

SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2011-001038

06/05/2014

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

CHEVRON U S A INC

MARK A FULLER

v.

ARIZONA DEPARTMENT OF REVENUE

JERRY A FRIES

JAMES G BUSBY JR.

UNDER ADVISEMENT

Following oral argument on May 5, 2014, the Court took Plaintiff's Motion for Summary Judgment, Defendant's Cross-Motion for Summary Judgment, and Plaintiff's Motion to Strike Internet References from Department's Summary Judgment Brief and Motion to Strike Affidavit of Lisa Neuville from Department's Summary Judgment, or in the Alternative, for Ruling that the Department has Waived Attorney-Client Privilege under advisement. Upon further consideration, the Court finds as follows.

Dealing first with the motions to strike, the Court believes the relevant facts concerning the products in question are generally as stated in Chevron's statement of facts, and places little if any weight on the internet materials submitted by the Department. In addition, Ms. Neuville's affidavit is of negligible value. The Court is concerned here with whether the Department's decision was correct or incorrect, not the quality of its decision-making process. Additionally, the Court finds the motions to strike to be improper under the new iteration of Rule 7.1(f), Ariz. R. Civ. P. The motions to strike are denied.

As both sides acknowledge, this case turns on whether the products qualify as components of "machinery and equipment" used directly in mining and metallurgical operations, or if they are "expendable materials." As the Supreme Court remarked, these terms lack definitional specificity. *State ex rel. Ariz. Dept. of Revenue v. Capitol Castings, Inc.*, 207 Ariz. 445, 448 ¶ 13 (2004). Consequently, the Court must perform an analysis that includes "the nature

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of the item and its role in the operations. Items essential or necessary to the completion of the finished product are more likely to be exempt. The prominence of an item's role in maintaining a harmonious 'integrated synchronized system' with the indisputably exempt items will also directly correlate with the likelihood that the exemption applies. The closer the nexus between the item at issue and the process of converting raw materials into finished products, the more likely the item will be exempt. As part of its analysis, the court should consider whether the item physically touches the raw materials or work in process, whether the item manipulates or affects the raw materials or work in process, or whether the item adds value to the raw materials or work in process as opposed to simply reducing costs or relating to post-production activities." *Id.* at 451 ¶ 25 (internal citations omitted). The difficulty of the issue is evidenced by *Capitol Castings* itself: while the Court declared some items to be part of the machinery or equipments and others not, it did not decide, and remanded to the Tax Court, a category called "refractory materials," which protected the machinery and equipment from the extreme heat generated by the manufacturing processes: a close analogue to the oils and greases here.

The Court concludes that, with the exception of the hydraulic fluids and transmission fluids which the Department has conceded to be exempt, the products do not qualify as machinery and equipment used directly in the covered activities. While they may have ancillary purposes as well, their primary function is to lubricate: a term the Court uses broadly to include the reduction of friction, the dissipation of heat, the suspension of debris, and so on. As such, they are not *parts* of the machine, they are foreign substances *applied to* the machine, either externally or internally, to prevent or minimize the destructive contact of machine parts. The oils and greases do not touch the raw materials or work in progress, nor affect them, nor add value to them; they play no direct part in the completion of the finished product. They do, on the other hand, reduce costs: the Court accepts Chevron's conclusion that, without its products, the machinery would be subject to frequent and catastrophic failures, but this is bad because repair expenses would be excessive. In short, the nexus between the oils and greases and the finished product is remote. Finally, there arises the logical and necessary question, if oil and grease are not expendable materials, what are? Something must be, because the legislature, in restoring the broad exemption that predated the first *Capitol Castings* opinion, nonetheless retained the statutory distinction. If the exemption is construed as broadly as Chevron urges, everything would fall under the exception-to-the-exception in subsection (C)(1) and there would have been no reason for the legislature to retain the exception at all. Grease and oil are sufficiently remote from the core function of the machinery that their taxation will not have a significant impact on economic development. *See id.* at 448 ¶ 13.

Based on the foregoing as well as the arguments made by the Defendant,

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IT IS ORDERED denying Plaintiff's Motion for Summary Judgment.

IT IS FURTHER ORDERED granting Defendant's Cross-Motion for Summary Judgment.

IT IS FURTHER ORDERED directing Defendant to lodge a form of judgment and file any Application and Affidavit for Attorney's Fees and Statement of Taxable Costs by July 3, 2014.