ARIZONA TAX COURT

TX 2003-000735 12/23/2005

HONORABLE MARK W. ARMSTRONG

CLERK OF THE COURT
L. Slaughter
Deputy

FILED:_____

ARIZONA DEPARTMENT OF REVENUE KENNETH J. LOVE

v.

RIM SOUTHWEST CORPORATION PAUL J. MOONEY

UNDER ADVISEMENT RULING

This matter was taken under advisement after oral argument held October 24, 2005. The Court has considered the Plaintiff's Motion to Dismiss and Alternative Motion for Summary Judgment, Defendant's Cross-Motion for Summary Judgment and arguments of counsel.

I. THE ISSUE

This case involves the valuation by the Arizona Department of Revenue ("the Department"/"Plaintiff") of two separate oil and gas interests owned by RIM Southwest Corporation ("RIM"/"Defendant") pursuant to A.R.S. §§ 42-14101 et. seq. The interests arise out of oil and gas wells located on what are referred to as the Dry Mesa and Black Rock oil and gas fields. The fields are located in northern Apache County, within the Navajo Indian Reservation.

Defendant asks the Court to dismiss the complaint filed by Plaintiff to restore its 2004 valuation of Defendant. Defendant claims dismissal is appropriate because the interests that are being taxed by the Plaintiff in this case derive from the extraction of certain oil and gas reserves owned by and located on Tribal property of the Navajo Nation that is not under state jurisdiction. Alternatively, Defendant moves for summary judgment as a matter of law arguing that Plaintiff similarly lacks authority or jurisdiction to apply A.R.S. §§ 42-14101 et. seq. to Defendant.

Plaintiff requests this Court to enter summary judgment in favor of the Department since it correctly applied A.R.S. §§ 42-14101 et. seq, and to restore the Department's valuation of RIM for tax year 2004. Additionally, based upon this court's ruling affirming the taxability of RIM's interest in the Black Rock oil and gas field, Apache County requests that RIM's counterclaim for refund of 2003 property taxes be denied.

II. FACTUAL BACKGROUND

A. BLACK ROCK.

On or about February 18, 1987, Chuska entered into an Operating Agreement (the "Agreement") with The Navajo Tribe of Indians (the "Tribe") to extract oil and gas reserves from the Black Rock oil and gas fields located on the Navajo Reservation in Apache County, Arizona ("Black Rock"). Under the terms of the Agreement, Chuska sold the oil and gas reserves it extracted from Black Rock and divided the sale proceeds with the Tribe. In addition, Chuska also paid the Tribe a certain specified amount for the exclusive right to operate Black Rock.

On or about September 1, 1993, Chuska changed its name to Harken Southwest Corporation ("Harken"). On December 21, 2000, RIM purchased Harken's stock and changed the corporate name to RIM. In essence, the same corporate entity ("Operator") has operated under the Agreement since its inception back in February 1987.

On February 12, 1996, the Department sent a letter to Harken confirming that Harken's oil and gas interests in Black Rock under the Agreement were not subject to tax. The letter also acknowledged that the Department had reached a similar determination with respect to the Black Rock interests of Chuska back in 1990.

On February 5, 2003, however, the Department notified RIM that it intended to impose a property tax on the Operator's interest under the Agreement based on the Arizona Supreme Court's decision in *State v. Superior Court for Maricopa County*, 113 Ariz. 248, 550 P.2d 626 (1976) ("*Kerr-McGee*").

On or about June 12, 2003, the Department mailed RIM an initial Notice of Value for the 2004 tax year in which it valued RIM's Black Rock operations under the Agreement at $544,191. On or about August 28, 2003, the Department mailed RIM a revised Notice of Value in which it decreased the value of RIM's Black Rock operations to $406,534 for the 2004 tax year. RIM appealed the valuation on October 1, 2003, by filing a petition for review with the State Board of Equalization ("State Board"). On November 26, 2003, the State Board issued a decision in favor of RIM, ruling that its interest in Black Rock under the Agreement was not subject to tax. The Department subsequently appealed the State Board's decision by filing this action on December 17, 2003, in the Arizona Tax Court. The Department amended its complaint on December 24, 2003. RIM filed an Answer and Counterclaim on January 13, 2004, naming Apache County as an additional counter-defendant for erroneous property taxes RIM previously paid to the Apache County Treasurer.

B. DRY MESA.

On or about April 1, 1958, Texas Pacific Coal and Oil Company, the Pure Oil Company, Monsanto Chemical Company and Sun Oil Company entered into a lease agreement (the "Lease") with the Tribe to extract oil and gas reserves from Dry Mesa.

After several intervening lease assignments, Dry Mesa Corporation as the sole lessee on or about July 3, 1997, assigned record title and operating rights under the Lease to Coleman Oil and Gas, Inc. ("Coleman"). Coleman subsequently assigned all its rights, title and operating interest under the Lease to RIM on August 1, 2001. Both RIM and Coleman have paid tax on their operations under the Lease to the Apache County Treasurer.

On or about June 12, 2003, the Department mailed RIM an initial Notice of Value for the 2004 tax year in which it valued RIM's Dry Mesa operations under the Lease at $256,766. The Department mailed RIM a revised Notice of Value on or about August 28, 2003, in which it decreased the value of RIM's Dry Mesa operations to $213,020 for the 2004 tax year. As with Black Rock, RIM appealed this valuation on October 1, 2003, by filing a petition for review with the State Board. On November 26, 2003, the State Board issued a decision in favor of RIM, ruling that the Dry Mesa interests under the Lease were not subject to tax. The Department appealed the State Board's decision by filing this action on December 17, 2003, in the Arizona Tax Court. The Department amended their complaint on December 24, 2003. RIM filed an Answer and Counterclaim on January 13, 2004, naming Apache County as an additional counter-defendant for erroneous property taxes RIM previously paid to the Apache County Treasurer.

III. ARGUMENTS OF THE PARTIES

- RIM Southwest Corporation's Arguments -

A. RIM'S INTERESTS ARE NOT SUBJECT TO TAX AS A MATTER OF LAW.

1. THE ARIZONA CONSTITUTION.

Tribal property located on reservation land is not subject to *ad valorem* property tax in Arizona. Article XX, ¶ Fifth of the Arizona Constitution prohibits the imposition of tax "on any lands or other property within an Indian reservation owned or held by any Indian." In addition, Article IX, § 2 of the Arizona Constitution specifically exempts from taxation all property of a governmental entity.

2. THE FEDERAL PREEMPTION DOCTRINE.

The doctrine of federal preemption also precludes the state from imposing property taxes on such operations. The state is generally prohibited from enforcing its tax laws against the Tribe on the Tribe's reservation. *Mescalero Apache Tribe v. Jones*, 411 U.S. 145, 93 S. Ct. 1267 (1973); *Pimalco, Inc. V. Maricopa County*, 188 Ariz. 550, 937 P.2d 1198 (App. 1997).

In *Williams v. Lee*, 358 U.S. 217, 79 S. Ct. 269 (1959) the Court examined the history of the establishment of Indian reservations and the various states' attempts to establish jurisdiction over those lands and people. The Court concluded:

> In a general statute Congress did express its willingness to have any State assume jurisdiction over reservation Indians if the State Legislature or the people vote affirmatively to accept such responsibility. To date, Arizona has not accepted jurisdiction, possibly because the people of the State anticipate that the burdens accompanying such power might be considerable.

Id. at 222, 79 S. Ct. at 272. In the middle of this citation is a reference to footnote 10, which states, in part: "Arizona has an express disclaimer of jurisdiction over Indian lands in its Enabling Act, s 20, 36 Stat. 569, A.R.S., and in Art. XX, Fourth, of its Constitution, A.R.S."

In another case involving Arizona's attempts to impose tax on reservation activities, *McClanahan v. State Tax Commission of Arizona*, 411 U.S. 164, 180, 93 S. Ct. 1257, 1266 (1973), the U.S. Supreme Court stated:

> If Montana may not assume jurisdiction over the Blackfeet by simple legislation even when the Tribe itself agrees to be bound by state law, it surely follows that Arizona may not assume such jurisdiction in the absence of Tribal agreement… However relevant the land-income distinction may be in other contexts, it is plainly irrelevant when, as here, the tax is resisted because the State is totally lacking in jurisdiction over both the people and the lands it seeks to tax. In such a situation, the State has no more jurisdiction to reach income generated on reservation lands than to tax the land itself.

Id. at 181, 93 S. Ct. at 1267.

Since the holding in *Williams*, there has been no amendment to Article XX of the Arizona Constitution. And similarly, there has been no Congressional enactment ceding jurisdiction over the Navajo Reservation to the State of Arizona. Absent some specific amendment to the federal or state constitutions, Arizona has no jurisdiction whatsoever over Tribal property located on reservation land.

3. ARIZONA PROPERTY TAX STATUTES.

The state's power to value and tax oil and gas interests is limited by statute only to land under the state's jurisdiction. Specifically, § 42-14102 grants the Department the authority to annually value all producing oil, gas and geothermal interests in Arizona. The term "producing" is statutorily defined as "any taking of oil or gas from any land in this state that is under the state's jurisdiction." A.R.S. § 42-14101(6). The parties are in agreement that reservation land is

not land under the jurisdiction of the state. RIM therefore holds no oil and gas "producing" interests over which the Department has taxing authority.

B. NOTHING IN THE LAW CHANGED TO WARRANT THE REVERSAL OF THE DEPARTMENT'S LONG-STANDING POLICY NOT TO TAX THE INTEREST IN BLACK ROCK.

On two separate occasions in 1990 and 1996, the Department confirmed in writing that the interest in Black Rock was not subject to tax. The Department noted that its position was subject to change based upon legal decisions rendered by state or federal courts. However, in 2003 the Department elected to tax the interest in Black Rock relying on *Kerr-McGee*, a decision from 1976 that existed at the time the Department issued its two prior determinations not to tax the interest in Black Rock. The Department now backtracks from relying solely on *Kerr-McGee* and contends that *Pimalco* "deal[s] with taxation of possessory interests in a manner that [is] favorable to [the] Department's later-adopted position." The Department's reliance on *Pimalco*, however, is misplaced.

In *Pimalco*, the taxpayers sought a refund of the possessory interest taxes they had paid under protest for the 1993 tax year and joined the Gila River Indian Community in challenging the validity of the possessory interest tax as applied to leasehold interests in Indian land. Ruling against the taxpayers and tribe, the Court of Appeals held that leasehold interests constituted taxable possessory interests and that the possessory interest tax was validly applied. Arizona, however, repealed the possessory interest tax in 1995. *Pimalco* therefore is a case limited in scope and application to the 1993 tax year, and thus has no bearing whatsoever to the issue presently before the court.

The Department is bound by its long-standing interpretation of "producing" unless it is manifestly erroneous.

C. *KERR-MCGEE* IS DISTINGUISHABLE AND, AT BEST, IS A CASE OF LIMITED APPLICATION.

Kerr-McGee was decided nearly 30 years ago under A.R.S. § 42-227.01, the predecessor to A.R.S. § 42-14101(6). A.R.S. § 42-227.01 was arguably more favorable to the Department's position as it could have been construed to allow the taxation of oil and gas production from any lands within the state. In addition, unlike the instant case, the statutory limitations placed upon the Department's ability to tax lands within the state's jurisdiction was never raised or addressed in *Kerr-McGee*. Most significantly, *Kerr-McGee* was also decided before Arizona's adoption in 1985 and subsequent repeal in 1995 of the possessory interest tax. The Department contends if the operative documents that bestow the grant create something that is tantamount to fee ownership, that interest under *Kerr-McGee* is taxable. If, however, the operative documents create some other type of interest such as a leasehold or possessory interest, Arizona law currently mandates that all such interests are not subject to tax.

In *Kerr-McGee*, the Supreme Court held that the lease at issue, in effect, created a freehold ownership interest in the land that was subject to tax because the terms of the lease granted oil and gas extraction rights that could perpetually endure with no possibility of termination. RIM's interests in Black Rock and Dry Mesa, however, are not tantamount to fee ownership insofar as RIM's interest in Black Rock is for a specified and limited duration. In addition, both the Operating Agreement and Dry Mesa Lease contain default and/or termination provisions, which either party may elect to invoke as circumstances warrant. RIM's interest in both Black Rock and Dry Mesa are therefore non-freehold interests and thus are not subject to taxation under the ruling in *Kerr-McGee*.

D. THE DEPARTMENT VIOLATES THE UNIFORMITY CLAUSE OF THE ARIZONA CONSTITUTION, ARTICLE IX, § 1.

Lastly, to the extent the Department contends based on *Kerr-McGee* or *Pimalco* that all non-tribal interests in oil and gas production on tribal lands are subject to state jurisdiction and thus taxable, the Department's interpretation and application of the statutes and applicable case law would violate the Uniformity Clause of the Arizona Constitution, Article IX, § 1. Arizona's Uniformity Clause requires that taxes be uniform on the same class of property. *Aileen Char Life Interest v. Maricopa County*, 208 Ariz. 286, 93 P.3d 486 (2004). In examining the meaning of the word "class" for Uniformity Clause purposes, the Arizona Supreme Court in *Apache County v. Atchison, Topeka and Santa Fe Railway Co.*, 106 Ariz. 356, 476 P.2d 657 (1970) stated:

> "A class may be the grouping together of persons or things for a common purpose or it may be a ranking of persons or things possessing the same attributes … the word "class," however, in Article IX, § 1 is obviously used in the latter sense, meaning the grouping of persons or things possessing common attributes." *Id.* at 359, 476 P.2d at 660.

Thus for purposes of uniformity, property possessing similar attributes must be taxed in the same manner. *America West Airlines v. Dep't. Of Revenue*, 179 Ariz. 528, 880 P.2d 1074 (1994). Oil and gas, like coal and copper, are all naturally occurring minerals that are subject to extraction from the earth. Yet, despite sharing these common attributes, the Department fails to tax these mineral interests uniformly thereby violating the Uniformity Clause.

In *Navajo County v. Peabody Coal Company*, 23 Ariz. App. 101, 530 P.2d 1134 (App. 1975), decided a year before *Kerr-McGee*, the Court of Appeals held that the interest of Peabody Coal Company under a lease to mine coal on the Navajo Reservation was not tantamount to fee ownership. The court found that Peabody had some interest under the lease, but it was not fee ownership. The court further stated: "the intention of the Legislature not to tax leasehold interests is clear." *Id.* at 103, 503 P.2d at 1136. As a result, the Department has repeatedly made it its practice not to tax leasehold interests in coal mines located on reservation land.

The Department's differing interpretations of the statutes and applicable case law that relate to the valuation of these naturally occurring minerals for property tax purposes renders some taxable and other non-taxable based solely on the composition of the mineral. This practice constitutes a violation of the Uniformity Clause.

- Arizona Department of Revenue's Arguments -

A. RIM HAS A TAXABLE INTEREST AS DEFINED BY LAW.

1. RIM'S DRY MESA INTEREST.

RIM's Dry Mesa interest originated with a 1958 lease that granted the lessees "the exclusive right and privilege to drill for, mine, extract, remove and dispose of all the oil and natural gas deposits." The lease further provided that enjoyment of the Leasehold shall be for the term of 10 years from after the approval of the Secretary of the Interior "and as much longer thereafter as oil and/or gas is produced in paying quantities from said land." That particular clause brings the Dry Mesa interest squarely in line with the holding in *Kerr-McGee,* 113 Ariz. 248, 550 P.2d 626 (1976).

In that case, the State and various governmental entities in Apache County filed a special action in the Supreme Court to determine whether Kerr-McGee Corporation, the real party in interest, could be taxed as a producer under former A.R.S. § 42-227.04, which provided that "producing oil and gas interests shall be listed, the valuation shall be determined and they shall be taxed individually as separate parcels of real estate separate and apart from the rest of the land where they are owned by a person other than the owner of the rest of the land." A.R.S. § 42-14105(A) provides for the valuation of producing oil, gas and geothermal interests, and 42-14106 states that the valuation of such interests owned by a person other than the owner of the land "shall be determined and the interests shall be taxed individually as separate parcels of real estate separate from the land," a phrase that is identical to the valuation statute being construed in *Kerr-McGee.*

The taxpayer in *Kerr-McGee* first argued that its interests could not be taxed because the law permitted imposition of tax only on the owner of the oil and gas interest. The Court dismissed that rationale because of the definitions in the oil and gas tax statutes, which, as in today's statute, extended taxation to those with producing oil and gas interests, not necessarily having ownership of the real property. More importantly, the Supreme Court held that the terms of the lease, in effect, created an ownership interest in the land notwithstanding the fact that the Tribe was the actual owner of the land and the oil and gas contained within it.

Pointing to the fact that the lease was for an initial term of ten years and "as much longer thereafter as oil and/or gas is produced in paying quantities from said land," *Kerr-McGee* held that the Lease created a qualified or determinable fee, which it determined to be a freehold estate in the land. Given identical terms in the Dry Mesa lease, the lease which RIM

acquired as successor in interest to the 1958 agreement appears to possess a qualified or determinable fee interest in the land.

2. RIM'S BLACK ROCK INTEREST.

Unlike its Dry Mesa interest, RIM's Black Rock interest came from a document styled an "Operating Agreement," which the Tribe signed with Chuska. The Agreement gave Chuska exclusive rights in the Black Rock Field as oil and gas developer with a duty "to explore for, develop, manage, service and sell" the production of the field. The extremely large amounts of up-front and incremental payments that the Operator was to pay the Tribe for the right to explore for, develop and sell the Tribe's oil makes the Agreement look very much like an oil and gas lease. Paragraph 13 of the Operating Agreement calls for a maximum term of 25 years for all drilling blocks not surrendered pursuant to Paragraph 12. Arguably, the grant is not capable of lasting forever and being described as a qualified or determinable fee, as was the case in *Kerr-McGee*.

Property taxation of oil, gas and geothermal properties, however, is not limited to parties owning the land where the oil, gas, and geothermal resources are located. A.R.S. § 42-14106 states:

> If producing oil, gas and geothermal interests are owned by a person other than the owner of the land, they shall be listed, the valuation shall be determined and the interests shall be taxed individually as separate parcels of real estate separate from the land.

The terms produced, producing or production are defined as "any taking of oil or gas from any land in this state that is under the state's jurisdiction." A.R.S. § 42-14101(6). A.R.S. 42-14106 does not exclusively tax producers, although that term is defined extensively and provides a description of a number of taxable interests. The statute does not provide a definition for the term interest. Under *Kerr-McGee,* a leasehold interest is clearly taxable. Moreover, the word interest is used in the Restatement of Property generically to include varying aggregates of rights, privileges, powers and immunities and distributively to mean any one of them. *Black's Law Dictionary* 729 (5th ed. 1979).

In viewing the Operating Agreement, it is important to note that the character of an instrument is not determined by the name given it, nor by the definitions contained therein, but by the general legal effect of its terms. *Holdren v. Peterson,* 82 P.2d 1095, 52 Ariz. 429 (1938). Paragraph 14 of the Operating Agreement utilizes the terms rental and rental fee in describing payment due the Tribe for acreage not put into production. Perhaps the most persuasive argument for calling the Agreement a lease is by reference to BLACK'S LAW DICTIONARY (5th ed. 1979), which defines oil and gas lease as the "grant of right to extract oil and/or gas from the land." *Id. at* 979. The RIM Operating Agreement clearly creates that right.

B. RIM OWNS TAXABLE "PRODUCING INTERESTS" IN THE FIELDS.

RIM asserts that its interests in the two fields do not constitute "producing" interests as defined in A.R.S. § 42-14101(6), which defines "produced", "producing," or "production" as "any taking of oil or gas from any land in this state that is under the state's jurisdiction." The above definition was created by Laws 1997, Ch. 150, § 172, effective January 1, 1999, as part of the recodification of the state tax code. Prior to recodification, the three above terms were defined, at former A.R.S. § 42-227.01(6), as "any taking of oil or gas from any lands within the state of Arizona or under its jurisdiction."

Although an appellate court normally assigns plain meaning to the words of a statute, courts will not do so when a plain meaning interpretation is at odds with the Legislature's intent. *State v. Vogel*, 207 Ariz. 280, 85 P.3d 497 (App. 2004). A review of the history surrounding the present statute reveals that the present form of the statute is at odds with legislative history that repeatedly stressed the fact that the purpose of the 1997 tax code recodification was "solely to recodify the existing statute law of taxation in Arizona," and "[t]hat the interpretation and construction of the provisions of the tax code shall not be changed solely due to changes that may have been made to the text of the tax code" by the recodification. Laws 1997, Ch. 150 §§ 175(A) and (C).

Recently, the Court of Appeals has addressed the issue of changed language brought about by recodification, holding:

> [w]hen statutes are changed as part of a recodification and the function of the new statute is identical in form to the former provision, it is presumed the Legislature meant to continue the same intent, even when the language of the new statute is not identical to the former. *See Vielma v. Eureka Co.*, 218 F.3d 458 (5th Cir. 2000); *see also* 73 Am.Jur.2d Statutes §224 (2001)…*State v. Kelly (Abdullah)*, 425 Ariz. Adv. Rep. 5 (App. 2005).

Plainly, Arizona law gives full effect to legislative expressions stating that a recodification is simply a reorganization of existing law, with no intent to amend the law, as would be the effect of limiting the definition of the term "producing" to "taking of oil or gas from any land in this state that is under the state's jurisdiction." Accordingly, RIM owns producing interests in Black Rock and Dry Mesa and that both interests are properly subject to valuation and assessment.

C. RIM'S RELIANCE ON PROVISIONS OF THE ARIZONA CONSTITUTION AND THE FEDERAL PREEMPTION DOCTRINE IS ENTIRELY INAPPOSITE.

RIM's reliance on the Arizona Constitution and federal preemption as they pertain to the imposition of tax on lands or other properties owned or held by Indians within the Indian

Reservations is entirely inapposite. The Department has not sought to value or assess taxes upon the lands or property owned or held by any Indian on the Indian Reservation where the oil and gas is located. Moreover, Apache County has not fixed, levied or assessed any taxes against the Tribe. RIM has not provided any evidence to suggest that it is a tribally owned entity. Rather, the Department is seeking to value the interests of non-tribal entities owning interests in the production of gas and oil wells that are located on the Tribal property.

RIM's reliance on *Williams v. Lee*, 358 U.S. 217, 79 S. Ct. 269 (1959) and *McClanahan v. State Tax Comm'n of Arizona,* 411 U.S. 164, 93 St. Ct. 1257 (1973) does not lend support to the argument that Arizona is preempted, either by federal law or its own constitution, from imposing property tax on the interests of non-tribal entities who own interests in oil and gas fields owned by the Tribe. *Williams* held that Arizona's courts did not have jurisdiction to hear a case brought by a non-tribal store operator, licensed to operate on reservation lands by the federal government, to collect for goods sold to Tribal members. *McClanahan* focused on whether Arizona was entitled to tax the income of reservation Indians when that income was derived solely from reservation sources. The primary issue in both cases was whether Arizona had jurisdiction over Tribal members. Neither case dealt with Arizona's right to impose tax on non-tribal entities operating on Tribal lands, or in conjunction with the Tribe.

The Department is not asserting its right of taxation over the Tribe. Rather, the State is asserting its tax laws against a non-tribal entity that is operating, or holds an interest in, an activity on the reservation. Case law, particularly as set forth in *Pimalco, Inc. V. Maricopa County*, 188 Ariz. 550, 937 P.2d 1198 (App. 1997), negates the presumption that RIM claims exists. *Pimalco* took note of the Ninth Circuit Court of Appeal's decision in *Gila River Indian Community vs. Waddell*, 91 F.3d 1232, 1239 (9th Cir. 1996) where the court held that the federal statutes and regulations governing the lease of trust land did not preempt state sales tax on ticket sales by non-Indians to non-Indians for events held on the reservation. See also, *Salt River Pima-Maricopa Indian Community v. State of Arizona*, 50 F.3d 734, 736 (9th Cir. 1995) (state law on sales of non-Indian goods by non-Indians to non-Indians at shopping center on leased reservation land not preempted); *Fort Mohave Tribe v. V. San Bernardino County*, 543 F.2d 1253 (9th Cir. 1976) *cert. denied*, 430 U.S. 983, 97 S.Ct. 1678, 52 L.Ed.2d 377 (1977) (state taxation of non-Indians' possessory interest in Indian lands not preempted). In particular, the *Gila River* court held that "in the field of taxation. . . The laws of both state and Tribe may be enforced simultaneously" and rejected the argument that "the mere existence of federal oversight over leasing of Indian lands preempts a state tax." *Id*. at 1393. Questions of whether federal legislation has pre-empted state taxation of interests in Indian land are not resolved by reference to standards of pre-emption that have developed in other areas of the law, and are not controlled by "mechanical or absolute conceptions of state or Tribal sovereignty." *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 145, 100 S.Ct. 2578, 2584, 65 L.Ed.2d 665 (1980).

D. THE DEPARTMENT IS NOT BOUND BY ITS LONG-STANDING POSITION.

RIM's argument that the Department must be bound by its long-standing interpretation of "producing" unless it is manifestly erroneous is incorrect. And even if the argument were correct, the argument would result in this Court having to uphold the Department's long-standing interpretation of those terms with regard to the Dry Mesa interest, which has been valued and taxed by the Department for in excess of 20 years.

RIM argues that long-standing interpretation of a statute by the agency entrusted with its administration should be given considerable deference. However, the aim of that particular rule of statutory interpretation is to establish legislative intent when a statutory ambiguity exists. *City of Mesa v. Killingsworth*, 96 Ariz. 291, 295, 394 P.2d 410, 413 (1964). RIM has not provided any basis for establishing that the Department's position respecting the Black Rock interest was premised upon uncertainty in the reading of an ambiguous valuation statute. Moreover, if RIM is arguing that ambiguity in the term "producer" comes about because of the Legislature's amendment of the valuation statute to limit the definition of "producing" to the taking of oil or gas from any landing this state under the jurisdiction of the state of Arizona (rather than those from any lands "within the State of Arizona or under its jurisdiction"), RIM ignores the fact that the statute was not altered until the amendment that took place in the tax code recodification passed in 1997, to be effective January 1, 1999. Laws 1997, Ch. 150, § 172, effective January 1, 1999. Consequently, the Department's position in letters in 1990 and 1996 has no bearing whatsoever regarding the amended language of the statute.

E. RIM'S RELIANCE UPON *LONG V. DICK* IS MISPLACED.

RIM's reliance upon *Long v. Dick*, 87 Ariz. 25, 347 P.2d 581 (1959), and *Bohannon v. Corporation Commission*, 82 Ariz. 25, 347 P.2d 581 (1959) is misplaced since the circumstances under which the administrative interpretation of a statute is binding pertains to where a court is attempting to construe an ambiguous statute. As a rule of statutory construction, the holdings in *Long, Bohannon,* and *City of Mesa v. Killingsworth*, 96 Ariz. 290, 394 P.2d 410 (1964), are largely premised upon the viewpoint that the administrative response to legislation helps place legislative intent into context, particularly since the Legislature, faced with the opportunity to amend otherwise "ambiguous" statutes, is presumed to know of the administrative interpretation. Hence, the administrative treatment of the law tends to corroborate legislative intent. However, when the administrative decision has to do with its interpretation of a particular document, such as the RIM Operating Agreement, and whether the document creates an interest in the production from the Black Rock Field, it can hardly be said that the administrative treatment of the taxpayer is necessarily tied to the question of how the Department is construing the words of a statute.

Arizona courts have recognized that the government must be free to correct a mistake of law. *Thomas & King, Inc. V. City of Phoenix*, 429 Ariz. Adv. Rep. 68, 71, 92 P.3d 429, 436 (2004). Hence, even if the Department and/or its counsel incorrectly analyzed the taxability of the Black Rock interest, that mistake is not immutable. Although RIM argues that a change of position is unwarranted because injustices are likely to result after a long period of time during which many rights will necessarily have been acquired (citing *Killingworth, supra.*, at p. 3, ll),

RIM has not presented this Court with any admissible evidence to show RIM's reliance on the Department's position, much less any injustices arising therefrom.

F. RIM IGNORES THE PLAIN IMPORT OF THE WORD "OR" IN ANALYZING FORMER A.R.S. § 42-227.01.

In analyzing former A.R.S. § 42-227.01, RIM ignores the plain import of the word "or", which was a key component of the statute that defined "produced," "producing" or "production" as "any taking of oil or gas from any lands within the state of Arizona or under its jurisdiction." Departing from the precept that words and phrases shall be construed according to the common and approved use of the language, A.R.S. § 1-213, RIM concludes that *or* actually meant *and* by arguing that the former statute limited taxation of oil and gas interests (not the reserves) from producing wells to those lands in the state that are under the state's jurisdiction. The word "or" is a disjunctive particle used to express an alternative or to give a choice of one among two or more things. Black's Law Dictionary 1095 (6th ed.) Using that definition of the word "or" means that the term "producing" (as in a producing well) is defined by the taking of oil or gas from any lands within the State of Arizona. Apache County is clearly within the State of Arizona, which is the situs of the wells in question. RIM does not distinguish any of the cases cited by the Department that pertain to changes in law mistakenly wrought by recodification.

G. THE TAX IS A VALID TAX ON PRODUCING OIL AND GAS INTERESTS.

RIM argues that *Kerr-McGee* never raised or addressed "the statutory limitations placed upon the Department's ability to tax lands within the state's jurisdiction" and failed to "examine the authority granted to the Department by the Legislature along with its corresponding limitations." However, the tax is a tax on producing oil and gas interests, not a tax on the wells, the land on which the wells sit or the reserves themselves. "*Kerr-McGee*, by reason of its lease, has a producing oil and gas interest, which must be valued for tax purposes at the amount of the gross yield for the preceding calendar year … and which shall, by § 42-277.04, be separately taxed apart from the rest of the land." *Id*. 113 Ariz. at 249, 500 P.2d at 627. A.R.S. § 42-14105(B) likewise states that "[t]his valuation does not affect the valuation of property other than the producing oil, gas or geothermal interests." The statute is silent about valuing land, except to state that if the interests are owned by a person other than the owner of the land, "they shall be listed, the valuation shall be determined and the interests shall be taxed individually as separate parcels of real estate separate from the land." A.R.S. § 42-14106. To the extent that *Kerr-McGee* even addressed the issue of a freehold estate, it was not a necessary component of the court's finding, having found that Kerr-McGee possessed an interest in production. RIM attempts to distinguish the operating agreement at Black Rock from the Dry Mesa lease. However, it has failed to show that the agreements do not constitute valid interests in production, whether freehold or otherwise.

H. THE *KERR-MCGEE* DECISION ALLOWS FOR THE TAXATION OF POSSESSORY INTERESTS IN OIL AND GAS INTERESTS ARISING OUT OF

CONTRACTUAL ARRANGEMENTS WITH INDIAN TRIBES.

As for RIM's discussion of possessory interests and "the decade-long legal struggle with the posessory interest tax" between 1985 and 1995, RIM ignores the historical context of the *Kerr-McGee* holding in the face of similar fact circumstances involving mining properties in which the Court of Appeals declined to uphold other valuation statutes as not firmly addressing possessory interests. It must be presumed that the Arizona Supreme Court, ruling in *Kerr-McGee*, was aware of the Court of Appeals holdings in *Pima County v. American Smelting and Refining*, 21 Ariz. App. 406, 520 P.2d 319 (1974) and *Navajo County v. Peabody Coal*, 23 Ariz. App. 101, 530 P.2d 1134 (1975), which held that the valuation statute for mining did not have the adequate legislative specificity to tax possessory interests. Notwithstanding that knowledge, *Kerr-McGee* upheld the statute for valuating oil and gas interests, which was written broadly enough to encompass the taxation of possessory interests in oil and gas interests arising out of contractual arrangements with Indian Tribes.

I. THE DEPARTMENT'S POSITION DOES NOT VIOLATE THE UNIFORMITY CLAUSE OF THE ARIZONA CONSTITUTION, ARTICLE IX, § 1.

RIM's Uniformity Clause argument begins with the premise that the there was no statutory authority in the mining valuation statute for the taxation of leasehold interests, which is a legal determination affirmed by the Supreme Court in *Peabody Coal Co. V. Navajo County*, 117 Ariz. 335, 572 P.2d 797 (1977). RIM makes its Uniformity Clause argument based upon the premise that oil and gas interests should not be classified differently than copper and coal mining interests. The power to classify property for tax purposes is legislative and the state may exercise wide discretion in selection of the subjects of taxation. *Apache County v. Atchison, T & S. F. Ry. Co.*, 106 Ariz. 356, 476 P.2d 657, appeal dismissed 91 St. Ct. 1257, 401 U.S. 1005, 28 L.Ed.2d 542 (1970). Here, the Legislature has determined that oil and gas interests should be placed in a separate class and treated as specified. RIM's assertion that "for purposes of uniformity, property possessing similar attributes must be taxed in the same manner" and that "the Department fails to tax these mineral interest uniformly" ignores that the Legislature has classified oil and gas interests differently.

To determine whether a property tax classification violates the Uniformity Clause, a court must consider whether the taxpayer and the comparison taxpayers are (1) direct competitors, (2) using the same equipment types, and (3) providing identical services (4) to the same customer base. Additional factors include the property's physical attributes, productivity, use and purpose. *Citizens Telecommunications Co. Of White Mountains v. Arizona Dept. Of Rev.*, 75 P.3d 123 (App. Div.1 2003). An oil and gas company is not a direct competitor of a copper producer and does not provide the same services to the same customer base. Likewise, the equipment used in mining, which requires excavation or tunneling and the removal of earth by earth moving equipment differs from the equipment used in the extraction of oil and gas, which is largely accomplished through drilling and the piped removal of the product via pressure, rather than via motor vehicle. Hence, while there may be common attributes between oil and gas extraction and

copper and coal excavation, there are enough differences to support creating separate property tax classifications for mines and oil and gas interests.

RIM's Uniformity Clause argument fails because there is no requirement for uniform treatment between classes of property; the uniformity that the Constitution requires is uniform treatment within classes. "Except as provided by § 18 of this Article, all taxes shall be uniform upon the same class of property . . ." Ariz. Const. Art. 9, § 1. Hence, the uniform taxation of RIM's interests within the oil and gas classification is not constitutionally at odds with the tax treatment of interests in a different class of property that the Legislature has created.

IV. THE COURT'S FINDINGS AND CONCLUSIONS

As this case involves the valuation by the Department of two separate oil and gas interests owned by RIM, the Court addresses each interest separately.

First, with respect to Dry Mesa, the Court concurs with Plaintiff's argument that the language of the lease agreement, which provides that enjoyment of the leasehold shall be for the term of 10 years from after the approval of the Secretary of the Interior "and as much longer thereafter as oil and/or gas is produced in paying quantities from said land," brings the Dry Mesa interest squarely within the holding in *Kerr-McGee.* Therefore, Plaintiff's valuation and taxation of Defendant's Dry Mesa interest is correct as it has been for the past twenty plus years. Although Defendant may be accurate that the Supreme Court in *Kerr-McGee* never considered the statutory limitations placed upon the Department's ability to tax lands within the state's jurisdiction, this Court is nevertheless bound to follow the Supreme Court's clear decision.

Second, regarding Black Rock, the Court agrees with Defendant that it is not subject to valuation and taxation by Plaintiff. The Court agrees that *Kerr-McGee* is distinguishable and does not apply to Defendant's interest in Black Rock. Defendant's interest in Black Rock was established by an Operating Agreement not a lease agreement. Further, the grant is not capable of lasting forever and being described as a qualified or determinable fee, as was the case in *Kerr-McGee*. Finally, the Black Rock interest is located on or beneath Tribal land that is not under the state's jurisdiction. *See* A.R.S. § 42-14101(6). Plaintiff has not convinced the Court that it should ignore the plain language of the statute even if it was part of a recodification. Nor, as argued by Defendant, has Plaintiff offered sufficient reasons to warrant the reversal of its long-standing policy not to tax the interest in Black Rock.

Finally, for the reasons advocated by Plaintiff, the Court finds that Defendant has failed to establish a prima facie case of a Uniformity Clause violation. Therefore, the Court declines to grant relief on that basis.

IT IS THEREFORE ORDERED granting in part and denying in part both motions to the extent stated above.

IT IS FURTHER ORDERED that both sides shall bear their own costs and attorneys' fees.