No. 08-1458

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

REPLY BRIEF IN SUPPORT OF PETITIONER

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REPLY BRIEF

Missouri Gas Energy's ("MGE") Petition presents important, unsettled Due Process and Commerce Clause issues that affect an industry critical to the security of, and quality of life in, our nation. The Assessor's Brief in Opposition to Certiorari ("Response") does not meaningfully address MGE's Due Process issues, and misperceives the Commerce Clause issues. The Assessor's confusion about the issues presented only highlights the need for this Court's guidance.

A. THE ASSESSOR MISPERCEIVES MGE'S COMMERCE CLAUSE ISSUES.

The issues presented in MGE's Petition are analogous to those addressed by this Court in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992). (*See* Pet. at 17). In *Quill*, the issue was whether the bright-line test articulated in *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 758 (1967)—that a State may not compel a vendor to collect a sales or use tax unless the vendor has a physical presence within the State—remained good law after this Court's decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). Here, the Petition presents the question whether this Court's analysis articulated in cases such as *Minnesota v. Blasius*, 290 U.S. 1 (1933), *Champlain Realty Co. v. Town of Brattleboro*, 260 U.S. 366 (1922), and *Carson Petroleum Co. v. Vial*, 279 U.S. 95 (1929)—that goods in transit in interstate commerce are not subject to taxation unless they come to rest, and then only after consideration of facts concerning the break in the continuity of transit—remain good law after *Complete Auto*. This Court has not overruled its "in transit" cases. *See Goldberg v. Sweet*, 488 U.S. 252, 262-63 (1989) (expressing doubt that States through which a telephone call's electronic signals merely pass have a sufficient nexus to tax that call citing pre-*Complete Auto* cases). Yet, the Oklahoma Supreme Court refused to apply this precedent. (App. 27a-29a (¶¶ 45-46)). Review of this case at this time is necessary to provide guidance to the many courts and parties currently grappling with these issues.

The Assessor erroneously claims MGE is now "criticizing the Oklahoma Supreme Court for applying the very test [*i.e.*, the *Complete Auto* test] it asked

that court to apply." (Resp. at 14). To the contrary, MGE's Petition presents the question whether this Court's precedent informs the "substantial nexus" prong of the *Complete Auto* test, or whether *Complete Auto* overruled that precedent. (Pet. at 16-21). In her Response, the Assessor does not address this issue or those cases at all.

It is the Assessor, not MGE, who makes a different argument in this Court than she made in the Oklahoma Supreme Court. In the Oklahoma Supreme Court, the Assessor argued that the "continuity of transit" line of precedent remained viable after *Complete Auto*. (*See* Assessor's Appellant's Brief at 15-17). Indeed, the Assessor requested the Oklahoma Supreme Court to "adopt" and "apply" the Louisiana court of appeals decisions in *Mississippi River Transmission Corp. v. Simonton*, 442 So.2d 764 (La. Ct. App. 1983) and *United Gas Pipe Line Co. v. Whitman*, 390 So.2d 913 (La. Ct. App. 1980) that are cited on page 22 of MGE's Petition. (*See* Assessor's Appellant's Brief at 15-17). Now, she ignores that line of authority and seems to argue that *Complete Auto* is the only relevant precedent. The Assessor's conflicting positions concerning the applicable rule of law again demonstrate the unsettled state of the law in this area.

B. The Facts Are Undisputed—Oklahoma Is Relying On An Allocation Formula To Tax MGE On Gas That Could Not Physically Reach The Oklahoma Storage Facility.

The Assessor devotes much of her Response to an erroneous argument that this Petition presents a challenge to "the Oklahoma Supreme Court's factual determination that MGE owned the assessed gas" in

storage in Woods County. (Resp. at 8). First, the Oklahoma Supreme Court did not purport to make any fact findings and, indeed, it could not properly do so even if it wanted. *See Nelson v. Pollay*, 916 P.2d 1369, 1376 (Okla. 1996); *Hedges v. Hedges*, 66 P.3d 364, 373 (Okla. 2002); *see also Pullman-Standard v. Swint*, 456 U.S. 273, 291-92 (1982) ("[f]actfinding is the basic responsibility of district courts rather than appellate courts . . . .") (citations omitted). Second, in its Petition, MGE does not challenge any of the district court's fact findings.

The fact findings on which this Petition is based are set forth in full on pages 62 through 70 of Petitioner's Appendix. The key findings on ownership and allocation are:

> 36. The Assessor assessed MGE for gas in storage at the North Hopeton Facility for tax years, 1998, 1999, and 2000 as follows:
>
> | Tax Year | Volume |
> |---|---|
> | 1998 | 352,606 mcf |
> | 1999 | 231,037 mcf |
> | 2000 | 229,336 mcf |
>
> 37. The Assessor based her assessments on accounting allocations of system-wide storage account volumes allocated to North Hopeton that she received from PEPL. . . . .
>
> 38. The allocations relied upon by the Assessor are not evidence of ownership of the molecules of gas assessed.

* * *

40. The volumes of gas placed in the PEPL System by MGE at receipt points upstream of the North Hopeton Facility bear no correlation to the volumes of gas assessed by the Assessor for tax years 1998, 1999, and 2000.

41. In calendar year 1997, MGE purchased 78,998 mcf of gas which was placed on the PEPL system at Oklahoma receipt points upstream of the North Hopeton Facility. In calendar year 1998, MGE purchased no gas at Oklahoma receipt points upstream of the North Hopeton Facility. In calendar year 1999, MGE purchased 526,170 mcf of gas which was placed on the PEPL system at Oklahoma receipt points upstream of the North Hopeton Facility.

(App. 69a-70a). The Assessor does not deny that in calendar year 1998, for example, it was physically impossible for any gas MGE placed in the Panhandle Eastern system to reach the Oklahoma storage facility, but the Assessor taxed MGE anyway.

Thus, this Petition presents a clear factual record in which MGE is being taxed on an allocation formula that does not account for the physical realties of where MGE purchases gas, places it into the pipeline, otherwise conducts its business activities, or, importantly, owns gas. The Oklahoma Supreme Court did, however, recognize the difference between "ownership" and the use of an "allocation formula." (App. 22a-23a (¶ 39)).

The Assessor, like the Oklahoma Supreme Court, argues that MGE is a "tenant in common" with all other shippers in the interstate pipeline because MGE's gas is commingled with other gas in the sys-

tem.[1] (App. 22a (¶ 38)). Then, the Assessor asserts that Oklahoma can use an allocation formula to determine the quantity of gas on which to assess taxes against MGE. That approach, if accepted, subjects shippers of natural gas in an interstate pipeline to the taxing jurisdiction of any state or local jurisdiction in which the interstate pipeline system and its storage facilities may be located.

Although MGE's Petition focuses on the "Field Zone" of the Panhandle Eastern Pipeline in Texas, Oklahoma, and Kansas, the Assessor acknowledges that the Panhandle Eastern system also reaches into Missouri, Indiana, Illinois, Michigan, and Ohio. (Resp. at 3). Under the Oklahoma Supreme Court's approach, there would be little to stop those additional states from trying to tax gas held in the pipeline system.

Neither the Oklahoma Supreme Court nor the Assessor cite any case in which this Court or any other court has held a party subject to the taxing authority of state or local governments through a commingling or "confusion of goods" theory. Instead, the Oklahoma Supreme Court bases its analysis on cases and state statutes applicable to commercial contract questions, such as the allocation of payments under a contract or the risk of loss of commingled goods that are destroyed. (*See* App. 22a

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[1] The Assessor and the Oklahoma Supreme Court ignore a logical flaw in their commingling analysis. If, as here, the undisputed facts show that "in the real, physical world" (App. 52a (¶ 80)) it was impossible for large quantities of MGE's gas to reach the Oklahoma storage facility, how can they argue that the gas nevertheless is commingled with the gas stored in the Oklahoma storage facility?

n.32). Those authorities do not address the constitutional questions presented in MGE's Petition.[2]

The issues presented here are whether the Due Process and Commerce Clauses allow the imposition of ad valorem property taxes on natural gas placed into an interstate system. When natural gas is placed in the hands of a common carrier for transportation and redelivery, does the natural gas acquire a taxable "situs" or a "substantial nexus" in any and every jurisdiction in which the pipeline transports, or temporarily stores, the gas on its system? Application of this Court's "in transit" precedent would lead to a "no" answer. The Oklahoma Supreme Court reached a contrary conclusion by refusing to apply this Court's precedent. (App. 27a-29a (¶¶ 45-46)).

C. THE ASSESSOR CANNOT AVOID THE ISSUES PRESENTED HERE BY RELYING ON PANHANDLE EASTERN'S ALLOCATION.

Throughout her Response, the Assessor states that she relied on Panhandle Eastern to allocate ownership of gas in Woods County. But the Assessor cites no facts or authority that allow Panhandle Eastern to perform that function for purposes of justifying the levy of ad valorem taxes. When a shipper places goods in the hands of and under the complete control of a common carrier, the shipper does not voluntarily subject itself to the taxing jurisdiction of any location of the common carrier's choosing. *See Quill*, 504 U.S. at 311-20. The Assessor cannot avoid this problem by relying on MGE's contracts with Panhandle Eastern.

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[2] MGE demonstrated that the taxes assessed on gas stored in Oklahoma discriminated against interstate commerce. (Pet. at 27-29). The Assessor has no rebuttal other than her inapposite "commingling of goods" theory. (Resp. at 18).

"Under its storage agreements with [Panhandle Eastern], MGE makes all nominations into and out of its storage accounts at 'receipt points' and 'delivery points' at the Haven compressor station in Reno County, Kansas" (App. 67a-68a (¶ 28))—not in Woods County, Oklahoma. While the Assessor accuses MGE of ignoring its storage contracts (Resp. at 1), she fails to explain how she can ignore that MGE's storage activities are contractually tied to Kansas, not Oklahoma. Rather, she attempts to subject MGE to taxation in Woods County based on the unilateral acts of a common carrier, which contravenes the Due Process Clause. *See Quill*, 504 U.S. at 308, 312 (noting that Due Process analysis focuses on the intentional activities of the taxpayer).

Moreover, the Assessor cannot rely on Panhandle Eastern's Federal Energy Regulatory Commission ("FERC") tariffs to expand her taxing jurisdiction. While it may be academically interesting to examine FERC's role in these issues, it is of no consequence in this case. There is no authority granting FERC jurisdiction to determine the situs of goods for purposes of state and local taxation. FERC jurisdiction over storage facilities in interstate pipeline systems was granted only because storage of gas is an integral part of the transportation of that gas. *See Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 295 n.1 (1988); 18 C.F.R. §284.1(a). Congress did not grant FERC the authority to regulate or expand the scope of state taxation authority, and FERC cannot authorize a violation of the Due Process Clause. *See generally* 15 U.S.C. §717, *et seq.* ("Natural Gas Act"); 15 U.S.C. §3371, *et seq.* ("Natural Gas Policy Act"); 42 U.S.C. §7172 (establishing jurisdiction for FERC).

Finally, the Assessor cannot rely on Panhandle Eastern's reporting allocation formula to avoid the risk of multiple taxation. The Assessor acknowledges that other states, now including Kansas, are trying to tax gas in storage in the Panhandle Eastern pipeline system. (Resp. at 19-20). She cites no authority to show that an allocation, for reporting purposes only, by a FERC-certificated pipeline company would be binding on her or any other tax assessor. Even if Oklahoma could rely on Panhandle Eastern's reporting to determine an allocation of gas for Oklahoma tax purposes, other states could employ a different approach.

D. MGE'S PETITION PRESENTS IMPORTANT QUESTIONS OF CONSTITUTIONAL LAW THAT SHOULD BE ADDRESSED NOW.

The Oklahoma Supreme Court, and all of the parties, agree this Court has not addressed the application of *Complete Auto* to an ad valorem property tax. (App. 27a (¶ 44)). Despite acknowledging its duty to follow this Court's precedent, the Oklahoma Supreme Court ignored directly applicable precedent, declaring it to be "old," "very difficult," and "inconclusive." (App. 31a (¶ 52)). This Court should grant this Petition now to clarify the impact (if any) of *Complete Auto* on its precedent establishing what is needed to obtain a taxable situs or nexus sufficient to justify the imposition of an ad valorem property tax on goods moving in transit in interstate commerce.

The Assessor misconstrues MGE's Petition when she writes: "MGE argues that the Oklahoma Supreme Court's decision in this case conflicts with the decision of another state court *of last resort*." (Resp. at 10) (emphasis added). MGE did not make such a claim. Instead, MGE demonstrated that "other state

courts" are grappling with the status of this Court's precedent and reaching differing conclusions. (Pet. at 16, 21-24).[3] By clarifying the issues raised in this Petition, this Court would help avoid the expenditure of immense effort and resources by courts and parties.

The *amicus* briefs from the Interstate Natural Gas Association of America (representing the interstate pipeline industry) and the American Gas Association (representing local gas distribution companies) demonstrate that the issues raised by MGE's Petition affect an entire industry, and not just a few parties. The Assessor's claim that this Petition involves an issue that arises "infrequent[ly]" is misleading. (Resp. at 12). When a state or county seeks to tax shippers who store gas in an interstate pipeline, they seek to tax every shipper using that pipeline, and not just one or two randomly selected entities. The Woods County Assessor alone has at least 35 cases pending in the Woods County District Court involving disputed ad valorem tax assessments on natural

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[3] The Assessor acknowledges that the Texas Supreme Court has requested briefing in two cases pending for review. (Resp. at 12 n.5). Under applicable Texas rules, a request for briefing does not mean that the Texas Supreme Court will review those cases. *See* TEX. R. APP. P. 55.1 ("With or without granting the petition for review, the Court may request the parties to file briefs on the merits."). But, even if the Texas Supreme Court does review those cases, its decision will not eliminate the need for guidance from this Court—if the Texas Supreme Court affirms, review will be needed to resolve a conflict among state supreme courts on an issue of federal constitutional law; if it reverses, review would still be needed because the constitutional issues presented in MGE's Petition would remain unsettled.

gas temporarily stored in an interstate pipeline.[4] Other taxing authorities in Texas and Oklahoma also are actively assessing taxes against the shippers of natural gas. With the Oklahoma decision standing as precedent, taxing authorities may feel they are obliged to seek to tax the natural gas they can locate in their jurisdictions. There are hundreds of natural gas storage facilities in interstate pipeline systems in at least 24 states. With more states seeking to raise revenues by taxing gas being stored in interstate pipelines (as evidenced by the recent Kansas legislation), the number of lawsuits challenging tax assessments under the Due Process and Commerce Clauses of the Constitution will continue to grow. This Court should grant this Petition and resolve the questions presented before an enormous amount of judicial resources are expended litigating tax assessments that are unconstitutional under this Court's precedent.

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[4] *See* Woods County District Court Case Nos. CV-2004-104, CV-2005-106, CV-2002-108, CV-2002-124, CJ-2003-116, CV-2004-103, CV-2005-108, CV-2006-103, CV-2007-135, CV-2008-120, CV-2002-107, CV-2002-123, CJ-2003-115, CV-2004-102, CV-2005-105, CV-2006-105, CV-2007-136, CV-2008-119, CV-2002-106, CV-2006-107, CV-2006-102, CV-2007-138, CV-2008-121, CV-2006-106, CV-2008-117, CV-2004-101, CV-2005-107, CV-2006-104, CV-2007-134, CV-2008-118, CV-2009-102, CV-2009-103, CV-2009-105, CV-2009-106, CV-2009-107.

CONCLUSION

For the reasons set forth in the Petition and this Reply, MGE respectfully requests that this Court grant this Petition for Writ of Certiorari.

Respectfully submitted,

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