DISTRICT COURT, CITY AND COUNTY OF DENVER, COLORADO Denver City and County Building 1437 Bannock Street, Room 256 Denver, CO 80202 (720) 865-8301	DATE FILED: March 19, 2014 10:05 AM CASE NUMBER: 2012CV5998
Plaintiff: DCP MIDSTREAM, LP **Defendants:** DEPARTMENT OF REVENUE OF THE STATE OF COLORADO; and BARBARA BROHL, in her official capacity as the Executive Director of the Department of Revenue of the State of Colorado	_ **COURT USE ONLY** _ Case No.: 12 CV 5998 Division: 275

ORDER ON MOTIONS FOR SUMMARY JUDGMENT

THIS MATTER comes before the Court upon Plaintiff's Cross-Motion for Summary Judgment ("Cross-Motion") and Defendants' Motion for Summary Judgment ("Motion"), filed in accordance with C.R.C.P. 56. The Court, having reviewed Plaintiff's Cross-Motion and related pleadings, Defendant's Motion and related pleadings, the Court file, and applicable legal authorities, and finding no genuine issues of material fact in dispute, hereby enters the following Order:

Nature of Dispute

This case involves the proper interpretation of the State's sales and use tax exemption for manufacturing machinery codified in C.R.S. § 39-26-709 (the "machinery exemption"), and its application to machinery used by DCP Midstream, LP ("DCP") to "manufacture" natural gas liquid commodities and pipeline quality natural gas from unusable raw natural gas.

The machinery exemption applies throughout the State, and exempts from tax "purchases of machinery or machine tools, or parts thereof, in excess of five hundred dollars to be used in Colorado directly and predominantly in manufacturing tangible personal property, for sale or profit." C.R.S. § 39-26-709(1)(a)(II). At the heart of the machinery exemption is the requirement that the subject machinery engage in "manufacturing," which the statute defines as "the operation of producing a new

product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials." C.R.S. § 39-26-709(1)(c)(III). The State Legislature enacted the machinery exemption in 1979.

In the Final Determination below, the Executive Director determined that DCP did not qualify for this exemption. The Executive Director concluded that the inclusion of the words "refining" and "processing" in a 1991 amendment to a different exemption statute found in the Urban and Rural Enterprise Zone Act, C.R.S. § 39-30-106 (the "enterprise zone exemption"), had the effect of excluding from the scope of "manufacturing" under C.R.S. § 39-29-709(1)(c)(III) all activities that include elements of "refining" or "processing." *See* Affidavit of Mark Medina ("Medina Affidavit"), Exh. A (Final Determination DD-628). The Department has adopted the Executive Director's analysis as its primary argument in the case. In other word the Department argues that DCP was entitled to the "manufacturing exemption" until the 1991 amendment which changed DCP entitlement to an "enterprise zone exemption" if the machinery is located in an enterprise zone. The Department argues that you may be subjection to one or the other exemption, but not both because they are mutually exclusive.

DCP asks the Court to reject the Department's analysis as a matter of law. Specifically, DCP asks the Court to rule that: (1) whether DCP qualifies for the State-wide machinery exemption must be determined solely by the terms of C.R.S. § 39-26-709, including its definition of "manufacturing"; and (2) the enterprise zone exemption statute, C.R.S. § 39-30-106, has no bearing on that analysis.

Legal Standards

A party may move for determination of a question of law without or without supporting affidavits. C.R.C.P. 56(h). "If there is no genuine issue of any material fact necessary for the determination of the question of law, the court may enter an order deciding the question." *Id*.

When a trial court is presented with cross-motions for summary judgment, the court must consider each motion separately, review the record, and determine whether a genuine dispute as to any fact material to that motion exists." *AviComm, Inc. v. Colorado PUC*, 955 P.2d 1023, 1029 (Colo. 1998). Summary judgment is appropriate if there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. C.R.C.P. 56(c). The Court agrees with the parties that no genuine issues of material fact require a trial in this case.

This matter is subject to *de novo* review. C.R.S. § 39-21-105(2)(b). DCP bears the burden to establish its right to the statewide manufacturing machinery tax exemption under C.R.S. § 39 26 709. See C.R.S. § 39-21-105(2)(b) ("taxpayer shall have the burden of proof with respect to the issues raised in the notice of appeal").

The parties have agreed that C.R.S. § 39-26-709 is clear and unambiguous. The Court agrees with the parties that C.R.S. § 39 26 709 is clear and unambiguous. However, the Court finds that C.R.S. § 39-30-106 is not clear and unambiguous.

"The proper construction of a statute is a question of law[.]" *Alvarado v. People*, 132 P.3d 1205, 1207 (Colo. 2006). A court's "fundamental responsibility in construing a statute is to give effect to the General Assembly's purpose and intent in enacting it." *Id*. If the plain language of a statute is clear and unambiguous, the statute should be interpreted according to its plain meaning. *Hernandez v. People*, 176 P.3d 746, 751 (Colo. 2008). When a statute is ambiguous and susceptible to more than one

reasonable interpretation, courts consider various statutory construction aides to determine the legislative intent, including the legislative declaration, purpose and history. *Id*. at 751-53; *State v. Nieto*, 993 P.2d 493, 501 (Colo. 2000).

When interpreting tax statutes, a court should not view the power to impose taxes expansively, and should resolve doubts in favor of the taxpayer. *Ball Corp*., 51 P.3d at 1056. There is a longstanding rule followed in Colorado that "the taxing power and taxing acts are construed strictly against the taxing authority and in favor of the taxpayer." *Rocky Mountain Prestress, Inc. v. Johnson*, 194 Colo. 560, 564 n. 2, 574 P.2d 88, 91 n. 2 (1978) (quoting *City & County of Denver v. Sweet*, 138 Colo. 41, 52, 329 P.2d 441, 447 (1958)).

However, this presumption is reversed when the court is construing an exemption from a tax. When a taxpayer is claiming an exemption, "we presume that taxation is the rule and exemption from taxation is the exception." *Telluride Resort & Spa, L.P. v. Colorado Dep't of Revenue*, 40 P.3d 1260, 1264 (Colo.2002). "The taxpayer has the burden of proving entitlement to the exemption claimed." Id.

"The interpretation of a statute by the agency charged with its enforcement is entitled to deference, but the reviewing court is not bound by such interpretation, especially in cases where the law has been misapplied or misconstrued." *Ball Corp*., 51 P.3d at 1056 (citing *Huddleston v. Bd. of Equalization*, 31 P.3d 155, 160 (Colo.2001)). The rules of construction applicable to the interpretation of administrative agency regulations are the same as those applicable to statutes. *Woolsey v. Colorado Dep't of Corr.*, 66 P.3d 151, 153 (Colo.App.2002).

Undisputed Material Facts

Weld County holds large deposits of crude oil and raw natural gas. To obtain these materials, an exploration and production company drills a wellbore into the earth to reach the producing reservoir. The exploration and production company installs at the well site the machinery needed to extract the crude oil and raw natural gas from the reservoir and bring it to the surface. DCP is not an exploration and production company. DCP does not own or install any machinery at well sites in Colorado. DCP does not drill or own any wells in Colorado. DCP does not extract any crude oil or raw natural gas from underground reservoirs in Colorado. Affidavit of Joseph Kuchinski ("Kuchinski Affidavit"), ¶¶ 3-5.

Once the wellbore is complete, pressure causes a mixture of crude oil, water, raw natural gas, and other materials to rise to the earth's surface. When the mixture reaches the surface, it is routed to a wellhead separator located near the wellbore. A wellhead separator is a passive device in which the crude oil, water, and raw natural gas separate naturally, by gravity, due to their different weights and densities. The exploration and production company owns the wellhead separator. DCP does not own any wellhead separators in Colorado. *Id*., ¶¶ 6-7.

DCP acquires the raw natural gas from the exploration and production company only after it exits the wellhead separator. When DCP acquires the raw natural gas, it is in gaseous form and unusable by end consumers. The exploration and production company keeps the crude oil for itself and returns the water to the earth. *Id*., ¶¶ 8-9. 4

When DCP acquires the raw gas, it is not a useable product in the consumer marketplace. It cannot be used to power a home furnace, run a car's engine, or fuel a barbeque grill. The raw gas that DCP acquires in Weld County is only useable by DCP and other midstream companies as a raw material to manufacture NGLs and marketable natural gas. The raw gas also is not a merchantable

product in the commercial marketplace. Raw gas is not a commodity sold in the commodities markets. The only type of business that might want to purchase raw gas from DCP is another midstream company that would use it as a raw material to manufacture the same types of finished products that DCP manufactures.

DCP produces a number of different liquid hydrocarbon products and commodities. These include liquid propane, butane, and natural gasoline (a liquid mixture of pentane and other hydrocarbons). These products are known as natural gas liquids or NGLs. DCP also produces a gaseous hydrocarbon product known as residue gas, but more commonly referred to as natural gas or methane. This is the product we use in our homes and businesses. DCP further produces and sells a mixture of NGLs known in the industry as Y-grade product, as well as a premium crude oil product known in the industry as stabilized condensate.

The NGLs and natural gas products produced by DCP are regularly traded as distinct commodities on commodity exchanges throughout the world. The additional products produced by DCP are regularly sold in the marketplace to third parties. All of the products and commodities produced by DCP must meet commercial and legal specifications to be sold in the marketplace.

The NGLs produced by DCP are in liquid form. There are no natural occurring reservoirs of NGLs. NGLs do not exist in nature. NGLs must be maintained in artificial conditions to maintain their liquid form. Each NGL also has a unique molecular weight, boiling point, freezing point, and British Thermal Unit ("BTU") energy content, as well as many other differing technical characteristics.

The natural gas or methane product produced by DCP is known as commodity grade or pipeline quality because it meets the commercial and legal specifications to be accepted and transported to market by pipeline transportation companies. It is safe for use in homes and businesses. This pipeline quality natural gas is not found in nature. The natural gas produced by DCP also has unique technical characteristics, including a distinct molecular weight, boiling point, freezing point, and BTU content.

The NGLs and natural gas produced by DCP have many uses. Liquid propane is used, for example, to dry crops; in homes for heating, cooking, and hot water; and in industry to power turbines and other machinery. Liquid butane is used in gasoline blending to promote cold-starting and resist vapor lock; and in the petrochemical industry to make specialty chemicals and plastics. Liquid natural gasoline often is used as a motor fuel. Marketable natural gas or methane is one of the most widely-used residential, commercial, and industrial fuel sources around the world. It is used every day for home furnaces, stoves, and water heaters, as well as many other commercial and industrial uses.

To make these marketable NGL products, DCP must apply manufacturing procedures to the raw gas. Once DCP takes ownership of the raw gas at the wellhead, it routes the gas through a system of gathering pipes to a gas plant or a field compression station, where its manufacturing process begins. During the 2000 to 2004 time frame, DCP owned and operated seven gas plants and twelve field compression stations in the Weld County operating region. The machinery and equipment at issue in the case is located at these facilities and includes compressors, coolers, dehydrators, heat exchangers, turbo-expanders, fractionation units, condensate stabilizers and other types of machinery and equipment. Since the 2000 to 2004 period at issue, DCP also has added amine units to its Colorado gas plants. None of the subject machinery or equipment is located in a state-designated enterprise zone. All

of this machinery works in a harmonious and integrated fashion to produce DCP's products and commodities.

To produce NGLs and marketable natural gas, DCP must first increase the pressure of the gas to very high levels of 900 to 1000 psi. DCP uses machines called compressors to compress the raw gas in stages from field levels (50-200 psi) to gas plant operating levels (900-1000 psi). As the gas is compressed, its temperature rises to more than 200°F. Machines known as coolers reduce the temperature of the gas to proper operating temperature levels while still preserving its high pressure.

As the gas cools in the coolers, a liquid known as raw condensate falls out. DCP collects the raw condensate and transports it to condensate stabilizers. A condensate stabilizer applies heating and cooling in multiple stages to produce a liquid product, commonly known as stabilized condensate, which DCP sells as a premium crude oil product.

DCP currently uses amine units or "treaters" in its Colorado gas plants, which were added after the 2000 to 2004 period at issue. DCP employs amine units to apply an amine solution to the gas to remove unwanted elements, such as carbon dioxide and hydrogen sulfide, through a chemical reaction. The amine solution forms molecular bonds with the carbon dioxide and hydrogen sulfide molecules, allowing those elements to be removed from the raw gas. Following the amine unit, DCP uses dehydrator machines to remove any residual water vapor from the gas. Commodity market specifications for NGLs and natural gas permit only minute levels of water in the products.

DCP next uses machinery known as heat exchangers and turbo expanders to continue the transformation of the gas into NGLs and marketable natural gas. These machines work in tandem. A series of heat exchangers first progressively reduce the temperature of the still highly pressurized gas to temperatures well below zero. Next, the turbo-expander dramatically lowers the pressure of the very cold gas from roughly 900 psi to 250 psi. This substantial change in pressure causes the gas to expand and reach even colder, cryogenic temperatures of -160°F. The tremendous changes in pressure, coupled with cryogenic temperatures, cause a substantial portion of the gas to liquefy into an aggregated NGL product known as "Y-grade" product. DCP sells the Y-grade product directly from its gas plants when it is economical to do so.

DCP also employs fractionation units in certain of its Weld County gas plants. These machines convert the Y-grade product into NGLs, including liquid propane, butane, and natural gasoline. Fractionation is a necessary step in the manufacturing process that is required to produce NGLs and marketable natural gas meeting the unique specifications required by each specific commodity market. Tanker trucks owned by DCP's customers regularly arrive at DCP's plants to purchase these discrete commodities.

In addition to converting raw gas into NGLs, DCP's manufacturing process also converts a portion of the raw gas input into pipeline-quality natural gas or methane, which is sold on commodity exchanges for use by consumers in homes, businesses, and factories. DCP sells this natural gas to third parties as its exits the tailgate of a gas plant and enters transportation pipelines owned by other companies.

Each of the machines described above, along with related machinery and equipment, is needed to produce NGLs. The machines operate dynamically and in harmony to produce new products and

commodities by applying tremendous forces to raw gas, including dramatic changes in pressure and temperature. If not for companies like DCP, NGLs would not exist. DCP similarly could not produce pipeline-quality residue gas without the machinery discussed above. If not for companies like DCP, pipeline-quality natural gas would not exist.

DCP sometimes performs the compression, cooling, and dehydrating elements of its manufacturing process at a field compression station. In these situations, DCP routes the gas directly to the remaining steps in the manufacturing process in the gas plant. The machinery and equipment used by DCP at the field compression station substitutes for the machinery and equipment performing these functions at the gas plant.

In 2000, the Department granted the machinery exemption to DCP's predecessor for the same types of machinery used at the same Weld County facilities. From 1993 to 2011, the Department's published guidance, FYI Sales 69, stated: "For Oil & Gas Operations: Refining is exempt under the definition of manufacturing found in § 39-26-709, C.R.S." The Department's current published guidance states that producing NGLs from liquid crude oil qualifies outside of enterprise zones for the manufacturing machinery exemption in C.R.S. § 39-26-709.

Conclusions of Law

In order for the machinery exemption to apply, the subject machinery must engage in "manufacturing:"

> "Manufacturing" means the operation of producing a new product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials.

C.R.S. § 39-26-709(1)(c)(III).

In 1986, a different Legislature enacted the Urban and Rural Enterprise Zone Act, C.R.S. §§ 39-30-101, *et seq*. (the "Enterprise Zone Act"). The Enterprise Zone Act for the first time established enterprise zones in Colorado. Among its provisions, the Enterprise Zone Act allowed a tax exemption for purchases of machinery, machine tools, parts, *etc*. to be used in manufacturing solely and exclusively in an enterprise zone. *See* C.R.S. § 39-30-106.

In 1991, yet another, different Legislature amended the Enterprise Zone Act. In response to lobbying by the mining industry, the 1991 Legislature added a sentence to C.R.S. § 39-30-106(2) of the enterprise zone exemption, which now forms the crux of the parties' dispute:

> For purposes of this section, in addition to the definition of "manufacturing" found in section 39-26-709(1)(c)(III), "manufacturing" shall include refining, blasting, exploring, mining and mined land reclamation, quarrying for, processing and beneficiation, or otherwise extracting from the earth or from waste or stockpiles or from pits or banks any natural resource.

C.R.S. § 39-30-106(2).

In the legislative declaration of policy that accompanied bill, Senate Bill 91-131, the 1991 Legislature plainly stated the narrow purpose and intent of the amendment – to afford tax relief to mining activities in enterprise zones.

> The general assembly hereby declares that its purpose in enacting this act is to clarify that activities related to mining shall be included within the definition of "manufacturing" for purposes of the sale and use tax exemption found in the "Urban and Rural Enterprise Zone Act", article 30 of title 39, [C.R.S.]

Medina Affidavit, Exh. C, pp. 12-13 (Legislative History of S.B. 91-131) (emphasis added)

The Department claims that DCP is precluded from relief under the machinery exemption statute enacted by the 1979 Legislature (C.R.S. § 39-26-709), based upon the amendment made to the enterprise zone exemption statute (C.R.S. § 39-30-106) by the 1991 Legislature. The Department infers that the 1991 Legislature's use of the words "refining" and "processing" in the enterprise zone exemption statute means that "manufacturing" as defined in the machinery exemption statute does not involve those activities.

The Court rejects the Department's argument. The machinery exemption does not exclude all refining or processing from the definition of "manufacturing," and the enterprise zone exemption is limited to mining activities, particularly activities surrounding the extraction of natural resources from the earth. The legislative history confirms that the 1991 Legislature intended to limit the Enterprise Zone Act amendment to mining activities.

The machinery exemption statute defines "manufacturing" to mean "the operation of producing a new product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials." C.R.S. § 39-26-709(1)(a)(III). That definition does not exclude "refining" or "processing." *State Dep't of Rev. v. Adolph Coors Co.*, 724 P.2d 1341, 1345 (Colo. 1986) (Courts "cannot restrict by judicial decision a provision that the General Assembly has left unrestricted."). Simply, the 1979 Legislature defined the term "manufacturing" in the machinery exemption, and that statutory definition governs. *Farmers Ins. Exch. v. Bill Boom, Inc.*, 961 P.2d 465, 470 (Colo. 1998) ("when the legislature defines a term in a statute, that definition governs"). If DCP satisfies the statutory definition of "manufacturing," it qualifies for the machinery exemption.

The enterprise zone exemption statute provides that "'manufacturing' shall include refining, blasting, exploring, mining and mined land reclamation, quarrying for, processing and beneficiation, or otherwise extracting from the earth … any natural resource." C.R.S. § 39-30-106(2). First, the phrase "or otherwise extracting from the earth … any natural resource" demonstrates the 1991 Legislature's intent to narrowly extend the exemption to mining and extraction activities, which are performed by mining companies or exploration and production companies. DCP is neither a mining company, nor an exploration and production company, and does not engage in mining or extracting natural resources from the earth.

Each of the listed activities has a specific and traditional meaning in the mining industry. A mining dictionary published by the U.S. Department of Interior confirms this point:

- Refining: "The purification of crude metallic products, as the refining of base bullion (silver lead) produces nearly pure lead and silver."

- Blasting: "The operation of breaking coal, ore, or rock by boring a hole in it, inserting an explosive charge, and detonating or firing it…." 9

- Exploration: "The search for coal, mineral, or ore by (1) geological surveys; (2) geophysical prospecting (may be ground, aerial, or both); (3) boreholes and trial pits; or (4) surface or underground headings, drifts, or tunnels."

- Mining: "The science, technique, and business of mineral discovery and exploitation. Strictly, the word connotes underground work directed to severance and treatment of ore and associated rock. Practically, it includes opencast work, quarrying, alluvial dredging, and combined operations, including surface and underground attack and ore treatment."

- Reclamation: "The recovery of coal or ore from a mine, or part of a mine, that has been abandoned because of fire, water, or other cause."

- Quarry: "An open or surface working, usually for the extraction of building stone, as slate, limestone, etc."

- Processing: "The methods employed to clean, process, and prepare coal and metallic ores into the final marketable product."

- Beneficiation: "The dressing or processing of ores for the purpose of (1) regulating the size of a desired product, (2) removing unwanted constituents, and (3) improving the quality, purity, or assay grade of a desired product…."

Medina Affidavit, Exh. D, pp. 97, 98, 401, 715, 866, 883, 902, 907 (U.S. Dep't of Interior, *Dictionary of Mining Terms* (Jan. 1990)). DCP does not refine, blast, explore, mine, reclaim, quarry, process or beneficiate coal or ores, as those terms are defined in the mining industry.

The Department misconstrues the word "processing" in the exemption by taking it out of context and treating it as a stand-alone term. This is contrary to the legislative history. The term "processing" appears in the statute as part of a single phrase, "processing and beneficiation," that is intended to be read together, just as the phrase "mining and mined land reclamation" is intended to be read together. The 1991 Legislature's intent in using the phrase, "processing and beneficiation."

The legislative history of the 1991 Legislature's amendment to the enterprise zone exemption in C.R.S. § 39-30-106 removes any doubt that the Department's interpretation is incorrect. The legislative history establishes that the amendment, Senate Bill 91-131, was intended to extend the enterprise zone exemption to the mining industry (specifically, extraction-related activities); that the amendment was enacted in response to the Department's position at the time that mining did not qualify for the enterprise zone exemption; and that the phrase "processing and beneficiation" is a mining term of art associated with "mineral ores."

The legislative declaration of policy is often the "best guide" to determine the scope and intent of a statute. *People v. McKinney*, 99 P.3d 1038, 1043 (Colo. 2004). Here, the 1991 Legislature plainly stated that it intended the amendment to achieve a narrow purpose – to afford tax relief to mining activities (specifically, extraction-related activities) in enterprise zones, and only to such activities:

> The general assembly hereby declares that its purpose in enacting this act is to clarify that activities related to mining shall be included within the definition of "manufacturing" for purposes of the sale and use tax exemption found in the "Urban and Rural Enterprise Zone Act", article 30 of title 39, [C.R.S.]

Medina Affidavit, Exh. C, pp. 12-13 (Legislative History of S.B. 91-131) (emphasis added).

The legislative history fully supports the narrow legislative declaration of policy. Senator Pastore, a bill sponsor, introduced Senate Bill 91-131 in the Senate Finance Committee and explained its intent and purpose:

> What this bill does is include mining within the purview of enterprise zones within the purview of manufacturing. That process, which now is different than the way my grandfather mined with a – a shovel, he drilled by hand, he went down in the mines – in the coal mines in Louisville, Colorado and drilled the mine. Now the miner is actually a machine. They're going to what we call the long wall and continuous mining machines. And these things cost – the continuous mining machine is a million dollars, for example. A long wall might be as much as $2 million. Very capital-intensive. And the actual individual person that runs the miner stands back and usually operates it by remote control, which, of course, is much safer.

Id., Exh. F, pp. 3-4 (emphasis added).

Senator Pastore further emphasized:

> But that's the – those are the background reasons that I'm running the bill, is to include mining, and what we are trying to do is stimulate the economy, the backbone of the economy, in several counties, including Delta County, in the state in coal mining. And many of the miners in Delta County are losing money, not making profits, because of the need to invest millions of dollars in these machines. And the enterprise zone designation designating mining as manufacturing in the enterprise zones could make the difference between closures of the mine – the mines or the mines staying open.

Id., Exh. F, p 4 (emphasis added).

Representative Williams, also a bill sponsor, added that Senate Bill 91-131 also responded to the Department's inconsistent treatment of mining under the enterprise zone exemption statute:

> Senate Bill 131 is a bill that is here because we want to make sure that the Department of Revenue clearly understands what the term of manufacturing is as it relates to mining activities. They have been treating it differently depending on the issue and so that's the reason we're bringing the bill.

Id., Exh. F, p. 14.

The Legislative Council's Revised Fiscal Note is equally clear. Relying on tax estimates provided by the Department for "mining equipment," the Legislative Council stated:

> An estimate of the amount of sales and use tax paid by mining concerns who are located within an enterprise zone cannot be made because, currently, no data are available which would identify the sales tax reports of mining firms located within Enterprise Zones.
>
> The Department of Revenue estimates that a total annual State sales and use tax collections on mining equipment is $1,677.0[0]. However, it is recognized that only mining equipment purchased within an enterprise zone would be exempt from state sales and use tax by the bill. Thus, the actual General Fund revenue loss as a result of the bill would be some fraction of the total mining equipment sales tax remittances as reported on sales tax returns.
>
> Some additional corporate or personal income tax revenues would be due to the State from the increase in the net incomes of mining operations as a result of reduced expenses for the payment of sales tax. Thus, corporate and individual income tax would make up approximately five percent of the General Fund sales tax reduction caused by the bill.

Id., Exh. C, p. 8 (Feb. 7, 1991 Legislative Council Revised Fiscal Note) (emphasis added).

Critically, the legislative history also establishes that the Department misconstrues the lynchpin to its legal theory – the word "processing" in C.R.S. § 39-30-106(2). The 1991 Legislature added the term "processing" to Senate Bill 91-131 by amendment as part of a single phrase intended to be read together, "processing and beneficiation," not two distinct words or activities. Indeed, upon Representative Williams' invitation, Diane Orf of the Colorado Mining Association testified as follows during the committee meetings: "Beneficiation is a term of art associated with the processing of mineral ores." *Id.*, Exh. F, p. 10 (emphasis added). The phrase "processing and beneficiation" is consistent with the 1991 Legislature's narrow purpose to extend the exemption to the mining industry. As intended by the 1991 Legislature, the phrase had nothing to do DCP or its activities.

The Department's statutory construction also is fundamentally illogical. Many industries, including the mining industry and the oil and gas industry, use the terms refining and processing. DCP often refers to its own facilities as gas processing plants. However, the terms have different meanings in different contexts. Simply because DCP operates a gas processing plant does not mean that it is engaged in "processing and beneficiation" within the meaning of C.R.S. § 39-30-106(2), nor does it mean that DCP cannot also engage in "manufacturing" within the meaning of C.R.S. § 39-26-709(1)(c)(III). The machinery exemption itself uses the phrase "manufacturing process," demonstrating that manufacturing and processing are fully compatible – not mutually exclusive. *See* C.R.S. § 39-26-709(1)(d). Indeed, the terms are often defined interchangeably in dictionaries: "manufacture" means "the process of making wares by hand or by machinery," while "process" means "a continuous operation or treatment esp. in manufacture." Merriam-Webster's Collegiate Dictionary, pp. 757, 990 (11th ed. 2003) (emphasis added). Another state tax exemption, informally known as the "processing exemption," underscores this point. This exemption establishes unequivocally that "manufacturing" a "product" may be accomplished by "processing":

> Sales to and purchases of tangible personal property by a person engaged in the business of manufacturing, compounding for sale, profit, or use, any article, substance, or commodity, which tangible personal property enters into the processing of or becomes an ingredient or component part of the product or service which is manufactured, compounded, or furnished, and the container, label, or the furnished shipping case

> thereof, shall be deemed to be wholesale sales and shall be exempt from taxation under this part 1.

CRS § 39-26-102(20)(a).

The Department's claim that "manufacturing" must be interpreted to exclude all forms of "processing" and "refining" is illogical. *See Flood v. Mercantile Adjust. Bureau, LLC*, 176 P.3d 769, 772 (Colo. 2008) (courts avoid constructions leading to illogical or absurd results).

The Department's own published guidance on the enterprise zone exemption further undermines its position. In August 2011, the Department issued the current version of For Your Information ("FYI") Sales 69, titled "Enterprise Zone Exemption for Machinery and Machine Tools Used in Mining." Medina Affidavit, Exh. E, pp. 19-20. FYI Sales 69 states that "refining" crude oil to produce hydrocarbon products outside an enterprise zone qualifies as exempt "manufacturing" under the machinery exemption. *Id.*, ¶ 19. Yet, in this case, the Department argues that "refining" raw natural gas to produce hydrocarbon products outside an enterprise zone does not qualify as exempt "manufacturing" under the machinery exemption. Whatever distinction the Department may be drawing between "refining" crude oil and "refining" raw natural gas is not found in either of the exemption statutes at issue, and makes little sense when one considers that the subject crude oil and raw natural gas well may have come from the same wellbore.

As a matter of law, the Department cannot define the scope of the 1979 machinery exemption statute based upon an amendment made to a different exemption statute, by a different 1991 Legislature, twelve years later. The Colorado Supreme Court has held that courts "cannot infer the intent of an earlier legislature from the views of a subsequent one." *Nieto*, 993 P.2d at 503, n.6.

These cases and principles are directly applicable here. The Legislature enacted the machinery exemption statute and the definition of "manufacturing" in 1979, before enterprise zones even existed. Seven years later, in 1986, a different Legislature enacted an entirely new set of statutes comprising the Enterprise Zone Act. Five years later, in 1991, yet another, different Legislature amended the enterprise zone exemption statute to add the disputed sentence to C.R.S. § 39-30-106(2). As a matter of law, the 1991 Legislature's amendment to C.R.S. § 39-30-106(2) cannot establish the meaning of "manufacturing" as defined by the 1979 Legislature. *Nieto*, 993 P.2d at 503 n.6; *People v. Duncan*, 109 P.3d 1044, 1046 (Colo. App. 2004). Indeed, *Nieto* and *Duncan* teach that even an amendment to the same statute cannot establish a prior legislature's intent. *Id*. Here, the Department seeks to infer the 1979 Legislature's intent in enacting the machinery exemption in C.R.S. § 39-26-709, by reference to the 1991 Legislature's amendment to a different statute, C.R.S. § 39-30-106, in a different article of the Colorado Revised Statutes. The Department's construction cannot be adopted.

Whether DCP's activities qualify for the machinery exemption must rise or fall based on the definition of "manufacturing" in the machinery exemption statute, C.R.S. § 39-26-709, as enacted by the Legislature in 1979, and not C.R.S. § 39-30-106.

DCP must show that it satisfies the definition of manufacturing in C.R.S. § 39 26 709(1)(c)(III), specifically, that it engages in the "operation of producing a new product, article, substance, or commodity different from and having a distinctive name, character, or use from raw or prepared materials."

First, it is clear that DCP begins its operations with inputs that constitute "raw or prepared materials" under the definition. Although DCP need only demonstrate that the raw natural gas that serves as its manufacturing input is either a raw material or a prepared material, The Court finds that the raw natural gas is both. Mr. Kuchinski testified by affidavit that the raw natural gas is regarded in the natural gas industry as a raw material for the production of DCP's NGLs and marketable natural gas. This testimony is consistent with a common understanding of the term "raw material," as interpreted by Colorado courts and common dictionary definitions. See, e.g., Wash. County Bd. of Equal. v. Petron Dev. Co., 109 P.3d 146, 152 (Colo. 2005) (referring to "wet oil" taken from a well as "raw material"); California Co. v. State, 348 P.2d 382, 398 (Colo. 1959) (referring to crude oil and raw gas as "raw materials" taken from "the bowels of the earth in Colorado"); The American Heritage Dictionary, p. 1454 (4th ed. 2006) (defining "raw material" as "[a]n unprocessed natural product used in manufacture").

I also conclude that the raw gas acquired by DCP is a "prepared material" under C.R.S. § 39 26 709(1)(c)(III). DCP purchases the raw gas as it exits a wellhead separator, which separates the raw gas from crude oil and water. In performing this separation, the separator has "prepared" the raw gas for DCP's manufacturing activities.

Second, as required by the governing statutory definition of "manufacturing," I find that DCP produces a "product, substance, article, or commodity" from the raw or prepared materials. The testimony of Mr. Kuchinski demonstrates that each NGL produced by DCP, as well as its marketable natural gas, is a separate and distinct product and commodity, sold by DCP to third parties, and traded on world commodity markets. Consistent with this testimony, in Final Determination DD 628, the Executive Director described the NGLs and marketable natural gas produced by DCP as "products" and "commodities." See, e.g., Final Determination DD 628, p. 5 ("The clear question in this case is whether the process employed by DCP to turn the gas stream into different commodities is manufacturing under C.R.S. § 39-26-709(1)(c)(III)."); id., p. 6 ("The materials removed [by DCP] are the various gases that are commodities and sold in markets to consumers."). It is therefore clear that DCP satisfies the statutory requirement that it produce a "product, article, substance, or commodity."

Third, under the definition of "manufacturing," DCP must produce a "new" product, substance, article, or commodity, which the definition describes as one that is "different from and having a distinctive name, character, or use from raw or prepared materials." C.R.S. § 39 26 709(1)(c)(III). DCP must satisfy only one of these differentiating criteria. In this case, each NGL and the marketable natural gas produced by DCP are different from and have a distinctive name, character, and use from the raw gas input.

Each NGL and marketable natural gas commodity produced by DCP has a distinctive name (liquid propane, butane, etc.) from the raw gas feedstock. The record testimony shows that each product is sold as a distinct commodity, under its distinct name, on commodities exchanges.

Each NGL produced by DCP has a distinctive character from the raw gas feedstock. Among these differences in character, the NGL products produced by DCP are liquids; the raw gas that serves as DCP's input is entirely in gaseous form. The NGL products produced by DCP do not exist in nature, while the raw gas is found in nature. The NGLs produced by DCP have a broad range of technical characteristics different from both raw gas and each other, including different molecular weights, boiling and freezing points, and BTU content. The marketable natural gas produced by DCP also has a different and distinctive character from the raw gas feedstock. Unlike raw gas, the marketable,

pipeline-quality natural gas product produced by DCP is not found in nature and is a unique commodity traded on commodity exchanges. The marketable natural gas product produced by DCP has various technical characteristics different from both raw gas and NGLs, including different molecular weights, boiling and freezing points, and BTU content.

Each NGL and marketable natural gas product produced by DCP has uses in the commercial marketplace that are very different from those of the raw gas feedstock. For example, the record shows that liquid propane is used to dry crops; in homes for heating, cooking, and hot water; and in industry to power turbines and other machinery. Liquid butane is used in gasoline blending to promote cold-starting and resist vapor lock, and also in the petrochemical industry as a feedstock to make specialty chemicals and plastics. Liquid natural gasoline is used as a motor fuel. Marketable natural gas is one of the most widely-used residential, commercial, and industrial fuel sources around the world. It is used every day for home furnaces, stoves, and water heaters, as well as many other commercial and industrial uses. The raw gas acquired by DCP cannot be used for any of these purposes. In fact, the raw gas lacks any use as an end product; its value resides only in its suitability as a raw material.

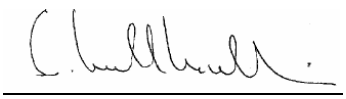
The Department view these processes as merely the separation of a natural gas stream into its various component hydrocarbons and argues that the Court in *Noble Energy, Inc. v. Colo. Dep't of Revenue*, 232 P.3d 293, 296 (Colo. App. 2010), held that separation of a natural gas well stream is not manufacturing under 39-26-709, C.R.S. *Noble* is distinguishable from the case before this Court. In Noble the taxpayer was wanted an exemption for a machinery that passively separates the natural gas well stream. Other than gravity, the machinery added nothing to this natural process. Further, after the separation, the resulting raw natural gas was not marketable other than to companies like DCP, where further processes are necessary to produce marketable products. As described in this order, the machinery used by DCP is not passive machinery.

Order

IT IS THEREFORE ORDERED that Plaintiff's Cross-Motion for Summary Judgment is GRANTED; Defendant's Motion for Summary Judgment is DENIED; and Judgment is entered in favor of Plaintiff and against Defendants on all claims.

DATED: March 19, 2014.

BY THE COURT:



R. Michael Mullins
District Court Judge