IN THE SUPREME COURT OF THE STATE OF OREGON

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

APPELLANT'S OPENING BRIEF

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

CAROL VOGT LAVINE, #91457
PO Box 697
Gladstone, OR 97027
Telephone: (503) 650-5361
Fax: (503) 650-6511

ERIC COFFILL
JENNI CHOI
Morrison & Foerster LLP
400 Capitol Mall, Suite 2600
Sacramento, CA 95814
Telephone: (916) 325-1324
FAX: (916) 448-3222

Of Attorneys for Plaintiff-Respondent
POWEREX CORP

ELLEN F. ROSENBLUM, #753239
Attorney General
MARILYN J. HARBUR, #802517
Senior Assistant Attorney General
Department of Justice
1162 Court Street NE
Salem, OR 97301
Telephone: (503) 947-4342
Fax: (503) 378-3784

Of Attorneys for Defendant-Appellant
DEPARTMENT OF REVENUE,
State of Oregon

7/29/13

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

TABLE OF AUTHORITIES

Statutes

Other Authorities

TABLE OF AUTHORITIES

Rules

I. STATEMENT OF THE CASE

A. Nature of the Action or Proceeding

The Department of Revenue (department) assessed corporation excise tax, interest, and penalty amounts to Powerex Corp. (Powerex) for its sales of electricity and natural gas in Oregon.[1] Powerex appealed to the Oregon Tax Court. The matter was heard in the Regular Division by special designation. After a decision on motions for partial summary judgment concerning the validity and applicability of two DOR administrative rules, a trial was held concerning (1) whether sales of electricity are sales of tangible personal property under ORS 314.665, and (2) whether sales of electricity (if tangible personal property) and natural gas were properly considered Oregon sales if the electricity and natural gas were delivered to purchasers in Oregon. The tax court entered an opinion deciding against the department on both issues. This appeal followed.

B. Nature of the Judgment

The tax court entered a General Judgment cancelling the deficiencies assessed by the department.

---

[1] As of July 21, 2006, the total tax, interest, and penalty for each tax year was: (2001) $1,448,962.78; (2002) $179,464.53; and (2003) $202,496.88.

C. Statutory Basis of Appellate Jurisdiction

This appeal is brought pursuant to ORS 305.445. Under that statute, this court may affirm, modify, or reverse the order or decision of the tax court appealed from, with or without remanding the case for further hearing, as justice may require.

D. Entry of Judgment and Timely-Filed Notice of Appeal

The General Judgment was entered on October 23, 2012, and the department's Notice of Appeal was served and filed on November 19, 2012, within the statutory time period for appeal. ORS 305.445 and ORS 19.255.

E. Questions Presented on Appeal

1. Do wholesale sales of electricity sold by Powerex on the Intertie power grid constitute sales of tangible personal property under ORS 314.665?

2. Were Powerex's wholesale sales of electricity and natural gas at issue in this case delivered to purchasers within Oregon under ORS 314.665 and OAR 150-314.665(2)-(A)(4)?

3. Do OAR 150-314.665(2)-(A), defining "tangible personal property" to include electricity and gas, and OAR 150-314.665(2)-(C), Sales Factor – Sales of Electricity or Natural Gas, apply to the tax years at issue?[2]

F. Summary of the Arguments

Powerex engaged in sales[3] of electricity and a small amount of natural gas under contracts, which required delivery to the purchasers at specified points in Oregon. Beginning with the 2001 tax year, Powerex failed to include the sales receipts from these trades in its sales factor numerator for purposes of apportioning its net income and reporting its corporation excise tax.

The department adjusted Powerex's returns to include the electricity and natural gas sales in the sales factor and issued notices of deficiency for the 2001 through 2003 tax years. These adjustments reflected the department's long-standing policies: (1) treating electricity as tangible personal property under ORS 314.665, and (2) treating deliveries of tangible personal property to purchasers in Oregon as Oregon sales under ORS 314.665.

---

[2] OAR 150-314.665(2)-(C) also requires inclusion of bookout sales in the sales factor numerator if the contract specifies a point of delivery in Oregon, but this question was not addressed by the tax court. The department advised the tax court in post-trial briefing that exclusion of the bookout sales from the sales factor would actually increase the tax assessed to Powerex.

[3] Wholesale sales of electricity and natural gas are also referred to in the industry as "trades" and the purchasers as "counterparties." (e.g., Tr 71, 77).

The term "tangible personal property," as used in ORS 314.665, is undefined. Prior to 2007, the department gave that term its usual and ordinary meaning: property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses, including electricity, water, gas, steam, and prewritten computer software. This is in essence the dictionary definition of the term. In 2007, the department adopted OAR 150-314.665(2)-(A)(1), defining "tangible personal property" in just those terms. The department also adopted OAR 150-314.665(2)-(C), describing sales of electricity and natural gas as being delivered within Oregon if the contractual point of delivery is in Oregon, and prescribing the treatment of bookout[4] sales. These interpretive rules were made retroactively effective for all periods open to examination under OAR 150-305.100-(B).[5] However, these rules did nothing more than make express the interpretation that the department had long placed on the term, "tangible personal property." The rules did not express a change in policy.

---

[4] The term "bookout" is used in the wholesale electric industry to describe the offsetting accounting adjustment (and FERC reporting) for sales of amounts of electricity under contracts between two or more counterparties who are both sellers and purchasers. (Tr 102 (Hopkins)).

[5] In December of 2010, the rules were repealed and immediately readopted as temporary rules to cure a defect in the small business impact statement, and in February of 2011 readopted as permanent rules.

The department intended "periods open to examination" to include appeal periods. Thus, it included the 2001-2003 tax years in that period. However, the tax court improperly determined that Powerex's returns were not open to adjustment and issuance of a notice of deficiency by the department, so the periods could not be open to examination. But, because the department "examines" closed as well as open years for various purposes, the word "examination" is broader than "adjustment" or "issuance of a deficiency." The court gave no deference to the department's interpretation of its own rule on this subject.

In addition, the tax court gave no deference to the department's rules interpreting "tangible personal property" and Oregon sourcing of electricity and natural gas sales "delivered to purchasers at contractual points of delivery" in Oregon.

The department's interpretation of "tangible personal property" to include electricity is reasonable.[6] In accordance with the definition of "tangible personal property" in OAR 150-314.665(2)-(A) and the department's long-standing practice, the department's physics expert, Dr. Joel Fajans, demonstrated in testimony and demonstrative evidence at trial and in his report (Ex LL) that electricity as sold on the Intertie power grid can be seen, weighed, measured, felt

[6] Powerex did not contest that natural gas is tangible personal property.

or touched, and heard, and further that electricity, which is commonly described as a flow of electrons, is physical and material. The tax court misconstrued Dr. Fajans' testimony and report, and mistakenly concluded that electricity is not "tangible personal property" because of Powerex's expert's testimony that the virtual photons, which "carry" the electrons, are not tangible.

Powerex was assessed under the Uniform Division of Income for Tax Purposes Act (UDITPA), but it meets the definition of a "public utility" in ORS 314.610(6), which requires apportionment pursuant to ORS 314.280. But, because the sales factor provisions are the same under either apportionment regime, the only significant difference is the extent to which a UDITPA uniformity analysis is required or appropriate. The tax court erred in its uniformity analysis. The majority of Multistate Tax Commission (MTC) member states treat electricity as tangible personal property.

In concluding that Oregon law requires sourcing sales of natural gas tangible personal property to its ultimate destination of consumption, the tax court ignored the actual language of the statute, as well as the parameters of the sales transaction that produced the sales income being sourced. Powerex sold natural gas (and electricity) to purchasers who took title to and delivery at contractually specified points in Oregon. Thus, the transactions concluded in Oregon where the goods were <u>delivered</u>. Other transactions between those purchasers and other purchasers

are not before the court and should not have been considered in determining the sourcing of Powerex's sales.

G. Summary of the Facts

Powerex engaged in the business of making wholesale sales of electricity (electric power or current) and natural gas to utilities and other wholesale energy traders during the fiscal years ending March 31 of 2002, 2003, and 2004 (tax years 2001, 2002, and 2003). The electricity sold by Powerex was generated by its parent company, BC Hydro, a Canadian utility. (Tr 12-14).

The contracts between Powerex and its purchasers specify a delivery point either at California-Oregon Border (COB), Nevada-Oregon Border (NOB), Malin, or some other point geographically located in Oregon. (Testimony of Steven Fisher, Tr 350-391). Examples of contracts and summary information provided by Powerex concerning electricity and natural gas sale transactions at specified delivery points in Oregon are provided in Confidential Exhibits A, H, I, J, N, O, P, R, and U, and NonConfidential Exhibits F and R.

Electricity is described as a flow of electrons, and can be weighed, measured, heard, felt or touched, and seen, and is otherwise perceptible to the senses. (Ex LL, testimony and demonstrative evidence of Dr. Joel Fajans). Electrons have physical mass and materiality. *Id.*

Other facts are mentioned in discussing the legal questions of statutory construction and the administrative rules raised by the department in this appeal.

FIRST ASSIGNMENT OF ERROR

The tax court erred in concluding that sales of electricity on the Intertie grid by Powerex were not sales of tangible personal property under both the ordinary and specialized meaning of those words as used in ORS 314.665. In reaching this conclusion, the tax court erred in excluding stipulated exhibit evidence of 10 years of Multistate Corporate Tax Guide CCH Surveys showing the treatment by 32 other states of electricity as tangible personal property, as follows:

> The department has also relied on a commercial summary of the positions of states as to how electricity is treated. There are obvious errors in this summary and the department has not provided the court with detailed analysis of the material in the summary or information that would assist the court in determining the authoritative validity of this summary. (ER 4).

SECOND ASSIGNMENT OF ERROR

The tax court erred in granting Powerex's second motion for partial summary judgment (2011 WL 3715961 (Or Tax Regular Div)), and erred in concluding that re-promulgated OAR 150-314.665(2)-(A)(1), defining "tangible personal property" to include property that can be seen, weighed, measured felt or touched, such as electricity and gas, and OAR 150-314.665(2)-(C), describing

when sales of electricity and natural gas are delivered within Oregon, could not be applied to the tax years in this case. The tax court held:

> A rule promulgated by the department, OAR 150-305.100-(B) provides that rules of the department may apply retroactively, but they will only apply to 'periods open to examination.' Notwithstanding arguments of the department otherwise, it is clear to the court that a 'period' is a tax year or period of time. *See* ORS 314.085.
> * * *
> The department argues that the litigation of a notice of deficiency amounts to a continuing examination of a tax period. However, it is clear that the 'examination' referenced in OAR 150-305.100-(B) is a process undertaken by the department, not this court. * * *
> The foregoing conclusion is consistent with actions of the Oregon legislature in making law with retrospective effect * * *by making the statutory change applicable to transactions 'open to audit, or with respect to which an appeal is pending, on the effective date of this Act.' * * * [B]y comparison, [OAR 150-305.100-(B)] contains only language referring to examination. No mention of appeal is made. (ER- 4-5).

And

> FN5. The department has asserted that it has a long held administrative position that electricity is tangible personal property. It is not clear that there is such a long held policy and the attempts by the department to articulate that conclusion have met with difficulties addressed in previous summary judgment proceedings in this case. *See Powerex Corp. v. Dept. of Rev., (3) OTR ___ (Aug 24, 2011) (slip op.); Powerex Corp. v. Dept. of Rev.*, (3) (3) (Dec. 17, 2010) (slip op.). (ER- 22).

THIRD ASSIGNMENT OF ERROR

The tax court erred in concluding that Powerex's sales and delivery of natural gas within Oregon are not sales within Oregon for purposes of the

numerator of the corporation excise tax sales factor because the purchasers are not located in Oregon, and erred in concluding that, contrary to OAR 150-314.665(2)-(A)(4), the delivery to the purchasers within Oregon should be ignored because the purchasers subsequently transferred the property to ultimate consumers in another state.

> For the year at issue, there is no question that the purchaser under the contract is not located in Oregon. * * * However, from the record provided it appears that the gas in question is being transmitted over interstate pipelines that are, or function as, common carriers. (Stip. Ex. 7.) The delivery point under the sales contracts in question is at a market center or hub that functions in an overall coordinated transmission system for natural gas that has developed in connection with changes in federal policy regarding interstate gas transmission. The gas in question is not consumed at the market hub point of delivery but is transferred to an ultimate user in another location.
> * * *
> In the opinion of the court, an ultimate destination rule should be followed as to these sales of natural gas and the position of the department must be rejected. (ER – 23-24).

FOURTH ASSIGNMENT OF ERROR

Even if wholesale sales of electricity are sales of intangible personal property, under ORS 314.665(4) and OAR 150-314.665(4), the direct costs of the transaction producing each separate item of income must be examined to determine whether the costs of performance of that transaction are greater in Oregon or some other state and the court erred in relying on evidence of indirect costs not related to separate transactions and items of income. The tax court found:

> The court finds as a matter of fact, based on the testimony and other record made in this case, that the majority of the costs incurred by taxpayer in carrying on the income producing activity of its wholesale electricity sales **business** are incurred in British Columbia. (ER-15) (Emphasis added).

FIFTH ASSIGNMENT OF ERROR

The tax court erred in deciding that the department's deficiency assessments to Powerex should be cancelled. (ER - 24).

A. Preservation of Error

Each of the errors cited above is preserved. The department argued in briefing and oral argument that sales of electricity are sales of tangible personal property for purposes of apportionment sourcing of the sales under ORS 314.665 and the corporation excise tax laws. (Defendant's Trial Memorandum, p 2; Defendant's Post-Trial Brief and Response to Plaintiff's Opening Brief, pp 1-9; Tr 118 (Dennis Maurer), Tr 200-269, 274-349 (Dr. Joel Fajans)). The department argued in briefing and oral argument that OAR 150-314.665(2)-(A)(1) and OAR 150-314.665(2)(C) apply to years open to examination, including the time in which the notices of deficiency are in litigation. (Def's Response to Plf's Second Motion For Partial Summary Judgment, pp 1-8; Tr 92-95 (August 12, 2011); Tr 90-1140). The department further argued in briefing and oral argument that sales of tangible personal property, i.e., natural gas and electricity, must be sourced to Oregon because the property is delivered to the purchasers at agreed-upon points in

Oregon. (Defendant's Post-Trial Brief and Response to Plaintiff's Opening Brief, pp 9-12; Tr 350-421 (Stephen Fisher)).

B. Standard of Review

This court reviews a decision of the tax court for "errors or questions of law or lack of substantial evidence in the record to support the tax court's decision." ORS 305.445. Each of the errors here are errors of law, with the exception of the tax court's conclusion that electricity is not "tangible personal property," which is a mixed question of law and fact not supported by substantial evidence in the record.

COMBINED ARGUMENT ONASSIGNMENTS OF ERROR

I. Sales Of Electricity On The Intertie Power Grid Are Sales Of Tangible Personal Property Under ORS 314.665.

A. The legislature's intent as to the meaning of "tangible personal property" as used in ORS 314.665 is found in the text and context of the statute.[7]

The issue in this appeal is whether Powerex's sales of electricity, which were delivered to purchasers at points on the Intertie power grid within Oregon,[8]

---

[7] The department has located no legislative history relevant to the interpretation of "tangible personal property" as used in ORS 314.665.

[8] The Pacific Northwest Intertie (the Intertie) is the system of electric transmission lines operated by the Bonneville Power Administration. The Intertie is shown on the Western Systems Coordinating Council map of principle transmission lines. (Ex 7).

were sales of "tangible personal property," and accordingly should be included in the sales factor numerator as Oregon sales under ORS 314.665.[9] To discern the legislature's intended meaning of "tangible personal property" as used in ORS 314.665, the court considers the statutory text, context, and any relevant legislative history. *See State v. Kurtz*, 350 Or 65, 72, 249 P3d 1271 (2011), citing *State v. Gaines*, 346 Or 160, 172, 206 P3d 1042 (2009).

1. Text - Dictionary definitions may be consulted to construe an undefined term.

The pertinent portion of ORS 314.665 reads as follows:

> ORS 314.665 Determination of sales factor; inclusions and exclusions; definitions.
>
> (1) As used in ORS 314.650, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period.
>
> (2) **Sales of tangible personal property** are in this state if:

[9] If this court concludes that electricity sales should have been treated as sales of tangible personal property, an issue remains as to whether the electricity was delivered to purchasers within Oregon. As discussed below, the tax court erroneously held that sales of natural gas, which is tangible personal property, were not delivered in Oregon because the purchasers were not "located" in Oregon and the purchasers later sold the natural gas for consumption someplace outside Oregon. The tax court presumably would reach the same erroneous conclusion with respect to electricity sales if electricity is tangible personal property. But, as explained below, that conclusion—either as to natural gas sales or electricity sales—is directly contrary to OAR 150-314.665(2)-(A)(4).

> (a) The **property is delivered** or shipped **to a purchaser** * * * **within this state** regardless of the f.o.b. point or other conditions of the sale.

(Emphasis added).[10]

In the absence of a definition of "tangible personal property" in the statute itself, the court assumes that the legislature intends a statutory term to be given its ordinary meaning, typically found in dictionary definitions. *Dept. of Rev. v. Faris*, 345 Or 97, 101, 190 P3d 364 (2008); *Pacficorp Power Marketing v. Dept. of Rev.*, 340 Or 204, 215, 131 P3d 725 (2006). However, when the legislature employs a term of art, that term is not necessarily given its ordinary meaning. Instead, the court will resort to a specialized usage. *State ex rel. Dept. of Transportation v. Stallcup*, 341 Or 93, 99, 138 P3d 9 (2006) ("we give words that have well-defined legal meanings those meanings"); *State v. Hess*, 342 Or 647, 650, 159 P3d 309 (2007) (resorting to *Black's Law Dictionary* (8th ed. 2004) to define the term "stipulation," which the Supreme Court characterized as a "legal term").

---

[10] Powerex was incorrectly assessed as a UDITPA company even though it is a "public utility" as defined in ORS 314.610(6): "any business whose principal business is * * * the * * * sale of electricity * * * or gas." Because Powerex has income from business activity as a public utility (as defined in ORS 314.610(6)) taxable both within and without this state, its taxable net income should have been determined under ORS 314.280. Although assessment under ORS 314.280 may obviate the relevance of UDITPA uniformity analysis, the assessment result is the same because the department adopted the UDITPA sales factor statute and rules for apportionment under ORS 314.280. *See* ORS 314.615.

The term "tangible personal property" has both an ordinary meaning and a specialized legal usage. The ordinary meaning is found in the dictionary, which defines "tangible property" as "property (as real estate) having physical substance apparent to the senses." *Webster's Third New International Dictionary*, 2337 (ed. 2002) (*Webster's)*.[11] The specialized, legal meaning of "tangible personal property" is "[c]orporeal personal property of any kind; personal property that can be seen, weighed, measured, felt, or touched, or is in any other way perceptible to the senses, such as furniture, cooking utensils, and books." *Black's Law Dictionary* (8th ed. 2004) (*Black's)*. *Black's* also defines "tangible property" as "property that has a physical form and characteristics," contrasting it with "intangible property," which is defined as "property that lacks a physical existence [examples include stock options and business goodwill]."[12]

---

[11] The term used by the legislature is "tangible personal property." The definitions of each of those words separately may not reflect the legislature's intent in the combined usage. *Cf. State of Oregon v. Tate*, 347 Or 318, 324325, 220 P3d 1176 (2009) (dictionary contained no definition of "corrections officer" so court looked at the definition of each word separately).

[12] These definitions focus on the "physical" qualities of tangible property rather than whether every part of the property is "matter." The Merriam-Webster's and Oxford English Dictionary definitions relied on by Powerex and its expert witness also stress the "'physical': capable of being perceived especially by the sense of touch, palpable, physical assets which can be precisely valued or measured, that may be discerned or discriminated by the sense of touch, as a tangible property or form," and so forth. But Powerex focused only on the word "material" to conclude that the virtual photons in electricity must have mass or "matter" in order to be

Electricity is commonly described as the flow of electrons. (*See, e.g.*, Testimony of Powerex's witness Lisa Hopkins 95:21-25, 96:1-13; and Ex RR – Powerex's witness Peter Fisher's WiTricity company website definition: "Electricity: The flow of electrons (current) through a conductor (like a wire) or charges through the atmosphere (like lightning)." These descriptions are consistent with the *Webster's* ordinary meaning of the terms "electric charge," "electric current" and "electricity," defined respectively as: (1) "a definite quantity of electricity, either negative or positive, usu. regarded as a more or less localized population of electrons separated or considered separately from their corresponding protons or vice versa : the quantity of electricity held by a body and construed as an excess or deficiency of electrons; (2) a movement of positive or negative electric particles (as electrons) accompanied by such observable effects as the production of heat, of a magnetic field, or of chemical transformations; and (3) a fundamental entity of nature consisting of negative and positive kinds composed respectively of electrons and protons or possibly of electrons and positrons, usu.

"tangible." (See Ex 2, pp 1-2, 6-7). Nothing in the phrase "tangible personal property," as used in ORS 314.665, suggests that the legislature was concerned with whether a component particle of electricity has mass or is "matter" according to particle physics. It is far more likely that in 1965, when ORS 314.665 was enacted, the legislature intended "tangible personal property" to have the physical characteristics allowing such property to be "sensed" and weighed, measured, and delivered at a particular location.

measured in electrostatic units (as the statcoulomb) or electromagnetic units (as the coulomb), observable in the attractions and repulsions of bodies electrified by friction and in certain natural phenomena (as lightning or the aurora borealis), and usu. utilized in the form of electric currents * * *." *Webster's.*

The tax court held that electricity is not tangible personal property, but did not rely on the ordinary meaning of the term "tangible personal property," as used in ORS 314.665. That was legal error, and requires reversal.

2. Context –ORS 314.665 determines sourcing of sales in Oregon.

The sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax period, and the denominator of which is the total sales of the taxpayer everywhere during the tax period. ORS 314.665(1). Whether viewed in the context of UDITPA (ORS 314.605 to ORS 314.675), requiring a fair representation of the taxpayer's business activity in the state, or ORS 314.280, requiring a fair and accurate reflection of the net income from business done within the state, the purpose of the sales factor in this case is to apportion to Oregon the net income derived by Powerex from electricity and natural gas sales attributable to Oregon.

The goal of ORS 314.665 is to determine whether a corporation's sales should be sourced to Oregon or some other state, and the test for tangible personal

property is whether it is "delivered or shipped" to a purchaser within Oregon. There is no dispute in this case that Powerex's contracts with purchasers transferred a specified quantity of electricity or electric power to a specific purchaser at a specified delivery point in Oregon. (*See, e.g.*, Stip Ex 18 (sample contracts); direct testimony of Stephen Fisher, Tr 350-390; cross-exam testimony of Lisa Hopkins, Tr 83-95). All of Powerex's sales to any delivery point in any state are included in the denominator of the sales factor. Only the sales to delivery points in Oregon are included in the numerator of the sales factor. Division of the denominator into the numerator of the sales factor yields an apportionment factor that is multiplied by the total net income to determine the portion of net income taxable by Oregon as opposed to all other states. This is the same calculation made for sales of natural gas. Treatment of electricity sales as tangible personal property—like sales of other products or commodities delivered at specified locations—promotes the purposes of using a sales factor to apportion the taxpayer's business income so that no portion goes untaxed by any state but only that portion representing the business done in Oregon is subject to tax by this state.

B. OAR 150-314.665(2)-(A)(1) defined "tangible personal property" consistent with its ordinary meaning, but the tax court gave the rule no deference.

Under the authority in ORS 305.100, ORS 314.280(1), and ORS 314.815, the department adopted OAR 150-314.665(2)-(A)(1), which defined "tangible

personal property" as used in ORS 314.665 as property that is perceptible to the senses, including electricity and gas: [13]

> (1) For purposes of ORS 314.665 and the rules thereunder, "tangible personal property" means personal property that can be seen, weighed, measured, felt or touched, or that is in any other manner perceptible to the senses. "Tangible personal property" includes electricity, water, gas, steam, and prewritten computer software.

This rule was initially adopted in 2007 and, under OAR 150-305.100-(B), the department intended that the rule be applied to all years open to examination. *See US Bancorp v. Department of Revenue*, 337 Or 625, 637-638, 103 P3d 85 (2004) (in deciding whether to apply a rule retroactively, the court must discern the intent of the promulgating agency and such intent is found in OAR 150-305.100-(B)); *Delehant v. Board on Police Standards*, 317 Or 273, 278, 855 P2d 1088 (1993).

After an unrelated department administrative rule was invalidated by the Court of Appeals because of an insufficient small business impact statement (*see Oregon Cable Telecommunications Assoc. v. Dept. of Revenue*, 237 Or App 628,

---

[13] The department also adopted one other administrative rule on this topic, OAR 150-314.665(2)-(C), describing delivery of electricity and natural gas sales in Oregon as based on the contractual delivery point, and treating "bookout" sales similarly (the delivery and bookout rule). This rule is discussed below. The delivery and bookout rule was adopted under the same statutory authority, had the same initial small business impact statement infirmity, and was re-adopted at the same time as OAR 150-314.665(2)-(A)(1).

240 P3d 1122 (2010)), the department repealed OAR 150-314.665(2)-(A)(1) (2007) on December 1, 2010, and at the same time re-adopted the same language as a temporary rule. The permanent rule, OAR 150-314.665(2)-(A), was re-adopted March 12, 2011, with a corrected small business impact statement. The operative language in OAR 150-314.665(2)-(A)(1) did not change between 2007 and 2011.

The tax court refused to apply OAR 150-314.665(2)-(A)(1) retroactively, determining that the words "periods open to examination" in OAR 150-305.100-(B) could not refer to the period when a deficiency assessment is on appeal in the tax court. The court stated that if the department had intended it to apply to appeals it should have expressly mentioned appeals. 2011 WL 3715961, 2 (Or Tax Regular Div)). Although not clearly stated in the court's order, the court assumed that "periods open to examination" is the same thing as "periods open to adjustment" or "periods open to issuance of a notice of deficiency." But those terms are not the same. The department not infrequently "examines" tax years closed to adjustment for various purposes, e.g., to determine the amount of a carry forward loss from a closed year in some later year that is open to adjustment. In that case, no deficiency notice may be issued for the closed year, but it is nonetheless open to examination because of the carryforward laws. Thus, "examination" is broader than "adjustment."

Because of the availability of formal discovery in a tax court case, the department continues to "examine" the tax years under appeal, whether or not the statute of limitations for issuance of a new deficiency is still open. ORS 305.575 recognizes that the department may submit new or different evidence that may increase the amount of an assessment. The department may reasonably intend that any rules it adopts interpreting undefined terms in statutes should be effective for periods open to such examination.

The consequence of giving effect to the department's intent in using the term "periods open to examination" would be that the tax court would appropriately give some deference to the agency's reasonable interpretation of a statute, rather than substituting the court's judgment for the agency's.

In 2009, the legislature enacted ORS 305.125, which provides that the department may not apply an administrative rule in a manner that requires a change in the treatment of an item of income or expense, a deduction, exclusion, credit or other particular on a report or return filed by a taxpayer if the taxpayer filed the report or return by the date it was due, and the treatment of the item on the report or return was consistent with an administrative rule adopted and in effect at the time that the report or return was filed.

In this case, the department had adopted no other rule defining "tangible personal property" prior to the 2007 rule, so Powerex did not file its 2002 to 2004

returns consistent with any previous rule. Thus, OAR 150-314.665(2)-(A)(1)'s application to the tax years at issue in this case does not run afoul of ORS 305.125. The legislature limited the scope of the department's retroactive rulemaking authority. The tax court's limitation exceeds the limitation imposed by the legislature.

The adoption of any interpretive administrative rule must be consistent with the statute it construes. This court has explained this relationship in *Friends of the Columbia Gorge, Inc. v. Columbia River Gorge Com'n*, 346 Or 366 (2009):

> We first note that, although agencies are bound by their own rules, we afford particular deference to agencies' interpretations of those rules. Federal courts have held that a federal agency's construction of its own regulation is controlling unless it is 'plainly erroneous or inconsistent with the regulation.' *Auer v. Robbins*, 519 U.S. 452, 461, 117 S.Ct. 905, 137 L.Ed.2d 79 (1997). Oregon courts are almost as deferential to Oregon agencies' interpretations of their own rules, deferring to an agency's interpretation of its own rule if the interpretation is plausible and not inconsistent with the rule, the rule's context, or any other source of law. *Don't Waste Oregon Com. v. Energy Facility Siting*, 320 Or 132, 142, 881 P2d 119 (1994).

In the present case, the tax court gave no deference to the department's interpretation of OAR 150-305.100-(B) and the term "periods open to examination." In turn, this led the court to give no deference to the department's

interpretation of "tangible personal property" under ORS 314.665 and OAR 150-314.665(2)-(A)(1).[14]

In *Twentieth Century-Fox film Corp. v. Dept. of Revenue*, 299 Or 220, 700 P2d 1035 (1985), the tax court had invalidated the department's rulemaking for the motion picture industry. In reversing that decision, this court concluded that the department's rulemaking supported uniformity in the apportionment of income within the state as well as among states, and was a valid exercise of the department's interpretative rulemaking authority under ORS 305.100(1) and ORS 314.815. *Id*. at 230. In the present case, OAR 150-314.665(2)-(A)(1) and OAR 150-314.665(2)-(C) provide consistent, standard treatment of electricity and natural gas sales' apportionment.

Even if, as the tax court held, the department could not apply its 2007 rules retroactively, the tax court still erred. Those rules simply made express the plain meaning of "tangible personal property" as historically interpreted by the department. Electricity, because of its physical qualities, was included in the term before and after the adoption of the 2007 rules.

---

[14] The tax court also gave no weight to the testimony of a department representative, Dennis Maurer, showing that the department had a long-standing policy of treating electricity as tangible personal property, as reflected in the department's audit manual, and that Powerex had filed returns consistent with that policy for at least the three-years prior to the tax years at issue in this case, which were the only years remaining in the department's computer system. (Tr 139-140).

C. Majority of states treat electricity as tangible personal property.

If Powerex is properly assessed under UDITPA, then uniformity with other states should be considered. *See Atlantic Richfield Co. v. Dept. of Revenue*, 300 Or 637, 650, 717 P2d 613 (1986). In that case, in order to further pursue the goal of uniformity under UDITPA, this court solicited a current survey of the statutes and rules of other states. Because of the importance of ascertaining the trend going forward, the court considered the positions of other states that changed after the decision of the tax court. *Atlantic Richfield Co. v. Dept. of Revenue*, 301 Or 242, 244, 722 P2d 727 (reconsideration) (1986). As the appendix attached to the *Atlantic Richfield* reconsideration opinion indicates, all states were surveyed , although an attempt was made to identify those states that were UDITPA states.[15] *Id*.

[15] The tax court in the present case attached a great deal of significance to reliance only on decisions from other UDITPA states. 2011 WL 4068501, 4. But, as noted in footnote 2 in the appendix to the *Atlantic Richfield* opinion, "reasonable people can differ" as to "whether a state should be considered to be a UDITPA state." The Multistate Tax Commission's website categorizes member states as "Compact Members," "Sovereignty Members," and "Associate & Project Members." (Appendix, p 1). California withdrew from the Compact on June 27, 2012; thus, it ranks equally with other associate and project member states, including both Illinois and Massachusetts. On June 13, 2013, Governor Kitzhaber signed Senate Bill 307, which repealed the Compact in Oregon and re-enacted it without Section 3, the election provision, and Section 4, all of UDITPA. This illustrates the complexity of determining "UDITPA states."

In the present case, the department and Powerex jointly submitted a similar survey, but limited to the years 1998 through 2007. *See* Stipulated Exhibit 17. This exhibit consists of the 1998 through 2007 Multistate Corporate Tax Guide CCH state surveys, which show that the trend in other states was to treat electricity sales as sales of tangible personal property for corporation excise tax purposes. Even in 1999 some 22 states treated electricity as tangible personal property, 8 states did not report, and 10 states reported treating electricity as either a service or intangible asset. By 2006 and 2007, some 32 states treated electricity as tangible personal property, 5 states did not report, and 9 states reported treating electricity as a service or intangible asset. The tax court dismissed Stipulated Exhibit 17 as a "commercial summary" with "obvious errors," but did not further explain. 2012 WL 2068501, 4. (ER-21).

In deciding that electricity should not be considered tangible personal property, the tax court gave undue weight to administrative decisions from California and Massachusetts. The first decision is *In the Matter of the Appeal of PacifiCorp*, 2002 WL 31153476 (2002 Cal.St.Bd.Eq. Not to Be Cited as Precedent). Like the Oregon statute, the California code does not define "tangible personal property," nor does it expressly address sales of electricity. The SBE opinion concludes that "sales of generation and transmission of electricity here were sales of services" like "the 'distribution system' by which the flow of

electrically charged particles occurred in *Otte* was a service."[16] *Id.* at 8. Thus, "for purposes of California tax law, electricity is intangible." *Id*. at 9.[17] In making this decision, the California SBE finds the testimony of Professor Joel Fajans (testifying for the Franchise Tax Board in *PacifiCorp* and also the department in the present case as discussed below) that electricity is "tangible personal property" consistent with the definition of electricity in *Otte* as a "flow of electrically charged particles along a conductor, and the conclusion that the "distribution

---

[16] *Otte v. Dayton Power & Light Co.*, 37 Ohio St3d 33, 523 NE2d 835 (1988), was an odd case for the California SBE to rely on. *Otte* cites no authority for the astounding surmise that "[e]lectricity appears to fall outside" the definition of a "product"—"anything made by human industry or art." *Id*. at 36. A great deal of human industry and even art has produced the massive electricity generation and transmission system—the Intertie—from which PacifiCorp sells electricity. By relying on *Otte*, the SBE strayed far afield from the treatment of wholesale sales of electricity for purposes of income tax apportionment.

[17] Four years after the SBE decided *PacifiCorp*, the California Court of Appeals concluded that electricity is tangible personal property under the sales tax, noting that nearly all states treat electricity sales as sales of tangible personal property for sales tax purposes. *See Searles Valley Minerals Operations, Inc. v. State Board of Equalization*, 160 Cal App 4th 514, 72 Cal Rptr 3d 857, 2008 Cal App LEXIS 282 (2008), *affirming* 2006 Superior Court decision (Attachments 4 and 5); *see also* Streamlined Sales and Use Tax Model Act, http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%2012-19-11.pdf. For purposes of determining whether a sale should be sourced to a particular state, it should make no difference whether a sale of electricity is being considered under a corporation excise tax or a tax on sales. California's inconsistent treatment of electricity sales as sales of tangible personal property under its sales tax, but sales of a service under its corporation excise tax, is an anomaly.

system" with respect to electricity there was a service." *Id*. at 8. No "generation" or "distribution system" ownership is involved in the present case and Powerex has not made the argument that it is selling a service; Powerex simply sells kilowatt hour quantities of electricity to its trading counterparties. The tax court did not decide that Powerex's sales of electricity are a "service," and inappropriately "followed" the SBE *PacifiCorp* decision. The SBE decision is not precedential, nor should it be followed, in Oregon.

The tax court followed a second administrative decision, *Eua Ocean State Corp. v. Comm'r of Revenue*, 2006 Mass Tax LEXIS 35 (Mass Tax 2006). The Massachusetts Appellate Tax Board (ATB) relied on the California SBE *PacifiCorp* decision as "persuasive authority" because like the Partnerships in the Massachusetts appeals, PacifiCorp owned and operated a power plant in a neighboring state, and sold electricity under contracts providing for delivery at a substation located in the same state as the generating plant. *Id*. at ATB 2006-280-281. Further, it found that the "use of the tangible personal property model does not effectuate the statutory purpose of the §38(c) apportionment formula for approximating that part of corporate income which is related to Massachusetts activities [citing *Boston Professional Hockey Association v. Commissioner of Revenue*, 443 Mass 276, 280, 820 NE2d 792 (2005)]." In addition to the SBE decision, the ATB relied on a Nebraska decision and three Illinois Supreme Court

decisions, including *Farrand Coal Co. v. Halpin*, 10 Ill2d 507 (1957). However, the Illinois Supreme Court recently rejected its statements concerning electricity in *Farrand Coal* as mere obiter dicta, and held that electricity is tangible personal property. *See Exelon Corp. v. Department of Revenue*, 234 Ill2d 266, 280-284, 917 NE2d 899 (2009).

There is another important reason that the two administrative tribunal decisions should not be followed. Both the California SBE and the Massachusetts ATB were reluctant to find electricity sales to be sales of tangible personal property where in both cases the state taxing authorities were urging that those sales be included in their respective states' sales factor numerators based on ultimate destination theories, despite the undisputed evidence showing that the electricity had been delivered not in those states, but in adjacent states, Oregon and Rhode Island, respectively. Moreover, in both cases, the taxing authorities conceded that costs of performance analysis for sales of other than tangible personal property would not allow inclusion of the sales in their states' numerators.[18] Thus, by deciding that sales of electricity were not sales of tangible personal property, the SBE and the ATB avoided the delivery versus destination dispute.

---

[18] The department does not concede that Powerex has met its burden of proof on this point in the present case, as discussed below.

In contrast to the taxing authorities' positions in the SBE and ATB appeals, in the present case, the department is asserting that the sales of electricity are sales of tangible personal property and, indeed, should be sourced to the state in which delivery was made, i.e., Oregon.[19] In so doing, the apportionment reflects the transactions between buyer and seller that occur in this state--no more and no less—effectuating the statutory purpose of ORS 314.665.

In *Exelon Corp. v. Department of Revenue*, 234 Ill2d at 280-284, the Illinois Supreme Court relied on Dr. Joel Fajans' report concerning the physical nature of electricity—the same report entered in evidence in this case (Ex LL)—in holding that "electricity constituted tangible personal property" for purposes of the Illinois Income Tax Act. *Id*. at 282-284. As discussed above, the Illinois Supreme Court's holding departed from dicta concerning electricity in its earlier decisions. The court quotes Dr. Fajans' report, as follows:

---

[19] Ironically, in the SBE case, PacifiCorp, represented by Eric Coffill, who also represents Powerex, argued that if the electricity sales were sales of tangible personal property, then the sales should be sourced to the contract point of delivery in Oregon. *Id*. at 2.

And, also ironically, in the present case the tax court accepted the parties' stipulation that natural gas is tangible personal property, but rejected the department's position that the state of delivery determines sourcing, in favor of Powerex's argument that it is the state of ultimate destination (although no one could testify as to where that is). Had the tax court followed the SBE and ATB decisions on this point, it would have accepted the department's position on "delivery" sourcing consistent with the language of ORS 314.665.

> Electricity is physical and material because, microscopically, it consists of the flow and 'pressure' of a material entity, namely electrons, and macroscopically, it can be sensed (felt, tasted, seen, and heard), measured, weighed, and stored, and is subject to universal laws of nature. * * * Without electrons, electricity cannot be transmitted. * * * Since electricity itself consists of the flow of a material object, electricity is physical and material.

Id.

The Illinois Supreme Court also cited *Utilicorp United Inc. v. Director of Revenue*, 75 SW3d 725, 723 n 6 (Mo 2001), which observed the contrast with the Webster's definition of "intangible": "something that cannot be touched or perceived by touch." *Id*. at 282-283. The court also noted that "[w]e now join the several courts that have expressly held in varying contexts that electricity constitutes 'tangible personal property," citing *Searles Valley Minerals Operations, Inc. v. State Board of Equalization*, 160 Cal App 4th 514, 521,72 Cal Rptr 3d 857, 862 (2008); *Narragansett Electric Co. v. Carbone*, 898 A23d 87, 97-98 (RI 2006); *Davis v. Gulg Power Corp*., 799 So2d 298, 300 (Fla Dist Ct App 2001); *Curry v. Alabama Power Co*., 243 Ala 53, 59-60, 8 So2d 521, 526 (1942). *Id.* at 284. The Illinois court's approach to uniformity analysis is more encompassing than the tax court's narrow focus on two administrative tribunals, and it suggests that the court's understanding of electricity as tangible personal property focused on the definition of the term "tangible personal property" and the physical characteristics of electricity, rather than a particular tax.

In its uniformity analysis, the tax court also improperly relied on a 1992 Multistate Tax Commission (MTC) audit manual statement[20] that electricity is considered intangible where tangible property is defined as commodities that are perceptible to the senses and movable.[21] (Stipulated Exhibit 16). This statement is inconsistent with the uncontradicted evidence in this case demonstrating that electricity is both perceptible to the senses and movable, as discussed below. Moreover, the Compact (ORS 305.655, Article VIII Interstate Audits) does not authorize MTC auditors performing multistate audits to substitute their view of the law for the applicable state law. MTC auditors are required to ascertain the particular laws and policies of the states for which they perform audits. Thus, an MTC auditor would have followed the Oregon department's policy to treat electricity as tangible personal property.

D. Electricity can be weighed, measured, touched or felt, seen, heard and delivered, i.e., physically sensed.

1. Department's expert demonstrated that electricity as sold on the Intertie power grid can be physically sensed.

---

[20] The MTC audit manual was compiled by MTC audit staff, in contrast with MTC Model Regulations, which are voted on by all MTC members after public hearings allowing for input from industry members and states.

[21] Natural gas would likely have been considered similar to electricity, not water and gasoline, which were the two examples of tangible property in the Manual. (Stip Ex 16).

Dr. Joel Fajans a Professor of Physics at University of California, Berkeley, and a member of the Alpha Collaboration CERN, testified for the department regarding the physical characteristics of electricity that meet the definition of "tangible personal property" discussed above. (See Ex KK for a complete listing of his many qualifications). Dr. Fajans provided a series of in-court demonstrations, mirroring those described in his report, which show that electricity has physical substance apparent to the senses. (Fajans Report - Ex LL; Fajans Tr 200 – 347). Using various devices, Dr. Fajans demonstrated that electricity, or more precisely electric power, which is the commodity bought and sold by Powerex and other companies, can be weighed, measured, touched or sensed,[22] seen, heard, and tasted. This is the electric current or electric power that flows over the Intertie grid wires in Oregon. (Exhibit LL, page 3, footnote 3, explains that one wire in the electrical circuit must have an excess of electrons and the other wire a deficit of electrons in order for electricity to flow through a transmission line). Like the simple circuit depicted in Exhibit LL, figure 1, the Intertie is a loop. (Tr 229). Even in the simple circuit on the order of a billion billion electrons are

---

[22] *Davis v. Portland General Elec. Co.*, 286 Or 195, 198, 593 P.2d 1135 (1979) (boom of the crane struck the power line, sending electricity through the crane and I-beam, causing plaintiff's injuries**)**, and *Portland General Electric Company v. Jungwirth Logging, Inc.*, 151 Or App 789, 951 P2d 1101 (1997) (death by electrocution) are just two of many Oregon decisions recognizing the injurious consequences of touching electricity.

flowing. (Tr 226). A number of the examples in Exhibit LL are based on the Exelon power grid and Dr. Fajans' work for that company in the Illinois *Exelon* case. It is undisputed that electrons have mass and are considered matter in physics.

Dr. Fajans' report (Ex LL) and testimony presenting the physical characteristics of electricity, or more specifically electric current over wires, supports the "physical substance" ordinary meaning of "tangible property" found in *Webster's*, as well as the specialized meaning of "tangible personal property" in *Blacks Law Dictionary*, as property that "can be seen, weighed, measured, felt, or touched, or is in any other way perceptible to the senses."

Dr. Fajans' testimony regarding electricity as it is bought, sold, and transmitted on the Intertie power grid is consistent with testimony of Powerex's witness, Lisa Hopkins, and department witness, Steven Fisher. Powerex's sales income is derived from selling a precisely measured and quantified product that flows over the Intertie infrastructure (wires, buildings, etc.), and is delivered to purchasers on a physical schedule. (Hopkins 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). Lisa Hopkins, testifying for Powerex, described one area of transmission lines as inadequate to "move" as much power as the market wants to move in one direction, creating a "traffic jam." (Tr 94:18-96:13). If electricity had no mass or matter, there would

be no traffic jam. Also, NonConfidential Exhibit R, page 2, a document provided by Powerex, lists all "physical deliveries" in Oregon. Nothing in ORS 314.665 suggests that this product (electricity generated by BC Hydro primarily) should not be considered tangible personal property just as is natural gas.[23] One thing is certain, Powerex was not selling merely the "virtual photons," which Powerex's witness testified push the electrons. The counterparties to Powerex's electricity sales purchased the flowing electrons, which do have mass and matter, as well as the virtual photons, because they purchased a quantity of power or current—also referred to as "electricity."

Steven Fisher testified for the department regarding the losses of electricity that occur in transmission, as a result of friction within the circuits, and the corresponding obligations and rights of parties to compensation or additional electricity delivery, in order to adjust for those losses. (Tr 368-369; Confidential Exhibit 15, p 15-17). These losses are reductions in the amount of electricity, a tangible physical substance, that Powerex and the counterparties agreed would be delivered. Powerex's sales income was derived from selling a precisely measured and quantified product that flows over the Intertie infrastructure (wires, buildings,

[23] Natural gas cannot be seen, tasted, touched, or heard, yet Powerex agrees that natural gas is tangible personal property. The smell is added to natural gas for safety reasons.

etc.), and is delivered to purchasers on a physical schedule. (Hopkins 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). The tax court's conclusion that electricity is not tangible is not supported by substantial evidence in the record.

2. Powerex's expert testified about the causation of electricity, focusing only on one part of electricity, the virtual photons, to the exclusion of electrons.

Peter Fisher, Professor of Physics and Division Head, Experimental Particle and Nuclear Physics, MIT, testified for Powerex on the nature of electricity. In his report, he concludes that "the particles that carry electric power at issue in this case are not matter and hence not tangible." (Ex 2, p 1). He further concludes:

> The force carriers [virtual photons] certainly exert an influence on the matter particles [e.g., electrons] and the whole of creation results from a precise interplay between the force carriers and matter particles. The manner of this interplay is precisely understood from fifty years of experiments. However, what the seller of electricity, like Powerex, delivers is electrical energy in the form of electrical force carriers; no matter particles are delivered to the customer, so the product being delivered to the customer cannot be considered material.

(Ex 2, p 6).

This appears to be a bit like "splitting hairs." When Professor Fisher was asked on cross-examination to look at the picture of the simple circuit in Figure 1, Exhibit LL, and asked "isn't it true that an enormous number of electrons are

flowing as a current, around in a circuit? Billion, billion, it would be on that scale?" (Tr 185). He replied, "Yep, they flow in, they flow out." *Id.*

Dr. Fajans testified that he and Professor Fisher did not really disagree on the science, the physics, but they very much disagree about the level of description that is appropriate for answering the question before the court, i.e., are sales of electricity, as it is bought and sold on the Intertie, sales of tangible personal property for purposes of ORS 314.665? (Tr 259-264).[24] The differing levels of description are aptly illustrated by the contradiction between Professor Fisher's testimony concerning electricity and its lack of tangibility because of the virtual photons, and the definition of electricity on his website. Professor Fisher testified about a wireless energy company that he and others had started, called WiTricity Corp. (Tr 172-174; Ex 2, p 11). On rebuttal, a copy of the WiTricity Corp. website was admitted into evidence as the department's Exhibit RR. It defines electricity as follows: "Electricity: The flow of electrons (current) through a conductor (like a wire) or charges through the atmosphere (like lightning)." This description for public Internet consumption makes no mention of virtual photons—only the flow of electrons. Likewise, *Webster's Dictionary* defines "electricity" in

[24] The tax court was incorrect in saying that the department's witness agreed with Powerex's witness.

terms of electrons and protons, not virtual photons. *See* quoted definition above, p 16.

As Dr. Fajans demonstrated, electricity is perceptible to the senses. It can be weighed, measured, seen, touched, felt, heard, and stored—and it can be delivered just like other tangible personal property to purchasers at points in Oregon. The tax court's contrary conclusion is not supported by substantial evidence in the record.

II. Sales Of Natural Gas Delivered To A Purchaser Within Oregon Are Oregon Sales Under ORS 314.665.

A. The text of ORS 314.665 and OAR 150-314.665(2)-(A)(4) requires that Oregon sales be delivered within Oregon to a purchaser – the purchaser's domicile "location" is not relevant.

The parties agreed that natural gas is tangible personal property, and that the contractual points of delivery for Powerex's natural gas transactions were in Oregon. Nonetheless, the tax court held that those transactions were not properly apportioned to Oregon, because Oregon was not the ultimate destination of the natural gas. This was legal error.

ORS 314.665 provides that sales of tangible personal property are in this state if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of the sale. The department adopted OAR 150-314.665(2)-(A)(4), an MTC model rule, to clarify that:

> Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

Neither the statute nor the rule supports the tax court's "ultimate" destination theory. The statute does not use the word "destination," but explicitly says "delivered."[25] Thus, the text of the statute and rule are clear: if the purchaser accepts delivery in this state, the sale is an Oregon sale. Moreover, as discussed earlier, the whole point of sourcing a sale from a particular transaction would be defeated by basing that sourcing on facts relating to a different sale, i.e., the subsequent sale from Powerex's purchaser to its buyer.

The other word used in the tax court's decision that does not exist in the statute is "location" as in "purchaser's location." The tax court does not explain what is meant by location, which provokes speculation: Is it a truck idling in a parking lot, is it registration with the Secretary of State to do business in the state, or is it the commercial domicile? Fortunately, the legislature did not use the word "location." Nor did it use the words "situs" or "commercial domicile."[26] The text of

---

[25] Testimony from Steven Fisher confirmed that, in any case, no one knows where the ultimate consumer used electricity sold at wholesale by Powerex. (Tr 389). Powerex concurred that the ultimate user of natural gas sold at wholesale is similarly unknown.

[26] References in communications to the legislature in 1965, when ORS 314.665 was enacted, mention a purchaser's situs. However, the legislature clearly did not enact any specific situs requirement in ORS 314.665. ORS 174.010 admonishes

ORS 314.665 simply provides that a sale of tangible personal property is in Oregon if it is delivered to a purchaser in Oregon.

B. Powerex's Contracts Specify Delivery Points in Oregon.

Powerex's sales of electricity and natural gas were delivered to purchasers in Oregon as agreed by contract. There is no dispute factually that the title to the electricity passes from Powerex to its purchasers at the delivery point specified in their contracts. Under the statute and rule, the only question is whether the electricity and natural gas were delivered to a purchaser who took title in Oregon. If so, the sale is an Oregon sale for sourcing purposes.

The department specifically clarified this point with respect to electricity and natural gas sales in OAR 150-314.665(2)-(C)(1), adopted in 2007, and, after correction of a procedural defect, it was re-adopted in 2011 for all periods open to examination. OAR 150-314.665(2)-(C)(1) provides:

> (1) A sale of tangible personal property, including but not limited to the sale of a commodity like electricity or natural gas, which is delivered or shipped to a purchaser with a contracted point of delivery in Oregon is a sale in this state. This is regardless of whether the purchaser uses the property in Oregon, transfers the property to another state, or resells the property in Oregon. If the contract states the point of delivery is at the border with another state, the sale is presumed to be

---

not to insert what has been omitted. In the course of their business operations, the natural gas purchasers in this case were in Oregon when they took title to and delivery of the natural gas in Oregon. That is all the statute requires.

> in Oregon unless the taxpayer can demonstrate to the satisfaction of the department that delivery occurred in some other place.

For the reasons stated above, the tax court erred in refusing to defer to the department's rule, in the absence of a showing that the interpretation is inconsistent with the statute. *See Don't Waste Oregon Com. v. Energy Facility Siting*, 320 Or 132, 142, 881 P2d 119 (1994).

The testimony of both Lisa Hopkins and Steve Fisher confirmed that Powerex delivered quantities of electricity to purchasers who took title to the electricity at designated points in Oregon, including "COB" and "NOB." (*See, e.g.*, Hopkins Tr 88-92; Steven Fisher Tr 378-388. *See also* Western Systems Power Pool (WSPP) [master agreement] Ex F, p 59). The WSPP, section 33.2 (Ex F, p 59) provides that "[t]itle and risk of loss of the electric energy shall pass from the Seller to the Purchaser at the delivery point agreed to in the Confirmation Agreement * * *."

NonConfidential Exhibit W is "BPA's 1996 Transmission Rate Schedules" followed by "Bonneville Power Administration Transmission Business Line Open Access Transmission Tariff Effective October 1, 2001." Section 1.33, at page 7, defines "Point(s) of Delivery: "Point(s) on the Transmission Provider's Transmission System, or point on other utility systems pursuant to section 36 of the Tariff, where capacity and energy transmitted by the Transmission Provider will be made available to the Receiving Party under Parts II and III of the Tariff. The

Point(s) of Delivery shall be specified in the Service Agreement for Long-Term Firm Point-to-Point and Network Integration Transmission Service." Further, Section 1.34 defines "Point(s) of Receipt" as "Point(s) of interconnection on the Transmission Provider's Transmission System where capacity and energy will be made available to the Transmission Provider by the Delivering Party under Parts II and III of the Tariff. The Point(s) of Receipt shall be specified in the Service Agreement for Long-Term Firm Point-to-Point and Network Integration Transmission Service."

Exhibit 16 shows sales of electricity with points of delivery in Oregon. See also Confidential Exhibits: B (natural gas sales with contractual delivery point in Oregon); J (electricity sales at Oregon delivery points); N (records of electricity sales at Oregon delivery points); P (records of electricity sales at Oregon delivery points; Q (schedules of sales to Oregon electricity providers); and U (Powerex's electricity and natural gas sales by State).

There is no dispute that the electricity and natural gas sales at issue were delivered to purchasers at contract points of delivery in Oregon. The question is whether ORS 314.665 requires that the purchasers must be "located" in Oregon and that the sales must be sourced to the "ultimate destination." Under the tax court's decision even if a purchaser is located in Oregon, the sale would still not be sourced

to Oregon if the electricity and natural gas is subsequently transmitted to a different purchaser outside Oregon. This result is clearly not consistent with the statute.

III. Even If Electricity Were Intangible Personal Property, Powerex Failed To Introduce Evidence Of Direct Costs For Each Separate Item Of Income As Required By OAR 150-314.665(4)(4).

Powerex's sales were sales of tangible personal property. However, if this court determines that the sales were other than tangible personal property, then the court must determine whether the income producing activity is performed "both in and outside this state," and, if so, whether the direct costs of performance of that income producing activity were greatest in Oregon. ORS 314.665(4) and OAR 150-314.665(4).

Assuming that the transactions at issue take place within and without Oregon—even though a failure to deliver in Oregon would result in a failure to complete a transaction and Powerex would receive no income to source—the direct costs of performance for each separate item of income must be examined to determine whether the sale is sourced to Oregon. As the department has argued in *AT&T Corp. v. Dept. of Revenue*, S060150 (under advisement), the provisions of ORS 314.665(4) and OAR 150-314.665(4)(4) require that "the analysis must begin with transactions that are or include 'income producing activit[ies].' The next step is to determine the gross receipts from that transaction. The final step is to determine where the direct costs of performance occurred geographically for each

transaction or activity." *Id*. The direct costs of performance "are those that are only incurred because the revenue producing transaction or activity in question occurred. * * * Stated otherwise, indirect costs would be those that would be incurred by taxpayer even if the transaction in question had not occurred." In the present case, each trade is an income producing activity, so we must look to the direct costs of producing the income from that trade, i.e., costs that would not have been incurred but for that specific trade.

Powerex failed to present evidence of direct costs. It presented only indirect and lump sum costs. For example, the desks and computers on the trading floor, as well as the headquarters building, were already purchased and in place before a single sale at issue in this case was made. Traders are paid a salary to make hundreds of trades, and would be paid that salary regardless of whether an individual trade is made. Thus, these are all indirect, sunk costs.

On the other hand, certain costs would be direct costs associated with a particular trade. For example, in some cases a brokerage fee is paid on a particular trade, and in many cases a transmission tariff is paid to BPA for transmission of the electricity sold in a particular trade. However, plaintiff did not present this evidence as to particular trades; only in aggregated form. For this reason, plaintiff failed to meet its burden of proving that the costs of performance were not greatest in Oregon.

IV. Conclusion.

The department asks this court to reverse the decision of the Oregon Tax Court and find as a matter of law that sales of electricity are sales of tangible personal property, which are Oregon sales when delivered to purchasers in Oregon, consistent with ORS 314.665, OAR 150-314.665(2)-(A)(1), and OAR 150-314.665(2)-(C).

DATED this 29th day of July 2013.

Respectfully submitted,

ELLEN F. ROSENBLUM
Attorney General

By: /s/ Marilyn J. Harbur
Marilyn J. Harbur, #802517
Senior Assistant Attorney General
Of Attorneys for Department of Revenue,
State of Oregon, Defendant-Appellant

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 10, 636 words.

Type size

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 29th day of July, 2013.

By: /s/ Marilyn J. Harbur
Marilyn J. Harbur, #802517
Of Attorneys for Defendant-Appellant

CERTIFICATE OF SERVICE

I certify that on July 29, 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:

ERIC COFFILL
JENNI CHOI
Morrison & Foerster LLP
400 Capitol Mall, Suite 2600
Sacramento, CA 95814

By: /s/ Marilyn J. Harbur
Marilyn J. Harbur, #802517
Of Attorneys for Defendant-Appellant
Department of Revenue