Private Enterprise: A Need for Reform,” 20 Seattle University L.R. 199, 201 (1996).

Courts have, on occasion, found “grossly inadequate” return. Determining whether something is “grossly inadequate” is a jury question. The Court defines it practically: A “grossly inadequate” return is something that is less, by sufficient degree, than “adequate.”⁶¹

A finding of “donative intent” or a “grossly inadequate” return will determine the level of scrutiny applied to the second prong of the “gift” test—consideration. Consideration analysis is explained in the next section (b. Consideration: A two-part formula, below.) For now it is important to understand that although donative intent and consideration require separate analyses, the two overlap considerably. One example is from a 2005 case where the Washington Appeals Court (Division II) found evidence of a “grossly inadequate” return and remanded the case to the trial court on the issue of consideration, stating the rule from *Adams* that once a “grossly inadequate” return is found, the trial court should analyze consideration under an “adequacy” of consideration standard.⁶²

In *Pierce County v. Washington Shellfish, Inc.*,⁶³ a Section 7 case, Pierce county leased tidelands to Washington Shellfish (WSF) for harvesting shellfish and geoduck. WSF paid \$360 for the first year of the lease, but had grossed over \$2 million in sales from the harvest. On summary judgment, the Washington Appeals Court remanded the matter for trial on a genuine issue of material fact to determine whether the lease was a gift of public funds.⁶⁴ “Here, there is a patent, grossly inadequate return. There is evidence that the lease agreement did not adequately provide for the amount of natural resources on the land. The County failed to survey the property for natural resources before entering into the lease agreement. Thus, WSF received the land and the natural resources on it for less than what the land was truly worth.”⁶⁵

Comparing Cap and Dividend to the facts of the shellfish case, where a \$360 one-year lease generated over \$2 million profit for WSF, it seems unlikely the courts will find that an annual \$1,000 dividend (or refund) check constitutes a “grossly inadequate” return such that courts would be forced to examine the adequacy of consideration under Cap and Dividend. Committee hearings and testimony should, however, consider what “grossly inadequate” return would look like in the Cap and Dividend context. Perhaps the legislature should establish reasonable limits on payment amounts to protect dividends from a “grossly inadequate” return challenge. A check on dividend amounts would also help ensure that Cap and Dividend survives the “fundamental governmental purpose” test such that the private benefit does not exceed the “overriding public purpose” of Cap and Dividend.

b. Consideration: A two-part formula

⁶¹ *Id.* at 631.

⁶² *Pierce County v. Washington Shellfish, Inc.*, 2005 Wash. App. LEXIS 391 (2005), citing *Adams v. University of Washington*, 106 Wn.2d 312, 327 (1986). As of this writing, no rule on what constitutes “adequacy of consideration” has emerged from the trial court or been tested at the appeals level.

⁶³ *Id.* at 19.

⁶⁴ *Id.* at 2.

⁶⁵ *Id.* at 19.

As mentioned above, the Washington Supreme Court applied a two-part formula to its analysis of consideration based on whether donative intent was present or absent.⁶⁶ If the transaction lacked donative intent or there was no evidence of a “grossly inadequate” return, then courts applied a “sufficiency” standard to consideration. If, on the other hand, courts found evidence of donative intent, then they applied an “adequacy” standard to consideration. The depth of judicial inquiry distinguishes the two standards.

i. “Sufficient” consideration

As long as there are not gross inadequacies, the courts will often defer to the terms of the bargain under the “sufficiency” standard. Defined traditionally under contracts law, the “sufficiency” standard is easily met. “[A]ny act or forbearance which has been bargained for is consideration sufficient to support a promise.”⁶⁷ Legal sufficiency “is concerned not with comparative value but with that which will support a promise.”⁶⁸ In other words, as long as there was a fair, bargained-for exchange, courts will respect parties’ freedom to contract and not inquire into value of the exchange, even if the terms favored one party over another (for example, a “mere peppercorn” is sufficient consideration in most circumstances).

The Washington Supreme Court has said that as long as “the public receives sufficient consideration, and benefit to an individual is only incidental to and in aid of the public benefit, no unconstitutional gift has occurred.”⁶⁹ Examples of sufficient consideration in Washington have included electricity saved through conservation,⁷⁰ and compliance with guidelines to produce safe and sanitary housing by the housing industry in return for public subsidies.⁷¹

It is rare that courts will determine consideration to be insufficient. The Supreme Court has invalidated a gift on insufficient consideration grounds only once.⁷² In *State v. O’Connell*, the Court declared unconstitutional a port district’s promotional hosting of potential customers because private individuals had no legal obligation and the only public benefit was potential business.⁷³

⁶⁶ *Adams*, 106 Wn.2d 312.

⁶⁷ *Id.*, citing *Huberdeau v. Desmoris*, 79 Wn. 2d 432, 439–40 (1971).

⁶⁸ *Browning v. Johnson*, 70 Wn.2d 145, 147 (1967) (“[A]nything which fulfils the requirements of consideration will support a promise whatever may be the comparative value of the consideration, and of the thing promised,” quoting 1 Samuel Williston, *Law of Contracts* §115 (1920).

⁶⁹ *Tacoma v. Taxpayers of Tacoma*, 108 Wn.2d 679, 705 (1987).

⁷⁰ *Tacoma*, 108 Wn.2d at 704. In *Tacoma*, the Court rejected the trial court’s prior ruling that uncertainty over the long-term impact of future energy savings (showing that the impact was “measurable and lasting”) undermined the sufficiency of the consideration. *Id.* at 701. Under *Adams*, the first year’s energy savings constituted sufficient consideration. *Id.* at 704. The Court in *Tacoma* affirmed its ruling in *Adams*, stating that uncertainty over future energy savings was inherent—not a death knell: “The inability to predict the actual savings over the long run, and the specific concerns listed by the trial court, seem inherent in any prediction of long-term cost effectiveness.”

⁷¹ *Wash. State Hous. Fin. Com v. O’Brien*, 100 Wn.2d 491 (1983).

⁷² *State v. O’Connell*, 83 Wn.2d 797, 834 (1974). See also Comment, David D. Martin, “Washington State Constitutional Limitation on Gifting of Funds to Private Enterprise: A Need for Reform,” 20 Seattle Univ. L. R. 199, 219 (1996).

⁷³ *O’Connell*, 83 Wn.2d at 804.

ii. “Adequate” consideration

Courts in Washington will not scrutinize consideration unless there is evidence of donative intent behind a transaction. The “adequacy” standard requires a close scrutiny of the transaction, and a balancing of consideration received by the public against that received by a private party. If the private benefit to the individual unreasonably exceeds the benefit to the public, a transaction might be invalidated for lack of adequate consideration.⁷⁴ But the courts are reluctant to apply this standard. The Washington Supreme Court has never found donative intent in an Article VIII case; thus, it has never scrutinized the adequacy of consideration.⁷⁵ The *Adams* court defended this position by stating that inquiring into the adequacy of consideration intrudes upon “the freedom of contract, establish[es] a burdensome precedent for future court calendars, and go[es] beyond its proper function.”⁷⁶ Thus only the most extremely unbalanced transactions will be trigger an “adequacy” analysis.⁷⁷ It is unlikely that consideration under Cap and Dividend will solicit dramatically different treatment than what Washington courts have become accustomed to issuing in the gift context.

2. Conclusion: Second Prong

Cap and Dividend would probably survive the second prong even if it were to fail the first prong. The Washington Supreme Court has neither found evidence of donative intent nor applied an “adequacy” standard to a transaction challenged under the gift ban. It seems unlikely that with clearly worded intent explaining the purpose behind Cap and Dividend that it would prompt a different reaction from the courts.

Under donative intent analysis (the first prong of the “gift” test), Cap and Dividend is likely to survive, particularly because case history favors the conclusion that courts will not upset status quo to find donative intent. Legislative hearings should be scheduled to assess whether Cap and Dividend is susceptible to a “grossly inadequate” return challenge. Such ruling seems unlikely, particularly if enabling legislation described the close nexus between the “cap” and “dividend.” The “legislative intent” section of Cap and Dividend legislation should convey that dividends are intended as refunds of higher fees on carbon, and that the dual intent of the policy is to provide a buffer against higher costs and an incentive for people to consume less carbon. Understood as refunds of peoples’ own money, dividends lack donative intent and provide sufficient consideration to survive the “gift” test, which seeks to invalidate government spending where the government receives nothing in exchange. Cap and Dividend policy benefits the government in many ways.

Assuming courts would not find evidence of donative intent with Cap and Dividend, Cap and Dividend could survive the sufficiency of consideration test given the many ways that Cap and

⁷⁴ Comment, David D. Martin, “Washington State Constitutional Limitation on Gifting of Funds to Private Enterprise: A Need for Reform,” 20 Seattle Univ. L. R. 199, 237 (1996).

⁷⁵ *Id.* at 201.

⁷⁶ *Id.* at 327.

⁷⁷ *Id.* at 219.

Dividend furthers consideration. First, under a Sky Trust⁷⁸ model, the consideration element might be satisfied when polluters pay citizens for the right to pollute the atmosphere. Other forms of consideration are also possible, such as providing an incentive to remain in Washington despite climate impacts on the state and its residents, such as downturns in agricultural production, forest fire danger, risks to drinking water supplies, and higher living costs post cap-and-trade. Cap and Dividend also facilitates public participation in reducing climate pollution. Finally, financial incentives to reduce individual carbon consumption might also be enough to satisfy sufficient consideration.⁷⁹

If on the other hand, courts found evidence of donative intent with Cap and Dividend, the adequate consideration test would apply. To survive an adequacy of consideration test, the dividends must be limited to a reasonable value that accomplishes the purposes of Cap and Dividend while perpetually remaining “merely incidental” to the “overriding public purpose” of reducing Cap and Dividend. The application of an adequacy standard relies on the courts finding evidence of donative intent, which is unprecedented, and thus is unlikely. In the off chance that an adequacy standard did apply, Cap and Dividend could survive scrutiny as long as enabling legislation was properly drafted.

The place where the adequacy of consideration analysis reconnects with the first prong is the weakest link of this analysis. Conclusions rest on the delicate balancing point where dividends are “merely incidental” to the “overriding public purpose” of Cap and Dividend. It is unclear what would tip the scales such that dividends were not treated as “merely incidental” so as to declare Cap and Dividend unconstitutional. It is relatively clear that the scale is tippy and unstudied. Again, however, the likelihood of the court applying the “adequacy” standard to consideration is slim, so this weakness should not prove fatal.

4. CONCLUSION

Cap and Dividend has a solid chance of surviving a constitutional challenge. The burden on the challenger to overcome the presumption of constitutionality is high. Courts generally restrict application of the gift ban to prohibit public subsidies to primarily private enterprises, in furtherance of the framers’ intent. As long as enabling legislation is carefully drafted, the courts will defer to the legislature in determining that Cap and Dividend serves a fundamental governmental purpose and therefore does not fall under the gift of public funds prohibition. Failing that, in every case implicating the gift prohibition courts have found no evidence of donative intent so it is unlikely here. It is also unlikely that courts will find a “grossly inadequate” return. Therefore it is likely that Cap and Dividend will be interpreted in ways that favor the policy as an exchange lacking donative intent and not an outright gift lacking consideration.

⁷⁸ The premise of the Sky Trust model is that money from the sale of carbon permits gets deposited into a trust with each U.S. citizen owning one share as a birthright. Each citizen then receives an equal dividend as payment for the pollution of the atmosphere. The model hopes to expand its reach to the global commons. At a transnational scale, every world citizen would earn a share in a global trust. See <http://www.capanddividend.org/>, and Peter Barnes, *Climate Solutions: What Works, What Doesn't, and Why: A Citizen's Guide* (Chelsea Green 2008).

⁷⁹ For more discussion of consideration, see “Cap and Dividend Policy Prescriptions,” Section A.

However, Cap and Dividend is unprecedented in Washington and this legal analysis assumes a favorable treatment by the legislature and the courts. In light of such vulnerability, a list of some potentially legally sound means of ensuring Cap and Dividend's survival follows this analysis. Please see the separate document titled "Cap and Dividend Policy Prescriptions."