IN THE SUPREME COURT OF THE STATE OF OREGON

POWEREX CORPORATION, Plaintiff-Respondent v. DEPARTMENT OF REVENUE, State of Oregon Defendant-Appellant.	Tax Court No. 4800 Supreme Court No. S060859

REPLY BRIEF OF *AMICUS CURIAE* PORTLAND GENERAL ELECTRIC COMPANY

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

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I. Introduction

In its response to PGE's brief as amicus curiae, Powerex mischaracterizes or simply fails to answer several of PGE's arguments. For example, contrary to Powerex's assertion, PGE's argument that the department's interpretation of "tangible personal property" is entitled to deference is not a new argument, nor is it based on the length of time the department has had a policy of characterizing electricity as tangible. (Powerex Br. 35-36.) Instead, PGE's argument is that the department's audit determination here is entitled to deference under the standards the Court established in *Atlantic Ritchfield Co. v Dep't of Rev.*, 300 Or 637, 717 P2d 613 (1986) ("*Arco*").

Similarly, Powerex seeks to avoid the problem that there is no uniformity among UDITPA states in treating electricity as tangible or intangible by drawing illusory distinctions between the case at hand and the Illinois and Arizona cases holding that electricity is tangible. (Powerex Br. 37.) However, both cases had to answer the question of whether electricity is tangible for income tax purposes and concluded that it is. More fundamentally, Powerex fails to respond to PGE's argument that treating electricity as tangible is consistent with the reason UDITPA distinguishes between tangible and intangible property in the first instance.

Powerex also wrongly criticizes PGE's citation to the Hellersteins' *State Taxation* treatise for its view that the better sourcing rule for tangible personal

property is the place-of-delivery rather than the ultimate-destination rule. (Powerex Br. 88.) The fact remains that the Hellersteins have endorsed the place-of-delivery rule, even if (as we point out, with case citations, on pp. 47-51 of the opening brief) a number of courts have not adopted their view.

Finally, Powerex incorrectly suggests that it is inappropriate for PGE to argue that the department's classification of electricity as tangible personal property and its adoption of the place-of-delivery sourcing rule survive scrutiny under the *Crystal Communications* interpretational framework applicable to public utilities. *See Crystal Communications, Inc. v. Dep't of Rev.*, 353 Or 300, 297 P3d 1256 (2013). (Powerex Br. 88-90.) It is precisely the role of amicus curiae to point out aspects of the issues in a case that the parties themselves have not briefed, and doing so does not constitute raising new issues.

Powerex's resort to mischaracterizing PGE's arguments does nothing to refute them, and its failure to respond to certain arguments reveals that Powerex has no answer to them. PGE offers this reply to respond to Powerex's misplaced criticisms.

II. Argument

A. PGE's Argument that the Department's Decision is Entitled to Deference is not a "New Argument."

There are two things wrong with Powerex's response to PGE's deference argument. First, Powerex incorrectly says that this is somehow a "new

argument" that was not preserved by the department below. To the contrary, the department consistently maintained below that its interpretation of "tangible personal property" and its applications of UDITPA's sourcing rules should be upheld. (*See* the department's First Assignment of Error, Blue Br. 8.)

PGE's mere use of the word "deference" does not make this a new argument. Moreover, as the *Arco* case makes clear, the deference owed to the department's audit determinations is always at issue on appeal. 300 Or at 644-46. Deference is embedded in any argument over whether the department has properly interpreted and applied UDITPA.

Second, Powerex mischaracterizes the basis for PGE's deference argument, which is not founded on the number of years it has been the department's policy to characterize electricity as tangible personal property or to source sales of tangible personal property to the place of delivery. (Powerex Br. 34-35.) Rather, it is based on the Court's statement in *Arco* that the department's audit determinations are entitled to deference, provided that the department's construction of UDITPA results in a reasonable approximation of the taxpayer's Oregon income and effectuates UDITPA's uniformity purpose. *Id.*

Powerex does not argue the "reasonableness" requirement. It does argue the "uniformity" requirement, which we turn to next.

B. Powerex's Attempts to Distinguish the Illinois and Arizona Decisions are Distinctions Without a Difference.

Powerex argues that the *PacifiCorp* and *EUA* cases are the only cases that address whether wholesale sales of electricity should be treated as tangible personal property for revenue sourcing purposes. (Powerex Br. 37-38.) *See Appeal of PacifiCorp,* Cal St Bd of Equal, No. 90027, 2002 WL 31153476 (Sept 12, 2002); *EUA Ocean State Corp. et al., v. Comm'n of Rev.,* No. C258405-406, 2006 WL 1085380 (Apr 24, 2006). Powerex asserts that the *Exelon* and *Tucson Electric* cases are not on point because *Exelon* involved whether a tax credit was available and *Tucson Electric* was a tax refund case. *See Exelon Corp. v. Dep't of Rev.,* 234 Ill2d 266, 917 NE2d 899 (2009); *Tucson Electric Power Co. v. Arizona Department of Revenue*, 170 Ariz 145, 822 P2d 498 (1991). (Powerex Br. 37) In so arguing, Powerex confuses the **context** in which the issue arose with the **issue** itself. All four cases answered the question of whether electricity is tangible personal property. Resolution of that issue was essential in *Exelon* because the taxpayer could not qualify as a retailer eligible for the tax credit unless the electricity it sold was tangible personal property. 917 NE2d at 903. Similarly, Tucson Electric was not eligible for a tax refund because the business of furnishing electricity that was subjected to Arizona's one-percent tax on gross income "logically includes not only the actual selling of electricity as a commodity, but also providing the numerous continuing services necessary to deliver the electricity to the customer reliably

and in a useful form." 822 P2d at 502. Powerex has not argued, nor can it credibly argue, that the courts in Illinois and Arizona would hold that electricity is tangible for one purpose under their states' income and excise tax laws but intangible for UDITPA sourcing purposes.

Powerex's other responses to PGE's uniformity arguments either miss or purposefully ignore the point of those arguments. For example, Powerex takes comfort from our statement that there are policy reasons, not present in tax cases, for **not** treating electricity as tangible in product liability cases. (Powerex Br. 37-38.) Powerex's efforts to turn this statement to its advantage are very clever, but not sound sense.

PGE's point about the consensus in product liability cases to treat electricity as tangible is just the opposite from the use Powerex would make of it. State courts have overwhelmingly found that electricity is a tangible product eligible for strict products liability treatment, even though there are good policy reasons not to subject power companies, and ultimately their ratepayers, to strict liability for supplying a product that is useful precisely for the reason that makes it inherently dangerous. Powerex has given this Court no policy reasons under UDITPA – because there are none – for the Court to conclude that the appellate courts of any of these states would say, "Electricity may be a tangible product for strict product liability purposes, but it is not for income tax purposes." It is far more likely that these courts would reach the same

conclusion about electricity in UDITPA cases as they have in product liability cases – that it is a product, made by man and confined, controlled, transmitted and distributed. *See Bryant v. Tri-County Elec. Membership Corp.*, 844 F Supp 347, 349 (WD Ken 1994).

Powerex similarly mischaracterizes PGE's argument from the sales tax cases, particularly the California *Searles Valley* case. (Powerex Br. 37-38.) *See Searles Valley Mineral Operations, Inc. v. State Bd. Of Equalization*, 160 Cal App 4th 514, 72 Cal RPTR 3d 857 (2008). The most significant feature of that case is its reliance on *Roth Drugs, Inc. v. Johnson*, 13 Cal App 2d 720, 734, 57 P2d 1022, 1028 (1936), in concluding that sales of electricity are sales of tangible personal property under California's sales and use tax. As the court noted, tax laws treat tangible and intangible property differently because the first is easy to identify and levy upon, while the second is not so readily located. *Searles Valley*, 72 Cal Rptr 3d at 863.

But even if the Court were somehow to conclude that the *PacifiCorp* and *EUA* cases are the only cases that matter to the uniformity analysis, Powerex still has the problem that it makes no sense that the first, or even second, administrative law decision to answer a difficult question under UDITPA should estop the highest court in every UDITPA state (including the state in which that administrative determination was made) from analyzing what the better rule should be. By adopting UDITPA, the states did not agree that, when

it came to interpreting this statutory scheme, their courts would be nothing more than dominoes that must tip in the direction dictated by the first administrative law judge to decide an issue. This leads us to the biggest flaw in Powerex's argument: its complete failure to address UDITPA's policy reasons for distinguishing between tangible and intangible property.

C. As a Matter of Economic Reality, Electricity Sales Are Sales of Tangible Personal Property.

Rather than address the policy reasons behind UDITPA's distinction between tangible and intangible personal property, Powerex makes two arguments to support the Tax Court's conclusion that electricity is intangible. First, Powerex argues from UDITPA's historical background. Powerex says that public utilities, including electric utilities, were excluded from UDITPA in part because most states already had well-developed statutory schemes for taxing utilities. (Powerex Br. 15-16.) Powerex further suggests that UDITPA was primarily written for manufacturing and merchandising businesses. Therefore, Powerex would conclude, wholesale sales of electricity cannot be sales of tangible personal property. (Powerex Br. 17.)

Powerex's entire historical argument is a *non sequitur*. Regardless of whether traditional manufacturing and merchandising businesses were the predominant form of multi-state businesses when UDITPA was drafted in the 1950s, UDITPA has always also applied to other forms of multi-state businesses such as accounting firms, publishing companies, and the like. And

the fact that most sales of electricity are retail sales that are not covered by UDITPA tells us nothing about whether wholesale transactions in electricity that are covered directly by UDITPA constitute sales of tangible or intangible personal property. As originally enacted, UDITPA had sourcing rules for intangibles as well. There is no logical reason from UDITPA's history to apply either of the two sourcing rules as the default rule for wholesale sales of electricity.

Second, Powerex argues the science of electricity at length. (Powerex Br. 53-69.) As other courts have repeatedly stated, however, while scientific testimony about the nature of electricity is fascinating, it is both legally inconclusive and peripheral to the application of tax laws. *See, e.g., Public Serv. Co. v. Dep't of Rev.*, __ P3d __, 2011 WL 4089971 at *6 (Colo Ct App Sept. 15, 2011), *cert. granted*, 2013 WL 105015 (Colo Jan 7, 2013) (No 11SC759); *Omaha Public Power District v. Nebraska Department of Revenue*, 248 Neb 518, 526-28, 537 NW2d 312, 317-18 (1995). This Court is not refereeing a scientific debate over the nature of electricity or whether a distinction should be drawn between electromagnetism, which is a boson that does not obey Pauli's exclusion principle, and electrons, which are fermions and do obey that principle. This is not T. H. Huxley and Bishop Samuel Wilberforce debating before the British Association for the Advancement of Science in Oxford in 1860 over the accuracy of Charles Darwin's *On the Origin*

of Species. The Court is deciding as a matter of tax policy what tax law sourcing rule ought to apply to wholesale sales of electricity.

Tax law analysis typically looks to the economic reality of a transaction. Here, a Powerex corporate affiliate manufactures electricity in British Columbia. Powerex then contracts to supply a specific number of megawatts of that electricity at a specific point of delivery to which it could not deliver without obtaining the rights to carry the load over specific transmission lines. Tr at 53:8-21; 63:20-23; 367:8-18; 397:2-400:4; 412:7-16. As a matter of economic reality, this looks like a sale of tangible personal property, which accounts for why the IRS uniformly treats electricity sales as sales of tangible personal property. As noted by the California Supreme Court in the *Roth Drugs* case, 57 P2d at 1028, and the California Court of Appeals in the *Searles Valley* case, 72 Cal Rptr 3d at 863, the reason for distinguishing between tangible and intangible property for purposes of taxation is because tangible property is easy to locate, while intangible property is not. The tax policy reason for drawing this distinction thus makes a clear case for treating electricity sales, which the market tells us can be readily located, as sales of tangible personal property. Powerex has no answer to this argument.

D. PGE Has Not Mischaracterized the Hellersteins' Discussion of the UDITPA Sourcing Rules.

Powerex incorrectly asserts that PGE misleadingly cites to the Hellersteins' endorsement of the place-of-delivery rule and fails to acknowledge

the number of states that use the ultimate-destination rule. (Powerex Br. 88.) Not so. In our full treatment of the issue on pp. 47-51 of PGE's amicus brief, we note the number of courts that have adopted the ultimate-destination rule. The point is that authority is split, that the Multistate Tax Commission ("MTC") favors the place-of-delivery rule, and that this is the better rule as advocated by the leading commentators on state tax law.

E. PGE's Argument to Limit the Application of the Decision in This Case Is a Proper Argument for an *Amicus Curiae*.

In asserting that it is improper for PGE to raise issues concerning public utilities taxed under ORS 314.280, Powerex misses the point of amicus briefing. (Powerex Br. 88-89.) The role of an amicus curiae is to offer a different perspective than the parties provide and to alert the court to circumstances that might otherwise go unnoticed. *See Village of North Atlanta v. Cook*, 133 SE2d 585, 589 (Ga 1963) (stating that the function of an amicus curiae is to alert the court to law, facts or circumstances in a matter then before it that might otherwise escape its attention). Frequently, this perspective comes from a party that may be affected by unknown or unintended consequences of a court decision:

> "Cases that address matters ranging from the most controversial social issues to more mundane questions of commercial law often have the potential to generate legal rules that could have consequences either unforeseen by the parties or upon which the parties cannot offer informed and cogent argument. Yet those consequences are no less real."

Andrew Frey, *Amici Curiae: Friends of the Court or Nuisances*, 33 No. 1 Litigation 5, 6 (2006).

Indeed, the lending of a unique perspective is the primary purpose of an amicus curiae brief:

> "Amici curiae perform a valuable role for the judiciary precisely because they are nonparties who often have different perspective from the principal litigants; amicus curiae presentations assist the court by broadening its perspective on the issues raised, and facilitate informed judicial consideration of a wide variety of information and points of view."

4 AM JUR2D *Amicus Curiae* § 1 (2013).

PGE is taxed as a public utility under ORS 314.280. It is perfectly appropriate for PGE to alert the Court to the potential spillover effect its decision may have on public utilities. As discussed in PGE's opening brief, when the interpretational framework for UDITPA that the Court announced in *Crystal Communications* is applied to public utilities' sales of electricity, there are very strong reasons to conclude that these sales should be treated as sales of tangible personal property that are sourced to the contracted point of delivery, even if the Court decides that electricity is intangible for purposes of UDITPA or that the ultimate-destination rule applies under UDITPA. PGE does *not* ask the Court to resolve the ORS 314.280 issues raised in its opening brief; instead, PGE respectfully asks the Court to acknowledge the possibility that this case might be resolved differently if the taxpayer were a public utility – and limit its

rulings to non-utility sellers of electricity such as Powerex here.

DATED this 14th day of November, 2013.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE WITH BRIEF LENGTH AND TYPE SIZE REQUIREMENTS

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 2,657 words.

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CERTIFICATE OF FILING AND SERVICE

I hereby certify that on the date set forth below, I directed the original **REPLY BRIEF OF *AMICUS CURIAE* PORTLAND GENERAL ELECTRIC COMPANY** to be filed electronically with the Appellate Court Administrator, Appellate Records Section, through the eFile system and served said document electronically through the same eFile system on:

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