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SUPERIOR COURT OF ARIZONA
MARICOPA COUNTY

TX 2007-000057 08/05/2009

HON. THOMAS DUNEVANT, III

CLERK OF THE COURT
T. Pavia
Deputy

CNL HOTELS AND RESORTS INC, et al. BRIAN W LACORTE

v.

ARIZONA STATE DEPARTMENT OF REVENUE, et al. KENNETH J LOVE

ROBERTA S LIVESAY

UNDER ADVISEMENT RULING
Defendant Maricopa County's Motion for Summary Judgment

This is a case turning on the ownership of improvements to government-owned land. The Court of Appeals has recently addressed this subject in *Calpine Const. Finance Co. v. Arizona Dept. of Revenue,* – Ariz. –, 2009 WL 1014583 (App. 2009). The Court recognizes that, as the mandate has not yet issued, that opinion may not be the final word. Nonetheless, the Court follows it, subject to reconsideration should it be materially modified by the Supreme Court.

Plaintiffs are the lessee for a 99-year period of two parcels owned by the Arizona State Land Department, and have constructed on them a resort facility and golf course. (Neither party asserts any significant difference between the tax treatments of the two, so for simplicity the Court focuses its analysis on the resort.) The resort was classified as class one. Plaintiff seeks reclassification as class nine. To qualify for class nine status, the property must be used for one or more of several specified purposes – a criterion Plaintiffs do meet – and the improvements must become the property of the lessor government upon termination of the lease.

Two aspects of the lease weigh against Plaintiffs. First, there is no requirement that the improvements remain on the land, in good repair and in a non-obsolescent condition, at the end of the lease. Paragraph 8.5 of the lease makes the lessee (Plaintiffs) owner of all improvements. By itself, this provision suggests that the improvements are Plaintiffs' property. *See Calpine*, *supra* at ¶ 17. At the end of the lease period, the lessee must of course peaceably surrender possession of the land and any fixtures then thereon. However, Paragraph 8.9 expressly states that the lessee "shall have the right … to remove or demolish all or any part of such Improvements on the Parcel without any obligation to reconstruct Improvements thereon." No approval from the State is required. Plaintiffs' ability to control what improvements will remain on the land at termination is another indicium of Plaintiff's ownership. *See id*. at ¶ 18. Plaintiffs attempt to distinguish *Calpine* by arguing that, unlike the power generating equipment in *Calpine*, a resort facility can, as it were, age gracefully. However, the Court of Appeals gave little weight to the obsolescence argument when raised in *Calpine*; *id*. at ¶ 19-21. (The Court observes, however, that Paragraph 8.7.2, dealing with the obligations of a post-termination purchaser of the improvements, requires that purchaser to keep the improvements in good condition until Plaintiffs are paid in full. No such obligation is placed on Plaintiffs vis-à-vis the State.) Moreover, just as in *Calpine*, Plaintiffs can remove any valuable improvements before the property reverts, leaving the State with only what it chooses to leave. Plaintiffs also argue that Paragraph 8.9 conflicts with A.R.S. § 37-322.03(A); they, however, qualify their position by denying themselves only the right of "complete demolition." That the State may be guaranteed *some* improvements at the end of the lease (and that may not in fact be guaranteed: A.R.S. § 37-322.03(B) permits the lessee to remove improvements within sixty days before termination, provided their removal does not injure the land) is inadequate. A.R.S. § 42-12009(1)(a) requires that improvements taxed as class nine become the property of the government lessor at the end of the lease; a demolished improvement no longer exists at termination, so obviously cannot become government property. Clairvoyance not being a practical option, the statute makes sense only if no demolition of improvements is allowed, and Plaintiffs do not assert that to be the case here.

Another clause in the lease, this one with no parallel in *Calpine*, impairs the State's reversionary interest. Articles 23 and 24 contain substantial restraints on the State's alienation of the parcel, not only during the lease term but after its expiration. As helpfully summarized in Plaintiffs' Response, "Articles 23 and 24 of the Ground Lease allow the State to control disposition of the improvements at termination, such as (i) the State selling the land to a third party, which allows the lessee to be reimbursed for improvements but nonetheless terminates the lease and allows the improvements to vest in the third party purchaser, (ii) the State keeping the improvements to run a convention hotel or re-let the same to another hotel operator, (iii) the State exchanging or swapping the parcel and improvements for other land, and (iv) the State re-letting the land to Plaintiffs for a subsequent ten year lease term. All these options are exclusively within the control of the State." The question, however, is not just whether the State will have the power to alienate the improvements at the end of the lease; it is whether its reversionary interest is less than full ownership.

Ownership of property is the "collection of rights to use and enjoy property, including [the] right to transmit it to others. The complete dominion, title, or proprietary right in a thing or claim. The entirety of the powers of use and disposal allowed by law." *Cutter Aviation, Inc. v. Arizona Dept. of Revenue*, 191 Ariz. 485, 490 (App. 1997) (quoting BLACK'S LAW DICT. (6^{th} ed. 1990) at 1106). Paragraph 8.7.1 states that, if the property is sold after termination of the lease, the new owner must pay Plaintiffs ten percent of the appraised value of the improvements. The terms on a new lessee are even more onerous: pursuant to Paragraph 8.7.4, it must pay one hundred percent of their appraised value. If the improvements alone are sold, Plaintiff is again entitled to one hundred percent of their appraised value under Paragraph 8.7.2. Plaintiffs' entitlement to even ten percent, let alone one hundred percent, of the value of the improvements after they have supposedly "reverted" to the State is inconsistent with the State's full ownership of them. Therefore,

IT IS ORDERED:

Defendant Maricopa County's Motion for Summary Judgment is granted.