HB
728

"An Act relating to state oil and gas leases."

COMMITTEE REPORT

HOUSE

2/11/76

Mr. Speaker: Date 4-21-76

The Committee on RESOURCES has had HB 728 under consideration. A Majority of the members of the Committee

( ) recommends it DO PASS

( ) recommends it DO NOT PASS

( ) recommends it DO PASS WITH ATTACHED AMENDMENT(S)

(X) recommends it BE REPLACED WITH CS FOR HB 728 AND THAT CS FOR HB 728 DO PASS

( ) "and" recommends it BE REFERRED TO THE ______ COMMITTEE

( ) reports it back WITHOUT RECOMMENDATION

( ) "other"

Members signing the Majority report:

[signature]

[signature]

Members NOT concurring in the Majority report:

______ recommends:

______ recommends:

______ recommends:

______ recommends:

______ recommends:

[signature] Chairman

AGO 935627

Bristol Bay Native Corporation 445 E. 5TH STREET / ANCHORAGE / ALASKA 99501 / PH. (907) 277-9511

March 2, 1976

The Honorable Nels A. Anderson, Jr.
Alaska State House of Representatives
Pouch "V"
Juneau, AK 99801

Dear Nels:

I do not have a position of HB 728, which you cosponsored, however I do have a few comments that may be useful in your deliberations next week.

First of all, it appears the bill was written for only one case, that is, Prudhoe Bay, TAPS, and a propsed Trans-Alaska gas line. Since the bill only applies to new leases, I see a few problems in other remote presently unleased areas of Alaska. Also, I see a lot of harassment and potential litigation from (t) (4 and 5).

The state could shut-in a field (oil or gas or both) where there were no pipelines or other transportation facilities to alleviate the supply problems in some other part of Alaska while notices, hearings, etc. were held before granting an exemption.

In some instances (Alaska Peninsula) a field could involve State, Federal and Native lands. It certainly would not be practical to shut-in the portion of the field. This would not be a sound conservation practice and could well result in a waste of the states resources as well as revenue.

Historically, gas sales have been long term, otherwise the transportation, distribution and manufacturing facilities could not be financed. This being the case, the state may well be entering an area where unintentionally they are retarding development within the state, which I am sure was not the original intent of the bill.

Actually, what I think you may be striving for is some mechanism that applies only to the states future oil and gas royalty to supply local demand before export. Since this bill does not apply to any of the present oil or gas field and under the terms of the leases, the state can take its royalty oil or gas "in kind" there seems to be no great problem. There is however, a problem for the industry to finance new plants of any type in Alaska as long as there is a threat of shutting-in a field or the portion of a field on state leases.

AGO 935628

As a matter for thought, consider the situation in California for the past several years where production lagged far behind refinery capacity. What if California had passed a law banning export of refined products until notices and hearings were held?

Very truly yours,

BRISTOL BAY NATIVE CORPORATION

W. C. Bishop

W.C. Bishop
Petroleum Consultant

DEPARTMENT OF COMMERCE & ECONOMIC DEVELOPMENT

TO: APC DATE: 2/11/76

(~~SENATE~~ - HOUSE) BILL 728

RE: state oil & gas leases

Check One:

1. TOP PRIORITY - in favor of X
2. FAVOR - in favor of, but not top priority
3. OK - no definite stand
4. NOT IN FAVOR
5. TOP PRIORITY - "Strongly Opposed"
6. BILL DOES NOT PERTAIN TO DIVISION
7. Bill does not directly pertain to division, but I am interested in its progress. Keep me informed.

COMMENTS: (Justification must be stated for #1 - #6 above. Continue on another page if needed).

In concept HB No. 728 appears to be wise legislation in that it would require the state to take a hard look at Alaska's need for oil and gas resources within the state before granting leases. Of course, any discussion of local consumption must take into consideration the cost of producing the resource and, more importantly, the cost of transporting it to the place of consumption (usually via pipeline).

It is not clear to the Commission, however, as to whether or not its determination of "existing need," as specified in the bill (p. 1, line 15), would satisfy the real intent of the legislature without some due consideration given to future need. Assuming rather constant growth in the state for the forseeable future, those resources which are in excess of present needs may very well be critical to future needs. I am referring here not to the overall availability of gas and oil in the state, but to the future

AGO 935630

Writer's Signature: [signature]
Writer's Title: Chairman

(Note: Please return to Information Officer/Leg. Asst., Office of the Commissioner)

(DEADLINE 24 hours)

cost of producing a given resource and transporting it to the point of consumption and the ultimate price which must be paid by the consumer.

Another suggestion to further strengthen the bill is that a new subsection (v) be added. This would incorporate the concept that an examination by the Commission be conducted, consistent with due process of law, of projected transportation costs for the resource encompassed by a proposed lease (including capital costs, operating costs and rates) in order for the state to gain a reasonable understanding of the expected impact on wellhead values and the ultimate royalties and taxes anticipated prior to granting the lease. The state could then force producers to develop hard figures on transportation costs to be carefully scrutinized by the Commission to insure the protection of Alaska's interest. This may be an effective means of controlling cost overruns such as we have experienced on the TAP system.

AGO 935631

at least

[line - 25 Consisting of members of oil industry, timber industry, fishing, mining industry, environmental interest groups, transportation]

Line 9 1,000,000 —

Fackler

O.K. Gulbrath — Texas Legislature - No problem because of Marketing, transportation.

Alaska - Limited Transportation - Refining - Leaves no alternative for refining w/in the state. Any operator would have to construct a refinery to market the gas.

Bill does not define who is responsible to enforce or transport oil & gas.

AS 31 Pipeline Comm does not have the expertise to carry out the function of the bill.

No requirement that there must be a way to get to the place it is needed. Nor how.

— Low demand for oil & gas due to small population.

industry probably wouldn't want to bid with this provision.

— Too many people would have to review the leases

Mandatory phrase is

who would make that determination

HB 728 40,000 barrels per day —

150,000 barrels per day in royalty at 1.2 million per day through the pipeline

impermissible burden on interstate commerce.

→ Standards set

If the needs are shown within the state the Commissioner may require it be refined within the state.

AGO 935632

problems trying get ride of 180,000 barrels of refined oil per day.

Standards of practicality -

AGO 935633

ALASKA STATE LEGISLATURE

MEMORANDUM

March 19, 1976

TO: Senator John Huber

FROM: Franklin D. Fleeks
Tax Counsel

SUBJECT: Legal Analysis in Support of SB 525 and HB 728
"An Act relating to state oil and gas leases."

Introduction

Many of the large oil and gas producing states have found themselves in a quandry. Because the oil and gas resource found on their state lands have previously been contracted for, in this time of shortage, the states cannot divert their oil and gas to the needs of their citizens. In order to avert this situation, SB 525 and HB 728 added new subsections to AS 38.05.180. (Copies of the bills are attached). The new subsections also give the Alaska Pipeline Commission the authority to determine, after notice and hearing, that the oil or natural gas is not required for intrastate use.

Industry' Position

The oil and gas industry does not agree with the new subsections. If the bills are passed, the industries' protest will probably be in the

AGO 935634

nature of a court case. The principal argument would be " . . . that the legislation would be an unconstitutional interference with interstate commerce, in violation of the Commerce Clause (Art. I, Sec. 8, clause 3) of the United States Constitution . . ." (see copy of letter attached) Two of the principal cases relied upon would be: (a) West v. Kansas Natural Gas Co., 221 US 229, 55 L.ed. 716, 31 S.Ct. 564, (1911) and (b) Commonwealth of Pennsylvania v. State of West Virginia, 262 U.S. 553, 67 L.Ed. 1117, 43 S.Ct. 658 (1923).

In West, a 1907 Oklahoma statute attempted to prohibit gas pipeline construction and transportation to only domestic corporations whose charters provided that the gas was only to be transferred to points within Oklahoma. The statute was held unconstitutional as interference with interstate commerce. The second case, Commonwealth of Pennsylvania, also involved natural gas. West Virginia passed a statute limiting the sales of natural gas from its wells to neighboring states. The case stated:

> ". . Natural gas is a lawful article of commerce, and its transmission from one state to another for sale and consumption in the latter is interstate commerce. A state law, whether of the state where the gas is produced or that where it is to be sold, which by its necessary operation prevents, obstructs, or burdens such transmission, is a regulation of interstate commerce - a prohibited transaction. . . "

If we stopped at those cases, then industries' position would be unassailable. However, the two cases mentioned above are not determinative.

Analysis in Support of SB 525 and HB 728

The new subsections are valid as an exercise of the state's police powers. The exercise of police power by a state is aimed at the conduct, activities and operations of people within the state in the interest of the health, welfare, and safety of the people of the state in general. The point was succinctly stated in Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 4 L.Ed. 2d 852, 80 S.Ct. 813 (1960):

> ". . . In determining whether the state has imposed an undue burden on interstate commerce, it must be borne in mind that the Constitution when 'conferring' upon Congress the regulation of commerce . . . never intended to cut the states off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country. Legislation, in a great variety of ways, may affect commerce and persons engaged in it without constituting a regulation of it, within the meaning of the Constitution . . ."

Later in the case the Supreme Court stated: " . . . State regulation based on the police power, which does not discriminate against interstate commerce or operate to disrupt its required uniformity, may constitutionally stand . . ."

To help interpret the impact of state regulations on interstate commerce the Supreme Court has formulated two tests. The tests are:

(a) Subject matter test -- If the subject matter of the state regulation does not require a single uniform rule, but rather is of local concern and permits diverse regulation, then the state regulation is generally valid.

(b) Balancing test -- (most frequently used) In each particular case, the Supreme Court will determine the extent of the burden on

AGO 935636

interstate commerce imposed by the state regulation in terms of difficulty, cost of compliance and the inefficiency involved. It will weigh this against the strength and merit of the state interest in the regulations.

The balancing test was used in Cities Service Gas Co. v. Peerless Oil and Gas Co., 340 U.S. 179, 95 L.Ed. 190, 71 S.Ct. 215 (1950). The case involved the state fixing a rate for transportation of gas. Ninety percent of the gas was consumed outside of the state. The Supreme Court held the following:

> ". . . It is now well settled that a state may regulate matters of local concern over which federal authority has not been exercise, even though the regulation has some impact on interstate commerce . . . The only requirement consistently recognized has been that the regulation not discriminate against or place an embargo on interstate commerce, that it safeguard an obvious state interest, and that the local interest at stake outweigh whatever national interest there might be in the prevention of state restrictions. Nor should we translate the quiesence of federal power into an affirmation that the national interest lies in complete freedom from regulation. . ."

Review of new subsection (t) of the bills reveals that the categories set out are "aimed at the conduct, activities and operations of people within the state in the interest of the health, welfare, and safety of the people of the state in general." supra. There is an obvious state interest in providing for its citizens" needs from oil and gas from state lands before shipment in interstate commerce and that interest outweighs the national interest.

In Commonwealth of Pennsylvania, supra, which the industry cites, Justice Holmes wrote a vigorous dissent. That dissent is pertinent for

AGO 935637

Alaska's case. The bills regulate oil and gas before it enters the stream of commerce. The dissent states:

> ". . . The statute seeks to reach natural gas before it has begun to move in commerce of any kind. It addresses itself to gas hereafter to be collected and states to what uses it first must be applied. The gas is collected under and subject to the law, if valid, and at that moment it is not yet matter of commerce among the states. <u>I think that the products of a state, until they are actually started to a point outside it, may be regulated by the state notwithstanding the commerce clause</u> . . . (emphasis added) However, for the decision in the case referred to goes, it cannot outweigh the consensus of the other decisions to which I have referred and that seem to me to confirm what I should think plain without them, <u>that the Constitution does not prohibit a state from securing a reasonable preference for its own inhabitants in the enjoyment of its products even when the effect of its law is to keep property within its boundaries that otherwise would have passed outside</u> . . ." (emphasis added).

<u>Conclusion</u>

From the discussion above, the bills are constitutional. Any court case brought by the oil and gas industry can be contested with a more than even chance of winning. In this endeavor, Alaska is not alone. The second largest state, Texas, has a similar law. (See copies attached.)

Attachments

I. SB 525

II. HB 728

III. Letter to Rep. Brown from Monte Taylor, Exxon Lobbyist

IV. Texas statute Art. 5382f.

AGO 935639

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF REVENUE

OFFICE OF THE COMMISSIONER

POUCH S – JUNEAU 99811

February 24, 1976

The Honorable Nels Anderson
Chairman
House Resources Committee
Alaska State Legislature
State Capitol Building
Juneau, Alaska

Re: House Bill No. 728

Dear Mr. Anderson:

House Bill No. 728, an Act relating to state oil and gas leases was introduced in the House on February 11, 1976 and was referred to the House Resources Committee.

For the consideration of the House Resources Committee, I am enclosing a copy of a Fiscal Note and accompanying memorandum prepared by Mr. Thomas K. Williams, Director, Petroleum Revenue Division, Department of Revenue, Anchorage, Alaska.

If you or any members of the House Resources Committee have any questions on the material submitted, please telephone the writer and I will contact Mr. Williams in Anchorage for further information.

Very truly yours,

R. D. Stevenson
Special Assistant

Enclosure

cc: The Honorable Mike Bradner
Speaker of the House
Prime Sponsor - House Bill No. 728

Thomas K. Williams
Director
Petroleum Revenue Division
Department of Revenue
Anchorage, Alaska

AGO 935640

THE LEGISLATURE OF THE STATE OF ALASKA
FISCAL NOTE
Second Session - Ninth Legislature

I. REQUEST
Bill No. House Bill 728
Title: Act relating to state oil and gas leases
Requested by: Date:
Return Date Requested:
Agency: Revenue Program: Petroleum Revenue

II. FISCAL DETAIL
Budget Request Unit(s) Affected: Petroleum Revenue
A. EXPENDITURES: (Thousands of dollars)

	OBJECT	FY 76	FY 77	FY 78	FY 79	FY 80	FY 81
100	PERSONAL SERVICES						
200	TRAVEL						
300	CONTRACTUAL						
400	COMMODITIES						
500	EQUIPMENT						
600	LAND & STRUCTURES						
700	GRANTS, CLAIMS, ETC.						
	TOTAL	None	None	None	None	None	None

B. FUNDING: (Thousands of dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						

C. POSITIONS:

PERMANENT/TEMPORARY	/	/	/	/	/	/
MAN MONTHS (P./T.)	/	/	/	/	/	/

III. ANALYSIS (See Fiscal Note Preparation Instructions, Section III)

IV. ATTACHMENTS
See attached memorandum dated February 20, 1976 from Thomas K. Williams to R. D. Stevenson.

V. DATE: February 20, 1976 PREPARED BY: Thomas K. Williams

Original: Legislative Finance
cc: Budget and Management
Prime Sponsor (First Legislator Named)

H/S 50

AGO 935641

MEMORANDUM State of Alaska

TO: R. D. Stevenson
Special Assistant
Department of Revenue

DATE: February 20, 1976

FILE NO:

TELEPHONE NO:

FROM: Thomas K. Williams
Director
Petroleum Revenue Division
Department of Revenue

SUBJECT: House Bill 728

H.B. 728 would require that no oil or gas production from future leases enter interstate commerce without a finding by the Alaska Pipeline Commission that such oil or gas is not needed by in-state users. If in-state users needed some or all of such oil or gas, the lessee would be required by the lease to discriminate against Outside users in favor of in-state users. This may impermissibly burden interstate commerce and the view of the Attorney General should be sought as to the constitutionality of the bill.

The Petroleum Revenue Division would not be involved in the determinations to be made by the Alaska Pipeline Commission, and so no additional expense or funding is needed for the Division.

No tangible effects on Treasury can be seen, except conjectural effects on bonus bids offered to the State in future lease sales. The possibility of State control over interstate sales of production could dampen would-be bidders' enthusiasm.

TKW:dh

cc: Frederick P. Boetsch
Deputy Commissioner - Taxation

AGO 935642

CHAIRMAN:
NELS A. ANDERSON, JR.

STAFF ASSISTANT:
GUY VANDOREN

POUCH V
JUNEAU, ALASKA 99811

VICE CHAIRMAN:
TED SMITH

SECRETARY:
XXXXXXXXXXXXXXXXXXX
Ruth I. Allington
PHONE: 465-3715
465-3781

House Resource Committee

FRED BROWN ALVIN OSTERBACK DICK ELIASON LEO RHODE
MIKE HERSHBERGER LESLIE (RED) SWANSON JAMES HUNTINGTON

March 8, 1976

Mr. Avrum Gross
Attorney General
State of Alaska

Dear Mr. Gross;

I would like to ask your assistance in giving to the House Resource Committee a legal opinion on the constitutionality of the proposed leasing condition expressed in HB 728. We will schedule another hearing on this legislation as soon as these verdicts are in.

Thank you.

Nels A. Anderson, Jr.
NAA/ra

AGO 935643

STATE OF ALASKA

JAY S. HAMMOND, GOVERNOR

DEPARTMENT OF LAW

April 1, 1976

Representative Nels A. Anderson, Jr.
Chairman
House Resources Committee
State of Alaska
Pouch V, State Capitol
Juneau, Alaska 99811

Dear Representative Anderson:

You have asked for a legal opinion concerning the constitutionality of HB 728. This bill would require that all State oil and gas leases issued after the effective date of the bill contain terms and conditions to the effect that a lessee agrees not to sell oil or gas produced from the leasehold outside the state, unless the Alaska Pipeline Commission finds the oil or gas is not needed for specified in-state uses. HB 728 is substantially the same as a law adopted by the State of Texas in 1975. 1/

The principal constitutional question raised by this bill is whether it would impermissibly burden interstate commerce. It is an established principle of constitutional law that

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1/ The Texas Attorney General's Office advises that no applications have been made to the Railroad Commission for sales outside of Texas because the intrastate price of gas is presently much higher than the interstate price. The Texas Attorney General's office also stated that it had not conducted an analysis of the constitutionality of the Texas statute.

AGO 935644

states may not create regulatory schemes which place an unreasonable burden on interstate commerce. Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959); Southern Pacific Co. v. Arizona 325 U.S. 761 (1945). This is true even when the purpose of the state regulatory scheme is to preserve for the use of its own citizens a natural resource produced within the state. State statutes designed to keep natural gas within the boundaries of a producing state frequently have been declared unconstitutional. Pennsylvania v. West Virginia 262 U.S. 553 (1923) is illustrative of this point. In that case, West Virginia, which had a shortage of gas for intrastate uses, passed a law which required all natural gas pipeline companies doing business within the State to sell gas to customers in West Virginia if a demand existed before making sales to out-of-state customers. The Supreme Court summarized the issue in the case as follows:

> [T]he principal issue [is] whether a state wherein natural gas is produced and is a recognized subject of commercial dealings may require that in its sale and disposal, consumers in that state shall be accorded a preferred right of purchase over consumers in other states, when the requirement necessarily

AGO 935645

> will operate to withdraw a large volume of gas from an established interstate current, whereby it is supplied in other states to consumers there. 262 U.S. at 595.

West Virginia argued that the local needs of her citizens justified the state statute. The Court responded that under the Commerce Clause the "welfare of all the states" transcended that of any particular state, 262 U.S. at 599, and concluded the West Virginia statute impermissibly burdened interstate commerce. See also, West v. Kansas Natural Gas Co., 221 U.S. 229 (1911); Haskell v. Cowhan 187 Fed. 403 (8th Cir. 1911).

If HB 728 simply prohibited the sale of gas before local needs were satisfied, it would clearly violate the Commerce Clause. But the bill does not go that far. It only applies to sales by lessees of the State, and premises the sale restrictions on conditions in a lease agreed to by the lessee when the lease was signed. The issue, therefore, is whether a state may avoid federal constitutional limitations through the exercise of state contractual rights in turn derived from the ownership of leased land.

AGO 935646

Proprietary Action

Courts have recognized a distinction between state action premised on a contractual or proprietary basis and regulatory action taken as a sovereign. Thus courts have upheld a variety of state classification schemes respecting sales of public property, despite the fact that such classification schemes would likely violate the Equal Protection Clause or Due Process Clause if the scheme had been implemented as part of an overall state regulatory program. South San Joaquin Irrig. Dist. v. Neumiller, 42 P.2d 64 (Cal. 1935) (holding that the legislature was free to dispose of tax deeded lands in any manner it deemed appropriate; public auction was not required). Cf. State ex rel. LaFollett v. Reuter, 153 N.W.2d 49 (Wis. 1967) (finding constitutional a statute which authorized the state highway commissioner to sell public rights-of-ways to a specified non-profit corporation).

The proprietary or ownership theory of state action has also been used in the analysis of state statutes alleged to impose a burden on interstate commerce. In American Yearbook Co. v. Askew, 339 F.Supp. 719 (M.D. Fla.) aff'd 409 U.S. 904 (1972), a three-judge federal court upheld the constitutionality

AGO 935647

of Florida statutes and regulations which required that all public printing for the State of Florida be done in Florida. The court began its analysis by noting that:

> "Governments in the United States traditionally possess two kinds of power: one governmental or public, in the exercise of which it is a sovereign and governs its people; the other, proprietary or business, by means of which the government acts and contracts for the private advantage of its constituents and of the government itself.
> 339 F. Supp. at 721.

In Askew, plaintiff had argued that the Florida statute was subject to the Commerce Clause, but the court rejected this argument noting that in cases where the Commerce Clause did apply, the state statute "regulated private industry." The Court went on to state that "[t]rade regulations are clearly subject to the Commerce Clause restrictions, but statutes that merely specify the conditions of state purchases are not." 339 F. Supp. at 725. Accord, People ex rel. Holland v. Bleigh Const. Co., 335 N.E.2d 469 (Ill. 1975) (upholding the Illinois "Preference to Citizens on Public Works Projects" statute from a challenge that it imposed

AGO 935648

an undue burden on commerce); City of Phoenix v. Superior Court, 514 P.2d 454 (Ariz. 1973) (upholding an Arizona statute awarding a 5% preference on public works contracts to those who had paid state and local taxes for at least two years).

The doctrine of proprietary, non-sovereign state action, however, is not without limitations. For instance, a state could not decide to contract with individuals on the basis of their race, religion or political affilation, whatever the theory used to justify such action. Cf. Burton v. Wilmington Parking Authority, 365 U.S. 715 (1961); Robinson v. Florida, 378 U.S. 153 (1964); American Civil Liberties Union v. Board of Education; 55 Cal. 2d 167, 359 P.2d 45 (1961). While discrimination of this nature might be distinguished as a "special case," the theory has been employed in other cases that have concluded that state action, even though premised on the State's proprietary interest, nevertheless imposed an undue burden on interstate commerce. For it is generally recognized that a State "owns" wild game within its borders. Geer v. Connecticut, 161 U.S. 519 (1896). Nonetheless, the Supreme Court has concluded that if a state does not "exercise its full power" to prohibit all interstate shipments of wild game, but instead "permit[s] shipments to other states, it could not at the same time condition such shipments so as to burden interstate commerce." Toomer v. Witsell, 334 U.S. 385, 404 (1947); Foster Packing Co. v. Haydel, 278 U.S. 1 (1928).

AGO 935649

Other cases have reached similar conclusions. In a case contrary to the Askew decision previously discussed, a New York court found unconstitutional a state statute which required that all public works contracts contain a clause that stone used on the project be worked, dressed and carved within the state. People v. Coler, 59 N.E. 776 (N.Y. 1901); but see American Institute for Imported Steel v. City of Erie, 297 N.Y.S. 2d 692 (Sup. Ct. 1968). (suggesting that Coler was no longer the law in New York). In Haskell v. Cowhan, 187 Fed. 403 (8th Cir. 1911), a federal court held unconstitutional a state statute which prohibited interstate natural gas pipelines from crossing state highways, expressly rejecting the theory that a state's proprietary interest in its highways might provide a basis for the validity of the statute. Accord, West v. Kansas Natural Gas Co., 221 U.S. 229 (1911); State v. Stanolind Pipe Line Co., 249 N.W. 366 (Iowa 1933).

Application of the principles ennuciated in the above-cited cases to HB 728 is by no means clear. As one court has recently observed: "The line between propriety and governmental functions is by no means a precise one." Alexandria Scrap Corp. v. Hughes, 391 F. Supp. 46, 55 (D. Md. 1975). Moreover, the test of constitutionality will often require an imprecise balance of local interests against the national interest in interstate

AGO 935650

commerce. The Supreme Court reaffirmed this test very recently in Great Atlantic & Pacific Tea Co. v. Cottrell, ___ U.S. ___ (1976), 44 U.S.L.W. 4240 (Feb. 26, 1976), when it stated:

> Although the criteria for determining the validity of state statutes affecting interstate commerce have been variously stated, the general rule that emerges can be phrased as follows: 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 imposed on such commerce is clearly excessive in relation to the putative local benefits. Huron Cement Co. v. Detroit, 362 U.S. 440, 443. If a legitimate local purpose is found, then the question becomes one of degree. And the 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. Pike v. Bruce Church Inc., 397 U.S. 137, 142 (1970)." 44 U.S.L.W. at 4241.

AGO 935651

Cottrell in discussing the basic test, also emphasizes the importance of the availability of alternative state action. When a state could have achieved the same basic goal by choosing an alternative less burdensome on interstate commerce, it is likely the courts will find the State's more burdensome method unconstitutional.

CONCLUSION

We are unable to render an unqualified opinion either that HB 728 is constitutional or that it is unconstitutional. We can state, however, that we believe there is a better than even chance that the bill is constitutional. In our opinion, this bill if enacted into law would be similar to the Florida statute approved in the Askew decision discussed, supra. HB 728 is distinguishable from cases such as Haskell, supra on the ground that it uses the state's proprietary right to restrict the flow into interstate commerce of natural gas found only on state land whereas in Haskell Oklahoma attempted to use State proprietary interests to restrict the flows of all gas discovered within the state. HB 728 is distinguishable from Pennsylvania v. West Virginia on several grounds. First, the West Virginia statute would have required gas pipeline companies to discontinue sales to established interstate customers. HB 728 on the other hand, will require no withdrawal of gas from established customers

AGO 935652

Second, the West Virginia statute applied to all private gas pipeline companies in the state. HB 728 will apply only to producers who choose to purchase state leases. Gas discovered on federal lands or private lands is not subject to restrictions. Finally, the West Virginia statute essentially "changed the rules of the game" after interstate commerce had already been established. HB 728 by comparison lays the ground rules on which the State's lands may be leased and oil and gas discovered thereon eventually placed in interstate commerce.

On the other hand, HB 728 contains certain regulatory features, in that a hearing and findings by the Pipeline Commission are prescribed prior to permitting out of state sales. That procedure certainly indicates the exercise of regulatory (i.e. sovereign) power. A court might conclude that given the grey area between proprietary and sovereign state actions, for HB 728 as a whole the sovereign action predominates. Such a conclusion would probably lead to the invalidation of the statute.

We believe any modifications to HB 728 which would diminish the regulatory aspect of the bill would increase the probability of a court's finding it constitutional, and take the liberty of offering two suggestions. We believe a better way to accomplish the objective of HB 728 might be to authorize inclusion

AGO 935653

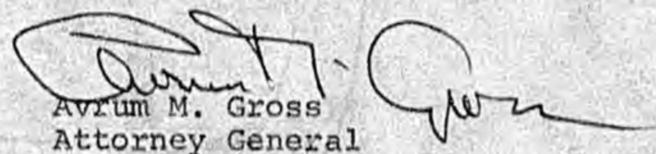
Nels A. Anderson
Representative

Page Eleven
April 1, 1976

in the State lease of a term which gives the State the option to buy all (or a portion) of the 7/8ths of the producers' gas. 2/ We believe this option would guarantee the availability of gas for in-state use with far less "regulation," and that there would be less question regarding its constitutionality. Cf. Honolulu Rapid Transit Co. v. Dolim, 459 F.2d 551 (9th Cir. 1972) (finding constitutional a provision in a franchise contract which gave the City of Honolulu the right to purchase the Honolulu Rapid Transit System, the purchase price not to exceed actual cost).

Should the committee find the alternative undesirable, we recommend that the authority to grant approvals for sales outside of the State be vested in the Commissioner of Natural Resources, rather than the Alaska Pipeline Commission, since the latter agency is a strictly regulatory body while the commissioner is responsible in both a sovereign and proprietary sense for state resources.

Yours very truly,



Avrum M. Gross
Attorney General

AMG:db

2/ This approach was adopted in New Mexico in 1972 by a regulation of the Mineral Leasing Board rather than by statute. Discussions with New Mexico officials indicate that as yet New Mexico has not exercised any of the options to buy.

AGO 935654

Portion of letter from Richard W. Schmude to
Frank L. Heard dated February 9, 1976

S.B. 525--which provides that the State may not issue oil and gas leases after the effective date of the legislation unless such leases contain provisions prohibiting the sale, etc., of oil or gas produced from the "mineral estates" subject to such leases for ultimate use outside of Alaska unless the Alaska Pipeline Commission, after notice and hearing, determines that such oil or gas is not needed to meet existing needs for fuel or raw materials per categories specified--if enacted, would present a constitutional problem, namely, that the legislation would be an unconstitutional interference with interstate commerce, in violation of the Commerce Clause (Art. I, §8, Cl. 3) of the U.S. Constitution. See West v. Kansas Nat. Gas Co., 31 S. Ct. 564 (1911); Commonwealth of Penna. v. State of West Virginia, 43 Sup. Ct. 648 (1923); Constitution of the United States of America, S. Doc. No. 39, 88th Cong. 1st Sess., pp. 279-282. The fact that the bill is to apply only to leases issued after the effective date of the legislation, and that the Alaska Pipeline Commission may grant exceptions thereto per specified standards, is of no particular moment here (although most important to 14th Amendment due process requirements).

In West v. Kansas Nat. Gas. Co., supra, the Supreme Court held that a 1907 Oklahoma statute--which prohibited gas pipeline construction and transportation except by domestic corporations, whose charters were to provide that the gas was to be transported only to points within Oklahoma and not to anyone engaged in transporting or delivering gas outside of Oklahoma, and granting to such domestic corporations the exclusive right of eminent domain and use of Oklahoma highways--was an unconstitutional interference with interstate commerce. What the Court there said is most revealing and apt to the instant situation (31 S. Ct. at p. 571):

> * * * It [the Oklahoma statute] does not alone regulate the right of the reduction to possession of the gas, but, when the right is exercised, when the gas becomes property, takes from it the attributes of property,--the right to dispose of it; indeed, selects its market, to reserve it for future purchasers

AGO 935655

and use within the state, on the ground that the welfare of the state will thereby be subserved. The results of the contention repel its acceptance. Gas, when reduced to possession, is a commodity: it belongs to the owner of the land; and, when reduced to possession, is his individual property, subject to sale by him, and may be a subject of intrastate commerce and interstate commerce. The statute of Oklahoma recognizes it 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. In other words, the purpose of its conservation is in a sense commercial,--the business welfare of the state, as coal might be, or timber. Both of those products may be limited in amount, and the same consideration of the public welfare which would confine gas to the use of the inhabitants of a state would confine them to the inhabitants of the state. 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. And why may not the products of the field be brought within the principle? Thus enlarged, or without the enlargement, its influence on interstate commerce need not be pointed out. To what consequences does such power tend? If one state has it, all states have it; embargo may be retaliated by embargo, and commerce will be halted at state lines. And yet we have said that "in matters of foreign and interstate commerce there are no state lines." In such commerce, instead of the states, a new power appears and a new welfare,--a welfare which transcends that of any state. But rather let us say it is constituted of the welfare of all of the states, and that of each state is made the greater by a division of its resources, natural and created, with every other state, and those of every other state with it. This was the purpose, as it is the result, of the interstate commerce clause of the Constitution of the United States. If there is to be a

For 728 file

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WESTERN DIVISION
PUBLIC AFFAIRS

March 11, 1976

NINTH LEGISLATURE -- SECOND SESSION

Honorable Fred Brown
Alaska State Representative
Pouch V
Juneau, Alaska 99811

Dear Representative Brown:

Attached is a legal analysis supporting our position on HB 728 (companion to SB 525) as requested by you on March 8, 1976. One other case of interest is Frost vs. RRC State of California, 46 S. Ct. 605 (1926).

Sincerely,

Monte Taylor

Monte Taylor

MT/ce
Attachment

cc: Nels Anderson
With Attachments

ALASKA
STATE LEGISLATURE

MEMORANDUM

March 19, 1976

TO: Senator John Huber

FROM: Franklin D. Fleeks
Tax Counsel

SUBJECT: Legal Analysis in Support of SB 525 and HB 728
"An Act relating to state oil and gas leases."

Introduction

Many of the large oil and gas producing states have found themselves in a quandry. Because the oil and gas resource found on their state lands have previously been contracted for, in this time of shortage, the states cannot divert their oil and gas to the needs of their citizens. In order to avert this situation, SB 525 and HB 728 added new subsections to AS 38.05.180. (Copies of the bills are attached). The new subsections also give the Alaska Pipeline Commission the authority to determine, after notice and hearing, that the oil or natural gas is not required for intrastate use.

Industry's Position

The oil and gas industry does not agree with the new subsections. If the bills are passed, the industries' protest will probably be in the

AGO 935658

nature of a court case. The principal argument would be " . . . that the legislation would be an unconstitutional interference with interstate commerce, in violation of the Commerce Clause (Art. I, Sec. 8, clause 3) of the United States Constitution . . ." (see copy of letter attached) Two of the principal cases relied upon would be: (a) West v. Kansas Natural Gas Co., 221 US 229, 55 L.ed. 716, 31 S.Ct. 564, (1911) and (b) Commonwealth of Pennsylvania v. State of West Virginia, 262 U.S. 553, 67 L.Ed. 1117, 43 S.Ct. 658 (1923).

In West, a 1907 Oklahoma statute attempted to prohibit gas pipeline construction and transportation to only domestic corporations whose charters provided that the gas was only to be transferred to points within Oklahoma. The statute was held unconstitutional as interference with interstate commerce. The second case, Commonwealth of Pennsylvania, also involved natural gas. West Virginia passed a statute limiting the sales of natural gas from its wells to neighboring states. The case stated:

> ". . Natural gas is a lawful article of commerce, and its transmission from one state to another for sale and consumption in the latter is interstate commerce. A state law, whether of the state where the gas is produced or that where it is to be sold, which by its necessary operation prevents, obstructs, or burdens such transmission, is a regulation of interstate commerce - a prohibited transaction. . . "

If we stopped at those cases, then industries' position would be unassailable. However, the two cases mentioned above are not determinative.

Analysis in Support of SB 525 and HB 728

The new subsections are valid as an exercise of the state's police powers. The exercise of police power by a state is aimed at the conduct, activities and operations of people within the state in the interest of the health, welfare, and safety of the people of the state in general. The point was succinctly stated in Huron Portland Cement Co. v. City of Detroit, 362 U.S. 440, 4 L.Ed. 2d 852, 80 S.Ct. 813 (1960):

> ". . . In determining whether the state has imposed an undue burden on interstate commerce, it must be borne in mind that the Constitution when 'conferring' upon Congress the regulation of commerce . . . never intended to cut the states off from legislating on all subjects relating to the health, life, and safety of their citizens, though the legislation might indirectly affect the commerce of the country. Legislation, in a great variety of ways, may affect commerce and persons engaged in it without constituting a regulation of it, within the meaning of the Constitution . . ."

Later in the case the Supreme Court stated: " . . . State regulation based on the police power, which does not discriminate against interstate commerce or operate to disrupt its required uniformity, may constitutionally stand . . ."

To help interpret the impact of state regulations on interstate commerce the Supreme Court has formulated two tests. The tests are:

(a) Subject matter test -- If the subject matter of the state regulation does not require a single uniform rule, but rather is of local concern and permits diverse regulation, then the state regulation is generally valid.

(b) Balancing test -- (most frequently used) In each particular case, the Supreme Court will determine the extent of the burden on

AGO 935660

interstate commerce imposed by the state regulation in terms of difficulty, cost of compliance and the inefficiency involved. It will weigh this against the strength and merit of the state interest in the regulations.

The balancing test was used in Cities Service Gas Co. v. Peerless Oil and Gas Co., 340 U.S. 179, 95 L.Ed. 190, 71 S.Ct. 215 (1950). The case involved the state fixing a rate for transportation of gas. Ninety percent of the gas was consumed outside of the state. The Supreme Court held the following:

> ". . . It is now well settled that a state may regulate matters of local concern over which federal authority has not been exercise, even though the regulation has some impact on interstate commerce . . . The only requirement consistently recognized has been that the regulation not discriminate against or place an embargo on interstate commerce, that it safeguard an obvious state interest, and that the local interest at stake outweigh whatever national interest there might be in the prevention of state restrictions. Nor should we translate the quiesence of federal power into an affirmation that the national interest lies in complete freedom from regulation. . ."

Review of new subsection (t) of the bills reveals that the categories set out are "aimed at the conduct, activities and operations of people within the state in the interest of the health, welfare, and safety of the people of the state in general." supra. There is an obvious state interest in providing for its citizens' needs from oil and gas from state lands before shipment in interstate commerce and that interest outweighs the national interest.

In Commonwealth of Pennsylvania, supra, which the industry cites, Justice Holmes wrote a vigorous dissent. That dissent is pertinent for

Alaska's case. The bills regulate oil and gas before it enters the stream of commerce. The dissent states:

> ". . . The statute seeks to reach natural gas before it has begun to move in commerce of any kind. It addresses itself to gas hereafter to be collected and states to what uses it first must be applied. The gas is collected under and subject to the law, if valid, and at that moment it is not yet matter of commerce among the states. I think that the products of a state, until they are actually started to a point outside it, may be regulated by the state notwithstanding the commerce clause . . . (emphasis added) However, for the decision in the case referred to goes, it cannot outweigh the consensus of the other decisions to which I have referred and that seem to me to confirm what I should think plain without them, that the Constitution does not prohibit a state from securing a reasonable preference for its own inhabitants in the enjoyment of its products even when the effect of its law is to keep property within its boundaries that otherwise would have passed outside . . ." (emphasis added).

Conclusion

From the discussion above, the bills are constitutional. Any court case brought by the oil and gas industry can be contested with a more than even chance of winning. In this endeavor, Alaska is not alone. The second largest state, Texas, has a similar law. (See copies attached.)

<u>Attachments</u>

I. SB 525

II. HB 728

III. Letter to Rep. Brown from Monte Taylor, Exxon Lobbyist

IV. Texas statute Art. 5382f.

AGO 935663

Look at language involved in establishing Critical Habitat areas.

3-8-76 HB 728 – Bradner Sign-off procedure in the leasing process
Recognition of the states needs.
Modeled ~~by~~ after Texas legislation – Suggested by Witherspoon.
adding the words "or future needs" ~~[illegible]~~ No objection from Bradner Would ~~strength~~ Strengthen the bill.

Smith – Moody report – In permissable section (be careful of)

Brown what about (sec v)
Take function completely way from Pipeline Commission
Why pipeline Commission vs Royalty Oil + Gas Board

Responsible Person for leases is the Commissioner of Commerce.
Important decision is who is going to make the decision of existing and/or future needs.

Gene Wilde Bids will be lower if this provision is added.
* "if the commission finds that there is a need w/in the State for existing then it is put in the lease.
Do not ~~put~~ require blanket coverage.

If the bill is continued in Committee get the A.G. opinion & Legislative Affairs Lawyer –

Monk Taylor EEXON – No official ~~opinion~~ opinion – But lawyers feel that it would Not survive Constitutional question.

West vs Nature 315 cr 1911
W. Virginia vs Penn. 43 Superior Court 648 –

Moody analysis: Louisiana had provision which was thrown out – and subsequently Changed.

AGO 935664