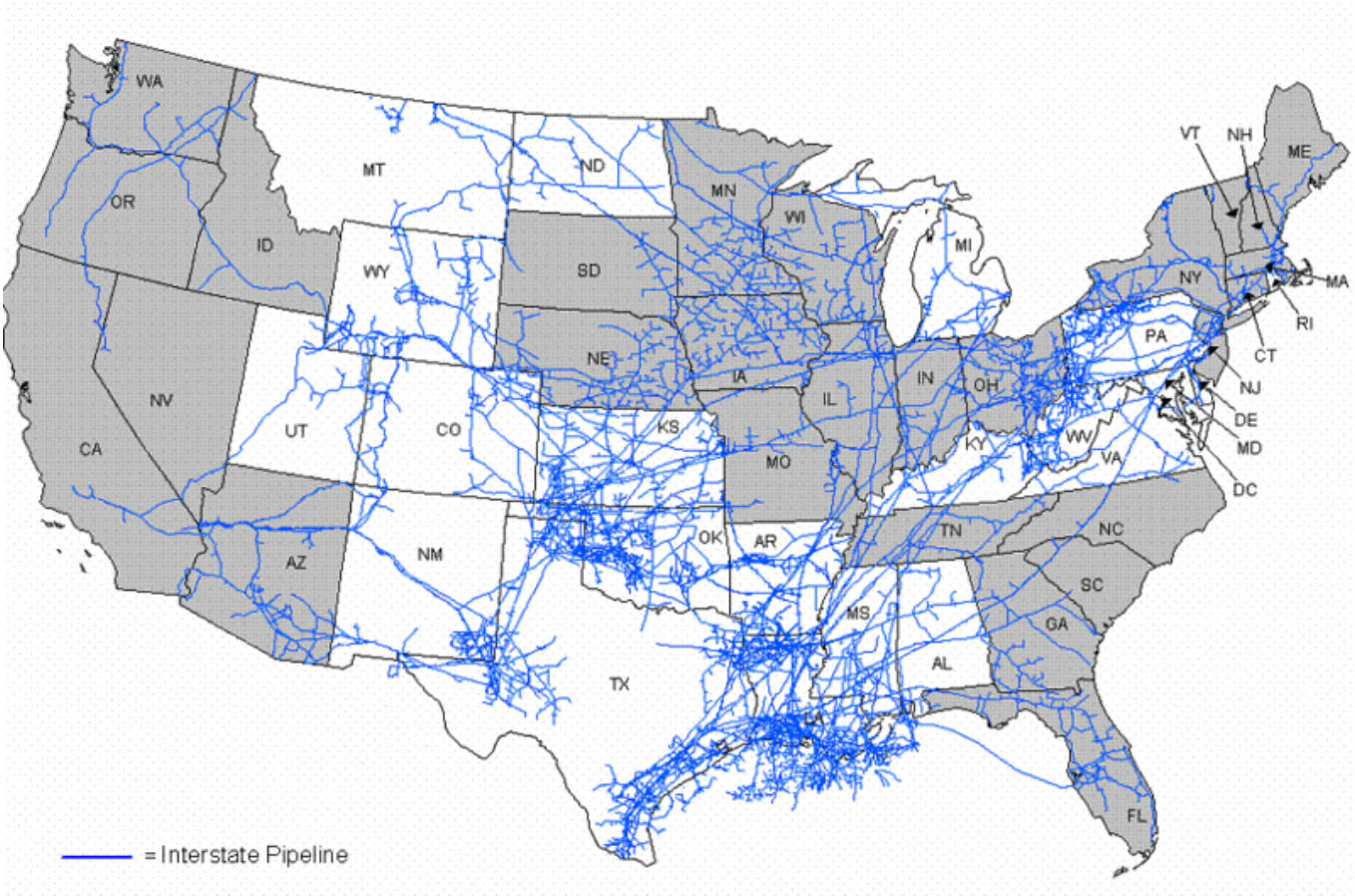
THE COMMERCE CLAUSE AND AD VALOREM TAXATION OF GAS, OIL, AND PETROLEUM PRODUCTS [1]



International Association Of Assessing Officers
32nd Annual Legal Seminar
December 8 & 9, 2011
New Orleans, Louisiana

Mario L. Dell'Osso
OLSON & OLSON, L.L.P.
Houston, Texas
www.olsonolson.com

[1] Map: http://205.254.135.24/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/interstate.html

INDEX

A. BACKGROUND: TAXATION & THE COMMERCE CLAUSE

1. INTRODUCTION [2]

Taxation of Interstate Activities under the Commerce Clause. Following the presentation of background, this paper will address developments affecting the interstate commerce exemption from ad valorem taxation of gas, oil, and other petroleum products under the Commerce Clause:

> **Congress shall have Power … to regulate Commerce … among the several states ….**

U. S. Const., art. I, § 8, cl. 3 (emphasis added).

To appreciate the topic of ad valorem taxation as it relates to the Commerce Clause, it is necessary to first develop the extensive background of those topics. That background is developed below.

Applicable to Other Personal Property. Generally, the same Commerce Clause principles are applicable to other personal property [3] or goods, from traveling sheep to logs transported by river, to coal oil, to sales of advertising space, to bus tickets, to natural gas and oil. (*infra*.)

— — —

[2] *This could be interesting …*

[3] This paper will not focus on instrumentalities of commerce, such as aircraft or railcars, which may receive interstate allocation based upon their use in more than one state.

2. A PERSPECTIVE ON TAXES (A/K/A EXACTIONS [4])

What Can Be Said about Taxes?

- **"No taxes can be devised which are not more or less inconvenient and unpleasant." [5]**
- **I've taken a tax deduction. You've found a loophole. They are evading their taxes. [6]**
- **"Only the little people pay taxes." [7]**
- **"Taxes are what we pay for civilized society." [8]**

Taxes are unpleasant, but necessary. However, when it appears that others are *not* required to pay their fair share, the perception of inequity - and real frustration - creep into the system. This leads to the subject at hand, ad valorem taxation of interstate commerce.

"Ad Valorem" Taxation. The Latin words mean "according to the value." [9] To assess and collect taxes according to the value of property, first it must be taxable. The exemption of goods in interstate commerce from ad valorem taxation has historically had a significant revenue impact at the state and local level. It can be said that impact is not always justified.

---

[4] "A tax is an exaction. … But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction." *State of Wisconsin v. J.C. Penney Co*., 311 U.S. 435, 443 (1940).
[5] George Washington, address of Sept. 17, 1796.
[6] Anonymous, commonly repeated saying.
[7] Statement attributed to billionaire hotel magnate, Leona Helmsley, circa 1989.
[8] The oft-quoted Oliver Wendell Holmes, Jr., in *Compania General de Tabacos de Filipinas v. Collector of Internal Revenue*, 275 U.S. 87 (1927).
[9] BLACK'S LAW DICTIONARY 57 (8th ed. 2004).

The Early Cases Disapproved of Taxation of Interstate Commerce. In early opinions of the Supreme Court goods in interstate commerce enjoyed near absolute immunity from state taxation. For example, in *Brown et al v. State of Maryland*, 25 U.S. 419 (1827), the U.S. Supreme Court held that a state license fee on imported "distilled spirituous liquors" was, in effect, a "tax" (*Id.* at 421-422) prohibited by the Commerce Clause. The Court wrote:

- **In performing the delicate and important duty of construing clauses in the constitution … which involve conflicting powers of the government of the Union, and of the respective States**, it is proper to take a view of the literal meaning of the words … and of the general objects to be accomplished …. *Id.* at 436 (emphasis added).

- From the vast inequality between the different States … as to commercial advantages, **few subjects were viewed with deeper interest, or excited more irritation, than …. [t]he general power of taxation** …. *Id*. at 438 (emphasis added).

- **It might … be said, that no State would be so blind to its own interests as to … diminish its trade. Yet the framers of our constitution have thought this a power which no State ought to exercise**. *Id.* at 440 (emphasis added).

- **We think … [*the fee*] [i]s … repugnant to that clause in the constitution which empowers "Congress to regulate commerce with foreign nations, and among the several States …"** *Id.* at 445 (insert and emphasis added).

- **The oppressed and degraded state of commerce previous to the adoption of the constitution can scarcely be forgotten**. *Id*. (emphasis added).

Salespeople. In 1887, the Supreme Court declared unconstitutional a state license tax on "drummers," although applied equally to citizens of the enacting state, holding that the power of Congress to regulate commerce among the states was exclusive, permitting

only one uniform plan of regulation. *Robbins v. Taxing Dist. of Shelby County*, 120 U.S. 489, 498-99 (1887); *see also Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888) (Invalidating a telecommunications license tax, holding "**[n]o state has the right to lay a tax on interstate commerce in any form** … such taxation is a burden on that commerce, and amounts to a regulation of it, which belongs solely to congress.") (emphasis added).

Coal Oil Received for Redistribution. In contrast, the Supreme Court found that the coal oil in issue in *General Oil Co. v. Crain*, 209 U.S. 211, 214 (1908) was subject to local taxation when received at a redistribution point, notwithstanding its separation into tanks marked "oil already sold" out-of-state, and "oil to be sold" out-of-state. The Court concluded the oil in those tanks was at an intermediate point, not actually in transit and had therefore ceased its interstate transit. *Id*. at 229-30.

Interstate Commerce MUST Pay Its Way. As the law on this subject evolved, the U.S. Supreme Court held:

"'Even interstate business must pay its way ...'"

The Court added that **"It was not the purpose of the commerce clause to relieve those engaged in interstate commerce from their just share of state tax burden even though it increases the cost of doing business."** *Western Live Stock v. Bureau of Revenue, et al*, 303 U.S. 250, 254 (1938) (upholding a state tax on the amounts received by an interstate publisher from the sale of advertising space in the enacting state) (emphasis added). More to the point, interstate commerce may be made to —

> **contribute to the cost of providing all governmental services, including those services from which it arguably receives no direct 'benefit.'** …

> [U]nless a court is to second-guess legislative decisions … it is difficult to see how the court is to go about comparing costs and benefits in order to decide whether the tax burden on an activity connected to interstate commerce is excessive.

Commonwealth Edison Co. v. Montana, 453 U.S. 609, 628 (1981) (emphasis added).

Timber in Transit by River. Two "classic" Commerce Clause cases, with different outcomes, warrant mention here. In *Coe v. Town of Errol*, 116 U.S. 517 (1886) (floated logs - taxable), the Supreme Court upheld the Town's appraisal for taxation of logs floated downriver, but detained at the Town of Errol "by low water." *Id*. at 518. Plaintiff Coe had claimed that "none of said logs were subject to taxation … in transit to market from one state to another …" by river, "a public highway for the floatage of timber …." *Id*. at 518-19. The Supreme Court disagreed with Coe, finding the stranded logs were properly "taxed as part of the general mass of property in the state … in the usual manner … not being in the course of transportation at the time …." *Id*. at 526.

Sheep in Transit on the Hoof. The Supreme Court's inquiry in *Kelley v. Rhoads*, 188 U.S. 1 (1903) (traveling sheep - not taxable) dealt with a flock of 10,000 sheep, traveling 500 miles eastward at the rate of about 9 miles per day across the state of Wyoming, from the "then territory of Utah to the state of Nebraska." Local officials attempted to collect taxes on this livestock, as personal property in Wyoming. *Id*. at 2-3. The now famous question was posed: did the sheep *graze to go*, or did the sheep *go to graze*? Were the sheep being fed incidental to their transit – just as they would be fed if shipped by rail? The Supreme Court determined the sheep *grazed to go*, and found the

tax invalid because there was no evidence "the transit of the sheep was delayed for the purpose of grazing while going through the state." *Id*. at 8.

3. THE COMMERCE CLAUSE

The Commerce Clause, Its Reach, and Interpretation. The Commerce Clause of the U.S. Constitution reads, as pertinent here:

> **The Congress shall have Power … to regulate Commerce with foreign Nations, and among the several states** ….

U. S. Const., art. I, § 8, cl. 3 (emphasis added). The Commerce Clause, as you can see, does not mention taxes or taxation. Nonetheless, it is the standard by which property taxes and other forms of taxes on interstate commerce are judged.

Roles of Congress and the Supreme Court. Within the Federal Government, Congress and the Supreme Court safeguard the flow of interstate commercial activities: Congress through its power to legislate, and the Supreme Court by interpreting the limits of the states' power to tax. The Supreme Court put it this way:

> **Congress has left it to the courts to formulate the rules … interpreting the commerce clause and its application.…** Congress has accommodated its legislation, as have the states, to these rules…. There has thus been left to the states wide scope for … regulation … provided it does not materially restrict **the free flow of commerce across state lines**, or interfere with it … which … **is of predominant national concern.… safeguarded by the commerce clause from state interference.**

Southern Pacific Co. v. State of Arizona, 325 U.S. 761, 770-71 (1945) (emphasis added) (state penalties levied on over-length trains impeded interstate commerce, contravened

the commerce clause and were invalid). The Supreme Court continues to struggle with state taxation which it finds "materially restricts" commerce among the states.

Relation To The Due Process Clause. Consideration of the commerce clause will invariably involve the ***Due Process Clause*** of the Fourteenth Amendment, which protects against the deprivation of property without due process of law. U. S. Const., amend. XIV, § 1. Regarding due process, the United States Supreme Court has established a (seemingly) straightforward inquiry:

> **A state is free to pursue its own fiscal policies**, unembarrassed by the constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given to protection which it has afforded, or to benefits which it has conferred by the fact of being an orderly, civilized society.
> ….
> That test is whether property was taken without **due process of law**. … **The simple but controlling question is whether the state has given anything for which it can ask return**. [Here] [t]he substantial privilege of carrying on business … clearly supports the tax …

State of Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444-45 (1940) (upholding a tax on interstate corporate earnings, attributable to activities in the state) (emphasis added). Though the Commerce and Due Process Clauses are often related in their application to the taxation of interstate commerce, the Due Process Clause has a broader reach: *e.g*, taxation of activities or property contained wholly within a state.

Both Clauses Together. As applied to interstate commerce, *both* the Due Process Clause (above) and the Commerce Clause require that a "fair relationship" exist between a tax and the benefits conferred by the state. In view of this overlap, both clauses are

addressed together in this paper. *See Goldberg v. Sweet*, 488 U.S. 252, 267 (1989) (tax on interstate telecommunications originating from an in-state service address did not violate the Commerce Clause: the "advantages of civilized society satisfied the requirement that the tax be **fairly related to benefits provided by the State** to the taxpayer.") (emphasis added).

Rhetorical question: What is the measure of state services "fairly related" to benefits provided by a state?

The "Dormant" Commerce Clause. No, you won't find the word "*dormant*" in the Commerce Clause, U.S. Const., art. 1, § 8, cl. 3. But within its express grant to Congress "**to regulate Commerce among the … states**," the U.S. Supreme Court—

> [has] consistently held this language to contain **a further**, **negative command, known as the dormant Commerce Clause**, **prohibiting certain state taxation** even when Congress has failed to legislate on the subject.

Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. 175, 179 (1995) (nondiscriminatory sales tax on sale of bus tickets for interstate travel upheld) (insert and emphasis added). The Supreme Court found this construction of the Commerce Clause, including this dormant command, serves (i) to prevent burdens on the flow of commerce between the states, benefiting the Nation as a whole, and (ii) preventing states from retreating into economic isolation. *Id*. at 179-80.

State Taxation of Interstate Commerce is a Nettlesome Subject. To what extent then is state taxation of interstate commercial activities limited by the Commerce Clause?

Consider this observation of the U.S. Supreme Court, addressing this complex and nettlesome subject. Referring to its prior decisions as a "**quagmire**" the Court wrote:

> [T]here is a ''**need for clearing up the tangled underbrush of past cases"** with reference to the taxing power of the States ... Commerce between the States having grown up … **and the States having understandably persisted in their efforts to get some return for the substantial benefits they have afforded it** [interstate commerce]…

Northeastern States Portland Cement Co. v. State of Minnesota, 358 U.S. 450, 457-58 (1959) (non-discriminatory State taxation of net income from interstate operations of foreign corporations did not violate the Commerce *or* Due Process Clauses) (insert and emphasis added).

Compendious Verbal Weapons. Also, consider this insight into the conundrum of taxation of interstate commerce:

> **Constitutional provisions are often so glossed over with commentary that imperceptibly we tend to construe the commentary** …. We cannot, however, be too often reminded that the limits on the … autonomous powers of the states are those in the Constitution and not **verbal weapons** imported into it. '**Taxable event**', '**jurisdiction to tax**', '**business situs**', 'extraterritoriality', **are all compendious** ways of implying … state power has nothing on which to operate.

State of Wisconsin v. J.C. Penney Co., 311 U.S. at 444 (emphasis added). In this area of the law, there is little solid guidance for either the practitioner or the assessment authorities. The proper accommodation of the Commerce Clause and the taxation of interstate commercial activities remains a quagmire.

The balance of this paper will address state efforts to be compensated for the services provided to interstate commercial activities.

— — —

B. DEVELOPMENTS: TAXATION & THE COMMERCE CLAUSE

4. THE MODERN ANALYSIS OF STATE TAXES ON INTERSTATE COMMERCE UNDER THE COMMERCE CLAUSE

The Modern Analysis: *Complete Auto Transit, Inc. v. Brady,* 1977. The United States Supreme Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), governs the *modern analysis* of state taxes on interstate commerce under the Commerce Clause.

It is important to note that earlier cases, such as *Coe v. Town of Errol*, *supra*, 1886 (floated/stranded logs taxable), still help to inform about the inquiries underlying *Complete Auto*.

Under the four-part test of *Complete Auto*, a state tax does not violate the Commerce Clause if it:

(1) is applied to an activity with a ***substantial nexus*** with the taxing state,

(2) is ***fairly apportioned***,

(3) ***does not discriminate*** against interstate commerce, and

(4) is ***fairly related to services provided*** by the state.

Id. at 279.

As applied, the test requires:

(1) Substantial nexus. The question: whether a local/state tax can be justified based on the taxable activity's connection to the taxing state. The substantial nexus requirement is "informed … by structural concerns about the effects of state regulation on the national economy. … Thus, the 'substantial nexus' requirement is not like the due process' 'minimum contacts' requirement … but rather a means for limiting state burdens on interstate commerce." *Quill Corporation v. North Dakota*, 504 U.S. 298, 312-13 (1992) (finding invalid a tax on an out-of-state office products vendor with no physical presence in the state).

(2) Fairly apportioned. The question: whether the tax is properly apportioned, such that each State taxes only its fair share of an interstate transaction. *See Oklahoma Tax Commission v. Jefferson Lines*, *Inc*., 514 U.S. at 184. The inquires include: (i) "[i]nternal consistency [whether] … the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." … and (ii) "[e]xternal consistency … whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Id.* at 185 (addressing prohibition of multiple taxation: when one state overreaches in taxation and the property is properly taxed again by another state) (insert added).

(3) Does not discriminate. The question: whether the tax discriminates by providing local businesses with a commercial advantage over those engaged in interstate

commerce. The United States Supreme Court has held, "States are barred from discriminating against foreign enterprises competing with local businesses … and from discriminating against commercial activity occurring outside the taxing State." *Oklahoma Tax Commission v. Jefferson Lines*, *Inc*., 514 U.S. at 197 (internal quotations and citations omitted).

(4) Fairly related to services provided by the state. The question: whether the amount of the tax can be justified based on the public burdens resulting from the taxpayer's activities or presence in the State. "**When a tax is assessed in proportion to a taxpayer's activities or presence in a State, the taxpayer is shouldering its fair share of supporting the State's provision of 'police and fire protection, the benefit of a trained work force, and 'the advantages of civilized society.**'" *Commonwealth Edison Company et al v. Montana*, 453 U.S. at 627 (upholding validity of severance tax on coal against Commerce Clause challenge that asserted 90% was shipped under contract to out of state utilities, thereby shifting the tax burden to other states' citizens) (emphasis added).

The Perennial Problem. In *Complete Auto* the Supreme Court began by observing, "[o]nce again we are presented with 'the perennial problem of the validity of a state tax for the privilege of carrying on within a state, certain activities' related to a corporation's operation of an interstate business." The Mississippi Supreme Court sustained a tax against a Commerce Clause challenge. The U.S. Supreme Court affirmed its validity.

If the Interstate Commerce label attaches, then what? *Both* the Mississippi and United States Supreme Courts *assumed* that the taxable event was "in *interstate commerce*." *Complete Auto* at 276. That did not end the inquiry. Attaching the "**interstate commerce label**" to the activity raised the issue of the exemption, but **did not answer any question about its taxability**. *Id.* at 279 (emphasis added). The United States Supreme Court analyzed the tax statute under the four part test.

Complete Auto dispensed once more the notion that interstate commerce should enjoy a sort of free trade immunity from taxation. The United States Supreme Court considered, but rejected, the line of authority that had supported a "sort of 'free trade' immunity" for interstate commerce. *Complete Auto* at 278, 288, 289. Citing *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938), *supra*, the Supreme Court upheld the Mississippi tax, eschewing semantics and applying a *practical analysis* of the economic effect of the tax. *Complete Auto* at 279. The Court found the tax "places no greater burden upon interstate commerce than the state places upon competing intrastate commerce of like character…." *Id*. at 282.

The Tax Under Review In *Complete Auto*. The subject tax on gross income from transportation "points within this state" was assessed against "every person **operating a pipeline**, **railroad**, **airplane**, **bus**, **truck** or … other business **for the transportation of persons or property for compensation** …." *Complete Auto* at 275 (emphasis added). GM vehicles arriving by rail from Michigan were transported by Complete Auto to

Mississippi GM dealers, usually within 48 hours. Complete Auto argued the transport "**was but one part of an interstate movement**." *Id*. at 277 (emphasis added).

Can Interstate Commerce Be Made To Pay Its Way? Yes, but ... In *Complete Auto* the Supreme Court acknowledged that "**adoption of a rule of absolute immunity for interstate commerce … would relieve this Court of difficult judgments that on occasion will have to be made**." *Complete Auto* at 289 n.15 (emphasis added). But the Court found that argument insufficient justification for abandoning the principle that —

> **"'interstate commerce may be made to pay its way.'"**

Id. (emphasis added). Again, this is a seemingly straightforward concept - in theory. Implementation is another matter.

Supreme Court Justice Scalia has it right:

> I remain of the view that **only state taxes that facially discriminate against interstate commerce violate the negative Commerce Clause** … [citations omitted]. Tax … assessed upon intrastate and interstate … at precisely the same rate … poses no constitutional difficulty.

Goldberg v. Sweet, 488 U.S. at 271 (concurring opinion) (emphasis added). Six years later Justice Scalia, joined by Justice Thomas, again wrote that passing the (single) test of **no facial discrimination against interstate commerce** was the "most" the Court could demand:

> to certify compliance with **the** "**'negative Commerce Clause"—which is "negative" not only because it negates state regulation of commerce, but also because it does *not* appear in the Constitution.**
> ….
> **I would not apply the remainder of the eminently unhelpful, so-called "four-part test" of *Complete Auto*** …. Under the *real* Commerce

> Clause (… U.S. Const., Art. I, § 8), it is for Congress to make the judgment that interstate commerce must be immunized from … nondiscriminatory state action - a judgment that may embrace … such **imponderables as how much "value [is] *fairly attributable* … within the taxing State," and what constitutes "*fair relation*** between a tax and benefits conferred … by the State."

Oklahoma Tax Commission v. Jefferson Lines, Inc., 514 U.S. at 201 (concurring opinion) (emphasis added: italics in original). **Imponderables indeed**.

C*omplete Auto* – Passing The Four-Part Test. Notwithstanding Justice Scalia's practical view (see above) — that a tax which does not facially discriminate against interstate commerce is valid — apparently a state tax must pass **each one** of the four *Complete Auto tests*, or it may be declared invalid.

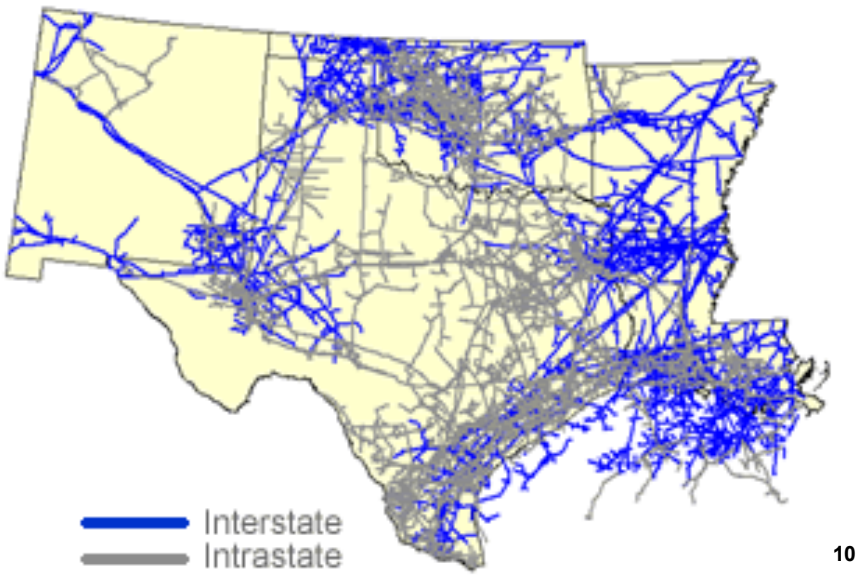
Beware: Pass 2 of the tests, and the tax under scrutiny may be invalid; pass three, and the tax may still fail. A 100% pass-rate seems to be required. *Complete Auto v. Brady*, 430 U.S. at 279. In this regard, consider these latest, and less-than-flattering, observations on the *Complete Auto* "test" expressed by Justices (i) Scalia and (ii) Thomas, respectively:

> (i) I agree … this fee does not violate the negative Commerce Clause. … without [referring] to various tests from our wardrobe of ever-changing negative Commerce Clause fashions ….
>
> (ii) I would affirm … because: " '[t]he negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application.

American Trucking Associations, Inc. v. Michigan Public Service Comm'n, 545 U.S. 429, 439 (2005) (state's flat $100 annual fee imposed on trucks engaged in commercial

hauling, collected on intrastate and interstate trucks, was focused on local activities, and did not violate the dormant Commerce Clause).

To illustrate the *quagmire* confronting practitioners, consider the cases below.



10

5. AD VALOREM TAXATION OF GAS, OIL, AND OTHER PETROLEUM PRODUCTS

Taxation of natural gas and other petroleum products in interstate commerce. Generally, **"there is no … distinction — in terms of economic effects— between … types of taxes that have been subjected to Commerce Clause scrutiny."** *Commonwealth Edison Company v. Montana*, *supra*, 453 U.S. at 616 (emphasis added). Recently, however, the validity of ad valorem taxation of stored natural gas has garnered the attention of the Supreme Court of the United States. The analysis applied to natural gas is *generally* applicable to other petroleum products, such as oil, gasoline, and diesel fuel, which can be stored and transported by pipeline.

[10] Map of Arkansas, Louisiana, New Mexico, Oklahoma, and Texas: http://205.254.135.24/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/southwest.html

To illustrate the sweep of the subject of natural gas, the Interstate Natural Gas Association of America reports that its members "operate approximately *217,000 miles of interstate pipeline* and over *160 underground storage fields* [*in 156 counties*] in *24 states* …. " Brief for Interstate Natural Gas Association of America as Amicus Curiae Supporting Petitioner, *Missouri Gas Energy v. Schmidt*, 130 S.Ct. 2141 (2010) (No. 08-1458), 2009 WL 1879518, *2 (insert added).

May a State levy an ad valorem tax on stored natural gas? In Oklahoma at least, the answer is **yes**. Recently (**2008-2010** time frame), the Oklahoma Supreme Court, *In re Assessment of Personal Property Taxes Against Missouri Gas Energy*, 234 P.3d 938 (Okla. 2008), *cert. denied*, 130 S.Ct. 1685 (2010) ("*Missouri Gas*"), was "**the first and only state court of last resort to have decided whether a State may levy an ad valorem tax on natural gas stored in the State pending transport via an interstate pipeline**." Brief of the Solicitor General for the United States as Amicus Curiae, *Missouri Gas Energy v. Schmidt*, 130 S.Ct. 2141 (2010) (No. 08-1458), 2010 WL 304443, *7 (emphasis added).

Tax assessed on natural gas stored underground. *The gas distribution company* — Missouri Gas Energy ("MGE"), a Missouri company, purchases gas from suppliers in Kansas, Oklahoma, and Texas. MGE sells no gas in Oklahoma and maintains no facilities in Oklahoma. *Missouri Gas*, 234 P.3d at 943.

The interstate pipeline and storage company — MGE contracts with Panhandle Eastern Pipeline Company ("Panhandle") for storage and transportation of the gas to

Missouri for sale to its customers. These contractual activities coincide with an injection-withdrawal cycle that matches the weather-related demand and pricing for gas. The gas is acquired in the warmer months, stored underground, and is withdrawn for customer delivery in the colder months. Panhandle, which has contracts with many gas shippers, owns and operates an interstate natural gas pipeline with branches in Texas and Oklahoma, which ultimately converge in Kansas. Panhandle also offers gas storage services to its shippers. Panhandle controls the system within which the gas is commingled. The shipper retains title to its "volume" of gas. *Id*. at 944-45.

Ad valorem taxes are assessed — The Woods County, Oklahoma Assessor assessed MGE's gas stored underground in the County on the assessment date for ad valorem taxation, by applying a FERC proportional ownership allocation formula, which was not in dispute. *Id*. at 952.

The Supreme Court of Oklahoma hears the challenge — MGE challenged the assessment. Following rulings in favor of MGE, the Oklahoma Supreme Court reversed, finding the gas was not "protected from state ad valorem taxation by the Commerce Clause …." *Id*. at 964.

Ad valorem tax on stored gas upheld against a dormant Commerce Clause challenge. The Oklahoma Supreme Court rejected MGE's (i) due process and (ii) dormant Commerce Clause challenges. The Court held that the gas "sojourn in storage in Oklahoma gives it at least a minimal nexus to this state sufficient to establish tax situs and to survive a due process attack." *Missouri Gas* at 951.

Proceeding with a *Complete Auto* analysis under the Commerce Clause, the Oklahoma Supreme Court noted there was no guiding precedent:

> **While the [U.S. Supreme] Court has applied the *Brady* test to many kinds of taxes, it has never addressed whether the *Brady* test applies to an ad valorem tax on goods in the process of being transported in interstate commerce**.

Id. at 953 (insert and emphasis added). First, the Court found that the gas in storage — over a period of months — had a substantial presence in Woods County, and was not merely passing through the state. *Id*. at 954-55. The Court also found the tax was fairly apportioned because the gas was "located in Woods County and nowhere else," and that it was not discriminatory because the tax was applied to "anyone owning property located within the state on the assessment date for the support of government services that benefit all persons and property." *Id*. at 958.

Regarding the relation of the tax to services provided by the State, MGE claimed it has no offices, or employees, or use of the State's infrastructure, and that any loss of the gas resulting from a "catastrophic event" falls on Panhandle, and it does not benefit from fire or police protection. Rejecting those arguments, the Oklahoma Supreme Court held that the tax is a general revenue tax, not a user fee, asking '"[t]he simple but controlling question … whether the state has given anything for which it can ask return.'" *Id*. at 959. The Court concluded that the MGE gas is taxed to the same extent as other personal property, and the MGE benefited from "'the advantages of a civilized society.'" *Id*.

From the Oklahoma Supreme Court to the United States Supreme Court — The Oklahoma Supreme Court held the tax did not violate the dormant Commerce Clause. MGE filed a petition for review in the United States Supreme Court.

The Supreme Court of the United States invited the Solicitor General to express the views of the United States. As requested by the Supreme Court, the Solicitor General did express the view for the United States — that the petition should be denied. It was denied. Brief for the United States as Amicus Curiae, *Missouri Gas*, at *1. The Solicitor General agreed with the Oklahoma Supreme Court:

> **No other state court of last resort or federal court of appeals has passed on the questions presented here. The Oklahoma Supreme Court applied the correct legal standard and … reached the correct result**.

Solicitor General Amicus Brief at *6 (emphasis added). The Solicitor General wrote that the "*Complete Auto* framework … has become the operative test for dormant Commerce Clause challenges to state taxes generally and provides a more comprehensive inquiry than the older 'continuity of transit' cases." *Id*. at *12.

The Solicitor General also rejected the argument that FERC's inclusion of "storage" in its definition of "transportation," for the regulatory purpose of ensuring open access to storage by non-pipeline owners, could preclude ad valorem taxation of stored gas, because "interstate commerce has no per se immunity from state taxation …. *Id*. at *16. Moreover, the Solicitor General wrote that the mere "hypothetical possibility" of multiple taxation of MGE's gas stored for months underground in Woods County, Oklahoma, did not establish a current constitutional violation. *Id*. at *20.

Conflict in rulings with decisions from Texas appellate courts. Citing two contemporaneous (**2008-2009** time frame) appellate decisions from Texas, MGE alleged a conflict in rulings which warranted certiorari review. The Solicitor General disagreed:

> **Based on the first prong of the dormant Commerce Clause test set forth in *Complete Auto* ... two Texas intermediate courts have invalidated local taxes on stored natural gas and oil** that was owned by shippers but **in the possession of an interstate pipeline operator**. *See Peoples Gas, Light, and Coke Co. v. Harrison Central Appraisal District*, 270 S.W.3d 208, 217-219 (Tex. App.—[Texarkana 2008, pet. denied]) (**natural gas stored by pipeline operator in underground facilities**) … *Midland Central Appraisal District v. BP America Production Co.* [et al.], 282 S.W.3d 215, 223-224 (Tex. App.—[Eastland 2009, pet. denied]) (**oil passing through tank farms operated by pipeline system**).

Solicitor General Amicus Brief at *7 (emphasis added). The Solicitor General argued that the conflicts which MGE highlighted between the Texas rulings invalidating ad valorem taxes on stored gas and pipeline oil, and the decision of the Oklahoma Supreme Court in *Missouri Gas* upholding the ad valorem taxation of stored gas, did not warrant review by the United States Supreme Court. Ultimately, the United States Supreme Court denied review in both of the Texas cases: 131 S.Ct. 2097 (2011).

As a result, the stored gas addressed in *Missouri Gas* is taxable in Oklahoma, but across the State line in Texas the stored gas addressed in *Peoples Gas* is not. Is there a lesson here? To borrow Justice Stewart's famous definition of the risqué, perhaps the *Complete Auto* analysis is such that: **"You can't explain it, but you know it when you see it."**

Thanks y'all & Regards,
Mario L. Dell'Osso
Olson & Olson, L.L.P.