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COMMENTS

CONSTITUTIONAL LIMITATIONS ON STATE SEVERANCE TAXES

> It seems to me that we are approaching three alternatives: One is the second conquest of the West by the power of the East. Another is the marshalling of forces by the West to become the OPEC of the North American Continent. . . . The third alternative is the development of a sane, rational policy of national scope which is fair to us all.
>
> —Former Texas Governor John B. Connally

As the nation's energy crisis deepens, so too do the smoldering divisions between the energy-producing states of the West and the more populous energy-consuming states. One indicator of that division is a bill before Congress that seeks to impose a federal ceiling on unreasonable and excessive state severance taxes on coal.[1] While not commanding majority support at this time, the proposed legislation is nevertheless expressive of a growing resistance to the taxes levied by most western states on the extraction of natural resources.[2] That resistance was aptly demonstrated during the recent congressional debates on the Windfall Profits Tax.[3] A proposed amendment to the bill would not only have restricted state severance taxes, but also would have extended the federal windfall tax to oil and gas wells owned and operated by state governments. The measure's sponsor, Senator John Danforth of Missouri, argued that the provision was necessary because energy producing states, like the oil industry, are enjoying an enormous revenue windfall from rapidly escalating prices. He predicted that these suddenly richer states will soon be able to conduct "the most effective economic warfare against the rest of the country ever dreamed of."[4]

Similar arguments are now before the Montana Supreme Court, where various utility and mining companies are challenging the Montana coal severance tax.[5] Set at approximately 30 percent of value, it

1. H.R. 5294, 96th Cong., 1st sess. (1979).

2. Note, *The Increasing Conflict Between State Coal Severance Taxation and Federal Energy Policy,* 57 TEX. L. REV. 675 (1979) [hereinafter cited as *Increasing Conflict*].

3. Crude Oil Windfall Profit Tax Act of 1980, Pub. L. No. 96-223, 94 Stat. 229 (to be codified in scattered sections of 7, 19, 26, 31, 42 U.S.C.).

4. 125 CONG. REC. S 18,056 (daily ed. Dec. 7, 1979).

5. Commonwealth Edison Co. v. Montana, No. 42657 (1st Jud. Dist. July 27, 1979). The court's dismissal of the case, for failure to state a claim, is currently on appeal to the Montana Supreme Court.

is the highest severance tax in the nation. The companies contend that if inflation and other factors are considered, the amount of tax payable on existing long-term contracts will amount to billions of dollars —a cost that ultimately will be passed on to consumers in the Midwest.[6] The firms argue that the tax raises the cost of coal far beyond the social cost of production and, in reality, effects a transfer of wealth from coal consumers to the state of Montana.

It is readily apparent that the question of resource taxation involves two of the most fundamental policy problems engendered by the energy crisis. Although at times haphazard and inefficient, the development, production and utilization of energy has always been regulated concurrently at the state and federal levels. The question now is whether this allocation of regulatory power should continue, or whether the responsibility should be consolidated at the federal level. A related and perhaps more immediate problem involves the division of benefits associated with higher energy prices.

Traditionally, extraction tax rates have always been considered nominal in relation to the value of the minerals extracted. Today, however, with energy prices increasing sharply, legislators in many states have moved to improve severance tax structures. As a result both the incidence and rate of taxation have risen rapidly.[7] This development poses significant new issues that bear sharply on the tenuous balance between state and federal power. Just as the Great Depression of the 1930s transformed the federal government into a powerful instrument for controlling the national economy, the energy crisis may similarly herald another historic shift in governmental powers. As severance taxes rise, they become subject to challenge as an impermissible burden on interstate commerce, as well as an attempt by energy-producing states to enhance their economies at the expense of the rest of the nation. To the extent that any exercise of state conservation, taxing or police power frustrates federal energy goals or endangers national security interests, there will be demands for federal preemption of the energy field.[8]

The problem confronting western states is how to exercise their sovereign powers in a responsible manner that will survive both legal challenge and political attack. Clearly, legitimate and even compelling public policies can justify mineral taxation. The ghost towns of the West are a vivid reminder of the disruptions that accompanied

6. Plaintiff's Memorandum in Opposition to Defendant's Motion to Dismiss at 5, Commonwealth Edison Co. v. Montana, No. 42657 (1st Jud. Dist. July 27, 1979) [hereinafter cited as Plaintiff's Memorandum].

7. *See* Whiteside & Gillig, *Coal and Conservation-Tax Policy*, 64 KY. L.J. 573 (1976).

8. *See Increasing Conflict*, *supra* note 2.

earlier booms. The settlement of the West, often dictated by national needs, has always occurred by leaps and bounds, by waves and impulses, and few western cities have not experienced their boom days.[9] For this reason, western states refuse to accept energy development solely as a necessity of national policy. To the extent that they are expected to fuel the rest of the nation, these states seek in return the development of high quality, economically diverse and viable communities that will prosper long after the mineral wealth is gone. Resource taxation is essential to this goal. This comment traces the development of modern legal principles applicable to commerce and supremacy clause attacks on state severance taxes. It also discusses the ingredients of an adequate defense, particularly the public purposes that must underlie state resource taxes.

COMMERCE CLAUSE LIMITATIONS

At the heart of the controversy over resource taxation is the meaning of the commerce clause of the United States Constitution. Article I, Section 8 includes among the powers of Congress, the authority "to regulate Commerce among the Several States. . . ." These few words comprise the great jurisdictional dividing line in our federal system. Implicit in the positive federal power to regulate national commerce is the negative implication that states do not have the same power. The early case of *Gibbons v. Ogden*[10] initiated a long controversy over the extent to which the commerce clause restricted state power and whether it was an exclusive or a concurrent power. The debate arises in part from the tension inherent in a federal system.[11]

Those who are committed to state sovereignty view the commerce clause as the product of a political compromise, an essentially negative restraint that merely defines the balance of power between the

9. R. HILL, THE PUBLIC DOMAIN AND DEMOCRACY 64 (1968).

> Western states have ever sought to protect their own interests and have resented interference; western communities and sections have fought valiantly for local control; and individuals have . . . sought to rid themselves of or avoid restraint. Economically and socially we have found explanations for this in the general conditions which have obtained in the West coincident with its occupation.

Id. at 128.

10. 22 U.S. (9 Wheat.) 1 (1824).

11. *See generally* F. FRANKFURTER, THE COMMON CLAUSE UNDER MARSHALL, TANEY, AND WHITE (1964); F. RIBBLE, STATE AND NATURAL POWER OVER COMMERCE (1937); L. TRIBE, AMERICAN CONSTITUTIONAL LAW (1978); Sholley, *The Negative Implications of the Commerce Clause,* 3 U. CHI. L. REV. 556 (1936); Stern, *The Commerce Clause and the National Economy, 1933-1946* (pt. 1), 59 HARV. L. REV. 645 (1946).

state and federal governments. Accordingly, they assert that the commerce clause prohibits only the most destructive exercises of state power: trade barrierism and economic discrimination or retaliation. Therefore, states have the power to levy reasonable severance taxes, despite their incidental effect on commerce. The countervailing view, as frequently expressed by Justice Frankfurter, is that the commerce clause is a free trade charter for national commerce, the hallmark of an economic order that seeks an optimum allocation of resources.[12] To the extent that any state tax or regulation makes interstate commerce more expensive, it must be declared unconstitutional. Proponents of this view argue that natural resources are national commodities in a free market and they recognize no right in states to levy resource taxes:

> Like a tollgate lying athwart a trading route, a severance or processing tax conditions access to natural resources. . . . The state's resources are diminished not by severance of a mineral, for the extractive process adds to its value, but by exportation—and the commerce clause clearly prohibits the imposition of a tax on exportation.[13]

But just as the ratio of federal-state power is not abstractly delineated, neither are the contours of the commerce clause fixed and static. The Constitution has been viewed as flexible and enduring, responsive to "the various crises of human affairs."[14] Likewise the scope of the commerce clause has been adapted to meet changing social and economic needs. It has been aptly stated that the history of commerce clause adjudication is best understood "as the search for that balance of federal-state power best serving the needs of society at any particular time, with the recognition that societal problems are continually changing and growing increasingly complex."[15]

"Old" versus "Modern" tests

The state of Montana is defending its coal severance tax on the premise that mining is a distinctly "local" activity not subject to commerce clause regulation. The argument relies heavily on a series of significant resource cases decided in the 1920s, a time when the United States Supreme Court nurtured a laissez-faire concept of nar-

12. *See* Brown, *The Open Economy: Justice Frankfurter and the Position of the Júdiciary*, 67 YALE L. J. 219 (1957).

13. Note, *Federal Limitations on State Taxation of Interstate Business*, 75 HARV. L. REV. 953, 970-71 (1962) [hereinafter cited as *Federal Limitations*].

14. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 415 (1819).

15. C. DUMARS & L. BROWN, LEGAL ISSUES IN STATE TAXATION OF ENERGY DEVELOPMENT 7 (1979).

rowly limited federal powers. The cases, known as the *Heisler* trilogy, each involved commerce clause challenges to state resource taxes.[16] In *Heisler v. Thomas Colliery Co.*, as in the present Montana case, the tax was levied on mined coal, most of which was shipped out of state. It was argued that the tax was largely a tribute upon the consumption of other states. But in each of the cases the Court found that mining and mineral production, "like manufacturing,"[17] is a local activity that precedes commerce and is not subject to commerce clause limitations.

The *Heisler* decisions were consonant with the prevailing notion that interstate and intrastate commerce were entirely separate and distinct. In those days the Court delineated the scope of the commerce clause by applying a rigid, mechanical test. If goods were found to be moving in interstate commerce, actually in transit from one state to another, they were within the ambit of federal jurisdiction and immune from state taxation and regulation. Correspondingly, if goods had not yet entered the stream of commerce or had ended their interstate journey, they were beyond the scope of federal taxation or regulation. Underlying this approach was a concern that the federal system would be endangered unless the Court drew sharp distinctions between mutually exclusive areas of state and federal control. The Court in *Heisler* feared that to extend the commerce power to local business activities would be to nationalize all industries:

> [I]t would nationalize and withdraw from state jurisdiction and deliver to federal commercial control the fruits of California and the South, the wheat of the West and its meats, the cotton of the South, the shoes of Massachusetts and the woolen industries of other States, at the very inception of their production or growth . . . because they are in varying percentages destined for and surely to be exported to States other than those of their production.[18]

It is the *Heisler* distinction between local business and the flow of commerce that continues to this day to shield state resource taxes from successful commerce clause challenge.[19] But while the *Heisler*

16. Hope Natural Gas Co. v. Hall, 274 U.S. (1927); Oliver Iron Mining Co. v. Lord, 262 U.S. 172 (1923); Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922).

17. Oliver Iron Co. v. Lord, 262 U.S. 172, 178 (1923).

18. Heisler v. Thomas Colliery Co., 260 U.S. 245, 259-60 (1922).

19. This analysis continues to be applied by modern state courts confronted with the severance tax/commerce clause issue. *See* Industrial Uranium Co. v. State Tax Commission, 95 Az. 130, 387 P.2d 1013 (1963); California Co. v. Colorado, 141 Colo. 288, 348 P.2d 382 (1959); Bel Oil Corp. v. Roland, 242 La. 498, 137 So.2d 308 (1962); Virginia Electric & Power Co. v. Haden, 200 S.E.2d 848 (W. Va. 1973), *cert. denied*, 416 U.S. 916 (1974).

cases have not been expressly overruled, a half-century of momentous commerce clause adjudication has seriously eroded their continuing validity. The intervening years have witnessed a remarkable extension of federal regulatory powers, which reach in varying degrees to each of the items enumerated in *Heisler* as reserved in the exclusive control of the states. Notably, Congress has used its commerce power to regulate coal as it lies in the ground and the many activities integral to coal mining.[20] In addition, the production of other natural resources, such as agricultural produce, has been successfully regulated by Congress.[21]

It was the Great Depression, and the realization that the states alone were unable to deal with a crippling nation-wide crisis, that saw the commerce clause transformed into perhaps the single most important tool for centralizing the national economy and achieving social reform. The consequent shift in power from the states to the federal government has impressed some as being almost revolutionary.[22] Today the commerce clause is said to be an affirmative power commensurate with national needs.[23] It is applicable whenever Congress finds that the regulated activity has a substantial effect on interstate commerce, even if the activity is wholly within a state and even if the particular activity standing alone would have but a trivial economic effect.[24]

Indeed, the *Heisler* Court scarcely could have foreseen that the commerce power would soon be extended to reach and prohibit the production of wheat by farmers for their own home consumption. In *Wickard v. Filburn*,[25] the Court rejected a farmer's contention that management of his 23 acre wheat field was a purely local activity, having at most an indirect effect on commerce. Not only did the Court reject the farmer's position as an unwarranted reliance upon mechanical applications of the law, but it also repudiated the underlying rationale with an historical survey of the commerce power and its expansion after Congress began to use it in an affirmative manner.

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20. The Federal Coal Mine Health and Safety Act, 30 U.S.C. §§ 801-962 (1976 & Supp. II 1978).

21. *See* Jones v. Rath Packing Co., 430 U.S. 519 (1977); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970); Wickard v. Filburn, 317 U.S. 111 (1942); Opp Cotton Mills v. Administrator of Wage & Hour Div., 312 U.S. 126, *amended* 312 U.S. 657 (1941).

22. H. ROTTSCHAEFER, THE CONSTITUTION AND SOCIO-ECONOMIC CHANGE 95 (1948).

23. American Power & Light Company v. S.E.C., 329 U.S. 90, 103 (1946).

24. Perez v. United States, 402 U.S. 146, 154 (1971). Moreover, the scope of the commerce power is limited only by other express Constitutional prohibitions and the restraints implicit in the nature of a federal system.

25. 317 U.S. 111 (1942).

The Court specifically referred to the *Heisler* cases as earlier pronouncements that are no longer the law.[26]

In *Parker v. Brown,*[27] the Court again refused to apply the *Heisler* test, and, equally as important, the Court emphasized that the commerce clause is a limitation on state power even without the affirmative action of Congress. While noting that California's regulation of raisin marketing would pass muster under a mechanical test, the Court continued:

> But courts are not confined to so mechanical a test. When Congress has not exerted its power under the Commerce Clause, and state regulation of matters of local concern is so related to interstate commerce that it also operates as a regulation of that commerce, the reconciliation of the power thus granted with that reserved to the state is to be attained by the accomodation of the competing demands of the state and national interests involved.[28]

The *Parker* case enunciated the rudiment of a balancing test that would be more precisely refined and applied increasingly in successive cases. It also signaled that, just as Congress was acting affirmatively under the commerce clause, the Court too would be more assertive in enforcing the negative limitations of the clause: invalidating state legislation that unduly restricted the national commerce. Subsequently, in *Southern Pacific Co. v. Arizona,*[29] the Court struck down an Arizona law limiting the length of trains passing through the state. The decision states firmly that, absent congressional action, the Court, "and not the state legislature, is under the commerce clause the final arbitrator of the competing demands of state and national interests."[30]

Nonetheless, the Court proceeded cautiously, unwilling at times to extend the negative scope of the commerce clause as broadly as it had recognized the clause's affirmative reach. As a result, a so-called "two-tiered" definition of the commerce clause developed, in which commerce was defined more narrowly when Congress had not acted than when it had acted. The distinction was recognized by the Court in *Minnesota v. Blasius,*[31] *Wickard v. Filburn,*[32] *United States v. Darby,*[33] and most recently in *Douglas v. Seacoast Products* where

26. *Id.* at 122-23.
27. 317 U.S. 341 (1943).
28. *Id.* at 362.
29. 325 U.S. 761 (1945).
30. *Id.* at 769.
31. 290 U.S. 1 (1933).
32. 317 U.S. 111 (1942).
33. 312 U.S. 100 (1941).

the Court said that its language in upholding the rights of states to tax interstate commerce cannot be "used interchangeably as statements of law where the issue is the power of Congress to regulate under the Commerce Clause."[34] On the basis of these cases, the state of Montana is arguing that cases dealing with Congress' plenary commerce power cannot be cited as authority for limiting the power of states to levy resource taxes. However, this argument is now open to question in light of two more recent Supreme Court decisions.

In *City of Philadelphia v. New Jersey,*[35] the Court struck down a state statute prohibiting the interstate transportation of waste destined for New Jersey landfills. The Court not only found garbage to be an item of interstate commerce, but it also indicated that the New Jersey Supreme Court, in upholding the statute, had erroneously relied on a two-tiered definition of commerce. The Court noted that many subjects of potential federal regulation inevitably escape congressional attention and may be regulated by the states "so long as they act within the restraints imposed by the Commerce Clause itself."[36] A year later, in an important footnote in *Hughes v. Oklahoma,*[37] the Court read *City of Philadelphia* as rejecting the two-tiered definition of commerce. The *Hughes* Court stated without equivocation that "the definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation."[38]

It is clear that if the dicta of *Hughes* becomes law, the severance-precedes-commerce test of *Heisler* will at last give way to the modern invalidating factor, substantially-affecting-commerce, thereby gutting the applicability of the early severance tax cases to future commerce clause challenges.[39] In any event, this is only one of the undercurrents working to erode the Heisler Doctrine and indicating that states should be prepared for a determination that severance taxation can be reached by the commerce clause. Since 1939, the Supreme Court has consistently rejected mechanical commerce clause tests in favor of a more flexible and policy-orientated balancing approach. The complexity of modern society, in which an interference at one point in the system can directly affect what happens in another area, underscores the simplistic approach of the old tests; with their formal distinctions and rigid application, they operated more as a legal con-

34. 431 U.S. 265, 282 n.17 (1977).

35. 437 U.S. 617 (1978), *rev'g* Hackensack Meadowlands Dev. Comm'n v. Municipal Sanitary Landfill Auth., 68 N.J. 451, 348 A.2d 505 (1975).

36. *Id.* at 623.

37. 441 U.S. 322 (1979).

38. *Id.* at 326 n.2.

39. C. DUMARS & L. BROWN, *supra* note 15, at 34.

clusion than a factual determination. By contrast, the balancing approach requires an inquiry into the actual effects of the regulation and a careful appraisal and accommodation of the competing demands of the state and national interests in each case.[40] The Court must balance the conflicting interests, an evaluative process in which the Court's discretion can be the decisive factor in either protecting state powers or expanding the area of effective federal control. Recent cases have significantly refined the balancing approach in the areas of both state taxation and regulation. The states must be prepared to deal with these cases.

State Regulation

The modern balancing test is most clearly articulated in *Pike v. Bruce Church, Inc.*[41] in which the Court struck down a state statute requiring that Arizona cantaloupes be packaged in-state before shipment in interstate commerce. The decision sets forth a four-pronged test:

> Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposedon such commerce is clearly excessive in relation to the putative local benefits. . . . (T)he extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities.[42]

a. Legitimate State Interest

The weight accorded to a state interest depends upon the Court's appraisal of both the necessity and nature of the objective sought. It had long been a general rule that health and safety interests, as traditional objects of State police power authority, were afforded the greatest deference against commerce clause attack. Conversely, at the other end of the regulatory scale, economically based regulations aimed at enhancing the local economy were always suspect and frequently invalidated. In recent cases, however, the Court has been more careful to scrutinize all state regulations and less willing to accept, without question, state health and safety laws. For instance, in *Raymond Motor Transportation, Inc. v. Rice,*[43] the Court invali-

40. Southern Pacific Co. v. Arizona, 325 U.S. 761, 769 (1945).
41. 397 U.S. 137 (1970).
42. *Id.* at 142.
43. 434 U.S. 429 (1978). *See also* Bibb v. Navajo Freight Lines, Inc., 359 U.S. 520 1959).

dated a state motor vehicle restriction, finding that the state had not overcome extensive evidence that the law did not in fact contribute to highway safety.

At the same time, courts have been willing to recognize a much broader range of legitimate subjects for state regulation, including regulations designed to provide local economic benefit. The Court has upheld state regulations to stabilize a produce industry,[44] ensure a steady supply of milk, create jobs, preserve a state's financial resources, or otherwise protect its residents' pocketbooks.[45] Courts have also accorded substantial deference to state environmental policies, upholding the nondiscriminatory conservation of natural resources,[46] the maintenance of the state's environmental quality,[47] and regulations aimed at water pollution control, solid waste problems and wildlife preservation.[48]

The Court's willingness to expand the scope of state regulatory power stems from a recognition that the social and economic forces that produced an expansion of federal powers have required a concurrent growth in state functions. But while paving the way for a more extensive assertion of state power, the courts are also making clear that the exercise of that power will be subject to a much closer scrutiny. The *Pike* test aims to ensure that a regulation's stated objectives are real and legitimate and the burdens to commerce no greater than necessary.

b. Evenhandedness

The requirement of evenhandedness ensures that a state regulation will not discriminate against interstate commerce. When a regulation is challenged, this is often the critical inquiry. Even those statutes that appear to be neutral are carefully examined for discriminatory effects in their operation.[49] For instance, when the burden of the challenged regulation falls disparately on out-of-state residents, as does resource taxation, the Court assumes that the state legislature has not been subject to proper political checks and a finding of dis-

44. *See* Parker v. Brown, 317 U.S. 341, 368 (1943).

45. *See generally* Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978).

46. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179 (1950).

47. Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440 (1960).

48. Proctor & Gamble Co. v. City of Chicago, 509 F.2d 69 (7th Cir.), *cert. denied,* 421 U.S. 978 (1975); Soap & Detergent Ass'n v. Clark, 330 F. Supp. 1218 (S.D. Fla. 1971); Palladio, Inc. v. Diamond, 321 F. Supp. 630 (S.D.N.Y. 1970), *aff'd,* 440 F.2d 1319 (2d Cir.), *cert. denied,* 404 U.S. 983 (1971); American Can Co. v. Oregon Liquor Control Comm'n, 517 P.2d 691 (Ore. App. 1973).

49. Arizona Public Service Co. v. Snead, 441 U.S. 141 (1979); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978); Lemke v. Farmers Grain Co., 258 U.S. 50 (1922).

crimination may follow.[50] When the effect is clearly discriminatory, the court requires a more rigorous judicial scrutiny and a greater burden for state justification.[51] Without substantial justification, the statute will fail. And where a state regulation is discriminatory on its face, in the nature of a trade barrier the Court applies a virtual *per se* rule of invalidity, reasoning that such measures invite retaliatory measures and multiple state barriers, all in contravention of the central purpose of the commerce clause.[52]

c. Balancing and a Less Intrusive Means

Even if a state regulation is not discriminatory, the *Pike* test requires a further inquiry. The court, having assessed the state interest, must determine the extent to which the legislative means chosen are reasonably related to the goal sought to be achieved. These factors are then weighed against the national interest in a free economy to decide if the burden upon commerce is excessive.

Generally, the Court has been reluctant to substitute its judgment for that of the states in determining whether the objective could be achieved through less drastic means. In fact, this less intrusive means requirement has been applied only where state regulations have been found to operate discriminatorily despite a legitimate state interest.[53] And in such cases, it is said that this prong of the test applies a rigid bottom line to an otherwise flexible standard, where "even the most compelling local purposes will not save the regulation *unless* there is no 'reasonable non-discriminatory alternative available' that is 'adequate to conserve [the] legitimate local intent.'"[54]

The balancing of state and federal interests, a constant theme[55] in commerce clause adjudication, is ultimately the decisive factor in the *Pike* test. Balancing of interests necessarily forces courts to make

50. Hunt v. Washington apple Advertising Comm'n, 432 U.S. 333 (1977); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951); H.P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949); Pennsylvania v. West Virginia, 262 U.S. 553 (1923).

51. Hunt v. Washington Apple Advertising Comm'n, 432 U.S. 333 (1977); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951). *See also* Nippert v. City of Richmond, 327 U.S. 416, 431 (1946).

52. Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361 (1964); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951). *See also* City of Philadelphia v. New Jersey, 437 U.S. 617 (1978). Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976).

53. *See* Hunt v. Washington State Apple Advertising Comm'n, 432 U.S. 333 (1977); Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951). Most recently, in Hughes v. Oklahoma, 441 U.S. 322 (1979), the Court restated this element of the *Pike* test in terms of discrimination: "Whether alternative means could promote this local purpose as well without discriminating against interstate commerce." *Id.* at 336.

54. C. DUMARS & L. BROWN, *supra* note 15, at 19, *quoting* Dean Milk Co. v. City of Madison, 340 U.S. 349, 854 (1951).

55. C. DUMARS & L. BROWN, *supra* note 15, at 16.

decisions on important matters of policy, sensitive to the tides of political opinion, and, here again, recent rulings indicate that the Court is showing a more careful analysis of the question. In the past, the Court sometimes spared the balancing test out of deference to state health and safety interests. For instance, in *Brotherhood of Locomotive Firemen v. Chicago, Rhode Island & Pacific Railroad,*[56] the Court remarked that "it is difficult at best to say that financial losses should be balanced against the loss of lives and limbs of workers and people using the highways." For a time after this decision the lower courts refused to balance health and safety concerns against economic loss. However, in the recent *Raymond Motor* case,[57] the Supreme Court put a halt to this trend. The Court there made clear that even where the state purpose is valid and proper deference is given to legislative judgment, the Court must nevertheless weigh the competing state and national interests to arrive at an attainable public policy balance.

In summary, the regulation cases require (1) that a proposed regulation be nondiscriminatory; (2) that it actually and demonstratively further legitimate local interests, and (3) that the state be able to show that any burdens on interstate commerce are outweighed by the local objective at stake. In addition, if the regulation is discriminatory, the state must overcome the virtually impossible burden of demonstrating that the legitimate state interest cannot be furthered by *any* less drastic means. The failure to "adequately answer all these concerns can leave the regulatory provision vulnerable to attack on any single one."[58]

State Taxation

While the Supreme Court was continuously polishing its approach to state regulations, its decisions in the related field of state taxation were greeted frequently with dismay and frustration. Commentators noted that the Court's attempts to delineate state taxing powers often defied national analysis, adding that the Court itself recognized that "consistency was not a hallmark of its pronouncements in this field."[59] Recent decisions, however, have marked a surprising and substantial change, a development so significant that it has been said, "The subject of interstate commerce and state taxation is perhaps the quiet revolution in current constitutional adjudication."[60]

56. 393 U.S. 129, 140 (1968).
57. Raymond Motor Transport, Inc. v. Rice, 434 U.S. 429 (1978).
58. C. DUMARS & L. BROWN, *supra* note 15, at 20.
59. Hellerstein, *State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication?*, 75 MICH. L. REV. 1426 (1977).
60. C. DUMARS & L. BROWN, *supra* note 15, at 20.

What the Court has done is to abolish what had long been a fundamental tenet of commerce clause doctrine: the notion that the privilege of doing exclusively interstate business could not be subject to state taxation. This principle evolved logically enough from an inference that the commerce clause precluded states from barring the transaction of interstate commerce within their borders.[61] But as much as the doctrine sought to protect interstate trade, it ignored the legitimate revenue needs of the states; state taxes were invalidated even though they were not levied as a condition to doing business in the state and despite the fact that both foreign and domestic businesses were taxed at an equal rate.

Over the years, the Court recognized various exceptions to the doctrine. In keeping with the distinction between strictly inter- and intrastate commerce, states were permitted to levy taxes on the purely "local" incidents of an otherwise interstate business.[62] But this approach seemed only to heighten the Court's tendency toward making formal and mechanical distinctions; hence taxes frequently were invalidated on no sounder reasoning than the local terminology used to describe the tax.[63] As early as 1929, Justice Stone criticized the privilege doctrine, saying he could find no "practical justification . . . for an interpretation of the commerce clause which would relieve those engaged in interstate commerce from their fair share of the expense of government of the states in which they operate by exempting them from the payment of a tax of general application, which is neither aimed at nor discriminates against interstate commerce."[64] Nearly fifty years later a majority of the Court agreed.

In 1977, in *Complete Auto Transit, Inc. v. Brady,*[65] the Court upheld a Mississippi "privilege" tax, announcing that interstate business must now pay a fair share of the state tax burden "even though it increases the cost of doing business."[66] The Court was careful to formulate a flexible test that would both free the states to levy taxes and yet safeguard against discriminatory levies, trade barriers and multiple or cumulative state tax burdens. A tax will be sustained if

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61. Pensacola Tel. Co. v. Western Union Tel. Co., 96 U.S. 1 (1877).

62. *See, e.g.,* Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948); Coverdale v. Arkansas-Louisiana Pipe Line Co., 303 U.S. 604 (1938). And, "[w]ithout explicitly abandoning the privilege concept, the Court developed the multiple taxation doctrine that undermined the basis for . . . tax immunity. . . ." Hellerstein, *supra* note 59, at 1443.

63. A tax on apportioned net income was upheld in Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450 (1959), while a similar tax, attached to the "privileges of doing business," was struck down in Spector Motor Service, Inc. v. O'Connor, 340 U.S. 602 (1951).

64. Helson v. Kentucky, 279 U.S. 245, 253 (1929) (Stone, J., concurring).

65. 430 U.S. 274 (1977).

66. *Id.* at 288, *quoting* Western Live Stock v. Bureau of Revenue, 303 U.S. 250, 254 (1938).

four conditions are met: the tax "is applied to an activity with a substantial nexus with the taxing state, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the state."[67] The Court expressly equated the new standard to the balancing test in *Pike*, saying the Court had "moved toward a standard of permissibility of state taxation based upon its actual effect rather than its legal terminology."[68]

a. Nexus and Discrimination

The nexus and discrimination provisions of the *Complete Auto* test underscore the constitutional restrictions on state taxation. Considerations of due process and jurisdiction are obviously implicit in the substantial nexus standard. There must be a "minimum contact" or sufficient presence of the taxpayer in the taxing state so that it has proper jurisdiction over the taxpayer. In addition, this requirement provides for an effective political check by ensuring that the tax will have some adverse impact on in-state interests to whom the state legislature is politically responsible.[69] There is no doubt that the activity of mineral severance, requiring as it does a large, local extractive industry, is sufficiently connected with the state to permit state taxation. The thorny question is whether such taxes are discriminatory. The mining industry can cite a host of cases for the proposition that a discriminatory tax, which permits a state to take advantage of its fortuitous position in the national economy at the expense of others, is *per se* void.[70] Severance taxes are contrary to the free trade purpose of the commerce clause in that they are placed on commodities destined primarily for the interstate market and to meet the energy needs of states not having their own energy resources.[71] The industry will argue that even if a tax is facially neu-

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67. *Id.* at 279.

68. *Id.* at 281.

69. *See* National Bellas Hess, Inc. v. Dep't of Revenue of the State of Illinois, 386 U.S. 753 (1967); American Oil Co. v. Neill, 380 U.S. 451 (1965).

70. *See, e.g.*, Hughes v. Oklahoma, 441 U.S. 322 (1979) (holding that state cannot keep minnows in-state while prohibiting out-of-state sales); City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (holding that state cannot isolate itself from other states' waste absent bona fide health reasons); Boston Stock Exchange v. State Tax Commission, 429 U.S. 318 (1977) (striking down a discriminatory state tax on stock transfers); Pennsylvania v. West Virginia, 262 U.S. 553 (1923) (holding that state cannot prefer in-state consumers over out-of-state purchasers in sale of natural gas); and Altus v. Carr, 255 F. Supp. 828 (W.D. Tex. 1966) (holding that state cannot prohibit out-of-state sales of groundwater).

71. In H. P. Hood & Sons, Inc. v. DuMond, 336 U.S. 525 (1949), the Court strongly expressed the central free trade purpose of the commerce clause:

> The material success that has come to inhabitants of the states which make up this federal free trade unit has been one of the most impressive in the history

tral, the disparate burden of the tax on citizens of other states makes such taxes discriminatory in application.

The state can respond by emphasizing that the Supreme Court has invalidated only those state taxes which have involved elements of economic or environmental isolationism; taxes such as those levied on out-of-state consumers coming into the state to trade, or on local persons attempting to do business out-of-state rather than through in-state markets.[72] The state will note that its severance tax applies to all who extract the resource. No discrimination exists since all companies pay the tax, irrespective of the state of incorporation, the business location, or the ultimate destination of the resource. The state can also argue that the "mere fact that the impact of the tax, because of the export nature of the business, may be passed on to out-of-state buyers of the ultimate product has never been held in and of itself to be discriminatory."[73]

b. Fair Apportionment and Relation to Benefits

These two requirements focus on the amount of the tax and its constitutional fairness, rather than the power to tax. The apportionment provision is designed to prevent interstate commerce from paying total taxes substantially greater than local commerce. By requiring that the amount of tax be relative to the amount of business activity occurring in the taxing state, this provision ensures that the state exacts only a fair demand for that aspect of interstate commerce to which it bears a special relation. Because the apportionment rule was intended to prevent multiple tax burdens, it is arguably not applicable to severance taxation: "The principle that every adjoining state cannot tax oil passing through a pipeline at its full value just because it 'passes through' has nothing to do with a severance tax. A com-

> of commerce, but the established interdependence of the states only emphasizes the necessity of protecting interstate movement of goods against local burdens and repressions. . . . May Michigan provide that automobiles cannot be taken out of that State until local dealers' demands are fully met? Would she not have every argument in the favor of such a statute that can be offered in support of New York's limiting sales of mile for out-of-state shipment to protect the economic interests of her competing dealers and local consumers? Could Ohio then pounce upon the rubber-tire industry, on which she has a substantial grip, to retaliate for Michigan's auto monopoly?

Id. at 538-39.

72. *See* cases cited at note 70 *supra*. *See also* Arizona Public Service Co. v. Snead, 441 U.S. 141 (1979); Hunt v. Washington Apple Advertising Comm'n, 432 U.S. 333 (1977); Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366 (1976); Pike v. Bruce Church, Inc., 397 U.S. 137 (1970).

73. C. DUMARS & L. BROWN, *supra* note 15, at 25. *See, e.g.*, Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922); Coe v. Errol, 116 U.S. 517 (1886).

modity can only be mined once. Thus, the potential for multiple mining taxation is logically impossible."[74]

Of much greater concern is the requirement that the tax be fairly related to the services provided by the State. This provision lies at the heart of the *Complete Auto* test; it is the ultimate constitutional measuring rod which asks the decisive question: "[W]hether the state has given anything for which it can ask return?"[75] Fortunately for the states, the Supreme Court not only has broadened the scope of state taxing powers, but it also has been generous in defining the kinds of benefits and costs that will justify taxation. In a leading case, the Court said that a state tax can contemplate both tangible services, such as police and fire protection, and more amorphous benefits such as the opportunities which it has given and the advantage it has conferred "by the fact of being an orderly, civilized society."[76] In *Department of Revenue v. Association of Washington Stevedoring Cos.*,[77] the Court firmly stated that "The commerce clause balance tips against the tax only when it unfairly burdens commerce by extracting more than a just share from the interstate activity."[78] In effect, a state is required to show no more than that the tax is reasonable in relation to the benefits and opportunities provided. The Court has turned an unsympathetic ear to the argument that an otherwise reasonable tax may incidentally increase the cost to consumers in other states. In *Michelin Tire Corporation v. Wages*,[79] in which the Court upheld an *ad valorem* property tax on tires stored in a warehouse, the Court said that a state's nondiscriminatory taxes are the "*quid pro quo* for benefits actually conferred by the taxing State. There is no reason why local taxpayers should subsidize the services used by the importer. . . ."[80]

The Court's reasoning in *Michelin* would seem to apply with equal force to the question of state severance taxes. As a source of public capital the severance tax can be passed directly to the energy consumer who bears the ultimate responsibility for and derives the ultimate benefit from the energy impact. To determine that consumers should not bear this cost "would accord to large population centers the luxury of demanding unlimited energy supplies regardless of the

74. C. DUMARS & L. BROWN, *supra* note 15, at 62.

75. Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940). "A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to the opportunities which it has given . . ." *Id.*

76. *Id. See also* Memphis Natural Gas Co. v. Stone, 335 U.S. 80 (1948); Freeman v. Hewitt, 329 U.S. 249 (1946).

77. 435 U.S. 734 (1978).

78. *Id.* at 748.

79. 423 U.S. 276 (1976).

80. *Id.* at 288-89.

adverse effects of energy conversion upon far-distant states where the conversion occurs."[81] In fact, the Supreme Court has gone so far as to indicate that the relevant commerce clause standard can involve more than the *Complete Auto* relation to benefits test. In *Arizona Public Service Co. v. Snead,*[82] the Court stated that a tax may also be justified because it effects a legitimate public purpose; in that case the environmental and other societal problems associated with coal-powered electrical generation. For the most part, the Court has been sensitive to state environmental concerns. Its stated willingness now to consider specific problems suggests that western states should not hesitate to articulate explicit policy objectives for the public purposes underlying resource taxation.

The most obvious need for severance taxes is to compensate the state for the special expenes incurred by state and local governments on behalf of the extractive industry: the construction and repair of special roads and other facilities that do not serve the general public; a portion of the impact costs of growth associated with boom towns; the cost of water use planning and extensive environmental monitoring, regulation and oversight; and finally, especially with uranium mining, the expense of mine waste stabilization and neutralization. The impact on state treasuries is heightened by the fact that much of the energy development is occurring in sparsely settled, remote areas with minimal physical and service infrastructure. Naturally, such communities have wholly inadequate or totally non-existent revenue bases. Severance taxes, because they can be easily adjusted as needs require, are an excellent mechanism for meeting these kinds of immediate needs.[83]

However, severance taxes should also contemplate longer-range problems, both those inherent in the mining process and those peculiar to the western setting. The mainstay of western economies–agriculture, wilderness, and recreational activities–are being adversely affected, perhaps permanently, and mining activity is occurring now

81. Van Baalen, *Mineral Export Legislation–Can it Withstand Federal Preemption and Commerce Clause Challenges?,* 12 LAND & WATER L. REV. 131, 176 (1977).

82. 441 U.S. 141 (1979). The case involved a constitutional challenge to the New Mexico electrical energy tax levied on power transmissions out-of-state. Because Congress interceded with a law aimed at invalidating the tax, the Supreme Court's decision overturning the tax was based on federal preemption rather than broader commerce clause principles. Nonetheless, the Court stated: "The generation of electricity in the Four Corners region undoubtedly also generates environmental and other problems for New Mexico. There is no indication that Congress intended to prevent the State from taxing the generation of electricity to pay for solutions to these problems." *Id.* at 150-51.

83. Severance taxes have been described aptly as ". . . analogous to the fabled tax on bachelors, where collections were earmarked for children born out of wedlock; the underlying tax policy was that the parties causing the problem should compensate society for some of the damage." Whiteside & Gillig, *supra* note 7, at 598.

in areas of high aesthetic quality. Severance taxes should encompass both the ecological degradation and the loss of alternative future uses for the mined lands. As one report notes, "Although these damages may not be readily measured, the large amounts of time and resources expended by many environmentally oriented citizens in attempting to reduce or eliminate these aesthetic damages reveal their significance."[84]

In addition, there is that severance tax policy which stirs the greatest controversy but which western states are increasingly adamant in asserting: the policy of asset replacement, or the notion that severance taxes represent a claim by the state to a part of the value of its underground wealth lost by the mining.[85] Free trade proponents bristle at this suggestion. The West, they claim, has no proprietary interest in its underground wealth and severance taxes represent nothing more than an unlawful booty on minerals that belong to the nation as a whole.[86] Moreover, they argue that the West is obligated to contribute appropriately in solving the national energy problem. But the western states are looking beyond the immediate crisis to a time when the mineral resources are ultimately depleted and the nation shifts to a non-fossil fuel economy in the early 21st century. Their economic planning is premised on the hard reality that each of the resources on which the taxes are levied is finite and non-renewable. As the resources diminish, state and local governmental units face the inevitable prospect of an eventual decline in the revenues available to support public services. For this reason western states caution that "energy development will find acceptance in the West only as an instrument of orderly and high quality community development and not as a necessity of national policy."[87] Their position is not one of gaining economic advantage but of simply maintaining parity with states having renewable resources.[88] Severance taxes should reflect the opportunity which is granted to mining concerns to exhaust a state's non-renewable resources. Likewise, the rate of taxation should be sufficient to establish a permanent fund that can be used to develop alternative sources of dependable revenue similar to that taken for granted in other states.

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84. C. DUMARS & L. BROWN, *supra* note 15, at 83.

85. *Id.* at 83, 115-29.

86. *Federal Limitations, supra* note 13, at 971.

87. THE ROCKY MOUNTAIN INSTITUTE FOR POLICY RESEARCH, FINANCING INFRASTRUCTURE IN WESTERN ENERGY DEVELOPMENT AREAS 2 (1975). "As a source of public capital for energy impacted areas the severance tax has the advantage that it is passed directly to the energy consumer who bears the ultimate responsibility for and derives the ultimate benefit from the impact . . ." *Id.* at 5.

88. C. DUMARS & L. BROWN, *supra* note 15, at 79.

Is Heisler Still Alive?

The Supreme Court has not decided a resource taxation case since the *Heisler* trilogy of the 1920s, and it remains to be seen whether the Court would analyze modern day severance taxes under the *Complete Auto* relation-to-benefits test or the severance-precedes-commerce standard of *Heisler.* It is perhaps significant that the Supreme Court has continued to cite the *Heisler* cases in recent decisions. In 1961, when the Court upheld a state license tax on the local business of commercial fishing, it cited with approval one of the *Heisler* cases:

> Here, as there, the market for the product obtained locally is interstate, the taking being a step in the process leading to an interstate market. In both the local product is promptly loaded for interstate shipment. But in each there is a preliminary local business being conducted—an occupation made up of a series of local activities which the State can constitutionally reach.[89]

The state of Montana views the Court's continuing citation of the *Heisler* cases as a demonstration of their continuing validity. However, the mining companies challenging the Montana severance tax point out that the *Heisler* rationale is completely irreconcilable with modern tax cases.[90] They contend that the *Heisler* cases are cited for a different purpose: to illustrate the type of local activity that will provide a sufficient nexus to permit state taxation under modern cases. They point out that the *Heisler* doctrine was formulated in an all-or-nothing context. In each of the *Heisler* cases taxpayers were seeking to avoid state taxes altogether. They did so by claiming that their activities were in interstate commerce and thus totally immune from state taxation. The Supreme Court rejected that contention in each case, ruling that the taxed activity was local in nature and therefore properly subject to state taxation. The Court, however, did not hold that such local taxation was necessarily immune from commerce clause analysis. In fact, in subsequent decisions the Court made clear that the commerce clause can invalidate state taxes on activities which might have been local under earlier rules.

In *Nippert v. Richmond*[91] the Court invalidated a tax on out-of-state solicitors, observing that "there is no known limit to the human mind's capacity to carve out from what is an entire or integral eco-

89. Alaska v. Arctic Maid, 366 U.S. 199, 203-04 (1961). *See also* Dunbar-Stanly Studios, Inc. v. Alabama, 393 U.S. 537 (1969), in which the Court again cited with approval one of the Heisler cases: "The extraction of a natural resource within a State is not immunized from state taxation merely because, once extracted, the product will immediately be shipped out of the state for processing and sale to consumers." *Id.* at 541.

90. Briefs for Plaintiff and Defendant, Commonwealth Edison Co. v. Montana, No. 42657 (1st. Jud. Dist. July 27, 1979).

91. 327 U.S. 416 (1946).

nomic process particular phases or incidents, label them as 'separate and distinct' or 'local,' and thus achieve its desired result."[92] The Court cautioned that finding a local incident was necessary but not alone sufficient to sustain a tax. Courts must also examine "considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce."[93]

In none of the *Heisler* cases was it argued that while states may exact a resource tax, it is the particularly high rate of tax that discriminates against interstate commerce. Once the argument is framed upon this distinction, the forcefulness of the *Heisler* trilogy appears questionable. The modern decisions effectively undermine the *Heisler* rationale in yet another way. The severance-proceeds-commerce rule was believed to be necessary if numerous state taxes were to be protected from commerce clause attack. If local activities had been deemed to be in commerce, state taxation would have been precluded according to the mechanical tests of the day. No longer is this concern necessary. The modern balancing approach, enunciated in *Complete Auto,* accomodates both state and federal interests. A state may now tax even wholly interstate activities, provided only that its taxes are non-discriminatory, fairly apportioned, based on some nexus to the state, and are reasonably related to the services provided by the state.

SUPREMACY CLAUSE LIMITATIONS

In challenging the Montana coal severance tax, the mining and utility companies have peppered their arguments with dire predictions from economic experts. They estimate that over the next decade alone the Montana tax will prevent the production of some 20 million tons of coal each year and will add approximately 72 million dollars annually to national energy costs.[94] Indeed, the companies argue that the severance tax has already had an immediate and chilling impact: not a single new coal mine has opened in Montana since the tax was enacted; existing mines are operating below capacity; contracts have been cancelled; and new contracts for Montana coal have dropped off dramatically.[95] In view of the country's critical energy situation, the argument presents an intolerable situation. It

92. *Id.* at 423.
93. *Id.* at 423-24.
94. Plaintiff's Supplemental Memorandum in Opposition to Defendant's Motion to Dismiss at 35-37, Commonwealth Edison Co. v. Montana, No. 42657 (1st Jud. Dist. July 27, 1979).
95. *Id.*

also permits the companies to argue that the tax is void under the supremacy clause of the Constitution.

The supremacy clause, Article VI, § 2 of the United States Constitution, preempts all state legislation which frustrates the full effectiveness or "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[96] It can preclude state regulation either because of a conflict with federal law or because it is determined that the federal legislation was meant to occupy the field. The mining companies assert that the Montana tax substantially impairs national energy and clean air policies aimed at encouraging the use of low sulfur coal. These policies are clearly expressed in the Energy Policy and Conservation Act of 1975;[97] the Power Plant and Industrial Fuel Use Act of 1978;[98] the Clean Air Act;[99] the Energy Supply and Environmental Coordination Act of 1974;[100] and the Federal Nonnuclear Energy Research and Development Act of 1974.[101]

In addition, the companies argue that the Montana tax directly contravenes the entire statutory scheme established by the Mineral Lands Leasing Act of 1920.[102] That act culminated and settled a long dispute between the federal government and western states over the control and use of the public domain. The act reflects the decision that public coal lands would be held in trust, allowing the federal government to derive the economic rents from the mineral through its coal leases. In turn the states were granted a share of all federal royalties from the mineral leases within their borders, partially to offset the costs imposed by the coal mining.[103] The mining companies argue that the Montana tax grossly distorts this legislative compromise since it appropriates directly to the state a major part of the economic rents attributable to coal extraction.[104]

The states, however, can point to language in the Mineral Act itself stating that the law shall not "be construed or held to affect the rights

96. Hines v. Davidowitz, 312 U.S. 52, 67 (1941). *See generally* Note, *Pre-emption as a Preferential Ground: a New Canon of Constitution,* 12 STAN. L. REV. 208 (1959).

97. 42 U.S.C. § § 6201-6422 (1976 & Supp. II 1978).

98. Pub. L. No. 95-620, 92 Stat. 3289 (1978) (codified in scattered sections of 15, 42, 45, 49 U.S.C.).

99. 42 U.S.C. § § 7401-7642 (Supp. II 1978).

100. 15 U.S.C. § § 791-798 (1976 & Supp. II 1978).

101. 42 U.S.C. § § 5901-5920 (1976 & Supp. II 1978).

102. Ch. 85, 41 Stat. 437 (1920) (current version at 30 U.S.C. § § 22-263 (1976 & Supp. II 1978).

103. The states originally received a 37½ percent share of all federal royalties. In 1976, this share was increased to fifty percent. Federal Coal Leasing Amendments Act of 1975, Pub. L. No. 94-377, § 9(a) 90 Stat. 1089 (1976) (codified at 30 U.S.C. § 191 (1976)).

104. Plaintiff's Memorandum, *supra* note 6, at 46.

of the states or other local authority to exercise any rights . . . including the right to levy and collect taxes upon improvements, output of mines, or other rights . . ."[105] The state can also argue that the Court should not accord preemptive force to general congressional policies which express no clear intent to preempt state severance taxes. Indeed, in the recently passed Windfall Profits Tax, Congress recognizes the right of states to exact severance taxes, albeit at a restricted level.[106] It should be noted that state resource taxation is an area historically rooted in the sovereign power of the states. It can be argued that if federal statutes are construed to prevent states from raising the revenue necessary to support state government, this would violate the principles of state sovereignty articulated in *National League of Cities v. Usery.*[107] That case struck down the extension of federal wage and hour laws to state and municipal employees, not because the regulated activity was beyond the scope of the commerce power, but rather because the regulation substantially interfered with the sovereign power reserved to the states by the Tenth Amendment. The decision broadly states that the Tenth Amendment may bar any federal action that impairs the state's integrity; forces relinquishment of important governmental activities; interferes with traditional aspects of state sovereignty; or forces directly upon the states . . . (federal) choices as to how essential decisions regarding the conduct of integral governmental functions are to be made.[108]

The states' arguments might find a receptive bench in the Burger Court. On the theory of cooperative federalism, the Court has been reluctant to find federal preemption absent a clear and manifest congressional intention to displace state regulation.[109] Nonetheless, the

105. 30 U.S.C. § 189 (1976).

106. Pub. L. No. 96-223, § 101(a) (§ 4996(c)), 94 Stat. 248 (1980) (to be codified as 26 U.S.C. § 4996(c)). The law permits a limited deduction for state severance taxes. In states that impose a severance tax higher than 15 percent, the deduction is figured as though the rate were 15 percent. *See* H.R. CONF. REP. NO. 817, 96th Cong., 2d Sess. 104, *reprinted in* [1980] U.S. CODE CONG. & AD. NEWS 1240, 1255.

107. 426 U.S. 833 (1976).

108. *Id.* at 843-55. The opinion in *Usery* may read too broadly. Justice Brennan dissented, saying that the decision attempted to repudiate the fundamental principle "that the Constitution contemplates that restraints upon exercises by Congress of its plenary comcomerce power lie in the political process and not in the judicial process." *Id.* at 857. And while Justice Blackmun concurred in the opinion, he emphasized that it should not be read to "outlaw federal power in areas such as environmental protection, where the federal interest is demonstrably greater and where state facility compliance with imposed federal standards would be essential." *Id.* at 856.

109. *See generally* New York State Department of Social Services v. Duplino, 413 U.S. 405 (1973) (welfare is a regulatory field of great interest to both states and the federal government); Goldstein v. California, 412 U.S. 546 (1973) (no clear and unambiguous intent to

state severance tax could still be invalidated if the Court were to conclude that the tax substantially frustrates national energy policies. With the prospect of a deepening energy crisis and increasing intergovernmental tensions, the supremacy clause should stand as a constant reminder to the states that they must act cautiously and with a demonstrable concern for their position in the federal system.

CONCLUSION AND FINAL CAVEATS

It is suggested that in large part the arguments on either side of the severance tax question "take on added or diminished stature depending on the rate of the particular tax."[110] The old severance-preceeds-commerce approach of earlier cases was perhaps appropriate in an era of nominal severance tax rates. But as these taxes now move into the double-digit figures, mineral states must be prepared to show, both factually and legally, that their taxes are fairly related to the benefits and services provided by the state or the costs incurred.

States should be cautioned that if excessively high resource taxes effectively preclude or hinder access to natural resources, the state most certainly will face charges of trade barrierism or resource isolationism. These are precisely the sort of practices that the commerce clause was intended to prevent, and recent cases indicate that when faced with such cases, the Supreme Court dispenses with the Pike balancing test and applies a virtual *per se* rule of invalidity.[111] Nowhere is this invalidating factor invoked more consistently than in cases involving natural resources. As the Court has said, "We need only consider the consequences if each of the few states that produce copper, lead, high-grade iron ore, timber, cotton, oil or gas should decree that industries located in that state shall have priority. What fantastic rivalries and dislocations and reprisals would ensue if such practices were begun!"[112] At the same time, since severance taxes have been justified as encouraging resource conservation, it should be noted that the Court has specifically recognized conservation as a legitimate state purpose, "similar to the States' interests in protecting

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exclude states from the patents and copyright field); City of Burbank v. Lockheed Air Terminal, Inc., 411 U.S. 624 (1973) (local control of take-off hours conflict with provisions of the Federal Aeronautics Act).

110. C. DUMARS & L. BROWN, *supra* note 15, at 66.

111. *E.g.* Hughes v. Oklahoma, 441 U.S. 322 (1979). State law forbidding transportation of natural minnows out of state for sale, subjected to strict scrutiny and held repugnant to commerce clause because rather than a less intrusive means of conservation, "Oklahoma has chosen to 'conserve' its minnows in the way that most overtly discriminates against interstate commerce." *Id.* at 338.

112. H.P. Hood & Sons v. DuMond, 336 U.S. 525, 538-39 (1949).

the health and safety of their citizens."[113] The Court has generally upheld non-discriminatory conservation measures and has said that when conservation is involved, "the national interest and the interest of producing states may well tend to coincide."[114]

These cases again underscore the value of establishing articulate state policy rationales to support resource taxation. States are reminded that the establishment of a tax is a rule-making procedure in administrative law, a fact that has not escaped the attention of the Supreme Court. The modern balancing tests take many factors into consideration, not the least of which may be the reasonableness with which a state acts. For example, in two recent cases the Supreme Court upheld state statutes that were aimed at ameliorating complex social problems but which resulted in obviously discriminatory impacts on interstate commerce.[115] In both cases, the Court showed a marked deference to the state legislature and remarked favorably on the rational and coherent way in which the legislation had been developed. Both statutes had been enacted only after a relatively thorough process involving special studies and market surveys, legislative hearings and, in one case, a special veto hearing before the governor. This process obviously persuaded the Court that the states were acting upon legitimate concerns and not solely to advance their own economic interests. The cases indicate that a well-reasoned legislative process may be the state's best assurance of success against commerce clause challenge. Not only can such a process favorably impress the Court, but it is likely to result in a comprehensive factual record which can then be used to establish each element of the modern balancing tests.

The development of a full and complete factual record is an essential tactic, but one that is perhaps not readily apparent to the states. This is because severance taxpayers are precluded by federal statute from bringing suit initially in federal court.[116] The challenge must be heard in the courts of the tax-imposing state, and there the judges tend to be more sympathetic to the state's position. For this reason, the easiest tactics available to the state are motions to dismiss for failure to state a claim upon which relief can be granted and motions

113. Hughes v. Oklahoma, 441 U.S. 322, 337 (1979).

114. Cities Service Gas Co. v. Peerless Oil & Gas Co., 340 U.S. 179, 188 (1950).

115. Exxon Corp. v. Governor of Maryland, 437 U.S. 117 (1978) (state statute requiring vertically integrated oil companies to divest themselves of their retail operations); Hughes v. Alexandria Scrap Corp., 426 U.S. 794 (1976) (state bounty to scrap processors for destruction of vehicles formally titled in Maryland; proof of ownership lower for in-state processors).

116. *See* 28 U.S.C. § 1341 (1976).

for summary judgment. This is precisely what happened in the Montana coal severance tax case. The Montana District Court granted the state's motion to dismiss and, consequently, a full factual record was never developed. The omission could prove fatal to the state's case if the United States Supreme Court agrees to hear the case. States would be much more prudent to anticipate Supreme Court review and bolster their defense with as comprehensive a factual record as possible, in addition to being prepared to meet the legal standards of the modern balancing tests.

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