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-Respondent.

Case No. S206587

First Appellate District Division Four, Case No. A130803
San Francisco County Superior Court, Case No. CGC-10-495911
The Honorable Richard A. Kramer, Judge

REPLY BRIEF ON THE MERITS

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INTRODUCTION

Gillette urges the Court to adopt an interpretation of the Multistate Tax Compact contrary to that held by its members. Though the Compact contains a provision allowing taxpayers to elect a specific tax formula, the member states reasonably construe the Compact to allow them to mandate the use of other, different formulas. In 1971, the member states unanimously approved a member's repeal of the election provision, and 14 of the 20 member states have since enacted other mandatory formulas.

In Gillette's view, the member states' construction and course of conduct are irrelevant and may not be considered because (it argues) the Compact's election provision is unambiguous. Gillette errs, however, focusing solely on the election provision. The key question is whether the Compact bars member states from subsequently imposing other mandatory formulas, which requires consideration of the Compact in its entirety. Because the Compact is silent on this question, the member states' course of conduct is indispensable to resolving the question.

The recent compact case from the Supreme Court of the United States, *Tarrant Regional Water District v. Herrmann* (2013) 560 U.S. 330 [133 S.Ct. 2120, 186 L.Ed.2d 153], is instructive. It dealt with a similar ambiguity, and looked to three factors that are also present here in construing the compact before it: the member states' course of conduct; the likelihood (or unlikelihood) that states would surrender a vital sovereign interest without unmistakably stating so; and similar treatment of the subject matter in other compacts.

Gillette's interpretation is also bad public policy. It disregards the states' vital interest in having a flexible Compact that both addresses the common concerns of the member states, and yet allows each state to protect its own sovereignty to enact tax laws as needed to protect its unique concerns. Moreover, Gillette's interpretation would impose a rule that

threatens the existence of the Compact, by barring member states from changing apportionment formulas without completely withdrawing from the Compact.

ARGUMENT

In 1974, California joined the Multistate Tax Compact, the text of which provides taxpayers with an election to apportion their income using either the state's defined formula, or an equally weighted three-factor formula as provided for in Article IV of the Compact. The Compact was set out in former Revenue and Taxation Code section 38006. At that time, California used the same three-factor formula, which was set out in section 25128.[1] In 1993, California amended section 25128 to require that most taxpayers use a different formula.[2] Section 25128, subdivision (a), provided that, "[n]otwithstanding Section 38006," multistate taxpayers were required to apportion their business income by exclusively using a double-weighted sales factor formula.

The Court of Appeal held that section 25128 was invalid and unconstitutional for three reasons: "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 [Board's] construction of the effect of the amended section 25128 runs afoul of the reenactment clause of the California Constitution." (Slip opn. at p. 16.)

The Board established in its opening brief on the merits that section 25128 did not conflict with the Compact because (1) the Compact reasonably permitted a member state to subsequently enact a law

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[1] Unless otherwise indicated, all statutory references are to the Revenue and Taxation Code.

[2] Subsequent references to section 25128 refer to the amended version unless otherwise stated.

establishing an alternate mandatory apportionment formula, and (2) states retain the authority to change their tax laws, unless that right has been surrendered in terms that are unmistakably clear. Moreover, the Board established that section 25128 did not violate the contract clauses of the federal and state constitutions, or the reenactment rule.

I. SECTION 25128 DOES NOT CONFLICT WITH THE MULTISTATE TAX COMPACT.

According to Gillette, the amended apportionment formula in section 25128 conflicts with the Compact because the election provision is expressly stated, supports the purposes of the Compact, and is unambiguous. Therefore, Gillette maintains, the member states' intent and actions are irrelevant, as are the policy reasons behind the Compact.

But while the election provision may be express, the Compact as a whole is utterly silent, and thus ambiguous, on the question of whether there is any limitation on a member state's authority to enact subsequent legislation mandating the use of a different apportionment formula. When faced with a similar ambiguity, the Supreme Court recently explained in *Tarrant Regional Water District v. Herrmann*, *supra*, 133 S.Ct. 2120, that it was necessary to look "to other interpretive tools [.]" (*Id.* at p. 2132.)

The Court's primary task here is to determine the member states' intent in forming the Compact. (*See Alabama v. North Carolina* (2010) 560 U.S. 330 [130 S.Ct. 2295, 176 L.Ed.2d 1070, 1091] [conc. opn. of Kennedy, J.].) Thus, the policy reasons behind the Compact, and the member states' actions in carrying it out, are not only relevant but indispensable to construing the Compact. (*Tarrant Regional Water District v. Herrmann*, *supra*, 133 S.Ct. at p. 2132.)

A. *Tarrant* Supports the Member States' Construction of the Compact.

In *Tarrant*, the Red River Compact provided that the member states "shall have equal rights to the use of [relevant] runoff . . . and undesignated

water[.]" (*Tarrant Regional Water District v. Herrmann*, *supra*, 133 S.Ct. at p. 2127.) Attempting to enforce its "equal rights" under the compact, a Texas state agency providing water to north Texas applied to Oklahoma for permits to divert compact water from Oklahoma into Texas. After joining the compact, Oklahoma had enacted statutes that effectively barred the cross-border diversion of compact water. Like Gillette, Texas claimed that Oklahoma's subsequent legislation conflicted with the compact, and therefore was preempted. Oklahoma, like the Board, pointed out that the compact was silent on the key issue as to whether subsequently enacted legislation would be permitted to alter certain particulars of a state's performance under the compact.

In *Tarrant*, the Supreme Court of the United States recognized that the pertinent question is not whether a compact promise of "equal rights" is express and unambiguous, but whether the *member states' right to impose limitations* on the "equal rights" is ambiguous. (*Tarrant Regional Water District v. Herrmann*, *supra*, 133 S.Ct. at p. 2132 ["§5.05(b)(1)'s silence is ambiguous regarding cross-border rights under the Compact"].) That distinction is important here. Had the Supreme Court decided *Tarrant* on the basis of the argument Gillette has made, it would have determined that the Red River Compact's provision on "equal rights" to water was express, and therefore that there was no need to look deeper. Instead, the Court determined that the *member states' right to enact subsequent legislation* was ambiguous, and therefore that the Court must "turn to other interpretive tools to shed light on the intent of the Compact's drafters." (*Ibid.*)

The Supreme Court looked at three factors in aid of its interpretation—each of which is also present in this case, and each of which supports the Board's construction: the member states' course of conduct; principles of state sovereignty; and language in other compacts.

1. Member states' course of conduct

The *Tarrant* Court explained that a member state's "'course of performance under the Compact is highly significant evidence of its understanding of the compact's terms." (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2135, quoting *Alabama v. North Carolina, supra*, 130 S.Ct. at p. 2295.) The Court noted that "[s]ince the Compact was approved by Congress in 1980, no signatory State had pressed for a cross-border diversion under the Compact until *Tarrant* filed suit in 2007." (*Ibid.*)

The member states' course of conduct in the present case is even more telling. Rather than an absence of action by the member states, in the present case, fourteen (14) member states—including California—have affirmatively enacted different mandatory apportionment formulas. And not one member state has claimed those changes violated the Compact.

2. State sovereignty

The *Tarrant* Court acknowledged that a state's authority over water within its own border is "an essential attribute of sovereignty." (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2132.) Contrary to the assertion that silence meant the member states had surrendered their sovereignty in this respect, the Court explained that "[s]tates rarely relinquish their sovereign powers, so when they do we would expect a clear indication of such devolution, not inscrutable silence." (*Id.* at pp. 2132-33.) This applies fully to the present case, because taxation is also an essential attribute of state sovereignty. (*Railroad Co. v. Peniston* (1873) 85 U.S. 21, 29.) Giving up the right to mandate the use of an apportionment formula (without having to withdraw from the Compact) would be a limitation on state sovereignty; states would not be expected to relinquish an aspect of sovereignty in this manner without stating so explicitly.

3. Other compacts

The *Tarrant* Court also noted that in other compacts, states giving up a sovereign right did so explicitly. (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at pp. 2133-34.) While not an exhaustive survey, it is worth noting that, unlike the Multistate Tax Compact, the text of almost every compact cited by Gillette explicitly provides that the compact at issue is binding, supersedes state law, or must be given full force and effect.[3] (See Answer Brief at p. 26.) As in *Tarrant*, the fact that states have explicitly given up their sovereign rights in the compacts cited by Gillette supports the Compact member states' construction that they would not have given up their sovereignty here without saying so explicitly.

B. Each Member State Retained the Authority Under the Compact to Enact Subsequent Legislation Mandating the Use of a Different, Alternate Apportionment Formula.

1. The member states' construction is consistent with the Compact.

According to Gillette, this Court may consider only the Compact's text to determine its meaning. (Answer Brief at p. 22.) But there is no hard and fast rule to that effect, and the cases Gillette relies on do not support

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[3] Veh. Code, § 15023, subd. (c) [*Driver License Compact* requires party states' laws "shall contain such provisions as may be necessary to ensure that full force and effect is given to this section"]; Welf. & Inst. Code, § 1400, art. X, subd. (b) [*Interstate Compact on Juveniles* "shall become effective and binding upon legislative enactment" of required number of states]; Pen. Code, § 11180, art. XIV, §§ A, B [*Interstate Compact for Adult Offender Supervision* provides "laws conflicting with this Compact are *superseded* to the extent of the conflict"]; Ed. Code, § 12510, art. VIII, subd. (b) [*Compact for Education* "shall become binding" when properly adopted]; Fam. Code, § 7907 [*Interstate Compact on the Placement of Children* states that "[n]o provision of law restricting out-of-state placement of children for adoption shall apply to placements made pursuant to the Interstate Compact on the Placement of Children"].

this claim. The same authority states have to enter into compacts in the first instance must also allow states to enter into compacts that permit subsequent legislative exercises of state sovereignty, whether the operative provisions are expressly stated or not. The *Tarrant* Court certainly recognized this when it upheld Oklahoma's subsequent legislation, which effectively barred Texas from obtaining "equal rights" to Red River Compact water in Oklahoma. (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2133.)

Nor does *Alabama v. North Carolina* (2010) 560 U.S. 330 [130 S.Ct. 2295, 2313] hold otherwise. In a dispute between member states, the Supreme Court held that a compact imposed no express limitations on a state's right to withdraw, and was not subject to an implied duty of good faith. (*Id.* at p. 2313.) That is not the same thing as refusing to recognize the member states' non-disputed, extra-textual common understanding that they had the right under the Compact to enact subsequent legislation mandating a different apportionment formula.

Gillette also erroneously claims that its text-only rule comes from contract law. In *Corwin v. Los Angeles Newspaper Service Bureau, Inc.* (1978) 22 Cal.3d 302, this Court held otherwise. "[E]ven if . . . the words [of the contract] standing alone might mean one thing to the members of this court, where the parties have demonstrated by their actions . . . that to them the contract [means] something quite different, the meaning and intent of the parties should be enforced." (*Id.* at p. 314; internal quotation marks and citations omitted.)

Corwin followed *Crestview Cemetery Assn. v. Dieden* (1960) 54 Cal.2d 744, in which this Court discussed the rule of "practical construction," and explained that "the parties by their actions have created the 'ambiguity' required to bring the rule into operation. If this were not the rule the courts would be enforcing one contract when [the] parties have

demonstrated that they meant and intended the contract to be quite different." (*Id.* at p. 755.)

Similarly, in *Pacific Gas & Elec. Co. v. G.W. Thomas Drayage & Rigging Co.* (1968) 69 Cal.2d 33, this Court explained that, "The exclusion of parol evidence . . . merely because the words do not appear ambiguous to the reader can easily lead to the attribution to a written instrument of a meaning that was never intended." (*Id.* at p. 39; *Universal Sales Corp. v. California Press Mfg. Co.* (1942) 20 Cal.2d 751, 762-763.)

Gillette's exclusive reliance upon express language is contrary to both compact cases and contract cases, and should be rejected.

2. The Compact is silent, and thus ambiguous, on whether member states may enact subsequent legislation.

The Compact is ambiguous. Gillette argues that because the Compact expressly allows variations from some of its terms, its silence on changes in the election provision shows that the provision is mandatory. (Answer Brief at p. 25.) However, Gillette's examples offer it no support. The audit provision in Article VIII is an opt-in requirement that affects the Multistate Tax Commission's operations, and the withdrawal provision is a common affirmative right that, when exercised, affects member dues. A state's change in its apportionment formula has no similar impact.

Gillette also claims that the member states' construction jeopardizes many compacts "with similar withdrawal provisions which . . . could now be modified at will by party states." (Answer Brief at p. 26.) But, again, the express text of each of the compacts Gillette specifically mentions explicitly provides that that compact is binding, supersedes state law, or must be given full force and effect. That is not the case here.

3. The member states' construction is consistent with the purposes of the Compact.

Gillette argues that its construction of the Compact advances the Compact's express purposes (Answer Brief at p. 28), while the member states' construction "result[s] in less uniformity[.]" (Answer Brief at p. 29).

Gillette confuses "to promote uniformity," an express purpose of the Compact, with "to secure uniformity," which is not. Promote means: "to help or encourage to exist or flourish[.]" (Random House Webster's Unabridged Dict. (1997) p. 1548.) Secure, on the other hand, means: "to effect; make certain of; ensure[.]" (Random House Webster's Unabridged Dict. (1997) p. 1731).) The Compact's own language shows its purpose was to encourage uniformity, not to mandate or require it. Gillette also confuses which formula best serves uniformity. More states, both members and non-members, now employ a hyper-weighted sales factor formula than the Compact's original formula.[4] The reality is that the mere existence of the Compact "promotes" uniformity because it provides a forum for member states to address common problems and encourage uniform solutions.

Gillette stubbornly clings to the notion that the member states were so concerned about possible federal action that they gave up all rights to vary from the Compact's three-factor formula unless, and until, they completely withdrew. But by the time the Compact became effective in California in 1974, six different attempts to deal with the subject of state taxation had died in Congress. (*U.S. Steel Corp. v. Multistate Tax Commission* (1978) 434 U.S. 452, 456.) In fact, to this day, Congress has

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[4] According to a Multistate Tax Commission analysis, of the 47 states and the District of Columbia that levy corporate income taxes, only 13 states use the equally weighted three-factor apportionment formula. (Board's Appendix in Support of Respondent's Brief, Exh. 1.)

not yet acted in this area. The course of history strongly suggests that Gillette's concern about potential congressional interference is unduly magnified.

4. Evidence of the member states' construction of the Compact and their course of conduct is indispensable.

Gillette's claim that courts may not consider member states' course of conduct is unsupported. (Answer Brief at p. 31.) Three of the cases Gillette cites—*Texas v. New Mexico* (1983) 462 U.S. 554, *Alabama v. North Carolina*, *supra*, 560 U.S. 330, and *Kansas v. Colorado* (1995) 514 U.S. 673—involved disputes between compact members where the Supreme Court was reasonably concerned about imposing a burden upon a compact member state to which the state had not expressly agreed. In contrast, California's actions in amending section 25128 have imposed no burden on other states, or even on the Multistate Tax Commission itself. Gillette's interpretation would impose a burden on all Compact member states by removing a right that they commonly believe they have, and could invalidate actions many took pursuant to that right.

The other two cases Gillette cites—*Sullivan v. Dept. of Transp.* (1998) 708 A.2d 481, and *In re C.B.* (2010) 188 Cal.App.4th 1034, 1036—refer to compacts, as discussed above, which expressly provide that the compacts themselves or specific provisions in them are binding.

5. The most relevant extrinsic evidence is the member states' construction of the Compact and their course of conduct.

Gillette argues that the most probative evidence is "evidence of the drafting and negotiation as well as the express purposes of the Compact, not evidence of subsequent conduct of party states." (Answer Brief at p. 32.) Yet none of the cases Gillette relies upon involve facts demonstrating a course of subsequent actions by the member states, let alone a 40-year

course of conduct. As demonstrated in *Tarrant*, course of conduct by member states subsequent to the compact is especially important. (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2135.) In addition, in *New Jersey v. Delaware* (2008) 552 U.S. 597, the Supreme Court followed the lead of a Special Master in placing "considerable weight" on the member states' "prior course of conduct" in construing an interstate compact. (*Id.* at pp. 618-619.)

6. The member states' conduct establishes that a member may enact a different, alternate mandatory apportionment formula.

Gillette claims that "no court has used 'course of performance' evidence to override the express terms of an interstate compact." (Answer Brief at p. 34.) However, *Tarrant* recently did that very thing. (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2135.) Even before that, the Court in *Alabama v. North Carolina* explained that "the parties' course of performance under the Compact is highly significant" in determining whether North Carolina took appropriate steps under the terms of a compact to obtain a license to operate a regional waste facility. (*Alabama v. North Carolina, supra*, 130 S.Ct. at p. 2309.) Gillette also argues that subsequent legislation "cannot be used to establish the intent of the earlier legislature[.]" (Answer Brief at p. 35.) But, section 25128 was based on the member states' common understanding of the Compact. It did not substitute a new intent for earlier intent, but took an action based upon an understanding of that earlier intent. California could have chosen to withdraw from the Compact instead, but it clearly believed it was not necessary to do so. California, and the other states that made similar changes in their laws, understandably relied on their interpretation of the Compact that such changes were allowed.

Finally, the suggestion that the 40-year history "is not a reliable indicator . . . because party states do not perform or deliver obligations to one another and have no incentive to enforce the Compact" (Answer Brief at p. 35), underscores why the member states' construction is correct. The lack of reciprocal obligations is not a disincentive to enforcing the Compact, but rather goes hand-in-hand with the member states' construction and the inherent flexibility molded into the Compact. The Compact reasonably omitted obligations between member states as part of an overall package intended to maximize the states' flexibility to exercise their own sovereign authority to address their unique concerns. This construction is consistent with the member states' common understanding that the Compact allowed a member state to enact subsequent legislation mandating the use of a different, alternate apportionment formula.

7. The Multistate Tax Commission's Florida Resolution supports the common construction that member states may enact different mandatory formulas.

Gillette claims that the Multistate Tax Commission's Florida Resolution "does not suggest, as [the Board] contends, that party states understood they were free to completely eliminate the Compact election." (Answer Brief at p. 37.) But eliminating the Compact election is precisely what Florida did, and the other member states may, as well.

Gillette also argues that Florida actually "maintained the three-factor, equal-weighted Compact formula," therefore party states knew they could not eliminate the election provision. (Answer Brief at p. 37.) Gillette's representation, however, is wrong. While Florida did maintain a "three factor formula," it did not maintain the equal-weighted formula, but rather used a double-weighted sales factor formula, just as California did in section 25128. (Supplemental Request for Judicial Notice, Ex. E, pp. 14-15.)

8. Policy considerations support the members' common construction permitting different formulas.

Gillette claims that the Board is asking the Court "to rewrite the Compact" for policy reasons. (Answer Brief at p. 38.) To the contrary, the Board is asking the Court to enforce the member states' common understanding of the Compact. Gillette cites *In re C.B.*, *supra*, 188 Cal.App.4th 1024 for the proposition that "while compact association's interpretation may be good policy, [the] court was not authorized to alter compact terms agreed to by sovereign states[.]" (Answer Brief at p. 38-39.) The Board, however, is not asking the Court to alter the Compact terms, but to enforce the member states' common understanding of what those terms were and are.

II. SECTION 25128 DOES NOT VIOLATE THE CONTRACT CLAUSE.

Gillette erroneously contends that section 25128 automatically violated the contract clause because, by eliminating the election provision, it "eviscerat[ed] a core provision of an *interstate* compact[.]" (Answer Brief at p. 39.) A state law that violates a compact or contract does not automatically run afoul of the contract clause. Modern contract clause analysis uses a three-pronged test to determine whether there is an unconstitutional impairment of contract rights. (*Energy Reserves Group, Inc. v. Kansas Power & Light Co.* (1983) 459 U.S. 400.) First, does the state law "operate[] as a substantial impairment of a contractual relationship[?]" (*Id.* at p. 411.) Second, does the state law have a significant and legitimate public purpose? (*Id.* at p. 412.) Third, does a reasonable and appropriate public purpose justify the state law? (*Ibid.*,

citing *United States Trust Co. of New York v. New Jersey* (1977) 431 U.S. 1, 22.)[5]

None of Gillette's cited cases support its argument that section 25128 automatically violated the contract clause by eliminating the election provision. *Green v. Biddle* (1823) 21 U.S. 1, 92-93 and *Pennsylvania v. Wheeling & Belmont Bridge Company* (1952) 54 U.S. 518 failed to discuss the factors that inform the Court's modern contract clause analysis. *General Expressways v. Iowa Reciprocity Board* (1968) 163 N.W.2d 413, merely construed a state statute so that its terms did not conflict with a previously adopted interstate compact (*id.* at p. 421), and in *Doe v. Ward* (W.D. Pa. 2000) 124 F.Supp.2d 900, no contract clause issue was raised, and the court did not engage in a contract clause analysis (*id.* at p. 911).

Gillette argues that the Board's reliance on modern contract clause analysis is misplaced. Gillette claims that "when the nature of [an] impaired obligation is a core provision of an interstate compact, . . . weighing is unnecessary. . . . In the context of a compact, the kind of exacting scrutiny sought by [the Board] is unwarranted." (Answer Brief at p. 42.) But this "exacting scrutiny" is what is required by modern contract clause jurisprudence. None of the cases cited by Gillette recognize this modern analysis, or even discuss it, and Gillette's implication that interstate compacts are treated differently than other contracts is unsupported by the law. Even *McComb v. Wambaugh* (3rd Cir. 1991) 934 F.2d 474, 479,

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[5] Because Gillette's argument is based solely on the assumption that section 25128 violated the Compact, the Board will not repeat its argument in the opening brief that *if* the Compact allows member states to enact subsequent legislation mandating the use of a different apportionment formula, then section 25128 does not violate the contract clauses of the state or federal constitutions because it does not "impair[] [the] contractual relationship[.]" (*General Motors Corp. v. Romein* (1992) 503 U.S. 181, 186.)

which Gillette cited (Answer Brief at pp. 19, 27), recognizes that compacts are construed as contracts. Despite this, Gillette fails to explain why a compact should be treated differently depending on whether the Court is conducting an interpretive analysis of the compact, or analyzing it under the contract clause.

A. There is No Substantial Impairment of a Contractual Relationship.

The first inquiry under modern contract clause analysis is "whether the state law has, in fact, operated as a substantial impairment of a contractual relationship." (*Energy Reserves Group, Inc. v. Kansas Power and Light, supra*, 459 U.S. at p. 411; *General Motors v. Romein* (1992) 503 U.S. 181, 186.) Here, the answer is No.

Gillette argues that no contractual relationship is necessary because this is a tax refund action, "not a breach of contract case." (Answer Brief at pp. 44-45, fn. 15.) But Gillette cites no authority for the proposition that one of the prongs of the multi-part analysis under the contract clause can be bypassed simply because the nature of Gillette's action is a tax refund. Gillette cannot escape the fact that it is not a signatory party to the Compact.

Alternatively, Gillette claims, it is an intended third-party beneficiary of the Compact. (Answer Brief at pp. 44-45, fn. 15.) Confronted with the requirement that a contract must be *expressly* made to benefit a third person for it to be a third party beneficiary (Civ. Code, § 1559; *Fireman's Fund Ins. Co. v. Maryland Casualty Co.* (1994) 21 Cal.App.4th 1586, 1600), Gillette argues that "[t]he Compact was *expressly intended to benefit taxpayers*" (Answer Brief at pp. 44-45, fn. 15). Purportedly, *Sofias v. Bank of America* (1985) 172 Cal.App.3d 583 supports this claim.

Gillette's reliance on *Sofias* is misplaced. There, the court explained that "'expressly' means 'in an express manner; in direct or unmistakable terms; explicitly; definitely; directly.'" (*Sofias v. Bank of America, supra*, 172 Cal.App. 3d at p. 583.) But Gillette fails to identify any unmistakable terms showing that the Compact was entered into expressly for the benefit of taxpayers.

Despite the absence of a contractual relationship between Gillette and the member states, Gillette claims taxpayers relied on the Compact's election provision. (Answer Brief, pp. 43-44.) However, since member states may withdraw from the Compact at any time, there could be no reasonable reliance on the election provision and thus no substantial impairment of the Compact. Nor is the election provision a vested right for any prospective tax year.

Gillette argues that the substantial impairment requirement does not apply because "taxpayers are justified in having heightened expectations about states' adherence to [the] terms [of a compact]." (Answer Brief at p. 44.) This unsupported argument is unpersuasive. On what basis would a taxpayer be justified in having heightened expectations about the member states' adherence to the Compact?

There are compacts approved by Congress which express federal law, and which "are construed as contracts under the principles of contract law." (*Tarrant Regional Water District v. Herrmann, supra*, 133 S.Ct. at p. 2131.) And there are non-congressionally approved compacts that are interpreted as both contracts and statutes pursuant to state law. (*McComb v. Wambaugh, supra*, 934 F.2d 474, 479.) Gillette seems to be claiming that the Compact belongs in a category other than these two, but there is no

authority for that claim.[6] Moreover, a taxpayer cannot have heightened expectations in the election provision when it cannot reasonably rely on the fact that the state will not withdraw from it.

B. Section 25128 Has a Significant and Legitimate Public Purpose.

Even if a state law constitutes a substantial impairment, there still is no bar under the contract clause if there is "a significant and legitimate public purpose behind the [law]." (*Energy Reserves Group, Inc. v. Kansas Power and Light*, *supra*, 459 U.S. at pp. 411-412, citing *United States Trust Co. of New York v. New Jersey*, *supra*, 431 U.S. at p. 22.) Gillette mistakenly contends that section 25128 lacks a proper public purpose unless it was based on the existence of some emergency, such as the Great Depression. (Answer Brief at p. 45.) However, "public purpose need not be addressed to an emergency or temporary situation." (*Energy Reserves, supra,* 459 U.S. at p. 412.)

California has a significant and legitimate interest generally in matters of state taxation because taxation is a core exercise of its sovereign power. (See *Louisville Water Co. v. Clark* (1892) 143 U.S. 1, 13; Cal. Const., art. XIII, § 31 [California's "power to tax may not be surrendered or suspended by grant or contract"].) The significant, legitimate purpose of section 25128 was to encourage and support the growth of in-state

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[6] Gillette cites the California Opinion of the Attorney General No. 96-806 (80 Ops. Cal. Atty. Gen. 213, August 5, 1997) for the proposition that the Compact is "a contract among the member states" which must be complied with until repealed. (Answer Brief at p. 21.) However, the Opinion is not relevant because it dealt with the effect of uncodified budget control language in the 1996-1997 Budget Act involving California's membership in, and obligation to pay dues to, the Multistate Tax Commission. Nowhere is the Compact even directly referenced.

businesses by reducing the tax burden on California-based businesses without incurring a large loss of tax revenues.

C. Section 25128 Was Reasonable and Appropriate to the Public Purpose.

When there is a significant and legitimate public purpose, the next inquiry is whether the state law is based on reasonable conditions and is of appropriate character. (*Energy Reserves Group, Inc. v. Kansas Power and Light*, *supra*, 459 U.S. at p. 412, citing *United States Trust Co. of New York v. New Jersey*, *supra*, 431 U.S. at p. 22.)

Gillette claims that section 25128 was not reasonable or appropriate because its purpose was merely to " increas[e] California's tax revenues." (Answer Brief at p. 46.) However, the legislative history contradicts that claim. Indeed, it explains that section 25128 would result in both "winners and losers." (See RJN-COA, Ex. 2.)

III. SECTION 25128 DOES NOT VIOLATE THE REENACTMENT RULE.

The reenactment clause of the California Constitution, article IV, section 9, provides "[a] section of a statute may not be amended unless the section is re-enacted as amended." Gillette argues that "[w]ithout reenactment of [s]ection 38006 in its amended form to show . . . [the elimination of the election provision], neither taxpayers nor legislators could tell that [s]ection 38006's election had been eviscerated by [section 25128]." (Answer Brief at p. 47.) This argument lacks merit. The "constitutional reenactment rule does not apply to the addition of new code sections or the enactment of entirely independent acts that impliedly affect other sections." (*White v. State of California* (2001) 88 Cal.App.4th 298, 314, quoting *American Lung v. Wilson* (1996) 51 Cal.App.4th 743, 749.)

The Legislature's amendment of section 25128 in 1993 does not offend the reenactment rule because it replaced the previous formula with

an entirely new formula, and because it is a separate statute from the Compact, which is set forth in section 38006. (*White v. State of California, supra,* 88 Cal.App.4th at p. 314.) Similarly, *Hellman v. Shoulters* (1896) 114 Cal. 136, held a subsequent statute did not violate the reenactment rule where it added a new section which by implication affected the operation of a previous act. As in *Hellman*, the Legislature amended section 25128 in its entirety by substituting a new apportionment formula, and adding two new subsections. While the addition of amended 25128 impliedly affects section 38006, this action "is not within the evils aimed at by [the reenactment rule]." (*Id.* at p. 152.)

American Lung Association v. Wilson, supra, 51 Cal.App.4th at p. 749, identifies a distinguishable exception to the general rule that reenactment is unnecessary when the Legislature enacts a separate statute. It held that an uncodified appropriations bill violated the reenactment rule because it failed to provide notice that it was changing the statutory percentages of money going to different funds under the Tobacco Tax and Health Protection Act of 1988 (Rev. & Tax. Code, § 30121 et seq.).

American Lung explained that "the key to the reenactment rule's applicability . . . [is] whether legislators and the public have been *reasonably notified* of direct changes in the law." (*American Lung Association v. Wilson, supra*, 51 Cal.App.4th at p. 749, quoting *Hellman v. Shoulters* (1896) 114 Cal. 136, 152; italics added.) Because the bill challenged in *American Lung* did not refer to either of the statutory provisions it changed, the confusion it created was clear. There should not be any similar confusion in this case because amended section 25128 explicitly refers to section 38006, which is the Compact.

Gillette claims that *American Lung* applies here because section 25128 failed to give adequate notice. (Answer Brief at p. 48.) Gillette reasons that since "[s]ection 38006 was not amended, the notice is not

adequate[.]" (*American Lung Association v. Wilson, supra*, 51 Cal.App.4th at p. 749.) However, section 38006 did not need to be amended to provide legislators and the public sufficient notice because section 25128 referred to it directly. Section 25128 states:

> (a) 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, except as provided in subdivision (b) or (c).

(Rev. & Tax. Code, § 25128, as amended.)

This plain language states that there will be only one apportionment formula, and it necessarily eliminates the election provision.[7] This construction is confirmed by (1) the explicit reference to "[n]otwithstanding section 38006," (2) the Legislature's use of the word "all" before business income, and (3) the use of the word "shall" before setting forth the double-weighted sales apportionment formula. "All" means "collectively and individually" (Black's Law Dict. (8th ed. 2004 p. 81, col. 2) or "the whole of" (Merriam-Webster's Collegiate Dict. (1999) p. 29, col. 2.) "Shall," on the other hand is defined "[h]as a duty to; more broadly, is required to." (Black's Law Dict. (8th ed. 2004 p. 1407, col. 2).) Section 25128 provides sufficient notice that taxpayers were required to use the new formula

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[7] Gillette's argument that section 25128 can be read to avoid conflict with section 38006 is puzzling (Answer Brief at p. 50) because the Court of Appeal acknowledged the "clear import" of section 25128 was to impose the mandatory use of the double-weighted sales factor formula. (Slip opn. at p. 15.) Gillette's reliance upon *Klasjic v. Castaic Lake Water Agency*, (2004) 121 Cal.App.4th 5, 13, is also misplaced as *Klasjic* notes that the statutory phrase "notwithstanding any other law" has been called a "term of art" that "declares the legislative intent to override all contrary law (citations omitted)." As amended by the Legislature, section 25128 cannot be reconciled with the election provision.

regardless of what section 38006 says. Nor, for these same reasons, does section 25128 fail to provide a guide to either legislators or taxpayers as to what portion of section 38006 is at issue. (Answer Brief at pp. 48-49.)

Gillette also asserts that the legislative history does not support the elimination of the election provision. (Answer brief at p. 48.) But whether or not the legislative history mentions the Compact by name, amended section 25128 is so clear that explicit reference in the history is not needed. Regardless, our legislature is presumed "aware of existing related laws and [to have] intended to maintain a consistent body of rules" when passing a statute. (*Scott Co. v. Workers' Comp. Appeals Board* (1983) 139 Cal.App.3d 98, 103.)

The Board explained in its opening brief that adoption of Gillette's argument would call into question many other California statutes that use the word "notwithstanding." Gillette counters that the Board misconstrues notwithstanding "as a repealer," whereas it is more generally used to carve out an exception. (Answer Brief at pp. 49-50.) That, however, is a distinction without a difference. Section 25128 both carves out an exception to section 38008 that effectively repeals it, and directs that it no longer applies.

CONCLUSION

For the foregoing reasons, the Court should reverse the decision of the Court of Appeal below.

Dated: September 20, 2013

Respectfully submitted,

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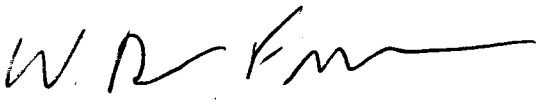

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CERTIFICATE OF COMPLIANCE

I certify that the attached **REPLY BRIEF ON THE MERITS** uses a 13 point Times New Roman font and contains 5,700 words.

Dated: September 20, 2013

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DECLARATION OF SERVICE BY U.S. MAIL

Case Name: The Gillette Company & Subsidiaries v California Franchise Tax Board
Supreme Court Case No. S206587
Court of Appeal Case No. A130803
San Francisco Superior Court Case No. CGC10495911

I declare:

I am employed in the Office of the Attorney General, which is the office of a member of the California State Bar, at which member's direction this service is made. I am 18 years of age or older and not a party to this matter. I am familiar with the business practice at the Office of the Attorney General for collection and processing of correspondence for mailing with the United States Postal Service. In accordance with that practice, correspondence placed in the internal mail collection system at the Office of the Attorney General is deposited with the United States Postal Service with postage thereon fully prepaid that same day in the ordinary course of business.

On September 20, 2013, I served the attached **REPLY BRIEF ON THE MERITS** by placing a true copy thereof enclosed in a sealed envelope in the internal mail collection system at the Office of the Attorney General at 455 Golden Gate Avenue, Suite 11000, San Francisco, CA 94102-7004, addressed as follows:

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I declare under penalty of perjury under the laws of the State of California the foregoing is true and correct and that this declaration was executed on September 20, 2013, at San Francisco, California.

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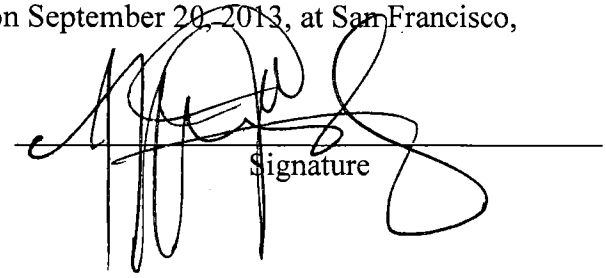

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