IN THE SUPREME COURT OF THE STATE OF OREGON

NORTHWEST NATURAL GAS COMPANY, an Oregon corporation; and PORTLAND GENERAL ELECTRIC COMPANY, an Oregon corporation,

Plaintiffs-Respondents/
Petitioners on Review,

and

ROCKWOOD WATER PEOPLE'S UTILITY DISTRICT,

Intervenor-Respondent,

v.

CITY OF GRESHAM, a municipality and public body within the state of Oregon,

Defendant-Appellant/
Respondent on Review.

Multnomah County Circuit Court No. 1107-08422

CA A150990

SC S062556

BRIEF ON THE MERITS OF *AMICI CURIAE* THE INDUSTRIAL CUSTOMERS OF NORTHWEST UTILITIES AND THE NORTHWEST INDUSTRIAL GAS USERS IN SUPPORT OF PETITIONERS

Date of Opinion: July 2, 2014
Author of Opinion: Armstrong, P.J.
Concurring: Hadlock, J., Egan, J.

On Review of the Decision of the Court of Appeals on Appeal From the Judgment of the Multnomah County Circuit Court, The Honorable Stephen K. Bushong, Judge

September 2014

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I. INTEREST OF *AMICI CURIAE*

The Industrial Customers of Northwest Utilities ("ICNU") is a non-profit association of large industrial electric customers in the Pacific Northwest, including many customers of the two largest electric companies operating in Oregon, Petitioner Portland General Electric Company ("PGE") and PacifiCorp. The Northwest Industrial Gas Users ("NWIGU") is a nonprofit association comprised of thirty-eight end-users of natural gas with major facilities in the states of Washington, Oregon and Idaho, including Oregon customers of Petitioner Northwest Natural Gas Company ("Northwest Natural").

As ratepaying customers of PGE, PacifiCorp, and Northwest Natural, ICNU and NWIGU members will be significantly and unjustly impacted by Oregon rate increases resulting from the Court of Appeals' decision. In short, ICNU and NWIGU members will be forced to bear higher utility rates which provide benefit to neither utility customers nor to the utilities themselves. Instead, as a consequence of the Court of Appeals' decision, ICNU and NWIGU members and other customers will pay higher rates simply to fund city operating expenses which bear no reasonable relation to fair compensation for utility use of city rights-of-way.

Some ICNU and NWIGU members may struggle to remain financially viable under such an illegal subsidization regime. Moreover, the

funding of non-utility related city operating expenses by ratepayers outside such cities is more than unjust—it also would violate: 1) long-standing rate regulatory precedent forbidding cities to abrogate state power and to affect rates in this manner; and 2) numerous legislative policy prescriptions embodied in the framework of regulatory statutes. For these reasons, ICNU and NWIGU jointly present this brief on the merits to protect the interests of their members and to impress upon this Court the crucially important rate, policy and statutory issues which should compel a reversal of the Court of Appeals' decision.

II. QUESTIONS PRESENTED AND PROPOSED RULES OF LAW

Amici accept and adopt the Questions Presented and Proposed Rules of Law of Petitioners.

III. NATURE OF THE ACTION AND RELIEF SOUGHT BELOW

Amici accept and adopt the Nature of the Action and Relief Sought Below of Petitioners.

IV. SUMMARY OF FACTS

Amici accept and adopt the Summary of Facts of Petitioners.

V. SUMMARY OF ARGUMENT

This Court should reverse the decision of the Court of Appeals, finding its construction of "franchise" unsupportable both in the context of ORS 221 and ORS 756-757. As discussed in the body of this brief, the City of Gresham's seven percent utility license fee should be found invalid because it

contravenes state law in instituting compulsory and unjust rate exactions which are irreconcilable with statutory prohibitions that protect utility ratepayers against unreasonable charges. Ultimately, city "franchise" fees which are not based upon compensation for utility use of city rights-of-way cannot be considered legally just or reasonable for inclusion in rates.

VI. ARGUMENT

This case must be determined based upon legislative rate policy and the effect that any interpretive issues have upon the framework of statutorily mandated ratepayer protection law. The Court of Appeals concluded that "a 'franchise,' as that term is used in ORS 221.450 … is not limited to a negotiated agreement" and "can be created by other means." Northwest Natural Gas Co. v. City of Gresham, 264 Or App 34, 46, 330 P3d 65 (2014). In reaching this conclusion, the Court of Appeals focused extensively on interpreting the potential meaning of "franchise" in the original drafting of the statute more than 80 years ago. Notwithstanding, however interesting and even theoretically sound the Court of Appeals' conclusions are from a purely academic standpoint, the decision cannot be reconciled within the entire framework of Oregon rate regulatory law.

Specifically, the legislature has created statutory protections for ratepayers like ICNU and NWIGU members from unjust and unreasonable exactions like city "franchise" fees which bear no relation to utility use of city

rights-of-way. Moreover, state regulatory policy forbids utilities from discriminating against ratepayers by giving undue preference to particular localities, such as the City of Gresham. Also, Oregon precedent establishes that the state retains all rate regulatory power to protect utility customers such as ICNU's and NWIGU's members, unless the legislature specifically delegates authority to municipalities by statute—a circumstance not present here. Hence, this Court should find that the word franchise, as used in ORS 221.450, does not include a city grant which allows for compulsory fee exactions contrary to state law, as further explained below.

A. Applicable Standards

This Court has an independent duty to correctly construe and apply statutes, irrespective of any potential interpretations asserted by parties, just as the Court of Appeals acknowledged in its decision. Id. at 42-43 (citing Stull v. Hoke, 326 Or 72, 77, 948 P2d 722 (1997)). In so doing, this Court must consider whether the City of Gresham's seven percent utility license fee is valid, based upon a determination of whether that local action contravenes state law. La Grande/Astoria v. PERB, 281 Or 137, 142, 576 P2d 1204, adh'd to on recons, 284 Or 173, 586 P2d 765 (1978). More specifically, inquiry must be made as to whether the City of Gresham's fee can operate concurrently with state law. Id. at 148.

Local and state law can operate concurrently only if the "laws can

operate consistently and are not repugnant to one another." Portland v. Dollarhide, 71 Or App 289, 293, 692 P2d 162 (1984). When, however, "a local enactment is found incompatible with a state law in an area of substantive policy, the state law will replace the local rule." La Grande/Astoria, 281 Or at 149.

B. The City of Gresham's Seven Percent Fee Is Not Reasonably Related to Compensation for Utility Use of Rights-of-Way

The City of Gresham justified its seven percent utility license fee as a means "to avoid further service disruptions in the police and fire departments." Amended Petition for Review, p. 8 (quoting Stipulated Facts ¶ 10 (ER-3)). The funding of municipal emergency services does not, however, bear any permissible legal relationship to the authority granted cities to charge for utility use of city rights-of-way.

Rather, the legislature only allows cities to exact by compulsion a "privilege tax" from a utility using city "streets, alleys or highways, or all of them" without a franchise. ORS 221.450. The explicit policy purpose stated by the legislature for this exaction is that this "privilege tax *shall be for the use* of those public streets, alleys or highways, or all of them." Id. (emphasis added). In other words, the legislature has enacted a plain policy that a city is *only* permitted to charge a compulsory tax "for the use of" city rights-of-way, and not simply for any purpose deemed to benefit a city. Further, the Oregon

Legislature has determined that a city may only charge for such specific, limited use "in an amount not exceeding five percent of the gross revenues of the … utility … currently earned within the boundary of the city." Id.

Therefore, a city is limited both as to the purpose and amount for which it may exact compulsory utility fees. In exacting a compulsory seven percent fee from Petitioners, the City of Gresham has violated both the purpose and percentage limitations of ORS 221.450. Consequently, the City of Gresham's action is incompatible with legislative rate policy in compelling utilities to pay fees above that which is permitted by statute, which fees are ultimately borne by utility ratepayers. ICNU and NWIGU members and other ratepaying customers of the Petitioners should not be forced to pay increased rates resulting from the City of Gresham's illegal action.

C. Ratepayer Impacts Resulting from the Court of Appeals' Decision Are Prohibited by Law

1. Undue Local Preferences Are Illegal

The legislature expressly proscribes any utility practices rendering undue preference to a city: "No public utility shall make or give undue or unreasonable preference or advantage to any particular person *or locality* …." ORS 757.325(1) (emphasis added). Indeed, any utility violating this statutory "section is guilty of discrimination." ORS 757.325(2).

At the end of the day, allowing cities to fill municipal coffers by

charging compulsory "franchise" fees forces utilities to involuntarily give undue preference to such cities. Ratepayers will ultimately suffer if the Court of Appeals' decision stands, as cities will have free reign to suborn utilities as a means to exact funds from the general public, an end which is surely incompatible with the Public Utility Commission of Oregon's ("PUC") mandate to use its powers to protect utility "customers, and the public generally." ORS 756.040(1).

2. Unjust and Unreasonable Exactions Are Illegal

The impossibility of the concurrent operation of state law and the City of Gresham's utility licensing fee can be demonstrated by considering PUC statutes in ORS 756-757. The PUC is required to protect utility "customers, and the public generally, from unjust and unreasonable exactions and practices." ORS 756.040(1). "Rates are prohibited and unlawful [if they are] unjust and unreasonable …." Gearhart v. PUC, 255 Or App 58, 61, 299 P3d 533 (2013). Therefore, rates will violate state law if they include inflated operating expenses, in the form of compulsory city exactions unjustly exceeding the five percent revenue limitation of ORS 221.450.

Likewise, state law requires that "the charges made by any public utility … shall be reasonable and just, and every unjust or unreasonable charge … is prohibited." ORS 757.020. Yet, the Court of Appeals' decision creates a hopeless conundrum in regard to this statute; i.e., utilities will be required to

levy prohibited charges on ratepayers when operating expenses incorporated into rates include city franchise exactions that are unjustly and unreasonably disproportionate to the revenues actually earned in those cities. The Court of Appeals' decision should be reversed to ensure that legislative policies through enacted statutes are upheld to safeguard ICNU and NWIGU members and other utility ratepayers from unjust rate exactions.

3. Requisite Cost Causation Principles Conflict with the Court of Appeals' Decision

The inevitability of the legal conflict that the Court of Appeals' decision will create is manifest with an understanding of the bedrock cost causation principle which the PUC relies upon in the determination of fair and reasonable utility rates. In short, rates are just when utility costs "are allocated fairly … based on the principles of cost-causation." 2011 Ore. PUC LEXIS 455 at *10, Order No. 11-517; accord 2012 Ore. PUC LEXIS 142 at *13, Order No. 12-159 (affirming "that cost-causation remains a relevant factor in our assessment of any proposed rate"); 1998 Ore. PUC LEXIS 246 at *20, Order No. 98-374 (finding "reasonable [a] way to allocate costs based on cost causation").

Further still, and directly relevant on application to city franchise fees incorporated as operating expenses into customer rates, a utility may charge "fees to customers on a cost-causation basis." 2001 Ore. PUC LEXIS

415 at *108, Order No. 01-777. Conversely, the PUC has rejected rate cost allocation practices which, "[b]y eliminating responsibility for differences in cost causation," result in subsidization between ratepayer groups. 2000 Ore. PUC LEXIS 359 at *51, Order No. 00-120, App. A (adopting an arbitrator's findings on this point).

The principle of cost causation in rates is also both recognized and required by the legislature in statutes governing the PUC. For instance, each electric utility governed by the PUC must, "to a reasonable level of detail, separately identify and account for its costs of … consumer service charges levied … and local taxes paid by retail electricity consumers." ORS 757.642(3). Thus, whether deemed a "franchise" charge or privilege tax, utility exactions ultimately paid by ratepayers for electric utility operations within a city must be identified and accounted for, in detail, and they may not exceed five percent.

D. The Framework of State Regulatory Power

1. The Connection between Rates, Exactions, and Franchise Fees

This Court has found that:

> The right of the state to regulate rates by compulsion is a police power, and must not be confused with the right of a city to exercise its contractual power to agree with a public service company upon the terms of a franchise. The exercise of power to fix rates by agreement does not include or embrace any portion of the power to fix rates by compulsion.

Woodburn v. Pub. Serv. Comm'n, 82 Or 114, 127, 161 P 391 (1916). Crucially, this Court assigns no significance to a distinction between a city's "power to fix *rates* by agreement" and a city's power to agree with a utility "upon the *terms of a franchise*." Id. (emphasis added). Woodburn equates the establishment of franchise "terms" with the fixing of "rates" by interchanging these phrases and, instead, emphasizes the actual point of signification by distinction—i.e., the power of a city to fix rates or franchise terms by agreement, as distinguished from the lack of power to do the same by compulsion. Therefore, any substantive differentiation between utility rates and compulsory fees paid by a utility to a city (whether termed as "franchise fees" or "privilege taxes") would be to miss the real issue before this Court and to create distinction without probative signification.

The propriety in *not* creating insignificant distinctions between franchise fees, exactions, and utility rates is demonstrated by the well-established and inseparable relationship between utility operating expenses and rate setting by the PUC. Consistent with Oregon law, "the PUC sets rates so as to provide a utility with an opportunity to recover its revenue requirement, *which is the amount of money the utility must collect to cover its reasonable operating expenses* incurred in providing services." Gearhart, 255 Or App at 61 (emphasis added). These operating expenses incorporated into utility rates

include local taxes and franchise fees, and license fees. E.g., id. at 62; 2013 Ore. PUC LEXIS 440 at *46, PUC Order No. 13-459; 2009 Ore. PUC LEXIS 14 at *95, Order No. 09-020; 2006 Ore. PUC LEXIS 23 at *37, Order No. 06-027. Thus, public utility rate setting necessarily involves the incorporation of local tax, license and franchise fees into rates, meaning that the power of a city to charge compulsory utility fees equates to the power to fix utility rates in part.

This Court has also stated: "The power to fix rates by compulsion as distinguished from the power to fix rates by agreement *is not granted to cities or towns*." Woodburn, 82 Or at 128 (emphasis added). The Woodburn decision is especially significant because it was decided in 1916, well before the 1933 predecessor to ORS 221.450 was enacted. Additionally, in La Grande/Astoria, the very case which provides the interpretive rubric for ultimate determination in the present case, this Court cited Woodburn as *the* example of state law displacing local law in the matter of utility rates, notwithstanding the passage of over 60 years between the decisions. See La Grande/Astoria, 281 Or at 149.

ICNU's and NWIGU's members pay millions of dollars in electric and gas rates. The impact of permitting a city to tack on an additional seven percent in alleged "franchise fees" would severely impact the economic viability of some ICNU and NWIGU members. The PUC is the proper rate setting body and electric and gas rates should not be used by a city that simply

needs additional operating revenues.

2. Limitations on the Legislative Delegation of Rate Authority

Bearing these facts in mind, the legislature's grant of power to cities in ORS 221.450 is telling. That is, cities are given the power to collect a "privilege tax" from utilities operating "without a franchise," but this compulsory exaction is authorized by the state only "in an amount not exceeding five percent of the gross revenues of the … utility … currently earned within the boundaries of the city." ORS 221.450. This special grant of power to cities by the legislature in 1933 was necessary, given that Woodburn had earlier affirmed that cities have no "power to fix rates by compulsion." 82 Or at 128. Moreover, the delegation of rate fixing power to cities in ORS 221.450 was specifically limited to the express terms of the statute, in accord with the fundamental principle of state sovereignty on rate regulation as acknowledged by this Court:

> The state's power to regulate by compulsion the charges of public service corporations is one of such vast and increasing importance to the public that the courts will not attribute to the state the intention to part with it or to delegate it unless the intention is clearly and unmistakably expressed.

Id. at 123 (quoting Charleston Consol. Ry. & Lighting Co. v. City Council, 92 S.C. 127, 131, 75 S.E. 390 (1912)).

In sum, ORS 221.450 is an explict delegation by the legislature to

grant cities the power to fix rates by compulsion, via the exaction of a utility privilege tax—but only up to the limit specified in *that* statute. Again, in this Court's own words, "[t]he state guards its right to regulate rates so vigilantly that specific authority is necessary to compel a surrender of this element of sovereignty …." Id. at 126. Accordingly, except for the very limited delegation of rate fixing authority in ORS 221.450, the legislature has retained with the state and the PUC full authority to protect ICNU and NWIGU members and other utility ratepayers from unjust rate exactions.

3. The Effects of Interpretation upon the Framework of State Rate Law

As explained herein, the Court of Appeals' construction of "franchise" in ORS 221.450 cannot operate consistently with Oregon law because the City of Gresham's utility license fee is repugnant to and incompatible with state law and legislative policy. If "franchise" in ORS 221.450 simply means a "governmental grant to a utility of the special privilege to occupy the public rights-of-way"—*regardless* of whether the franchise is created by contract, as the Court of Appeals maintains—that means that a city may unilaterally prescribe franchise terms without reaching agreement with a utility. Northwest Natural Gas, 264 Or App at 46. In other words, a franchise can be compulsory under the construction of the Court of Appeals.

Adopting the Court of Appeals' interpretation, however,

functionally ignores the Woodburn principle of closely guarded state regulatory power and throws the entire regulatory framework into confusion; that is, interpreting "franchise" to include the compulsory fixing of charges via the City of Gresham's utility license fee means that ORS 221.450 is not an express and limited delegation of the state's sovereign right to regulate rates. Rather, cities would have plenary power to fix franchise terms well above the five percent limit in ORS 221.450, effectively surrendering the PUC's rate setting power completely to cities whenever the city needs additional operating revenue which is incorporated into utility rates. ICNU and NWIGU members and all ratepayers alike would suffer unjustifiably high rate increases as a result. Using a fee for use of a right-of-way to fund basic city functions is not only bad policy but impermissibly gives the city a powerful taxing mechanism.

The correct interpretation of "franchise," which harmonizes with Woodburn and ORS 221, is to limit the term franchise to a contractual agreement, much as the trial court originally determined. Oregon law allows a city to determine utility fees and charges "by contract or prescribe by ordinance or otherwise." ORS 221.420(2)(a). By applying the Court of Appeals' interpretation, however, any of these means—contract, ordinance, or otherwise—constitutes the creation of a "franchise," thereby permitting cities to bypass the "without a franchise" limitation of ORS 221.450 (via the compulsory dictation of any franchise terms).

Conversely, if the term "franchise" is construed to be synonymous with contract in the context of both ORS 221.420 and 221.450, then a city may only exceed the five percent limit of ORS 221.450 via agreement (i.e., to permit a utility to operate without agreement is to allow it to operate "without a franchise," subjecting a city to the ORS 221.450 limit). This result protects utility customers from unjust rate exactions and is in keeping with the principle that a city *does* have the inherent "power to fix rates by agreement." Woodburn, 82 Or at 128. Such an interpretation also aligns with ORS 221.460, which establishes term limits for "[a]ll franchises, privileges or permits" granted to a utility for the use of the public spaces. This legislative phrasing plainly demonstrates a purposeful distinction between "franchises" and other means of conveying grants to utilities, mirroring the same distinction in ORS 221.420 between "contracts" and other grant means.

a*. *The Court of Appeals' Interpretation Is Implausible

Ultimately, this Court is faced with construing statutory language in ORS 221. The Court of Appeals argues that the 1933 legislature would have used the word "contract" instead of "franchise" in ORS 221.450 if it meant to equate the two terms: "If the legislature meant for ORS 221.450 to apply whenever a city had used something other than a contract to grant a utility the special privilege to occupy the city's rights-of-way, then that is what the legislature would have said." Northwest Natural Gas, 264 Or App at 47.

Nevertheless, this Court must also determine, as the Court of Appeals itself recently considered, whether "the concurrent operation of the local and state law [is] impossible." Rogue Valley Sewer Servs. v. City of Phoenix, 262 Or App 183, 192, 329 P3d 1 (2014). Therefore, the conclusive test of whether the legislature meant to equate franchise to contract in ORS 221.450 ultimately depends on whether such an interpretation renders the concurrent operation of local and state law possible and, conversely, whether the Court of Appeals' interpretation renders concurrent operation impossible by forcing utilities to unjustly increase customer rates.

Interpreting franchise to be synonymous with contract creates a far more plausible and practically useful interrelationship between statutes than the alternative presented by the Court of Appeals. In footnote 7 of its decision, the Court of Appeals presents a scenario in which a city might "determine" that a utility could operate within the city without "permission." Northwest Natural Gas, 264 Or App at 46, n.7. This scenario should immediately be recognized as an obvious fiction, since any city that actually *determines* that a utility may operate without permission is, in reality, actively granting tacit permission for that utility to operate. Since the Court of Appeals equates a city's grant of permission to the grant of a franchise (i.e., "a city can choose the manner in which it requires a utility to obtain its permission—*viz.*, its franchise—to occupy the public rights-of-way," id. at 48), the scenario posited is all the less

persuasive.

The Court of Appeals expressly found that because the City of Gresham passed an ordinance creating a franchise and, then, a resolution increasing its licensing fee to seven percent, "ORS 221.450 does not apply and cannot preempt the city's resolution." Id. When all a city has to do in bypassing ORS 221.450 is to enact an ordinance and then a resolution—and a city which cannot do these two things cannot continue to function at all as a city—the Court of Appeals' hypothetical of a city without "the resources or desire to create and enforce a regulatory scheme for utilities operating within their rights-of-way," id. at 46, n.7, is utterly without merit. This interpretation gives cities far too much authority to in effect tax utility ratepayers. ICNU and NWIGU members and other utility ratepayers should be protected from the unreasonable rate effects that would result from such actions.

b. The Trial Court's "Franchise" Interpretation Preserves the Sound Framework of State Rate and Regulation Law

All issues of concurrent state/local law operation are solved simply by affirming the trial court's conclusion that "franchise" in ORS 221.450 must be interpreted to mean an agreement for consideration via contract, thereby limiting *compulsory* city exactions to what the legislature has deemed the reasonable limit of five percent of revenues earned in that city in connection with utility use of city rights-of-way. Doing so avoids the host of conflicts

outlined above with PUC statutes and precedent which prohibit unreasonable and unjust exactions in utility rates. Additionally, doing so guarantees that ratepayers like ICNU and NWIGU members will be afforded protection from unreasonable rates as required by Oregon law.

The Court of Appeals' decision, in allowing cities to functionally exact utility fees for non-utility purposes from ratepayers outside local and municipal boundaries, plainly violates Oregon law: "the authority of the cities is not extended 'over subjects that are not properly municipal and germane to the purposes for which municipal corporations are formed.'" Woodburn, 82 Or at 125 (quoting Branch v. Albee, 71 Or 188, 205, 142 P 598 (1914)). Likewise, "[b]eyond such municipal boundaries and in matters of general concern not pertaining solely to local municipal affairs, cities are amenable to the general laws of the state which do not infringe upon the right of cities to local self-government." Id. (quoting Coleman v. La Grande, 73 Or 521, 525, 144 P 468 (1914)). The PUC, with authority delegated by the Oregon Legislature, and not the Court of Appeals or the City of Gresham, should be the only authority permitted to establish electric and gas company rates affecting ICNU and NWIGU members.

This Court would not infringe upon the local self-government rights of any city by reversing the Court of Appeals' decision and refusing to allow cities to exact "franchise" fees above five percent. Indeed, the City of

Gresham justified its seven percent utility license fee as a means "to avoid further service disruptions in the police and fire departments." Amended Petition for Review, p. 8 (quoting Stipulated Facts ¶ 10 (ER-3)). A laudable goal, but one local in nature and which justice and state law dictate should be funded by the city's own residents, and not through electric and gas utility bills.

VII. CONCLUSION

For the reasons stated above, *Amici* respectfully request this Court to reverse the Court of Appeals' decision and affirm the trial court's finding that the City of Gresham's seven percent utility license fee violates state law.

DATED this 17th day of September, 2014.

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

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 4,306 words.

I certify that the size of the type in 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).

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