

No. 08-1056

IN THE SUPREME COURT OF TEXAS

**TGS-NOPEC GEOPHYSICAL COMPANY
d/b/a TGS-NOPEC CORPORATION**

Petitioner

vs.

**SUSAN COMBS, SUCCESSOR-IN-INTEREST TO
CAROLE KEETON STRAYHORN, COMPTROLLER OF PUBLIC ACCOUNTS,
& GREG ABBOT, ATTORNEY GENERAL OF TEXAS**

Respondents.

**PETITIONER AND AMICUS CURIAE'S
POST-SUBMISSION BRIEF**

BAKER BOTTS L.L.P.
Thomas R. Phillips
State Bar No. 00000102
98 San Jacinto Boulevard, Suite 1500
Austin, Texas 78701
Telephone: (512) 322-2500
Facsimile: (512) 322-2501

Renn G. Neilson
State Bar No. 14878300
2001 Ross Avenue Suite 600
Dallas, Texas 75201
Telephone: (214) 953-6871
Facsimile: (214) 661-4871

**ATTORNEYS FOR AMICUS CURIAE
WESTERNGECO LLC**

JACKSON WALKER L.L.P.
James T. McBride
State Bar No. 00787988
1401 McKinney, Suite 1900
Houston, Texas 77010
Telephone: (713) 752-4200
Facsimile: (713) 752-4221

**ATTORNEYS FOR PETITIONER, TGS-
NOPEC GEOPHYSICAL COMPANY D/B/A
TGS-NOPEC CORPORATION**

Petitioner TGS-NOPEC Geophysical Company and Amicus Curiae WesternGeco LLC submit this Post-Submission Brief to address questions raised by the Court and reinforce arguments by counsel for Petitioner and its Amici at oral argument.

ARGUMENT

I. Deference to the Comptroller’s “new” interpretation is not justified.

As Justice Medina observed during oral argument, the interpretation of a statute by an agency that is charged with its administration is ordinarily entitled to some deference. However, an agency’s interpretation – such as the Comptroller’s in this instance – that violates rules of statutory construction and grammar, transforms essential statutory language into surplusage, and creates inconsistencies with current rules and entire industries is not entitled to deference. *See generally Continental Cas. Co. v. Downs*, 81 S.W.3d 803, 806–09 (Tex. 2002) (refusing to defer to agency interpretation that “render[ed] meaningless” parts of a statute and had a “perverse effect” on the insurance industry), *overruled on other grounds, Sw. Bell Tel. Co. v. Mitchell*, 276 S.W.3d 443 (Tex. 2008). Because the Comptroller’s interpretation of Subsection (4)¹ does all of the above, her flawed reading of the statute does not begin to tip the scales of deference. *See* Brief on the Merits at 10–15.

The Comptroller erroneously argued that the word “license” should be open-ended, and encompass not only the intangible asset “a license”, but the act of or mechanism of “licensing”. Had the Legislature intended such an open-ended definition, it would have expressed this intent and it would have to apply equally across the board to

¹ TEX. TAX CODE § 171.103(a)(4) and § 171.1032(a)(4) are referred to throughout this brief as “Subsection (4)”.

all intangible assets and all mechanisms for transferring those assets. (*i.e.*, the act of patenting, the act of copyrighting...).²

Moreover, even if the Comptroller’s current interpretation were plausible on its face, it is still inapplicable because TGS is not the “owner” of a license, as required by the Comptroller’s own rules. 34 TEX. ADMIN. CODE §§ 3.549(e)(30) & 3.557(e)(25)(A). *See* Brief on the Merits at 14–15; Amicus Brief at 5–6.

The deference afforded an agency’s interpretation is not conclusive or unlimited; it operates only to the extent that the interpretation accords with the statute’s plain meaning and is otherwise reasonable, and no deference is due where an agency’s interpretation fails to follow the clear, unambiguous language of its own regulations. *See Rodriguez v. Serv. Lloyds Ins. Co.*, 997 S.W.2d 248, 254–55 (Tex. 1999); *See Mid-Century Ins. Co. of Tex. v. Ademaj*, 243 S.W.3d 618, 623 (Tex. 2007).

II. Franchises (like licenses) are revenue-generating intangible assets and are taxed to the asset owner based upon place of use.

During oral argument, the Court questioned counsel about the applicability of Subsection (4) to franchises. Contrary to the Comptroller’s assertion, franchises in this context, whether governmental or private, are intangible assets, just like patents, copyrights, trademarks, and licenses—not a transfer mechanism. The Comptroller again

² As discussed during oral argument, the result the Comptroller seeks through Subsection (4) was accomplished in Wisconsin’s sourcing statute. WIS. STAT. § 71.25(9)(dj). The Wisconsin statute uses the word “license” to refer to the act of licensing – the transfer mechanism, and uses it again in an illustrative list of intangible assets capable of being licensed - like an FCC license. Further, the Wisconsin statute actually includes “seismic data” among the assets whose receipts are the subject of such sourcing. It prefaces the particular list of assets with a catch-all phrase, “intangible assets.” Thus, any time an intangible asset is licensed and receipts are obtained from its use, Wisconsin sources those receipts to the place of use. The Texas Legislature could have, but did not, draft a statute capable of this result. Subsection (4) sets out a finite list of five intangible assets – “seismic data” is not among them. Further, it uses “license” only as an intangible asset – not as a mechanism of transfer.

incorrectly conflates the franchise agreement or the mechanism of franchising with the intangible asset of a franchise.

1. The governmental franchise is an intangible asset.

Justice Johnson asked TGS's counsel whether there are "any governmental franchises granted where you have some protection or something granted apart from the operation itself?" The answer is yes. "Franchise" includes certain rights or privileges granted by governmental authorities. See BLACK'S LAW DICTIONARY 546 (abridged 8th ed. 2005) (defining "franchise" in part as "[t]he government-conferred right to engage in a specific business or to exercise corporate powers"); see also *McCutcheon v. Wozencraft*, 255 S.W. 716, 718 (Tex. Comm'n App. 1923) (discussing the distinction between public franchises and public licenses), *rev'd on other grounds*, 294 S.W. 1105 (Tex. 1927). Governmental franchises in Texas are common and include:

- Franchises to offer specialized schooling programs, such as fire protection training. See 37 TEX. ADMIN. CODE § 427.409(c)(3); 40 TEX. ADMIN. CODE § 807.173(c).
- Franchises to provide cable and video service. TEX. UTIL. CODE § 66.001.
- Franchises to operate a toll bridge or ferry service. TEX. WATER CODE § 51.135.
- Franchises to operate a port facility. TEX. WATER CODE § 61.164.
- Franchises to operate an interurban railway property. TEX. TRANSP. CODE § 131.032.
- Franchises to transport ground water. TEX. TRANSP. CODE § 227.033.
- Franchises to operate a facility on the Trans-Texas Corridor. TEX. TRANSP. CODE § 227.082.
- Franchises to operate a toll underpass or tunnel. TEX. TRANSP. CODE § 282.002.
- Franchises to operate a public utility. See, e.g., TEX. UTIL. CODE § 39.456.
- Franchises to operate a harbor. TEX. GOV'T CODE § 1505.207.
- Franchises to operate an airport. TEX. GOV'T CODE § 1503.154.
- Franchises to operate a park or pool. TEX. GOV'T CODE § 1502.053.
- Franchises to collect solid waste. See, e.g., HEALTH AND SAFETY CODE § 364.034.

A taxpayer owning a governmental franchise may, when permitted by law, license the right to use its franchise to a third party. Under such circumstances the licensee's payments to the franchise owner constitute receipts from the use of a franchise, and such receipts would be subject to place-of-use sourcing under Subsection (4).³

2. *The commercial franchise is an intangible asset.*

In a commercial setting, the term “franchise” – used as an intangible asset - describes the bundle of intangible assets and goodwill held by a franchisor that constitute a commoditized system for marketing and selling goods and services. It is the business system that the franchisor owns—as in McDonald's parent corporation “owns” a franchise.

In *Armstrong v. Taco Time International*, the Washington Court of Appeals concluded that Taco Time had “a legitimate interest in protecting the basic product it sells—its franchise.” 635 P.2d 1114, 1119 (Wash. Ct. App. 1981). The court based its reasoning on similar statements made by the Pennsylvania Supreme Court and the Idaho Supreme Court. *Id.* (citing *Piercing Pagoda, Inc. v. Hoffner*, 351 A.2d 207, 211 (Pa. 1976) (“[T]o hold that no protectable interest exists overlooks the basic product which the franchisor has to sell, namely the franchise itself”) and *Shakey's Inc. v. Martin*,

³ For example, a taxpayer owning a franchise to operate an airport may, if the terms of the franchise agreement allow, license that right to a third-party operator. The operator uses the taxpayer's franchise by operating the airport. The operator's payments to the taxpayer for the right to use the taxpayer's franchise constitute “receipts from the use of a franchise,” and should be sourced to the location where the operator uses the taxpayer's franchise, most likely the location of the airport. This applies equally to public licenses. For instance, if an FCC license-holder licenses its FCC rights to a third-party broadcaster, the broadcaster's payments to the license holder for the right to use the FCC license constitute receipts from the use of a license, and should be sourced to place of use under Subsection (4). This is not because the rights are conveyed by license, but because what is conveyed is a right in a license.

430 P.2d 504, 509 (Id. 1967) (“[T]his conclusion of law overlooks the basic product that [franchisor] had to sell, i.e., its franchise . . .”).

The Comptroller mistakenly argued that the existence of a *franchise agreement*—the franchising mechanism—brings these transactions into Subsection (4). To the contrary, what brings these transactions into Subsection (4) is the franchisor’s ownership of a franchise—a bundle of intangible assets and goodwill—coupled with the franchisee’s use of that bundle of assets.

The franchisor licenses the assets (comprising its franchise) to a franchisee that then uses the assets in operating its business. In other words, the franchisee uses the *franchisor’s* franchise. The franchisee’s payments are therefore “receipts from the use of a franchise.” Because franchises are enumerated in Subsection (4), the receipts are subject to place-of-use sourcing. This construction equalizes treatment of franchises with the treatment of the other intangible assets enumerated in Subsection (4). It also harmonizes with the Comptroller’s rule which makes clear that the franchise referenced in Subsection (4) must be owned by the taxpayer.

The Comptroller’s focus on “franchise” as the bundle of licenses received by the franchisee ignores the franchisee’s use of the bundle of assets subject to those licenses—the *franchisor’s* franchise. Such an interpretation violates the ownership requirement in the Comptroller’s own rules and creates the surplusage and internal inconsistencies as described more fully in TGS’s and the Amicus’s Briefs. *See* Brief on the Merits at 10–15; Amicus Brief at 5–6.

CONCLUSION

The only correct interpretation is that urged by TGS and its Amici. The Comptroller's new interpretation, as exemplified in this assessment against TGS, produces inconsistent, incoherent results in what the Legislature intended to be a predictable undertaking. For all these reasons, in addition to the earlier arguments set forth in their Briefs, Petitioner TGS and Amicus Curiae WesternGeco LLC urge this Honorable Court to reverse the judgment of the Court of Appeals and grant such other relief to which Petitioner may be entitled.

Respectfully submitted,

By: James T. McBride

JACKSON WALKER L.L.P.
James T. McBride
State Bar No. 00787988
1401 McKinney, Suite 1900
Houston, Texas 77010
Telephone: (713) 752-4200
Facsimile: (713) 752-4221

**ATTORNEYS FOR APPELLANT, TGS-
NOPEC GEOPHYSICAL COMPANY D/B/A
TGS-NOPEC CORPORATION**

BAKER BOTTS L.L.P.
Thomas R. Phillips
State Bar No. 00000102
Matthew Wood
State Bar No. 24066306
98 San Jacinto Boulevard
1500 San Jacinto Center
Austin, Texas 78701
Telephone: (512) 322-2500
Facsimile: (512) 322-2501

Renn G. Neilson
State Bar No. 14878300
2001 Ross Avenue Suite 600
Dallas, Texas 75201
Telephone: (214) 953-6871
Facsimile: (214) 661-4871

**ATTORNEYS FOR AMICUS CURIAE
WESTERNGECO LLC**

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Petitioner and Amicus Curiae's Post-Submission Brief has been served upon the following counsel of record on the _____ day of June, 2010, by certified mail:

Kevin D. VanOort
Assistant Attorney General
CHIEF COMPTROLLER TRIAL ATTORNEYS
Taxation Division - 029
P.O. Box 12548
Austin, Texas 78711-2549