

ORIGINAL

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 81-1020 & 81-1268

TITLE EXXON CORPORATION, ET AL.,
Appellants

v.

RALPH EAGERTON, JR., COMMISSIONER OF REVENUE
OF ALABAMA, ET AL.; and

EXCHANGE OIL AND GAS CORPORATION, ET AL.,
Appellants

v.

PLACE RALPH P. EAGERTON, JR., COMMISSIONER OF REVENUE
OF THE STATE OF ALABAMA
Washington, D. C.

DATE February 22, 1983

PAGES 1 thru 45



ALDERSON REPORTING

(202) 628-9300
440 FIRST STREET, N.W.
WASHINGTON, D.C. 20001

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

IN THE SUPREME COURT OF THE UNITED STATES

~~ORAL ARGUMENT SET~~ - - - - - X

EXXON CORPORATION, ET AL., :

on behalf of the Appellants :

Appellants :

C. B. ARENDALL, JR., ESQ. :

No. 81-1020

on v. behalf of the Appellees :

RALPH EAGERTON, JR., COMMISSIONER :

OF REVENUE OF ALABAMA, ET AL.; :

EXCHANGE OIL AND GAS CORPORATION, :

ET AL., :

Appellants :

No. 81-1268

v. :

RALPH P. EAGERTON, JR., COMMISSIONER :

OF REVENUE OF THE STATE OF ALABAMA :

- - - - - X

Washington, D.C.

Tuesday, February 22, 1983

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:11 a.m.

APPEARANCES:

RAE M. CROWE, ESQ., Mobile, Alabama; on behalf of the Appellants.

C. B. ARENDALL, JR., ESQ., Mobile, Alabama; on behalf of the Appellants.

JOHN J. BRECKENRIDGE, ESQ., Montgomery, Alabama; on behalf of the Appellees.

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 564-2345

STATE OF ALABAMA. CONTENTS

ORAL ARGUMENT OF: JUSTICE BURGER: We will hear arguments PAGE his

RAE M. CROWE, ESQ. Corporation against Eagerton and the consoli 3 dated
on behalf of the Appellants
case.

C. B. ARENDALL, JR., ESQ. ii
on behalf of the Appellants may proceed whenever you are

JOHN J. BRECKENRIDGE, ESQ. 22
on behalf of the Appellees

IN THE ORAL ARGUMENT OF RAE M. CROWE, ESQ.

ON BEHALF OF THE APPELLANTS

MR. CROWE: Mr. Chief Justice, and may it please the

Court: This piece of legislation

This piece of legislation, passed in Alabama in 1979,

involves several constitutional questions which have been

raised by producers or servers of natural gas and crude oil

within the state.

It was introduced in 1979 by Representative Hines

of Escambia County, one of the state's largest producing counties

insofar as oil and gas production is concerned. It initially

was introduced to increase the tax assessment state-wide.

Representative Hines, according to the record, was

unable to pass this legislation in the previous session.

QUESTION: Is he able to pass legislation either

himself or does the legislature pass it?

MR. CROWE: We can pass it in the legislature under the

courtesy if it affects only his county. He being the

representative from the county, we will discuss it.

2 CHIEF JUSTICE BURGER: We will hear arguments first this
3 morning in Exxon Corporation against Eagerton and the consolidated
4 case. MR. CROWE: Yes.

5 Mr. Crowe, I think you may proceed whenever you are
6 ready. House, by his own courtesy, is the Governor's office,

7 ORAL ARGUMENT OF RAE M. CROWE, ESQ.
8 ON BEHALF OF THE APPELLANTS

9 MR. CROWE: Mr. Chief Justice, and may it please the
10 Court: This tax was two percent, it was increased to two

11 percent. This piece of legislation, passed in Alabama in 1979,
12 involves several constitutional questions which have been
13 raised by producers or servers of natural gas and crude oil
14 within the state.

15 It was introduced in 1979 by Representative Hines
16 of Escambia County, one of the state's largest producing counties
17 insofar as oil and gas production is concerned. It initially
18 was introduced to increase the tax two percent state-wide.

19 Representative Hines, according to the record, had
20 failed to pass this legislation in three previous occasions.

21 QUESTION: Is he able to pass legislation all by
22 himself or does the legislature pass it?

23 MR. CROWE: He can pass legislature under local
24 courtesy if it affects only his county, he being the only
25 representative from the county, from that district, in the

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 State of Alabama.

2 why -- If the amendment passed the legislature, what is the reason
3 QUESTION: But, is it actually -- Is the bill actually
4 enacted, at least in form, by the whole legislature?

5 MR. CROWE: Yes.

6 When he encountered the difficulty with the Speaker
7 of the House, by his own testimony, in the Governor's office,
8 in the House Ways and Means Committee, he submitted a very
9 important amendment, we submit, as a matter of legislative
10 history.

11 This tax was four percent. It was increased to two
12 percent. At the foot of the taxing paragraph, he entered a
13 so-called depth proviso which provided, in effect, that provided,
14 however, that the increase shall be limited to well producing in a
15 smackover formation at the depth of 15/15.8.

16 His county was, according to the record, the only
17 county in the state, then and now, producing hydrocarbons
18 in this geological interval at this depth.

19 He represented to the committees and on the floor
20 that his amendment had made the bill local, applied to his
21 own county. He was quoted in the newspapers as having said
22 this. And, the bill passed with no nays essentially.

23 Accordingly, the bill received local courtesy. The
24 Chairman of the Ways and Means Committee so testified. The
25 legislative journal entries show that the bill was carried
on the journal as an uncontested local bill along with --

1 QUESTION: Excuse me, Counsel, I am a little uncertain
2 why -- If the enactment passed the legislature, what difference
3 does it make how it got there?

4 MR. CROWE: It makes a difference in this respect:
5 Our clients are non-Escambia County producers which were not
6 expected to have been taxed under the legislation. Once the
7 bill had been passed, the Commissioner of Revenue, the
8 Appellee here, construed it legally to be a state-wide measure.
9 Refund suits were filed by the producers, the non-Escambia
10 County producers; uncontested legislative history in the form
11 of journal entries, physical notes, limiting the revenues only
12 to Escambia County. There was no contrary legislative history.

13 The Circuit Court of Montgomery County reads that
14 the act, under the legislative history, was clearly and without
15 any question a local act applying only to one county out of 67.

16 QUESTION: What federal claim do you make out of all
17 these facts? I mean, doesn't the Supreme Court of Alabama have
18 the final say as to whether or not --

19 MR. CROWE: I realize that this Court does not,
20 Justice Rehnquist, involved generally in statutory construction
21 of state statutes. But, when the Supreme Court of Alabama
22 ruled that they would not look at the legislative history, we
23 contend we were not given a fair hearing as a matter of due
24 process when they totally ignored the uncontroverted legislative
25 history, including statements from the sole sponsor of the

1 local bill.

2 QUESTION: Aren't we bound by what the Alabama Supreme
3 Court rules?

4 MR. CROWE: I think we cite in our brief two cases
5 that indicate -- One is a Missouri case, the Brinkerhoff case,
6 where this Court held that actions of the Missouri Supreme
7 Court deprived the litigants there of due process.

8 QUESTION: Well, the Alabama Supreme Court, I take
9 it, heard your argument on legislative history. They just
10 didn't highlight the legislative history.

11 MR. CROWE: They said they could not stray into the
12 mazes of conjecture.

13 QUESTION: Well, there are lots of opinions from this
14 Court that say the same thing, aren't there?

15 MR. CROWE: Under circumstances, however, where there
16 is uncontroverted testimony from the sponsor himself, the sole
17 and only sponsor, that it was his intention to tax his own county
18 to address a revenue shortfall in his own county.

19 QUESTION: I speak only for myself, but I hope you
20 have a better federal claim than that one.

21 QUESTION: Mr. Crowe, on a slightly different subject,
22 as I understand it, the Commissioner now takes the position that
23 the act in question does not prohibit producers, working
24 producers, from passing through the increase in severance taxes
25 just so long as they don't do it as taxes.

1 Now, if that position is correct, how have your clients
2 suffered any injury?

3 MR. CROWE: Well, first, during the currency of this
4 act, they were prohibited from passing through the severance
5 taxes.

6 QUESTION: As taxes.

7 MR. CROWE: As a tax.

8 QUESTION: And -- So, I am curious how you establish
9 your injury if the Commissioner's present position is correct.

10 MR. CROWE: All right. Justice O'Connor, the contracts
11 fix a price. They fix a definite price. The National Gas Policy
12 Act for various categories of natural gas fix a price. And,
13 either by virtue of the maximum statutory ceiling price and/or
14 by virtue of the contract provisions themselves, we could only
15 charge the price either permitted by law or agreed to by con-
16 tract, but were permitted to pass on taxes under the express
17 wording of the contract.

18 QUESTION: Do we have the proof in front of us that
19 would clearly establish that your clients could not have
20 increased the price to take care of this --

21 MR. CROWE: The contracts are in the record. And,
22 of course, the law is that --

23 QUESTION: And they allow escalation of prices.

24 MR. CROWE: The contracts?

25 QUESTION: Uh-huh.

1 MR. CROWE: I am not certain whether -- The price
2 escalation was not involved here. I am not sure whether they --
3 Some of them may have and some of them may have not depending upon --
4 ship. QUESTION: In other words, we don't really know whether
5 your clients suffered any injury. Would we have to remand to
6 determine that?

7 MR. CROWE: I think you do know, Justice O'Connor,
8 that the clients who could not pass through the severance
9 statutes as agreed upon and had to swallow that tax suffered
10 the loss of the amount of tax that they could not pass through.

11 QUESTION: But, we don't know, if I may pursue it
12 further, whether they could have passed it on in some other form?

13 MR. CROWE: I think they could not have because the
14 NGPA mandates the maximum price in both intra and interstate
15 commerce and the contracts, some of which predated the NGPA,
16 specified what that price would be.

17 Turning for a moment to the equal protection arguments
18 that we have advanced to the Court with respect to the Royalty
19 Owners Exemption, the Act in question exempted the royalty owners
20 from the two percent increase, but apparently left the royalty
21 owners subject to the four percent portion of the tax.

22 The record shows that we had both leases as well as
23 the contracts, to which Justice O'Connor referred, which
24 specifically provided in the case of the leases that the lessee
25 and the lessor will share and bear the severance tax prorata.

1 mineral. So, we are contending that we have -- that the Royalty
2 Owner Exemption should be held unconstitutional.

3 equally. The class, we submit to the Court, is one of owner-
4 ship. There is a mineral fee, if the Court will, a producing
5 mineral estate. The royalty owner owns a share in it as a joint
6 tenant. The lessee owns a share in it as a joint tenant.

7 widely. This Court has held in Barwise v. Sheppard that an
8 oil and gas lease constitutes nothing more or less than a common
9 or joint adventure with the profits to be shared prorata in
10 accordance with the terms and provisions of the lease.

11 Thus, we submit that a lessor is a royalty owner and
12 the -- is a land owner, and the lessee is likewise a land owner
13 under the jurisprudence of Alabama and most oil producing states.

14 There are three reasons for this. The Alabama Code
15 specifically provides that the tax will be levied in proportion
16 to ownership. The Alabama Code specifically provides that
17 producers shall include a royalty owner. The Alabama Code
18 specifically says that the tax is levied on the full stream of
19 the well including that known as the royalty interest.

20 Furthermore, the Code provides -- and this is not
21 in any of the briefs and perhaps it should have been -- The
22 Code provides that the severance taxes in lieu of ad valorem
23 taxes and ad valorem taxes, of course, being a tax on real
24 estate and we say that the only reasonable, logical, fair
25 classification is that of ownership of the production from the

1 mineral fee and that there is no reasonable classification that
2 can be -- where it says four percent of the tax will be borne
3 equally, but two percent will be borne unequally and dispro-
4 portionate to the ownership.

5 It simply We submit to the Court that there is another reason
6 that makes the tax regressive. Royalty percentage is very
7 widening. This record shows some royalties up to over 50%.

8 QUESTION: What is constitutionally in front of us
9 about a regressive tax?

10 MR. CROWE: Well, I think it is a question of
11 classification and equal protection within the price.

12 QUESTION: Well, I suppose I agree with you, but you
13 said you are arguing now that the tax is regressive and a
14 regressive tax isn't an unconstitutional tax.

15 MR. CROWE: Well, it does not apply equally even
16 between lessees.

17 QUESTION: Well, no taxes apply equally. Some
18 people are taxed and some are not.

19 MR. CROWE: Well, what I am saying, I think, is,
20 Justice Rehnquist, that the tax does not apply equally between
21 either royalty owners or working interest owners or land owners.
22 And, if that -- the land owner should be the criteria for making
23 a distinction between one molecule of gas and another molecule of
24 gas; that the royalties' gas should be the same share of
25 production as the working interest. In fact, the largest royalty

1 owner in Mobile County is one of the major oil companies. One of
2 the major paper companies is probably the -- owning a lot of
3 land -- is probably second. So there is no societal distinction
4 between the royalty-interest side and the working-interest side.
5 It simply is that some people prefer to invest on the royalty
6 side and others invest on the working-interest side.

7 In the Barwise case which I previously referred to, it
8 was a Texas tax involved which was equally imposed on the full
9 production of the well both on the lessor and the lessee. And
10 this Court held that it was a reasonable classification as to
11 both the lessor as it was to the lessee. Our authority for
12 the proposition we are submitting to the Court is a 1937 decision
13 of this Court in Barwise v. Sheppard.

14 ORAL ARGUMENT OF C. B. ARENDALL, JR., ESQ.

15 ON BEHALF OF THE APPELLANT

16 MR. ARENDALL: Mr. Chief Justice, and may it please
17 the Court:

18 Before Act 434 was adopted by the legislature of
19 Alabama, the state had a very simple and understandable tax
20 scheme for the severance taxation of oil and gas production.
21 The tax was imposed on all of the oil and gas produced. There
22 was a definition of who were the producers of that gas or oil.
23 It included both the royalty owner and the working-interest
24 owner, each of whom bore the ultimate incidence of the tax in
25 accordance with his or its ratable ownership of oil or gas

1 produced. When Act 434 was passed, however, we find a drastic
2 change in the Alabama scheme. Because the legislature comes
3 along and for the first time with respect to the two percent
4 increase that was provided by that statute exempts the royalty
5 owner -- the royalty owner's share of production -- from any
6 portion of the tax increase. The language of the statute was
7 "any person who is a royalty owner shall be exempt from the
8 payment of any increase in taxes herein levied and shall not be
9 liable therefore." To make doubly clear the intent of the
10 legislature, they then proceeded with what is called in the
11 briefing in this case the Pass-Through Prohibition in which
12 they say, "the privilege tax herein levied shall be absorbed
13 and paid by those persons engaged in the business of producing
14 or severing oil or gas only. And the producer shall not pass
15 on the cost of such tax payments either directly or indirectly
16 to the consumer. It being the express intent of this Act that
17 the tax herein levied shall be borne exclusively by the producer
18 or severer of oil or gas."

19 QUESTION: That means the working interest, I think.

20 MR. ARENDALL: That --

21 QUESTION: Normally.

22 MR. ARENDALL: As construed by the state, that is what
23 it means. But that construction, if Your Honor please, comes in
24 a background of a statutory scheme where the statutory definition
25 of producers unchanged by Act 434 covers both the royalty owner

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 and the working-interest owner. And so any --
2 just say QUESTION: The two percent specifically excluded the
3 royalty owner -- the amendment?

4 MR. ARENDALL: Well, it depends, if the Court please,
5 on whether they have by implication repealed the definition of
6 producer which we do not think that they have because, among
7 other things, the statute continues to say that the tax shall be
8 imposed on all of the production including the share of the
9 royalty owner. Now this comes in a posture where the evidence
10 showed my clients, for example, had leases where the land owner
11 would expressly agree to pay his proportionate share of severance
12 taxes. We had gas sales contracts where the purchaser would
13 expressly agree to pay any increase in severance taxes. And,
14 because of the existence of those contracts, our first contention
15 is that there has been an unconstitutional impairment of
16 contracts. Our second contention is that there has been a
17 denial of the equal protection of the law. Now, --

18 QUESTION: Do you have a position on the question of
19 the position now taken by the Commissioner that the tax in effect
20 could be passed on if you call it something else and just raise
21 the price?

22 MR. ARENDALL: Yes, I do, Justice O'Connor, and I
23 recall your question to Mr. Crowe on that subject. As we
24 endeavor to point out in our reply brief, the Commissioner is
25 engaged in an absolutely impermissible attempt to rewrite the

1 clear language of the statute. When you say, as the language that
2 I just said, does say that the tax has got to be absorbed by the
3 producer, and that he cannot pass it on to anybody else, how can
4 the Commissioner say to the contrary?

5 address? QUESTION: You think that Alabama Supreme Court opinion
6 was equivocal on that point?

7 O'Connor? MR. ARENDALL: I do not understand the language of the

8 this comp? QUESTION: The language, at least, does not make it
9 crystal clear, and I wonder whether that is not a question for
10 the state law courts rather than a question for us?

11 MR. ARENDALL: I do not understand what the Supreme
12 Court has said. I see what the Commissioner has said, and I can
13 read very clearly what counsel for the Commissioner said at an
14 earlier date. If Your Honor will look at page 40 of the Joint
15 Appendix, you will find a quotation from Exhibit 19 -- Plaintiff's
16 Exhibit 19 -- in which counsel for the Commissioner construed the
17 Act and expressly said that it prohibited and pass-through to
18 anybody.

19 equal pro? QUESTION: Mr. Arendall, you mentioned two questions
20 that you saw in this case. I must -- I have this case confused
21 with some other case on the calendar. I had been under the
22 impression that at least one question was whether this area --
23 this Alabama statute -- had been preempted by federal law?

24 MR. ARENDALL: Well, that is certainly an additional --

25 QUESTION: I have not heard the word preemption from

1 anyone yet.

2 MR. ARENDALL: That is certainly an additional question
3 if Your Honor please. And, it is one, of course, that we
4 addressed in our brief that the government -- as Amigee has
5 addressed. We do say that it has been preempted, and it is
6 interesting in this regard and in connection with Justice
7 O'Connor's question that in the state's initial brief they urged
8 this complete misreading of the statute claiming that we could
9 pass-through as long as we fraudulently represented that we were
10 doing something else.

11 QUESTION: Well, are you going to discuss the pre-
12 emption issue in your argument?

13 MR. ARENDALL: Yes, I expect to, and I --

14 QUESTION: Well how else can you win this case except
15 on a federal constitutional ground such as preemption?

16 MR. ARENDALL: Well, it seems to be that we have three
17 questions. We have got the supremacy question as the preemption
18 question. We have the impairment of contracts. We have got the
19 equal protection question. And those are the only grounds we
20 assert on behalf of my clients.

21 QUESTION: And, did you present all of those to the
22 Alabama Supreme Court?

23 MR. ARENDALL: We presented all of those to the
24 Alabama Supreme Court, yes.

25 QUESTION: On both acts did you present the preemption

1 question?

2 MR. ARENDALL: I beg, sir.

3 QUESTION: Did you present the preemption question on
4 both Acts?

5 MR. ARENDALL: No, we did not. We presented the
6 preemption question solely on the NGPA.

7 QUESTION: Well, then what right do you have to do it
8 on the other Act here if you did not present --

9 MR. ARENDALL: We have not, sir. My clients have not.
10 The reason -- a reason being, first that we think it is
11 clear that the statutory prohibition and its conflict with the
12 NGPA is not a severable item. The legislature of Alabama never
13 intended to say you cannot pass-through as to gas but you can as
14 to oil. So that if it is bad under the NGPA, it is bad. And,
15 it gets stricken. And, we think that is the easy, clear argument.
16 In the second place, two of my clients are engaged in the Tully
17 litigation. It is their belief that the EPAA issues are properly
18 addressed in the federal courts, the federal court system at Topeka.

19 If we were asked to express an opinion, and if this
20 Court cares to pass on an EPAA thing, we certainly agree with
21 the position taken by Amigee in its brief on that question.
22 But, we did not argue that in our brief.

23 What this act has done, is not only, you see, to tax the
24 producer, the working interest owner, on his own share of produc-
25 tion, but has required that he pick up the tax and pay it on the

1 royalty owners' interest share of production. Completely contrary
2 to the definition of who shall be producers -- completely contrary,
3 we believe, to this Court's opinion in Barwise v. Sheppard. Now,
4 it is interesting to see that when the state addresses the
5 impairment question here, he makes no effort to try to meet the
6 kinds of tests that the Court has laid down in Blazedale and his
7 progeny insofar as the circumstances under which contracts may be
8 impaired. All he does in substance is to say that the legislature
9 probably was trying to avoid being perceived as levying a consumer
10 tax. Now, that may be a good political reason for a member of
11 the legislature, but it certainly in our judgment does not express
12 the kind of broad public general societal purpose that is required
13 if you are going to have a constitutional impairment. And in
14 this instance, our reasonable contractual expectations were cer-
15 tainly destroyed. Even, Justice O'Connor, if the state were
16 correct in rewriting the statute as they attempted to do, how do
17 they take the part -- what about the royalty owner? What do they
18 say about that? Do they say that the royalty owner has to pay
19 its tax? Do they rewrite that too?

20 QUESTION: Are your clients royalty owners?

21 MR. ARENDALL: Our clients are lessees and also royalty
22 owners. We are both working interest and royalty owners -- and
23 are royalty owners.

24 So we submit that as far as the impairment question is
25 concerned, there is complete absence on the part of the state

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 to really address the tests in Blazedale and his progeny.

2 When you get to the equal protection aspects of the
3 matter, in addition to the statutory definition -- Look, if the
4 Court will, at the impact of what this does. If you have got a
5 royalty owner -- if you have got a lease --

6 QUESTION: Please, are you going to get --

7 MR. ARENDALL: Excuse me, sir?

8 QUESTION: Please, the preemption point?

9 MR. ARENDALL: Preemption -- On preemption the NGPA --
10 and that is the only argument that we make in our brief, and I
11 will address that only rather than the EPAA question. The NGPA
12 clearly says that to the maximum lawful price may be added
13 severance taxes imposed by the state. Flat language of the
14 statute says that. I submit to Your Honor, there is no way to
15 read this statute -- this Pass-Through Prohibition in this
16 statute -- without saying that the legislature of Alabama has
17 directly sought to nullify that provision NGPA. There is a clear
18 and direct conflict.

19 QUESTION: But, returning to Justice O'Connor's question
20 of a while ago, if the Commissioner -- the state Commissioner is
21 correct that the law does not permit pass-throughs, as long as you
22 do not say you are passing through the tax in so many words, do
23 you think there is any necessary conflict with the federal law?

24 MR. ARENDALL: Well, may I just go back again, if I may
25 to that Page 40 on the Joint Appendix --

1 QUESTION: I know that. I just said if he is correct.
2 Now, let's just suppose -- just suppose that the Supreme Court of
3 Alabama had expressly said, this law does not forbid pass-throughs
4 as long as you do not call what you are passing through a tax
5 expressly. Now suppose that the Alabama Supreme Court had said
6 that. Would you be here then?

7 MR. ARENDALL: I think, if Your Honor please, we still --

8 QUESTION: You would still be making your Equal Protec-
9 tion Contract Clause arguments?

10 MR. ARENDALL: Yes.

11 QUESTION: You would not be making your preemption
12 arguments?

13 MR. ARENDALL: If Your Honor please, to get to the
14 preemption question which I think is the first one that Your
15 Honor put to me -- I think, yes, we would have a conflict with
16 NGPA.

17 QUESTION: Because they say you may pass-through the
18 tax?

19 MR. ARENDALL: The tax, right. You may -- and they
20 do not say, for example -- They set a maximum lawful price based
21 on the factors of escalation and so on. They do not say we can
22 up that any two percent and then having done that just say we
23 have had a price increase so we have met the Alabama statute as
24 currently interpreted by the Commissioner. Yes, I think we would
25 clearly continue to have the preemption problem in the case.

1 is correct. As to whether we would continue to have any impairment
2 or equal protection, I think Your Honor started asking me to just
3 say that we are going to violate the law.

4 Honor. QUESTION: Just say yes. You would still be here on the
5 other two questions?

6 MR. ARENDALL: Right. I would be here on the other two
7 questions --

8 QUESTION: Thank you.

9 through. MR. ARENDALL: And, we would indeed still -- even the
10 Commissioner's argument, of course, does not get to the Royalty
11 Owner Exemption. Even if he can rewrite the clear language of
12 the statute like he claims to, there is no way for him to say
13 that we had any right to go and deduct from the royalty owner --
14 payments to the royalty owners taxed on his proportionate share
15 of the production.

16 QUESTION: Counsel, are you making claim for the taxes
17 that you did not pass-through before this latest interpretation
18 by the Alabama court?

19 MR. ARENDALL: We have not -- we are making a claim for
20 the two percent that we have paid to the state under what we
21 consider to be a nonseverable unconstitutional statute.

22 QUESTION: This is money you have already paid out?

23 MR. ARENDALL: We have paid the money to the state. It
24 is being held in escrow pending the resolution of the case.

25 QUESTION: Are you saying that if the Court interpretation

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 is correct, you still have claim for back taxes that you should not
2 have had to pay?

3 MR. ARENDALL: I am sorry. I did not understand, Your
4 Honor.

5 QUESTION: Well, if you accept the new interpretation
6 by the Commissioner that the tax can be passed through if you
7 hide it enough, do you still have a claim assuming you accept his
8 interpretation -- for back taxes -- the taxes you could not pass
9 through. Perhaps I do not understand it.

10 MR. ARENDALL: Yes, I would say that we do because we
11 have not, in fact, passed through the taxes, you see. We have
12 just paid the money to the state. And, if the court were to now
13 say, for example, that we are not going to declare the entire
14 Act unconstitutional, we consider it severable, but we are going
15 to nullify on preemption grounds and on equal protection and on
16 impairment of contract, or whatever, these unconstitutional pro-
17 visions, then presumably we would have some chance of going after
18 the people with whom we had contracts. But only those with whom
19 we had contracts. As, for example, if we sold crude oil on the
20 spot market during the time that this Act was in effect, we got
21 no contract to get no more money from those people. We were
22 prohibited by the state from adding the severance tax to the
23 price. We paid the tax on that sale. But, we cannot go back and
24 say to somebody, say there would be two percent more to you in
25 those days if we had been able to pass it through. So, yes we --

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 QUESTION: May I ask you a question about what you
2 actually put into escrow in the state? You paid the two percent
3 increase. First of all, you had a four percent tax before. I
4 want -- say you had an example where you had a 75 percent working
5 interest and a 25 percent royalty. Under the four percent you
6 paid 75 -- four percent of 75 percent of the production, and
7 under the two percent you pay 100 percent. So, and you paid
8 100 percent regardless of the size of the working interest. Is
9 that correct? And all that money is in escrow?

10 MR. ARENDALL: Right.

11 QUESTION: The whole two percent?

12 MR. ARENDALL: And the two percent, not the four percent,
13 the two percent is paid under protest and is in escrow --

14 QUESTION: I missed that. Thank you.

15 CHIEF JUSTICE BURGER: Mr. Breckenridge, I am sure it
16 must be apparent to you now that we are somewhat interested in
17 the preemption question, and we want you to be sure to address
18 that in your own time.

19 ORAL ARGUMENT OF JOHN J. BRECKENRIDGE, ESQ.

20 ON BEHALF OF THE APPELLEES

21 MR. BRECKENRIDGE: Mr. Chief Justice, and may it please
22 the Court:

23 I was going to address the arguments that they raised
24 as they raised them, but I sitting here, determined that this
25 Court is highly interested in the preemption clause, and I better

1 get to that first and not delay any longer.

2 It is the position of the Commissioner of Revenue that
3 there is no conflict with the federal statute and thus, there is
4 no preemption issue. The NGPA, The Natural Gas Policy Act, the
5 only federal statute that we are talking about here today -- and
6 let me say why I say that -- The trial court did not say anything
7 about the EPAA and neither did the Supreme Court of Alabama. This
8 Court has been asked to look at the decision of the Supreme Court
9 of Alabama to see if it is correct or not. There is nothing in
10 the Supreme Court of Alabama's decision whatsoever about the EPAA.
11 So, I would like to address my preemption clause -- preemption
12 question solely to the Natural Gas Policy Act.

13 What the Natural Gas Policy Act says -- the particular
14 section of the Natural Gas Policy Act that is in dispute -- what
15 it says is that the first seller of the natural gas is allowed to
16 raise the maximum lawful price to reflect recovery -- and it uses
17 the word recovery -- of certain items -- and they are listed
18 A, B, C, D, and E. And Item A is state severance taxes. Item B
19 is cost of transportation, et cetera, et cetra. These are all
20 deemed costs under the NGPA that allows a first seller, or
21 producer -- a working interest -- a producer, first seller to
22 recover his costs. Now --

23 QUESTION: Now the language of this Alabama statute
24 says that the producer cannot pass on the tax either directly or
25 indirectly.

1 MR. BRECKENRIDGE: That is correct.

2 QUESTION: Well, you are arguing he can do it indirectly,
3 are you not?

4 MR. BRECKENRIDGE: What I am saying is that the Alabama
5 Supreme Court, when faced with this statute -- First of all, they had
6 certain rules of statutory construction to give the Appellants
7 equal protection and due process that they have to follow. And,
8 what the Supreme Court of Alabama said is --

9 QUESTION: You think the Supreme Court of Alabama really
10 decided that question?

11 MR. BRECKENRIDGE: I believe so, yes ma'am. And I --
12 Let's go to the language they used. "The two Acts were aimed," --
13 this is the Supreme Court of Alabama speaking, -- "The two Acts
14 were aimed at entirely different" --

15 QUESTION: Do you have the citation to the appendix
16 to the petition?

17 MR. BRECKENRIDGE: Yes, Justice Rehnquist. It is Page
18 12 of the Joint Appendix.

19 QUESTION: Thank you.

20 MR. BRECKENRIDGE: Page 12. "The two Acts" -- they are
21 talking about the Alabama Act and the NGPA, -- "are aimed at
22 entirely different purposes. In other words, although," -- and
23 this is the point I want to emphasize, -- "although it would be
24 perfectly permissible for the oil and gas companies to raise the
25 price for the first sale of natural gas, subject to the limitations

1 of the Natural Gas Policy Act" --

2 QUESTION: I think it is 11A. I am sorry. I have the
3 Jurisdictional Statement. You are --

4 MR. BRECKENRIDGE: Let me emphasize the language I am
5 speaking about. "In other words, although it would be perfectly
6 permissible for the oil and gas companies to raise the price for
7 the first sale of natural gas, subject to the limitations of the
8 Natural Gas Policy Act, all that Act 79-434 requires is that
9 the increase in severance tax mandated by that Act be borne by
10 the producer or severer of the oil or gas. Thus the Pass-Through
11 Prohibition contained in Act. No. 79-434 does not conflict with
12 the Natural Gas Policy Act of 1978, and the trial court's findings
13 to that effect is due to be reversed." Now, what they said is
14 that under the Alabama law and a reading of the NGPA it is per-
15 fectly permissible for the first seller of the natural gas to
16 include in the maximum lawful price the increase in the tax,
17 just so long as he does not tack it on as a tax.

18 Now, I take strong exception to something that Mr.
19 Crowe said -- I mean Mr. Arendall said -- He said that the
20 Natural Gas Policy Act requires clearly in its language that the
21 tax be added to the maximum lawful price as a tax. Let's look
22 at what the Act really says. I do not have the Joint Appendix
23 cite for this. It is 15 U.S.C. §3320 (a) 1. "A price for the
first sale of natural gas shall not be considered to exceed the
maximum lawful price applicable to the first sale of such

1 of such natural gas under this part if such for-sale price
2 exceeds the maximum lawful price to the extent necessary to
3 recover." And then it says subdivision one, "state severance
4 taxes attributable to production of such natural gas and borne
5 by the seller." If you look on, it also allows the recovery of
6 the cost of transportation, the additional increased cost of
7 production --

8 QUESTION: But, Mr. Breckenridge, doesn't that mean
9 that the only way the producer can get the increase under the
10 federal statute is to identify it as the recovery of the
11 severance tax? And isn't that the one thing the state law
12 prohibits?

13 MR. BRECKENRIDGE: I do not think so, Justice Stevens.
14 I think, sure he can give an itemized billing, but he cannot add
15 a surcharge or surtax as --

16 QUESTION: If you go over the ceiling by a certain per-
17 cent, doesn't he have to make it perfectly clear for federal
18 purposes that the extra amount being charged is to recover the
19 state severance tax?

20 MR. BRECKENRIDGE: I would think so.

21 QUESTION: And, is that permitted under state law?

22 MR. BRECKENRIDGE: Yes sir, I would think so.

23 QUESTION: Well, then what does the state law prohibit?

24 MR. BRECKENRIDGE: The state law simply prohibits billing
25 the consumer, when he gets the gasoline or the fuel oil or whatever

1 it is used for, saying the price of this gasoline is \$1.09 a
2 gallon plus 3 cents increase severance charge.

3 QUESTION: Which is put on to recover the severance tax.
4 That is prohibited by state law. But that is what he must do
5 under federal law to get the increase.

6 MR. BRECKENRIDGE: But, the federal law does not pro-
7 hibit -- the federal law does not require that the tax be added to
8 the maximum lawful price. It says it shall be included in the
9 maximum lawful price.

10 QUESTION: It does say that you can raise your price by
11 the amount of a severance tax if you have separately billed or
12 charged the severance tax.

13 MR. BRECKENRIDGE: That is correct. And I think Justice
14 Stevens says when you send somebody that bill where you have
15 increased your maximum lawful price, you think it is okay for
16 them to tell the buyer why the price is increased -- that it is
17 due in this instance to an increase in the state severance tax.
18 And I say, yes, I think it is permissible to tell the buyer that
19 the increased maximum lawful price has been increased because of
20 a two percent severance tax in Alabama.

21 QUESTION: Let me give you two examples. Suppose there
22 is a charge made of a quoted price of a dollar and to that is
23 added a two percent severance tax, so your bill is \$1.02 per
24 item. Now, is that permissible under Alabama law?

25 MR. BRECKENRIDGE: If you say the price is a dollar

1 plus two percent tax -- as we go into a -- Can I draw an analogy
2 real quick?

3 QUESTION: Perhaps you could just answer that and
4 then --

5 MR. BRECKENRIDGE: I would say that you could not do
6 it that way.

7 QUESTION: But, supposing you have -- you bill the
8 person \$1.02 and say two cents of this is for --

9 MR. BRECKENRIDGE: You could do it that way.

10 QUESTION: But, do you think you could recover -- Do
11 you think you could raise your price under the NGPA if you did
12 it that way?

13 MR. BRECKENRIDGE: Yes, I think you could. And, to
14 answer one of Justice O'Connor's questions, what injury have
15 they suffered if they are allowed to pass along the tax? How
16 have they been harmed? They are allowed to pass along the tax
17 and I don't see what they say -- how they have been injured.

18 QUESTION: What is the state interest in requiring
19 the billing procedure to follow a precise form, one form rather
20 than another? I can understand a state law that says you can't
21 pass it on, but what is the purpose for a state law that says
22 you can pass it on provided you do it in the following form.

23 MR. BRECKENRIDGE: In Alabama, we have certain rules,
24 statutory construction, that the Commissioner of Revenue has to
25 follow and even the Supreme Court follows these rules in

1 Alabama and that is that you don't try to find out the motives of
2 why the legislature --

3 QUESTION: You don't really care whether there is a
4 reason for it or not.

5 MR. BRECKENRIDGE: As long it is not palpably
6 arbitrated erroneously.

7 QUESTION: Why isn't it palpably arbitrated, say you
8 must follow this form rather than another?

9 MR. BRECKENRIDGE: I think they -- I think the
10 legislature has full discretion. I think the Supreme Court of
11 the United States has said over and over again that legislatures
12 have wide discretion in where they want to levy the tax and who
13 they want the tax to fall on. I think --

14 QUESTION: Even if you cannot identify a rational
15 basis for doing it for that requirement?

16 MR. BRECKENRIDGE: I think a rational basis could
17 be identified. I assume that the --

18 QUESTION: Tell me what it is.

19 MR. BRECKENRIDGE: I assume that the legislature --

20 QUESTION: What is the rational basis for saying
21 must bill in this particular way?

22 MR. BRECKENRIDGE: I assume that the legislature of
23 Alabama decided that they did not want to be perceived as levy-
24 ing another consumer tax, but wanted the tax to be upon the
25 producers and that is what --

1 QUESTION: Well, if that is the purpose, I would think
2 it would violate the prohibition of the Alabama law however you
3 showed the severance tax on your bill. If you put a footnote
4 at the bottom and say, by the way, two cents of the above \$1.02
5 charge is severance tax, I would think you are right in the
6 teeth of the purpose of the Alabama law. You are then telling
7 the consumer, don't blame the Feds, blame the legislature.

8 MR. BRECKNERIDGE: Let's look at what the Alabama Supreme
9 Court, some of the rules they were faced with when they saw this
10 conflict.

11 The rules of Alabama and the rules of the Supreme
12 Court are that when two statute -- when a statute is before
13 the court and there are two interpretations, one of which will
14 require a holding that the statute is unconstitutional, and
15 another interpretation that will save the statute, that the
16 courts are duty bound to adopt the interpretation that will
17 uphold the constitutionality of the statute. The legislature
18 is presumed to have acted reasonably and not to have passed
19 unconstitutional law.

20 The Supreme Court of Alabama, in answering Justice
21 O'Connor's questions about did they specifically say that the
22 producers could do this, they said, look at both of the laws,
23 we think it is perfectly permissible to raise the maximum law
24 for price just so long as you don't pass it along as a consumer
25 tax.

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 QUESTION: That is where I have trouble, I guess, is
2 the quotation you read from page 12 of the Joint Appendix where
3 you have that thrust in there. To me, that thrust doesn't follow
4 at all. You are hung with it because that is what you have to
5 defend.

6 MR. BRECKENRIDGE: That is the language that the
7 Supreme Court of Alabama used and we assume -- The Commissioner
8 has to assume that they meant what they said.

9 QUESTION: Mr. Breckenridge, does it come down to --
10 You suggest that Alabama says tax can be "passed on" without
11 saying so?

12 MR. BRECKENRIDGE: No, Justice Marshall. I would say
13 what they say is maximum lawful price can be raised, but that
14 the --

15 QUESTION: Can it be raised the amount of the tax?

16 MR. BRECKENRIDGE: It can be raised -- The statute
17 says, and I believe Alabama Supreme Court says implicitly that
18 it can be raised an amount to recover the cost of their paying
19 the tax.

20 Now, one of the things about the bill is that the
21 tax has to be borne by the seller.

22 QUESTION: If you question and you say what was this
23 two cent raise, you would say that was the amount of the tax.
24 What else could you say?

25 MR. BRECKENRIDGE: That was the amount that was

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 necessary -- This is the amount I am allowed to recover from
2 you for my paying the State of Alabama severance tax.

3 QUESTION: But, it is not a tax?

4 MR. BRECKENRIDGE: It is not a tax on you, no, sir.

5 It is a tax on me and I am allowed to pass it on --

6 QUESTION: It is not a passed-on tax?

7 MR. BRECKENRIDGE: No, sir. I am allowed to recover

8 my costs.

9 QUESTION: You want us to approve that?

10 MR. BRECKENRIDGE: Sir?

11 QUESTION: You want us to approve that?

12 MR. BRECKENRIDGE: Yes, sir.

13 QUESTION: Mr. Breckenridge, would it be fair to say
14 that the Supreme Court of Alabama interpreted as narrowly as
15 conceivable the anti pass-on provision where the legislature
16 said you can't pass it on directly or indirectly? I suppose
17 maybe you might have read that requirement the same, that the
18 only way to absorb it is after you declare a dividend to the
19 stockholders you have to take the tax out of that dividend.
20 But, the Alabama Supreme Court came out at the other end of
21 the spectrum and said that really all we are talking about is
22 you can't add it to a quoted price.

23 MR. BRECKENRIDGE: I would agree with that, Justice
24 Rehnquist.

25 The Appellants have also raised certain issues about

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 the contract clause and they have cited the Barwise case as we
2 have cited the Barwise case. I think the Barwise case, the
3 United States Supreme Court case, Barwise v. Sheppard, is more
4 in favor of the State of Alabama or the Commissioner of Revenue's
5 interpretation than the Appellant oil company. It is almost
6 black-letter law in America that parties to a private contract
7 cannot limit a state's ability to levy taxes or to select upon
8 whom those taxes are to fall.

9 that should clearly two individuals or two corporations can't get
10 together and say, as between us, we are going to bind the
11 State of Alabama or any other state and say that they can't
12 levy additional, increased taxes on us.

13 remainder I would like to point out, and I am sure that the
14 Court realizes, that every tax of any kind to some extent affects
15 a contract right. Any tax that I can think of to some extent
16 affects somebody's contract. It is just inconceivable that
17 the state's sovereign right to tax can be taken away by a
18 contract between private corporations.

19 There is an implicit -- The Commissioner submits that
20 there is an implicit limitation on the right to contract that
21 must recognize the sovereign right of a state to exercise its
22 power of taxation.

23 As Justice Holmes has said in the Barwise case or
24 was quoting the Barwise case, "when these rights are subject to
25 state restrictions cannot remove them from the power of the state

1 by making a contract about them."

2 I would like to go back for a moment about the Natural
3 Gas Policy Act and raise an issue that we raised in our briefs
4 and that is that the Alabama statute contains a Severability
5 Clause. The Alabama statute we are talking about is over four
6 pages long and the main sentence we are talking about is simply
7 that, one sentence.

8 It is the position of the Commissioner of Revenue
9 that should this Court decide that the pass-through prohibition
10 is pre-empted under the Supremacy Clause by the NGPA; that be-
11 cause of -- that contains a severability Clause which says that
12 should any portion of this Act be deemed unconstitutional the
13 remainder of the Act shall stand, shall survive; that the Court,
14 as the very least, would have to send it back down to the State
15 Supreme Court of Alabama to determine whether or not -- what
16 effect the Severability Clause has.

17 Now, it is a matter of record that less than ten
18 months later the legislature of Alabama adopted the identical
19 language of that 79-434 and they left out one sentence, the
20 Pass-Through Prohibition, and they added on sentence that
21 allowed unitization method of reporting.

22 We think this is highly persuasive that the Pass-
23 Through Prohibition was not an essential part of the 79 Act.
24 so as to cause the whole Act to fall.

25 QUESTION: This assumes you get by the other grounds

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 that would invalidate the two cent tax, the two cent increase.

2 MR. BRECKENRIDGE: I am not clear, Justice White, on
3 what other grounds you are referring.

4 QUESTION: I mean the equal protection and the
5 contract.

6 MR. BRECKENRIDGE: If the Court rules, for instance,
7 that the Pass-Through Prohibition --

8 QUESTION: The pre-emption ground wouldn't question
9 the validity of the two cent increase?

10 MR. BRECKENRIDGE: Let's look at the contract clause.
11 What the oil companies are saying is that because of the Anti
12 Pass-Through Prohibition their contracts were invalidated
13 because they can't pass along the tax.

14 QUESTION: Well, you see, the reason I said -- Suppose
15 we thought that the Pass-Through Provisions were invalid under
16 the NGPA --

17 MR. BRECKENRIDGE: Yes, sir.

18 QUESTION: -- wouldn't we still -- Would we still have
19 to pass on the equal protection and the contract clause issues?

20 MR. BRECKENRIDGE: I don't understand how you could
21 pass on the contract clause. That is what I was trying to say
22 here. If the Anti Pass-Through Provision, if you strike it down,
23 if this Court strikes it down, it is out. Where is the contract
24 clause question then? The contract clause also hinges on the
25 Anti Pass-Through Prohibit.

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 equal protection QUESTION: Well, how about the equal protection?

2 for royalty MR. BRECKENRIDGE: I can address that now.

3 equal protection QUESTION: Well, I know, but wouldn't we have to --

4 MR. BRECKENRIDGE: The Court could --

5 QUESTION: Wouldn't we have to address it?

6 MR. BRECKENRIDGE: I don't think so. I could suggest

7 disagree QUESTION: If they are right on the equal protection,

8 if that issue is properly here, and if they are right on it,

9 it means that the two cent exclusion of the royalty owner is

10 unconstitutional, right?

11 answer MR. BRECKENRIDGE: No, sir. I will say why. I think

12 what the Court would do is if it decided to strike down the

13 Pass-Through Prohibition and send it back down to the Alabama

14 Supreme Court, usually this prudent Court waits until the

15 State Supreme Court has ruled on that question before it will --

16 The State Supreme Court may strike the whole statute down, it

17 may not. But, we would never get to the Equal Protection Clause.

18 The equal protection argument is -- If I may go over what the

19 equal protection argument is, they are saying, because the

20 Supreme Court of Alabama refused to accept their version of

21 the legislative history, things they call legislative history,

22 that they were denied equal protection in the state court.

23 That is all that is. It has got nothing to do with the language

24 in the statute.

25 QUESTION: That is their due process argument. Their

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 equal protection argument is the fact that there is an exemption
2 for royalty for the non-working interest owners. That is their
3 equal protection argument.

4 MR. BRECKENRIDGE: If the Court decides to address --

5 QUESTION: We have to decide it.

6 MR. BRECKENRIDGE: Justice Stevens, I would sorely
7 disagree with you because not only do they say due process,
8 but they say we were denied equal protection because --

9 QUESTION: You may be right about the label, but let's
10 talk about the royalty owner problem for a minute. How do you
11 answer that one? Let me ask you, in the legislation ten months
12 later, did you change the statute in this respect?

13 MR. BRECKENRIDGE: With regard to the royalty owner
14 exemption, no, sir.

15 QUESTION: No, that is still there.

16 MR. BRECKENRIDGE: Let me reiterate. There were only
17 two changes in the statute ten months later; one, the Anti Pass-
18 Through Prohibition was deleted, and a method of reporting on
19 the unitization method was added.

20 QUESTION: How do you justify -- Say you have one -- Two
21 producers, one has a 50% working interest and the other has a
22 75% working interest. They both, say, pay the same tax, is
23 that right?

24 MR. BRECKENRIDGE: Yes, sir, same rate of tax.

25 QUESTION: The same rate and the same dollar amount

1 if they produce the same amount. And, the exemption -- Does not
2 the exemption mean that the smaller working interest pays a
3 higher rate on his actual earnings?

4 MR. BRECKENRIDGE: I don't know, sir. I don't think
5 so. I don't see it that way. I think that a 50% working-interest
6 owner would still pay at the rate of two percent and a 75% owner--

7 QUESTION: If you have got 100% of production. You
8 pay two percent on 100% production even though his economic
9 interest is only 50%, isn't that right? Isn't that their
10 argument? Maybe I don't understand their argument.

11 MR. BRECKENRIDGE: I don't understand that at all.
12 I don't understand what you are saying honestly.

13 QUESTION: Do you understand they are making an equal
14 protection argument based on the exemption for the royalty
15 interest, because the economic effect of the exemption is to
16 produce distortions in the rates paid by those who actually
17 produce the gas?

18 MR. BRECKENRIDGE: Well, with regard to that answer --

19 QUESTION: The only exemption is for royalty interest,
20 isn't it?

21 MR. BRECKENRIDGE: Yes, sir.

22 QUESTION: Is there another standard royalty rate in
23 Alabama?

24 MR. BRECKENRIDGE: No, sir. The oil companies for
25 lessees -- The testimony in the volumes of record go from

1 anywhere from 1/8 to 1/16 to 1/32. It is just whatever the
2 market will bear.

3 QUESTION: So, Justice Stevens has to be correct,
4 doesn't he, that if the tax is paid by the working interest
5 and the royalty interests are exempt, then this tax burdens some
6 producers more than others.

7 MR. BRECKENRIDGE: As the income tax burdens people
8 with a higher income than people who make less. The legislature
9 has the discretion to set the rate of tax and they can decide --
10 They have the clear --

11 QUESTION: Well, again, what is the rational basis
12 for charging one producer a higher rate simply because he has a
13 different percentage interest in the lease?

14 MR. BRECKENRIDGE: I don't think a royalty owner
15 is a producer under the increase. I disagree with that assertion
16 right away.

17 QUESTION: That is a matter of statutory construction.

18 MR. BRECKENRIDGE: That is correct.

19 QUESTION: But, if you construe the statute your way,
20 it does have the affect of charging different producers
21 different rates for the same amount of gas being produced.

22 MR. BRECKENRIDGE: If you construe it my way?

23 QUESTION: Yes.

24 MR. BRECKENRIDGE: I say the royalty owner for the
25 two percent increase is not a producer so it would not --

1 QUESTION: No, but the producer -- If the producer
2 has a smaller percentage interest in the lease and they all pay
3 two percent on total production, the producer with the smaller
4 percentage is paying a higher percentage on what he actually
5 earns.

6 MR. BRECKENRIDGE: If they all pay two percent on
7 their production and one producer produces more, is a larger
8 producer than the others, I don't see how that is a denial of
9 equal protection. The smaller producer could produce more. I
10 could make \$1 million and pay income on \$1 million or I could --
11 I don't see where that is denial of equal protection.

12 What we are doing here is so long as you treat every
13 member of the class or subclass the same you are not denying
14 them equal protection. If you keep royalty owners, all of the
15 royalty owners one way and all the producers another way, but
16 so long as you treat them the same, you are not violating equal
17 protection.

18 QUESTION: Mr. Breckenridge, do your opponents say --
19 base their equal protection argument on the discrimination among
20 producers or do they say that you may not exempt royalty owners?

21 MR. BRECKENRIDGE: They say both.

22 QUESTION: They say both?

23 MR. BRECKENRIDGE: Yes, sir.

24 QUESTION: Did they use both of those arguments in
25 the Supreme Court of Alabama?

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 MR. BRECKENRIDGE: I think they did.

2 QUESTION: Is this discussion of the Supreme Court of
3 Alabama where they cite the state case of Hayden against Watson
4 at page 9 of the Appendix? The Supreme Court of Alabama seems
5 to simply talk in terms of the power of the legislature to
6 establish classification. Was that a response to a federal
7 equal protection argument by the --

8 MR. BRECKENRIDGE: Yes, I think it was, Justice
9 Rehnquist.

10 QUESTION: Aren't there a lot of severance taxes that
11 just hit the working interests around the country and exempt --

12 MR. BRECKENRIDGE: Yes.

13 QUESTION: It is not unheard of --

14 MR. BRECKENRIDGE: None come to mind.

15 QUESTION: It is not unheard of to exempt royalty
16 owners from severance tax liability?

17 MR. BRECKENRIDGE: That is correct. The one that
18 comes readily to mind in Alabama is the coal severance tax
19 that is levied on producers.

20 QUESTION: That may be true, but that doesn't answer
21 the equal protection argument insofar that it is based on a
22 discrimination among producers.

23 MR. BRECKENRIDGE: As I understand Justice Stevens'
24 example, what we -- He says you seemed to be treating smaller
25 producers at a different rate than the larger producers.

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 does not QUESTION: Oh, no.

2 MR. BRECKENRIDGE: But, then, they are different.

3 They are smaller producers. We are not saying they are

4 different.

5 QUESTION: Two producers producing exactly the same

6 amount of oil are going to pay different amounts of tax or they

7 are going to pay the same amount of tax, but they have less

8 economic interest in the oil that is produced, one of them

9 does.

10 MR. BRECKENRIDGE: I disagree, because --

11 QUESTION: The tax is going to be more burdensome.

12 MR. BRECKENRIDGE: I disagree, because they can't --

13 Neither one of them can pass a law on the increase to the royalty

14 owner. They are both going to bear 100% of the tax.

15 QUESTION: That may be -- That may be so, but if I

16 am delivering tax free to the royalty owner 50% and still paying

17 \$100,000 severance tax, and my competitor is delivering only 25%

18 tax free.

19 MR. BRECKENRIDGE: I think the Court -- the statute

20 does not say that at all. The statute says the increase in

21 the severance tax will be borne by the producer and shall not

22 be passed along to the royalty owner. So, the fact that he

23 has got-- The producer is going to pay 100% of the severance

24 tax on the amount of oil and gas that he severs and the fact

25 that he has got a royalty owner and one of his competitors

1 does not have to share his proceeds with a royalty owner does
2 not mean that they are being denied equal protection.

3 *Commissioner* QUESTION: Well, I just suggest to you that two
4 producers in the position that Justice Stevens posited to you
5 one of them is going to end up -- One of them is going to end up
6 with less money in his pocket than the other.

7 *and Gulf* MR. BRECKENRIDGE: I don't believe by paying the
8 severance tax will cause them to lose it. At any rate, he is
9 going to pay the same rate.

10 *Owner Exem* I believe that if I pay income tax that I am going to
11 pay a different rate than somebody else and at the end of the
12 year I will wind up with less money than someone else, but that
13 doesn't mean that I am being denied equal protection by the
14 income tax laws.

15 *producer* QUESTION: The irony here is that the smaller your
16 working interest the higher your tax.

17 *Tessor dev* Go ahead.

18 *Drilling* MR. BRECKENRIDGE: The Appellants Exchange and Getty
19 and Union have raised up here again the question of whether the
20 Alabama statute is a local law or a general law. We feel like
21 the State of Alabama has the ultimate competence to answer that
22 question and we feel like the -- the Commission feels like the
23 Supreme Court of Alabama answered that question fully.

24 Before I finish, I would like to go back to the
25 Severability Clause though. If the Court decides to agree with

1 Appellants with regard to the pre-emption question and the
2 Anti Pass-Through Prohibition, it is the position of the
3 Commissioner of Revenue that the case must be sent back down
4 to Alabama to determine the effects of the state's Severability
5 Clause.

6 And, we would also like to say that Appellant Exxon
7 and Gulf and Louisiana Land and Exploration have drawn the
8 analogy that the Royalty Owner Exemption and the Anti Pass-
9 Through Prohibition are the same and they are not. The Royalty
10 Owner Exemption says that the producer is prohibited from
11 passing the tax along to the royalty owner and it says that
12 the royalty owner's interest is exempt from the tax is what it
13 says.

14 The Anti Pass-Through Prohibition says that the
15 producer cannot pass the tax along to the consumer. The royalty
16 owner is not the consumer of the gas. What he is, he is a
17 lessor usually or contributes in some manner, investing in the
18 drilling of the well.

19 To say that the royalty owner is in the same position
20 as the consumer is a gross distortion of the facts in the
21 opinion of the Commissioner of Revenue.

22 CHIEF JUSTICE BURGER: Your time has expired, Mr.
23 Breckenridge.

24 Thank you, gentlemen, the case is submitted.

25 We will hear arguments next in the Pennhurst State

300 7TH STREET, S.W., REPORTERS BUILDING, WASHINGTON, D.C. 20024 (202) 554-2345

1 School against Halderman.

2 (Whereupon, at 11:14 a.m., the case in the above-
3 entitled matter was submitted.)
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23

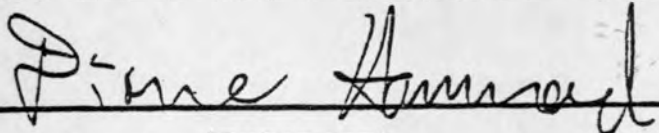
8

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represent an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of the United States in the Matter of: EXXON CORPORATION, ET AL., Appellants v. RALPH EAGERTON, JR., COMMISSIONER OF REVENUE OF ALABAMA, ET AL.; #81-1020 and EXCHANGE OIL AND GAS CORPORATION, ET AL., Appellants v. RALPH P. EAGERTON, JR., COMMISSIONER OF REVENUE OF THE STATE OF ALABAMA # 81-1268

and that these attached pages constitute the original transcript of the proceedings for the records of the court.

BY

A handwritten signature in cursive script, appearing to read "P. H. Howard", is written over a solid horizontal line.

(REPORTER)

RECEIVED
SUPREME COURT, U.S.
MARSHAL'S OFFICE

983 MAR 1 PM 4 37