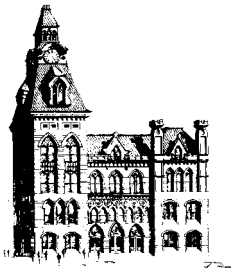
OFFICE OF THE CORPORATION COUNSEL

MEMORANDUM



TO: LITIGATION SETTLEMENT COMMITTEE

FROM: DEPUTY CORPORATION COUNSEL CARL AMENTO

DATE: 12/14/07

RE: PROPOSED CSX SETTLEMENTS

CONFIDENTIAL LEGAL DOCUMENT

A. BACKGROUND:
In 2005, CSX Real Estate, Inc. initiated assessment appeals in Superior Court regarding three of its properties after the City Assessor issued a determination that the properties were not exempt from the local property tax for the 2003, 2004, 2005 and 2006 Grand Lists.

B. ISSUES TO BE DECIDED:
1. Is the property owner a "railroad company" under Conn. Gen. Statutes Sec. 16-1?
2. If the property owner is a "railroad company" as defined by statute, is the property in question being used "exclusively for railroad purposes" under Conn. Gen. Statutes Sec. 12-155?
3. If the property owner is a "railroad company" and the property is being used "exclusively for railroad purposes", has the property owner paid the State of Connecticut Railroad Companies Tax on its gross earnings within the state?
4. If the property owner is a "railroad company, the property is "exclusively used for railroad purposes", and the property owner has paid the state tax which is "in lieu of all other taxes in this state" including local property taxes, does this mean that the properties in question should be exempt from local property taxes?

1. A "RAILROAD COMPANY":
There is no doubt that the plaintiff in the tax appeals is a "railroad company". CSX Real Estate, Inc. is a subsidiary of CSX Corporation. CSX Corporation is also the parent company of CSX Transportation, Inc. CSX is the successor by Federal legislation to Consolidated Rail Corporation (ConRail).

CSX owns and operates the largest railroad system in the eastern United States with a 21,000 mile rail network. In Connecticut, CSX owns about 70 miles of track from the New York border in southwestern Connecticut to New Haven. CSX owns one freight distribution/ transloading facility in Connecticut, the 280-acre Cedar Hill Rail Yard in both New Haven and North Haven. The rail yard has been in operation for over 100 years.

Section 16-1 of the Connecticut statutes defines a "railroad company" as including "every person owning, leasing, maintaining, operating or controlling any railroad, or any cars or any other equipment employed thereon or in connection therewith, for public or general use within the state". CSX is a "railroad company" as defined in Section 16-1.

Consolidated Rail Corporation entered into a lease with Nicesca, LLC in 1996 of 95 acres of land in the rail yard in New Haven and North Haven. Nicesca is a local company, whose principal is Andrew Anastasio. Nicesca, LLC subleases one of the three properties in New Haven to A. Anastasio & Sons Trucking Co., Inc. A second property is subeased to Circle of Life, LLC, of whom Andrew Anastasio is also the principal. The third property is not subleased.

All of the reported cases supported the notion that the tax-exempt railroad property can be rented by a third party and still be exempt as long as the property is owned by a railroad company. "We may assume that the railroads, in order to carry on their businesses as interstate carriers, are not bound to maintain their own freight stations, but may contract out with others to supply them and to perform there the transportation services which they are under a duty to perform." Merchants' Warehouse Co. v. United States, 283 U.S. 501, 506 (1931). In Walter Osborn, Tax Collector v. The Hartford & New Haven Railroad Co., 40 Conn. 498 (1873), the wharves and docks of the railroad company, including a portion of a building upon the dock leased by the railroad company to a steamboat company for the storage of freight, were determined to be exempt from local taxation.

Who is the taxpayer? Conn. Gen Statutes Sec. 12-48 provides that the owner/landlord of a lease contract for a term of years is the taxpayer responsible to the City. A lease provision requiring the tenant to pay property taxes is a contract between the landlord and tenant and has no effect on which party the City holds responsible for the property's taxes. In this case, the owner/landlord is CSX, and CSX is a "railroad company".

2. "USED EXCLUSIVELY FOR RAILROAD PURPOSES":

The State of Connecticut levies a Railroad Companies Tax on the gross earnings within the state of any corporation operating a railroad in the state (See Conn. Gen. Statutes, Sec. 12-249). State statutes in Section 12-255 provide that the gross earnings tax on railroad companies "shall be in lieu of all other taxes in this state, but the real estate in this state owned by such corporation, or by a corporation whose property is operated by it, when not used exclusively for railroad purposes, shall be assessed and taxed where it is located (emphasis supplied)". Conversely then, if the real estate is "used exclusively for railroad purposes", a municipality has no authority to assess and collect taxes on that real estate.

The case law generally supports a broad definition of what constitutes railroad use. Virtually all the tax cases reviewed were older cases that upheld the tax exempt status of "railroad property", such as "freight houses, grain elevators and warehouses" Minneapolis St. Paul & S.S.M. Railway Co. v. Douglas County, 159 Wis. 408 (1915); "freight depots or freight houses" The Milwaukee & St. Paul Railway Co. v. City of Milwaukee, 34 Wis. 271 (1874); "passenger station", "freight station and freight grounds" Naugatuck Railway Co. v. City of Waterbury, 78 Conn. 193 (1905); and "rented storehouse property owned by railroad" City of Montpelier v. Central Vermont Railway Co., 89 Vt. 36 (1915).

The lease of the properties in question requires that the properties leased by the tenant be "used exclusively for railroad purposes". Article 4 of the 1996 Lease agreement between ConRail and Nicesca provides in pertinent part: "Lessee shall use the Premises solely for a freight rail facility for the receipt and storage of rail cars, unloading of commodities…installation of tracks, butler type warehouse buildings, paving and grading and for no other purpose."

The CSX property leased to Nicesca is located in both New Haven and North Haven. The North Haven portion of the leased property is considered exempt from local property taxes by the North Haven Assessor because it is "railroad property" and is "used exclusively for railroad purposes".

All the freight and material at the rail yard has either arrived by rail or is being shipped out by rail, according to statements made by CSX, its attorneys and Mr. Anastasio.

Acting Assessor David Ambrose and I visited the site of the freight yard in early October and concluded that all freight and material appeared to have either arrived by rail or was being shipped out by rail.

In a June 5, 2003 letter to Kevin Anastasio from City Building Official Andrew Rizzo, Mr. Rizzo writes that he has no jurisdiction to issue a building permit because the property is “Railroad Property”. Attached is a copy of that letter.

On the CSX website, Connecticut is shown as having one CSX “rail-to-truck distribution facility in New Haven” and one “rail-to-truck TRANSFLO transloading facility in New Haven”. Attached is a copy of that page from the website.

If the rail property were assessed and taxed, and taxes were not paid, the City’s only remedy to collect would be to initiate a foreclosure action against the property. Federal law would pre-empt a foreclosure procedure under state law. However, practically speaking, even without the issue of preemption, could the City, through a foreclosure action, take title to or force the sale of railroad property such as this, which is a rail freight yard used in interstate commerce?

3. RAILROAD COMPANIES TAX PAID TO THE STATE

CSX Transportation, Inc. filed with the state and paid to the state Gross Earnings Tax on Railroad Companies for 2005 and 2006. Attached are copies of the tax bills and payment checks.

4. EXEMPTION FROM LOCAL PROPERTY TAXES

The property owner is a “railroad company”, the property is “used exclusively for railroad purposes”, and the property owner has paid the state gross receipts tax for the years in question in lieu of local property taxes, as provided by state statute. Therefore, the properties in question are exempt from local property taxes pursuant to Conn. Gen. Statutes Sec. 12-255.

C. POSSIBLE OBJECTIONS:

The conclusion that the properties in question are exempt from local property taxes has raised some controversy. Below, we will examine three possible objections to the tax exempt status: (1) Circle of Life, LLC, a subtenant of the property applied and was granted a state DEP permit; (2) the lease of the property provides that the tenant will pay real property taxes; (3) Two New Jersey federal court cases held that claimed railroad activities were not “transportation by rail carrier” were not entitled to federal preemption under federal law.

(1) Circle of Life, LLC applied for and was granted a permit by the State DEP for a Solid Waste Volume Reduction Facility. Circle of Life also applied for and received from the City of New Haven approval for a Coastal Site Plan application. If this is railroad property and federal preemption applies, why were these state and local permits applied for and was granted? CSX's attorney responded in writing in June of 2007 to my inquiry on this issue. He said:

"Circle of Life, LLC applied to the DEP for a license primarily at the advice of then counsel who was not familiar with the federal railroad exemption. Subsequently, my client has retained new counsel locally and from New Jersey who are familiar with the federal exemption laws and have educated my clients of their rights. Let me add, my clients have considered taking legal action against its previous counsel for advising them that the DEP approvals were necessary. They have ultimately decided to move on, and have not, since being enlightened regarding their rights, sought any approvals in connection with the facility including a building permit, which decision not to obtain was upheld after meeting with other members of City government and counsel from your office."
"I have previously forwarded you a copy of the letter in June, 2003 in which Andy Rizzo confirmed that the Building Department had no jurisdiction over the Railroad Property. It is my understanding that this conclusion was supplied by Corporation Counsel's Office at the time."

It should be noted that Circle of Life, LLC was the permit applicant, not CSX. At the time of the application, Circle of Life was a proposed operator and a prospective subtenant, not an actual operator or subtenant of any portion of the railyard. The fact that Circle of Life applied for and was granted a DEP permit would not be considered credible evidence supporting a denial of CSX's claim for exemption from local taxation, given its payment of state railroad taxes.

(2) I also asked CSX's attorney to explain: if no local real property taxes are allowed to be charged against the railroad property leased to Nicesca, why does Paragraph 6 of the Lease Agreement with Nicesca provide that the "Lessee shall pay all taxes (including without limitation real estate, transfer, sales and use taxes), assessments (including without limitation all assessments for public improvements or benefits, whether or not to be completed during the Lease term), water, sewer and other rents, rates and charges, excises, levies, license fees, permit fees, inspection fees and other charges (including all interest and penalties thereon) which at any time during the Lease Term may be assessed, levied, confirmed or imposed against the Premises, the Primary Access Routes, against any improvements made by Lessee, or other property of Lessee, real or personal, located on the Premises".

The attorney's written answer was:

"The provision regarding the "Tenant" paying any taxes is a standard lease provision included for the sole purpose of establishing the premise that if the tenant constructed a facility NOT used for rail purposes (i.e.: a golf driving range or baseball batting cages) such facilities would conceivably be taxed and said tax would not be paid by the Landlord. That is the sole purpose for the provision. CSX is fully aware of the federal exemption provisions, which is evidenced by their participation and assistance in the appeals".

The attorney's answer appears to be off-base, since the lease's use provision prohibits the tenant from building or operating anything not for railroad purposes. However, the explanation that this was a standard provision is plausible, especially since the lease provision refers to many types of taxes and assessments as well as property taxes. The inclusion of property taxes in the leases general provision dealing with all taxes and assessments would not be considered credible evidence supporting a denial of CSX's claim for exemption from local taxation, given its payment of state railroad taxes.

(3) In several recent federal court cases, that did not involve the issue of taxation, the court found that certain claimed railroad activities did not involve "transportation by rail carriers" and were, therefore, not entitled to federal preemption over state regulation. The Interstate Commerce Commission Termination Act ("ICCTA") of 1995 abolished the Interstate Commerce Commision and created the Surface Transportation Board ("STB"), an independent agency within the Department of Transportation. The STB was given exclusive jurisdiction [federal preemption] over "transportation by rail carriers". 49 U.S.C. Sec. 10501(b).

ICCTA defines "transportation" broadly as including: "(A) a locomotive, car, vehicle, vessel, warehouse, wharf, pier, dock, yard, property, facility, instrumentality or equipment of any kind related to the movement of passengers or property, or both, by rail, regardless of ownership or an agreement concerning use; and (B) services related to that movement, including receipt, delivery, elevation, transfer in transit, refrigeration, icing, ventilation, storage, handling, and interchange of passengers and property", 49 USC Sec. 10102(9).

ICCTA defines a "rail carrier" as "a person providing common carrier railroad transportation for compensation, but does not include street, suburban or interurban electric railways not operated as part of a general system of rail transportation." 49 U.S.C. Sec. 10102(5).

In 49 USC 10102(6), a “railroad” is defined to include:
“A. A bridge, car float, lighter, ferry and intermodal equipment used by or in connection with a railroad;
B. The road used by a rail carrier and owned by it or operated under an agreement; and
C. A switch, spur, track. terminal, terminal facility and a freight depot, yard and ground, used or necessary for transportation”.

Despite these broad definitions of “transportation” and “railroad” under federal law, three recent New Jersey cases did not uphold federal preemption for claimed railroad uses. In Hi Tech Trans LLC v. New Jersey, 382 F.3d 295 (3d Cir. 2004), the case involved a plaintiff, not a rail carrier, who agreed to develop a bulk waste loading facility at a rail yard owned by the railroad. The State claimed that the facility required a permit from the state and Hi Tech argued that the state permitting requirements were preempted by exclusive federal jurisdiction over “transportation by rail carriers”. The court found that the facility did not involve “transportation by rail carriers”, but was rather “transportation to rail carriers”. The court also recognized the “compelling state interest in DEP’s enforcement of its environmental laws”. J.P. Rail, Inc. v. New Jersey Pinelands Commission, 404 F.Supp. 2d 636 (D.N.J. 2005), dealt with a proposed railway company, which proposed to lease land from a non-railroad, and argued federal preemption in trying to avoid applying for a permit to construct a solid waste transfer facility from a commission charged with the environmental protection of National Preserve land. The company had also not yet obtained approval from the state to construct a spur line from the proposed facility. The court determined that the case was not within the exclusive jurisdiction of the federal STB, that a permit from the Pinelands Commission was required, and that the proposed activity was not “transportation by rail carriers”, but rather was “transportation to rail carriers”. A third New Jersey federal case, Hackensack Riverkeepers, Inc. v. Delaware Ostego Corp., 450 F. Supp. 2d 467 (D.N.J. 2006) held that a transloading activities did not involve “transportation by rail carriers” and federal preemption of local environmental permitting was denied. The court noted that state and local “regulation of transloading of construction and demolition waste for shipment by railroads is not preempted by ICCTA. This is the holding of J.P. Rail which followed the lead of the Court of Appeals decision in Hi Tech.”

Two other federal cases have not upheld federal preemption over local and state laws in the railroad context. In Florida East Coast Railway Co. v. City of West Palm Beach , 266 F3d 1324 (11 CA 2001), the court found that the claimed railroad activities were really a private distribution facility not open to the public. The court held that there was no federal preemption of local zoning and licensing ordinances. In Massachusetts, in Grafton & Upton Railweay Co. v. Town of Milford, 417 F. Supp 2d 171 (D. Mass. 2006), planned steel fabrication activities proposed for a railyard were held not to be "transportation by rail carriers" and federal preemption of local and state laws was denied.

However, the most recent federal case on this subject is also from New Jersey. The New York, Susquehanna and Western Railway Company v. Jackson, 2007 WL 576431 (D.N.) dealt with the applicability of state environmental regulations to solid waste freight activities conducted on railroad property. In the 2007 New Jersey case, the court noted that these types of cases required a "case-by-case and fact-specific determination". The court noted that "a rail carrier was not a party to the litigation in either Hi Tech or J.P. Rail". The court found in New York, Susquehanna that the solid waste activities did constitute "transportation by rail carriers" and federal law preempted the state permitting requirement. In the 2007 case, the property owner was clearly a rail carrier, and the railroad activities involved were in existence. The case law appears to support broad federal preemption regarding railroad property, generally superseding state and local permitting requirements, but, in this area of law, especially in New Jersey, developing a "carve out" from absolute federal preemption for the state and local exercise of "traditional police powers to protect public health and safety." I also note that Hi Tech and J.P. Rail cases each involved prospective, not existing facilities, a single site, and single-material facilities, unlike the comprehensive and long-standing freight yard in the instant cases at which many types of material are handled.

The federal cases do not deal with taxation. They deal with federal preemption issues. The cases involve the court in determining the issue of whether a "carve out" should be made from absolute federal preemption for state and local laws pertaining to health and safety (e.g., environmental laws). The most recent of the cases, New York, Susquehanna distinguishes itself on factual grounds from its predecessor cases, Hi Tech and J.P. Rail, and upholds federal preemption. All of the federal cases are distinguishable on their facts from the present case. It would be hard to imagine arguing that CSX is not entitled to exemption from local property taxes, when it has paid the state tax, based on federal cases dealing with the issue of the boundaries of federal preemption when confronted with state and local environmental and safety laws.

D. SUMMARY:

Tax exemption in these three cases appears to be supported by the gross earnings tax paid by CSX to the state (and the specter of double taxation), the lease provision restricting the tenant's use to only railroad uses, the treatment of the properties by the North Haven Assessor and the City's Building Official, a site visit, and the broad language of state statutes and case law. We have examined the possible objections to tax exemption, and the tenant's application to DEP and the lease provision on taxes both have plausible explanations. The New Jersey cases from 2004 and 2005 do not deal with taxation at all, and the 2007 New Jersey case appears to distinguish those earlier cases and limit them to their unique facts. For the foregoing reasons, the three CSX properties warrant tax exemption, and a court, after trial, would very likely determine that to be so.