COTTON PETROLEUM CORPORATION v. NEW MEXICO, 109 S.Ct. 1698 (1989): THE INEXORABLE ZERO COMES TO INDIAN PREEMPTION ANALYSIS

TERENCE THATCHER
PIRTLE, MORISSET, SCHLOSSER & AYER

Presentation To The Third Annual Western Regional
Indian Law Symposium
University of Washington School of Law

September 23, 1989

Pirtle, Morisset, Schlosser & Ayer
1000 Second Avenue, Suite 1500
Seattle, WA 98104-1046
(206) 386-5200

COTTON PETROLEUM CORPORATION v. NEW MEXICO, 109 S.Ct. 1698 (1989): THE INEXORABLE ZERO COMES TO INDIAN PREEMPTION ANALYSIS

TERENCE THATCHER
PIRTLE, MORISSET, SCHLOSSER & AYER

I. INTRODUCTION TO THE CASE

A. Facts

Cotton Petroleum leases trust land and operates oil and gas wells on the Jicarilla Apache Reservation. To the tribe, Cotton Petroleum pays royalties, land rents and a 6% severance tax on the oil and gas production. The tribal severance tax was upheld in Merrion v. Jicarilla Apache Tribe, 455 U.S. 130 (1982). Cotton Petroleum has also been paying state oil and gas production taxes of about 8%.

B. The Litigation Below

Cotton challenged the state taxes in New Mexico state court. It did not argue that the taxes were preempted by federal law or policy. According to Cotton Petroleum, such an argument was foreclosed because the taxes had no economic impact on the tribe. Instead Cotton asked the court to invalidate the taxes under the Constitution's Commerce Clause. Cotton's theory: A state can impose taxes on non-Indian reservation activities only up to the level of dollars spent by the state providing services to the activity. Here the state purportedly provided yearly services worth $89,000 to Cotton but taxed it over $2 million.

The Tribe appeared as amicus. The Tribe and state argued preemption.

The New Mexico Court of Appeals upheld the tax because:

(1) it believed there was no requirement under the Commerce Clause that taxes equal services provided by the taxing authority; and

(2) there was no preemption by Federal law because Cotton had not shown that the taxes interfered with the Federal policy of promoting tribal economical development or adversely affected the Reservation or tribal economy. 745 P.2d 1170 (N.M. App. 1987).

II. THE SUPREME COURT'S OPINION (authored by Stevens, J.; dissent by Blackmun, Marshall, and Brennan)

A. 1938 Leasing Act

On appeal, Cotton Petroleum finally argued preemption and the Supreme Court judged the case, in part, on that issue.

To begin with, the Court considered whether Congress, in passing the 1938 Leasing Act, 25 U.S.C. § 396 et seq., had meant to foreclose state taxation on non-Indian lessees producing oil and gas on Indian reservations.

The 1938 Leasing Act was passed in an effort to bring uniformity to mineral and oil and gas leasing on all Indian reservations. In passing it, however, Congress did not bother to repeal the 1924 and 1927 Leasing Acts which had contained explicit grants of authority to the states to tax oil and gas production on reservations "in all respects the same as production on unrestricted lands." 25 U.S.C. § 398, 398c. In addition, the 1924 and 1927 Acts explicitly allowed states to tax the royalty interests of the tribes.

In the case of Montana v. Blackfeet Tribe, 471 U.S. 759 (1985), the Supreme Court (with White, Rehnquist, and Stevens dissenting), concluded that the silence of the 1938 Act should be interpreted to repeal the provisions of the 1924 and 1927 Acts permitting taxation of Indian royalties. The Court said that no such taxes could be assessed on royalties from any well leased under the 1938 Act.

In Cotton Petroleum, however, a new majority concluded that the 1938 Act's silence on the question of taxation should be interpreted to permit taxation of non-Indian oil and gas producers as provided by the 1924 and 1927 Acts. The Court first cited the general rule that, absent a Congressional prohibition (either explicit or implicit), states are permitted to tax non-Indian activity within Indian reservations. The majority held that the silence in the 1938 Leasing Act was insufficient to overcome that presumption. The Court also engaged in a lengthy discussion of the 1938 Act's legislative history which it felt supported its view.

B. Pre-emption By Other Federal Law Or Policy

Having concluded that Congress had not intended the 1938 Act to prohibit state taxation, the Court went on to consider the tax question under the broader preemption analysis employed in Indian cases. As a general matter, the flexible preemption test requires that a court engage in a "particularized inquiry" of the tribal, state and federal interest involved in the activity which a state seeks to tax or regulate. The test has been described previously by the Supreme Court as follows:

> "[T]he State jurisdiction is preempted by the operation of federal law if it interferes or is incompatible with federal and tribal interests reflected in federal law, unless the state interests at stake are sufficient to justify the assertion of state authority."

New Mexico v. Mescalero Apache Tribe, 462 U.S. 324, 333 (1983).

The Court in the past has not required explicit Congressional statements before it would find state authority preempted; preemption can be implied from legislative action. Further, the Court has looked not solely at Congressional action on a particular subject. It has also supported preemption by reference to general Congressional "policy" on Indian self-determination, federal regulatory law, and general executive policies supporting Indian self-determination and economic development. The importance of an activity to the Tribe involved -- often it is the Tribe's primary generator of revenue -- also weighs in the balance.

The Court has said that the states' interest in regulating or taxing is particularly weak where its tax or regulation is directed at values generated on a reservation (such as minerals, timber, wildlife) and is strongest when the tax or regulation is directed at off-reservation value that has been imported onto the reservation (such as cigarettes). Washington v. Confederated Tribes of the Colville Indian Reservation, 447 U.S. 134, 157 (1980); See also California v. Cabazon Band of Mission Indians, 107 S. Ct. 1083 (1987).

The majority in Cotton Petroleum referred to the general rule, although it ignored the Court's broadest declarations of the test. But the majority never engaged in a "particularized inquiry" into state, federal and tribal interests. Instead, its preemption analysis consisted almost wholly of a few pages in which it distinguished Cotton Petroleum's circumstances from those present in two previous preemption cases: White Mountain Apache Tribe v. Bracker, 448 U.S. 136 (1980) and Ramah Navajo School Board v. Bureau of Revenue of New Mexico, 458 U.S. 832 (1982).

According to the majority, Bracker and Ramah, (and Montana v. Crow Tribe of Indians, 819 F.2d 895 (1987), (summarily affirmed, 484 U.S. 997), were unusual and extreme cases. In Ramah and Bracker, it said, the state had absolutely no interest or involvement in the on-reservation activity. (Bracker, involved timber harvesting and BIA-constructed roads; Ramah Navajo considered the operation of Indian schools). In Cotton Petroleum, the state regulated the spacing and mechanical integrity of the oil wells.

Further, in each of the prior cases the tribes had proven that the tax had an adverse economic impact on them. By contrast, the lower court in Cotton Petroleum found no adverse economic impact. (Of course, the plaintiff had conceded that point at the outset).

The Court also dismissed Montana v. Crow Tribe, as a case involving "an unusually large state tax [that] has imposed a substantial burden on the Tribe," 109 S. Ct. at 1713 (emphasis added.)

The majority found significant that New Mexico provided "substantial services to both the Jicarilla Tribe and Cotton", costing the state approximately $3,000,000 a year. 109 S. Ct. at 1712. (It is not clear, in the Court's opinion, whether that

$3,000,000 is related solely to services affecting oil and gas production or all services provided to the reservation or its residents.) Once it had identified these substantial benefits flowing to the reservation, the majority held that a state need not show that the services it provides are exactly proportional to the taxes that it imposes on reservation activity.

In reaching its conclusions about preemption, the Court did not mention that the state only regulates spacing and mechanical integrity of wells with BLM approval. See, Blackmun dissent, 109 S. Ct. at 1723 n.9. It also gratuitously suggested that the fact that a tribe might obtain a lower return on its oil and gas because of state taxes was a mere "indirect effect" insufficient to justify a finding of preemption. 109 S. Ct. at 1713.

C. The Commerce Clause

The Court does not explicitly identify what Commerce Clause test it applies. It seems, at first, to utilize the normal four-part test for determining whether a state tax can pass scrutiny under the Interstate Commerce Clause. That test requires answers to the following questions:

> (1) Whether the activity taxed has a sufficient nexus for the state to justify a tax;
>
> (2) Whether the tax is fairly related to the benefits provided by the state to the taxpayer;
>
> (3) Whether the tax discriminates against interstate commerce; and
>
> (4) Whether the tax is fairly apportioned to local activities.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

Although it mentions all of these ideas in some fashion, the Court focuses on -- and rejects -- Cotton Petroleum's theory that taxes must equal services. Once a sovereign has jurisdiction to tax, its provision of services need not represent a strict quid pro quo. See Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 491, n.21 (1987); Commonwealth Edison Co. v. Montana, 453 U.S. 609 (1981).

The last question the Court answers, however, is whether a tribe shall be considered a state for purposes of the Interstate Commerce Clause restrictions on "multiple taxation" and its requirement of "apportionment." The Court's answer is an unequivocal "no". If that is the case, why did the Court bother to engage in any other Commerce Clause analysis at all?

According to the Court, an Indian tribe should not be treated as a state for two reasons: (1) the purposes of the Indian Commerce Clause are different than the purposes of the Interstate Commerce Clause, (the one was passed to provide Congress with plenary power to legislate in the field of Indian affairs and the other to maintain free trade among the states); and (2) because reservations lie within the external boundaries of states, tribes and states generally have "concurrent jurisdiction over the same territory", making it inappropriate to apply Commerce Clause doctrine. 109 S. Ct. at 1715.

The Court uses its seemingly unnecessary Commerce Clause analysis, however, to provide dicta that could prove inconvenient to tribes in the future. First, it repeats two or three times in different ways its theory that activity on reservations is generally subject to state and tribal "concurrent jurisdiction".

Of course, it is the assertion of concurrent jurisdiction that the Court has repeatedly rejected under the Indian preemption analysis. _See_, _e.g._, _New Mexico v. Mescalero Apache Tribe_, _supra_. In addition, in comparing the tax assessed to the services provided by the state, the Court asserts, "the relevant services provided by the state include those that are available to the lessees and the members of the tribe off the reservation as well as on it." 109 S. Ct. at 1714. The Court went on to say:

> The intangible value of citizenship in an organized society is not easily measured in dollars and cents; moreover, the district court found that the actual per capita state expenditures for Jicarilla members are equal to or greater than the per capita expenditures for non-Indian citizens.

_Id_.

Recall that the Court's discussion here relates solely to the Commerce Clause, not preemption. Should this same analysis be applied to preemption cases, however, implied federal preemption of state taxation on Indian reservations will be dealt a serious blow. (_See_ Part III. B. (1) _infra_.)

D. The Dissent

Justices Blackmun, Brennan and Marshall dissented. They considered that _Montana v. Blackfeet Tribe_ had answered the question about the meaning of the 1938 Leasing Act in favor of the tribes and their lessees.

The dissenters charged that although the majority gave lip service to the general rules of preemption in the Indian law context, it applied that doctrine in a fashion that made it almost unrecognizable. The dissenters concluded that a fair "particularized" inquiry into tribal, state and federal interests would support a finding that the taxes had been preempted.

They agreed with the majority's conclusion that tribes are not to be treated as states for purposes of the Interstate Commerce Clause but rejected the rest of the majority's analysis on the subject as unnecessary.

III. LESSONS AND IMPLICATIONS

Does Cotton Petroleum mark a major break from past Indian law preemption analysis? Or is it merely an aberration in a long string of tribal victories on preemption grounds? Tribes can hope to limit the decision to its facts, especially given the failure of the plaintiffs to show any economic harm to the tribe. In short, the case can still be distinguished and tribes can still win preemption claims. See Hoopa Valley Tribe v. Nevins, 881 F.2d 657 (9th Cir., July 28, 1989).

But if read to apply fairly broadly, the case substantially weakens the doctrine of preemption in the Indian law context and manifests the method the new Court majority will use to whittle away at tribal sovereignty. That method, and one not unknown to courts in other contexts, involves a refusal to rely on broad language from previous cases, (Bracker, and Ramah Navajo, for instance) and an insistence that previous pro-tribe cases be limited to the specific, narrow facts before the Court in each instance. It probably is of no little significance that Justices White, Rehnquist and Stevens all dissented in Montana v. Blackfeet. Now, with the replacement of Justices Powell and Burger, Justice Stevens may more often command a new majority, including himself and Justices White, Rehnquist, O'Connor, Scalia and Kennedy.

A. The Statutory Interpretation Of The 1938 Leasing Act

The Supreme Court's decision in Montana v. Blackfeet Tribe dealt only with the assessment of state taxes against tribal royalties. Despite the specific question asked, the answer the Court gave in Montana v. Blackfeet would seemed to have foreclosed the result in Cotton Petroleum. In Blackfeet, the Court concluded that if the permission to tax found in the 1924 Act "survives at all, it reaches only those leases executed under the 1891 Act and its 1924 amendments [not leases executed under the 1938 Act]." 471 U.S. at 767. According to the Court, "it is clear that the 1924 Act does not authorize Montana to enforce its tax statutes with respect to leases issued under the 1938 Act." 471 U.S. at 766 (emphasis added.) There is no indication in this broad language that the Court meant to limit its analysis to royalty taxes and permit taxes on the non-Indian lessee's incomes.

(The Blackfeet Court relied on the general goal of the 1938 Act of insuring that Indians receive "the greatest return from their property: to support its conclusion on preemption. 471 U.S. at 766 n.5. The Cotton Petroleum majority refused to credit that argument in its preemption analysis. 109 S. Ct. 1708-1709.)

Perhaps, given the different beginning points from which the Court viewed Blackfeet taxes and Cotton Petroleum taxes, the contradictory results were inevitable. In Blackfeet, the Court started with the premise that "the state may tax Indians only when Congress has manifested clearly its consent to such taxation . . . [and that] statutes are to be construed liberally in favor of the

Indians with ambiguous provisions attributed to their benefit . . . ." In <u>Cotton Petroleum</u>, the Court commenced its analysis on the precept that "[non-Indian] lessees operating on an Indian reservation [are] . . . subject to non-discriminatory state taxation as long as Congress [has] . . . not act[ed] affirmatively to preempt the state taxes." 109 S. Ct. at 1706. In <u>Cotton</u> the Court also took passing notice of the general guide for interpreting ambiguous statutes in favor of Indians, but the first rule seems to have overwhelmed it.

The dissenters quite effectively criticized the statutory interpretation employed by the majority in <u>Cotton Petroleum</u>. What seems clear enough is that Congressional action in 1938 is fraught with ambiguity. The Court had to choose between one of two premises, one in favor of states and one in favor of tribes. The majority's choice may indicate that traditional precepts of Indian law favorable to tribes no longer play such an important role in the Court's decisions.

B. What Is Left Of Preemption?

The Court's interpretation of the 1938 Leasing Act is unfortunate for tribes. It can easily be corrected by Congress, however, if the legislative branch wishes. What the Court may have done to the general rules of Indian law preemption is more disturbing.

(1) The Particularized Inquiry

In order to reach its result, the Court did not, in fact, balance the state, tribal and federal interests in light of the strong federal policy to enhance tribal economic development. Instead, the so-called "particularized inquiry" that previously formed the basis of preemption analysis has come down to what Justice Blackmun called the "inexorable zero." That is, once the state has shown that it has _any_ involvement with an on-reservation activity, no matter how much greater the federal and tribal involvement or interests, the state can tax. If that is to be the rule, then it raises very serious policy questions for tribes who have recently moved toward a more "cooperative" approach in their relations with states.

(2) Economic Impact

The Court also seems to have increased the tribes' burden to show interference with their economic interests. The taxes in _Bracker_ and _Ramah_ were less than five percent of value each, but the Supreme Court had no difficulty in concluding that they interfered with tribal economic self-sufficiency by reducing returns to the tribe or increasing costs to the tribe of engaging in certain activities. In _Cotton Petroleum_, the Court said that such small and "indirect" reductions in tribal revenues will not justify a finding of preemption.

The practical result could be that tribal efforts to increase revenues from resource development by imposing taxes on top of royalties may falter. The prices of most tribal resources are set in competitive markets. In such a setting, the price buyers are willing to pay will likely be discounted by nearly the amount of any additional tax the tribe would assess.

(3) Federal Regulation

Bracker and cases following it found significant federal involvement that "left no room" for state involvement on the basis of comprehensive federal regulations of the activity involved.

The regulatory involvement of the Interior Department in oil leasing is certainly no less comprehensive than its regulatory role in timber harvests which preempted state taxes in Bracker. Yet, these comprehensive federal regulations did not lead to the same result. Perhaps the Court will now concentrate more on Congressional acts than executive regulations.

And what of those circumstances in which there is no Congressional action and no comprehensive regulation of an activity, but merely its encouragement and approval by Interior Department? For instance, in California v. Cabazon Band, supra, one could not say (at least prior to the passage of Indian Gaming Act) that the federal government comprehensively regulated gambling on Indian reservations. But the Court found that federal interests in enhancing tribal economic activity were sufficient to overcome California's interest in controlling organized crime. At first blush, at least, California's concern appears to be more compelling than the vague state interests presented in Cotton Petroleum.

(4) The Nexus Between Taxes And Services

An important feature in virtually all previous preemption analysis has been the Court's demand that a state seeking to justify a tax must show that the tax proceeds are used to benefit or regulate the activity taxed. There must, in other words, be a nexus between the state's regulatory involvement on the reservation and the tax the state wishes to impose. See e.g., Ramah Navajo School Board v. Bureau of Revenue of New Mexico, supra (tax on school construction not justified where state benefits to a tribe "are [not] in any way related to construction of schools on the Indian land"); New Mexico v. Mescalero Apache Tribe, 462 U.S. 324, 342 (1983) (rejecting state hunting regulations and license fees on non-Indians on reservation despite state services to the tribe when "no services [the state] . . . has performed [are] in connection with hunting and fishing by non-members"). Cf. McClanahan v. Arizona State Tax Comm'n, 411 U.S. 165, 173 n.12 (1972) ("conferring rights and privileges on these Indians cannot affect their [tax immune] situation . . . .") The Court well summarized this rule in the Mescalero Apache case as follows: "[T]he exercise of state authority which imposes additional burdens on a tribal enterprise must ordinarily be justified by functions or services performed by the state in connection with the on-reservation activity." 462 U.S. at 336.

The Ninth Circuit dealt even more explicitly with this issue in Crow Tribe of Indians v. Montana (Crow Tribe II), 819 F.2d 895 (9th Cir. 1987), summarily aff'd 484 U.S. 997 (1988). In that case, the Ninth Circuit struck down a Montana state severance tax assessed against non-Indian operators of coal mines on the Crow Reservation. The Court invalidated the state taxes both because it considered the tax preempted by federal law and it concluded that the taxes infringed on the tribe's rights to self-government. The Court held that the taxes could not stand unless the state could show a "carefully tailored relationship between the severance tax revenues and the coal-related [state] services." 819 F.2d at 901-902.

In Cotton Petroleum, the Court did not explicitly abolish the nexus requirement. Some of its language carries disturbing hints, however. See 109 S. Ct. at 1714; Dissent, at 109 S. Ct. at

1724 n.10. The majority required no nexus in judging the taxes under the Commerce Clause.

California has indicated its intention to seek certiorari on the nexus issue in Hoopa Valley Tribe v. Nevins, supra. In that case, the Ninth Circuit adhered to the nexus standard, having been persuaded that Cotton Petroleum did not change that rule. As the Ninth Circuit obviously understood, if there need be no nexus between the activity taxed by a state and the state provision of services to reservation communities, then there will be few grounds upon which to stop almost any state tax on almost any non-Indian activity on Indian reservations. Most states do provide some services -- social services, education -- on many reservations simply because members of Indian tribes are also citizens of the United States. Without the nexus requirement, in other words, a state could tax tribal coal, oil, timber, water, or any other resource simply because it also funded a reservation Headstart program.

C. Lessons For Tribal Strategy

Cotton Petroleum's lawyer knows Indian law. But he represented a private firm, not the tribe, and the record made at the trial level continued to hurt the tribe all the way to the Supreme Court. If the exercise of sovereign power by a tribe is to be put at issue in court, the tribe risks much if it is not a full litigating party.

35-TLT1.16/COTTON.BRF
klb/090789