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CERTIFIED FOR PUBLICATION

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FOUR

THE GILLETTE COMPANY et al., Plaintiffs and Appellants, v. FRANCHISE TAX BOARD, Defendant and Respondent.	A130803 (San Francisco City & County Super. Ct. Nos. CGC-10-495911, CGC-10-495912, CGC-10-495916, CGC-10-496437, CGC-10-496438, CGC-10-499083)

At the operative times, California was a signatory to the Multistate Tax Compact (Compact). (Former Rev. & Tax. Code,[1] § 38001, California's enactment of the Compact.) 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. (§ 38006, art. III, subd. 1.) 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.

[1] On June 27, 2012, after the oral argument in this case, the Governor signed into law Senate Bill No. 1015, which states: "Part 18 (commencing with Section 38001) of Division 2 of the Revenue and Taxation Code is repealed." (Stats. 2012, ch. 37, § 3, eff. June 27, 2012.) Senate Bill No. 1015, and any issue concerning its effect or validity, were not before this court.

Unless noted otherwise, all statutory references are to the Revenue and Taxation Code.

Prior to 1993, California subscribed to a single method of apportioning and allocating income, the Compact formula, which ascribed equal weight to three factors: property, payroll and sales. (Former § 25128, as added by Stats. 1966, ch. 2, § 7, p. 179.) Then, in 1993 the Legislature amended section 25128 to give double weight to the sales factor for most business activity, specifying that "[n]otwithstanding 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 . . . ." (Former § 25128, subd. (a), italics added, as amended by Stats. 1993, ch. 946, § 1, p. 5441.)[2]

These consolidated appeals brought by appellants the Gillette Company and its subsidiaries, and other corporate entities (Taxpayers),[3] present the issue of whether, for the tax years at issue since 1993, Taxpayers were entitled to elect the Compact formula, or, as respondent Franchise Tax Board (FTB) asserts, did the 1993 amendment to section 25128 repeal and supersede that formula, thereby making the state formula mandatory? We conclude that the Compact is a valid multistate compact, and California was bound by it and its apportionment election provision throughout the years in question because California had not repealed former section 38001 et seq. and withdrawn from the Compact during that timeframe. Accordingly, we reverse the trial court's order sustaining the FTB's demurrer without leave to amend.[4]

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[2] For purposes of this appeal, the current version of section 25128, subdivision (a) is similar in all material respects to the 1993 amendment, reading as follows: "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 . . . ."

[3] Other appellants are Procter & Gamble Manufacturing Company; Kimberly-Clark Worldwide, Inc., and its subsidiaries; Sigma-Aldrich, Inc.; RB Holdings (USA) Inc., and Jones Apparel Group, Inc.

[4] Despite the absence of a judgment of dismissal, we deem the order to incorporate such judgment because the trial court sustained a demurrer to all causes of action, and all that remains to render the order appealable is the formality of entering a judgment of dismissal. (*Melton v. Boustred* (2010) 183 Cal.App.4th 521, 527-528, fn. 1.)

I. BACKGROUND

A. *Historical Context Leading to Enactment of the Compact*

Recognizing the need for uniformity in the apportionment of corporate income for tax purposes among the various taxing states, in 1957 the National Conference of Commissioners on Uniform State Laws promulgated the Uniform Division of Income for Tax Purposes Act (UDITPA). (7A pt. 1 West's U. Laws Ann. (2002) pp. 141-142 & § 9.) To apportion a multistate corporation's business income among the various taxing states, UDITPA uses a three-factor, equally weighted formula consisting of property, payroll and sales receipts. (*Id*., § 9.) California adopted the UDITPA in 1966. (§ 25120 et seq.; Stats. 1966, ch. 2, § 7, pp. 177-181.)

By 1959, only a few states had adopted the UDITPA. (7A pt. I, West's U. Laws Ann., *supra*, p. 141.) That year, the United States Supreme Court delivered its decision in *Northwestern Cement Co. v. Minn.* (1959) 358 U.S. 450, 452 (*Northwestern Cement*), holding 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 State forming sufficient nexus to support the same." *Northwestern Cement* raised concerns in the business community and within weeks of the decision, Congress commenced hearings, culminating in the passage of Public Law No. 86-272 as an emergency, temporary measure some six months later. This law was intended to restrict the application of *Northwestern Cement* and created a subcommittee to study state business taxes and recommend legislation establishing uniform standards which states would observe in taxing income of interstate companies. (Fatale, Federalism and State Business Activity Tax Nexus; Revisiting Public Law No. 86-272 (Spring 2002) 21 Va. Tax Review, 435, 475-476; *U.S. Steel Corp. v. Multistate Tax Comm'n* (1978) 434 U.S. 452, 455 (*U.S. Steel*).) The subsequent study, commonly referred to as the "Willis Report" after Congressman Edwin E. Willis who chaired the subcommittee,[5] called for federal legislation that would have limited state authority to tax

[5] Fatale, *supra*, at page 477.

interstate business operations and imposed a uniform apportionment regime on the states. (State Taxation of Interstate Commerce, Rep. of the Special Subcommittee on State Taxation of Interstate Commerce of the Com. on the Judiciary, House of Representatives (Sept. 2, 1965) vol. 4, chs. 38, 39, pp. 1135-1136, 1143, 1161.)

In the wake of the Willis Report, Congress introduced a number of bills incorporating its recommendations. (*U.S. Steel*, *supra*, 434 U.S. at p. 456, fn. 4; Sharpe, *State Taxation of Interstate Businesses and the Multistate Tax Compact: The Search for a Delicate Uniformity* (1974) 11 Colum. J. of Law and Social Problems, 231, 242 & n. 43.) To stave off federal encroachment on their taxing powers and devise workable alternatives that would eliminate the need for congressional action, state tax administrators and other state leaders drafted the Compact; by June 1967, nine states had enacted the Compact, which by its terms became effective after seven states had adopted it. (Multistate Tax Com., First Ann. Rep. (1968) pp. 1-2; § 38006, art. X, subd. 1.)

B. *Compact Provisions*[6]

California enacted the Compact in 1974. (Former § 38001, Stats. 1974, ch. 93, § 3, p. 193.) Its purposes 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 . . . . [¶] 4. Avoid duplicative taxation." (Former § 38006, art. I.)

Article IV adopts the UDITPA and its equally weighted, three-factor apportionment formula, stating in part: "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." (Former § 38006, art. IV, subd. 9.) However, article III allows taxpayers the option of apportioning and allocating income pursuant to the UDITPA formula *or* pursuant to a

[6] Because the Compact continues to exist despite a member state's repeal of its enabling legislation, we describe its operative terms in the present tense.

given state's alternative apportionment provisions: "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." (Former § 38006, art. III, subd. 1.) As noted in the Multistate Tax Commission's Third Annual Report (1969-1970),[7] "The Multistate Tax Compact makes UDITPA 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 which is selling into a state in which it has little property or payroll will want to insist upon the use of the three-factor formula (sales, property and payroll) which is included in UDITPA because that will substantially reduce his tax liability to that state below what it would be if a single sales factor formula were applied to him[;] on the other hand, he will look with favor upon the application of the single sales factor formula to him by a state from which he is selling into other states, since that will reduce his tax liability to that state. 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." (*Id*. at p. 3.)

Article V sets out the rules for sales and use tax credits and exemptions, therein obligating each party state to provide a full credit to taxpayers who previously paid sales or use tax to another state with respect to the same property, and to honor sales and use tax exemption certificates from other states. (Former § 38006, art. V, subd. 1.)

The Compact leaves other matters entirely to state control. For example, it reserves to the states control over the rate of tax (former § 38006, art. XI, subd. (a)), and simply does not address the composition of a corporation's tax base.

As well, the Compact creates the Multistate Tax Commission (Commission) with powers to study state and local tax systems, develop and recommend proposals for

[7] Hereafter, Third Commission Report.

greater uniformity of state and local tax laws, and compile and publish information helpful to the states. (Former § 38006, art. VI, subds. 1, 3.) Each party state appoints a member to the Commission and pays its share of expenses. (*Id*., art. VI, subds. 1(a), 4(b).) The Commission may adopt uniform regulations in cases where two or more states have uniform or similar provisions relating to specific types of taxes. (*Id*., art. VII.) However, such regulations are advisory only—each state makes its own decision whether to adopt the regulation in accordance with its own law. (*Id*., art. VII, subd. 3.) Additionally, the Commission may perform interstate audits, if requested by a party state; the governing article applies only in states that specifically adopt it by statute. (*Id*., art. VIII, subds. 1, 2.)

Finally, under the Compact, states are free to withdraw from the Compact at any time "by enacting a statute repealing the same." (Former § 38006, art. X, subd. 2.)

C. *U.S. Steel*

In 1972, a group of multistate corporate taxpayers brought an action on behalf of themselves and all other such taxpayers threatened with audits by the Commission. The complaint challenged the constitutionality of the Compact on several grounds, including that it was invalid under the compact clause of the United States Constitution.[8] (*U.S. Steel*, *supra*, 434 U.S. at p. 458.)

The high court acknowledged that the compact clause, taken literally, would require the states to obtain congressional approval before entering into any agreement among themselves, "irrespective of form, subject, duration, or interest to the United States." (*U.S. Steel*, *supra*, 434 U.S. at p. 459.) However, it endorsed an interpretation, established by case law, that limited application of the compact clause " 'to agreements that are "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." [Citations.]' This rule states the proper balance between federal and state

[8] The compact clause of article I, section 10, clause 3 of the United States Constitution states: "No state shall, without the consent of Congress, . . . enter into any agreement or compact with another state, or with a foreign power . . . ."

power with respect to compacts and agreements among States." (*Id*. at p. 471, initial quote from *Virginia v. Tennessee* (1893) 148 U.S. 503, 519.)

Framing the test as whether the Compact enhances state power with respect to the federal government, the court concluded it did not: "This pact does not purport to authorize the member States to exercise any powers they could not exercise in its absence. Nor is there any delegation of sovereign power to the Commission; each State retains complete freedom to adopt or reject the rules and regulations of the Commission. Moreover . . . , each State is free to withdraw at any time." (*U.S. Steel, supra,* 434 U.S. at p. 473.) In the end the court rejected all of the plaintiffs' challenges to the constitutional validity of the Compact. (*Id*. at p. 479.)

D. *Amendment of Section 25128; Litigation*

Prior to 1993, California required corporations to apportion their business income to California using the standard UDITPA, equally weighted three-factor apportionment formula. (§ 25128, as adopted in 1966; see also former § 38006, art. IV, subd. 9.) In 1993, the Legislature amended this formula to give double weight to the sales factor and specified that the new formula was mandatory, providing in relevant part: "*Notwithstanding Section 38006* [the Compact], 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 . . . ." (§ 25128, subd. (a), italics added; Stats. 1993, ch. 946, § 1, p. 5441.)

In January 2010, the Taxpayers lodged six complaints for the refund of taxes which the court thereafter consolidated. Therein, they argued that the amended section 25128 did not override or repeal the UDITPA formula set forth in (former) section 38006, and sought a refund of approximately $34 million. The Taxpayers alleged that they began filing claims for refund in 2006,[9] based on their election to compute their California apportionable income "using the three-factor apportionment formula (property,

[9] Sigma-Aldrich, Inc., began filing refund claims in 2003; RB Holdings (USA), Inc., began filing refund claims in 2007.

payroll, and single-weighted sales) set forth in . . . § 38006." The FTB denied the refund claims for the years at issue.

The FTB demurred on grounds that the amended section 25128 mandated the exclusive use of the double-weighted sales factor, and according to its plain and unambiguous language, negated the Taxpayers' claim of entitlement to elect the UDITPA formula. The trial court agreed that section 25128 "clearly express[ed] an intention to take away the alternative under [section] 38006," and additionally the court in *U.S. Steel* determined that this alternative statutory scheme "could be obviated in the manner that the Legislature did." Therefore, it sustained the FTB's demurrer to the complaints without leave to amend and entered judgment accordingly.

II. DISCUSSION

A. *Introduction*

The Taxpayers are adamant that the Compact is a valid compact, was binding on California during the operative timeframe, and as such, the Legislature could not override and eliminate the (former) section 38006 option for taxpayers to elect the Compact's apportionment formula. The FTB maintains as a threshold matter that the Taxpayers lack standing to complain of any purported violation of the Compact. On the substantive front, the FTB contends that the plain language of section 25128 mandates the exclusive use of the double-weighted sales apportionment formula, thereby eliminating use of the equally weighted three-factor apportionment formula set forth as a taxpayer option in (former) section 38006. Further, it urges that under California statutory and contract law, the Legislature had the power, and in 1993 properly enacted legislation, to repeal the Compact legislation to the extent necessary to impose this mandatory apportionment formula on taxpayers.

B. *Nature of Interstate Compacts*

Some background on the nature of interstate compacts is in order. These instruments are legislatively enacted, binding and enforceable agreements between two or more states. (Litwak, *Interstate Compact Law: Cases and Materials* (Semaphore Press 2011) pp. 5, 12.) Initially used to resolve boundary disputes, today interstate compacts

are a staple of interstate cooperation and, in addition to taxes, span a wide range of subject matter and issues including forest firefighting; water allocation; mining regulation; storage of low level radioactive waste; transportation; environmental preservation and resource conservation; regulation of electric energy; higher education and regional cultural development. (Davis, *Interstate Compacts in Commerce and Industry* (1998) 23 Vt. L.Rev. 133, 139-143.)

As we have seen, some interstate compacts require congressional consent, but others, that do not infringe on the federal sphere, do not. Questioning whether similar statutes in two states constituted a compact, the Supreme Court has outlined what it deemed "classic indicia" of such instruments: "We have some doubt as to whether there is an agreement amounting to a compact. The two statutes are similar in that they both require reciprocity and impose a regional limitation, both legislatures favor the establishment of regional banking in New England, and there is evidence of cooperation among legislators, officials, bankers, and others in the two States in studying the idea and lobbying for the statutes. But several of the classic indicia of a compact are missing. No joint organization or body has been established to regulate regional banking or for any other purpose. Neither statute is conditioned on action by the other State, and each State is free to modify or repeal its law unilaterally. Most importantly, neither statute requires a reciprocation of the regional limitation." (*Northeast Bancorp v. Board of Governors, FRS* (1985) 472 U.S. 159, 175 (*Bancorp*).) The Ninth Circuit Court of Appeals has aptly summarized *Bancorp* as setting forth three primary indicia: "These are establishment of a joint organization for regulatory purposes; conditional consent by member states in which each state is not free to modify or repeal its participation unilaterally; and state enactments which require reciprocal action for their effectiveness." (*Seattle Master Builders v. Pacific N.W. Elec. Power* (9th Cir. 1986) 786 F.2d 1359, 1363.)

Where, as here, federal congressional consent was neither given nor required, the Compact must be construed as state law. (*McComb v. Wambaugh* (3d Cir. 1991) 934 F.2d 474, 479.) Moreover, since interstate compacts are agreements enacted into state law, they have dual functions as enforceable contracts between member states and as

statutes with legal standing within each state; and thus we interpret them as both. (*Aveline v. Bd. of Probation and Parole* (1999) 729 A.2d 1254, 1257; see Broun et al., *The Evolving Use and the Changing Role of Interstate Compacts* (ABA 2006) § 1.2.2, pp. 15-24 (Broun on Compacts); 1A Sutherland, Statutory Construction (7th ed. 2009) § 32:5; *In re C.B.* (2010) 188 Cal.App.4th 1024, 1031 [recognizing that Interstate Compact on Placement of Children shares characteristics of both contractual agreements and statutory law].)

The contractual nature of a compact is demonstrated by its adoption: "There is an offer (a proposal to enact virtually verbatim statutes by each member state), an acceptance (enactment of the statutes by the member states), and consideration (the settlement of a dispute, creation of an association, or some mechanism to address an issue of mutual interest.)" (Broun on Compacts, *supra*, § 1.2.2, p. 18.) As is true of other contracts, the contract clause of the United States Constitution shields compacts from impairment by the states. (*Aveline v. Bd. of Probation and Parole*, *supra*, 729 A.2d at p. 1257, fn. 10.) Therefore, upon entering a compact, "it takes precedence over the subsequent statutes of signatory states and, as such, a state may not unilaterally nullify, revoke or amend one of its compacts if the compact does not so provide." (*Ibid.*; accord, *Intern. Union v. Del. River Joint Toll Bridge* (3d Cir. 2002) 311 F.3d 273, 281.) Thus interstate compacts are unique in that they empower one state legislature—namely the one that enacted the agreement—to bind all future legislatures to certain principles governing the subject matter of the compact. (Broun on Compacts, *supra*, § 1.2.2, p. 17.)

As explained and summarized in *C.T. Hellmuth v. Washington Metro. Area Trans.* (D.Md. 1976) 414 F.Supp. 408, 409 (*Hellmuth*): "Upon entering into an interstate compact, a state effectively surrenders a portion of its sovereignty; the compact governs the relations of the parties with respect to the subject matter of the agreement and is superior to both prior and subsequent law. Further, when enacted, a compact constitutes not only law, but a contract which may not be amended, modified, or otherwise altered without the consent of all parties. It, therefore, appears settled that one party may not enact legislation which would impose burdens upon the compact absent the concurrence

of the other signatories." Cast a little differently, "[i]t is within the competency of a State, which is a party to a compact with another State, to legislate in respect of matters covered by the compact so long as such legislative action is in approbation and not in reprobation of the compact." (*Henderson v. Delaware River Joint Toll Bridge Com'm* (1949) 66 A.2d 843, 849-450.) Nor may states amend a compact by enacting legislation that is substantially similar, unless the compact itself contains language enabling a state or states to modify it through legislation " 'concurred in' " by the other states. (*Intern. Union v. Del. River Joint Toll Bridge, supra,* 311 F.3d at pp. 276-280.)

C. *Taxpayers Have Standing to Pursue These Actions*

The FTB asserts that even if California breached its obligations under the Compact, the Taxpayers have no judicial remedy, are not parties to the agreement and have no enforceable rights under it.

First, this is an action for the refund of corporate taxes paid to the state pursuant to section 19382, and without question the Taxpayers have standing in such an action to claim "that the tax computed and assessed is void in whole or in part . . . ." (*Ibid*.)

Furthermore, the Compact, at former section 38006, article III, subdivision 1 explicitly gives taxpayers whose income is subject to apportionment and allocation under the laws of a party state the option to elect to apportion its taxes under UDITPA, the Compact formula. This is a right specifically extended not to the party states but to taxpayers as third parties regulated under the Compact, and as such Taxpayers may seek to enforce this right as part of its tax refund suit. Moreover, the stated purposes of the Compact explicitly embrace taxpayer interests. These purposes include facilitating (1) "proper determination of State and local tax liability of multistate taxpayers, including the equitable apportionment of tax bases" and (2) "taxpayer convenience." (Former § 38006, art. I, subds. 1, 3.)

Alabama v. North Carolina (2010) ___ U.S. ___ [130 S.Ct. 2295], characterized as "particularly instructive" by the FTB, is not. There, the Supreme Court ruled that the agency created by the Compact could not bring claims for breach of compact by a party state *in a stand-alone action under the Supreme Court's original jurisdiction* because it

had "neither a contractual right to performance by the party States nor enforceable statutory rights under [the compact]." (*Id.* at p. 2315.) Our case has nothing to do with the unique features of federal original jurisdiction. (U.S. Const., art. III, § 2, cl. 2.)

In any event, in contrast, here the codified compact extends the right to election to appropriate taxpayers. We find the decision in *Borough of Morrisville v. Delaware Riv. Bas. Com'n* (E.D.Pa. 1975) 399 F.Supp. 469, 472-473, footnote 3 persuasive. There, the plaintiff municipalities who used water from the Delaware River claimed that the compact commission in question exceeded its authority and violated the compact and federal law by imposing certain water charges. Resolving the standing issue in favor of the plaintiffs, the district court further stated that " '[t]o hold that the Compact is an agreement between the political signatories imputing only to those signatories standing to challenge actions pursuant to it would be unduly narrow in view of the direct impact on plaintiffs and other taxpayers.' " (*Id.* at p. 473.) This view is reinforced by commentators: "For the most part, interstate compacts have not created any privately assertable rights . . . . However, this is not invariably the case. For example, water allocation compacts, while they apportion water among states, may affect the rights of individual water users in such a way as to make them proper parties to suits. In such situations, the governing fact is that compacts are statutory law. Consequently, the assertion of private rights created or otherwise affected by a compact is procedurally similar to the assertion of such rights conferred by other statutes of the jurisdiction dealing with similar subject matter." (Zimmerman & Wendell, *The Law and Use of Interstate Compact*s (The Council of State Governments 1976) Compact Law, ch. 1, pp. 14-15.)

D. *The Compact Is a Valid, Enforceable Interstate Compact*

To reiterate, the high court in *U.S. Steel* upheld the facial validity of the Compact against various constitutional challenges. (*U.S. Steel*, *supra*, 434 U.S. at pp. 473-479.) A number of years ago, our own Attorney General acknowledged the binding force of the Compact at the time. (80 Ops.Cal.Atty.Gen. 213, 214 (1997): by virtue of enacting the Compact as part of the law of this state, the Compact made California a member of the

Commission and the only way to withdraw from commission membership was by enacting repealing legislation.)

Moreover, the Compact satisfies indicia of a compact. (See *Seattle Master Builders v. Pacific N.W. Elec. Power, supra,* 786 F.2d at p. 1363.) The Commission is an operational body charged with duties and powers in furtherance of the Compact's purposes. It oversees the Compact, is composed of tax administrators from all member states, and is financed through a process of allocation and apportionment. (Former § 38006, art. VI.) Meeting on at least an annual basis, and with representation from each signatory state, the Commission is a vehicle for continuing cooperative action among those states.

Additionally, the Compact builds in binding reciprocal obligations that advance uniformity. First, as we have discussed, it secures an election for multistate taxpayers to opt for apportioning their business income under UDITPA, the Compact formula, or in accordance with the state's own apportionment formula. (Former § 38006, art. III, subd. 1.) The election provision is not optional for party states. Because any multistate taxpayer "may elect" either approach, the party states must make the election available. As set forth above, the Commission has explained that the mandate to make UDITPA available on an optional basis to taxpayers preserves "the substantial advantages with which lack of uniformity provides [the taxpayer] in some states." (Third Commission Report, *supra,* at p. 3.) Thus the Compact reserves to the states the right to provide taxpayers with alternative formulas, while at the same time making uniformity available when and where desired. (*Ibid.*)

As well, the Compact commits each state to provide sales and use tax credits and exemptions. (Former § 38006, art. V.) Again, the sales and use tax provisions are mandatory on signatory states.

Finally, the Compact provides for a state's orderly withdrawal, namely by enacting a statute repealing the Compact. However, any repealing legislation must be prospective in nature, because it cannot "affect any liability already incurred by or chargeable to a party State prior to the time of such withdrawal." (Former § 38006,

art. X, subd. 2.) Although notice to sister states is not specifically required, by requiring repealing state legislation, the process itself calls for a measured, deliberative decision prior to withdrawal. Moreover, advance notice could easily be accomplished through the work of the Commission.

Nevertheless, the right to withdraw is unilateral. Citing *Bancorp*, the FTB suggests that the withdrawal provision renders the Compact something less than a binding agreement. However, this type of withdrawal provision is common in other interstate compacts and has not been the death knell rendering them nonbinding and invalid. California is a party to a number of interstate compacts containing virtually identical withdrawal provisions, coupled with some type of notice requirement. (See Gov. Code, § 66801 (art. X, subd. (c)) [delineating withdrawal provision for Tahoe Regional Planning Compact]; Veh. Code, § 15027 [same for Driver License Compact]; Welf. & Inst. Code, § 1400, art. XI, subd. (a) [same for Interstate Compact on Juveniles]; Pen. Code, § 11180, art. XII, § A [Interstate Compact for Adult Offender Supervision]; Ed. Code, § 12510, art. VIII [Compact for Education].)

Furthermore, the situation in *Bancorp*, cited by the FTB, differs dramatically from the case at hand. There, Massachusetts and Connecticut enacted similar statutes allowing regional interstate banking acquisitions. However, unlike former section 38006, these statutes were not jointly entered into as a binding agreement; they did not create an administrative body nor did they require reciprocation in key respects; and they could be changed as well as repealed at will. (*Bancorp*, *supra*, 472 U.S. at p. 175.)

The FTB also points to a recent Commission document that refers to the Compact as a "model law" and "not truly a compact."[10] The Commission's statements do not alter the reality that the Compact was binding on California throughout the timeframe at issue. Indeed, the Compact operates as a model law as to those states that choose to be associate

[10] Multistate Tax Compact, Suggested State Legislation and Enabling Act, accessed on the Web site of the Multistate Tax Commission on October 1, 2012. <http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/About_MTC/MTC_Compact/COMPACT(1).pdf>

members, rather than signatory members. Pursuant to the Commission bylaws, the Commission may grant associate membership to states which have not enacted the Compact but which have, for example, enacted legislation that makes effective adoption of the Compact dependent on a subsequent condition. (Third Commission Report, *supra*, at p. 96.) Before the Legislature enacted the Compact, California was an associate member. At the relevant time, California was a full Compact member, having enacted the Compact "into law and entered into [it] with all jurisdictions legally joining therein . . . ." (Former § 38001.) That the Compact did not "enter into force" until enacted into law by seven states also distinguishes it from a model law.

The FTB also intimates that the Compact is invalid under article 13, clause 31 of our state Constitution, which states: "The power to tax may not be surrendered or suspended by grant or contract." But of course by entering the Compact, California neither surrendered nor suspended its taxing powers. California retained full control of its tax base, tax rate and tax revenues; it simply obligated itself to provide taxpayers with an option to use UDITPA or the state formula until such time as it withdrew from the Compact.

E. *California Cannot Unilaterally Repeal Compact Terms*

The thrust of the FTB on appeal is this: Confirming the Legislature's authority to amend, repeal or supersede existing statutes, it proceeds to urge as a matter of statutory construction that the Legislature's choice of the "[n]otwithstanding Section 38006" language in section 25128 overrode former section 38006, thus excising the taxpayer option to use UDITPA, the Compact apportionment formula. Indeed, it goes so far as to say that this language constituted "a repeal of section 38006 to the extent necessary to impose a mandatory double-weighted sales apportionment formula upon taxpayers."

Were this simply a matter of statutory construction involving two statutes—section 25128 and former section 38006—we would at least entertain the FTB's argument that section 25128 overrode the former section 38006 taxpayer election to apportion under the Compact formula, and mandated the exclusive use of the double-weighted sales apportionment formula at the pertinent times. This is the clear import of

the statutory language. However, so construed section 25128 is invalid because it completely ignores the dual nature of former section 38006. Once one filters in the reality that former section 38006 was not just a statute but was also the codification of the Compact in California, and that through this enactment California entered a binding, enforceable agreement with the other signatory states, the multiple flaws in the FTB's position become apparent. 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.

1. *The Compact Superseded Section 25128*

By its very nature an interstate compact shifts some of a state's authority to another state or states. Thus signatory states cede a level of sovereignty over matters covered in a compact in favor of pursuing multilateral action to resolve a dispute or regulate an interstate affair. (*Hess v. Port Authority Trans-Hudson Corporation* (1994) 513 U.S. 30, 42; Broun on Compacts, *supra,* § 1.2.2, p. 23.) Because the Compact is both a statute and a binding agreement among sovereign signatory states, *having entered into it, California could not, by subsequent legislation, unilaterally alter or amend its terms*. Indeed, as an interstate compact the Compact *is superior to prior and subsequent the statutory law of member states*. (*McComb v. Wambaugh*, *supra*, 934 F.2d at p. 479; *Hellmuth, supra*, 414 F.Supp. at p. 409.)

This means that at the times in question, the Compact trumped section 25128, such that, contrary to the FTB's assertion, section 25128 *could not override* the UDITPA election offered to multistate taxpayers in former section 38006, article III, subdivision 1. It bears repeating that the Compact *requires* states to offer this taxpayer option. If a state could unilaterally delete this baseline uniformity provision, it would render the binding nature of the Compact illusory and contribute to defeating one of its key purposes, namely to "[p]romote uniformity or compatibility in significant components of tax

systems." (Former § 38006, art. I, subd. 2.) Because the Compact takes precedent over subsequent conflicting legislation, these outcomes cannot come to pass.

The FTB offers an alternative argument, namely that the UDITPA election can be superseded and repealed pursuant to the Compact's own withdrawal provision. Specifically, it casts the withdrawal clause as a flexible tool giving member states the "means of overriding any and all of its provisions, including the election and apportionment provisions. Member states can simply utilize the unrestricted withdrawal provision . . . to repeal and withdraw from the Multistate Tax Compact, in whole or in part."

As a matter of compact law, this cannot be. Having established that the Compact is a binding, valid compact, we construe and apply it according to its terms. (*Texas v. New Mexico* (1983) 462 U.S. 554, 564.) In part because compacts are agreements among sovereign states, we will not read absent terms into them or dictate relief inconsistent with their express terms. (*Alabama v. North Carolina*, *supra*, 130 S.Ct at p. 2313.)

With these concepts in mind, it is obvious that the plain language of the withdrawal provision, enabling a party state to withdraw from the Compact "by enacting a statute repealing the same," allows only for complete withdrawal from the Compact. After withdrawal, a state remains liable for any obligations incurred prior to withdrawal. 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. That is what the plain language says, and we will not read into that language an inconsistent term allowing for piecemeal amendment or elimination of compact provisions. At the time of the trial court's ruling and the submission of the case to this court after oral argument, California had *not* withdrawn from the Compact.

The FTB refers us to *Alabama v. North Carolina*, *supra*, involving the same compact withdrawal provision, to support its position that we should not restrictively interpret the withdrawal provisions of the Compact. The FTB focuses on the following passage: "The Compact imposes no limitation on North Carolina's exercise of its statutory right to withdraw. . . . There is no restriction upon a party State's enactment of

such a law . . . ." (*Alabama v. North Carolina*, *supra*, 130 S.Ct. at p. 2313, italics omitted.) However, the FTB omits the context, which is crucial. North Carolina withdrew from the compact in question by enacting a law repealing its status as a member state, *as required by the compact*. (*Id.* at p. 2304.) The plaintiffs alleged that North Carolina withdrew *in bad faith* to avoid monetary sanctions. Holding that there was no limitation on North Carolina's exercise of its withdrawal right, the Supreme Court explained that there was nothing in the compact suggesting that there were certain purposes for which the conferred withdrawal power could not be employed. (*Id*. at p. 2313.) In context, it is apparent that the case does not support the principle of partial withdrawal or piecemeal alteration or amendment. Rather, the withdrawal provision calls for withdrawal from the Compact by passing a law repealing the Compact, period.

In further support of its position that the withdrawal provision should be construed to permit partial repeal or unilateral amendment, the FTB interprets the severability clause as providing for liberal construction of Compact provisions. This standard clause says that if any provision is declared invalid, the remaining provisions will not be affected. In other words, if a court declares any provision unconstitutional or invalid, it will be severed to avoid invalidation of the entire Compact. (Former § 38006, art. XII.) How this clause advances the FTB's cause is not apparent to this court. It has nothing to do with liberal construction or the validity of state action to alter or amend existing Compact provisions.

Taking a slightly different tact, the FTB points out that a number of parties to the Compact have adopted statutes over the years that deviate from the Compact's taxing provisions. According to materials furnished in the FTB's request for judicial notice and summarized in its brief, 14 of 20 member states have passed some variation of a *mandatory*, state-specific apportionment formula that departs from the Compact provisions. The states have accomplished this in a variety of ways.

The FTB recommends that we consider the extrinsic evidence of this "course of conduct" in ascertaining whether the Compact is reasonably susceptible to an interpretation that renders its taxing provisions nonbinding and capable of being

amended, superseded and repealed, in whole or part, by member states. Both parties concur that the key is whether the Compact is reasonably susceptible to the interpretation offered. (*Cedars-Sinai Medical Center v. Shewry* (2006) 137 Cal.App.4th 964, 980.)[11] It is not. As we have demonstrated, the Compact's express, unambiguous terms require extending taxpayers the option of electing UDITPA, and set forth reciprocal repeal terms allowing a member state to cease its participation and reclaim its sovereignty.

As important, the proffered interpretation runs counter to the express purposes of the Compact, which include facilitating "equitable apportionment of tax bases" and promoting "uniformity or compatibility in significant components of tax systems." (Former § 38006, art. I, subds. 1, 2.) The FTB's interpretation, that the Compact does not require states to provide multistate taxpayers with the election to use the UDITPA formula, would eviscerate the availability of a common formula for all taxpayers to use as an alternative, thereby diluting a potent uniformity provision of the Compact. Moreover, the course of performance of a contract is only relevant to ascertaining the parties' intention *at the time of contracting*. (Civ. Code, § 1636; *Cedars-Sinai Medical Center v. Shewry*, *supra*, 137 Cal.App. 4th at p. 983.) The express, stated purposes of the Compact are a much truer measure of that intent than the subsequent statutory changes to state apportionment formulae.

Similarly, the purpose of admitting course of performance evidence is grounded in common sense: "[W]hen the parties perform under a contract, without objection or dispute, they are fulfilling their understanding of the terms of the contract." (*Employers*

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[11] The FTB adds that "[i]n interpreting a compact, 'the parties' course of performance under the Compact is highly significant,' " quoting *Alabama v. North Carolina*, *supra*, 130 S.Ct. at page 2309. As a general statement this is highly misleading. The court's reference to the course of performance pertained to "whether, in terminating its efforts to obtain a license, North Carolina failed to take what the parties considered 'appropriate' steps . . . ." (*Alabama v. North Carolina*, *supra*, 130 S.Ct. at p. 2309.) The compact in question obligated the defendant to take appropriate steps to ensure that an application to construct and operate the facility in question was filed and issued by the proper authority. (*Id.* at p. 2303.) The issue was what constituted "appropriate steps" under the compact. Of course, in this particular context, the parties' course of performance would help flesh out that concept.

Reinsurance Co. v. Superior Court (2008) 161 Cal.App.4th 906, 922.) The course of performance doctrine is thus premised on the assumption that one party's response to another party's action is probative of their understanding of the contract terms. But in the context of the Compact, the member states do not perform or deliver their obligations to one another, unlike a typical contract in which a party provides services or goods to the other party, who in turns monitors the first party's compliance with contract terms. Thus the foundation for finding course of performance evidence relevant and reliable is faulty. For example, in *Cedars-Sinai*, the reviewing court concluded that course of conduct performance was *not* relevant to interpret a disputed provision because the conduct in question had nothing to do with providing incentives to monitor or enforce contract compliance. (*Cedars-Sinai Medical Center v. Shewry, supra*, 137 Cal.App.4th at p. 983.)

F. *The FTB's Construction Violates the Federal and State Constitutional Prohibition Against Impairment of Contracts*

Our federal and state Constitutions forbid enactment of state laws that impair contractual obligations. "No state shall . . . pass any . . . law impairing the obligation of contracts . . . ." (U.S. Const., art. I, § 10, cl. 1.) "A . . . law impairing the obligation of contracts may not be passed." (Cal. Const., art. I, § 9.) This constitutional prohibition extends to interstate compacts. (*Green v. Biddle* (1823) 21 U.S. 1, 12-13, 17 [Kentucky law that narrowed rights and diminished interests of landowners under compact between Kentucky and Virginia violated compact and was unconstitutional]; *Doe v. Ward* (W.D.Pa. 2000) 124 F.Supp.2d 900, 915, fn. 20.) Section 25128, by its plain terms, sought to override and disable California's obligation under the Compact to afford taxpayers the option of apportioning income under the UDITPA formula. To this extent, and during the tax years at issue, section 25128 was unconstitutional as violative of the prohibition against impairing contracts.

G. *The FTB's Construction Runs Afoul of the Constitutional Reenactment Rule*

The FTB is adamant that the intent of the "[n]otwithstanding [former] Section 38006" language in section 25128 was to repeal and supersede the taxpayer election to

apportion under the Compact formula. At a minimum this outcome would have eliminated or rewritten article III, subdivision 1 and eliminated article IV, subdivision 9 of former section 38006. However, this result flies in the face of the California Constitution, article IV, section 9, stating in part: "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."

Long ago our Supreme Court expressed the purpose of the reenactment rule as avoiding " 'the enactment of statutes in terms so blind that legislators themselves [are] sometimes deceived in regard to their effect, and the public, from the difficulty of making the necessary examination and comparison, fail[s] to become appraised [*sic*] of the changes made in the laws.' " (*Hellman v. Shoulters* (1896) 114 Cal. 136, 152; accord *American Lung Assn. v. Wilson* (1996) 51 Cal.App.4th 743, 748.) Clearly the reenactment rule applies to acts " 'which are in terms . . . amendatory of some former act.' [Citation.]" (*American Lung Assn. v. Wilson*, *supra*, 51 Cal.App.4th at p. 749.) Its applicability does not depend on the method of amendment, but rather "on whether legislators and the public have been reasonably notified of direct changes in the law." (*Ibid*.)

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.

III. DISPOSITION

The judgment of dismissal is reversed. FTB to bear costs on appeal.

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Reardon, J.

We concur:

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Ruvolo, P.J.

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Sepulveda, J.[*]

[*] Retired Associate Justice of the Court of Appeal, First Appellate District, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.

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