
IN THE
Supreme Court of Indiana

No. 49S02-0908-CV-00383

| | | |
|-------------------------------------|---|-----------------------|
| FOUNDATIONS OF EAST CHICAGO, INC., |) | Appeal from the |
| successor by merger to EAST CHICAGO |) | Marion Superior Court |
| COMMUNITY DEVELOPMENT |) | |
| FOUNDATION, INC. and TWIN CITY |) | Cause No. |
| EDUCATION FOUNDATION, INC., |) | 49D13-0705-PL-019348 |
| |) | |
| Appellant (Plaintiff Below), |) | The Honorable |
| |) | S.K. Reid, Judge |
| v. |) | |
| |) | |
| CITY OF EAST CHICAGO, |) | |
| |) | |
| Appellee (Defendant Below), and |) | |
| |) | |
| STATE OF INDIANA, |) | |
| |) | |
| Appellee (Intervenor-Defendant |) | |
| Below). |) | |

SUPPLEMENTAL BRIEF OF THE STATE OF INDIANA

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STATEMENT OF THE ISSUE

Whether, consistent with the state and federal constitutions, the General Assembly may authorize a municipality to cancel a regulatory agreement directing casino gambling revenue intended for public economic development to private foundations.

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SUPPLEMENTAL BRIEF OF THE STATE OF INDIANA

The State of Indiana, as Intervenor-Defendant and Appellee, respectfully submits this supplemental brief in response to the Court's August 21, 2009 grant of transfer and Order directing the parties to explain "how this Court's recent decisions in two related appeals—*City of East Chicago v. East Chicago Second Century*, 908 N.E.2d 611 (Ind., June 30, 2009), and *Zoeller v. East Chicago Second Century*, 904 N.E.2d 213 (Ind., Apr. 13, 2009)—should guide consideration of the instant case." *Foundations of East Chicago, Inc. v. City of East Chicago, et al.*, No. 49S02-0908-CV-00383 (Ind. Aug. 21, 2009) (Order Directing Additional Briefing).

BACKGROUND AND PRIOR TREATMENT OF THE ISSUES

This case is a challenge to the constitutionality of Section 302 of the Budget Act of 2007. Section 302 amended Indiana Code § 4-33-6-7 by adding the following:

(c) This subsection applies to an owner's license issued for the City of East Chicago. If a controlling interest in the owner's license is transferred, the fiscal body of the City of East Chicago may adopt an ordinance voiding any term of the development agreement (as defined by IC 36-1-8-9.5) between: (1) the city; and (2) the person transferring the controlling interest in the owner's license; . . . The ordinance may provide for any payments made under the redevelopment agreement, including those held in escrow, to be redirected to the City of East Chicago for use as directed by ordinance of the city fiscal body. . . .

H.E.A. 1001, 115th Gen. Assembly, 1st Reg. Sess. (Ind. 2007). Thus, Section 302 expressly authorized the City of East Chicago ("the City") to void or modify the terms of the local development agreement ("LDA") that existed between it and the East Chicago riverboat casino licensee upon transfer of the license.

In its June 22, 2009 Combined Response to the Petition to Transfer and the Motion to Consolidate, the State set forth a detailed explanation of the background of this case as well as its intersection with two related cases—*City of East Chicago v. East Chicago Second Century, Inc.*, 908 N.E.2d 611 (Ind. 2009) (“*East Chicago I*”) and *Zoeller v. East Chicago Second Century, Inc.*, 904 N.E.2d 213 (Ind. 2009) (“*East Chicago II*”). The facts set forth in the State’s Combined Response remain unchanged with one exception: on June 30, 2009, after the State filed its Combined Response, this Court issued its decision in *East Chicago I*. In that decision, the Court held the following:

(1) The trial court properly dismissed three of the City of East Chicago’s claims on statute of limitations grounds: Count I (“Breach of Fiduciary Duty”); Count III (“Constructive Fraud/Unjust Enrichment”); and Count VIII (“Reformation of Contract”). *East Chicago I*, 908 N.E.2d at 618-19, 621.

(2) The trial court erred in dismissing five of the City’s claims on statute of limitations grounds: Count II (“Inducement of Breach of Fiduciary Duty/Participating in Breach”); Count IV (“Breach of Fiduciary Duty”); Count V (“Accounting”); Count VI (“Declaratory Judgment/Return of Public Funds”); and Count VII (“Declaratory Judgment/Return of Public Funds”). *Id.* at 618-21.

(3) The trial court did not err in declining to dismiss Count IX of the City’s Complaint, which alleged breach of contract against Second Century for its failure to “open its books and records to the City in order to permit the City to exercise the agreed upon oversight” *Id.* at 622. As to this Count, “[i]t is difficult to see how

the City could adequately determine whether Second Century was using the funds entrusted to it under the letter agreement without viewing Second Century's financial records." *Id.*

(4) Although the letter agreements embedded in the East Chicago riverboat license "do not appear terminable at will, the City is correct that they are subject to periodic alteration (through the administrative processes of the Gaming Commission)." *Id.* at 624.

(5) "While the Foundations can be said to have justifiably relied on the revenue that has flowed [to it] as a result of the local development agreements and the license issued by the Gaming Commission, that reliance should not be a permanent bar to altering the methods employed to further economic development in East Chicago." *Id.*

Thus, the trial court's opinion was affirmed in part, reversed in part, and remanded for further proceedings on the merits. *Id.*

ARGUMENT

I. This Court's Decision in *East Chicago I* Substantially Undercuts the Rationale for the Decision of the Court of Appeals

While the Court's order granting transfer in this case has already vacated the Court of Appeals' opinion, it is nonetheless worth considering whether the Court of Appeals' rationale remains viable in light of the Court's decision in *East Chicago I*. In the decision below, the Court of Appeals held that, regardless of Section 302, "the East Chicago Common Council has *always* retained the authority to modify the arrangement encapsulated in the letter agreements[.]" *Foundations of East*

Chicago, Inc. v. City of East Chicago, 905 N.E.2d 30, 35 (Ind. Ct. App. 2009). The court reasoned that it would violate public policy to enforce the letter agreements as binding agreements of indefinite duration. *Id.* (“To enforce this policy would be akin to permitting a corrupt public official to enter into an agreement that would bind his or her constituents in perpetuity To enforce such a policy would be profoundly unwise.”). Thus, the court held that the only way in which the agreements could be interpreted “logically [] and prudently” is to conclude that the City has always possessed the authority to modify the agreements and change the recipient of the licensee’s local economic development funds. *Id.*

This holding is now directly at odds with this Court’s decision in *East Chicago I*, where the Court held that “[t]he City does not have the authority unilaterally to terminate or alter the terms and conditions of a license issued by the Gaming Commission.” *East Chicago I*, 908 N.E.2d at 623. Rather, the Court held that the agreements—which “the Commission incorporated . . . as conditions to Showboat’s license,” *id.* at 615—are subject to alteration only “through the administrative processes of the Gaming Commission[.]” *Id.* at 624. In light of this holding, the rationale applied by the Court of Appeals in the decision below is no longer tenable.

II. The General Assembly May Alter the Scope of the Gaming Commission’s Authority With Respect to the Validity of Local Development Agreements

In *East Chicago I*, the Court discussed the authority of the Gaming Commission and its “central” role in the events of these three cases. *See East*

Chicago I, 906 N.E.2d at 623-24. The Commission does, indeed, have broad authority to regulate gambling in Indiana. As this Court noted, it has the power to both grant and revoke licenses, to renew existing licenses, to approve the sale or transfer of a license, and to alter or cancel specific terms of licenses. *Id.* (citing Ind. Code § 4-33-6-17; Ind. Code § 4-33-6.5-12; Ind. Code §§ 4-33-4-1(a)(11), (14)).

However, it is a long-held principle that any power bestowed by the legislature can likewise be revoked or modified by the legislature. *See Schultz v. State*, 417 N.E.2d 1127, 1136 (Ind. Ct. App. 1981) (“While this court recognizes that the delegation of legislative power is necessary for the effectiveness of modern government, we also recognize that the legislature’s prerogative to control that power should be assiduously respected.”) (citations omitted); *State ex rel. Evansville Tel. Co. v. Stickelman*, 182 Ind. 102, 105 N.E. 777, 779 (1914) (“As the legislature gave, so that body may take away or modify, that power.”) (quoting *Coverdale v. Edwards*, 155 Ind. 374, 380, 58 N.E. 495, 497 (1900)); *cf. Barco Beverage Corp. v. Indiana Alcoholic Beverage Comm’n*, 595 N.E.2d 250, 255 (Ind. 1992) (“Had the legislature believed that Rule 28 was not in conformance with its policy or was outside of the powers delegated to the Commission, it has had several opportunities either to repeal Rule 28 or to amend the statute so as to deny the Commission the power to promulgate such a rule.”)

By enacting Section 302, the legislature simply exercised its authority to lessen the exclusivity of the Gaming Commission’s powers by conferring upon the City the authority to adopt an ordinance voiding any term of the East Chicago LDA

upon transfer of the East Chicago riverboat license. *See* H.E.A. 1001, 115th Gen. Assembly, 1st Reg. Sess. (Ind. 2007). Section 302 applies only to the East Chicago license, which is both necessary and appropriate due to the long history of corruption that has plagued the City. *See* State's Br. of Appellee 35-43; State's Combined Resp. to Pet. to Transfer 2-5 (both describing the history of public corruption in East Chicago). Thus, Section 302 is not a wholesale alteration of the Gaming Commission's regulatory authority (though, even if it were, it would be a valid exercise of legislative authority). Rather, it is a narrowly targeted piece of legislation that simply modifies one small portion of the authority the legislature previously conferred upon the Commission.

III. Because this Court Has Held That the East Chicago Local Development Agreement is a Mode of Regulation Rather Than an Ordinary Commercial Contract, the Contracts and Takings Clauses Cannot Apply and Section 302 Cannot be Impermissible Special Legislation

The State has argued throughout this case that local development agreements such as that between the City and the East Chicago riverboat licensee are an important part of the regulatory matrix governing riverboat gambling in Indiana. *See* State's Br. of Appellee 7; State's Pre-Trial Mem. 5-10. These LDAs provide the detailed means for effectuating the General Assembly's general directives concerning the relationship between casinos and local development; therefore, they are more like administrative rules than they are like ordinary commercial contracts. State's Br. of Appellee 7.

In *East Chicago II*, the Court agreed with this argument, holding that the East Chicago local development agreement “is not like an ordinary commercial contract *at all*. This agreement was a mode of implementing the casino’s obligation to contribute to local economic development.” *East Chicago II*, 904 N.E.2d at 221 (emphasis added). This holding—a *key* principle that FEC has consistently denied—effectively negates FEC’s arguments that Section 302 violates the Contracts and Takings Clauses of the state and federal constitutions.

FEC has argued that Section 302 violates both the state and federal Contracts Clauses because it “directly and purposely authorizes the City to *eliminate* the Foundations’ contract rights and seize those rights for itself.” FEC’s Br. of Appellant 18. However, where there is no actual contract in any normal sense, there can be no impairment of contract rights. Likewise, there can be no property interest subject to a “taking.” See FEC’s Br. of Appellant 26 (arguing that Section 302 “authorizes a direct taking by the City of the Foundations’ contract rights to funds distributed under the Agreement[.]”). As the State has previously argued, claiming a property interest in the funds flowing from the LDA is fundamentally the same as claiming a property interest in the LDA itself. See State’s Br. of Appellee 28. However, FEC cannot claim an interest in a form of government regulation, which this Court has held the East Chicago LDA to be. Accordingly, FEC cannot claim an interest in the proceeds incidentally flowing from such regulation. No taking has been effected.

East Chicago II's acknowledgment of the LDA as a form of regulation also suggests an answer to the special legislation issue. This Court has said that special legislation is permissible if it does not stand by itself but, rather, functions as an integrated component of a regulatory scheme. *See Williams v. State*, 724 N.E.2d 1070, 1085 (Ind. 2000) (upholding statute that “provide[d] for the appointment of magistrates only in Lake County courts”). Here, the legislature enacted Section 302 as an amendment to the Riverboat Gambling Act. Section 302 coheres with the scheme of the Act and with the overall regulatory matrix governing riverboat gambling in Indiana (of which the East Chicago LDA is one component). Indeed, many provisions of the Riverboat Gambling Act apply only to riverboat gambling licenses or activities in particular cities or counties. *See, e.g.*, Ind. Code § 4-33-6-18(b) (applies only to Ohio County); Ind. Code § 4-33-12-6(d) (applies only to Lake County); Ind. Code §§ 4-33-12.5-2, -6 (same); Ind. Code § 4-33-6-7(b) (applies only to largest city in Lake Michigan counties). Thus, Section 302 functions as part of an integrated regulatory scheme and therefore cannot be impermissible special legislation. *See State’s Br. of Appellee 35-42* (further analysis of special legislation issue).

IV. Important Holdings From *East Chicago I* Also Support the Validity of Section 302

As noted, the Court in *East Chicago I* held that, although the LDA is not terminable at will by East Chicago, it is nonetheless “subject to periodic alteration (through the administrative processes of the Gaming Commission).” *East Chicago I*, 908 N.E.2d at 624. In the same vein, the Court observed that, “[w]hile the

Foundations can be said to have justifiably relied on the revenue that has flowed [to it] as a result of the local development agreements and the license issued by the Gaming Commission, that reliance should not be a permanent bar to altering the methods employed to further economic development in East Chicago.” *Id.* It follows from these observations and holdings that Section 302 survives several of FEC’s constitutional objections.

A. Section 302 is not an unlawful impairment of contracts under either the State or Federal Constitutions

FEC argues that Section 302 violates both the State and Federal Contracts Clauses because “[i]t directly and purposely authorizes the City to *eliminate* the Foundations’ contract rights and seize those rights for itself.” FEC’s Br. of Appellant 18. If FEC’s reliance interests are insufficiently strong to constitute barriers “to altering the methods employed to further economic development in East Chicago” generally, *East Chicago I*, 908 N.E.2d at 625, it follows that those interests cannot thwart Section 302, which is merely one means of “altering” those methods. *See Energy Reserves Group, Inc. v. Kansas Power and Light, Co.*, 459 U.S. 400, 416 (1983) (holding that, the more regulation an industry has previously endured, the less contracts in that industry may reasonably be deemed impaired by subsequent legislation); *see also* State’s Br. of Appellee 12-16 (further Contracts Clause analysis).

Furthermore, even if the Court finds a cognizable substantial impairment, its holdings in *East Chicago I* demonstrate that Section 302 is still valid due to the legitimate and significant public purpose behind the law. *U.S. Trust Co. of New*

York v. New Jersey, 431 U.S. 1, 22 (1977). Section 302 serves a number of important and legitimate public purposes, including: (1) subjecting public funds to oversight by electorally accountable public officials; (2) ensuring that gambling revenues are used for local development; (3) helping to foster a sense of openness in a city that has been plagued by scandals and corruption; and (4) maintaining credibility and integrity, and decreasing opportunities for corruption, in riverboat gambling operations. These purposes are all part of the State's police power to protect the welfare of its people. In view of these important state interests, any legally cognizable impairment is both reasonable and appropriate. *Energy Reserves*, 459 U.S. at 412; *Clem v. Christole, Inc.*, 582 N.E.2d 780, 784 (Ind. 1991); *see also* State's Br. of Appellee 10-24 (further Contracts Clause analysis).

B. Section 302 does not create an unconstitutional taking under either the state or federal Takings Clauses

FEC also claims that it has a private property interest in the riverboat gambling funds reserved to it under the local development agreement and that Section 302 "authorizes a direct taking by the City of the Foundations' contract rights to funds distributed under the Agreement[]." FEC's Br. of Appellant 26. By holding that the LDA could, prior to the enactment of Section 302, be altered by the Gaming Commission, the Court has already in essence arrived at the conclusion that the LDA does not create constitutionally protectable interests. *See East Chicago I*, 908 N.E.2d at 623-24.

Here, again, the fact that the LDA is a mode of regulation rather than a typical commercial contract is important. FEC was created to receive and

distribute riverboat gambling revenues only as part of the overall regulatory scheme designed to channel revenues from the riverboat casinos to various beneficial public uses. It is not, therefore, an ordinary third-party beneficiary to an ordinary contract, as the Court recognized with its observation that the Gaming Commission itself could alter the LDA. *See id.*

Furthermore, under the balancing test for asserted regulatory takings—factors that examine the financial impact of the regulation, the investment-backed expectations of the property owner, and the character of the regulation, *Penn Central Transportation Co. v. City of New York*, 438 U.S. 104, 124 (1978)—the Court’s holding in *East Chicago I* further weakens FEC’s case. First, as to the financial impact, the Court has already held that FEC’s interests are insufficient to preclude the government from restructuring the distribution of East Chicago riverboat casino economic development proceeds. *See East Chicago I*, 908 N.E.2d at 623-24. Furthermore, *East Chicago I* perforce deems the character of the government action enabled by Section 302—“altering the methods employed to further economic development in East Chicago,” *id.* at 625—to be entirely legitimate. As with a hypothetical alteration by the Gaming Commission, Section 302 has nothing to do with appropriating private property for the government or regulating a stand-alone business out of existence. It has to do instead with heading off a deal that siphoned revenue intended to benefit the public into the coffers of the former East Chicago mayor’s associates. *See State’s Br. of Appellee* 24-32 (further Takings Clause analysis).

C. *East Chicago I* moots FEC's separation-of-powers argument

FEC has previously argued in this case that, in enacting Section 302, the General Assembly violated separation-of-powers doctrine because it sought to vacate a previous judgment of Indiana courts, namely Judge Bradford's trial court judgment in *East Chicago I* that the LDA constituted an enforceable agreement, to which the Foundations are a third-party beneficiary. FEC's Br. of Appellant 34-37. The State has previously explained why this argument is unavailing (*see* Br. of Appellee 43-46), but now that this Court has entered its own judgment in *East Chicago I*, it should treat this issue as moot. While the Court did affirm some of Judge Bradford's holdings, it remanded *East Chicago I* back to the trial court for further proceedings that could as yet undermine the validity of the LDA even apart from Section 302. For example, this Court held, among other things, that Count VII of the City's complaint should not have been dismissed. That Count alleged that "[a]ny provision purporting to require payment of funds from the East Chicago riverboat directly to Second Century is void to the extent it was approved as a result of a breach of fiduciary duty." *East Chicago I*, 908 N.E.2d at 621 (citation omitted). On remand, a trial court ruling on this Count in the City's favor would undermine the validity of the LDA.

Accordingly, there is no longer any foundational judgment on which the Foundations may base their separation-of-powers argument.

CONCLUSION

The Court should reject the methodology of the decision below, but ultimately affirm the Court of Appeals' holding that Section 302 should not be struck down.

Respectfully submitted,

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WORD COUNT CERTIFICATE

As required by the Court's August 21, 2009 Order Directing Additional Briefing, I verify that this Supplemental Brief of the State of Indiana contains no more than 4,200 words.

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CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of September, 2009, a copy of the foregoing was served via First Class United States mail, postage pre-paid upon the following:

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