Certification of Word Count: 2,509

SUPREME COURT, STATE OF COLORADO 2 East 14th Avenue Denver, CO 80203	FILED IN THE SUPREME COURT JUN 13 2007 OF THE STATE OF COLORADO SUSAN J. FESTAG, CLERK
ORIGINAL PROCEEDING PURSUANT TO § 1-40-107(2), C.R.S. (2006) Appeal from Ballot Title Board	▲ **COURT USE ONLY** ▲
IN THE MATTER OF THE TITLE, BALLOT TITLE AND SUBMISSION CLAUSE FOR 2007-2008 #13 J. GREG SCHNACKE, Petitioner, v. MEGAN FERLAND AND MATT SAMELSON, PROPONENTS AND WILLIAM A. HOBBS, DANIEL DOMENICO AND SHARON EUBANKS, TITLE BOARD, Respondents.	Case No.: 07SA154
JOHN W. SUTHERS, Attorney General MAURICE G. KNAIZER, Deputy Attorney General* 1525 Sherman Street, 5th Floor Denver, CO 80203 (303) 866-5380 Registration Number: 05264 *Counsel of Record	
~~ANSWER~~ BRIEF OF TITLE BOARD	

Opening

TABLE OF CONTENTS

PAGE

TABLE OF AUTHORITIES

PAGE

CASES

CONSTITUTIONS

TABLE OF AUTHORITIES

PAGE

STATUTES

William A. Hobbs, Daniel Domenico and Sharon Eubanks, as members of the Title Board (hereinafter "Board"), hereby submit their Answer Brief.

STATEMENT OF THE ISSUES

1. Does proposed initiative 2007-2008 #13 (#13) contain a single subject?

2. Does the statement of the tax increase in the title comply with the requirements of Colo. Const. art. X, § 20(3)(c)?

STATEMENT OF THE CASE

On April 20, 2007 the proponents submitted #13 to the Title Board ("Board"). On May 2, 2007, the Board determined that the content of #13 constituted a single subject and proceeded to set a title. On May 8, 2007, the opponents filed a motion for rehearing. They contended that the measure contained more than one subject because it created a new tax and dedicated the revenues from the tax to programs unrelated to the tax. They also alleged that the titles failed to inform the voters of the estimate of the final, full tax year dollar increase will result form the new tax. On May 16, 2007 the Board denied the motion for rehearing. J. Greg Schnacke, an opponent, filed a timely appeal with this Court. A copy of the entire administrative record has been filed.

STATEMENT OF THE FACTS

#13 imposes a tax on the gross income from the sale of oil and gas severed from the ground. It contains the following provisions:

Section 1 states:

> The people of the State of Colorado hereby find that nonrenewable natural resources of oil and gas are part of Colorado's treasure and legacy and, when removed from the earth, the value of such resources to the State of Colorado is irretrievably lost; and that it is appropriate and fitting that the State assess a tax upon income derived from the extraction and sale of such nonrenewable resources and dedicate the revenues collected for the benefit and welfare of the people of Colorado.

Section 2 establishes the tax rate. Section 3 prohibits the reduction of the tax by credits for ad valorem taxes assessed on the value of real or personal property. Section 4 excludes revenues generated by the tax from the revenue limits imposed by Colo. Const. art. X, § 20. Section 5 mandates that (1) twenty-five percent of the revenues must be appropriated and distributed directly to counties and municipalities socially or economically impacted by development, processing, transportation or energy conversion of oil and gas, and (2) seventy-five percent shall be appropriated for purposes to be determined by the General Assembly. Section 6 repeals § 39-29-105, C.R.S. because the statute sets a tax rate that

conflicts with the proposed constitutional amendment. Section 7 authorizes the General Assembly to exempt oil and gas wells with *de minimus* production levels. Section 8 directs the General Assembly to make conforming amendments. Pursuant to section 9, the effective date of the measure is January 1, 2008.

SUMMARY OF THE ARGUMENT

1. #13 contains only one subject: A severance tax on gross income from oil and gas extraction. The designation of revenues to specified funds is part and parcel of the imposition of the tax.

2. The titles are valid. The titles accurately reflect the tax increase, as required by Colo. Const. art. X, § 20(3)(c). Art. X, § 20(3)(c) requires only that the titles disclose the first full fiscal year dollar increase if the tax is not phased in.

ARGUMENT

I. The measure includes only one subject: A severance tax on gross income from oil and gas extraction.

The opponent contends that the Board should not have set titles because #13 contains more than one subject, thereby violating Colo. Const. art. V, § 1(5.5), which states:

> No measure shall be proposed by petition containing more than one subject, which shall be clearly expressed

> in the title; but if any subject shall be embraced in any measure which shall not be expressed in the title, such measure shall be void only as to so much thereof as shall not be so expressed. If a measure contains more than one subject, such that a ballot title cannot be fixed that clearly expresses a single subject, no title shall be set and the measure shall not be submitted to the people for adoption or rejection at the polls.

A proposed initiative violates the single subject rule if it "relate[s] to more than one subject and ...[has] at least two distinct and separate purposes which are not dependent upon or connected with each other." *In re Title, Ballot Title and Submission Clause for 2005-2006 #55*, 138 P.3d 273, 277 (Colo. 2006)(*#55*); *In re Title, Ballot Title and Submission Clause for Proposed Initiatives 2001-2002 #21 and #22*, 44 P.3d 213, 215 (Colo. 2002) (quoting *In re Proposed Initiative "Public Rights in Water II"*, 898 P.2d 1076, 1078-79 (Colo. 1995) (*#21*). A proposed initiative that "tends to effect or to carry out one general objective or purpose presents only one subject." *In re Ballot Title 1999-2000 #25,* 974 P.2d 458, 463 (Colo. 1999). The single subject rule both prevents joinder of multiple subjects to secure the support of various factions and prevents voter fraud and surprise. *In re Title, Ballot Title and Submission Clause for Proposed Initiative 2001-02 #43*, 46 P.3d 438, 442 (Colo. 2002) (*#43*).

The Court will not address the merits of a proposed initiative, interpret it or construe its future legal effects. *#21*, 44 P.3d at 215-16, *#43*, 46 P.3d at 443. The Court may engage in a limited inquiry into the meaning of terms within a proposed measure if necessary to review an allegation that the measure violates the single subject rule. *#55*, 138 P.3d at 278. The single subject requirement must be liberally construed to avoid the imposition of undue restrictions on initiative proponents. *In re Title, Ballot Title and Submission Clause, and Summary for 1997-98 #74*, 962 P. 2d 927, 929 (Colo. 1998).

The opponent contends that #13 has two distinct and separate purposes which are not dependent or connected with each other: (1) the imposition of a tax on gross income from oil and gas extraction, and (2) the allocation of the revenues from the tax that are unrelated to the subject of the tax.

A strong link exists between the imposition of the tax and the appropriation of twenty-five percent of the tax revenues for distribution "to counties and municipalities socially or economically impacted by the development, processing, transportation, or energy conversion of the nonrenewable natural resources of oil and gas." (#13, section 22(5)). It is undisputed that oil and gas extraction imposes significant costs on local governments for roads, public safety, courts and social

services. The revenues dedicated to the counties and municipalities are intended to help the affected communities deal with the impact of extraction of oil and gas on their communities. The measure assures that each community has the resources necessary to cope with the impact of extraction.

Courts in other states have rejected arguments to that posed by the opponents. The North Dakota Supreme Court addressed a tax measure similar to #13. *Sunbehm Gas Co. v. Conrad,* 310 N.W.2d 766 (N.D. 1981). An initiated tax measure imposed an oil extraction tax. The revenues from the tax were placed in an oil extraction development fund. Forty-five percent of the revenues were allocated to the state school aid program. Ten percent was dedicated to a special trust fund. The remaining forty-five percent was allocated to the state's general fund for general state purposes. (The formula was later amended to provide for a sixty-ten-thirty split.) The plaintiff argued that the establishment of the fund, the allocation of the money in the fund and the provision of certain tax credits constituted multiple subjects. The court rejected the claim, finding that these matters "related to or are in consequence of the imposition of the oil extraction tax." *Id.* at 773.

In *Kennedy Wholesale, Inc. v. State Board of Equalization*, 806 P.2d 1360 (Cal. 1991), a distributor of tobacco products challenged the California Tobacco

Tax and Health Protection Act on the ground that it violated the single subject rule. Under the Act, revenue generated by a tax increase on tobacco products was deposited in a cigarette surtax fund. The money in the fund could be used for tobacco-related education programs, tobacco-related disease research and payment for certain medical care. In addition, the money could be allocated to fire prevention, environmental conservation, and protection of wildlife, and enhancement of parks and recreation. The distributor contended that the measure violated the single subject rule because it did not guarantee that every expenditure from the fund would be related to tobacco use. The California Supreme Court rejected the challenge, noting that the expenditures for non-tobacco related items were merely collateral effects. *Id.* at 254. See also, *Advisory Opinion to the Attorney General re Authorizes Miami-Dade and Broward County Voters to Approve Slot Machines in Parimutuel Facilities*, 880 So.2d 522, 524 (Fla. 2004)(imposition of tax on slot machines and allocation of tax to public education not separate subjects)

There is also a strong link between the taxes imposed by the measure and the allocation of seventy-five percent of the funds raised to the general fund. The General Assembly has recognized the connection between the oil and gas severance tax and the allocation of the revenues to the general fund. The

legislative declaration to the statute authorizing the existing oil and gas severance tax provides.

> (1) The general assembly hereby finds and declares that, when nonrenewable natural resources are removed from the earth, the value of such resources to the state of Colorado is irretrievably lost. Therefore, it is the intent of the general assembly to recapture a portion of this lost wealth through a special excise tax, in addition to other business taxes, on the nonrenewable natural resources removed from the soil of this state and sold for private profit.
>
> (2) The general assembly further finds and declares that the severance of nonrenewable resources provides a potential source of revenue to the state and its political subdivisions. Therefore, it is the intent of the general assembly to impose a tax on the process of severance in addition to other business taxes.
>
> (3) It additionally is the intent of the general assembly that a portion of the revenues derived from such a severance tax be used by the state for public purposes, that a portion be held by the state in a perpetual trust fund, and that a portion be made available to local governments to offset the impact created by nonrenewable resource development.

Section 39-20-101, C.R.S. (2006). The General Assembly recognizes that the extraction of nonrenewable resources such as oil and gas affects both state government and political subdivisions.

The Court has long acknowledged the nexus between taxation of any item not prohibited by the State Constitution and the need to raise revenues to pay for

the general functions of the State. The State "has the unlimited power of taxation, not only as to the subjects of taxation, but also as to the rate, and may tax its own citizens for the prosecution of any particular business." *Parsons v. People*, 32 Colo. 221, 76 P. 666, 670 (1904). A tax may be imposed on a narrow range of subjects for the purpose of raising money for the general fund. For example, this Court has concluded that a tax imposed upon a narrow subject and allocated to a more general purpose does not violate the single subject rule. *In re Hunter's Estate*, 97 Colo. 279, 49 P.2d 1009 (1935). Colorado assessed a surcharge on inheritance taxes, fees paid to the Secretary of State and motor vehicle registration fees, and allocated the surcharge to the old age pension fund. The Court found that the imposition of the three additional charges served one purpose and did not violate the single subject rule. *Id.* 97 Colo. at 286-87, 49 P.2d at 1011.

For these reasons, the Court must conclude that #13 contains a single subject.

II. The titles comply with Colo. Const. art. X, § 20(3)(c). The titles set forth the tax increase for the first fiscal year.

The opponent contends that the titles fail to comply with Colo. Const. art. X, § 20(3)(c) because they fail to disclose the final, full fiscal year dollar increase that

will result from the new tax. For the following reasons, the Court must reject the claim.

Article X, §20(3)(c) provides, in pertinent part:

> Ballot titles for tax or bonded debt increases shall begin, **"SHALL (DISTRICT) TAXES BE INCREASED (first, or if phased in, final full fiscal year dollar increase) ANNUALLY...?"**

#13 repeals section 39-29-105, C.R.S. (2006). This section imposed a graduated tax on the gross income attributable to the sale of oil and gas severed from the earth. The tax ranged from 2% for income under $25,000 to 5% for income of $300,000 and over. Section 39-29-105(1)(b), C.R.S. (2006). In addition, the statute authorized as a credit against the tax an amount equal to eighty-seven and one-half percent of certain ad valorem taxes. Section § 39-29-105(2)(b), C.R.S. (2006).

#13 imposes a tax rate of 5% on gross income attributable to the sale of oil and gas severed from the earth. It also provides that the state may not create a credit against the tax in any amount based upon ad valorem taxes assessed on the value of real of real or personal property.

The Office of State Planning and Budgeting estimated that the enactment of the measure would result in a tax increase of $244.6 million annually. (Ex. A,

attached hereto.) It arrived at this figure by subtracting the gross amount of severance tax revenue estimated under the present tax structure from the gross amount of severance tax estimated under #13.

The opponent apparently contends that the titles must include the sum of $428.3 million, which is the gross amount estimated to be collected annually under #13. This analysis is incorrect. It is not the gross amount collected under the new tax but rather the amount of the tax *increase* that must be included in the titles. *Bolt v. Arapahoe County School District No. 6*, 898 P.2d 525, 537 (Colo. 1995)("The overriding scheme of Amendment 1 with respect to taxes evidences an intent on the part of voters to limit tax *increases* that do not receive prior voter approval.") In this case, the increase is the difference between the amount raised under the present tax schedule and the amount to be raised if #13 passes.

Under article X, § 20(3)(c) the Board must place in the titles the amount of the tax increase in the first fiscal year of the tax if the tax is not phased in. If the tax is phased in, then the Board must set forth the amount of the tax increase when the tax increase is fully implemented.

#13 does not phase in a tax increase. Instead, it increases the tax rate as of January 8, 2008. The Board therefore properly set forth the amount of the tax increase in the first year of implementation.

CONCLUSION

For the reasons stated herein, the Court must approve the action of the Title Board.

JOHN W. SUTHERS
Attorney General

MAURICE G. KNAIZER, 05264*
Deputy Attorney General
Public Officials
State Services Section
Attorneys for Title Board
*Counsel of Record

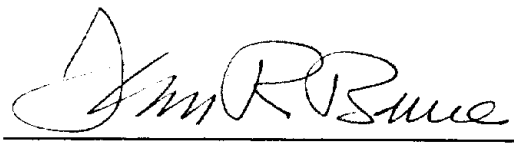
AG ALPHA: ST EL GRAMA
AG File: P:\SS\SSKNAIMG\RETAIN\SOS\INIT2007SEVERANCETAX.DOC

CERTIFICATE OF SERVICE

This is to certify that on the 12th day of June, 2007, I served a true and complete copy of the foregoing ***Answer Brief of Title Board*** by overnight courier (DHL Express) to each of the following:

Sean R. Gallagher, Esq.
Jacquiline S. Cooper, Esq.
Hogan & Hartson LLP
1200 17th Street, Suite 1500
Denver, CO 80202

Edward Ramey, Esq.
Isaacson Rosenbaum PC
633 17th Street, Suite 2200
Denver, CO 80202



THOMAS R. BOVEE
Legal Assistant
State Services Section

STATE OF COLORADO

OFFICE OF STATE PLANNING AND BUDGETING
111 State Capitol Building
Denver, Colorado 80203
(303) 866-3317

Bill Ritter, Jr.
Governor

Todd Saliman
Director

MEMORANDUM

TO: Title Setting Review Board

FROM: Todd Saliman, Director

DATE: April 30, 2007

SUBJECT: Fiscal Analysis for Proposed Ballot Initiative #13

Ballot Initiative #13 would repeal the existing severance tax statutes and replace them with a new tax set forth in the Constitution. Apart from some minor but important technicalities, the most noticeable change in tax policy is to eliminate the *ad valorem* tax credit allowed on oil and natural gas. As the initiative appears to constitute a new tax, the Governor's Office of State Planning and Budgeting (OSPB) is tasked with calculating the annual amount of the tax increase as specified by TABOR in the following format: "Shall state taxes be increased $_____ annually...?"

The OSPB has several concerns regarding proposed Ballot Initiative #13. They are outlined below. These concerns relate solely to estimating the fiscal impact of the initiative. It is important to note that the revenue received from this tax increase could vary greatly from the fiscal estimate if passed. In an effort to create a reasonable fiscal estimate, the OSPB consulted with the Department of Local Affairs and Legislative Council Staff economists on the assumptions inherent to this analysis.

- **Severance taxes are extremely volatile.** Energy prices are effectively determined by a small cartel of OPEC ministers, whose future output decisions will hinge on unknown economic and geopolitical events. The production decisions of firms in Colorado depend on several variables apart from output price, such as interest rates, technological ability and the political climate around drilling in areas of environmental significance. Colorado is a marginal state with respect to energy production, and as such it experiences all of the booms and busts of the industry in an aggravated manner.

- **The fiscal impact of this initiative is not observable *ex post*.** As this initiative replaces an existing tax with a new one, it is simply not possible to identify the net revenue gain after the fact. Whereas under the existing statutes, firms had incentives to operate across several counties in order to maximize their *ad valorem* credit, the new constitutional language would incentivize firms to arrange their corporate ownership structure so as to come in under the $300,000 gross revenue threshold. Consequently, it will not be possible to examine data and determine what the existing severance tax would have generated were it not repealed. Therefore, there is no basis for calculating the net revenue gain for TABOR compliance purposes. For the reference of the title board, the OSPB will

EX A

furnish two numbers: the estimated incremental revenue impact from the entire initiative, and a forecast of the gross amount of tax revenue generated by the new tax.

Fiscal Analysis

Prices for Colorado's natural gas and oil are a weighted approximation, derived at the point-of-sale at hubs located in surrounding states where Colorado natural gas and oil is priced. These weighted prices are tracked by the Colorado Oil and Gas Conservation Commission and accessible from their website (http://oil-gas.state.co.us/). Colorado is distant from markets, leading to generally lower prices and a "basis differential" from national market gas prices. Ultimately, the basis differential, combined with national market behavior in response to supply and storage capacity, all act to create an extremely dynamic price environment.

The OSPB used the component analysis done by the Department of Local Affairs to establish the percentage increase DOLA expects to see in oil and gas tax revenue above DOLA's current-law forecast. After some technical adjustments regarding differences in assumptions between the OSPB and DOLA forecasts, this growth factor was applied to the OSPB forecast to establish the forecast of the gross amount of tax revenue resulting from the new tax.

The OSPB estimates that the gross amount of tax revenue generated by the new tax will be $428.3 million in FY 2008-09. The OSPB March 2007 forecast of severance tax revenue in FY 2008-09 is $183.7 million, **which leaves the incremental impact of this initiative at $244.6 million.** The OSPB wishes to reiterate that this incremental amount is the difference between two forecasts, which are both heavily dependent on price and volume forecasts that can vary widely from actual data. As indicated above, it will not be possible to calculate the true fiscal impact of this initiative, because the old severance tax will be abolished and the new tax is structured differently from the old one.