No. 17-422

# In the Supreme Court of the United States

ETC MARKETING, LTD.,
*Petitioner*,
v.
HARRIS COUNTY APPRAISAL DISTRICT,
*Respondent*.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF TEXAS

## REPLY IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

GREGORY G. GARRE
*Counsel of Record*
ROMAN MARTINEZ
GRAHAM E. PHILLIPS
LATHAM & WATKINS LLP
555 11th Street, NW
Suite 1000
Washington, DC 20004
(202) 637-2207
Gregory.Garre@lw.com

*Counsel for Petitioner*

## TABLE OF CONTENTS

Page

## TABLE OF AUTHORITIES

Page(s)

### CASES

## TABLE OF AUTHORITIES—Continued

Page(s)

### OTHER AUTHORITIES

## ARGUMENT

The Texas Supreme Court—along with the high courts of Oklahoma and Kansas—have now all fundamentally misconstrued the Commerce Clause of the Federal Constitution to allow State taxation of natural gas temporarily stored in the course of interstate transit. And HCAD's position is that this Court should just look the other way.

As ETC and its amici have explained, the question presented is exceptionally important to a critical sector of the nation's economy. *See* Pet. 5-9, 17-19; Plains Marketing Amicus Br. 5-10; Texas Pipeline Association Amicus Br. 2-3. Natural gas is the second-largest source of energy in the United States; there are over 400 underground gas storage facilities that are spread across 26 States and store *trillions* of cubic feet of natural gas; and the tax liability at stake potentially runs to the hundreds of millions of dollars. Notably, HCAD cannot—and does not—even try to dispute the significance of the question presented. Far from it: HCAD concedes that the interstate delivery of natural gas across the Nation is important, and it opens its response by emphasizing the importance of Texas (and Harris County) to the natural gas industry. Opp. 1. That just underscores the importance of this case.

Unable to deny the significance of the question presented, HCAD instead offers an extended defense of the Texas Supreme Court's decision on the merits. But that defense is unpersuasive, especially as a basis to deny certiorari. Indeed, remarkably, HCAD just ignores *Carson Petroleum Co. v. Vial*, 279 U.S. 95 (1929)—the key precedent discussed in the petition and relied on by the dissent below (Pet. App. 52a-54a). The conflict between the decision below and *Carson*

*Petroleum* is itself a sufficient reason to grant review. But instead of trying to grapple with *Carson Petroleum*, HCAD harps on the notion that FERC's regulatory definition of "transportation" to include the temporary storage of natural gas does not *conclusively* determine the Commerce Clause analysis. Yet ETC has never taken that position. ETC's point is simply that the FERC regulation confirms the practical reality that storage is an inseparable part of natural gas transportation. HCAD offers no persuasive response to that fact.

HCAD is also on weak ground in suggesting that the question presented is not recurring or disputed. This is the *fifth* certiorari petition to raise this issue in less than a decade, and, notably, both sides of the issue—taxing authorities as well as companies forced to pay storage taxes—have sought review. Moreover, the constitutional analysis in the decision below clearly diverges from that of other state supreme court decisions. Particularly given the significance of Texas in the production and distribution of natural gas—a fact that HCAD itself emphasizes, Opp. 1—allowing the decision below to stand will only invite other jurisdictions to follow HCAD's lead and tax natural gas temporarily stored within its reach, and thus invite more litigation.

This Court's review would be merited even if gas like ETC's could face such unconstitutional state taxation only *once* in the course of its interstate journey. But because gas can be placed in storage multiple times as it works its way through the country's vast interstate natural gas pipeline network before it is ultimately consumed, letting the decision below stand would permit the same gas to be taxed

again and again by multiple jurisdictions along its path. Pet. App. 55a (dissent). Whether the Constitution permits such a burden to be placed on such an important form of interstate commerce is a question that warrants the Court's resolution.

### A. The Decision Below Conflicts With This Court's Decisions

At bottom, HCAD's position seems to be that, because "[n]atural gas is property," it can tax it. Opp. 1. But that position is fundamentally at odds with this Court's Commerce Clause precedents.

1. In particular, as ETC has explained, the Texas Supreme Court's decision upholding the tax in this case cannot be squared with the principles established by this Court's "in-transit" decisions. Pet. 21-29. HCAD does not dispute the premise of ETC's argument—that this Court's in-transit decisions remain vital and govern whether a "substantial nexus" exists for purposes of the *Complete Auto* test. *See* Pet. 21-23; Opp. 19-25. But, tellingly, HCAD just ignores the most important of those decisions—*Carson Petroleum*.

HCAD's response says literally nothing about *Carson Petroleum*. Not a word. HCAD does not embrace the Texas Supreme Court's unpersuasive attempt to distinguish the case (Pet. App. 19a-20a), it does not offer any distinctions of its own, and it does not try to respond to the dissent's (*id.* at 52a-54a), ETC's (Pet. 26-28), or ETC's amici's (Plains Marketing Amicus Br. 16-19) reading of *Carson Petroleum*. Instead, HCAD employs the "ostrich defense," burying its head in the proverbial sand and pretending that *Carson Petroleum* does not exist, no doubt hoping this Court will too. But of course *Carson Petroleum does* exist. And for the reasons explained by Chief Justice

Hecht, ETC, and ETC's amici, the decision below conflicts with it—as HCAD's total silence effectively concedes. That conflict merits this Court's review.[1]

2. Rather than engage with the most apposite precedent at the heart of ETC's petition, HCAD offers a series of unpersuasive arguments designed to simply duck review of the question presented. The first of these is that ETC's petition "ignores the facts and circumstances of this case" and instead relies on "broad generalizations about the natural gas industry." Opp. 6. That is incorrect.

To be sure, the petition describes the natural gas industry, natural gas transportation, and the critical role of underground storage. Pet. 5-9. But that is hardly surprising; the constitutional analysis established by this Court's in-transit decisions calls for an examination of how the goods at issue move in interstate commerce. The important point is that HCAD does not identify any way in which ETC has mischaracterized the process of natural gas transportation or the critical role of storage in that process. The key (and unrefuted) facts are these:

- Unlike conventional commodities—such as "furniture" (Opp. 4)—natural gas cannot be packaged, stored, and shipped by standard means. Instead, it travels through a nationwide network of pipelines that

---

[1] HCAD does acknowledge *Federal Compress & Warehouse Co. v. McLean*, 291 U.S. 17 (1934), albeit in a short bullet. Opp. 24-25. But as ETC has explained (Pet. 28-29), *McLean* supports the conclusion that once ETC entrusts its gas to the pipeline—a common carrier analogous to the *railroad* in *McLean*, not the warehouse—it is in transit in interstate commerce. HCAD, once again, just ignores that argument.

take it from the production well all the way to the consumer's stovetop or furnace.

- Unlike other commodities, natural gas is also physically commingled once it enters the pipeline system—it is impossible to distinguish one unit of gas from another once it begins its journey.

- Gas production is relatively constant, but demand fluctuates significantly based on the season, meaning that sometimes more gas is being added to the pipeline network than is being consumed.

- In order to maintain a safe operating pressure, it is critical that the transportation network contain facilities in which gas can be stored when supply outstrips demand and from which gas can be extracted when demand outstrips supply.

- Accordingly, "[t]he underground storage of natural gas is critical in assuring that overall demands and specific requirements of natural gas customers are met." Rate Regulation of Certain Natural Gas Storage Facilities, 71 Fed. Reg. 36,612, 36,613 (June 27, 2006).

HCAD does not dispute any of this, yet the unique facets of this system have direct bearing on the constitutionality of whether the gas can be taxed while it is temporarily stored during its journey from wellhead to user. *See* Pet. App. 47a-52a (dissent); Pet. 23-26. This does not mean that ETC is asking that natural gas be given "special consideration" (Opp. 6) under the dormant Commerce Clause. To the contrary. ETC is simply asking this Court to hold that its in-transit decisions compel the conclusion that gas remains "in transit" in these circumstances, even when it is temporarily stored. In suggesting that this case can be disposed of based on a crude analogy to "furniture held in a storeroom or warehouse" (Opp. 4),

HCAD is asking this Court to ignore the central teachings of those precedents.

ETC has never denied that it tends to sell its stored gas when demand and therefore price have increased; it is, after all, in the *business* of selling natural gas. But as ETC and Chief Justice Hecht explained, that does not mean the temporary stoppage breaks the continuity of transit. *See* Pet. 27-28; Pet. App. 50a-51a. Because pipelines must operate within a fixed range of pressures, it is not possible to move the gas unless there is adequate demand. As Chief Justice Hecht put the point, pipeline capacity "becomes available . . . *when* market conditions are most advantageous," and so "[t]his is all a matter of physics, not ETC's or any other gas shipper's marketing strategy." Pet. App. 50a-51a. Thus, the fact that ETC sells when the price goes up does not undermine the point that its use of storage is "for the purpose of safety and convenience in the course of movement." *Minnesota v. Blasius*, 290 U.S. 1, 9-10 (1933).

3. HCAD spends much of its brief attacking a strawman: the notion that the FERC regulation (18 C.F.R. § 284.1) defining natural gas *transportation* as including *storage* is "the cornerstone" (Opp. 4-5) of ETC's Commerce Clause argument. *See id.* at 12, 13-17. But ETC has never argued that the regulation "control[s] the dormant Commerce Clause analysis" here. *Id.* at 20-21. Rather, ETC has simply pointed to the regulation as confirmation of the practical reality that the storage of gas is an integral component of the larger process of the interstate transportation of gas. *See* Plains Marketing Amicus Br. 19 ("FERC's regulatory definition of transportation confirms a higher-level point: namely, that the kind of temporary

storage involved in this case simply is *not separable*, as a practical matter, from transportation of natural gas."). Surely FERC would know.

That more general point is not undermined at all by the fact that the ultimate purpose of the regulation was to ensure open access to natural gas storage. The reason FERC required open access to such storage was to remedy the "unfair advantage" that pipelines' control of storage gave them over other gas shippers. FERC Order 636, 57 Fed. Reg. 13,267, 13,288 (Apr. 16, 1992). In other words, FERC recognized that storage is so critical to the efficient transportation of gas that market participants who did not have equal access to storage simply could not compete. *See id.* (noting that pipelines could "use storage as a supplement to transmission capacity" and "to maintain a constant flow of gas" in order to deliver gas more efficiently than non-pipeline shippers). Thus, the regulation just reinforces the importance of storage to the interstate transportation of natural gas.

4. Finally, HCAD tries to analogize this case to cases like *Blasius*, where property had "come to rest" in a given State and any future interstate movement was uncertain. Opp. 19-23. But that analogy is also utterly unpersuasive. In *Blasius*, *McLean*, and *Bacon v. Illinois*, 227 U.S. 504 (1913), the taxes were all imposed *before* the taxpayer had entrusted its goods to any carrier. *See* Pet. 25-26, 28-29. Here, by contrast, ETC had already entrusted the gas to the pipeline, a common carrier, which had physical control of the gas and stored it in a facility that is integrated into the national pipeline network. The Texas Supreme Court squarely held that ETC's gas had "enter[ed] interstate commerce." Pet. App. 14a. And the court likewise

recognized that a majority of ETC's gas is shipped to out-of-state customers. *Id.* at 13a-14a. ETC's gas had thus begun its interstate journey and in no sense had "come to rest" in Texas.

Because the gas was "in transit" under this Court's precedents when temporarily stored, there was no "substantial nexus" under *Complete Auto*.[2]

### B. This Court's Guidance Is Sorely Needed

HCAD also ignores the conflict and confusion in the lower courts. As ETC has explained, the question presented has divided state high courts (as it divided the Texas Supreme Court and court of appeals below). In addition, although three state supreme courts ultimately have upheld taxes on gas temporarily stored during interstate transit, they have split 2-1 over the relevance of this Court's older in-transit decisions. Pet. 30-33. Remarkably, in the face of this widespread disagreement, HCAD denies that the question is recurring and argues that no conflict exists (Opp. 31-36). It is wrong again.

1. The question presented is indisputably recurring. This is the fifth petition in less than ten years to raise the question of what limits the dormant Commerce Clause places on the ability of States and localities to tax gas (or oil) that is temporarily stored

---

[2] Once again trying to change the subject, HCAD discusses at length the *other* three prongs of the *Complete Auto* test. Opp. 25-30. But, though ETC does not concede that the other prongs are satisfied, the crux of the dispute in this case has always been the substantial nexus requirement. And so long as even just that one requirement is not met, the tax cannot stand. HCAD's lengthy discussion of the other *Complete Auto* requirements cannot make up for its failure to rebut ETC's arguments concerning the lack of substantial nexus.

during interstate transport. HCAD vaguely asserts that these cases had "different factual and procedural backgrounds." Opp. 34. To some degree, of course, *all* cases do. But HCAD does not identify any difference that undermines ETC's point that all five cases raise fundamentally the same question about the scope of the dormant Commerce Clause (as they clearly do).

HCAD's attempt to paper over *Midland Central Appraisal District v. BP America Production Co.*, 282 S.W.3d 215 (Tex. App. 2009), *cert. denied*, 563 U.S. 936 (2011), is particularly misguided. According to HCAD, *Midland Central* did not raise the same legal question because "the oil in that case 'was not in storage but, rather, was *in transit* in the stream of interstate commerce.'" Opp. 35 (emphasis added) (quoting *Midland Cent.*, 282 S.W.3d at 224). But that description was simply the court's way of expressing its legal conclusion that the stoppage in that case—and there was undeniably a stoppage—"did not interrupt the continuity of transit" because it "was incidental to the transportation of the oil by the common carrier and was necessary for the safe and efficient operation of the pipeline system." *Midland Cent.*, 282 S.W.3d at 223. That is precisely ETC's argument here. The fact that the *Midland Central* court accepted that argument—in contrast to the decision below—bolsters the need for review.

Moreover, the state high courts themselves have expressly noted the lack of guidance in this area. The Supreme Court of Oklahoma observed that this Court "has never addressed whether the [*Complete Auto*] test applies to an ad valorem tax on goods in the process of being transported in interstate commerce." *In re Assessment of Pers. Prop. Taxes Against*

*Missouri Gas Energy*, 234 P.3d 938, 953 (Okla. 2008) (*Missouri Gas*), *cert. denied*, 559 U.S. 970 (2010). And the majority below noted that this Court has "provided little insight into what constitutes a 'substantial nexus'" under *Complete Auto*. Pet. App. 10a. Unless the Court grants review in this case and provides the necessary guidance, it is only logical that the question will continue to recur.

2. HCAD's contention (Opp. 31-34) that there is no split among state high courts concerning the proper constitutional analysis is also wrong.

HCAD first contends that there is no conflict between the decision below and *Missouri Gas*. HCAD says that rather than ignoring this Court's in-transit precedents, the Oklahoma Supreme Court merely "did not decide the case on 'the subjective factors critical to the *Blasius* analysis' because it found the analysis 'inconclusive' on the facts before it." Opp. 31-32 (quoting *Missouri Gas*, 234 P.3d at 955). But failing to decide a case on the basis of factors that this Court's precedents make "critical" is tantamount to *ignoring* those precedents. And the Oklahoma Supreme Court did not hide the fact that it was doing just that. It said flatly that "*[w]ere* the court making the old 'in transit' or 'at rest' determination"—wording that unmistakably reveals it was *not* making that "old" determination—it would find the task "very difficult." *Missouri Gas*, 234 P.3d at 955 (emphasis added). The constitutional analysis in *Missouri Gas* is manifestly different from the analysis in the decision below.

HCAD's attempt to deny a conflict with *In re Appeals of Various Applicants from a Decision of the Division of Property Valuation for Tax Year 2009*, 313 P.3d 789 (Kan. 2013) (*Kansas Gas*), *cert. denied*,

135 S. Ct. 51 (2014), is also unpersuasive. HCAD claims there is no conflict because it is questionable whether the taxpayers in *Kansas Gas* made an in-transit argument. Opp. 32-34. But whatever the parties may have argued, there is no uncertainty about what the Kansas high court *held*: that "[t]here is axiomatically a substantial nexus between Kansas and the gas stored in this state." *Kansas Gas*, 313 P.3d at 799. That per se holding unquestionably governs in Kansas and is unquestionably inconsistent with the decision below.

Moreover, as ETC pointed out (Pet. 23), the Supreme Court of Texas itself recognized that its mode of analysis diverged from that of its sister courts. *See* Pet. App. 16a-17a. And respected commentators likewise noted that the decision below creates a "doctrinal divide in the case law over the continuing relevance of the question whether the goods at issue were 'in transit.'" Walter Hellerstein & John A. Swain, *State Taxation* ¶ 4.13[3][a] (3d ed. 2017, Westlaw). The division of authority, in short, is real. And because only this Court can resolve the "continuing relevance" of its own precedents, the question presented cries out for this Court's review.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

GREGORY G. GARRE
*Counsel of Record*
ROMAN MARTINEZ
GRAHAM E. PHILLIPS
LATHAM & WATKINS LLP
555 11th Street, NW
Suite 1000
Washington, DC 20004
(202) 637-2207
Gregory.Garre@lw.com

*Counsel for Petitioner*

November 20, 2017