

***UTILITY COMPENSATION  
CHANGING THE PARADIGM***

**LEAGUE OF OREGON CITIES  
ANNUAL CONFERENCE**

November 6, 2004  
Portland, Oregon

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## ***UTILITY COMPENSATION CHANGING THE PARADIGM<sup>1</sup>***

### **INTRODUCTION**

In March of this year, Springfield staff proposed to the City Council that staff begin to explore the possibility of imposing a tax on all utilities. One reason behind this proposal was the need to address an intractable General Fund revenue gap; one which has placed the City in the position of needing to continue to ratchet down spending, in the face of stagnant revenues. The other reason, and the one which this discussion will focus on, was the perceived lack of long-term viability of the City's current revenue streams generated by activities in the utility industry, particularly telecommunications.

### **HISTORICAL CONTEXT**

As we all know, currently, most Oregon cities derive revenue from the activities of utilities through a system of franchise fees. For over a century, Oregon cities have relied on these fees which, in many cases, represent the second largest source of general fund revenue following the real property tax. These fees are not, however, unique to Oregon. For example, cities in New York State have, for almost two centuries, relied, to varying degrees, on essentially similar fees. Throughout the eastern United States, in fact, throughout the entire country, the basic right of a local government to determine, by grant of a franchise, who may provide these critical services, and what compensation is to be paid to the local government for that grant, is a tradition that goes back to the beginning of the republic.

In many states that system has deteriorated as a source of revenue, as states move to consumption based taxation. Local governments which impose sales and use taxes often view these as broader based successors to the revenue based fees upon which franchise compensation has traditionally been based. Thus the aspect of a franchise as "rental" of property held in trust for the public by the renting local government has declined as a practical source of revenue.

The potential decline of the franchise fee "rent" approach has been accelerated by the Congress' action in 1996 to "increase competition" in the telecommunications arena – one of the

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avowed, but as yet unrealized, purposes of the Telecommunications Act of 1996, which significantly amended the Communications Act of 1934.

More traditional utilities – electricity, natural gas, and even water and sewer, particularly when provided by someone other than the local government, have long accepted these fees as a standard cost of doing business, and adjusted their business model to accommodate them.

Not so with the telecommunications industry. The enormous capital costs associated with telecommunications infrastructure, particularly the extension of wireline facilities across long reaches, prompted the newer entrants into the industry, most of whom were thinly capitalized, at best, to challenge every conceivable cost center. Payments to local government, which were not easily perceived by telecom customers as providing them a benefit, were among the first to be attacked. Although the imitative may have been taken by the new entrants, the incumbents in the field soon recognized that this challenge posed a threat to their competitive position and they joined the fray.

With the incumbent industry joining the attack on franchise fees, two general theories were advanced to justify their position. First – telecommunications was described as the railroad of the 21<sup>st</sup> century, the interconnected network which constitutes the interstate backbone for the information age. The industry pointed to the enormous concessions granted to the railroad industry to foster a rapid deployment across the country in the middle of the 19<sup>th</sup> century, and argued forcefully that the demands of modern technology required that they be granted the “modest” concession of not being burdened with “complex and onerous” fees to make advanced telecommunications services available to all our citizens. (Most of whom have yet to see any such services.)

They also argued that the very language of the 1996 act, which required that right of way fees be reasonable and competitively neutral, demanded that the fees be eliminated, or reduced to the level of the cost of administering access to public rights of way. To support their argument, they point out that much of the most rapidly expanding technology involves more extensive and intensive use of the facilities that are already in the right of way. Now that the fiber-optic explosion has run its course, in one sense, they have a sort of point. The lines in the right of way that handled a single telephone conversation fifty years ago have been replaced by cables that handle 2 million conversations simultaneously – and generally require no more maintenance or other intrusion into the public rights of way. The future appears to hold not more congestion under our streets, but more efficient use of what is already there.

Don't get me wrong. I do not believe that it is impossible to provide for a system that can track the revenue generated by the multitude of users of the facilities in the rights of way. I think it can be done with relative ease, and that it is, in fact, still possible for the rent based model to work. For a long time to come, that vast majority of communications will touch facilities located in rights of way at some point. My concern, and it is what motivated our staff toward the newer model which has been proposed for Springfield, is that increasingly those of us who believe in

the existing model are in the minority. In courthouse and state houses across the country, the arguments of the industry are having an effect.

As you know, Qwest has directly challenged the rent model in Oregon. Although chiefly due to the acumen and diligence of the attorneys representing Portland and the other cities challenged by Qwest, including both Springfield and Eugene, cities prevailed in the District Court and, with respect to the continued viability of franchise fees based on gross revenues, at the Ninth Circuit Court of Appeals, there remains concern about the long term future of such fees. Although the City of Eugene has prevailed in its litigation on the two percent registration fee (which even Eugene calls a tax), those decisions do not address the fundamental issues of the franchise fee “rent” model, which was not at issue in those cases. In other states, and other federal Circuits, the battle goes not as well. Although no court has yet held that franchise fees calculated as a percentage of gross revenue are incompatible with the provisions of the 1996 Act, in a number of cases opinions striking down telecommunications ordinances, generally on other grounds, have left lingering doubts and concerns, and helped to fuel the vigor of the attack on such fees by the industry.

Last month, the Ninth Circuit Court of Appeals rendered its long-awaited decision in *Qwest Communications, Inc. v. City of Portland*<sup>2</sup>. Pam Beery, counsel for the City of Springfield, among others, in that litigation, will present a more detailed analysis of the Court’s decision at these proceedings. For purposes of this discussion, it is sufficient to note that while the Court affirmed the ruling of the District Court on the question of whether franchise fees need to be cost-based, it did so under circumstances where future challenges are not precluded, even in the Ninth Circuit. Fortunately, the Court did acknowledge that its decision in *City of Auburn v. Qwest*<sup>3</sup>, which the industry has held up as proof that gross revenue based fees are improper, did not address that question.

Through the past several sessions of the Legislative Assembly, cities, led by League of Oregon Cities staff, have successfully defended the existing regulatory scheme. While those of us in the trenches every day are gratified by our continued success, we realize we are fighting a defensive campaign. As with the courts, in other state legislatures, the rent model does not fare well. Perhaps, in part because most other state legislatures are familiar with, and comfortable with, the consumption tax model, increasingly legislation is being passed which either imposes a statewide tax or authorizes cities to impose such taxes and curtails the power of local government to impose fees based on the rent model.

Neither of these trends provides comfort that Oregon cities can stand by and await the ultimate outcome of either the judicial or legislative conversations on local revenue. It is for that

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<sup>2</sup> *Qwest Corporation v. City of Portland*, 200 F.Supp.2d 1240 (District Or. 2002); \_\_\_\_ F.3d \_\_\_\_, 9<sup>th</sup> Circuit, October 12, 2004, Case NO. 02-35473.

<sup>3</sup> *City of Auburn v. Qwest*, 247 F.3d 966, *superseded on rehearing*, 260 F.3d 1160 (9<sup>th</sup> Cir. 2001) *cert. den’d*, 122 S. Ct. 809, \_\_\_\_ US \_\_\_\_ (2002).

reason that Springfield staff suggested, earlier this year, that it was time to change the conversation, to become proactive, not remain reactive. Candidly, there is reason to fear that the increasing centralization of revenue powers in the State Legislative Assembly, the underlying objective of those groups sponsoring approaches like Measure 5, will result in preemption of local powers before they can be exercised.

Beyond these concerns, the changing nature of the utility industry also creates reasons for concern. One of the developments associated with deregulation of every portion of the utility industry has been the increased utilization of facilities located within the rights of way by companies who have no ownership connection to those facilities. This development has focused attention on the increased commoditization of utilities.

At a fundamental level, what utilities provide is truly a fungible commodity. Electrons, photons, molecules of natural gas or H<sub>2</sub>O are each identical. To the end user of the service, the identity or source of the commodity is irrelevant, as long as the correct ones arrive. Most utilities have recognized for some time that their facilities were built to serve peak demand and, accordingly, often operated at far below optimum efficiency. One of the theoretical underpinnings of the push to deregulation of utilities is the thesis that increased efficiency of service delivery systems produces reductions in net cost. A natural gas supplier can deliver energy at reduced unit cost if it can increase the quantity of gas that moves through its pipes. While the maximum benefit could be realized if the owner of the pipes owned and delivered all of the gas, if other companies can serve their customers using those pipes, the pipe owner can load shed some of its costs of infrastructure maintenance, while the pipe tenant can provide energy without having to fund and amortize the cost of infrastructure.

The same is true in other utilities. The consumer does not really know, or care, what was the original generating source that produced the voltage differential which is represented at the outlet in the home. As long as the potential difference is 110 volts, more or less, and can be maintained at the necessary current load, the appliances will work. Although the situation is somewhat more complex in telecommunications, because the electrons that are delivered are prepackaged in certain ordered ways, the consumer can be unconcerned about every stage of the process as long as the packages are correct and arrive in the correct order.

The combination of these two principles: low system efficiency and commoditization of the delivery system create an opportunity for the industry, but a challenge to the owner of the right of way through which the commodities travel. The cost that the pipe owner imposes on the user is low, since it includes only amortization of some portion of the cost of infrastructure which, in many cases, has already been almost fully amortized. It is that small cost that factors into the traditional franchise fee paid by the utility who owns the pipes.

By contrast, from the perception of the consumer, the cost of the service appears comparable regardless of who is the supplier. In the case of the supplier who does not have facilities in the rights of way, the consumer ends up absorbing that cost in his or her rates; but in

the middle, the City whose infrastructure has made the whole construct feasible, recovers virtually nothing.

In the telecommunications arena, the industry refers to this as the “unlevel” playing field. For the industry, however, the playing field is not, however, “unlevel.” Although the facilities based provider has higher costs because of franchise fees, it also has an extraordinarily valuable asset – the infrastructure based facility. In reality, where the system is out of balance is that an increasing number of companies are making profits because of, and through use of, the facilities that we cities have allowed to be placed in our rights of way, but only an increasingly smaller proportion of those companies are compensating the cities for that use. By keying compensation to ownership of the infrastructure facilities, we have allowed ourselves to be shortchanged by the changing nature of the use of those facilities. This introduces into the franchise fee revenue stream the same sort of economic constraints that Measures 5, 47, and 50 introduced into the property tax revenue equation. By tampering with the relationship the electorate has further weakened the link between economic activity and revenue. By failing to recognize the shift in the nature of utility activity, cities do the same thing for the utility revenue stream – sever the relationship between economic activity and revenue. Already most cities have observed, over the past two to three years, a disconnect between the level of utility activity (particularly telecommunications) and the level of municipal revenue. Franchise fee payments have begun to stagnate.

Future developments will only exacerbate that discrepancy. Both the high cost of capital investment, and the approaching saturation of rights of way will inevitably lead to fewer things being added to the rights of way, but more intensity of use of those things that are there. Keep in mind, even in the days of “wi fi” “wi-max” “VoIP” and expanded use of cellular and satellite technology, at some point, almost every telecommunications activity touches and infrastructure based facility at some point, for some portion of its route. As a result, it is reasonable to recognize that beneficial use of the rights of way is not limited to those who have placed facilities there.

It is this balance that the Springfield utility tax proposal seeks to restore.

## **THE SPRINGFIELD PROPOSAL**

The proposal which staff has presented to the Springfield Council, and which remains under study today, it, in many respects, very simple. It is a tax. There is no equivocation about whether it is a tax or a fee. Fees may still be charged for services rendered (*e.g.*, reviewing and approving encroachment permits, reviewing and approving licensing and registration, etc.). If there is one thing that remains clear from the litigation surrounding this issue, it is that the fundamental and innate power of a government to levy taxes is unchanged and undiminished. The industry often points to *City of Auburn v. Qwest* as its holy grail for limiting fees to actual cost. I don’t propose to engage in extensive legal commentary on that or any other case, but I will point out that what is oft-overlooked in analyzing the *Auburn* case is any agreement by the parties that the Revised Code of Washington allows of a six percent gross receipts tax.

The tax in the Springfield staff proposal is designed to generally apply to all utilities. At this point, it applies only to public utilities.<sup>4</sup> As a result, water and electricity service provided by the Springfield Utility Board, created by the City Charter, is not included,<sup>5</sup> although there appears to be no legal reason that they could not be included. Other cities, like Ashland, already impose a similar burden on their electric facilities. Similarly, it does not apply to the storm drainage and sanitary sewer utilities operated by the City itself, although, again this is a policy decision, not because of some legal impediment. Here, also, there are numerous examples of cities, including Portland, which impose fees or taxes of similar amounts on drainage and sewer utilities.<sup>6</sup> Even limited in this fashion, it represents a relatively broad base. This is important, for one area where taxes can be subject to legal attack is that they are discriminatory because they do not treat the relevant universe of taxpayers equally.<sup>7</sup> This issue does not appear to have been raised in any of the Eugene cases.

Two models for utility taxation exist. The Springfield ordinance follows the approach used by Washington cities.<sup>8</sup> That approach is also used in Utah and New York<sup>9</sup>. Under this approach the tax is imposed on the utility. The alternative approach is to impose the tax on the user of the utility service. This approach is followed in states such as Illinois, Virginia and California<sup>10</sup>. The end result of each of these approaches is somewhat similar, since in those states where the tax is imposed on the utility, the utility is authorized to either pass that tax along to

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<sup>4</sup> Public utilities, defined in ORS 747.005 include :(A) Any corporation, company, individual, association of individuals, or its lessees, trustees or receivers, that owns, operates, manages or controls all or a part of any plant or equipment in this state for the production, transmission, delivery or furnishing of heat, light, water or power, directly or indirectly to or for the public, whether or not such plant or equipment or part thereof is wholly within any town or city.

(B) Any corporation, company, individual or association of individuals, which is party to an oral or written agreement for the payment by a public utility, for service, managerial construction, engineering or financing fees, and having an affiliated interest with the public utility.

<sup>5</sup>ORS 757.005(1)(b) provides: As used in this chapter, “public utility” does not include:(A) Any plant owned or operated by a municipality.

<sup>6</sup>Seattle, in its utility taxes, see note 7 *infra*, imposes the tax on activities by the City.

<sup>7</sup> Article 1, Section 32, of the Oregon Constitution provides as follows:  
Section 32. Taxes and duties; uniformity of taxation. No tax or duty shall be imposed without the consent of the people or their representatives in the Legislative Assembly; and all taxation shall be uniform on the same class of subjects within the territorial limits of the authority levying the tax.

<sup>8</sup>See Seattle Municipal Code 5.48.010, *et seq.*, City of Tukwilla Ordinance 1998, adopted November 18, 2002.

<sup>9</sup> See, for example, Salt Lake City Municipal Code 3.06.010, *et seq.* and 3.10.010, *et seq.*, New York City Administrative Code §11-102

<sup>10</sup> See, for example, Glendale Municipal Code 4.36.010, *et seq.*, Urbana Municipal Code Section 22-44 through 59; City of Hampton Municipal code Section 37-201 through 353.

consumers or to reimburse itself, from customers, for the tax obligation. There are, however, subtle differences which may be significant.

In the user tax model, the utility typically acts as collector of the tax. Although this increases the utility's revenue, the net effect on the utility's corporate taxes (state and federal) is generally zero, because the increased revenue is offset with an equal expense – the payment of the tax receipts to the taxing entity. The transaction as a whole does not affect the utility's financial position or condition, and the full tax burden is absorbed by the consumer.

In the utility model, imposition of the tax results in a net reduction in corporate taxable revenue, because the tax is allowed as an ordinary operating expense for corporate tax purposes. While the utility is free to recover the tax burden from its customers, in doing so, it is possible for it make the net effect on the corporate financial position neutral while collecting less than the full amount of the tax imposed. This results from the impact of the tax in reducing corporate taxable revenue and, in effect, is load shedding of a portion of the tax burden to other taxing entities. To the extent the utility chooses to follow this course, it is possible for the tax to have a smaller net effect on the consumer.

Under the Springfield study draft, a copy of which has been distributed, the tax imposed is five percent of gross revenue. Although tax rates vary widely across the country, the Springfield tax sets the level at the fee imposed in most existing franchises. That level was designed to avoid imposing a substantial additional burden upon those utilities who already paying a franchise fee while, at the same time, allowing for recovery of an equivalent amount from those entities who, because they do not have facilities located within the rights of way, are presently paying nothing. In furtherance of that objective, the draft ordinance provides that taxpayers can receive a full credit against their tax liability, for all sums paid as franchise fees.

In the current draft, the definition of gross revenue is, intentionally, as expansive as possible. That has created a certain level of controversy, because of the existence of proposed legislation at the federal level which might attempt to exempt, from some or all forms of taxation, some activities related to telecommunications. Proposals to extend the moratorium of taxation of internet access which expired in November, 2003, might be read as conflicting with the most expansive reading of the gross revenues provision in the draft.<sup>11</sup>

## **COMMENTS FROM THE INDUSTRY**

On April 15, 2004, staff provided copies of a draft proposal to over 100 members of the utility industry, including not only those utilities known to be operating in Springfield, but all those who had registered under the Eugene telecommunications license ordinance, as well as other companies that staff believe might have an interest.

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<sup>11</sup> Senate 150, which was passed by the Senate but not considered by the House, would have extended the moratorium for four years and expanded it to cover certain aspects of telecommunications services needed to access the internet.

On May 19, 2004 staff held an open house for any interested party to come and provide comments or ask question about the concept and the ordinance. Representatives of the Comcast, Qwest, NW Natural and the Oregon Cable Television Association all attended that open house. Subsequently each of these organizations submitted written comments on the draft ordinance. In addition to those written comments, comments were submitted by representatives of MCI, Sprint, Cingular Wireless, NexTel, T-Mobile USA and Verizon. The period for submission of comments ended on July 19, 2004.

All written comments received opposed any action to impose a utility tax. Interestingly, all commenters, except NW Natural, stated their opposition to taxes imposed only on the telecommunications industry, even though the proposal clearly applies to other industries. Industry commenters associated with the wireless telephone industry suggested that the ordinance, if enacted, would be in violation of federal law. Representatives of Qwest, the incumbent wireline carrier, and representatives of the cable television industry did not raise this objection. In many cases, however, these objections appear to stem from a fundamental misunderstanding of the proposal. For example, Sprint observed that both state and federal law contain provisions which address impositions for use of the public right of way, and suggested that those provisions would preclude the proposed tax. This tax is on the privilege of doing business, not the privilege of using the public rights of way and that, accordingly, those federal and state provisions are not relevant. The Oregon Court of Appeals, in *TCI v. City of Eugene*, 177 Or.App 433, 38 P.3d 269 (2001), specifically noted that a more narrowly based imposition (a 2% registration fee and a 7% license fee) by the City of Eugene was a “general tax” which was not covered by federal limitations in 47 U.S.C. 542<sup>12</sup> with respect to the amount of franchise fees imposed on cable television operators. Similarly, in *U. S. West Communications v. City of Eugene*, 177 Or.App 424, 35 P.3d 1001 (2001), \_\_\_ Or \_\_\_, 81 P3d 702 (2003),<sup>13</sup> the Court of Appeals determined that a two percent tax imposed by the City of Eugene was not invalidated by ORS 221.515, which sets limits on tax imposed for use of the right of way, to the extent the City sought to apply it to revenues other than local exchange revenues (which were the revenues upon which privilege taxes for use of the ROW were imposed). Since the City had conceded that its 7 percent license fee was for use of the right of way and that the revenues upon which that fee were based were subject to ORS 221.515, the Court concluded that the two percent tax could not

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<sup>12</sup> 47 USC 542 provides, in part :

(g) "Franchise fee" defined

For the purposes of this section -

(1) the term "franchise fee" includes any tax, fee, or assessment of any kind imposed by a franchising authority or other governmental entity on a cable operator or cable subscriber, or both, solely because of their status as such;

(2) the term "franchise fee" does not include -

(A) any tax, fee, or assessment of general applicability (including any such tax, fee, or assessment imposed on both utilities and cable operators or their services but not including a tax, fee, or assessment which is unduly discriminatory against cable operators or cable subscribers);

<sup>13</sup> The Supreme Court vacated a portion of the Court of Appeals decision that is not relevant to this discussion.

be imposed on those revenues, and did not have an occasion to consider whether ORS 221.515 limits taxes imposed on a basis other than for use of the rights of way.

**A. Licensing.**

Several commenters expressed concern about the requirements for securing a license, terming them onerous. It is true that recently the courts, particularly the federal courts, have cast a jaundiced eye on requirements for licensing of telecommunications entities. In many respects what seem to be relatively innocuous requirements for information, from a local perspective, have been struck down. In the original draft of the ordinance, which was drawn, in large part, from the existing telecommunications provisions in the Springfield Municipal Code, there was little distinction drawn between those things required of a company who wish to place things in the public way, and a company who merely wished to conduct business. In this draft, those provisions which are relevant only to entities seeking to place facilities in the public way have been moved from the licensing section, to sections related to encroachments in the public right of way. This should obviate most of the concerns expressed by some of the commenters, and assure that the City is not seen to be seeking information not relevant to the purpose for which the information is sought.

**B. Gross Revenues.**

Several commenters suggested that the definition of “gross revenue” in the ordinance was overly broad. In particular, some commenters noted that as originally drafted, the gross revenue definition would have captured not only revenue from operations, but also earnings but the sale of assets. The current draft clarifies that revenue under the ordinance does not include earnings on transactions outside the ordinary scope of business, using language directly taken from definitions adopted by the Financial Accounting Standards Board (“FASB”)<sup>14</sup>.

Other commenters noted that the definition would capture and subject to tax revenue from activities of affiliated companies that would not be subject to tax if the activities were performed by unaffiliated companies. This is correct. Over the past several years many companies, including telecommunications companies, have become increasingly creative in relying on complex corporate structures and affiliations to isolate otherwise taxable activity – whether the tax is a utility tax like the current proposal, or a general corporate income or gross receipts tax. Staff believes that these tax avoidance mechanisms can be used to completely defeat the efficacy of taxation, and should not be supported; consequently we continue to propose a definition of gross income of all activity which the taxpayer chooses to conduct within the umbrella of the taxpayers corporate status, including those where the taxpayer determines, for valid business reasons, that it wishes to maintain levels of affiliation. Clearly, the final decision on what falls within the gross revenue decision is that of the taxpayer. It must balance the value of affiliating an ancillary service with the parent corporate entity with the cost of the tax implications of that action.

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<sup>14</sup>See Financial Accounting Standards Board, Statement of Financial Accounting Concepts, SFAC 6.

At the open house, representatives of Qwest suggested that the tax, if imposed, should be imposed only on retail transactions. They observed that since under the draft ordinance all retail transactions were subject to the tax, failure to exclude intercarrier transactions would subject some transactions to “double taxation”, once when the customer purchased services from the carrier, and again when the carrier completed the customer’s transaction by purchasing bandwidth or access from another carrier. In examining taxes from other states and localities, there are a small number that are limited to retail sales. Most, however, do not attempt to distinguish among the many ways the utility receives revenue, except to exclude transactions outside the ordinary course of business, like sales of capital assets.

Qwest also suggested that premises equipment should be excluded from the tax, since the equipment is sold in direct competition with other retail outlets which, because they are not in the utility business, are not subject to taxation based on the value of such sales. To date, we have found only once instance of such an exclusion – in a franchise agreement between Qwest and the City of New York.

**C. Minimum Tax.**

NW Natural pointed out that as originally drafted, the minimum tax language would result in a situation where utilities with facilities in the right of way would be subject to a much larger obligation than the tax calculated on the basis of gross revenue. Staff have revised the language to make it clear that the minimum tax calculation does not use the per foot method for a utility which provides services within the City.

**D. Revenue Potential.**

Virtually all commenters suggested that the tax would have significant impacts on their businesses, by subjecting to taxation revenue that is not presently subject to either taxation or fees. In some cases this appears to be accurate. For example, it now appears that a substantial portion of the revenue typically generated by Qwest is for services other than local exchange access – the sole activity which is included in the revenue basis for determining the current franchise fee, or the privilege tax authorized by ORS 221.515 (which is authorized as a tax for permission to use the rights of way). It is likewise true that many companies who offer services similar to those offered by Qwest pay no fees or taxes to the City. In the area of other utilities, it appears that companies other than NW Natural provide natural gas to some Springfield businesses. Although these companies pay a small fee to NW Natural for transportation of the gas to the customer through NW Natural pipes, and this amount is included as revenue when NW Natural calculates its franchise fee, the value of the gas itself is never subject to a fee, even though the equivalent amount of gas distributed by NW Natural would be subject to the existing franchise fee.

## THREATS AND OPPORTUNITIES

As with any novel approach to a vexing problem, there are a number of areas where difficult policy choices need to be made in assessing the wisdom of moving forward with the utility tax model.

### Revenue Scope

As noted above, there are concerns about whether the sweep of the gross revenue definition impinges on areas that the Congress intends to be subject to exclusively federal regulation. This is a point which will be studied closely in the coming months. The ability of the Congress to dictate to the states how they may choose to tax business activity has implications far beyond the telecommunications arena. Certainly, it did not seem prudent, in an early study draft, to presume how a discussion about the interrelationship between the national government and the states might play out in the arena of business taxation. As staff indicated in a recent update to the status of the utility tax, there was no intent to interfere with the process of federal legislation. The breadth of the gross revenue definition is a subject that will be further considered in the light of existing federal law should the Council direct that the proposal be moved forward for a first reading and public hearing.

Related, and in fact essential to, but legally separate from the tax obligation, the proposed ordinance continues the requirement that any company providing utility services within the city, or using facilities within the city, be licensed. As currently drafted, this is a licensing fee program, not a licensing tax as adopted in Eugene's telecommunications ordinance. The fees are modest and designed only to cover the cost of registration. The purpose of continuing the registration requirement is, of course, to make it possible to identify those utilities who should be taxpayers under the tax.

In these areas, the recent Ninth Circuit opinion in *Qwest v. Portland* may be instructive. On its own motion, the Court took pains to draw a distinction between telecommunications specific regulation and fee imposition, and more broadly drawn utility regulation. In connection with its discussion of the remand to the District Court for individual findings on whether the several ordinances impermissibly created a "barrier to entry" within the meaning of Section 253(a), the Court observed: "We doubt whether *City of Auburn* can be read so broadly as to apply to ordinances that are not specific to the telecommunications permitting process."<sup>15</sup> It seems possible to draw from that reasoning that utility taxation should certainly be no more restricted by Section 253(a) than is telecommunications specific taxation, which the Oregon state

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<sup>15</sup> *Qwest v. Portland, supra, n. 2*, at headnote 5. Claims concerning right of way fees based on gross revenue was decided favorably to the cities on the basis that the same claim had been raised and resolved by *Qwest* in the state courts. Thus the Court did not need to reach this issue in deciding that aspect of the case. See *Qwest v. Portland*, at headnote 10. Nonetheless, it did observe that *City of Auburn* did not address the issue of whether right of way fees based on gross revenue were prohibited by Section 253(a).

courts have found not inconsistent with Section 253 in the Eugene cases.<sup>16</sup> This is consistent with the observed situation, where such taxes are imposed in several states without apparent legal impediment.

### **The future of franchising**

There have been suggestions that the Springfield approach is related to an elimination of the franchising system of regulation. This is not the case, although use of the tax vehicle for revenue collection, as opposed to the franchise fee, may have implications for the future of franchises now in existence. Licensure under the Springfield draft would grant access to public rights of way, subject to standard City permitting processes. This could reduce the incentive for a utility to seek a franchise. The City currently regulates work in the rights of way under separate provisions of its municipal code; these are not specified in existing franchise. It is thus possible that as some existing franchises expire, the utility and the City may come to the conclusion that the franchise no longer serves a purpose. In that case, it is possible that a franchise would not be continued.

In other cases, there might well be a different result. For example, the current cable television franchise contains provisions dealing with customer service, public education and government ("PEG") channels provided by the company, as well as capital financial support. Those requirements are not presently dealt with in City Code. If the Council desires to retain those requirements, or similar ones, it may conclude that a franchise is appropriate, even if it does not involve a substantial franchise fee. Likewise, the Council could conclude that such matters should be regulated by general ordinances and could adopt such ordinances, thereby eliminating, perhaps, the need for a franchise. These decisions have not been made by the Council. In fact, the council has clearly indicated that should it move in the direction contemplated by the draft ordinance, it will not address that subject until existing franchise begin to reach their expiration dates.

### **Nexus to the Rights of Way**

There are also concerns that this approach severs the traditional nexus between utility revenue and use of the public rights of way. This is, of course, the result of moving to a system of taxation. In large part this change of focus is a recognition of the technological change that has affected the utility industry, particularly the telecommunications sector. In every case, we see not so much increased use of the rights of way, as increased intensity of the existing use. As discussed above, a number of factors lead to the conclusion that tying compensation for beneficial use of the rights of way to those entities who own the facilities placed there is no longer the most efficient method to assure that all who profit from the rights of way compensate its owner for that benefit.

Does this change create additional risk for local governments? There is not a simple answer to that question. Under the tax model that is being discussed, the underlying rationale is

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<sup>16</sup> The issue of preemption by Section 253 of the Telecommunications Act was addressed in *AT&T Communications v. City of Eugene*, 177 Or. App 379, 35 P3d 1021, *rev den*, 334 Or 491 (2002).

that companies doing business in a city may be obliged to pay business taxes to that city. That concept is no more foreign than is the concept that a renter has an obligation to pay rent to the landlord; it is simply a different concept. There is no more reason to suggest that cities will be ousted from the taxing arena in the case of utilities than there is to suggest that their power to charge rent for right of way will be overthrown. In fact, perhaps the opposite is true, for while, in the case of telecommunications, the industry has vigorously attacked the rent model, the tax model that exists side by side has not been attacked and has, in some cases, been expressly acknowledged.<sup>17</sup>

## CONCLUSION

Springfield staff believe that the time is right to consider a proactive approach to what appears to be a problem looming on the horizon. Although at present, it appears on the horizon as no larger than a man's hand, as it draws closer it threatens to overwhelm the landscape. We anticipate that in the future, what is now the second largest source of general fund revenue for many cities will increasingly stagnate even as the utility industry grows, because the growth will be in intensity of use of the rights of way, not in the form of increased presence. The principal source of general fund revenue – property taxes – is already a relatively economically insensitive revenue stream; it lags economic activity on the upside and, because of the peculiarities of Oregon law, is unable to reflect fully that activity. The emergence of the same trend in the utility franchise fee stream should be deeply troubling to Oregon city officials.

At present, staff will return to the Council on November 8, 2004, for further discussion of the ordinance and the concept. Staff will present to the council a number of alternatives ranging from leaving the current system in place to changing the licensing provisions of the current law without imposing the tax, or moving to enact a new approach to compensation from those businesses whose activities have a special effect on the City, because of the nature of their use of City assets. Obviously, staff is unable to predict what course of action the Council will choose to follow. All we can do is point out the risks and potential rewards associated with each approach and rely upon the Council to use their sound discretion in the best interests of the City as a whole.

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<sup>17</sup> In *City of Auburn v. Qwest*, *supra*, Qwest explicitly acknowledged that the State of Washington imposed a tax and that such tax was not under challenge.