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 S063625

REPLY BRIEF AND APPENDIX 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. SUMMARY OF ARGUMENT.

The Multistate Tax Compact ("Compact") is a valid and binding interstate contract. Oregon was prohibited from repealing the apportionment election (Articles III and IV) by the Compact's terms and by the United States and Oregon Constitutional Contract Clauses.

Defendant and its amici erroneously argue that Oregon was not bound in contract to provide taxpayers the Compact's apportionment election and eliminating the apportionment election did not violate the Contract Clause. Yet, future legislatures certainly can be bound by contract. *Strunk v. PERB*, 338 Or 145, 189, 108 P3d 1058 (2005). Defendant and amici concede that other non-Congressionally approved compacts are contracts. Answering Br 16; Br of *Amici Curiae* the States of Texas et al. ("States Br") 21. Rather than acknowledge what makes them binding (offer, acceptance, and consideration) and that the Compact has these features, they attempt to distinguish them from the Compact based on their substantive provisions and purposes. Answering Br 48-49 & n 31; States Br 21-23. However, those distinctions are irrelevant because a contract can have countless different substantive provisions. Moreover, contractual promises can be delivered solely to non-parties, such as taxpayers.

Defendant and amici do not dispute that offer, acceptance, and consideration are present in the Compact or, thus, that the parties entered an

agreement. The terms of that agreement formed a Commission with specific powers, funded it, allowed participation in its governance and provided certain benefits to taxpayers, including sales and use tax credits, a simplified filing system for small businesses, and the apportionment election. Such matters as whether the Commission's actions bind the parties and whether the apportionment election is delivered directly to the other parties do not bear upon whether the Compact was binding. Likewise, common in contracts, a withdrawal provision provided a way to end the agreement prospectively. Finally, while originally an optional model law, the apportionment method became binding when included in a contract.

Defendant and amici erroneously ask this Court to refer to extrinsic evidence to interpret the Compact. The Compact's mandatory apportionment election, however, is unambiguous. Deviations by some party states do not inform its interpretation or the determination what all parties intended *at the time of contracting.*

Defendant's and amici's reliance on the unmistakability doctrine is a red herring. All contractual promises include an implicit promise not to do the contrary. No authority requires a compact to expressly prohibit deviation from its terms.

Defendant concedes that eliminating the apportionment election impaired the Compact, but argues the impairment was not substantial. Defendant's

analysis of substantial impairment is wrong because it misconstrues decisions regarding parties' reasonable expectations. Further, the statute is not saved as reasonable and necessary to a public purpose because the alleged purposes were served by the apportionment election, nor did the State make any effort to determine whether actual problems or adequate alternatives existed

This Court should reverse and remand for entry of an order awarding plaintiffs the claimed refunds.

II. ARGUMENT.

A. *Former* ORS 305.655 does not permit piecemeal deviations.

1. The Compact's Text.

"[A]s with any contract, [the Court must] begin by examining the express terms of the Compact as the best indication of the intent of the parties." *Tarrant Reg'l Water Dist. v. Herrmann*, ___ US ___, 133 S Ct 2120, 2130, 186 L Ed 2d 153 (2013); *Yogman v. Parrott*, 325 Or 358, 361, 937 P2d 1019 (1997) ("To interpret a contractual provision, * * * the court examines the text of the disputed provision, in the context of the document as a whole. If the provision is clear, the analysis ends.").

A compact is a specific legal act long recognized as an agreement between states. Opening Br 20-21. "[T]he terms compact and contract are synonymous," *Green v. Biddle*, 21 US 1, 92, 5 L Ed 547 (1823), and a "compact is a contract" or a "bargained-for exchange between its signatories,"

Kansas v. Colorado, 533 US 1, 20, 121 S Ct 2023, 150 L Ed 2d 72 (2001). The Court must presume that the Compact says what it means and means what it says, that it *is* a contract. *Conn. Nat'l Bank v. Germain*, 503 US 249, 253-54, 112 S Ct 1146, 117 L Ed 2d 391 (1992); *see Alabama v. North Carolina*, 560 US 330, 350-53, 130 S Ct 2295, 176 L Ed 2d 1 (2010).

The Compact's "enter into force" and withdrawal provisions are unmistakable indications of contractual intent. Stating "[t]his compact shall enter into force when enacted into law by any seven states," is different from providing an ordinary statute's effective date. A State does not *enter* into a statute as it *enters* into an agreement. *See* Br of *Amicus Curiae* Multistate Tax Comm'n ("Comm'n Br") 13-14.[1] Likewise, states need not withdraw from an ordinary statute. Combined with repeated use of the term "compact," entry into force and withdrawal provisions make it impossible to construe the Compact as an ordinary statute.

In 1970, the Commission agreed that the Compact is "like all compacts." ER-109, 111, 120 (Comm'n Third Annual Report). Over 40 years later, the

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[1] Courts are the ultimate interpreters of a compact. *Alabama v. North Carolina*, 560 US 330, 343-44, 130 S Ct 2295, 176 L Ed 2d 1070 (2010). The Commission's views are not entitled to deference because it lacks authority to interpret the Compact or to determine a party's compliance. *Id.* at 339-44 (compact terms delineate authority of compact agency); *see also Texas v. New Mexico*, 462 US 554, 569, 103 S Ct 2558, 77 L Ed 2d 1 (1983) (compact agency lacked authority to determine compact compliance).

Commission claims the Compact is merely advisory or a uniform law. Comm'n Br 7-21. This is rebutted by the Commission's own authority. *See, e.g.,* Caroline Broun et al., *The Evolving Use and the Changing Role of Interstate Compacts: A Practitioner's Guide* 13 (2006) (describing advisory compacts as designed not to resolve an interstate issue, but simply for study); Comm'n Br 9 (citing Broun: "[A]dvisory compacts cede no sovereignty").

The Compact did not just establish a commission to study problems. Party states must provide the apportionment election, honor sales/use tax exemptions and credits, pay dues, and provide members to the Commission. *Former* ORS 305.655, Arts III(1), V, VI(1), and VI(4)(b), *repealed by* Or Laws 2013, ch 407, § 4. The Commission does more than study problems as it has a robust audit function. *Id.* at Art VIII. The Compact does cede some state sovereignty — authority to unilaterally impose an exclusive apportionment formula.

Defendant does not dispute that the Compact as a whole is binding, but argues the election may be eliminated without complete withdrawal. Answering Br 10-11. *Hughes v. State*, 314 Or 1, 838 P2d 1018 (1992), contradicts this. There, this court held that a statute exempting retirement benefits from state tax was binding because it was part of a contract (the Public Employees' Retirement Act of 1953), *id.* at 20, that contained "mandatory" language: "As enacted, the exemption said PERS retirement benefits 'shall be'

exempt from all state and local taxes," *id*. at 26. Here, the Compact's election is part of a contract (the Compact) and contains mandatory language: "Any taxpayer subject to an income tax * * * may elect to apportion and allocate his income" according to a State formula or "may elect" the Compact formula. *Former* ORS 305.655, Art III(1).

The Compact satisfies the "unmistakability doctrine." The Compact as a whole unmistakably is a contract, and the election is unambiguous and contains an implicit promise to keep the promise. Defendant cites no authority holding that, unless a compact expressly prohibits piecemeal amendment, such is permitted. That view was rejected in *United States v. Winstar Corp.*, 518 US 839, 922, 116 S Ct 2432, 135 L Ed 2d 964 (1996) (Scalia, J., concurring).

Nor does the Compact exhibit silence of the type that *Tarrant*, 133 S Ct at 2133, directs should be construed against a surrender of state sovereignty. *Tarrant* interpreted a substantive provision's ambiguous scope narrowly to not waive a party state's sovereignty over water within its borders. The question was not whether silence meant that a party could contradict a compact provision.

The Compact does not implicate any other states' constitutional bar on surrendering or suspending its taxing power. *See* Answering Br 17-18. Defendant and amici cite no case law interpreting these types of provisions. Actual decisions establish that such bars extend only to irrevocable limitations

on tax collections and assessments, such as a permanent tax exemption (including one irrevocable for a set term).[2] The Compact's apportionment election is not irrevocable — the Compact permits prospective withdrawal.

Neither the withdrawal nor severability clauses support Defendant's contradiction of the Compact. Nearly all compacts include a withdrawal provision, and contracts may be binding despite them. *See, e.g.*, 3 *Williston on Contracts* § 7:13 (4th ed 2015); 13 *Corbin on Contracts* § 68.9 (2016). Because it is in a contract, the Compact's withdrawal provision is binding and, accordingly, the only way to avoid the terms of the Compact. If it permitted piecemeal amendment, the Compact's withdrawal provision would be superfluous. Likewise, the severability clause is boilerplate that would be found in any well-drafted contract.

Nor is course of performance evidence admissible to override the unambiguous election. Opening Br 34-36. Other states' modifications that

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[2] *See, e.g.*, *Switzer v. City of Phoenix*, 86 Ariz 121, 127-28, 341 P2d 427 (1959) (parallel provision is a "prohibition against the surrender or relinquishment of the right to impose a tax" and "against the irrepealable grant of immunity from taxation"); *Sheehy v. Pub. Emps. Ret. Div.*, 262 Mont 129, 135, 864 P2d 762 (1993) ("[T]he state cannot promise any group of taxpayers that it will never tax them."); *Blair v. State Tax Assessor*, 485 A2d 957, 960 (Me 1984) (state constitution prevents legislature from granting permanent tax exemptions); *Reserve Mining Co. v. Minnesota*, 310 NW2d 487, 493-94 (Minn 1981) (state contract not to "impose any other taxes on taconite companies" violates the state constitution's anti-surrender provision because it "contract[s] away the legislature's right to tax"); *Bolton v. Terra Bella Irrigation Dist.*, 106 Cal App 313, 328, 289 P 678 (1930) (anti-surrender provision not implicated when legislative grant can be withdrawn).

occurred after Oregon joined are not probative of legislative intent upon entering the Compact. *Id*. at 32-34, 36-37. Nor have courts ruled on the legality of other states' modifications with finality. Additionally, some party states still adhere to the Compact election. Opening Br 37-38. As Defendant recognizes (Answering Br 21 n 12), in repealing the election, Florida provided a "safety valve" that gave taxpayers a mechanism for achieving "an election comparable to the one provided under Article III of the compact." Michael Herbert et al., *MTC and the Fallacy of its Florida Resolution*, State Tax Notes 935, 936 (Sept 14, 2015). This comports with the spirit of the Compact. In any event, it has not been tested in litigation.

If this Court considers extrinsic evidence to construe the Compact, it will find the contemporaneous drafting and enactment history most probative, confirming the Compact drafters intended that the Compact be binding just like the numerous, already operating, binding compacts. Opening Br 34-37. Defendant's summary of the Compact's history, as singularly motivated to preserve state sovereignty (Answering Br 18-20), is misleading. Preserving sovereignty was not an express purpose. *See former* ORS 305.655, Art I; Opening Br 34-36. Under the specter of pending federal legislation contemplating *complete* preemption and a single, mandatory apportionment formula, the Compact framers opted for the narrowest surrender of sovereignty to possibly forestall preemption. The states retained "complete control" over

the tax base, tax rate, and tax assessment and collection procedures. *U.S. Steel Corp. v. Multistate Tax Comm'n*, 434 US 452, 457, 98 S Ct 799, 54 L Ed 2d 682 (1978). The Compact was a sensible tradeoff for a narrow surrender of state sovereignty (which could be withdrawn prospectively).

2. Properly analyzed, *Northeast Bancorp* supports Plaintiffs.

The *Amici* States misapply *Northeast Bancorp, Inc. v. Board of Governors of the Federal Reserve System*, 472 US 159, 105 S Ct 2545, 86 L Ed 2d 112 (1985), as did the California Supreme Court in *Gillette Co. v. Franchise Tax Board*, 62 Cal 4th 468, 473, 363 P3d 94 (2015), *petition for cert filed*, No. 15-1442.

Northeast Bancorp did not establish a bright-line test for identifying binding compacts. It involved a different issue — whether Congressional consent was required. The statutes did not resemble the Compact or interstate compacts generally, so the court dismissed the approval question by only casually mentioning some missing compact indicia rather than rigorously identifying prerequisites for Congressional approval, let alone essential elements to make a compact *binding.*

In any event, properly understood, the *Northeast Bancorp* indicia apply here. *See* States Br 6-11. First, *Northeast Bancorp* did not refer to a regulatory commission, but a commission for "any * * * purpose," which the Compact provides. 472 US at 175; States Br at 7-8. Second, the Compact evidences

"reciprocal action" by requiring a specific number of states to enact the Compact before it becomes effective; this is the essence of a compact. States Br at 8-9. Third, *Northeast Bancorp* stated that the statutes at issue were not "conditioned on action by the other State, and each State [was] free to modify or repeal its law unilaterally." 472 US at 175. In contrast, the Compact is expressly conditioned upon its enactment by other states, and the ability to withdraw from a contract *prospectively* does not render the contract non-binding. Moreover, it makes no sense to ask whether a compact can be unilaterally modified to determine whether the compact is binding, *i.e.,* cannot be unilaterally modified.

3. ORS 314.606 violates the Contract Clause.

Under current law, any impairment violates the Oregon Contract Clause. Thus, assuming the Compact is a contract, eliminating the election is unconstitutional. Opening Br 44-46. This Court has rejected many opportunities to adopt the federal Contract Clause balancing test. *See, e.g.*, *Hughes*, 314 Or at 14 n 16, 29-33, 35; *Eckles v. State*, 306 Or 380, 399, 760 P2d 846 (1988). Defendant offers no reason for a different approach here. Answering Br 38. In any event, that federal test would not save ORS 314.606.

a. ORS 314.606 is a substantial impairment.

Defendant concedes that if the Compact and the election are binding, Oregon has impaired the Compact. Answering Br 41-43. However, Defendant contends the impairment was insubstantial because no taxpayer reasonably could rely on Article III(1) of ORS 305.655 after 1993, when the Oregon legislature enacted ORS 314.650's alternate formula, Answering Br 42-43, and because the Act put Plaintiff in the same position as if Oregon "had repealed" the Compact and "readopted" it without the election. *Id.* at 37. But it is irrelevant whether taxpayers could rely on the apportionment election *after* Oregon purportedly overrode it, and withdrawing from and reenacting the Compact is not the same as ignoring a provision. *See United Healthcare Ins. Co. v. Davis*, 602 F3d 618, 628 (5th Cir 2010) (power to terminate contract does not include power to impair it). Unless all parties agreed to omit the election, the reenactment would have been a garden-variety statute rather than re-admittance into the Compact.

The cases finding that parties' reasonable expectations supported a conclusion of no substantial impairment are distinguishable. Many involved highly-regulated industries, such as energy or water, and contracts which anticipated future impairment by providing they were "subject to future regulation." *See Energy Reserves Group, Inc. v. Kan. Power & Light Co.*, 459 US 400, 103 S Ct 697, 74 L Ed 2d 569 (1983); *United States v. State Water Res.*

Control Bd., 182 Cal App 3d 82 (1986). In addition to significant regulation and warnings of future impairment in contracts, in evaluating reasonable expectations, courts consider whether a covenant was abolished or merely modified, whether the abridged right was the parties' primary consideration, and whether the term was replaced by a comparable one. *City of Charleston v. Pub. Serv. Comm'n of W. Va.*, 57 F3d 385, 392-94 (4th Cir 1995).

This analysis supports a determination of substantial impairment here. The Compact's election was a material term, central to the aim of avoiding federal preemption. The drafters and states intended the Compact to be binding and the election to be mandatory. Opening Br 34-36. Their reasonable expectation upon contracting was that a state in the Compact would honor the election. The Compact not only lacks any indication of possible impairment, but also promises that each state will abide by all terms unless it withdraws pursuant to the withdrawal provision. Although taxation might be "highly-regulated" with frequently changing laws, embodying the withdrawal provision in an interstate compact communicates the opposite, *i.e.,* stability.

b. No public purpose saves ORS 314.606.

Defendant claims the purposes of eliminating the election were "mak[ing] sure all taxpayers were 'on the same playing field'"; "giv[ing] taxpayers an incentive to locate in Oregon"; and "mitigat[ing] the tax impact

created by 'other states that enacted the double-weighted sales factor first.'" Answering Br 44.

The first two purposes already were served by the Compact itself, and mitigating a "tax impact," is an insufficient justification for impairment. *See Home Bldg. & Loan Ass'n v. Blaisdell*, 290 US 398, 444-45, 54 S Ct 231, 78 L Ed 413 (1934) (foreclosure moratorium passed in response to Great Depression). Whatever the requirements for the asserted purpose, Defendant has not shown any problems actually existed, what their costs were, or whether other means to address them were available.

The admitted impairment was neither reasonable or necessary to achieve the listed purposes because states could have renegotiated and reenacted the Compact, Oregon could have withdrawn from the Compact, and there are other ways to incentivize taxpayers to locate in Oregon.

c. Waiver; material breach; third-party rights: Red Herrings.

This is not a contract action; no basis exists for applying contract defenses of waiver or material breach. No case supports relieving a party to a complex multi-party agreement, let alone an interstate compact, on these grounds. Defendant's contention fallaciously leads one to conclude that, in any multi-party contract, if any one party materially breaches, any other party could assert waiver and material breach against any third-party beneficiary. To the contrary, *Bennett v. Farmers Ins. Co.*, 332 Or 138, 148, 26 P3d 785 (2001),

involved a simple contract between two parties; letters and oral representations evidenced both contractual modification and waiver. This court said, "[W]aiver must be unequivocal." *Id.* at 157.

Here there is only inaction and silence. Several Compact states retain their equally-weighted apportionment formulas and have never commented upon another state's departures from the Compact. *See C. R. Shaw Wholesale Co. v. Hackbarth*, 102 Or 80, 100, 201 P 1066, 1069 (1921) (silence, without more, is insufficient to establish assent). Defendant's material breach authorities also have no applicability to this complex, multi-party situation.

No authority holds that third-party beneficiary status is necessary for a Contract Clause violation. Nevertheless, taxpayers are "intended" beneficiaries of the Compact. The party states clearly "intend[ed] to give the [taxpayers] the benefit of the promised performance." *See Restatement (Second) of Contracts* § 302(1).

B. The Compact supersedes conflicting state law.

As previously explained, ORS 314.606 is invalid because, having ceded sovereignty under the Compact, Oregon was bound to all of its terms, including the Compact's election and apportionment formula. Opening Br 38-43. Defendant dismisses Plaintiffs' entire argument, saying Plaintiff's authorities involved Congressionally-approved compacts. Answering Br 47-48. But the reasoning supporting the Plaintiff's cited cases (i.e., by entering into compacts,

states cede authority to the extent of the particular compact's terms and, consequently, cannot act inconsistently unless they withdraw pursuant to the compact) does not depend on prior Congressional approval. Opening Br 40-42.

C. Other Compacts are not materially distinguishable.

Amicus Commission never explains why the distinctions alleged with the five discussed compacts impact whether the Multistate Tax Compact is binding. The Commission claims the other compacts "contain provisions that use the kind of explicit contractual language typical of binding contracts or agreements on which the parties expect to rely." Comm'n Br 24. But it does not specify why that language results in a binding contract, nor does it cite supporting authority. What makes a contract binding are offer, acceptance and consideration.

Despite subject matter differences, all of Oregon's non-Congressionally approved compacts exhibit offer, acceptance and consideration. Opening Br 21-22. Nearly all of Oregon's non-approved compacts "enter into force" upon enactment of a substantially similar statute by a specified number of states. *See, e.g.*, ORS 357.340, Art XI; ORS 421.296, Art VI; ORS 802.560, Art VI. They constitute reciprocal legislation prescribing comprehensive rules governing specific subject areas. *See, e.g.*, ORS 144.600 (adult offender supervision); ORS 417.200 (adoption); ORS 732.820 (insurance regulation). All contain unilateral withdrawal mechanisms, many identical to the Compact's provision

in substance, language, or both. *See, e.g.*, ORS 732.820, Art XIV; ORS 830.080, Art IV ("Any party state may withdraw from this compact by enacting a statute repealing the same."). These provisions shared with the Compact but never found in regular statutes, indicate intent to be bound. And many compacts do not have a commission, let alone a *regulatory* one. *See, e.g*., ORS 417.200; ORS 428.310. Critically, none contain the express statement that the states will not deviate from their terms, which Defendant claims is necessary to satisfy the unmistakability doctrine.[3]

The arguments of Defendant and amici, including the unmistakability and *Northeast Bancorp* arguments, would render virtually all Oregon non-Congressionally approved compacts non-binding. That would endanger all of these compacts and their stakeholders, potentially costing Oregon the ability to regulate the interstate movements of adult offenders (ORS 144.600), denying Oregon access to its sister states' firefighters to combat forest fires (ORS 421.296), jeopardizing its wildlife (ORS 496.750), and more. This risk is underscored by the State of Ohio on pages 9-11 of its Brief of *Amicus Curiae* in support of a petition for certiorari to the United States Supreme Court in *Gillette Co. v. Cal. Franchise Tax Bd.* (2016); App 1, p 15-17.

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[3] Two compacts mandate that conflicting state laws are superseded by the compact. ORS 417.030, Art XIII(A)(2); and ORS 144.600, Art XIV(a)(2) restate the precept of law-making: later-enacted statutes supersede previously-enacted statutes. But overwhelmingly the State's compacts do not contain such a provision.

This court should uphold the Compact election as binding.

D. ORS 314.606 violates Article IV, Section 22.

No blanket exception to the Full Publication Rule, Article IV, Section 22, lies for all implied repeals. An exception exists only where "the act is in itself complete and perfect." *See Warren v. Crosby*, 24 Or 558, 561-62, 34 P 661 (1893).[4] That exception does not apply here; ORS 314.606 does not "exhibit on its face" its "scope." It does not identify specific conflicts between Oregon's statutes and the Compact. It requires analysis of the potentially competing statutes. In the wake of this intense litigation, it is a bit disingenuous to suggest that Oregon's apportionment formula clearly displaced the Compact formula. Answering Br 2, 52-53.

ORS 314.606 presents the type of opaque repeal that Article IV, Section 22 means to prevent. It is unconstitutional.

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[4] Similar exceptions in other states have been narrowly interpreted. *See Hellman v. Shoulters*, 114 Cal 136, 151-53, 45 P 1057 (1896) ("To say that every statute which thus affects the operation of another is therefore an amendment of it would introduce into the law an element of uncertainty which no one can estimate. It is impossible for the wisest legislator to know in advance how every statute proposed would affect the operation of existing laws."); *Brosnahan v. Brown*, 32 Cal 3d 236, 256-59, 651 P2d 274 (1982).

III. CONCLUSION.

Defendant unlawfully denied Plaintiffs' refund claim. The Tax Court erroneously sustained the denial. This court should reverse and remand the entry of an order awarding Plaintiffs the refunds.

Respectfully submitted this 28th day of July, 2016.

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I certify that (1) this brief complies with the word−count limitation in ORAP 5.05(2)(b), and (2) the word-count of this brief (as described in ORAP 5.05(2)(a)) is 3,959 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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