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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

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

Interstate transportation of natural gas throughout the United States cannot occur effectively without the temporary storage of gas in the pipeline system. From the time a shipper places natural gas into an interstate pipeline system until it is withdrawn, the gas is in the possession, and under the control, of the pipeline company – a common carrier. This Petition presents the following questions:

1. Whether the Commerce and Due Process Clauses prohibit a state from imposing upon a shipper an ad valorem property tax on natural gas moving in interstate commerce while temporarily stored in an interstate pipeline system.

2. Whether a state violates the Commerce and Due Process Clauses when taxing natural gas temporarily stored in an interstate pipeline system by allocating ownership of the gas among various shippers without regard to: (1) the individual taxpayer's activities in or directed toward the state, or (2) even the state in which the taxpayer's gas physically is, or could be, located.

RULE 29.6 STATEMENT

Pursuant to Rule 29.6 of the Rules of this Court, petitioner states that it is a division of Southern Union Company. Southern Union Company has no parent corporation and no publicly held company owns 10% or more of Southern Union Company's stock.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner Missouri Gas Energy respectfully petitions for a writ of certiorari to review the judgment of the Supreme Court of Oklahoma in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Oklahoma (App. 1a-59a) is reported: *In re Assessment of Personal Property Taxes Against Missouri Gas Energy*, No. 103,355, 2008 WL 4648330 (Okla. Oct. 21, 2008). The district court's Findings of Fact and Conclusions of Law (App. 62a-75a) and Journal Entry of Judgment (App. 76a-78a) are unreported.

JURISDICTION

The Oklahoma Supreme Court entered its judgment on October 21, 2008 (App. 1a), and denied Petitioner's Petition for Rehearing on February 23, 2009. App. 60a. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

This case presents questions of whether the Oklahoma Supreme Court's application of Oklahoma tax statutes violates the Commerce and Due Process Clauses of the United States Constitution. The pertinent provisions of the Constitution and the Oklahoma tax statutes are reproduced in the Appendix. App. 79a-80a.

STATEMENT OF THE CASE

Petitioner Missouri Gas Energy ("MGE") challenges an ad valorem property tax assessed by the Woods County, Oklahoma ("Woods County") Tax Assessor on natural gas moving in interstate commerce but temporarily held in a Federal Energy Regulatory Commission ("FERC") certificated natural gas pipeline storage facility in Woods County. MGE is a local distribution company certificated and regulated by the Missouri Public Service Commission. App. 64a (¶ 8), 67a (¶ 25). MGE purchases gas from suppliers and contracts with Panhandle Eastern Pipeline Company ("Panhandle Eastern") for transportation of that gas to its customers in Missouri. App. 64a (¶ 10).

No doubt some gas was stored temporarily in Panhandle Eastern's North Hopeton storage facility in Woods County. App. 66a (¶ 22). Finding gas there,

Woods County decided to tax it. But Woods County did not determine the actual ownership of the gas. Instead, it used a fictional ownership allocation calculated by considering all the gas stored on the interstate pipeline system—not just gas physically stored in Oklahoma on the date of assessment. App. 69a (¶¶ 37-39). Woods County's formula attributed large quantities of gas in storage in Oklahoma to MGE for tax purposes, when, as a matter of physics, most, if not all, of that gas could not have belonged to MGE. App. 65a-66a (¶ 20), 69a-70a (¶¶ 36, 40-41). For example, in calendar year 1998, it was not physically possible for any of the gas that MGE purchased to have reached the storage facility in Oklahoma. App. 70a (¶ 41). Yet, Woods County assessed taxes against MGE for more than 200,000 Mcf of gas in storage as of January 1, 1999. App. 69a (¶ 36).

The Oklahoma Supreme Court upheld the tax assessment against Due Process and dormant Commerce Clause challenges. Its decision conflicts with a long line of precedent from this Court addressing the Due Process and dormant Commerce Clause limitations on the ability of a state to tax goods stored temporarily, but moving in interstate commerce. The Oklahoma Supreme Court's endorsement of a fictional ownership allocation subjects MGE and other natural gas shippers to the risk of multiple taxation and imposes an impermissible extraterritorial and discriminatory tax on MGE.

There is widespread confusion among state courts regarding the propriety of taxing natural gas in interstate pipeline storage facilities. There is also a need for clarification of the continued vitality of certain of this Court's precedents, which the Oklahoma Supreme Court refused to follow. If allowed to stand,

the Oklahoma Supreme Court's decision will be precedent to subject natural gas shippers to ad valorem taxation in every jurisdiction in which an interstate pipeline is located, without regard to: (1) whether the shipper actually owns property within the jurisdiction; or (2) whether there is any nexus between the taxing authority, the taxpayer, and taxpayer's property. This Petition presents a timely opportunity to resolve the existing confusion potentially affecting every shipper of natural gas and the customers to whom the natural gas ultimately is sold.

A. Taxation of Natural Gas Stored Temporarily in an Interstate Pipeline System Presents Difficult Constitutional Issues.

1. Interstate transportation of natural gas is critical for consumers throughout the country and temporary storage of gas in the pipeline system is an integral part of that function.

Every day billions of cubic feet of natural gas are transported through interstate pipelines in the United States. Pipelines perform an essential function in the United States economy, transporting natural gas from receipt points in producing states such as Texas, Oklahoma, and Kansas, to markets in other states such as Arizona, California, Michigan, Ohio, New York, Missouri, Vermont, and elsewhere. Pipelines also play an important role in mitigating a key physical problem in the natural gas industry—although production of gas in the field occurs at a relatively constant rate, the demand for gas is seasonal. Consistent with their FERC certificated design, interstate natural gas pipeline storage facilities (which are owned, controlled, and operated by the interstate pipeline companies) are used to enable

gas to continue flowing from wells in the field into pipeline systems to maintain constant production and to hold the gas produced in the system for use when needed.

"Underground gas storage facilities are a necessary and integral part of the operation of piping gas from the area of production to the area of consumption." *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 295 n.1 (1988). Without storage, there would often be an insufficient supply of gas to meet demands created by seasonal needs, whether heating in winter or cooling in summer. Moreover, without storage, the lack of demand in the summer months would cause disruption in natural gas production because there would be nowhere for the gas to flow once the pipeline itself was at full capacity. Recognizing the importance of storage to the transportation process, FERC has defined transportation to include storage in its regulations. *See* 18 C.F.R. § 284.1(a).

2. Gas in an interstate pipeline system is commingled and, after shippers place natural gas into an interstate pipeline system, they have no control over the physical movement of the gas.

The physics of natural gas transportation creates difficulties for determining who owns what gas in a pipeline facility. The Oklahoma Supreme Court's "solution" to these difficulties ignores reality. Here is why: Once natural gas is introduced into an interstate pipeline system, it is commingled with other gas. App. 65a (¶ 19). Thereafter, it is impossible to trace the ownership of any specific volume or molecule of gas, and neither the pipeline companies nor shippers attempt to do so. App. 68a (¶ 33), 71a (¶¶ 11-12). Before 1992, ownership was not problematic

because interstate pipeline companies typically owned the gas in their pipeline systems. In 1992, FERC issued Order 636, after which pipeline companies generally have not owned the gas in their systems. Thus, after FERC Order 636, interstate pipeline companies transport gas belonging to others and keep account of the quantity of gas each shipper has in the entire system.

Pipeline companies at all times maintain control over the movement of gas in their systems, meaning that the shipper has no ability to direct the actual movement of its gas. *See* App. 66a (¶ 21). If gas is placed into storage, the shipper does not control where that gas is stored on a system. *See* App. 68a (¶ 29). Although the gas is commingled, it can only travel downstream from production to the ultimate marketplace destination. Thus, gas in a given storage facility necessarily can originate only upstream of that facility. App. 65a-66a (¶¶ 19-20).

Woods County wants to tax the gas stored in Oklahoma, but there is no way to show who owns the gas stored there. So with no legitimate basis, Woods County assumed it could tax gas in storage and used a fictitious allocation that is blatantly wrong to assign ownership of the stored gas.

B. Factual Background

1. MGE and the Panhandle Eastern pipeline system

MGE is a local gas distribution company headquartered in Kansas City, Missouri. MGE is regulated by the Missouri Public Service Commission, which sets the rates that MGE may charge and imposes obligations on MGE to provide a steady supply of gas to its

customers in Missouri. App. 64a (¶ 8), 67a (¶ 25). For the years in question, MGE sold gas only to its customers in Missouri. MGE does not maintain an office or employees in Oklahoma, nor does it own any facilities there. App. 69a (¶ 35). To meet its obligations to the Missouri market, MGE purchases gas at various places in the United States, and contracts with interstate pipelines such as Panhandle Eastern to deliver that gas to Missouri when needed. *See* App. 67a (¶ 26).

Panhandle Eastern operates an interstate pipeline that extends into numerous states, including Texas, Oklahoma, Kansas, Missouri, Indiana, Ohio, and Michigan. App. 64a (¶ 11). Panhandle Eastern's pipeline system is divided into a "Field Zone" where gas is gathered and received into the system, and a "Market Zone" where gas ultimately is delivered to customers. Gas only moves downstream through the system from the receipt points in the Field Zone to the delivery points in the Market Zone. *See* App. 65a (¶¶ 19-20).

The Field Zone is made up of two pipeline legs that are connected only at a central compressor station in Haven, Kansas. App. 65a (¶ 20). One leg, the "Elk City System," originates in Oklahoma. *Id.* The other leg, the "Hansford System," originates in Texas. *Id.* Each of those legs has a storage facility in the Field Zone: The North Hopeton facility is in Woods County, Oklahoma on the Elk City System, and the Borchers facility is in Meade County, Kansas on the Hansford System. *Id.* Both of these storage facilities are located "upstream" of Haven, Kansas where the two legs of the Field Zone pipelines connect. It is physically impossible for (1) gas received in the Hansford System to reach or be stored in the North Hopeton

facility; or (2) gas received in the Elk City System to reach or be stored in the Borchers facility. *Id.*

MGE can choose where it purchases gas, thereby determining the receipt points for gas into the Panhandle Eastern system, which in turn determines the leg of the pipeline system—the Elk City System or the Hansford System—through which its gas will flow. *See* App. 65a (¶¶ 17-19). Once in the system, MGE can nominate gas for delivery to its customers in Missouri, or it can nominate gas into storage. *See* 67a (¶¶ 27-28). Under its contracts with Panhandle Eastern, and in compliance with FERC certificated tariffs, if MGE nominates gas into storage, MGE must pay to transport that gas to Haven where it will be accepted by Panhandle Eastern for storage. When MGE nominates gas out of storage for delivery to its markets in Missouri, Panhandle Eastern delivers the stored gas to MGE at Haven, Kansas, and charges MGE to transport it from Haven to MGE's delivery point in Missouri. *See* App. 67a-68a (¶¶ 28-30).

Panhandle Eastern has exclusive control over the movement and flow of gas in its pipeline system. App. 66a (¶ 21). As the Oklahoma Supreme Court recognized, after MGE nominates gas into the pipeline system, MGE "has absolutely no control over the movement of its gas in the pipeline." App. 9a (¶ 16). Other than making the specified storage nominations in Haven, MGE has no control over how or where the gas actually is stored by Panhandle Eastern. App. 66a (¶ 21), 68a (¶ 29). Indeed, because there is no actual storage facility in Haven, the nomination process is primarily an accounting exercise under which Panhandle Eastern merely tracks the amount of gas that MGE has on account in the system for later nomination to its markets. Panhandle Eastern

does not, in the ordinary course of its business, and could not, even if it had a need to, determine where MGE's gas is stored in its pipeline system. App. 68a (¶ 33), 71a (¶¶ 11-12).

2. The disputed tax assessment

In 2001, the Woods County Tax Assessor (the "Assessor") attempted for the first time to tax the gas being stored in the North Hopeton facility. *See* App. 62a (¶ 1). Because the Assessor did not know the quantity of gas located in the North Hopeton facility, or even who owned that gas, the Assessor asked Panhandle Eastern for that information. *See* App. 69a (¶ 37). Panhandle Eastern, however, did not have the information requested.

Instead, Panhandle Eastern gave the Assessor a fictional ownership allocation among shippers for gas stored in Oklahoma for 1997, 1998, and 1999.[1] The allocation was based on the following formula:

$$\text{Total gas nominated by the shipper to storage} \times \frac{\text{Total gas storage inventory in Oklahoma}}{\text{Total gas storage inventory in Oklahoma and Kansas}}$$

See App. 69a (¶ 37), App. 23a (¶¶ 41, 41 n.35). That formula contradicts the realities of where MGE actually purchased its gas, where its gas was deli-

[1] Oklahoma ad valorem taxes are determined on January 1 of each year. Accordingly, the three years in question in this Petition are sometimes referred to as "tax years 1998, 1999, and 2000" but actually relate to activities occurring in 1997, 1998, and 1999.

vered into the pipeline system, and where its gas physically could be stored in the pipeline system. App. 69a-70a (¶¶ 36-37, 40-41); *see also* App. 23a (¶ 40 (Assessor argued, and the Oklahoma Supreme Court agreed, "there is no need for there to be a correlation between the volumes purchased by MGE upstream of North Hopeton and the volumes upon which it is taxed.")). Under the allocation formula used by Woods County, the amount of gas MGE actually purchases in Oklahoma—and, therefore, the amount of MGE's gas that physically could ever be present in Oklahoma—is irrelevant. *Id.* Rather, the tax depends on the amount of gas MGE nominates into storage and a comparison of that amount to the total amount of gas stored in the pipeline's storage facilities in Kansas and Oklahoma on a date chosen by the taxing authority.

For example, in 1997, 96.04% of the gas MGE purchased for transportation in the Panhandle Eastern pipeline system was on the Hansford System. That gas could never physically reach the storage facility in Oklahoma; but the Assessor attempts to tax MGE on 47.7% of its stored gas as of January 1, 1998, as if it were stored in the North Hopeton facility in Oklahoma. Using that fictional allocation, then, a shipper who purchased 100% of its gas in the Elk City System in Oklahoma during 1997 would be taxed in Oklahoma on only 47.7% of its gas in storage as of January 1, 1998, even though all of its gas in storage would necessarily have been in Oklahoma and could not have been physically delivered to the storage facility in Kansas.

After reviewing the allocation formula, the district court expressly found "no correlation" between the volume of gas MGE placed in the Panhandle Eastern

system in Oklahoma and the volume of gas for which MGE was being taxed in Oklahoma. App. 69a-70a (¶ 40). The undisputed facts prove the truth of the district court's finding: In 1997, for example, MGE purchased a total of 78,998 Mcf of gas at receipt points in Oklahoma on the Elk City System, but was assessed taxes on 352,606 Mcf of gas in Oklahoma. App. 69a-70a (¶¶ 36, 41). And, in 1998, MGE purchased *no* gas at receipt points in Oklahoma on the Elk City System, but was assessed taxes on 231,037 Mcf of gas in Oklahoma. *Id.*

C. The Location of the Gas Makes a Difference

The location of gas moving in interstate commerce and temporarily stored in the pipeline system matters because ad valorem tax laws vary from state-to-state. Oklahoma imposes an ad valorem tax on gas in storage, and then allows the assessor to use a fictional ownership allocation to determine whom to tax. Kansas, by contrast, did not tax out-of-state public utilities on their quantities of gas in storage for the years in question. *See In re Dir. of Prop. Valuation*, 161 P.3d 755, 765 (Kan. 2007); *In re Cent. Ill. Pub. Servs. Co.*, 78 P.3d 419, 427 (Kan. 2003). Accordingly, if MGE had stored its gas in Kansas, its customers in Missouri would not have been burdened with local ad valorem taxes on the gas while in transit from the field to the market. But, if gas is deemed to be in Oklahoma, the costs associated with transporting the gas from the field to the market increase due to the Oklahoma tax burden. There are countless permutations of the problems caused by allocating ownership interests across state lines given that some states may impose higher tax rates, others may use different allocation formulas or, as in

Kansas, may not tax at all.[2] Accordingly, the taxation of gas in storage and the reallocation of ownership to determine who to tax raise substantial issues for entities that purchase and ship natural gas in interstate pipelines as well as for their customers and the pipeline.

D. Procedural History

After being assessed with taxes and penalties for the three years in dispute, MGE appealed to the Woods County Board of Equalization, which affirmed the tax assessment. App. 62a (¶¶ 1-2). MGE then appealed to the district court for a trial de novo. MGE argued, among other things, that the Assessor's attempt to tax MGE on gas in storage violated the Oklahoma Freeport Exemption, violated its due process rights because none (or not all) of MGE's gas that Oklahoma taxed ever had a tax situs in Oklahoma, and violated the dormant Commerce Clause. The district court found the Oklahoma Freeport Exemption inapplicable because the gas being taxed originated in Oklahoma (App. 63a (¶¶ 4-5)), but agreed with MGE that the tax assessment violated the dormant Commerce Clause. App. 72a-73a (¶¶ 14-25).

The district court found that MGE should not have been taxed because the gas in question was in interstate commerce, and was not in MGE's possession and control. App. 74a (¶¶ 29, 35). Moreover, the district court concluded that the Assessor could not use

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[2] Kansas, however, repeatedly has attempted to tax natural gas in storage, although it did not impose such a tax during the years relevant here. In fact, Kansas recently enacted legislation again seeking to tax gas temporarily stored in interstate pipelines. *See* Kan. H. Sub. S.B. 98, 2009-2010 Leg. Sess., § 5 (April 17, 2009). *See infra* pp. 29-30.

an allocation formula to reallocate ownership of the gas to tax MGE. App. 73a (¶¶ 23-24). Not only did the district court find the lack of a substantial nexus to support imposition of the ad valorem tax on MGE (App. 73a (¶ 22)), it concluded that the Assessor's tax was discriminatory because "the assessments impute ownership of tangible personal property to interstate shippers" without regard to the shippers' contacts and activities in Oklahoma. App. 73a (¶ 23).

The Oklahoma Supreme Court affirmed the district court's decision on the Freeport Exemption, but reversed the district court's dormant Commerce Clause determination and rejected MGE's due process claims. App. 2a (¶ 1), 19a (¶ 32). The Court rejected MGE's Due Process and Commerce Clause arguments by ignoring the actual facts regarding the origin of MGE's gas. Instead, the court endorsed a fictional allocation under which MGE was taxed on gas stored in Oklahoma that did not and could not have been the same gas MGE actually purchased. Justice Watt dissented. App. 54a-59a.

REASONS TO GRANT THE WRIT

This Court should grant review in this case to resolve a widening disagreement and confusion regarding the constitutional limitations on a local or state taxing entity's ability to impose an ad valorem tax on natural gas in storage in an interstate pipeline system. For nearly a century before this Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), this Court held that a state does not automatically gain the right to tax goods traveling in interstate commerce simply because those goods are stored temporarily and could be found within the state during transportation. *See, e.g., Champlain*

Realty Co. v. Town of Brattleboro, 260 U.S. 366 (1922), *Carson Petroleum Co. v. Vial*, 279 U.S. 95 (1929). Instead, the analysis of the state's taxing authority requires review of many factors including the reasons why the goods are stored and who has control over the goods when stored. *See Minnesota v. Blasius*, 290 U.S. 1 (1933); *Champlain Realty Co.*, 260 U.S. at 376. Since *Complete Auto*, though, state courts disagree over the extent to which this Court's earlier precedent still apply. As acknowledged by the Oklahoma Supreme Court, this Court has not addressed the impact of *Complete Auto* on the question of a state's authority to impose ad valorem property taxes on goods stored in a state as part of the continuing movement in interstate commerce. App. 27a (¶ 45). Doing so would help resolve the confusion over states' ability to tax stored natural gas. The Court's guidance also would be highly beneficial to the natural gas industry, those it serves, and any entity that temporarily stores goods during shipment in interstate commerce.

Seizing upon the lack of recent authority on this issue, the Oklahoma Supreme Court acknowledged its duty to apply directly applicable precedent from this Court, but then refused to do so deeming that analysis "old," "very difficult," and "inconclusive" when applied to the state's attempt to tax natural gas. App. 31a (¶ 52). Instead of applying the proper test to determine whether gas in storage could be taxed, the Oklahoma Supreme Court assumed that it could tax the gas based on the supposed "objective facts" that gas in the pipeline system was stored in Oklahoma and that MGE stored gas in that system somewhere. *Id.* The Oklahoma Supreme Court did not even attempt to reconcile its decision with the district court's finding that there is "no correlation"

between the gas MGE placed into the pipeline system and the volumes of gas that the Assessor taxed. The Oklahoma Supreme Court's decision conflicts with this Court's precedent and with the decisions of other state courts addressing the issue.

The need to review this case is amplified because the "solution" Oklahoma adopted for this case conflicts with this Court's precedent holding that:

(a) "[t]he Due Process and Commerce Clauses forbid the States to tax 'extraterritorial values,'" *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 128 S.Ct. 1498, 1502 (2008);

(b) a state cannot impose a property tax on goods located in another state, *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194, 204 (1905);

(c) a state cannot impose a tax that discriminates against out-of-state goods, *Chemical Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334, 344 (1992); and

(d) a state cannot subject taxpayers to the risk of multiple taxation, *Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 242 (1987).

By starting with an assumption that Woods County could tax gas it could locate in a storage facility in Woods County, the Oklahoma Supreme Court then had to tackle the more difficult question of whose gas is in storage. Instead of analyzing the actual facts, which show that it was physically impossible for MGE to own the quantity of gas in Oklahoma on which it was taxed, the Oklahoma Supreme Court endorsed an ownership allocation under which Okla-

homa could tax a portion of any gas a shipper nominated into storage on the pipeline system regardless of the physical location of the shipper's activities or the physical location of the gas it purchased and delivered to the pipeline. Under the Oklahoma Supreme Court's analysis, MGE could conduct its business entirely outside Oklahoma, but nevertheless be taxed there. For calendar year 1998, that result is precisely what happened.

The Oklahoma Supreme Court's decision not only allows the state to impose a property tax on goods that could have been located only in another state, but it also has the effect of improperly shifting the burden of paying local Oklahoma taxes to the interstate system. Even worse, if allowed to stand, that decision places a shipper of natural gas at the peril of the taxing authority of every state and county in which an interstate pipeline may be located (matters over which a shipper has no control), because the location of the shipper's physical activities would be irrelevant to the determination of whether it could be taxed.

This Court should grant review in this case and reverse the Oklahoma Supreme Court's decision now as it creates great confusion regarding the scope of state taxing authority and condones violations of the United States Constitution.

A. The Oklahoma Supreme Court's Decision Conflicts with Precedent from this Court and with Decisions from Other State Courts Regarding the Ability to Tax Gas in Storage in an Interstate Pipeline System.

1. MGE recognizes that interstate commerce is not *per se* immune from state and local taxation. *See*

Complete Auto, 430 U.S. at 280. In *Complete Auto*, this Court explained that a state tax on interstate commerce may be sustained against a dormant Commerce Clause challenge if (1) it is applied to an activity with a substantial nexus to the taxing state, (2) it is fairly apportioned, (3) it does not discriminate against interstate commerce, and (4) it is fairly related to the services provided by the state. *Id.* at 279. Relying on a long line of authority, however, this Court has made clear that a substantial nexus with the taxing state does not exist simply because goods pass in transit through the state. *See Goldberg v. Sweet*, 488 U.S. 252, 262-63 (1989). Moreover, a taxpayer does not become subject to state and local taxation simply through its dealings with an interstate common carrier. *Quill Corp. v. North Dakota,* 504 U.S. 298, 311, 315 (1992).

In *Quill*, the Court recognized that *Complete Auto* did not reject all prior dormant Commerce Clause jurisprudence. *Id.* at 314-17. The *Quill* majority opinion authored by Justice Stevens recognized the benefit of adhering to the pre-*Complete Auto* bright-line rule requiring physical presence in the state before a taxpayer could be subjected to state sales and use taxes. *See id.* at 315-17. Justice Scalia's concurrence (joined by Justices Kennedy and Thomas) also recognized the importance of *stare decisis* and adhering to well-established precedent under the dormant Commerce Clause. *See id.* at 320. This Petition presents a vitally important question analogous to that presented in *Quill* that has not yet been addressed by this Court—what is the impact of *Complete Auto* on this Court's precedent regarding the ability to assess ad valorem taxes on goods temporarily stored by a common carrier while in transit in interstate commerce?

Unlike the situation presented by sales and use taxes, in which the taxpayer's physical presence is a necessary prerequisite to finding a substantial nexus with the taxing state, the nexus required to support state ad valorem property taxes depends on the physical presence of the taxpayer's property in that state. Prior to *Complete Auto*, the analysis of the nexus for goods traveling in interstate commerce turned on whether there was a break in the "continuity of transit" such that the taxpayer's goods had come "to rest" in the taxing state, and if they had, the reasons why. *See Blasius*, 290 U.S. at 9-11. For decades, this Court analyzed cases such as this one to determine the extent of interruption of the interstate journey, the reason for the interruption, and whether the owner of the property had control over the property. *See, e.g., Kelley v. Rhoads*, 188 U.S. 1, 5-9 (1903) (sheep herded across Wyoming were in transit and not subject to tax); *Bacon v. Illinois*, 227 U.S. 504, 516 (1913) (grain stored in elevator under the possession and control of the owner could be taxed); *Susquehanna Coal Co. v. Mayor & Council of South Amboy*, 228 U.S. 665, 668-71 (1913) (coal stored for anticipated sale by the owner could be taxed); *Champlain Realty Co.*, 260 U.S. at 373-74 (logs held by a boom not subject to tax because they were detained until river conditions allowed for safe transport); *Carson Petroleum Co.*, 279 U.S. at 108-09 (storage of oil in tanks awaiting arrival of ships to complete transportation could not be taxed).

If goods do not come to rest in the taxing state, there is no taxable "situs." *See Blasius*, 290 U.S. at 8 (equating "come to rest" with "acquired a tax situs within the state"). As the Court explained in *Champlain Realty Co. v. Town of Brattleboro*:

> When [property] is shipped by a common carrier from one state to another, in the course of such uninterrupted journey, it is clearly immune. The doubt arises when there are interruptions in the journey, and when the property in its transportation is under the complete control of the owner during passage.

260 U.S. 366, 376 (1922). As early as 1886, the Court drew a distinction between situations in which goods were held in the hands of a common carrier and other situations in which goods were part of the "general mass of property in the state, subject, as such, to its jurisdiction, and to taxation in the usual way[.]" *Coe v. Town of Errol,* 116 U.S. 517, 527 (1886). The Oklahoma Supreme Court held that it can tax gas in a storage facility "on the basis of the objective fact" that there is gas physically located in the storage facility on the tax assessment day. App. 31a (¶ 52). This Court has never endorsed the simplistic analysis that merely because goods can be found in storage, they can be taxed without further inquiry.

Since *Complete Auto*, this Court has not revisited this issue for purposes of determining whether a nexus exists to support ad valorem taxes. *But see D.H. Holmes Co. v. McNamara,* 486 U.S. 24, 31 (1988) (rejecting the "at rest" analysis in the context of a use tax that was not an "attempt[] to tax only the existence of goods within the State.")[3] Without a

[3] In *D.H. Holmes*, the Court recognized that the "at rest" distinction may still be relevant for purposes such as determining whether a "taxable moment" has occurred. 486 U.S. at 31. That comment is consistent with the Court's recognition in *Blasius* that the "continuity of transit" analysis also is relevant to the determination whether there is a taxable situs sufficient to satisfy due process concerns. *See* 290 U.S. at 8-9.

"continuity of transit" analysis for ad valorem taxes, though, there would be little to prevent a state from taxing personal property anywhere that property could be found on the tax assessment day, regardless of why or how long the property was in that location.[4]

This Court's decision in *Carson v. Vial* illustrates the proper dormant Commerce Clause analysis of an ad valorem tax in a case analogous to this one. In *Carson*, the taxpayer obtained oil from the Mid-Continent Field (*i.e.* Kansas, Oklahoma, and Texas), and transported it to the Louisiana coast for ultimate delivery to ships bound for England and France. When the oil arrived in Louisiana, it was placed in storage awaiting further transportation. The oil was not sold in Louisiana, and no business was conducted in Louisiana. The oil on hand was always awaiting the arrival of a ship or the accumulation of a sufficient quantity of oil to make a shipment possible. The Court recognized that "it would be impracticable to carry on the export oil business by any other method than by storing the oil in large storage tanks as the train loads of oil arrive, and shipping from accumulation when the ships arrive." 279 U.S. at 100.

Here, natural gas is placed in storage to allow the gas to be transported from the field to end markets in Missouri. Gas production occurs at a relatively constant rate, meaning that the pipelines must be able to transport that gas away from the field to keep the gas flowing. But, the need for gas in the end markets

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[4] This Court still employs a "continuity of transit" analysis to analyze taxes on goods traveling in foreign commerce in cases involving the Import-Export Clause of the Constitution. *See United States v. Int'l Bus. Machs. Corp.*, 517 U.S. 843, 861-62 (1996).

fluctuates with seasonal demands that are beyond the control of MGE, the pipeline, and the producer. Unlike in *Carson*, where the taxpayer maintained control over its own oil, when MGE has gas in storage, that gas is under the control of a common carrier. Current technology provides no other practicable way to conduct the business of transporting natural gas from the field to the markets without storage.

Given that the demand for natural gas is driven in large part by seasonal conditions, the need to store natural gas is analogous to the need to store oil pending arrival of a ship, *Carson*, 279 U.S. at 108-09, or the need to hold logs in a boom waiting for the weather conditions to allow a river level to subside, *Champlain Realty Co.*, 260 U.S. at 373-74. If this Court's pre-*Complete Auto* precedent were applied here, the Oklahoma Supreme Court should have found as the district court did that MGE's gas was in transit in the hands of a common carrier for delivery into an established market outside of Oklahoma. The gas should not have been subject to property tax in Oklahoma.

2. The Oklahoma Supreme Court's decision upholding an ad valorem tax on gas traveling in an interstate pipeline without applying this Court's "continuity of transit" analysis and without regard to the fact that MGE had no control over the gas creates a conflict with decisions from state courts in Texas and Louisiana. The Kansas Supreme Court also has recognized this constitutional problem.

Texas courts have recognized the continued validity of this Court's pre-*Complete Auto* "continuity of transit" analysis under the substantial nexus prong of the *Complete Auto* test. In *Peoples Gas, Light, &*

Coke Co. v. Harrison Central Appraisal District, 270 S.W.3d 208 (Tex. App.—Texarkana 2009, pet. pending), a case factually analogous to the present case, the Texas court relied on the shipper's lack of control over gas in the pipeline to find that there was no break in the continuity of transit that would enable the local taxing authority to tax gas held in storage. The court then relied on its conclusion that the gas remained in the stream of interstate commerce to conclude that there was no substantial nexus under the first prong of the *Complete Auto* test. In *Midland Central Appraisal District v. BP America Production Company et al.*, No. 11-07-00048-CV, 2009 WL 780456 (Tex. App.—Eastland Mar. 26, 2009, no pet. h.), the Texas court found that oil in a tank farm established as part of an interstate pipeline could not be taxed because the presence of oil in the tank farm did not break the continuity of transit. The Oklahoma Supreme Court's decision in this case cannot be reconciled with these Texas decisions refusing to allow state taxation of gas and oil owned by a shipper that is in the possession and control of an interstate pipeline.

Louisiana courts also have applied this Court's pre-*Complete Auto* "continuity of transit" analysis to review attempts to tax gas in storage in interstate pipelines. *See Miss. River Transmission Corp. v. Simonton*, 442 So.2d 764, 769-70 (La. Ct. App. 1983); *United Gas Pipe Line Co. v. Whitman*, 390 So.2d 913, 916-17 (La. Ct. App. 1980). The Louisiana courts upheld the ad valorem tax placed on gas in storage, but did so under circumstances in which the party being taxed was the pipeline company that owned

and controlled the gas being stored.[5] The Oklahoma Supreme Court refused to apply the very line of precedent that the Louisiana courts followed to reach their decisions.

The Kansas Supreme Court also recognized that it was "at least arguably, a potential violation of the Commerce Clause" to tax natural gas owned by a shipper that was in storage in an interstate pipeline. *See In re Cent. Ill. Pub. Servs. Co.*, 78 P.3d at 428. Although the Kansas Supreme Court did not expressly resolve that Commerce Clause issue (and for its purposes did not need to do so), it found that the state did not violate the Equal Protection Clause of the U.S. Constitution by treating in-state and out-of-state public utilities differently because it was at least arguably a dormant Commerce Clause violation to impose an ad valorem tax on the out-of-state utilities. *Id.* If the Kansas Supreme Court followed the Oklahoma Supreme Court's reasoning in this case, it would have found that there were no dormant Commerce Clause concerns.

The divergent decisions from courts in Oklahoma, Texas, Louisiana, and Kansas show that the issue presented in this case is a recurring one that needs to be resolved by this Court. Although the Oklahoma Supreme Court may believe that it is "very difficult" to apply this Court's established test to a commingled product like gas in an interstate pipeline, that is no reason to depart from precedent. To the contrary, the Oklahoma Supreme Court should have recognized

[5] Those Louisiana cases were issued before FERC Order 636, following which interstate pipelines generally do not own the gas in their pipelines. The present case is different because post-Order 636, gas shippers have no control over the gas in the interstate pipeline system.

that the only reason MGE's gas was commingled with other gas was for purposes of transportation in interstate commerce and that it was not subject to ad valorem property taxation in Oklahoma.

B. Oklahoma Endorsed an Extraterritorial and Discriminatory Tax that Creates a Risk of Multiple Taxation.

After finding that the gas in storage in the interstate pipeline system was tangible personal property that could be taxed, the Oklahoma Supreme Court had to address the question of who owns the gas being taxed. The Oklahoma Supreme Court endorsed a fictional ownership allocation to "solve" that problem. Oklahoma's "solution" violates the Due Process and dormant Commerce Clauses of the United States Constitution.

1. This Court has long held that states may not tax real or tangible personal property located in another state. In *Union Refrigerator Transit Co. v. Kentucky*, 199 U.S. 194 (1905), this Court held that it was "essential to the validity of a tax that the property shall be within the territorial jurisdiction of the taxing power." *Id.* at 204. A state's taxation of property beyond its jurisdiction "partakes rather of the nature of an extortion than a tax, and has been repeatedly held by this court to be beyond the power of the legislature, and a taking of property without due process of law." *Id.* at 202. The Court noted that "[t]his rule receives its most familiar illustration in the cases of land, which, to be taxable, must be within the limits of the state," and explained that "[t]he argument against the taxability of land within the jurisdiction of another state applies with equal

cogency to tangible personal property beyond the jurisdiction." *Id.* at 204.

This Court's state property tax decisions show:

> first, that the exaction by a state of a tax which it is without power to impose is a taking of property without due process of law in violation of the Fourteenth Amendment; secondly, that while a state may so shape its tax laws as to reach every object which is under its jurisdiction it cannot give them any extraterritorial operation; and, thirdly, that as respects tangible personal property having an actual situs in a particular state, the power to subject it to state taxation rests exclusively in that state.

Frick v. Pennsylvania, 268 U.S. 473, 488-89 (1925). Echoing the holding of *Union Refrigerator*, the Court in *Frick* held that to impose a property tax, "the state must have jurisdiction over the thing that is taxed, and to impose [such a tax] without such jurisdiction is mere extortion and in contravention of due process of law." *Id.* at 492; *see also Johnson Oil Ref. Co. v. Oklahoma*, 290 U.S. 158, 161 (1933) ("[T]he state of the domicile has no jurisdiction to tax personal property where its actual situs is in another state."); *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 209 (1936) ("[I]t is essential to the validity of [an ad valorem property tax], under the due process clause, that the property shall be within the territorial jurisdiction of the taxing state[,]" and it is "impossible for one state to reach out and tax property in another without violating the Constitution.") (citations omitted). As noted above, the Court reaffirmed these principles in *MeadWestvaco Corp. v. Illinois Dep't of Revenue*, 128 S.Ct. 1498 (2008) where Justice Alito, writing for the Court, began the opinion stating "[t]he Due Process

and Commerce Clauses forbid the States to tax 'extraterritorial values.'" *Id.* at 1502.

The Oklahoma Supreme Court recognized that "[a]n ad valorem tax is assessed only on property located within a single state" (App. 38a (¶ 60)), but ignored this rule by endorsing a fictional allocation that extended its ad valorem property tax to gas necessarily stored outside of Oklahoma – in Kansas. The Oklahoma Supreme Court expressly recognized that "in the real, physical world" all of the gas stored at North Hopeton originates in Oklahoma. App. 52a (¶ 80). But, when it was time to assess taxes on the gas in North Hopeton, the Oklahoma Supreme Court allowed the assessor to reallocate *ownership* of the natural gas using a formula that does not account for where the gas originates, or whose gas possibly could have reached North Hopeton.

To demonstrate the extraterritorial effect of Woods County's tax, consider the following facts found by the district court regarding Woods County's tax assessments:

Year	Amount of gas MGE Purchased in Oklahoma	Amount of gas Oklahoma assessed against MGE[6]
1997	78,998 Mcf	352,606 Mcf
1998	0 Mcf	231,037 Mcf

App. 69a-70a (¶¶ 36, 41). In 1998, none of the gas MGE purchased for transport in Panhandle Eastern's pipeline physically could have been stored in Woods

[6] The Woods County Assessor assessed taxes for each calendar year on January 1 of the following year.

County. In 1997, only a fraction of the gas it purchased came from Oklahoma. *See* App. 65a (¶ 20). Yet, by using a fictional ownership allocation, Woods County assessed taxes on MGE for far more gas than MGE physically could have had in that State. Woods County's reallocation of ownership means that Woods County is taxing MGE on its gas in Kansas. It may be that "[t]he facts of life do not neatly lend themselves to the niceties of constitutionalism; but neither does the Constitution tolerate any result, however distorted, just because it is the product of a convenient mathematical formula." *Norfolk & W. Ry. Co. v. Mo. State Tax Comm'n*, 390 U.S. 317, 327 (1968).

2. The Oklahoma approach also discriminates against out-of-state goods in violation of settled dormant Commerce Clause principles. A state may not discriminate against out-of-state goods by seeking to shift local burdens away from in-state economic interests. *See Chem. Waste Mgmt., Inc.*, 504 U.S. at 344; *City of Philadelphia v. New Jersey*, 437 U.S. 617, 626-28 (1978). "'[D]iscrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Or. Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 99 (1994). On its face, the Oklahoma ad valorem tax statute does not discriminate because it seeks to tax tangible personal property located within the State on January 1. But, as applied to natural gas using the fictional ownership allocation, the Woods County tax assessment is discriminatory in effect. That is, by reallocating ownership throughout the interstate system, Woods County is taxing MGE on gas that could only be located in Kansas, while relieving other taxpayers of some of

their burden to pay Woods County taxes on gas originating in Oklahoma.[7]

By shifting the burden of Woods County ad valorem taxes to the interstate pipeline system as a whole, Oklahoma is providing an economic incentive to entities purchasing their gas in Oklahoma in the form of lower taxes, and is providing an economic penalty to entities purchasing and storing gas outside of Oklahoma in the form of an extraterritorial tax. This problem is highlighted by the fact that the Kansas Supreme Court has held that MGE and many other public utilities are exempt from Kansas ad valorem taxes. *See In re Dir. of Prop. Valuation*, 161 P.3d at 765; *In re Cent. Ill. Pub. Servs. Co.*, 78 P.3d at 427. MGE has an economic incentive to purchase gas that would end up in storage in Kansas where it would not be taxed. Indeed, MGE's contracts expressly call for all storage nominations to be made in Kansas. But, if Woods County can reallocate the ownership of gas, Woods County can eliminate the incentive for MGE and other entities, thereby depriving the out-of-state gas of the economic advan-

[7] The following hypothetical illustrates this reallocation problem. Assume that in a given year, there was a total of 100,000 Mcf of gas in storage in Oklahoma and 100,000 Mcf of gas in storage in Kansas, resulting in a 50% allocation of stored gas to each state. If MGE conducts all of its business on the Kansas part of the pipeline system and stores 100,000 Mcf of gas in the system, MGE will be taxed in Oklahoma on 50,000 Mcf of gas in Oklahoma. If another entity conducts all of its business in Oklahoma and stores 100,000 Mcf of gas in the system, that entity would only have to pay taxes on 50,000 Mcf of gas in Oklahoma due to the reallocation of ownership across the system. That reallocation provides a preference to those who conduct business in Oklahoma that is paid at the expense of those choosing to do business in Kansas.

tage associated with the Kansas tax exemption. This Court has expressly condemned attempts to strip out-of-state goods of their commercial advantages. *See, e.g., W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194-96 (1994) (holding that tax seeking to equalize costs of in-state and out-of-state goods was unconstitutional); *Hunt v. Wash. State Apple Adver. Comm'n*, 432 U.S. 333, 351 (1977) (finding state regulation that had the effect of stripping out-of-state goods of their economic advantage was unconstitutional).

Woods County's use of a fictional ownership allocation is a plain violation of the dormant Commerce Clause.

3. The Oklahoma "solution" also subjects shippers of natural gas to an unconstitutional risk of multiple taxation. The Oklahoma Supreme Court rejected MGE's concerns about multiple taxation because Kansas, the only other state with Field Zone storage on this pipeline, did not actually tax gas in storage because its statutes exempt public utility companies from such taxation. App. 38a (¶ 60). Under this Court's precedent, however, actual multiple taxation is not the test. The relevant test is the risk of multiple taxation. In *Armco, Inc. v. Hardesty*, 467 U.S. 638, 644-45 (1984), this Court categorically rejected the requirement that a taxpayer prove that specific interstate transactions were subjected to multiple taxation in order to advance a claim of discrimination. *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 242 (1987). The unconstitutionality of a state's tax "cannot be alleviated by examining the effect of legislation enacted by its sister States," *Tyler Pipe*, 483 U.S. at 242, or "depend on the shifting complexities of the tax codes of 49 other states." *Armco*, 467 U.S. at 645.

The risk of taxation in Kansas is real. For more than 15 years the Kansas legislature has sought (unsuccessfully to date) to tax gas stored in Kansas in Panhandle Eastern's pipeline system. *See In re Dir. of Prop. Valuation*, 161 P.3d at 765; *In re Cent. Ill. Public Servs. Co.*, 78 P.3d at 427; *Colo. Interstate Gas Co. v. Bd. of County Comm'rs*, 802 P.2d 584 (Kan. 1990). Kansas recently enacted legislation that again seeks to tax gas temporarily stored in interstate pipelines. *See* Kan. H. Sub. S.B. 98, 2009-2010 Leg. Sess., § 5 (Apr. 17, 2009) (amending Kan. Stat. Ann. § 79-5a01 (Supp. 2008) in a manner intended to enable taxation of natural gas in storage). If Kansas taxed the gas MGE stored in Kansas, and, rather than utilizing an improper fictional allocation like Woods County, taxed the actual gas that shippers stored in Kansas, then in years like 1997 and 1998, MGE's gas obviously would have been subjected to multiple taxation.

CONCLUSION

The issue of whether a state can tax gas in storage in an interstate pipeline system is one that has caused great confusion in the law, leading some courts, including the Oklahoma Supreme Court, to question the continued viability of this Court's precedent. This Court should grant review to clear up the confusion in the law, before Oklahoma's unconstitutional "solution" to the problem becomes the law in other states.

Respectfully submitted,

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