No. 15-1442

In the Supreme Court of the United States

THE GILLETTE COMPANY, THE PROCTER & GAMBLE MANUFACTURING COMPANY, KIMBERLY-CLARK WORLDWIDE, INC., AND SIGMA-ALDRICH, INC.,
Petitioners,

v.

CALIFORNIA FRANCHISE TAX BOARD,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of California

REPLY BRIEF FOR PETITIONERS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Page(s)

Cases

Constitutions and Statutes

Other Authorities

TABLE OF AUTHORITIES
(continued)

Page(s)

REPLY BRIEF FOR PETITIONERS

We showed in the petition that the decision below misapplied this Court's precedents, an error that led the California Supreme Court to misconstrue the Compact. That holding has tremendously significant, harmful practical consequences. It also places the law in a state of confusion, calling into question the meaning of dozens of compacts and leaving States and private parties uncertain about their obligations.

California's opposition does not address several of these points. And the little that it does say is wrong or inconsistent with its own prior statements. As confirmed by the many *amici* that support the petition—including the State of Ohio, which is directly affected by the principles of compact interpretation at issue here—the question presented is recurring, significant, and warrants this Court's attention.

A. The Decision Below Misapplied This Court's Guidance On Compact Construction And Misconstrued The Compact.

1. To begin with, California makes no meaningful response to our demonstration that the decision below departed from the federal common law rules of compact construction applied by this Court—and erred in holding that the Compact is not a binding contract.

First, the Compact's form and language unambiguously establish the Compact's binding status. The Compact is structured as a contract; is triggered by the entry-into-force mechanism by which States generally form binding contracts and that would be meaningless if the Compact is not binding; contains a withdrawal provision and limiting clauses that also would be superfluous were the Compact nonbinding; contains reciprocal provisions imposing mandatory obligations on the "party states," which cannot be read as optional

elements of a model law; and includes statements of purpose that can be effectuated only if the Compact is binding. See Pet. 15-20. California has literally nothing to say about *any* of these controlling elements of the Compact's language.[1] That default is telling.

Second, the little that the State does say about the Compact's text is wrong. California declares it significant that "'[n]o express language of the Compact'" proscribes unilateral departure from its agreed-upon terms. Opp. 9. But that gets the law of contracts backwards; a party *must* fulfill its contractual duties unless the contract expressly says otherwise. See 17A Am. Jur. 2d Contracts § 507 ("one party to a contract may not unilaterally alter its terms"). California also declares that "the most salient textual features of the Compact" are those providing that "states may 'unilaterally come and go as they please.'" Opp. 9 (quoting Pet. App. 15a). That quotation, however, is taken not from the Compact, but from the state court's inaccurate paraphrase of the agreement. The Compact's *actual* withdrawal provision supports the conclusion that the Compact is binding. See Pet. 18. On this point, too, the State offers no response.

Third, having nothing to say about the Compact's language, California declares it doubtful that the signatory States would have made use of a "peculiar," "all-or-nothing arrangement" under which States that wish to cease compliance with particular Compact terms must withdraw from the Compact altogether. Opp. 9-10. But there is nothing unusual about such a

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[1] California discounts the drafters' use of the term "compact" because "the label attached to a particular arrangement is not dispositive." Opp. 9 n.3. But the word "compact" was understood to be synonymous with "binding contract" at the time the Compact's framers used it. See Pet. 17.

contractual structure. Compacts typically include such withdrawal requirements (see Pet. 31-33), which are standard elements of contracts generally; where a contract provides a method for parties to withdraw, they are bound to use that method and may not unilaterally depart from particular contractual duties. See, *e.g.*, 17A Am. Jur. 2d Contracts § 535; Restatement (Second) of Contracts § 283 cmt. A.

Nor is there any mystery why the compacting States adopted that approach. All agree that States entered into the Compact to pretermit preemptive federal legislation by adopting a uniform approach that guaranteed taxpayer choice in the selection of a tax apportionment formula. See Pet. 2-6. These purposes would be frustrated if States could disregard particular Compact provisions at will. There is no need to speculate on this point; as shown in the petition (at 21) and by *amicus* David Doerr (see Doerr Br. 9-11), the Compact's drafters plainly intended to make its provisions binding. And here, again, California offers no response at all.

Fourth, California maintains in passing that the Compact should not be read to limit state authority to change tax law in any respect because the Compact does not declare such a limit in "unmistakable" terms. Opp. 11. But that argument, which was not embraced by the court below, is wrong. For the reasons already addressed, the Compact could have no purpose *but* to bind the signatory States, a result that the Compact's language accomplishes unambiguously. Cf. *Tarrant*, 133 S. Ct. at 2132 (sovereign powers not ceded where compact "ambiguous"). California also repeatedly urges special reluctance to permit enforcement of the Compact by "private taxpayers" (Opp. 1, 8, 13, 15), but that argument was not advanced by California to, or endorsed by, the court below, and for good reason: it is

fundamental that third-party beneficiaries may sue to enforce agreements intended to benefit them. See, *e.g.*, *Ger. All. Ins. Co.* v. *Home Water Supply Co.*, 226 U.S. 220, 230 (1912); Restatement §§ 302(1)(b), 304. And here, the Compact's framers unquestionably intended it to benefit taxpayers.

2. By the same token, California makes no attempt to defend the rationale advanced by the court below. The California Supreme Court looked almost exclusively to this Court's decision in *Northeast Bancorp*, which it understood to list the considerations that bear on whether a compact is binding. See Pet. 14-15, 23-25. Evidently recognizing that this approach is indefensible, California denies that the state court treated *Northeast Bancorp* as stating an "inflexible 'test,'" instead insisting that the court below "took full account of other factors." Opp. 15; see *id.* at 15 n.7. But that is simply not so. Following the lead of the Commission, the California Supreme Court "derived" its "test" from *Northeast Bancorp* (Pet. App. 11a-12a), which it understood to be the decision that "first articulated the factors to consider in determining the binding nature of an interstate agreement." *Id.* at 12a n.8. The California court's analysis then looked to the three "indicia of binding interstate compacts noted in *Northeast Bancorp*." *Id.* at 11a-20a.

On any fair reading, this decision is premised on the view that *Northeast Bancorp* offers a unique set of considerations that govern the interpretation of interstate compacts. The court below looked to none of the standard guides to contract interpretation, such as the Restatement, instead pointing to *Northeast Bancorp* repeatedly. See Pet App. 12a ("does not satisfy any of the indicia * * * noted in *Northeast Bancorp*"); *id.* at 13a (binding compact must contain "key features," citing *Northeast Bancorp*); *id.* at 15a (Compact not "a

binding interstate agreement under *Northeast Bancorp*"); *id*. at 16a (Compact not "the type of binding agreement contemplated by *Northeast Bancorp*"); *id*. at 17a (MTC "not a regulatory organization within the meaning of *Northeast Bancorp*"); *id*. at 19a (MTC "not a joint regulatory organization as contemplated by *Northeast Bancorp*").

This Court need not take our word on the point; *amici* that have no particular ax to grind here, including both Ohio and academic authorities on compact law, understand the decision below to "convert[] a non-exhaustive list of 'indicia of a compact' appearing in this Court's dicta [in *Northeast Bancorp*] into exhaustive, binding criteria for determining whether interstate agreements have been formed." Ohio Br. 1; see *id*. at 2-4; Litwak Br. 5-6.

And that is not all that the court below got wrong about *Northeast Bancorp*. That court also misunderstood this Court's discussion of the particular factors addressed in the decision, which all *support* the conclusion that the Compact is a binding agreement. Aside from noting that the court below "considered" the "same factors" as *Northeast Bancorp* (Opp. 14-15), the State ignores our contrary showing (Pet. 25-28) and offers no explanation *why Northeast Bancorp* supports its position.[2]

Those errors warrant this Court's attention. The California Supreme Court misunderstood this Court's precedent, a mistake that this Court has a special responsibility to correct. And as Ohio has explained, the decision below "creates uncertainty about how

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[2] California's invocation of *U.S. Steel*'s observation that the Compact does "not enhance collective state power '*quoad* the National Government'" (Opp. 14) says nothing about whether the Compact binds the signatory States.

States create binding agreements." Ohio Br. 8-9. Such a decision should not be left intact.

3. In nevertheless defending the decision below, California points to an MTC resolution approving Florida's repeal of Compact Articles III and IV, as well as the Compact's purportedly "unique history." Opp. 11-13. For several reasons, that contention is not well-founded.

First, we showed in the petition (at 20) that this sort of extrinsic evidence of a contract's purported meaning bears no weight where, as here, the contractual language is unambiguous. California does not deny that is so.

Second, the MTC's Florida Resolution is considerably less helpful to California's position than the State contends. The resolution has no legal force; the MTC has no special authority to interpret the Compact and its interpretation is not entitled to deference. See Pet. 23 n.10.[3] Moreover, the text of the resolution does *not* stand for the proposition that the Compact is nonbinding; to the contrary, the resolution proclaimed that Florida was "'still legislatively[] adhering to the spirit of the Compact'" (Michael Herbert et al., *MTC and the Fallacy of Its Florida Resolution*, State Tax Notes 935 (Sept. 14, 2015) (reprinting resolution)), an evident reference to Florida's "constitutional safety valve" allowing taxpayers to avoid overtaxation. Although California is correct that this "safety valve" legislation was not identical to the Compact (Opp. 11-12 n.5), the Florida Resolution—which, from all that appears, was not brought to the attention of the state

[3] The MTC had a fiscal self-interest in accommodating Florida at the time of the resolution, as it currently has in supporting the litigation interests of Compact members. See Herbert, State Tax Notes at 937-39.

legislatures that approved the Compact—does not purport to approve blanket, at-will departure from the Compact's terms.[4]

Third, the subsequent state actions that California invokes (Opp. 12-14) are not probative as "course of performance" evidence. Such evidence should be viewed as persuasive only where contractual counterparties have an incentive to object to breaches. See, *e.g.*, Restatement § 202; 5 Corbin on Contracts § 24.16 (2015). That is not the case here, where signatory States do not obtain particular direct benefits from contractual performance by other Compact members. Moreover, the course of performance under the Compact has not been consistent; although some States have departed from the Compact's election provision, others have never altered the election or have properly withdrawn from the Compact in accord with its terms. See Pet. 22 n.9. Although we made this point in the petition, California offers no response.

Fourth, and perhaps most notably, California's Attorney General himself formally opined that the Compact's terms are binding—at a time when the State did not have a litigation interest to advance. See Pet. 19-20. California's attempt to characterize that opinion as addressing only those provisions of the Compact that bear on "potential financial obligations" (Opp. 13 n.6) manifestly misstates it; the opinion declared flatly that the Compact "is a contract among the member states" (Ops. Cal. Atty. Gen. 213, 219

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[4] California is wrong in suggesting that its law contains a similar "safety valve." Opp. 12 n.5. Unlike Florida's mandatory provision, California provides for discretionary relief "only in specific cases where unusual fact situations (which ordinarily will be unique and nonrecurring) produce incongruous results." Cal. Code Regs. tit. 18, § 25137.

(1997)) and that California is bound by the Compact's terms "unless and until the compact is repealed in accordance with its provisions" through "the enactment of a state statute repealing the Compact." *Id.* at 213, 216. California's Attorney General reached this conclusion long after, and despite, the MTC's Florida Resolution.

B. The Question Presented Is Significant And Recurring.

California thus has little to say in response to the petition's demonstration that the decision below misapplied this Court's decisions in a manner that led it to misconstrue the Compact. And the State has even *less* to say when it addresses our showing that the question presented is one of exceptional importance that warrants review.

1. We showed in the petition (at 28-30) that the issue presented here has enormous practical significance, involving tax liability running well into the billions of dollars and implicating the fairness of state tax regimes across the Nation. California evidently agrees, as it makes no response to these points.

California gets little further with its brief, half-hearted response to our demonstration that the decision below creates grave uncertainty about the enforceability of many dozens of other compacts and the proper drafting of future compacts. Opp. 19-21. In fact, the point is not fairly debatable. *Amici* who can speak to the point authoritatively—including Ohio—confirm that "[t]he decision below could affect other compacts" (Ohio Br. 9), and "is extremely damaging to the effectiveness of existing compacts and to the willingness of states to enter into such agreements in the future." Litwak Br. 12.

Although California declares that "no actual compact organization" has urged review (Opp. 20), it fails to note that such organizations filed before the court below, where they argued that California's position would allow "any other compact member state unilaterally to contravene the uniform requirements of other interstate compacts including the [Interstate Compact for Juveniles (ICJ)] or [Interstate Compact on the Placement of Children (ICPC)]," and thus "has serious implications [for] * * * compacts across the nation." Br. of *Amici Curiae* ICJ and ICPC 6. And before that court (when it was buttering the other side of its bread), California *agreed*, emphasizing "the importance of this case" because it "could possibly be extended to other laws that vary from the Compact, to other compacts, and to other revenue streams." Cal. Merits Br. 9 n.16.

California now changes course and insists that other compacts are not similar to the Multistate Tax Compact. In doing so, however, it points to the language of only one such compact. Opp. 19-20. Yet at least forty-five other interstate compacts also permit States to withdraw unilaterally, most commonly by repealing the enacting statute—a mechanism California characterizes as "the *most salient* textual feature[]" of the Multistate Tax Compact. Opp. Br. 9 (emphasis added). Each of these compacts is placed in jeopardy by the decision below.

Even the Interstate Insurance Receivership Compact ("IIRC") (the only compact California addresses) allows States to withdraw simply by repealing the enacting statute. Opp. 19 (citing IIRC, art. XII(A)(1)). And, like the Multistate Tax Compact, the IIRC allows States to choose whether to enact rules promulgated by its commission. See IIRC, art. VII(4).

The other compacts cited in the petition hew even more closely to the Multistate Tax Compact. All become effective upon enactment by a minimum number of States, and virtually all allow a State to withdraw only by expressly repealing the enacting statute. Several use the same language as this Compact. See, *e.g.*, Interstate Mining Compact, art. VIII; Nurse Licensure Compact, art. X(a); Boating Offense Compact, art. IV(2). Likewise, many of these compacts set out the obligations of compacting States without the redundancy of referring to those obligations as "binding." See, *e.g.*, NASDTEC Interstate Agreement § IV; Interstate Compact on Licenses of Participants in Horse Racing, art. V.

In short, the holding of the court below would imperil these similar compacts, leaving unclear whether States are bound by compacts they already have joined or should join additional compacts that are or will become open for membership. See Litwak Br. 14-15. That would make it impossible for States to use such compacts to advance shared programs and goals.

2. Finally, California's observation that taxpayer arguments similar to those in this case have not "met with success" in the courts of other States does not make review unnecessary. Opp. 16-19. In fact, the course of such litigation reveals considerable uncertainty about the governing standards.

The Michigan Supreme Court, for example, initially ruled for the *taxpayers* as a matter of state law, finding it unnecessary to decide "whether the Compact is binding and, thus, whether the Legislature even could repeal [it] by implication." *IBM* v. *Dep't of Treasury*, 852 N.W2d 865, 877 n.67 (Mich. 2014). After the Michigan Legislature then purported to repeal the Compact's election provision retroactively and the Michigan Court of Appeals upheld that legislation in

reliance on *Northeast Bancorp* (see Opp. 18), two Justices of the Michigan Supreme Court dissented from denial of review, noting that the "issues raised here are * * * of considerable constitutional significance as to matters affecting tax policy and procedures, the fiscal and business environments, and the jurisprudence of this state." *Gillette Commercial Operations. N. Am. & Subs.* v. *Dep't of Treasury*, 880 N.W.2d 230 (mem.) (Mich. 2016).

The Minnesota Supreme Court, meanwhile, recently held that the Compact is not binding, but entirely disregarded *Northeast Bancorp*, instead taking the view that contracts limiting state taxing authority are per se invalid and invoking the unmistakability doctrine. *Kimberly-Clark Corp.* v. *Comm'r of Revenue*, 880 N.W.2d 844, 849-852 (Minn. 2016). The decision below, in contrast—which itself overruled a unanimous contrary decision of the California Court of Appeal—made no mention of that doctrine, resting instead on *Northeast Bancorp*.[5]

It thus appears that the only constant in these state-court decisions is the determination to rule *for* the State and *against* out-of-state taxpayers. Given this Court's historic role in addressing actions that involve the interests of numerous States and that disadvantage out-of-state entities, and in light of the errors committed by the court below, further review is appropriate.

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[5] We understand that the Michigan and Minnesota taxpayers will seek review in this Court.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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