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Appellate Court Records

IN THE SUPREME COURT OF THE STATE OF OREGON

HEALTH NET, INC., and SUBSIDIARIES,

Plaintiffs-Appellants,

vs.

DEPARTMENT OF REVENUE, State of Oregon,

Defendant-Respondent.

Tax Court (Regular Division)
Case No. TC 5127
S 0603625

CORRECTED OPENING BRIEF AND EXCERPT OF RECORD OF PLAINTIFFS-APPELLANTS HEALTH NET, INC., AND SUBSIDIARIES

On Appeal from Judgment of the Tax Court (Regular Division) entered September 28, 2015, The Honorable Henry Breithaupt

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I. STATEMENT OF THE CASE.

A. Nature of the Proceedings and Relief Sought.

Plaintiffs-Appellants Health Net, Inc., a Delaware Corporation headquartered in Woodland Hills, California, and its subsidiaries (collectively, "plaintiffs") are engaged in the delivery of managed health care services through health plans and government-sponsored managed care plans. ER-187.

On or about October 15, 2010, plaintiffs timely filed claims for tax refunds for the Oregon corporation excise tax years ending December 31, 2005, and December 31, 2006. ER-189. On or about July 7, 2011, plaintiffs filed a claim for refund for the Oregon corporation excise tax year ending December 31, 2007. *Id.* The basis for all of the claims was that under Article III of the Multistate Tax Compact ("Compact"), codified as ORS 305.655, plaintiffs were entitled to make an election to compute their taxable income using the apportionment formula in Article IV of the Compact.

On May 11, 2011, Defendant-Respondent Department of Revenue, State of Oregon ("defendant") issued Notices of Proposed Refund Adjustment for tax years 2005 and 2006, rejecting plaintiffs' refund claims. *Id*. On August 23, 2011, defendant issued a Notice of Proposed Refund Adjustment for tax year 2007, rejecting plaintiffs' refund claim in part. *Id.* at 189-90. Plaintiffs timely requested a conference for each Notice of Proposed Refund Adjustment. *Id*. at 190. By conference decision letter dated April 2, 2012, defendant upheld the denials of plaintiffs' refund claims for the tax years, determining that plaintiffs were required to use the apportionment formula in ORS 314.650 and were not entitled to use the apportionment formula in Article IV of the Compact. *Id.* Plaintiffs thereby exhausted all available administrative remedies.

The Oregon Tax Court (Regular Division) entered a Judgment on September 28, 2015, sustaining the denials of plaintiffs' refund claims. ER-237. On direct appeal to the Oregon Supreme Court, plaintiffs seek reversal of the Judgment and an order that plaintiffs are entitled to the refunds sought.

B. Nature of the Judgment Sought to be Reviewed.

The Judgment from which plaintiffs appeal provided:

> "On September 9, 2015, the court entered an Order Denying Plaintiffs' Motion for Summary Judgment and Granting Defendant's Cross-Motion for Summary Judgment (the order), upholding the department's refund denials for Tax Years 2005, 2006, and 2007 and sustaining the department's determination that Plaintiffs were required to use the apportionment formula in ORS 314.650 and were not entitled to use the apportionment formula in Article IV of the Multistate Tax Compact."

ER-237.

C. Basis of Appellate Jurisdiction.

The Oregon Supreme Court has jurisdiction under ORS 305.445.

D. Dates of Entry of Judgment and Notice of Appeal Filing.

The Judgment of the Oregon Tax Court (Regular Division) was dated September 28, 2015. ER-237. Plaintiffs filed the Notice of Appeal on October 26, 2015, within the thirty-day time period for filing such notice. ER-239.

E. Questions Presented on Appeal.

1. Is the Multistate Tax Compact ("Compact") a valid and binding interstate contract?

2. If the Multistate Tax Compact is a valid and binding interstate contract, was Oregon prohibited from repealing Articles III and IV by the terms of the Compact?

3. If the Multistate Tax Compact is a valid and binding interstate contract, was Oregon prohibited from repealing Articles III and IV of the Compact by the Contract Clause (Article I, Section 10, Clause 1, of the United States Constitution and Article I, section 21, of the Oregon Constitution)?

4. Did the legislative process employed in adopting ORS 314.606 violate Article IV, section 22, of the Oregon Constitution?

F. Summary of Argument.

At issue is whether the Compact is a binding agreement affording plaintiffs the right to make an election to compute their taxable income according to the Compact's formula for the years 2005 through 2007, despite ORS 314.606 purporting to eliminate the Compact's election.

The Compact was conceived and drafted in 1966, in response to imminent Congressional preemption of state taxation of multistate corporations. The key concern that prompted the preemptive legislation was a lack of uniformity in states' apportionment formulas leading to likely multiple taxation of multistate corporations. Desperate to maintain control of their taxing power, states entered into the binding Compact, which included a taxpayer election to apportion their income in any party state according either to the Compact's three-factor apportionment formula or any alternative formula a state might enact. This assured taxpayers a baseline uniformity in apportionment across party states. *Sustained* uniformity was possible because party states agreed to exercise their sovereignty collectively through a binding interstate compact that could not be altered unilaterally.

When Oregon entered the Compact in 1967, it became bound by all of its terms unless and until it withdrew pursuant to the Compact's withdrawal provision.

The Compact has all elements of a contract. The Tax Court erred in concluding that the only consideration was mere promises that were illusory due to the Compact's withdrawal provision and, therefore, the Compact was not a contract. To the contrary, consideration was supplied by performance (enactment of a statute), not solely by mere promises. Moreover, the withdrawal provision (which is found in all of Oregon's non-Congressionally approved compacts) did not render the promises in the Compact illusory because it did not confer an unfettered right to avoid contract obligations.

A large body of nationwide federal and state case law, developed over approximately 200 years, makes clear that a compact is a binding contract and in entering into a compact, party states cede sovereignty pursuant to the compact's terms, so states no longer have sovereignty to act contrary to those terms. Thus, compacts take precedence over conflicting state law, and they cannot be unilaterally altered by a party state, as Oregon attempted to do with ORS 314.606.

Oregon is a party to numerous non-Congressionally approved interstate compacts crucial to its citizens, including the Interstate Compact on the Placement of Children (ORS 417.200); the Interstate Compact on Juveniles (ORS 417.030); the Driver's License Compact (ORS 802.540); the Interstate Compact on Mental Health (ORS 428.310); and the Interstate Corrections Compact (ORS 421.245). The notion that a party state can unilaterally alter any interstate compact is a radical departure from settled compact analysis, jeopardizing Oregon's ability to rely on other states adhering to the commitments reflected in these compacts, and ultimately, Oregon's ability to enforce those obligations.

This court should sustain plaintiffs' claims based on the Compact's apportionment election because the Compact is a binding interstate contract, and Oregon was barred from unilaterally overriding its election and apportionment formula.

G. Summary of Facts.

The relevant facts have been established through stipulation (ER-171-179) and are recited in the Tax Court decision dated September 9, 2015. ER-187-236.

H. Other Necessary Matters.

1. A brief history of state taxation.

The origin of the Compact dates back to just after World War II. Corporate taxpayers were increasingly expanding their operations into multiple states, and state income taxes were becoming more popular. By 1960, 37 states imposed corporate income taxes. ER-4-6 (House Report No. 1480 (88th Congress, 2d Sess (1964)), vol 1, *State Taxation of Interstate Commerce, Report of the Special Subcommittee on State Taxation of Interstate Commerce*) ("Willis Report, vol 1"). The proliferating state income taxes varied widely (including their apportionment formulas). *Id*. Taxpayers faced increasing complexity in attempting to comply with these varying apportionment formulas, and with that complexity came steep costs. With different apportionment formulas, taxpayers also risked being taxed on more than 100% of their total income. *Id*. at 7, 22. As explained below, Congress and taxpayers began to demand uniformity in state taxation of multistate businesses, and states responded with the Compact. *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 US 452, 452-55, 98 S Ct 799, 54 L Ed 2d 682 (1978).

2. Uniform Division of Income for Tax Purposes Act.

In an early attempt to promote uniformity, the National Conference of Commissioners on Uniform State Laws drafted a model law, the Uniform Division of Income for Tax Purposes Act ("UDITPA") in 1957. ER-11 (Willis Report, vol 1); ER-140 (Sharpe, *State Taxation of Interstate Business and the Multistate Tax Compact*, 11 Colom J L & Soc Probs 231, 240 (1974-75). UDITPA is a formula for computing an apportionment percentage that determines a multistate corporation's total income subject to tax in a particular state. UDITPA's formula is the average of three factors — a property factor, a payroll factor, and a sales factor — giving equal weight to each factor. Each factor is expressed as a fraction, with the numerator representing the dollar value within the state and the denominator the dollar value everywhere:

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

See ER-12. UDTIPA offered states a uniform apportionment formula, but did not address the other distinct aspects of the determination of corporate tax liability, namely tax base and tax rate.

If states had widely adopted UDITPA, there would have been substantial uniformity in apportionment formulas across the United States. However, UDITPA was optional, and it was not promptly adopted by the states. By 1965, it had only been enacted in three states. ER-142 (Sharpe, *supra*).

3. Congressional intervention.

Meanwhile, in 1959, the Supreme Court decided *Northwestern States Portland Cement Co. v. Minnesota*, 358 US 450, 79 S Ct 357, 3 L Ed 2d 421 (1959), which unexpectedly adopted a very broad view of the ability of states to tax multistate businesses. ER-2 (Willis Report, vol 1). The business community reacted with alarm, questioning whether there were any effective limits on state taxation. *Id.* Responding to taxpayers' demand for action, Congress reacted swiftly and for the first time in its history adopted an act, Public Law 86-272, restricting the power of states to tax interstate business. ER-3 (Willis Report, vol 1); 15 USC §381-84.

Also to assuage taxpayers, Congress ordered a full-scale study of state taxation of multistate business to recommend legislation establishing uniform standards. *U.S. Steel*, 434 US at 455; ER-3 (Willis Report, vol 1); ER-142 (Sharpe, *supra*). In multi-volume reports issued in 1964-65, the Congressionally-appointed Willis Commission concluded that taxation of multistate taxpayers was inefficient and inequitable:

> "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."

ER-28 (Willis Report, vol 4), *see also* ER-4-5 (Willis Report, vol 1) (concluding that the lack of uniformity in state taxation unacceptably burdened interstate companies).

The Willis Commission particularly criticized the diversity in apportionment formulas and the propensity of states to change them frequently:

> "[V]ariation appears to be [formulary 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."

ER-7 (Willis Report, vol 1) (describing at least eleven different state apportionment formulas as of 1963); *see also id.* at 14, 16-17 (variance in apportionment formulas causes complexity in compliance and over-taxation).

To address complexity, volatility, and over-taxation, the Willis Report recommended federal legislation to mandate uniformity in state taxation. *See U.S. Steel*, 434 US at 455; ER-29 (Willis Report, vol 4) ("There is every reason to believe that, without congressional action, the worst features of the present system will continue to multiply."). Finally, it made specific legislative recommendations, including a single, mandatory apportionment formula to divide corporate income among the states, a uniform sales and use tax act, and federal oversight — in short, federal preemption of critical aspects of state taxation. *See* ER-30-33 (Willis Report, vol 4); ER-142 (Sharpe, *supra*). Soon after the report's release, Congress introduced a bill (HR 11798, 89th Cong, 2d Sess (1965)), including the mandatory apportionment formula, to implement these sweeping recommendations. *See* ER-112.

4. The Multistate Tax Compact background.

Federal preemption would have been a disaster for states, and especially given the speed with which Congress adopted Public Law 86-272, they were highly motivated to suggest an alternative. *U.S. Steel*, 434 US at 454; ER-143 (Sharpe, *supra*) ("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."); ER-86 (Multistate Tax Commission 1st Annual Report (Jan 28, 1969)) ("The origin and history of the Multistate Tax 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 * * *")); ER-67 (Council of State Governments, *Compact Summary and Analysis*, January 20, 1967) ("Development of the [C]ompact is the result of * * * the growing likelihood that federal action will curtail seriously existing State and local taxing power if appropriate coordinated action is not taken very soon by the States.").

Thus, the National Association of Tax Administrators promptly convened an "unprecedented" special meeting in January 1966, to oppose HR 11798 and to devise an alternative that would eliminate the need for federal legislation. *See* ER-144 (Sharpe, *supra* at n 49). The model law, UDITPA, had already proven inadequate to prompt uniformity in apportionment and to sufficiently minimize multiple taxation. An interstate compact was a completely different approach, a way to bind states to an agreement. Having each entered into many interstate compacts before, states were familiar with this established mechanism for resolving interstate problems. The drafters included compact experts from the Council of State Governments, as well as interstate representatives of other organizations, including the National Association of Attorneys General. *Id.*; *see also* ER-86 (Multistate Tax Commission 1st Annual Report). The historical documents indicate that, familiar with binding interstate compacts and understanding how they work, the drafters and the states intended for the Compact to be one. ER-67-80 (*Compact Summary and Analysis*, *supra*).

Unveiled in 1967, by its terms, the Compact would become effective as to all party states upon its enactment by any seven states, only seven months after the final draft. ER-87 (Multistate Tax Commission 1st Annual Report). Oregon was one of the seven original party states, enacting the Compact in 1967: "The 'Multistate Tax Compact' is hereby enacted into law and entered into with all jurisdictions legally joining therein * * *." ORS 305.655. For the years at issue, Oregon did not change its Compact membership status to anything less than full membership. ER-174.

Thus, the Compact was a bargain struck by states, for the benefit of taxpayers; the party states agreed to be bound by the terms of the Compact, and thereby addressed taxpayer and Congressional concerns by establishing both a baseline level of uniformity and a way to avoid multiple taxation. They expected taxpayers would be satisfied and would back down, and consequently the federal government would not enact legislation imposing uniformity. *See* ER-94-95 (Multistate Tax Commission 1st Annual Report). After the Compact became effective, Congress declined to enact the legislation proposed in the Willis Report.

5. The Compact's provisions.

Article III(1) of the Compact contains apportionment election, which mandates that states joining the Compact offer the Compact's apportionment formula — UDITPA's equal-weighted, three-factor formula — as an option to taxpayers, but also allows states to craft their own alternative 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*."

ORS 305.655, Art III(1) (emphasis added).

Article IV(9) contains the Compact's apportionment 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."

According to the Supreme Court, Article III(1) "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 US at 457 n 6 (emphasis added); *see also* ER-67 (*Compact Summary and Analysis*, *supra*) ("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."); ER-82-83 (Legislative History for ORS 305.655 — Oregon Tax Commission's Explanation of H.B. 1124) ("The compact is designed to permit taxpayers the type of uniformity which is required as a solution to the problems alleged to exist. It allows taxpayers the choice of apportionment on the basis of the particular apportionment tax policies already adopted by a state, or on the basis of the Uniform Division of Income for Tax Purposes Act (adopted by Oregon in 1965 as part of this program), which is made a part of the compact * * *." The compact guarantees a uniformity of tax treatment which is not contained in proposed federal legislation."). While a party state may offer an alternative apportionment formula, it is *required* to allow taxpayers to elect the Compact's formula.

In addition, when it enacted the Compact, Oregon also enacted ORS 314.710, which confirmed availability of the Compact election and Compact formula for Oregon corporate taxpayers: "The provisions of Articles III and IV of the Multistate Tax Compact apply to the allocation and apportionment of the income of corporations and nonresident individuals and do not apply to income of resident individuals, resident estates and resident trusts, taxable as provided in the Personal Income Tax Act of 1969."

The ability of taxpayers to elect a single apportionment formula in all party states ensured base-line uniformity and compatibility among state tax apportionment formulas. In this way, the Compact addressed the key apportionment concern set forth in the Willis Report, and Congress' one-size-fits-all apportionment formula became unnecessary. *See* ER-7, 12, 16-17, 18, 23; Walter Hellerstein, *State and Local Taxation* 565 (6th ed 1997) ("* * * Compact was developed * * * to offset the severe criticism the Willis Committee leveled against the widespread diversity in state apportionment and allocation methods."). It was recognized that the election allows multistate corporations to make the business decision to choose the apportionment formula that works best for them. ER-111 (Multistate Tax Commission 3rd Annual Report (Oct 10, 1970)) ("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.”).

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.

ORS 305.655, Art I; *see also U.S. Steel*, 434 US at 456. ORS 305.655, Art XII directs that the Compact “shall be liberally construed so as to effectuate the purposes thereof.”

The Willis Report also addressed inequities in state sales and use tax laws. *See* ER-3. Thus, Article V of the Compact obligates each party state (a) to provide a full use tax credit to taxpayers who previously paid sales or use tax to another state for the same property, and (b) to honor tax exemption certificates from other states. ORS 305.655, Art V; *see also* ER-111.

Beyond the binding requirements for uniformity — reciprocal sales/use tax credits and exemptions, and the taxpayer election to use the Compact’s apportionment formula — the Compact leaves other matters to the states’ individual control. It explicitly reserves party states’ control over the rate of tax. ORS 305.655, 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 US 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").

When a Compact provision is optional, the Compact expressly says so. *See, e.g.*, ORS 305.655, 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."). No other provision in the Compact contains this language making it optional.

The Compact allows only prospective withdrawal, and requires the state to enact 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."

ORS 305.655, Art X(2).

The Compact establishes the Multistate Tax Commission ("Commission") as a vehicle for continuing cooperation among party states. Each party state must appoint a Commission member and pay its share of the Commission's expenses. ORS 305.655, Art VI(1)(a), (4)(b).

In addition to the power to perform audits in states that adopted Article VIII(1), 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 US at 457.

In sum, the Compact's express provisions and purposes struck a 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 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.

6. Oregon's enactment of the Compact and amendments of the UDITPA apportionment formula.

As described above, the Compact secures a taxpayer's option to apportion its multistate income under the uniform Compact formula (the equal-weighted, three-factor formula) or under an alternative apportionment formula enacted by a party state. ORS 305.655, Art III(1). Until 1989, Oregon did not enact an alternative apportionment formula — it only offered the equal-weighted, three-factor formula.

In 1989, the Legislature amended Oregon's version of UDITPA, but not the Compact, to provide an alternative apportionment formula. Whereas the Compact's formula equally-weighted each of the three factors, Oregon's alternative formula double-weighted the sales factor. ORS 314.650 (1990).

In 1993, Oregon enacted ORS 314.606, which states: "In any case in which the provisions of ORS 314.605 to 314.675 are inconsistent with the provisions of ORS 305.655, the provisions of ORS 314.605 to 314.675 shall control." The Tax Court interpreted ORS 314.606 to override the Compact's election and apportionment formula. Plaintiffs do not appeal that conclusion.

In 2001, Oregon amended ORS 314.650 to provide for an apportionment formula weighted 80% by the sales factor, 10% by the property factor, and 10% by the payroll factor. ORS 314.650. In 2005, Oregon again amended ORS 314.650, this time to provide for a single sales factor apportionment formula, effective for tax years beginning on or after July 1, 2005. ORS 314.650.

Through all of these changes to Oregon's apportionment formula, the Legislature did not amend or repeal the Compact or ORS 314.710 (which provides for application of Articles III and IV of the Compact).

II. ASSIGNMENT OF ERROR.

The Tax Court erred in denying plaintiffs' motion for summary judgment, granting defendant's cross-motion for summary judgment, and entering judgment sustaining plaintiffs' refund claim denials.

A. Preservation of Error.

Plaintiffs and defendant framed the issue for appeal in their respective summary judgment motions. Plaintiffs' motion said, in pertinent part:

> "[Plaintiffs] move this Court for an Order granting summary judgment in Plaintiffs' favor on the ground that Plaintiffs' corporate excise tax liability for 2005 through 2007 was properly computed using the apportionment formula contained in ORS 305.655, the [Compact], pursuant to their election under Article III of the Compact * * *."

ER-177.

Defendant's contrary motion for summary judgment said, in pertinent part:

> "[Defendant] moves this court for an order entering summary judgment in its favor determining that the Oregon legislature was authorized to enact ORS 314.606 to disable the election in ORS 305.655.III.l, that ORS 314.606 does, in fact, disable the election in ORS 305.655.III.l * * *."

ER-182.

The Tax Court (Regular Division) denied plaintiffs' motion, granted defendant's motion, and entered judgment for defendant which said:

> "The actions of the legislature of Oregon in adopting ORS 314.606 were for the purpose of disabling the Compact Election. That legislative action violated no procedural or substantive provision of the Oregon Constitution… It did not violate the Compact Clause or Federal Contract Clause. * * * The motion of the department is granted and that of taxpayer is denied."

ER-236.

The Tax Court entered the Judgment (ER-237) quoted and cited above at page 2.

B. Standard of Review.

This court reviews the Tax Court's ruling on cross-motions for summary judgment to determine whether either party is entitled to judgment as a matter of law. *Martin v. City of Tigard*, 335 Or 444, 449, 72 P3d 619 (2003). Where a judgment results from cross-motions for summary judgment, the appellate court reviews "the record for each motion in the light most favorable to the party opposing it." *Eden Gate, Inc. v. D & L Excavating & Trucking, Inc.*, 178 Or App 610, 622, 37 P3d 233 (2002).

III. ARGUMENT ON ASSIGNMENT OF ERROR.

A. The Compact is a binding interstate contract.

Interstate compacts, a longstanding mechanism to address interstate problems, are universally recognized as contracts. *See, e.g.*, *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 US 92, 104, 58 S Ct 803, 82 L Ed

1202 (1938) (interstate compacts date back to the colonies); *West Virginia ex rel. Dyer v. Sims*, 341 US 22, 24, 71 S Ct 557, 95 L Ed 713 (1951); *see also* Felix Frankfurter and James Landis, *The Compact Clause of the Constitution — A Study in Interstate Adjustment*, 34 Yale LJ 685 (1925) (discussing history and expansive uses of interstate compacts).

Interstate compacts generally follow a similar format, and contain similar features that render them binding. In particular, they state that they *enter into force* upon enactment by the required number of party states. This reciprocal state action required before a compact goes into effect is express language evidencing the intent to enter into an agreement. It is what transforms otherwise garden-variety statutes of multiple states into a binding agreement among them. In addition, compacts lay out clear reciprocal obligations pertinent to the subject of the compact. And they contain a withdrawal provision, again with terms that serve the policies of the particular compact. Nearly all of Oregon's non-Congressionally approved compacts have each of these features.[1]

They also have the legal elements of a contract.

> "Interstate compacts are formal agreements between states, and hence, are contracts subject to the principles of contract law. '[A] Compact is, after all,

[1] *See, e.g.*, ORS 417.200 (Interstate Compact on Placement of Children); ORS 421.296 (Interstate Forest Fire Suppression Compact); and ORS 732.820 (Interstate Insurance Product Regulation Compact).

> a contract.' *Petty v. Tennessee–Missouri Bridge Comm'n*, 359 U.S. 275, 285, 79 S.Ct. 785, 3 L.Ed.2d 804, (1959) (Frankfurter, J., dissenting). It remains a legal document that must be construed and applied in accordance with its terms. *Texas v. New Mexico*, 462 U.S. at 564, 103 S.Ct. 2558; *West Virginia ex rel. Dyer v. Sims*, 341 U.S. 22, 28, 71 S.Ct. 557, 95 L.Ed. 713 (1951). Interstate compacts may be considered contracts because of the manner in which they are enacted: there is an offer (the presentation of a reciprocal law to state legislatures), an acceptance (the actual enactment of the law) and consideration (the settlement of a dispute or the creation of a regulatory scheme). *See Aveline v. Pa. Bd. Prob. & Parole*, 729 A.2d 1254, 1257 n. 10 (Pa.Cmwlth.1999)."

Doe v. Penn. Bd. of Prob. & Parole, 513 F3d 95, 105 (3d Cir 2008) (footnotes omitted).

In this case, the Compact has each of the elements of a binding contract among the member states. The presentation of a reciprocal law to the state legislatures for enactment is a contractual offer. The enactment of the law by each of the party states is a contractual acceptance. Simultaneously with acceptance, enactment of the Compact is also the performance that the parties bargained for. Enacting the provisions into law as statutes obligates the party states and all other interested parties (taxpayers) to the statutory terms in a substantively different way than the act of accepting an offer to contract. That is, *by the states accepting the offer*, the Compact became a binding *agreement* among the member states to abide by its provisions until a state enacts legislation withdrawing from the Compact; *by the states' performance* (enacting the statutes) the Compact became *statutory law* within the state, binding the state and taxpayers like any other state law.

Agreeing that the Compact satisfies the requirements of offer and acceptance, the Tax Court held that the Compact was not a binding contract because it lacked consideration. The Tax Court appeared to believe that the Compact was merely a set of promises. ER-201 ("No compact member state paid money or gave up anything other than the purported promise to participate in the Compact."). The Tax Court also appeared to understand that promises can serve as consideration. However, the Tax Court believed that the promises in the Compact were not consideration because the withdrawal provision made them illusory. Citing Restatement (Second) of Contracts § 77 (1981), the Tax Court stated that the illustrations "show that the unfettered right to terminate an agreement without notice leads to a failure of consideration." ER-203.

The Tax Court's analysis of the consideration requirement is incorrect. First, the Compact does not consist *only* of promises. Oregon did not merely promise to enact the Compact. Oregon also enacted the Compact into law. As noted, enactment of the Compact as a statute constitutes performance which itself is consideration. Restatement (Second) of Contracts § 50 (1981) (providing that a party may accept a contract by performance or by a return promise). Likewise, the Compact's statutory terms are mandatory for the states, and Oregon indeed abided by them, *e.g.*, at all times, Oregon participated in the

Commission, including paying dues, and it enforced the provisions of the Compact (with the sole exception of the apportionment election after 1993).

Second, the withdrawal provision does not make the Compact's promises illusory because it is not, as the Tax Court alleged, "an unfettered right to terminate an agreement." *Id.* According to Williston on Contract, also relied on by the Tax Court, what makes promises illusory is "always [having] within his power to keep his promise and yet escape performance of anything detrimental to himself or beneficial to the promisee." ER-203. Williston states further:

> "[A] promise, in a bilateral agreement, under which the promisor expressly reserves to itself the right of immediate cancellation at any time is not consideration. Where, however, the right to cancellation is tempered by its terms, express or implied, or by operation of law, so that cancellation is not solely at the whim of the promisor, the promise may serve as consideration."

Id.

The Compact's withdrawal provision is not a right to immediate cancellation and does not give party states the power to keep their promise and yet escape performance of anything detrimental to itself. To withdraw, a state must draft a bill providing for withdrawal from the Compact, legislative committees must consider and pass the bill, the full Legislature must consider and pass the bill, and the Governor must sign it. This very deliberate, often lengthy process for withdrawal is analogous to the 30 day notice period in

Restatement (Second) of Contracts § 77, illustration 5.[2] In addition, the Compact's withdrawal provision permits withdrawal from the Compact only prospectively, while requiring adherence to promises up until the legislation is enacted and effective. ORS 305.655, Art X. Thus, the Compact's withdrawal provision does not allow for unfettered termination at any time to avoid

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[2] Illustration 5 provides:

> "A promises B to act as B's agent for three years on certain terms, starting immediately; B agrees that A may so act, but reserves the power to terminate the agreement on 30 days' notice. B's agreement is consideration, since he promises to continue the agency for at least 30 days."

Restatement (Second) of Contracts § 77.

The Tax Court contrasted illustration 5 with illustration 4 (ER-203), which provides:

> "A agrees to sell and B to buy between 400 and 600 tons of fertilizer in installments as ordered by B, A reserving the right to terminate the agreement at any time without notice. B's promise is without consideration."

Id.

Illustration 4 is distinguishable from the Compact because consideration is provided only by promises, not performance.

performance.[3]

Finally, the U.S. Supreme Court rejected a Compact Clause challenge to the Compact based on the lack of Congressional consent. After a lengthy analysis of the history of compacts and the purpose of consent, the Court held that the Compact did not require consent because it was not "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 456-58, 471-78 (*citing Virginia v. Tennessee*, 148 U.S. 503, 518-19 (1893)). In reaching this holding, the Court assumed that the Compact was a valid, binding compact (otherwise the case and its analysis would have been entirely superfluous).

In sum, like all of Oregon's non-Congressionally approved compacts, the Compact is a binding contract because it contains an offer, acceptance, and

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[3] It is striking that the Tax Court describes the *current* Interstate Compact on Juveniles as "a binding legislative contract" (ER-228) despite a unilateral withdrawal provision virtually identical to the Compact's withdrawal provision. "The effective date of withdrawal is the effective date of the repeal." ORS 417.030, Art XI(A)(2). There is no notification period. The only requirement is that, similar to the Compact, "[t]he withdrawing state shall immediately notify the chairperson of the Interstate Commission in writing upon the introduction of legislation repealing this compact in the withdrawing state." In addition, the statutes which this court found to be contracts could be repealed prospectively at the will of the Oregon Legislature. *See, e.g.*, *Eckles v. Oregon*, 306 Or 380, 760 P2d 846 (1988); *Hughes v. Oregon*, 314 Or 1, 838 P2d 1018 (1992); *see also* ER-201-02 (citing *Eckles* and *Hughes* favorably).

consideration, and it has numerous other indicia of intent to form a contract.[4]

B. The Compact election is mandatory for party states.

1. Interpretation must be consistent with 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*, 462 US at 128 (explaining that an interstate compact is a contract and a "legal document that must be construed and applied in accordance with its terms"); *Alabama v. N. Carolina*, 560 US 330, 341-43, 130 S Ct 2,295, 176 L Ed 2d 1070 (2010) (courts must remain true to express terms of interstate compacts); *In re C.B.*, 188 Cal App 4th at 1031-32

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[4] The recent decision by the California Supreme Court in *Gillette Co. v. Franchise Tax Bd.*, Cal. Supreme Court No. S206587 (decision for tax authority, petition for certiorari to the United States Supreme Court pending), holding that the Compact is not a binding agreement between states, is likewise wrong. The court purported to apply the "indicia" of compacts identified in *Northeast Bancorp, Inc. v Bd. of Governors*, 472 U.S. 159, 175 105 S. Ct. 2545 (1985), which the court articulated as "reciprocal obligations," "conditional, [not] unilateral action," and "regulatory organization." However, as the Tax Court held, *Northeast Bancorp* involved a different issue. ER-224 n 28 ("[T]hat question is irrelevant in the case before this court."). Even if *Northeast Bancorp* were relevant here, in taking the Supreme Court's words out of context and failing to apply any meaningful analysis to them, the California court misunderstood and mis-applied the so called indicia of *Northeast Bancorp.* Understood properly, insofar as they are actually indicia of a compact, the *Northeast Bancorp* indicia are satisfied here.

(analyzing plain language of terms of non-approved ICPC). While this interpretative rule is the same for contracts in general and for statutes, it is particularly imperative for interstate compacts:

> "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. N. Carolina, 560 US at 350-52 (citations omitted); *see also In re C.B.*, 188 Cal App 4th at 1036.

2. The Compact election is mandatory.

Article III(1) requires party states to allow taxpayers to elect either the Compact's equally-weighted, three-factor apportionment formula or a party state's own, alternative apportionment 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."

ORS 305.655, Art III(1); *see U.S. Steel*, 434 US 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”); ER-67 (*Compact Summary and Analysis*, *supra*).

In 1970, the Commission itself recognized as much:

> “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 [selling into a state may prefer the Compact’s 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.”

ER-111 (Multistate Tax Commission 3rd Annual Report).

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. ORS 305.655, 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 US 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 the election is mandatory. *See Rosentool v. Bonanza Oil & Mine Corp.*, 221 Or 520, 527, 352 P2d 138 (1960) (“The Court cannot insert what has been omitted or omit what has been inserted and when there are several provisions, such construction is to be adopted as will give effect to all.”).

In addition, the plain language of the withdrawal provision allows only for complete withdrawal from the Compact (prospectively only) by enactment of an express repealing statute:

> "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."

ORS 305.655, Art X.

The withdrawal provision does not allow piecemeal alteration or elimination of Compact provisions. *See also Alabama v. N. Carolina*, 560 US at 352-53 (refusing to read additional language into a similar compact withdrawal provision); *In re O.M.*, 565 A2d 573, 579 (DC App 1989); 80 Ops Cal Atty Gen 213 (Aug 5, 1977); 1965 Or AG LEXIS 40, 32 Op Atty Gen Ore 146 (1965) (withdrawal from a compact permitted only according to an express withdrawal provision and there was none in the compact at issue).

In short, the Compact's election provision is express and unambiguous. And there is nothing in the Compact that permits a party state to deviate from that express language. Moreover, ORS 305.655, Article XII directs that, "[the] [C]ompact shall be liberally construed so as to effectuate the purposes thereof."

And allowing an election advances each of the Compact's express purposes, whereas allowing each party state to impose its own mandatory apportionment formula would undermine these purposes. Specifically, permitting taxpayers to use the same apportionment formula in every state (the equally-weighted three factor 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 a single formula would simplify taxpayer compliance. As the Council of State Governments explained in 1967, when it distributed the 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."

ER-46 (Council of State Governments, Memorandum accompanying final text of the Compact, Dec 20, 1966) (emphasis added); ER-67 (*Compact Summary and Analysis*, *supra*).

In sum, the Compact's election provision is express and unambiguous. Its mandatory nature is further supported by the Compact's express purposes. There is nothing in the Compact that permits a party state to deviate from that express language and allowing party states to override the Compact election would undermine the Compact's purposes.

C. The Tax Court's reasons for holding the Compact is not a contract and the election is not mandatory are unavailing.

The Tax Court claims that the Compact does not "unambiguously express an intention to create a contract," and that it does not state that "member states may not amend or disable provisions of the Compact." ER-206-07. However, as noted above, the Compact does contain precise language expressing an intention to create a contract, and it is the same language that is in all of Oregon's non-Congressionally approved compacts. *See supra* § III(A).

The absence of a statement that "member states may not amend or disable provisions of the Compact" does not mean that members are free to flaunt the terms of the Compact. As explained above, the Compact's apportionment election is expressed in mandatory terms and Oregon agreed to be bound by those terms. As a matter of contract law, by enacting the Compact, Oregon accepted the offer to enter into the Compact and became bound by its terms until subsequent withdrawal legislation was enacted. Also as a matter of logic, a promise to do something (*e.g.*, provide the election to taxpayers) for the term of an agreement encompasses a promise not to unilaterally stop doing it. Consistent with this logic, there is no authority for the requirement of a second promise not to disable the election or any other term in the Compact. None of Oregon's other non-Congressionally approved compacts contains such a second promise not to deviate from any of its terms.

The Tax Court also contended that the parties' course of conduct supported a conclusion that the Compact was not binding and/or the parties were free to modify it unilaterally. As the Tax Court concedes, "there must be an ambiguous contract provision at issue in order for a court to consider extrinsic evidence meaning." ER-210; *Alabama v. N. Carolina*, 560 US at 341-43 (explaining that a court is "not free to rewrite" a compact to include additional terms); *Texas v. New Mexico*, 462 US at 568 (refusing to grant relief inconsistent with the express terms of the compact).

The Tax Court claims that there is "ambiguity as to the intent of the states which adopted the Compact as well as the meaning of the Compact." ER-211. To the contrary, as established above, the plain terms of the Compact establish unambiguously that the parties intended to enter into a binding contract (*see supra* § III(A)), and the Compact election is unambiguously mandatory. *See supra* § III(B).

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*, 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. 514 U.S. 673, 690, 115 S Ct 1,733, 131 L Ed 2d 759 (1995); *cf. Tarrant Reg. Water Dist. v. Herrmann*, 133 S Ct 2120, 186 L Ed 2d 153, 168, 172 (2013) (looking to party states' practical conduct in purchasing water to interpret ambiguous compact provision regarding water flow sharing); *Alabama v. N. Carolina*, 560 US at 345-46 (considering party states' practical conduct in interpreting ambiguous compact provision requiring "appropriate steps").

If the Compact were ambiguous,[5] the extrinsic evidence most probative of the parties' intent at the time they entered into the Compact is the evidence of its drafting and negotiation, as well as its express purposes, not evidence of subsequent conduct of party states. *See Oklahoma v. New Mexico*, 501 US 221, 231-37, 111 S Ct 2, 281, 115 L Ed 2d 207 (1991) (relying on "purpose and negotiating history" to interpret ambiguous phrases "conservation storage" and "originating" in Canadian River Compact); *Texas v. New Mexico*, 462 US at

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[5] The cases cited by the Tax Court regarding use of conduct evidence are not applicable to the interpretation of highly negotiated complex agreement between multiple parties and affecting innumerable stakeholders. ER-210. Several of the cases purporting to allow conduct evidence to override the terms of an agreement involved claims that an individual was an employee despite an independent contractor agreement, which obviously raises idiosyncratic concerns. *See Wallowa Valley Stages v. Oregonian*, 235 Or 594, 386 P2d 430 (1963); *Jenkins v. AAA Heating*, 245 Or 382, 421 P2d 971 (1966). *Bruckman v. Breitenbush Hot Springs*, 272 Or 1, 534 P2d 971 (1975), used conduct evidence to resolve two competing written agreements (stock shares and mortgages), which again raises different issues than this case. *Perkins v. Standard Oil Co.*, 235 Or 7, 383 P2d 107 (1963), *reh'g den*, 383 P2d 1002, involved a form contract (in contrast to the highly negotiated between states as equal sovereigns at issue here). And *Krieg v. Union Pacific Land res. Corp.*, 269 Or 221, 525 P2d 48 (1974), permitted conduct evidence to interpret an ambiguous contract term.

568 n 14 (using context at time of compact's enactment to aid in interpretation of ambiguous provision); *Arizona v. Oregon*, 292 US 341, 359-60, 54 S Ct 735, 78 L Ed 1, 298 (1934); *McComb v. Wambaugh*, 934 F2d 474, 481 (3d Cir 1991).

This more probative evidence confirms that the Compact drafters knew and intended for the Compact to be a binding interstate compact just like the numerous binding compacts the states had previously entered into. It equally confirms that the Compact drafters intended the Compact and the apportionment election to be mandatory and binding.

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* ER-7, 12-13, 16-17 (Willis Report, vol 1); ER-30-45 (Willis Report, vol 4). Having each entered into many interstate compacts before, states were familiar with this established mechanism for resolving interstate problems. The drafters included compact experts from the Council of State Governments, as well as representatives of other organizations, including the National Association of Attorneys General. *Id.*; *see also* ER-86 (Multistate Tax Commission 1st Annual Report). The historical documents indicate that, familiar with compacts and understanding how they work, the drafters and the states intended for the Compact to be one. ER-67 (*Compact Summary and Analysis*, *supra*). A mandatory election was a core element of the Compact in order to secure *for taxpayers* a base-line level of uniformity and thus critical for states to avoid federal imposition of a one-size-fits-all apportionment formula. ER-94-96 (Multistate Tax Commission 1st Annual Report); ER-46 (Council of State Governments Memorandum) (expressly providing that taxpayers would have the option to use the Compact formula); ER-67 (*Compact Summary and Analysis*, *supra*) (to the same effect); ER-111 (Multistate Tax Commission 3rd Annual Report) (to the same effect). The centrality of the election as mandatory for the party states is also confirmed by the purposes of the Compact. ORS 305.655, Art I. In sum, the most compelling evidence of the party states' intent in enacting the Compact — its contemporaneous negotiating and drafting history — confirms the Compact was a binding agreement and the election was not optional.

By contrast, the subsequent laws amending or repealing states' enactment of the Compact are not probative because subsequent legislation does not establish the intent of an earlier legislature. *See, e.g.*, *De Fazio v. Wash. Pub. Power Supply Sys.*, 296 Or 550, 561, 679 P2d 1 (1984) (explaining that views of later legislators "is of no weight in interpreting a law enacted by their predecessors"); *Holcomb v. Sunderland*, 321 Or 99, 105, 894 P2d 457 (1995) ("The proper inquiry focuses on what the legislature intended at the time of enactment * * *."). Here, all but one of the variances listed by the Tax Court occurred twenty or more years *after* the Compact became effective.

Furthermore, there is no foundation for considering the states' actions to interpret the agreement entered into years or decades before under different circumstances. 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. 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.[6] Thus, at most the states' recent actions show that the incentive for the party states to adhere to the Compact election had ceased, and one by one they came to believe it would be beneficial to them and there would be no consequence for overriding it. They were trying to maintain the benefits of the Compact but not the detriments.

It is critical to recognize that the states' actions were not consistent. Many have not altered the election. *See, e.g.*, Missouri (RS Mo § 32.200); North Dakota (ND Cent Code § 57-59-01); Montana (Mont Code Ann § 15-1-

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[6] *See Gillette Co. v. Franchise Tax Bd.*, Cal Supreme Court No S206587 (decision for tax authority, petition for certiorari to the United States Supreme Court pending); *International Business Machines Corp. v. Mich. Dep't of the Treasury*, Mich Supreme Court No 146440 (decision for taxpayer, remanded to lower court); *Graphic Packaging Corp. v. Tex. Comptroller of Public Accounts*, Tex Supreme Court No 15-0669 (pending); *Kimberly-Clark Corp. v. Minn. Comm'r of Revenue*, Minn Tax Court No 8670-R (pending, filed on December 12, 2013).

601); New Mexico (NM Stat Ann § 7-5-1). Other states have withdrawn from the Compact rather than comply with its obligations. *See U.S. Steel*, 434 US at 454 n 1 (citing statutes repealing the Compact in Florida, Illinois, Indiana and Wyoming); Nevada (1981 Nev Stat ch 181, at 350); Maine (PL 332 (2005)); Nebraska (LB 344 (1985)); West Virginia (Act 1985 (160)). None of those actions have been ruled on with finality by courts. Meanwhile, a number of states that previously modified or overrode the election subsequently withdrew completely from the Compact.[7]

For all of these reasons, the Compact was a binding agreement between party states and the Compact election was mandatory.

D. The Compact's terms prohibit overriding the election.

The essence of an interstate compact is that party states contractually cede portions of their sovereignty pursuant to the compact's terms to address a shared problem. *C.T. Hellmuth & Associates, Inc. v. Washington Metro. Area Transit Auth.*, 414 F Supp 408, 409 (D Md 1976); *Int'l Union of Operating Engineers*, *Local 542 v. Del River Joint Toll Bridge Comm'n*, 311 F3d 273, 276 (3d Cir 2002) (stating that by entering into an interstate compact, the States "have each surrendered a portion of their sovereignty"); *Hess v. Port Auth Trans-Hudson Corp.*, 513 US 30, 42, 115 S Ct 394, 130 L Ed 2d 245 (1994)

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[7] *See, e.g.*, Minnesota (2013 Minn Ch Law 143 (HF 677)); Utah (2013 Utah Laws 462 (SB 247)); California (Cal Stats 2012 ch 37 § 3 (S.B. 1015)).

("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."); *KMOV-TV v. Bi-State Dev Agency*, 625 F Supp 2d 808, 811 (ED Mo 2008); ER-163 (Caroline N. Broun, et al., *The Evolving Use and Changing Role of Interstate Compacts* (ABA 2006) (by compact, "the member states have collectively and contractually agreed to reallocate government authority away from individual states to a multilateral relationship").

> "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.*"

CT Hellmuth, 414 F Supp at 409 (emphasis added).

The consequence of having ceded sovereignty pursuant to the compact's terms is that the compact "*is superior to both prior and subsequent law.*" *Id.* That is, having ceded sovereignty pursuant to the compact's terms, party states no longer have sovereignty to legislate inconsistently with those terms. This also explains the necessity of a withdrawal provision. It is the mechanism by which a state regains complete sovereignty over the subject matter of the agreement.

This principle of a compact being superior to prior and subsequent law holds true regardless of whether the compact has Congressional consent. This is because it derives from the ceding of sovereignty, which is independent of and unrelated to Congressional consent. Stated differently, Congressional consent does not cause the ceding of sovereignty.[8]

In re O.M., 565 A2d 573, held that subsequent state law could not invalidate a non-Congressionally approved compact, the Interstate Compact on Juveniles.

> "The Documents Act does not and cannot affect the continuing validity of the Compact because, once the ratification papers were executed on August 24, 1970, the Compact became law in the District of Columbia. * * * At the time the Mayor signed the ratification papers, before the Documents Act even existed, those papers had the desired legal effect of making the District a party to the Compact. The District's consent to and participation in the Compact was complete as of that moment. To withdraw its consent thereafter, the District was required to follow the renunciation procedures spelled out in Article XIV of the Compact itself. No other action by either the

[8] When a compact has been approved by Congress, it is treated as a federal law. Principles of preemption prevent a Congressionally-approved compact from being overridden by subsequent state law. However, Congressional approval is an additional reason (not the sole one) for this principle. See *Alcorn v. Wolfe*, 827 F Supp 47, 52 (D DC, 1993) ("In light of the Supremacy Clause * * * *and because compacts are analogous to contracts between states*, the terms of the * * * compact cannot be modified unilaterally by state legislation and take precedence over conflicting state law.") (emphasis added); ER-166 (Broun, *supra*) ("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."). And it serves very specific, unrelated purposes. Congressional consent ensures that, where relevant, Congress knows about, and agrees to, the interstate agreement. Thus Congressional consent is required only if the compact "tend[s] to the increase of political power in the States, [and thus] may encroach upon or interfere with the just supremacy of the United States." *US Steel*, 434 US at 471 (citing *Virginia v. Tennessee*, 148 US 503, 518-19; 13 S Ct 728; 37 L Ed 537 (1893)).

> Mayor or the Council could have any effect on the District's rights and duties under the Compact, or on the courts' obligation to enforce those rights and duties."

Id at 579.

Similarly, in *McComb*, 934 F2d at 479, the court explained:

> "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."

See also Gen. Expressways, Inc. v. Iowa Reciprocity Bd., 163 NW2d 413, 419 (Iowa 1968) (subsequent legislation could not "unilaterally alter the terms of the compact previously entered into by the board").

Thus, subsequent state law such as ORS 314.606 is ineffective in overriding provisions of an interstate compact. As explained above, the Compact must be interpreted and enforced according to its express, unambiguous terms, to allow plaintiffs' election to use the Compact's apportionment formula.

The Tax Court dismissed virtually all of plaintiffs' authorities supporting this argument because they involved Congressionally-approved compacts or did not distinguish between approved and non-approved compacts. *See, e.g.*, ER-226-36 ("cases that address interstate compacts that *were* approved by Congress * * * provide no authority for the analysis of a compact *not* approved by Congress when, as here, the issue is binding restrictions on state legislative action arising from prior legislative contracts" (emphasis in original)). However, as explained above, the principle of a compact being superior to prior and subsequent law derives from the ceding of sovereignty, which is independent of, and unrelated to, Congressional consent; Congressional consent does not cause the ceding of sovereignty. Thus, the reasoning of the cases did not turn on the compacts having been approved by Congress and their reasoning is as relevant to non-Congressionally approved compacts as it is to Congressionally-approved compacts.

The Tax Court's analysis and criticism of *In re O.M.* are wrong. The relevant issue in *In re O.M.* was whether failure to comply with the Documents Act, enacted years after the District validly entered into the Interstate Compact for Juveniles, nullified that compact. 565 A2d 573. First, several of the Tax Court's reasons for rejecting plaintiffs' analysis of *In re O.M.* relied on observations about the Interstate Compact for Juveniles. However, the Tax Court was citing to the wrong compact. While termed the Interstate Compact for Juveniles, ORS 417.030 is entirely different than the original Juveniles compact that was at issue in *In re O.M.* The original Juveniles compact was superseded by a new compact after *In re O.M.* and was enacted by Oregon in 2009. Or Laws 2009, ch 891, § 1. Critically, the original Juveniles compact did not have Congressional authorization or consent. (Congress participated in its capacity as the legislative body for the District of Columbia.) Nor did it provide that it superseded all state law other than constitutions. *Id*.

Second, in stating that "[t]he court discussed two analyses pursuant to which the later adopted procedural statute [the Documents Act] * * * was not even applicable," the Tax Court implied that the passage on which plaintiffs focus was merely dicta. To the contrary, it is those two prior analyses that were dicta: "We need not resolve this issue on either of these [two] other grounds, however, for there is a more fundamental reason why appellant's argument lacks merit." *In re O.M.*, 565 A2d at 579. The "more fundamental reason" was that the subsequent Documents Act could not affect the validity of the duly entered into compact. *Id.* at 578-80. The Tax Court similarly tried to render dicta the key passage in *In re O.M.* by observing that Congress commanded the courts to enforce the Compact. Indeed, this might provide an alternative reason for the court's decision, but it does not detract from the fact that the court referred to the key passage as a "fundamental reason" for its decision.

In sum, because states cede sovereignty pursuant to the compact's terms when they enter a compact, the states lack sovereignty to legislate inconsistently with those terms.

E. The Contract Clauses prohibited repealing the Compact election.

If ORS 314.606 were interpreted to override and eliminate the Compact election and Compact formula, the statute would violate the Contract Clause of the U.S. and Oregon Constitutions. US Const, Art I, § 10, cl 1 ("No state shall * * * pass any * * * law impairing the obligation of contracts * * *."); Or Const, Art I, § 21 (No * * * law impairing the obligation of contracts shall ever be passed * * *."); *see Green v. Biddle*, 21 US 1 (1823); *Doe v. Ward*, 124 F Supp 2d 900, 914-915 n 20 (WD Pa 2000).

The Tax Court concluded that there was no violation of Oregon's Contract Clause because "no contract was formed" and ended its analysis there. ER-213. By contrast, in its analysis of the federal Contract Clause, the Tax Court observed again that "no contract exists under Oregon law," but then continued to consider whether, if there were a contract, the impairment was "reasonable and necessary to serve an important purpose." ER-217.

This contrast in the Tax Court's analysis of the Oregon Contract Clause and the federal Contract Clause highlights the fact that Oregon law does not recognize any defense to impairment of a contract. *See Strunk v. Pub. Employees Ret. Bd.*, 338 Or 145, 207, 108 P3d 1058, 1095 (2005) ("Respondents next argue by way of affirmative defense that, even if the impairment is substantial, a substantial impairment can be justified if reasonable and necessary for an important public purpose. Oregon has not adopted that view.”). This court has repeatedly applied this strict liability standard for the Oregon Contract Clause. *See Hughes*, 314 Or 1; *Eckles v. Oregon*, 306 Or 380, 760 P2d 846 (1988). Therefore, because the Tax Court interpreted ORS 314.606 to eliminate the Compact’s election provision, such impairment of the Compact violates Oregon’s Contract Clause and is unconstitutional.

The U.S. Supreme Court has also applied a strict liability standard in holding that the federal Contract Clause prohibits state laws that impair interstate compacts. *Green*, 21 US at 91-93;[9] *see also* ER-161 (Broun, *supra*) (“The Contracts Clause of the U.S. Constitution prohibits the impairment of contracts, and that prohibition extends to interstate compacts.”); *Pennsylvania v. Wheeling & Belmont Bridge Co.*, 54 US 518, 14 L Ed 249 (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); *Gen. Expressways*, 163 NW2d 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, 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

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[9] *Green* continues to be cited favorably by the United States Supreme Court (*see, e.g.*, *Norfolk So. Railway v. Kirby*, 543 US 14, 32, 125 S Ct 385, 160 L Ed 2d 283 (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).

well as the Contract Clause. *Id.* at 914-15, 915 n 20 ("the Contract Clause of the United States Constitution protects compacts from impairment by the states").

While *Green*, 21 US 1, predates the modern cases that entertain a "reasonable and necessary" defense, one can appreciate why impairment of a compact should be subject to strict liability. A compact is a contract between states, in some cases nearly all 50 states, entered into to solve a shared problem. All compacts have innumerable stakeholders beyond the states themselves. Given the enormous legal, practical and policy considerations at play in an interstate compact, and the fact that parties are able to renegotiate an interstate compact or withdraw from it, the Contract Clause does not recognize any impairments as justified.

Assuming such a defense were available, ORS 314.606 would still violate the federal Contract Clause. The Tax Court recognized that ORS 314.606 impaired the Compact, but rejected plaintiffs' claim. It found the purpose for the impairment to be "fiscal disaster" threatening states and ORS 314.606 reasonable and necessary because it was caused by unforeseen circumstances. ER-220-21.

The Tax Court relied on *El Paso v. Simmons*, 379 US 497, 508-09, 85 S Ct 577, 13 L Ed 2d 446 (1965), in which, under the 1876 Constitution, in order to sell land as quickly as possible to fund public schools and encourage settlement, Texas sold land for minimal down payment, and minimal annual payments, and if land was forfeited, allowed repurchases at any time with interest forgiven. However, discovery of oil and gas led to speculation and exploitation of the changes in the use and value of lands. Speculators would forfeit while land was worthless, and then repurchase when it became potentially productive of oil and gas. This conferred considerable unforeseen advantages on purchasers at the great expense of the State and others, and it caused a crisis in confidence over stability and integrity of land titles, and significant revenue losses for schools. The challenged law changed the terms of the original purchases of land, restricting the right of reinstatement to only the most recent purchaser and requiring exercise within five years of forfeiture. Rather than eliminating the right to repurchase land, the State built in some restrictions, which the court described as "mild" and "hardly burdensome." It was also crucial that the provisions of the contract that were amended were not the ones that induced the purchasers into the contract.

The Tax Court erred in concluding that *Moorman Manufacturing Co. v. Bair*, 437 US 267, 98 S Ct 2,340, 57 L Ed 2d 197 (1978) (upholding a single sales factor apportionment formula in the face of a facial constitutional challenge), was a "change as dramatic as moving from settlement to oil speculation in Texas" resulting in "[m]any states [adopting] single or heavily weighted sales factor apportionment," and that party "states like Oregon were faced with potential fiscal disaster unless the provisions of the Compact election were either amended or disabled." ER-219-20.

However, to justify impairment, circumstances must have been unforeseen when the contract was negotiated and entered into. When Oregon adopted the Compact in 1967, very few states utilized the three-factor formula (only three states by 1965). ER-142 (Sharpe, *supra*). Even assuming the Tax Court were correct that after *Moorman*, states increasingly veered away from the three-factor formula, such a change would be a return to the status quo when the Compact was originally drafted and adopted, which would not be an unforeseen change justifying impairment of the Compact.

In fact, the Compact was written with the understanding and expectation that states would utilize a range of apportionment formulas and that they would change from time to time. An election would not have been needed if the expectation was that the three-factor formula would dominate indefinitely. Finally, in contrast to the contract provisions in *Simmons*, 379 US 497, the Compact's election was critical to the agreement and did induce the parties into the contract.

Nor is there any evidence that when ORS 314.606 was enacted Oregon was on the edge of fiscal disaster. No disaster is mentioned in ORS 314.606's legislative history, and even if there were one, impairment of the Compact would not have been reasonable or necessary. Tax rates could be raised, exemptions could be reconsidered, and if necessary, the states could have negotiated an amendment and re-enacted the Compact. As the U.S. Supreme Court recognizes, when a state attempts to avoid its own contractual obligation, extra scrutiny of its alleged justification is warranted. *United States Trust Co. of New York v. New Jersey*, 431 U.S.1, 25-26 (1976) ("deference * * * is not appropriate because the State's self-interest is at stake"). The Tax Court's explanation does not meet the high standard for a justifiable impairment of a contract. ORS 314.606 violates the Contract Clause.

F. ORS 314.606 violated Oregon Constitution Article IV, Section 22.

The Tax Court held that ORS 314.606 eliminated the Compact election and its apportionment formula, not by amending it but by disabling it. ER-200. However, there is no practical difference between disabling the Compact election, overriding it, or repealing it. Thus, under the Tax Court decision, ORS 314.606 amended the Compact. Moreover, it did so expressly because ORS 314.606 expressly references ORS 305.655.

This express repeal is ineffective because the Legislature did not repeal and then set forth and publish at full length the Compact as required by Article IV, Section 22 of the Oregon Constitution. That section provides, "No act shall ever be revised, or amended by mere reference to its title, but the act revised, or section amended shall be set forth, and published at full length." The purpose is to prevent deception and confusion of legislators and the public. *See, e.g.*, *Martin v. Gilliam Cty.*, 89 Or 394, 397, 173 P 938 (1918) (purpose of the rule is to prevent "the enactment of amendatory statutes in terms so blind that legislators themselves were sometimes deceived in regard to their effects, and the public, from the difficulty in making the necessary examination and comparison, failed to become apprised of the changes made in the laws."; quoting Cooley, Const. Lim. (5 ed.), 182); *State v. Coats*, 158 Or 102, 107-108, 74 P2d 1120 (1938) (to the same effect).

This litigation illustrates exactly the mischief that the constitutional full publication rule seeks to avoid. The Compact, including Articles III(1) and IV, remained on the books in its entirety, without amendment. ORS 305.655. The text of the Compact provided taxpayers and legislators no indication that the election and Compact formula had been overridden, resulting in a trap for unwary taxpayers.

In fact, even defendant was apparently confused by ORS 314.606. On the one hand, in this case, it contends that ORS 314.606 eliminated the election and Compact formula. On the other hand, in 1993, the same year the Legislature enacted ORS 314.606, defendant promulgated a regulation expressly acknowledging the availability of the Compact election and Formula. OAR 150-305-655 ("This option [*i.e.*, the Compact election] is available to taxpayers * * *.").

Because ORS 305.616 expressly referred to the Compact's apportionment provisions, it was an express repeal, and any exception to Article IV, Section 22 for implied repeals does not apply. Under Oregon's Constitution, ORS 314.606 has no effect.

IV. CONCLUSION.

For all of the foregoing reasons, plaintiffs respectfully request that this court overturn the Tax Court and sustain plaintiffs' claims for refund.

Respectfully submitted this 24th day of March, 2016.

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CERTIFICATE OF COMPLIANCE WITH ORAP 5.05(2)(d)

The court granted a motion to exceed the length limit of the combined excerpt of record and appendix for this brief. The Amended Order granting that motion was dated March 21, 2016, and permits an Excerpt of Record up to 250 pages. I certify that (1) this brief complies with that order, and (2) the word count of this brief (as described in ORAP 5.05(2)(a)) is 12,147 words.

I certify that the size of the type in this brief is not smaller than 14 point for both the text of the brief and footnotes as required by ORAP 5.05(4)(f).

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CERTIFICATE OF FILING AND SERVICE

I certify that on March 24, 2016, I caused to be filed the foregoing **CORRECTED OPENING BRIEF AND EXCERPT OF RECORD OF PLAINTIFFS-APPELLANTS HEALTH NET, INC. AND SUBSIDIARIES** with the Appellate Court Administrator by using the eFiling system.

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