BEFORE THE OFFICE OF TAX APPEALS

STATE OF CALIFORNIA

IN THE MATTER OF THE APPEAL OF:	)	
	)	
JANUS CAPITAL GROUP, INC. & SUBSIDIARIES,	)	OTA NO. 20096605
	)	
Appellant.	)	CERTIFIED COPY
	)	

TRANSCRIPT OF PROCEEDINGS

Sacramento, California

Wednesday, April 19, 2023

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ANGEL LOVE
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TRANSCRIPT OF PROCEEDINGS, taken at 400 R Street, Sacramento, California, commencing at 9:10 a.m. and concluding at 12:06 p.m. on Wednesday, April 19, 2023, reported by ANGEL LOVE, CSR No. 13845, a Certified Shorthand Reporter in and for the State of California.

APPEARANCES:

Panel Lead:	HON. SARA HOSEY
Panel Members:	HON. SHERIENE RIDENOUR HON. OVSEP AKOPCHIKYAN
For the Appellant:	PAUL MELNICZAK YONI FIX
For the Respondent:	AMANDA SMITH Tax Counsel
	MARGUERITE MOSNIER Tax Counsel
	DELINDA TAMAGNI Hearing Representative

I N D E X

E X H I B I T S

(Appellant's Exhibits 1-6 were received at page 7)

(Appellant's Exhibit 8 was received at page 7)

(Respondent's Exhibits A-I were received at page 7)

(Respondent's Exhibit J was received at page 7)

PRESENTATION

Sacramento, California; Wednesday, April 19, 2023

9:10 a.m.

JUDGE HOSEY: We're now on the record in the Appeal of Janus Capital Group, Inc. and Subsidiaries. OTA Case Number 20096605. Today is April 19, 2023, and it is 9:10 a.m. We're in Sacramento, California.

I am the lead Administrative Law Judge, Sara Hosey. And with me today are Judge Sheriene Ridenour and Judge Ovsep Akopchikyan.

Can I have the parties identify themselves for the record, starting with Appellants.

MR. MELNICZAK: Good morning. Paul Melniczak, from Reed Smith. Here for the Appellant.

MR. FIX: Yoni Fix, from Reed Smith, for the Appellant.

JUDGE HOSEY: And Respondents.

MS. SMITH: Amanda Smith, for Respondent.

MS. MOSNIER: Marguerite Mosnier.

MS. TAMAGNI: Delinda Tamagni.

JUDGE RIDENOUR: Appellants, pretty much you have to have the mic so close to your mouth, otherwise we can't hear you.

MR. FIX: It's really uncomfortable.

JUDGE RIDENOUR: Yes, it is, as you can tell.

But if you'd just make sure to do that, that would be great.

JUDGE HOSEY: Thank you.

The issues on appeal today are, one, does the Office of Tax Appeals have jurisdiction to declare a regulation invalid.

Two, if the answer to Issue 1 is affirmative, has Appellant established that Regulation Section 25137-14 is invalid because it was not promulgated in 2007, in accordance with the Administrative Procedures Act or became inoperative when Section 25136 was amended by California voters in 2012, to provide that sales from services are in the state to the extent the purchaser of the service received the benefit of the service in the state.

And three, is Regulation Section 25137-14 the standard apportionment rule for assigning Appellant's service receipts.

As for exhibits, we marked Exhibits 1 through 6 for Appellant, and A through I for Respondent, the Franchise Tax Board, at the prehearing conference. Exhibits 1 through 6 and A through I were presented and discussed.

Appellants, do we have any objections to the exhibits?

MR. FIX: No.

JUDGE HOSEY: Respondent, any objections to the exhibits?

MS. SMITH: No.

JUDGE HOSEY: Having no objections, Exhibits A through I, and 1 through 6, are now admitted as evidence into the record.

(Appellant's Exhibits 1-6 admitted.)

(Respondent's Exhibits A-I admitted.)

JUDGE HOSEY: We have new exhibits today. We have Exhibit 8, from the Appellants, which were redacted in the post conference orders submitted last week.

Do we have any objections from the Franchise Tax Board?

MS. SMITH: No.

JUDGE HOSEY: Thank you. Exhibit 8 is now admitted into the record.

(Appellant's Exhibit 8 admitted.)

JUDGE HOSEY: We also have Exhibit J, from the Franchise Tax Board.

Do we have any objections from Appellant?

MR. FIX: No.

JUDGE HOSEY: Thank you. Exhibit J is now admitted as evidence into the record.

(Respondent's Exhibit J admitted.)

JUDGE HOSEY: All right. This is the open session portion of our hearing today. We'll go ahead and start with arguments from Appellants on Issue 1.

Are we ready to begin presentation?

MR. FIX: Yes.

JUDGE HOSEY: Okay. You have 90 minutes, I believe. So go ahead when you're ready.

MR. FIX: Thank you.

Good morning, Honorable Judges.

Can you hear me okay?

JUDGE HOSEY: Yes.

MR. FIX: Okay. Great.

So as part of the argument today, we'll discuss really three different parts of this case. The first part, which I will address, deals with OTA's jurisdiction to invalidate certain regulations.

Part two will be whether the FTB's special apportionment Regulation 25137-14 is invalid for a couple of independent reasons that my colleague, Mr. Melniczak, will address.

And then finally, part three will be finally how to properly source Appellant's service receipts from providing investment services to its clients under California Revenue Tax Code 25136.

To start, I think it makes sense to kind of

begin at the beginning of the OTA, and kind of give some historical background before getting kind of to the crux of the case, with respect to jurisdiction.

So, as you know, the OTA's powers are derived from its enabling legislation, Assembly Bill Number 102 and 131, which transferred to the OTA the various duties, powers, responsibilities of the State Board of Equalization, necessary or appropriate to conduct appeal hearings.

So not surprisingly in the OTA regulations, on the books, in Section 30104, that defines the OTA jurisdiction, it's similar to the prior section that governed the Board of Equalization's jurisdiction, which was Regulation Section 5412. And that regulation, before its repeal, had defined the jurisdiction of the BOE.

It's important to understand the chronological history of the BOE's regulatory language and subsequent case law, as well as administrative decisions by the BOE, to understand what is the OTA's jurisdiction today.

Importantly, the regulation that governed the BOE's powers, which were transferred to the OTA, discussed that -- whatever limitations applied. And those limitations were that the OTA -- is that the BOE -- sorry -- was limited by essentially Article 3, Section 3.5, of the California Constitution, that

essentially said that an administrative agency or board cannot invalidate a statute on the basis that it is unconstitutional under the California or federal constitution.

Other than that, the BOE and, today, the OTA, by succeeding to those powers, has the authority to invalidate, we believe, regulations. And there's also obviously the argument that the OTA could invalidate anything that is not on the basis of constitutionality, but I think this case today is much simpler because we're not going to be asking you to invalidate a statute today.

Instead, we're going to be focusing on a regulation, and I will explain why what we're asking today, and the OTA's jurisdiction to rule in this case today, is within the BOE's jurisdiction, as well as within the OTA's precedential decisions on point.

So let me start with some of the arguments that might come up today by the FTB, which involve who has jurisdiction to invalidate a regulation. And I expect, based on their briefs, they will say that the sole jurisdiction to invalidate regulations is vested in the OAL by the courts, and they'll cite to Government Code 11350, and I will explain why that code section doesn't stem from that.

In fact, that's an issue that has been looked at

by the courts and specifically address the fact that Government Code 11350 doesn't stand for the proposition that only the OAL and only the courts can invalidate regulations. Rather, it stands for the fact that the legislator intended to provide taxpayers with an opportunity to ask for declaratory relief by the courts to rule that a certain regulation is invalid.

The intention behind that was never to take away other remedies that are available by law to taxpayers.

Specifically, if you look to -- there's a California appeals case that deals specifically with this issue with -- with Government Code 11350, which specifically said that -- and I'll -- the name of the case is Stoneham V. Rushen.

It's a Court of Appeals case from the -- 1984, that specifically said the purpose of Government Code 11350, which provides for independent declaratory relief to challenge validity of regulations, so only talking about declaratory relief action is available, but was not with intention to limit available remedies available by law, such as providing -- taking that action in controversy.

Instead, it was an alternative option for taxpayers who did not want to enter into conflicting actions in court, meaning being assessed or in refund,

but rather wanted to get declaratory relief directly from the Court, instead of going to the OAL or filing a refund or protest.

That same holding was held in -- by the California Supreme Court, in Chas L. Harney, Inc. V. Contractors State License Board, in 1952, which said that, by the enactment of the section, the legislator must have intended to permit persons affected by such a regulation to test its validity without having to enter into contracts with third persons in violation of the terms or subject themselves to prosecution or disciplinary proceedings.

So again, both the California Supreme Court and the Court of Appeal in California said, Government Code 11350 was not put on the books by the legislator to limit or to give the OAL sole jurisdiction or to the Court sole jurisdiction. Rather, it's pretty clear from the text of that section that it's only with respect to judicial declaration as to validity of regulation.

We're talking about declaratory relief. You still have the ability to bring other actions in court to invalidate a regulation such as in a conflicting action controversy, such as the case today.

JUDGE RIDENOUR: May I interrupt, please? Can you slow down just a little bit, please.

MR. FIX: Of course.

JUDGE RIDENOUR: Thank you so much.

MR. FIX: No problem.

So that takes care of Section 11350, which the FTB relies on to -- for this improper allocation of sole jurisdiction to the OAL to the courts. That's not the case.

Secondly, as was interpreted by the Board of Equalization in its regulations, the California Constitution Article 3, Section 3.5, specifically says that the statute -- that agencies cannot invalidate -- cannot refuse to enforce a statute or refuse to enforce a statute on the basis of it being unconstitutional. That's all it says. It doesn't say anything else, and the plain meaning of the statute is to enforce or declare a statute on the basis of unconstitutionality.

So if a taxpayer brings any other action to invalidate a statute, they could do that.

Thankfully, this case is much simpler than that because this case does not involve a statute. It involves a regulation. And the important part here and consistent with the OTA's own precedent, which is the Talavera case, the precedential case in which the OTA said that the OTA did not have jurisdiction to declare a quasi-legislative regulation invalid because it had the

force and effect of the statute.

So I'll stop there, and I'll point to -- on the easel, which hopefully provides for a clear representation of two types of regulations that -- categories that the California Supreme Court has identified. One are quasi-legislative regulations, and the other one are interpretive regulations.

The distinction between the two is that, if you have a quasi-legislative regulation, it has the force and effect and dignity of a statute.

So if you fall into the bucket of having a quasi-legislative regulation, then you obviously have to look to Article 3, Section 3.5, of the California Constitution and see whether or not the taxpayer is bringing an action to invalidate that specific legislative regulation on constitutional grounds.

But if you are in the interpretative regulation bucket, it's not treated as a statute. Instead, it is simply treated as is a regulation that would -- with lesser deference. Obviously there's some deference to it, but the level -- the standard of review is much lower than it would be if it was quasi-legislation.

And the important piece here is: What's a distinction between the two? How do you figure out which is -- which regulation you have at issue?

And the Talavera case cites kind of the main case on point, which is the Yamaha case, which was then preceded by the Western States case. And in those cases, they summarize California precedent on point, where they say the distinction between the two is that -- in both cases you have delegation of power to -- to the administrative agency to pass the rules and regulations.

The difference is one is a delegation of power which is to "fill in the gaps." That's important language. All of these cases talk about fill in the gaps. Fill in the details that the statute doesn't otherwise have. What that means is, and the courts have talked about this is, fill in the gaps so that it would be possible to enforce some legal standard under the statute.

Meaning, without the regulation filling in the gap, it would be difficult for citizens, taxpayers, to understand what the standard -- what is an enforceable standard? Without the existence of that quasi-legislative regulation, there would be no enforceable standard to apply.

On the other hand, if you have a delegation of power to pass rules and regulations to an administrative agency, but is not to fill in the gap, but rather it is to interpret the meaning and effect of an existing

statute, that has an enforceable statute, an existing enforceable legal standard.

So that the distinction is: One statute does not have a legal enforceable standard on its own. There is some gaps in there that need to be filled.

And the other one is: There is a legal enforceable standard, and the interpretative power that's being delegated is simply telling the agency, you have expertise in this, please interpret how to apply the enforceable legal standard at issue to the facts of the citizen or taxpayer in that case.

Now, the important part here is what are we dealing with? Talavera, which is your precedential decision on point, as well as cases that followed, all talk about this distinction of: If you have a quasi-legislative regulation as the dignity of law and the OTA does not have the power to invalidate a statute, a quasi-regulation.

Nowhere in the decisions, and correctly they don't, say that the OTA does not have the power to invalidate an interpretative regulation.

So the question that's important here, which is the crux of this Issue 1, is: What do we have at issue in this case? Do we have a quasi-legislation regulation, or do we have an interpretative one?

And I think it's pretty easy to see what it is, by applying that standard on the presentation there to our case.

The difference is that, in our case and Appellant's case, there is an existing enforceable standard. California Revenue Tax Code 25136 provides for the standard, which is you source service receipts to the location that the purchaser received the benefit.

To take that a step further, that specific California Revenue Tax Code 25136 says that the FTB shall pass rules and regulations to enforce this statute. They have. Regulation 25136-2 elaborates further on that.

So when you look at that, you have an enforceable legal standard. The legal standard is you source service receipts to the location the purchaser received the benefit. There is no question here. Whatever question that they were around, what that standard is, 25136-2 addressed that.

So when the FTB passes 25137-14, you have to ask two questions:

One, is there a delegation of power anywhere in the statute?

And, two, is this a delegation to fill in gaps because there is no existing enforceable standard, or is it simply to interpret it?

And the statute -- the statutory delegation of power in this case that the FTB will point to, and I agree with, is the general delegation of power, which is in California Revenue Tax Code 19503. That simply says -- it's the general kind of broad language.

It says that FTB shall prescribe rules and regulation to enforce parts X, Y, and Z, including Chapter 11, which includes the apportionment at issue, Section 25136 and Section 25137, Cal Revenue Tax Code 25137, that addresses alternative apportionment.

So we have a delegation of power. That is not something that tells us whether it's a quasi or interpretative regulation yet.

The next question is, what does Dash 14 say? Dash 14 says, you will source your receipts to the location of the shareholders. Okay. If you take that enforceable legal standard away, do you have a legal enforceable standard in place?

If the answer is no, then you have quasi-legislative. If the answer is yes, you take Dash 14 off the books and you have an enforceable legal standard, that means that it is an interpretative regulation power being delegated to the FTB.

And that answer is it's the latter, because when you take away Dash 14, the enforceable legal standard is

in California Revenue Tax Code 25136, and the dash 2 regulation.

So what does that mean?

That means that we have not a quasi-legislative regulation that has the dignity of law. Instead, what we have is an interpretative regulation that is not a statute in the OTA under the fact that it succeeded to the powers of the BOE, and is only limited by California constitution. Article 3, Section 3.5 has the authority to review and invalidate an interpretative regulation. Okay.

Importantly, this decision, free to rule this way, is not asking you to change your precedent. This is consistent with Talavera, and the nonprecedential decisions that have applied to Talavera. It's simply saying, if it is not quasi-legislative, then it is not a statute, which therefore the OTA has jurisdiction to rule on and to decide whether it's invalid.

And parts two and three of today, the discussion will go around whether or not it is invalid or not and the important part here is that the delegation of power to pass regulation in the general section of California Revenue Tax Code 19503 cannot be relied on, and there is no precedent on point that will say that when there is a general grant of authority to pass rules and regs to an

administrative agency, to enforce its mandate, that that means that every regulation that they pass is quasi-legislative.

That would be a ridiculous outcome and, frankly, has been addressed by the California Supreme Court in Western States where it said that would make the distinction between interpretative and quasi-legislative regulation, one, without a difference, which makes no sense.

In fact, it has to be a situation where you have a delegation of power to fill in gaps where there is no enforceable legal standard, which is not the case here.

I would like to address also, obviously, the BOE. I think everyone in the room is aware of the BOE's use of its power to invalidate regulations when they're interpreting the -- the ability for the BOE, when it was still reviewing appeals to invalidate regulations.

And one of those decision is Save Mart. And the FTB will tell you that that is not good law because the BOE did not look to whether or not it had jurisdiction to invalidate a regulation. And I think that's a little misleading.

If you read the Save Mart case, Save Mart case, the FTB specifically brought up Yamaha, the California Supreme Court that discusses a distinction between

interpretative and quasi-legislative regulations, and brought that and briefed it to the BOE, but also admitted, conceded, that the regulation at issue was interpretative.

In that case, the BOE found that the regulation went beyond the statute and invalidated it.

So, to me, Save Mart is still good law and actually is consistent with Talavera. Talavera involved a quasi-legislative delegation of power, a quasi-legislative regulation where there was -- there was a gap in the statute as to the bad debt deduction and how and when and to what amount you need to be able to deduct that, and specifically in the statute it asked for that FTB to fill that in, that gap -- and they did in the quasi-legislative regulation and to the contrary, if you look at Save Mart, you have an interpretative regulation.

When that is the case the BOE, and now the OTA, has jurisdiction to invalidate it because it's not a statute under law.

And I think with that, I would like to just make sure that I reserve whatever time is left for rebuttal of this part one. Thank you.

JUDGE HOSEY: Thank you, Mr. Fix. You have about 20 minutes remaining, so we'll hold on to that temporarily. Thank you.

Moving to the Franchise Tax Board. Are you ready for your presentation on Issue 1?

MS. SMITH: Yes, we are. I want to say good morning. I'm -- again, I'm Amanda Smith. I'm the tax counsel three with the Franchise Tax Board. And with me today are Ms. Marguerite Mosnier, an attorney five, and Delinda Tamagni, ACC of the Multi State Tax Bureau, with the Franchise Tax Board.

And at heart, this is really a straightforward case where we are applying settled law to undisputed facts. The Appellant in this case is a mutual fund service provider required to apportion its income to determine its California tax liability.

California law is clear that Regulation 25137-14, which I will sometimes refer to as Dash 14, is standard apportionment for mutual funds service providers like Appellant to a portion their income.

That's actually how Appellant filed its -- its taxes for the years at issue in this case. However, later it did file a claim for refund, stating that Dash 14 is no -- or, is not, excuse me, standard apportionment. But as we go through our presentation today, we will demonstrate that Dash 14 continues to be standard apportionment and must be applied to apportion the Appellant's income.

The first issue we're going to address is jurisdiction because Appellant argues that the OTA has a jurisdiction to -- or, that it should invalidate Regulation 25137-14 entirely. And it's Respondent's position that the OTA will act as such jurisdiction.

To go into this matter further, I am going to hand over the microphone to my colleague, Ms. Mosnier.

MS. MOSNIER: Thank you, and good morning.

Before I start, I would like to thank first Mr. Melniczak and his team for their willingness to work so quickly with Franchise Tax Board after the prehearing conference minutes and orders were issued to work with us to get a joint updated statement of the issues and single suit.

And I thank you, Judge Hosey, for your quick consideration and issuance of that post confirmation order. It really, I think, helped both parties probably prepare for the hearing today.

So turning to Issue Number 1.

The Office of Tax Appeals does not have jurisdiction to invalidate a regulation. The law is clear that only a court has that power. The OTA is a tribunal with limited jurisdiction, and as it noted in its 2019 precedential opinion, the Appeal of Liljestrand Irrevocable Trust.

The OTA's jurisdiction is limited by statute, and it cited approvingly to the Board of Equalizations' 1995 decision in Appeal of Schillace that held that an agency cannot act in excess of the jurisdictional limitations conferred upon it.

In general, the OTA's rules for tax appeals conferred jurisdiction over appeals from proposed assessments, claim denials, interest and penalty abatement questions and spouse determinations, taxpayer bill of rights, reimbursement claims and the like.

There is nothing in Regulation Section 30103 that states that the -- or hints even, that the OTA has the power to invalidate a regulation. And that's correct because the legislature designated the state court as the sole forum to determine the validity of a regulation.

It did so when it enacted the Administrative Procedures Act, which governs the adoption, amendment, repeal, and is relevant to this appeal, challenges to an existing regulation. And it's found -- the APA is found in Chapter 3.5 of the Government Code, Sections 11340 through 11361.

The legislature designated a single state agency, the Office of Administrative Law, or OAL, to oversee state agency and departments compliance with the Administrative Procedures Act when it promulgated

regulations.

And in addition to setting out the statutory requirements for adoption, amendment, and appeal of regulations, the APA also sets out the statutory remedy to challenge the validity of a regulation.

And as Appellant noted, it's found in Government Code Section 11350, and it states:

> "Any interested person may obtain a judicial declaration as to the validity of any regulation or order of repeal by bringing an action for declaratory relief in the Superior Court in accordance with the Code of Civil Procedure."

And that is the only remedy the APA sets out to challenge the validity of a regulation. And that section cannot be read to include other state agencies.

First, the phrase, "action for declaratory relief in Superior Court," is unambiguous.

Second, the legislature knew how to provide review and determination authority to a state agency because it did so in Article 6 of the APA, which addresses the review of a proposed regulation. Those are Sections 11349 through 11349.6. And the legislature did so in Article 7, review of existing regulations, conferred power to the office administrative -- of

administrative law, to take action when it believed that a regulation does not meet the requirements of Section 11349.1. And it empowered the OAL to act when it is notified that statutory authority for an existing regulation has been repealed or when a regulation becomes ineffective or inoperative by its own terms.

The OT -- the OAL has power to act under those circumstances to require the promulgating agency to show cause why the regulation in question should not be repealed.

But it's important to the note that even this grant of authority to the Office of Administrative Law does not invest sole decision-making power in the OAL, which must notify both the legislature and the governors, so both the legislative and executive branches of the state government, of its proposed decision and vests the governor with the power to override OAL's determinations.

In fact, 11349.9 vests the governor's office with the right to review adverse OAL determinations repealing a regulation.

So we see here the legislature's intent not to allow even the one state agency it has authorized to ensure compliance with the Administrative Procedures Act to make a unilateral, unappealable, determination as to the validity of the regulation. But that is precisely

with the Appellant here today is asking the OTA to do.

Further, the OTA recognizes the limits of its authority in this area and that it does not have the power to invalidate a regulation.

And before I go further in this, I would say that I would emphasize that, as the OTA said in the Liljestrand Appeal opinion, its jurisdiction is limited by its enabling legislation. So that is to say, in other words, that it is not established by whatever authority its predecessor, the Board of Equalization, had.

That entity had jurisdiction that was limited by its enabling legislation, which was the California constitution. This agency, the OTA, is limited by a different set of authorities.

So the OTA understands the limits of its power to act in this area. It did so, as you have heard, in Appeal of Talavera in 2020. The OTA correctly concluded that the sales and use tax regulation at issue was a quasi-legislative regulation and had the force and effect of a statute and, therefore, it could not be invalidated by the OTA because of Government Code Section 11350, Subdivision (b), which limits the right to invalidate a regulation to the courts, and it is clear from Government Code Section 15672 that the OTA is not a court.

Additionally, since issuing the Talavera

opinion, the OTA has issued franchise and income tax opinions that reached the same conclusion. It has no authority to invalidate a franchise and income tax regulation.

In its opinion in Appeal of Hajikhani and Shepard, a 2021 opinion, the issue was the interpretation of Regulation Section 19 -- excuse me, 19133, regarding imposition of the demand penalty. In that case, the OTA found the regulation was quasi-legislative under a Yamaha corporation analysis, because FTB has a legislative grant of authority to promulgate regulations for Revenue and Taxation Code Section 19503, and that the regulation, therefore, has the force and effect of a statute, and the majority sustained FTB's interpretation of that regulation.

The dissent in that opinion had argued a specific case, I think it was the Cook case, as evidence that the regulation should be disregarded. And the majority countered that argument by noting that the case in question had to do with the determination of the validity of a regulation. And OTA noted that that was not the issue in the case.

It was not regarding the validity of a regulation. It was regarding the interpretation of a regulation. And that, perhaps, is an outcome

determinative distinction, and I'll address it a little more in detail later on.

After the Hajikhani opinion, the OTA, in 2022, issued the opinion in Appeal of Faries and in the OTA's consideration whether a statute Revenue Tax Code Section 17952, or a personal income tax regulation, Section 17951-4, controlled determination of California source income.

The OTA noted again that that regulation was quasi-legislative because it was promulgated under the authority both in Revenue and Taxation Code Section 17954, and Section 19503, and, therefore, the OTA agreed with the parties' assertion that the OTA did not have authority to invalidate that regulation, citing both to Government Code Section 11350 and to the Talavera opinion. It's on Page 11 of that opinion.

And next came the opinion in Bed Bath and Beyond. Also issued in 2022. That was an appeal from a denial. FTB's denial of a refund claim based on the addition of gross receipts from treasury functions and vendor allowances to the sales factor denominator.

OTA found that per Sections 19503, and 25137, the very statute related to regulation at issue here today, the OTA found under 25137, FTB had promulgated special apportionment regulations to address situations

where application of the Uniform Division of Income for Tax Purposes Act, or the acronym UDITPA, would not fairly reflect the extent of a taxpayers business activity in a state.

OTA rejected the Appellant's argument that the regulation, in that case it was Regulation 25137, Subdivision (c)(1)(D), contradicted case law, the Microsoft decision, regarding treasury receipts in the sales factor, and it rejected, also, the Appellant's concerns regarding the validity of the regulation, and it did so by explaining that the OTA lacked authority to invalidate FTB's regulations with cites, again, to Government Code Section 11350 and to Talavera.

And to lay this issue to rest, the OTA has proposed two amendments to its current Regulation Section 30104.

First proposal is to add subdivision (D) to state outright that it lacks jurisdiction to determine the validity of a regulation. And secondly, to add subdivision (I) to state that the Office of Tax Appeals may not issue declaratory relief, which is what a determination of validity or invalidity of a regulation is.

Further, Appellant's reliance on the Board of Equalizations Save Mart decision, its 2002 opinion, and

on Whitcomb Hotel versus California Employment Commission, to confer authority on OTA to invalidate a regulation, are misplaced.

The Whitcomb Hotel decision addressed an administrative rule, not a regulation, promulgated in conformity with the APA, and in any event, in that decision, there was no issue and no resolution of an issue whether the -- whether the employment commission had authority to invalidate a regulation. It just didn't address the power of a state agency to invalidate a regulation.

Save Mart, likewise, is no help to the Appellant. It too did not consider or rule on the agency's or, in that case, the board's authority to invalidate a regulation.

I don't know -- Appellant's counsel referred to what was in briefing. That is not, as I've been able to determine, a public record, so I note not only that the opinion does not raise the issue of the power of the Board of Equalization to invalidate a regulation, there is no discussion of that issue, and there is no determination of that issue.

That opinion, like the Hajikhani opinion by the OTA, addressed simply the interpretation of a regulation. And that is where probably Yamaha is the most -- is the

most important. But even Yamaha, while providing guidance on factors to consider when determining -- determining whether a regulation is interpretive or quasi-legislative for purposes of determining the scope of deference to the agency's interpretation.

Even Yamaha does not address an agency's power to invalidate a regulation because the issue in that case was the interpretation, not the validity. Not even of a regulation. In that case what was at issue were what were referred to as "annotations." They were business tax law guide -- guidelines that were opinions on summary opinions.

So we see that the legislature has a specific statutory scheme to challenge a regulation's validity, and we see that the OTA has recognized that it cannot act on that issue. And therefore, the OTA should, consistent with Government Code Section 11350, consistent with its opinions in Talavera, Hajikhani, Faries and Bed Bath and Beyond, and consistent with the proposed regulatory amendments to Regulation Section 30104.

It should hold that it lacks jurisdiction in this appeal to determine the validity of a regulation, including Regulation Section 25137-14.

However, in the event that the OTA determines that it does have that authority, Ms. Smith will now

address the specific challenges the Appellants have raised -- oh, I suppose, she will turn to that, but I believe we will be going back first to the Appellant for argument on that issue, and then she will take over from there.

That concludes my presentation, and I didn't know if you -- I'm happy to address questions now or whether you're reserving questions for later. Thank you.

JUDGE HOSEY: Thank you, Ms. Mosnier. I think we're going to go back -- before we have questions from the panel to see if Appellants would like to respond.

Okay. Go ahead, Mr. Fix.

MR. FIX: Thank you. I thought the FTB made -- Respondent made a really good presentation, making my argument for me frankly. And I'll address her -- her arguments in order.

Starting with 11350. The FTB's taking too far its interpretation of Government Code 11350. With all due respect to Respondent, FTB, the courts have already looked at what the legislator's intent was with respect to Government Code 11350. That was addressed, as I mentioned, during my opening statements in two cases in California; one, the Court of Appeal decision and the other one by the California Supreme Court, the Stoneham V. Rushen, case from 1984 -- Stoneham is S-T-O-N-E-H-A-M,

V. Rushen, R-U-S-H-E-N -- in which it specifically said that the purpose of Government Code 11350 was to provide for independent declaratory relief. Respondent even read that -- those exact words off the statute.

They specifically say, this is to provide declaratory relief. Nowhere does it say that the OAL has sole authority. Nowhere does it say that that is the sole remedy available to taxpayers. And in the Stoneham decision, it specifically said that, yes, this code provides for declaratory relief action that you can bring in court without having to go through the OAL's path to declaratory relief.

That regulation should be invalidated because the legislature wanted to provide and not limit available remedies to challenging a regulation by -- without having to bring a case of controversy where there's conflicting actions.

That was also addressed by the California Supreme Court in the Chas L. Harney Inc., V. Contractors' State License Board case, 1952 case, where they specifically said, by enacting this section, the legislature must have intended to permit persons affected by such a regulation to test its validity without having to enter into contracts with third persons or subject themselves to prosecution or disciplinary proceedings.

Between those two cases, the California courts have said, it's clear that this is simply providing for a declaratory relief path. This does not mean that you are -- that precluded from bringing other legal remedies, such as legal actions for damages, which are available under the law.

And there is case law that you are allowed to bring actions to administrative boards to invalidate regulations. Those cases both at the California court level and at the BOE. And frankly, it's consistent with Talavera.

Second, I'd like to address the second point about the Talavera case and the Hajikhani case. And maybe -- I'll address it in order.

Talavera is the only precedential case on point, and I mention that not because I think the Hajikhani case is -- goes against the correct interpretation. I think it actually supports our case.

Talavera specifically says, which is the only precedential case here by the OTA, it says if you have a quasi-legislative regulation, it has the dignity of statutes. Okay. And the OTA does not have authority to invalidate a statute.

If it's an interpretative regulation, you do have that; right? That authority to review and

invalidate a regulation.

Now, as I mentioned in the Talavera case, the standard applies. You have delegation of power to fill in gaps in the statute. The -- that was done by the CDTFA and, therefore, was found to be within the scope of the statute and a quasi-regulation. Therefore, it could not be invalidated.

But beyond that, it's important to note that the OTA in its decision said, notwithstanding the fact that we can not invalidate a regulation, we, the OTA, are authorized under the Government Code to determine and interpret the application of state and local taxes.

And they went further and said, even though it's quasi-legislative, looking at it we think it's within the scope of the statute and consistent, and therefore not invalid.

So even in quasi-legislative cases, the OTA can still look and determine whether or not a regulation is invalid. It just can't invalidate it if it's quasi-legislative, but thankfully in our case, that's not the case. It's an interpretative regulation.

Now the Hajikhani case, I'm glad that the FTB raised that case because it's just another example where the -- it's consistent with the standard that we articulated, which is quasi-legislative versus an

interpretative. Okay.

So the Hajikhani case, similar to Talavera, involved -- specifically it was the demand penalty. So by statute, and the FTB -- the statute said the FTB may, and I'm paraphrasing, may apply a penalty for -- for demand -- to the taxpayer, doesn't respond to demands for information like returns, but didn't provide for an enforceable standard --

JUDGE RIDENOUR: Excuse me really quick. The stenographer gave me a look. Can you please slow down?

MR. FIX: Okay. The important part is that if you apply -- Hajikhani is within -- under the standard articulated in Yamaha, which was then repeated in Talavera, the statute and the regulation at issue was a quasi-legislative. Why is that?

Because when you look to the statute, it did not have an enforceable standard. It was unclear what it meant where a taxpayer did not comply with an information request and when the FTB may apply a demand penalty.

So without a regulation in place, there's a gap and there is no enforceable standard. Therefore, the regulation and the delegation of power, in that situation, is a delegation of quasi-legislative power. Okay.

So consistent with that, Hajikhani, even though

not precedential is consistent with Talavera, which is that OTA does not have jurisdiction to invalidate a quasi-legislative jurisdiction.

Next point was the -- the proposed amendments.

Frankly, the proposed amendments, one, have not been adopted and, two, I think is improper to even mention given the fact that by -- under the Government Code there is a potential here for prejudice, given the fact that the -- the passing of regulation is within the purview of the director, and the director of the OTA, by statute, is not allowed to interfere with the decision-making of the OTA.

And so I don't think that that -- those initiatives by the director to pass regulation should impact the decision as to whether the current regulation on the books, which says that the OTA has the jurisdiction to -- the only thing that it says is that you cannot invalidate a regulation or statute based on the constitutional grounds.

Our case does not involve constitutional grounds. And two, it's consistent with Yamaha and Talavera, in the fact that it doesn't involve a quasi-legislative regulation.

And I think -- finally, I think the Faries case that she mentioned, the parties conceded that it was --

that the OTA didn't have jurisdiction, since you were conceding it was quasi-legislative. So it wasn't even an issue. So to me that case is just consistent with Talavera and other cases like Hajikhani, who simply are applying the Talavera threshold.

So with that, I'll conclude and see if you have any questions.

JUDGE HOSEY: Thank you, Mr. Fix.

I will go ahead and move to my panel to see if we have any questions on Issue 1.

I will ask Judge Ridenour. Any questions?

JUDGE RIDENOUR: No questions at this time.

Thank you.

JUDGE HOSEY: Okay. Thank you.

Judge Akopchikyan?

JUDGE AKOPCHIKYAN: I'll wait until after Issue 2 to ask questions.

JUDGE HOSEY: Okay. Thank you.

I did want to mention that the panel is aware of the pending regulations that may apply to this case, but as discussed in the minutes and orders, we're moving forward with arguments, and we understand that's not -- have not been adopted and we're working with what we have here.

So moving to Issue 2. We are still in open

session. We have Appellants --

Mr. Melniczak, are you presenting on Issue 2?

MR. MELNICZAK: Yes.

JUDGE HOSEY: Okay. Again, when you're ready.

Thank you.

MR. MELNICZAK: Great, thank you.

JUDGE HOSEY: Oh, and you have 45 minutes.

MR. MELNICZAK: Thank you.

JUDGE HOSEY: Okay. Go ahead.

MR. MELNICZAK: I'd like to start the second part of the open session, Issue 2, by just giving a little overview of the three different ways that receipts for asset managers can be sourced, because -- across states --

JUDGE RIDENOUR: I'm going to interrupt. Sorry for all my interruptions to both parties, but I don't think the stenographer can hear you. So if you can please move the microphone closer to you, I would appreciate that.

MR. MELNICZAK: Sure. Is that a bit better?

Thank you. I'll start from the top.

I just want to start by giving an overview of how receipts for mutual funds service providers, like Janus, are sourced. There's really three different methods, three different ways in which they can be

sourced. The states across the country are split among these three different methods and these three different methods will come -- I'll refer to them often.

So just to give an overview, the first method I want to cover is the cost of performance method, where receipts are essentially sourced based on the location where the activities are performed. That's the method that California had in its statute prior to enduring the first portion of when 25137-14 was promulgated.

That's the cost performance method.

The second method is the shareholder sourcing method, and that's the method that the FTB promulgated under the Dash 14 regulations.

And finally, the third different approach to source and receipts is market sourcing. That's what California, by voter initiative, switched to in 2013, when they changed Statute 25136, and said that receipts are sourced to the location where the purchaser receives the benefit of the service.

So that's market sourcing, the third approach.

Now, like I mentioned, Dash 14 was promulgated under the prior version of Statute 25136, which was sourcing our receipts, mutual fund and otherwise, based on the cost of performance method. And again, taxpayers there had to look to where the -- where the services were

actually performed.

Also at that time, prior to 2013, the statute had a property and a payroll factor. So it was three-factor apportionment.

Now, while the cost performance rule wasn't in effect back in 2007, the FTBA had promulgated the Dash 14 regulation because they believed that cost of performance method did not fairly represent the -- the extent of activities in the state for mutual funds service provider. They felt it was distortive.

Now, the FTB didn't dispute the fact that Dash 14 conflicted with the statute. In fact, they acknowledge it did conflict with the statute, and they said the only way to -- it was clear that the only way that Dash 14 read it could be promulgated was under the FTB's authority under Section 25137.

Now, if the FTB wants to promulgate a reg under 25137, it needs to do two things.

One, as the language in the statute for 25137 indicates, the party invoking 25137 must show that the allocation and apportionment provisions in the statute don't fairly reflect the taxpayer's business activity.

And secondly, the FTB must comply with the requirements of the Administrative Procedures Act, or the APA.

So I want to talk about the APA first.

Now, as you saw in our briefs and our prehearing statement, we've argued that Dash 14 was invalid, both when it was initially promulgated, back in 2007, and during the switch to market sourcing in 2013.

Now, the reason it was invalid back when it was initially promulgated, in '07, is because the FTB didn't comply with the requirements of the APA.

It's important to note the -- the purpose of the APA. The purpose of the APA is to have transparency and to encourage meaningful public communication in the adoption of regulations.

The APA was also meant to address the legislature's concern that complying with too many regulations was becoming burdensome for taxpayers. And now as we've argued in our brief, the FTB failed one of the most important aspects of the APA, which is to provide an adequate economic and fiscal impact statement.

And one of the purposes of that Economic Impact Statement is to notify taxpayers of the cost of complying with the regulation. This is an important step. And in the FTB's impact statement, they simply noted that the cost of complying with the regulation would be zero dollars.

Not one single dollar of cost, they estimated,

it would cost for taxpayers to switch from the cost performance method, which is where the services are performed, to a shareholder sourcing method.

Under shareholder sourcing, a mutual fund service provider would have to look at each of its -- each of its customers. And a large asset manager, like Janus, may have --

JUDGE HOSEY: Okay. Can you slow down a little bit?

MR. MELNICZAK: My apologies.

JUDGE HOSEY: Thank you so much. We really appreciate it.

MR. MELNICZAK: Now, for a large asset manager, like Janus, the cost of switching to a shareholder sourcing approach is significant because Janus, and other large asset managers, have hundreds if not thousands of -- of customers located around the country, and they would have to go to each individual customer, and not know where the customer is located, they would have to know where that customer's shareholder is located. And for each individual customer --

JUDGE HOSEY: Okay. Sorry. Can you slow down a little bit more?

MR. MELNICZAK: Yes.

JUDGE HOSEY: Okay. Thank you.

MR. MELNICZAK: So the difficulty in the compliance for -- for an asset manager like Janus is they would have to look to each of its hundreds if not thousands of customers and identify where each of their shareholders are. And to the extent any of them are located in California, they would have to determine the portion of receipts they received from their customer that should be attributed to that -- attributable to that shareholder.

That even means if -- for example, if a mutual fund service provider had a pension fund in Arkansas, which has pensioners throughout the country, they have to find where each individual pensioner is located and find out if any of them are located in California, what portion of receipts should be attributable to that.

That's a pretty burdensome process, and the FTB knew it would be a burdensome process because they received comments to that effect. They received comments from taxpayers in the community noting that this would be burdensome and perhaps a census method would be an easier way to comply with the regulation.

They received comments noting that there are certain types of asset manager receipts, which are received through financial intermediaries, sometimes called omnibus accounts, and for these the asset manager

is one additional level removed from the shareholder. So it's even more difficult to identify where the shareholder is.

Commenters also mentioned the fact that sometimes asset managers provide asset managing services on a subadvisor basis, meaning these advisory services are performed for another asset manager, and again, they're one additional level removed from the shareholder.

So it makes it really hard to track where the shareholders are. So even though the FTBA received those comments, they essentially ignored them, and in the impact statement they simply stated that the total cost of complying would be zero dollars. And it just doesn't show adequate respect for the process to say that, after all those comments and all those burdens, the cost of complying would be zero dollars.

A second problem with the impact statement is the fact that the FTB reported the tax effect on taxpayers in net terms, rather than gross terms.

Now, the purpose of this portion of the impact statement, under the APA rules, is to show the potential of an adverse economic impact on California businesses.

So it is the FTB's responsibility to articulate the economic effect on all mutual fund service providers

who would be subject to an increase of tax under the Dash 14 regulation, but the FTB simply reported the tax effect on a net basis, which ended up being relatively small. If you look at the -- if you look at the impact statement, that the net effect was only $10 million, but the problem with that is it disguised the fact that there were very big winners and losers under the regulation.

To be clear, there was one cohort of taxpayers who would pay a lot more tax under the regulation, and there's another cohort of taxpayers who would pay --

(Reporter clarification)

MR. MELNICZAK: A cohort, a group of tax -- there would be one group of taxpayers.

(Reporter clarification)

MR. MELNICZAK: I'm sorry. C-O-H-O-R-T.

My apologies.

As a result of the regulation, there would be two different groups of taxpayers. There would be one group of taxpayers who would pay more tax as a result of the regulatory change, and there would be another group of taxpayers who would pay less tax.

So the fact that the tax effect was only referred on net terms disguises this change. For example, the group of taxpayers who would be paying more tax could perhaps be paying $100 million per year in

additional tax, whereas the other group of taxpayers who are paying less tax, they could end up seeing a $90 million tax reduction.

So it's easy to look at that and compare the $100 million with the $90 million, and say well, the net effect is only $10 million. It looks relatively small. But again, the purpose is to show the adverse -- potential adverse economic impact on certain taxpayers, and by merely reporting it on net -- on a net basis, it disguised the effect of that big tax increase for -- for the group of taxpayers who would be paying, in my example, $100 million of additional tax.

And the FTB had to put those -- those taxpayers who were paying more tax, the FTB had a duty to put them on notice that they would be seeing a large increase so that they would have an opportunity to respond to the comment period. And the FTB simply didn't do that in its impact statement.

And the California Supreme Court has acknowledged the importance of the impact statement. There's a case called Western States, which we cited in our brief, in which the supreme court invalidated a Board of Equalization regulation because its Economic Impact Statement was opaque and unreasonable. And in that decision, the Court acknowledged that there was a heavy

burden on the agency, but that an opaque calculation just doesn't cut it. The taxpayer has to be put on notice. The taxpayers who are paying more tax must be put on notice.

So that's our first argument that, back when the statute was promulgated in 2007, the FTB didn't comply with the APA.

Our second argument is that, even if the APA -- the FTB did comply with the APA, back in 2007, the regulation is invalid now, because when the statute was changed, in 2013, to provide for market sourcing, the FTB did not make a finding of distortion relative to that new market sourcing statute.

Now, under the Microsoft case, in order to prove distortion, the burden is on the party who is seeking to invoke Section 25137. So initially promulgating a regulation, the burden there would be on the FTB to show whether there is adequate distortion sufficient to invoke its 25137 regulatory powers.

So the FTB must prove, by clear and convincing evidence, that the standard formula is not a fair approximation and that its proposed alternative is reasonable.

Now, to the FTB's credit, they did make an effort to show distortion back in 2007, as I mentioned,

under the cost performance rule. And if you look through the regulatory file, there were three reasons in particular why the FTB, and many commenters, found the cost performance rule to be distortive, and I have listed some of them on this chart right here.

I'm going to turn to the next page on our chart here because I do want to highlight the three different reasons that the FTB found the cost performance rule to be distortive.

JUDGE HOSEY: I think we're losing your mic a little bit too. Just make sure it -- yeah, when you turn your head, sometimes it doesn't catch.

MR. MELNICZAK: Thank you.

So as you can see here from the chart, we highlighted the three different ways in which the FTB had found the cost performance rule to be distortive.

The first problem with the cost performance rule is that it resulted in most or all receipts going to one single state. That's because under the cost performance rule, you simply look to where the services are performed, and for many asset managers, most or all of that activity occurs in a single state.

So for many commenters in the draft regulation, as you may have seen, many of them are California based and they perform most or all of their services in

California, and they said this results in all of -- all of our receipts going to one state.

Meanwhile, you have out-of-state mutual fund service providers who perform their services in other states. They would have a zero factor, whereas these California companies would have a 100 percent factor. Many commenters found this to be distortive.

The second problem with the cost performance rule is that it didn't adequately reflect market as the founders of UDITPA had intended. For example, it was noted in the reg file that the founders of UDITPA, such as William Pierce, who is frequently cited, they had viewed the purpose of the sales factor as to be given weight to the marketplace.

And in defining what the term "marketplace" means, there's frequently a particular focus given on the contribution of the customer.

And again, cost performance doesn't do this. Cost performance gives no regard to where the customer is. It merely looks to where the services are performed.

And the third problem with the cost performance rule is that it was merely duplicative of the property and payroll factors.

Again, prior to 2013, California had three-factor apportionment, and because cost performance

merely looks to where the services are performed, naturally, of course, that coincides with where taxpayers' offices and where their payroll are. So in many cases, cost performance would merely duplicate that.

And again, this was what -- contrary to what the sales factor was intended to do. The sales factor was intended to give balance to the other factors, not merely duplicate it.

So again, all these concerns were relevant to the general statute that was effect in 2007, which is source receipts based on cost performance, and which also had a property and a payroll factor.

And again, to the FBA's credit, they did make an effort to show distortion back in 2007.

However, none of that matters today, because in 2013, when Section 25136 was amended to provide for market sourcing, the FTB did not make a similar showing of distortion.

Another change, that happened in 2013, is California eliminated the property and payroll factors and switched to single factor sales apportionment.

So if you look at the -- the thing about distortion that we mentioned earlier under the cost performance rule, the FTB did not evaluate whether that distortion continued to exist under the new market

sourcing rules. The FTB simply included in its update of its market sourcing regs, in 2013, that the Dash 14 rules apply.

And again, the sole reason the FTB even had the authority to promulgate the Dash 14 regulation is because it found distortion under the statute. So it's clear they have to find distortion under this statute, as well.

And if the FTB were to conduct this distortion analysis under the new market sourcing statute, the same showing of distortion couldn't be made because none of these three factors that were present, back in 2007, are present under the market sourcing statute.

Again, the first problem with COP is that it resulted in all receipts going to a single state. That's not the case under market sourcing. The taxpayer here, Janus Capital Group, has taxpayers all across the country, including a significant number in California, and we'll talk about that during the closed session.

So there's not simply an issue that under the new approach all receipts will go to one state, rather under market sourcing, you look to where the purchaser receives the benefit, and again, Janus has purchasers all over the country.

Again, the second objection with cost performance is that it didn't reflect market. Well,

market sourcing does reflect market now. Again, market sourcing looks to where the purchasers are and Janus's market, which is its purchasers, are located all across the country.

And finally, the third objection, which is that the cost performance rule was duplicative of property and payroll, that's no longer a problem, because first of all, there is no longer a property and payroll factor. It's single factor.

And secondly, market sourcing is not duplicative of property and payroll because, again, it looks to where the purchasers are. It doesn't look to where the services are performed.

So essentially the entire basis on which the FTB concluded there was distortion under the old cost performance rule doesn't exist under the new market sourcing statute.

So not only could the FTB not find distortion under the new market sourcing rules, the FTB didn't even make an effort to show distortion under the new market sourcing rules. There was no analysis, during the 2013 switch to market sourcing, like there was in 2007, under the cost performance rule.

Now, when the statute changes, the FTB doesn't get to keep its old ruling. If you look at the language

of 25137, the statute, it says that the FTB may oppose an alternate method if the allocation and apportionment provisions of this act do not fairly represent a taxpayer's activity.

It doesn't refer to some prior act in the past. It refers to apportionment of this act.

So the FTB needs to do this analysis to show distortion any time a new statute is passed or if it's changed in a meaningful way that alters the prior distortion analysis.

Otherwise, if the FTB were not required to do this, a regulation would essentially be grandfathered into existence whenever it was promulgated. And that would mean that California's voters, or the legislature, could never change the law unless the FTB agreed to it.

So under the FTB's position, if Dash 14 were to survive the statutory change from cost performance to market without any further showing of distortion, that would mean that California's legislature, or the voters, could never change the law.

Now, if the FTB does have the view that market sourcing is distortive, and -- the FTB may seek to invoke its 25137 powers in the future to try to establish that the current market sourcing statute is distortive and perhaps seek an alternate method like the Dash 14 method,

but the FTB would need to actually prove distortion.

If you look at the Fluor case and the Amarr case, it's clear that the party seeking to invoke Section 25137 would have the power of showing distortion.

And here, the FTB would have the burden of showing that 25136 is distortive and that -- they would have the burden of advocating for a new method. They can't simply rely on a prior finding of distortion that's not applicable today.

Thus, the FTB hasn't shown that the market sourcing rule is distortive and hasn't met its burden under 25137. Therefore, Dash 14 is invalid.

And I'd like to reserve any remaining time for rebuttal.

JUDGE HOSEY: Okay. Thank you, Mr. Melniczak.

I'm just going to check in with our reporter.

Would you like to take a break before we -- okay.

We're going to take a 10-minute break before we come back and have the Franchise Tax Board presentation on the same Issue 2. That will be 10:35. Thank you.

(A break was taken)

JUDGE HOSEY: Thank you. We are back on the record for Janus Capital Group Inc., and Subsidiaries. We are resuming with Issue 2, moving to Respondent,

Franchise Tax Board.

Ms. Smith, are you making a presentation?

MS. SMITH: Yes.

JUDGE HOSEY: Okay. Please begin when you're ready. Thank you.

MS. SMITH: Thank you.

As my colleague stated earlier, it's Respondent's position that the OTA does not have jurisdiction to invalidate a regulation.

Nevertheless, if your office does determine it has jurisdiction to invalidate a regulation, it should not invalidate Regulation 25137-14 because Appellant failed to show that Dash 14 should be invalidated.

Appellant failed to show that the APA was not complied with during its promulgation and failed to show that it is not standard apportionment for Appellant after California's change to market-based sourcing in 2012.

We'll go through both of these arguments one-by-one. First, the APA.

Appellant hasn't met its burden to demonstrate that the APA wasn't complied with, and it can't because the APA was complied with. Government Code Section 11343.6 provides that, once a regulation is filed with a Secretary of State, it's presumed that the APA was complied with.

And this makes sense because in order to file at the Secretary of State, the regulation has to go through multiple reviews by state agencies. The Department of Finance being one, and the Office of Administrative Law being the other.

So here we know that Dash 14 was filed with the Secretary of State. We submitted Exhibit J, which is the Rule Making File for that regulation. It's Form 400. And you can see in the top right corner, there's a stamp from the Secretary of State.

So we know that, again, the APA is presumed to be complied with.

So Appellant really begins in a difficult position when it states that, nevertheless, despite this filing, despite the review by multiple state agencies that, nevertheless, the Economic Impact Statement, which is part of the APA requirements, was insufficient.

And it's unable to meet its burden to demonstrate that the APA was not complied with.

To understand the role of the Economic Impact Statement in the APA, it's really helpful to actually understand the purpose of the APA itself.

Now, the California Supreme Court has stated in Western States Patrolling Association versus Board of Equalization that the purpose of the APA is to provide

meaningful public participation in the development of agency regulations and to provide a record for effective judicial review.

It does this in two ways.

First, it provides basic minimum procedural requirements, which allow interested parties to provide statements and arguments regarding the regulation. And also calls on the agency to review all the -- relevant matter, excuse me, presented to it.

Two, it also provides that any interested party may obtain, in Superior Court, a judicial declaration as to the validity of any regulation.

So essentially the function of the APA really is meaningful public participation in the development of regulations and for the ability for interested parties to obtain a judicial declaration as to their validity in Superior Court.

So circling back to -- circling back to the Economic Impact Statement. What's it's role in this?

Well, it does form part of the requirements of the administrative record. So we're talking about that record for effective judicial review, but also it provides a basis for meaningful public participation in the development of the regulation.

We know that the Economic Impact Statement is

intended to be an initial determination, so an initial determination, that the regulation will not have a significant adverse economic impact on business, and specifically, California enterprises.

Statutorily, it requires that agencies promulgating regs consider certain issues. There's a list of them. Effect on creation or elimination of jobs in California, impact on housing costs, et cetera.

And actually there's a form, a government Form 399, which was developed to ensure that agencies, like the Franchise Tax Board, when it is promulgating regulations, to address each of these statutory requirements.

What more do we know about the Economic Impact Statement?

Well, we know it may not be exhaustive or conclusive, and the agency need not assess or declare all adverse economic impact anticipated.

In fact, failure to comply with every procedural facet of the APA does not automatically invalidate a regulation.

A court may declare the regulation invalid only for substantial failure to comply with the act.

Substantial compliance in regards to this means, where there is compliance as to all matters of substance,

then technical deviations are not to be given the stature of noncompliance. Substance prevails over form.

Now, here, FTB has done all that was required by the APA and more. First, you can take a look at the Form 399, which is statutorily required inquiries are included on that form, 399. And FTB filled out that form completely and supported it with statements and testimony.

And you can find that at Exhibit 3 of the Rule Making File, and the Rule Making File itself was helpfully provided as Appellant's Exhibit 4.

And in its testimony, Franchise Tax Board's testimony supporting its determinations, it made a few important notes.

The first was the inherently limited reach of the regulation. It affected only how mutual funds service providers apportion income.

Secondly, and importantly, Regulation Dash 14 was a codification of FTB's then current policy. So Dash 14 was a codification of how many in-state taxpayers, California taxpayers and businesses, mutual fund service providers were already filing.

And you can see this on Statement 3 of the Economic Impact Statement, as well as the initial Statement of Reasons that FTB filed.

Now, many in-state taxpayers were already filing this way because these taxpayers filed variance requests with the Franchise Tax Board, under Section 25137. And the method adopted eventually, by Dash 14, applied the method already used in those various requests.

So thus, based on this testimony, in the Economic Impact Statement, the impact was expected to be minimal or nonexistent overall in-state, and the implementation of the reg, of course, were not expected to affect housing or health, safety of California workers because its inherent -- inherently, excuse me, limited nature, but also it wasn't particularly expected to affect competitive or California businesses because many of those businesses were already impacted due to the approved variance requests applying the Dash 14 method.

So you can see that under the Form 399, that FTB filled -- fulfilled the four corners of the APA scheme, but in addition, if you look at the Rule Making File, you can see that it's replete with evidence, additional evidence, showing that Respondent diligently assessed the economic impact of this regulation.

Some highlights of the record demonstrate this.

There is a letter from FTB's executive officer providing the method that FTB used to determine the tax impact upon taxpayers. FTB generated an in-depth

economic study to gauge that impact. It took a random stratified sample of corporate taxpayers, screened that sample to include only those taxpayers that appeared to be in the mutual funds service provider industry, then went to the actual tax returns, looked at them to ensure that these taxpayers were in the mutual fund service provider industry, and then it compared their As Filed apportionment percentages to what that apportionment percentage would be under the new regulation.

And not only did it engage in this in-depth economic study, but then there was a lot of informed discussion and consideration amongst interested parties in the Franchise Tax Board regarding this study.

There was a third party, for instance.

An economic analyst named Mr. Romero, and he was sponsored by four mutual fund service providers to conduct a study. And his results were quote, "quite close," to the FTB's results. Where FTB came up with a $10 million impact, Mr. Romero, his study concluded that there would be a $12.6 million impact.

And, of course, he did concede that, because FTB source data was actual taxpayers, that that would be the better basis for a study.

So again, not only was there an economic study conducted, but in-depth discussion and consideration

amongst interested parties and the Franchise Tax Board.

Further, Respondent went beyond this initial study and provided, actually, a supplemental economic analysis.

Respondent carefully studied a third economic analysis provided by an interested party and it noted, in detail, why the competing analysis was flawed.

So you can see that there was a lot of informed discussion on the economic impact of this regulation.

Now, specifically, Appellant mentions compliant costs, and states incorrectly that FTB ignored or did not consider compliance costs when it promulgated Regulation Dash 14.

First, FTB provided testimony in its Economic Impact Statement and its initial statement of reasons that the regulation was an implementation of then current policy. So an initial determination -- an initial determination on the impact -- as to the impact of this regulation, logically, wouldn't anticipate much in the way of compliance costs.

Also, the record further addresses compliance costs. Although taxpayers stated that interested parties mentioned that the draft language would be very burdensome because they'd have to locate shareholders, which may provide difficult.

Instead of ignoring that, as Appellant states, instead they modified the language of the regulation.

If you look at Subsection (b)(1)(A)(1), for instance, it provides that if the taxpayer doesn't know that location, then a mutual service fund provider may use any reasonable basis to determine the proper location of assignment.

That was specifically addressed in the Rule Making File, and that perceived compliance burden was much eliminated, essentially, by this added layer of extreme flexibility.

Furthermore, although the taxpayer states that the $10 million tax increase is -- because it was proposed at -- or, explained that it was a net figure, and therefore that the regulation should fail the APA requirements, the fact is that FTB did actually put taxpayers on notice. It did say, in Statement 3 of its Economic Impact Statement, the testimony does provide that $10 million number but also notes that some taxpayers would see an increase in their sales factor while other taxpayers would see a decrease in their sales factor.

So the idea is that, when taxpayers are reading this initial statement, they understood that the $10 million was presented at net and that some taxpayers

would see an increase in their tax liability and some would see a decrease in their tax liability.

So as you can see, Respondent's compliance with the APA, particularly in regards to the Economic Impact Statement, is beyond question. But even if your office decides that some portion of the record did not meet APA requirements, you know, despite the fact that they were completed and approved Forms 399 and 400, you know, despite the economic study described and the supplemental economic study engaged in and despite the in-depth discussion amongst interested parties and the FTB regarding the regulations economic impact --

JUDGE RIDENOUR: Excuse me. Can you slow down just a tad, please? Especially when you read. I'm the same. So I understand.

MS. SMITH: Yes. No problem. I apologize.

So even if your office does decide that some portion of the record did not meet APA requirements, remember that failure to comply with every facet, a procedural facet of the APA, does not automatically invalidate a regulation.

The Court may declare the regulation invalid only for a substantial failure to comply with the act.

Here, not only was the black letter law of the APA followed, but FTB fulfilled the spirit of the APA,

which was to create meaningful participation by interested parties in the regulations development and to create a robust administrative record in cases of judicial review.

So Dash 14 should not be invalidated because it did, in fact, meet the APA's requirements.

Appellant also makes an additional argument.

Although Appellant argues that Regulation Dash 14 does not apply after 2012, because the generic rule for assigning services at Section 25136 changed with the passage of Proposition 39 in 2012, the OTA's own recent precedential decision demonstrates that this is not true.

Your office, in the end of 2021, released the precedential decision Appeal of Amarr. And that case states that, when the FTB passes a special regulation under Section 25137, its rules are standard apportionment for those taxpayers whose circumstances match those that are in the regulation itself.

Your office decided this nine years after market-based sourcing was passed, and the decision addressed the year 2013, when market-based rules were in effect.

So we already know what the law is post the implementation of market-based sourcing rules because your office has told us that special regulations continue

to be standard apportionment when the circumstances described in the special rule fit the taxpayer's particular situation.

Now, here, Regulation Dash 14 controls because it is uncontested that the circumstances match Appellant's situation. An Appellant must apply Section -- or, excuse me, Regulation 25137-14, as it did in its original returns for the years at issue.

Now, if Appellant wishes to pursue the argument, it has the Government Code to look to, to provide a remedy, as noted by my colleague.

Appellant says California could never change the law if -- if we continue to apply Dash 14, despite the change in Regulation -- or, Statue 25136, but that is not true and we know that because there is a remedy, at 11349.8, in the Government Code.

It provides that, if any statute is changed, such that the statutory authority for a regulation has been repealed or becomes unaffected -- ineffective, Appellant's remedy is to notify the AOL (sic).

The AOL (sic) will review, ask the agency that promulgated the regulation questions to defend its position. It will make a determination, but then the state legislature and the governor's office have a final say on whether OAL's decision stands.

So, in short, Dash 14 still applies, despite the fact that we are now operating in market-based sourcing years.

And furthermore, if Appellant wishes to continue to pursue the argument that it does not because 25136, that section changed, its remedy is with the Office of Administrative Law and the Governor's office.

This on concludes our presentation on jurisdiction, and -- well, it was earlier, and the regulation's validity.

Thank you.

JUDGE HOSEY: Thank you for your presentation, Ms. Smith.

I'm going to go ahead and go back to Appellants.

Would you like to respond to the Franchise Tax Board's presentation?

MR. MELNICZAK: Yes, please.

JUDGE HOSEY: Go ahead when you're ready.

MR. MELNICZAK: I'd like to address the comments regarding the APA first, and then I have a comment regarding the switch to market sourcing in 2013.

First, regarding the validity of Dash 14, with respect to the APA.

As the FTB correctly notes, the purpose of the APA was meaningful public participation. But

participation is not meaningful if comments are simply ignored.

As we noted, there were many comments about the burdensome requirements. There were some comments that -- requesting that a census approach be used or that a different approach be used for receipts through financial intermediaries.

Now, the FTB just rejected those comments and the FTB did not incorporate them in the final regulation.

It's also not -- the public participation is not meaningful if it's opaque or if it's not clear to taxpayers what the burden is.

And with respect to the net cost, merely reporting the cost to taxpayers on a net basis, again, is opaque because, as the FTB noted, there was a separate report done by Mr. Romero, but that report was not reported on the impact statement, and that report again only reported the receipts on a net basis.

And to be clear, our dispute is not about the distinction between the $10 million on the impact statement and the $12 million in Mr. Romero's analysis.

If that were the case, surely it would be tough to overcome the FTB's argument that they are in substantial compliance with the APA. The dispute is between the $10 million on a net basis and, in my example

earlier, between the winners and losers, that potential $100 million cost that would be borne by the taxpayers who were made worse off by the regulation.

And by disguising that amount and only putting that amount on the net basis, it doesn't invite meaningful public participation, as the APA is required to do, because it doesn't make taxpayers fully aware of that and make them fully available for comment.

(Reporter clarification)

MR. MELNICZAK: It doesn't give taxpayers the opportunity to be put on notice that the regulation affects them by only reporting the tax effect on a net basis because you'd have taxpayers who, again, might have a $100 million tax burden but they see that the net effect is only $10.

Again, that disguises it, and it doesn't encourage that participation, if they don't know the full effect borne by taxpayers.

JUDGE RIDENOUR: Excuse me. Are you having trouble hearing?

MR. MELNICZAK: My apologies.

JUDGE RIDENOUR: So just again, mic close.

Thank you.

MR. MELNICZAK: I also wanted to address the comment made regarding the Amarr case, and the extent to

which the burden is on the FTB versus a taxpayer when invoking Section 25137.

Now, when the statute changes, the burden is on the FTB. It's clear that, again, if a valid regulation is in effect, Amarr does state that a taxpayer seeking to deviate from that regulation, that taxpayer is the one invoking Section 25137, and that taxpayer is the one required to show distortion. But that's only if there is a valid regulation in effect.

So in this case, if Janus Capital Group were to bring a claim for periods prior to 2013 and argue against the validity of Dash 14, they would -- they would have the burden of showing distortion because they would be the ones invoking Section 25137.

But if there is no valid regulation in effect, the FTB would be the party who needs to show distortion because they would be the ones who are deviating from the statutory provision, which in this case is the market sourcing statute under Section 25136.

The FTB can't simply rely on its prior showing of distortion because 25137 requires -- again, requires a showing that the allocation and apportionment provisions of this act don't fairly represent a taxpayer's business activity, not a prior act in the future.

And simply put, the current statute is not

distortive. The FTB has not made any attempt to show it's distortive. Therefore, it does not have any valid powers, under Section 25137, to promulgate or enforce a regulation that conflicts with the statute.

And again, otherwise, if they do not have that power, that existing -- taxpayers would not have a remedy through this office to pursue a claim for refund because the FTB would -- would simply say that its existing regulation is still in effect.

I don't have any other comments.

JUDGE HOSEY: Thank you, Mr. Melniczak. I'm going to move to the panel to see if there's questions on either Issue 1 or 2.

Moving to Judge Ridenour. Any questions?

JUDGE RIDENOUR: No questions. Thank you.

JUDGE HOSEY: Thank you.

Judge Akopchikyan?

JUDGE AKOPCHIKYAN: Yes, I have a few questions. I'll start with Issue 1.

It's a question, I guess, for both parties, but we'll start with Appellant.

Do you think the analysis for Issue 1 is the same for situations where, on one hand, OTA is asked to declare a regulation invalid on the basis that the tax agency did not follow the requirements of the

administrative procedure act, which would require an OTA panel to understand and apply the APA, and on the other hand, situations where OTA is asked to declare a regulation invalid on the basis that it conflicts with the tax statute or that requirements of a tax statute were not followed, such as showing distortion, which involves tax law?

Start with Appellant, please.

MR. FIX: Sure. Thank you.

I think the answer is yes. The analysis as to both of those scenarios involve interpretation of whether or not a regulation is valid. The regulation at hand is the tax, although it needs to be interpreted whether it's valid or not.

The analysis as to whether or not the OTA has jurisdiction to invalidate that regulation, under both scenarios, is governed by Yamaha and Western States, in the sense that you need to first make a determination as to whether or not this is a quasi-legislative regulation or an interpretative one. And so under both scenarios, you would end up with it being an interpretative because the FTB did not have delegation of quasi-legislative powers because there is an underlying enforceable legal standard under 25136, which states how to source service receipts to the benefit location to the purchaser.

Both allow the OTA to look into the underlying requirements as to whether or not a regulation is valid, so I do not think that there is anything that would preclude the OTA from reviewing it as long as you've determined, according to Talavera, that you have an interpretative regulation at hand.

JUDGE AKOPCHIKYAN: Thank you.

MS. MOSNIER: And probably not surprisingly, you would hear from the Franchise Tax Board that the answer to your question, Judge Akopchikyan, is no, that it does not matter whether a challenge would be to compliance with the Administrative Procedures Act when clearly the Office of Tax Appeals, which is staffed with tax experts, would be asked to interpret the Administrative Procedures Act, which is not typically within the body of tax law knowledge and certainly not housed even in the Revenue Taxation Code.

But also, even if it has to do with determining that a regulation is invalid, say, as applied, there is no distinction in the Administrative Procedures Act that would allow a determination of invalidity for either -- on either basis.

We go back to the Liljestrand case where the OTA stated clearly that its jurisdiction is limited to its enabling legislation. The Government Code sections

authorizing the existence and subject matter areas to be addressed by the Office of Tax Appeals do not provide for the issuance of declaratory relief, nor do they provide for determinations regarding the validity or invalidity of a regulation. And so I think that, obviously, that the increase stops there.

And I would note that, with respect to a distinction under Yamaha, between a interpretative and quasi-legislative regulation, those distinctions are important for the Auer, A-U-E-R, deference standard when interpreting a regulation. Because that's what Yamaha was about. It was about interpreting a regulation, and that's not what we are here about today.

We are here about the OTA's authority to invalidate a regulation, which is an unrelated issue, and Yamaha, in that context, is not particularly relevant, perhaps not relevant at all.

And I would note on -- also, with respect to the distinction between interpretative or quasi-legislative, classification of a regulation, that in, for example, the Hajikhani opinion, the OTA did not separate -- did not qualify its lack of jurisdiction to determine the validity of a regulation.

It said, on Page 18, that "Such a federal standard under the validity of a federal regulation is

inapplicable here," it's discussing some -- previously some federal cases, "as we are only addressing the interpretation of a California regulation."

"OTA does not have the jurisdiction to determine the validity of a California regulation," not a California interpretative regulation, not a California quasi-legislative regulation.

Simply, "does not have authority to invalidate a California regulation."

You will find the same language on Page 6 of the Bed, Bath and Beyond opinion.

MR. FIX: May I please respond?

JUDGE AKOPCHIKYAN: You may.

MR. FIX: Thank you.

First, I'd like to address that I'm not disagreeing with Respondent as to the ability to provide declaratory relief. 11 -- Government Code 11350 says, if you would like declaratory relief, you need to go to the OAL or to the Court.

We agree on that. The problem is that is not the only remedy available to taxpayers. Rather, you could also bring action to invalidate a regulation as to applied to specific taxpayers, and that is clear by the cases that I cited before.

Second, I think it's a little misleading to say

that Hajikhani, which is, one, not precedential, but again, consistent with the standard that we articulated that is in Yamaha, which is very relevant, and which is the main source of authority that's cited in Talavera and Hajikhani, which is the regulation at issue, and the analysis in Hajikhani discusses the fact that regulation that was at issue in that case, 19133, was not an interpretative because it -- because it does not merely interpret the relevant statute, citing Western State's case, as well as the Yamaha.

Instead, it is more than that. And to the language that we put on the board, it is -- it is not merely interpreting because it adopts language that fills the gap to create new language, new legal standard, as to when the FTB may add the demand penalty.

And in Hajikhani you cite the GMRI, Inc., versus California Department of Tax and Fee Administration, 2018 California Appellate case. That specifically discussed this statute and specifically articulated and repeated the standard that was set in Yamaha and in Western States as to the distinction between the two regulations.

So again, the Hajikhani case is consistent with what Appellant is arguing in the sense that the regulation at issue and the analysis that OTA took was, do we have an interpretative regulation or a quasi-

legislative one? And if it is quasi-legislative, which it was in this case, the OTA, because it is receiving dignity of a statute, according to Yamaha, Western States, GMRI, cannot be invalidated by the OTA.

If you are outside of that category and it's interpretative, like in this case, then the OTA does have jurisdiction.

And specifically, as I mentioned, the -- there is no gap to be filled with respect to how to source service receipts. It's clearly articulated in Section 25136 and in Regulation 25136-2.

According to Yamaha, Western States, GMRI, if you remove the regulation at issue, are you left with an enforceable legal standard?

The answer is yes.

The fact that the FTB cites to Section -- Revenue Tax Code 19503, as essentially a blank -- blank check, that the FTB can just pass regulations whenever they want, is contrary to case law and, frankly, constitutionally concerning from a separation of powers.

And that was specifically addressed in the GMRI case that said that an administrative agent, an administrative agency cannot disguise new law in the form of rules and regulations. Rather, it has to be within the statute.

And the power that was provided by 19503 is a general one, general mandate that is provided to any administrative agency in California. If you interpret that to mean that you can just pass any regulation you want, then there -- then the distinction that the California Supreme Court articulated in Yamaha, which says there are two types of regulation, is a distinction without a difference, which was addressed in -- that concern was addressed in Western States by one of the justices.

So what you're left with is that you need to look to this specific case, and Section 19503, on its own, does not answer your question, which bucket you fall into. You then need to look to whether there is a gap, and there isn't.

And beyond that, the -- the statute that's cited together with 19503, Section 25137, is a limited power that, as my colleague, Mr. Melniczak, mentioned can only be invoked if there is distortion under the apportionment rules under the act.

So the FTB cannot use Section 19503 as a blank check to assert what the legislature has been delegated, which is to pass statutes. Not every regulation is a statute. And they admitted that, in Save Mart, when they conceded that the regulation at issue was interpretative,

even though it relied on the same delegation of power, Statute 19503, that they are relying on today for the position that it is somehow quasi-legislative.

So that's it. Thank you.

JUDGE AKOPCHIKYAN: Thank you.

MS. MOSNIER: May I respond?

JUDGE AKOPCHIKYAN: You may.

MS. SMITH: Thank you.

One thing I think we have to keep in mind is that, if the OTA were to draw a dividing line between authority to invalidate a regulation, quote, "as applied," in an individual case or, for example, in toto for a lack of compliance with the APA, we have to consider -- we have to tease this out a bit and consider what remedy rests for the Franchise Tax Board.

If the OTA erred in its determination, for example, that a regulation were interpretative as opposed to quasi-judicial -- or, excuse me, quasi-legislative and therefore determined that it wasn't entitled to the -- to the respect as a statute which can be invalidated, of course, only by the legislature or by the courts through a determination of validity.

So in the big picture, that is a very important factor and consideration. When you determine the scope of the lack of authority to act, remember here, we are

not looking for existing authority in finding a carve-out. We don't presume authority and find a carve-out. You actually have to find authority to act under either scenario and none exists.

And I know that the Appellant has spoken about court case law. There were two other cases Appellant mentioned during its general jurisdiction argument that I had not been able to locate in the briefing, but I did over the short break. And if I could, I would like to respond to those because we didn't have an opportunity before today to, and we weren't aware of them and didn't have an opportunity to prepare.

The first is with respect to the Stoneham versus Rushen case, at 137 Cal.App.3d 729. It's a 1984 case. And an inmate signed a writ of mandate preventing the Department of Corrections from implementing certain emergency administrative regulations about classification of inmates for housing purposes.

The trial court granted the writ and subsequently a preliminary judgment in favor of the petitioner, in favor of the inmates.

And on appeal, that -- the determination that those -- the guidance that had not been implemented and adopted in compliance with the APA was, in fact, essentially an underground regulation, and the judgment,

putting implementation of that emergency system of classification on hold pending compliance with the APA, was affirmed.

There was no issue regarding the ability of a state agency to invalidate a regulation in that case.

Neither was there in the other case Appellants discussed, Chas Harney Incorporated versus the State Licensing Contractor's Board, a 1952 decision, which is found at 238 P.2d 637. The only issue in that appeal was whether the complaint was sufficient to state a cause of action.

It was styled as a declaratory relief action, and the appellate court sustained the trial court's granting the defendant's motion for judgment on the pleadings, and affirmed that there no -- no decisional controversy.

Again, there was no issue regarding the ability or power of any state agency to invalidate a regulation in that case either. Thank you.

MR. FIX: I would like to respond to that.

JUDGE HOSEY: I was just going to ask, would Appellants like to respond to that?

MR. FIX: Yes.

I think -- yeah, I think it's interesting that the FTB is trying to murky the water with respect to

precedent. The fact that the facts at issue in those two cases are different from the one here does not mean that it is not good case law and holding with respect to -- in both cases, the California Supreme Court and the California Court of Appeal looked to the intent behind Section 11350.

And that is the question here; right?

Because the FTB is arguing that section -- Government Code 11350 is the universe of types of remedies they can take other than going to the OAL to invalidate it. They're saying, taxpayer, you don't like this regulation, either you go to the OAL, or you go straight to Superior Court and you ask for declaratory judgment.

And in both these cases, the Court specifically addressed the legislative history and intent of Government Code 11350, for the -- standing for the position that the intent was not, by enacting this section, to preclude or limit the available remedies to taxpayers, including bringing controversy that would invalidate a regulation.

Thank you.

JUDGE HOSEY: Okay. Thank you.

Were there any other questions you had, Judge Akopchikyan?

JUDGE AKOPCHIKYAN: I had a few more questions.

JUDGE HOSEY: Okay. Go ahead.

JUDGE AKOPCHIKYAN: I have a question for Franchise Tax Board.

What do you think the OTA should do if a panel -- we get an appeal, hypothetical, and a panel decides that there's a statute directly on point and points to a certain outcome and then there is an interpretative regulation that point to a different outcome and that is the basis for the Franchise Tax Board assessment?

The panel thinks -- is the panel allowed to follow the statute and apply the statute in that case?

MS. MOSNIER: I hesitate to offer an opinion on a hypothetical, principally because I just don't have the opportunity to percolate it, let it percolate through and -- and think about it. But I think at the end of the day, the OTA always has to come back to the limits of its jurisdiction. And there will be -- and there have been opinions for various reasons having nothing to do with the Administrative Procedures Act or regulation, where the OTA has held that it does not have jurisdiction to act.

And so I just -- I am uncomfortable opining one way or the other except to know that it --

JUDGE AKOPCHIKYAN: I understand.

MS. MOSNIER: It's something worth considering in another setting.

JUDGE AKOPCHIKYAN: Okay. Thank you.

I have a question for Appellant. I just want to clarify on Issue 2.

Throughout the briefing, the term "conflict" is used for the Dash 14 regulation and Section 25136 of the statute. But in the oral presentation today, it seems like the basis for asking that we declare the regulation invalid is really two separate issues.

One is the APA procedurally defective under the APA, and the second one is that a distortion study wasn't done after California switched to market-based sourcing.

So just to clarify, is there -- is Appellant's position that the regulation doesn't enlarge or otherwise alter the scope of the statute, like conflict is not being used in that context?

MR. MELNICZAK: Yes.

So in the second argument, which is -- that we made today, which is that the regulation -- whether or not it was valid in 2007, the question whether it is valid when the statute changed to -- to market sourcing in 2013, yes, there is a conflict between the regulation and the statute.

The statute provides for market sourcing, looking to the purchasers, and the regulation looks through those purchasers to where the shareholders are located.

So there is a conflict, just as there was a conflict in 2007, when the regulation conflicted with the cost performance rule. The fact that there's a conflict is significant because the only instance in which the FTB can issue a regulation that conflicts with the statute is by using its 25137 powers. And 25137 requires the FTB show distortion in order to promulgate a regulation that deviates from the statute.

And again, to clarify, they did not make a showing of distortion under the new statute in 2013.

MR. FIX: Can I add one more thing?

In addition to that, the statute -- the regulation, 25137-14, not only conflicts with 25136, as my colleague, Mr. Melniczak, mentioned, it also conflicts with California Revenue Tax Code 25137.

25137 says that the FTB may use an alternative apportionment only if there is distortion under the current apportionment under the act. Under this hard set of facts, Dash 14, during market years, as Mr. Melniczak presented, there is no distortion. So not only is Dash 14 in conflict with 25136, it's also in conflict with

25137.

Thank you.

JUDGE AKOPCHIKYAN: Thank you.

So how would Appellant respond to the following argument, that the Dash 14 regulation is not in conflict with 25136 because they're both based on the principles of market-based sourcing?

So, for example, 25136-2 regulation has cascading rules for sourcing sale of services to businesses. I think the second cascading rule allows for reasonable approximation.

Is using a shareholder's domicile, is that a reasonable approximation method or not? And if it is, is that truly a direct conflict?

MR. MELNICZAK: It's not a reasonable approximation.

And I do want to note at the outset that, first, that argument is not before the OTA because, in fact, the FTA -- the FTB has explicitly acknowledged that there is a conflict between Section 25136 and the Dash 14 regulations.

You can take a look in their initial brief. I believe it's on Page 7. They acknowledge our argument that the statute, Section 25136, is different than the regulation. They acknowledge that the regulation

deviates from that statute, but they note that Section 25137 expressly authorizes deviation from the statute.

If the FTB were to -- were to reverse course and no longer claim there's a conflict and claim as, Your Honor, as you noted, make the argument that Dash 14 is consistent with market sourcing, that's not true because they each look to different locations.

Market sourcing looks to where a purchaser receives the benefit. And shareholder sourcing looks through the purchaser -- to where the purchaser shareholder receives the benefit.

And I know you mentioned the cascading waterfall test in the regulation for looking to where the purchaser receives the benefit, but each case where that test has been applied, it's always been a question where the purchaser receives the benefit, not where the purchaser shareholders are.

There have been multiple examples, both in case law and in the FTB's regulation, where services have been provided to a corporation. It's true that in some instances, if the corporation has acted in a subcontractor role, perhaps they've looked through the corporation to where the corporation's customers are, in this case the customer's customers are, but that's not

the case here.

There's no subcontracting of activity. Janus's customers, which are regulated investment companies and pension funds, they are the purchasers. They're the in-use purchasers. They don't have customers of their own. And in no instance has the FTB -- has FTB or the OTA looked to where a corporation received the benefit and have they looked to a corporation shareholders.

Thank you.

JUDGE AKOPCHIKYAN. Thank you. No additional questions at this time.

JUDGE HOSEY: Okay.

So we've gone over Issue 1 and 2. This concludes the open session portion of this appeal. We're going to take a quick five-minute break before resuming with the closed session. Thank you.

(A break was taken)

JUDGE HOSEY: Okay.

We are back on the record for Janus Capital Group, Inc., and Subsidiaries. This is now the closed session. I don't believe we have anybody from the public here.

So it's been marked for the recording, and we are discussing Issue 3, which was laid out in the minutes and orders issued April 4, 2023.

We're going to start with Appellants' argument, and we have, I believe, 45 minutes set for this portion.

Okay. Go ahead when you're ready. Thank you.

MR. MELNICZAK: Issue 3 is the issue of whether Regulation 25137-14 is the standard apportionment rule for assigning Appellant's service receipts.

Dash 14 is not the standard apportionment rule because it's invalid.

As we discussed earlier, the FTB didn't meet the requirements of Section 25137 when Section 25136 was amended to market sourcing in 2013.

The FTB never showed that the market sourcing rules were distorted.

Now, it's true under the Fluor case and under the Amarr case that, if Dash 14 is valid, both when it was initially promulgated in 2007 and when the statute switched to market sourcing, if Dash 14 is valid, the burden is on the taxpayer to show why the Dash 14 regulations don't fairly represent the extent of business activity within the state.

But if there is no special apportionment rule, such as Dash 14, the standard UDITPA formula must be applied unless the party seeking to deviate from it can show distortion.

So in short, if Dash 14 is valid, we agree the

burden is on Janus to deviate from an otherwise valid regulation. But if Dash 14 is invalid, the burden is on the FTB to deviate from the market-sourcing statute.

Because Dash 14 is invalid, Janus must default to the general rule for sourcing services under 25136, and if the FTB wants to deviate from that, it has the burden of proof.

Now, looking at that statutory rule for 25136, which applies here, again, you look to where the purchaser receives the benefit of the service. And there's a focus on the purchaser there. And we had provided an affidavit, which was labeled Exhibit 8, which I provided some context regarding who Janus's purchasers are and where they receive the benefit of the service.

As we noted, Janus's purchases are the parties that it contracts with. So those include regulated investment companies, or RICs, but they also include pension funds, employee benefit plans, and retirement associations. Those are the purchasers of Janus's services.

The shareholders of those purchasers, or in the case of a pension fund, for example, the pensioners, they are not customers of Janus. They are not purchasers of Janus's services.

And in each case, it's the purchasers that

contract with Janus. It's not the shareholders that contract with Janus.

And we provided some contracts in our exhibits which support this.

For example, Exhibit 5 -- Exhibit 5 to our prehearing statement is a contract that we provided, which is between Janus and the Cement Masons Pension Trust Fund.

And if you look at that contract, it describes, on Page 1, the investment advisors services -- services performed by Janus, and also states at the top, it's clear that the parties to the contract are Janus and the Cement Masons Pension Trust Fund. There's no mention of the shareholders anywhere in the contract.

That contract also describes the fees that Janus received for its services. And if you were to look at the -- the very last page of that contract, there's a note that describes the fees provided by the Cement Masons, and it says that Janus's fee, the advisory fee, is billed directly to the Cement Masons.

It's not billed to any shareholders. And it's the responsibility of the Cement Masons, not the shareholders or the pensioners, to pay that fee within 30 days of the invoice.

The contract also makes clear that the decision

to hire Janus to provide its management services, as well as any decision to end the business relationship, so both hiring and firing, can only be done by Janus's purchasers.

Like the Cement Masons here. If you look on Page 1, in the Recital section, Recital A states that the Cement Masons have the authority to appoint an investment advisor. The shareholders don't have that authority.

And in Recital B, it states that it's the Cement Masons, not the shareholders, which are employing Janus.

So it's clear from this contract that the purchaser is the fund, in this case the Cement Masons Pension Trust. And the Cement Masons receive the benefit of Janus's services in their home State of California.

California is the location of the Cement Masons on Janus's books and records, and the FTB is not alleging a different location for any of Janus's purchasers.

The Cement Masons have no customers of their own, and they are an in-use customer.

Now, to address the question of how asset management receipts are sourced under Section 25136, which is the question received from the earlier section, I do want to note that there's only one other state court that has considered the question of how to source receipts from asset management services under a

market-sourcing statute, and that's the Lutheran Brotherhood case out of Minnesota.

That's a case we cited in our briefs. Minnesota had a market sourcing rule for services that was very similar to California's. They look to the states where the purchaser -- essentially, where the benefit was received. In Lutheran, the court held that the purchasers of investment services were the actual investment companies themselves, the companies that were contracting with the asset management service provider.

They specifically held it was not the investors of those companies who were the customers. And Lutheran also held that the funds themselves, the purchasers, they received the benefit of the services at their place of domicile. They didn't look through to where those fund shareholders were located.

And the result in Lutheran is consistent with the rules in many other states throughout the country.

As you may have seen from the Dash 14 regulatory file, some commenters noted that there had been, you know, a handful of states, perhaps a dozen or so, that had enacted a shareholder sourcing rule. That was back in 2007. And that number since then has remained relatively constant. However, by far, the much more common position is a market purchase approach, which

looks to where the purchaser receives the benefit of the service.

In fact, since 2007, there's been about 20 additional states that have switched to market sourcing for services. Most of those switches have come from a cost performance market.

So the trend among states is clearly towards market sourcing, and there are more states that follow a market-sourcing approach than a shareholder-sourcing approach.

Now, the FTB hasn't at any point in its briefing alleged that, if the benefit received rule does apply, the benefit is received at any location other than where the purchaser is located. It hasn't alleged that under 25136 that the benefit is received at the shareholder location.

In fact, as I mentioned before, when that came up in briefing, the FTB acknowledged the conflict and said that 25137 expressly authorized deviation from the statute.

So both sides agree that 25136 should split from Dash 14. If, in fact, the reg is invalid, then the only possible interpretation is the source to the actual purchaser's location.

Now, we had attached an exhibit to our

prehearing statement, which is Exhibit 2, which is a schedule, based on Janus's business records, which provides a break out of receipts from each of Janus's purchasers.

I want to quickly walk through the four columns that are on that exhibit. And right now I'm just looking at the first page of the exhibit, which is a list of Janus's customers in 2013.

That first column, the Customer column, just provides the names of purchasers from which Janus earned receipts that were included either on its As Filed or As Corrected sales factor numerator.

The second column, State of Domicile, provides the domicile of each purchaser based on the mailing address that Janus maintains on its books and records.

The third column, which is labeled California Sales As Filed column, that's essentially -- that's how Janus computed its receipts on its As Filed return. So that's following the Dash 14 approach, in which case they source their receipts based on the location of the underlying shareholders.

And the fourth column is what we have proposed in the refund claim before us today, which is labeled California Sales As Corrected. That's the market sourcing column. That column represents the portion of

receipts from each of Janus's purchasers that are located in California.

Essentially, if the purchaser was located in California, we included that number in the As Corrected column.

For example, you can -- you can take a look at each of the purchasers on this list that are located in California, and there are several.

For example, take a look at -- four lines down, there's a purchaser called California Ironworkers Field Pension Trust, and you can see if you look to the far right, Janus earned about $305,000 of receipts from the Ironworkers Field Pension Trust. That's a purchaser that's clearly located in California.

And you can take a look at other names down the list. There's California Teacher's Association. There's California Winery Workers. The same goes for them.

Now, many of these purchasers no doubt have -- have pensioners or shareholders of their own that are located all throughout the country. It may be that one of the former California winery workers, pensioners, has moved to another state.

Janus is not proposing to exclude those amounts from the sales factor enumerator. Rather, the California winery workers or the California Ironworkers Field

Pension Trust are both purchasers of Janus. Janus would source every dollar of receipts from those purchasers to California, regardless of where the ultimate shareholders or pensioners are located.

Now, you can see at the top, you can see a comparison between the two methods. The third column, which is the Dash 14 method, shows California sales As Filed as at the very top of $61 million.

That's the amount that was included in Janus's As Filed sales factor enumerator. But applying the California sales As Corrected method, the market sourcing method results in a revised sales factor enumerator of about $16 million. And that's shown under the -- on the far right column.

So we want to make clear that, unlike under the old cost performance rule, here under the benefit received test, fourth column there, the $16 million column, it's not an all or nothing test like it was under the cost performance rule.

Had we included a column here showing the cost performance method, perhaps it would have shown a zero because Janus does not provide -- does not perform many of its services in California. And no doubt the FTB may find that distortive to have zero receipts from California because it doesn't reflect California's market

place.

But we're not proposing that method. We're proposing merely to follow the statute, which provides a market sourcing rule, which has a focus on where the purchaser is located. And that's what that fourth column of $16 million represents.

Thank you.

JUDGE HOSEY: Thank you, Mr. Melniczak, for your presentation.

Now we're going to move to the Franchise Tax Board for your presentation on Issue 3.

MS. SMITH: Thank you.

JUDGE HOSEY: Go ahead when you're ready.

Thank you.

MS. SMITH: All right.

So we're now at what I consider the central issue of this case, and that is the sourcing argument.

And in this case, we are applying settled law to uncontested facts, as I mentioned earlier. Appellant is a mutual fund service provider required to apportion its income to California to satisfy its California tax liability, and California law is clear that Regulation Dash 14 provides a standard of apportionment method for mutual fund service providers.

Dash 14 is how Appellant originally filed in

2013 through '16 and how it should have filed.

Earlier I mentioned the case Appeal of Amarr. And I want to quote from it directly right now. And you remember that this was decided by your office at the end of 2021, and it regards a special regulation under Section 25137, as in effect during market-based sourcing years.

The quote is:

> "FTB has promulgated special apportionment regulations under Revenue and Taxation Code Section 25137. If a relevant special formula is specifically provided for in the Revenue and Taxation Code Section 25137 regulations, and the conditions and circumstances delineated in such regulations are satisfied, the method of apportionment proscribed in those regulations shall be the standard by which the parties are to compute the taxpayers' apportionment formula."
>
> "In other words, once found to be applicable to the particular situation, the Revenue and Taxation Code Section 25137 regulation will control."

And this was actually adopting a previous --

reasoning in a previous case by the State Board of Equalization, Appeal of Fluor, which itself was a long-standing precedent. So this has been the law of the land for about, I believe, 28 years now.

So Franchise Tax Board is applying, you know, nothing new. The rules are not unexpected. Regulation Dash 14 is a special regulation under Section 25137, and it's uncontested that the conditions and circumstances in Dash 14 apply to Appellant.

Now, Appellant speaks a lot about Dash 14 conflicting with Section 25136, such that it should not be applied. But Regulation 25137-14 was promulgated under Revenue and Taxation Code 25137.

That statutory section provides that, when generic apportionment rules, like 25136, do not fairly reflect a taxpayers' activities in state, FTB can require the taxpayer to use any other method to fairly reflect its activities.

The California legislature, when it was passing 25137 in the 1960s, specifically allowed deviation from the generic assignment rules, like Section 25136.

So Section 25137 was designed to provide alternate rules. That's its explicit purpose.

As a specific application of 25137, Dash 14 fulfills the purpose of its governing statute, imposes no

issue of statutory conflict with 25136.

Furthermore, the taxpayer discusses that Dash 2, meaning regulation 25136-2, provides standard apportionment, which it doesn't, and we know that from Appeal of Amarr.

However, I did want to point out that there is nothing regarding the standard of benefit of the service, which requires assignment to the physical location of a purchaser.

Taxpayer mentioned -- excuse me. Appellant mentioned that there are examples of some contracting situations where a customer's customer was the location of assignment. But there is no inherent limiting location where a benefit can be found, and in some examples, that location is not where the physical location of a customer is, and not just in subcontracting situations.

Furthermore, the Appellant has said nothing regarding why the location itself of the purchaser of these funds is where the benefit is received. And in doing so, it actually falls into the same trap as the Lutheran court did. In the Lutheran case, which Appellant mentioned --

First of all, I want to note that the law there is different from the law here in California. It talks

about where the benefit of a service is consumed. So first off, there's a different standard that the Court was applying in that case.

Secondly, Lutheran, just as Appellant here has done at court, did no analysis as to where the funds consumed the benefit of the service. It assumed a physical location and it didn't actually run through any analysis whatsoever on why that physical location was the location where it received a benefit.

So in short, you know, at the end of the day, this case is really quite simple. Its Appellant is a mutual funds service provider, and it's required to apply Regulation Dash 14 to assign its sales to the state.

Although Appellant has argued that Dash 14 is invalid, in applying its apportionment rules -- to avoid applying its apportionment rules, the OTA lacks jurisdiction to invalidate Respondent's duly passed regulation.

Furthermore, even if your office determines that it does have jurisdiction to invalidate a regulation, Appellant hasn't met its burden of demonstrating that the FTB didn't comply with the Administrative Procedures Act when promulgating the regulation.

And furthermore, it has not shown that the change to 25136, brought about in Proposition 39, in

2012, changed the validity of the regulation.

So then even if your office determines it has jurisdiction to consider the validity of Dash 14, at the end of the day, Dash 14 applies, and FTB's position should be sustained.

Thank you.

JUDGE HOSEY: Thank you, Ms. Smith.

Would the Appellant like to reply?

MR. MELNICZAK: Yes, please.

JUDGE HOSEY: Go ahead.

MR. MELNICZAK: I'd like to address the language that was referenced from the Amarr case, which also involved a 25137 regulation, and which noted that, generally speaking, the regulation is the standard.

The issue with that, as applied to this case, is that it begs the question whether the regulation is valid in the first instance.

If -- again, if this appeal involved years prior to market sourcing, prior to 2013, Amarr certainly holds and is true that we would -- we would, in fact, have a valid regulation, and Janus would be seeking to deviate from it, and we would very well have the requirement of showing distortion. That's only if the regulation is invalid.

As we mentioned in the prior section, the

regulation is not invalid because a regulation that conflicts with the statute can only be done under 25137, and 25137 requires that the apportionment provisions of the act in place at the time do not reflect a taxpayer's business activity.

Again, that simply begs the question as to whether or not Dash 14 is valid in the first place. Certainly if it is valid, we don't get to the question of -- of whether market sourcing applies because we would have the burden of showing distortion, and we have not, today, made an argument that Dash 14 is distortive. We would argue that it simply is not valid.

Another distinction with the Amarr case is that, while it did involve a 25137 regulation, it involved the 25137 regulation which excluded certain substantial and occasional sales of tangible personal property from the sales factor.

Now, the reason that the FTB wanted to exclude those sales is because in certain instances, it was found that, you know, including a large, you know, one-off sale of property, for example, could distort a taxpayer's sales factor because it doesn't fairly reflect that taxpayer's business.

So the FTB found that was distortive in certain cases, but there's nothing about the switch from cost

performance to market sourcing, in 2013, that alters that distortion analysis. So there is no reason at all to believe that the substantial and occasional sale exclusion, that was at issue in Amarr, should no longer apply aftermarket sourcing.

First off, substantial occasional sale refers to sales of tangible personal property. And the change at issue here, from cost performance to market, affects sales of services.

And secondly, the analysis that the FTB undertook to include that substantial and occasional sales should be excluded, meaning they don't fairly represent a business, there's nothing about that that changed after they switched to market sourcing, unlike the three factors we mentioned earlier, which is that cost performance went up for services, went all to one state, it didn't reflect market, it didn't reflect property and payroll.

Those are three big factors that the FTB relied on to show distortion under the cost of performance rule, and those factors no longer exist under market sourcing.

However, all the factors for substantial and occasional sales, all of the factors for their exclusion from the factor remain before and after the law changed.

So there's no reason to apply a different rule.

In Amarr, there was no reason to apply a different rule post 2013 rather than pre 2013.

And finally, I want to address the question of whether the purchaser must always receive the benefit where it is located.

In our case, our purchasers have only one location of their own. They have no customers of their own. So there is no -- no customer to look through, and it -- it has never been found appropriate to look to where a customer's shareholders are.

For example, if legal services were provided to a corporation, say Microsoft, you might look to where Microsoft is located. You might look to their offices. You might even look to where Microsoft customers are, but you would never look to where Microsoft's individual shareholders are, and that's what FTB would be seeking to do in -- by equivocating a shareholder sourcing rule with a market sourcing rule, which looks to where the purchasers receive the benefit.

Thank you.

MS. SMITH: May I respond?

JUDGE HOSEY: Thank you.

Go ahead, Ms. Smith.

MS. SMITH: Thank you.

I wanted to specifically address the Regulation

C -- 25137(c)(1)(A), which is the regulation at issue in Amarr.

First, I do want to point out that it does actually apply to intangibles. One of the examples actually in that regulation discusses stock. So there is no limit, first off, regarding sales of intangibles.

But secondly, it is incorrect to state that the reason for passing (c)(1)(A) did not have to do with cost of performance assignment methodology. (c)(1)(A), what it does is it takes out of the sales factor large infrequent, so substantial and occasional, sales of property that's used in a business or it could be a factor a year, as they said in the example sales of stock.

And this was promulgated under COP years. And one of the reasons that it was promulgated was because there would be an over emphasis, like taxpayer argues in its -- in its case here, that there would be an over emphasis assigning that sale to the location of property and payroll. So essentially duplicating the property and payroll factors for a sale.

So the remedy for this, under 25137, was to take it out of the sales factor to -- so as to not duplicate the -- by using cost performance, the locations of property and payroll.

So I would say that actually Amarr, its ruling is particular on point, because when your office looked at that case, it was dealing with a regulation that was passed during the COP years. And one of the basis -- basis for the promulgation was because COP over emphasized the property and payroll locations of that -- of the taxpayer.

So furthermore, I think that if we are going to -- so essentially if OTA -- OTA was -- trying to say how to phrase this.

Essentially the same background occurred for (c)(1)(A) as it does for this case, and so we already know that despite, you know, the basis of COP, the background of the COP as being one of the bases for the (c)(1)(A), nevertheless, OTA affirmed that nevertheless, this is standard apportionment if the circumstances and situations apply to the taxpayer. And the same thing is happening here with Dash 14.

Thank you.

JUDGE HOSEY: Thank you.

Appellant, would you like to respond before we move to questions from the panel?

MR. MELNICZAK: Yes, please.

JUDGE HOSEY: Okay. Go ahead.

MR. MELNICZAK: I just want to highlight that we

do acknowledge that 25137(c)(1)(A), which was at issue in Amarr, does apply to intangibles, as well. But in this case, we are not talking about intangibles. We are talking about services. So we do have a direct conflict between Dash 14, which applies to mutual fund service receipts, and 25136, the statute which also applies to services.

Now, the other key fact about 25137(c)(1)(A) is that the distortion there was focused on the incidental nature of a sale. As the FTB mentioned, there could be a one-off sale of property or a factory or stock, which could be intangible, that could be distortive of a taxpayers' factor.

And I just want -- and I just wanted to repeat that that -- that same distortion, the fact that a one-off sale could have a, you know, a huge or distortive effect on a sales factor, that remains present both under the cost performance rule for services and the market rule for services because, again, the switch to market only affected services, not tangible personal property or intangibles.

Thank you.

JUDGE HOSEY: Okay. Thank you. I'm going to move to questions from the panel.

I'm going to start with Judge Ridenour.

Any questions?

JUDGE RIDENOUR: No questions. Thank you.

JUDGE HOSEY: Thank you.

Move to Judge Akopchikyan.

Any questions?

JUDGE AKOPCHIKYAN: I don't think I have any questions. I'm going to confirm. I'll let you know.

JUDGE HOSEY: Okay. I think without any questions, we are ready to submit the case and conclude the hearing. The evidence has been admitted into the record, and we have the arguments and your briefs, as well as the oral arguments presented today.

We now have a complete record from which to base our decision and are ready to submit the case. The record is now closed. This concludes the hearing for this appeal. The parties should expect a written opinion within 100 days from today.

With that, we are now off the record, and the hearings are concluded for today.

Thank you, everybody.

I appreciate your time today.

(Proceedings concluded at 12:06 p.m.)

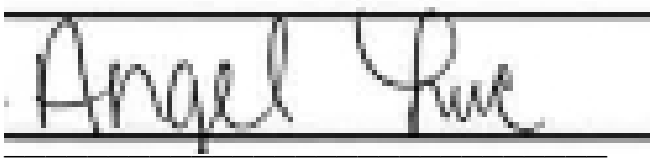
REPORTER'S CERTIFICATE

STATE OF CALIFORNIA)
) ss.
COUNTY OF ALAMEDA)

I, Angel Love, a Certified Shorthand Reporter of The State of California, do hereby certify that I am a disinterested person herein; that I reported the foregoing hearing to the best of my ability in shorthand writing; that I thereafter caused my shorthand writing to be transcribed into typewriting.

I further certify that I am not of counsel or attorney for any of the parties to said hearing, or in any way interested in the outcome of the said hearing.

IN WITNESS WHEREOF, I have subscribed this certificate at Sacramento, California, on this 10th day of May 2023.



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