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ATTORNEYS FOR DEFENDANT

STATE OF WYOMING	)	IN THE DISTRICT COURT
	) ss	
COUNTY OF CAMPBELL	)	SIXTH JUDICIAL DISTRICT

KENNETH B. GEER,	)	
	)	
Plaintiff,	)	
	)	
vs.	)	Civil Action No. 32940
	)	
ANADARKO E&P ONSHORE LLC, Successor to Lance Oil & Gas Company, Inc., a Delaware Corporation,	)	
	)	
Defendant.	)	

DEFENDANT'S MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT ON PLAINTIFF'S IMPROPER TAX CALCULATION CLAIM

Defendant Anadarko E&P Onshore LLC, formerly known as Lance Oil & Gas Company, Inc. (Lance), submits this Memorandum in support of its Motion for Summary Judgment on

Plaintiff's claim that Lance improperly calculates its royalty owners' share of production taxes when it withholds taxes from its royalty owners' monthly checks.[1]

I. INTRODUCTION AND SUMMARY OF THE ARGUMENT

Lance produces coal bed methane (CBM) gas from thousands of wells in Campbell County, Wyoming, and is required to report and pay ad valorem and severance taxes on 100% of the gas it produces, even though it does not own all of that gas. There are typically many others with an interest in the gas produced by Lance, but as the operator of the wells Lance is required by Wyoming law to report and pay the taxes on behalf of all interest owners and then seek reimbursement from them for their share of the taxes Lance is required to pay.

There are many thousands of such owners. Most own either a royalty or an overriding royalty interest in the production from the wells. Royalty owners (lessors) own the mineral interest and have leased their development rights to Lance (lessee), and overriding royalty owners are persons who own small fractions of the leasehold interest that they share with Lance (both hereinafter "royalty owners"). Each month, Lance produces the gas from the wells, sells the gas in distant sales markets outside Wyoming, and then remits by check to each owner his or her share of the sales proceeds less certain costs, as determined by the specific terms of the individual lease contract, the Wyoming Royalty Payment Act (WRPA), or Lance's internal accounting practices building on those obligations. Individual lease and other contract terms vary widely on royalty owed, and there are many legal uncertainties associated with the WRPA, so the calculation for each of the thousands of separate owners is a complicated and uncertain undertaking. In part to simplify these complexities and uncertainties, Lance has chosen to forego

[1] Compl. at ¶¶ 13b, 19b, 36a, 38a.

some cost deductions that individual lease terms or the WRPA otherwise allow, which Lance contends means that many interest owners are actually overpaid each month, usually in an amount that exceeds the small amount of disputed taxes at issue here.

This case arises because of how Lance recovers from owners their share of the ad valorem, severance and conservation taxes ("production taxes") Lance is required to pay on their behalf. Lance's procedure is simple. Each month, Lance calculates the amount of royalty proceeds each owner is entitled to be paid based upon his lease, the WRPA, or Lance's accounting methods, and then Lance applies the production tax rates to the amount royalty owners are paid. The amount of tax so calculated is then deducted from each monthly royalty payment check. In this fashion, each owner pays the amount of tax owed on the revenues they actually receive each month.

Plaintiff contends that this approach is wrong. Mr. Geer argues that the amount of tax he owes should not be calculated by the amount of money he actually gets, but rather by applying the tax rates to his percentage of "taxable value," a number which is separately determined under the tax statute after deductions for costs Mr. Geer does not pay. Stated differently, Mr. Geer does not want to pay taxes on the production revenues he actually receives, but rather on a smaller amount that is calculated for tax purposes. Mr. Geer seeks the benefit of tax deductions associated with costs he never pays.

Under Mr. Geer's approach, he would pay less in taxes each month than his share of the royalty proceeds would actually require. Lance contends that Mr. Geer's approach is not supported by the statutes, is illogical, is contrary to basic tax theory, and is an attempt to take advantage, not once but twice, of costs that are incurred on his behalf but for which he is never

charged. For example, Lance pays for processing costs which must be paid to market Plaintiff's share of the gas, but Plaintiff argues that he should also get the tax deductions for these costs even though he does not pay them.

The law directly relevant to this controversy is set forth in Wyo. Stat. § 39-14-203(i) (ad valorem) and -203(c)(iii) (severance). Section 39-14-203(c)(iii), relating to severance taxes, states that a producer like Lance "may deduct the taxes paid from any amounts due or to become due to the interest owners of such production **in proportion to the interest ownership.**" (emphasis added). Lance contends that the statutory phrase "in proportion to the interest ownership" refers to the **royalty interest ownership** Mr. Geer owns in the production. "Ownership" refers to something someone owns, not a tax calculation, and what royalty owners like Mr. Geer "own" is a share of the production proceeds as determined by their leases and royalty law, not the tax statutes. Mr. Geer contends, on the other hand, that the statutory phrase "in proportion to the interest ownership" refers to a proportion of "taxable value," not the actual royalty interest paid. So the question posed for the Court is whether the statute should be read as contended by Lance: "in proportion to the [royalty] interest ownership," or as contended by Mr. Geer: "in proportion to the [taxable value] interest ownership."

Lance contends that the answer to this question can be found in both logic and the text of Section 39-14-203(c)(i). This provision states that "[i]n the case of ad valorem taxes . . . the lessor [royalty owner] is liable for the payment of ad valorem taxes . . . to the extent of the lessor's **retained interest under the lease, whether royalty** or otherwise . . . ." (emphasis added). This makes clear that tax responsibility flows from the **royalty interest** in the lease, not the **taxable value.** The statute does not say that the royalty owner's share of the ad valorem tax

is based on the royalty owner's interest in "taxable value." The statute provides that the royalty owner's share of tax liability is based on the actual leasehold property interest, which gives a normal and logical meaning to the statutory word "interest" in both Sections 39-14-203(c)(i) and (iii). The statutory term "interest" is a reference to a property right that can be "owned," not a reference to a tax calculation on a tax reporting form that cannot be "owned" by anyone.

Since there cannot be an "ownership" interest in a tax calculation, the plain and logical meaning of the relevant tax provision is that taxes are owed by Plaintiff and other royalty owners based on the amount of the royalty interest paid to them, not the amount of a taxable value calculated with reference to costs they are never charged. Lance is therefore entitled to judgment as a matter of law on Plaintiff's claim related to whether his taxes are owed on his royalty share or some portion of the taxable value calculated upon costs he never shares.

II. STANDARD OF REVIEW

Summary judgment is appropriate when "there is no genuine issue as to any material fact and [] the moving party is entitled to a judgment as a matter of law." Wyo. R. Civ. P. 56(c). "Summary judgment is a proper means of reaching the merits of a controversy where no material issue of fact is present and only questions of law are involved." *Treemont, Inc. v. Hawley*, 886 P.2d 589, 591-592 (Wyo. 1994).

A court properly resolves a claim on summary judgment where there is a question of law but no issue of fact; however, granting of the motion is "not precluded because the question of law is important, difficult or complicated." *Fugate v. Mayor & City Council*, 348 P.2d 76, 81 (Wyo. 1959). "Normally where the only conflict is as to what legal conclusions should be drawn from the undisputed facts, a summary judgment should be entered." *Id.* Here, there is no dispute

over the relevant facts. Lance applies the tax rate to the amounts Plaintiff actually receives for his royalty, but Plaintiff contends that the tax rate should be applied to a portion of the "taxable value" reported by Lance to the Department of Revenue, which gives Plaintiff the advantage of tax deductions for costs he does not pay. Which position is correct is a question of law.

III. ARGUMENT

A. Taxable Value and Royalty Value Are Separately and Differently Defined Under Wyoming Law -- Taxes Should be Apportioned Based on the Royalty Value Received, as This Divides the Tax Burden Equally and Is Consistent with the Statutes

This case arises because typically under Wyoming law "taxable value" and "royalty value" are not calculated the same way. When "royalty value", as a percentage of wellhead production, exceeds "taxable value", as a percentage of wellhead production, the royalty owner enjoys a larger cash value for his share of the production because the producer does not deduct some costs (primarily, processing costs[2])[3] from the royalty share that the producer can deduct from the taxable value for that production. The producer pays these costs, not the royalty owner[4], and therefore Lance contends that the tax deduction that comes with these costs belongs to Lance, not the royalty owner. The entity that pays the costs gets the tax deduction associated

[2] Under most of its leases with royalty owners, Lance could deduct processing costs. *See* Ex. 5, Terry Report ¶¶ 45-46; Excerpts of Deposition of James S. Wilson attached as Ex. 6 (S. Wilson Dep.) 71-73. The fact that Lance does not deduct most processing costs from royalty owners should not entitle royalty owners to a double benefit of a tax deduction for processing costs too.

[3] All exhibits to this memorandum are attached to Defendant's Rule 56.1 Statement of Facts Relating to its Motion for Summary Judgment on Plaintiff's Tax Calculation Claim (Statement). Please see the Statement for the initial reference to Exhibits 1-5 and 14.

[4] Ex. 1, Wallner ¶¶ 2-4; Ex. 6, S. Wilson Dep. 75.

with them. That's the dispute in a nutshell, because Mr. Geer wants the benefits of cost deductions he never pays.

Taxable value is a concept created under Wyoming tax statutes for the purpose of taxing mineral production and has a fixed definition. Conversely, royalty value is determined by individual lease language or, where the lease is silent, the WRPA, and represents a property interest in mineral production. Taxable value and royalty value are similar in that each involves deduction of costs from the gross sales value of mineral production, but that is where the similarity ends.

1. Taxable Value Defined

Wyo. Stat. § 39-14-203(b)(vi)(C) defines taxable value as "the sales price minus expenses incurred by the producer for transporting produced minerals to the point of sale and third party processing fees." The Wyoming Supreme Court has determined[5] that the production process for tax purposes is completed at the outlet of the initial dehydrator, so taxable value is gross sales receipts less costs incurred downstream of the outlet of the initial dehydrator.[6] In essence, the taxpayer "nets back" the costs he has incurred from the point of sale back to the point of taxable value, the outlet of the initial dehydrator, to calculate taxable value. Taxable value is static by being fixed at the outlet of the initial dehydrator and enables the taxing

[5] *Williams Prod. RMT Co. v. Wyo. Dep't of Revenue*, 2008 WY 155, ¶ 14, 197 P.3d 1258, 1263 (Wyo. 2009).

[6] As explained in the Chris Wilson Affidavit, the initial dehydrator is near the end of the Gathering Segment and before the gas is processed or transported by high pressure and downstream pipelines. Ex. 2, Chris Wilson ¶ 13. Therefore, processing and transportation costs are deductible by Lance from gross sales value to determine taxable value. Ex. 1, Wallner ¶ 7; Expert Report of Debbie S. Liller, CPA, dated June 19, 2013 attached as Ex. 7 (Liller Report) at 2.

authority to uniformly tax CBM gas production irrespective of various ownership interests in the production.

2. Royalty Value Defined

Conversely, royalty value is the amount of a specific owner's property interest in mineral production and varies widely from owner to owner depending on lease or other contract language defining royalty value.[7] "Unless otherwise expressly provided for by specific language in an executed written agreement, 'royalty' " is defined as "the mineral owner's share of production, free of the costs of production . . . " and "[o]verriding royalty" is defined as "a share of production, free of the costs of production, carved out of the lessee's interest under an oil and gas lease[.]" Wyo. Stat. § 30-5-304(a)(vii), -304(a)(v), -305(a).[8] Accordingly, royalty value for any given royalty owner is also calculated by "netting back" costs from the point of sale to the point of royalty, but those costs that can be netted back, and consequently the point of valuation for royalty purposes, changes from royalty owner to royalty owner depending on contract language.

[7] Ex. 5, Terry Report ¶ 10; Ex. 6, S. Wilson Dep. 54.

[8] "Costs of production," in turn, are defined as follows:

> . . . all costs incurred for exploration, development, primary or enhanced recovery and abandonment operations including, but not limited to lease acquisition, drilling and completion, pumping or lifting, recycling, gathering, compressing, pressurizing, heater treating, dehydrating, separating, storing or transporting . . . the gas into the market pipeline. **"Costs of production" does not include the reasonable and actual direct costs associated with transporting . . . the gas from the point of entry into the market pipeline or the processing of gas in a processing plant;**

Wyo. Stat. § 30-5-304(a)(vi) (emphasis added).

However, because fewer costs (primarily, processing costs[9]) are netted back for royalty valuation purposes than for tax valuation purposes, royalty value is typically higher than taxable value.[10] Stated differently, the point of royalty value as paid by Lance is usually downstream of the point of taxable value because processing costs incurred after the outlet of the initial dehydrator are deducted from taxable value but not deducted by Lance from royalty value.[11]

3. Plaintiff Seeks the Benefit of the Tax Deduction Associated with Processing Costs that Plaintiff and Royalty Owners Do Not Pay

Because the point of royalty value that Lance pays is generally downstream of the point of taxable value, royalty owners' gas is transported without cost to the royalty owners from the point of taxable value to the point of royalty value. In the interest of administering its varying leases efficiently and taking a conservative approach to its royalty calculations, Lance pays the costs to process the gas but does not pass that expense along to royalty owners because some leases do not permit processing.[12] Thus, the royalty interest owners benefit by not having to pay costs of processing of its gas after the point of taxable value. Lance incurs those processing

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[9] "Processing of gas in a processing plant" as that term is used in the Wyoming Royalty Payment Act occurs at the Medicine Bow, Little Thunder and Bison processing plants. Ex. 14, Enick Report 1. Although Lance does not generally deduct these costs from royalty owners, (Ex. 1, Wallner ¶¶ 3-4), it could under most leases or the WRPA. Ex. 5, Terry Report ¶¶ 45-46 and Ex. D; Ex. 6, S. Wilson Dep. 71-73.

[10] If Lance were to deduct the Gathering and Processing costs that it could deduct under 80% of its leases (Ex. 5, Terry Report ¶¶ 27, 45, Ex. D), royalty value would actually be lower than taxable value, a result that causes Plaintiff's theory to further fail as shown in Part IV.D.4. below.

[11] Ex. 1, Wallner ¶¶ 3-4; also attached for the Court is a visual aid depicting different royalty and taxable values and where those values are located along the path of moving gas from the wells to downstream sales markets. Ex. 8, Values chart.

[12] Ex. 4, Wallner Dep. 17-19, 35-36; Ex. 5, Terry Report ¶ 46; Ex. 7, Liller Report 3.

costs, but does not recover most of them from the royalty owner as a deduction from royalty value although allowed under most leases.[13]

The fact that Lance's royalty payment practices place the point of taxable value upstream of the point of royalty value means that Lance deducts processing costs from taxable value, costs not paid by the royalty interest owners. Thus, Lance appropriately receives a tax benefit for costs that it incurs, but does not charge royalty owners. Lance does not allocate that tax benefit to the royalty owner because the royalty owner does not pay those costs.[14] Mr. Geer argues that Lance should allocate this tax deduction to the royalty owners despite the fact that these owners do not pay the costs associated with that deduction. Mr. Geer therefore seeks a windfall and double benefit: a tax deduction for costs he does not pay,[15] and increased production revenues attributable to his royalty value that is free of those costs as well.

B. Wyoming Tax Statutes Impose Production Taxes on Royalty Owners' Ownership Interest in Production, a Royalty

Owners of CBM gas production are responsible for production taxes levied on their interest. As operator, Lance pays production taxes on 100% of CBM production and then must deduct royalty owners' share of severance and ad valorem taxes from the royalties Lance pays royalty owners. The statutes governing taxes assessed on the gross product of a well provide the framework to ensure that "both the lessee and lessor are responsible for payment in proportion to

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[13] Ex. 1, Wallner ¶ 4; Ex. 5, Terry Report ¶ 45 and Ex. D.; Ex. 6, S. Wilson Dep. 72-73.

[14] *See* Excerpts of Debra S. Liller Deposition attached as Ex. 9 (Liller Dep.) 24; Ex. 7, Liller Report 3.

[15] Mr. Geer's leases would require that he pay Processing Costs that Lance does not currently deduct from his royalty. Ex. 5, Terry Report ¶¶ 30-33 and Ex. G.

their ownership shares." *Ashland Oil Co. v. Jaeger*, 650 P.2d 265, 268 (Wyo. 1982). Royalty owners own a share of production, or royalty, which is the ownership interest that is taxed.

Wyo. Stat. § 39-14-203 governs the imposition of severance taxes[16] and the payment of both severance and ad valorem taxes on CBM gas production. Wyo. Stat. § 39-14-203(c)(i) imposes on lessors ad valorem taxes on natural gas removed "only to the extent of the lessor's retained interest under the lease, whether royalty or otherwise . . . ." Wyo. Stat. § 39-14-203(c)(ii) imposes on any person owning an interest in the natural gas production severance taxes "to the extent of their interest ownership." Wyo. Stat § 39-14-203(c)(iii) allows any taxpayer paying severance taxes on natural gas production to "deduct the taxes paid from any amounts due or to become due to the interest owners of such production in proportion to the interest ownership."

Thus, royalty owners are taxed on their interest in production, or their royalty interest. Royalty owners pay taxes on, and only to the extent of, what they own. The importance of this proposition is that royalty owners are responsible for taxes on an interest that takes into account costs deducted from royalty. Certain costs paid by Lance (processing) are not deducted from royalty, and therefore any tax benefit associated with those costs is allocated to Lance and not shared with royalty owners. This is the appropriate tax treatment, as it "proportion[s] the interest ownership," which is royalty value. Mr. Geer "owns" a royalty, not a "taxable value." *See Hearing No. 11,660*, 1982 WL 12798, *13 (Tex.Cptr.Pub.Acct.) (attached as Ex. 10) (holding that the operator and royalty owners "should share natural gas severance tax burden in the same

[16] An identical basis for imposing an ad valorem tax on CBM production is provided at § 39-13-103(b)(iv).

proportion they share the net proceeds from a downstream sale of the gas, not the respective fractional interests in the mineral estate").

Applying the tax rates to royalty value ensures that both parties are taxed equally on what they actually get, the most sensible, fair, equal and logical result. Applying the tax rates to "taxable value," which is something nobody owns, gives the plaintiff a double benefit. He gets to be "cost free" to the point of royalty value, and then the costs he does not have to pay also become his tax deduction. That is just not logical.

C. Wyoming Courts Have Approved Lance's Practice of Not Giving Royalty Owners a Tax Deduction for Tax-Deductible Expenses They Are Not Charged

Wyoming courts have approved Lance's practice of deducting taxes from royalty payments in a manner that allocates to the party paying the tax-deductible expense the tax deduction. "Generally, deductions attributable to expenditures are allowable to the taxpayer who bears the economic burden of the expenditure and who receives the benefits of the expenditures." MAULE, 503-3rd Tax Management Portfolio, *Deductions: Overview and Conceptual Aspects* VII(A), (Bloomberg BNA) (*citing, e.g., Case v. Comr.*, 50 T.C.M. 1291, 1295 (1985); *Bordo Prods. Co. v. U.S.*, 476 F.2d 1312, 1327 (Ct. Cl. 1973). Contrary to Plaintiff's claim that Lance employs an "illegal methodology" (Pl. Mot. for Cert. at 13), this very Court approved the *Addison/Barlow* royalty class settlements, which state that Royalty Owners are not entitled to tax benefits on costs that the royalty owners do not bear. *See, e.g.,* Pennaco Settlement Agreement at ¶ 1.10.1 ("The Settlement Class Members will bear their proportionate share of taxes,

however, they will not receive any tax benefits or credit associated with the costs or expenses they do not bear.") and others in Settlement Agreements Exhibit.[17]

A taxpayer is only entitled to a tax deduction for a cost he pays. By advocating that his production tax liability should be an evenly-shared proportion of taxable value, Plaintiff argues that he is entitled to share in tax deductions for expenses he does not pay. Accounting for costs actually paid by royalty owners in determining their pro rata tax liability properly quantifies their "ownership interest" and gives effect to the basic tax principle that a taxpayer is not entitled to a tax deduction for a cost he does not pay.[18]

D. Plaintiff's Theory that Royalty Owners' Tax Liability Is a Proportionate Share of Taxable Value Based on Gross Receipts Cannot Be Correct

Plaintiff argues that his production tax liability does not come from his ownership of a royalty interest, but instead is a proportion of taxable value based on his gross receipts share of production. He advocates a reading of the tax statute that distributes tax liability between Lance and the royalty owner not based on production revenues each party actually receives, but instead on an allocation of taxable value that ignores which party was charged tax-deductible expenses.

The following example illustrates Plaintiff's position and shows that the impact of his theory is to alter the effective tax rate that each party pays on their actual cash receipts:[19] If the gross sales value for production from a well is $10,000 and a royalty owner's interest in that

[17] Ex. 11 contains excerpts of five of these class settlement agreements with various CBM producers in which the Court approved those settlements including the identical provision that royalty owners will not receive tax benefits for costs they do not pay.

[18] Ex. 7, Liller Report 5.

[19] *See* Ex. 7, Liller Report 4; Ex. 9, Liller Dep. 22-26; Ex. 6, S. Wilson Dep. 96-106; and S. Wilson Dep. Ex. 22, attached as Ex. 12.

production is 5% ($500), and if Lance pays $3,000 in transportation costs and $1,000 in processing costs to move the gas to market, then the net proceeds are $6,000 ($10,000 - $3,000 - $1,000 = $6,000). Lance deducts the royalty owner's pro rata share of transportation costs from royalty (5% x $3,000 = $150), but does not deduct any processing expense. The royalty owner thus receives $350 in net production proceeds ($500 - $150 = $350). Since Lance incurs the entire expense for processing, it receives $5,650 ($10,000 - $3,000 - $1,000 - $350 = $5,650). The royalty owner therefore receives 5.8% of the net proceeds ($350 out of the $6,000) and Lance receives 94.2% of the net proceeds ($5,650 out of the $6,000).[20]

If a 12.04%[21] tax rate is applied to the $6,000 taxable value ($10,000 less $3,000 transportation and $1,000 processing), then the tax liability on the production from the well is $722.40 ($6,000 x 12.04% = $722.40). Under Lance's practice, the tax liability is apportioned equally between Lance and the royalty owner based upon the tax-deductible costs each party incurs, which ensures that each party's effective tax rate is exactly 12.04%. Lance pays $680.26 (12.04% x $5,650) and the royalty owner pays $42.14 (12.04% x $350). Under Plaintiff's theory, however, Lance pays 95% of the $722.40 ($686.28) and the royalty owner pays 5% of the $722.40 ($36.12). However, because Lance pays the entire tax-deductible processing costs, including those attributable to the royalty share, apportioning taxes based on taxable value alters the effective tax rate that each party pays on their actual cash receipts. Lance's effective tax rate increases to 12.15% ($686.28 divided by $5,650) and the royalty owner's effective tax rate

[20] *Id.*; *see* especially Ex. 12, S. Wilson Dep. Ex. 22, pp. 1-2.

[21] This is a hypothetical but realistic estimated combined rate for severance, ad valorem, and conservation tax rates set by statute (severance), Campbell County Commissioners (ad valorem), and the Wyoming Oil and Gas Conservation Commission (conservation).

decreases to 10.32% ($36.12 divided by $350).[22] Under Plaintiff's theory, Lance's effective tax rate exceeds the tax rate required by law and Plaintiff's tax rate is less than the tax rate required by law. Plaintiff's expert agrees that Plaintiff's theory leads to different effective tax rates paid by Lance and royalty owners.[23]

The net result is unequal tax burdens on the same gas production. If this Court were to approve that approach, serious constitutional problems would arise.

1. Plaintiff's Theory Violates Art. I § 34, Art. XV § 3, and Art. XV § 11 of the Wyoming Constitution

The Wyoming Constitution authorizes the State to impose ad valorem taxes on mineral production, but requires that such taxation be "equal and uniform." Wyo. Const. Art. XV, § 3; Wyo. Const. Art. XV, § 11(d).

The State's taxing authority is derived from Article XV, Section 3 of the Wyoming Constitution, which provides: "All mines and mining claims from which . . . mineral oil or other valuable deposit, is or may be produced shall be taxed . . . on the gross product thereof . . ." To further clarify the State's taxing authority, the Wyoming Constitution designated three classes of property for which "[a]ll taxation shall be **equal and uniform**. . . ." Wyo. Const. Art. XV, § 11(d) (emphasis added). One of the three classes, defined as "[g]ross production of minerals and mine products in lieu of taxes on the land where produced," is directly implicated in this case. Wyo. Const. Art. XV, § 11(a)(1). In addition, the Constitution provides that "[a]ll laws of a general nature shall have a uniform operation." Wyo. Const. Art. I, § 34.

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[22] Ex. 9, Liller Dep. 29-30.

[23] Ex. 6, S. Wilson Dep. 100-101, 106; Ex. 12, S. Wilson Dep. Ex. 22, p. 3.

Under these Constitutional provisions, each taxpayer is entitled to have his taxes "assessed at a uniform rate, and a departure therefrom if made in an illegal manner is . . . a discrimination against it which would not only be a fraud against [the taxpayer], but would also violate the constitutional provision of uniformity." *Bunten v. Rock Springs Grazing Ass'n*, 215 P. 244, 251 (Wyo. 1923). Such discrimination may arise in various ways, for instance by the adoption of a wrong or illegal taxation principle or methodology; "and an unjust tax resulting therefrom has frequently been enjoined as illegal." *Id.*

In this case, Plaintiff's theory "runs afoul of the constitutional equal-and-uniform mandates where *all* taxpayers are indigenous to the one class by constitution." *Rocky Mountain Oil & Gas Ass'n v. State Bd. of Equalization*, 749 P.2d 221, 236 (Wyo. 1987) (emphasis in original). Here, only one class of taxpayers is implicated, those who are obligated to pay taxes on "[g]ross production of minerals and mine products in lieu of taxes on the land where produced." Wyo. Const. Art. XV, § 11(a)(1). Because all taxpayers belong to the one constitutionally defined class, uniform and equal taxation is required. Plaintiff's tax theory violates this requirement, because Plaintiffs' theory would impose different tax burdens on the cash receipts of taxpayers within the same class.

2. Plaintiff's Theory Violates the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution

"[T]he imposition of a tax burden resulting from a systematic, arbitrary, or intentional undervaluation of some property, as compared to the valuation of other property in the same class, would violate the uniformity clause of the [Wyoming] State constitution" as well as the Equal Protection and the Due Process Clauses of the Federal Constitution. *Weaver v. State Bd.*

of Equalization, 511 P.2d 97, 98 (Wyo. 1973); *White v. State*, 784 P.2d 1313, 1314 (Wyo. 1989) ("the due process and equal protection guaranties of the federal Bill of Rights serve as a minimum standard for the protection of individual liberties and . . . the Wyoming Constitution may legitimately expand those safeguards"); *Unemployment Comp. Comm'n v. Renner*, 143 P.2d 181, 186 (Wyo. 1943) (Wyoming's "requirement of equal and uniform taxation substantially covers the ground of the due process and equal protection clauses of the Federal and State Constitution").

The Equal Protection Clause of the Fourteenth Amendment protects the individual from state action which selects him out for discriminatory treatment by subjecting him to taxes not imposed on others of the same class. *Rocky Mountain Oil & Gas Ass'n*, 749 P.2d at 234. The Wyoming Constitution, as well as the Fourteenth Amendment, requires that "the burden of taxation shall be borne by all alike, or, in other words, equality in the imposition of such burdens shall exist." *Id.* at 235.

Moreover, the Due Process Clause forbids taxation based on the property of another. *Hoeper v. Tax Comm'n of Wis.*, 284 U.S. 206, 215 (1931). The U.S. Supreme Court in *Hoeper* held: "because of the fundamental conceptions which underlie our system, any attempt by a state to measure the tax on one person's property or income by reference to the property or income of another is contrary to due process of law as guaranteed by the Fourteenth Amendment." *Id.* Plaintiff's theory of taxation results in the taxation of some class members based on the property valuation of other taxpayers, in violation of *Hoeper*.

3. Courts Must Construe Statutes to Avoid Constitutional Infirmity

Wyoming statutes are "presumed to be constitutional and all doubts are resolved in favor of constitutionality." *BP Am. Prod. Co. v. Dep't of Revenue*, 2006 WY 27, ¶ 40, 130 P.3d 438, 469 (Wyo. 2006) (construing statute in light of Wyo. Const. Art I § 34 and Art. XV §§ 3 and 11); *see also State v. Newman*, 2004 WY 41, ¶ 11, 88 P.3d 445, 449 (Wyo. 2004) (courts should strive to "reasonably interpret the statute in such a way that it is not viewed as unconstitutional"); *Holm v. State*, 404 P.2d 740, 741 (Wyo. 1965) (court will "not declare any portion of [a statute] unconstitutional which can reasonably be interpreted as being constitutional"). As a result, if confronted with two reasonable readings of a statute, the one which does not present constitutional problems should be adopted by the Court.

Plaintiff advocates a reading of Wyo. Stat. § 39-14-203 that would impose a different tax rate on Lance than on royalty owners for the value each ultimately receives for the production. If section -203(c)(iii) is read as "in proportion to the [taxable value] interest ownership," Lance's effective tax rate would be higher than 12.04% and royalty owners' effective tax rate would be lower than 12.04%. However, there is an interpretation of the statute that does not result in a change in the effective tax rate, and instead ensures that every lessee's and lessor's interest is assessed a 12.04% tax rate. If read as "in proportion to the [royalty] interest ownership," each taxpayer pays a tax on what he receives and each taxpayer pays the same tax rate on the same produced gas, thereby avoiding any constitutional violation. Given the two possible interpretations of the statute, the Court must construe § 39-14-203 in a fashion that avoids a constitutional violation, which is to hold that "in proportion to the interest ownership" refers to royalty owners' royalty interest rather than a proportionate share of taxable value.

4. Plaintiff's Theory Breaks Down in the Circumstance Where Royalty Value is Less Than Taxable Value

Plaintiff's theory is also revealed to be illogical and result-oriented when applied to the circumstance in which royalty value is less than taxable value.[24] For instance, if a royalty owner's lease allows deduction of gathering charges downstream of the central delivery point (CDP) and Lance charged the royalty owner processing, the royalty owner's effective tax rate would increase under Plaintiff's theory.[25] Continuing with the example, if gathering charges were $2000, then the royalty owner would receive $200 after deductions ($10,000 - $3,000 - $1,000 - $2,000 = $4,000) (5% x $4,000 = $200). Under Plaintiff's theory, the royalty owner's tax liability would still be $36.12 (5% x $722.40), which would increase the royalty owner's effective tax rate to 18.06% ($36.12 of the $200 proceeds received).[26] Plaintiff's theory does not generate consistent results when applied to varying situations in which different expenses are deductible from royalty.

IV. CONCLUSION

Royalty owners are liable for taxes assessed on their interest ownership, a royalty. Lance does not charge royalty owners for certain tax-deductible expenses like processing that Lance must pay to move the gas to market. Royalty owners should not benefit twice from this fact by getting an additional tax deduction on costs they do not pay. Lance's practice of deducting taxes

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[24] Royalty value can be greater than or less than taxable value, a fact Plaintiff's expert readily admits. Ex. 6, S. Wilson Dep. 67.

[25] This circumstance is far from hypothetical. *See* Terry Report, in which Terry states that 80% of class leases allow deduction of gathering costs, as well as processing and transportation costs, from royalty. Ex. 5, Terry Report ¶¶ 27, 45.

[26] *See* Ex. 6, S. Wilson Dep. 106-110; Ex. 23 to S. Wilson Dep., attached as Ex. 13.

from royalty payments based on what royalty owners receive complies with Wyo. Stat. §39-14-203 and gives logical and constitutional effect to "in proportion to the interest ownership." Accordingly, Lance is entitled to summary judgment in its favor.

DATED July 31, 2013.

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CERTIFICATE OF SERVICE

I hereby certify that on July 31, 2013, I served the foregoing **DEFENDANT'S MEMORANDUM BRIEF IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT ON PLAINTIFF'S IMPROPER TAX CALCULATION CLAIM** by placing a true and correct copy thereof in the United States mail, postage prepaid and properly addressed to the following:

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