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Maryland v. Louisiana Compared with *Commonwealth Edison v. Montana* or How to Tax Energy Production

by Nicolette Prevost

During the summer of 1981, the United States Supreme Court considered two cases involving apparently similar facts and reached an opposite result in each. Both cases involved state taxation of energy obtained from *"federally controlled lands"* with the burden of the tax falling on consumers in other states. In each instance, the tax was challenged as a violation of the Supremacy Clause[1] and of the Commerce Clause.[2] In *Maryland v. Louisiana,*[3] the Court struck down Louisiana's First Use Tax[4] because it violated both clauses. In *Commonwealth Edison v. Montana,*[5] the Court upheld Montana's Severance Tax. This article is an attempt to reconcile these apparently opposing decisions.

In *Maryland v. Louisiana,* the Court first considered as a threshold issue, and rejected, a motion to dismiss because the case was not an appropriate one for the exercise of original jurisdiction.

On the merits, the Court found that the plaintiffs were entitled to judgment on the pleadings, first of all, since ¶1303 C of the Louisiana First Use Tax was found to be invalid under the Supremacy Clause, i.e., preempted by federal legislation. The First Use Tax was imposed on the "first use" of any gas imported into Louisiana which was not previously subjected to taxation by another state or the United States. The tax is precisely equal to the severance tax the state imposes on Louisiana gas producers. A taxable "use" was defined as the sale, the transportation in the state to the point of delivery at the inlet of any processing plant, or the transportation in the state of unprocessed natural gas to the point of delivery.[6] The primary effect was on the owners of gas produced in the outer continental shelf (land outside the three-mile off-shore limit) in which the U.S. possesses a paramount interest. Section 1303 C of the tax prohibited recovery of the costs associated with the tax from anyone other than a purchaser of the gas. Since the Natural Gas Act[7] grants the Federal Energy Regulatory Commission (FERC) the authority to regulate the wholesale pricing of natural gas and to allocate the costs associated with its production, the Court held that the effect of ¶1303 C was to interfere with the FERC's authority to regulate the determination of the allocation of costs associated with the sale of natural gas to consumers. The Tax was held to be unconsitutional because it was inconsistent with the federal scheme.

The plaintiffs also pressed, as a Supremacy Clause issue, the inconsistency of the First Use Tax with the Outer Shelf Lands Act which declares that the subsoil and seabed of the outer Continental Shelf appertain to the United States and are subject to its jurisdiction, control and power of disposition as provided in this subchapter.[8] The court acknowledged that this provision expressly declared that "[s]tate taxation laws shall not apply to the outer Continental Shelf."[9]

The First Use Tax was also held unconstitutional because it violated the Commerce Clause which, by negative implication, limits state power over interstate and foreign commerce. In *Maryland* and *Montana,* the Court employed the test set forth in *Complete Auto Transit, Inc. v. Brady,*[10] to determine compliance with the Commerce Clause. The *Brady* test states that no state tax may be sustained unless the tax: (1) has a substantial nexus with the State; (2) is fairly apportioned; (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State.[11] The tax was held to discriminate against interstate commerce because of exemption provisions within the act and provisions for tax credits in other state statutes for intrastate owners, effectively causing the burden of the tax to fall on consumers outside the state.

The First Use Tax failed to survive scrutiny as a compensatory tax, with discriminatory effects. In *Henneford v. Silas Mason Co.,*[11] a use tax was held to complement a sales tax. Here Louisiana's argument that the First Use Tax complemented its severance tax on Louisiana producers was rejected. It was held that the tax was not compensatory since "Louisiana has no sovereign interest in being compensated for the severance of resources from the federally-owned OCS (outer continental shelf) land."[12]

In *Commonwealth Edison v. Montana,*[13] the state of Montana, under a 1921 act, imposed a severance tax on coal mined in the state, including that mined on federal land. A group of Montana coal producers and their out-of-state utility customers sought refunds of taxes paid under a tax schedule enacted in 1979.[14]

The Court held that the tax did not violate the Commerce Clause. Under the *Brady* test, it was conceded that the tax satisfied the first two prongs of the test. The fact that the only nexus of the severance of the coal is established in Montana satisfies one prong. "Because no other state can tax the severance of the coal, there is no question of apportionment or multiple taxation and the second prong is satisfied."[15]

The tax was found not to be discriminatory even though 90% of the coal was shipped to other states and the tax burden was shifted to citizens of other states. This conclusion was based on the fact that the tax was computed at the same rate regardless of its destination. A higher amount of tax was paid because of the greater amount of gas consumed, rather than an in-state/ out-of-state discrimination.

Ultimately, the discrimination issue was based on a claim that the tax was not "fairly related to the services provided by the state."[16] After determining that the tax was not a "user" fee but a general revenue, the Court stated "there is no requirement that the amount of general revenue taxes collected from a particular activity must be reasonably related to the value of the services provided to the activity."[17] Montana's tax on coal survived scrutiny under the Commerce Clause.

The tax did not violate the Supremacy Clause since it did not substantially frustrate the purposes of the Mineral Lands Leasing Act of 1920.[18] The Court found that in §32 of the act, Congress expressly authorized the States to impose severance taxes on federal lessees without imposing any limits on the amount of such taxes and that if the tax was "otherwise lawful, the 1920 Act (Mineral Lands Leasing Act) does not forbid it."[19]

Finally, the Court considered the assertion that the tax was unconstitutional because it substantially frustrates national energy policies reflected in several federal statutes encouraging the production and use of coal. The Court examined the relevant statutes including the Powerplant and Industrial Fuel Use Act of 1978.[20] Section 601(a)(2) of that act provides that severance taxes be "taken into account" when determining the need of a state for federal financial assistance because of the adverse effects of increased coal or uranium mining. The Court concluded that there is evidence that the statute contemplates the continued existence, not the pre-emption of state severance taxes on coal and other minerals.[21]

In summary, the similarity of the two cases is only a surface one and there are distinctions between them (the Court sought to distinguish *Maryland* in *Montana*.) The presence of exemptions and credits for Louisiana producers can be contrasted with Montana's tax rate which was consistent for all. Louisiana was taxing energy obtained from lands outside its borders while Montana's tax fell on resources from within its borders. It appears that severance taxes on energy can be passed along to consumers even when the energy is obtained from federal land, as long as there are no contrary federal statutory provisions and as long as the tax is computed at the same rate regardless of its ultimate destination.

Footnotes

[1]The "Constitution and the Laws of the United States. ...shall be the supreme Law of the Land. . . ." U.S. Const. art. VI,cl.2.

[2]"Congress shall have the Power. . .to regulate Commerce with foreign nations, and among the several States and with the Indian Tribes. . . ." U.S. Const. art. I,§8,cl.3.

[3]101 S. Ct. 2114 (1981).

[4]47 La. Rev. Stat. §§1301-1315 (1980).

[5]101 S. Ct. 2946 (1981).

[6]101 S. Ct. 2114, 2121, n.8 (1981) (quoting 47 La. Rev. Stat. §1302 (8) (1980)).

[7]15 U.S.C. §§717a-717w (Gas Act) as amended by the Gas Policy Act of 1978 (15 U.S.C. §3320 Supp. III 1979).

[8]101 S. Ct. 2114, 2132, n.26 (1981) (quoting 43 U.S.C. §1331-1336 (Supp. III 1979)).

[9]*Id.* at 2132, n.26.

[10]430 U.S. 274 (1977).

[11]300 U.S. 577 (1981).

[12]101 S. Ct. 2114, 2135 (1981).

[13]101 S. Ct. 2946 (1981).

[14]Mont. Code §15-35-10 et seq. (1979).

[15]101 S. Ct. 2946, 2954 (1981).

[16]*Id.* at 2955.

[17]*Id.* at 2956.

[18]Mineral Lands Leasing Act §1, 30 U.S.C. §§180-287 (1976).

[19]101 S. Ct. 2946, 2961 (1981).

[20]42 U.S.C. §8301 (b) (3) (Supp. III 1976).

[21]101 S. Ct. 2946, 2963 (1981).