

# THE EFFECT AND VALIDITY OF STATE TAXATION OF ENERGY RESOURCES

## I. INTRODUCTION

In its infancy the energy industry was problem ridden.<sup>1</sup> Over production caused deflated prices, waste,<sup>2</sup> and environmental damage.<sup>3</sup> In reaction, the states began to conserve their energy resources.<sup>4</sup> As demand approached supply, producers resisted state control because it depressed profits.<sup>5</sup> At the insistence of the influential oil lobby,<sup>6</sup> state efforts to curb production<sup>7</sup> gave way to federal regulation that favored accelerated production.<sup>8</sup> Although the ever increasing federal regulation of energy divests the states of the largely independent control they

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1. See D. DAVIS, ENERGY POLITICS 49 (1974).

2. "Waste" describes a failure to extract all the mineral from a field.

3. D. DAVIS, *supra* note 1, at 45, 49.

4. See generally R. SULLIVAN, CONSERVATION OF OIL AND GAS, A LEGAL HISTORY (1958).

5. See, e.g., R. ENGLER, THE POLITICS OF OIL *passim* (1961); G. NASH, UNITED STATES OIL POLICY 1890-1964, at 72-127 (1968); H. WILLIAMSON, THE AMERICAN PETROLEUM INDUSTRY 238-99, 466-535 (1963).

6. D. DAVIS, *supra* note 1, at 53-66.

7. M. WILLRICH, ADMINISTRATION OF ENERGY SHORTAGES 252 (1976). The Texas Railroad Commission regulated production, including methods to obtain maximum recovery. *Id.* at 249. Louisiana stressed full removal and waste avoidance. The experiences of that state demonstrate that conservation and production are synonymous. R. SULLIVAN, *supra* note 4, at 110.

The several producing states entered into interstate compacts as an additional means to regulate production and to avoid federal control. D. DAVIS, *supra* note 1, at 53; N. ELY, THE INTERDEPENDENCE OF THE STATES IN OIL CONSERVATION—A SURVEY OF THE INTERSTATE COMPACT (1932). The states fought in the courts to establish their right to regulate production. See, e.g., *Cities Serv. Gas Co. v. Peerless Oil & Gas Co.*, 340 U.S. 179 (1950) (preemption not at issue); *Champlin Ref. Co. v. Corporation Comm'n*, 286 U.S. 210 (1932).

8. D. DAVIS, *supra* note 1, at 49. Congress in recent years has enacted a variety of production incentives including the oil depletion allowance and quota price-fixing, despite objections from the Department of the Interior. *Id.* The federal government simultaneously tightened its regulatory hold on the oil and gas industry. Supreme Court decisions in the *Tidelands Cases*, *United States v. Texas*, 339 U.S. 707 (1950); *United States v. Louisiana*, 339 U.S. 699 (1950); *United States v. California*, 332 U.S. 19 (1947), deprived the states of valuable offshore property rights. See McElroy, *Severance Taxes on Offshore Production—Fact or Fiction*, 9 BAYLOR L. REV. 17, 18-20 (1957). In 1976 Congress returned some of this property, The Outer Continental Shelf Lands Act, 43 U.S.C. § 1331 (1976), but the initial deprivation marked a high point in the federal-state conflict. D. DAVIS, *supra* note 1, at 59, 61. In addition, Congress passed the Hot Oil Act, 15 U.S.C. § 715-715(m) (1976), which supported conservation and ensured a higher price for producers. The Natural Gas Act, 15 U.S.C. § 717-717(w) (1976) vested the authority in the Federal Power Commission to set interstate rates for the sale and transportation of natural gas.

once enjoyed,<sup>9</sup> the state struggle to regulate production and distribution of energy resources is continuing.<sup>10</sup>

States often used taxation as a means of regulation. Because energy is often an article of interstate commerce,<sup>11</sup> state regulation affecting it may conflict with federal regulation. This federal-state conflict raises constitutional problems involving the dormant commerce clause<sup>12</sup> and the supremacy clause.<sup>13</sup> The several energy producing states clearly desire: 1) control of the manner and amount of production;<sup>14</sup> 2) compensation for the loss of state wealth associated with the extraction of energy resources;<sup>15</sup> and 3) compensation for environmental damage and other related costs of energy production.<sup>16</sup> This Note explains each of those objectives, applies the objectives to a scheme of taxation, and finally examines the tax in a constitutional context. Part II of the Note examines the goal of controlling production by looking at the New Mexico electricity generation tax and the Oklahoma natural gas production tax. Part III focuses on Louisiana's first use tax on gas as an example of a state attempt to gain compensation for depletion of energy resources. Part IV discusses the third goal of compensation for environmental damage. The Note identifies limitations on states' abilities to tax energy and also identifies means to avoid the limitations. The Note suggests guidelines for tax schemes that affect the control of energy resources.

## II. CONTROL OF PRODUCTION

Control of the manner and the amount of production is an affirmation of the ongoing state desire to conserve scarce energy resources and

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9. The Texas Railroad Commission possessed comprehensive authority to control the oil industry in Texas. The Commission fixed rates and regulated production. The Commission's control was an extreme example of one state's attempt to control the industry. M. WILLRICH, *supra* note 7, at 249-52.

10. For a discussion of federally imposed curtailment and allocation orders in the 1970's, see *id.* at 77-107.

11. *Id.* at 245-47.

12. U.S. CONST. art. I, § 8, cl. 3 provides: "The Congress shall have the power . . . to regulate Commerce with foreign Nations, and among the several States . . ."

13. U.S. CONST. art VI, cl. 2 states: "The Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any Thing in the Constitution or Laws of any State to the Contrary notwithstanding."

14. See M. WILLRICH, *supra* note 7, at 252; notes 17-73 *infra* and accompanying text.

15. See notes 76-79 *infra* and accompanying text.

16. See notes 104-10 *infra* and accompanying text.

to protect the environment. Several energy producing states realize this objective by taxing the volume of energy produced. Recent tax legislation in New Mexico and Oklahoma illustrates this type of state regulation.

### A. *The Statutes*

The abundance of coal in the northwestern corner of New Mexico,<sup>17</sup> coupled with the economics of high-voltage transmission of electricity, encouraged the construction of several electrical generating plants in that region.<sup>18</sup> Utilities and consumers in New Mexico, Arizona, California, and Texas use electricity produced in this area.<sup>19</sup> New Mexico imposes a tax on any person that generates electricity in New Mexico for the purpose of sale.<sup>20</sup> The tax applies to each net kilowatt hour<sup>21</sup> of generated electricity.<sup>22</sup> New Mexico also provides a credit against its gross-receipts tax for any generation tax paid to New Mexico or to any neighboring state.<sup>23</sup> The usual gross-receipts tax is roughly equal to four percent of electricity sales.<sup>24</sup> A person who generates electricity in New Mexico for interstate sale pays a generation tax of about two percent of sales. A person who generates electricity in New Mexico for intrastate sale pays no generation tax, but is liable for a gross-receipts tax roughly equal to four percent of sales. New Mexico's scheme of taxation increases the utilities' cost of operations, which in turn limits development and encourages efficiency. The tax thus deters rapid ex-

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17. Brief for Respondent at 2, *Arizona Public Serv. Co. v. Snead*, 441 U.S. 141 (1979).

18. New Mexico, in *Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141 (1979), argued that appellant utilities saved \$119 million annually by generating electricity in New Mexico and transmitting it, for example, to Phoenix, Tucson, Los Angeles or El Paso. The figure accounts for the economic advantages of generating electricity in this part of the country and the costs associated with coal burning in the densely populated areas to which appellants sell. See generally Bagge, *Coal and Clean Air Law: A Case for Reconciliation*, 4 *ECOLOGICAL Q.* 479 (1975); Smith, *Electricity and the Environment: A Season of Discontent*, 33 *FED. B.J.* 71 (1974).

19. Brief for Respondent, *Arizona Public Serv. Co. v. Snead*, 441 U.S. 141 (1979).

20. N.M. STAT. ANN. § 7-18-3 (1978).

21. Electrical Energy Tax Regulation 3:1 (form issued by taxing body of the state of New Mexico to users):

Net kilowatt hours are calculated by subtracting kilowatt hours of electricity used directly in the operation of the plant for a month from the gross kilowatt hours generated by the plant in the same month. Electricity used in any facility of an electrical utility other than a generating plant may not be subtracted from the total of electricity generated to New Mexico.

22. N.M. STAT. ANN. § 7-18-3 (1978).

23. *Id.* § 7-8-80 (1978).

24. *Id.* § 7-9-7 (1978).

ploitation of New Mexico's coal and discourages rapid industrial growth in the four corners region.

Oklahoma taxes the volume of natural gas removed from the ground.<sup>25</sup> This complex<sup>26</sup> tax scheme affects gas that has a gross value per thousand cubic feet (MCF) between seventeen and one-half cents and one dollar; the tax increases as the value of the gas decreases. Oklahoma provides a credit against the state income tax if all state excise taxes exceed 7.085% of the gross value of minerals produced and if the state has not reimbursed the producer for the excise taxes paid.<sup>27</sup>

## B. *Constitutional Issues*

### 1. *Commerce Clause*

Conservation has traditionally been a function of state power.<sup>28</sup> The Constitution, however, might not allow the particular means used to effect this power.<sup>29</sup> A tax levied on the generation of electricity produced in New Mexico but sold outside the state burdens interstate commerce. At one time, the mere acknowledgement that the "operating incidence"<sup>30</sup> of a state tax affected interstate commerce placed the tax's validity in jeopardy,<sup>31</sup> and the states had to show that the taxed activity

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25. OKLA. STAT. ANN. tit. 68, § 1101 (West Supp. 1979).

26. *Id.* § 1108(A) provides:

There is hereby levied on all natural gas and/or casinghead gas produced and saved excluding non-taxable royalty a conservation excise tax of seven cents (\$0.07) per thousand cubic feet (MCF), less seven percent (7%) of the gross value of each such MCF of natural gas and for casinghead gas; provided that the conservation excise tax hereby levied shall not exceed one-third (1/3) of the gross value of each such MCF of the natural gas and/or casinghead gas so produced and saved. Provided further, the conservation excise tax herein levied shall never be less than zero.

27. *Id.* § 2357(D).

28. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84, 93 (1963) ("There is no doubt that the States do possess power to allocate and conserve scarce natural resources upon and beneath their lands."). See also Patterson v. Standolind Oil & Gas Co., 305 U.S. 376 (1939); Bandini Petroleum Co. v. Superior Court, 284 U.S. 8 (1931); Walls v. Midland Carbon Co., 254 U.S. 300 (1920).

29. Northern Natural Gas Co. v. State Corp. Comm'n, 372 U.S. 84 (1963).

30. The term of art describes the impact of the tax. Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 (1940).

31. Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602 (1951), *rev'd*, Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977); Freeman v. Hewitt, 329 U.S. 249 (1946). *Spector* specifically and the principle in *Freeman* generally were overruled in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288-89 (1977). See note 33 *infra* and accompanying text. The Court, at one time, permitted a tax when the taxpayer engaged in both intrastate and interstate business and tax liability was computed by applying the tax rate to the amount of in-state business. Interstate Oil

was local in nature.<sup>32</sup> The Court has now expressly eliminated the absolute immunity from state taxation that interstate commerce once enjoyed.<sup>33</sup> A state tax that affects the control of energy in interstate commerce is valid if: 1) there is a substantial nexus between the taxed activity and the taxing state; 2) the tax does not discriminate against interstate commerce; and 3) the tax fairly relates to the services provided by the state.<sup>34</sup> This tripartite rule reflects economic realities and

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Pipe Line Co. v. Stone, 337 U.S. 662 (1949); International Harvester Co. v. Evatt, 329 U.S. 416 (1947); Atlantic Lumber Co. v. Comm'r of Corps. & Taxation, 298 U.S. 553 (1936). The Court in *Spector* flatly invalidated any state tax on the privilege of engaging in interstate commerce. Connecticut had imposed a franchise tax, for the privilege of doing business within the state, on a foreign trucking company using Connecticut highways to conduct its exclusively interstate business. The tax was computed at a nondiscriminatory rate on the part of the company's net income that was reasonably attributable to its business within the state. Thus, it was an invalid tax upon the privilege of engaging in interstate commerce, because the taxpayer had no other business connection with the state. 340 U.S. at 606-10.

32. Utah Power & Light Co. v. Pfof, 286 U.S. 165 (1932); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923). See also Interstate Oil Pipe Line Co. v. Stone, 337 U.S. 662 (1949); Freeman v. Hewit, 329 U.S. 249 (1946); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922); California Co. v. State, 141 Colo. 288, 348 P.2d 382 (1959), *appeal dismissed*, 364 U.S. 285 (1960); Virginia Elec. & Power Co. v. Haden, 200 S.E.2d 848 (W. Va. 1973), *cert. denied*, 416 U.S. 916 (1974).

State supreme courts relied on the local activity doctrine to sustain the New Mexico and Oklahoma taxes discussed in the text. Arizona Pub. Serv. Co. v. O'Chesky, 91 N.M. 485, 487, 576 P.2d 291, 293 (1978), *rev'd sub nom.* Arizona Pub. Serv. Co. v. Snead, 441 U.S. 141 (1979); Post Oak Oil v. Oklahoma Tax Comm'r, 575 P.2d 964 (Okla. 1978). Reliance on the local activity doctrine is misplaced. Instead, constitutionality depends upon the tax's effect on the interstate economy. *Developments in the Law—Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 968 (1962) [hereinafter cited as *Developments in the Law*]. This recognition does not necessarily invalidate a tax on production, on generation, or on first uses, but the taxing state must justify the economic impact of the tax. Accordingly, a tax will not be invalid because the subject is not local enough. See generally 29 U. FLA. L. REV. 752 (1977).

33. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 288-89 (1977). The most pronounced reliance on the locality doctrine appeared in Carter v. Carter Coal Co., 298 U.S. 238 (1936), and adherence to the test faded rapidly. Helvering v. Davis, 301 U.S. 619 (1937); Steward Mach. Co. v. Davis, 301 U.S. 548 (1937); NLRB v. Friedman-Harry Marks Clothing Co., 301 U.S. 58 (1937). In NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1 (1937) the Court shifted focus away from "local-versus-national" to whether the regulated activity had a sufficient economic impact on interstate commerce. United States v. Darby, 312 U.S. 100, 118 (1941) impliedly overruled the locality doctrine.

34. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 285 (1977). The test also requires apportionment. See Washington Revenue Dep't v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 750 (1978); General Motors Corp. v. Washington, 377 U.S. 436, 441 (1964). See generally Freeman v. Hewit, 329 U.S. 249 (1946); Illinois Cent. R.R. v. Minnesota, 309 U.S. 157 (1940).

A tax is permissible if it applies in proportion to the business carried on within the state, International Shoe v. Shartel, 279 U.S. 429, 433 (1929), but a tax is invalid if it applies to business conducted outside the state. See note 42 *infra*. Apportionment prevents taxing more of the activity's value than occurs within the state. Wash. Revenue Dep't v. Association of Wash. Stevedoring Cos., 435 U.S. 734, 746-47 (1978); General Motors Corp. v. Washington, 377 U.S. 436, 439-40

is not intended to pose a trap for the unwary state legislature.<sup>35</sup>

Nexus is the threshold requirement.<sup>36</sup> A definite link must exist between the taxing state and the person, property, or transaction that the state seeks to tax.<sup>37</sup> The existence of a nexus is essentially a due process requirement.<sup>38</sup>

The second element of the test involves the principle that a state may not levy a tax that discriminates against interstate commerce. This rule

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(1964). Taxes on energy production do not implicate apportionment, because the taxed activity occurs in-state. Taxes levied against in-state uses are similarly beyond the reaches of apportionment. For these reasons, state taxes affecting the control of energy resources avoid apportionment problems.

35. See 430 U.S. at 279. The components of the *Complete Auto* test are a synthesis of confusing precursors. See, e.g., *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457-58 (1958); *Freeman v. Hewitt*, 329 U.S. 249, 252 (1946). Despite reliance on the tax-immunity status of interstate commerce proclaimed in *Spector*, the Court did not invalidate state taxes that had an economic impact on interstate commerce if the state, through careful language, avoided a direct imposition on interstate commerce. *Railway Express Agency, Inc. v. Virginia*, 358 U.S. 434 (1959). The Court examined the tax to decide if it discriminated against interstate commerce. *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977); *Halliburton Oil Well Co. v. Reilly*, 373 U.S. 64 (1963); *Nippert v. City of Richmond*, 327 U.S. 416 (1946); *Darnell & Son v. City of Memphis*, 208 U.S. 113 (1908); *Guy v. Baltimore*, 100 U.S. 434 (1880); *Welton v. Missouri*, 91 U.S. 275 (1876). The Court applied the discrimination test in combination with apportionment and nexus analysis. *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). In addition, the Court looked for a special relationship between the tax and the aspect of commerce taxed. If the taxing state conferred certain benefits, powers, and privileges on the commerce involved, the Court upheld the tax. *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100 (1975); *Memphis Natural Gas Co. v. Stone*, 335 U.S. 80 (1948). See 19 B.C. L. REV. 312, 313 (1978). The test of *Complete Auto* represents the accumulation of over fifty years of judicial thought. See generally Hellerstein, *State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline*, 62 VA. L. REV. 149, 188 (1976). This culmination plus the unanimous nature of the *Complete Auto* opinion gives great weight to the test.

36. *Developments in the Law*, note 32 *supra* at 968.

37. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756 (1967); *Scripto, Inc. v. Carson*, 362 U.S. 207, 210-11 (1960); *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954). A tax levied on a transaction is generally passed on to consumers. Therefore a tax ultimately paid by in-state consumers would not pose a nexus problem. The Court, however, is concerned with the necessary nexus between the state and the person directly liable for the tax. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 757 n.9 (1967). See also *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952); *State Tax Comm'n v. Aldrich*, 316 U.S. 174 (1942) (Jackson, J., dissenting).

38. *International Harvester Co. v. Department of Treasury*, 322 U.S. 340, 352-57 (1944) (Rutledge, J., concurring and dissenting); *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 308-26 (1944) (Stone, C.J., dissenting). Due Process prevents a state from taxing a person or activity outside its jurisdiction. Perhaps the recent redefinition of personal jurisdiction will reduce the incidence of this problem. See *Shaffer v. Heitner*, 433 U.S. 186 (1977). See generally *Symposium: The Impact of Shaffer v. Heitner*, 1978 WASH. U.L.Q. 273.

is firmly rooted in both history and law.<sup>39</sup> The Court does not limit its inquiry to an evaluation of facial discrimination but accounts for all relevant factors that might make the tax discriminatory when applied.<sup>40</sup> The Court considers the economic nature of the taxed activity,<sup>41</sup> reviews the combinations of taxes that operate against that economic activity,<sup>42</sup> and examines the taxing schemes of neighboring states that affect the commerce involved.<sup>43</sup> Underlying the rule is the desire to

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39. *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 533 (1949). *Contra*, *Madden v. Kentucky*, 309 U.S. 83, 87 (1940) (Kentucky ad valorem property tax of ten cents per one hundred dollars deposited in the state banks and fifty cents per hundred in out-of-state banks sustained; aberrational result inconsistent with the foregoing analysis).

The discrimination test is not reserved solely for taxation cases. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117 (1978) (retail gasoline sales); *Hunt v. Washington State Apple Advertising Comm'n.*, 432 U.S. 333 (1977) (interstate sales); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964) (interstate milk sales); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951) (interstate milk sales); *Milk Control Bd. v. Eisenberg Farm Prods.*, 306 U.S. 346 (1939) (interstate milk sales). *But see* *Breard v. City of Alexandria*, 341 U.S. 622 (1951) (ordinance regulating peddlers soliciting orders in interstate commerce not unreasonable burden on interstate commerce).

Mechanically stated, the rule is simple: "No state may impose a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business or by subjecting interstate commerce to the burden of multiple taxation." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959) (citations omitted). A similar test is stated in *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1950).

40. *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64 (1963); *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959) (Harlan, J., concurring); *Dean Milk Co. v. City of Madison*, 340 U.S. 349 (1951); *Breard v. Alexandria*, 341 U.S. 622 (1951); *Nippert v. City of Richmond*, 327 U.S. 416 (1946).

41. *Nippert v. City of Richmond*, 327 U.S. 416, 421 n.5 (1946). *See also* *McGoldrick v. Berwind-White Coal Mining Co.*, 309 U.S. 33, 46-49 (1940).

42. *Developments in the Law, supra* note 32, at 968: "A number of taxes of different descriptions are imposed by different states: franchise taxes, severance taxes, excises on manufacturing, on transportation, storage . . . sales taxes, use taxes. Even if no state exacts payment of all of these, a multistate concern may well find itself paying many . . ." *See also* *McCullough Trans. Co. v. Division of Motor Vehicles*, 113 N.J. Super. 356, 358-59, 273 A.2d 786, 788-89 (App. Div. 1971).

43. The Court recognizes the prohibition against multiple burdens, but it is unclear from the case law whether the prohibition applies to actual burdens or to the mere risk of multiple burdens. *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) (potential for multiple burdens considered relevant); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440 (1960) (must show actual discrimination); *Bibb v. Navajo Freight Lines, Inc.*, 359 U.S. 520 (1959) (Court considered conflicting regulations); *Joseph v. Carter & Weekes Stevedoring Co.*, 330 U.S. 422 (1947) (risk of multiple burdens); *Southern Pac. Co. v. Arizona*, 325 U.S. 761 (1945) (potential for multiple inconsistent burdens). *See also* *Burbank v. Lockheed Air Terminal*, 411 U.S. 624 (1973); *Morgan v. Virginia*, 328 U.S. 373 (1946); *Hall v. DeCuir*, 95 U.S. 485 (1878); *Williams Rentals, Inc. v. Tidwell*, 516 S.W.2d 614 (Tenn. 1974). Commentators have encouraged the Court to adopt the risk approach, because it prevents one state from exploiting another state's failure to tax interests commerce to the full extent possible. *See* P. HARTMAN, *STATE TAXATION OF INTERSTATE COMMERCE* 273-85 (1953); *Developments in the Law, supra* note 32, at 965. In *Complete Auto*, however, the

establish a strong union not susceptible to destruction through balkanization of its economy.<sup>44</sup> Discrimination arises in two contexts: state attempts to erect barriers to outgoing trade and state attempts to erect barriers to incoming trade.<sup>45</sup>

The third element of the test mandates that a state tax be fairly related to the services provided by the state. The state must provide financial justification for the levy.<sup>46</sup> States commonly provide a variety of services, including access to the courts and police protection, to persons operating within their boundaries. In addition, states must deal with environmental problems caused by energy production.<sup>47</sup> Finally, states face socioeconomic problems directly attributable to the growth of communities in which new energy production facilities are located.<sup>48</sup>

The New Mexico tax may survive a commerce clause test. The subject of the electricity generation tax occurs within the state's boundaries and thus satisfies the nexus requirement.<sup>49</sup> New Mexico's tax on generation of electricity sold in the interstate market at first appears to be a

Court in dictum required an actual showing of multiple burdens. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 288-89 n.15. See also *Washington Revenue Dep't v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 746 (1978).

44. An explication of the Founder's intention appears in Justice Jackson's opinion in *H.P. Hood & Sons v. DuMond*, 336 U.S. 525 (1949):

"[T]his principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. . . . [T]he established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . .

. . . .  
Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality.

*Id.* at 537-39.

45. G. GUNTHER, *CONSTITUTIONAL LAW, CASES AND MATERIALS* 127 (9th ed. 1975).

46. See *Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141, 151 (1979) (Rehnquist, J., concurring).

47. *Ingels v. Morf*, 300 U.S. 290 (1937); *Interstate Transit, Inc. v. Lindsey*, 283 U.S. 183 (1931); *Clark v. Poor*, 274 U.S. 554 (1927). The Court diluted this requirement by creating a strong presumption that the tax represents no more than reasonable compensation to the state. *Capital Greyhound Lines v. Brice*, 339 U.S. 542 (1950).

48. See notes 104-10 *infra* and accompanying text.

49. *Washington Revenue Dep't v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 750 (1978); *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275, 279 (1972).

discriminatory burden on outgoing trade, because interstate sellers must pay the two percent generation tax, while intrastate sellers are allowed to credit the generation tax against their gross-receipts tax. Intrastate sellers, however, remain liable for a gross-receipts tax that is close to four percent, which is a greater tax burden than that imposed on interstate sellers.<sup>50</sup> For these reasons, energy production taxes structured like New Mexico's do not discriminate against interstate commerce. Concerning the relationship between services and the tax, New Mexico must show that the state uses the revenue received from the tax to alleviate the problems caused by energy production and to provide required services.<sup>51</sup> The Court has vigorously expressed its intentions to require more than legislative design as a justification.<sup>52</sup> In order to make a *prima facie* case, the state should provide figures that accurately show total direct costs, total indirect costs, and the attributable share of each to the taxpayer operating in interstate commerce.<sup>53</sup> A state could determine whether a fair relationship exists between the tax and the services provided by matching these figures with the estimated proceeds. States have not made this type of showing in the courts,<sup>54</sup> which suggests that an inequitable relationship exists between the taxes paid by energy producers and the costs incurred by the state. Although this analysis indicates a need for stricter scrutiny, the Court will not necessarily invalidate a tax like New Mexico's if a reasonable basis exists for taxing producers.

The foregoing analysis sustains the New Mexico generation tax against a commerce clause challenge. The Oklahoma tax should also survive commerce clause criticism. The commerce clause test requires

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50. See notes 23-24 *supra* and accompanying text.

51. The controlling question is whether the State has given anything for which it can ask compensation. *Wisconsin v. J.C. Penny Co.*, 311 U.S. 435, 444 (1949). See also *National Bellas Hess v. Department of Revenue*, 386 U.S. 753, 756 (1967); *Standard Oil Co. v. Peck*, 342 U.S. 382, 385 (1952); *Ott v. Mississippi Valley Barge Line*, 336 U.S. 169, 174 (1949).

52. *Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429 (1978) (Court invalidated a safety regulation as an impermissible burden on interstate commerce; state failed to demonstrate sufficiently that the regulation actually enhanced safety).

53. The Supreme Court has not required a detailed showing. Instead, a state is permitted to impose a tax to pay for provisions to the taxpayer of police protection, for access to legal process, for access to the courts, and for the right to sell property, without a specific showing of costs attributable to the group of taxpayers levied against. *Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 109 (1975); *Memphis Natural Gas Co. v. Stone*, 335 U.S. 80, 96 (1948).

54. See *Arizona Pub. Serv. Co. v. O'Chesky*, 91 N.M. 485, 576 P.2d 291 (1978), *rev'd sub nom.* *Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141 (1979); *Post Oak Oil Co. v. Tax Comm'n*, 575 P.2d 964 (Okla. 1978); *Virginia Elec. & Power Co. v. Haden*, 200 S.E.2d 848 (W. Va. 1973).

a nexus between the activity and the state, nondiscrimination against interstate commerce, and a reasonable relationship between the tax and state services. Gas production is the direct result of an activity that occurs within the state's boundaries. The numerous gas wells in the state are physical evidence of the nexus between the activity taxed and the taxing state. The Oklahoma tax satisfies the second part of the commerce clause test, because it does not discriminate against interstate commerce. Oklahoma taxes all in-state production at a facially nondiscriminatory rate. The state allows the taxpayer a credit for a portion of the taxes paid, but applies the credit against a tax on all producers—the state income tax. Interstate producers may use the credit to the same extent as intrastate producers. In this way, Oklahoma avoids unconstitutional discrimination against interstate commerce.<sup>55</sup> The Oklahoma tax may be fairly related to the state services provided to producers, but Oklahoma has not offered empirical proof to substantiate the relationship. The tax yielded forty million dollars in 1978.<sup>56</sup> The state has not disclosed the types of services and the cost of providing the services.<sup>57</sup> If challenged, Oklahoma would be forced to demonstrate a fair relationship. Although an application of strict scrutiny is unlikely, a court would demand more than a general recital of costs.

## 2. *Supremacy Clause*

The New Mexico and Oklahoma statutes must also undergo supremacy clause analysis.<sup>58</sup> Congress recently enacted legislation

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55. The tax indirectly favors intrastate sales, because it decreases with increases in gross value. Higher gross values attach to intrastate sales. Intrastate sellers, therefore, pay less tax than interstate sellers, because of federally imposed lower prices on interstate gas. Any discrimination that results is too tenuously related to the state tax to raise constitutional concerns. See notes 25-27 *supra* and accompanying text.

56. See notes 25-27 *supra* and accompanying text.

57. See notes 104-10 *infra* and accompanying text.

58. See notes 20-27 *supra*. The federal government is one of enumerated powers. *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).

Congress may exercise an enumerated power to achieve an end within the scope of the enumerated power themselves. . . . When Congress regulates an activity . . . within the scope of an enumerated power, as a means to some end that is also within the enumerated powers, the power of the states to regulate either the means or the ends depends upon the will of Congress.

*Id.* at 405. See also Engdahl, *Preemptive Capability of Federal Power*, 45 COLO. L. REV. 51, 57 (1973).

Before congressional action, the Court is concerned with the preemptive power of the dormant

prohibiting electricity generation or transmission taxes that discriminate against out-of-state consumers.<sup>59</sup> In *Arizona Public Service Co. v. Snead*,<sup>60</sup> the Court relied on federal legislation to invalidate the New Mexico generation tax,<sup>61</sup> basing its decision on the supremacy clause.<sup>62</sup> The New Mexico tax, through the operation of its tax credit provisions, imposed a levy against interstate market electricity and exempted electricity bound for intrastate markets. Congress was not concerned with the impact of the entire scheme of taxation. Congress intended the statute to invalidate a discriminatory tax on generation.<sup>63</sup> In view of this narrow meaning of discrimination, the New Mexico generation tax indirectly, but necessarily, discriminated against interstate commerce. The supremacy clause invalidated the tax because the tax conflicted directly with federal law.<sup>64</sup> This federal legislation does not necessarily preclude all generation taxes; there is evidence that Congress specifically designed the federal law to invalidate the New Mexico tax.<sup>65</sup>

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commerce clause, which governs the extent of state regulation allowable when Congress is silent. *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851). Once Congress regulates an area the focus shifts to the supremacy clause. The cases are complicated by the Court's recognition of concurrent state and federal regulation in certain cases. *City of New York v. Miln*, 36 U.S. (11 Pet.) 102 (1837) (recognized concurrent regulation as compatible). *Contra Missouri Pac. R.R. v. Porter*, 273 U.S. 341, 346 (1927) (recognized federal regulation as exclusive); *Charleston & W. Carolina Ry. v. Varnville Furniture Co.*, 237 U.S. 597, 604 (1915) (overlapping state law held ineffectual inasmuch as it attempted to go further than federal law). Modern interpretation of the supremacy clause prohibits concurrent regulation. Note, *The Preemptive Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623, 653-54 (1975). State regulation is valid only if Congress has not made clear its intention to preempt or if a conflict is not ripe or is peripheral to the purpose of the federal statute. *Id.* at 653.

59. Energy Policy and Conservation Act, 42 U.S.C. § 6201 (1976).

60. 441 U.S. 141 (1979).

61. *Id.* at 148-49.

62. *Id.* at 146.

63. See note 65 *infra* and accompanying text.

64. 441 U.S. at 149-50.

65. Senator Fannin of Arizona proposed a bill to ban the Electrical Energy Tax. The Senate Finance Committee approved the bill. S. REP. NO. 94-938, pt. I, 94th Cong., 2d Sess. 437-38 (1976). The Senate later passed the bill, 122 CONG. REC. D1093 (daily ed. July 28, 1976); the bill's sponsors, however, decided to make it a part of the Tax Reform Act. The Bill then went to a House-Senate Conference Committee that discarded the Senate bill's test of discrimination and devised a new one. 122 CONG. REC. D1144 (daily ed. Aug. 25, 1976). The new language was tailored to avoid invalidating West Virginia's generation tax. Brief for Respondent at Appendix C, *Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141 (1979). As the brief suggests, appellants "wished to steer a bill through Congress which would outlaw New Mexico's tax but no other state's." *Id.* at 16.

When confused, courts may consult the legislative history as an aid to construction—*Train v. Colorado Pub. Interest Research Group*, 426 U.S. 1, 10 (1975); *United States v. American Truck-*

The Natural Gas Act of 1938<sup>66</sup> prevents the states from directly or indirectly regulating the price of gas sold in interstate commerce.<sup>67</sup> The Oklahoma tax on production is a cost ultimately borne by the consumer and thus, constitutes an indirect regulation of rates. In addition, the Natural Gas Act and its regulations show a clear congressional intent to subject natural gas to uniform rates and regulations.<sup>68</sup> Supplementary state regulation is inappropriate,<sup>69</sup> especially if that regulation hinders the objective of uniformity by imposing a tax that discriminates against interstate commerce. State production taxes, however, fall outside the scope of the Act.<sup>70</sup> The Federal Energy Regulatory Commission (FERC) is without power to expand the scope of the Act.<sup>71</sup> For these reasons, a tax on production avoids preemption. If the tax does not contravene the commerce clause, it provides the states with a valid means of protecting their energy resources. Taxes on generation are valid if not complicated by crediting schemes that nullify the liability of intrastate generators.<sup>72</sup> In addition, a taxing scheme is valid if it lowers the gross-receipts tax on sales of electricity instead of providing for a gross-receipts tax credit equal to the generation tax. This type of taxing scheme is appropriate even though the plan has the same practical effect as the New Mexico tax because it embodies an even-handed tax on generation.<sup>73</sup>

Another way in which the states can avoid preemption problems is to tax activities that Congress entrusted to state regulation. The genera-

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ing Ass'ns, 310 U.S. 534, 543-44 (1940); Murphy, *Old Maxims Never Die: The "Plain Meaning Rule" and Statutory Interpretation in the "Modern" Federal Courts*, 75 COLUM. L. REV. 1299 (1975)—but they seldom rely on it. *United States v. Oregon*, 366 U.S. 643, 648 (1961); *Packard Motor Car Co. v. NLRB*, 330 U.S. 485, 492 (1947); *Railroad Comm'n v. Chicago B. & Q. R.R.*, 257 U.S. 563, 589 (1922).

66. 15 U.S.C. §§ 717(a)-(z) (1976).

67. *Northern Natural Gas Co. v. State Corp. Comm'n*, 372 U.S. 84, 91 (1963); *Natural Gas Pipeline Co. v. Panoma Corp.*, 349 U.S. 44, 44-45 (1955) (per curiam) (prohibited a direct interference).

68. 15 U.S.C. § 717(d) (1979). See *Atlantic Refining Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959).

69. *Panhandle E. Pipe Line Co. v. Public Serv. Comm'n*, 332 U.S. 507 (1947).

70. *Statements of General Policy and Interpretation under the Natural Gas Act*, 18 C.F.R. § 2.56(a) (1979), exclude from the rate base all state or federal taxes on production. *Federal Power Comm'n v. Panhandle E. Pipe Line Co.*, 337 U.S. 498, 503 (1949) (Act expressly exempts from its coverage the production and gathering of natural gas).

71. *Mobile Oil Corp. v. Federal Power Comm'n*, 463 F.2d 256 (D.C. Cir. 1972).

72. See PA. STAT. ANN. tit. 72, § 8101 (Purdon Supp. 1979); WASH. REV. CODE §§ 82.16.020, .050 (1974); W. VA. CODE §§ 11-13-2(d)(m) (Supp. 1979).

73. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 278 n.7 (1977).

tion tax, which imposed economic disincentives on coal mining, prompted conservation. New Mexico could have imposed similar disincentives by increasing the tax on the severance of coal from the ground. The tax would slow depletion of a finite energy resource and would discourage exploitation of New Mexico's coal fields by increasing the cost of electricity generated from this coal. The Oklahoma tax utilizes this technique.

## II. COMPENSATION FOR EXTRACTION OF ENERGY RESOURCES

### A. *Economic Background*

The second objective of energy producing states, compensation for the depletion of wealth associated with the extraction of energy resources, suggests a desire by these states to provide for themselves at the expense of the nation. The framers of the Constitution designed the commerce clause to prevent this type of balkanization.<sup>74</sup> The Supreme Court expressed at an early date, in *Pennsylvania v. West Virginia*, its intolerance for state regulation that favored state citizens to the detriment of foreign citizens.<sup>75</sup> In 1920, natural gas reserves in West Virginia were significantly depleted. Noting the increasing demand for gas, the state legislature required each distributor of gas produced in West Virginia to meet the in-state demand before distributing gas interstate. The legislature, through regulation, afforded in-state consumers a preferred right of purchase of West Virginia gas. The Court invalidated this regulation that clearly discriminated against interstate consumers of energy.<sup>76</sup>

A tax which compensates a state for the depletion of its valuable energy resources is similarly invalid because the tax requires foreign citizens to reimburse the state for the loss of resources and simultaneously benefits the state's citizens from the lower price of the product. The pursuit of compensation for extraction of resources necessarily ex-

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74. See note 39 *supra*.

75. 262 U.S. 553 (1923).

76. *Id.* at 593. For a similar result, see *West v. Kansas Natural Gas Co.*, 221 U.S. 229 (1920): The statute [of Oklahoma] recognizes [gas] to be a subject of intrastate commerce, but seeks to prohibit it from being the subject of interstate commerce, and this is the purpose of its conservation. . . . If the States have such power a singular situation might result. Pennsylvania might keep its coal, the Northwest its timber, the mining States their minerals. . . . If one State has it, all States have it; embargo may be retaliated by embargo, and commerce will be halted at state lines.

*Id.* at 255.

plotts foreign citizens in need of energy, inhibits free competition, and prevents free trade among the states.<sup>77</sup> A state desiring this kind of compensation should not declare that intention<sup>78</sup> because the declaration taints the court's analysis and provides a basis for invalidating the tax. Louisiana recently enacted a use tax on energy.<sup>79</sup> The tax does not specifically propose to derive compensation for the depletion of energy resources, but the history behind its enactment suggests that the legislature intended compensation.<sup>80</sup>

Prior to 1950, Louisiana maintained sovereignty over the tidelands off its coast, which held an abundant supply of oil and gas. A series of Supreme Court cases deprived Louisiana of this valuable offshore

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77. The Court has not permitted the states to burden the exportation of local products to enhance local interests. *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) (invalidated Arizona law requiring canteloupes to be packaged in-state); *H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525 (1949) (denial of license to Massachusetts milk distributor by state of New York on ground that local supply would be reduced overturned); *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1 (1928) (restrictions on interstate shipment of shrimp as means of insuring local employment invalidated); *cf. Sligh v. Kirkwood*, 237 U.S. 52 (1915) (upholding state law prohibiting the interstate shipment of citrus fruit not fit for consumption).

The Court has permitted state regulations that prohibit the shipment of water out of the state, *Hudson County Water Co. v. McCarter*, 209 U.S. 349, 356 (1908), and wild animals, *Geer v. Connecticut*, 161 U.S. 519, 529 (1896); *McCready v. Virginia*, 94 U.S. 391, 394 (1877). The Court has not overruled these decisions, but they are dubious and deserve mention only because of the interesting theory advanced in the cases. The Court recognized the state as an equitable owner of all state resources on behalf of the citizenry until these resources were reduced to possession. In this capacity, the state could regulate certain transactions before they became a part of interstate commerce.

The recognized invalidity of state action advantaging local citizens at the expense of interstate citizens is a principle the Court applies in privilege and immunity clause cases. *See Baldwin v. Fish and Game Comm'n*, 436 U.S. 371 (1978); *Toomer v. Witsell*, 334 U.S. 385 (1948).

78. The taxing states demonstrated a desire to raise revenue, perhaps partly to account for the indirect costs associated with energy production. More pertinent to this discussion, each state enacted a tax to equalize what it perceived to be inherent discrimination operating against the state and its citizens. This assertion, though speculative, follows from the history surrounding the taxes. Louisiana probably considers the gas producers on the Outer Continental Shelf, who were once under Louisiana's control, unfairly advantaged because they need not pay a tax comparable to the Louisiana severance tax. *See* note 83 *infra*. Oklahoma also reacted, eliminating an existing discrimination perceived to operate against its citizens because of the effect of federal regulations on severance taxpayers. *See* note 55 *supra*. New Mexico implies a similar dissatisfaction with pretax conditions, perhaps feeling exploited by neighboring states and their citizens. *See* note 18 *supra*.

79. LA. REV. STAT. ANN. § 47-1301-07 (West Supp. 1980). *See* notes 83-88 *infra* and accompanying text.

80. *See* note 8 *supra*. *See also First Use Tax*, 31 La. Coastal L. Rep. 1 (October 1978).

property.<sup>81</sup> In 1976 Congress passed legislation returning some of the property,<sup>82</sup> but Louisiana still lacks sovereignty over most offshore gas production. Louisiana thus, cannot tax offshore producers under the state severance tax on natural gas. Louisiana's inability to tax awards offshore producers an economic advantage over Louisiana producers, who must pay a severance tax.<sup>83</sup>

Louisiana imposed a tax on the first use of gas in the state to eradicate this economic discrepancy.<sup>84</sup> "First use" includes any ascertainable action within the state. First uses include sale, transportation to a point of delivery, and processing for the extraction of waste.<sup>85</sup> A tax of seven cents per MCF applies to the first use of gas.<sup>86</sup> The first use tax exempts gas already subject to a severance tax on the volume of production.<sup>87</sup> The scheme excludes all gas purchased in Louisiana and in neighboring states.<sup>88</sup> The tax, in practical terms, operates only against gas entering the state from the Outer Continental Shelf or from foreign countries.<sup>89</sup> In addition, the state provides a credit against the use tax equal to any severance tax due Louisiana.<sup>90</sup> Only producers who own wells on the Shelf and in Louisiana may credit any use tax against severance tax liability because only these producers are liable for both the Louisiana severance tax and the Louisiana use tax. This circumstance further focuses the impact of the use tax on nonLouisiana producers.

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81. *United States v. Texas*, 339 U.S. 707 (1950); *United States v. Louisiana*, 339 U.S. 699 (1950); *United States v. California*, 332 U.S. 19 (1947).

82. The Outer Continental Shelf Act, 43 U.S.C. § 1331 (1976); The Submerged Land Act, 43 U.S.C. § 3101 (1976).

83. *First Use Tax*, 31 La. Coastal L. Rep. 1 (October 1978).

84. LA. REV. STAT. ANN. § 1301(A) (West Supp. 1980).

85. *Id.* § 47-1302(8):

"Use" is: the sale; the transportation in the state to the point of delivery at the inlet of any processing plant; the transportation in the state of unprocessed natural gas to the point of delivery at the inlet of any measurement or storage facility; transfer of possession or relinquishment of control at a delivery point in the state; processing for the extraction of liquefiable component products or waste materials; use in manufacturing; treatment; or other ascertainable action at a point within the state.

86. *Id.* § 47-1303(B).

87. *Id.* § 47-1303(A).

88. *Id.* Texas imposes a severance tax on the production of natural gas, TEX. TAX CODE ANN. § 22.01 (Vernon 1979), as do Mississippi, MISS. CODE ANN. § 27-25-701 (1972), and Oklahoma, OKLA. STAT. ANN. tit. 68, § 1101 (West Supp. 1979).

89. *First Use Tax*, 31 La. Coastal L. Rep. (October 1978).

90. LA. REV. STAT. ANN. § 47-647 (West Supp. 1979).

## B. *Constitutional Analysis*

### 1. *Commerce Clause*

#### a) *Nexus*

The commerce clause analysis begins with the nexus requirement. The nexus between the "first use" and Louisiana is not readily apparent. The subject of the tax is not the gas, the property, or the right to produce the gas—rather, the tax applies to the first use of gas in the state, whether the use is sale, transportation, transfer of possession, or processing.<sup>91</sup> The presence of several salesmen conducting local solicitation is sufficient to charge an out-of-state seller with a use tax on the sale of goods shipped to customers in-state,<sup>92</sup> but when the taxpayer is engaged only in the delivery of goods to a point in-state, the nexus is insufficient.<sup>93</sup> The use tax on transportation of gas inland, therefore, is suspect. Transportation of gas, however, differs from the delivery of other goods. Gas travels by pipeline or ship; the pipeline owns most of the gas brought ashore.<sup>94</sup> The state gives the pipelines, which necessarily touch Louisiana, police and judicial protection. In return, the state taxes the operation of the pipelines. Similarly, shipping lines that deliver gas use state police and judicial protection while docked in Louisiana ports. This nexus satisfies the constitutional requirement.

#### b) *Discrimination*

The tax may not discriminate against interstate commerce. This requirement is the major obstacle to achieving compensation for extraction of resources. Compensating use taxes are valid despite challenges based on discrimination.<sup>95</sup> The Louisiana use tax eliminates some of

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91. *First Use Tax*, 31 La. Coastal L. Rep. 1, 1-2 (October 1978). Any in-state activity that produces income is sufficient. See *Northwestern Portland Cement Co. v. Minnesota*, 358 U.S. 450, 465 (1959).

92. *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960).

93. *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954) (delivery using company trucks pursuant to orders solicited by local advertising); *Nelson v. Montgomery Ward & Co.*, 312 U.S. 373 (1941) (delivery through the mail without the assistance of in-state retail outlets); *Nelson v. Sears Roebuck & Co.*, 312 U.S. 359 (1941) (delivery through the mail without the assistance of in-state retail outlets).

94. *First Use Tax*, 31 La. Coastal L. Rep. 1, 2 (October 1978).

95. *Henneford v. Silas Mason Co.*, 300 U.S. 577 (1937). See also *General Trading Co. v. State Tax Comm'n*, 322 U.S. 335 (1944); *Gregg Dyeing Co. v. Query*, 286 U.S. 472 (1932). Washington enacted a tax on retail sales, and because several neighboring states did not, Washington feared a large reduction in the volume of retail sales in Washington. As a remedy, Washington imposed a compensating use tax. All items purchased out-of-state and brought into Washington

the economic advantages once enjoyed by interstate concerns. Offshore producers, not liable for a severance tax, now pay a use tax. Louisiana producers, not liable for a use tax, now pay a severance tax. The Louisiana tax, because it equalizes the treatment of intrastate and interstate producers, is valid. Opponents, however, contend that the tax is designed to provide a source of compensation for the depletion of offshore reserves originally under Louisiana sovereignty.<sup>96</sup> The tax would thus, discriminate against interstate commerce because it would burden incoming gas rather than gas produced in-state.<sup>97</sup> A reviewing court might hold the tax invalid if the court would conclude that the Louisiana measure is actually a production tax on offshore gas.

### c) Relation Between the Tax and State Services

The Louisiana tax does not violate the third prong of the commerce clause test. Louisiana incurs costs in providing state services to pipeline and tanker owners. Information detailing the actual revenue needed to provide state services is not available. Louisiana should be able to demonstrate a reasonable relationship between revenues and costs and justify at least part of the intake.

## 2. *Supremacy Clause*

The Louisiana tax faces other constitutional challenges;<sup>98</sup> a possible

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were subject to a tax equal to the Washington sales tax. In-state sales were exempt, because the compensating tax was designed to equalize the treatment of all users of retail merchandise in Washington.

96. See note 4 *supra*. Production taxes compensate the state for depletion of the resource to the extent that the revenue received exceeds the cost of production to the state, *e.g.*, environmental damage. The same logic applies to the Louisiana use tax levied against offshore producers.

97. The case law test of discrimination that appears in *Dean Milk Co. v. City of Madison*, 340 U.S. 349, 354 (1951), prevents the imposition of an economic barrier that operates to the advantage of local citizens by inhibiting interstate concerns. The basic rule retains its vitality. *Exxon Corp. v. Maryland*, 437 U.S. 117, 126 (1978); *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 353 (1977). Figures submitted by the federal government in *Federal Energy Regulatory Comm'n v. McNamara*, No. 78-394 (D. La., filed September 29, 1978), indicate the extent of the interstate burden imposed by the Louisiana tax:

Based on the OCS volumes entering Louisiana in interstate commerce in 1977, the imposition of the First Use Tax will cost interstate consumers approximately \$225,000,000 per annum. By geographic region, the impact of the First Use Tax will be as follows: New England \$6.8 million, Appalachian \$84.8 million, Southeast \$28.6 million, Great Lakes \$52.4 million, Gulf Coast \$48.5 million.

98. The Louisiana tax exempts the use of gas in the manufacture of fertilizer or ammonia within the state. LA. REV. STAT. ANN. § 47-1303(A) (West Supp. 1980). This provision is open to

violation of the supremacy clause is the most formidable.<sup>99</sup> FERC has the express power to establish a uniform regulation of the sale and transportation of gas traveling in interstate commerce.<sup>100</sup> FERC's authority is inclusive of the power to fix prices.<sup>101</sup> Unlike the severance tax, the use tax is not outside the scope of FERC's control. A conflict thus, arises between the exercise of federal power and state taxation.<sup>102</sup> FERC's opposition to the tax<sup>103</sup> may perhaps preempt the state tax.

The above discussion indicates that achieving the first objective of compensation for extraction of resources is very difficult, if not impossi-

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a commerce clause challenge on the grounds that it discriminates against out-of-state manufacturers.

The Louisiana tax allegedly impairs the obligation of contracts, U.S. CONST. art. I, § 10, cl. 1, because it declares invalid any agreement by which an owner claims a right of reimbursement for first use taxes paid from any other party in interest, LA. REV. STAT. ANN. § 47-1303(C) (West Supp. 1980), to insure that consumers pay the tax.

The New Mexico and Louisiana taxes are subject to challenges that they violate the import-export clause, U.S. CONST. art. 1, § 10, cl. 2. Challengers of the New Mexico tax argue that some of the electricity generated in-state travels to Mexico and thus prevents New Mexico from imposing an export duty on it. A similar attack can be levied against the Louisiana tax, because it operates against gas imported from foreign countries, LA. REV. STAT. ANN. § 47-1303(A) (West Supp. 1980), as long as there is no federal duty on imported gas. 19 U.S.C. § 1202, Sch. 4, Item 475.15 (1976). "To export means to carry or send abroad; to import means to bring into the country. Those acts begin and end at the water's edge. [A broader definition] would lead back to every forest, mine, and factory in the land and create a zone of tax immunity never before imagined." *Canton R.R. v. Rogan*, 340 U.S. 511, 515 (1951). See *Cornell v. Coyne*, 192 U.S. 418 (1903); *Coe v. Errol*, 116 U.S. 517 (1886). These cases defeat the challengers' argument because both states' taxes operate at a point sufficiently removed from the border.

The Oklahoma tax raised a privileges and immunities clause issue—U.S. CONST. art. IV § 2—and an equal protection issue—U.S. CONST. amend. XIV. The Oklahoma Supreme Court impliedly dismissed both, in *Post Oak Oil v. Tax Comm'n*, 575 P.2d 964 (Okla. 1978). The United States Supreme Court upheld the tax even though it operated exclusively against out-of-state purchasers. *Henneford v. Silas Mason*, 300 U.S. 577, 588 (1937).

99. The government also challenges the state's attempt to regulate economic waste. The Secretary of Energy may establish and enforce curtailment programs, 42 U.S.C. § 7151(b) (Supp. 1979); 42 U.S.C. § 7172(a)(1)(E) (Supp. 1979).

100. 15 U.S.C. § 717(d) (Supp. 1979); *Atlantic Refining Co. v. Public Serv. Comm'n*, 360 U.S. 378 (1959).

101. Energy Policy and Conservation Act, 42 U.S.C. § 6201 (1976).

102. The Louisiana tax interferes with Section 7(c) of the Natural Gas Act, 15 U.S.C. § 717(f)(c) (1976). Section 7(c) requires interstate sellers to obtain a certification of public convenience. The certification contains the terms for the sale of gas, including the right of pipelines to seek reimbursement from producers for all costs, including taxes. The Louisiana statute declares these reimbursement contracts invalid. LA. REV. STAT. ANN. § 47:1303(C) (West Supp. 1979). An obvious conflict arises, which is likely to result in the invalidation of that part of the Louisiana statute that invalidates such contracts.

103. *Federal Energy Regulatory Comm'n v. McNamara*, No. 78-394 (D. La. filed September 28, 1978).

ble. A state may not devise a taxing scheme that exploits interstate consumers by exacting from them compensation for the depletion of the states' resources. The courts are likely to disfavor this second objective of energy producing states because of the need for the unimpeded flow of interstate commerce. The third enumerated objective—compensation for environmental change—is not difficult to realize.

### III. COMPENSATION FOR ENVIRONMENTAL DAMAGE AND ANCILLARY COSTS OF PRODUCTION

The energy producing states seek compensation for environmental damage and other related costs of energy production.<sup>104</sup> Taxation is the most logical means to reach this objective. The commerce clause, according to recent interpretation,<sup>105</sup> does not prohibit a tax that provides this compensation, but rather encourages a tax imposed to compensate for environmental damage. The Court recognizes that interstate commerce is not immune from state taxation if the tax is fairly related to services provided.<sup>106</sup>

The taxes described above respond, at least in part, to the cost of reversing the environmental damage associated with energy production. The states allocate most of the proceeds derived from the taxes to general revenue accounts,<sup>107</sup> but also devote a substantial amount to

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104. OKLA. STAT. ANN. tit. 68, § 1108, 1111 (West Supp. 1979) set aside the tax receipts for energy conservation and research programs. 1978 LA. ACTS 293 creates a special conservation fund, allocating to it twenty-five percent of the tax receipts. The fund accommodates "capital improvement projects designed to conserve, preserve, and maintain the barrier islands, reefs, and shores of" the state's coastline that are necessarily subject to environmental damage by the maintenance of pipelines to the Outer Continental Shelf. LA. REV. STAT. ANN. § 47-1351(A)(3) (West Supp. 1980). New Mexico dedicates half the proceeds of its tax to the Electrical Energy Fund. N.M. STAT. ANN. § 7-1-6 (1978). The statute does not express a purpose, but the tax probably provides some funds to remedy problems caused by the generation of electricity.

105. See generally *Washington Revenue Dep't v. Association of Wash. Stevedoring Cos.*, 435 U.S. 734, 751 (1978); note 109 *infra*.

106. See notes 33-38, 49 *supra* and accompanying text.

107. New Mexico allocates half of the tax proceeds to the general fund. N.M. STAT. ANN. § 7-1-6 (1978). Oklahoma allocates 90% of the proceeds to the retirement fund, OKLA. STAT. ANN. tit. 68, § 1103 (West Supp. 1979), but evidence suggests that this allocation is temporary and that the ultimate beneficiary of these proceeds will be the general fund. The Oklahoma Daily Law Journal, Nov. 2, 1977, at 1, col. 4. Louisiana allocates 75% of the proceeds to debt retirement and redemption accounts. LA. REV. STAT. ANN. § 47-1351A(2) (West Supp. 1980). The general funds' revenues are substantial. Oklahoma expected the tax to yield \$40,000,000 in 1978 (*Post Oak Oil v. Tax Comm'n*, 575 P.2d 964, 967 (Okla. 1978)); Louisiana expects \$185,000,000 in 1979 (*First Use Tax*, 31 La. Coastal L. Rep. 1 (October, 1978)); and New Mexico assessed a tax of \$5,000,000 on

conservation.<sup>108</sup>

Energy production certainly causes environmental damage—the issue is the extent of the damage. Under present commerce clause analysis, costs must fairly relate to revenue.<sup>109</sup> The state bears the burden of showing an acceptable correlation between revenues and costs because the state has ready access to the necessary figures.<sup>110</sup> A reasonable relation, not necessarily a one-to-one correlation, must exist.

### CONCLUSION

Energy producing states desire control over the amount and manner of production, compensation for the depletion of their energy resources, and compensation for damage to the environment and for socioeconomic problems associated with energy production. These states often attempt to achieve these goals through taxation.

This Note has attempted to demonstrate the various problems raised by the imposition of a state tax on energy. Approaches to the problems begin with a thorough examination of the taxation statute's design. The constitutional analysis consists of a series of questions: is there a sufficient nexus with the taxing state?; does the tax discriminate against interstate commerce?; is the tax fairly related to the services provided by the state?; has Congress preempted state regulation in this area? This line of questioning can demonstrate the validity of a state tax on energy.

Rules governing state taxation will not remain static because the courts have decided to scrutinize more carefully state taxation of interstate commerce. The power to control the amount of production and

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three utilities (*Arizona Pub. Serv. Co. v. O'Chesky*, 91 N.M. 485, 487, 576 P.2d 291, 293 (1978), *rev'd sub nom. Arizona Pub. Serv. Co. v. Snead*, 441 U.S. 141 (1979)).

108. Louisiana, for example, allocates 25% of the proceeds to a special conservation fund. In 1979, Louisiana expected the tax to yield \$185,000,000. Thus, the state allocated \$406,625 for the restoration of Louisiana's coastlines and barrier reefs. *First Use Tax*, 31 La. Coastal L. Rep. 1 (October, 1978).

109. See notes 33-38, 49 *supra* and accompanying text.

110. The best analogy is to federal income tax law. The taxpayer carries the burden of proving his deductions. *Hughes v. Commissioner*, 451 F.2d 975 (2d Cir. 1971); *cf. Cohan v. Commissioner*, 39 F.2d 540 (2d Cir. 1930) (Board of Tax Appeals allowed to use estimates for expenses in computing tax owed). See Heckerling, *The Rise and Demise of the Cohan Rule*, 7 TAX COUNSELOR'S Q. 23 (1963); Sheehan & Sullivan, *Convention Expenses: How to Prove Business Connection to the IRS's Satisfaction*, 6 TAX. FOR ACCOUNTANTS 146 (1971); Taylor, *Record Keeping Requirements: Steps to Take to Avoid Disallowance of T & E Expenses*, 5 TAX. ACCOUNTANTS 366 (1970).

distribution of natural resources may be preempted. Preservation of the environment through compensatory assessments, however, is not beyond the limits of state power. In addition, state taxes are valid if they are designed to raise a fair sum for the cost of providing state services incident to energy production. Any tax is unconstitutional if the tax recoups the depletion of a state's wealth and is not in some measurable way associated with actual costs to the state. Constitutional demands force the producing states to recognize their inability to favor their own citizens or to hoard future supplies. These same demands, however, allow the prevention of resource exploitation, which benefits the individual states and the nation.

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