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Colorado Court of Appeals Case No. 12CA1897 Opinion by Judge Sternberg (Loeb, C.J. and Vogt, J. concurring)	
Denver District Court Case No. 11CV2567 The Honorable Kenneth M. Laff	▲ COURT USE ONLY ▲
Petitioner/Appellee: BP America Production Company v. **Respondents/Appellants**: Colorado Department of Revenue; and Barbara Brohl, in her official capacity as Executive Director of the Colorado Department of Revenue	Case No. 2013SC000996
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BRIEF OF AMICUS CURIAE COLORADO PETROLEUM ASSOCIATION IN SUPPORT OF CERTIORARI

Certificate of Compliance

Undersigned counsel certifies that this brief complies with C.A.R. 32 and 53(a). The brief contains 3,440 words as measured by the word-count function of Microsoft Word, inclusive of footnotes, headings and quotations, and exclusive of the portions delineated in C.A.R. 53(a).

/s/ Shannon Stevenson
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Pursuant to C.A.R. 29, the Colorado Petroleum Association ("CPA") respectfully submits this *amicus curiae* brief in support of the Petition of BP America Production Company ("BP") for this Court to grant certiorari to review this matter.

INTEREST OF AMICUS CURIAE CPA

CPA is a non-profit organization representing Colorado's oil and gas industry before federal, state, regional, and local governmental entities, and in the Colorado courts. CPA supports every sector of the industry, including exploration, production, processing, and transportation, and works to promote a strong, sustainable, and thriving energy industry and the well-being of communities across Colorado.

The oil and gas industry plays a crucial role in Colorado's economy. For example, the Denver Post reported that employment on oil and gas fields in Colorado is more than 30,000 and increasing rapidly in spite of the weak economy. Mark Jaffe, *Jobs in Colorado's oil and gas fields swell to nearly 30,000*, The Denver Post, August 19, 2013, at 10A. Direct employment in the oil and gas industry in this state is 51,000, and public revenues from the industry have risen to $1.6 billion. *Id.* In 2010, the oil and gas industry contributed $31.4 billion to Colorado's economy.

A brief on behalf of CPA is desirable in this case because CPA represents a consensus of the oil and gas industry and can provide an important and unique perspective on the faulty analysis of the Court of Appeals' decision in this matter and the potential impacts of the decision. CPA, together with its tax committee, represents the views of the entire industry, including both large and small operators, and is uniquely positioned to offer guidance on the impact of the Court of Appeals' interpretation of the severance tax statute. CPA's constituents uniformly believe that the severance tax statute allows for the deduction of the cost of capital, and that not permitting these deductions would adversely impact the industry and Colorado's economy. This is an important view that should help the Court evaluate the ramifications of the Court of Appeals' decision. For the reasons discussed below, CPA urges this Court to grant certiorari to review the Court of Appeals' decision.

REASONS FOR GRANTING CERTIORARI

The Court of Appeals erroneously determined a matter of first impression, and its published decision will have far reaching, unintended adverse consequences if not reviewed. The court's new interpretation of Colorado's severance tax would upend the established practice of Colorado's oil and gas industry and discourage capital investment that is necessary to sustain the industry's current growth and

fiscal contributions to the state. The court's erroneous interpretation also violated standard rules of statutory construction articulated by this Court. Thus, if not reviewed, the court's decision will inject a new impediment to oil and gas production in Colorado that the legislature did not intend based on a rationale that violates basic rules of statutory construction.

I. THE COURT OF APPEALS' NEW INTERPRETATION OF THE SEVERANCE TAX STATUTE IS A MATTER OF FIRST IMPRESSION THAT CONFLICTS WITH INDUSTRY PRACTICE.

In addition to a number of other taxes on oil and gas production, Colorado imposes a separate severance tax on the value of raw materials at the point of extraction ("wellhead value"). The value of oil and gas, however, is typically not determined until it is sold at market, which is often far removed from the wellhead, and after the raw natural resource has been processed and transported for sale. The market price reflects these transportation and processing costs. Thus, to determine the wellhead value to be taxed, the severance tax statute permits taxpayers to deduct the transportation and processing costs from their gross revenues:

> "Gross income" means: . . . the net amount realized by the taxpayer for sale of the oil or gas, whether the sale occurs at the wellhead or after transportation, manufacturing, and processing of the product. Net amount shall be calculated on the basis of the gross lease revenues, less deductions for any transportation, manufacturing, and processing costs borne by the taxpayer.

C.R.S. § 39-29-102(3)(a).

The costs deducted from the gross revenues include costs attributable to the transportation and processing infrastructure. In this regard, the Colorado oil and gas industry has uniformly deemed the cost of capital used to build processing and transportation infrastructure to be deductible under the applicable statute, which allows deductions for "any transportation, manufacturing, and processing costs borne by the taxpayer." C.R.S. § 39-29-102(3)(a).

Interpreting the severance tax statute for the first time, the Court of Appeals departed from the industry's uniform and unremarkable view that the cost of capital is a cost. The court's new interpretation conflicts with the uniform understanding of the industry and presents a significant question of first impression that this Court should review.

II. THE COURT OF APPEALS' DECISION DISCOURAGES GROWTH AND INNOVATION IN A VITAL AND BOOMING INDUSTRY.

The issue presented for review is of great public importance because the Court of Appeals' decision discourages growth and innovation in a vital Colorado industry. The oil and gas industry contributes substantial revenues to state and local governments, school districts, and special districts. In 2010, the industry contributed more than $1.1 billion in revenues to these state and local

governments, including more than $137 million in oil and gas severance tax revenue.

And the industry is surging:

- In 2010, the industry paid Colorado workers $3.2 billion, up 14% from the $2.8 billion paid in 2009;
- the current production of natural gas liquids in Colorado is 28 times greater than in 2000;
- the number of drilling permit applications for 2010 was 5,996, up 16% from 2009.

This recent surge is made possible by new technologies and research that have opened up vast amounts of oil and gas in Colorado to extraction while minimizing environmental impacts. As long as investments in infrastructure keep pace with the growth in extraction, Colorado is poised to continue its rise in prominence in the nation's pursuit of energy independence. As discussed below, however, the Court of Appeals' decision discourages investment in the oil and gas infrastructure necessary to the success of the industry.

A. The Court of Appeals' Decision Discourages Investment in Infrastructure and Impedes Growth of the Industry in Colorado.

The Court of Appeals' denial of deductions for the cost of capital discourages development and construction of oil and gas transportation and processing systems in Colorado by increasing the cost to invest in this infrastructure. Because of the recent development of new extraction technologies, many states have an abundance of oil and gas available to be produced. Because of the limited amount of drilling rigs available, operators carefully assess the profitability of their many drilling opportunities before deciding where to drill.

By denying the deduction for the cost of capital, the Court of Appeals' decision reduces the anticipated profitability on a potential investment in oil and gas infrastructure in Colorado. Because many states permit the deduction of the cost of capital in the calculation of severance tax, denying the deduction decreases the operator's anticipated profit and discourages oil and gas production in Colorado in favor of production in other states.

In addition, infrastructure to transport and process oil and gas is essential to take these resources to market. If the necessary infrastructure does not exist or is insufficient, the value of the resource is diminished, further reducing the likelihood that it will be extracted. Thus, a lack of infrastructure prevents Colorado's

operators, royalty owners, and state and local governments from receiving full value for the state's natural resources.

Investment in transportation infrastructure also benefits the environment. Although pipeline infrastructure is currently used primarily for the transportation of gas, the industry is developing infrastructure to transport oil that will ultimately save hundreds of thousands of miles traveled by trucks. The development of this infrastructure will reduce emissions and eliminate safety risks inherent in the current transportation of oil.

In short, the development of transportation and processing infrastructure is necessary to sustain the recent surge in the oil and gas industry in Colorado. By denying the tax deduction for the cost of capital associated with the development of this infrastructure, the Court of Appeals' decision will discourage capital investment in this infrastructure and discourage development of Colorado's oil and gas resources, threatening the continued vitality and growth of this critical industry.

B. The Court of Appeals' Decision Arbitrarily Authorizes Disparate Treatment of Certain Taxpayers.

Another unintended consequence of the Court of Appeals' decision that may discourage growth of the industry is that it authorizes the disparate treatment of certain operators, such as BP, by creating an arbitrary distinction based on whether

the operator develops and funds the infrastructure necessary to transport and process oil and gas itself, or outsources these functions to a third party. This disparate treatment is inconsistent with the purpose of the severance tax.

The purpose of the severance tax is to recapture a portion of wealth lost from the removal of nonrenewable natural resources. C.R.S. § 39-29-101(1). To serve this purpose, the value of the natural resource is measured at the point of extraction, which is why costs related to post-extraction activity are not included in the income subject to the severance tax. *See* C.R.S. § 39-29-102; *see also* Opinion at 13 (quoting legislative history that the goal of the definition for "gross income" was to tax only the "raw value" of "product at the wellhead"). The raw value of gas has nothing to do with time value of the money used to create infrastructure for activity that occurs after extraction. Thus, regardless of who develops the infrastructure, the severance tax was not intended to tax the time value of money attributable to the infrastructure.

The Court of Appeals held that the cost of capital on transportation and processing infrastructure may not be deducted from the net amount subject to severance tax when the taxpayer has funded the infrastructure itself. Many producers, however, extract oil and gas from a well and then pay a third party (a midstream company) to construct and operate the gas transportation system. The

payment to the midstream company most likely reflects the midstream company's full cost of infrastructure and operations, including the midstream company's cost of capital to build the infrastructure. This payment may be deducted under the Court of Appeals' rationale because the producer pays the money to a third party pursuant to an invoice—and that invoice amount includes the cost of capital. *See* 2013 COA 147 (the "Opinion") at 14-15.

The Court of Appeals' interpretation, however, arbitrarily denies deduction of the very same cost if the producer builds the infrastructure itself, rather than paying a midstream company. The result is that an integrated operator may pay a higher severance tax on the same raw value of gas than operators who hire midstream companies.

The Court of Appeals' disparate treatment of integrated operators is entirely arbitrary, but has real world consequences. The disincentive to integrated operators discourages—and potentially eliminates—innovation for projects where third parties are unwilling to bear the risk. The infrastructure at issue in this case is just one example of successful projects completed by an integrated operator who took a risk that the rest of the industry declined. The arbitrary disincentive to integrated operators in Colorado does not exist in other states, and the producers with the amount of capital capable of developing integrated systems may thus elect

to produce oil and gas outside of Colorado. The disparate treatment of integrated operators is inconsistent with the purpose of the severance tax and may discourage oil and gas production in Colorado.

C. The Court of Appeals' Decision Injects Uncertainty Into The Calculation of Severance Tax.

The Court of Appeals' decision also creates uncertainty over the calculation of severance tax and over which costs may be deducted from gross revenues.

The Court of Appeals held that the cost of capital is not a "cost" within the meaning of section 39-29-102(3)(a) because the taxpayer does not receive an invoice and actually "pay" the cost of capital to anyone. Opinion at 12-13. At the same time, however, the court recognized that depreciation—a cost which is also not invoiced or paid to anyone—is a "cost" that may be deducted under section 39-29-102(3)(a). Thus, the Court of Appeals' rationale is internally inconsistent because the court allowed deductions for depreciation, which is a cost never "invoiced" or actually paid, but the court also held that deductible costs must be invoiced and paid. This inconsistency calls into question whether other costs borne by the taxpayer—such as salaries, amortization, and employee benefits—will continue to be recognized as deductions, since these costs are not paid to a third party pursuant to an invoice. This uncertainty may discourage investment in Colorado by rendering tax calculations less predictable.

In sum, a serious and unintended consequence of the Court of Appeals' decision is that it discourages essential investments in the production of oil and gas in Colorado. If not reviewed by this Court, the disincentive created by the Court of Appeals' error will impede the industry's current growth to the detriment of Colorado's economic well-being and to the revenues of state and local governments, as well as royalty owners.

III. THE COURT OF APPEALS' DECISION IS NOT IN ACCORD WITH THIS COURT'S PRECEDENT ON STATUTORY CONSTRUCTION.

This Court should also grant certiorari because the Court of Appeals' analysis conflicts with this Court's precedent on statutory construction. The Court of Appeals determined that the word "costs" in section 39-29-102(3)(a) is ambiguous because other courts have found the term ambiguous in different statutes and contracts. Opinion at 8 ("This case law shows us that the term 'costs' is not unambiguous on its face."). The court engaged in no other analysis to determine whether the Department of Revenue's ("Department") proposed construction is reasonable in light of the plain words and context of section 39-29-102(3)(a). This analysis violates this Court's precedents governing statutory construction. Had the Court of Appeals applied the correct analysis, it would have rejected the Department's unreasonable interpretation that the cost of capital is not a "cost."

A. This Court's Precedent Requires Courts to Consider a Term in its Context to Determine Whether it is Ambiguous.

The objective in construing a statute is to ascertain the intent of the legislature as expressed in the plain language of the statute. *Dep't of Transp. v. Gypsum Ranch Co., LLC*, 244 P.3d 127, 131 (Colo. 2010). The plain meaning of the statute controls, and extrinsic aid may be applied only where an ambiguity exists. *Id.*; *see also In re People In Interest of A.A.*, --- P.3d ---, 2013 CO 65, ¶ 10 ("If … the language of the statute does not admit of more than one reasonable interpretation, and is therefore unambiguous, that sole reasonable interpretation must stand as the meaning of the statute, without further attempts at construction.").

To determine whether a term is ambiguous, courts must look to more than case law that examines the term in different contexts. Instead, the court must determine whether there is more than one reasonable interpretation of the statute by considering the particular term in context. *Marquez v. People*, 311 P.3d 265, 268 (Colo. 2013) ("a term or provision that is part of a greater statutory scheme should be interpreted, to the extent possible, harmoniously with the … purpose of that scheme."); *see* C.R.S. § 2-4-101 ("Words and phrases shall be read in context and construed according to the rules of grammar and common usage.").

Accordingly, "[t]he plainness or ambiguity of statutory language is determined by reference to the language itself, the specific context in which that language is used, and the broader context of the statute as a whole." *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341 (1997). As a result, cases finding ambiguity in different contexts, such as those relied upon by the Court of Appeals in this case, carry little weight because ambiguity must be determined by considering a proposed interpretation of a specific statute in its context. *See* 2A *Sutherland Statutory Construction* § 45:15 (7th ed.) ("Every statute is an independent communication, for which either the intended or the understood meaning may be different. For this reason, a decision on a point of statutory construction has little relevance as a precedent for the construction of any other statute.").

B. The Court of Appeals Found an Ambiguity by Considering Interpretations of Other, Unrelated Statutes and Contracts.

None of the cases cited by the Court of Appeals render the Department's proposed interpretation reasonable because none of them interpreted the term "costs" in the context of section 39-29-102(3)(a) or its purpose. *See* Opinion at 8 and cases cited therein. The problem with the court's rationale is that a particular term is not doomed to be ambiguous in all situations simply because it is ambiguous in one situation. For example, the fact that the term "cost of development" could mean direct costs, indirect costs, or all costs in the context of a

valuation statute has nothing to do with the question whether the term "costs" in the severance tax scheme could reasonably exclude certain types of costs. *See id.* (citing *Douglas Cnty. Bd. of Equalization v. Fidelity Castle Pines, Ltd.*, 890 P.2d 119, 125 (Colo. 1995)).

In short, the Court of Appeals erroneously relied on interpretations of different statutes (and even contracts) to manufacture an ambiguity in the severance tax statute. In addition to the unintended consequences of this error described above in Section I, the court's opinion will stand as precedent for flawed statutory interpretation under which a term deemed ambiguous in one statute will be ambiguous in all other statutes.

C. The Court of Appeals' Interpretation of "Costs" Is Unreasonable.

Under the correct analysis to determine the existence of an ambiguity, the severance tax statute is unambiguous because the Court of Appeals' interpretation is unreasonable as a matter of law. *First*, the thrust of the interpretation violates the plain meaning of words and common sense. All parties and the courts below agree that the cost of capital, or return on investment, is a type of cost. Neither the Department nor the Court of Appeals can explain the concept without using the word "cost." Instead, what the Department is really arguing is that cost of capital is not the type of cost contemplated by the legislature. However, the severance tax

statute limits the phrase "any … costs" only by the requirement that the costs be attributable to the transportation, manufacture, or processing of oil and gas. Thus, the argument, essentially, is that a "cost" is not a "cost." This makes no sense, but it is the only interpretation under which the Department can prevail because once an item is deemed a "cost," it must be contemplated by the phrase "any … cost."

Second, the Court of Appeals' interpretation is unreasonable because it conflicts with another related statute that is linked to the severance tax by section 39-29-105(2)(b), which provides for a credit against the severance tax based on "all ad valorem taxes assessed during the taxable year." C.R.S. § 39-29-105(2)(b). As explained in BP's petition, there is no dispute that gross income is calculated under the ad valorem tax statute by deducting the cost of capital attributable to transportation and processing. Petition at 10-11.

Despite nearly identical definitions, the Department contends that "gross income" is different for severance tax purposes than it is for ad valorem (*i.e.* property tax purposes). Such a difference in nearly identical phrases that are linked together in a common scheme is contrary to basic rules of statutory construction because it would undermine the effectiveness and purpose of the ad valorem tax deduction allowed for the cost of capital. Because it conflicts with and undermines the ad valorem tax credit, the Department's interpretation cannot be

reasonable and, as a result, cannot give rise to an ambiguity. *Moffett v. Life Care Centers of Am.*, 219 P.3d 1068, 1072 (Colo. 2009) ("When statutory provisions concern the same subject matter or are part of a common design, we must read them together to give full effect to each.").

Accordingly, the industry's interpretation is the only reasonable interpretation of the severance tax statute. There is no need to resort to extrinsic sources to construe the meaning of the term "cost."

CONCLUSION

The incorrect decision below threatens Colorado's surge in oil and gas industry by discouraging the development of infrastructure essential to the production and sale of oil and gas. The decision also sets precedent for flawed statutory interpretation that allows courts to easily manufacture ambiguities and defeat clearly expressed legislative intent. For these reasons, CPA respectfully requests that this Court grant BP's Petition for a Writ of Certiorari and reverse the Court of Appeals' decision.

Dated: December 19, 2013

Respectfully submitted,

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The undersigned certifies that on December 20, 2013 the **BRIEF OF AMICUS CURIAE COLORADO PETROLEUM ASSOCIATION IN SUPPORT OF CERTIORARI** was served via the ICCES system on:

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