

No. 08-1458

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IN THE
Supreme Court of the United States

MISSOURI GAS ENERGY,
Petitioner,

v.

MONICA SCHMIDT,
WOODS COUNTY, OKLAHOMA ASSESSOR,
Respondent.

**On Petition for a Writ of Certiorari to the
Supreme Court of Oklahoma**

**AMICUS CURIAE BRIEF OF
AMERICAN GAS ASSOCIATION
IN SUPPORT OF PETITIONER**

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INTEREST OF AMICUS CURIAE¹

Amicus curiae represents natural gas local distribution utilities that ship natural gas through the FERC regulated interstate natural gas transmission

¹ The parties have consented to the filing of this brief. Counsel of record for all parties received notice at least 10 days prior to the due date of the *amicus*' intention to file this brief. No counsel for a party authored this brief in whole or in part, and no counsel or party made a monetary contribution intended to fund the preparation or submission of this brief. No person other than the *amicus* made a monetary contribution to its preparation or submission.

system that fully integrates natural gas storage as part of that transmission process. For this reason, *amicus* has a substantial interest in ensuring that local *ad valorem* taxes are not imposed by state and local taxing authorities in violation of the Commerce Clause.

The American Gas Association (“AGA”) is the national trade association representing energy members that deliver natural gas. AGA members include: (1) publicly traded energy utilities, municipally owned energy utilities, and privately held utility companies; and (2) natural gas distributors, pipelines, marketers and storage facilities. The AGA represents over 200 natural gas local distribution companies (“LDCs”), located in all 50 states that deliver natural gas to 64 million customers throughout the United States.

An LDC, such as Petitioner, is the entity that provides natural gas to end users, such as consumers, business, industry, and government. LDCs are regulated through tariffs approved by local or state public utility service commissions. The tariffs detail the terms, conditions and rate information applicable to various types of service and allow LDCs to recover their “cost of service.” Under this regulatory regime, LDCs generally pass the cost of gas service, including transportation in interstate commerce, directly to the consumers and make no profit on it. (See Petitioner’s App. 69a (numbered paragraph 34)). Thus, the persons most impacted by *ad valorem* taxes imposed by local jurisdictions like Woods County, Oklahoma will be LDCs and the 64 million consumers served by AGA’s members to whom these costs may be passed.

AGA is an advocate for local natural gas utility companies and provides a broad range of programs

and services for members including the filing of *amici* briefs commenting on issues that could affect its members and their customers.

SUMMARY OF ARGUMENT TO GRANT WRIT

The *ad valorem* taxation of natural gas in FERC-regulated storage within the interstate transportation system presents a recurring issue that merits this Court's attention. The Commerce Clause of the United States Constitution provides that the Congress has the power to regulate commerce among the several states, U.S. Const. Art. I, § 8, cl. 3. The Commerce Clause has long been interpreted to prohibit the States from taxing property "in transit" in interstate commerce.

Imposition of *ad valorem* tax on natural gas that has been delivered to an interstate natural gas pipeline carrier for interstate transmission, including temporary storage, violates the U.S. Constitution. The trial court's finding was that all of the natural gas in issue had been delivered to Panhandle Eastern Pipeline Company ("Panhandle Eastern"), an interstate natural gas pipeline carrier, for transport, delivery and storage (Petitioner's App. 64a (numbered paragraphs 8-16)) and was under Panhandle Eastern's sole possession and control. (Petitioner's App. 68a (numbered paragraph 29)). The transportation of natural gas in interstate commerce includes the temporary storage of that gas. *See e.g.*, 18 C.F.R. 284.1(a). Thus, neither the gas delivered to Panhandle Eastern for transport nor the gas delivered to Panhandle Eastern for storage may be subjected to local *ad valorem* taxation under the U.S. Constitution.

The Petition presents the Court with an opportunity to:

- Provide needed guidance on this Court's "in transit" cases;
- Address the proper application of the four part "test" this Court set forth in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) to an *ad valorem* property tax, an issue of first impression;
- Provide needed guidance to *Complete Auto's* "substantial nexus" test so that potential taxpayers have fair notice of the conduct that will subject them to local taxation by foreign states and their local jurisdictions; and
- Ensure that the natural gas in the FERC-regulated interstate transportation system is not subject to multiple taxing authorities.

ARGUMENT TO GRANT WRIT

I. HISTORY AND IMPORTANCE OF NATURAL GAS AND NATURAL GAS STORAGE

A. Natural Gas Is an Increasingly Important Energy Resource in the United States

During the 1800's, natural gas was used mainly to power street and housing lights. Today, almost 200 years later, natural gas is one of the principal energy sources in the United States, integral to the needs of individual consumers, business and industry, local and state governments, and the federal government. It is the source for approximately a quarter of all energy used in this country. (See U.S. Department of Energy, Energy Information Administration's

web site, http://www.eia.doe.gov/emeu/aer/pecss_diagram.html).

With domestic oil supplies dwindling, a volatile oil commodity market, and the move to a lower carbon economy with anticipated climate change legislation, the abundance of natural gas, the lowest carbon fossil fuel source, means that natural gas will play an ever increasing role in meeting the constantly expanding energy needs of the United States. It is hard to overstate the importance of natural gas to our energy future and national security.

B. Early Developments and Regulation of the Natural Gas Industry

Initially, the distribution of natural gas was regulated by local municipalities through LDCs. By the early 1900's, the first intrastate pipelines were developed and transportation of natural gas between municipalities began to occur. In the late 1920s, technological advances in the development of steel for larger diameter pipe permitted interstate pipelines to be developed, and the interstate distribution of natural gas began. As with their predecessors, the local municipalities, state governments could only regulate the distribution of pipelines within their individual jurisdictions; they could not regulate the new interstate natural gas pipelines.

In 1938, Congress passed the Natural Gas Act, 15 U.S.C. § 717 et seq., and charged the federal government with regulating the prices charged by the companies that owned and operated the interstate natural gas pipelines. From 1954 through the early 1970's, the federal government utilized different schemes to regulate the price of natural gas. But, these regulatory attempts often backfired since they

blunted incentives to produce natural gas. In fact, during 1976 and 1977, severe natural gas shortages led to closures of industries and schools in the Midwest while states in the producing regions of the country experienced no shortages.

C. Federal Regulation of the Natural Gas Industry Through NGPA and the FERC

To remedy the strains created by natural gas shortages, Congress enacted the Natural Gas Policy Act of 1978, 15 U.S.C. § 3301 et seq. ("NGPA"). Congress had three main goals in implementing the NGPA: (1) creating a single, national, natural gas market; (2) equalizing supply and demand; and (3) allowing market forces to establish the wellhead price of natural gas. To help meet these goals, Congress created the Federal Energy Regulatory Commission ("FERC"). Using its authority under the NGPA, the FERC began the process of deregulating the natural gas market to allow greater competition among natural gas suppliers.

D. FERC Changed the Market Landscape with Order Nos. 436 and 636

Historically, pipeline operators purchased natural gas from producers, transported it to customers—mostly LDCs—selling the gas and transportation as a bundled product. This meant that a pipeline customer, like the LDCs, could not purchase natural gas from a producer as one product and transportation service as a separate service from a pipeline company.

In 1985, the FERC issued Order No. 436, which permitted pipelines to offer transportation service as

a separate service.² Essentially, with Order No. 436, the FERC allowed pipelines, on a voluntary basis, to offer transportation services to customers who requested them on a first come, first served basis. At the same time, the FERC barred interstate pipelines from discriminating against such customer transportation requests in favor of protecting their own merchant services (*i.e.*, the bundled product of gas and transportation service). One of the long term effects of Order No. 436 was that the transportation and temporary storage of natural gas became the primary function of the interstate pipelines and the practice of bundled gas and transportation services declined.

In 1992, the FERC issued Order No. 636, which completed the final steps toward permanent unbundling of pipeline services.³ Essentially, Order No. 636 requires that pipelines separate their transportation

² *Regulation of Natural Gas Pipelines after Partial Wellhead Decontrol*, Order No. 436, FERC Stats. & Regs., Regs. Preambles ¶ 30,665 (1985), *vacated and remanded*, *Associated Gas Distrib. v. FERC*, 824 F.2d 981 (D.C. Cir. 1987), *cert. denied*, 485 U.S. 1006 (1988), *readopted*, Order No. 500, FERC Stats. & Regs., Regs. Preambles ¶ 30,761 (1987), *remanded*, *American Gas Ass'n v. FERC*, 888 F.2d 136 (D.C. Cir. 1989), *readopted*, Order No. 500-H, FERC Stats. & Regs., Regs. Preambles ¶ 30,867 (1989), *order on reh'g*, Order No. 500-I, FERC Stats. & Regs., Regs. Preambles ¶ 30,880 (1990), *aff'd in relevant part*, *American Gas Ass'n v. FERC*, 912 F.2d 1496 (D.C. Cir. 1990), *cert. denied*, 111 S.Ct. 957 (1991).

³ *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, Order No. 636, FERC Stats. & Regs., Regs. Preambles ¶ 30,939, *order on reh'g*, Order No. 636-A, FERC Stats. & Regs., Regs. Preambles ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 FERC ¶ 61,272 (1992), *aff'd in relevant part*, *United Distribution Cos. v. FERC*, 88 F.3d 1105 (D.C. Cir.), *cert. denied*, 520 U.S. 1224 (1997).

and sales services so that all pipeline customers may purchase gas from any producer and may purchase transportation services from any pipeline according to rates filed with the FERC in the form of a Tariff. The main purpose of Order No. 636 was to give both natural gas producers and purchasers an even playing field on which to sell, purchase, and transport natural gas.

E. Storage Is an Essential Part of the Federally Regulated Interstate Transmission System

Another important part of Order No. 636 was that it required interstate pipelines to offer services that allow for efficient and reliable delivery of natural gas to end users by LDCs. Temporary storage makes these services possible.

These services include the institution of no-notice transportation, access to storage facilities, increased flexibility in receipt and delivery points, and capacity reassignment programs.

No-notice transportation services allow LDCs and utilities to receive natural gas from pipelines on demand to meet peak service needs for customers, without incurring penalties. Natural gas storage is integral to pipelines providing this no-notice transportation service since the duty to provide no-notice service may exceed the physical ability of production facilities and the transmission pipelines system to provide natural gas. The FERC required these services to be offered by the interstate pipelines based on LDC and utility concerns that the required restructuring of the industry might decrease the reliability needed to meet their own customers' needs and lead to a return of the gas shortages seen during the mid-1970's.

The capacity reassignment programs allow pipeline customers to resell or release their unwanted pipeline capacity to other pipeline customers. Order No. 636 required interstate pipelines to set up electronic bulletin boards, accessible to all customers on an equal basis, to show the available and released capacity on any particular pipeline. A customer requiring pipeline transportation can refer to these bulletin boards and find out if there is any available capacity on the pipeline, or if there is any released capacity available for purchase or lease from one who has already purchased capacity but does not need it. Again, the flexibility and fluid nature of the regulatory scheme demonstrate the continuous and unimpeded "in transit" nature of the natural gas in the transmission pipeline system.

All participants in the national, natural gas industry understand that an LDC must have the flexibility these services provide, including access to storage capacity, to meet its distribution function, which includes providing service on peak days and seasons.

An LDC's distribution of natural gas peaks during periods of high usage, which includes extremely cold weather in the winter where natural gas is used as a heating fuel and hot days in the summer where natural gas is used a fuel to generate electricity.

An LDC anticipates peak days and seasons to avoid curtailment of service during periods when demands for gas exceed the maximum daily delivery capability of a pipeline or distribution system or where production may be curtailed due to weather conditions, *e.g.*, hurricanes in the Gulf of Mexico.

To serve customers on their dates of greatest need, *i.e.*, peak usage dates, a natural gas utility must be-

gin the process in the late spring, summer and early fall of transporting gas to storage for later withdrawal and delivery of the gas during peak periods.

For this reason, the amount of natural gas in storage fluctuates in a regular pattern year after year rising in early spring through early fall and falling in late fall through late winter. The graph at Appendix A, from the U.S. Department of Energy's Energy Information Administration's web site, illustrates the flow of natural gas through storage and charts the five year average for working gas in underground storage. App. 1a.

For this reason, storage is an integral part of the transit process for peak periods. Due to the physical limitations of production fields and pipeline capacity, natural gas transmission, including temporary storage, must begin well in advance of the generally known peak periods of use.

Since efficient and reliable transportation of natural gas by an interstate pipeline is accomplished through access to storage, it is not an accident that the FERC considers storage to be part of the transportation function offered by interstate pipelines. 18 C.F.R. § 284.1(a) ("Transportation includes storage, exchange, backhaul, displacement, or other methods of transportation.").

The development of the natural gas industry has been of critical importance to the development of the United States. Given the abundance of natural gas and the efficient and reliable single, national market regulated by the FERC that allows producers and purchasers to choose the most efficient means of obtaining and transporting gas, the natural gas industry remains vitally important to our national inter-

ests. On behalf of its members, the AGA urges the Court to grant the Petitioner's petition and hold that local *ad valorem* taxes on natural gas being shipped in interstate commerce is unconstitutional, is at odds with both the letter and spirit of the federal government's regulatory scheme, and in conflict with the national interest and individual consumer interest in having a single, efficient, and reliable market for natural gas.

II. THIS COURT SHOULD GRANT CERTIORARI TO CLARIFY THAT NATURAL GAS ON INTERSTATE PIPELINE SYSTEMS IS IN INTERSTATE COMMERCE

A. The Panhandle Eastern Facility is Used to Transport Gas in Interstate Commerce

Congress has found that the "business of transporting and selling natural gas for ultimate distribution to the public is affected with a public interest, and that the Federal regulation in matters relating to the *transportation of natural gas and the sale thereof in interstate and foreign commerce* is necessary in the public interest." 15 U.S.C. § 717(a). (emphasis added). The FERC has jurisdiction over natural gas companies engaged in the transportation of natural gas in *interstate commerce*. 15 U.S.C. § 717(b) (emphasis added). Accordingly, Panhandle Eastern had to apply for and receive a certificate of public convenience and necessity from the FERC to construct and operate its storage facility in Woods County, Oklahoma. *See* 15 U.S.C. § 717(f).

The FERC issued certificates of public convenience and necessity to Panhandle Eastern, under Section 717(f) of the NGA, permitting Panhandle Eastern to

develop its natural gas storage facility. The FERC can only issue certificates under Section 717(f) of the NGA in instances where the facility serves interstate commerce. Therefore, the Panhandle Eastern gas storage facility in Woods County necessarily operates and provides services in interstate commerce.

Further, it is indisputable that natural gas in Panhandle Eastern's storage facility is in interstate commerce. Interstate transport of natural gas includes the storage function. *See Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 295 n.1 (1988) (quoting *Columbia Gas Transmission Corp. v. Exclusive Gas Storage Easement*, 776 F.2d 125, 129 (6th Cir. 1985)) ("Underground gas storage facilities are a necessary and integral part of the operation of piping gas from the area of production to the areas of consumption.") *See also* 18 C.F.R. § 284.1(a) ("Transportation includes storage, exchange, backhaul, displacement, or other methods of transportation.") Since the FERC has found that Panhandle Eastern's storage facility serves interstate commerce, the actual molecules of gas stored there constitute gas that is being transported in interstate commerce.

B. Goods "In Transit" In Interstate Commerce Are Not Subject to State *Ad Valorem* Property Tax

1. Goods In Transit

The Commerce Clause of the United States Constitution provides that the Congress has the power to regulate commerce among the several states, U.S. Const. Art. I, § 8, cl. 3. The Commerce Clause has long been interpreted to prohibit the States from taxing property "in transit" in interstate commerce. *See, e.g., Coe v. Town of Errol*, 116 U.S. 517 (1886);

Empresa Siderurgica, S.A. v. County of Merced, Cal., 337 U.S. 154, 157 (1949); *Kosydar v. National Cash Register Co.*, 417 U.S. 62, 65-67 (1974) (applying the Import-Export Clause, which uses the same stream of commerce test).

For purposes of determining whether goods are “in transit” and the resulting exemption from taxation, transit begins when the goods have been “shipped or entered with a common carrier for transportation, to another state, or have been started upon such transportation in a continuous route or journey.” *Coe*, 116 U.S. at 527.

Any natural gas in the Panhandle Eastern system was on an interstate natural gas transmission pipeline regulated by the Federal government. The natural gas being transported is controlled, not by any shippers, but by Panhandle Eastern—the system operator and carrier. (Petitioner’s App. 68a (numbered paragraph 29)). Any attempt by Woods County to tax gas in the Panhandle Eastern system must fail, as did the tax invalidated by the U.S. Supreme Court in *Maryland v. Louisiana*, 451 U.S. 725 (1981). In *Maryland v. Louisiana*, the U.S. Supreme Court reviewed a Louisiana statute that imposed a first-use tax on natural gas extracted from the continental shelf in an amount equivalent to the severance tax imposed on natural gas extracted in Louisiana. With respect to whether the natural gas was in interstate commerce, the Court stated:

Initially, it is clear to us that the flow of gas from the OCS [outer continental shelf] wells, through processing plants in Louisiana, and through interstate pipelines to the ultimate consumers in over 30 States *constitutes interstate commerce* [W]e do not agree that the flow of gas from the

wellhead to the consumer, even though ‘*interrupted*’ by *certain events*, is anything but a continual flow of gas in interstate commerce.

Maryland v. Louisiana, 451 U.S. at 754-55 (emphasis added). Accordingly, the Court held that the Louisiana statute violated the Commerce Clause and that the effect of the statute was to interfere with the FERC’s authority to regulate the determination of the proper allocation of costs associated with the sale of natural gas to consumers. *Id.* at 750, 759-60.

Similarly, Woods County’s efforts to tax gas at the Panhandle Eastern facility must also fail. If an “interruption” for processing at plants in Louisiana does not change the fact that there is a “continual flow of gas in interstate commerce,” neither does temporary presence of constantly moving gas in a storage facility integral to the delivery of gas through an interstate gas pipeline.

2. Any Taxation of Gas At the Panhandle Eastern Storage Facility Would Not Be Valid Under the Complete Auto Test

A property tax is not valid under the Commerce Clause if it fails to satisfy the four part test of *Complete Auto Transit v. Brady*, 430 U.S. 274, 277-279 (1977) (“*Complete Auto*”): (1) the tax must be applied to an activity that has a substantial nexus with the state; (2) the tax must be fairly apportioned to activities carried on by the taxpayer in the state; (3) the tax must not discriminate against interstate commerce; and (4) the tax must be fairly related to services provided by the state. If a tax on interstate commerce is to stand, it must meet all four of these

factors. Any one factor that is not met means that the tax cannot be applied.

Analysis of the *Complete Auto* factors indicates that none of the factors would be met:

A Substantial Nexus. In general, the only nexus between the shippers on interstate transmission systems and local taxing jurisdictions are contract rights for transportation and storage services on an interstate carrier of natural gas that happens to have one of its storage facilities located in such taxing jurisdictions. These contractual relationships are not sufficient to establish a substantial nexus between the shippers and the state or local taxing jurisdictions. This is true of MGE in this case. (Petitioner's App. 69a (numbered paragraph 35); 73a (numbered paragraphs 21, 22)).

b. Fair Apportionment to Activities Carried On by Taxpayer in the State. MGE does not maintain any offices or employees in Oklahoma. Similarly, it conducts no business with the State of Oklahoma or Woods County. (Petitioner's App. 69a (numbered paragraph 35)). Indeed, the trial court's findings of fact found that there was no correlation between the MGE natural gas that entered the Panhandle Eastern transmission system upstream of North Hopeton and the gas assessed by Woods County. (Petitioner's App. 69a-70a (numbered paragraph 40); 73a (numbered paragraph 24)). In view of this lack of activities, which would be similar to other non-Oklahoma resident utilities, no amount of taxes could be fairly apportioned to shippers.

c. **Discrimination Against Interstate Commerce.** The Woods County's *ad valorem* tax is based on implying ownership of natural gas in interstate commerce to a shipper regardless of contracts, tariffs, cases and federal regulations post-Order 636, which make clear that a shipper does not own volumes of natural gas found in particular physical locations on an interstate pipeline's system. The act of implying ownership where no ownership, in fact, exists discriminates against interstate commerce. This imposes a local tax burden on the Panhandle Eastern transmission system as a whole and unfairly imposing local tax burdens on foreign residents.

d. **Fairly Related To Services Provided By the Local Taxing Authorities.** Petitioner and nonresident shippers do not receive the benefit of any governmental services in Woods County; do not make use of any public roads in Woods County; enjoy none of the law enforcement services provided for citizens of Woods County; have no employees who use the services of Woods County health Departments; receive no benefit from the District Attorney's office; and have no workforce which was educated by the school district. Since local taxing authorities provide no services, no amount of tax would be fairly related.

C. *Ad Valorem* Taxation of Gas Moving In Interstate Commerce Is A Recurring Issue That This Court Should Address

Permitting Woods County to list MGE's natural gas for *ad valorem* taxation in Woods County, Oklahoma will inevitably lead other jurisdictions to impose an *ad valorem* tax on natural gas on interstate gas pipelines present in those jurisdictions. Peti-

tioner's Petition expounds on how Kansas has aggressively pursued these local property taxes as well as how Texas and Louisiana courts have analyzed the constitutionality of such taxes. *See* Petitioner's Petition p. 12 n. 2, and pp. 21-24. However, the breadth of the use of storage for natural gas "in transit" in the natural gas transmission system spreads well beyond those states.

The U.S. Department of Energy's Energy Information Administration reports that at the close of 2007 there were 400 underground natural gas storage facilities in thirty states. (U.S. Department of Energy, Energy Information Administration web site at http://www.eia.doe.gov/pub/oil_gas/natural_gas/analysis_publications/ngpipeline/index.html and http://tonto.eia.doe.gov/dnav/ng/ng_stor_sum_a_EPG0_sat_mmc_f_m.htm. The physical location of these facilities are shown on a map of the lower forty-eight states provided by the Department of Energy's Energy Information Administration and in Appendix B. App. 2a. These locations roughly follow the corridors where pipelines are most concentrated as demonstrated in the map of the lower forty-eight states provided by the Department of Energy's Energy Information Administration and in Appendix C. App. 3a.

If the Oklahoma Supreme Court's holding is allowed to stand, such attempts to tax natural gas in storage in the interstate transmission system by the many other localities where storage is located along the interstate pipeline system should be reasonably anticipated.

Such local taxation would violate both the U.S. Constitution and result in needless expenditures of costs and resources to defend against them. Thus,

the Court should grant Petitioner's writ of certiorari and review this case.

CONCLUSION

For the foregoing reasons, *amicus* urges this Court to grant the subject Petition for Writ of Certiorari.

Respectfully submitted,

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