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No. 83, Original

IN THE

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1980

STATE OF MARYLAND, *et al.*,

Plaintiffs,

v.

STATE OF LOUISIANA,

Defendant.

ON MOTIONS OF THE PLAINTIFFS FOR JUDGMENT ON THE PLEADINGS AND OF THE DEFENDANT FOR DISMISSAL OF THE COMPLAINT

REPORT OF THE SPECIAL MASTER

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September 15, 1980

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This is the second preliminary report to be filed by the Special Master. The first, filed on May 14, 1980, contained the Special Master's recommendations with respect to various motions to intervene and to appear as *amicus curiae.* Those motions are still pending before the Court awaiting action on exceptions to the report. This report will contain the Special Master's recommendations with respect to a motion by the plaintiffs for judgment on the pleadings filed on September 18, 1979,[1] and a motion by the defendant for dismissal of the complaint, filed on October 22, 1979.[2]

It seems to the Special Master more orderly to deal with the motion to dismiss first, since it is largely concerned with jurisdictional and prudential issues not directly involving the central theme of the complaint and can therefore be considered as preliminary to the issues on the merits raised by the motion for judgment on the pleadings.

FACTS

This case involves the constitutionality of Louisiana's "first use" tax on natural gas. La. Rev. St. 47:1301-1307. Effective April 1, 1979, that law imposes a tax of seven cents per thousand cubic feet of natural gas on the first use within Louisiana of natural gas which is not

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[1]Those pipelines which filed motions to intervene have also moved for leave to file a motion for judgment on the pleadings. Since the motion to intervene has not been acted on by the Court, this report will not address the pipelines' motion, but will be limited to the motion of the plaintiffs. However, it may be noted that the positions of the plaintiffs and of the pipelines are entirely consistent. Also it should be noted that the United States and the Federal Energy Regulatory Commission (F.E.R.C.—both hereafter referred to as the United States) have filed a brief *amici curiae* supporting the motion of the plaintiffs for judgment on the pleadings.

[2]Although this motion has not been specifically referred to the Special Master for a recommendation, the Special Master believes that the direction to him to "submit such reports as he may deem appropriate" is sufficient authority to justify a report on the motion. Order of March 3, 1980.

subject to State severance taxes imposed by Louisiana or by any other State, or to import duties imposed by the United States. In practical effect, all parties agree that the tax is in fact imposed on the first use within Louisiana of natural gas produced from the submerged lands of the outer continental shelf[3] outside Louisiana and from federal enclaves within Louisiana.[4]

The Louisiana statute states that its purpose is to compensate its citizens "for costs incurred and paid with public funds, which costs enure solely to the benefit of the owners of natural gas produced beyond the boundaries of Louisiana" and to recover for "damages to the state's waterbottoms, barrier reefs, and sensitive

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[3]The outer continental shelf consists of submerged lands seaward of the three-mile coastal belt ceded to Louisiana in 1953 by the Submerged Lands Act (43 U.S.C. 1301-15) as interpreted and applied to Louisiana by the opinion of this Court in *United States v. Louisiana*, 363 U.S. 1 (1960). By the Outer Continental Shelf Lands Act (43 U.S.C. 1331-43) Congress retained for the United States all rights of exploration, development and production from the outer continental shelf. The coastal States are specifically excluded from imposing their tax laws on the outer continental shelf.

[4]Nothing developed in the case to date indicates how much gas is produced on federal enclaves. A brief filed by the United States on November 20, 1979, indicates that some gas is produced from the Barksdale Air Force Base, but no figures on amount are provided. There may be a legal distinction between the application of the Louisiana law to gas from enclaves as against gas from the outer continental shelf since the latter production is outside the boundaries of Louisiana and therefore crosses that boundary when it is brought into the State without regard to its ultimate destination. For purposes of the application of the Natural Gas Policy Act of 1978, gas produced on the outer continental shelf is deemed "committed or dedicated to interstate commerce." 15 U.S.C. 3301(18)(A)(i). None of the parties have attributed any significance to this variance in the source of the gas.

shorelands as a direct consequence of activity within the state associated with such natural gas by the owners thereof."[5] La. Rev. St. 47:1301C.

Under the Louisiana law, the tax is imposed on the owner of natural gas at the time it is first subjected to a "use" within the State. La. Rev. St. 47:1303. The term "use" is defined as

> "the sale; the transportation in the state to the point of delivery at the inlet of any processing plant; the transportation in the state of unprocessed gas to the point of delivery at the inlet of any measurement or storage facility; transfer of possession or relinquishment of control at a delivery point in the state; processing for the extraction of liquefiable component products or waste materials; use in manufacturing; treatment; or other ascertainable action at a point within the state." La. Rev. St. 47:1302(8).

In practical effect, this case involves for the most part the application of Louisiana's tax to natural gas produced from the outer continental shelf.[6] In a proffer of proof

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[5] In its opposition to the plaintiff's motion to file the complaint, Louisiana cites authorities who estimate that Louisiana is expending $40,000,000 a year for governmental services required for outer continental shelf development and is suffering erosion of its shoreline and barrier reefs of about sixteen square miles annually, 40% of which can be attributed to activities for the development and production of natural gas. The value of the lost land is estimated to amount to $300,000,000 yearly. (Louisiana Brief in Opposition to the motion for leave to file the complaint, p. 24.) In a proffer of proof filed with the Special Master on April 15, 1980, Louisiana recites in great detail the costs to it of services rendered and damages suffered by reason of the operations on the outer continental shelf, but gives no estimate of the dollar amount involved. Louisiana Proffer of Proof, pp. 61-90.

[6] In hearings before the Louisiana Senate Revenue and Fiscal Affairs Committee with respect to the bill which became the first

[footnote continued]

submitted by Louisiana on April 15, 1980, pursuant to the request of the Special Master, there is a description of the procedures involving this gas. It rises to the surface at a platform in the Gulf of Mexico. There it passes through a separator or dehydrator to remove salt water and some impurities. In most cases ownership of the gas passes at the wellhead to the pipeline company. With respect to about 15% of the gas, the producer retains title to the gas until it is brought to shore and the processing is complete. In either case the gas passes through a gathering system of underwater pipelines which lead to the shore and thereafter to processing plants[7] where liquid and liquefiable hydrocarbons and pollutants are removed by a process of compression and decompression, heating and cooling and being subjected to contact with chemicals and oils. Some 5% in volume of the gas is thus removed at the processing plant. At the completion of the processing the dry gas is delivered to pipelines and more than 98% of this gas moves on out of the state. The products removed in the processing, including butanes, propanes, and ethanes, are transported to chemical plants for use as feedstock and fuel. Ordinarily the ownership of these products remains with, or reverts to, the producer.

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use tax, one of the sponsors of the bill, Wilbert J. Tauzin, II, stated at page 3, "We are talking about natural gas brought into this state from outside our boundaries that is not taxed by some other jurisdiction. At the present time that practically means OCS federal gas. That gas is produced outside our three mile limit in federal waters. It is piped in to processing companies in Louisiana and then the dry gas is shipped out of the state."

[7]Louisiana states that there are 124 processing plants in Louisiana which process 95% of the outer continental shelf gas. A processing plant typically occupies about seventy-five acres of land and represents a present cost value of $40,000,000. La. Proffer of Proof, p. 11.

Throughout the process described above, the natural gas is under pressure, either from the well pressure or from compressors, and is in continuous movement throughout its journey. In *Michigan-Wisconsin Pipeline Co. v. Calvert,* 347 U.S. 157, 163 (1954), the Court noted that "the entire movement of the gas, from producing wells through the Phillips gasoline plant and into the Michigan-Wisconsin pipeline to consumers outside Texas, is a steady and continuous flow." And the Fifth Circuit in *Deep South Oil Co. v. Federal Power Commission,* 247 F.2d 882 (1957), *cert. den.,* 355 U.S. 930 (1958), stated at pp. 887-88:

> ". . . petitioner's own brief testifies eloquently to the continuous movement of the gas which it sells at the wellhead. Petitioner admits, as, of course it must, 'that there is a continuous flow of gas from the Deep South wells into the gathering system of Texas gas; that the mass of gas of which the Deep South gas becomes a part moves continuously through the gathering system into a processing plant; that the movement through the processing plant is continuous; that there is a continuous movement of natural gas from the outlet of the processing plant to both interstate and intrastate destinations. . . .' "

However, gas which would be subject to the tax is exempted if it is used in Louisiana for "the drilling for or production of oil, natural gas, sulphur, or in the processing of natural gas for liquids extraction within the state . . ." or is 'consumed in the manufacture of fertilizer and anhydrous ammonia within the state." La. Rev. St. 47:1303A. A separate law provides that an owner subject to the first use tax, who is also subject to a severance tax on other production of gas or oil within the state, may credit his payment of the first use tax against his severance tax liability. La. Rev. St.

47:647. Further tax credits may be claimed against any other Louisiana tax to the extent that electric or gas utility companies or direct purchasers from the pipelines have been subjected to increases in their costs attributable to the first use tax. La. Rev. St. 47:11.

The first use statute declares "as against public policy," and makes unenforceable, any contractual provision which would entitle an owner of gas subject to the tax to recover the amount of the tax from any person other than a purchaser. La. Rev. St. 47:1303C. Thus, the burden of the tax, when it is imposed on a pipeline as the owner, may not be passed back to the producer, but must be borne by the pipeline or passed down the line to those who take the gas from the pipeline. Under the statute the tax is considered a cost of preparation or marketing of the gas. La. Rev. St. 47:1303C. So important did the Louisiana legislature consider these provisions that it added another section providing that if it is finally adjudicated that a contract for such pass-back is enforceable then either all first use taxes previously paid and subject to the contract shall be refunded, or the entire statute shall be null and void. La. Rev. St. 47:1307 Sec. 4.[8]

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[8]The Federal Energy Regulatory Commission has authorized the pipelines to pass on to their customers the first use tax collected from them, subject to refund when and if the tax is adjudged to be illegal. *State of Louisiana First Use Tax in Pipeline Rate Cases,* Docket No. RM78-23, Order No. 10, 43 Fed. Reg. 45553 (1978); Order No. 10-A, 43 Fed. Reg. 60438 (1978); and Order No. 10-B, 44 Fed. Reg. 13460 (1979), petitions for review pending *sub nom. Tennessee Gas Pipeline Co., et al. v. Federal Energy Regulatory Commission,* No. 78-3816 (5th Cir.). On April 24, 1980, the Commission issued an additional order modifying in some respects the terms of the prior orders with respect to insuring refunds to consumers. Order No. 10-C. On the same date, the Commission issued a show cause order in the same docket case to

[footnote continued]

Estimates of the amount of tax to be collected under the act vary from $225,000,000 (Md. Complaint, ¶ XIV) to $275,000,000 (Pipeline Br., p. 15) annually. The amount actually collected during the first year of operation has not been established. Other indications of the importance of this case to the natural gas industry are provided in Louisiana's proffer of proof. It is stated that there are 13,500 wells on the outer continental shelf producing 4.1 trillion mcf per year. The pipelines used to bring the gas ashore comprise 9,650 miles. The natural gas produced constitutes 10% of the natural gas consumed in the United States. La. Proffer, pp. 6-8.

The plaintiffs in this action are Maryland, New York, Massachusetts, Rhode Island, Illinois, Indiana, Michigan and Wisconsin. The sole defendant is Louisiana. The plaintiffs filed their motion for leave to file the complaint on March 29, 1979. The complaint alleged unconstitutionality under the commerce clause, the supremacy clause, the duty on imports clause, impairment of the obligation of contracts and the equal protection clause of the Fourteenth Amendment. Only the interstate commerce and the supremacy arguments are involved in the present motions. The plaintiff States allege injury by reason of the additional cost of gas used by them and by reason of such additional costs incurred by their citizens. The amounts alleged are very large: Maryland, $4,000,000; New York, $29,000,000; Massachusetts, $8,000,000; Rhode Island, $370,000; Illinois, $33,000,000; Indiana, $9,000,000; Michigan, $30,000,000; Wisconsin, $10,000,000.

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resolve the question of whether persons other than natural gas consumers should bear the burden of the first use tax while the constitutionality of the law is litigated. Show Case Order in Docket No. RM78-23 (Phase II) issued April 24, 1980.

On May 29, 1979, the defendant, Louisiana, filed a brief in opposition to the motion for leave to file. The United States, seventeen pipelines, the American Gas Association, the State of Alabama, and Associated Gas Distributors all filed briefs supporting the plaintiffs. On June 18, 1979, the Court granted the motion for leave to file the complaint and gave the defendant sixty days to answer. On August 17, 979, Louisiana filed its answer generally denying the assertions of the complaint and asserting the validity of the tax. Thereafter, on September 18, 1979, the plaintiffs filed a motion for judgment on the pleadings. On October 22, 1979, Louisiana filed a motion to dismiss the complaint. The pipelines and the United States filed briefs *amici curiae* supporting the plaintiffs.

On March 3, 1980, the Court appointed the undersigned Special Master and referred the motion for judgment on the pleadings to him. The Special Master has held two open hearings on March 21, 1980, and June 19, 1980, at which the parties and the applicants for intervention participated, to consider the course of proceedings and to hear argument on the various motions. Also, the Special Master requested Louisiana, which had moved for an evidentiary hearing, to submit a proffer of proof covering the factual matters as to which it asserted evidence was necessary. Louisiana has filed an extensive proffer of proof to which the other participants have responded by memoranda asserting that no evidentiary hearing is necessary.

And so the matter stands.

I.

MOTION TO DISMISS THE COMPLAINT

The defendant presents three arguments for dismissal of the complaint: First, the States have no standing to attack the constitutionality of the tax since the tax is imposed on the owners at the time of the first use of the gas and the fact that those owners have passed the tax on in the form of higher prices does not give the States standing to sue either for their own increased costs or for the increased costs to their citizens; second, the case is not a proper one to invoke the original jurisdiction of the Court since it is really not a dispute between the plaintiffs and Louisiana but between the pipelines or gas consumers and Louisiana; and, third, the dispute can better be tried in some other court, preferably a Louisiana court where State questions of construction can be decided and where constitutional issues, if they survive, can be tried on a full record and then appealed, if necessary, to the Supreme Court. The motion to dismiss does not argue that the constitutionality of the Louisiana law can be upheld on the face of the pleadings.[9]

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[9]The grounds urged by the defendant for dismissal are substantially the same as the grounds on which the defendant opposed the plaintiffs' motion for leave to file their complaint. The plaintiffs therefore argue that the granting of their motion over the objections of the defendant amount to a rejection of the defendant's jurisdictional and prudential arguments. However, the Court's order did not explicate the reasons for the order and the defendant argues that it should be taken as postponing consideration of its objections, rather than rejecting them. It does not seem profitable to speculate on the reasons underlying a *per curiam* order. Since the issues are constitutional, the defendant is probably not foreclosed from renewing its argument in the form of a motion to dismiss whatever the basis for the order.

A. Standing of Plaintiffs To Challenge Tax

Louisiana is, of course, correct in its assertion that no tax is directly imposed by it on the plaintiff States. At no time are they called on to remit funds to Louisiana; they and their citizens pay the pipelines which are liable for the first use tax. At least theoretically the seven cents per thousand cubic feet of gas could be absorbed by the producers of the gas or the pipelines. However, by the terms of the Louisiana statute, the owners liable for the tax are not allowed to pass it back to the producers. La. Rev. St. 87:1303C. The pipelines are public utilities whose rates, and the prices paid by purchasers from them, are controlled by FERC. Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. 717c and 717d. Thus they are entitled to recover from their customers all of the legitimate costs of obtaining the gas, processing it, and transporting it.[10] The Louisiana statute specifically provides that "this tax shall be deemed a cost associated with uses made by the owner in preparation of [or] marketing of the natural gas. La. Rev. St. 87:1303C. Although the FERC had previously accepted contracts which required producers to assume the costs of transporting liquid hydrocarbons associated with natural gas and of processing the natural gas to recover liquid and

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[10]*See FPC v. United Gas Pipe Line Co.*, 386 U.S. 237, 243 (1967):

> "One of [the Commission's] statutory duties is to determine just and reasonable rates which will be sufficient to permit the company to recover its costs of service and a reasonable return on its investment. Cost of service is therefore a major focus of inquiry. Normally included as a cost of service is a proper allowance for taxes, including federal income taxes. The determination of this allowance, as a general proposition, is obviously within the jurisdiction of the Commission."

liquefiable hydrocarbons, FERC has now ordered that the amount of the Louisiana first use tax be handed on to customers, thus accepting for the time being Louisiana's treatment of the item as a cost of processing the gas for transportation.[11] Thus, both by reason of the Louisiana law and the orders of FERC, the ultimate cost of the tax is now borne by the plaintiffs and by consumers in the plaintiff States. Under these circumstances it is clear that, although the tax is collected from the pipelines, it is really a burden on consumers. The parties required to stand the cost of the tax should be accorded standing to contest its constitutionality.

In analagous situations this Court has held that a state has standing to sue when it and its citizens have been adversely affected by the actions of a sister state. *Pennsylvania v. West Virginia,* 262 U.S. 553 (1923). In that case where West Virginia was attempting to restrict the flow of natural gas, this Court said at page 592:

> This interference gives rise to a matter of grave concern in which the state, as the representative of the public, has an interest apart from that of the individuals affected. It is not merely a remote or ethical interest, but one which is immediate and recognized by law.

In *Georgia v. Pennsylvania Railroad,* 324 U.S. 439, 447 (1945), an alleged conspiracy with respect to freight charges imposed on shippers was found to implicate the state sufficiently to sustain its standing to sue. In a more

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[11] *State of Louisiana First Use Tax in Pipeline Rate Cases,* Docket No. RM78-23. In issuing its order in this case the FERC challenged the constitutionality of the tax and required the pipelines to institute refund proceedings in the Louisiana courts and to make appropriate undertakings to insure refunds to their customers if the tax is thrown out.

recent case this Court held that, although ordinarily only direct purchasers may recover Clayton Act treble damages, cost-plus purchasers may be in a different posture. *Illinois Brick Co. v. Illinois,* 431 U.S. 720, 736 (1977). In these cases the Court looks beyond forms to the substance of the claim. *Arkansas v. Texas,* 346 U.S. 368, 371 (1953).

It would be unfortunate if the parties who actually stand the loss were required to rely on an intermediary who had passed on the loss to them to press the claim of unconstitutionality. In this case the pipelines are in agreement with the plaintiffs, but their interest is different and the states would be allowed to speak for themselves. I conclude they have standing to sue.

B. Jurisdiction as an Original Action

The original jurisdiction of this Court, established by Article III, Sec. 2, Clauses 1 and 2 of the Constitution, and made exclusive by 28 U.S.C. 1251(a)(1), may not be invoked when the plaintiff State is really asserting a claim in behalf of individuals who are the real parties in interest. *Oklahoma v. A.T. & Santa Fe Ry.,* 220 U.S. 277 (1911); *Pennsylvania v. New Jersey,* 426 U.S. 660 (1976).[12]

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[12] In the latter case the Court said at 665-66:

"It has, however, become settled doctrine that a State has standing to sue only when its sovereign or quasi-sovereign interests are implicated and it is not merely litigating as a volunteer the personal claims of its citizens.

* * *

"This rule is a salutary one. For if, by the simple expedient of bringing an action in the name of a State, the Court's original jurisdiction could be invoked to resolve what are, after all, suits to redress private grievancies, our docket would be inundated. And, more important, the critical distinction, articulated in Art. III, Sec. 2, of the Constitution, between suits brought by 'Citizens' and those brought by 'States' would evaporate."

The defendant argues that in this case the plaintiffs are not the real parties in interest, but are volunteers for the pipelines, or for their own citizens. I have discussed the issue of standing with respect to the pipelines above and concluded that the fact that the cost of the tax is indirect rather than direct does not foreclose plaintiffs from asserting the injury to them and their citizens. With respect to the impact of the tax on consumers, the plaintiffs allege damage both in their proprietary status as users of natural gas in their various governmental functions and as *parens patriae.*

The plaintiff States allege that they have incurred material added costs as consumers of natural gas forced to pay higher prices by reason of the first use tax. The annual cost to each of the plaintiffs as alleged in the complaint is as follows: Maryland, $60,000 (¶ XVI); New York, $300,000 (¶ XXVI); Massachusetts, $25,000 (¶ XXII); Rhode Island, $25,000 (¶ XXVIII); Illinois, $270,000 (¶ XVIII); Indiana, $70,000 (¶ XX); Michigan, $650,000 (¶ XXIV); Wisconsin, $70,000 (¶ XXX). As far as these sums are involved, the States are not suing *parens patriae* or in any other representative capacity; they are suing to protect their own treasuries.

With respect to the injury done to the States by reason of the imposition of the additional costs on their citizens, the States do have a quasi-sovereign interest in their economic welfare. The individuals affected are not a selected group but practically the entire population. Perhaps some large consumers and the public utilities have individual claims of sufficient size to justify suits; but by and large it would seem difficult if not impossible for individual consumers to establish sufficient damage to themselves and a class suit would seem to be unmanageable. *Cf. Hawaii v. Standard Oil Co. of California,* 405

U.S. 251 (1972). The case seems to fall within the general class of cases in which the states have been recognized as proper parties. *See Pennsylvania v. West Virginia,* 262 U.S. 553 (1923) (restriction on shipment of oil); *Missouri v. Illinois,* 180 U.S. 208 (1901) (sewage in river); *Kansas v. Colorado,* 206 U.S. 46 (1907) (diversion of water); *New York v. New Jersey,* 256 U.S. 296 (1921) (pollution of harbor); *North Dakota v. Minnesota,* 263 U.S. 365 (1923) (altering flow of stream).

The Special Master concludes that the case falls within the original jurisdiction of the Court.

C. Court's Discretionary Authority To Restrict Use of Original Actions

Assuming that the plaintiffs have standing to sue and that the case falls within the original jurisdiction of the Court, the question still remains whether the Court should exercise its discretion over the use of original actions by dismissing the action.

It is clear, of course, that controversies between the States fall within the original jurisdiction of the Court under Article III, Section 2, Clauses 1 and 2 of the Constitution, which jurisdiction is exclusive by reason of 28 U.S.C. 1251(a)(1). The exclusivity of the jurisdiction suggests that in ordinary course the Court should accept such cases since the very grant of power to the court to the exclusion of other federal courts carries the implication that the Court will exercise its authority. But it is also clear that the Court can, and will, refuse to accept jurisdiction of a cause when there are other and better ways of resolving the dispute. *Arizona v. New Mexico,* 425 U.S. 794 (1976); *Massachusetts v. Missouri,* 308 U.S. 1, 18-19 (1939). In *Louisiana v. Texas,* 176 U.S. 1 (1900), the Court said at 15:

> But it is apparent that the jurisdiction is of so delicate and grave a character that it was not contemplated that it would be exercised save when the necessity was absolute and the matter itself properly justiciable.

In *Illinois v. City of Milwaukee*, 406 U.S. 91 (1972), the Court stated at pp. 93-94:

> It has long been this Court's philosophy that our original jurisdiction should be invoked sparingly. * * * We construe 28 U.S. 1251(a)(1) as we do Art. III, Sec. 2, Cl. 2 to honor our original jurisdiction but to make it obligatory only in appropriate cases. And the question of what is appropriate concerns, of course, the seriousness and dignity of the claim; yet beyond that it necessarily involves the availability of another forum where there is jurisdiction over the named parties, where the issues tendered may be litigated, and where appropriate relief may be had. We incline to sparing use of our original jurisdiction so that our increasing duties with the appellate docket will not suffer.

The alternatives to the original suit here do not seem attractive as the means of deciding this controversy between the States. The defendant urges that the best forum to hear the case is the judicial system of Louisiana where the courts would have authority to construe the Louisiana statute and perhaps decide it on State grounds which would avoid the necessity of a constitutional adjudication.

There are at present two lines of cases in the State courts. First, the Governor and other officials of the State brought an action on September 22, 1978, against the pipelines and other owners subject to the tax. The case was filed in the Nineteenth Judicial District Court of Louisiana. The title of the case is *Edwards v. Trans-*

continental Gas Pipe Line Corp., Docket No. 216,867. The plaintiffs asked for a declaratory judgment on the constitutionality and construction of the first use statute. The defendants have filed answers raising the same arguments the plaintiffs present in this case. The case is presently in the discovery stage. The plaintiff States in this case are not parties to that proceeding, nor is the United States or FERC.

Second, the pipeline companies which have sought to intervene in this proceeding have filed a tax refund suit on June 22, 1979, in the Nineteenth Judicial District Court. *Southern Natural Gas Co. v. McNamara,* Docket No. 225,533. The defendants are the Secretary of the Department of Revenue and Taxation, the Department itself, and the State of Louisiana. The plaintiffs raise the same issues as are involved in the other State case and here. Again the plaintiff States here are not parties, nor is the United States or FERC. This case also is in the discovery stage.

Finally, the Federal Energy Regulatory Commission filed an action in the United States District Court for the Middle District of Louisiana on September 29, 1978, against the State officials. *Federal Energy Regulatory Commission v. McNamara,* C.A. 78-394. The plaintiffs sought to enjoin enforcement of the first use tax on the same grounds as are asserted in the other cases. On motion of the defendants the action was stayed on January 26, 1979. An appeal from the stay was filed in the Court of Appeals for the Fifth Circuit, but that appeal is presently stayed.

None of these cases appears to be a suitable substitute for the original action. In the State cases, the plaintiff States have no standing and the court apparently has no authority to grant injunctive relief pending the outcome of the cases. The refunds, if ordered, appear to be limited as to interest to 6% which would result in a substantial advantage to the State and damage to the plaintiffs in view of the quarter of a billion dollars which is being collected annually. But, in any event, the plaintiffs should not be required to depend on private parties to conduct their litigation and protect their interests; they should be permitted to speak for themselves.

As for the United States District Court case, it is clear that the Constitution and Judicial Code give exclusive jurisdiction over the States' case against Louisiana to the Supreme Court so that the States cannot intervene. In view of the amounts involved, moreover, it would seem questionable to leave it to the United States to litigate, to invite the delays incident to a trial, to appeal to the Court of Appeals and then to an application for review here and eventually to consideration on the merits here. Of course cases can be expedited, but if the matter is to be tried in an evidentiary hearing of the type asserted to be necessary by the defendant, it will take time; if the evidentiary hearing is not required, it equally well can be decided here.

The strongest precedent in favor of dismissing the complaint and allowing the issues to be litigated in some other forum is *Arizona v. New Mexico*, 425 U.S. 794 (1976). That case involved an attempt by Arizona to institute an original action in this Court. Arizona was suing in its proprietary capacity as a consumer of electricity and as *parens patriae.* New Mexico had levied a tax on electric generation which fell on three companies that sold electricity in Arizona. Although the taxing statute appeared nondiscriminatory on its face, it was alleged that certain tax credits with respect to electricity sold in New Mexico resulted in the tax actually applying only to electricity sold outside of the State. By the time the motion for leave to file came before the Court, suit had already been brought in the New Mexico courts by the three interstate electric companies attacking the constitutionality of the tax. One of the plaintiffs in that suit was related to Arizona so that the state could in effect represent itself in the New Mexico suit. This Court denied Arizona leave to file, holding in a *per curiam* decision that it was more appropriate to rely on the New Mexico proceeding.[13]

Both the plaintiffs (Brief in Support of Motion for Leave to File Complaint, pp. 14-18) and the United States (Brief *Amicus* on Motion for Leave to File Complaint, pp. 10-14) have drawn distinctions between that case and this. All the distinctions have merit, but the really significant difference is that, by reason of its relationship to one of the litigants, Arizona could be heard in its own behalf in the State court. The plaintiffs here cannot represent themselves in the State court proceedings described above. Also, in the Arizona case the issue was decided on the motion for leave to file. This Court has granted that motion in this case, permitting the filing, and to dismiss it now on grounds raised on consideration of the motion would be a far more serious reversal, penalizing the plaintiffs both in time and money.

The nature of this case seems to be appropriate for this Court's attention. It is important both because of

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[13]After the litigation in the State courts, on appeal this Court held the tax invalid. *Arizona Public Service Co. v. Snead*, 441 U.S. 141 (1979). The Court held the tax invalid under the Supremacy Clause as inconsistent with a federal statute, 15 U.S.C. 391, prohibiting a state from imposing a tax on the generation or transmission of electricity that imposes a greater tax burden on electricity consumed outside of the taxing State than in it.

the huge sums involved and because of the number of States affected, thirty in all. The issues are important on their own account and because of their effect on the price of gas. The defendant asserts the case is not appropriate for original consideration by the Court because, it asserts, an extensive evidentiary hearing is necessary. Even if such a hearing proves to be necessary, the Court has adopted procedures for trying such cases.[14] An expeditious settlement of the controversy is desirable since the refund proceedings cannot make the plaintiffs whole and, while no great speed seems possible in a case of this magnitude and complexity, this Court can at least control the case and, if it desires, move it forward more speedily than would be possible in a trial and appeal procedure.

The Special Master recommends that the motion to dismiss the complaint be denied.

II.

MOTION FOR JUDGMENT ON THE PLEADINGS

The plaintiff States argue that on the basis of the complaint and answer they are entitled to judgment. While there are many facts in dispute, the plaintiffs assert that the Louisiana first use tax should be declared unconstitutional on the basis of facts that are not in dispute, on facts as to which the Court may take judicial notice, and on principles of law established by the Court. The tax act must fall, they say, because under the Supremacy Clause it is overruled by the Natural Gas

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[14] *See, e.g., Arizona v. California,* 373 U.S. 546 (1963), a case which took two years to try before a special master. Three hundred and forty witnesses were heard and the transcript consisted of 25,000 pages.

Act, the Natural Gas Policy Act of 1978 and the Outer Continental Shelf Act. In the second place, plaintiffs claim that, apart from its inconsistency with federal statutes, the act must fall because it encroaches on the exclusive interstate commerce field assigned to federal control. As to both claims it is argued that no evidentiary hearing is necessary or appropriate.

It is the Special Master's conclusion that the facts disclosed in the complaint and answer do not, without more, require that the act be invalidated on the basis of the Supremacy Clause. There are provisions of the federal and State laws which may be irreconcilable in operation; the Louisiana first use tax may in fact interfere with the federal regulatory process; but, on the other hand, the interference may be so indirect, so peripheral, so subject to administrative adjustments, as to permit the State and federal programs to coexist. Evidentiary hearings are necessary to reach a conclusion on these issues.

As far as the Interstate Commerce Clause is concerned, the Special Master believes that a determination on the validity of the Louisiana tax could be made on the pleadings, plus a generous application of judicial notice. But the Special Master also suggests that to reach a conclusion on the papers involves such an application of judgment that it would be desirable to withhold a conclusion until the issues can be tested against facts developed in an evidentiary hearing. To invalidate a State tax law is a serious limitation on the State's prerogative to manage its own fiscal affairs.[15] The Special Master believes that the chance of an erroneous decision can

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[15] *See Great Lakes Dredge and Dock Company v. Huffman*, 334 U.S. 385 (1949); *Matthews v. Rodgers*, 384 U.S. 521 (1932). The Congress has recognized this policy in 28 U.S.C. 1341, limiting the district courts' authority to issue injunctions in such cases.

be materially reduced by permitting the parties to present a factual record on the operation of the law rather than judicially noticing abstract scientific theories and engineering practices and then applying legal theories and findings from prior cases to situations not contemplated at the time they were pronounced.

A. Application of the Supremacy Clause

The Natural Gas Act (15 U.S.C. 717-717w) was enacted in 1938 to assure consumers of natural gas of fair prices and to protect them from the monopolistic power of the interstate pipelines in a field where the States were powerless to act. *See Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591, 610 (1944); *Atlantic Refining Co. v. Public Service Commission of New York,* 360 U.S. 378, 388-89 (1959). The Federal Power Commission (FPC), whose duties have been inherited by the Federal Energy Regulatory Commission (FERC), was given authority to regulate the interstate gas industry from the wellhead to the delivery of the gas to intrastate distributors or consumers. *Phillips Petroleum Co. v. Wisconsin,* 347 U.S. 672 (1954). Authority was given the Commission to regulate the prices of sales in interstate commerce for resale, to require certificates of convenience for the connection of pipelines, to approve contracts for the acquisition of gas, and fix the charges for transportation of gas. 15 U.S.C. 717c, 717d, 717f. Every aspect of the interstate natural gas business was entrusted to FPC regulation. Sec. 1(b) of the Act (15 U.S.C. 717(b)) provides:

> (b) The provisions of this act shall apply to the transportation of natural gas in interstate commerce, to the sale in interstate commerce of natural gas for resale for ultimate public consumption for domestic, commercial, industrial, or any other use, and to

natural-gas companies engaged in such transportation or sale, but shall not apply to any other transportation or sale of natural gas or to the local distribution of natural gas or to the facilities used for such distribution or to the production or gathering of natural gas.

The courts have interpreted the Act through the years in line with its purpose to grant the FPC, and now the FERC, full authority to implement the Act by rules, regulations or orders as domestic and international conditions have developed.

The Natural Gas Policy Act of 1978 (15 U.S.C. 3301) amended the Natural Gas Act in an attempt to undo the economic effect of fixing prices for interstate natural gas while leaving intrastate gas unregulated. This had resulted in a severe shortage of gas in the interstate market while producers sought to profit from the higher prices in the intrastate market. The 1978 act was an attempt to put all natural gas on an equal basis and thus to alleviate the shortage. In order to protect consumers of gas from the inclusion in the processing and transportation costs of expenses more properly allocable to the production and transportation of liquid and liquefiable hydrocarbons, FERC was given specific authority to allocate such costs between the products involved. 15 U.S.C. 3320.

The second federal statute involved is the Outer Continental Shelf Lands Act which was enacted in 1953. (43 U.S.C. 1331). This Act provides that the development of the resources of the submerged lands seaward of the boundaries of the coastal states be given to the federal government with authority over the exploration, leasing, and production of natural resources including oil and gas. The act specifically excludes the States from control over that area. 43 U.S.C. 1333.

The history of the dispute with Louisiana over its interest in the submerged lands goes back to 1950 when this Court determined that the U.S. had paramount rights in the submerged lands up to the shoreline. *United States v. Louisiana,* 339 U.S. 707. Congress, heedful of the States' claim that they had lost revenue from areas on which they had previously relied, ceded to the coastal States the submerged lands and their resources within their historic boundaries. *Submerged Lands Act,* 43 U.S.C. 1301 (1953). The validity of this cession was upheld in *Alabama v. Texas,* 347 U.S. 950 (1954), and the Louisiana boundary under the act was fixed at three miles in *United States v. Louisiana,* 361 U.S. 1 (1960).

Having given to the coastal States the submerged lands within their boundaries, the Congress then proceeded to make provision for the development of the remainder of the continental shelf seaward of the belt given to the States. In the committee hearings leading up to this statute, Louisiana and the other gulf States presented strong pleas that they be granted a share of the income from the parts of the shelf abutting their boundaries to compensate them for the expenses they foresaw devolving on them as a result of the offshore operations. Hearings before the Senate Committee on Interior and Insular Affairs on S. 1901, 83d Cong., 1st Sess. pp. 185-6, 187-8, 191-3, 265-6. In the end the Congress decided to give no share of the income from the outer continental shelf to the States and specifically wrote into the law a prohibition against any application of the States' tax laws to the area. S. Rep. No. 411, 83d Cong., 1st Sess., pp. 2-3, 13-14. 43 U.S.C. 1333(a)(2)(A) provides: ". . . State taxation laws shall not apply to the Outer Continental Shelf." And in 1933(a)(3): "The provisions of this section for adoption of State law as the law of the United States shall never be interpreted as a basis for claiming any interest in, or jurisdiction on behalf of, any State for any purpose over the seabed and subsoil of the outer Continental Shelf, or the property and natural resources thereof or the revenues therefrom." Section 9 of the Act (43 U.S.C. 1338) provides that all revenues go into the federal treasury.[16]

The final federal statute involved is the Coastal Zone Management Act. 16 U.S.C. 1451. One of the provisions of this statute provides for a fund to make grants to the States to compensate them for the impact of the federal programs for energy development. 16 U.S.C. 1456a. This is one of the purposes declared by the Louisiana legislature in the first use tax as a justification for imposing the tax.

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[16]In a sense, the first use tax can be considered the most recent step in Louisiana's continuing effort to press its claim to profit from the production of oil and gas off its coast. The claim was first asserted in the initial dispute with the United States over title to all of the submerged lands, a dispute which was resolved in favor of the United States in *United States v. Louisiana,* 339 U.S. 707 (1950). The attempt in Congress to recover by legislation what had been lost in litigation was partially successful in that the Submerged Lands Act gave Louisiana the three mile belt along its coast. As pointed out in the text, Louisiana failed to convince Congress that it should share in the proceeds from the outer continental shelf. Louisiana continued to litigate as to the extent of its historic boundaries, which was finally fixed at three miles in *United States v. Louisiana,* 361 U.S. 1 (1960). Since that decision there has been extensive further litigation to fix the line and determine the disposition of royalties theretofore collected. *See, e.g., United States v. Louisiana,* 420 U.S. 529 (1975). The entire history of this litigation is described in an opinion of the Court issued last term. *United States v. Louisiana,* 100 S. Ct. 1618 (1980). The imposition of the first use tax, which is at precisely the same rate as the severance tax, is looked upon by the plaintiffs as one more step by Louisiana to recover some of the revenues it lost when it lost the submerged lands case.

Considering first the possible conflict with the Natural Gas Act, it is clear that Congress did not totally exclude the States from regulating some phases of the industry. This Court in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), recognized that, before the passage of the Natural Gas Act, the States had been held powerless under the Commerce Clause to protect themselves against abuses in the industry. *See, e.g., Missouri v. Kansas Gas Co.*, 265 U.S. 298 (1924). The Court in *Hope* noted at pp. 609-10 that the House report on the bill stated that its purpose was to fill the gap. In accomplishing that purpose the bill was designed to take "no authority from State Commissions" and was "so drawn as to complement and in no manner usurp State regulatory authority." H. Rep. 709, 75th Cong., 1st Sess p. 2. By the terms of the statute the federal government is given authority over interstate transportation, sales for resale in interstate commerce, and over gas companies engaged in such transportation or sale; while the States retain power to regulate local distribution and "the production or gathering of natural gas." 15 U.S.C. 717. Nothing is specified about State taxation, but the Natural Gas Policy Act of 1978 seems to recognize that the States may impose severance taxes on local production. 15 U.S.C. 3320(a)(1).

The plaintiffs highlight two aspects of federal regulation under the Natural Gas Act and the Natural Gas Policy Act which they assert override the provisions of the first use tax.

First, they assert that the federal authority to fix prices, the very "heart" of the Natural Gas Act (*Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, 611 (1944)), is undercut by the Louisiana law, since the tax is added to the cost of the gas which is to be sold in interstate commerce. Plaintiffs rely on such authority as *Northern Natural Gas Co. v. State Corporation Commission of Kansas,* 372 U.S. 84 (1963); and *Oklahoma Corporation Commission v. Federal Power Commission,* 415 U.S. 961 (1974). They may be right since the impact of the tax appears to be directed at interstate sales by reason of the exemptions and credits granted intrastate users. But a decision is hard to make on the pleadings since it is difficult to calculate how great an effect on the regulatory power of the FERC is imposed. We do know that the FERC has permitted, over its strong disinclination to do so, the first use tax to be treated as a cost of transportation and of processing and therefore included as one of the underlying factors on which the price to consumers is fixed. *State of Louisiana First Use Tax Rate Cases,* Docket No. R.M. 78-23 Orders No. 10, 10-A and 10-B, n.8, *supra.* The issue eventually to be resolved is whether the first use tax is just one of the many factors affecting the price, some of which are beyond FERC control, or whether it is a substantial hindrance to the Commission's powers.

Second, the plaintiffs press a more difficult problem resulting from the provisions of the Louisiana law which allot the tax to the cost of preparation [or] marketing of natural gas and outlaw contractual provisions passing the tax back to producers while permitting it to be added to the purchase price of consumers. La. Rev. St. 47:1303C. Basically this does not appear to be a fiscal matter since the revenue to the State is the same whoever eventually pays the bill. Louisiana in its Answer to the Complaint justifies the provision by stating that "the sole purpose, intent, and application of the [provision] has been to ensure that the First Use Tax will not unreasonably burden any person within the interstate commerce stream but will be passed along to the ultimate users and consumers. Because the tax will be borne by the ultimate users and consumers, neither party to the contracts in question suffers." La. Answer, ¶ LX, p. 21. But FERC had previously accepted contracts that provided that the processing involved and the tax on it were properly considered costs of producing liquid and liquefiable hydrocarbons, not properly to be borne by consumers of the natural gas.

For the present, FERC has adopted regulations permitting the tax to be passed along, but making provision for refunds to the consumers if the tax is finally held invalid and mandating the pipelines to seek relief in the Louisiana courts. *State of Louisiana First Use Tax Rate Cases,* Docket No. R.M. 78-23. And FERC is itself seeking to upset the tax in the federal courts. *Federal Energy Regulatory Commission v. McNamara,* C.A. 78-394 M.D. La. Meanwhile the FERC administrative proceedings are continuing with an order to show cause why the producers should not be billed for and pay the First Use Tax with respect to liquid or liquefiable hydrocarbons transported with or extracted from natural gas. FERC Order to Show Cause in R.M. 78-23.

Thus FERC's final decision as to the allotment of the tax is still not made.

There is an ongoing dispute between the parties as to the legal effect of the processing by which the hydrocarbons are extracted and its effect on the natural gas. In part this turns on the physical nature of the process. If the natural gas is essentially the same when it goes into, and comes out of, the processing plant, and if the hydrocarbons are products which were retained by the producers from the start and are separated for their profit, then the position of the FERC is sound that the cost, including the tax, should revert to the producers rather than being passed on to the customers. But if the processing is essentially a step to make the gas dry and of the Btu content standardized for transportation and use, then it is reasonable to pass the tax on to consumers. Plaintiffs claim that the authority to make that judgment is granted to FERC (*Federal Power Commission v. United Gas Pipe Line Co.*, 386 U.S. 237, 243-246 (1967)), and that Louisiana interferes with its function when it seeks to allot the tax. The Special Master believes that the conflict with the Natural Gas Act is the type of issue which cannot suitably be resolved on the papers or by reference to past decisions which were not really focused on the issue. Moreover, it may be that in the end FERC's orders can be adjusted so that the laws will mesh without conflict.

The alleged conflict between Louisiana's law and the Outer Continental Shelf Lands Act does not appear to require an evidentiary hearing. The argument appears to be that Louisiana is in effect imposing a tax on the production of gas produced in the federal domain, in spite of a specific prohibition against that action. 43 U.S.C. 1333(a)(2)(A). This is a legal question which can be answered by an analysis of the two statutes. It is true that the principle objects of the first use tax are actions with respect to, or transactions in, natural gas produced on the outer continental shelf. But no tax is imposed on any action or person until the gas has been brought into the state. To be sure, all, or almost all, of the gas produced does come into the State, and all, or almost all, of the gas that is brought into the State is subjected to one of the "uses" which results in liability for the tax. But that does not of itself answer the question since what happens in the State may subject it to authority of the State. *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937).

The case which most strongly supports Louisiana's position is *Portland Pipeline Corp. v. Environmental Improvement Commission*, 307 A.2d 1 (Maine), *appeal dismissed*, 414 U.S. 1035 (1973). There, in order to provide funds to clean up oil spills, a tax was levied on the movement of oil over Maine's harbor waters. All, or almost all, of the oil taxed was, or had been, the subject of interstate or foreign commerce. Nevertheless, the court held that the tax was not on the oil itself but on the act of transporting it over Maine's waters. This case dealt not with a tax on gas but on oil, so that there was no question of the supremacy of the Natural Gas Act though a question could have been raised about the supremacy of the Water Quality Improvement Act of 1970. 33 U.S.C. 1321. What the case stands for is the continuing right in the States to protect their interests so long as their regulations do not hamper interstate commerce.

The most substantial possible conflicts appear to be between the Louisiana tax law and the Natural Gas Act, particularly the provisions with respect to passing the burden of the tax back to the producers or forward to the consumers. This may prove to be an irreconcilable conflict but, as this Court said in *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 at 157 (1978):

> The Court's prior cases indicate that when a State's exercise of its police power is challenged under the Supremacy Clause, we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act. *Rice v. Santa Fe Elevator Corporation*, 331 U.S. 218-23 (1947).

The decision whether to decide the issue on the pleadings, or to hold evidentiary hearings, is complicated by the fact that if hearings are held and the case prolonged, Louisiana stands to gain materially by continuing to collect a quarter of a billion dollars a year which, under its provisions for the refund of taxes paid under protest, would be repaid with only 6% interest, whereas the current value of this enormous fund would be far greater than 6%. It is desirable, therefore, to reduce the delay in deciding this case or to eliminate the profit to Louisiana from the delay.[17]

It does not appear to the Special Master that the desirability of expediting a decision outweighs the desirability of deciding the issues on the basis of a complete record. The Special Master recommends that the Court not grant the motion for judgment on the pleadings on the basis of the Supremacy Clause.

B. Interference with Interstate Commerce

We are concerned here with gas which is produced from the outer continental shelf, brought ashore by pipelines, processed in plants which remove pollutants and liquid and liquefiable hydrocarbons, delivered to interstate pipelines and transported out of the State. The whole movement is "steady and continuous flow." *Michigan-Wisconsin Pipeline Co. v. Calvert,* 347 U.S. 157, 163 (1954). And in *Deep South Oil Co. v. Federal Power Commission,* 247 F.2d 61 (5th Cir. 1957), it was

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[17]An interim injunction against the collection of the tax while its validity is being determined would eliminate this element of rewarding Louisiana for extending the litigation, but injunctions against the collection of State taxes are not favored.

recognized that "the mass of gas of which the Deep South gas became a part moves continuously through the gathering system into a processing plant; that the movement of natural gas from the outlet of the processing plant to both interstate and intrastate destinations." The courts have held that the natural gas is in interstate commerce during the entire journey. *California v. Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965); *Interstate Natural Gas Co., Inc. v. Federal Power Comm.*, 331 U.S. 682, 684-7 (1947); *Federal Power Commission v. East Ohio Gas Co.*, 338 U.S. 464, 467 (1950).

The defendant asserts that the interstate transportation of natural gas commences at the tailgate of the processing plant and that the processing is a local activity that transforms "wet" gas into a different product, "dry" gas, so that the processing and the steps which precede it do not directly involve the interstate transportation. In view of the continuous movement of the gas, this seems a doubtful interpretation, but it hardly helps Louisiana in any event since the movement from the outer continental shelf across the state boundary and up to the processing plant would itself seem to be an interstate journey. *See Continental Oil Co. v. Federal Power Commission*, 370 F.2d 57, 66 (5th Cir. 1966). Moreover, the Natural Gas Policy Act of 1978 defines the term "committed or dedicated to interstate commerce" to include "(i) natural gas which is from the Outer Continental Shelf", 15 U.S.C. 3301(18). Thus, all of the uses preceding the processing would be part of a prior interstate transportation even if Louisiana were correct in asserting that the processing itself broke the chain. Moreover, even if the tax is considered to be imposed on a separable local event, it still will offend the interstate commerce clause if the result of the tax is to impair or hinder the interstate commerce. *Boston Stock*

Exchange v. State Tax Commission, 429 U.S. 318 (1977); *Halliburton Oil Well Co. v. Reily,* 373 U.S. 64 (1963).

Although it has been recognized that interstate commerce can be called on to meet its fair share of the State's costs, it has been held that in order to be valid a tax must be (1) "fairly apportioned; (2) "not discriminatory against interstate commerce"; (3) "applied to activity with a substantial nexus with the State"; and (4) "fairly related to service provided by the State." *Department of Revenue of Washington v. Association of Washington Stevedoring Companies,* 435 U.S. 734, 750 (1978). The plaintiffs claim that Louisiana's tax does not fall equally on both inter- and intrastate transactions, and that it is not fairly apportioned to an identifiable activity within the state.

Louisiana replies that its tax does not discriminate since a tax of seven cents per thousand cubic feet is imposed on all natural gas within the State, either as a severance tax with regard to gas produced within the State or as a use tax when the gas is produced outside the State and thereafter subjected to the specified uses within the State. But this equality is confused by a series of exclusions and credits. First, there is excluded gas used in drilling for or producing oil, natural gas, sulphur or in processing natural gas for liquids extraction, or in the manufacture of fertilizer and anhydrous ammonia, all within the State. La. Rev. St. 47:1303A. No exclusion is provided if these uses are made of the gas outside of the State. Secondly, a severance tax credit is allowed under which a taxpayer liable for the first use tax may, if he is also a producer of other gas within Louisiana, credit his first use tax payment dollar for dollar against his liability for severance taxes.[18] Since there is no apparent relation between the ownership of outer continental shelf gas and the production of gas in Louisiana, it is hard to understand Louisiana's motive in permitting this credit, but it obviously aids an intrastate operation in a way not available to a pipeline engaged only in interstate transportation or producing gas outside of Louisiana. Finally, another credit for any increase in fuel costs by reason of the first use tax is allowed for use within the State by electric generating plants, gas distribution services, and direct purchasers from an interstate pipeline. This credit may be taken against any Louisiana tax or combination of taxes, other than severance taxes, owed to Louisiana, subject to a maximum credit of $2,000,000 and a minimum of $250. La. Rev. St. 47:11. Thus, Louisiana customers of local utilities and local consumers buying directly from the pipelines are protected in whole or in part from the incidence of the tax which is passed on to consumers out of the State.

The plaintiffs assert that these exclusions and credits all work to discriminate against the out-of-state consumer in favor of the Louisiana user.[19] Perhaps so, but

[18]The brief for the United States, n.47, p. 51, illustrates the effect of this credit: "This difference can be illustrated by the following example. Owner A has 1000 mcf of OCS gas; owner B has 500 mcf of OCS gas and 500 mcf of gas subject to Louisiana's severance tax. A owes $70 of first use tax; B owes $35 of first use tax and $35 in severance tax. B, however, pays only $35 in first use taxes. He owes no severance tax because he can credit the first use payment against the severance tax liability."

[19]In *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963), this Court held unconstitutional a Louisiana use tax which on its face was merely complementary to a sales tax, but in operation discriminated against out-of-state purchases. *See also Nippert v. City of Richmond*, 327 U.S. 416 (1946).

it is hard to tell from the pleadings what adjustments can be made in the base prices, and what allowances can be made between buyers and sellers which might reduce or eliminate any disadvantage of one over the other. This Court has said:

> "in each case it is our duty to determine whether the statute under attack, whatever its name may be, will in practical operation work discrimination against interstate commerce. [*Best & Co. v. Maxwell,* 311 U.S. 454, 455-456.] This concern with the actuality of operation, a dominant theme running through all state taxation cases, extends to every aspect of the tax operations. . . . Considered in isolation, the Louisiana use tax is discriminatory; it was intended to apply primarily to goods acquired out-of-state and used in Louisiana. If it stood alone, it would be invalid. However, a proper analysis must take 'the whole scheme of taxation into account.'" *Halliburton Oil Well Cementing Co. v. Reily,* 337 U.S. 64, 69 (1963).

So here, instead of being discriminatory, the "actuality of operation" may show that the tax is a "compensating" tax intended to complement the State severance tax as the use tax complemented the sales tax in *Henneford v. Silas Mason Co.,* 300 U.S. 577 (1937).

The plaintiffs also assert that the Louisiana tax is invalid because it does not meet the *Washington Stevedoring* case's requirement that the tax must be fairly apportioned. It would seem that that test would be of prime importance when a State is imposing a tax on a business's gross revenues or on its assets as a whole, when, in order to avoid multiple taxation by numerous States, each should tax only the proportion of the entirety which falls within its domain. Here the tax is on the total amount of natural gas within the State and subject to use there. Just as a sales tax, or a severance tax, is imposed on the total amount of the commodity sold or produced, so it would seem appropriate to levy a use tax on the total amount involved. It does not seem to the Special Master that the apportionment requirement has any application here, unless the tax is so large as to put a barrier in the path of interstate commerce. If it does in fact obstruct or hinder interstate commerce it is bad; but that is a factor which would have to be developed in a full hearing. *Cf. Pennsylvania v. West Virginia,* 262 U.S. 553 (1923).

Probably the case which on its facts is closest to this one is *Michigan-Wisconsin Pipeline Co. v. Calvert,* 347 U.S. 157 (1954). In that case Texas levied what it termed an occupation tax on "gathering" gas, an activity the regulation of which is left to the States by the terms of the Natural Gas Act. 15 U.S.C. 717(b). In the artificial definition of "gathering" prescribed by the Texas law, it included "taking" gas from the outlets of a scrubbing plant, where the liquid and liquefiable hydrocarbons are separated from the wet gas and dry gas suitable for pipeline transportation is produced. The Court found that after this "taking" there was no separable local activity not an integral part of the flow of interstate commerce. The "taking" the Court held was not a local event separable from the interstate transportation. It was not an activity like producing natural gas, generating electricity, or mining ore, activities upon which a tax may be levied if it is fair and not a burden or hindrance. A real "gathering" tax might be different. Applying the *Michigan-Wisconsin Pipeline* case to Louisiana's uses as defined in the act would result in some of the acts being too intimately connected with interstate transmission to survive. However, the statute has a separability clause. La. Rev. Stat. 47:1307, Sec. 2. Some of the uses may be constitutionally taxable even though others are bad. Probably the best cases can be made for the "uses" defined as "processing for the extraction of liquefiable component products or waste materials" or as "use in manufacturing." La. Rev. Stat. 47:1302(8).

There is a very real dispute among the parties as to the legal effect of the "processing" use. The plaintiffs would have the Court hold that the processing does not interrupt the transportation process and that the gas delivered at the outlet of the processing plant is the same gas received at the entry with impurities and hydrocarbons removed. Louisiana would analogize the processing process as being similar to the manufacture of a new product. They would like to prove that it changes the chemical content of the gas so that what comes out of the plant is different from what goes in.[20]

In passing upon the constitutionality of other use taxes, this Court has said:

> Not the tax in a vacuum of words but its practical consequences for the doing of interstate commerce in applications to concrete facts are our concern. *Nippert v. Richmond,* 327 U.S. 416, 431 (1946).

If it were not for the time factor which favors Louisiana and permits it to continue to collect a quarter of a billion dollars a year and to gain an enormous financial advantage from the use of the funds even if required to give a refund in the end, it would be obviously advantageous to permit the parties to support their divergent positions by evidence relevant to the interpretation and

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[20]The parties have not addressed the significance of the "use in manufacturing" use, but since it must take place within the State to be taxable one can assume that the tax credits and exclusions referred to above would minimize any tax on this use.

administration of the law, the physical features of the entire process, and the economic impacts on and adjustments by buyers and sellers and consumers. However, the plaintiffs have not asked for interim relief. The best way to minimize the time factor is to press the proceedings forward as expeditiously as possible. I cannot conclude that the time factor justifies the Court in granting the motion on the pleadings.

RECOMMENDATIONS

The Special Master recommends that:

1) The motion of the defendant for the dismissal of the complaint be denied.

2) The plaintiffs' motion for judgment on the pleadings be denied without prejudice to a reconsideration of the issues raised on the basis of further proceedings.

Respectfully submitted,

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September 15, 1980