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Third Circuit Overrules Dismissal of Suit Challenging Property Tax Breaks Conditioned on the Use of Union Labor

On September 12, the Third Circuit Court of Appeals held that the United States District Court for the District of New Jersey erred in dismissing a suit against Jersey City challenging its ordinance which required the use of union labor on certain construction projects which were subject to property tax abatements. In *Associated Builders and Contractors, Inc. v. City of Jersey City*, 2016 U.S. App. Lexis 16654 (3d Cir., Sept. 12, 2016), the Third Circuit reversed the District Court's holding that Jersey City was a "market participant" rather than a "regulator" in enforcing a City ordinance which required developers, as a condition of property tax abatement agreements, to enter into agreements with labor unions to bind developers, their contractors and subcontractors to use union labor on the projects. In that regard, the Third Circuit held that the City was not acting as a "market participant" but rather as a "regulator," and therefore the plaintiffs' NLRA, ERISA and dormant Commerce Clause claims against the City were cognizable and thus were reinstated.

New Jersey's Long Term Tax Exemption and Five Year Exemption and Abatement Laws (N.J.S.A. 40A:20-1 to -22; 40A21-1 to -21) authorize the City to provide tax exemptions and abatements to private developers of projects within areas the City has designated for redevelopment. Such property tax abatements significantly reduce the developers' tax burden and result in lieu of tax payments, which are well below the property taxes due if the projects were taxed in accordance with the constitutional standard of fair market value.

The City enacted an ordinance which provided developers tax abatements for certain developments which cost at least $25 million and were funded only with private investment. The City's ordinance provided that, prior to commencing work on construction projects, developers of the projects must execute project labor agreements (PLAs), which require developers of tax-abated projects to negotiate with labor unions that would represent all employees during negotiations and for the duration of the project, and which would also bind the developers' contractors and subcontractors even if the developers, contractors and subcontractors did not ordinarily employ unionized labor and its employees were not union members. Moreover, the PLA provided that each contractor or subcontractor working on a tax-abated project would have a local federally registered apprentice program and 20 percent of all labor hours would be performed by apprentices who were city residents. If a developer did not abide by the conditions of the ordinance, the City could, among other things, suspend the tax abatement until such time as there was compliance, during which time the City could assess three times the amount of conventional real estate taxes due and owing on the project, or the City could terminate the abatement if the project were not brought into compliance within six months.

The plaintiffs challenged the ordinance on the grounds that it was preempted by Sections 7 and 8 of the NLRA (29 U.S.C. §§ 157-58), it violated the dormant Commerce Clause and Privileges and Immunities Clause of the United States Constitution, it was preempted by ERISA (29 U.S.C. § 1144(a)), and it violated the Due Process and Equal Protection Clauses of the United States and New Jersey Constitutions as well as the Civil Rights Act of 1964 (42 U.S.C. § 1983). The City moved to dismiss the complaint for failure to state a claim upon which relief could be granted as to the NLRA, dormant Commerce Clause and ERISA claims. The City particularly argued that it imposes and enforces the PLA requirement in its capacity as a "market participant," not as a "regulator." The District Court concluded that the City enforces the ordinance as a "market participant" and therefore dismissed the claims under the NLRA, ERISA and dormant Commerce Clause.

The Third Circuit found that, despite their differences, the NLRA, dormant Commerce Clause and ERISA share the same threshold requirement that the alleged unlawful act by the state or local government be "regulatory" in nature. Federal preemption under these laws would not apply if the state or local government were acting as a "market participant." The

"market participant" exception is founded by the notion that the government, like any other party participating in the market economy, is free to engage in the efficient procurement and sale of goods and services. In *Hotel Empls. & Rest. Empls. Union Local 57 v. Sage Hosp. Res., LLC*, 390 F.3d 206 (3d Cir. 2004), the Third Circuit employed a two-part test to determine whether the government acted as a "market" participant. First, the court looked to whether the ordinance "serve[d] to advance or preserve the state's proprietary interest in a project or transaction, as an investor, owner or financier," and, second, the court asked whether "the action [was] so broad as to be considered, in effect, regulatory."

The Third Circuit did not need to go any further than the first step of the "*Sage* test." The Third Circuit found that the Supreme Court's decision in *Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 117 S.Ct. 1590, 137 L.Ed.2d 852 (1997), was directly on point. In that case, the Supreme Court held that the state was not acting as a "market participant" when it gave tax breaks to charities, rejecting the argument that a tax exemption is akin to a government "purchase" of charitable services, resulting in a proprietary interest in the entities receiving the exemption. Property tax exemptions, reasoned the Supreme Court, are the "assessment and computation of taxes – a primeval government activity." Hence, a "tax exemption is not the sort of direct state involvement in the market that falls within the market-participation doctrine."

The Third Circuit concluded that "Jersey City here does not purchase or otherwise fund the services of private developers or contractors who are constructing tax abated projects, or the goods used in those projects; nor does it sell those services or goods or invest, own or finance the projects." Instead, the court reasoned, "the City simply reduces the developers' tax burden for a period of time." The City has no proprietary interest in the tax-abated projects. Therefore, in enforcing the ordinance and the PLAs, the City was acting in its "regulatory" posture and not as a "market" participant. The District Court's dismissal of the plaintiffs' NLRA, ERISA and dormant Commerce Clause claims were reversed, and the matter was remanded to the District Court for adjudication.

The significance of this decision is that the plaintiffs' challenge to the ordinance requirement of the PLAs will be allowed to go forward. If the plaintiffs prevail, they may not be required to otherwise comply with the collective bargaining requirements of the ordinance. Other redevelopers may be hesitant to enter into tax abatement agreements with the City under the ordinance unless and until the validity of the ordinance's collective bargaining provisions are adjudicated one way or the other. Moreover, non-union contractors and subcontractors may be waiting in the wings to bid on tax-abated projects, depending on the outcome of the ordinance challenge. It is possible that some tax-abated redevelopment projects may be held in abeyance until the efficacy of the ordinance is ultimately resolved.

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