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Contract and Property Law - Does a Contractual Right to Receive Production Payments Create a Taxable Ownership Interest in Minerals: Sutherland v. Meridian Granite Co., 273 P.3d 1092 (Wyo. 2012)

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Case Note

CONTRACT AND PROPERTY LAW—Does a Contractual Right to Receive Production Payments Create a Taxable Ownership Interest in Minerals?; *Sutherland v. Meridian Granite Co.*, 273 P.3d 1092 (Wyo. 2012)

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Introduction

Like many states, the State of Wyoming taxes the minerals produced from mines.[1] In Wyoming, each owner of an interest in mine products is responsible for the taxes due on the value of minerals produced in proportion to his or her ownership interest.[2] Western landowners frequently own only surface rights, while another party owns the subsurface or mineral rights.[3] In general, the owner of the mineral rights has the right to use the surface to the extent reasonably necessary to explore for and develop minerals.[4] If mineral exploration or development damages

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[1] *See* 5 Rocky Mountain Mineral Law Foundation, American Law of Mining §§ 190.4, 192.01 (2d ed. 2012) [hereinafter American Law of Mining]; 58 C.J.S. *Mines and Minerals* § 445 (2013); 71 Am. Jur. 2d *State and Local Taxation* § 520 (2013); [Wyo.] All St. Tax Guide Online (RIA), § 1430; 4 Nancy Saint-Paul, Summers Oil and Gas § 49:2 (3d ed. 2012) [hereinafter Summers Oil and Gas].

[2] 011-000-006 Wyo. Code. R. § 5 (Weil's 2010), *available at* http://soswy.state.wy.us/Rules/RULES/6284.pdf (DOR Rules and Regulations, Ad Valorem and Severance Taxes on Mineral Production).

[3] Clarence A. Brimmer, *The Rancher's Subservient Surface Estate*, 5 Land & Water L. Rev. 49, 49 (1970); *see* 1 American Law of Mining § 9.01[2], *supra* note 1.

[4] Brimmer, *supra* note 3, at 52; Drake D. Hill & P. Jaye Rippley, *The Split Estate: Communication and Education Versus Legislation*, 4 Wyo. L. Rev. 585, 585 (2004); M. Kristeen Hand & Kyle R. Smith, Comment, *The Deluge: Potential Solutions to Emerging Conflicts Regarding On-Lease and Off-Lease Surface Damage Caused by Coal Bed Methane Production*, 1 Wyo. L. Rev. 661, 664 (2001); *see, e.g.*, Kinney-Coastal Oil Co. v. Kieffer, 277 U.S. 488, 495 (1928); Mingo Oil Producers v. Kamp Cattle Co., 776 P.2d 736, 740 (Wyo. 1989); Sanford v. Arjay Oil Co., 686 P.2d 566, 567 (Wyo. 1984); Holbrook v. Continental Oil Co., 278 P.2d 798, 799 (Wyo. 1955); *see generally* Bruce M. Kramer, *The Legal Framework for Analyzing Multiple Surface Use Issues*, *in* Severed Minerals, Split Estates, Rights of Access, and Surface Use in Mineral Extraction Operations, Paper No. 2, 12 (Rocky Mtn. Min. L. Fdn. 2004); 6 American Law of Mining § 200.02[1], *supra* note 1; Jan G. Laitos, *Literature Review of Severed Minerals, Split Estates, Rights of Access, and Surface Use in Mineral Extraction Operations*, *in* Severed Minerals, Split Estates, Rights of Access, and Surface Use in Mineral Extraction Operations, Paper No. 1B (Rocky Mtn. Min. L. Fdn. 2004).

the surface, mineral producers may be required to compensate the surface owner.[5] Parties often negotiate the terms of access, use, and compensation, which results in a surface use agreement or lease.[6] In a recent decision, *Sutherland v. Meridian Granite Co.*, the Wyoming Supreme Court interpreted such a lease.[7]

In *Sutherland*, part of the agreement covered split estate land.[8] The Sutherlands owned the surface and the mining company planned to acquire mineral rights owned by the federal government.[9] In this agreement, the Sutherlands released the mining company from liability for surface damages in exchange for payments based on the amount of production.[10] The Sutherlands objected to the mining company's practice of withholding Wyoming's production taxes from the payments.[11] The Sutherlands took the position they were not responsible for mineral production taxes because they did not own an interest in the minerals.[12]

In *Sutherland*, the Wyoming Supreme Court missed the opportunity to clarify whether the receipt of payments based on production creates a taxable ownership interest in mineral production.[13] A divided court determined the plain language of the lease required the Sutherlands to pay a portion of the production taxes.[14] The court based its decision on language in the agreement obligating the Sutherlands to pay taxes "imposed upon or measured by" the production

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[5] Mineral producers who acquire minerals from the federal government on lands patented under the Stock Raising Homestead Act are required to post a bond for "the payment of all damages to . . . crops and improvements." 30 U.S.C. § 122 (2011); 6 AMERICAN LAW OF MINING § 200.02 [1][c], *supra* note 1; *see Holbrook*, 278 P.2d at 799. Wyoming also requires a bond for the use and benefit of the surface owner to pay for damages to the surface estate before the issuance of a mining permit, but this requirement can be waived with the surface owner's consent. WYO. STAT. ANN. § 35-11-416 (2012). For a general discussion of the history of compensation for surface damages in Wyoming, see Belle Fourche Pipeline Co. v. State, 766 P.2d 537, 544–48 (Wyo. 1989).

[6] Guy L. Nevill, *Multiple Uses and Conflicting Rights*, 13 ST. MARY'S L.J. 783, 792 (1982); *see* § 35-11-416 ("A bond for surface damage shall not be required when the agreement negotiated between the surface owner and the mineral owner or developer waives any requirement therefor."); *see also* David Patton, *Negotiating a Surface Use Agreement for Private Lands*, *in* DEVELOPMENT ISSUES AND CONFLICTS IN MODERN GAS AND OIL PLAYS, Paper No. 10, § III (Rocky Mtn. Min. L. Fdn. 2004).

[7] Sutherland v. Meridian Granite Co., 273 P.3d 1092 (Wyo. 2012).

[8] *Id.* at 1097; *see infra* note 22 and accompanying text.

[9] *Sutherland*, 273 P.3d at 1097.

[10] Mining Lease at 4, 31, Sutherland v. Meridian Granite Co., No. 171-843 (Wyo. Dist. Feb. 11, 2011).

[11] *Sutherland*, 273 P.3d at 1094.

[12] *Id.*

[13] *See id.* at 1096 n.4; *infra* notes 127–30 and accompanying text.

[14] *Sutherland*, 273 P.3d at 1097. Justices Burke, Kite, and Voigt formed the majority and Justices Hill and Golden dissented. *Id.* at 1093, 1097.

payments.[15] The court declined to determine whether the Sutherlands owned an interest in the mineral production because it concluded the taxes were *measured by* the payments.[16] But the agreement did not allow Meridian Granite Company (Meridian) to charge the Sutherlands with a pro rata share of production taxes unless the state actually *imposed* taxes on the Sutherlands' interest.[17] The court's failure to resolve the question of whether the state would impose production taxes on the Sutherlands in the absence of an agreement left important questions about mineral ownership unresolved.

This note argues the *Sutherland* court should have used a substance-over-form approach to conclude the Sutherlands were properly taxed because their receipt of rental payments was substantively an interest in mineral production.[18] The background section outlines Wyoming's mineral tax structure and property rights, the Wyoming Supreme Court's development of a substance-over-form approach to mineral ownership, and the court's abandonment of the substance-over-form approach.[19] The principal case section tracks the history of the *Sutherland* case through the inception of the mining operation, the dispute at the

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[15] *Id.* at 1095–96. "Production Payment" is sometimes defined as "a share of the oil or minerals produced from certain property, free of the costs of production, that terminates when a certain dollar amount from the sale of such oil or minerals has been achieved." Robert L. Theriot & Jana L. Grauberger, *Assignments and Conveyances*, *in* OIL AND GAS AGREEMENTS: THE EXPLORATION PHASE, Paper No. 11, 10 (Rocky Mtn. Min. L. Fdn. 2010). By this definition, the payments received by the Sutherlands were not "production payments" because they were not scheduled to terminate after a specified amount had been paid. *See id.* This note uses the phrase "production payments" in the generic sense to mean payments based on mineral production.

[16] *Sutherland*, 273 P.3d at 1096–97.

[17] *See infra* notes 154–82 and accompanying text.

[18] *See infra* notes 211–38 and accompanying text; Fed. Tax Coordinator Second Series Online (RIA) ¶ I-1202. Many articles have been written about the substance-over-form approach in federal tax law. *See* Jeffrey C. Glickman & Clark R. Calhoun, *The "States" of the Federal Common Law Tax Doctrines*, 61 TAX LAW. 1181, 1185 (2008) ("The basic premise of the substance over form doctrine is that the tax results of a particular transaction should be evaluated based on the substance of what took place rather than the formal steps the taxpayer took to achieve a particular result."); Philip Sancilio, *Clarifying (or is it Codifying?) the "Notably Abstruse": Step Transactions, Economic Substance, and the Tax Code*, 113 COLUM. L. REV. 138, 139 (2013); Yoram Keinan, *It Is Time for the Supreme Court to Voice Its Opinion on Economic Substance*, 7 HOUS. BUS. & TAX L.J. 93, 103–06 (2006); Michael E. Baillif, *The Return Consistency Rule: a Proposal for Resolving the Substance-Form Debate*, 48 TAX. LAW. 289, 289 (1995). Scholars often conceptualize the approach as various doctrines (e.g., the step-transaction doctrine, the business-purpose doctrine, the sham-entity doctrine). Allen D. Madison, *The Tension Between Textualism and Substance-Over-Form Doctrines in Tax Law*, 43 SANTA CLARA L. REV. 699, 738 (2003); Jay A. Soled, *Use of Judicial Doctrines in Resolving Transfer Tax Controversies*, 42 B.C. L. REV. 587, 588 (2001). The situation faced by Wyoming's court, a question of mineral ownership, is most similar to the *economic interest* doctrine used to determine mineral ownership in federal tax cases. *See* ERNST & YOUNG LLP, ERNST & YOUNG'S OIL AND GAS FEDERAL INCOME TAXATION ¶ 201 (John R. Braden et al. eds., 1996); [601-3rd] Tax Mgmt. – U.S. Income Portfolios Online (BNA), *Natural Resources* § II (2012), 20XX WL 4740162; *see also* Comm'r v. Sw. Exploration Co., 350 U.S. 308 (1956); Palmer v. Bender, 287 U.S. 551 (1933); Treas. Reg. § 1.611-1(b)(1).

[19] *See infra* BACKGROUND.

trial court, and the Wyoming Supreme Court's decision.[20] The analysis section argues the Sutherlands may only be taxed if their receipt of payments amounted to an ownership interest in the produced minerals, such a tax would not be unconstitutional, and a substance-over-form approach to mineral ownership would provide clarity for contracting parties.[21]

BACKGROUND

Wyoming Property Rights and Split Estate Ownership

Subsurface minerals can be owned separately from the surface, resulting in a split estate.[22] Each estate has separate and distinct rights. The surface estate includes the right to use and occupy the surface.[23] The mineral estate includes the right to transfer or lease the minerals, the right to develop the minerals, the right to receive bonuses and delay rentals, and the right to royalty payments.[24] A mineral producer will commonly acquire the right to extract minerals either by purchasing the mineral estate or through a mineral lease.[25] When mineral rights

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[20] *See infra* PRINCIPAL CASE.

[21] *See infra* ANALYSIS.

[22] 53A AM. JUR. 2D *Mines and Minerals* § 159 (2013); W. Hume Everett, *The Exclusive Power of One to Lease a Mineral Interest of Another the Executive Right to Lease*, 3 ROCKY MTN. MIN. L. INST. 509, 511 (1957). *See* BUREAU OF LAND MGMT., SURFACE OPERATING STANDARDS AND GUIDELINES FOR OIL AND GAS EXPLORATION AND DEVELOPMENT: THE GOLD BOOK 11 (4th ed. 2007), *available at* http://www.blm.gov/bmp/goldbook.htm.

[23] *See* Hand & Smith, *supra* note 4, at 680.

[24] 55 TEX. JUR. 3D *Oil and Gas* § 21 (2013); OWEN L. ANDERSON ET AL., HEMINGWAY OIL AND GAS LAW AND TAXATION §2.1, 39 (4th ed. 2004) [hereinafter HEMINGWAY OIL AND GAS]; 3 AMERICAN LAW OF MINING § 83.03, *supra* note 1. Bonus is defined as "[a] payment that is made in addition to royalties and rent as an incentive for a lessor to sign an oil-and-gas lease." BLACK'S LAW DICTIONARY 206 (9th ed. 2009). Many mineral leases expire if the lessee does not commence production within a prescribed period, and a "delay rental clause" will allow a production company to maintain a lease by making periodic rental payments in lieu of starting production. *See id.* at 491. The Wyoming Supreme Court has defined "royalty" in a number of previous cases. Picard v. Richards, 366 P.2d 119, 123 (Wyo. 1961) (defining royalty "in the strict sense as a share of the product or proceeds therefrom, reserved to the owner of the land for permitting another to use the property" (citing 1 WILLIAMS AND MEYERS, OIL AND GAS LAW § 301)); Ashland Oil Co. v. Jaeger, 650 P.2d 265, 272 (Wyo. 1982) (Rooney, J., dissenting) (defining royalty as "a share of the proceed or profit reserved by the owner of land for permitting another to develop the land for oil or gas"); Hillard v. Big Horn Coal Co., 549 P.2d 293, 294 (Wyo. 1976) (defining royalty as "a share of the product reserved by the owner of land for permitting another to use his property, and . . . a right to receive in kind or in money equivalent a stipulated fraction of the mineral products"). In the Wyoming Royalty Payments Act, the legislature sets out four different types of ownership interests that can arise in the context of oil and gas: "royalty," "overriding royalty," "working interest," and "other nonworking interest." WYO. STAT. ANN. §§ 30-5-301 through -305 (2012). "Royalty" is defined as "the mineral owner's share of production, free of the costs of production." § 30-5-304(a)(vii).

[25] *See* 53A AM. JUR. 2D *Mines and Minerals* § 187 (2013) (licenses distinguished); 4 AMERICAN LAW OF MINING § 120.07, *supra* note 1.

are leased, the lessor commonly retains an ownership interest in a portion of the minerals produced, entitling the lessor to royalty payments.[26] The Wyoming Department of Revenue (DOR) charges the mineral producer the full amount of taxes due.[27] Generally, the mineral producer will pay the mineral lessor's share of taxes and deduct that amount from the royalty payments owed to the lessor.[28]

The largest mineral owner in Wyoming is the United States government.[29] The federal government owns the mineral rights on 41.6 million acres in Wyoming, including 11.6 million acres of split estate lands where private parties own the surface.[30] The Bureau of Land Management (BLM) administers the federal government's mineral interests.[31] Depending on the type of mineral involved, mineral producers can use one of three different methods to obtain the right to extract government-owned minerals.[32] First, mineral producers can stake a claim on locatable minerals including gold and most metals.[33] Second, leasable minerals, including oil, gas, and coal, are leased through a competitive bidding

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[26] HEMINGWAY OIL AND GAS § 7.1, *supra* note 24, at 305; 3 AMERICAN LAW OF MINING § 85.02, *supra* note 1; *see* Powder River Coal Co. v. Wyo. State Bd. of Equalization, 38 P.3d 423, 427 (Wyo. 2002); *see generally* James E. Sperling, *The More Important Oil and Gas Lease Clauses*, 14 ROCKY MTN. MIN. L. INST. 383, 390 (1968); Robert E. Sullivan, *All About Royalties*, 16 ROCKY MTN. MIN. L. INST. 227, 235 (1971). Certain mineral owners, including Indian tribes and the federal government are exempt from mineral taxes, but private mineral owners are responsible for their share of production taxes. 011-000-006 WYO. CODE. R. §§ 4(o), 5 (Weil's 2010); *see* WYO. STAT. ANN. § 39-11-105 (2012).

[27] 011-000-006 WYO. CODE. R. § 6(a) (Weil's 2010).

[28] *See id.* §§ 6, 7.

[29] Wyoming is the nation's largest energy exporter. BUREAU OF LAND MGMT. WYO., 2012 ANNUAL REPORT 3 (2013), *available at* http://www.blm.gov/pgdata/etc/medialib/blm/wy/information/annual reports.Par.74106.File.dat/2012annrpt.pdf. In 2012, the federal government collected over two billion dollars from mineral royalties and other mineral revenues from federally owned minerals in Wyoming. *Id.* at 4. Roughly half of this income is shared with the state government. *Id.*

[30] U.S. DEP'T OF THE INTERIOR, BUREAU OF LAND MGMT., PUBLIC LAND STATISTICS 7, Table 1-3 (2011), *available at* http://www.blm.gov/public_land_statistics/pls11/pls2011.pdf; *see* 1 AMERICAN LAW OF MINING § 4.13, *supra* note 1.

[31] 1 AMERICAN LAW OF MINING § 4.21, *supra* note 1; *see generally* Bruce M. Pendery, *BLM's Retained Rights: How Requiring Environmental Protection Fulfills Oil and Gas Lease Obligations*, 40 ENVTL. L. 599 (2010). The Federal Land Policy and Management Act, 43 U.S.C. § 1732 (2012), provides the general authority for BLM to manage the use, occupancy, and development of the public lands. 43 C.F.R. § 3601.3 (2012). The BLM's authority is somewhat circumscribed; the BLM does not manage lands in the National Park System, National Forest System, National Wildlife Refuge System, or acquired lands. *Id.* § 3809.2. The BLM's authority to administer federal minerals is also subject to the General Mining Act of 1872 as amended. 30 U.S.C. § 21a (2011).

[32] 1 AMERICAN LAW OF MINING § 8.01[1], *supra* note 1.

[33] 30 U.S.C. §§ 21–54 (2011) (General Mining Act of 1872); 1 AMERICAN LAW OF MINING § 8.01[3], *supra* note 1.

process.[34] Third, saleable minerals, including common varieties of stone, sand, and gravel, are sold to commercial producers.[35]

Wyoming Mineral Taxation

The Wyoming Constitution establishes the broad outlines of the state's mineral tax system.[36] Under the Wyoming Constitution, mines are taxed on the value of the minerals produced.[37] The DOR assesses minerals extracted from the ground at the fair market value of the minerals at the mouth of the mine to determine the taxable value.[38] Wyoming imposes two production taxes on mineral production based on the fair market value assessment, the ad valorem tax and the severance tax.[39]

The ad valorem tax is a property tax levied on mineral production.[40] Because it is a property tax, ad valorem tax liability depends on mineral ownership.[41] But the assignment of tax liability does not depend on who owns title to the mineral estate—a lessee is liable for a proportionate share of the ad valorem tax

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[34] 30 U.S.C. §§ 181–287 (2011) (Mineral Leasing Act of 1920); 1 AMERICAN LAW OF MINING § 8.02[2], *supra* note 1.

[35] 30 U.S.C. §§ 601–604, 611 (2011) (Mineral Materials Act of 1947 and the Surface Resources Act); 43 C.F.R. §§ 3601.1–3601.80 (2012) (Mineral Materials Disposal; General Provisions); GEORGE CAMERON COGGINS & ROBERT L. GLICKSMAN, 4 PUB. NAT. RESOURCES L. § 40:36 (2d ed. 2013); 1 AMERICAN LAW OF MINING §§ 4.19, 8.02[3], 21.01, *supra* note 1; *see* Ethel R. Alston, Annotation, *What Constitute "Common Varieties" Within Meaning of Federal Statute (30 U.S.C.A. § 611) Providing that No Deposit of Common Varieties of Sand, Stone, Gravel, Pumice, Pumicite, or Cinders Shall Be Deemed "Valuable Mineral Deposit"*, 38 A.L.R. FED. 456, § 1[c] (1978). Wyoming law does not recognize ordinary sand or gravel as a mineral which can be reserved in a deed for private or state lands. Miller Land & Mineral Co. v. State Highway Comm'n, 757 P.2d 1001, 1004 (Wyo. 1988). But Wyoming's rule does not apply when mineral interests were reserved by the federal government through congressional action. Watt v. W. Nuclear, Inc., 462 U.S. 36, 57 (1983) (holding gravel is a mineral reserved to the United States in lands patented under the Stock-Raising Homestead Act, 43 U.S.C. §§ 291–302); *see* 1 AMERICAN LAW OF MINING § 9.03[5], *supra* note 1 ("[T]he traditional rules applied by courts to construe severance deeds granted by private parties are not fully applicable to patents granted by the United States.").

[36] WYO. CONST. art. 15.

[37] *Id.* § 3; *see* WYO. STAT. ANN. § 39-13-103(b)(iv) (2012).

[38] *E.g.*, § 39-13-103(b)(iv).

[39] *Id.*; *see* Wyo. State Tax Comm'n v. BHP Petroleum Co., 856 P.2d 428, 434 (Wyo. 1993) (distinguishing ad valorem tax from severance tax).

[40] WYO. STAT. ANN. §§ 39-13-101 through -112 (2012).

[41] *BHP Petroleum Co.*, 856 P.2d at 434 ("Ownership is the important question for ad valorem tax liability purposes."). The most concise statement of parties who are responsible for the ad valorem production tax is found in the paragraph describing tax liens for unpaid production taxes:

> As used in this paragraph, "delinquent taxpayer" means any person who has the legal responsibility to pay ad valorem taxes, fees, penalties or interest on mineral production and who has not made payment as of the date due of such taxes, fees, penalties or interest. A delinquent taxpayer may include a mineral lessee who is receiving production from the mineral interest; the mineral lessor to the extent of

even though the lessor retains title to the mineral estate.[42] The ad valorem tax is calculated by applying mill levies imposed by the state and local governments, as well as by any special taxing districts, to the fair market value of minerals.[43] Pursuant to the Wyoming Constitution, ad valorem production taxes are levied in lieu of taxes on the land.[44] As a result, the surface estate of mining land is exempt from state property taxes.[45]

The severance tax is imposed on the privilege of extracting minerals from the ground.[46] The severance tax rate is determined by both the Wyoming Constitution

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> the lessor's retained interest; an owner of a royalty, overriding royalty or other interest carved out of the mineral estate; a person severing the mineral if the person has the legal responsibility for remittance of ad valorem tax, fees, penalties or interest on the mineral production.

§ 39-13-108(d)(vi)(O).

[42] A lessee's responsibility for ad valorem taxes is contained in the various severance tax statutes:

> (c) Taxpayer. The following shall apply:
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> (i) In the case of the gross product of all mines and mining claims produced under lease, the lessor is liable for the payment of ad valorem taxes on the product removed only to the extent of the lessor's retained interest under the lease, whether royalty or otherwise, and the lessee or his assignee is liable for all other ad valorem taxes due on production under the lease . . . .

Id. § 39-14-103(c) (severance tax on coal); *see also id.* § 39-14-203(c)(severance tax on oil and gas); *id.* § 39-14-303(c) (severance tax on trona); *id.* § 39-14-403(c) (severance tax on bentonite); *id.* § 39-14-503(c) (severance tax on uranium); *id.* § 39-14-603(c) (severance tax on sand and gravel); *id.* § 39-14-703(c) (severance tax on other valuable deposits).

[43] WYO. CONST. art. 15, § 11; § 39-13-104 (containing a non-exhaustive list of mill levies); § 39-13-103(b)(iii) (minerals are taxed at 100% of value, industrial property is taxed at 11.5% of value, and all other property is taxed at 9.5% of value). The division of ownership of surface and mineral rights is sometimes referred to as "severance." HEMINGWAY OIL AND GAS § 1.1, *supra* note 24, at 1; *see generally* 6 AMERICAN LAW OF MINING § 200.01, *supra* note 1. Severance can also mean "[t]he removal of anything (such as crops or minerals) attached or affixed to real property, making it personal property rather than part of the land." BLACK'S LAW DICTIONARY 1498 (9th ed. 2009). The Wyoming Statutes use "severance" to mean extraction of minerals; this note follows the same definition. *See, e.g.*, WYO. STAT. ANN. § 39-14-701(a)(ix) (2012) ("'Severance tax' means an excise tax imposed on the present and continuing privilege of removing, extracting, severing or producing any mineral in this state.").

[44] WYO. CONST. art. 15, § 3. Ad valorem means "according to the value;" an ad valorem tax is a tax "proportional to the value of the thing taxed." BLACK'S LAW DICTIONARY 60 (9th ed. 2009).

[45] WYO. CONST. art. 15, § 3; WYO. STAT. ANN. § 39–11–105(a)(xxviii) (2012). The improvements on mining lands are not exempt. WYO. CONST. art. 15, § 3.

[46] WYO. CONST. art. 15, § 19; *e.g.*, § 39-14-703 (severance tax on miscellaneous minerals); BLACK'S LAW DICTIONARY 1597 (9th ed. 2009). The statutory provisions imposing Wyoming's severance tax are divided into several sections based on the type of mineral. WYO. STAT. ANN. §§ 39-14-101 through -111 (2012) (severance tax on coal); *id.* §§ 39-14-201 through -212 (severance tax on oil and gas); *id.* §§ 39-14-301 through -311 (severance tax on trona); *id.* §§ 39-14-401 through -411 (severance tax on bentonite); *id.* §§ 39-14-501 through -511 (severance tax on uranium); *id.* §§ 39-14-601 through -611 (severance tax on sand and gravel); *id.* §§ 39-14-701 through -711 (severance tax on other valuable deposits).

and the legislature.[47] The rate varies based on the type of mineral produced, and is calculated by multiplying the rate by the assessed fair market value.[48] As with the ad valorem tax, entities that own or extract minerals are responsible for severance taxes in proportion to their ownership interest.[49]

The taxable value of minerals is the fair market value at the mouth of the mine, after the mining or production process is complete.[50] When minerals are sold at the mouth of the mine in an arm's length transaction, the fair market value of the minerals is the sales price.[51] But when minerals are sold away from the mouth of the mine after additional transportation or when minerals are sold after additional processing, the DOR utilizes other methods to determine what portion of the sales price is attributable to the value of the minerals, separate from the value added by transportation or processing.[52] One method used by the

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[47] The Wyoming Constitution requires a 1.5% tax on coal, petroleum, natural gas, and oil shale. WYO. CONST. art. 15, § 19. Additional severance taxes are imposed in article 39, chapter 14 of the Wyoming Statutes. The following statutes set out the base tax rate: § 39-14-104 (7% surface coal, 3.75% underground coal); § 39-14-204 (6% crude oil, lease condensate, or natural gas); § 39-14-304 (4% trona); § 39-14-404 (2% bentonite); § 39-14-504 (4% uranium); § 39-14-604 (2% sand and gravel); § 39-14-704 (2% other valuable deposits). Under certain conditions, there are exemptions from the tax on coal, oil and gas, and uranium. §§ 39-14-105, -205, -505.

[48] WYO. STAT. ANN. art 39, ch. 14; *e.g.*, § 39-14-701(a)(x) (taxable value is 100% of the fair market value of miscellaneous minerals); *see supra* note 47.

[49] 011-000-006 WYO. CODE. R. § 5 (Weil's 2010). Wyoming's severance tax statutes all contain similar language regarding liability for severance taxes:

> (c) Taxpayer. The following shall apply:
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> . . . .
>
> (ii) Any taxpayer paying the taxes imposed by this article on any valuable deposit may deduct the severance taxes paid from any amounts due or to become due to the interest owners of such valuable deposit in proportion to the interest ownership;
>
> (iii) Any person extracting valuable products subject to this chapter and any person owning an interest in the valuable products to the extent of their interest ownership are liable for the payment of the severance taxes imposed by this article together with any penalties and interest.

§ 39-14-103(c) (severance tax on coal); *see also* §§ 39-14-203(c), -303(c), -403(c), -503(c), -603(c), -703(c).

[50] 011-000-006 WYO. CODE. R. § 9 (Weil's 2010) (Ad Valorem and Severance Taxes on Mineral Production); *e.g.*, § 39-14-703(b)(i) (severance tax on miscellaneous minerals); *id.* § 39-13-102(m)(i) (ad valorem tax).

[51] 011-000-006 WYO. CODE. R. § 9(b) (Weil's 2010); *see* § 39-14-703(b)(iii) (2012). This principle applies to oil, gas, trona, and miscellaneous minerals. For other minerals, the fair market value is the sales price less exempt royalties. § 39-14-103(b)(iv) (coal); § 39-14-403(b)(ii) (bentonite); § 39-14-503(b)(iv) (uranium); § 39-14-603(b)(ii) (sand and gravel).

[52] *See generally* 5 AMERICAN LAW OF MINING § 193.03, *supra* note 1; 011-000-006 WYO. CODE. R. § 10 (Weil's 2010). In *Certain-teed Products Corp. v. Comly*, the Wyoming Supreme Court addressed some of the problems with valuing a mineral which was not saleable at the mouth of the mine but was used in the on-site manufacturing of plaster. 87 P.2d 21, 23 (Wyo. 1939). The court charged

DOR to determine the value of minerals is the proportionate profits method.[53] The proportionate profits method is intended to "ascertain gross income from mining by applying the principle that each dollar of the total costs paid or incurred to produce, sell, and transport the first marketable product . . . earns the same percentage of profit."[54] Royalty payments are paid for the privilege of mining, not processing, and the payments are free of the costs of production.[55] Therefore, royalty payments are taxed at their full value, and are not adjusted by the proportionate profits method or other methods for calculating the taxable value of minerals.[56]

Royalties Represent a Taxable Ownership of Mineral Production

Although mineral rights are considered real property interests in Wyoming, produced minerals are personal property.[57] In *State v. Snyder*, the Wyoming

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the legislature with creating a method for valuing the minerals which would balance the state's interest in generating revenue from mines with the state's interest in promoting economic activity. *Id.* at 27. Some severance tax statutes outline specific methods for valuing the minerals. *See, e.g.*, § 39-14-303(b)(2) (trona). Other statutes leave the DOR broad discretion. *See* § 39-14-703(b)(iv) ("[T]he department shall determine the fair market value [of miscellaneous minerals] by application of recognized appraisal techniques."); § 39-14-203(b)(vi) (outlining four methods for valuing oil and gas).

[53] RME Petroleum Co. v. Wyo. Dep't of Revenue, 150 P.3d 673, 682–83 (Wyo. 2007). *See infra* note 165. The proportionate profits method appears in several Wyoming statutes, for example the oil and gas severance tax statute provides:

> The fair market value is: . . . The total amount received from the sale of the minerals minus exempt royalties, nonexempt royalties and production taxes times the quotient of the direct cost of producing the minerals divided by the direct cost of producing, processing and transporting the minerals; plus . . . [n]onexempt royalties and production taxes.

§ 39-14-203(b)(vi)(D).

[54] Powder River Coal Co. v. Wyo. State Bd. of Equalization, 38 P.3d 423, 427 (Wyo. 2002) (quoting Treas. Reg. § 1.613-4(d)(4) (2001)). Wyoming's proportionate profits method is slightly different from the IRS proportionate profits method. *See* Treas. Reg. § 1.613(d)(4) (2012).

[55] *Powder River Coal Co.*, 38 P.3d at 429 (defining royalty as "a small interest free of the cost of production"); Hillard v. Big Horn Coal Co., 549 P.2d 293, 301 (Wyo. 1976) ("It thus is apparent that royalty must be paid for the privilege of mining, not processing.").

[56] *RME Petroleum Co.*, 150 P.3d at 688 (analyzing the proportionate profits method and stating "the resulting taxable value includes the full value of both non-exempt royalties and production taxes"); *Hillard*, 549 P.2d at 301 (reasoning "the value of the coal at the mine must be sufficient to pay both the costs of mining and royalty," and stating "royalty is a full component of the value of the coal at the mine"); *see infra* notes 165–78 and accompanying text.

[57] Denver Joint Stock Land Bank v. Dixon, 122 P.2d 842 (Wyo. 1942). In *Denver Joint Stock Land Bank*, the defendants executed a mortgage secured by their real property and did not reserve any mineral rights. *Id.* at 844. When the loan went into default and the bank acquired the property, the defendants argued their mineral rights did not transfer because the right to receive royalties was personal property. *Id.* The Wyoming Supreme Court held the defendants' mineral rights were real property rights that transferred to the bank upon disposition of the property without reservation. *Id.* at 850. Other states have reached different conclusions about the classification of mineral interests as either real or personal property. 5 AMERICAN LAW OF MINING § 191.02[7], *supra* note 1.

Supreme Court used a substance-over form approach to conclude that an interest in minerals was a real property interest.[58] The court determined that funds from the disposition of minerals produced from state school lands should be characterized as funds from the sale of school lands because, even though the minerals were produced under a lease, in substance, mineral production removed part of the land and disposed of it "never to return."[59] Thus, while the minerals were treated as part of the real property (school lands), the court recognized the minerals were converted from real property to personal property when they were severed from the land.[60]

Wyoming's production taxes are a tax on personal property, not a tax on real property. In *Oregon Basin Oil & Gas Co. v. Ohio Oil Co.*, the Wyoming Supreme Court examined the constitutional prohibition on the taxation of mine lands and determined production taxes are not taxes on the land.[61] The lease at issue in *Oregon Basin* required the lessee to pay all taxes levied on the lands.[62] The issue was whether the lessee was acting in accordance with the lease when it deducted mineral production taxes from the royalty interest prior to paying the lessor royalties.[63] If production taxes were characterized as taxes on the land, the contract would have put the obligation to pay the production taxes on the lessee.[64] Because the Wyoming Constitution levies production taxes in lieu of taxes on the land, the court concluded Wyoming's production taxes were not "taxes on the land."[65]

In *Miller v. Buck Creek Oil Co.*, the Wyoming Supreme Court determined a lessor who retained a mineral interest was responsible for a pro rata share of production taxes.[66] The lessee, Buck Creek Oil, agreed to pay the lessors a percentage of the net proceeds from the oil sold off the leased land, or the lessors could elect to take their royalty in kind (*i.e.*, take a portion of the oil in lieu of payment).[67] The oil company paid the royalty but deducted the lessors' share of the tax owed on the oil.[68] The Wyoming Supreme Court was asked to determine

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[58] State v. Snyder, 212 P. 758, 762 (Wyo. 1923).

[59] *Id.*

[60] *Id.* at 766 ("The final disposition of the oil or gas, or sale, if we please to call it so, does not take place—is not in any event consummated—until after the oil is taken from the earth, has become severed from the realty, and has become personal property."); *see* First Nat'l Bank of Chi. v. Cent. Coal & Coke Co., 3 F. Supp. 433, 436 (D. Wyo. 1933) (interpreting *Snyder,* 212 P. 758).

[61] Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198 (Wyo. 1952).

[62] *Id.* at 199 (quoting mineral lease agreement).

[63] *Id.*

[64] *See id.*

[65] *Id.* at 200, 205.

[66] Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928).

[67] *Id.* at 44; *see* 011-000-006 WYO. CODE. R. § 4b(s) (Weil's 2010).

[68] *Miller*, 269 P. at 44.

whether the "net returns from the sales" should be calculated before or after the taxes were paid.[69] The court held "in the absence of an agreement in regard to the payment of a property tax based on production, each party to the lease intended that he should be liable for the tax on his share of the production."[70] The court used a substance-over-form approach, reasoning that "a lessee, who is the virtual owner of the property, may be considered the owner for the purposes of taxation," and "[t]he practical result is that the tax paid by the lessee is in lieu, not only of taxes on the mining claim, but also of taxes on the lessors' royalty interest."[71] The court reasoned that if the Millers had elected to take their royalty in kind they would have been owners of the oil and would have owed taxes on the quantity received.[72] Consequently, when the oil company sold the Millers' portion of the oil, it was acting as an agent of the Millers; therefore, it was proper for the oil company to deduct the tax before paying the royalty.[73]

In subsequent cases, the Wyoming Supreme Court followed the *Miller* rule even when the lessor did not have the option to take its share of production in kind.[74] *Ashland Oil Co. v. Jaeger* illustrates the court's approach.[75] The court examined its own precedent and the Wyoming Statutes and confirmed, "with regard to taxes assessed on the gross products of a mine or well, both the lessee and lessor are responsible for payment in proportion to their ownership shares."[76]

The Wyoming Supreme Court created a workable system for determining mineral ownership and production tax liability by employing the substance-over-form analysis, but in 2007, the court apparently rejected seventy-five years of Wyoming jurisprudence to elevate form over substance. The case, *Wyoming Department of Revenue v. Exxon Mobil Corp.*, arose out of a dispute regarding the applicability of Wyoming's production taxes to helium produced from federal natural gas leases in the LaBarge field, located in Sublette County.[77]

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[69] *Id.* at 44–45.

[70] *Id.* at 45.

[71] *Id.*

[72] *Id.*

[73] *Id.*

[74] *See* Ashland Oil Co. v. Jaeger, 650 P.2d 265, 268 (Wyo. 1982); Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 199 (Wyo. 1952).

[75] *Ashland*, 650 P.2d at 267–70.

[76] *Id.* at 268. At the time, the Wyoming Statutes provided: "Any taxpayer paying the taxes imposed by this article on any valuable deposit may deduct the taxes paid from any amounts due or to become due to the interest owners of such valuable deposit in proportion to the interest ownership." WYO. STAT. ANN. § 39-6-304(h) (1977). Identical language is now located in Wyoming's severance tax statutes. *E.g.*, WYO. STAT. ANN. § 39-14-703(c) (2012); *see supra* note 49.

[77] Wyo. Dep't of Revenue v. Exxon Mobil Corp., 162 P.3d 515, 519 (Wyo. 2007).

In 1925, Congress, concerned about national security, reserved to the federal government the ownership of any helium contained in natural gas produced under federal mineral leases.[78] Subsequently, Exxon entered into several federal leases allowing the company to extract natural gas from the LaBarge field, with the government reserving the ownership of and the right to extract helium from the leased gas.[79] Because the natural gas extracted from the LaBarge field was "sour gas," which is lethal due to its high concentration of hydrogen sulfide, it was not possible for the federal government to extract its helium until after processing to remove the hydrogen sulfide.[80] Consequently, the federal government entered into an agreement with Exxon whereby Exxon purchased the helium after the company separated the gas stream at its processing plant in Lincoln County.[81]

In substance, this agreement was exactly like a federal gas lease—Exxon was granted the exclusive right to extract the helium from the gas stream, and the company paid the government a percentage of the sale proceeds free of the cost of production.[82] The payments were structured exactly like royalty payments, and Exxon paid the same percentage the company would have paid under a natural gas lease.[83] Nevertheless, a unanimous court ruled the helium production was exempt from state production taxes because the federal government retained title until after the processing was complete.[84] The court noted that it construes any ambiguity in tax statutes against the government and in favor of the taxpayer—a rule which seems to preclude a substance-over-form approach, at least in the arena of statutory interpretation.[85] Inexplicably, the court found Exxon did "not possess

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[78] *Id.* The legislation reserving helium is located in the Mineral Leasing Act of 1920. 30 U.S.C. § 181 (2011). In 1996, Congress enacted the Helium Privatization Act, which legalized the leasing of helium. 50 U.S.C. § 167a.

[79] *Exxon Mobil*, 162 P.3d at 520.

[80] *Id.* at 519. A hydrogen sulfide concentration in a gas stream of 700 parts per million can be lethal; the LaBarge gas stream contains 50,000 parts per million hydrogen sulfide. *In re* Exxon Mobil Corp., Nos. 2006-69, 2006-116, 2008 WL 1692796, at *6 (Wyo. St. Bd. Eq. 2008).

[81] *Exxon Mobil*, 162 P.3d at 520–21.

[82] Brief of Appellant Wyo. Dep't of Revenue, *Exxon Mobil Corp.*, 162 P.3d 515 (Nos. 06-41, 06-42), 2006 WL 4782196, at *6.

[83] *Id.*

[84] *Exxon Mobil*, 162 P.3d at 526.

[85] *Id.* at 525. ("[T]ax imposition statutes are to be construed in favor of the taxpayer and are not to be extended absent clear intent of the legislature."). This rule of strict construction seems to have first appeared in Wyoming case law in 1939. State Bd. of Equalization v. Sanolind Oil & Gas Co., 94 P.2d 147, 153 (Wyo. 1939). The rule later appeared in an estate tax case. Kelsey v. Taft, 263 P.2d 135, 137–38 (Wyo. 1953) (quoting Gould v. Gould, 245 U.S. 151, 153 (1917)). Subsequently, the rule seems to have lain dormant for a number of years before making a comeback in the late 20th and early 21st century. *See* Qwest Corp. v. State *ex rel.* Wyo. Dep't of Revenue, 130 P.3d 507, 511 (Wyo. 2006); Amoco Prod. Co. v. Dep't of Revenue, 94 P.3d 430, 438 (Wyo. 2004); Basin Elec. Power Coop. v. Bowen, 979 P.2d 503, 509 (Wyo. 1999); Chevron U.S.A., Inc. v. State, 918 P.2d 980, 984–85 (Wyo. 1996). Wyoming's shift from a substance-over-form approach to a rule of general construction seems to go against the general trend. *See* 1 BORIS I.

the privilege of removing, extracting, severing or producing the helium" because those rights were reserved to the federal government in the original leases, even though the later helium sale agreement unequivocally gave Exxon those rights.[86] In response to the decision, the legislature amended Wyoming's tax statutes to impose a severance tax on any party who physically separates helium from a gas stream and an ad valorem tax on any party producing helium under a contract right.[87] Nevertheless, it is not clear whether *Exxon Mobil* was an aberration which only applied in the unique circumstance of federally owned helium, or whether *Exxon Mobil* indicates the Wyoming Supreme Court has abandoned the substance-over-form approach in favor of a rule of strict construction of tax statutes against the government.[88]

Using a substance-over-form approach, the Wyoming Supreme Court developed the general principles governing mineral ownership and taxation in the state. Although Wyoming treats the right to receive royalty payments as an interest in real property, minerals become personal property when they are severed from the land.[89] Accordingly, Wyoming's mineral production taxes are taxes on personal property, not taxes on real property.[90] In the absence of a contract allocating the tax burdens, the owners of minerals extracted in Wyoming are responsible for production taxes in proportion to their ownership shares.[91] In the past, ownership for tax purposes was determined using a substance-over-form approach—lessors who retain a royalty interest are considered owners of produced minerals even when they do not have the right to take possession of the minerals, and lessees are considered owners of the minerals they produce even though they do not

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BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS ¶ 4.3.1 (2012) (characterizing the rule of strict construction as a nineteenth century doctrine that has been largely abandoned by contemporary courts); *but see* Madison, *supra* note 18, at 738 (arguing substance-over-form doctrines are incompatible with the modern Supreme Court's textualist approach to statutory interpretation).

[86] *Exxon Mobil*, 162 P.3d at 525.

[87] ABA Energy & Res. Comm., *Oil and Gas 2009 Annual Report*, 2009 ABA ENV'T ENERGY & RES. L.: YEAR IN REV. 265, 295 (2009); *see* WYO. STAT. ANN. §§ 39-13-112, -14-112 (2012).

[88] *See Exxon Mobil*, 162 P.3d at 525.

[89] McGinnis v. McGinnis, 391 P.2d 927, 929 (Wyo. 1964); Dame v. Mileski, 340 P.2d 205, 209 (Wyo. 1959); Denver Joint Stock Land Bank v. Dixon, 122 P.2d 842, 845, 850 (Wyo. 1942); State v. Snyder, 212 P. 758, 758 (Wyo. 1923); *see* First Nat'l Bank of Chi. v. Cent. Coal & Coke Co., 3 F. Supp. 433, 436 (D.Wyo. 1933); *supra* notes 57–60 and accompanying text; *see generally* Martin J. McMahon, Annotation, *Oil and Gas Royalty as Real or Personal Property*, 56 A.L.R. 4th 539 (1987).

[90] Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 205 (Wyo. 1952); *see supra* notes 61–65 and accompanying text.

[91] *See* Ashland Oil Co. v. Jaeger, 650 P.2d 265, 267–68 (Wyo. 1982); *Or. Basin*, 248 P.2d at 204; Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928) (noting the rule only applies "in the absence of an agreement in regard to the payment of a property tax based on production"); *see generally* 5 AMERICAN LAW OF MINING § 193.03[4][b], *supra* note 1.

have title to the mineral estate.[92] Although the ownership rules arising out of the substance-over-form analysis remain good law, in *Exxon Mobil*, the Wyoming Supreme Court elevated form over substance and determined a mineral producer did not owe any taxes because it did not yet have legal title at the moment the mineral was extracted from the ground.[93] Consequently, it is unclear whether the court will determine future questions about mineral ownership with a form-over-substance approach, or whether the court will resolve future questions based on legal title to the minerals.

PRINCIPAL CASE

During the latter half of the twentieth century, Morrison-Knudson Company operated a rock quarry east of Cheyenne in Laramie County, Wyoming.[94] The Sutherland family owned the land where the original quarry was located, including the mineral rights.[95] In 1988, Morrison-Knudson transferred its interest in the quarry to Granite Canyon Quarry, a joint venture.[96] The managing partner of the joint venture was Meridian Granite Company (Meridian), a subsidiary of Martin Marietta Materials.[97] Granite Canyon Quarry's main product is railroad ballast, a type of crushed rock used in the construction of railroad tracks, which is sold to the Union Pacific and Burlington Northern Santa Fe railroads.[98] By all indications, this type of material is classified by the BLM as a common variety mineral.[99]

When Meridian began operating the quarry in 1988, the company negotiated a new agreement with the landowners, John Sutherland and his mother, Minerva Sutherland.[100] This agreement was titled "Mining Lease," but it actually served multiple purposes.[101] First, the agreement was a typical mining lease

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[92] *Miller*, 269 P. at 45.

[93] *Exxon Mobil*, 162 P.3d at 526.

[94] Appellants' Opening Brief, Sutherland v. Meridian Granite Co., 273 P.3d 1092 (Wyo. 2012) (No. S-11-0091), 2011 WL 3276336, at *5; Affidavit of John Sutherland at 2, Sutherland v. Meridian Granite Co., No. 171-843 (Wyo. Dist. Feb 11, 2011).

[95] Sutherland v. Meridian Granite Co., 273 P.3d 1092, 1094 (Wyo. 2012).

[96] *Id.*

[97] *Id.*; Appellants' Opening Brief, *supra* note 94, at *6.

[98] Martin Marietta Materials, Inc., Granite Canyon Quarry: Getting the Loadout in the Western Division, http://www.martinmarietta.com/Corporate/features.asp?ID=29 (last visited April 30, 2013).

[99] *See* 30 U.S.C. § 601 (2011); *supra* note 35 and accompanying text; *see also* Alston, *supra* note 35, at §§ 3, 6 (stating that deposits are considered common varieties when similar deposits exist in large quantities outside the area of the claim, or when the deposits do not possess unique properties which give them a distinct and special value).

[100] *Sutherland*, 273 P.3d at 1094.

[101] Mining Lease, *supra* note 10, at 1.

giving Meridian the right to enter the Sutherlands' land and mine the rock the Sutherlands owned.[102] In exchange, the Sutherlands were paid a royalty based on production.[103] This part of the agreement applied to the parcel of land where the then-existing quarry was located, referred to by the parties as Parcel 1.[104] Meridian, however, contemplated expanding the mining operation onto a second parcel of land, referred to by the parties as Parcel 2.[105] The Sutherlands owned the surface rights to Parcel 2, and the federal government owned the mineral rights.[106] Because the federal government owned the mineral rights, the Sutherlands could not grant Meridian the right to quarry rock from Parcel 2.[107] In order to mine the common variety minerals from Parcel 2, the company would have to enter into a sales contract with the BLM.[108] Therefore, in the second part of the agreement, the Sutherlands gave Meridian the right to enter onto Parcel 2 for mining purposes and the Sutherlands released any claim for surface damages, provided the company was able to acquire the right to mine from the BLM.[109] The agreement further stated, the Sutherlands were to be compensated for the use of their land by "Production Royalties" based on the amount of production.[110] Although the agreement covered two parcels of land with different mineral owners, and the Sutherlands were to be paid a lower rate on production from Parcel 2, the remaining provisions of the agreement treated the parcels the same.[111] Significantly, the provisions in the agreement dealing with the payment of taxes did not distinguish between the two parcels.[112]

In 1990, Mr. Sutherland learned Meridian was withholding a pro rata share of state mineral taxes from the royalties paid on production from Parcel 1.[113] The Sutherlands objected to this practice as being contrary to the practice of the original mining company, Morrison-Knudson.[114] Meridian believed its actions were correct based on the language of the agreement:

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[102] *Id.* at 2–5.

[103] *Id.* at 10.

[104] *Id.*

[105] *Id.* at 30.

[106] Sutherland v. Meridian Granite Co., 273 P.3d 1092, 1094 n.2 (Wyo. 2012).

[107] *See id.*; *supra* notes 32–35 and accompanying text.

[108] 30 U.S.C. §§ 601–604 (2011); *see supra* note 35.

[109] Mining Lease, *supra* note 10, at 4, 31.

[110] *Id.* at 10.

[111] *See Sutherland*, 273 P.3d at 1097.

[112] *Id.*

[113] *Id.* at 1094.

[114] *Id.*; Appellants' Opening Brief, *supra* note 94, at *6.

> Lessor [the Sutherlands] shall pay when due all general and ad valorem taxes levied and assessed against the premises and any taxes imposed upon or measured by advance royalties or Production Royalties paid to Lessor. Lessee [Meridian], shall pay when due all taxes lawfully assessed and levied against improvements and equipment placed upon the Premises by Lessee, upon production from the Premises except such portions thereof as are payable for Production Royalty paid to Lessor and upon other rights, property and operations of Lessee.[115]

Despite their strong objections, the Sutherlands did not take legal action, and for more than a decade Meridian continued to withhold a portion of the payments necessary to cover state production taxes.[116]

In 2003, Meridian began mining rock from Parcel 2.[117] Treating the payments from Parcel 2 the same as the payments from Parcel 1, Meridian withheld a portion of the payments attributable to the Sutherlands' proportionate share of state mineral taxes.[118] Again, the Sutherlands objected.[119]

Eventually, the Sutherlands conceded the agreement allowed Meridian to withhold taxes from the royalty payments made with respect to Parcel 1, but they continued objecting to the practice of withholding payments made with respect to Parcel 2.[120] The Sutherlands argued they could not be liable for state production taxes because they did not own the minerals in Parcel 2.[121] In 2008, the Sutherlands sued Meridian for breach of contract and declaratory judgment regarding Meridian's practice of withholding taxes from the royalty payments made with respect to Parcel 2.[122] The trial judge granted summary judgment for Meridian.[123] On appeal, the Wyoming Supreme Court affirmed.

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[115] *Sutherland*, 273 P.3d at 1094; Mining Lease, *supra* note 10, at 21–22.

[116] *See Sutherland*, 273 P.3d at 1094.

[117] *Id.*

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.*

[122] *Id.*

[123] Sutherland v. Meridian Granite Co., No. 171-843, 2011 WL 2972247 (Wyo. Dist. Feb. 11, 2011).

Majority Opinion

The Wyoming Supreme Court, in a three-to-two decision, concluded Meridian properly withheld taxes from the payments made to the Sutherlands.[124] The Sutherlands argued they were not responsible for the taxes because they did not own the minerals, and Wyoming law imposes severance and ad valorem taxes on the owner of minerals.[125] The Sutherlands relied on section 39-14-703(c)(i) of the Wyoming Statutes, which states the lessor of minerals will only be liable for ad valorem taxes to the extent of the lessor's retained interest under the lease.[126]

Justice Burke, writing for the majority, avoided the question of whether the Sutherlands had any ownership of the mineral production that would subject them to taxes under the general rule from *Ashland* and *Miller*.[127] Under the general rule, production taxes are divided pro rata among the parties who have an ownership interest in the products of a mine or well.[128] The court determined Meridian and the Sutherlands rendered the general rule inapplicable when they agreed to a different arrangement for the payment of taxes.[129] According to the majority, the exact nature of the Sutherlands' ownership interest was inconsequential because the language of the lease was clear.[130]

The majority rejected the idea that Parcel 1, where the Sutherlands owned the mineral interest, should be treated differently from Parcel 2 for tax purposes.[131] The court found the lease agreement treated the two parcels the same on the issue of tax liability.[132] The court concluded the plain language of the contract reflected the parties' intention that the Sutherlands would pay taxes on *both* parcels.[133] Specifically, the lease required the Sutherlands to pay any taxes "measured by" the "Production Royalties."[134] Meridian submitted undisputed evidence that the DOR includes royalty payments in the value of minerals as part of the calculation of the taxable value of minerals.[135] The majority reasoned mineral taxes were

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[124] *Sutherland*, 273 P.3d at 1096–97.

[125] *Id.* at 1096.

[126] *Id.*

[127] *Id.*

[128] Ashland Oil Co. v. Jaeger, 650 P.2d 265, 268 (Wyo. 1982); Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928); *see supra* notes 66–76 and accompanying text.

[129] *Sutherland*, 273 P.3d at 1096.

[130] *Id.* n.4.

[131] *Id.* at 1097.

[132] *Id.*

[133] *Id.*

[134] *Id.* at 1094.

[135] *Id.* at 1095–96.

"measured by" the royalties paid to the Sutherlands because the value of minerals for tax purposes included the value of royalties paid.[136] Therefore, the terms of the lease required the Sutherlands to pay taxes attributable to those royalties.[137]

Dissenting Opinion

Writing for the dissent, Justice Hill rejected the majority's interpretation of the contract.[138] In the dissent's view, the law as it existed in 1988 relating to production taxes became a part of the mining lease.[139] Part of that law was Wyoming's constitutional prohibition on the taxation of mine lands.[140] At the time of the lease, the only rights transferred to Meridian with regards to Parcel 2 were surface rights.[141] According to the dissent, the Sutherlands' surface interest was exempt from taxation under Wyoming law while the mine was in production.[142]

The dissent argued, under Wyoming law, only the legislature can impose a tax.[143] Therefore, Meridian could not "impose taxes on an otherwise exempt interest and thereafter deduct the taxes on the exempt interest from their own tax liability."[144] Furthermore, the dissent agreed the Sutherlands could contract to pay some of Meridian's taxes, but disagreed this was a proper characterization of the agreement.[145]

Ultimately, the dissent rejected the majority's conclusion that taxes should have been calculated based on the "Production Royalties" paid to the Sutherlands. The dissent reasoned "Meridian cannot by virtue of Wyoming Law subject the surface estate to Wyoming mineral taxes by simply defining the terms of the payment for the surface estate as a royalty."[146] According to the dissent:

> The only Wyoming taxes imposed are on the production of the minerals, which are not measured by or computed on the royalties paid to the Sutherlands as the lessor of the surface estate. The [payments related to Parcel 2 are] irrelevant to the

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136 *Id.* at 1096.

137 *Id.*

138 *Id.* at 1098 (Hill, J., dissenting).

139 *Id.*

140 *Id.*

141 *Id.* at 1097.

142 *Id.* at 1098.

143 *Id.*

144 *Id.*

145 *Id.*

146 *Id.* at 1099.

> computation, measurement, or calculation of the taxes on the minerals being produced from parcel 2. The taxable estate is the mineral estate.[147]

The dissent concluded, under Wyoming law, only the royalty paid for a mineral interest is subject to tax.[148] Therefore, according to the dissent, the Sutherlands' payments were exempt from production taxes because the payments were rent for surface interests, and not a royalty.[149]

ANALYSIS

Wyoming law imposes production taxes on the value of minerals extracted within the state.[150] The owners of extracted minerals are responsible for the production taxes in proportion to their ownership share.[151] If the Sutherlands owned a portion of the mineral production, Wyoming law would properly impose production taxes on that ownership interest. Then, the Sutherlands would have been responsible for the payment of those taxes under the law and under their agreement with Meridian. Unfortunately, Wyoming law is unclear as to whether an interest like the Sutherlands' is a properly taxable ownership interest.

The *Sutherland* court missed the opportunity to clarify whether and when the right to receive production payments becomes a taxable ownership interest in mineral production. The court focused on the interpretation of the Mining Lease, holding the Sutherlands were contractually responsible for the full amount of production taxes on the payments they received because the mineral taxes were "measured by" the payments made to the Sutherlands.[152] This reasoning is faulty because mineral production taxes are only *measured by* royalty payments because the state *imposes* production taxes on royalty interests.[153] Therefore, the court should have held that the Sutherlands owned a royalty interest in mineral production upon which the state *imposes* taxes. Although the court ultimately concluded the Sutherlands owed the tax, it reached this conclusion for the wrong reason, leaving the core question of ownership unanswered.

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[147] *Id.*

[148] *Id.* at 1100.

[149] *Id.*

[150] WYO. STAT. ANN. §§ 39-13-103, 39-14-101 through -711 (2012); *see supra* notes 36–54 and accompanying text.

[151] *See, e.g.*, WYO. STAT. ANN. §§ 39-13-108 (2012); § 39-14-603(c)(iii), -703(c)(iii); *see supra* notes 39–49, 66–76 and accompanying text.

[152] *Sutherland*, 273 P.3d at 1095.

[153] *See* RME Petroleum Co. v. Wyo. Dep't of Revenue, 150 P.3d 673, 688 (Wyo. 2007); Ashland Oil Co. v. Jaeger, 650 P.2d 265, 268 (Wyo. 1982); Hillard v. Big Horn Coal Co., 549 P.2d 293, 301 (Wyo. 1976); Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928).

This analysis is divided into four sections. First, the analysis examines Wyoming's proportionate profits method of valuing mineral production, demonstrating the flaw in the *Sutherland* majority's reasoning. Second, the analysis examines the rights and obligations created by the agreement between the Sutherlands and Meridian, concluding that a tax on the Sutherlands' interest would not violate Wyoming's constitution. Third, the analysis argues the Wyoming Supreme Court should have used a substance-over-form approach to conclude the payments the Sutherlands received were substantively equivalent to ownership of a share of the minerals produced. Finally, the analysis proposes non-judicial solutions and steps practitioners drafting mineral agreements can take to protect their clients from unanticipated tax liability.

State production taxes are measured by royalty payments only because taxes are imposed on a royalty interest.

The Wyoming Supreme Court erred in determining the Sutherlands were charged with the proper amount of taxes under the lease even if taxes were not imposed on the Sutherlands' interest. The Mining Lease permitted Meridian to withhold taxes "imposed upon or measured by" the payments made to the Sutherlands.[154] Most likely, the parties intended this clause to restate the general rule that mineral owners are proportionally responsible for their share of production taxes.[155] Nevertheless, the *Sutherland* court analyzed "imposed upon" and "measured by" separately.[156]

The only reasonable reading of "imposed upon" is that the Sutherlands would have been liable for taxes on the payments to the extent the state imposed taxes on those payments.[157] Under the rule from the production tax statutes, as well as *Ashland*, *Oregon Basin*, and *Miller*, the state could impose taxes on the payments the Sutherlands received if those payments represented an ownership interest in the minerals.[158] The district court touched on this theory, but did not base its holding on the assignment of an ownership interest to the Sutherlands.[159] The

[154] *Sutherland*, 273 P.3d at 1094.

[155] *See* Sutherland v. Meridian Granite Co., No. 171-843 at 13, 2011 WL 2972247 (Wyo. Dist. Feb. 11, 2011); *infra* note 159.

[156] *Sutherland*, 273 P.3d at 1096.

[157] *See* WYO. STAT. ANN. § 39-14-703(c)(ii) (2012). The statute applies to "[a]ny taxpayer paying the taxes *imposed* by this article." *Id.* (emphasis added).

[158] § 39-14-703; *Ashland*, 650 P.2d at 268; Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 204 (Wyo. 1952); *Miller*, 269 P. at 45.

[159] The district court reasoned that the lease simply restated the general rule:

> The second assignment of tax liability to the Sutherlands is applicable. It applies to "any taxes imposed upon or measured by advance royalties or production royalties paid to Lessor." This portion of the clause restates the general rule announced in *Miller, Oregon Basin Oil & Gas Co.,* and *Ashland* that a royalty interest owner is proportionally responsible for his share of taxes imposed against production.

Sutherland v. Meridian Granite Co., No. 171-843 at 13, 2011 WL 2972247 (Wyo. Dist. Feb. 11, 2011).

Wyoming Supreme Court, following the district court, held it was not necessary to determine whether the State of Wyoming would have held the Sutherlands liable for the taxes.[160] Instead, the court's decision relied on the lease language requiring the Sutherlands to pay taxes "measured by" the payments.[161] But Wyoming's mineral taxes can only be measured by royalty payments if taxes are actually imposed on the royalty payments based on the theory that royalty payments represent an ownership interest.[162] Therefore, the contractual language permitting Meridian to withhold taxes "measured by" the payments did not authorize Meridian to withhold the full severance tax or ad valorem tax unless the payments represented an ownership interest.

The court determined the taxes were measured by the payments because private royalty payments were included on the DOR's Form 8301, Annual Gross Products Report for Miscellaneous Minerals.[163] This reasoning is circular—royalty payments are only used to calculate the value of minerals on Form 8301 because the state imposes taxes on the full value of royalty payments.[164] Form 8301 calculates the taxable value of minerals using Wyoming's proportionate profits method.[165] Listing the Sutherlands' payments as a private royalty payment on Form 8301 is correct only if taxes are imposed upon the payments.[166]

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[160] *Sutherland*, 273 P.3d at 1096–97.

[161] *Id.* at 1096.

[162] *See Ashland*, 650 P.2d at 268; *Or. Basin*, 248 P.2d at 204; *Miller*, 269 P. at 45; *infra* notes 163–78 and accompanying text.

[163] *Sutherland*, 273 P.3d at 1095–96. Sand and gravel sold away from the mouth of the mine is not valued using the proportionate profits method, instead it is valued at 25% of the sales price. WYO. STAT. ANN. § 39-14-603(b)(iii) (2012). Although the aggregate produced at Granite Canyon Quarry might commonly be referred to as "gravel," it is actually crushed rock, and seems to have been treated as a miscellaneous mineral for tax purposes. *See Sutherland*, 273 P.3d at 1095–96.

[164] *See* RME Petroleum Co. v. Wyo. Dep't of Revenue, 150 P.3d 673, 688 (Wyo. 2007); Hillard v. Big Horn Coal Co., 549 P.2d 293, 301 (Wyo. 1976).

[165] WYO. DEP'T OF REVENUE, ANNUAL GROSS PRODUCTS REPORT FOR MISCELLANEOUS MINERALS (FORM 8301) (2010), *available at* http://revenue.wyo.gov/mineral-tax-division/miscellaneous-solid-minerals [hereinafter FORM 8301]; *see RME Petroleum*, 150 P.3d at 681; *supra* note 53. The calculation starts with the sales value of minerals sold away from the mouth of the mine. Next, exempt mineral royalties, private royalties, and production taxes are subtracted from this amount. The resulting value is multiplied by the ratio of direct mining costs to total direct costs, representing the idea that only a portion of the sales price is attributable to mining. Finally, production taxes and private royalties are added back into the equation to arrive at the taxable value. This method is probably best explained by its mathematical formula. Under this formula, the taxable value of minerals is equal to:

$$\left((\textit{Sales price} - \textit{Royalties \& Taxes}) \times \left(\frac{\textit{Direct Mining Costs}}{\textit{Direct Mining Costs} + \textit{Other Direct Costs}}\right)\right) + \textit{Private Royalties \& Taxes.}$$

RME Petroleum, 150 P.3d at 681.

[166] *See Sutherland*, 273 P.3d at 1099 (Hill, J., dissenting) (concluding the payments were "irrelevant to the computation, measurement, or calculation of the taxes on the minerals being produced" because the payments were not taxable).

The proportionate profits method calculation begins with the gross receipts from the sale of minerals.[167] The gross receipts from the sale of minerals are then reduced by the ratio of direct mining costs to total direct costs.[168] Since royalty payments are considered ownership of production *free of the costs of production*, they are not reduced by the proportionate profits method and "the resulting taxable value includes the full value of . . . non-exempt royalties."[169] Despite the fact that Form 8301 removes royalties from the proportionate profits reduction because royalties represent ownership free of the costs of production, the court accepted that the Sutherlands' payments were properly listed as private royalties on Form 8301 without first determining whether the payments represented ownership of a portion of mineral production.

The court found the lease language requiring the Sutherlands to pay taxes "measured by" the payments unambiguous.[170] This determination is questionable because, absent the imposition of production taxes on the Sutherlands' payments, there is no clear relationship between the amount of taxes the Sutherlands paid and the payments they received. In order to determine the amount of taxes "measured by" the payments, some sort of comparison must be made between the payments and the resulting taxes. Perhaps the most straightforward interpretation of taxes "measured by" the payments is the amount of taxes resulting from inclusion of the payments in the calculation compared to the amount of taxes which would result if the calculation were performed without the payments. The amount the taxes increase or decrease due to the inclusion of the payments in the calculation depends on how the payments are classified.[171]

The Sutherlands were paying severance taxes levied by section 39-14-704 of the Wyoming Statutes on the full value of their "Production Royalties" (the full tax rate).[172] But, compared to the taxes Meridian would pay if the payments were not included in the calculation, the increase in taxes due to the inclusion of private royalty payments on Form 8301 will always be less than the full tax

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[167] *See* WYO. STAT. ANN. § 39-14-203(b)(vi)(D) (2012) (proportionate profits method for valuing oil).

[168] *Id.*; *RME Petroleum*, 150 P.3d at 681. For definitions of direct costs and direct mining costs see 011-000-006 WYO. CODE. R. §§ 4–9 (Weil's 2010).

[169] *RME Petroleum*, 150 P.3d at 688.

[170] *Sutherland*, 273 P.3d at 1095 (interpretation of an unambiguous contract is a matter of law); Mining Lease, *supra* note 10, at 21–22; *see supra* note 115 and accompanying text.

[171] *See* 011-000-006 WYO. CODE. R. §§ 4–9 (Weil's 2010) (classification of costs); *infra* notes 173–76 and accompanying text.

[172] According to Meridian's opening brief, as of 2009, "the rate of severance tax withheld from Sutherlands' Production Royalties on Parcel 2 was 2% and the rate of ad valorem tax withheld from Sutherlands' Production Royalties on Parcel 2 was approximately 6%." Cross Appeal Opening Brief of Cross Appellant (Defendant), Meridian Granite Co., *Sutherland*, 273 P.3d 1092 (No. S-11-0092), 2011 WL 3276337, at *6.

rate.[173] So even if the payments to the Sutherlands were properly classified as taxable royalty payments, an argument could be made that the amount of taxes "measured by" private royalty payments is less than the full tax rate imposed on those payments.

If the payments to the Sutherlands were not royalty payments based on ownership of a portion of the mineral production, the payments would probably be classified as direct costs of production.[174] The amount of tax increase attributable to the inclusion of direct production costs in the proportionate profits calculation will rarely be equal to the full tax rate.[175] Payments classified as other direct costs

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[173] *See RME Petroleum*, 150 P.3d at 681. In the proportionate profits calculation, taxable value is:

$$\left((\textit{Sales price} - \textit{Royalties \& Taxes}) \times \left(\frac{\textit{Direct Mining Costs}}{\textit{Direct Mining Costs + Other Direct Costs}}\right)\right) + \textit{Private Royalties \& Taxes.}$$

Id.; *see supra* note 165. The inclusion of royalty payments in the calculation increases the total taxable value by a percentage of the royalty payments (and production taxes) equal to the complement of the direct cost ratio. The more direct mining costs dominate the ratio, the less impact royalty payments have on the total taxable value. For example, if the sales value of the minerals was $10,000, private royalty and taxes were $2000 and direct mining costs were 90% of the total direct costs, i.e., $\textit{taxable value} = \left((10{,}000 - 2{,}000) \times \left(\frac{90}{100}\right)\right) + 2{,}000$, the taxable value of the minerals would be $9200, an increase of $200 over the taxable value if royalties (and taxes) had not been included in the calculation. When mining costs make up a smaller percentage of total direct costs, private royalties increase the taxable value by a larger amount. So $\left((10{,}000 - 2{,}000) \times \left(\frac{50}{100}\right)\right) + 2{,}000$ results in a taxable value of $6000, an increase of $1000. Thus, including royalty payments in the proportionate profits calculation increases the total amount of tax due, but decreases the amount the lessor is obligated to pay.

[174] *See* Hillard v. Big Horn Coal Co., 549 P.2d 293, 301 (Wyo. 1976) (A "royalty must be paid for the privilege of mining, not processing . . . .").

[175] *See RME Petroleum*, 150 P.3d at 681; *supra* note 165. The analysis in *Hillard v. Big Horn Coal Co.* would seem to indicate that payments for the use of the surface would be treated as direct costs of mining. 549 P.2d at 301. The inclusion of additional direct costs of mining in the proportionate profits formula can be represented by the equation: $\textit{Taxable value} = 10{,}000 \times \left(\frac{2000+x}{(2000+x)+2000}\right)$, where the sales price is $10,000, the direct mining costs are $2000, indirect mining costs are $2000, and additional direct mining costs are represented by *x*. At small values, additional direct mining costs increase the taxable value by more than the amount of tax on the full value of those costs. For example, $500 in additional direct mining costs increases the taxable value from $5000 to $5556, a difference of $556. (Presumably, this result explains why the Sutherlands did not argue their payments should be classified as direct mining costs.) The amount of taxes measured by increased mining costs is equal to the full value of the tax on that amount only at one point—$1000 in additional mining costs increases the taxable value by $1000. Larger amounts have a decreasing impact. $2000 in additional direct mining costs increases the taxable value by $1667. A $6000 increase in direct costs of mining would increase the taxable value by $3000, but the mine would no longer be profitable with that level of expenses. (These simplified calculations ignore the effect of additional private royalties and taxes.) *See supra* note 165.

would decrease the amount of taxes, while indirect costs would have no effect on the calculation.[176] No matter how the payments are classified, including the payments in the proportionate profits formula does not increase the total amount of taxes (compared to the taxes when the payments are not included) by the amount the Sutherlands paid.

The increase in the total taxes levied on the mineral production is only equal to the amount the Sutherlands paid if the amount of taxes resulting from the inclusion of private royalties in the calculation is compared to the amount that would result if those same payments were classified as *tax-exempt* royalties.[177] Because the only difference between a private royalty and a tax-exempt royalty is the imposition of production taxes, this result leads to an inescapable conclusion—payments should only be classified as private royalties if production taxes are imposed on those payments. Nevertheless, the Wyoming Supreme Court concluded the taxes were measured by the payments without completing the necessary step of determining whether the payments were a taxable ownership interest in minerals.[178]

Ultimately, the majority opinion in *Sutherland* was based on a misinterpretation of Wyoming's proportionate profits method of mineral valuation. The court stopped short of concluding the Sutherlands had an ownership interest in production, on which Wyoming law would impose production taxes.[179] The court misconstrued the significance of Form 8301.[180] The calculations on Form 8301 are premised on the imposition of production taxes on "private royalties."[181] Because the proportionate profits calculation presupposes that payments classified as private royalties are subject to tax, the amount the Sutherlands paid in taxes could only be viewed as "measured by" the payments they received if the payments they received were taxable private royalties. Therefore, the Mining Lease could not subject the Sutherlands to the full amount of tax on the payments they received unless Wyoming law imposed production taxes on the payments.[182]

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[176] *See RME Petroleum*, 150 P.3d at 682 ("We observe, for purposes of this opinion, that including production taxes and royalties in the direct cost ratio as direct costs of production results in greater tax liability."); *supra* notes 165, 173, and 175.

[177] *See* FORM 8301, *supra* note 165; notes 163–65 and accompanying text. In the first step of the proportionate profits calculation, both private royalties and tax-exempt royalties are subtracted from the gross receipts from the sale of minerals. In the final step of the calculation, private royalties are added back in to arrive at the taxable value, i.e.,
((*Sales price – Royalties & Taxes*) x *Cost Ratio*) + *Private Royalties & Taxes*. *See supra* note 173.

[178] Sutherland v. Meridian Granite Co., 273 P.3d 1092, 1096 (Wyo. 2012).

[179] *Id.* at 1097. *Sutherland* cannot be read as implicitly holding that the payments made to the Sutherlands were taxable royalty payments because the court explicitly determined it "need not decide whether the Sutherlands would owe the taxes under [WYO. STAT. ANN.] § 39-14-703(c)." *Id.*

[180] *Id.* at 1095.

[181] *See* FORM 8301, *supra* note 165; *supra* note 165 and accompanying text.

[182] Mining Lease, *supra* note 10, at 21–22; *see supra* note 165 and accompanying text.

The Wyoming Constitution's exemption of mine lands does not exempt the Sutherlands' interest in the mineral production from taxation.

After Meridian purchased minerals from the BLM, it severed those minerals from the mineral estate and became the owner of the minerals.[183] Meridian agreed to transfer part of its mineral production to the Sutherlands in the form of payments based on production.[184] As discussed, Wyoming imposes taxes on mineral production, not on the mineral estate.[185] Accordingly, the payments the Sutherlands received should have been viewed as a taxable ownership interest in Meridian's production.[186] Such a holding would not conflict with the Wyoming Constitution, statutes, or case law.

According to the dissent, the Wyoming Constitution forbids the imposition of production taxes on the payments made to the Sutherlands because mine lands are exempt from property taxes.[187] In the dissent's view, the Sutherlands did not own an interest in mineral production—they only owned surface interests on Parcel 2.[188] The dissent asserted "[t]he Sutherlands have never owned or claimed any ownership in the minerals produced from Parcel 2."[189] Since the majority declined to decide the Sutherlands' ownership interest in the mineral production, it is unclear whether the court as a whole would agree with the dissent's assertion.

Nevertheless, it is clear the Sutherlands did not own a real property interest in the mineral estate.[190] A mineral estate is real property; as such, an interest in the mineral estate can only be transferred in accordance with Wyoming's real property conveyance statutes.[191] But since Wyoming taxes produced minerals as

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[183] As the Wyoming Supreme Court noted in *Sutherland*: "The record reflects that Meridian has conducted mining operations on Parcel 2, but does not establish how Meridian acquired the rights to do so, or whether the mineral estate is now owned by Meridian or the BLM." 273 P.3d at 1094 n.2. But, when dealing with commercial producers, the BLM can only dispose of common variety minerals like the gravel mined by Meridian by selling the material at not less than fair market value. 43 C.F.R. § 3601.6 (2012). Consequently, the company must have entered into a sales contract with the BLM. *See id.*

[184] *Sutherland*, 273 P.3d at 1094.

[185] *Id.* at 1095 ("Indeed, in Wyoming, mineral severance and ad valorem taxes are imposed on the mineral product after severance, not upon the lands or 'Premises' at all.").

[186] *See* Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928); *supra* notes 66–76 and accompanying text.

[187] *Sutherland*, 273 P.3d at 1097.

[188] *Id.*

[189] *Id.* at 1098.

[190] *Id.* at 1096 ("[T]he Sutherlands do not own any share of the mineral estate of Parcel 2.").

[191] WYO. STAT. ANN. §§ 34-1-101 through -103 (2012); *see* David E. Pierce, *Basic Conveyance Principles*, *in* MINERAL TITLE EXAMINATION, Paper No. 4, 2 (Rocky Mtn. Min. L. Fdn. 2012).

personal property, it does not matter whether the Sutherlands' right to receive future payments was a real property right as long as they owned an interest in the produced minerals.[192] If the payments received by the Sutherlands represented a personal property interest in the produced minerals, production taxes should have been imposed.[193] If the payments represented the Sutherlands' exempt surface interest and were calculated simply with reference to the minerals produced, as the dissent argued, then the payments should have been tax-exempt.[194]

The main thrust of the dissent's reasoning was, since the surface estate was exempt from taxes under the Wyoming Constitution, a royalty interest received in exchange for rights to use the surface estate must also be exempt.[195] The dissent's focus on the Sutherlands' rights prior to the agreement was misplaced. Because ownership of minerals gives rise to tax liability, the only question is whether the Sutherlands owned an interest in the rock produced from the Granite Canyon Quarry. Thus, the proper inquiry is not into the nature of the rights the Sutherlands granted in the agreement, but into the nature of the rights the Sutherlands received in exchange.[196]

It is generally accepted there are five distinct incidents to ownership of a mineral estate: the right to transfer or execute a lease, the right to develop minerals, the right to bonuses, the right to delay rentals, and the right to royalties.[197] Before they entered into the agreement with Meridian, the Sutherlands did not own any mineral rights with regards to Parcel 2.[198] But in the Mining Lease, Meridian granted the Sutherlands the right to receive payments substantially similar to royalties.[199] Both in Wyoming and elsewhere, courts have consistently held

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[192] *See Sutherland*, 273 P.3d at 1095; *supra* notes 61–65 and accompanying text. Furthermore, Wyoming's production taxes are a tax on personal property—it is the severed minerals that are subject to production taxes, not the mineral estate. Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 205 (Wyo. 1952). Therefore, it should not matter whether the federal government owned an interest in the mineral estate for the purposes of production taxes. *See Sutherland*, 273 P.3d at 1099 (Hill, J., dissenting) (arguing only Meridian's interest and any interest retained by the federal government would be subject to tax).

[193] *See* Ashland Oil Co. v. Jaeger, 650 P.2d 265, 268 (Wyo. 1982); *Or. Basin*, 248 P.2d at 204; Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928).

[194] WYO. CONST. art. 15, § 3; *Sutherland*, 273 P.3d at 1099.

[195] *Sutherland*, 273 P.3d at 1099.

[196] *See* Wyo. State Tax Comm'n v. BHP Petroleum Co., 856 P.2d 428, 434 (Wyo. 1993) ("Ownership is the important question for ad valorem tax liability purposes."); *supra* notes 41, 49.

[197] *In re* Powder River Coal Co., No. 97-206, 1999 WL 535401, at *8 (Wyo. St. Bd. Eq. July 9, 1999) (quoting Antelope Prod. Co. v. Shriners Hosp. for Crippled Children, 464 N.W.2d 159, 161 (Neb. 1991)); Picard v. Richards, 366 P.2d 119, 123 (Wyo. 1961); *see supra* note 24.

[198] *See Sutherland*, 273 P.3d at 1094.

[199] *Id.*

royalty accruing from production is personal property.[200] Since the payments were based on the amount of minerals produced instead of on the amount of damage to the land, the court should have concluded the Sutherlands traded their right to compensation for surface damage for an ownership interest in a portion of the mineral production.[201]

The fact the surface was exempt from property taxes has no bearing on whether the interest in the mineral production was exempt.[202] There are two reasons why royalty payments arising from ownership of the surface estate should be treated the same as royalty payments arising from ownership of the mineral estate. First, it is impossible to separate payments for the surface estate from payments for the mineral estate when the lessor owns fee-simple title to both the surface and the subsurface. Landowners who own both the surface rights and mineral rights often transfer both interests to a mineral producer in exchange for royalties.[203] Those royalties are not divided into a tax-exempt portion representing surface rights and a taxable portion representing mineral rights.[204] Second, both types of royalty payments convert a tax-exempt real property interest into a taxable personal property interest. Both the surface estate and the mineral estate are real property interests.[205] Both estates are exempt from property taxes under the

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[200] Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 205 (Wyo. 1952); Denver Joint Stock Land Bank v. Dixon, 122 P.2d 842, 849 (Wyo. 1942); HEMINGWAY OIL AND GAS § 2.5(B), *supra* note 24, at 58; *but see* 5 AMERICAN LAW OF MINING § 191.02[7], *supra* note 1 ("[T]here is a bewildering maze of variations among the states, often rooted in arcane concepts of traditional property law, in the classification of [reserved mineral] interests as real or personal property.").

[201] *See Sutherland*, 273 P.3d at 1094, *supra* notes 3–6, 23–28 and accompanying text (rights of surface owners).

[202] *See generally* Helvering v. Mountain Producers Corp., 303 U.S. 376 (1938) (holding a private company's income from production on exempt Wyoming state school lands was taxable); Indian Territory Illuminating Oil Co. v. Bd. of Equalization, 288 U.S. 325 (1933) (sustaining an ad valorem tax on oil extracted from exempt Indian lands); Grp. No. 1 Oil Corp. v. Bass, 283 U.S. 279 (1931) (holding profits derived by a lessee from the sale of oil and gas produced under a lease from the State of Texas were not to immune from federal taxation); Hudson Oil Co. v. Bd. of Comm'rs of Fremont Cnty., 106 P.2d 286 (Wyo. 1940) (overruling Hudson Oil Co. v. Bd. of Comm'rs of Fremont Cnty., 52 P.2d 683 (Wyo. 1935)) (holding the share of production from exempt Indian trust lands owned by the oil company lessee was subject to county ad valorem production taxes).

[203] 3A SUMMERS OIL AND GAS § 30:1, *supra* note 1; 5 AMERICAN LAW OF MINING § 1910.2[7], *supra* note 1.

[204] *See Sutherland*, 273 P.3d at 1094 (confirming that there is no question the royalty payments the Sutherlands received based on production from Parcel 1 were taxable).

[205] Denver Joint Stock Land Bank v. Dixon, 122 P.2d 842, 849 (Wyo. 1942). The property interest which gives rise to a royalty is a limited one:

> As an interest in property, a royalty interest is characterized by two basic elements:
>
> 1. The royalty holder has a right to a certain portion of the minerals, or monetary payment in lieu thereof, from the property to which the royalty applies free from the obligation to contribute any part of the costs of mineral production.

Wyoming Constitution.[206] The exemption of the mineral estate of a mine was arguably the central aim of the exemption, with the exemption of the mine's surface being merely collateral.[207] In the normal course of mining operations, the exempt mineral interest is converted into a taxable personal property interest.[208] Thus, the dissent's assertion that "[t]he taxable estate is the mineral estate" missed the point of the exemption.[209] Only when the minerals are produced are they converted from exempt real property to taxable personal property.[210] Just because the Sutherlands' exempt surface interest was converted into an interest in produced minerals does not exempt the converted interest in produced minerals from taxation.

The Wyoming Supreme Court should have taken a substance-over-form approach to the mining lease and held the Sutherlands were granted a royalty interest.

The general rule from *Ashland* and *Miller*, which holds royalty interest owners are responsible for their share of production taxes, was based on the substance-over-form analysis[211] The *Sutherland* court should have used the same type of analysis and determined the Sutherlands' payments were royalties in substance, even though the payments were not in the typical form of a lessor's royalty.[212] The unfortunate result of elevating form over substance is that a sophisticated party may manipulate the tax system, and shift financial liability.[213]

> 2. A royalty does not include the executive right, *i.e.*, the right to execute leases or other grants of right to explore and develop the mineral estate or any possessory rights in the mineral estate.

3 AMERICAN LAW OF MINING § 85.02, *supra* note 1 (footnotes omitted).

[206] WYO. CONST. art. 15, § 3.

[207] The framers of the Wyoming Constitution were concerned that an accurate assessment of mineral lands is impossible because there is no way to know the exact extent and value of minerals buried in the ground. JOURNAL AND DEBATES OF THE CONSTITUTIONAL CONVENTION OF THE STATE OF WYOMING 641 (1893). Additionally, mineral producers may not be able to pay the tax until they extract and sell the minerals. In *Oregon Basin,* Justice Ilsley discussed the wisdom of the constitutional exemption:

> Many an early day mining prospector held on to his claim, with a pick and shovel and a sack of grub, because he was sure that his claim would not be lost through a tax sale. It was found through practical experience that it was time enough to levy a tax when the prospector had produced something with which to pay.

Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 203 (Wyo. 1952).

[208] *See* Ashland Oil Co. v. Jaeger, 650 P.2d 265, 268 (Wyo. 1982).

[209] *Sutherland*, 273 P.3d at 1099.

[210] *Or. Basin*, 248 P.2d at 204.

[211] *Ashland*, 650 P.2d at 268; Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928); *see supra* notes 66–90 and accompanying text.

[212] *Sutherland*, 273 P.3d at 1094.

[213] *See* sources cited *supra* note 18.

In *Miller*, the court used a substance-over-form approach because the lessors could have chosen to receive their compensation either in monetary payments or in oil.[214] The court held that the monetary payments were equivalent to a hypothetical share of the minerals and should be taxable just as would an actual share of the minerals.[215] Subsequent cases, including *Ashland*, made it clear the same principles apply regardless of whether the royalty recipient had the option to take his or her royalty in kind.[216] Just as the payments in *Ashland* and *Miller* were treated as functionally equivalent to a share of oil, the payments received by the Sutherlands should have been treated as functionally equivalent to a share of the rock produced by Meridian.[217]

The Sutherlands' interest was not a typical lessor's reserved royalty—instead, it was a contractual right to production payments. Normally, the mineral owner grants an operating interest and reserves a non-participating royalty.[218] In *Sutherland*, the mineral owner, Meridian, granted contractual, non-participating "Production Royalties" to the Sutherlands and reserved the operating interest.[219] When Meridian agreed to pay the Sutherlands a production royalty on minerals produced from Parcel 2, the company granted an interest in the mine production to the Sutherlands, conditional on Meridian's acquiring the minerals from the BLM.[220] After Meridian acquired the minerals, the company became the mineral owner and legally able to transfer any part of its ownership interest.[221] In a substance-over-form analysis, the fact that the Sutherlands did not have legal title to the rock would be irrelevant—*Miller* asked whether the parties owned rights that were substantively equivalent to a share of the mineral production, not whether they had actual title to the produced minerals.[222]

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[214] *Miller*, 269 P. at 45 ("[A] lessee, who is the virtual owner of the property, may be considered the owner for the purposes of taxation.").

[215] *Id.*

[216] *See Ashland*, 650 P.2d at 268.

[217] *See Sutherland*, 273 P.3d at 1094; *supra* notes 66–76 and accompanying text.

[218] *Sutherland*, 273 P.3d at 1096 n.4; 3 AMERICAN LAW OF MINING § 85.02[2][a], *supra* note 1.

[219] *Sutherland*, 273 P.3d at 1094.

[220] *Id.* n.2.

[221] See 1 AMERICAN LAW OF MINING § 21.04[8], *supra* note 1. Minerals sold by the BLM are typically paid for in installments, but mineral producers are prohibited from removing more minerals than they have paid for. *See* BUREAU OF LAND MANAGEMENT, *Example Mineral Sales Contract*, BLM Form 3600-9 (April 2002), http://www.blm.gov/or/districts/spokane/files/FY11NR_005_appendix.pdf. Any rock extracted by Meridian from Parcel 2 was bought and paid for and title passed to Meridian before it was severed from the land. *But see Sutherland*, 273 P.3d at 1099 (Hill, J., dissenting) ("The owners of the minerals produced from Parcel 2 would be either Meridian or the BLM, or both.").

[222] Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928).

Since the Sutherlands had the right to payments based on the amount of rock produced, they were a "virtual owner" of a portion of the mineral production.[223] The lack of a formal grant complying with Wyoming's property conveyance statutes would have prohibited either party's rights or obligations to each other from running with the land,[224] but as long as the Sutherlands owned the land and Meridian mined the minerals, the interest the Sutherlands gained in exchange for the use of their land was indistinguishable in substance from the royalty interest a mineral lessor might retain in a lease or an interest that a mineral owner might grant to another.[225] Therefore, the court should have treated the payments the Sutherlands received as substantively equivalent to taxable royalties.[226]

The *Exxon Mobil* decision demonstrates the flaws inherent in elevating form over substance for mineral tax purposes.[227] Structuring the disposition of helium from the federal government's LaBarge field leases as a sale rather than a lease did not alter Exxon's practices in any way.[228] But the court's adherence to the fiction that the federal government owned the helium—which was at all times in the possession and control of Exxon, the "virtual owner," bestowed a windfall on the corporation and deprived Wyoming of significant revenue.[229] The technical

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223 *Id.*

224 *See* WYO. STAT. ANN. §§ 34-1-101 through -103 (2012); Pierce, *supra* note 191.

225 *See Sutherland*, 273 P.3d at 1094; HEMINGWAY OIL AND GAS §2.1, *supra* note 24, at 39; 3 AMERICAN LAW OF MINING § 83.03, *supra* note 1; *supra* notes 24–26 and accompanying text.

226 The *Sutherland* court seemed to indicate the Sutherlands' interest may have been a royalty even if it was not a typical lessor's royalty:

> The Sutherlands further contend that, because they do not own the mineral estate of Parcel 2, the payments they receive from Meridian are not royalties at all, but only payments for surface damage. We agree that their interest in Parcel 2 is not a typical lessor's royalty, which is "created upon the granting of a leasehold in the mineral estate by means of a reservation to the owner." [3 ROCKY MOUNTAIN MINERAL LAW FOUNDATION, AMERICAN LAW OF MINING § 85.02[2][a] (2d ed. 2011)]. However, the term royalty is defined more broadly to include "[c]ompensation for the use of property, usually copyrighted material or natural resources, expressed as a percentage of receipts from using the property or as an account per unit produced." [BLACK'S LAW DICTIONARY 1330 (6th ed. 1990)]. The Sutherlands are compensated for use of the surface of Parcel 2 by payment of 6¢ per ton produced, and these payments may be referred to as royalties. But as the district court observed, "the exact nature of the Sutherlands' ownership interest ... [is] of little importance given the clear language of ... the lease." [Sutherland v. Meridian Granite Co., No. 171-843 at 12 n.3, 2011 WL 2972247 (Wyo. Dist. Feb 11, 2011).]

Sutherland, 273 P.3d at 1096 n.4.

227 Wyo. Dep't of Revenue v. Exxon Mobil Corp., 162 P.3d 515, 519 (Wyo. 2007).

228 *See id.* at 523 (gas from state leases which contained taxable helium was processed in the same facility).

229 The LaBarge gas field contains the largest reserve of helium in the United States. Brief of Appellant, Sublette Cnty. at 2, Wyo. Dep't of Revenue v. Exxon Mobil Corp., 162 P.3d 515 (Wyo. 2007) (Nos. 06-41, 06-42), 2006 WL 4782193, at *2. In 1989, Exxon's Shute Creek Plant was producing around 2.2 million cubic feet of helium per day, and was expected to produce over 40

distinctions surrounding ownership of minerals are complex.[230] The provisions of mineral leases and other mineral agreements can be even more complicated.[231] Large mineral producers are often sophisticated enough to create ambiguity in even the most well-drafted statute by entering into formal agreements unanticipated by the statute's drafters.[232] Sophisticated parties should not then be able to benefit because courts resolve the deliberate ambiguity in their favor.[233] In *Sutherland*, the failure to apply substance-over-form principles did not lead to an incorrect result. Nevertheless, the application of those principles was the proper analysis. The Sutherlands' interest could only be subject to tax if the payments they received were equivalent in substance to the ownership of a portion of the mineral production.[234] Wyoming's tax system would be compromised if mineral producers could shift their tax burden onto third parties by simply classifying all of their direct costs of production as royalties.

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billion cubic feet over the lifetime of the plant. RODNEY H. DEBRUIN, WYOMING'S OIL AND GAS INDUSTRY IN THE 1980S: A TIME OF CHANGE (The Geological Survey of Wyoming 1989), *available at* http://www.wsgs.uwyo.edu/public-info/onlinepubs/docs/PIC-28.pdf.

[230] *See* McMahon, *supra* note 89, at § 2[a]; HEMINGWAY OIL AND GAS § 2.5(B), *supra* note 24, at 58; 5 AMERICAN LAW OF MINING § 191.02[7], *supra* note 1; *supra* notes 57–73 and accompanying text.

[231] *See* Sperling, *supra* note 26.

[232] *See* True v. United States, 190 F.3d 1165, 1173 (10th Cir. 1999) (using substance-over-form-principles to characterize a complex series of land and mineral lease exchanges for income tax purposes); Kuper v. Comm'r, 533 F.2d 152, 159 (5th Cir. 1976) (noting a substance-over-form approach is necessary because "all of the combinations conceivable by a resourceful tax bar cannot be perceived in advance"). In a 2009 dispute between the DOR and Exxon over taxation of natural gas from the LaBarge Field, Justice Hill expressed dissatisfaction with the court's strict construction of tax statutes:

> I am unable to agree that, in the light of modern views of revenue laws, the somewhat antiquated principle of construing tax legislation strictly in favor of the taxpayer plays a significant role in circumstances such as these. Exxon is easily one of the most sophisticated taxpayers on Earth and Wyoming is likely one of the very smallest revenue collectors that Exxon has to deal with in its efforts to avoid taxation.

Exxon Mobil Corp. v. Wyo. Dep't of Revenue, 219 P.3d 128, 150 (Wyo. 2009) (Hill, J., dissenting). For an example of this phenomenon in another context, see the numerous lawsuits attempting to collect hotel occupancy taxes from online travel companies who sell hotel rooms using an unconventional formal arrangement. James A. Amdur, Annotation, *Obligation of Online Travel Companies to Collect and Remit Hotel Occupancy Taxes*, 61 A.L.R. 6th 387 (2011).

[233] The sheer bulk of litigation involving Exxon and taxation of the LaBarge field demonstrates this point. *See generally* Exxon Mobil Corp v. Wyo. Dep't of Revenue, 266 P.3d 944 (Wyo. 2011) (resulting in a loss for Exxon); Exxon Mobil Corp. v. State, 219 P.3d 128 (Wyo. 2009) (resulting in a win for Exxon); *Exxon Mobil*, 162 P.3d 515 (resulting in a win for Exxon); *In re* Bd. of Cnty. Comm'rs, Sublette Cnty., 33 P.3d 107 (Wyo. 2001) (resulting in a favorable decision for Exxon, which was not a party); Exxon Corp. v. Bd. of Cnty. Comm'rs, Sublette Cnty., 987 P.2d 158 (Wyo. 1999) (resulting in a partial win for Exxon); Amoco Prod. Co. v. State, 751 P.2d 379 (Wyo. 1988) (resulting in a loss for Exxon and its co-appellants).

[234] Sutherland v. Meridian Granite Co., 273 P.3d 1092, 1100 (Wyo. 2012) (Hill, J., dissenting) (arguing the payments were not taxable because they represented rent, not royalties).

Earlier Wyoming cases used a substance-over-form analysis to conclude royalty payments are taxable because they are equivalent to a share of mineral production.[235] Applying the same type of analysis to the *Sutherland* dispute leads to the same conclusion.[236] Meridian acquired an interest in minerals from the BLM, and the company granted a portion of that interest to the Sutherlands.[237] The form of the transaction—what Meridian received in exchange for its mineral interest and whether that interest was reserved or granted—is secondary to the substance of the interest the Sutherlands received, which was the right to monetary payments equivalent to a share of mineral production.[238] The early Wyoming Supreme Court's use of a substance-over-form approach was prescient. A substance-over-form approach to statutory construction allows courts to implement the legislature's intent even when sophisticated parties invent creative and unorthodox business arrangements. Failure to use a substance-over-form approach allows a sophisticated party to structure its transaction and ultimately shift financial liability by staying one step ahead of the legislature and taxing authorities.

Until Wyoming law regarding taxable interests in minerals is clarified, practitioners should take care in drafting mineral agreements.

Before *Sutherland*, many reasonable mineral attorneys probably would have agreed with Justice Hill: a mineral producer cannot "subject the surface estate to Wyoming mineral taxes by simply defining the terms of the payment for the surface estate as a royalty."[239] After *Sutherland*, it is not clear whether Wyoming will view payments based on production or designated as "royalties" as a taxable ownership interest in minerals. Since the court missed the opportunity to clarify whether an interest like the Sutherlands' is taxable, the legislature should clarify the production tax statutes. Mineral lessors, lessees, and surface owners would all benefit from clear definitions of the interests subject to mineral taxes. The DOR may also be able to define mineral ownership interests in its rules pursuant to its authority to "[d]ecide all questions that may arise with reference to the construction of any statute affecting the assessment, levy and collection of taxes."[240]

Until Wyoming law is clarified regarding what constitutes a taxable ownership interest in mineral production, certain types of mineral payments could be subject to unanticipated tax liability. In the meantime, careful drafting of mineral

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[235] Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928); *see supra* notes 66–76 and accompanying text.

[236] *See Sutherland*, 273 P.3d at 1094; *supra* notes 223–26 and accompanying text.

[237] *See Sutherland*, 273 P.3d at 1094; *supra* note 221.

[238] *See* Mining Lease, *supra* note 10, at 10; *supra* notes 110–15 and accompanying text.

[239] *Sutherland*, 273 P.3d at 1099.

[240] WYO. STAT. ANN. § 39-11-102(c)(xii) (2012).

lease agreements should prevent disputes about which party is responsible for taxes.[241] In *Sutherland*, the Wyoming Supreme Court determined a clause which applied to two different parcels of land to mean the parties intended both parcels would be treated the same.[242] If parties want different parcels of land or different mineral interests to be treated separately, the agreement should address each interest or parcel individually. Because tax burdens can be allocated by contract, attorneys drafting mineral agreements can avoid future litigation by explicitly and unambiguously defining the tax obligations of each party and each interest.[243]

CONCLUSION

Under the Mining Lease in *Sutherland*, the Sutherlands were required to pay any taxes "imposed upon or measured by" the production payments they received.[244] The Wyoming Supreme Court determined, under this contract, the exact nature of the Sutherlands' ownership interest was inconsequential, and overlooked the fact that the full tax rate applied to the Sutherlands' payments could not be the amount "measured by" the payments unless the state imposed taxes on those payments.[245] Before assigning tax liability to the Sutherlands, the court needed to rule that the Sutherlands owned an interest in the mineral production. Ultimately, the court was correct in assigning tax liability to the Sutherlands, but the court's reasoning left the ownership question unanswered. Future disputes like the one in *Sutherland* can be prevented if the ownership interests subject to Wyoming's production taxes are clearly defined. The issue can be solved by the Wyoming Legislature or through the DOR's rulemaking process.[246] If the issue comes before the Wyoming Supreme Court again, the court should employ a substance-over-form approach to conclude that the receipt of a production payment is equivalent to an ownership interest in mineral production regardless of whether the payment is a traditional lessor's royalty or is created in some other way, such as by contract.[247]

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241 *See generally* Shona Smith & Christopher L. Doerksen, *Ten Critical Due Diligence Issues that Can Spoil Your Day and Deal*¸ DUE DILIGENCE IN OIL AND GAS TRANSACTIONS, Paper No. 2, 12 (Rocky Mtn. Min. L. Fdn. 2011) (advising parties to obtain tax advice early in the process); Theriot & Grauberger, *supra* note 15.

242 *Sutherland*, 273 P.3d at 1097.

243 *See* Ashland Oil Co. v. Jaeger, 650 P.2d 265, 267–68 (Wyo. 1982); Or. Basin Oil & Gas Co. v. Ohio Oil Co., 248 P.2d 198, 204 (Wyo. 1952); Miller v. Buck Creek Oil Co., 269 P. 43, 45 (Wyo. 1928).

244 *Sutherland*, 273 P.3d at 1095–96.

245 *Id.* at 1096 n.4.

246 WYO. STAT. ANN. § 39-11-102(c)(xii) (2012).

247 *See supra* notes 235–38 and accompanying text.