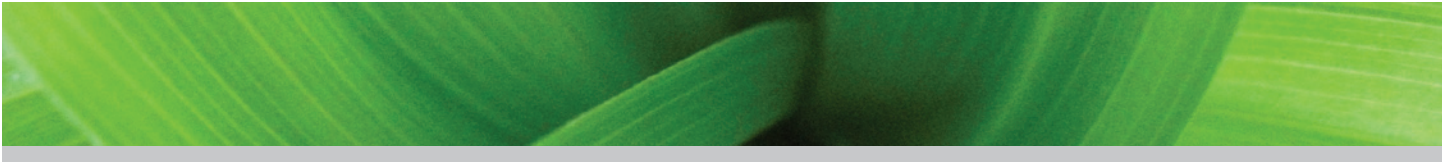


Texas State Court of Appeals Rules that Natural Gas Stored in FERC-Regulated Storage Facilities Constitutes Goods in Interstate Commerce that are Shielded by the Commerce Clause from Ad Valorem Property Taxes

The Court of Appeals of the Sixth Appellate District of Texas has ruled that natural gas stored in a FERC-jurisdictional storage facility is being transported in interstate commerce, and thus cannot be subject to a local tax. The Harrison County Appraisal District (HCAD) levied an ad valorem tax against Peoples Gas, Light and Coke Company (Peoples) on natural gas stored in Natural Gas Pipeline of America's (NGPL) North Lansing storage field in Harrison County, Texas. The Court of Appeals held that the action violated the Commerce Clause of the United States Constitution. *Peoples Gas, Light and Coke Company v. Harrison County Appraisal District*, (Tex. App. September 24, 2008). *Note: Van Ness Feldman prepared and submitted a brief amicus curiae on behalf of the Interstate Natural Gas Association of America urging that the tax was unconstitutional.*

NATURAL GAS STORED IN FERC-REGULATED INTERSTATE STORAGE FACILITIES IS GAS IN INTERSTATE COMMERCE

HCAD argued that since the natural gas at issue in this case was not actually moving in the pipeline, but rather stored beneath Harrison County, the gas was outside interstate commerce and subject to taxation as a part of the mass of property within the State of Texas. The Court of Appeals noted that when there is a break in the interstate transit and property comes to rest within a state, it may become subject to the power of the state to impose a property tax. Specifically, if the stoppage is attributable to the business purpose of the owner, the continuity of transit terminates and the goods become taxable. However, under FERC Order No. 636 and preceding open access orders, pipelines do not own natural gas in the pipeline systems, although pipeline companies remain in complete control of the physical operation of the pipeline. Therefore, Peoples, like interstate pipeline transportation and storage customers generally, had no control over the location or movement of natural gas after delivery to NGPL. Only the pipeline company can decide how the natural gas is moved and directs where it may be stored. Further, based on how NGPL operates its system, volumes stored for individual customers cannot be traced to any specific storage facility because all such facilities are integrated into the entire pipeline transportation system and operated in the aggregate. Since Peoples had no control over where the natural gas was stored and how much is stored at any given location, the stoppage of natural gas in North Lansing was not attributable to Peoples. Moreover, the FERC, which has exclusive jurisdiction over the interstate transportation of natural gas, expressly defines interstate "transportation" to include "storage." 18 C.F.R. § 284.1(a). FERC's definition coincides with the Supreme Court's determination that gas storage in interstate pipeline facilities is transportation of gas in interstate commerce. *Schneidewind v. ANR Pipeline Co.*, 485 U.S. 293, 295 n.1 (1988). The gas at North Lansing cannot be



segregated from the pipeline itself, because its storage is “necessary and integral” to the pipeline’s transportation function. Gas injected into an interstate pipeline therefore does not leave interstate commerce when it is held in the pipeline’s integrated storage.

THE HCAD AD VALOREM TAX IS PROHIBITED BY THE COMMERCE CLAUSE OF THE UNITED STATES CONSTITUTION

The Court of Appeals also held that HCAD’s ad valorem tax on gas stored in NGPL’s interstate gas storage facilities violated the Commerce Clause because the tax failed to satisfy the four-part test in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

Under *Complete Auto Transit*, states and local governments may tax interstate commerce if the tax: (1) is applied to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) does not discriminate against interstate commerce; and (4) is fairly related to services provided by the taxing authority. If the tax fails to satisfy any one of these elements, it violates the Commerce Clause and is invalid. The Court of Appeals found that Peoples did not maintain offices nor did it have employees or physical facilities in the state of Texas. Further, there was no evidence that any of the natural gas purchased by Peoples was delivered to any customer in Texas. Therefore, there was an insufficient nexus between Texas and the entity, property, or transaction to be taxed and thus, the HCAD tax failed to satisfy the first prong of *Complete Auto Transit*. Moreover, even though Harrison County provides numerous valuable services such as police and fire protection, these services serve the North Lansing facility itself, which is owned not by Peoples, but by NGPL. The tax therefore failed the fourth prong as well, because the measure of the tax was not reasonably related to the extent of the taxpayer’s presence or activities within the taxing state.

IMPLICATIONS

The holding in this case establishes strong precedent restricting the ability of states and local governments to tax natural gas transported in interstate commerce, including natural gas that is stored in FERC-jurisdictional interstate facilities owned and operated by interstate gas pipeline companies pursuant to FERC-approved transportation and storage agreements. The decision confirms that natural gas shipped on interstate pipeline transportation systems with integrated storage facilities, cannot, under the federal Constitution, be subjected to local property taxes.

FOR ADDITIONAL INFORMATION

Van Ness Feldman provides legal advice on a wide variety of matters related to energy, including the transportation and storage of natural gas on interstate pipelines. For more information please contact Patricia F. Godley, Howard E. Shapiro, Paul Korman, or any member of our Natural Gas Practice at (202) 298-1800.

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