No. 83, Original

In the Supreme Court of the United States

OCTOBER TERM, 1980

STATE OF MARYLAND, ET AL., PLAINTIFFS

v.

STATE OF LOUISIANA

ON THE REPORT OF THE SPECIAL MASTER OF SEPTEMBER 15, 1980

EXCEPTION OF THE UNITED STATES AND THE FEDERAL ENERGY REGULATORY COMMISSION AND BRIEF IN SUPPORT OF EXCEPTION

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The United States and the Federal Energy Regulatory Commission respectfully except to the Report of the Special Master dated September 15, 1980, insofar as he recommends that the plaintiffs' motion for judgment on the pleadings be denied.

WADE H. MCCREE, JR.
Solicitor General

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STATE OF MARYLAND, ET AL., PLAINTIFFS *

v.

STATE OF LOUISIANA, ET AL.

ON THE REPORT OF THE SPECIAL MASTER OF SEPTEMBER 15, 1980

BRIEF FOR THE UNITED STATES AND THE FEDERAL REGULATORY COMMISSION IN SUPPORT OF EXCEPTION

QUESTIONS PRESENTED

1. Whether the pleadings establish that the Louisiana First Use Tax on Natural Gas is invalid under the Supremacy Clause of the United States Constitution because it conflicts with the exclusive statutory jurisdiction of the Federal Energy Regulatory Commission to regulate the sale and transportation of natural gas in interstate commerce, and to apportion costs among producers, processors, and consumers.

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* Plaintiffs are the States of Maryland, Illinois, Indiana, Michigan, New York, Rhode Island, Wisconsin, and the Commonwealth of Massachusetts. Plaintiffs sue "in their proprietary capacities as substantial purchasers of natural gas" subject to the First Use Tax,

2. Whether the pleadings establish that the Louisiana First Use Tax violates the Commerce Clause of the United States Constitution.

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and in their *parens patriae* capacities on behalf of their citizens who will purchase such gas (Complaint 6-7 ¶ III). Subsequent to the Court's granting of the plaintiffs' Motion for Leave to File the Complaint, New Jersey filed a motion for leave to intervene, to file a complaint, and a brief in support thereof. Seventeen interstate natural gas pipeline companies also sought leave to intervene. In addition, a motion for leave to file a brief amicus curiae and the brief were filed on behalf of Associated Gas Distributors.

On March 3, 1980, the Court appointed a Special Master to whom all pending motions were referred. Thereafter, the United States and the Federal Energy Regulatory Commission moved for leave to intervene. On May 14, 1980, the Special Master recommended: (1) that the motions of New Jersey for leave to intervene and file its complaint be granted; (2) that the motion of the United States and the Federal Energy Regulatory Commission to intervene as plaintiffs be granted; (3) that the 17 pipelines be permitted to intervene, reserving the final determination of the applicability of the Eleventh Amendment until the final decision of the case; and (4) that the motion of the Associated Gas Distributors for leave to file a brief amicus curiae in support of the plaintiffs' motion for judgment on the pleadings be granted. The parties have previously filed exceptions and briefs with respect to the Report of the Special Master on these motions for leave to intervene and to appear as amicus curiae.

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JURISDICTION

The motion for leave to file a complaint invoking the original jurisdiction of this Court was granted on June 18, 1979. The jurisdiction of this Court rests on the Constitution of the United States, Article III, Section 2, Clauses 1 and 2, and 28 U.S.C. 1251(a)(1).

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

Article I, Section 8, Clause 3 ("Commerce Clause"), and Article VI, Clause 2 ("Supremacy Clause") of the Constitution of the United States are set forth at page 4 of the Plaintiffs' Brief in Support of Motion for Judgment on the Pleadings, filed on September 18, 1979.

The First Use Tax on Natural Gas, La. Rev. Stat. Ann. §§ 47:1301-47:1307 (West Supp. 1980), the First Use Tax on Natural Gas—Severance Tax Credit, La. Rev. Stat. Ann. § 47:647 (West Supp. 1980), the First Use Tax Trust Fund, La. Rev. Stat. Ann. § 47:1351 (West Supp. 1980), and the Tax Credit to Operators of Electric Generating Plants and Natural Gas Distribution Services, La. Rev. Stat. Ann. § 47:11 (West Supp. 1980), are set forth at pages 1a-20a in the Appendix to Plaintiffs' Brief in Support of Motion for Judgment on the Pleadings, filed on September 18, 1979.

Sections 4, 5, and 7 of the Natural Gas Act of 1938, 15 U.S.C. 717c, 717d, and 717f, and Sections 2(18), 110, 121(b), and 601 of the Natural Gas Policy Act of 1978, 15 U.S.C. (Supp. II) 3301(18), 3320, 3331(b), and 3431, are set forth at pages 1a-9a in the Appendix to the Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae, filed on November 20, 1979.

STATEMENT

A. Introduction

This litigation was initiated last year by the plaintiff States to obtain a declaratory judgment that the Louisiana First Use Tax on Natural Gas[1] is unconstitutional and an order permanently restraining the collection of the tax and compelling the refund of all revenues collected plus "all interest earned on such revenues" (Complaint 6 ¶ II).

In our brief amici curiae of June 1979 in support of the plaintiffs' motion for leave to file a complaint and our brief amici curiae of November 1979 in support of the plaintiffs' motion for judgment on the pleadings, we advised the Court that both the United States and the Federal Energy Regulatory Commission have a substantial and immediate interest in this case. Louisiana is presently collecting at least $225 million per year under its First Use Tax on Natural Gas. As a consumer of natural gas in the operation of military and civilian installations, the United States, like the citizens of the plaintiff states, is directly affected by the additional costs imposed by the First Use Tax.

Moreover, the First Use Tax directly conflicts with the authority of the Federal Energy Regulatory Commission to regulate the interstate sale and transportation of natural gas. Although couched in terms of a tax on the "use" of natural gas, the principal impact of the levy is to increase the price of gas extracted from federal lands (primarily submerged lands of the Outer Continental

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[1] Act No. 294, 1978 La. Sess. Law Serv. 482 (West), codified as La. Rev. Stat. Ann. §§ 47:1301-47:1307 (West Supp. 1980). Hereinafter, the various provisions of the act will be referred to by the section number used in the codification, and the act itself will be referred to as the "First Use Tax" or the "Act."

Shelf) or from federally-leased areas, when such gas is shipped through Louisiana in interstate commerce. Since Congress vested in the Federal Energy Regulatory Commission the exclusive authority to set rates for the sale and transportation of such natural gas in interstate commerce, the Louisiana tax is incompatible with the federal regulatory scheme.

Finally, as the Special Master correctly observed (Report 31), if protracted proceedings in this case ensue, "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" (footnote omitted).[2]

There is indisputably a compelling need for a prompt decision on the merits in this case. But, contrary to the Special Master's conclusion, we submit that the pleadings contain all of the facts necessary for a determination of the validity of the First Use Tax. The prospect for substantial unjust enrichment by Louisiana therefore calls for addressing plaintiffs' motion for judgment on the

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[2] Representative Tauzin, the sponsor of the First Use Tax, candidly explained Louisiana's attempt to profit from an unconstitutional tax as follows:

> So that the total amount that we might be liable for in the event that we should lose the litigation is available for refund at 6% interest. We are likely to make more than 6% interest on it in investments. We are actually going to probably come out a little bit ahead on it.

Hearings on H.B. 768 Before the Revenue and Fiscal Affairs Committee of the Louisiana Senate 6 (June 26, 1978). See also *"1st-Use Tax Will Profit La. Even If Cash Is Returned,"* The Times Picayune/The States-Item, Oct. 7, 1980, § 1, at 17.

pleadings without the delay inherent in the further factual hearings recommended by the Special Master.

To be sure, we share the Master's concern that "the chance of an erroneous decision can be materially reduced by permitting the parties to present a factual record" (Report 21-22). But, as we shall show, the facts of this case, as set forth in the pleadings, are no different from those of many other cases in which the Court has determined the constitutional validity of state taxes under the Supremacy and Commerce Clauses. We therefore respectfully except to the Special Master's recommendation that further evidentiary hearings be held and submit that the plaintiffs' motion for judgment on the pleadings be granted.

B. The Nature of the Louisiana Tax

The First Use Tax Act imposes a tax of seven cents per thousand cubic feet (subject to certain exclusions) upon the first "use" within Louisiana of any natural gas that is not subject to any severance or production tax levied by Louisiana or any other state or territory of the United States, or is not subject to any import tax or tariff levied by the United States on imports from foreign countries. La. Rev. Stat. Ann. § 47:1303 A (West Supp. 1980) (Mot. App. 4a-5a).[3]

The Act imposes the First Use Tax on the owner when the gas is first subjected to a taxable use in Louisiana. La. Rev. Stat. Ann. §§ 47:1302(9), 47:1303 (West Supp. 1980) (Mot. App. 4a-6a).[4] The term "use" is defined broadly as "[1] the sale; [2] the transportation in [Louisiana] to the point of delivery at the inlet of any process-

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[3] "Mot. App." refers to the Appendix to the Plaintiffs' Motion for Judgment on the Pleadings.

[4] La. Rev. Stat. Ann. § 47:1302(9) (West Supp. 1980) (Mot. App. 4a) defines "owner" as "the person or person [*sic*] having title to and the right to alienate the natural gas subject to the tax at the time a use occurs in [Louisiana except] any person to whom temporary possession or control has been transferred. In the event of a sale the purchaser shall be deemed the owner."

ing plant; [3] the transportation in [Louisiana] of unprocessed natural gas to the point of delivery at the inlet of any measurement or storage facility; [4] transfer of possession or relinquishment of control at a delivery point in [Louisiana]; [5] processing for the extraction of liquefiable component products or waste materials; [6] use in manufacturing; [7] treatment; or [8] other ascertainable action at a point within [Louisiana]." La. Rev. Stat. Ann. § 47:1302(8) (West Supp. 1980) (Mot. App. 4a).[5]

The First Use Tax Act recites that it is "a cost associated with uses made by the owner in preparation of [*sic*] marketing of the natural gas" (La. Rev. Stat. Ann. § 47:1303 C (West Supp. 1980)) and not a tax on the natural gas itself.[6] It also expressly abrogates provisions of existing contracts which underlie and form the basis for certificates of public convenience and necessity issued by the Federal Energy Regulatory Commission concerning the apportionment of taxes among sellers, processors, and purchasers of gas. In this connection, La. Rev. Stat. Ann. § 47:1303 C (West Supp. 1980) (Mot. App. 5a) provides:

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[5] If any enumerated use "first occurring is determined not to be a constitutionally taxable incident, the tax shall be imposed upon the first occurring thereafter." La. Rev. Stat. Ann. § 47:1303 F (West Supp. 1980) (Mot. App. 6a). The Act provides that if the section reciting that the tax is a cost associated with uses made by the owner in preparation or marketing of the gas is held invalid, the entire Act shall be void. Section 4(2), 1978 La. Sess. Law Serv. 486 (Mot. App. 8a). The remaining parts of the Act are severable. Sections 2, 4, 1978 La. Sess. Law Serv. 485, 486 (Mot. App. 7a, 8a).

[6] The First Use Tax statute recites that it is not imposed "on the production, severance, or ownership of natural gas produced outside of the boundaries of the State of Louisiana * * * [and] that the incidence of this tax shall not be upon the natural gas nor upon the property or rights from which it is produced, but rather shall be only upon the privilege of performance or allowing the performance, by the owner of the enumerated actions comprising first use within [Louisiana]." La. Rev. Stat. Ann. § 47:1303 E (West Supp. 1980) (Mot. App. 6a).

> Any agreement or contract by which an owner of natural gas at the time a taxable use first occurs claims a right to reimbursement or refund of such taxes from any other party in interest, other than a purchaser of such natural gas, is hereby declared to be against public policy and unenforceable to that extent. Notwithstanding any such agreement or contract, such an owner shall not have an enforceable right to any reimbursement or refund on the basis that this tax constitutes a cost incurred by such owner by virtue of the separation or processing of natural gas for extraction of liquid or liquefiable hydrocarbons, or that this tax constitutes any other grounds for reimbursement or refund under such agreement or contract, unless there has been a final and unappealable judicial determination that such owner is entitled to such reimbursement or refund, notwithstanding the public policy and purpose of this part and the foregoing provisions of this Subsection C. In any legal action pursuant to this Subsection, the state shall be an indispensable party in interest.

Thus, when the tax is imposed on a pipeline as an owner, that pipeline may not pass the tax back to a producer but must either bear the tax itself or pass it on to those persons who purchase the gas from the pipeline.

The tax does not apply to all uses of natural gas in Louisiana. Certain uses are exempt from the tax.[7] Moreover, the First Use Tax is not levied on gas subject to a production or severance tax imposed by Louisiana or any other state or any import tax imposed by the United

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[7] The tax does "not apply to natural gas otherwise subject thereto * * * *used* or consumed in the drilling for or production of oil, natural gas, sulphur, or in the processing of natural gas for liquids extraction within [Louisiana]; [or] to gas shrinkage volumes attributable to the extraction of ethane, propane, butanes, natural or casinghead gasoline or other liquefied hydrocarbons * * * [; or] to natural gas used or consumed in the manufacture of fertilizer and anhydrous ammonia within [Louisiana]." La. Rev. Stat. Ann. § 47:1303 A (West Supp. 1980) (Mot. App. 4a-5a) (emphasis added).

States. Almost every state, including Louisiana,[8] has a severance tax. As a result, the major impact of the First Use Tax is on gas produced from the Outer Continental Shelf (OCS), to which state severance taxes do not apply.[9] Indeed, the Louisiana legislature intended that the principal target of the tax would be OCS gas.[10]

What is more, the practical impact of the tax falls on OCS gas that passes through the state because Louisiana allows all electric generating utilities, gas distribution companies, and other persons in Louisiana who purchase natural gas directly from an interstate pipeline a credit against their Louisiana state and local taxes for any increases in the transportation and marketing costs for OCS gas which they purchase.[11] Because Louisiana has characterized the First Use Tax as a cost of transporting and marketing gas (La. Rev. Stat. Ann. §§ 47:1303 C, E (West. Supp. 1980)), this credit allows Louisiana consumers who consume OCS gas otherwise subject to the First Use Tax to offset increased rates for natural gas

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[8] La. Rev. Stat. Ann. §§ 47:631-47:646 (West 1970).

[9] *E.g., Mississippi River Fuel Corp.* v. *Cocreham,* 382 F.2d 929 (5th Cir. 1967), cert. denied, 390 U.S. 1014 (1968); accord, *Humble Pipe Line Co.* v. *Waggonner,* 376 U.S. 369 (1964). See also Outer Continental Shelf Lands Act, Section 4(a)(2), 43 U.S.C. 1333 (a)(2).

[10] See, *e.g., Hearings on H.B. 768 Before the Revenue and Fiscal Affairs Committee of the Louisiana Senate* 3 (June 26, 1978) (Rep. Tauzin). The tax also applies to gas produced from federal enclaves within Louisiana, including Barksdale Air Force Base. Finally, by its terms, the tax is also applicable to gas imported from abroad because the United States does not levy any import taxes upon gas from abroad. See 72 Stat. 72, 19 U.S.C. 1202, Schedule 4, Part 10, Item 475.15. However, Louisiana claims (Brief in Response to Brief for the United States and the Federal Energy Regulatory Commission as Amici Curiae 11, 24) that it is not assessing the First Use Tax on imported gas because the United States could impose duties on such gas. See also Answer 19 ¶ LV.

[11] See Act No. 599, Tax Credits to Operators of Electric Generating Plants and Natural Gas Distribution Services, 1978 La. Sess. Law Serv. 1112, codified as La. Rev. Stat. Ann. § 47:11 (West Supp. 1980).

attributable to that tax through reductions in other taxes paid to Louisiana. Indeed, the legislative history shows that the very purpose of the credit is to ensure that Louisiana consumers do not bear any of the costs associated with the First Use Tax.[12]

C. The Proceedings Before the Special Master

During the proceedings before the Special Master, three issues emerged, which are addressed by the second preliminary Report of September 15, 1980, now before the Court.[13] The first is whether the complaint in this case should be dismissed on the motion of Louisiana, filed with the Court on October 22, 1979. Since the Master recommended that the Court deny Louisiana's motion on this score (Report 10-20), we have no occasion to address it at this stage. If (as we anticipate) Louisiana excepts to the Master's ruling, we shall of course respond.

The remaining issues relate to the plaintiffs' motion for judgment on the pleadings on the grounds that the Louisiana First Use Tax is invalid under the Supremacy and Commerce Clauses of the Constitution. These motions were first filed with the Court on September 18, 1979, and, in briefs amici curiae filed in June and November, 1979, the United States and the Federal Energy Regulatory Commission supported the plaintiff States. In the first of those briefs, we urged that the resolution of the constitutional validity of the tax did not require the appointment of a Special Master because there are no

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[12] *Hearings on H.B. 768 Before the Committee on Ways and Means of the Louisiana House of Representatives* 4 (colloquy between Rep. Tauzin and unidentified speakers), 5 (colloquy between Reps. Sour and Bagert), 6 (Rep. Labords) (June 5, 1978).

[13] The Special Master's first preliminary report, filed on May 14, 1980, contained his recommendations with respect to: (1) motions to intervene by New Jersey, the United States and the Federal Energy Regulatory Commission, and 17 pipelines; and (2) a motion to appear as amicus curiae by the Associated Gas Distributors. See pages I-II, note *, *supra*.

genuine issues as to any material facts. In the second brief, we urged that the Court grant the plaintiffs' motion for judgment on the pleadings and hold that the Louisiana tax is unconstitutional. On March 3, 1980, the Court appointed a Special Master and referred the motions for judgment on the pleadings to him (Report 9). After hearing argument by the various parties and amici curiae, the Special Master recommended that 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 (Report 38).

1. *The Supremacy Clause.* The Special Master concluded that the facts disclosed in the pleadings do not, without more, require that the Act be invalidated on the basis of the Supremacy Clause. In so ruling, the Master acknowledged that "the Louisiana first use tax may in fact interfere with the federal regulatory process * * *" (Report 21). But he further observed that "the interference may be so indirect, so peripheral, so subject to administrative adjustments, as to permit the State and federal programs to coexist" (*ibid.*). In the Master's view, "[e]videntiary hearings are necessary to reach a conclusion on these issues" (*ibid.*).

The Master recognized that the Natural Gas Act and the Natural Gas Policy Act vest the Federal Energy Regulatory Commission with exclusive authority to regulate the transportation and sale of natural gas in interstate commerce and that any state law that interfered with the Commission's exclusive jurisdiction would violate the Supremacy Clause. He further observed that the Commission's authority includes the power to allocate costs of processing and transporting liquid and liquefiable hydrocarbons between producers and pipelines (Report 22-23) and that § 47:1303 C of the First Use Tax Act prohibits a pipeline from passing the First Use Tax back to a producer (Report 26-29, 30). But the Master concluded that evidentiary hearings are necessary to determine whether the processing that occurs within Louisiana by which the hydrocarbons are extracted changes the nature of the gas so as to justify passing on the First Use Tax on to consumers.

In so holding, the Master rejected our argument that under the decisions of this Court, the Commission has the exclusive authority to allocate costs, and that Louisiana interferes with the Commission's function when it seeks to allot the tax. In the Master's view, "the conflict [between] the Natural Gas Act [and the Louisiana tax] 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" (Report 29). Moreover, he concluded that "it may be that in the end FERC's orders can be adjusted so that the laws will mesh without conflict" (*ibid.*). Accordingly, the Master recommended that the Court not grant the plaintiffs' motion for judgment on the pleadings on the basis of the Supremacy Clause (Report 31).

2. *The Commerce Clause.* With respect to the Commerce Clause, the Special Master conceded that "a determination on the validity of the Louisiana tax could be made on the pleadings, plus a generous application of judicial notice" (Report 21). But he suggested 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" (*ibid.*).

In so holding, the Master recognized that the continuous movement of the gas from the Outer Continental Shelf across the state boundary and up to the processing plant is interstate commerce during the entire journey and that the tax would violate the Commerce Clause if its result is to impede interstate commerce (Report 32-33). He therefore rejected Louisiana's argument that the tax was levied on a local activity within the state.

Moreover, the Master agreed with the plaintiffs' contention that under the system of exclusions and credits provided by the First Use Tax, "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" (Report 34). But the Master nevertheless resisted the conclusion that the exclusions and credits unconstitutionally discriminated against the out-of-state consumer. While he acknowledged that such discrimination might be the case, the Master concluded that "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" (Report 34-35).

Finally, the Special Master regarded the facts of this Court's decision in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157 (1954), to be "closest to this one" so that, under the rule of that case, many of the uses defined in the First Use Tax Act "would result in some of the acts being too intimately connected with interstate transmission to survive" (Report 36). But in light of the Louisiana statute's severability clause, the Master recommended that evidence should be heard as to the legal effect of the term "processing" in the statute to determine whether "processing" interrupts the interstate journey of the gas (Report 37).

INTRODUCTION AND SUMMARY

I.

"[I]t was settled even before the passage of the Natural Gas Act, that *direct* regulation of the prices of wholesales of natural gas in interstate commerce is beyond the constitutional power of the States—whether or not framed to achieve ends, such as conservation, ordinarily within the ambit of state power." *Northern Natural Gas Co.* v. *Kansas Commission*, 372 U.S. 84, 90 (1963) (emphasis in original). In passing the Natural Gas Act in 1938 and the Natural Gas Policy Act in 1978, Congress did something more. In the Court's words, "[t]he Congress enacted a comprehensive scheme of federal regulation of 'all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company[,]' *Phillips Petroleum Co.* v. *Wisconsin*, [347 U.S. 672,] 682 [1954] * * *" (372 U.S. at 91; footnote omitted).

The Louisiana First Use Tax conflicts with the federal regulation of the sale and transportation of natural gas in interstate commerce and is therefore invalid under the Supremacy Clause of the Constitution. Although couched in terms of a tax on the "use" of natural gas, the principal impact of the levy is to increase the price of gas extracted from federally-leased areas on the Outer Continental Shelf and from federal enclaves and shipped through Louisiana in interstate commerce. Since Congress by the Natural Gas Act and the Natural Gas Policy Act has vested in the Federal Energy Regulatory Commission the exclusive authority to set rates for the sale and transportation of such natural gas in interstate commerce, the Louisiana tax is incompatible with the federal regulatory scheme. It is therefore clear that the Louisiana tax trenches upon "matters which directly affect the ability of the [Commission] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which [is] an objective of the Natural Gas Act [and the Natural Gas Policy Act]." *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, 372 U.S. at 91-92.

Contrary to the assertion of Louisiana, the decisions of this Court establish that the interstate journey of the gas subject to tax is not interrupted by the occurrence of any of the taxable "uses" enumerated in the Louisiana statute unless the gas is sold for ultimate consumption in Louisiana. Thus, whatever the extent of processing or treatment that occurs within Louisiana, it is settled that such processing does not break the interstate journey of gas that is produced outside of Louisiana and is brought into and/or through Louisiana for ultimate consumption in other states. The Master therefore erred in concluding that evidence must be taken with respect to the legal effect of the processing of the gas.

Like the plaintiff States, we believe that the invalidity of the Louisiana tax under the Supremacy Clause can be demonstrated as a matter of law and that the Master erred in recommending against granting the plaintiffs' motion for judgment on the pleadings. It is undisputed that the principal impact of the Louisiana tax is on gas produced from fields located outside Louisiana on the Outer Continental Shelf and on federal enclaves. Moreover, the decisions of this Court further demonstrate that such gas moves in interstate commerce. Finally, it is clear that Louisiana has outlawed contractual provisions subject to regulation by the Federal Energy Regulatory Commission. Given Congress' intent to preempt the field and to grant exclusive regulatory authority over such gas to the Federal Energy Regulatory Commission, the incompatability of the Louisiana tax with that exclusive jurisdiction is established as a matter of law. The Louisiana tax is therefore invalid under the Supremacy Clause.

The Master's conclusion that evidentiary hearings are necessary in order to determine the degree of conflict between the Louisiana tax and the authority of the Federal Energy Regulatory Commission cannot be squared with the Supremacy Clause decisions of this Court. Where, as here, Congress determines to preempt the field of interstate gas regulation as to which the states never had any authority, any possible conflict between federal and state authority voids the state statute under the Supremacy Clause. As this Court aptly observed in *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, 372 U.S. at 92, "although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision * * * that the [state] orders must be declared a nullity in order to assure the effectuation of the comprehensive federal regulation ordained by Congress."

II.

The pleadings also establish that the Louisiana First Use Tax is invalid under the Commerce Clause. The Commerce Clause flatly prohibits state taxation of goods that are merely in transit through the state when the tax is assessed. The Master acknowledged that the facts of *Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157 (1954), are "closest to this one" (Report 36). We submit that *Michigan-Wisconsin Pipe Line Co.* controls this case. There, the Court struck down a similar state statute upon the entire volume of natural gas to be shipped in interstate commerce. The Court held it to be an unapportioned levy on the transportation of gas and therefore invalid under the Commerce Clause.

While the Louisiana tax is characterized as "upon the privilege of performance or allowing the performance by the owner, of the enumerated actions comprising first use within Louisiana" (La. Rev. Stat. Ann. § 47:1303 E (West Supp. 1980) (Mot. App. 6a), the provisions of the Act demonstrate that the tax falls on the transportation of the natural gas within Louisiana, not the privilege of use. Stripped to its essentials, the Louisiana levy is nothing more than an "unapportioned levy on the transportation of the entire volume of gas." *Wash. Rev. Dep't* v. *Stevedoring Ass'n,* 435 U.S. 734, 749 n.18 (1978). There is accordingly no need to conduct a factual inquiry into the nature of the processing of the gas, as the Master has recommended.

Even if the Louisiana First Use Tax is not simply a transit levy on gas moving in interstate commerce, it is nevertheless invalid because it is not fairly apportioned and because it discriminates against interstate commerce. It is not related to either the value of identifiable activities occurring within the taxing state, the taxpayer's investment in facilities within the state, its gross income from business or the percentage of business conducted within the state, or the length of the facilities or distance traveled within the state. The Master therefore erred in concluding that the apportionment requirement is not applicable to this case.

The Louisiana tax also discriminates against interstate commerce in two distinct ways. First, while Louisiana has prohibited the purchasers of gas subject to the tax from shifting it to the producer, it does not prohibit purchasers of gas subject to its severance tax from shifting all or part of the tax to the producer. The practical effect of prohibiting the shifting of the First Use Tax is to impose a tax on Outer Continental Shelf and federal enclave gas which is greater than the tax imposed on gas produced within Louisiana.

Finally, the Louisiana First Use Tax discriminates against interstate commerce by requiring out-of-state consumers to bear the entire burden of the levy. This discrimination is accomplished by a system of credits designed to ensure that Louisiana consumers are relieved of any First Use Tax liability. The Louisiana tax therefore "falls short of the substantially even-handed treatment demanded by the Commerce Clause." *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 332 (1977).

ARGUMENT

I. THE PLAINTIFFS ARE ENTITLED TO JUDGMENT WITHOUT FURTHER EVIDENTIARY PROCEEDINGS BECAUSE THE PLEADINGS ESTABLISH THAT THE LOUISIANA FIRST USE TAX CONFLICTS WITH ~~THE~~ FEDERAL REGULATION OF THE SALE AND EXCLUSIVE TRANSPORTATION OF NATURAL GAS IN INTERSTATE COMMERCE AND IS THEREFORE INVALID UNDER THE SUPREMACY CLAUSE OF THE CONSTITUTION

A. The Gas Subject To The First Use Tax Moves In Interstate Commerce

As we have already explained (*supra*, page 7), the Louisiana First Use Tax applies to OCS gas and federal enclave gas. Gas in each of these categories moves in interstate commerce as that term is defined by the decisions of this Court.

It has long been established that natural "gas which crosses a state line at any stage of its movement from wellhead to ultimate consumption[,]" or gas which is commingled with gas so moving, is in interstate commerce during the entire journey. *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965).[14] That journey commences at the wellhead (*California* v. *Lo-Vaca Gathering Co., supra; East Ohio Gas Co.* v. *Tax Commission*, 283 U.S. 455 (1931)). It ends after the pressure is reduced and the gas is delivered into local distribution systems for ultimate consumption (*FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 472-473 (1950); *East Ohio Gas Co.* v. *Tax Commission, supra*, 283 U.S. at 470), or after the gas is delivered to an industrial user for consumption (15 U.S.C. 717(b)), or to a distribution company, or intrastate pipeline, which is subject to state or local regulation, at the border of, or within, a state and the gas is actually consumed within that state (15 U.S.C. 717(c)). This standard applies to the two categories of gas involved in this case.

a. *OCS gas.* OCS gas is produced from "field[s] * * * *located outside the borders of any state and any gas taken will have to be transported across state lines for sale* within the United States." *Continental Oil Co.* v. *FPC*, 370 F.2d 57, 66 (5th Cir. 1966) (emphasis in original), cert. denied, 388 U.S. 910 (1967). Thus, "the onshore movement of gas produced in the Federal domain offshore Louisiana constitutes interstate commerce within the meaning of the Natural Gas Act * * *." *Chandeleur Pipe Line Co.*, 42 F.P.C. 20, 25 (1969). See also *United*

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[14] See also *FPC* v. *East Ohio Gas Co.*, 338 U.S. 464, 467, 469-472 (1950); *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 687-689 (1947); *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, 314 U.S. 498, 503-506 (1942); *East Ohio Gas Co.* v. *Tax Commission of Ohio*, 283 U.S. 465, 470 (1931); *Peoples Natural Gas Co.* v. *Public Service Commission of Pennsylvania*, 270 U.S. 550, 554 (1926); *Public Service Commission of Kentucky* v. *FERC*, 610 F.2d 439, 444 (6th Cir. 1979); *Louisiana Public Service Commission* v. *FPC*, 359 F.2d 525, 527-528 (5th Cir. 1966); *Deep South Oil Co. of Texas* v. *FPC*, 247 F.2d 882, 887-889 (5th Cir. 1957), cert. denied, 355 U.S. 930 (1958).

Gas Pipe Line Co., 30 F.P.C. 560, 563-564 (1963). Furthermore, most of the OCS gas which enters Louisiana is transported through that state for ultimate consumption in other states.[15] This interstate movement is not interrupted by any of the taxable uses described in La. Rev. Stat. Ann. § 47:1302(8) (West Supp. 1980), unless the gas is sold to a local distribution company, intrastate pipeline, or user of gas within Louisiana, for ultimate consumption there.

b. *Federal enclave gas.* Federal enclave gas from Barksdale Air Force Base also moves in interstate commerce. That gas is processed near the field in plants owned by Union Texas Petroleum Company and Arkansas Louisiana Gas Company. The gas is then delivered to Arkansas Louisiana Gas Company, Mississippi River Transmission Corporation, Texas Gas Transmission Company, and United Gas Pipe Line Company. Some of this gas is sold to distribution companies and directly to industrial and other users in Louisiana; the remainder is transported to out-of-state consumers. The total volume of gas from Barksdale Air Force Base either moves in interstate commerce or is commingled with such gas. Thus, such federal enclave gas moves in interstate commerce from the time it leaves the wellhead until it is sold for ultimate consumption within Louisiana or other states.

B. The Taxable "Uses" Enumerated In The Louisiana Statute Do Not Interrupt The Journey Of The Gas In Interstate Commerce

1. Louisiana does not dispute the fact that each of the two categories of gas to which the First Use Tax applies—OCS gas and federal enclave gas—moves in in-

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[15] *Hearings on H.B. 768 Before the Committee on Ways and Means of the Louisiana House of Representatives* 7 (Rep. Tauzin) (June 5, 1978); *id.* at 9 (Mr. Brooksher) (June 6, 1978); *Hearings on H.B. 768 Before the Revenue and Fiscal Affairs Committee of the Louisiana Senate* 4 (Rep. Tauzin) (June 26, 1978).

terstate commerce. Moreover, the Master likewise agreed that the "natural gas is in interstate commerce during the entire journey" (Report 32). Louisiana contends, however, that extensive processing and treatment of the gas occurs in Louisiana and that these activities interrupt the journey of the gas in interstate commerce and thereby justify imposition of the tax (see Motion to Dismiss 22-26; Answer 11 ¶ XXXV, 13 ¶ XL). The Master concluded that evidentiary proceedings are necessary because "[t]here 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" (Report 28). See also Report 37.

But the decisions of this Court establish that the interstate journey of OCS and federal enclave natural gas is not interrupted by the occurrence of any of the taxable "uses" enumerated in the Louisiana tax statute unless the gas is sold for ultimate consumption in Louisiana. Thus, whatever the extent of processing or treatment that occurs within Louisiana, it is settled that such processing does not break the interstate journey of gas that is produced outside of Louisiana and is brought into and/or through Louisiana for ultimate consumption in other states. We turn now to a discussion of each of the taxable "uses" enumerated in the Louisiana First Use Tax Act.

a. The "sale" or "transfer of possession of relinquishment of control at a delivery point [within Louisiana]" (La. Rev. Stat. Ann. § 47:1302(8) (West Supp. 1980)) does not necessarily interrupt the interstate movement of gas subject to the First Use Tax. *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co.*, *supra*, 314 U.S. at 503-504; *Peoples Natural Gas Co.* v. *Public Service Commission of Pennsylvania*, 270 U.S. 550, 554 (1926).

In transactions involving gas that is sold and/or delivered to another pipeline, which transports the gas, or commingles it with gas transported, out of Louisiana, or sells and/or delivers the gas to a third pipeline, which transports the gas out of Louisiana, "the particular point at which the title and custody of the gas pass to the purchaser, without arresting its movement to its intended destination, does not affect the essential interstate nature of the business." *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co., supra,* 314 U.S. at 503-504.[16]

b. The "transportation in [Louisiana] to the point of delivery at the inlet of any processing plant" or "the transportation in [Louisiana] of unprocessed gas to the point of delivery at the inlet of any measurment or storage facility" (La. Rev. Stat. Ann. § 47:1302(8) (West Supp. 1980)) by an interstate pipeline does not interrupt the interstate movement of the gas. To the contrary, such transportation is an inseparable segment of the interstate movement of the gas from wellhead to the ultimate consumers located in Louisiana and in other states. Cf. *Michigan-Wisconsin Pipe Line Co.* v. *Calvert,* 347 U.S. 157, 163 (1954); *Area Rate Proceeding (Southern Louisiana Area),* 40 F.P.C. 530, 611 (1968), aff'd, 428 F.2d 407 (5th Cir.), cert. denied, 400 U.S. 950 (1970).

c. The storage of gas within Louisiana by an interstate pipeline, which may constitute "other ascertainable

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[16] On the other hand, if the gas is sold and delivered to an intrastate pipeline, or distribution company at the border of, or within, Louisiana, and is actually consumed within that state, it ceases to be in interstate commerce once that delivery is made. 15 U.S.C. 717(c); *Illinois Natural Gas Co.* v. *Central Illinois Public Service Co., supra,* 314 U.S. at 503-504; *FPC* v. *East Ohio Gas Co., supra,* 338 U.S. at 472-473. The same is true if gas is sold and delivered to an industrial or other user within Louisiana. 15 U.S.C. 717(b); *Panhandle Eastern Pipe Line Co.* v. *Public Service Commission,* 332 U.S. 507 (1947).

Gas which is subject to the First Use Tax and which is "use[d] in manufacturing" in Louisiana (§ 47:1302(8)) has ceased to be in interstate commerce with its delivery to the manufacturer, or the local distribution company or intrastate pipeline which serves that manufacturer. Moreover, the various credits and exclusions would minimize or eliminate any tax on this use. See Report 37 n.20.

action at a point within the state" (§ 47:1302(8)) does not interrupt the interstate movement if it is a temporary incident of such movement. Cf. *Board of Trade of City of Chicago* v. *Olsen*, 262 U.S. 1, 33-34 (1923).[17] This gas has moved in interstate commerce prior to storage and will so move upon withdrawal from storage in the manner previously authorized by the Commission until such time as the Commission, by an amendment to the certificate authorizing operation of the storage facility, authorizes a different movement. The seasonal storage of such gas does not break the interstate journey because the gas is stored to facilitate its movement to the ultimate consumers, whether in Louisiana or in other states, during the winter heating season when the demand for gas is the greatest.[18] Cf. *Champlin Realty Co.* v. *Brattleboro*, 260 U.S. 366, 376-377 (1962).

d. Finally, the delivery of gas to the operator of a treating and/or processing plant, treatment of the gas for removal of impurities and/or waste products, and processing to extract liquid and liquefiable hydrocarbons (see § 47:1302(8)) do not interrupt the interstate movement. Instead, as this Court has observed, the "[t]he entire movement of the gas, from the producing wells through the [processing plants] and into the [interstate] pipeline[s] to consumers outside [Louisiana] is a steady and continuous flow." *Michigan-Wisconsin Pipe Line Co.*

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[17] Storage of gas subject to the First Use Tax by an intrastate pipeline, local distribution company, or industrial or other consumer of gas within Louisiana presents a different legal issue. Such gas has ceased to be in interstate commerce by reason of the sale of such gas to those persons.

[18] See Federal Power Commission, *Natural Gas Survey*, Vol. I, at 39-40, 44-46, 47 (1975).

v. *Calvert*, 347 U.S. 157, 163 (1954); *California* v. *Lo-Vaca Gathering Co.*, 379 U.S. 366, 369 (1965); *Interstate Natural Gas Co.* v. *FPC*, 331 U.S. 682, 685 n.7 (1947). *Public Service Commission of Kentucky* v. *FERC*, 610 F.2d 439, 444 (6th Cir. 1979). Thus, processing does not interrupt the continuous movement of the gas from the wellhead to consumer burner tips * * *." *Deep South Oil Co.* v. *FPC*, *supra*, 247 F.2d at 888.

C. The Louisiana Tax Interferes With The Federal Regulation Of The Transportation And Sale Of Natural Gas In Interstate Commerce

1. Once it is recognized that the First Use Tax is imposed upon OCS and federal enclave natural gas, and that these categories of gas move in interstate commerce, it can be readily seen that the Louisiana levy interferes with the federal regulation of the transportation and sale of gas in interstate commerce and is therefore invalid under the Supremacy Clause.[19]

We focus on § 47:1303 C of the First Use Tax as it interferes with the Commission's regulation of the transportation and sale of natural gas in interstate commerce. By the terms of the First Use Tax Act, § 4(2), 1978 La. Sess. Law Serv. 486, if that provision is unconstitutional, the entire statute becomes void.[20] Thus, if the Court agrees with our submission that the pleadings

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[19] "Although [these claims are] basically constitutional in nature, deriving [their] force from the operation of the Supremacy Clause, Art. VI, cl. 2, they are treated as 'statutory' for purposes * * * of deciding statutory claims first to avoid unnecessary constitutional adjudications." *Douglas* v. *Seacoast Products, Inc.*, 431 U.S. 265, 271-272 & n.6 (1977); *Hagans* v. *Lavine*, 415 U.S. 528, 549 (1974).

[20] See *Hearings on H.B. 768 Before the Revenue and Fiscal Affairs Committee of the Louisiana Senate* 4, 13, 28 (Rep. Tauzin) (June 26, 1978).

show, without more, that § 47:1303 C is invalid under the Supremacy Clause, it need not reach any of the plaintiffs' other claims.[21]

Section 47:1303 C declares the First Use Tax to be "a cost associated with uses made by the owner in preparation of [*sic*] marketing of the natural gas." It abrogates "agreement[s] or contract[s] by which an owner of natural gas at the time a taxable use first occurs claims a right to reimbursement or refund of such taxes from any other party in interest, other than a purchaser of such natural gas * * * on the basis that this tax constitutes a cost incurred by such owner by virtue of the separation or processing of natural gas for extraction of liquid or liquefiable hydrocarbons, or * * * any other grounds for reimbursement or refund * * *." Louisiana's answer states that "the sole purpose, intent, and application of [§ 47:1303 C is] 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." Answer 21 ¶ LX. The pleadings therefore show that § 47:1303 C seeks to regulate the apportionment of costs among producers, processors, and pipelines, and that it interferes with the Commission's exclusive jurisdiction.

2. Section 47:1303 C impinges upon the Commission's ratemaking authority under Sections 4 and 5 of the Natural Gas Act (15 U.S.C. 717c and 717d). Insofar as it characterizes the First Use Tax as a cost associated with

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[21] Contrary to Louisiana's denial (Answer 17-18 ¶ XLVIII), § 47:1303 C is a regulation of the transportation and sale of natural gas in interstate and foreign commerce. To " 'regulate' is to lay down the rule by which a thing shall be done." *FPC* v. *Corporation Commission of Oklahoma,* 362 F. Supp. 522, 532 (W.D. Okla. 1973) (three-judge court), aff'd per curiam, 415 U.S. 961 (1974). As it prescribes, "the rule by which natural gas produced [outside of Louisiana's taxing jurisdiction] may move from [Louisiana] to other states[,] [§ 47:1303 C] constitute[s], therefore, a regulation * * *" (362 F. Supp. at 533).

uses of the gas by the interstate pipeline owner and abrogates contractual provisions which would require persons other than gas consumers to bear the tax, § 47:1303 C interferes with the Commission's authority to allocate costs between gas consumers and the owners of liquid and liquefiable hydrocarbons which aer carried by interstate pipelines.

Because many natural gas pipelines transport extractable hydrocarbons as well as natural gas, the Commission must determine which costs should be borne by natural gas consumers and which should be borne by the owners of the extractable hydrocarbons.[22] The First Use

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[22] *Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238, 1241-1243, 1247, 1249 (D.C. Cir. 1973); *City of Detroit* v. *FPC*, 230 F.2d 810, 819-821 (D.C. Cir. 1955), cert. denied, 352 U.S. 829 (1956); *Cities Service Gas Co.* v. *FPC*, 155 F.2d 694, 703 (10th Cir.), cert. denied, 329 U.S. 773 (1946); *Hope Natural Gas Co.* v. *FPC*, 134 F.2d 287, 307-308 (4th Cir. 1943), rev'd on other grounds, 320 U.S. 591 (1944); *Panhandle Eastern Pipe Line Co.* v. *FPC*, 324 U.S. 635, 641-642 (1945); *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 588-590 (1945).

When these cases were decided, the Commission could not directly prescribe rates for the transportation of liquid hydrocarbons; it could only assign costs to that service and preclude the recovery of such costs in rates charged natural gas consumers. *Mobil Oil Corp.* v. *FPC*, *supra*, 483 F.2d at 1246-1249. Arguably, the Commission could regulate the terms on, and rates at, which liquefiable hydrocarbons—those hydrocarbons produced with natural gas existing in a gaseous state when produced and transported that may be extracted from the gas stream by processing, liquefied, and treated as liquids (*id.* at 1241)—are transported in interstate commerce pursuant to the Natural Gas Act (*id.* at 1242, 1246, 1249). The Commission's authority to regulate the transportation of liquid and liquefiable hydrocarbons by interstate natural gas pipelines (cf. *id.* at 1242-1243), was established when the Department of Energy Organization Act ("DOE Act") vested the Commission with jurisdiction to set rates for the transportation of oil by common-carrier pipeline (DOE Act, Section 402(b), 42 U.S.C. (Supp. II) 7172(b)), including any "petroleum by-products, derivatives or petrochemicals." H.R. Rep. No. 95-539, 95th Cong., 1st Sess. 69 (1977). Thus, the Commission may now prescribe directly the rates for the transportation of liquid and liquefiable hydrocarbons by natural gas pipelines providing common carriage for such prod-

Tax, like other taxes and costs, is an element of the pipeline's cost of service. *FPC* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 243 (1967). It is for the Commission and the Commission alone to determine whether this cost should be borne by gas consumers or others. *Id.* at 243-246.

The Commission has consistently held that a pipeline's natural gas customers do not receive any benefits from the pipeline's transportation of liquid and liquefiable hydrocarbons for the owners, and that the costs associated with the transportation and delivery of those products at the inlet of a processing plant must be borne by the producers, who benefit from such activities, and not by natural gas consumers.[23] The Commission has also held that costs associated with the processing of natural gas to extract the liquid and liquefiable hydrocarbons must be borne by the owners of the products, and not by the natural gas consumers.[24]

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ucts. Accordingly, since any natural gas pipeline operating on the Outer Continental Shelf, which carries liquid and liquefiable hydrocarbons for producers, must operate as a common carrier (43 U.S.C. 1334(c)), the Commission may now prescribe directly the rates for the transportation by pipeline of liquid hydrocarbons as well as for the liquefiable hydrocarbons and natural gas carried by such pipelines.

[23] *Union Oil Company of California*, Docket Nos. C177-828, *et al.*, order at 7, 10-11 (Apr. 12, 1978); *Canadian Superior Oil (U.S.) Ltd.*, Docket No. C177-802 (Mar. 28, 1978); *High Island Offshore System*, Docket Nos. CP75-104, *et al.*, order at 10, 16-17, 18 (June 4, 1976); *Tennessee Gas Pipeline Co.*, 38 F.P.C. 691, 698 (1967); *Northern Natural Gas Co.*, 28 F.P.C. 1155, 1163-1165 (1962); aff'd *sub nom. Mid-American Pipeline Co.* v. *FPC*, 330 F.2d 226 (D.C. Cir. 1964); *Continental Oil Co.*, 27 F.P.C. 96, 107-108 (1962); *Texas Eastern Transmission Corporation*, 11 F.P.C. 435, 447 (1952). See also *Pipeline Costs Allocable to the Transportation of Liquids, Liquefiable Hydrocarbons, etc., For Others*, 47 F.P.C. 208 (1972), rev'd on other grounds *sub nom. Mobil Oil Corp.* v. *FPC*, 483 F.2d 1238 (D.C. Cir. 1973).

[24] Natural gas is processed to extract liquid and liquefiable hydrocarbons because those products are considered more valuable than the processed gas. *E.g., Deep South Oil Co. of Texas* v. *FPC, supra*, 247 F.2d at 888; *National Rates for Natural Gas*, 54 F.P.C. 3090,

The First Use Tax is such a cost. It is imposed on activities which, in most cases, occur solely because the pipeline transports and delivers the gas stream to a processing plant so that the producers may separate and extract the liquid and liquefiable hydrocarbons contained in that stream. Thus, "the transportation in [Louisiana]

3096-3102 (1975), reh. denied, 15 P.U.R. 4th 1, 12-13 (1976), aff'd in part and rev'd in part on other grounds *sub nom. Tenneco Oil Co.* v. *FERC*, 571 F.2d 834, 844-845 (5th Cir. 1978). The removal of these hydrocarbon products does not benefit gas consumers because it reduces both the volume, and heat content, of the processed gas. *Area Rate Proceeding (Southern Louisiana Area)*, 40 F.P.C. 530, 611 (1968), aff'd, 428 F.2d 407 (5th Cir.), cert. denied, 400 U.S. 950 (1970); *Northern Natural Gas Co.*, 28 F.P.C. 1155, 1158, 1163-1165 (1962), aff'd *sub nom. Mid-American Pipe Line Co.* v. *FPC*, 330 F.2d 226 (D.C. Cir. 1964).

Although the methodologies have differed, the Commission has applied the policy of requiring the owner of hydrocarbons to bear the cost of their extraction in establishing rates for producers as well as for pipelines. In establishing producer rates, the Commission had either credited revenues from the sale of the extracted hydrocarbons against costs, or allocated costs between the processed gas and the extracted hydrocarbons on the basis of economic and physical characteristics of the two products. *National Rates For Natural Gas*, Docket No. RM75-14, Opinion No. 770, 15 P.U.R. 4th 21, 49-50 (1976), reh. denied, Opinion No. 770-A, 17 P.U.R. 4th 317, 346-347 (1976), aff'd *sub nom. American Public Gas Association* v. *FPC*, 567 F.2d 1016 (D.C. Cir. 1977), cert. denied, 435 U.S. 907 (1978); *National Rates for Natural Gas*, 54 F.P.C. 3090, 3096-3102 (1975), reh. denied, 15 P.U.R. 4th 1, 12-14 (1976). In establishing rates for those pipelines, which own the extracted hydrocarbons as well as the processed gas, the Commission has credited the revenues from the sales of the liquids against the pipeline's cost of service. *Kansas-Nebraska Natural Gas Company*, 53 F.P.C. 1691, 1702-1703 (1975), reh. denied, 54 F.P.C. 923 (1975); *Panhandle Eastern Pipe Line Co.*, 25 F.P.C. 787, 797-798 (1961), remanded *sub nom. Panhandle Eastern Pipe Line Co.* v. *FPC*, 305 F.2d 763, 767-768 (D.C. Cir. 1962), cert. denied, 372 U.S. 916 (1963), aff'd on remand, 32 F.P.C. 636 (1964), aff'd per curiam, 348 F.2d 340 (D.C. Cir.), cert. denied, 382 U.S. 944 (1965); *Northern Natural Gas Co.*, 28 F.P.C. 1155, 1163-1165 (1962), aff'd *sub nom. Mid-American Pipeline Co.* v. *FPC*, 330 F.2d 226 (D.C. Cir. 1964); *Tennessee Gas Transmission Co.*, 18 F.P.C. 428, 435 (1957); *id.* at 474-479 (Initial Decision).

of unprocessed natural gas to the point of delivery at the inlet of any measurement or storage facility[,] * * * processing for the extraction of liquefiable component products or waste material[,] * * * [and] treatment" [25] occur solely because the gas is delivered to a producer-owned processing plant. Moreover, the pipeline must "transfer * * * possession or relinquish[] control at a delivery point in [Louisiana]" (§ 47:1302(8)) at the inlet of the processing plant to enable the producers to process the gas. Since such activities benefit only the producers, the Commission must determine whether the producers or the pipelines' natural gas customers must bear the costs (including any taxes) incurred by the pipelines because of these activities.

Section 47:1303 C, however, seeks to preclude the Commission from classifying the First Use Tax as a cost associated with the extraction of hydrocarbons and requiring that it be recovered from those products. It does this by abrogating contracts which require the owners of the extracted hydrocarbons to reimburse the transporting interstate pipelines for costs allocated to transporting and processing of those products. This abrogation prohibits the interstate pipeline from obtaining reimbursement from the owner of the extracted hydrocarbons and requires the interstate pipeline to seek reimbursement, if at all, from subsequent purchasers of the processed gas. The practical effect of this provision is to shift the incidence of significant costs incurred primarily for the benefit of the owners of the extracted hydrocarbons to the ultimate consumer of the processed gas without the prior approval of the Commission.

D. No Evidentiary Proceedings Are Necessary To Establish The Invalidity Of The First Use Tax Under The Supremacy Clause

1. In his Report, the Master acknowledged that Congress has vested in the Federal Energy Regulatory Commission the exclusive authority to regulate the sale and

[25] La. Rev. Stat. Ann. § 47:1302(8) (West Supp. 1980).

transportation of natural gas in interstate commerce and that "the impact of the tax appears to be directed at interstate sales by reason of the exemptions and credits granted intrastate users" (Report 27). Despite the conceded conflict between the Louisiana tax and the federal regulatory scheme, the Master nevertheless concluded that "a decision [on the Supremacy Clause] 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" (*ibid.*). As the Master saw the matter, "[t]he 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 the FERC control, or whether it is a substantial hindrance to the Commission's powers" (*ibid.*). In so ruling, the Master observed that "it may be that in the end FERC's orders can be adjusted so that the laws will mesh without conflict" (Report 29).

But the Master's conclusion that further inquiry is required to determine the degree of conflict between the Louisiana tax and the authority of the Commission cannot be squared with the decisions of this Court interpreting the Supremacy Clause. The Master's point might be well taken if this were a case where Congress has legislated in an area which the States have traditionally occupied. In those circumstances, the Court "start[s] with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977); *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151, 157-158 (1978), and cases cited therein. In such a case, the state statute is void to the extent that it actually conflicts with a valid federal statute, *i.e.*, "where compliance with both federal and state regulations is a physical impossibility * * *" (*Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142-143 (1963)), or where the state "law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941).

This is not a case in which actual conflict between federal and state authority must be proved to establish a violation of the Supremacy Clause. Here, the federal regulation scheme is "so pervasive as to make reasonable the inference that Congress left no room for the States to supplement it." *Rice* v. *Santa Fe Elevator Corp.*, *supra*, 331 U.S. at 230. Indeed, it is beyond question that the states have not traditionally occupied the field of regulation of interstate sales of gas. As we have pointed out (*supra*, page 11), "it was settled even before the passage of the Natural Gas Act, that *direct* regulation of the prices of wholesales of natural gas in interstate commerce is beyond the constitutional power of the States—whether or not framed to achieve ends, such as conservation, ordinarily within the ambit of state power." *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, 372 U.S. at 90 (emphasis in original). Accord: *Public Utilities Commission* v. *Attleboro Steam & Electric Co.*, 273 U.S. 83 (1927); *Missouri* v. *Kansas Natural Gas Co.*, 265 U.S. 298 (1924); *Pennsylvania* v. *West Virginia*, 262 U.S. 553 (1923); *West* v. *Kansas Natural Gas Co.*, 221 U.S. 229 (1911). Thus, in passing the Natural Gas Act in 1938, Congress intended to "touch a field in which the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws of the same subject." *Rice* v. *Santa Fe Elevator Corp.*, *supra*, 331 U.S. at 230. See also *Ray* v. *Atlantic Richfield Co.*, *supra*, 435 U.S. at 157-158, and cases cited therein. Accordingly, Congress did not intend to complement existing state regulation but to establish an exclusive federal authority that would preempt all forms of state regulation not expressly authorized.[26]

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[26] *Portland Pipe Line Corp.* v. *Environmental Improvement Commission*, 307 A.2d 1 (Me. 1973), which the Master cited as "[t]he case which most strongly supports Louisiana's position" (Report 30), has no bearing on the Supremacy Clause issue. There, the Supreme Court of Maine upheld a Maine tax levied upon the move-

In these circumstances, there is no need for a factual inquiry to determine the degree of interference between the Louisiana tax and the authority of the Commission. Given Congress' intent to preempt the field, Louisiana cannot enact laws that "conflict, or interfere with, curtail or complement, the federal law, or enforce additional or auxiliary regulations." *Hines* v. *Davidowitz*, *supra*, 312 U.S. at 66-67; *Jones* v. *Rath Packing Co.*, *supra*, 430 U.S. at 525; *San Diego Building Trades Council* v. *Garmon*, 359 U.S. 236, 244 (1959); *Machinists* v. *Wisconsin Employment Relations Commission*, 427 U.S. 132, 138-139 (1976). Accordingly, any possible interference between the First Use Tax and the authority of FERC voids the state statute. As the Court stated in the closely analogous situation in *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, 372 U.S. at 92, "although collision between the state and federal regulation may not be an inevitable consequence, there lurks such imminent possibility of collision * * * that the orders must be declared a nullity to assure the effectuation of the comprehensive federal regulation ordained by Congress."

Here, the Louisiana tax indisputably adds a cost to the price of gas sold in interstate commerce and requires that such cost be absorbed by the pipeline or passed on

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ment of oil in the state harbor waters in order to provide funds to clean up oil spills. But the court did not consider whether the tax violated the Supremacy Clause. Rather, it addressed claims raised under the Due Process, Commerce, Import-Export, Tonnage, and Admiralty Clauses.

Moreover, the Master's suggestion (*ibid.*) that a question could have been raised in that case about the supremacy of the Water Quality Improvement Act of 1970, 33 U.S.C. 1321, is not well taken. As the Maine court correctly observed (307 A.2d at 40), there was no conflict between federal and state law. Congress declared in that statute that "it did not intend to preempt the field." See also 33 U.S.C. 1251(b) ("It is the policy of the Congress to recognize, preserve, and protect the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution * * *"). Here, on the other hand, Congress did preempt the field of interstate natural gas regulation.

to the ultimate consumer. Congress has decreed that it is for the Commission—and not Louisiana—to make such a judgment. The Commission is not required to accommodate its orders to the Louisiana tax.[27] Hence, the First Use Tax violates the Supremacy Clause; no amount of evidence that Louisiana may submit can save the tax from a judgment of invalidity.

Indeed, the Court's decision in *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, underscores our point with particular force. There, this Court held that the orders of the Kansas Commission—requiring an interstate pipeline to purchase ratably from all wells connected to its pipelines system within the state—imper-

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[27] Hence, the Master erred in relying (Report 27) upon the fact "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."

To begin with, the Master has misapprehended the purpose and nature of the Commission's action. The Commission does not consider the First Use Tax to be a cost which should be passed along to consumers. *State of Louisiana First Use Tax in Pipeline Rate Cases*, Order No. 10, 43 Fed. Reg. 45553 (1978); Order No. 10-A, 43 Fed. Reg. 60438 (1978); Order No. 10-B, 44 Fed. Reg. 13460, 13461-13462 & nn.16, 19, 20 (1979); Order No. 10-C, 45 Fed. Reg. 29011, 29012, 29014 (1980), petitions for review pending *sub nom. Tennessee Gas Pipeline Company* v. *FERC*, No. 78-3816 (5th Cir.). The Commission has allowed the pipelines to collect the tax subject to refund while the constitutionality of the First Use Tax is litigated only because the courts have held that, where a utility is required to pay a tax and sue for a refund, it is entitled to collect the tax subject to refund while the tax refund suit is pending. See *Tennessee Natural Gas Lines, Inc.* v. *FPC*, 221 F.2d 531 (D.C. Cir. 1954); accord: *City of Cleveland* v. *FPC*, 525 F.2d 845, 850 n.37 (D.C. Cir. 1976).

At all events, even on the assumption that the Commission has adjusted, albeit provisionally, to the economic reality imposed by the tax, the fact of the Commission proceeding has no bearing on the resolution of the Supremacy Clause issue. Since Congress has preempted the field of the regulation of the interstate sale of natural gas, the critical question is not whether the Commission can accommodate itself to the Louisiana tax but whether the tax impinges upon the Commission's authority.

missibly encroached upon the Commission's exclusive regulatory domain (372 U.S. at 91-92, 97-98), because they "necessarily deal with matters which directly affect the ability of the Federal [Energy Regulatory] Commission to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which was an objective of the Natural Gas Act" (*id.* at 91-92). The Court found that the State order to purchasers to take ratably "could seriously impair the * * * Commission's authority to regulate the intricate relationship between the purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other States[,] * * * a matter with respect to which Congress has given the [Commission] paramount and exclusive authority" (*id.* at 92). The Court then held that, since "Congress [had] so plainly occupied the regulatory field," the state regulation must be subordinated to federal regulation to avoid jeopardizing the objective of uniformity (*id.* at 93, 98).

Like the orders of the Kansas Commission, § 47:1303 C of the Louisiana statute seeks to regulate the costs to be borne by interstate pipelines. Section 47:1303 C requires that when an interstate pipeline pays the First Use Tax, the pipeline must recover the tax, if at all, from subsequent purchasers of the gas and may not pass the burden of tax back to the producers. Section 47:1303 C thus seeks to determine the apportionment of costs between producers, pipelines, and consumers. But regulation of this very type of apportionment is a matter over which Congress has given the Commission paramount and exclusive authority. Sections 4, 5 and 7 of the Natural Gas Act of 1938, 15 U.S.C. 717c, 717d and 717f; Section 110 of the Natural Gas Policy Act of 1978, 15 U.S.C. (Supp. II) 3320. "The federal regulatory scheme leaves no room either for direct state regulation of the prices of interstate wholesales of natural gas * * * or for state regulations which would indirectly achieve the same result." *Northern Natural Gas Co.* v. *Kansas Commission*, *supra*, 372 U.S. at 91.

2. Nor is there any need to hold evidentiary hearings on the legal effect of § 47:1303 C of the Louisiana statute that prohibits contracts that pass the tax back to producers but permit it to be added to the purchase price of the consumers. In addressing this provision, the Master acknowledged (Report 28) that "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." Despite the conflict between the Louisiana tax that outlaws contracts and the exclusive authority of the Commission to which such contracts are subject, the Master concluded that "[t]here 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" (*ibid.*). The Master concluded that the Commission's position would be sound only if the gas emerges from the processing plant in essentially the same state and that evidence should be taken on this point.

But in so ruling, the Master has overlooked the critical fact that the allocation of costs among producers, pipelines, and consumers of natural gas is a judgment for the Commission, and the Commission alone, to make. The Commission has the exclusive authority to make that determination. The fact that Louisiana has outlawed contracts that require the producers to bear the tax where such contracts are subject to the exclusive regulation of the Commission necessarily voids the Louisiana levy under the Supremacy Clause.

There is accordingly no need to take evidence on the nature of the processing of the gas. Even if the processing involves the chemical transformation of "wet gas" into "dry gas" and other products, as Louisiana contends (Report 29),[28] the Commission still has the exclusive

[28] Louisiana's description of the nature and purpose of processing (Motion to Dismiss and Brief in Support of Motion to Dismiss and in Opposition to Motion for Judgment on the Pleadings 24-26; Brief in Response to Brief for the United States and the

authority to determine whether the tax may be passed on to consumers or back to the producers.

In light of the foregoing, it is clear that § 47:1303 C trenches upon "matters which directly affect the ability of the [Commission] to regulate comprehensively and effectively the transportation and sale of natural gas, and to achieve the uniformity of regulation which [is] an objective of the Natural Gas Act [and the Natural Gas Policy Act]." *Northern Natural Gas Co.* v. *Kansas Commission, supra,* 372 U.S. at 91-92. By providing that the First Use Tax can only be passed on only to natural gas consumers, § 47:1303 C "seriously impair[s] the [Commission's] authority to regulate the intricate relationship between the [pipeline] purchasers' cost structures and eventual costs to wholesale customers who sell to consumers in other states" (372 U.S. at 92).

Federal Energy Regulatory Commission as Amici Curiae 33 & n.8) is at odds with the definition of processing in the First Use Tax (La. Rev. Stat. Ann. § 47:1302(3) (West Supp. 1980)). There, the Act defines "processing" as

> the scrubbing of a natural gas stream by specifically applied mechanical processes of absorption, compression, cooling, cryogenics, refrigeration or any combination thereof for the purpose of extracting natural or casinghead gasoline, methane, ethane, propane, butane and other liquefiable hydrocarbons[.]

It is also at odds with the description of natural gas production, transportaiton to processing plants, and processing found in *Mobil Oil Corp.* v. *FPC,* 483 F.2d 1238, 1241 (D.C. Cir. 1973) (transportation to processing plants); *Freeland* v. *Sun Oil Co.,* 184 F. Supp. 754, 756, 758-759 (W.D. La. 1959), aff'd, 277 F.2d 154 (5th Cir.), cert. denied, 364 U.S. 826 (1960) (processing); *Continental Oil Co.,* 27 F.P.C. 96, 149-150 (1962) (Initial Decision) (movement of gas from offshore platform through a processing plant); *Deep South Oil Company of Texas,* 14 F.P.C. 308, 313 (1955) (processing), aff'd, 247 F.2d 882 (5th Cir. 1957), and *Phillips Petroleum Co.,* 10 F.P.C. 246, 255-261 (1950) (processing), rev'd on other grounds, 347 U.S. 672 (1954).

In practical effect, Louisiana seeks to resurrect the long-discredited distinction between "wet gas" and "dry gas." See, *e.g., Deep South Oil Company of Texas* v. *FPC, supra.* Moreover, Louisiana's position is contrary to the well-established exclusive jurisdiction of the Commission to allocate costs incurred prior to the completion of processing.

Since regulation of "[t]his relationship is a matter with respect to which Congress has given the [Commission] paramount and exclusive authority[,]" § 47:1303 C should be "declared a nullity in order to assure the effectuation of the [regulatory scheme] ordained by Congress" (372 U.S. at 92).

II. THE PLEADINGS ESTABLISH THAT THE LOUISIANA FIRST USE TAX IS INVALID UNDER THE COMMERCE CLAUSE

A. The Louisiana Tax Is A Transit Levy On Gas Moving In Interstate Commerce

1. Article I, Section 8, Clause 3 of the Constitution provides that: "Congress shall have power * * * to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." As the Court observed in *McLeod* v. *J. E. Dilworth Co.*, 322 U.S. 327, 330 (1944), "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." It is settled by the decisions of this Court that "the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. * * * [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States." *Freeman* v. *Hewit*, 329 U.S. 249, 252 (1946). See also *Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318, 328 (1977).

The Commerce Clause flatly prohibits state taxation of goods that are merely in transit through the state when the tax is assessed. *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, 347 U.S. 157 (1954); *Michelin Tire Corp.* v. *Wages*, 423 U.S. 276, 290 n.11 (1976). Moreover, to the extent the goods come to rest and the tax can be said to reach a local activity, it is valid only where it is applied to activities having a substantial nexus with the state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state. See, *e.g.*, *Wash. Rev. Dep't* v. *Stevedoring Ass'n*, 435 U.S. 734, 750 (1978); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977).

2.a. The First Use Tax is imposed upon gas that is in transit through Louisiana in interstate commerce. While the tax is characterized as "upon the privilege of performance or allowing the performance by the owner, of the enumerated actions comprising first use within [Louisiana]" (La. Rev. Stat. Ann. § 47:1303 E (West Supp. 1980) (Mot. App. 6a), provisions of the Act demonstrate that the tax falls on the transportation of the natural gas within Louisiana, not the privilege of use.[29]

As we have pointed out (pages 4-5, *supra*), "[t]he tax imposed * * * shall be computed at a rate of seven cents on each unit of natural gas as to which a use first occurs within [Louisiana]" and the term "unit" is defined as "one thousand cubic feet of natural gas" measured at a specified pressure and temperature. La. Rev. Stat. Ann. § 47:1303 B (West Supp. 1980) (Mot. App. 5a). But such a levy is no different than a tax imposed "at the rate of 9/20 of one cent per thousand (1,000) cubic feet of gas gathered" at the outlet of a processing plant that this Court struck down in *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, *supra*, 347 U.S. at 161. There, Texas levied a tax on the production of natural gas measured by the entire volume of gas to be shipped in interstate commerce. A refinery extracted the gas from crude oil and transported it 300 yards to the pipeline. Like Louisiana, the State identified, as a local

[29] "Where a federal right is concerned we are not bound by the characterization given to a state tax by state courts or legislatures, or relieved by it from the duty of considering the real nature of the tax and its effect upon the federal right asserted." *Carpenter* v. *Shaw*, 280 U.S. 363, 367-368 (1930). See also *Society for Savings* v. *Bowers*, 349 U.S. 143, 150 (1955); *Lawrence* v. *State Tax Commission*, 286 U.S. 276, 280 (1932).

incident, the transfer of gas from the refinery to the pipeline. The Court held the tax to be unconstitutional under the Commerce Clause because it was an unapportioned levy on the transportation of the entire volume of gas. The extraction did not relate to the length of the Texas portion of the pipeline or the percentage of the taxpayer's business that was attributable to Texas. In these circumstances, the Court ruled that the Texas tax could not survive attack under the Commerce Clause.

In our view, *Michigan-Wisconsin Pipe Line Co.* controls the Commerce Clause aspects of this case. Stripped to its essentials, the Louisiana tax is simply a transit fee on the privilege of moving gas through the state. It is unrelated to the actual consumption of the gas within the state. Indeed, to the extent that gas subject to tax comes to rest and is consumed within the state, there are credits that are available to offset other Louisiana taxes payable by the users. Nor does the tax bear any reasonable relationship to the transporter's business within Louisiana. It is nothing more than an "unapportioned levy on the transportation of the entire volume of gas" (*Wash. Rev. Dep't* v. *Stevedoring Ass'n, supra,* 435 U.S. at 749 n.18) and is therefore invalid under the Commerce Clause.

b. The Master acknowledged the force of our contention under *Michigan-Wisconsin Pipe Line Co.*, by observing that it is "the case which on its facts is closest to this one" (Report 36). He further conceded that "[a]pplying the *Michigan-Wisconsin Pipe Line Co.* 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" (*ibid.*). However, the Master resisted the conclusion that the tax was invalid under the Commerce Clause because "[t]here is a very real dispute among the parties as to the legal effect of the 'processing' use" (Report 37).

But the Master's reservations with respect to the "processing" use cannot be squared with the well settled authorities (which he apparently accepted—see Report 31-

32) holding that "processing does not interrupt the continuous movement of the gas from the wellhead to consumer burner tips and is merely a part of the business of transporting and marketing gas in interstate commerce" (*Deep South Oil Company of Texas* v. *FPC*, *supra*, 247 F.2d at 888; accord, *Michigan-Wisconsin Pipe Line Co.* v. *Calvert*, *supra*, 347 U.S. at 163; *Interstate Natural Gas Co.* v. *FPC*, *supra*, 331 U.S. at 685 n.7; *Public Service Commission of Kentucky* v. *FERC*, *supra*, 610 F.2d at 444), and that "gas which crosses a state line at any stage of its movement from wellhead to ultimate consumption [is] 'in interstate commerce' within the meaning of the [Natural Gas] Act." *California* v. *Lo-Vaca Gathering Co.*, *supra*, 379 U.S. at 369. There is accordingly no basis for the Master's suggestion that "processing" may be local activity subject to state tax.

B. The Louisiana Tax Is Not Fairly Apportioned And Discriminates Against Interstate Commerce

1. A tax on interstate activities is properly apportioned if it is related to the value of identifiable activities occurring within the taxing state (*Wash. Rev. Dep't* v. *Stevedoring Ass'n*, *supra*, 435 U.S. at 746-747), the taxpayer's investment in facilities within the state (*Colonial Pipeline Co.* v. *Traigle*, 421 U.S. 100, 107 n.5 (1975); *Memphis Natural Gas Co.* v. *Stone*, 335 U.S. 80, 81-82 nn.1 & 2, 93 (1948) (Opinion of Reed, J.)), gross income from business conducted within the state (*Wash. Rev. Dep't* v. *Stevedoring Ass'n*, *supra*, 435 U.S. at 737-738 & n.4, 750; *Complete Auto Transit, Inc.* v. *Brady*, *supra*, 430 U.S. at 275), the percentage of the taxpayer's business in the state (*Wash. Rev. Dep't* v. *Stevedoring Ass'n*, *supra*, 435 U.S. at 749 n.18; *Case of the State Freight Tax*, 82 U.S. (15 Wall.) 232, 273, 278 (1872)), or the length of the facilities or distance traveled within the state (*Norfolk & W. Ry.* v. *Tax Comm'n*, 390 U.S. 317, 323-325 (1968)).

The First Use Tax is not related to any of these factors. Rather, it is imposed on the entire volume of OCS and federal enclave gas entering the state, except such gas as is consumed in certain uses with Louisiana. La. Rev. Stat. Ann. §§ 47:1303 A, B (West Supp. 1980) (Mot. App. 4a-5a). The tax "is the same whether the [gas is] moved one mile or three hundred." *Case of the State Freight Tax, supra,* 82 U.S. (15 Wall.) at 273. It is therefore simply "an unapportioned levy on the transportation of the entire volume of gas." *Wash. Rev. Dep't* v. *Stevedoring Ass'n, supra,* 435 U.S. at 749 n.18.

Contrary to Louisiana's contention (Answer 10 ¶ XXXIV, 12 ¶XXXVII), and the Master's observations (Report 35-36), the tax is not apportioned simply because it applies only if the gas is subjected to one of the enumerated uses. The Louisiana taxable "uses," like the taking of gas by a pipeline at the outlet of a processing plant, are inseparable elements of the interstate transmission of gas. *Michigan-Wisconsin Pipe Line Co.* v. *Calvert, supra.* As the Court there stated, in terms that are strikingly appropriate to this case, there are "aspect[s] of interstate transportation [which] cannot be 'carve[d] out from what is an entire or integral economic process,' * * * by legislative whimsy and segregated as a basis for [a] tax" (347 U.S. at 169, quoting *Nippert* v. *Richmond,* 327 U.S. 416, 423 (1946)). The Master therefore erred in concluding (Report 36) that "[i]t does not seem * * * that the apportionment requirement has any application here."

2. One of the unquestioned principles in this Court's Commerce Clause jurisprudence is that no state, consistent with the Commerce Clause, may "impose a tax which discriminates against interstate commerce * * * by providing a direct commercial advantage to local business" (*Northwestern States Portland Cement Co.* v. *Minnesota,* 358 U.S. 450, 457 (1959)). See also *Halliburton Oil Well Co.* v. *Reily,* 373 U.S. 64 (1963); *Nippert* v. *Richmond,* 327 U.S. 416 (1946); *I. M. Darnell & Son* v. *Memphis,* 208 U.S. 113 (1908); *Guy* v. *Baltimore,* 100 U.S. 434, 443 (1880); *Welton* v. *Missouri,* 91 U.S. 275 (1876). "The prohibition against discriminatory treat-

ment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the Clause protects." *Boston Stock Exchange* v. *State Tax Comm'n*, *supra*, 429 U.S. at 329, quoting from *Dean Milk Co.* v. *Madison*, 340 U.S. 349, 356 (1951). The First Use Tax discriminates against interstate commerce in two distinctive ways.

a. First, Louisiana has prohibited the purchasers of gas subject to the First Use Tax from shifting any or all of that tax to the producer. La. Rev. Stat. Ann. § 47:1303 C (West Supp. 1980) abrogates provisions of contracts that require persons other than purchasers of such gas to pay the First Use Tax. On the other hand, Louisiana does not prohibit purchasers of gas subject to its severance tax from shifting all or part of the tax to the producer. To the contrary, Louisiana permits the purchasers and sellers of such gas to determine, by contract, who shall bear that tax. La. Rev. Stat. Ann. § 47:633.1 (West Supp. 1980).

The practical effect of prohibiting the shifting of the First Use Tax while allowing the shifting of the severance tax is to impose a tax on OCS and federal enclave gas which is greater than the tax imposed on gas produced within Louisiana. As matters now stand, purchasers of gas produced in Louisiana, and sold in either interstate or intrastate commerce, can seek the advantage of the lower tax burden that is denied to interstate purchasers of the gas subject to the First Use Tax. There is no constitutional warrant for such discriminatory treatment. *Boston Stock Exchange* v. *State Tax Comm'n*, *supra*, 429 U.S. at 333-336. "The conclusion is inescapable: equal treatment for in-state and out-of-state taxpayers similarly situated taxpayers is the condition precedent for a valid use tax on goods imported from out-of-state." *Halliburton Oil Well Co.* v. *Reily*, *supra*, 373 U.S. at 70.

b. The Louisiana First Use Tax also discriminates against Interstate commerce by requiring out-of-state consumers to bear the entire burden of the levy. This discrimination is accomplished by a system of exemptions and credits designed to ensure that Louisiana consumers are relieved of First Use Tax liability.

La. Rev. Stat. Ann. § 47:1303 A (West Supp. 1980) (Mot. App. 4a-5a),[30] provides that the First Use Tax shall not be levied against natural gas, otherwise subject to the tax, which is consumed in specified uses within Louisiana. However, natural gas subject to the tax which is consumed in identical uses in other states is not granted a similar exemption. So, also, the related Severance Tax Credit[31] permits taxpayers liable for the First Use Tax to credit that liability, dollar-for-dollar, against their liability for Louisiana's severance tax. As a result of this credit, Louisiana imposes a higher tax on those persons who do not pay Louisiana severance taxes than it does on those who do.[32] Thus, Louisiana businesses enjoy a distinct commercial advantage over their out-of-state competitors in the form of lower prices for natural gas.

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[30] The First Use Tax does "not apply to natural gas otherwise subject [to the tax] * * * used or consumed in the drilling for or production of oil, natural gas, sulphur, or in the processing of natural gas for liquids extraction within the state; nor * * * to gas shrinkage volumes attributable to the extraction of ethane, propane, butanes natural or casinghead gasoline or other liquefied hydrocarbons * * *[,] nor * * * to natural gas used or consumed in the manufacture of fertilizer and anhydrous ammonia within the state." § 47:1303 A.

[31] First Use Tax On Natural Gas—Severance Tax Credit, Act No. 436, 1978 La. Sess. Law Serv. 842 (West), La. Rev. Stat. Ann. § 47:647 (West Supp. 1980).

[32] 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 tax payment against his severance tax liability (see Report 34 n.18).

c. Finally, Act No. 599 [33] allows every Louisiana electric generating plant, gas distribution service, and direct purchaser of natural gas from an interstate pipeline, to recoup that portion of increased rates it pays for natural gas which is attributable to increased transportation and marketing costs for natural gas from the federal domain of the Outer Continental Shelf through direct credits against any tax or combination of taxes, other than severance taxes, owed to Louisiana. Since the First Use Tax is "deemed [to be] a cost associated with" the transportation and marketing of OCS and federal enclave natural gas (La. Rev. Stat. Ann. § 47:1303 C (West Supp. 1980)) (Mot. App. 5a), Louisiana consumers of such gas may effectively recoup the amounts attributable to that tax through a reduction in other state taxes. The legislative history indicates that the sole purpose of Act No. 599 is to ensure that Louisiana consumers do not incur any increased costs for natural gas as a result of the First Use Tax.[34]

In sum, the equivalence between the First Use Tax and the Louisiana Severance Tax suggested by the Master (Report 35) is illusory. Purchasers of gas subject to severance tax can shift the burden of the tax to the producer of gas but purchasers of gas subject to the "equivalent" First Use Tax cannot shift the burden of the levy other than onto the consumer. Thus, contrary to the Master's belief (*ibid.*), no adjustments in the base prices or allowances can be made that would reduce or eliminate this discrimination against the out-of-state consumer.[35]

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[33] Tax Credit for Electric and Natural Gas Service, 1978 La. Sess. Law Serv. 1112 (West), codified as La. Rev. Stat. Ann. § 47:11 (West Supp. 1980).

[34] *Hearings on H.B. 768 Before the Committee on Ways and Means of the Louisiana House of Representatives* 4 (Rep. Tauzin and unidentified speakers), 5 (colloquy between Reps. Sour and Bagert), 6 (Rep. Laborde) (June 5, 1978).

[35] The Master's reliance (Report 35) upon *Henneford* v. *Silas Mason Co.*, 300 U.S. 577 (1937), is therefore misplaced. There,

Moreover, the burden of the First Use Tax falls entirely on out-of-state consumers of gas. The Louisiana First Use Tax therefore "falls short of the substantially evenhanded treatment demanded by the Commerce Clause." *Boston Stock Exchange* v. *State Tax Comm'n*, *supra*, 429 U.S. at 332.

CONCLUSION

For the reasons stated, the plaintiffs' motion for judgment on the pleadings should be granted.

Respectfully submitted.

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the Court upheld a state use tax because it did not violate the Commerce Clause and it was a "compensating" tax intended to complement the state sales tax. Thus, the fact that Louisiana has a valid severance tax cannot save its unconstitutional First Use Tax even on the assumption that the latter levy may "compensate" for the severance tax.

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