

No. 39872-9-II

**COURT OF APPEALS, DIVISION TWO
OF THE STATE OF WASHINGTON**

Puget Sound Energy, Inc.,

Appellant,

v.

State of Washington, Department of Revenue,

Respondent.

BRIEF OF APPELLANT

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TABLE OF CONTENTS

	Page
I. Assignment of Error	1
II. Issue Presented	1
III. Statement of the Case	1
A. PSE's Business.....	1
B. NWP's Business.....	2
C. PSE and NWP's Natural Gas Distribution Service.....	2
D. DOR's Position Below	3
E. Prior PSE – DOR Litigation Regarding the Services Furnished Jointly Services.....	4
IV. Standard of Review	5
V. Argument.....	6
A. PSE and NWP Are Providing "Services."	6
B. PSE and NWP Are Providing Services "Jointly."	7
1. The plain meaning of "jointly"	7
2. The anti-pyramiding purpose and structure of the PUT confirm PSE's deduction under the plain language of RCW 82.16.050(3).....	9
3. The DOR's long-standing rules confirm PSE's deduction under the plain language of the statute.....	11
VI. Conclusion.....	15

TABLE OF AUTHORITIES

	Page
Cases	
<i>HomeStreet, Inc. v. Department of Revenue</i> , 166 Wn.2d 444, 210 P.3d 297 (2009)	5, 7
<i>PUD No. 2 of Grant County v. Department of Revenue</i> , 82 Wn.2d 232, 510 P.2d 206 (1973)	9
<i>Qwest Corp. v. City of Bellevue</i> , 161 Wn.2d 353, 166 P.3d 667 (2007)....	5
<i>State v. Engel</i> , 166 Wn.2d 572, 210 P.3d 1007 (2009)	9
Statutes	
RCW 82.16.010(10)(a)	7
RCW 82.16.010(7)	7
RCW 82.16.050(3)	passim
Regulations and Rules	
WAC 458-20-13501	11, 13
WAC 458-20-179	11, 12, 13, 14
Other Authorities	
Washington DOR, Research Division, Tax Reference Manual (2007)	9
Washington DOR, Study of Electricity Taxation (1999)	9
Webster's Third New International Dictionary 1219 (2002)	8

I. Assignment of Error

The trial court erred by failing to apply the plain language of RCW 82.16.050(3) (the "services furnished jointly" deduction) to permit Puget Sound Energy ("PSE") to deduct from its public utility tax ("PUT") base amounts paid to Northwest Pipeline ("NWP") for its portion of natural gas services provided together with PSE.

II. Issue Presented

May PSE deduct from its PUT base amounts paid to NWP under the plain language of RCW 82.16.050(3) where the undisputed facts show that (i) PSE and NWP are gas distribution businesses taxable under the PUT and (ii) PSE and NWP work together to provide natural gas distribution service to Washington customers?

III. Statement of the Case

A. PSE's Business

PSE is Washington's oldest and largest energy utility.¹ CP 32. PSE provides electricity and natural gas services to customers located primarily in the Puget Sound region of Western Washington. CP 32. PSE's natural gas service business is a "gas distribution business" under the Washington PUT, Chapter 82.16 RCW. CP 33. That is, PSE

¹ PSE was formerly known as Puget Sound Power & Light Company. CP 32. In this brief, PSE will refer to Puget Sound Power & Light Company and Puget Sound Energy, Inc. as "PSE."

"operat[es] a plant or system for the ... distribution for hire or sale of gas" in Washington. CP 33.

B. NWP's Business

NWP, like PSE, operates a plant or system for the distribution of gas in Washington and is a "gas distribution business" under Chapter 82.16 RCW. CP 35. Although NWP's system extends beyond Washington's borders and, accordingly, is subject to Federal Energy Regulatory Commission ("FERC") regulation, NWP's portion of the gas distribution service at issue in this case is primarily between points within Washington (*i.e.*, receipt points near Sumas and Spokane to PSE's system in Western Washington). CP 35, 335.

C. PSE and NWP's Natural Gas Distribution Service

In order to provide natural gas distribution service to customers, natural gas must be purchased—generally outside of Washington—and transported through natural gas pipelines from production or storage areas in Canada and elsewhere to homes and businesses in the Puget Sound area.

Natural gas in much of Western Washington is provided through the joint efforts of PSE and NWP. PSE, the gas distribution business with the direct contractual relationship with the customer, purchases natural gas needed to serve its customers from a diverse group of natural gas

producers and marketers in the United States and Canada. CP 33. PSE contracts and works together with NWP to transport and distribute the natural gas from receipts points near Sumas, Spokane, and elsewhere to customers in Western Washington. CP 34. NWP transports the gas within Washington on its gas distribution system to PSE's system. CP 35, 335. PSE completes the distribution of the natural gas by transporting the gas from NWP's system to customers' homes and businesses. *See* CP 33, 335.

During the period January 1999 through December 2003 (the "Period at Issue"), PSE paid NWP for its portion of the natural gas distribution service pursuant to FERC tariffs and written contracts. CP 34. PSE received consideration for the entire natural gas distribution service from its Washington customers and paid PUT on the total amount received. CP 238, 245, 246.

D. DOR's Position Below

During an audit by the Department of Revenue ("DOR"), the DOR denied PSE's PUT deduction under RCW 82.16.050(3) (the "services jointly furnished" deduction) for amounts paid to NWP for NWP's portion of the natural gas distribution services. CP 232 - 236. The DOR denied PSE's refund claim because NWP was "not 'taxable under chapter 82.16 RCW' and you would not qualify for the 'services jointly furnished deduction.'" CP 246. On administrative appeal, the DOR Appeals

Division likewise denied the deduction because "the Taxpayer has not shown that NWP's transportation services are 'capable of being taxed' and therefore eligible for deduction." CP 312.

Following the DOR's administrative determination, PSE timely filed a *de novo* Complaint for Refund of Taxes, which gives rise to this appeal. CP 4 - 17. In cross motions for summary judgment, the DOR abandoned its original basis for denying PSE's refund: "Puget makes a compelling argument. ... For purposes of this summary judgment proceeding, the Department will agree that Northwest is a person subject to the public utility tax on the amounts at issue in this case." CP 367. Instead, the DOR asserted a new argument that PSE was not entitled to the deduction because PSE and NWP are not furnishing services "jointly." *See* CP 367.

E. Prior PSE – DOR Litigation Regarding the Services Furnished Jointly Services

In 1974, PSE and the DOR litigated the application of the services furnished jointly deduction to PSE's electric energy ("light and power") business.² CP 36. In that litigation, the superior court held that PSE was entitled to deduct from its PUT base amounts paid to other utilities for transporting (wheeling) PSE's electricity over the other utilities'

² PSE did not have a natural gas business in 1974. PSE acquired its natural gas business in 1997 when it merged with Washington Energy Company, parent of Washington Natural Gas.

transmission facilities.³ CP 36, 326 – 333 (Memorandum Opinion, *Puget Sound Power & Light Co. v. State of Washington*, Thurston County Cause No. 38039 (April 24, 1974)). The DOR did not appeal the Court's decision, and PSE has deducted amounts paid to other utilities for the wheeling of electricity without further controversy or challenge by the DOR since 1974. CP 36.

IV. Standard of Review

Washington courts review a trial court's grant of summary judgment *de novo*. *Qwest Corp. v. City of Bellevue*, 161 Wn.2d 353, 358, 166 P.3d 667 (2007). Summary judgment is proper if there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. *Id.* Facts and reasonable inferences therefrom are construed in favor of the nonmoving party (PSE). *Id.* Statutory interpretation is also a question of law reviewed *de novo*. *HomeStreet, Inc. v. Department of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009).

³ The third-party transmission / wheeling of electricity is functionally similar to the third-party transmission of natural gas in this case. CP 335. In both situations, a third-party utility is transporting electricity or natural gas owned by PSE over the third party's transmission system. *Id.* This transmission occurs upstream from PSE's final distribution of the electricity or natural gas to the ultimate customer. CP 34, 332, 335.

V. Argument

RCW 82.16.050(3) allows natural gas distribution companies and other public service businesses to deduct from gross income under the PUT:

Amounts actually paid by a taxpayer to another person taxable under this chapter as the latter's portion of the consideration due for services furnished jointly by both, if the total amount has been credited to and appears in the gross income reported for tax by the former.

RCW 82.16.050(3). In this case, there is no dispute that (a) the deduction amount claimed by PSE was "actually paid" by PSE to NWP; (b) NWP is "taxable under [chapter 82.16 RCW]" as a gas distribution business; and (c) the total amount of consideration for natural gas distribution service "has been credited to and appears in the gross income reported for tax" by PSE. CP 34, 238, 245 -246, 367. The only issue is whether amounts paid by PSE to NWP were for "services furnished jointly."

The phrase "services furnished jointly" involves two components: PSE and NWP must be providing "services" and those services must be provided "jointly."

A. PSE and NWP Are Providing "Services."

The parties have stipulated that both PSE and NWP are in the same public *service* business—the "gas distribution business." CP 33, CP 35.

See RCW 82.16.010(10)(a) (defining "public service business" to include a "gas distribution business"). The "gas distribution business" consists of "the business of operating a plant or system for the production or distribution for hire or sale of gas, whether manufactured or natural." RCW 82.16.010(7). Neither PSE nor NWP operate a system for the "production" of gas. Instead, both operate systems for the "distribution" of gas in Washington. See CP 33, 335. NWP uses its system to distribute gas from receipt points near Sumas, Spokane, and elsewhere to PSE's system in Western Washington. CP 35, 335. PSE completes the gas distribution service by using its system to transport the gas from NWP's system to customers' homes and businesses. CP 33, 335.

B. PSE and NWP Are Providing Services "Jointly."

1. The plain meaning of "jointly"

The word "jointly" is not defined in the public utility tax. When interpreting a statute, courts normally give the undefined words in a statute their common and ordinary meaning. *HomeStreet, Inc. v. Department of Revenue*, 166 Wn.2d 444, 451, 210 P.3d 297 (2009). To determine the common and ordinary meaning of an undefined term, courts look to the dictionary definition of the word. *Id.* The dictionary definition of "jointly" is "in a joint manner," "together," "unitedly." Webster's Third New

International Dictionary 1219 (2002). "Joint" is defined as "joined, united, combined." *Id.*

The undisputed facts of this case demonstrate that PSE and NWP work "together" to distribute natural gas. PSE has a contractual and regulatory obligation to distribute natural gas to customers in much of Western Washington. PSE cannot distribute a molecule of natural gas to its customers without NWP, another natural gas distribution business, first delivering the gas to PSE through NWP's gas distribution system. CP 34, 35. Multiple interconnected pipelines are required to transport natural gas from production areas in Canada and the United States to homes and businesses in Western Washington. CP 33, 335. PSE delivers natural gas to customers in Western Washington, but doing so requires that it work "together" or "unitedly"—jointly—with NWP, another Washington gas distribution business.

This conclusion is reinforced by the structure of the PUT chapter, which was designed by the Legislature to avoid pyramiding of PUT, and the DOR's long-standing administrative rules applying the services furnished jointly deduction.

2. The anti-pyramiding purpose and structure of the PUT confirm PSE's deduction under the plain language of RCW 82.16.050(3).

In determining the plain meaning of a statute, courts use not only the ordinary meaning of the language at issue, but also "the context of the statute in which that provision is found, related provisions, and the statutory scheme as a whole." *State v. Engel*, 166 Wn.2d 572, 578, 210 P.3d 1007 (2009). In this case, the statutory scheme reinforces the plain meaning of the word "jointly."

The public utility tax system is structured with a series of deductions designed to avoid pyramiding of PUT. *See PUD No. 2 of Grant County v. Department of Revenue*, 82 Wn.2d 232, 241, 510 P.2d 206 (1973) (describing PUT as being "imposed only once under the Washington taxing scheme" with the deduction at issue permitting "the singular tax imposition by preventing the pyramiding effect of the public utility tax which is certain to occur). The DOR regularly contrasts the PUT structure with the state business and occupation (B&O) tax structure: "Unlike the B&O tax which pyramids ... the public utility tax applies only on sales to consumers." Washington DOR, Research Division, Tax Reference Manual (2007) at 119. *See also* Washington DOR, Study of Electricity Taxation (1999) at 7 ("Unlike the B&O tax, the PUT does not pyramid.").

Although all gas distribution business are required to report and pay PUT on the "gross income of the business," the Legislature avoids pyramiding of PUT among gas distribution businesses by giving a deduction to the gas distribution business receiving payment from the customer (*i.e.*, PSE) a deduction for amounts paid to other natural gas distribution businesses. RCW 82.16.050(3). In this case, PSE reports and pays PUT on amounts it receives for gas distribution services and is entitled to a deduction for amounts it pays to NWP for gas distribution services. NWP, in turn, is taxable on amounts it receives from PSE for its portion of the gas distribution service.

More than thirty-five years ago, PSE and the DOR litigated the application of the same service furnished jointly deduction to PSE's light and power business.⁴ CP 326 – 333 (*Puget Sound Power & Light Co. v. State of Washington*, Thurston County Cause No. 38039 (April 24, 1974)).⁵ In that case, the superior court concluded that amounts paid by PSE to other light and power businesses to transmit electricity over the other utilities' facilities were deductible from PUT as "services jointly furnished" under RCW 82.16.050(3). The court's reasoning, long-

⁴ PSE did not enter the gas distribution business until it acquired Washington Energy Company, parent of Washington Natural Gas, in 1997.

⁵ The DOR did not appeal the superior court's decision. CP 36. PSE has been deducting amounts paid to other utilities for wheeling electricity since 1974 without further controversy or challenge by the DOR. CP 36.

accepted by both PSE and the DOR, confirms the anti-pyramiding nature of the PUT system:

Agreements which provide for "wheeling" and "load factoring" result in electricity often being furnished to customers as the result of a joint effort, though that *joint effort may be unknown to the customer*. RCW 82.16.050(3), it seems to me, recognizes that services will be furnished jointly and wisely allows a deduction for amounts paid by one taxpayer, subject to the utility tax, to another taxpayer subject to the same tax. *The reason for this is obvious because it avoids pyramiding of the same tax.*

CP 333 (emphasis added). The same rationale and legislative purpose applies in the current case.

3. The DOR's long-standing rules confirm PSE's deduction under the plain language of the statute.

The DOR's administrative rules do not define "jointly," but provide several examples of "jointly furnished" services—each involving transportation services. WAC 458-20-179 ("Rule 179"); WAC 458-20-13501(5)(a) ("Rule 13501").

The first example, which has been in the various iterations of Rule 179 for almost 40 years, concludes that a trucking company (taxable as a "motor transportation business" or an "urban transportation business") is entitled to deduct consideration paid to a ferry company (taxable as an "other" public service business):

Amounts derived from the following sources may be deducted from the gross income under the public utility tax ...:

(c) Amounts actually paid by a taxpayer to another person taxable under chapter 82.16 RCW as the latter's portion of the consideration due for services jointly furnished by both. ***This includes the amount paid to a ferry company for the transportation of a vehicle and its contents*** ... when such vehicle is carrying freight or passengers for hire and is being operated by a person engaged in the business of urban transportation or motor transportation.

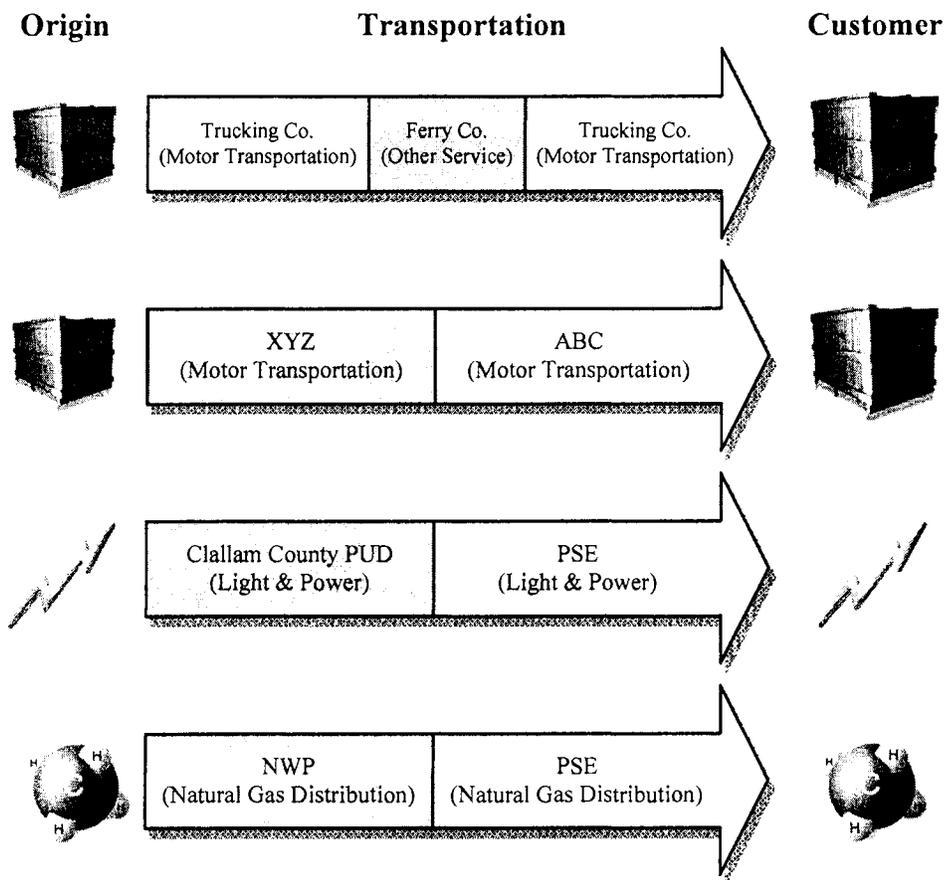
WAC 458-20-179(9)(c) (emphasis added). Nothing in Rule 179 suggests that the services furnished jointly deduction is disallowed because the ferry is providing service "to" the trucking company rather than having a direct contractual relationship with the trucking company's customer. Not only does the ferry not have a direct contractual relationship with the trucking company's customer, the ferry company is not even in the same public service as the trucking company. (This contrasts with NWP and PSE, which are both gas distribution businesses.) Consistent with the plain meaning of the deduction, the trucking company is permitted a deduction because the ferry company is "taxable" under the PUT and is providing a public service "together"—"jointly"—with the trucking company.

In the second example, added to Rule 179 in 1994, the DOR concludes that a trucking company that subcontracts a portion of the transportation service to another company is entitled to deduct payments made to the subcontractor for "jointly furnished service":

Customer A hires ABC Transport to haul goods from Tacoma, Washington to a manufacturing facility at Bellingham. ABC Transport subcontracts part of the haul to XYZ Transport and has XYZ haul the goods from Tacoma to Everett where the goods are loaded into ABC's truck. ABC may deduct the payments it makes to XYZ as a 'jointly furnished service.'

WAC 458-20-179(9)(c)(ii). ABC is entitled to the deduction for amounts paid to XYZ even though XYZ is providing service to ABC as a subcontractor. XYZ, just like NWP, has no direct contractual relationship with the ultimate customer and is hired by the prime contractor to provide the initial leg of a longer transportation service. ABC, like PSE, has the only direct contractual relationship with the customer and is providing the final leg of the transportation service. As with NWP and PSE in this case, XYZ is providing transportation services "together, unitedly"—"jointly"—with ABC for the benefit of the ultimate consumer. *See also* WAC 458-20-13501(5)(a) (describing a prime contractor's "services furnished jointly" deduction for amounts paid to a subcontractor for transportation services).

The examples in the DOR's rules and the 1974 superior court case each reflect the application of the plain meaning of "jointly": together, unitedly, combined. The ferry company in Rule 179(9)(c), XYZ trucking company in Rule 179 (9)(c)(ii), Clallam County PUD in the 1974 case, and NWP in this case are public service businesses that contract with other public service businesses (the trucking company, ABC trucking company, PSE, and PSE, respectively) to provide a portion of a larger public service to end customers:



These examples present similar facts that result—or should result—in a PUT deduction for services furnished jointly:

- Each involves at least two public service businesses providing multi-leg transportation service
- Except for the ferry example, each involves taxpayers in the same public service business
- Each involves end customers that have a contractual relationship only with the taxpayer entitled to the PUT deduction.
- Each involves a taxpayer contracting with another public service business for the performance of service that allows the taxpayer to fulfill its obligations to the end customer.
- Each involve public service businesses working together to provide a public service

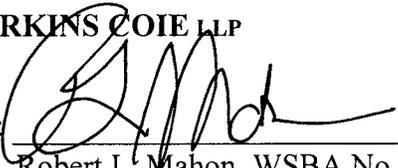
As in these examples, PSE should be entitled to a deduction amounts paid to NWP for services furnished jointly.

VI. Conclusion

For the reasons set forth above, the trial court erred by failing to apply the plain language of RCW 82.16.050(3) and allow PSE's deduction for amounts paid to NWP for NWP's portion of natural gas distribution services provided together with PSE. Accordingly, PSE respectfully requests that this Court vacate the trial court's summary judgment in favor of the DOR and order judgment entered in favor of PSE.

DATED: December 24, 2009

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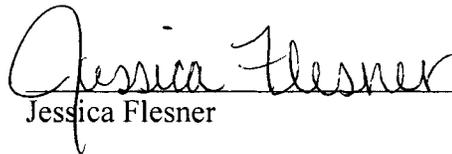
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CERTIFICATE OF SERVICE

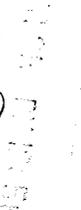
I certify and declare under penalty of perjury under the laws of the State of Washington that on December 24, 2009 I caused a true and correct copy of this Brief of Appellant to be served by legal messenger on the following:

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DATED this 24th day of December, 2009 at Seattle, Washington.



Jessica Flesner

BY:  DATE: 12/24/09
BY:  DATE: 12/24/09
BY:  DATE: 12/24/09