ARIZONA SUPREME COURT

CITY OF PHOENIX, et al.,	)	No. CV-18-0275-PR
	)	
Plaintiffs/Appellees/	)	Court of Appeals
Cross-Appellants,	)	No. 1 CA-TX 16-0016
	)	1 CA-TX 16-0018
v.	)	(Consolidated)
	)	
ORBITZ WORLDWIDE, et al.,	)	Maricopa County
	)	Superior Court
Defendants/Appellants/	)	No. TX-2014-000470
Cross-Appellees	)	TX-2014-000471
	)	TX-2014-000472
	)	TX-2014-000473
	)	TX-2014-000474
	)	TX-2014-000475
	)	(Consolidated)
	)	

PLAINTIFFS/APPELLEES/CROSS-APPELLANTS' RESPONSE IN OPPOSITION TO PETITION FOR REVIEW AND, IN THE ALTERNATIVE, CROSS-PETITION FOR REVIEW

Jeffrey R. Finley (009683)
SCHNEIDER WALLACE COTTRELL KONECKY WOTKYNS LLP
8501 N. Scottsdale Road, Suite 270
Scottsdale, Arizona 85253
jfinley@schneiderwallace.com
(480) 428-0145

Scott Andersen (020094)
WRIGHT WELKER & PAUOLE, PLC
10429 S. 51st Street, Suite 285
Phoenix, Arizona 85044
sandersen@holmwright.com
(480) 961-0040

John Crongeyer (GA Atty ID 197267)
CRONGEYER LAW FIRM, P.C.
2170 Defoor Hills Road
Atlanta, Georgia 30318
jw552020@gmail.com
(404) 542-6205
Pro Hac Vice

Attorneys for Plaintiffs/Appellees/Cross-Appellants

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PLAINTIFFS/APPELLEES/CROSS-APPELLANTS'
RESPONSE IN OPPOSITION TO PETITION FOR REVIEW

In accordance with Ariz. R. Civ. App. P. 23, Plaintiffs/Appellees/Cross-Appellants, comprised of the City of Phoenix and 10 other Arizona cities (hereinafter "the Cities"), respond to the Defendants/Appellants/Cross-Appellees' Petition for Review. Each of the Cities has adopted hotel and transient lodging taxes per the Model City Tax Code ("MCTC"), and each determined via audit that the Defendant/Appellant/Cross-Appellee Online Travel Companies (hereinafter "the OTCs") that sell hotel rooms via online transactions, have evaded their concomitant tax obligations. As shown herein, this Court should deny the OTCs' Petition for Review as the Court of Appeals correctly decided this case based on the plain language of the MCTC, and there are no "important issues of law that have been incorrectly decided." Ariz. R. Civ. App. P. 23(d)(3).

In the alternative, should this Court grant the OTCs' Petition for Review regarding the Court of Appeals' compelling plain-language analysis of MCTC § __-444, it should also grant the Cities' cross-petition for review of the Court of Appeals' decision regarding the applicability of MCTC § __-447. In other words, if this Court is inclined to depart from a pure plain-language analysis of the pertinent statutory language of MCTC § __-444 and the related, specific definitions of the terms "person" and "broker," the Cities ask this Court to also review the Court of Appeals' plain-language decision regarding the applicability MCTC § __-447 to the OTCs'

hotel-room sales.

I. INTRODUCTION

In its thoughtful, well-reasoned decision, the Court of Appeals correctly determined, under the plain language of the relevant sections of the MCTC, and the definitions applicable thereto, that the OTCs are "brokers" of hotel rooms within the plain meaning of MCTC § __-100, and therefore, pursuant to MCTC § __-444, are "persons" subject to taxes on the gross income they receive from consumers in online hotel-room purchases. (*See generally* Court of Appeals' Decision at ¶¶ 14-25, appended to the OTCs' Petition for Review at APP040-43.)

Per the same plain-language analysis, the Court of Appeals also determined that the OTCs are not liable under MCTC § __-447 for taxes on the gross income they receive from consumers in online hotel-room purchases because, by its plain language, § __-447 applies only to "hotels," as opposed to "person[s] [including 'brokers'] engaging in the business of operating a hotel charging for lodging." MCTC § __-444. (*See generally* Court of Appeals' Decision at ¶¶ 26-28, appended to the OTCs' Petition for Review at APP043-44.)

Finally, the Court of Appeals correctly determined that the Cities are not barred under MCTC § __-542(b)(2) from assessing taxes, penalties, and interest against the OTCs prior to 2013 because the Cities' position advanced in this litigation—that the OTCs are "brokers" subject to the subject taxes—was not based

on a "new interpretation or application" of the MCTC. (*See generally* Court of Appeals' Decision at ¶¶ 29-31, appended to the OTCs' Petition for Review at APP044-45.)

The OTCs seek this Court's review of the Court of Appeals' determinations regarding the applicability of both MCTC §§ __-444 and 542. Regarding § __-444, the OTCs contend that the Court of Appeals: (1) incorrectly applied the plain statutory language; (2) failed to construe § __-444 against the Cities due to statutory ambiguity; (3) misconstrued the meaning of "broker" and incorrectly determined that the OTCs are "brokers" for hotels; (4) incorrectly determined that the OTCs' service fees are included in their taxable gross income; and (5) reached an untenable, unprecedented determination that taxes may be imposed for remote "facilitation" of a taxable privilege. (*See generally* OTCs' Petition for Review at 7-10.)

Regarding, MCTC § __- 542, the OTCs contend that the Court of Appeals: (1) improperly determined that, because the Cities had not adopted a new interpretation or application of MCTC § __-444, the Cities could recover pre-2013 taxes, penalties, and interest from the OTCs; (2) wrongly assigned the OTCs the burden of establishing that § __- 542 applies; and (3) and failed to give proper weight to "tax collector inaction" in reaching its decision. (*See generally* OTCs' Petition for Review at 10-13.)

As set forth below, the Court of Appeals' determinations of OTC tax liability under MCTC §§ __-444 and 542 are correct based on the unambiguous statutory language of the MCTC and the attending definitions of "person" and "broker," as well as the Court's sound legal analysis. Thus, there are no "important issues of law that have been incorrectly decided," Ariz. R. Civ. App. P. 23(d)(3), and the OTCs' Petition for Review should be denied accordingly. Furthermore, the Court of Appeals' decision in this matter is "unreported" and consequently of no precedential value. Therefore, the requisite reasons for granting a petition, as identified in Ariz. R. Civ. App. P. 23(d)(3), have not been met.

II. ARGUMENT AND CITATION OF AUTHORITY

A. The Court of Appeals' decision that the OTCs are subject to taxes under MCTC § __-444 based on the plain, unambiguous statutory language is well-reasoned and correct.

The pertinent statutory language is clear and unambiguous. MCTC § __-444 provides:

> The tax rate shall be at an amount equal to ____ percent (_%) of the gross income from the business activity upon every ***person*** engaging or continuing in the business of operating a hotel charging for lodging and/or lodging space furnished to any person or transient.

(Emphasis added.)

MCTC § __-100 defines "person" as "an individual, firm, partnership, joint venture, association, corporation, estate, trust, receiver, syndicate, ***broker***, the

Federal Government, this State, or any political subdivision or agency of this State." (Emphasis added.)

Further, MCTC § __-100 defines "broker" as "***any person engaged or continuing in business who acts for another for a consideration in the conduct of a business activity taxable under this Chapter, and who receives for his principal all or part of the gross income from the taxable activity***." (Emphasis added.)

Reg. ___-100.1 clarifies that MCTC § __-444 is broadly applicable and applies not only to the gross income of any person or company engaging in the business of operating a hotel but also to the gross income of those who act as "brokers" for any person or company engaging in the business of operating a hotel:

> (a) For the purposes of proper administration of this Chapter and to prevent evasion of taxes imposed, brokers shall be wherever necessary treated as taxpayers for all purposes, and shall file a return and remit the tax imposed on the activity on behalf of the principal. No deduction shall be allowed for any commissions or fees retained by such broker, except as provided in Section ___-405, relating to advertising commissions.
>
> (b) Brokers for vendors. A broker acting for a seller, lessor, or other similar person deriving gross income in a category upon which this Chapter imposes a tax shall be liable for such tax, even if his principal would not be subject to the tax if he conducted such activity in his own behalf, by reason of the activity being deemed a "casual" one….

Based on this plain language, the Court of Appeals reached the only rational conclusion: The OTCs are "brokers" because they are "persons" engaged in business who act for others (hotels) for consideration in the conduct of a business activity

taxable under this Chapter (the business of operating a hotel charging for lodging furnished to any person or transient), and who receives for his principal all or part of the gross income from the taxable activity. (*See* Court of Appeals' Decision at ¶¶ 14-21, appended to the OTCs' Petition for Review at APP040-41.)

1. <u>The Court of Appeals correctly applied the plain statutory language of MCTC § __-444 and the related, specific definitions of the terms "person" and "broker."</u>

The OTCs first contend that, for a "broker" to be taxable under the plain language of the applicable provisions, the broker must be "engaging in the business of operating a hotel." (*See* OTCs' Petition for Review at 8.) The OTCs' argument, however, ignores the MCTC's expansive definition of "broker," *i.e.*, "any person engaged or continuing in business ***who acts for another for a consideration in the conduct of a [taxable] business activity*** … and who receives for his principal all or part of the gross income from the taxable activity." MCTC § __-100 (emphasis added). Further, if the OTCs' position were correct, the MCTC's broker provisions would be rendered superfluous as any broker would also have to be a hotel operator to be subject to the lodging tax, and the MCTC's distinct broker language would carry no added import whatsoever. *See, e.g., Phoenix Newspapers, Inc. v. Dep't of Corr.*, 188 Ariz. 237, 244 (Ct. App. 1997) ("We presume that the legislature does not enact superfluous or reiterative legislation."). Thus, the OTCs' argument simply cannot be squared with the MCTC's relevant, plain statutory

language. Because the applicable definitions of "person" and "broker" are unambiguous, the Court of Appeals correctly declined to resort to rules of statutory construction and, instead, properly relied upon a plain-language analysis.

2. The plain statutory language of MCTC § __-444 and the related, specific definitions of the terms "person" and "broker" are not ambiguous.

While the OTCs contend that the pertinent definitions of "person" and "broker," *supra*, are ambiguous (*see* OTCs' Petition for Review at 8-9), this Court can plainly see for itself that these definitions are clear on their face and do not require resorting to interpretive aids or canons of construction. Thus, contrary to the OTCs' position, there are simply no statutory ambiguities that the Court of Appeals needed to resolved. *See, e.g., Baker v. Univ. Physicians Healthcare*, 231 Ariz. 379, 383 (2013) ("When the language is clear and unambiguous, and thus subject to only one reasonable meaning, [the courts] apply the language without using other means of statutory construction."). The Court of Appeals properly determined that, per the plain meaning of the MCTC's applicable definitions, the OTCs are "persons" and "brokers" subject to MCTC § __-444.

3. The OTCs' argument that they are brokers for travelers, not hotels, is irrelevant per the applicable definition of "broker."

In its decision, the Court of Appeals correctly found that, per the evidence, the OTCs contract with hotels to list and sell available hotel rooms. (*See* Court of Appeals' Decision at ¶ 2, appended to the OTCs' Petition for Review at APP037.) Indeed, that the OTCs contract with hotels is uncontested. The Court of Appeals also reasoned that, per the MCTC, the OTCs are "brokers" because: "(1) they act for hotels by providing advertising, booking, and other hotel services; (2) they accept payment for their services from travelers; (3) they accept consideration for their services from hotels; and (4) they assist hotels with taxable hotel operations." (*See* Court of Appeals' Decision at ¶ 16, appended to the OTCs' Petition for Review at APP040.) The Court of Appeals reasoned that, based on these factual findings, among others, the OTCs fell within the MCTC's definition of "broker." (*See id.* at ¶¶ 17-21, appended to the OTCs' Petition for Review at APP040-41.) *Cf. Modern Pioneers Ins. Co. v. Nandin*, 103 Ariz. 125, 130-31 (1968) (providing that the courts will "closely scrutinize every suspicious transaction in order to ascertain its real nature" and will "look to and construe" transactions by their "substance and effect.").

To the extent that it makes any sense at all, the OTCs' attempted distinction between "brokers for hotels" and "brokers for travelers" is irrelevant because the OTCs meet the applicable statutory definition of "broker." Indeed, the OTCs' business practices align perfectly with the MCTC's definition of "broker." Whether the OTCs consider themselves brokers for hotels, for travelers, or for both, is simply

immaterial to whether the facts show the OTCs to be "brokers" within the meaning of the MCTC.

4. The Court of Appeals correctly determined that, per the plain language of MCTC, the OTCs' service fees are included in their taxable gross income.

Next, the OTCs contend that the Court of Appeals incorrectly determined that the OTCs' service fees are included in their taxable gross income. However, the Court of Appeals reached the clearly correct decision on this issue as well.

The MCTC plainly provides that brokers are to be taxed on their gross income, including their markups and fees:

> For the purposes of proper administration of this Chapter and to prevent evasion of taxes imposed, brokers shall be wherever necessary treated as taxpayers for all purposes, and shall file a return and remit the tax imposed on the activity on behalf of the principal. ***No deduction shall be allowed for any commissions or fees retained by such broker,*** except as provided in Section ___-405, relating to advertising commissions.

Reg. ___-100.1(a) (emphasis added). This provision accords with the MCTC's definition of gross income.

MCTC § __-200(a) defines "gross income" broadly as:

> (1) the value proceeding or accruing from the sale of property, ***the providing of service***, or both.
>
> (2) the ***total amount of the sale***, lease, license for use, or rental price at the time of such sale, rental, lease, or license.

> (3) ***all receipts, cash, credits, barter, exchange, reduction of or forgiveness of indebtedness, and property of every kind or nature derived from a sale, lease, license for use, rental, or other taxable activity***.
>
> (4) ***all other receipts*** whether payment is advanced prior to, contemporaneous with, or deferred in whole or in part subsequent to the activity or transaction.

(Emphasis added.)

Thus, under the MCTC's broad language, the OTCs' taxable "gross income" includes their markups and service fees; it is not limited to the net-rate room price agreed to by the OTCs and their partnering hotels. *Accord* MCTC § __-400(c) ("For the purpose of proper administration of [the MCTC's privilege taxes] and to prevent evasion of the taxes imposed … it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer.").

In sum, the Court of Appeals properly determined per a plain reading of the MCTC and Reg. ___-100.1(a) that the OTCs are liable for taxes upon their gross income as brokers, including the amounts they receive for their markups and service fees. Because the Court of Appeals decided this issue correctly, there is simply no reason for this Court to grant review of this issue.

5. <u>The Court of Appeals determination of the OTCs' tax liability under MCTC § _-444 is neither untenable nor unprecedented.</u>

The Cities have all taxed "brokers" since their enactments of the MCTC. Travel agents and merchant model transactions have both been around since the

inception of the MCTC's broker provisions, and traditional travel agents have always been liable for and paid taxes in Arizona based upon their gross income. Just because the OTCs broker hotel rooms via online websites rather than more traditional means, it does not somehow render the Court of Appeals' finding of broker tax liability unsound or unprecedented. Because the OTCs unambiguously broker hotel-room transactions in the Cities, they are liable for taxes on their gross income. The fact that they make their sales via the internet is of no consequence. (*Cf.* Court of Appeals' Decision at ¶ 31, appended to the OTCs' Petition for Review at APP045 ("Brokering hotel and travel services is not a new industry; although the OTCs provide these services through the internet, the nature of the services remains the same.")

B. <u>The Court of Appeals correctly determined that that the Cities are not barred under MCTC § __-542(b)(2) from assessing taxes, penalties, and interest against the OTCs prior to 2013.</u>

MCTC § __-542(b)(2) provides, in pertinent part:

> If the Tax Collector adopts a new interpretation or application of any provision of this Chapter or determines that any provision applies to a new or additional category or type of business and the ***change*** in interpretation or application is not due to a change in the law … the Tax Collector shall not assess any tax, penalty or interest retroactively based on the ***change*** in interpretation or application.

(Emphasis added.) Thus, the MCTC prohibits retroactive application only where there has been a ***change*** in an interpretation or application of tax laws.

1. The Court of Appeals correctly determined that the Cities had not adopted a new interpretation or application of MCTC § __-444 so as to prohibit pre-2013 taxes, penalties, and interest.

In its decision, the Court of Appeals determined that MCTC § __-542(b)(2)'s bar against retroactive application did not apply in this case because "the record shows no evidence that Cities held positions contrary to the ones they now advance." (*See* Court of Appeals' Decision at ¶ 31, appended to the OTCs' Petition for Review at APP045.) The Court of Appeals' finding, based on lack of evidence of a previously held contrary position, is fully supported because the record contains no evidence whatsoever that the Cities have ever changed their interpretation or application of the relevant "broker" provisions. This is because such evidence simply does not exist. Since the OTCs did not and could not proffer any such evidence, the Court of Appeals properly found that the OTCs did not meet their burden of establishing they are excluded from pre-2013 taxation under MCTC § __-542.

2. The Court of Appeals correctly determined that the OTCs bear the burden of proving that the Cities adopted a new interpretation or application of the law.

Next, the OTCs contend that that the Court of Appeals erred in its MCTC § __-542(b)(2) analysis by finding that the OTCs bear the burden of proving that the Cities had previously taken a contrary position regarding whether the OTCs are "brokers." However, the Court of Appeals properly determined that the burden of establishing an exclusion from privilege taxes falls on the OTCs. (*See* Court of

Appeals' Decision at ¶ 30, appended to the OTCs' Petition for Review at APP045.) *Accord* MCTC § __-370(a) ("All deductions, exclusions, exemptions, and credits provided in this Chapter are conditional upon adequate proof and documentation of such as may be required either by this Chapter or Regulation."); MCTC § __-400(c) ("For the purpose of proper administration of this Chapter and to prevent evasion of the taxes imposed by this Chapter, it shall be presumed that all gross income is subject to the tax until the contrary is established by the taxpayer."); *Valencia Energy Co. v. Ariz. Dep't of Rev.*, 191 Ariz. 565, 582 ¶ 55 (1998) ("A taxpayer may establish the affirmative defense of estoppel against the Department of Revenue by proving the Department's conduct was inconsistent with a position later assumed….").

The OTCs cite the 1927 case, *Herndon v. Hammonds*, for the proposition that the burden falls on the party seeking retroactive application. But, *Hammond* does not involve tax liability; it pertains to the applicability to constitutional provisions, not to the MCTC. *Id.*, 33 Ariz. 88, 92 (1927). Here, as set forth above, the MCTC itself provides by its plain language that the taxpayers—the OTCs—bear the burden under MCTC § __-542(b)(2). Because the Court of Appeals decided this issue correctly, there exist no grounds for this Court to grant review of this issue.

3. <u>The Court of Appeals considered and addressed the Cities' prior inaction in their assessment of taxes against the OTCs and correctly determined that tax liability arises automatically when a taxpayer engages in taxable activity, regardless of whether or when the taxing entity seeks to collect.</u>

Finally, the OTCs contend that the Court of Appeals "discredited" the Cities' prior inaction in their assessment of taxes against the OTCs. But, the Court of Appeals' decision establishes that the Court did in fact consider and address the Cities' prior inaction and correctly determined that tax liability arises automatically when a taxpayer engages in taxable activity, regardless of whether or when the taxing entity seeks to collect:

> While taxing authorities may audit select taxpayers to ensure compliance, privilege taxes are self-assessed… Failure to collect a privilege tax does not render an unambiguous statute unenforceable and does not preclude the tax authority from seeking to collect those revenues in the future. *Miami Copper Co. Div., Tenn. Corp. v. State Tax Comm'n*, 121 Ariz. 150, 153 (App. 1978).

(Court of Appeals' Decision at ¶ 30, appended to the OTCs' Petition for Review at APP045.) As the Court of Appeals properly considered the State's prior inaction in the assessment of privilege taxes against the OTCs and properly reasoned that the State's prior inaction is immaterial to its MCTC § __-542 analysis, this Court should decline to review this issue as well.

III. CONCLUSION

As set forth above, the Court of Appeals, in a compelling, well-reasoned decision, correctly decided this case based on the plain language of the MCTC. Thus, there are no "important issues of law that have been incorrectly decided" for this Court to review. Ariz. R. Civ. App. P. 23(d)(3). The OTCs' Petition for Review

should be denied accordingly.

In the alternative, should this Court grant the OTCs' Petition for Review regarding the Court of Appeals plain-language analysis of MCTC § __-444, the Cities respectfully request that this Court consider and grant the Cities' cross-petition for review, below.

PLAINTIFFS/APPELLEES/CROSS-APPELLANTS' "ALTERNATIVE" CROSS-PETITION FOR REVIEW

If this Court is inclined to review whether the Court of Appeals should have strayed from the plain statutory language and resorted to tools of statutory construction and interpretation it its analysis of MCTC § __-444, the Cities respectfully ask this Court to also review the Court of Appeals' plain-language decision regarding the applicability MCTC § __-447 to the OTCs' hotel-room sales. Specifically, if the relevant provisions of the MCTC are indeed ambiguous, as the OTCs contend, this Court should determine whether MCTC § __-444, § __-447, as well as other, broadly applicable provisions of the MCTC should be read *in pari materia* to arrive at legislative intent. *See, e.g.*, *Collins v. Stockwell*, 137 Ariz. 416, 419, 671 P.2d 394, 397 (1983) (providing that statutes that relate to the same person or thing and have similar purposes are referred to as being *in pari materia* and that statutes *in pari materia* must be read together, and all parts of the law on the same subject must be given effect, if possible).

Here, the evidence shows that the Cities have always considered MCTC §§ __-444 and __-447, with each imposing privilege taxes on those that provide hotel rooms in Arizona, to apply to the same entities and to encompass "brokers," as well as hotels and hotel operators. The OTCs even acknowledge in their brief that "city-issued guidance instructed that tax liability under §§ -444 and -447 runs together and applies to the same persons." (OTCs' Petition for Review at 13.) Additionally, if § __-447 is read in isolation to include only brick-and-mortar hotels, and to exclude entities like the OTCs with whom hotels contract to perform traditional hotel operations and services—such as advertising, marketing, selling of rooms, and collection of payment and taxes—on the hotels' behalf, other provisions of the MCTC, such as MCTC §§ __ -210[1] and __-220,[2] and the presumption of taxability

[1] MCTC § __ -210 provides:

> In transactions between affiliated companies or persons, or in other circumstances where the relationship between the parties is such that the gross income from the transaction is not indicative of the market value of the subject matter of the transaction, the Tax Collector shall determine the "market value" upon which the City Privilege and Use Taxes shall be levied. "Market value" shall correspond as nearly as possible to the gross income from similar transactions of like quality or character by other taxpayers where no common interest exists between the parties, but otherwise under similar circumstances and conditions.

[2] MCTC § __ -220 provides:

> The Tax Collector may examine any transaction, reported or unreported, if, in his opinion, there has been or may be an evasion of the taxes imposed by this Chapter and to estimate the amount subject to tax in

set forth in MCTC § __ -400(c), *supra*, would be rendered superfluous. Further, if § __-447 is read in isolation, hotels may avoid their tax liability under § __-447 simply by contracting their operations and services to third parties that are not "hotels." The drafters of the MCTC could not have intended this result. For these reasons, if §§ __-444 and __-447 are not plain on their face and require resorting to canons of statutory construction, this Court should consider whether the Court of Appeals erred by failing to construe these parallel statutes and the remainder of the MCTC *in para materia*.

In sum, in the alternative, should this Court grant the OTCs' Petition for Review regarding the Court of Appeals' compelling plain-language analysis of MCTC § __-444, the Cities ask that this Court also grant their cross-petition for review of the Court of Appeals' decision regarding the construction and applicability of MCTC § __-447.

Respectfully submitted, this 22nd day of October, 2018.

By: /s/ *Jeffrey R. Finley*

Jeffrey R. Finley (009683)
SCHNEIDER, WALLACE, COTTRELL KONECKY, WOTKYNS LLP
8501 N. Scottsdale Road, Suite 270
Scottsdale, Arizona 85253
jfinley@schneiderwallace.com

cases where such evasion has occurred. The Tax Collector shall disregard any transaction which has been undertaken in an artificial manner in order to evade the taxes imposed by this Chapter.

Scott Andersen (020094)
WRIGHT WELKER & PAUOLE, PLC
10429 S. 51st Street, Suite 285
Phoenix, Arizona 85044
sandersen@holmwright.com

In association with:

John Crongeyer *(Pro Hac Vice)*
CRONGEYER LAW FIRM, PC
2170 Defoor Hills Road
Atlanta, Georgia 30318
jw552020@gmail.com

Attorneys for Plaintiffs/Appellees/ Cross-Appellants

CERTIFICATE OF COMPLIANCE

Pursuant to ARCAP 14, I certify that the attached brief uses proportionately spaced type of 14 points or more, is double-spaced using Times New Roman font, and contains 5,007 words.

/s/ *Jeffrey R. Finley*
Jeffrey R. Finley (009683)

CERTIFICATE OF SERVICE

The undersigned hereby certifies that on this 22nd day of October, 2018, a copy of the foregoing **PLAINTIFFS/APPELLEES/CROSS-APPELLANTS' RESPONSE IN OPPOSITION TO PETITION FOR REVIEW AND, IN THE ALTERNATIVE, CROSS-PETITION FOR REVIEW** was sent via email, addressed to the following:

Barbara J. Dawson
Andrew M. Jacobs
Robert I. Schwimmer
SNELL & WILMER, LLP
One Arizona Center
400 E. Van Buren
Phoenix, AZ 85004-2202
bdawson@swlaw.com
ajacobs@swlaw.com
rschwimmer@swlaw.com

Deborah Sloan
JONES DAY
2727 North Harwood Street
Dallas, Texas 75201
dsloan@jonesday.com

Bryan T. Davis
KELLY HART & HALLMAN LLP
201 Main Street, Suite 2500
Fort Worth, Texas 76102
bryan.davis@kellyhart.com

/s/ *Jeffrey R. Finley*
Jeffrey R. Finley (009683)