Michael K. Jeanes, Clerk of Court
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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2012-000184 02/28/2014

HONORABLE DEAN M. FINK

CLERK OF THE COURT
S. Brown
Deputy

ARIZONA EASTERN RAILWAY COMPANY MARK D CHERNOFF

v.

STATE OF ARIZONA DEPARTMENT OF REVENUE BENJAMIN H UPDIKE

PETER C GUILD

UNDER ADVISEMENT RULING

Following oral argument on February 24, 2014, the Court took Plaintiff's Motion for Partial Summary Judgment and Defendant's Cross-Motion for Summary Judgment under advisement. Upon further consideration, the Court finds as follows.

Rehab project

The Court believes it obvious enough to warrant judicial notice that the business of operating a railroad requires rails, and that those rails require periodic work both for efficient operation of the trains and to comply with government regulations. The parties acknowledge that the Rehab Project moneys were specifically intended at least for the latter, to place the rails in compliance with the FRA's class II safety standards. It is not suggested that payment of the rehab charge entitles the payor to an upgrade in service, or that customers were given the option not to pay if they were willing to accept transport on non-FRA-compliant track; instead, the money was dedicated to the general improvement of the Short Line. It thus strikes the Court that the cost of this periodic work is integral and incidental to Arizona Eastern's overall railroad business, whether it is identified as a distinct line item or incorporated into the overall cost of carriage. The Court does not read *City of Phoenix v. Arizona Rent-A-Car Systems, Inc.*, 182 Ariz. 75, 79-80 (App. 1995), as requiring that the charge be made explicit.

On the other hand, the rails are not freight, nor are they transported. They are no different from any other machinery or equipment used in Arizona to produce goods or services for interstate commerce. They are therefore outside the exclusion set forth at A.R.S. § 42-5062(A)(5). The Court is aware of no Commerce Clause jurisprudence that prevents a state from taxing property that is used in producing goods or services sold in interstate commerce, provided that sufficient nexus, such as physical location within the taxing state, exists, as it does here. The same would apply to income used to purchase or maintain that property.

There is no breakdown between the charge for track rehabilitation and the charge, if any, for the first refusal option, and no basis on which to assign that option a value. The option would of course be worthless if Arizona Eastern does not sell, and there is nothing in the record to indicate that selling was considered a possibility likely enough to warrant a non-nominal payment. The Department was therefore within its rights to disregard the option and treat the entire charge as rehab-related. *Contrast State Tax Comm. v. Holmes & Narver, Inc.*, 113 Ariz. 165, 169 (1976) (revenues are not merged where amount in question "can be readily ascertained without substantial difficulty" and is "not inconsequential" in relation to total Arizona business).

Switching

Mere weighing of the railcars or their contents, even if the contents are removed for that purpose, would not affect the interstate nature of their commerce. However, the processing of the materials transported on the Short Line into other objects of materially changed character, utility, and value before being placed on other railcars does interrupt their movement in commerce. *Arkadelphia Milling Co. v. St. Louis Southeastern Ry. Co.*, 249 U.S. 134, 151 (1919). (For a discussion on the effect of *Arkadelphia* on *Southern Pacific Terminal Co. v. Interstate Commerce Comm.*, 219 U.S. 498, 526 (1911), on which Plaintiff relies, *see Roberts v. Levine*, 921 F.2d 804, 815-16 (8th Cir. 1990), and *Baltimore & O. R. Co. v. U.S.*, 15 F.Supp. 674, 676 (D.C.N.Y. 1936).) It is clear that what is described as tank house switching involves such processing: unformed copper is taken to the rod mill, where it is unloaded and turned into copper rod (by a non-railroad party, so outside the A.R.S. § 42-5062(A)(5) exemption) before being put back onto railcars. It is not clear from the briefing whether materials were also processed in the concentrate and anode switching. Thus, unless the parties can reach agreement, the taxability in whole or in part of these switches must remain a fact question.

Demurrage

In effect, demurrage is a fee for rental of a railcar beyond normal loading, travel, and unloading time. Its exclusion (at least under the contract here, where it is limited to time spent loading and unloading and not applied to periods when the railcar sits empty) would appear to be predicated on whether the underlying commerce is or is not interstate. That at any rate is

apparently the Department's position. But the Court is at a loss to understand the Department's calculation that one-third of the demurrage revenue is taxable, a figure that seems to be arbitrary.

Therefore, the Court grants Plaintiff's motion only as to the switching revenues designated weighing. It grants the Department's motion with respect to the rehab project revenues and the switching revenues designated tank house. On the remainder of the issues, questions of fact remain, so both motions are denied.

Pursuant to the above ruling,

IT IS ORDERED as follows:

Counsel/parties are to meet personally to discuss all of the matters set forth in Rule 16(b), Ariz. R. Civ. P. Counsel/parties shall prepare and file with the Court, no later than **May 2, 2014,** a Joint Pretrial Memorandum, **and** a form of Order **(preferably in Word format)**, for discovery, motion and disclosure deadlines.

If the parties agree to the dates, they should prepare a Stipulation signed by all counsel or parties **and** a form of order for the Court to sign in the form set forth below, containing the provisions which are applicable to their case. For example, paragraph 1 of the Order set forth below need not be included in the parties' proposed Order if the parties intend to disclose their experts' identity and opinions at the same time they disclose their experts' areas of testimony. Similarly, if the parties agree to simultaneously disclose the identity and opinions of their expert witnesses, they need not include in their proposed Order the language set forth in paragraph 2a. and b., below.

The proposed Order shall include specific dates (**"**December 5, 2009**"** is a specific date. **"**90 days prior to trial" is a date in reference to a trial date and is not a specific date). All applicable blanks should be filled in, except for the date of the Scheduling/Status Conference, as indicated. Do not incorporate a firm trial date in the proposed Order.

If counsel/parties are unable to agree on any of the items that are to be included in the Order, the reasons for their inability to agree shall be set forth in their Pretrial Memorandum and each shall prepare a separate proposed Order.

The Court will review the Joint Pretrial Memorandum and Scheduling Order. If all is in order, the Court will set a scheduling/status conference after the discovery cutoff date. At the scheduling/status conference, if the parties have completed discovery and are ready for trial, the Court will set firm dates for the final pretrial management conference and the trial. If the parties

are not ready for trial, the matter will be placed on the Inactive Calendar for dismissal **within 60 days**.

If counsel/parties feel a pretrial conference is still necessary at this stage of the litigation, they should address the reasons why in the first paragraph of the Joint Pretrial Memorandum.

If a Joint Pretrial Conference Memorandum and Scheduling Order are not timely submitted, the Court will place the matter on the Inactive Calendar for dismissal.

Counsel/parties shall provide prepaid return-addressed envelopes for the return mailing of the Scheduling Order and the appropriate number of copies of the Scheduling Order for all parties involved in this case, unless the parties are taking advantage of the e-filing program.

The following is the general format to be used in the scheduling order:

SCHEDULING ORDER LANGUAGE:

The Court has received and reviewed the parties' Joint Pretrial Memorandum and proposed Scheduling Order.

In accordance therewith,

IT IS ORDERED as follows:

1. The parties shall exchange initial Rule 26.1 disclosure statements no later than 5:00 p.m. on _____. **(If already exchanged, this order may be omitted.)**

2. The parties shall mutually and simultaneously disclose areas of expert testimony by **5:00 p.m. on _____, 2010.** [**or**]

   a. Plaintiffs shall disclose areas of expert testimony by **5:00 p.m. on _____, 2010.**

   b. Defendants shall disclose areas of expert testimony by **5:00 p.m. on _____, 2010.**

3. The parties shall mutually and simultaneously disclose the identity and opinions of their expert witnesses by **5:00 p.m. on _____, 2010.** [**or**]

   a. Plaintiffs shall disclose the identity and opinions of their expert witnesses by **5:00 p.m. on _____, 2010.**

   b. Defendants shall disclose the identity and opinions of their expert witnesses by **5:00 p.m. on _____, 2010.**

4. Any and all discovery requests shall be served by **5:00 p.m. on _____, 2010.**

5. The parties shall disclose all non-expert witnesses and areas of testimony by **5:00 p.m. on _____, 2010.**

6. The parties shall mutually and simultaneously disclose their rebuttal expert witnesses and opinions by **5:00 p.m. on _____, 2010.**

7. All discovery shall be concluded by **5:00 p.m. on _____, 2010.**

8. The parties shall have exchanged up-to-date final Rule 26.1 Supplemental Disclosure Statements by **5:00 p.m. on _____, 2010.** This Order does not replace the parties' obligation to seasonably disclose on an on-going basis under Rule 26.1 as information becomes available.

9. Settlement conference (choose one):

   a. **PRIVATE MEDIATION**

   The parties shall participate in private mediation by **5:00 p.m. on _____, 2010;**

   All counsel/parties and their clients, or non-lawyer representatives who have full and complete authority to settle this case, shall personally appear and participate in good faith in this mediation, even if no settlement is expected. The mediator may permit a non-lawyer representative to appear telephonically if such appearance is requested and granted prior to the hearing.

OR

b. **REFERRAL TO ADR FOR SETTLEMENT CONFERENCE**
Referral will be issued by Clerk via separate minute entry.

The parties request a referral to the Court's Alternative Dispute Resolution Office (ADR) for the appointment of a judge *pro tempore* to conduct a settlement conference. The parties request that the judge *pro tempore* conduct a settlement conference not later than **_____, 2010**. (**NOTE:** The ADR Office requires a minimum of 90 days to set a conference date.)

10. No expert witnesses, expert opinions, lay witnesses, or exhibits shall be used at trial other than those disclosed in a timely manner, except for good cause shown or written agreement of the parties.

11. All dispositive motions shall be filed by 5:00 p.m. on **_____, 2010**.

12. A Telephonic Status/Scheduling Conference is set for the purpose of assigning a trial date on **(___LEAVE DATE AND TIME BLANK___)**. Counsel/parties shall have their trial calendars available for the conference.

NOTE: Counsel for the _____ is to initiate the telephonic conference by first arranging the presence of all other counsel or self-represented parties on the conference call and by calling this division (**602-506-3776**) at the scheduled time.

13. Should any discovery disputes arise, counsel/parties, prior to filing discovery motions, shall meet and confer pursuant to Rule 37, Ariz.R.Civ.P.

14. The dates set forth in this Order are FIRM dates and will not be extended or modified by this Court absent good cause. Lack of preparation will not ordinarily be considered good cause.

15. **If the parties stipulate to extend any of these deadlines, the Court must be notified of said stipulation and must enter an order granting same. If no order is obtained, the foregoing orders shall not be altered, despite any agreement of the parties.**

16. Rule 38.1 of Ariz.R.Civ.P. is waived unless and until otherwise ordered by the Court.

17. Continuing this case on the inactive calendar until _____.

Date

Honorable Dean M. Fink
Judge of the Superior Court