IN THE SUPREME COURT OF THE STATE OF CALIFORNIA

THE GILLETTE COMPANY & SUBSIDIARIES,

Plaintiffs and Appellants,

v.

CALIFORNIA FRANCHISE TAX BOARD, an Agency of the State of California,

Defendant and Respondent.

Case No. S206587

Consolidated with the following cases:

1) The Procter & Gamble Manufacturing Co. v. Franchise Tax Board, CGC-10-495912
2) Kimberly-Clark Worldwide, Inc. & Subsidiaries et al. v. Franchise Tax Board, CGC-10-495916
3) Sigma-Aldrich, Inc. v. Franchise Tax Board, CGC-10-496437
4) RB Holdings (USA) Inc. v. Franchise Tax Board, CGC-10-496438
5) Jones Apparel Group v. Franchise Tax Board, CGC-10-499083

First Appellate District, Division Four, Case No. A130803
San Francisco County Superior Court, Honorable Richard A. Kramer
Case No. CGC-10-495911 (and consolidated cases listed above)

ANSWER BRIEF ON THE MERITS

SILVERSTEIN & POMERANTZ LLP
AMY L. SILVERSTEIN (Bar No. 154221)
EDWIN P. ANTOLIN (Bar No. 172599)
JOHANNA W. ROBERTS (Bar No. 191472)
CHARLES E. OLSON (Bar No. 262642)
LINDSAY T. BRAUNIG (Bar No. 244125)
55 Hawthorne Street, Suite 440
San Francisco, CA 94105
Telephone: (415) 593-3500
Facsimile: (415) 593-3501
Attorneys for Plaintiffs and Appellants The Gillette Company & Subsidiaries, The Procter & Gamble Manufacturing Co., Kimberly-Clark Worldwide, Inc. & Subsidiaries, et al., Sigma-Aldrich, Inc., RB Holdings (USA) Inc., and Jones Apparel Group

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page(s)

CASES

STATUTES

California

Constitutional Provisions

Other Authorities

INTRODUCTION

The Multistate Tax Compact (former Rev. & Tax. Code § 38006, the "Compact") is a binding interstate compact with other sovereign states, and California is bound by its terms unless and until it withdraws from the Compact. California's attempt to eliminate the provision most central to achieving the Compact's purposes— the *election* to apportion multistate income *either* using the formula set forth in the Compact (the "Compact Formula") *or* an alternative state formula (the "State Formula") — by amendment of Rev. & Tax. Code Section 25128 is invalid and illegal.[1]

Interstate compacts are an essential tool of interstate cooperation, addressing a wide-range of subjects where collective state governance is vital — from child welfare, parole and prisoner transfer, and education, to water resources, environmental concerns, transportation, licensing, and taxation. The Council of State Governments' database identifies more than 200 compacts in effect. The unique and powerful characteristic of interstate compacts is that they are instruments for contractually allocating collective state authority, *i.e.*, they are both contracts and binding reciprocal statutes among sovereign states. A large body of nationwide federal and state case law, developed over approximately 200 years, makes clear that compacts take precedence over conflicting state law and cannot be unilaterally altered by a party state.

The Compact was developed in 1966 in response to imminent Congressional preemption of state taxation of multistate corporations. As

---

[1] Senate Bill No. 1015 was enacted on July 27, 2012, after appellate argument in this case and purports to repeal the Compact in full on a prospective basis. *See* Op. at n. 1. The validity of that repeal will likely be the subject of future litigation but is not at issue here. For purposes of this brief, references to the Compact or Section 38006 are to the Compact as enacted and in force for the years at issue, and references to Section 25128 are to the version amended in 1993.

corporations increasingly expanded their operations nationally and the Supreme Court loosened the restrictions on state taxation, the apportionment of income between states became much more important. Reacting to significant concerns that multistate corporations would be subject to varying apportionment formulas, leading to taxation of more than 100% of their total income and complex and costly compliance, Congress was poised to enact legislation imposing a single, nationwide apportionment formula and other sweeping measures. Yet states desperately wanted to maintain control of their taxing power. By entering into the Compact, and particularly by agreeing to allow taxpayers to elect the Compact Formula in all party states, the states assured baseline uniformity in state taxation of multistate businesses and, thus, staved off federal preemption. The deal was possible only because party states agreed to exercise their sovereignty collectively through a binding interstate compact that could not be altered unilaterally.

The Court of Appeal properly struck down Section 25128's attempt to override the Compact on three independent bases:

> First, under established compact law, the Compact superseded subsequent conflicting state law.
>
> Second, the federal and state Constitutions prohibit states from passing laws that impair the obligations of contracts.
>
> And finally, the FTB's construction of the effect of the amended section 25128 runs afoul of the reenactment clause of the California Constitution.

Op. at 16.

In response, Defendant and Respondent Franchise Tax Board ("FTB") claims compact law does not apply because the Compact was not approved by Congress. The United States Supreme Court, in *United States Steel Corp. v. Multistate Tax Commission,* 434 U.S. 452 (1978), held that the Compact is a valid and enforceable interstate compact among the signatory states that did not require approval from Congress. *Id.* at 472-79.

Ample case law confirms that interstate compacts (with or without Congressional approval) take precedence over subsequent conflicting statutes due to their dual status as *both* statutes *and* contracts among sovereign entities, and they cannot be unilaterally altered by one party state.

Alternatively, FTB urges this Court to interpret the Compact to flexibly allow amendments because some other party states have attempted to eliminate the Compact election (mostly decades after entering into the Compact). The express terms and codified purposes of the Compact are unambiguous; therefore, resort to extrinsic evidence is inappropriate. Even if extrinsic evidence could be considered, the contemporaneous drafting history is far more reliable and confirms that the apportionment election is mandatory.

FTB also asks this Court to ignore the settled law that eviscerating a core provision of an interstate compact through a subsequent statute violates the Constitutional ban on statutes that impair contract obligations. FTB argues that "modern contract clause analysis" dictates a different result, but it cites no case upholding a state statute in conflict with a state's clear obligation undertaken by interstate compact. Even if that analysis could be applied, Section 25128 would violate the Contract Clause as a substantial and unjustifiable impairment of California's Compact obligations.

Finally, FTB claims this Court should ignore the requirements of the constitutional reenactment rule because Section 25128 is just an implicit amendment. But the reenactment rule *does* apply when one statute directly affects another statute, as here. And there is no exception to the reenactment rule where certain members of the public were aware of the repeal, as FTB suggests. California's attempt to eliminate provisions from the Compact by enacting a later statute, without amending the Compact itself, violates the

reenactment rule.[2]

California is a party to numerous interstate compacts, some congressionally approved and others not, including the Interstate Compact on the Placement of Children which governs the placement of children in foster care and adoption across state lines (Fam. Code §§ 7900 *et seq.*); the Interstate Compact on Juveniles which governs the interstate supervision of juveniles on probation and parole (Wel. & Inst. Code §§ 1400 *et seq.*); the Driver's License Compact which requires party states to report and recognize out-of-state driving offenses to ensure roadway safety (Veh. Code §§ 15000 *et seq.*), and others crucial to California's citizens. *See, e.g.,* Compact for Education (Ed. Code §§ 12510 *et seq.*); Interstate Corrections Compact (Pen. Code §§ 11189 *et seq.*); Tahoe Regional Planning Compact (Gov. Code §§ 66800 *et seq.*); Southwestern Radioactive Waste Disposal Compact (Health & Saf. Code §§ 115250 *et seq.*). The radical departures from settled compact analysis that FTB is advancing would jeopardize California's ability to rely on other states adhering to their compact commitments and the ability of all states to use the crucial tool of interstate compacts to address complex issues.

The Court of Appeal correctly determined that the trial court improperly sustained FTB's demurrers to Plaintiffs' complaints seeking refunds of corporate income taxes based on elections to apportion under the Compact, and the appellate decision should be affirmed.[3]

---

[2] This independent basis for affirming the appellate decision does not rest on compact law or the status of Section 38006 as a compact/contract but rather on constitutional requirements for enacting statutes. *Even if* California could override the Compact's core election provision, the way it attempted to do so here violated the California Constitution.

[3] "Plaintiffs" refers to Plaintiffs and Appellants The Gillette Company & Subsidiaries and Plaintiffs/Appellants in the consolidated appeals.

I. COMPACT AND STATUTORY FRAMEWORK

A. Brief History of State Taxation

The Compact arose in response to an increased need for uniformity in state taxation of corporate income. FTB Br. at 4; Op. at 3-4; *U.S. Steel,* 434 U.S. at 454-55. Nonconformity became a major concern after World War II with the widespread adoption of state income taxes and marked growth in the multistate presence of corporate taxpayers. Pls. Request for Judicial Notice, filed with the Court of Appeal, and granted on July 24, 2012 ("Pls. COA-RFJN") Ex. A (H.R. Rep. No. 88-1480 (1964)) at 99-103, 131. For a corporate taxpayer operating in multiple states, its total taxable income (*i.e.,* tax base) must be divided among those states. Each state uses a formula to derive the percentage of the corporation's tax base that it may tax, *i.e.,* the state's apportionment formula. *See, e.g.,* Jerry Sharpe, *State Taxation of Interstate Businesses and the Multistate Tax Compact,* 11 Colum. J. L. & Soc. Probs. 231, 234-238 (1974). If each state's apportionment formula is different, many taxpayers will pay tax on greater than 100% of their tax base and to face significant complexity and compliance costs. *Id.*; *see also,* Pls. COA-RFJN Ex. A at 118-19 (describing at least eleven different state apportionment formulas as of 1963), 596; Paul Hartman, *State Taxation of Interstate Commerce,* 46 Va. L. Rev. 1051, 1102-1104 (1960).

1. Uniform Division of Income for Tax Purposes Act

Recognizing the need for uniformity in 1957, the National Conference of Commissioners for Uniform State Laws drafted a model law, the Uniform Division of Income for Tax Purposes Act ("UDITPA"). *See* Pls. COA-RFJN Ex. A at 132-33; Sharpe, 11 Colum. J.L. & Soc. Probs. at 241-42. UDITPA apportions a multistate corporation's total income to a taxing state by a three-factor formula, utilizing a property factor, a payroll

factor, and a sales factor, giving equal weight to each factor:

$$\left(\frac{\text{In-state property}}{\text{Total property}} + \frac{\text{In-state payroll}}{\text{Total payroll}} + \frac{\text{In-state sales}}{\text{Total sales}} \right) \div 3$$

See Pls. COA-RFJN Ex. A at 169; *see also,* Sharpe, 11 Colum. J.L. & Soc. Probs. at 236-38. In simple terms, the corporation's tax base is multiplied by the apportionment factor (the number computed by the formula above) and that result is multiplied by the state's tax rate to determine the company's state tax liability.

UDITPA was not promptly adopted by the states — only 3 states enacted it by 1965. *See* Pls. COA-RFJN Ex. A at 133; Sharpe, 11 Colum. J.L. & Soc. Probs. at 242. California adopted UDITPA in 1966 (Rev. & Tax. Code §§ 25120 *et seq.*), including its three-factor, equal-weighted formula (Rev. & Tax. Code § 25128).

2. Congressional Involvement

In the meantime, in 1959, the Supreme Court decision in *Northwestern Portland Cement v. Minnesota,* 358 U.S. 450 (1959), exacerbated the growing concerns about state taxation of multistate corporations. The Court held that in-state solicitation of sales provided sufficient nexus for the state to tax corporate income and directed that "net income from the interstate operations of a foreign corporation may be subjected to state taxation, provided the levy is not discriminatory and is properly apportioned to local activities within the taxing [s]tate." *Id.* at 452. Concern that there were no effective limits on state taxation triggered an uproar in the business community. *See* Pls. COA-RFJN Ex. A at 7; Hartman, 46 Va. L. Rev. at 1051. Congress reacted swiftly and for the first time in its history adopted an act (Public Law 86-272) restricting the power of the states to tax interstate business. *See* Pls. COA-RFJN Ex. A at 8; 15 U.S.C. §§ 381-84. Public Law 86-272 curtailed *Northwestern Portland.*

In addition, Congress ordered a study of state taxation of multistate

businesses to recommend legislation establishing uniform standards. *See U.S. Steel,* 434 U.S. at 455; Pls. COA-RFJN Ex A. at 8-9; Sharpe, 11 Colum. J.L. & Soc. Probs. at 242. In its multi-volume reports issued in 1964-65, the Congressionally-appointed Willis Commission explained the problem:

> Increasingly the States, reinforced by judicial sanction, have broadened the spread of tax obligations of multistate sellers. . . . The expanding spread of tax obligations has not, however, been accompanied by the development of an approach by the States which would allow these companies to take a national view of their tax obligations. The result is a pattern of State and local taxation which cannot be made to operate efficiently and equitably when applied to those companies whose activities bring them into contact with many States.

Pls. COA-RFJN Ex. B (H.R. Rep. No. 89-952 (1965)) at 1127. The Willis Report decried the states' efforts at uniformity (Pls. COA-RFJN Ex. A at 599) and criticized the variation in state apportionment formulas:

> [V]ariation appears to be [formula apportionment]'s most significant historical characteristic. Not only have there always been wide diversities among the various formulas employed by the States, but the composition of those formulas seems to be constantly changing.

Id. at 118-19, 194 (variance in apportionment formulas causes complexity in compliance and overtaxation), 247-9.

The Willis Report made specific Congressional legislative recommendations, including a mandatory apportionment formula as the sole method for dividing corporate income among the states, a uniform sales and use tax act, and federal oversight, including the power to modify the apportionment formula. *See* Pls. COA-RJFN Ex. B at 1133-38, 1143-64; Sharpe, 11 Colum. J.L. & Soc. Probs. at 242. In short, the Willis Report proposed federal preemption of critical aspects of state taxation. *Id.* Soon

after the Report's release, Congress introduced a bill (H.R. 11798, 89th Cong., 2nd Sess. (1965)), including one mandatory apportionment formula, to implement these recommendations.

B. The Multistate Tax Compact

Threatened by expansive Congressional action in an area long left to state control, a group of tax administrators and Attorneys General in January 1966 began work on a total affirmative answer for the states – the Compact. *See U.S. Steel*, 434 U.S. at 455; Pls. Request for Judicial Notice in Support of Answer Brief to the Cal. Sup. Ct. ("Pls. Sup. Ct. RFJN") Ex. S (The Council of State Governments Compact Summary and Analysis) at 1 (development of the Compact was the result of the threat of federal legislation); Sharpe, 11 Colum. J. L. & Soc. Probs. at 243-44 ("With the . . . Willis Bill, it became apparent to state tax administrators that Congress would act if businesses and the states failed to reform the existing system."); Pls. COA-RFJN Ex. C (Commission 1st Ann. Rep.) at 1 ("The origin and history of the [] Compact are intimately related and bound up with the history of the states' struggle to save their fiscal and political independence from encroachments of certain federal legislation introduced in [C]ongress. . ."). The legislative history for California's enactment of the Compact confirms the purpose was to stave off federal preemption. AA0173-74 ("One of the principal reasons for joining the [Compact] is to offer an alternative to restrictive federal interstate tax legislation.").

The Compact was drafted quickly. Pls. COA-RFJN Ex. C at 1-2; AA0196. By its terms, it became effective as to all party states upon its enactment by any seven states. *U.S. Steel,* 434 U.S. at 454. This occurred only seven months after the final draft. *Id.* After the Compact became effective, no federal legislation imposing uniformity on the states as proposed in the Willis Report was ultimately enacted. By agreeing to be bound by the terms of the Compact, the signatory states satisfied the federal

government that a baseline level of uniformity had been achieved. *See* Pls. COA-RFJN Ex. C. at 9-10.

The states' stake in this battle was enormous — their "fiscal and political independence" were on the line. *Id.* at 1-2, 8-10. Congress' sweeping legislation threatened to curtail state sovereignty over core aspects of state taxation. Pls. COA-RFJN Ex. A at 1135-38; Pls. Sup. Ct. RFJN Ex. S at 4-6. The fiscal consequences were also substantial. When California decided to enter into the Compact, the estimated cost of the pending federal legislation was $100 million (in 1973 dollars). AA0136. California became a party state to the Compact in 1974: "The 'Multistate Tax Compact' is hereby enacted into law and entered into with all jurisdictions legally joining therein. . ." Rev. & Tax Code § 38001, 38006.

C. The Compact's Provisions[4]

In unmistakable terms, Article III(1) mandates that states joining the Compact *must* offer the Compact Formula — UDITPA's equal-weighted, three-factor formula — as an option to taxpayers, but also allows states to craft their own alternative State Formula:

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party state . . . may elect to apportion and allocate his income in the manner provided by the laws of such state . . . without reference to this compact, *or may elect to apportion and allocate in accordance with article IV.*

Section 38006, Art III(1) (emphasis added). The Compact Formula is specified in Article IV(9):

> All business income shall be apportioned to this state by multiplying the income by a fraction the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

---

[4] A copy of the complete Compact is attached as an Appendix.

According to the Supreme Court, this provision "allows multistate taxpayers to apportion and allocate their income under formulae and rules set forth in the Compact *or* by any other method available under state law." *U.S. Steel,* 434 U.S. at 457 n. 6 (emphasis added); *see also* AA0142 (analysis in legislative history of Section 38006: "Compact requires member states to use the [UDITPA] apportionment formula."); Pls. Sup. Ct. RFJN Ex. S (Council of State Governments Compact Summary and Analysis) at 1 ("Each party State could retain its existing division of income provisions, but it would be required to make [UDITPA] available to any taxpayer wishing to use it."). While a party state may offer an alternative State Formula, it is *required* to allow taxpayers to elect the Compact Formula.

This common apportionment formula ensured base-line uniformity and compatibility among state tax obligations. In this way, the Compact addressed the key concerns set forth in the Willis Report, and the Report's one-size-fits-all apportionment formula became unnecessary. *See* Pls. COA-RFJN Ex. A at 118-19, 168-71, 247-49, 521, 595-96; Hellerstein, State and Local Taxation (6th ed. 1997), at 565 (" . . . Compact was developed . . . to offset the severe criticism the Willis Committee leveled against the widespread diversity in state apportionment and allocation methods."). The election also allowed multistate corporations to make the business decision to choose the apportionment formula that works best for them. AA0197 (Commission 3rd Ann. Rep.) ("The [] Compact thus preserves the right of the states to make such alternative formulas available to taxpayers even though it makes uniformity available to taxpayers where and when desired.").

Other provisions of the Compact are instructive to the proper resolution of this case. Article I enumerated the purposes of the Compact:

1. Facilitate proper determination of state and local tax

liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.
3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.
4. Avoid duplicative taxation.

Section 38006, Art I; *see also, U.S. Steel,* 434 U.S. at 456. The first purpose of the Compact is to secure the "equitable apportionment of tax bases" — the very provision of the Compact that FTB seeks to eliminate. Indeed, the apportionment election is vital to all four of the stated purposes of the Compact. *See* Section 38006, Art. XII ("This compact shall be liberally construed so as to effectuate the purposes thereof.").

The Willis Report also focused on inequities in state sales and use tax laws. *See* Pls. COA-RFJN Ex. A at 9. Thus, Article V obligates each party state (a) to provide a full use tax credit to taxpayers who previously paid sales or use tax to another state as to the same property, and (b) to honor tax exemption certificates from other states. Section 38006, Art. V; *see also,* AA0142, AA0197.

Beyond the binding requirements for uniformity — reciprocal sales/use tax credits and exemptions, and the taxpayer option to use the Compact's apportionment provisions — the Compact leaves other matters to the states' individual control. It explicitly reserves to party states control over the rate of tax. Section 38006, Art XI(a). In addition, like UDITPA, the Compact does not dictate how a state computes a corporation's tax base. *See U.S. Steel,* 434 U.S. at 457 (explaining that individual member states retain "complete control over all legislation and administrative action affecting the rate of tax, the composition of the tax base (including the determination of the components of taxable income), and the means and

methods of determining tax liability and collecting any taxes determined to be due").

The Compact also allows withdrawal by party states only through enactment of a statute repealing the Compact in full:

> Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

Section 38006, Art. X(2). And, when a Compact provision is optional, the Compact expressly says so. *Id.* at Art VIII(1) ("This Article [relating to audits by the Multistate Tax Commission] shall be in force only in those party States that specifically provide therefor by statute."); *U.S. Steel,* 434 U.S. at 457 ("Article VIII applies only in those States that specifically adopt it by statute.").

The Compact establishes the Multistate Tax Commission (the "Commission") as a vehicle for continuing cooperation. Each party state must appoint a Commission member and pay its share of the Commission's expenses. Section 38006, Art. VI.1(a), 4(b). The powers of the Commission are set forth in Article VI: to study state and local tax systems, to develop and recommend proposals for greater uniformity, and to compile information helpful to the states. *Id.* at Art VI(3). The Commission may propose uniform regulations relating to state taxation, but "[e]ach such [s]tate and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures." *Id.* at Art VII(3); *U.S. Steel,* 434 U.S. at 457.

Finally, the Compact was expressly drafted and enacted as an interstate compact. Pls. Sup. Ct. RFJN Ex. S (Council of State Governments Compact Summary and Analysis) at 8-9 ("For handling significant problems which are beyond the unaided capabilities of the regularly constituted agencies of individual State governments, the accepted instrument is an

interstate compact;" discussing the use of other interstate compacts to address multistate problems). Including in its title, the term "compact" is used 25 times. Underscoring its difference from an ordinary statute, it required enactment by seven states to become effective. Section 38006, Art. X(1); Section 38001 ("The [] Compact is hereby enacted into law and entered into with all jurisdictions legally joining therein. . ."). As the Commission stated in 1970, the Compact is "like all compacts" allowing states to accomplish collectively what they cannot do individually. AA0206; *see also,* Black's Law Dictionary (6th ed.) at 281 ("compact: An agreement or contract between persons, nations or states. Commonly applied to working agreements between and among states concerning matters of mutual concern."); Pls. COA-RFJN Ex. C at 1-2.

In sum, the Compact's express provisions and purposes struck the necessary balance between binding uniformity to stave off federal preemption, state flexibility over revenue matters, and taxpayer interests. Although some matters are left to the party states by the Compact (such as tax rate, tax base, and the decision whether to adopt any regulations proposed by the Commission or pursue multistate taxpayer audits), other matters are mandatory and leave no choice to a party state but to follow them unless and until it withdraws from the Compact — the sales and use tax credit; the election to use the Compact Formula; and the obligation to pay dues to the Commission.

As noted, after the Compact became effective, no federal legislation imposing uniformity on the states as proposed in the Willis Report was ultimately enacted. The states achieved the goal they set when embarking on the Compact project through the deal struck and reflected in the Compact.

D. *U.S. Steel*

In 1972, a group of multistate corporate taxpayers challenged the constitutionality of the Compact on grounds that included not receiving Congressional consent under the Constitution's Compact Clause. *U.S. Steel*, 434 U.S. at 454; U.S. Const. Art. I, § 10, cl. 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State."). The Commission and party states defended the Compact as a valid and binding compact, and the Supreme Court agreed. Congressional consent is only required if a compact "is directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States." *U.S. Steel,* 434 U.S. at 471 (*citing Virginia v. Tennessee,* 148 U.S. 503, 518-19 (1893)). The Court determined that the Compact dealt with the traditionally non-federal issue of state taxes and did not grant party states any powers over taxation that they did not already possess individually (and could therefore commit to exercise collectively) and that the states did not delegate sovereign powers to the Commission. *Id.* at 456-58, 471-78. Thus, the Compact was valid and enforceable without Congressional consent. *Id.*

E. California's Amendment of the UDITPA Apportionment Formula: Section 25128

As described above, the Compact secures a multistate taxpayer's option (election) to apportion its business income under the Compact Formula or under the State Formula — an alternative apportionment formula that may be enacted by a party state. Section 38006, Art III(1). Until 1993, California had no alternative State Formula — it offered only the equal-weighted, three factor formula (both in the Compact and in its separate enactment of UDITPA, found at Section 25128).

Then, in 1993, the Legislature amended Section 25128, but not the Compact, to provide an apportionment formula different from the Compact – a formula that double weights the sales factor:

> Notwithstanding Section 38006, all business income shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor, and the denominator of which is four....

Rev. & Tax Code § 25128. According to FTB, by use of the three words "[n]otwithstanding Section 38006," Section 25128 eliminated the election to apportion under the Compact.

II. ARGUMENT

A. SECTION 25128 IS AN INVALID ATTEMPT TO ALTER AN INTERSTATE COMPACT THROUGH SUBSEQUENT CONFLICTING STATE LAW

Of the Court of Appeal's three independent bases for its decision, the primary holding is that "under established compact law, the Compact superseded subsequent conflicting state law." Op. at 16. FTB raises two counter-arguments: compact law does not apply because the Compact did not receive Congressional approval, and even if compact law applies, the Compact can be construed to not conflict with Section 25128.

1. The Fundamental Nature of Interstate Compacts

Interstate compacts are long-standing, well-recognized and crucial mechanisms of cooperation among states as equal sovereigns. *See, e.g., Hinderlider v. La Plata River & Cherry Creek Ditch Co.,* 304 U.S. 92, 104 (1938) (discussing history of interstate compacts dating back to the Colonies); *West Virginia ex rel. Dyer v. Sims,* 341 U.S. 22, 24 (1951); *see also,* Felix Frankfurter and James Landis, *The Compact Clause of the Constitution – A Study in Interstate Adjustment,* 34 Yale L.J. 685 (1925)

(discussing history and expansive uses of interstate compacts). Without interstate compacts, states would need federal legislation, or litigation in federal court, to solve issues that cross borders. *Hinderlider,* 304 U.S. at 104; *West Virginia ex rel. Dyer v. Sims,* 341 U.S. at 27 (encouraging states to use interstate compacts). "Thus, compacts are singularly important because through a compact, the states can create a state-based solution to regional or national problems. . . ." Caroline Broun, et al., The Evolving Use and Changing Role of Interstate Compacts (ABA 2006) ("Broun on Compacts"), § 1.1 at 2-3. Interstate compacts address an ever-widening range of subjects, including child support and welfare, parole and prisoner transfer, water resources, environmental concerns, transportation, education, licensing, and taxation. *See id.* at Chs. 8-9. The Council of State Governments' compact database identifies more than 200 interstate compacts in effect, many without Congressional approval. Pls. COA-RFJN Ex. E. In short, compacts are an essential and unique tool of interstate cooperation. *See U.S. Steel,* 434 U.S. at 460-71 (recounting long-standing use of compacts).

Through interstate compacts, party states commit to collectively exercise their sovereignty in specified ways, in order to address a shared problem or issue. *Hess v. Port. Auth. Trans-Hudson Corp.,* 513 U.S. 30, 42 (1994) ("An interstate compact, by its very nature, shifts a part of a state's authority to another state or states, or to the agency the several states jointly create to run the compact."); *West Virginia ex rel. Dyer,* 341 U.S. at 30-31; *KMOV-TV v. Bi-State Dev't Agency,* 625 F. Supp.2d 808, 811 (E.D. Mo. 2008); *C.T. Hellmuth v. Washington Metro. Area Trans. Auth.,* 414 F. Supp. 408, 409 (D. Md. 1976); Broun on Compacts, at 21 (by compact, "the member states have collectively and contractually agreed to reallocate government authority away from individual states to a multilateral relationship").

The essential characteristic of interstate compacts as unique instruments for contractually allocating collective state authority is that they are *both* contracts *and* binding reciprocal statutes among sovereign states, and courts draw on both bodies of law to construe them. *See* Broun on Compacts, § 1.2 at 17-24; *Texas v. New Mexico,* 482 U.S. 124, 128 (1987); *C.T. Hellmuth,* 414 F. Supp. at 409; *Doe v. Ward*, 124 F. Supp. 2d 900, 914-15 (W.D. Pa. 2000). Under the well-developed body of case law referred to as compact law, because multiple states have exercised their sovereign will to commit to the terms of an interstate compact, an interstate compact takes precedence over other state law, and therefore *one state cannot subsequently alter or eliminate a compact's terms piecemeal.* As the Supreme Court directed in *West Virginia ex rel. Dyer v. Sims*, 341 U.S. 22 (1951), "an agreement entered between states by those who alone have political authority to speak for a state cannot be unilaterally nullified" or altered by any one of the contracting states. *Id.* at 28; *Alcorn v. Wolfe*, 827 F. Supp. 47, 52 (D.D.C. 1993) ("the terms of the MWAA compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law"); *Doe v. Ward*, 124 F. Supp. 2d at 914 ("An interstate compact functions as a contract and takes precedence over statutory law in member states"; finding Parole Compact superseded Pennsylvania Megan's Law statute that imposed additional transfer conditions); *C.T. Hellmuth,* 414 F. Supp. at 409 ("when enacted, a compact constitutes not only a law, but a contract which may not be amended, modified or otherwise altered . . ."; holding Maryland may not unilaterally impose its public records act on compact agency); *KMOV-TV,* 625 F. Supp. 2d at 811; *In re O.M.,* 565 A.2d 573, 579-80 (D.C. Ct. App. 1989) (holding subsequent conflicting state law cannot alter compact).

Because party states commit to act collectively over specified matters and cannot unilaterally amend compacts piecemeal, compacts typically

contain an express provision setting forth the terms for a state to withdraw and to thereby regain complete sovereignty over the issue. *See Alabama v. North Carolina,* 130 S. Ct. 2295, 2313 (2010) (applying withdrawal provision similar to this Compact); *U.S. Steel,* 434 U.S. at 473; Broun on Compacts, § 3.7.4 at 118.

2. The Lack of Congressional Consent Does Not Change the Fundamental Nature and Precedence of Interstate Compacts

The power of states to exercise their sovereignty and choose to enter into interstate compacts is well-established. *See West Virginia ex rel. Dyer v. Sims,* 341 U.S. at 30-31. This power is limited only by the Compact Clause of the U.S. Constitution. *Hinderlider,* 304 U.S. at 106; U.S. Const. Art. I § 10, cl. 3 ("No State shall, without the Consent of Congress . . . enter into any Agreement or Compact with another State."). As discussed above in § I.D, the United States Supreme Court has long held that consent is only required under the Compact Clause for compacts that threaten federal supremacy. *See U.S. Steel,* 434 U.S. at 471. Further, the Supreme Court held specifically that the Compact is a valid and binding interstate compact that did not require consent. *Id.* at 473-79.

As noted above, interstate compacts (approved or not) take precedence over other state laws. *West Virginia ex rel. Dyer v. Sims,* 341 U.S. at 28. The primary basis for this precedence is the essential nature of compacts as both statutes and binding agreements among sovereign states. If an interstate compact requires and receives Congressional approval, then it is *also* interpreted as federal law subject to the Supremacy Clause. *Cuyler v. Adams,* 449 U.S. 433 (1981). Its status as federal law provides an *additional* reason why it cannot be overridden by subsequent state law. *See, e.g., Alcorn,* 827 F. Supp. at 52 ("In light of the Supremacy Clause to the United States Constitution . . . *and because compacts are analogous to*

contracts between states, the terms of the MWAA compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law.") (Emphasis added); Broun on Compacts, at 23 ("The contractual nature of the agreement and its federal standing, where applicable, trumps individual state statutory schemes . . ."). Prior to *Cuyler,* it was not clear that approved compacts were to be treated as supreme, federal law and yet, due to their fundamental nature as codified contracts among states committing to exercise their collective sovereignty in specified ways, the courts consistently held that they take precedence over other state laws and could not be unilaterally altered by one party state. *See West Virginia ex rel. Dyer,* 341 U.S. at 28, 30-31. "Congressional consent may change the venue in which compact disputes are ultimately litigated; it does not change the controlling nature of the agreement on the member states." Broun on Compacts, § 2.1.7 at 65.

As a consequence of compacts taking precedence over state law, states cannot amend them piecemeal through subsequent legislation. Ample law confirms that even without Congressional approval this is true. As *McComb v. Wambaugh,* 934 F.2d 474 (3rd Cir. 1991), explains:

> Because Congressional consent was neither given nor required, the [Interstate] Compact [for Placement of Children] does not express federal law. Consequently, this Compact must be construed as state law. Nevertheless, uniformity of interpretation is important in the construction of a Compact because in some contexts it is a contract between the participating states. Having entered into a contract, a participant state may not unilaterally change its terms. A Compact also takes precedence over statutory law in member states.

Id. at 479 (overruled on other grounds, *State Dept. of Econ. Sec. v. Leonardo,* 22 P.3d 513 (Ariz. 2001)); *see also, General Expressways v. Iowa Reciprocity Board*, 163 N.W.2d 413, 419 (Iowa Sup. Ct. 1968) (subsequent legislation could not "unilaterally alter the terms of the compact

previously entered into by the board"); *In re O.M.*, 565 A.2d at 579-80 (signatory to non-approved compact could not unilaterally alter its compact obligations); *In re D.B.*, 431 A.2d 498 (Vt. Sup. Ct. 1981) (holding Interstate Compact on Juveniles was valid and enforceable between party states despite lack of Congressional consent).

In re C.B., 188 Cal. App. 4th 1024 (2010), confirms that as "formal agreements among and between states that have the characteristics of both statutory law and contractual agreements," interstate compacts — there, the non-approved Interstate Compact on the Placement of Children ("ICPC") — cannot be contradicted or overridden by inconsistent state law. *Id.* at 1031 (refusing to enforce rule that was inconsistent with compact and suggesting that party states would have to agree to amend compact). Similarly, *In re Crockett*, 159 Cal. App. 4th 751 (2008), held that California could not enforce statutory probation requirements that were inconsistent with the non-approved Interstate Compact for Juveniles which "provides for the welfare and protection of juveniles . . . with respect to . . . cooperative supervision [among the states]" as to probation and parole. *Id.* at 761-62. *See also, In re Johnny S.*, 40 Cal. App. 4th 969 (1995) (invalidating regulations inconsistent with ICPC terms); *In re John M.*, 141 Cal. App. 4th 1564 (2006) (invalidating Cal. Rule of Court that was inconsistent with ICPC terms).

No case supports FTB's position that without Congressional approval the Compact loses its fundamental status as an interstate compact and can instead be treated as just a garden-variety statute or a contract which can be "amended, repealed or superseded, in whole or in part, by a subsequently enacted statute." FTB Br. at 18-20. Such a rule would completely undermine the validity of interstate compacts as a tool for resolving critical multistate issues and would jeopardize all of California's numerous non-approved compacts, including the ICPC which governs the interstate

placement of children in foster care and adoption (Fam. Code §§ 7900 *et seq.; In re C.B.,* 188 Cal. App. 4th at 1030); the Interstate Compact on Juveniles which governs the interstate supervision of juveniles on probation and parole (Wel. & Inst. Code §§ 1400 *et seq.*; *In re Crockett,* 159 Cal. App. 4th at 761); the Driver's License Compact which requires party states to report and recognize out-of-state driving offenses to ensure roadway safety (Veh. Code §§ 15000 *et seq.*; *McDonald v. DMV,* 77 Cal. App. 4th 677, 682 (2000)), and others crucial to California's citizens. *See* Ed. Code §§ 12510 *et seq.* (Compact for Education); Pen. Code §§ 11189 *et seq.* (Interstate Corrections Compact); *see also, U.S. Steel,* 434 U.S. at 459-71 (discussing longstanding use of non-approved interstate compacts).

In 1997, the California Attorney General faced these same issues when asked whether California could enact legislation contrary to the Compact directing that its continued membership on the Commission and payment of dues was contingent on the Commission adopting open meeting policies. 80 Ops. Cal. Atty. Gen. 213 (1997). The Attorney General concluded that California could not impose conditions on, or alter, the Compact (*i.e.,* alter its Commission membership and obligation to pay dues) by a subsequent statute because the Compact is "a contract among the member states." *Id.* at 219 ("California's fiscal obligations under the Compact may not be changed by [statutory budget control language].") Rather, California was bound to comply with all Compact provisions "unless and until the Compact is repealed in accordance with its provisions." *Id.* at 213; *Long Beach v. Dep't of Ind. Relations,* 34 Cal. 4th 942, 952 (2004) (Attorney General opinion is entitled to "considerable weight"). The same result holds here.[5]

---

[5] A statute that only indirectly impacts a compact organization may not be

3. The Compact Election is Mandatory for Party States

The Court of Appeal properly relied on the Compact's terms and explicit purposes to interpret it:

> This binding, multistate agreement obligates member states to offer its multistate taxpayers the option of using either the Compact's three-factor formula to apportion and allocate income for state income tax purposes, or the state's own alternative apportionment formula. This is one of the Compact's key mandatory provisions designed to secure a baseline level of uniformity in state income tax systems, a central purpose of the agreement.

Op. at 1; 16-20. Contrary to FTB's contentions, the unambiguous, mandatory terms of the Compact cannot be reread as flexible ones based solely on some other party states' self-serving attempts to alter their own Compact obligations (often, decades after enactment of the Compact).

a. Interpretation of an Interstate Compact Must Be Consistent with its Express Terms and Purposes

An interstate compact must be construed and applied in accordance with its express terms. *Tarrant Reg. Water Dist. v. Herrmann,* 133 S. Ct. 2120; 186 L. Ed. 2d 153, 167 (2013) ("[A]s with any contract, we begin by examining the express terms of the Compact as the best indication of the intent of the parties."); *Texas v. New Mexico*, 482 U.S. at 128 (explaining that an interstate compact is a contract and a "legal document that must be

---

invalid under compact law. *See, e.g., KMOV-TV v. Bi-state Development Agency,* 625 F. Supp.2d 808 (E.D. Mo. 2008) (considering whether the application of Missouri's sunshine law to the compact agency was invalid when the sunshine law did not conflict with any express compact provision but did impact the operation of the agency). However, here, where the subsequent statute (Section 25128) *directly* conflicts with (and indeed, eliminates) a core Compact provision, the compact takes precedence and the state statute is invalid. *See, e.g., Doe v. Ward,* 124 F. Supp. 2d at 914-15.

construed and applied in accordance with its terms"); *Alabama v. North Carolina*, 130 S. Ct. at 2307, 2313 (courts must remain true to express terms of interstate compacts); *In re C.B.*, 188 Cal. App. 4th at 1031-32 (analyzing plain language of terms of non-approved ICPC).

This interpretative rule for compacts – that the plain terms govern – is the same for contracts in general and also for statutes. *See* Civ. Code § 1639 ("When a contract is reduced to writing, the intention of the parties is to be ascertained from the writing alone, if possible."); Civ. Code § 1638 (the "language of a contract is to govern its interpretation"); *Wolf v. Walt Disney Pictures,* 162 Cal. App. 4th 1107, 1125-26 (2008) (same); Code Civ. Proc. § 1858; *In re Steele,* 32 Cal. 4th 682, 693-4 (2004) (plain terms of statute govern). The principle is particularly imperative for interstate compact interpretation:

> We are especially reluctant to read absent terms into an interstate compact given the federalism and separation-of-powers concerns that would arise were we to rewrite an agreement among sovereign [s]tates, to which the political branches consent. As we have said before, we will not order relief inconsistent with the express terms of a compact, no matter what the equities of the circumstances might otherwise invite.

Alabama v. North Carolina, 130 S. Ct. at 2312-13 (citations omitted); *see also, In re C.B.,*188 Cal. App. 4th at 1036.

Indeed, the case cited by FTB confirms that the express terms of a compact *must* govern its interpretation. FTB argues:

> In construing a multistate compact, the most important task is to determine the member states' intent. (*Int'l Union of Operation Eng'rs, Local 542 v. Del. River Joint Toll Bridge Comm'n* (3d Cir. 2002) 311 F.3d 273, 281["court's] role in interpreting the Compact is, therefore, to effectuate the clear intent of [the] sovereign states"]...

FTB Br. at 11. Arguing that intent here must be established by actions by some party states decades later, FTB omits the remainder of the quote from

Local 542: "Our role in interpreting the Compact is, therefore, to effectuate the clear intent of both sovereign states, *not to rewrite their agreement or order relief inconsistent with its express terms.*" *Id.* at 276 (emphasis added). The primary source for determining the parties' intent in a compact — or a contract or a statute — is the express language, and courts need go no further if the language is clear, as here.

b. The Express Terms of the Compact are Unambiguous

As the Court of Appeal properly concluded the terms at issue are unambiguous and mandatory. Op. at 4-6, 13-18; *see also,* § I.C above.

Article III(1), the central provision at issue, requires party states to allow taxpayers to elect either the Compact Formula (an equal-weighted, three-factor apportionment formula) or a party state's own alternative State Formula (if the state chooses to enact one):

> Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes . . . may elect to apportion and allocate his income in the manner provided by the laws of such State . . . without reference to this compact, or may elect to apportion and allocate in accordance with Article IV.

Section 38006, Art. III(1). Article IV then provides the Compact Formula:

> All business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

Id. Art IV(9). As the Court of Appeal explained, "[t]he election provision is not an option for party states. Because any multistate taxpayer 'may elect' either approach, the party states must make the election available." Op. at 13; *see also, U.S. Steel*, 434 U.S. at 457 n. 6 (this provision "allows multistate taxpayers to apportion and allocate their income under formulae and rules set forth in the Compact or by any other method available under

state law."); AA0142 ("Compact requires member states to use the [UDITPA] apportionment formula."); Pls. Sup. Ct. RFJN Ex. S at 1.

In 1970, the Commission recognized as much:

> The Multistate Tax Compact makes UDITPA [including, the Compact Formula] available to each taxpayer on an optional basis, thereby preserving for him the substantial advantages with which lack of uniformity provides him in some states. Thus a corporation [selling into a state may prefer the Compact Formula, and a corporation which is selling from a state may prefer an alternative, sales-weighted formula]. The Multistate Tax Compact thus preserves the right of the states to make such alternative formulas available to taxpayers even though it makes uniformity available to taxpayers where and when desired.

AA0197.

The Compact is express when it allows variations from its terms. For example, the Compact explicitly allows party states not to enact Article VIII's audit provisions. Section 38006, Art. VIII(1) ("This Article shall be in force only in those party [s]tates that specifically provide therefore by statute."); *U.S. Steel,* 434 U.S. at 457 ("Article VIII applies only in those [s]tates that specifically adopt it. . ."). That this optional language was *not* included for any other provisions, including the election, further confirms that it is mandatory. *See Quarry v. Doe I,* 53 Cal. 4th 945, 970 (2012) (where statute contains express exception, others are not to be presumed); *People v. Medina,* 41 Cal. 4th 685, 696 (2007) (each part of a statute should be construed to "produce a harmonious whole"); *Harris v. Klure,* 205 Cal. App. 2d 574, 577-78 (1962) (the whole of a contract is to be taken together, giving effect to every part).

In addition, the Compact's withdrawal provision is unambiguous:

> Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

Section 38006, Art. X. As the Court of Appeal concluded, "the plain language of the withdrawal provision . . . allows only for complete withdrawal from the Compact. . . . Faced with the desire to escape an obligation under the Compact, a state's only option is to withdraw completely by enacting a repealing statute." Op. at 17. The withdrawal provision does not allow piecemeal alteration or elimination of Compact provisions. *Id.*; *see also, Alabama v. North Carolina,* 130 S. Ct at 2313 (refusing to read additional language into a similar compact withdrawal provision); *In re O.M.,* 565 A.2d at 579; 80 Ops. Cal. Atty. Gen. 213 (Aug. 5, 1977).

The express terms do not permit an interpretation of the withdrawal provision to allow partial repeal of certain provisions. Such an interpretation would render the language in Article VIII expressly allowing a state to opt-out of the audit provisions superfluous. *Wells v. One2One Learning Found.,* 39 Cal. 4th 1164, 1207 (2006); *Harris,* 205 Cal. App. 2d at 577-78. It would also jeopardize the many California interstate compacts with similar withdrawal provisions which, under FTB's view, could now be modified at will by party states. *See* § II.A.2 at 20-21; Veh. Code § 15027 (withdrawal provision for Driver's License Compact: "any party state may withdraw from this compact by enacting a statute repealing the same ..."); Wel. & Inst. Code § 1400 (withdrawal provision for Interstate Compact on Juveniles: "a compacting state may withdraw from the compact by specifically repealing the statute which enacted the compact into law"); Pen. Code § 11180 (withdrawal provision for Interstate Compact for Adult Offender Supervision); Ed. Code § 12510 (withdrawal provision for Compact for Education).

Finally, FTB's two arguments that the Compact needed additional language to make its express terms mandatory and binding lack merit. First, FTB cites no authority for its unworkable suggestion that the Compact had

to *expressly prohibit* partial repeal or modification of the election provision in order to make this provision binding. The rule is the opposite – the terms of a compact (or contract) are mandatory, and a party cannot alter or ignore them unilaterally unless authorized by its terms. *See, e.g., West Virginia ex rel. Dyer v. Sims,* 341 U.S. at 28; *McComb,* 934 F.2d at 479; *In re C.B.,* 188 Cal. App. 4th at 1031. Without a provision expressly allowing variance from compact terms, no variance is allowed. *See Local 542,*311 F.3d at 281 ("This is because the 'concurred in' provision introduces the issue of, and mechanism for, modification, without which there is absolutely no authority for, let alone specific means of accomplishing, a modification of the Compact . . .").

Second, FTB argues that the Compact must be construed as optional because California did not "waive or surrender in unmistakably plain terms" its sovereign authority. FTB Br. at 15-17. None of the cases cited by FTB involve interstate compacts which are fundamentally mechanisms for states to commit to exercise their sovereignty in specified ways, as party states have done in the Compact. In any event, California did not impermissibly waive or surrender its power of taxation. California retained full control of its tax base, rate, revenues and means of collection – it simply obligated itself to comply with the Compact obligations until such time as it withdrew in accordance with the Compact (which it purportedly did through S.B. 1015 in July 2012). *See* Op. at 15; *see also,* 80 Ops. Cal. Atty. Gen. 213 (1997). Even if California did waive or surrender powers related to taxation, it did so in unmistakable, plain terms. *See* § II.A.3(b) above. The express language makes clear that the election is mandatory.[6]

---

[6] Below, FTB and the Commission also argued that the Compact was a "model law," rather than a binding compact. FTB has not sought review on this basis, and the Court of Appeal rejected this argument. Op. at 12-

In sum, FTB's claim that "nothing in the text of the Compact prevented a member state from repealing the original provision or formula, or from enacting its own mandatory formula" is wrong. FTB Br. at 12. The Compact election is unambiguous and mandatory.

c. The Compact's Express Purposes Confirm the Election is Mandatory

The Compact's election to use the same apportionment formula in all party states unquestionably advances each of the Compact's express purposes: to "[f]acilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases," "[p]romote uniformity, "[f]acilitate taxpayer convenience and compliance," and "[a]void duplicative taxation." Section 38006, Art. I, *see* § I.C; *U.S. Steel,* 434 U.S. at 456. Further, Section 38006, Art. XII directs that, "[the] [C]ompact shall be liberally construed so as to effectuate the purposes thereof."

Ensuring multistate taxpayers the election to apportion across states using the *uniform* Compact Formula facilitates proper determination of their state and local tax liability, equitably apportions their tax bases among states, prevents duplicative taxation, and secures base-line uniformity and compatibility. In addition, using the same formula in multiple states would indisputably make taxpayer compliance simpler and more convenient. As the Council of State Governments put it in 1967 when it distributed the

---

15. There are levels of membership in the Compact, and it may operate akin to a model law for states that choose *associate* membership and do not enact and enter into the Compact as full members. AA0208. For signatory party states, like California, that have "enacted and entered into" the Compact in its entirety (Rev. & Tax. Code § 38001), it is a binding compact, as confirmed by its intentional use of the compact mechanism, clear obligations and purposes, express withdrawal provision, and drafting history.

Compact for consideration by the states:

> One of the principle measures for improvement – i.e., *simplification of taxpayer compliance* and *elimination of the possibility of double taxation* – in the income tax field is the Uniform Division of Income for Tax Purposes Act. The compact would permit any multistate taxpayer, *at his option*, to employ the Uniform Act for allocation and apportionment involving party states of [*sic*] their subdivisions. Each party state could retain its existing division of income provisions but it would be required to make the Uniform Act available to any taxpayer wishing to use it. Consequently, any taxpayer could obtain the benefits of *multi-jurisdictional uniformity* whenever he might want it.

Pls. Sup. Ct. RFJN Ex. N (Council of State Governments memorandum accompanying final text of the Compact) at 1 (emphasis added); *id.* Ex. S (Council of State Governments Compact Summary and Analysis) at 1 (to the same effect).

By contrast, FTB's interpretation allowing every party state to impose its own unique formula would eviscerate each of the purposes of the Compact. Different formulas across party states would insure complexity and higher compliance costs, result in less uniformity, and significantly risk double-taxation. *Oklahoma v. New Mexico,* 501 U.S. 221, 230-31 (1991) (interstate compact must be interpreted consistent with its stated purposes); *Burden v. Snowden,* 2 Cal. 4th 556, 562 (1992) (courts may not interpret statute to accomplish a purpose that does not appear on the face of the statute or from its legislative history); *Dyna-Med, Inc. v. Fair Empl. & Housing Comm'n,* 43 Cal. 3d 1379, 1392-3 (1987).

Because the express purposes undermine their interpretation, FTB and the Commission essentially fabricate a new purpose: to "preserv[e] member states' sovereign authority to effectuate their own tax policies." FTB Br. at 12. Under this guise, they argue that the Compact should be

interpreted to allow party states to eliminate the election.[7] The preservation of state sovereign authority is *not* an express purpose of the Compact. Further, the undisputed impetus behind the Compact was not to preserve state's *individual* sovereignty but instead to preserve the states' *collective* sovereignty over tax matters and to avoid federal preemption. *See U.S. Steel,* 434 U.S. at 454-55; § I.B. When Compact history refers to state sovereignty, it makes clear that state sovereignty was preserved through avoiding federal action only because party states committed to *increased uniformity, i.e.,* the election. In the Commission's words, "Increased uniformity in state taxation eases the administrative burden . . . and by forestalling the need for congressional action, preserves state sovereignty." Pls. COA-RFJN Ex. J (Charter of MTC Uniformity Comm.); Ex. I (MTC *Microsoft* Amicus Brief) at 3 ("The promise of uniformity established by the states' adoption of the Compact and UDITPA was critical to preserving [states'] sovereignty. . ."). The election provision was central to the avoidance of federal preemption by which state sovereignty was preserved — "preserving state sovereignty" cannot now be used to justify interpreting the Compact to allow party states to refuse to allow the election.[8]

---

[7] This interpretation makes all provisions of the Compact vulnerable. States could also choose to eliminate the provisions in Article V that require them to provide sales and use tax credits and exemptions. *See, e.g., Chemehuevi Indian Tribe v. State Bd. of Equaliz.,* 800 F.2d 1446, 1450 (9th Cir. 1986) (recognizing that under the Compact, California must afford a tax credit to persons who pay sales and use taxes to other party states); *Nevada v. Obexer & Son, Inc.,* 660 P.2d 981, 985 (Nev. Sup. Ct. 1983). Similarly, party states could ignore their obligations to pay dues or send representatives to the Commission. 80 Ops. Cal. Atty. Gen. 213.

[8] Any deference to the Commission's current interpretation of the Compact is unfounded. First, the position taken by the Commission conflicts with the plain terms of the Compact. *See In re C.B.,* 188 Cal. App. 4th at 1036 (rejecting interpretation offered by compact agency that was inconsistent

d. Extrinsic Evidence is Unnecessary Because the Compact Terms are Unambiguous

FTB's analysis skips over the Compact's express terms and purposes directly to extrinsic evidence, *i.e.,* subsequent conduct of the party states. FTB Br. at 11-14. As noted above, where express compact terms are clear and unambiguous, courts are prohibited from re-writing them or interpreting them in any other way. *Alabama v. North Carolina,* 130 S. Ct. at 2307 (explaining that a court is "not free to rewrite" a compact to include additional terms); *Texas v. New Mexico,* 462 U.S. 554, 568 (1983) (refusing to grant relief inconsistent with the express terms of the compact); *Sullivan v. Dept. of Transp.*, 708 A.2d 481 (Pa. Sup. Ct. 1998) (Driver's License Compact must be interpreted according to plain meaning and may not be "given . . . a meaning that conflicts with that of the language used"); *In re C.B.,* 188 Cal. App. 4th at 1036 (explaining that court cannot rewrite an interstate compact to vary from its plain terms); *Kansas v. Colorado,* 514 U.S. 673, 690-91 (1995).

The principle holds for interpretation of statutes and contracts as well — the plain terms govern, and extrinsic evidence should only be considered if there is an ambiguity. *See In re Steele,* 32 Cal. 4th at 693-94;

---

with compact terms); *McComb,* 934 F.2d at 481. Second, the Commission lacks authority to interpret the Compact or to determine whether or not a party state is in compliance. The authority of a compact agency must be delineated by the terms of the compact itself. *Alabama v. North Carolina,* 130 S. Ct. at 2305-08. Here, the powers explicitly granted to the Commission are limited and do not include authority to interpret the terms of the Compact or to determine and enforce compliance. *See* § I.C. Nor does the Commission have the incentive to enforce compliance with the election, as it is self-interested to maximize membership and dues. The Commission's interpretation lacks both authority and persuasive force. *Id.* at 2308; *Texas v. New Mexico,* 462 U.S. at 569-70; *Yamaha Corp. v. State Bd. of Equaliz.,* 19 Cal. 4th 1, 12-13 (1998).

Corwin v. Los Angeles Newspaper Service Bureau, 22 Cal. 3d 302, 314 (1978) (considering extrinsic evidence to interpret an ambiguous contract provision); *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith,* 68 Cal. App. 4th 445 (1998) (looking to extrinsic evidence to interpret a contract provision that was "somewhat ambiguous"); *see also, Cedars-Sinai Medical Ctr. v. Shewry,* 137 Cal. App. 4th 964, 980 (2006) (contract must be reasonably susceptible to the interpretation before extrinsic evidence should be considered).

This Court must reject FTB's argument based on subsequent party conduct because there is no ambiguity in the terms of the Compact's election and its express purposes. *See also,* Op. at 19.

e. The Most Relevant Extrinsic Evidence Supports the Mandatory Election

Even if this Court considered extrinsic evidence, the purpose would be to determine the party states' intent *at the time they enacted and entered into* the Compact. *Bank of the West v. Superior Ct.,* 2 Cal. 4th 1254, 1264 (1992); Civ. Code § 1636. In doing so, the Court would have to consider such evidence as a whole, including the contemporaneous drafting and enactment history. *Alabama v. North Carolina,* 130 S. Ct. at 2309-2311; *City of Atascadero,* 68 Cal. App. 4th at 474 (court should consider range of extrinsic evidence including the surrounding circumstances under which the parties negotiated or entered into the contract [and] the object, nature and subject matter of the contract . . .); *see also, Cedars-Sinai Medical Ctr.,* 137 Cal. App. 4th at 980.

The evidence most probative of the parties' intent at the time they entered into the Compact is the evidence of the drafting and negotiation as well as the express purposes of the Compact, not evidence of subsequent conduct of party states. *See Oklahoma v. New Mexico,* 501 U.S. at 231-37 (relying on "purpose and negotiating history" to interpret ambiguous phrases

"conservation storage" and "originating" in Canadian River Compact); *Texas v. New Mexico,* 462 U.S. at 568 n. 14 (using context at time of compact's enactment to aid in interpretation of ambiguous provision); *Arizona v. California,* 292 U.S. 341, 359-60 (1934); *McComb,* 934 F.2d at 481.

As detailed above, the Compact drafters intended the apportionment election to be mandatory and binding. *See* §§ I.A-B; Pls. Sup. Ct. RFJN Ex. N (Council of State Governments memorandum accompanying final text of the Compact) at 1 (expressly providing that taxpayers would have the option to use the Compact Formula); *id.* Ex. S (Council of State Governments Compact Summary and Analysis) at 1 (to the same effect); *see also,* AA0142 (analysis in legislative history of Section 38006: "Compact requires member states to use the [UDITPA] apportionment formula."); AA0197 (Commission 3rd Ann. Rep.).

Variation in state apportionment formulas was a primary focus of the Congressional report, and Congress was poised to impose a mandatory apportionment formula on all states. *See* § I.A.2 above; *see also* Pls. COA-RFJN Ex. A at 118-19, 168-71, 247-49; Ex. B at 1133-64. The election was a core element of the Compact in order to secure a base-line level of uniformity and thus critical for states to avoid federal imposition of a one-size-fits-all apportionment formula. Pls. COA-RFJN Ex. C at 9-11; AA0142-43; Op. at 1. The offering of an optional model law (UDITPA) had already proven insufficient to stave off federal action. The centrality of the election as mandatory for the party states is also confirmed by the purposes of the Compact, discussed above. *See* § I.C; Op. at 19. In sum, the most compelling evidence of the party states' intent in enacting the Compact – its contemporaneous negotiating and drafting history – confirms the election is

not optional.[9]

f. The Conduct of Other Party States Cannot Override the Compact's Express Terms

Ignoring the contemporaneous negotiation and drafting history of the Compact, FTB argues, "[t]he Compact's history shows that the member states' intent and construction of the Compact was to allow them to change their state laws to establish alternate mandatory apportionment formulas." FTB Br. at 11. As the Court of Appeal properly reasoned, FTB's cherry-picked examples of some state deviations from the Compact's terms, most of them decades after enactment, cannot be used to render the expressly mandatory Compact terms optional. Op. at 18-20.

First, as discussed above, no court has used "course of performance" evidence to override the express terms of an interstate compact as opposed to aid in the interpretation of an *ambiguous* compact provision. In *Kansas v. Colorado*, 514 U.S. 673 (1995), the Supreme Court explicitly refused to allow "the subsequent practice of the parties" to alter the Court's interpretation of the Arkansas River Compact when that practice was inconsistent with the "clear language" of the compact. *Id.* at 690; *cf. Tarrant Reg. Water Dist.*, 186 L. Ed. 2d at 168, 172 (looking to party states' practical conduct in purchasing water to interpret ambiguous compact provision regarding water flow sharing); *Alabama v. North Carolina,* 130 S.Ct at 2309 (considering party states' practical conduct in interpreting ambiguous compact provision requiring "appropriate steps").

Second, the type of evidenced proffered by FTB – subsequent legislation – cannot be used to establish the intent of the earlier legislature

---

[9] To hold the election provision optional in light of this drafting history would be to interpret the Compact as a sham, meant to give the appearance of securing uniformity to stave off federal intervention.

that enacted the law. *See, e.g., Peralta Community College Dist. v. Fair Employment & Housing Com.*, 52 Cal. 3d 40, 52 (1990) (explaining that conduct of a later legislature is of little weight in determining the relevant intent of the earlier legislature that actually enacted the law, and it is of no relevance when it is inconsistent with the terms of the enactment and other evidence). "This is especially true where, as here, 'a gulf of decades separates the two [legislative bodies].'" *Apple, Inc. v. Super. Ct.,* 56 Cal. 4th 128, 145-46 (2013). Here, of the fourteen state variances listed by FTB, eleven occurred ten to twenty-plus years *after* the Compact became effective. Five occurred after this litigation was filed. *Cedars-Sinai,* 137 Cal. App. 4th at 983; *Grove v. Grove Valve and Regulator Co.,* 4 Cal. App. 3d 299, 309 (1970) (extrinsic evidence only relevant (if at all) "before any controversy arose"). In other words, what a later legislature or a current state official says about their understanding of the Compact has no weight in determining the intent of the legislature that enacted and entered into the clear Compact terms years ago.

Third, there is no evidence of *consistent* party conduct to support FTB's interpretation that all party states considered the election optional. Many states have not altered the election. *See, e.g.,* Missouri (R.S. Mo. § 32.200); North Dakota (N.D. Cent. Code, § 57-59-01); Montana (Mont. Code Ann. § 15-1-601); New Mexico (N. M. Stat. Ann. § 7-5-1). Other states have withdrawn from the Compact rather than comply with its obligations. *See U.S. Steel,* 434 U.S. at 454 n.1 (citing statutes repealing the Compact in Florida, Illinois, Indiana and Wyoming); Nevada ((1981 Nev. Stat. ch. 181, at 350); *see also,* Pls. COA-RFJN Ex. D ("Nevada withdrew because of its reluctance to allow a sales tax credit.")); Maine (P.L. 332 (2005)); Nebraska (L.B. 344 (1985)); West Virginia (Act. 1985 (160)); AA0143 (explaining that New York withdrew because of its opposition to "mandat[ing] uniformity"). This subsequent conduct does not support

FTB's view that the party states *consistently* understood the Compact's terms to be optional.[10] Furthermore, to the extent party states have eliminated the election, the legality of these enactments has not been ruled upon with finality.

Fourth, as the Court of Appeal properly analyzed, this evidence is not a reliable indicator of the meaning of the Compact's terms, because party states do not perform or deliver obligations to one other and have no incentive to enforce the Compact. Op. at 20; *Cedars-Sinai Medical Center,* 137 Cal. App. 4th at 983; *Employers Reinsurance Co. v. Superior Ct.*, 161 Cal. App. 4th 906, 922 (2008). This is not the type of contract where the parties exchange obligations and are in a meaningful position to gauge each other's compliance. Further, having succeeded in avoiding federal preemption of state taxation through the Compact almost thirty years ago, party states do not have any occasion or incentive to monitor each other's compliance with the election provision in the Compact. Therefore, there is no foundation for considering "course of performance." *See Cedars-Sinai Medical Center*, 137 Cal. App. 4th at 983. The parties that do have an interest in enforcing party states' Compact obligations, such as taxpayers, are currently litigating challenges to other party states' attempts to unilaterally alter the Compact. *See, e.g., IBM Corp. v. Dept. of Treasury,* 2012 Mich. App. LEXIS 2293 (Nov. 20, 2012).[11]

---

[10] The recent decisions of several party states that previously altered the election to now withdraw from the Compact cast further doubt on FTB's view. Minnesota (2013 Minn. Ch. Law 143 (H.F. 677)); Utah (2013 Utah Laws 462 (S.B. 247)).

[11] The Michigan Supreme Court granted IBM's application to review this decision on July 3, 2013. In its unpublished decision, the Michigan Court of Appeals refused to allow apportionment pursuant to the Compact's election provision without meaningful analysis of the status of the

For all of these reasons, the Court of Appeal properly rejected FTB's course of conduct evidence to re-write the express terms of the Compact.

g. Florida's Compact Legislation

The Commission's 1972 minutes discussing conduct by Florida prior to California's enactment of the Compact do not support FTB's interpretation.

First, FTB overstates what the Florida documents say about California's understanding of the Compact's terms. Although Florida repealed Articles III and IV of the Compact in 1971, it maintained the three-factor, equal-weighted Compact Formula as the required apportionment formula for its multistate taxpayers. FTB's RFJN Ex. C. Because the core Compact Formula remained intact, Florida "still legislatively, adher[ed] to the spirit of the Compact." FTB Br. at 6. This history does not suggest, as FTB contends, that party states understood they were free to completely eliminate the Compact election. FTB. Br. at 13-14. Nor do the Florida documents show that party states understood they could repeal portions of the Compact *at will.* Procedurally, Florida sought the approval of all existing party states in order to alter its Compact terms. Whether or not that alteration comported with the Compact or compact law has not been tested. At most, the 1972 Florida minutes indicate that party states understood there might be a procedure to seek formal variance from the Compact terms if all party states agreed, not that they were free to eliminate Compact terms without any process or approval (as California has done).

---

interstate compact. In granting review, the Michigan Supreme Court has expressly directed the parties to submit briefing on this issue. Litigation regarding the Compact election is also pending in Oregon (*Health Net, Inc. v. Dep't of Rev.,* Case No. TC5127 (Or. Tax Ct.)) and Texas (*Graphic Pkg. Corp. v. Coombs,* Case No. 12-003038 (Travis County Dist. Ct.)), and there are countless cases at the administrative level in many party states.

Second, the Florida documents are not relevant to the intent of the *California Legislature* when it entered into the Compact several years later. *See* FTB's RFJN at 4 (Florida documents are relevant because they "occurred prior to California joining the Multistate Tax Compact in 1974"). The documents indicate merely that a representative from California (likely either from FTB or the State Board of Equalization, but certainly not from the Legislature) attended the meeting discussing Florida's request for approval. FTB provides no evidence that this document was ever before the California Legislature. Therefore, this document cannot reflect legislative intent. In *Oklahoma v. New Mexico,* 501 U.S. 221 (1991), the Supreme Court rejected this same type of evidence. *Id.* at 236 (letter between one state senator and Compact official was not evidence of the legislature's understanding of the Compact unless clearly communicated to the legislative body); *see also, Burden,* 2 Cal. 4th at 564; *Whaley v. Sony Computer Entertainment America, Inc.,* 121 Cal. App. 4th 479, 487-88 (2004) ("In the absence of any evidence that [the report] was considered by the legislators, it is not a proper indicator of legislative intent."); *Kaufman & Broad Communities, Inc.,* 133 Cal. App. 4th 26, 30, 38-9 (2005). Therefore, this document sheds no light on what the enacting California Legislature understood the Compact terms to mean when it enacted and entered into the Compact in its entirety.

h. FTB's Policy Argument Must Also Be Rejected

FTB urges this Court to rewrite the Compact as a matter of "good policy." FTB Br. at 14. "As we have said before, we will not 'order relief inconsistent with [the] express term' of a compact, 'no matter what the equities of the circumstances might otherwise invite.'" *Alabama v. North Carolina,* 130 S. Ct. at 2313, citing *New Jersey v. New York,* 523 U.S. 767, 811 (1998); *Texas v. New Mexico,* 462 U.S. at 564; *see also, In re C.B.,* 188 Cal. App. 4th at 1036 (while compact association's interpretation may be

good policy, court was not authorized to alter compact terms agreed to by sovereign states).

Contrary to FTB's claim, party states' only option is not just to withdraw and destroy the Compact. FTB Br. at 14. Party states can collectively negotiate to amend the Compact. The Court of Appeal explicitly recognized this option when asked to interpret the non-approved ICPC contrary to its terms, directing "[i]t may be time for a 50-state effort to extend the ICPC to this situation." *In re C.B.,* 188 Cal. App. 4th at 1036; *see also,* Broun on Compacts, at 23 ("[O]nce adopted, the only means available to change the substance of a compact (and the obligations it imposes on a member state) is through withdrawal and renegotiation of its terms, or through an amendment adopted by all member states. . .").

In sum, as a matter of compact law, California is bound to offer multistate taxpayers the election to apportion under the Compact unless and until it withdraws.

B. THE CONTRACT CLAUSE BARS SECTION 25128 FROM ELIMINATING THE ELECTION

In eviscerating a core provision of an *interstate compact*, Section 25128 also violated the Contract Clause of the U.S. and California Constitutions. Op. at 20; *see* U.S. Const. art. I, § 10, cl. 1 ("No state shall . . . pass any . . . law impairing the obligation of contracts . . ."); Cal. Const. art. I, § 9 ("A . . . law impairing the obligation of contracts may not be passed."); *see Green v. Biddle,* 21 U.S. 1 (1823); *Doe,* 124 F. Supp.2d at 914-915 n.20. Although FTB argues that "modern contract clause analysis" dictates a different result, it cites no case upholding a state statute in conflict with an interstate compact. Indeed, none of the cases cited by FTB involved the question of whether a state statute invalidly impairs a *compact.* FTB Br. at 19-25. Even applying FTB's framework, Section 25128 is a substantial and

unjustifiable impairment of California's clear obligations, providing a separate basis for affirming the Court of Appeal.

1. Section 25128 Violates the Contract Clause

The Supreme Court has held that the Contract Clause prohibits state laws that impair the state's own obligations committed to by interstate compact. *Green v. Biddle,* 21 U.S. 1 (1823); *see also,* Broun on Compacts, § 1.2 at 17 ("The Contracts Clause of the U.S. Constitution prohibits the impairment of contracts, and that prohibition extends to interstate compacts."). In *Green*, the Supreme Court invalidated a Kentucky statute that materially impaired the rights of land owners subject to an interstate compact between Virginia and Kentucky on Contract Clause grounds:

> [T]he duty, not less than the power of this Court, as well as of every other Court in the Union, to declare a law unconstitutional, which impairs the obligation of contracts, whoever may be the parties to them, is too clearly enjoined by the constitution itself, and too firmly established by the decisions of this and other Courts, to be now shaken; and that those decisions entirely cover the present case.
>
> . . .
>
> If we attend to the definition of a contract, which is the agreement of two or more parties, to do, or not to do, certain acts, it must be obvious, that the propositions offered, and agreed to by Virginia, being accepted and ratified by Kentucky, is a contract. In fact, the terms compact and contract are synonymous: and in *Fletcher v. Peck*, the Chief Justice defines a contract to be a compact between two or more parties. The principles laid down in that case are, that the constitution of the United States embraces all contracts, executed or executory, whether between individuals, or between a State and individuals; and that a State has no more power to impair an obligation into which she herself has entered, than she can the contracts of individuals. Kentucky, therefore, being a party to the compact which guarantied[sic] to claimants of land lying in that State, under titles derived from Virginia, their rights, as they existed under the laws of Virginia, was incompetent to violate that contract, by passing any law which rendered those rights less valid and secure.

Id. at 91-93.[12] *See also, Pennsylvania v. Wheeling & Belmont Bridge Co.,* 54 U.S. 518 (1852) (State statute authorizing construction of bridge so as to obstruct navigation is unconstitutional where it is contrary to the states' compact committing to free navigation); *General Expressways,* 163 N.W.2d at 420-21 (interpreting later statute to not conflict with compact in order to avoid violation of Contract Clause). Similarly, in *Doe v. Ward,* 124 F. Supp. 2d 900 (W.D. Penn. 2000), a federal district court held that a subsequent Pennsylvania statute could not impose additional obligations on a probationer's transfer rights under the Parole Compact, citing compact law as well as the Contract Clause.[13] *Id.* at 914-15 and n. 20 ("the Contract Clause of the United States Constitution protects compacts from impairment by the states"). Thus, an attempt by a party state by subsequent statute to take away a core obligation established under an interstate compact violates the Contract Clause, and Section 25128's elimination of the Compact election is invalid.

2. Even Under FTB's Analysis, Section 25128 is a Substantial and Unjustified Impairment of the Compact

According to FTB, the Court of Appeal's Contract Clause holding was wrong because it failed to apply the multi-step modern analysis. FTB

---

[12] *Green* continues to be cited favorably by the United States Supreme Court (*see, e.g., Norfolk So. Railway v. Kirby,* 543 U.S. 14, 32 (2004)) and in many compact law treatises and articles (*see, e.g.,* Claire Carothers, The Interstate Compact as a Tool for Effecting Climate Change, 41 Ga. L. Rev. 229, 237 (2006); Broun on Compacts, at 127).

[13] FTB's note that the *Doe* court did not address this Constitutional issue is incorrect. FTB Br. at n. 18. The probationer pursued various Constitutional issues that the court did not reach (equal protection, due process, ex post facto law and violation of the right to travel), but the court itself raised and fully addressed the compact issues.

Br. at 19. None of the cases relied upon by FTB involve the determination of whether a subsequent state statute unconstitutionally impairs an obligation of the state *pursuant to an interstate compact with other sovereign states.* FTB's cases involve fundamentally different questions — whether a subsequent state statute impermissibly impaired a contract between private parties or between the state and a private party.[14] In those situations, courts have scrutinized the balance between the nature of the contract impaired (for example, a private mortgage or a contract to purchase public land) against the state's legitimate justification for the subsequent statute (for example, an emergency or a substantiated need for broad regulation). *See, e.g., Energy Reserves Group v. Kansas Power & Light,* 459 U.S. 400, 411-12 (1983); *Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234, 241-42 (1978). Specifically, courts have asked (1) did a change in law substantially impair a contractual obligation; and (2) if so, was the change in law "reasonable and necessary to serve an important public purpose." *United States Trust Co. of New York v. New Jersey,* 431 U.S. 1, 22, 25 (1976). As *Green* and its progeny recognize, when the nature of impaired obligation is a core provision of an interstate compact, one party state's impairment of the compact is unauthorized and cannot be justified, and weighing is unnecessary. *See Green,* 21 U.S. at 89-93; *Doe,* 124 F. Supp. 2d at 914-15. In the context of a compact, the kind of exacting scrutiny sought by FTB is unwarranted.

Even if the multi-step Contract Clause analysis were appropriate

---

[14] *See, e.g., Home Bldg. & Loan Ass'n v. Blaisdell,* 290 U.S. 398 (1934) (whether mortgage industry regulation impaired private mortgage contracts); *Allied Structural Steel Co. v. Spannaus,* 438 U.S. 234 (1978) (whether benefit statute impaired employer's contractual obligations); *El Paso v. Simmons,* 379 U.S. 497 (1965) (whether statute changing forfeiture rules impaired land sale contract between Texas and purchaser).

when an interstate compact is at issue, here it would confirm that FTB's interpretation of Section 25128 is unconstitutional.

a. Section 25128 Substantially Impaired a Contractual Obligation

Whether a law substantially impaired a contractual obligation hinges on an assessment of the nature and significance of the impaired obligation. *See Mobil Oil Corp. v. Rossi*, 138 Cal. App. 3d 256, 263 (1982); *Valdes v. Cory,* 139 Cal. App. 3d 773, 786-87 (1983). The Compact is an interstate contract among sovereigns. Rev. & Tax. Code § 38001 (enacting the Compact and "enter[ing] into [it] with all jurisdictions legally joining therein"); *U.S. Steel,* 434 U.S. at 471 (detailing the Compact's obligations and the "multilateral nature of the agreement"); *Texas v. New Mexico*, 482 U.S. at 128 (interstate compact is a contract); *Green,* 28 U.S. at 88-89. By its terms and as a matter of compact law, California and all other party states contractually committed to provide multistate taxpayers with the election to apportion under the Compact unless and until they withdrew from the Compact. This was a core provision of the Compact, central to each of its purposes and to staving off federal preemption. *See* § II.A.3. Thus, Section 25128's attempt to eliminate the Compact election is a *substantial* impairment of the entire Compact. *See Allied Structural,* 438 U.S. at 247 (subsequent statute that "nullifies express terms" central to the contract found to violated contract clause); *U.S. Trust,* 431 U.S. at 108 ("total[] eliminat[ion]" of an important contract provision is a substantial impairment).

FTB argues that the Compact was not impaired because "member states intended and construed [the Compact] to allow for subsequent changes to the apportionment formulas." FTB Br. at 21. This is a replay of FTB's unsound interpretation argument – that the Compact (or at least the election) must be construed as optional. *See* § II.A.3. As detailed above, the

election is unambiguously mandatory.

FTB further argues that any impairment would not be substantial, in essence because taxpayers had no right to expect the Compact election to be available indefinitely because a state could choose to withdraw. FTB Br. at 22-23. Even if a taxpayer cannot generally assume tax laws embodied in ordinary statutes will never change, a compact takes precedence over ordinary statutes and cannot be amended piecemeal, and taxpayers are justified in having heightened expectations about states' adherence to its terms. Particularly, taxpayers and party states expect that the express terms of the Compact will remain in force until the Compact is repealed and that the Compact's terms will not be amended on a piecemeal basis. For each tax year that the California Legislature did not undertake the necessary steps to repeal the Compact, taxpayers were entitled to elect to apportion under the Compact. The Compact obligation to allow a taxpayer election was substantially impaired by Section 25128, and this impairment is not diminished simply because a state could have — but had not — repealed the Compact for the years at issue.[15]

---

[15] Any argument that the Compact was not substantially impaired by Section 25128 because there is no contractual obligation *to taxpayers* is wrong. The cases cited by FTB involve the right of a third party to sue for breach of contract, not the Contract Clause. *See Mariani v. Price Waterhouse*, 70 Cal. App. 4th 685, 704 (1999) ("incidental beneficiaries" of contract "not entitled to sue for breach of contract"); *Fireman's Fund Ins. Co. v. Maryland Casualty Co.*, 21 Cal. App. 4th 1586, 1603 (1994) (without third party beneficiary status, "claim for breach of the implied covenant is without vitality"). This is not a breach of contract case. Plaintiffs' claims are for refund of taxes illegally collected, claims for which they unquestionably have standing. Rev. & Tax. Code § 19382. As part of their refund action, Plaintiffs have every right to argue for an interpretation of the Rev. & Tax. Code that comports with the Constitution. *See Green,* 21 U.S. at 91-92; *Olin v. Kitzmiller,* 259 U.S. 260 (1922); *General Expressways,* 163 N.W.2d at 427. Last, taxpayers were intended third

b. The Impairment Was Not Reasonable and Necessary to Achieve a Legitimate Public Purpose

The next question is whether Section 25128 "is reasonable and necessary to serve an important public purpose." *U.S. Trust*, 431 U.S. at 25. The level of scrutiny increases as the severity of the impairment increases. *Allied Structural*, 438 U.S. at 245 ("Severe impairment . . . will push the inquiry to a careful examination of the nature and purpose of the state legislation."). Further, when a state is attempting to avoid one of its own contractual obligations, a court must closely scrutinize claims that the impairment is justified by and tailored to meet a public purpose. *U.S. Trust,* 431 U.S. at 25-26 ("deference . . . is not appropriate because the State's self-interest is at stake"); *Valdes,* 139 Cal. App. 3d at 790.

California has no legitimate public purpose in unilaterally eliminating the Compact's election. The types of legitimate public purposes that can save an otherwise unconstitutional impairment are typically economic emergencies, such as the Great Depression, or the necessity to regulate regarding a broad-based social ill under a state's police powers. *Energy Reserves Group,* 459 U.S. at 411-12; *Allied Structural Steel,* 438 U.S. at 242-44. These purposes recognize that states must retain some authority to legislate to safeguard the welfare of their citizens even if contracts are impacted. However, there is no evidence of an emergency. FTB has not even claimed any emergency existed, and this was not a broad-based regulation under California's reserved police powers. Rather, FTB enumerates several alleged purposes for amending Section 25128, implying that they "safeguard the economic structure" and "promote the welfare of its

---

party beneficiaries of the Compact. The Compact was *expressly intended to benefit taxpayers*, as enumerated in the election and its stated purposes. *See, e.g., Sofias v. Bank of America*, 172 Cal. App. 3d 583, 587 (1985).

people." FTB. Br. at 23-24. FTB makes no attempt to establish that these purposes would actually be served or to explain why, and prove that, they are important. At bottom, these are dressed-up labels for increasing California's tax revenues. FTB should not be relieved of its burden to establish a justification for impairment, and thereby circumvent the Contract Clause, by a mere list. In fact, because the impaired obligation was an interstate compact, it is much more difficult to validate any subsequent statute. *See U.S. Trust,* 431 U.S. at 22 (explaining that the scope of a state's power to legislate depends on nature of the impaired contractual relationship). While California may have inherent power to legislate regarding certain types of contracts, California has no authority to unilaterally alter an interstate compact once it has agreed to be bound by its terms simply for the purpose of raising revenue. *See, e.g., Green,* 21 U.S. at 89 ("Can the government of Kentucky fly from this agreement, acceded to by the people in their sovereign capacity, because it involves a principle which might be inconvenient, or even pernicious to the State, in some other respect? The Court cannot perceive how this proposition could be maintained."); *West Virginia ex rel. Dyer,* 341 U.S. at 28. If California could avoid the Contracts Clause merely by a list of this sort, all other non-approved compacts would be at risk.

Finally, even if justified, the impairment was not reasonable, necessary, or tailored. If the Legislature determined that a mandatory apportionment formula should be imposed on all taxpayers, it had the authority to withdraw from the Compact. *See U.S. Trust,* 431 U.S. at 30 (state may not impose a drastic impairment when an alternative course is available). In sum, Section 25128's impairment of the Compact violates the Contract Clause.

C. PRINCIPLES OF STATUTORY INTERPRETATION PROVIDE A SEPARATE BASIS TO VOID SECTION 25128

1. The Reenactment Rule Invalidates Section 25128

"A statute may not be amended by reference to its title. A section of a statute may not be amended unless the section is re-enacted as amended." Cal. Const., art. IV, § 9. Thus, when a statute is amended but such amendment is not clear on its face, it must be reenacted to give citizens and the legislature notice of the amendment. *St. John's Well Child & Family Ctr. v. Schwarzenegger*, 50 Cal. 4th 960, n.20 (2010). As the Court of Appeal reasoned,

> The FTB's construct triggers the reenactment statute because it posits that the 1993 amendment to section 25128 repealed and superseded the UDITPA apportionment formula. Nonetheless, the purportedly deleted UDITPA election remained in former section 38006. The Legislature did not repeal, amend or reenact any part of the Compact at the time, and thus neither the public nor the legislators had adequate notice that the intent of this amendment was to eviscerate former section 38006.

Op. at 21. FTB contends that Section 25128 "completely eliminat[ed]" the election in Section 38006 to apportion using the Compact Formula. FTB Br. at 25. Yet, at least until California's recent repeal of the Compact, Section 38006 remained on the books in its entirety (including, of course, the election and the Compact Formula). Without reenactment of Section 38006 in its amended form to show the deletions, neither taxpayers nor legislators could tell that Section 38006's election had been eviscerated by later law, and Section 25128's amendment violated the reenactment rule.

In a similar case, *American Lung Ass'n v. Wilson*, 51 Cal. App. 4th 743 (1996), an appropriations bill, reduced the percentages of the Cigarette and Tobacco Products Surtax Fund marked for health education and research and redirected those funds to indigent medical services, violating the reenactment rule. The Court of Appeal explained that the bill violated

the reenactment rule because the Act in which the original percentages were found was not correspondingly amended:

> [I]f one looks for these changes to section 30124 [of the Act], subdivision (b) in the logical spot – in the section itself – they will be disappointed. Section 30124, subdivision (b) reads exactly the same after [the appropriations bill] as it did before [the appropriations bill]. In short, section 30124, subdivision (b), with its purported amendments from [the appropriations bill] was not reenacted with those amendments. The reenactment rule "applies clearly to acts which are in terms . . . amendatory of some former act."

Id. at 749 (citations omitted).

FTB contends that *American Lung* is distinguishable, because "there was ample and reasonable notice" that Section 25128 eliminated the election. FTB. Br. at 28. First, whether there is adequate notice must be evaluated by the language of the statutes, not the awareness of certain members of the public — whether by tax forms or any other means than a statutory amendment. *See Hellman v. Shoulters,* 114 Cal. 136, 152 (1896) (discussing language of statutes, not specific intent of individuals); *American Lung*, 51 Cal. App. 4th at 749 (same). Because Section 38006 was not amended, the notice is not adequate. *Id.* Second, even if legislators were aware that changing formulas would affect the tax calculation for interstate businesses, the legislative history does not indicate that anyone was aware that Section 25128 eliminated the right to elect the Compact Formula as an alternative to a State Formula. The legislative history does not mention the Compact's election, refer to the Compact by name, or even include the word "compact." The legislative history does not indicate that the legislators knew an election existed or why Section 25128 referred to Section 38006.[16] The confusion here is even greater than in *American Lung*

[16] Indeed, up until this point, the Compact Formula and the State Formula

because the oblique phrase "notwithstanding section 38006" neither guides a legislator or taxpayer to what portion of the lengthy Section 38006 is at issue, nor indicates that part of Section 38006 is, as FTB says, "completely eliminate[d]" for all purposes.

FTB's argument that Section 25128 is free from scrutiny under the reenactment rule because it is an implicit amendment (implied repeal) of Section 38006 is wrong. The reenactment rule is not violated when a later statute impliedly (rather than directly) affects existing statutes. In other words, if the new provision could *potentially* impact the operation of other statutes in some circumstances, those statutes do not need to be amended and reenacted. *See Hellman*, 114 Cal. at 151-153 (reenactment rule not violated by later statute that "leave[s] in full operation all the language of the earlier statute but might affect the operation of the earlier act in certain situations); *White v. California*, 88 Cal. App. 4th 298, 314 (2001); *American Lung,* 51 Cal. App. 4th at 750. However, the reenactment rule applies when, as here, a new provision directly impacts the application of another statute. In this situation, the Compact's provisions had to be re-enacted. Any other analysis would be overly mechanical and rigid: "The key to the enactment rule's applicability . . . does not turn on a particular method of amendment but on whether legislators and the public have been reasonably notified of direct changes in the law." *American Lung*, 51 Cal. App. 4th at 749.

Application of the reenactment rule here would *not* call into question the use of "notwithstanding" clauses in other California statutes. FTB Br. at 28. FTB's interpretation of "notwithstanding" in Section 25128 as a repealer is inconsistent with most usages of "notwithstanding," which

---

had been identical, so there was no reason for legislators to have known of the election at the time Section 25128 was amended.

merely acknowledge the general application of a provision, while directing that it will not apply to the specific subject addressed. *See In re Summer H.*, 139 Cal. App. 4th 1315, 1328 (2006) ("The term 'notwithstanding' is to be an expression of legislative intent that the statute controls in the circumstances covered by its provisions, despite the existence of other law which would otherwise apply to require a different or contrary outcome."); *People v. Moody*, 96 Cal. App. 4th 987, 993-94 (2003); *People v. Flannery*, 164 Cal. App. 3d 1112, 1120 (1985) (explaining that use of the phrase "notwithstanding [a specific statute]" expresses the legislative intent to "carve out an exception" to that statute). This more typical usage of "notwithstanding" does not implicate the reenactment rule, and FTB's "slippery slope" concerns are unfounded.

The Court of Appeal correctly ruled that Section 25128's elimination of the Compact election is invalid under the constitutional reenactment rule.

2. Other Principles of Statutory Construction Confirm that Section 25128 Cannot Be Interpreted to Repeal the Election

Although not addressed in the Court of Appeal opinion (Op. at 15), under statutory interpretation principles, Section 25128 can be read to avoid conflict with the Compact. Given the ambiguity in "notwithstanding Section 38006," Section 25128 should be interpreted to set forth California's alternative State Formula rather than to override the Compact Formula. As discussed above, "notwithstanding" commonly indicates that there are laws that co-exist but apply under different circumstances. For example, in *Klasjic v. Castaic Lake Water Agency,* 121 Cal. App. 4th 5 (2004), the court interpreted "notwithstanding subdivision (b) of Section 12944.7 of the Water Code" to mean that the general conditions of Section 12944.7 would not apply in the specified circumstances, not that Section 12994.7(b) was inapplicable for all purposes. *See also, Sacramento Newspaper Guild v.*

Sacramento County Bd. of Supervisors, 263 Cal. App. 2nd 41, 54 (1968). Therefore, "notwithstanding Section 38006" acknowledges that Section 38006's formula shall apply if elected, but notwithstanding the availability of such an election, the State Formula shall require double-weighted sales if the Compact Formula is not elected.[17] This construction also comports with fundamental principles of statutory construction. *Agnew v. State Bd. of Equaliz.*, 21 Cal. 4th 310, 326 (1999) (ambiguities in tax statute must be construed in favor of the taxpayer); *Dept. of Corr. v. Workers' Comp. Appeals Board*, 23 Cal. 3d 197, 207 (1979) (statutes must be construed to be constitutional when possible).

This viable construction of Section 25128 and Section 38006 further undermines FTB's attempt to dodge the reenactment rule. FTB argues that the reenactment rule does not apply to implied repeals. Even if the reenactment rule did not apply when one statute impliedly affects another, there is a presumption against implied repeal, rebuttable only by showing (1) that the two statutes are "irreconcilable, clearly repugnant, and so inconsistent that the two cannot have concurrent operation;" and (2) "undebatable evidence" of intent to supersede the other statute. *Western Oil & Gas Assn. v. Monterey Bay Unified Air Pollution*, 49 Cal. 3d 408, 419-20 (1989); *Schatz v. Allen Matkins Leck Gamble & Mallory LLP*, 45 Cal. 4th 557, 573 (2009). As just detailed, Section 25128 and Section 38006 can comfortably coexist, and Section 25128's legislative history lacks undebatable intent to supersede the Compact's election as it never references

---

[17] The use of the word "shall" in Section 25128 does not preclude this interpretation. The Compact also includes the mandatory "shall." Both provisions — Section 38006, Art. IV(9) and Section 25128 — contain the *same language*: "[a]ll business income *shall* be apportioned to this State by. . . ." The proper interpretation is that the Compact Formula *shall* apply when elected, and California's own State Formula (Section 25128) *shall* apply in other circumstances.

the Compact or its election. *See* § II.C.1 at 48-49.

In sum, statutory interpretation principles also bar Section 25128 from eliminating the election from the Compact.

CONCLUSION

For all the reasons stated herein, the Court of Appeal's decision should be affirmed.

Dated: July 16, 2013

Respectfully submitted,

SILVERSTEIN & POMERANTZ LLP
AMY L. SILVERSTEIN
EDWIN P. ANTOLIN
JOHANNA W. ROBERTS
CHARLES E. OLSON

By _____
Amy L. Silverstein

Attorneys for Plaintiffs and Appellants
The Gillette Company & Subsidiaries
The Procter & Gamble Manufacturing Co.
Kimberly-Clark Worldwide, Inc. & Subsidiaries et al.
Sigma-Aldrich, Inc.
RB Holdings (USA) Inc.
Jones Apparel Group

CERTIFICATE OF WORD COUNT
(Cal. Rules of Court, rule 8.204(c)(1))

The text of this brief consists of 15,994 words as counted by the Microsoft Word word-processing program used to generate this brief.

Dated: July 16, 2013

Respectfully submitted,

SILVERSTEIN & POMERANTZ LLP
AMY L. SILVERSTEIN
EDWIN P. ANTOLIN
JOHANNA W. ROBERTS
CHARLES E. OLSON

By _____
Amy L. Silverstein

Attorneys for Plaintiffs and Appellants
The Gillette Company & Subsidiaries
The Procter & Gamble Manufacturing Co.
Kimberly-Clark Worldwide, Inc. & Subsidiaries et al.
Sigma-Aldrich, Inc.
RB Holdings (USA) Inc.
Jones Apparel Group

APPENDIX: MULTISTATE TAX COMPACT

Rev. & Tax. Code § 38001.

The "Multistate Tax Compact" is hereby enacted into law and entered into with all jurisdictions legally joining therein, in the form substantially as set forth in Section 38006 of this part.

Rev. & Tax. Code § 38006.

The full text of the Multistate Tax Compact referred to in Section 38001 is as follows:

Article I. Purpose.

The purposes of this compact are to:

1. Facilitate proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases and settlement of apportionment disputes.

2. Promote uniformity or compatibility in significant components of tax systems.

3. Facilitate taxpayer convenience and compliance in the filing of tax returns and in other phases of tax administration.

4. Avoid duplicative taxation.

Article II. Definitions.

As used in this compact:

1. "State" means a State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, or any Territory or Possession of the United States.

2. "Subdivision" means any governmental unit or special district of a State.

3. "Taxpayer" means any corporation, partnership, firm, association, governmental unit or agency or person acting as a business entity in more than one state.

4. "Income tax" means a tax imposed on or measured by net income including any tax imposed on or measured by an amount arrived at by deducting

expenses from gross income, one or more forms of which expenses are not specifically and directly related to particular transactions.

5. "Capital stock tax" means a tax measured in any way by the capital of a corporation considered in its entirety.

6. "Gross receipts tax" means a tax, other than a sales tax, which is imposed on or measured by the gross volume of business, in terms of gross receipts or in other terms, and in the determination of which no deduction is allowed which would constitute the tax an income tax.

7. "Sales tax" means a tax imposed with respect to the transfer for a consideration of ownership, possession or custody of tangible personal property or the rendering of services measured by the price of the tangible personal property transferred or services rendered and which is required by State or local law to be separately stated from the sales price by the seller, or which is customarily separately stated from the sales price, but does not include a tax imposed exclusively on the sale of a specifically identified commodity or article or class of commodities or articles.

8. "Use tax" means a nonrecurring tax, other than a sales tax, which (a) is imposed on or with respect to the exercise or enjoyment of any right or power over tangible personal property incident to the ownership, possession or custody of that property or the leasing of that property from another including any consumption, keeping, retention, or other use of tangible personal property and (b) is complementary to a sales tax.

9. "Tax" means an income tax, capital stock tax, gross receipts tax, sales tax, use tax, and any other tax which has a multistate impact, except that the provisions of Articles III, IV and V of this compact shall apply only to the taxes specifically designated therein and the provisions of Article IX of this compact shall apply only in respect to determinations pursuant to Article IV.

Article III. Elements of Income Tax Laws.

Taxpayer Option, State and Local Taxes.

1. Any taxpayer subject to an income tax whose income is subject to apportionment and allocation for tax purposes pursuant to the laws of a party State or pursuant to the laws of subdivisions in two or more party States may elect to apportion and allocate his income in the manner provided by the laws of such State or by the laws of such States and subdivisions without reference to this compact, or may elect to apportion and allocate in accordance with Article IV. This election for any tax year may be made in all party States or subdivisions thereof or in any one or more of the party

States or subdivisions thereof without reference to the election made in the others. For the purposes of this paragraph, taxes imposed by subdivisions shall be considered separately from State taxes and the apportionment and allocation also may be applied to the entire tax base. In no instance wherein Article IV is employed for all subdivisions of a State may the sum of all apportionments and allocations to subdivisions within a State be greater than the apportionment and allocation that would be assignable to that State if the apportionment or allocation were being made with respect to a State income tax.

Taxpayer Option, Short Form.

2. Each party State or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return, whose only activities within the taxing jurisdiction consist of sales and do not include owning or renting real estate or tangible personal property, and whose dollar volume of gross sales made during the tax year within the State or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax due on the basis of a percentage of such volume, and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The Multistate Tax Commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the Commission, shall replace the $100,000 figure specifically provided herein. Each party State and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph.

Coverage.

3. Nothing in this Article relates to the reporting or payment of any tax other than an income tax.

Article IV. Division of Income.

1. As used in this Article, unless the context otherwise requires:

(a) "Business income" means income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations.

(b) "Commercial domicile" means the principal place from which the trade or business of the taxpayer is directed or managed.

(c) "Compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services.

(d) "Financial organization" means any bank, trust company, savings bank, industrial bank, land bank, safe deposit company, private banker, savings and loan association, credit union, cooperative bank, small loan company, sales finance company, investment company, or any type of insurance company.

(e) "Nonbusiness income" means all income other than business income.

(f) "Public utility" means any business entity (1) which owns or operates any plant, equipment, property, franchise, or license for the transmission of communications, transportation of goods or persons, except by pipe line, or the production, transmission, sale, delivery, or furnishing of electricity, water or steam; and (2) whose rates of charges for goods or services have been established or approved by a Federal, State or local government or governmental agency.

(g) "Sales" means all gross receipts of the taxpayer not allocated under paragraphs of this Article.

(h) "State" means any State of the United States, the District of Columbia, the Commonwealth of Puerto Rico, any Territory or Possession of the United States, and any foreign country or political subdivision thereof.

(i) "This State" means the State in which the relevant tax return is filed or, in the case of application of this Article to the apportionment and allocation of income for local tax purposes, the subdivision or local taxing district in which the relevant tax return is filed.

2. Any taxpayer having income from business activity which is taxable both within and without this State, other than activity as a financial organization or public utility or the rendering of purely personal services by an individual, shall allocate and apportion his net income as provided in this Article. If a taxpayer has income from business activity as a public utility but derives the greater percentage of his income from activities subject to this Article, the taxpayer may elect to allocate and apportion his entire net income as provided in this Article.

3. For purposes of allocation and apportionment of income under this Article, a taxpayer is taxable in another State if (1) in that State he is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that State has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the State does or does not.

4. Rents and royalties from real or tangible personal property, capital gains, interest, dividends or patent or copyright royalties, to the extent that they constitute nonbusiness income, shall be allocated as provided in paragraphs 5 through 8 of this Article.

5. (a) Net rents and royalties from real property located in this State are allocable to this State.

(b) Net rents and royalties from tangible personal property are allocable to this State: (1) if and to the extent that the property is utilized in this State, or (2) in their entirety if the taxpayer's commercial domicile is in this State and the taxpayer is not organized under the laws of or taxable in the State in which the property is utilized.

(c) The extent of utilization of tangible personal property in a State is determined by multiplying the rents and royalties by a fraction, the numerator of which is the number of days of physical location of the property in the State during the rental or royalty period in the taxable year and the denominator of which is the number of days of physical location of the property everywhere during all rental or royalty periods in the taxable year. If the physical location of the property during the rental or royalty period is unknown or unascertainable by the taxpayer, tangible personal property is utilized in the State in which the property was located at the time the rental or royalty payer obtained possession.

6. (a) Capital gains and losses from sales of real property located in this State are allocable to this State.

(b) Capital gains and losses from sales of tangible personal property are allocable to this State if (1) the property had a situs in this State at the time of the sale, or (2) the taxpayer's commercial domicile is in this State and the taxpayer is not taxable in the State in which the property had a situs.

(c) Capital gains and losses from sales of intangible personal property are allocable to this State if the taxpayer's commercial domicile is in this State.

7. Interest and dividends are allocable to this State if the taxpayer's commercial domicile is in this State.

8. (a) Patent and copyright royalties are allocable to this State: (1) if and to the extent that the patent or copyright is utilized by the payer in this State, or (2) if and to the extent that the patent or copyright is utilized by the payer in a State in which the taxpayer is not taxable and the taxpayer's commercial domicile is in this State.

(b) A patent is utilized in a State to the extent that it is employed in production, fabrication, manufacturing, or other processing in the State or to

the extent that a patented product is produced in the State. If the basis of receipts from patent royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the patent is utilized in the State in which the taxpayer's commercial domicile is located.

(c) A copyright is utilized in a State to the extent that printing or other publication originates in the State. If the basis of receipts from copyright royalties does not permit allocation to States or if the accounting procedures do not reflect States of utilization, the copyright is utilized in the State in which the taxpayer's commercial domicile is located.

9. All business income shall be apportioned to this State by multiplying the income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor, and the denominator of which is three.

10. The property factor is a fraction, the numerator of which is the average value of the taxpayer's real and tangible personal property owned or rented and used in this State during the tax period and the denominator of which is the average value of all the taxpayer's real and tangible personal property owned or rented and used during the tax period.

11. Property owned by the taxpayer is valued at its original cost. Property rented by the taxpayer is valued at eight times the net annual rental rate. Net annual rental rate is the annual rental rate paid by the taxpayer less any annual rental rate received by the taxpayer from subrentals.

12. The average value of property shall be determined by averaging the values at the beginning and ending of the tax period but the tax administrator may require the averaging of monthly values during the tax period if reasonably required to reflect properly the average value of the taxpayer's property.

13. The payroll factor is a fraction, the numerator of which is the total amount paid in this State during the tax period by the taxpayer for compensation and the denominator of which is the total compensation paid everywhere during the tax period.

14. Compensation is paid in this State if:

(a) the individual's service is performed entirely within the State;

(b) the individual's service is performed both within and without the State, but the service performed without the State is incidental to the individual's service within the State; or

(c) some of the service is performed in the State and (1) the base of operations or, if there is no base of operations, the place from which the service is directed or controlled is in the State, or (2) the base of operations or the place from which the service is directed or controlled is not in any State

in which some part of the service is performed, but the individual's residence is in this State.

15. 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.

16. Sales of tangible personal property are in this State if:

(a) the property is delivered or shipped to a purchaser, other than the United States Government, within this State regardless of the f.o.b. point or other conditions of the sale; or

(b) the property is shipped from an office, store, warehouse, factory, or other place of storage in this State and (1) the purchaser is the United States Government or (2) the taxpayer is not taxable in the State of the purchaser.

17. Sales, other than sales of tangible personal property, are in this State if:

(a) the income-producing activity is performed in this State; or

(b) the income-producing activity is performed both in and outside this State and a greater proportion of the income-producing activity is performed in this State than in any other State, based on costs of performance.

18. If the allocation and apportionment provisions of this Article do not fairly represent the extent of the taxpayer's business activity in this State, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

(a) separate accounting;

(b) the exclusion of any one or more of the factors;

(c) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this State; or

(d) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article V. Elements of Sales and Use Tax Laws.

Tax Credit.

1. Each purchaser liable for a use tax on tangible personal property shall be entitled to full credit for the combined amount or amounts of legally imposed sales or use taxes paid by him with respect to the same property to another State and any subdivision thereof. The credit shall be applied first against the amount of any use tax due the State, and any unused portion of

the credit shall then be applied against the amount of any use tax due a subdivision.

Exemption Certificates, Vendors May Rely.

2. Whenever a vendor receives and accepts in good faith from a purchaser a resale or other exemption certificate or other written evidence of exemption authorized by the appropriate State or subdivision taxing authority, the vendor shall be relieved of liability for a sales or use tax with respect to the transaction.

Article VI. The Commission.

Organization and Management.

1. (a) The Multistate Tax Commission is hereby established. It shall be composed of one "member" from each party State who shall be the head of the State agency charged with the administration of the types of taxes to which this compact applies. If there is more than one such agency the State shall provide by law for the selection of the Commission member from the heads of the relevant agencies. State law may provide that a member of the Commission be represented by an alternate but only if there is on file with the Commission written notification of the designation and identity of the alternate. The Attorney General of each party State or his designee, or other counsel if the laws of the party State specifically provide, shall be entitled to attend the meetings of the Commission, but shall not vote. Such Attorneys General, designees, or other counsel shall receive all notices of meetings required under paragraph 1(e) of this Article.

(b) Each party State shall provide by law for the selection of representatives from its subdivisions affected by this compact to consult with the Commission member from that State.

(c) Each member shall be entitled to one vote. The Commission shall not act unless a majority of the members are present, and no action shall be binding unless approved by a majority of the total number of members.

(d) The Commission shall adopt an official seal to be used as it may provide.

(e) The Commission shall hold an annual meeting and such other regular meetings as its bylaws may provide and such special meetings as its Executive Committee may determine. The Commission bylaws shall specify the dates of the annual and any other regular meetings, and shall provide for the giving of notice of annual, regular and special meetings. Notices of special meetings shall include the reasons therefor and an agenda of the items to be considered.

(f) The Commission shall elect annually, from among its members, a Chairman, a Vice Chairman and a Treasurer. The Commission shall appoint an Executive Director who shall serve at its pleasure, and it shall fix his duties and compensation. The Executive Director shall be Secretary of the Commission. The Commission shall make provision for the bonding of such of its officers and employees as it may deem appropriate.

(g) Irrespective of the civil service, personnel or other merit system laws of any party State, the Executive Director shall appoint or discharge such personnel as may be necessary for the performance of the functions of the Commission and shall fix their duties and compensation. The Commission bylaws shall provide for personnel policies and programs.

(h) The Commission may borrow, accept or contract for the services of personnel from any State, the United States, or any other governmental entity.

(i) The Commission may accept for any of its purposes and functions any and all donations and grants of money, equipment, supplies, materials and services, conditional or otherwise, from any governmental entity, and may utilize and dispose of the same.

(j) The Commission may establish one or more offices for the transacting of its business.

(k) The Commission shall adopt bylaws for the conduct of its business. The Commission shall publish its bylaws in convenient form, and shall file a copy of the bylaws and any amendments thereto with the appropriate agency or officer in each of the party States.

(l) The Commission annually shall make to the Governor and legislature of each party State a report covering its activities for the preceding year. Any donation or grant accepted by the Commission or services borrowed shall be reported in the annual report of the Commission, and shall include the nature, amount and conditions, if any, of the donation, gift, grant or services borrowed and the identity of the donor or lender. The Commission may make additional reports as it may deem desirable.

Committees.

2. (a) To assist in the conduct of its business when the full Commission is not meeting, the Commission shall have an Executive Committee of seven members, including the Chairman, Vice Chairman, Treasurer and four other members elected annually by the Commission. The Executive Committee, subject to the provisions of this compact and consistent with the policies of the Commission, shall function as provided in the bylaws of the Commission.

(b) The Commission may establish advisory and technical committees, membership on which may include private persons and public officials, in furthering any of its activities. Such committees may consider any matter of concern to the Commission, including problems of special interest to any party State and problems dealing with particular types of taxes.

(c) The Commission may establish such additional committees as its by-laws may provide.

Powers.

3. In addition to powers conferred elsewhere in this compact, the Commission shall have power to:

(a) Study State and local tax systems and particular types of State and local taxes.

(b) Develop and recommend proposals for an increase in uniformity or compatibility of State and local tax laws with a view toward encouraging the simplification and improvement of State and local tax law and administration.

(c) Compile and publish information as in its judgment would assist the party States in implementation of the compact and taxpayers in complying with State and local tax laws.

(d) Do all things necessary and incidental to the administration of its functions pursuant to this compact.

Finance.

4. (a) The Commission shall submit to the Governor or designated officer or officers of each party State a budget of its estimated expenditures for such period as may be required by the laws of that State for presentation to the legislature thereof.

(b) Each of the Commission's budgets of estimated expenditures shall contain specific recommendations of the amounts to be appropriated by each of the party States. The total amount of appropriations requested under any such budget shall be apportioned among the party States as follows: one-tenth in equal shares; and the remainder in proportion to the amount of revenue collected by each party State and its subdivisions from income taxes, capital stock taxes, gross receipts taxes, sales and use taxes. In determining such amounts, the Commission shall employ such available public sources of information as, in its judgment, present the most equitable and accurate comparisons among the party States. Each of the Commission's budgets of estimated expenditures and requests for appropriations shall indicate the sources used in obtaining information employed in applying the formula contained in this paragraph.

(c) The Commission shall not pledge the credit of any party State. The Commission may meet any of its obligations in whole or in part with funds available to it under paragraph 1 (i) of this Article: provided that the Commission takes specific action setting aside such funds prior to incurring any obligation to be met in whole or in part in such manner. Except where the Commission makes use of funds available to it under paragraph 1 (i), the Commission shall not incur any obligation prior to the allotment of funds by the party States adequate to meet the same.

(d) The Commission shall keep accurate accounts of all receipts and disbursements. The receipts and disbursements of the Commission shall be subject to the audit and accounting procedures established under its bylaws. All receipts and disbursements of funds handled by the Commission shall be audited yearly by a certified or licensed public accountant and the report of the audit shall be included in and become part of the annual report of the Commission.

(e) The accounts of the Commission shall be open at any reasonable time for inspection by duly constituted officers of the party States and by any persons authorized by the Commission.

(f) Nothing contained in this Article shall be construed to prevent Commission compliance with laws relating to audit or inspection of accounts by or on behalf of any government contributing to the support of the Commission.

Article VII. Uniform Regulations and Forms.

1. Whenever any two or more party States, or subdivisions of party States, have uniform or similar provisions of law relating to an income tax, capital stock tax, gross receipts tax, sales or use tax, the Commission may adopt uniform regulations for any phase of the administration of such law, including assertion of jurisdiction to tax, or prescribing uniform tax forms. The Commission may also act with respect to the provisions of Article IV of this compact.

2. Prior to the adoption of any regulation, the Commission shall:

(a) As provided in its bylaws, hold at least one public hearing on due notice to all affected party States and subdivisions thereof and to all taxpayers and other persons who have made timely request of the Commission for advance notice of its regulation-making proceedings.

(b) Afford all affected party States and subdivisions and interested persons an opportunity to submit relevant written data and views, which shall be considered fully by the Commission.

3. The Commission shall submit any regulations adopted by it to the appropriate officials of all party States and subdivisions to which they might apply. Each such State and subdivision shall consider any such regulation for adoption in accordance with its own laws and procedures.

Article VIII. Interstate Audits.

1. This Article shall be in force only in those party States that specifically provide therefor by statute.

2. Any party State or subdivision thereof desiring to make or participate in an audit of any accounts, books, papers, records or other documents may request the Commission to perform the audit on its behalf. In responding to the request, the Commission shall have access to and may examine, at any reasonable time, such accounts, books, papers, records, and other documents and any relevant property or stock of merchandise. The Commission may enter into agreements with party States or their subdivisions for assistance in performance of the audit. The Commission shall make charges, to be paid by the State or local government or governments for which it performs the service, for any audits performed by it in order to reimburse itself for the actual costs incurred in making the audit.

3. The Commission may require the attendance of any person within the State where it is conducting an audit or part thereof at a time and place fixed by it within such State for the purpose of giving testimony with respect to any account, book, paper, document, other record, property or stock of merchandise being examined in connection with the audit. If the person is not within the jurisdiction, he may be required to attend for such purpose at any time and place fixed by the Commission within the State of which he is a resident: provided that such State has adopted this Article.

4. The Commission may apply to any court having power to issue compulsory process for orders in aid of its powers and responsibilities pursuant to this Article and any and all such courts shall have jurisdiction to issue such orders. Failure of any person to obey any such order shall be punishable as contempt of the issuing court. If the party or subject matter on account of which the Commission seeks an order is within the jurisdiction of the court to which application is made, such application may be to a court in the State or subdivision on behalf of which the audit is being made or a court in the State in which the object of the order being sought is situated. The provisions of this paragraph apply only to courts in a State that has adopted this Article.

5. The Commission may decline to perform any audit requested if it finds that its available personnel or other resources are insufficient for the pur-

pose or that, in the terms requested, the audit is impractical of satisfactory performance. If the Commission, on the basis of its experience, has reason to believe that an audit of a particular taxpayer, either at a particular time or on a particular schedule, would be of interest to a number of party States or their subdivisions, it may offer to make the audit or audits, the offer to be contingent on sufficient participation therein as determined by the Commission.

6. Information obtained by any audit pursuant to this Article shall be confidential and available only for tax purposes to party States, their subdivisions or the United States. Availability of information shall be in accordance with the laws of the States or subdivisions on whose account the Commission performs the audit, and only through the appropriate agencies or officers of such States or subdivisions. Nothing in this Article shall be construed to require any taxpayer to keep records for any period not otherwise required by law.

7. Other arrangements made or authorized pursuant to law for cooperative audit by or on behalf of the party States or any of their subdivisions are not superseded or invalidated by this Article.

8. In no event shall the Commission make any charge against a taxpayer for an audit.

9. As used in this Article, "tax," in addition to the meaning ascribed to it in Article II, means any tax or license fee imposed in whole or in part for revenue purposes.

Article IX. Arbitration.

1. Whenever the Commission finds a need for settling disputes concerning apportionments and allocations by arbitration, it may adopt a regulation placing this Article in effect, notwithstanding the provisions of Article VII.

2. The Commission shall select and maintain an Arbitration Panel composed of officers and employees of State and local governments and private persons who shall be knowledgeable and experienced in matters of tax law and administration.

3. Whenever a taxpayer who has elected to employ Article IV, or whenever the laws of the party State or subdivision thereof are substantially identical with the relevant provisions of Article IV, the taxpayer, by written notice to the Commission and to each party State or subdivision thereof that would be affected, may secure arbitration of an apportionment or allocation, if he is dissatisfied with the final administrative determination of the tax agency of the State or subdivision with respect thereto on the ground that it would

subject him to double or multiple taxation by two or more party States or subdivisions thereof. Each party State and subdivision thereof hereby consents to the arbitration as provided herein, and agrees to be bound thereby.

4. The Arbitration Board shall be composed of one person selected by the taxpayer, one by the agency or agencies involved, and one member of the Commission's Arbitration Panel. If the agencies involved are unable to agree on the person to be selected by them, such person shall be selected by lot from the total membership of the Arbitration Panel. The two persons selected for the Board in the manner provided by the foregoing provisions of this paragraph shall jointly select the third member of the Board. If they are unable to agree on the selection, the third member shall be selected by lot from among the total membership of the Arbitration Panel. No member of a Board selected by lot shall be qualified to serve if he is an officer or employee or is otherwise affiliated with any party to the arbitration proceeding. Residence within the jurisdiction of a party to the arbitration proceeding shall not constitute affiliation within the meaning of this paragraph.

5. The Board may sit in any State or subdivision party to the proceeding, in the State of the taxpayer's incorporation, residence or domicile, in any State where the taxpayer does business, or in any place that it finds most appropriate for gaining access to evidence relevant to the matter before it.

6. The Board shall give due notice of the times and places of its hearings. The parties shall be entitled to be heard, to present evidence, and to examine and cross-examine witnesses. The Board shall act by majority vote.

7. The Board shall have power to administer oaths, take testimony, subpoena and require the attendance of witnesses and the production of accounts, books, papers, records, and other documents, and issue commissions to take testimony. Subpoenas may be signed by any member of the Board. In case of failure to obey a subpoena, and upon application by the Board, any judge of a court of competent jurisdiction of the State in which the Board is sitting or in which the person to whom the subpoena is directed may be found may make an order requiring compliance with the subpoena, and the court may punish failure to obey the order as a contempt. The provisions of this paragraph apply only in States that have adopted this Article.

8. Unless the parties otherwise agree the expenses and other costs of the arbitration shall be assessed and allocated among the parties by the Board in such manner as it may determine. The Commission shall fix a schedule of compensation for members of Arbitration Boards and of other allowable expenses and costs. No officer or employee of a State or local government who serves as a member of a Board shall be entitled to compensation therefor unless he is required on account of his service to forego the regular

compensation attaching to his public employment, but any such Board member shall be entitled to expenses.

9. The Board shall determine the disputed apportionment or allocation and any matters necessary thereto. The determinations of the Board shall be final for purposes of making the apportionment or allocation, but for no other purpose.

10. The Board shall file with the Commission and with each tax agency represented in the proceeding: the determination of the Board; the Board's written statement of its reasons therefor; the record of the Board's proceedings; and any other documents required by the arbitration rules of the Commission to be filed.

11. The Commission shall publish the determinations of Boards together with the statements of the reasons therefor.

12. The Commission shall adopt and publish rules of procedure and practice and shall file a copy of such rules and of any amendment thereto with the appropriate agency or officer in each of the party States.

13. Nothing contained herein shall prevent at any time a written compromise of any matter or matters in dispute, if otherwise lawful, by the parties to the arbitration proceedings.

Article X. Entry Into Force and Withdrawal.

1. This compact shall enter into force when enacted into law by any seven States. Thereafter, this compact shall become effective as to any other State upon its enactment thereof. The Commission shall arrange for notification of all party States whenever there is a new enactment of the compact.

2. Any party State may withdraw from this compact by enacting a statute repealing the same. No withdrawal shall affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal.

3. No proceeding commenced before an Arbitration Board prior to the withdrawal of a State and to which the withdrawing State or any subdivision thereof is a party shall be discontinued or terminated by the withdrawal, nor shall the Board thereby lose jurisdiction over any of the parties to the proceeding necessary to make a binding determination therein.

Article XI. Effect on Other Laws and Jurisdiction.

Nothing in this compact shall be construed to:

(a) Affect the power of any State or subdivision thereof to fix rates of taxation, except that a party State shall be obligated to implement Article III 2 of this compact.

(b) Apply to any tax or fixed fee imposed for the registration of a motor vehicle or any tax on motor fuel, other than a sales tax: provided that the definition of "tax" in Article VIII 9 may apply for the purposes of that Article and the Commission's powers of study and recommendation pursuant to Article VI 3 may apply.

(c) Withdraw or limit the jurisdiction of any State or local court or administrative officer or body with respect to any person, corporation or other entity or subject matter, except to the extent that such jurisdiction is expressly conferred by or pursuant to this compact upon another agency or body.

(d) Supersede or limit the jurisdiction of any court of the United States.

Article XII. Construction and Severability.

This compact shall be liberally construed so as to effectuate the purposes thereof. The provisions of this compact shall be severable and if any phrase, clause, sentence or provision of this compact is declared to be contrary to the constitution of any State or of the United States or the applicability thereof to any government, agency, person or circumstance is held invalid, the validity of the remainder of this compact and the applicability thereof to any government, agency, person or circumstance shall not be affected thereby. If this compact shall be held contrary to the constitution of any State participating therein, the compact shall remain in full force and effect as to the remaining party States and in full force and effect as to the State affected as to all severable matters.

PROOF OF SERVICE

I declare that I am employed with the law firm of Silverstein & Pomerantz LLP, whose address is 55 Hawthorne Street, Suite 440, San Francisco, California 94105-3910. I am not a party to the within cause, and I am over the age of eighteen years.

I further declare that on July 16, 2013, I served a copy of:

ANSWER BRIEF ON THE MERITS

☒ **BY PERSONAL SERVICE [Code Civ. Proc sec. 1011]** by placing a true copy thereof enclosed in a sealed envelope addressed as follows for collection and delivery at the mailroom of Silverstein & Pomerantz LLP, causing personal delivery of the document(s) listed above to the person(s) at the address(es) set forth below through registered process server Wheels of Justice whose business address is located at 657 Mission Street, #502, San Francisco, California 94105.

I am readily familiar with Silverstein & Pomerantz LLP's practice for the collection and processing of documents for hand delivery and know that in the ordinary course of Silverstein & Pomerantz LLP's business practice the document(s) described above will be taken from Silverstein & Pomerantz LLP's mailroom and hand delivered through registered process server Wheels of Justice to the document's addressee (or left with an employee or person in charge of the addressee's office) on the same date that it is placed at Silverstein & Pomerantz LLP's mailroom.

First District Court of Appeal
Division Four
350 McAllister Street
San Francisco, California 94102

San Francisco Superior Court
Honorable Richard A. Kramer
Department 304
400 McAllister Street
San Francisco, California 94102-4514

Lucy F. Wang
Deputy Attorney General
455 Golden Gate Avenue, Suite 11000
San Francisco, California 94102-7004
Counsel for Defendant and Respondent Franchise Tax Board

☒ **BY OVERNIGHT DELIVERY [Code Civ. Proc sec. 1013(d)]** by placing a true copy thereof enclosed in a sealed envelope with delivery fees provided for, addressed as follows, for collection by UPS, at 55 Hawthorne Street, San Francisco, California 94105-3910 in accordance with Silverstein & Pomerantz LLP's ordinary business practices.

I am readily familiar with Silverstein & Pomerantz LLP's practice for collection and processing of correspondence for overnight delivery and know that in the ordinary course of Silverstein & Pomerantz LLP's business practice the document(s) described above will be deposited in a box or other facility regularly maintained by UPS or delivered to an authorized courier or driver authorized by UPS to receive documents on the same date that it (they) is are placed at Silverstein & Pomerantz LLP for collection.

Joe Huddleston
Shirley Sicilian
Sheldon H. Laskin
444 North Capitol Street, N.W., Suite 425
Washington, D.C. 20001-1538
Amicus Curiae Multistate Tax Commission

Wm. Gregory Turner
Senior Tax Counsel
1415 L Street, Suite 1200
Sacramento, California 95814
Amicus Council On State Taxation (COST)

Richard L. Masters
Masters, Mullins & Arrington
1012 South Fourth Street
Louisville, Kentucky 40203
Amici Curiae Association of Compact Administrators of the Interstate Compact on the Placement of Children

Richard L. Masters
General Counsel
Interstate Commission for Juveniles
836 Euclid Avenue
Louisville, Kentucky 40502
Amici Curiae Interstate Commission For Juveniles

Jeffrey B. Litwak
1608 NE Knott Street
Portland, Oregon 97212
Amicus Curiae Jeffrey B. Litwak

Cory Fong, Tax Commissioner
Office of State Tax Commissioner
State of North Dakota
600 E. Boulevard Avenue, Department 127
Bismarck, North Dakota 58505-0599
Amicus Curiae State of North Dakota

Lawrence G. Wasden
Attorney General, State of Idaho
State of Idaho Office of the Attorney General
P.O. Box 83720
Boise, Idaho 83720-0010
Amicus Curiae State of Idaho

R. Bruce Johnson
Commission Chair
Utah State Tax Commission
210 North 1950 West
Salt Lake City, Utah 84134
Amicus Curiae State of Utah

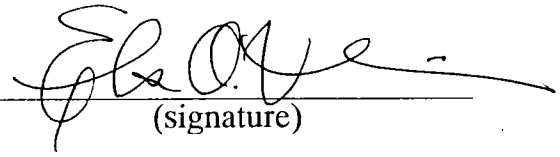
Ellen F. Rosenblum
Attorney General, State of Oregon
Department of Justice
Justice Building
1162 Court Street NE
Salem, Oregon 97301-4096
Amicus Curiae State of Oregon

Rance L. Croft
Assistant Solicitor General
Office of the Attorney General
300 W. 15th Street
Austin, Texas 78701
Counsel for Amici Curiae States of Texas, Alabama, Alaska, Arkansas, Colorado, District of Columbia, Hawaii, Kansas, Michigan, Minnesota, Missouri, New Mexico, South Dakota, Utah, and Washington

Jeffrey Margolis
Tax Counsel IV
California Franchise Tax Board
Sacramento, California 95827
Defendant and Respondent

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed at San Francisco, California, this 16th day of July, 2013.

Elsa O. Valmidiano
(typed)


(signature)