IN THE SUPREME COURT OF THE STATE OF OREGON

POWEREX CORPORATION,
Plaintiff-Respondent,

v.

DEPARTMENT OF REVENUE, State of Oregon,
Defendant-Appellant.

Tax Court
4800

S060859

APPELLANT'S REPLY BRIEF

Appeal from the Judgment of the Oregon Tax Court
The Honorable Henry C. Breithaupt, Judge

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I. "TANGIBLE PERSONAL PROPERTY" IS REASONABLY CONSTRUED TO INCLUDE ELECTRICITY FOR PURPOSES OF ORS 314.665 AND INCOME APPORTIONMENT BASED ON SALES.

The first issue in this case is whether sales of electricity are within the definition of "tangible personal property" for purposes of apportionment factor sourcing under ORS 314.665. This issue does not concern application of the UDITPA sales factor, but whether electricity as sold by Powerex on the Intertie grid has physical properties such that it is capable of being sensed (felt, tasted, seen, and heard), measured, weighed, and stored, under the commonly understood *Webster's* dictionary definition of "tangible personal property."

Powerex concedes that the drafters of UDITPA did not address this definitional question and they excluded electric utilities from the coverage of UDITPA. But, ironically, Powerex argues for UDITPA uniformity, asking this Court to look only at what it characterizes as UDITPA decisions, i.e., the two administrative law decisions from California and Massachusetts, which addressed sourcing of electric utilities' sales as "services."

Powerex claims that wireless electricity traveling through walls and virtual photon carriers having no mass preclude electricity from being tangible personal property under ORS 314.665. But wireless electricity and virtual photon carriers are not what Powerex sold. Professor Fajans' Report puts this in perspective: "It is

possible to transmit electrical energy in the form of radio waves or light without using electrons. Electrical energy can also be transferred through a capacitor or transformer without the use of electrons. However the primary mode of transmission of power over the electrical power grid relies on the flow and "pressure" of electrons. Radio waves and light are irrelevant to electrical transmission, and capacitors and transformers make up a small part of the transmission grid." Ex L, p 5, n 5. Thus, it is accurate to say that "without electrons, electricity cannot be transmitted on the [Intertie] electric power grid." *Id.* at p 5.[1] In fact, the WiTricity website—the website of Powerex's witness, Professor Peter Fisher—defines electricity as "the flow of electrons." Ex RR. Powerex did not comment on this impeachment of its witness' testimony in its answering brief.

[1] Powerex relies on the Tax Court's characterization of Professor Fajan's testimony. Ans Br, p 9, n 9. However, it was mischaracterized. In context, Professor Fajans merely agreed that individual electrons are not transferred from seller to buyer, which does not contradict all his other testimony, written and oral, that electric power as sold on the Intertie grid involves the flow of electrons, which have mass and matter, and it has physical properties. Statements made by Professor Fajans in Recross Examination by Mr. Coffill and the court are illustrative of his testimony. *See* Tr 336-349. Powerex sells energy, which is power consumed over time (Ex LL, p 2), to its purchasers, specifically in quantities of Megawatts per hour (MW/hr). *See, e.g.,* Confidential Stip Ex 18, pp 15-16.

Assuming that uniform treatment of electricity sales by the states is a valid goal, this Court's approach in *Atlantic Richfield v. Dept. of Revenue*[2] (*ARCO*) instructs that we should look at taxing authorities' treatment currently. The department and Powerex introduced these facts for years 1998 - 2007 in a national survey, the CCH Multistate Tax Guide. Stip Ex 17. Instead, Powerex argues that the universe of uniformity consists of two administrative decisions from seven-ten years ago and the MTC's 1992 Audit Guidelines.[3] Powerex's approach ignores Illinois Supreme Court's *Exelon*[4] decision and the current version of the MTC Audit Guidelines, which deleted the language Powerex relied on from the old version. The current version was submitted to the Tax Court with defendant's post-trial brief, and is publically available on the MTC website.[5]

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[2] 301 Or 242, 722 P2d 727 (reconsideration) (1986).

[3] Contrary to Powerex's repeated references to the "MTC view" and "MTC position," the MTC has never adopted a regulation concerning electricity or the definition of tangible personal property for income and excise tax purposes.

[4] 234 Ill2d 266, 917 NE2d 899 (2009).

[5] http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Audit_Program/Resource/MTC%20IFTAM%20PUBLIC%20DRAFT(2).pdf

Powerex's myopic view of *ARCO* would bar this Court from looking at any case regarding electricity as tangible personal property that is outside their "uniform" framework just because *ARCO* involved a narrow issue that could only arise in one way: Should IDCs be included as part of "original cost?" By contrast, whether electricity is tangible personal property has been considered in a variety of contexts. Indeed, Powerex relies on California (*Pacificorp)* and Massachusetts (*EUA*) administrative decisions that relied on the *Otte* product liability case.

Moreover, "decisions" from other states may not be the best indicator of uniformity. A paucity of decisions may indicate merely a lack of controversy,[6] when in reality all states' taxing authorities other than California and Massachusetts could be treating electricity as tangible personal property for purposes of the income tax sales factor—without objection from taxpayers. The CCH Multistate Tax Survey indicates many states are doing so (the current 2013 numbers correlate to those reported for 2007). Stip Ex 17.

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[6] Powerex makes the same error in reviewing only "decisions" concerning "delivery" versus "ultimate destination," as discussed below. Also, those decisions acknowledge that the particular state had not adopted UDITPA, but merely patterned language after portions of it. Inconsistently, for electricity uniformity, Powerex insists on only "UDITPA state" decisions, to the exclusion of Illinois, which has patterned language after UDITPA. As observed in our opening brief, "UDITPA-ness" is a fluid concept.

Powerex's trial position that its sales of electricity must be "intangible" property because virtual photons are not matter is completely inconsistent with Powerex's documents prepared for non-trial purposes and its witness's testimony. First, pages 2-3 of Exhibit R shows a list of Powerex's "Physical deliveries" of electricity in Oregon, as compared with its bookout transactions. A "physical delivery" indicates a tangible property item. Second, Powerex's witness, Lisa Hopkins, testified that each sale must be scheduled with BPA for transmission. E.g., Tr 25:1, 29:11, 34:18, 35:19, 41:2, 44:18, 49:25, 56:15, 69:11, 83:9, 84:22, 97:15-17, and 104. Third, Exhibit M contains documents provided by Powerex to the department, including a May 2001 article entitled "Pacific Intertie: The California Connection on the Electron Superhighway." In that article (Ex M, p 8) is a Table showing the "Net Transfer to the Southwest in Average Megawatts" and the "Energy Equivalent in Billion Cubic Feet of Natural Gas" for years 1986 – 2000. In describing the West Coast Power Crisis, the article describes "shortages," "battles of supply and demand," "shipping power south" to meet the demand. Ex M, p 4. These were physical shortages that could not be met with "intangible" property. Fourth, the department's witness, Steven Fisher (as well as Powerex's Lisa Hopkins) described the losses of electricity that occur in transmission. *See, e.g.*, Tr 420-421. Some of these exhibits and testimony, and many other illustrations of the physical nature of electricity as sold by Powerex on the Intertie grid in Oregon, were

discussed in the department's opening brief at pages 32-35. Powerex's only response is "virtual photons are not matter" and Oregon must be uniform with two other states' administrative decisions.

The Tax Court was presented with two approaches to determine the meaning of "tangible personal property"—particle physics and tactile sensory perception—and incorrectly chose the former, notwithstanding that Powerex presented no rebuttal evidence (Tr 421) to refute Professor Fajans' demonstrations showing electricity can be weighed, measured, felt, seen, tasted, stored, and heard.

II. CONTRACTUAL POINT OF DELIVERY IN OREGON EQUATES TO DELIVERY TO A PURCHASER WITHIN OREGON UNDER ORS 314.665(2)(a).

For purposes of sourcing sales of tangible personal property to apportionment Powerex's business income, the question for this Court is how the text of ORS 314.665(2)(a) should be construed:

> (2) Sales of tangible personal property are in this state if:
> (a) The property is delivered or shipped to a purchaser, other than the United States Government, within this state regardless of the f.o.b. point or other conditions of the sale;

The department interprets this language as saying that sales are in this state if the property (natural gas and electricity) is delivered to a purchaser in Oregon, rather than looking to the state of ultimate destination, i.e., the state in which that purchaser or a subsequent purchaser makes a final retail sale to a consumer.

A. Distinguish "Dock Sale" Cases and Ultimate Destination[7]

Powerex contends cases from other jurisdictions support their "ultimate destination" theory of sourcing for the natural gas and electricity sales at issue in this case and should be followed by this Court. They argue that these cases preclude sourcing sales of tangible personal property to Oregon if the "delivery or shipment [is not] to a purchaser's business location within Oregon" even where the ultimate destination is unknown. *Cf.* ORS 314.665(2)(a). However, closer examination of these cases shows how little they support this theory, particularly for sales of natural gas and electricity.

The first case came from Florida. *See Department of Revenue v. Parker Banana Co.*, 391 So2d 762 (Fla App 1980) (*Parker Banana*).[8] The Florida Department of Revenue argued that "within the state" applied to "delivery," but not to "shipped to," which the majority opinion found to be logically and grammatically

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[7] "Dock sale" describes a sale of merchandise that is picked up by the purchaser at the seller's "dock" or in-state warehouse and then driven to a location out-of-state, as discussed below.

[8] Powerex lists one earlier decision from six months prior to *Parker Banana*: *Dupps Company v. Lindley, Tax Commr.*, 62 Ohio St2d 305, 405 NE2d 716 (1980). But this case is not on point because the court held the customer's pickup of machinery parts for transport out of state was not an Ohio sale based on different statute language: "the place at which such property is ultimately received after all transportation has been completed shall be considered as the place at which such property is received by the purchaser."

impossible. *Id*. at 763. The taxpayer argued that it, as an out-of-state purchaser who merely took delivery of bananas in Florida, should not be required to source the sale of those bananas to Florida. The Florida court resolved the ambiguous placement of the phrase "within the state" in favor of the taxpayer's "destination" theory and against the "delivery" position of the department.[9] The *Parker Banana* court states that it found no authority, and neither party had cited any, addressing what the words "within the state" refer to. The court surmises that the lack of authority probably results from the fact that the issue simply does not arise where apportionment is permitted only to a truly multistate business or the throwback rule is adopted (Florida had not adopted this rule), such that the "statutory language barrier" facing the department may very well be unique to Florida. *Id*. at 764. The well-reasoned dissent points out that no "shipping" facts are before the court so the majority should have ignored that and focused on the literal language in the statute, which simply requires sourcing a sale to Florida if the goods are delivered to a purchaser at any location in Florida. *Id*. at 766. The dissent also observed that the state is concerned only with the seller's income and the state cannot afford the entirely unmanageable

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[9] Florida had not adopted UDITPA, but had adopted its language for sourcing tangible personal property sales without the United States government clause. *Id.* at 762. Florida withdrew from the MTC Compact in 1972 because they did not want to apply certain UDITPA provisions, such as the equal three-factor weighting.

task of knowing the subjective intentions of all purchasers. *Id*. at 767. Notwithstanding its weaknesses, the majority's holding became "precedent setting."

Other "dock sale" cases followed *Parker Banana*. *See Olympia Brewing Co. v. Comm'r of Revenue,* 326 NW2d 642 (1982) (deciding the sales were not Minnesota sales, the court observed that the fatal weakness in the commissioner's position is his treatment of sales differently based on the mode of transportation—whose truck does the transporting); [10] *Strickland, Com'r v. Patcraft Mills, Inc.*, 251 Ga 43, 302 SE2d 544 (1983)[11] (court decided destination test correctly recognizes the contribution by a consumer state to the realization of corporate income, and acknowledges that 'the process of manufacturing [results] in no profits until it ends in sales,' *Bass v. State Tax Commission*, 266 U.S. 271, 282, 45 S. Ct. 82, 84, 69 L. Ed. 282 (1924)); *Pabst Brewing Co. v. Wisconsin Dept. of Revenue*, 130 Wis2d 291,

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[10] The Minnesota court notes that weight should be given the MTC's amicus brief statement that no tax administrators have construed or implemented the sales factor definition differently than the position taken by the tax commissioner in this case, but rejected it because the MTC cited only administrative decisions from Pennsylvania and California, whereas Olympia Brewing cited the *Parker Banana* court decision. *Id.* at 646.

[11] Powerex cites another 1983 decision, but the case is distinguishable because there was no "sale." *See Lone Star Steel Co. v. Dolan, Dir. Dept. of Revenue*, 668 P2d 916 (1983) (alleged purchaser was mere intermediary who transformed pipe physically before shipping to actual out-of state purchaser, so there was no "delivery" and the transaction between taxpayer and intermediary was not a "sale" for Colorado income tax purposes).

387 NW2d 121 (1986) (court's circular rationale bases its conclusion on the contrary legislative intent expressed in the same statute it determined was ambiguous, and cites no cases in support); *Texaco, Inc. v. Groppo, Comm'r of Revenue*, 215 Conn 134, 574 A2d 1293 (1990) (distinguishable because it involves gross earnings tax on sale of petroleum products, which were marketed and distributed in states other than Connecticut, which is more consistent with department's "delivery" interpretation); *McDonnell Douglas Corp. v. Franchise Tax Board*, 26 Cal App 4th 1789 (1994)[12] (the purpose of UDITPA—rather than the literal language of the statute—requires sourcing to the destination state instead of the state where airplanes were delivered, citing Keesling & Warner, *California's Uniform Division of Income for Tax Purposes Act* (1968) 15 UCLA L. Rev. 655, 671, and Reich, *Dock Sales-The New State Income Tax Battleground* (1982) 1 J. St. Taxation 42, 43 ("the drafters… made a deliberate policy decision to recognize the contribution of the 'consumer' states to the production of income by allocating sales to those states that produce the buyer")); *Revenue Cabinet v. Rohm and HAAS Kentucky, Inc.*, 929 SW2d 741 (1996) (involving transfer of products to out-of-state parent company from in-state subsidiary; but in Oregon a subsidiary-parent sale transaction would be eliminated

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[12] *Cf. Appeal of Mazda Motors of Am. (Cent.), Inc.*, No. 94-SBE-0009, Cal St Bd of Equaliz, Nov 19, 1994 (sales receipts for vehicles stores, assembled, serviced, and repaired in California and subsequently shipped to Texas are California sales; *McDonnell Douglas* distinguished as involving "dock sales").

from income and the sales factor under consolidation rules (ORS 317.715)); and *Commonwealth of Pennsylvania v. Gilmour Manufacturing Co.*, 573 Pa 143, 822 A2d 676 (2003) (involving in-state dock sales, the court construed slightly different language: "if the property is delivered or shipped to a purchaser, within this State regardless of the * * *," concluding that the Commonwealth's regulation, which provided that sales of tangible personal property are in the state in which delivery to a purchaser occurs, was inconsistent with the plain language of the statute as interpreted by other states, citing decisions discussed above, Pennsylvania Chamber of Business and Industry's amicus brief, and concern that the sales factor would be artificially inflated by sales to non-Pennsylvania customers—sales at issue were made to certain out-of-state customers who preferred to drive their own trucks to the in-state manufacturing dock to pick up their lawn and garden products—had they elected to receive them via common carrier instead, the sales would not be Pennsylvania sales under the Commonwealth's "delivery" regulation). [13]

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[13] Powerex's citation of a 1995 Tennessee Department of Revenue Ruling (expressly "not binding" on that department) and the Alabama administrative law order (PACCAR, Inc. v. Dept. of Revenue, Docket No. Corp. 04-715) similarly address "dock sales." Alabama used the "destination" rule to include an out-of-state truck manufacturer's sales via third-party truck carrier to Alabama dealers in its sales factor numerator. However, had the ALJ viewed the third-party truck carrier as the manufacturer's agent, the trucks would have been delivered to a purchaser in Alabama, illustrating the arbitrary character of these decisions.

Powerex has no "docks" in Oregon, thus dock sale cases are irrelevant in this case. Purchasers of Powerex's natural gas and electricity take delivery in Oregon at delivery points specified in the contracts for other business reasons. Wholesale trades are made at well-established hubs on transmission networks. Manipulation of the contractual delivery points for sales of electricity and natural gas for income tax purposes has not been a problem under the department's long-standing delivery interpretation, but will most certainly become a manipulation problem if ultimate destination sourcing is upheld.

B. Other Cases Look to Delivery State

Other states have either ignored or rejected the *Parker Banana* line of cases. *See Department of Revenue v. Parsons Corp.*, 843 P2d 1238 (1992) (Supreme Court of Alaska held contracts between taxpayer and oil company to construct modular oil and gas facilities in Alaska were for sale of tangible personal property delivered to purchaser in Alaska for purposes of Multistate Tax Compact because, as specified in contracts, modules were shipped to and delivered to a purchaser in Alaska even though ordered from outside Alaska); *Indiana Department of Revenue v. Miller Brewing Co.*, 975 NE2d 800 (2012) (corporation's sales to Indiana customers of products picked up by third-party carrier from Ohio brewery and shipped to customers were Indiana sales under plain language of statute and rule,

notwithstanding a contradictory "Example" without the force of law);[14] and *Stryker Corp. v. Dir., Div. of Taxation*, 18 NJ Tax 270 (1999) (rejects taxpayer's reliance on the *Parker Banana* line of dock sale cases in the context of a "drop-shipment transaction," which in fact is actually two transactions from manufacturer to dealer and from dealer to dealer's customer).

That cases cited by Powerex involve "dock sales" and the present case does not, is sufficient reason for this Court to ignore those cases. Powerex's purchasers did not pick up electricity or natural gas at Powerex's office in Oregon. Even if, arguendo, the dock sale decisions might be correct for, e.g., sales of carpet from taxpayer's manufacturing plant, it is not the right, nor reasonable result for wholesale electricity sales delivered to purchasers on the Intertie power grid in Oregon or wholesale natural gas sales delivered to points on Oregon pipelines. The participants in the wholesale electricity market and the natural gas market negotiated contractual points of delivery for business reasons. Powerex and it purchasers have

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[14] Powerex argues that a reference to "delivery or shipped to Oregon purchasers" on the Oregon corporation excise tax return instructions suggests the department has adopted an ultimate destination rule. This inaccurate perception reflects Powerex's conflation of "destination" with "ultimate destination." The destination for the electricity and natural gas transactions at issue in this case is Oregon, the place where the purchaser takes delivery. The record is clear: no one knows the ultimate destination for the electricity and natural gas sold in these transactions. These commodities likely will be traded (bought and sold) many more times before reaching an ultimate consumer.

elected to use facilities in Oregon and specify contractual delivery points in Oregon, so that Powerex can realize income from Oregon sales transactions.

The department's administrative rules reflect the reality of the wholesale electricity and natural gas markets and constitute a reasonable approach to sourcing sales of electricity and natural gas, consistent with the statutory language "delivery to a purchaser within the state." The department's rules should be applied here.[15] Moreover, other state courts' preference for relying on "destination" purpose statements in law review articles over the literal "delivery" language in the statute is not consistent with this Court's prior decisions. *See Sherwin-Williams Co. v. Dept. of Revenue*, 329 Or 599, 602 (2000) *(*"gross receipts" as used in UDITPA means "gross receipts," not receipts "net of return of capital" as argued by the department and amicus MTC); *Willamette Industries, Inc. v. Dept. of Revenue*, 331 Or 311, 319 (2000) ("integral" as used in the UDITPA statute does not mean "incidental" as used in administrative rule adopting the MTC's model rule language).

Professor Hellerstein states in his preeminent state taxation treatise that "[a]s a matter of statutory construction, one can reasonably answer the question raised by

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[15] Because the Tax Court decided the department's administrative rules were procedurally barred from application in this case, the court never reached their validity under ORS 314.670 as "any other method to effectuate an equitable allocation and apportionment of the taxpayer's income." However, nothing suggests that the court would have deferred to the department's rules if that analysis had been undertaken.

Parker Banana either way. Consequently, in determining what is the destination of the goods, the decisive consideration should be the facilitation of simple and inexpensive taxpayer compliance and administration by the taxing authorities. For we are here dealing with a vast number of transactions that occur annually over the country, and it is unlikely that any significant shift of revenues among the states will result from the adoption of either rule as to the destination of the goods in the types of transactions under discussion. * * * [T]he Florida legislature evidently shares our view, because it legislatively reversed the result in *Parker Banana* by providing that '[s]ales of tangible personal property occur in this state if the property is delivered or shipped to a purchaser within this state, *regardless of the . . . ultimate destination of the property*, unless shipment is made via a common or contract carrier. [n 953 Fla. Stat. § 220.15(5)(b)1.]" (Emphasis in original) *State Taxation* at ¶9.18[1][a] 9-254 through 9-255.

The "delivery" interpretation of ORS 314.665(2)(a) is as reasonable as "ultimate destination," which is wholly unworkable in most situations, particularly for sales of electricity and natural gas. For sales of these commodities, the contractual delivery points specified pursuant to standard industry practice provide the most consistent and workable method of sales sourcing for both taxpayers and the department to insure a fair and equitable apportionment of income.

III. CONCLUSION

The department asks this court to reverse the decision of the Oregon Tax Court and find that sales of electricity are sales of tangible personal property, and that sales of electricity and natural gas are Oregon sales when delivered to purchasers in Oregon, whether or not they are "located" in Oregon, consistent with ORS 314.665, OAR 150-314.665(2)-(A)(1), and OAR 150-314.665 (2)-(C).

DATED this 6th day of December 2013.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE
WITH ORAP 5.05(2)(d)

Brief length

I certify that (1) this brief complies with the word-count limitation in ORAP 5.05(2)(b) and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 3752 words.

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I certify that the size of this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(4)(f).

Dated this 6th day of December, 2013.

By: /s/ Marilyn J. Harbur
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CERTIFICATE OF SERVICE

I certify that on December 6, 2013, I directed the original DEFENDANT-APPELLANT'S OPENING BRIEF to be electronically filed with the Appellate Court Administrator, Appellate Records Section, and upon Carol Vogt Lavine, of attorneys for respondents. Also upon Eric Coffill and Jenni Choi, by regular United States Mail and addressed to the following:

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