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STATE OF MICHIGAN
IN THE SUPREME COURT
Appeal from the Michigan Court of Appeals
Tukel, P.J., and Sawyer and Riordan, JJ.

VECTREN INFRASTRUCTURE SERVICES CORP.,

Plaintiff-Appellee,

v

MICHIGAN DEPARTMENT OF TREASURY,

Defendant-Appellant.
_____/

Supreme Court No. 163742

Court of Appeals No. 345462

Court of Claims No. 17-000107-MT

BRIEF ON APPEAL OF APPELLANT MICHIGAN DEPARTMENT OF TREASURY

ORAL ARGUMENT REQUESTED

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Dated: May 4, 2022

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TABLE OF CONTENTS

Page

Index of Authorities ii

Statement of Jurisdiction v

Statement of Questions Presented vi

Statutes Involved vii

Introduction 1

Statement of Facts and Proceedings 2

Standard of Review 19

Argument 19

I. Vectren does not support its alternative apportionment proposals with clear or cogent evidence. 19

II. Vectren has not shown violations of the due process or commerce clauses. 25

III. It is Treasury's exclusive authority to approve any alternative apportionment method. 34

Conclusion and Relief Requested 36

RECEIVED by MSC 5/4/2022 4:43:00 PM

INDEX OF AUTHORITIES

Cases

Allied Signal, Inc v Director, Div of Taxation,
504 US 768 (1992) 30

Bass, Ratcliff & Gretton Ltd v State Tax Comm,
266 US 271 (1924) 33

Complete Auto Transit, Inc v Brady,
430 US 274 (1977) 26

Container Corp of Am v Franchise Tax Bd,
463 US 159 (1983) ..... passim

Detroit Edison Co v Dep't of Treasury,
498 Mich 28 (2015) 36

Exxon Corp v Wisconsin Dep't of Revenue,
447 US 207 (1980) 27

Ford Motor Co v Beauchamp,
308 US 331 (1939) 28, 29

Hans Rees' Sons v North Carolina,
283 US 123 (1931) 30, 32, 33

Miller Brothers Co v Maryland,
347 US 340 (1954) 25

Moorman Mfg Co v Blair,
437 US 267 (1978) 28, 29

Nat'l Leather Co v Massachusetts,
277 US 413 (1928) 33

Norfolk & Western Ry Co v Missouri State Tax Comm,
390 US 317 (1968) 21

People v Benton,
294 Mich App 191 (2011) 23, 35

Sidney Frank Importing Co, Inc v Dep't of Treasury,
unpublished per curiam opinion of the Court of Appeals, issued December 4, 2012 (Docket No. 306742) 30

South Dakota v Wayfair, Inc,
___ US ___; 138 S Ct 2080 (2018) 25

State Tax Assessor v Kraft Foods Grp, Inc,
235 A3d 837 (2020) 29

Syntex Laboratories v Dep't of Treasury,
233 Mich App 286 (1998) 30

Trinova Corp v Dep't of Treasury,
433 Mich 141 (1989) (*Trinova I*) 19, 27, 30, 31

Trinova Corp v Michigan Dep't of Treasury,
498 US 358 (1991) (*Trinova II*) 26, 27

Underwood Typewriter Co v Chamberlain,
254 US 113 (1920) 26, 33

Vectren Infrastructure Servs Corp v Dep't of Treasury,
331 Mich App 568 (2020) 32

Statutes

IRC § 1361 11

IRC § 338(h)(10) 12, 15

MCL 208.1101 *et seq.* vi

MCL 208.1115(1)(a) 13

MCL 208.1115(1)(b) 13

MCL 208.1303 12

MCL 208.1309 ..... 15, 16, 35

MCL 208.1309(1) 19

MCL 208.1309(2) ..... vi, 34

MCL 208.1309(3) ..... vi, 19

RECEIVED by MSC 5/4/2022 4:43:00 PM

RECEIVED by MSC 5/4/2022 4:43:00 PM

Rules

MCR 2.110 22

MCR 7.303(B)(1) v

MRE 602 21

Constitutional Provisions

Const 1963, art 3, § 2 34

RECEIVED by MSC 5/4/2022 4:43:00 PM

STATEMENT OF JURISDICTION

This Court has jurisdiction over the Department of Treasury's application for leave to appeal under MCR 7.303(B)(1) based on this Court's March 23, 2022 order granting Treasury's application for leave to appeal.

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STATEMENT OF QUESTIONS PRESENTED

In an order dated March 23, 2022, this Court asked the parties to brief the following three questions in its grant of argument on the application:

1. Whether the taxpayer established by clear and cogent evidence that "the business activity attributed to it in this state 'is out of all appropriate proportion to the actual business activity transacted in this state and leads to a grossly distorted result' " under MCL 208.1309(3) of the Michigan Business Tax Act, MCL 208.1101 *et seq*.?

   Treasury's answer: No.

   Appellee's answer: Yes.

   Trial court's answer: No.

   Court of Appeals' answer: Yes.

2. Whether application of the statutory formula in this case runs afoul of the Due Process and Commerce Clauses incorporated in the statute because it does not fairly determine the portion of income from the sale of a business attributed to in-state activities?

   Treasury's answer: No.

   Appellee's answer: Yes.

   Trial court's answer: No.

   Court of Appeals' answer: Yes.

3. Whether remand for the parties to determine an alternate method of apportionment conflicts with MCL 208.1309(2), which vests exclusive authority to approve an alternate method of apportionment in the Department of Treasury?

   Treasury's answer: Yes.

   Appellee's answer: No.

   Trial court's answer: Did not answer.

   Court of Appeals' answer: No.

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STATUTES INVOLVED

MCL 208.1201

(1) Except as otherwise provided in this act, there is levied and imposed a business income tax on every taxpayer with business activity within this state unless prohibited by 15 USC 381 to 384. The business income tax is imposed on the business income tax base, after allocation or apportionment to this state, at the rate of 4.95%.

MCL 208.1105

(1) "Business activity" means a transfer of legal or equitable title to or rental of property, whether real, personal, or mixed, tangible or intangible, or the performance of services, or a combination thereof, made or engaged in, or caused to be made or engaged in, whether in intrastate, interstate, or foreign commerce, with the object of gain, benefit, or advantage, whether direct or indirect, to the taxpayer or to others, but does not include the services rendered by an employee to his or her employer or services as a director of a corporation. Although an activity of a taxpayer may be incidental to another or to other of his or her business activities, each activity shall be considered to be business engaged in within the meaning of this act.

MCL 208.1301

* * *

(2) Each tax base of a taxpayer whose business activities are confined solely to this state shall be allocated to this state. Each tax base of a taxpayer whose business activities are subject to tax both within and outside of this state shall be apportioned to this state by multiplying each tax base by the sales factor calculated under [MCL 208.1303].

MCL 208.1303

(1) Except as otherwise provided in subsection (2) and section 311, the sales factor is a fraction, the numerator of which is the total sales of the taxpayer in this state during the tax year and the denominator of which is the total sales of the taxpayer everywhere during the tax year.

MCL 208.1309

(1) If the apportionment provisions of this act do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the treasurer may require the following, with respect to all or a portion of the taxpayer's business activity, if reasonable:

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(a) Separate accounting.

(b) The inclusion of 1 or more additional or alternative factors that will fairly represent the taxpayer's business activity in this state.

(c) The use of any other method to effectuate an equitable allocation and apportionment of the taxpayer's tax base.

* * *

(3) The apportionment provisions of this act shall be rebuttably presumed to fairly represent the business activity attributed to the taxpayer in this state, taken as a whole and without a separate examination of the specific elements of either tax base unless it can be demonstrated that the business activity attributed to the taxpayer in this state is out of all appropriate proportion to the actual business activity transacted in this state and leads to a grossly distorted result or would operate unconstitutionally to tax the extraterritorial activity of the taxpayer.

MCL 208.1115(1)

(1) "Sale" or "sales" means, except as provided in subdivision (e), the amounts received by the taxpayer as consideration from the following:

(a) The transfer of title to, or possession of, property that is stock in trade or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business. For intangible property, the amounts received shall be limited to any gain received from the disposition of that property.

(b) The performance of services that constitute business activities.

(c) The rental, lease, licensing, or use of tangible or intangible property, including interest, that constitutes business activity.

(d) Any combination of business activities described in subdivisions (a), (b), and (c).

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INTRODUCTION

Vectren's tax appeal suffers significant flaws—both as matters of substance and of procedure/evidence—which are fatal to its claims here.

First, Vectren does not dispute that Minnesota Limited, Inc. (MLI) had business activity in Michigan, i.e., the Enbridge contract, which figured into Treasury's determination of MLI's tax base/liability. To the contrary, MLI's own returns placed the gain from the sale of MLI into MLI's own tax base. Vectren's arguments that there is gross distortion or taxation out of all proportion to MLI's business activities are belied by its own returns and acknowledgment that it had the amount of Michigan business activity that Treasury determined. Accordingly, Vectren has not shown that Treasury's determination of MLI's Michigan business activity is out of proportion with MLI's actual Michigan business activity. While Vectren sets forth the various alternative apportionment formulae for the Court's consideration, it demonstrates no evidentiary basis for these proposals. Vectren merely expects Treasury, and this Court, to take Vectren's word for it without proofs.

Second, while Vectren alleges Due Process and Commerce Clause violations, these claims are meritless because Vectren has not shown that the statutory apportionment formula as applied to MLI's in-state activities is unfair, and has not proposed a different metric, aside from a historical geographic accounting analysis of sales, to answer this question. But even if it did, courts around the country—including this Court—have established that some tolerance is made for apportionment purposes and rejected the geographic accounting Vectren proposes.

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Third, the Court of Appeals' decisions contradict the statute and create separation of powers problems in ordering the parties to work towards an alternative apportionment scheme despite Treasury's exclusive authority to approve the same.

For these reasons, the Court of Claims properly dismissed Vectren's action, and this Court should reverse the Court of Appeals' decisions and affirm Treasury's tax determination.

STATEMENT OF FACTS AND PROCEEDINGS

Minnesota Limited Inc.'s business operations

MLI was an S-corporation organized under the laws of Minnesota. (App'x Vol I, p 60a, ¶ 1 (Am Compl); *id*. at 83a (Leines Dep Tr).) Up to and through the 2011 tax year, MLI's business operations consisted of oil and gas pipeline construction, repair, and HAZMAT response services. (*Id*. at 104a–105a, Resp No. 2 (Pl's Resp to Def's 1st Disc Req); *id*. at 61a, ¶ 3 (Am Compl).) Specifically, the company provided construction services to natural gas, crude oil, refined products, and hydrocarbon industries in the United States. (*Id*. at 104a–105a, Resp No. 2.) Over the years, the company continued to expand its territorial and customer base, and eventually was licensed and did work in approximately twenty-four states. (*Id*. at 81a–82a (Leines Dep Tr).)

In March 2010, the shareholders of MLI, siblings Christopher Leines and Paulette Britzius, were looking to sell MLI. Ms. Britzius was experiencing health issues and wanted to "get out of the business." (*Id*. at 84a.) Therefore, Mr. Leines

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"either [ ] had to buy her out, or we had to shut the company down or look for a seller." (*Id*. at 86a.) Further, "[they] were kind of being pursued too as well." (*Id*. at 85a.)

The shareholders retained Green Holcomb & Fisher to assist them in selling their business. (*Id*. at 80a–81a, 87a; *id*. at 61a, ¶ 7 (Am Compl).) To promote the business, Green Holcomb & Fisher prepared a Memorandum entitled *Project Cadillac Confidential Memorandum* (Offering Memo), that contained information obtained from MLI (among other sources).[1] (*Id*. at 122a–216a (Offering Memo); *id*. at 87a–88a (Leines Dep Tr).) Mr. Leines reviewed the memorandum "to make sure it [was] as accurate as we could make it for the potential buyers," and ultimately approved it. (*Id*. at 87a–93a (Leines Dep Tr).) This Offering Memo was given to potential buyers, including Vectren, to convey information concerning MLI's business, some of its core customers,[2] and its industry. (*Id*. at 94a–99a.)

While Vectren contends that MLI's business operations in Michigan had been occasional and sporadic in the past several years, there were various opportunities for MLI in Michigan at the time it began looking for purchasers. Specifically, according to its Offering Memo, MLI stood to benefit from both high fuel prices and "renewed domestic attention to difficult to access oil and gas deposits and shale

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[1] The Offering Memo states the following: "[i]nformation contained herein has been obtained from the Company and other sources which are believed to be reliable." (App'x Vol I, p 123a.) One such other source identified in the Offering Memo is *IBIS Pipeline Construction in the U.S. Report, dated January 4, 2010*. (*Id*. at 141a.)

[2] MLI did not list all of its customers in the Offering Memo as a precaution that other competitors would review the document for recognizance purposes. (App'x Vol I, p 94a (Leines Dep Tr).)

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recovery techniques." (App'x Vol I, pp 127a, 133a.) "Unconventional gas production (which includes 'shale gas') now represents approximately 40% of all U.S. gas production . . . ." (*Id*. at 133a.) "Much of this unconventional oil and gas production, including the Marcellus and Antrim [located in Michigan] Shale formations, are right in [MLI's] geographic sweet spot." (*Id*.) In addition, MLI claimed it had substantial capabilities to expand its operations "with an emphasis on expansion both west of the Mississippi and areas in the Great Lakes region." (*Id*. at 127a.)

Produced in the Offering Memo, figure 1 below identifies certain new shale gas basins, including Michigan's Antrim shale basin. (*Id*. at 133a.)

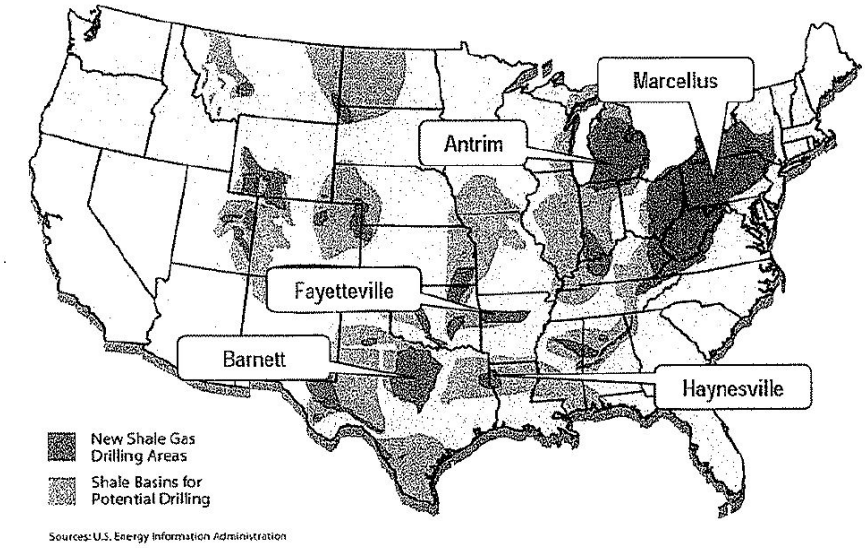

Figure 1. Obtained from MLI's Project Cadillac Confidential Memorandum

Further, the Offering Memo states that "[m]uch of the natural gas pipeline construction activity is supporting an increasing reliance on natural gas as a feedstock for electricity generation." (*Id*. at 132a.) Over 50% "of all new electricity generation in the U.S. in 2008 used natural gas as a feedstock and . . . this trend

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[was expected] to continue for the next decade." (*Id.*) Consumers Energy, a Michigan Corporation that operates primarily in Michigan (App'x Vol I, p 230a (Consumers 2011 10-K)), was a major customer of MLI at the time of selling its business. (*Id.* at 101a (Leines Dep Tr); App'x Vol II, p 553a, Part 4.23 (Purchase Agr).)

Also, according to the Offering Memo, MLI had a facility in Illinois that served as a "beachhead for securing work in Illinois, Michigan, Indiana, and Missouri. [MLI] plan[ned] to continue this strategy and [was] evaluating opening two additional locations that would better position it for work in the Great Lakes region and Rocky Mountain region." (App'x Vol I, p 169a.)

And because MLI performed most of its services in the Midwest, it is directly affected by the Canadian oil industry and production in the Rocky Mountains, which opened construction opportunities in the Great Lakes region. "Canada is the only country that delivers oil to the U.S. by pipeline, and delivers most of this oil from Western Canada through the Midwest into the U.S. pipeline network. In the last decade, there has been significant natural gas pipeline construction between Canada and the Great Lakes region." (*Id.* at 150a.) In addition, "[a] significant amount of [MLI's] work is concentrated in the Midwest which is a major pipeline crossroad connecting production in the Rocky Mountain and Western Canada Regions with major markets in the Upper Midwest and east of the Mississippi." (*Id.* at 153a.)

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Finally, in the summer of 2010, MLI "was engaged by Enbridge Energy ('Enbridge') to respond to a severe oil pipeline rupture that occurred in a tributary of the Kalamazoo River in July of 2010." (App'x Vol I, p 61a, ¶ 8 (Am Compl).) According to Vectren, this project was MLI's largest single contract ever performed in Michigan. (*Id*. at ¶ 9.) "The work commenced in July 2010 and was completed in May 2012." (*Id*. at 108a–109a, Resp No. 7 (Pl's Resp to Def's 1st Disc Req).) In 2010, approximately 40% of MLI's sales revenue was generated in Michigan compared to everywhere else. (*Id*.) But MLI's former president, Christopher Leines, could not state with any specificity how much equipment was located in Michigan: "[t]here would have been some company equipment on the project in Michigan and a lot of rented equipment from the local Cat dealer and John Deere and such." (*Id*. at 100a.)

Vectren Corporation

Vectren is an energy utilities company that expanded its business in December 2000. Specifically, Vectren acquired Miller Pipeline Corporation (Miller) to provide infrastructure services such as underground pipeline construction, replacement, and repair in order to carry natural gas, liquids, water and wastewater. (App'x Vol II, pp 605a–606a (Vectren 2001 10-K); *id*. at 667a–669a (Banning Dep Tr).) Miller had three distinct lines of businesses:

(1) A distribution pipeline construction company that constructed pipelines for local distribution companies;

(2) A transmission pipeline construction company, i.e., Miller constructed interstate pipelines generally regulated by Federal Energy Regulatory Commission; and

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(3) A water and wastewater rehabilitation business that rehabilitates wastewater and constructs new pipelines. [*Id.* at 668a (Banning Dep Tr).]

In 2008 through 2011, Vectren believed new shale formations and fracking technology presented profitable opportunities in its infrastructure services business of constructing, replacing, and repairing pipelines. (*Id.* at 670a–671a.) The industry saw growth in demand for gas transmission construction and pipeline upgrades. (*Id.* at 685a–686a.) In the United States, new shale formations were discovered, along with new techniques to frack those formations to extract oil, natural gas, and wet gases (ethane, propane, butane). (*Id.* at 673a–674a.) Vectren looked to expand their business into new territories and increase their customer base but did not have sufficient management or infrastructure to take advantage of these opportunities. (*Id.* at 670a–671a, 679a, 681a–683a.)

While Vectren looked to acquire an entity in the industry, MLI approached Vectren about a potential sale. (*Id.* at 670a–671a.) At the time, Vectren was operating in approximately 20 to 25 states and was looking to expand its territory. (*Id.* at 672a.) Although Vectren claims that the Antrim shale formation had nothing to do with purchasing MLI, Vectren's president, Douglas Banning, explained that Vectren was looking for new customers and territories in which those customers work, and that Vectren's lack of a customer base in the Antrim region would be "a plus" insofar as Vectren was trying to expand their territory and customer base. (*Id.* at 677a–680a, 682a.) And MLI's transmission territory included Michigan as shown in figure 2 below. (*Id.* at 691a (Vectren 2011 8-K Exhibit 99.1).)

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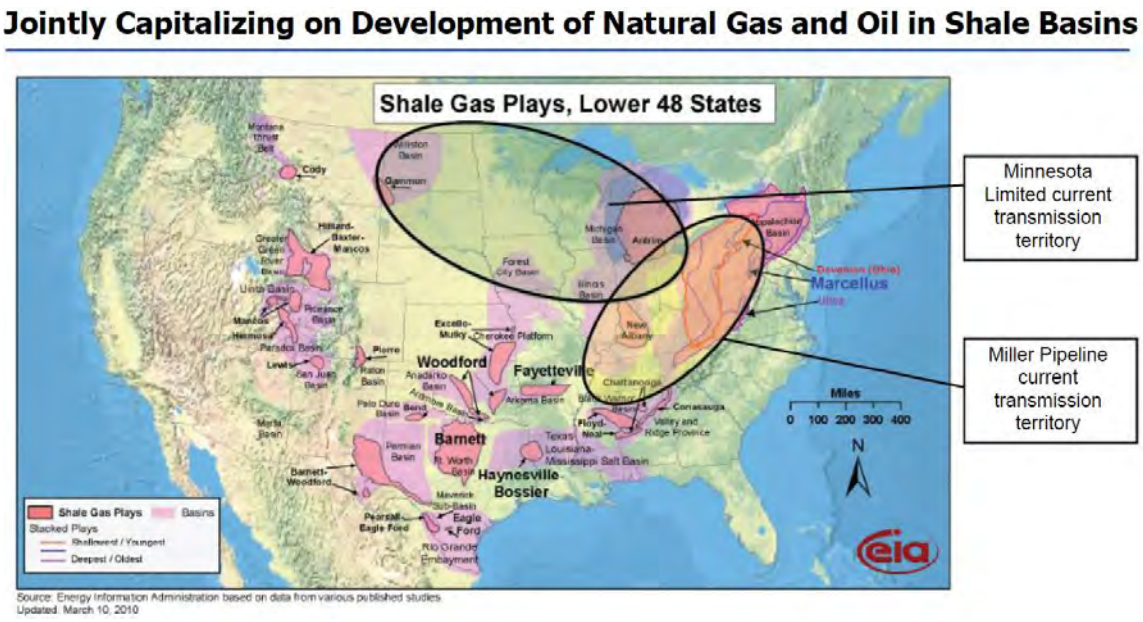

Figure 2. Obtained from Vectren's 2011 Form 8-K attachment.

Between the transmission territories of the two entities, Vectren would be "[p]ositioned well to take advantage of the pipeline construction impacts from shale," including development of natural gas and oil in certain shale basins, including Michigan's Antrim shale basin. (*Id.* at 688a–692a.) Further, according to Vectren's 2011 Form 8-K, Vectren was aware of MLI's current customers, including but not limited to, Enbridge Energy (which had a significant contract with MLI in 2011) and Consumers Energy (which operates primarily in Michigan). See figure 3 below. (*Id.* at 692a; *id.* at 675a–676a (Banning Dep Tr).) And while Mr. Banning claimed that Vectren had "more sophisticated market data" than the Offering Memo contained, and that Vectren instead looked to MLI's financials, he admitted that the financials say nothing about MLI's customer base. (App'x Vol II, pp 684a, 687a (Banning Dep Tr).) Instead, Vectren relied "somewhat [on] the offering memorandum," (*id.* at 687a), which describes MLI's major customers including

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Consumers Energy and Enbridge Energy as shown in figure 3 below. (*Id.* at 692a (Vectren 2011 8-K Exhibit 99.1).)

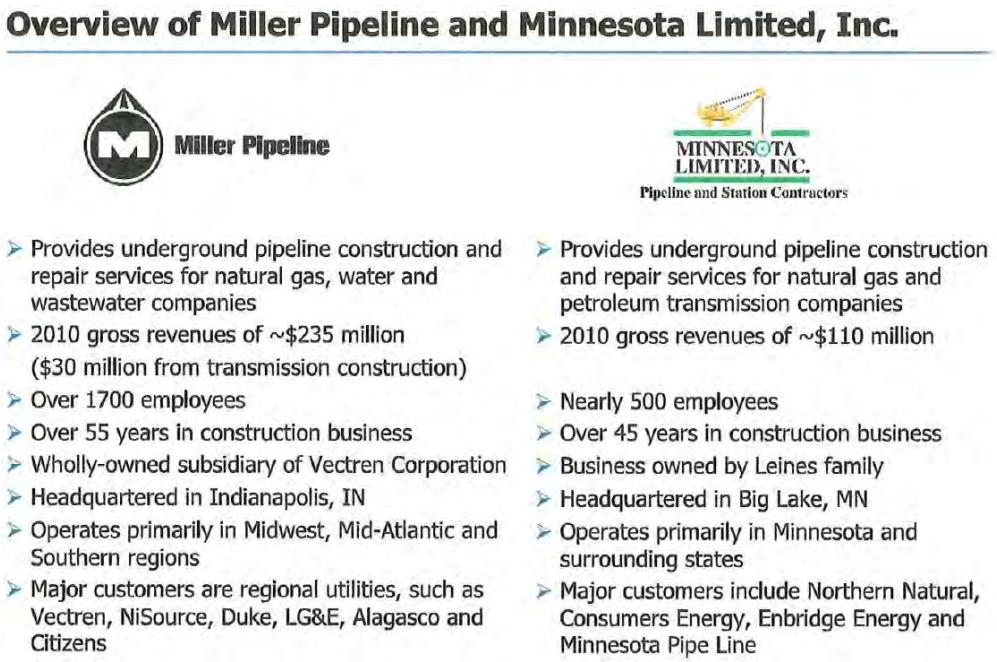

Figure 3. Obtained from Vectren's 2011 Form 8-K attachment.

Vectren believed that acquiring MLI was "[c]onsistent with Vectren's plans to target infrastructure services growth through geographic and market expansion opportunities." (*Id.* at 690a.) MLI would "[p]rovide[] access to new customer base and geographic territories for both Miller and Minnesota Limited." (*Id.*) Vectren believed this acquisition positioned it to take advantage of anticipated growth in demand for "gas transmission construction resulting from the need to transport new sources of natural gas and oil found in shale formations and the need to upgrade the nation's aging pipelines." (*Id.* at 733a, 766a (Vectren 2011 10-K).)

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Vectren's Purchase of MLI

On March 31, 2011, Vectren Corporation, through its wholly owned subsidiary Vectren Infrastructure Services Company, Inc., purchased MLI for approximately $88.6 million ($83.4 million cash and $5.2 million assumption of debt), which included:

- $14.8 million of net working capital;
- $34.4 million of property, plant, and equipment;
- $19.1 million of identifiable intangibles; and
- $20.3 million of implied goodwill.

(App'x Vol II, pp 702a, 733a–734a, 766a–767a (Vectren 2011 10-K); *id*. at 830a, 854a (KPMG Draft Val); App'x Vol I, pp 468a–469a, ¶ 7.1(e)(ii) (Purchase Agr).) Note that goodwill equals the price paid for MLI minus the fair market value of MLI's net identifiable assets and represents the intangible value Vectren expected to realize from MLI over time. (*Id*. at 733a–734a, 766a–767a (Vectren 2011 10-K); *id*. at 825a (Hirsch Dep Tr).) In other words, goodwill is a forward-looking concept that considers future value/opportunities.

Valuation of MLI's Intangible Assets

On December 1, 2010, Vectren engaged KPMG to provide a valuation of MLI's intangible assets in connection with the acquisition. (App'x Vol II, p 827a (KPMG Draft Val).) KPMG prepared a draft report on August 30, 2011, which was never finalized by KPMG. (*Id*. at 814a (Hirsch Dep Tr).) The purpose of the report was to value intangible assets in order to comply with certain financial reporting

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requirements and tax regulatory purposes. (*Id*. at 830a (KPMG Draft Val).) KPMG did not value any other business assets. KPMG also did not value any intangible assets on a state-by-state basis. (*Id*. at 815a–822a (Hirsch Dep Tr).) Accordingly, there is no way to ascertain the value of assets, both tangible and intangible, associated to business activities in Michigan.

In the report, KPMG identified three separate intangible assets with a combined valuation of $19,116,000:

- Trade Name was valued at $4,241,000;
- Customer Relationships was valued at $14,588,000; and
- Backlog was valued at $287,000.

(*Id*. at 830a, 847a, 854a (KPMG Draft Val).) KPMG valued MLI's intangible assets based on future earnings generated by the use of these assets. (*Id*. at 823a–824a (Hirsch Dep Tr).)

Specifically, KPMG calculated goodwill by taking the purchase price and subtracting the tangible assets (value provided by MLI) and identified intangible assets (valued by KPMG). (*Id*. at 825a; *id*. at 854a (KPMG Draft Val).) The residual equals goodwill. (*Id*. at 825a (Hirsch Dep Tr).) In short, the valuation of intangible assets was a largely forward-looking analysis.

Vectren's 2011 Michigan Business Tax Return

In 1996, MLI filed an election to be treated as an S-Corporation under Internal Revenue Code (IRC) § 1361. (App'x Vol I, pp 455a–456a, ¶ 4.10(e) (Purchase Agr).) For purposes of MLI's 2011 federal tax liability, MLI and Vectren

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jointly elected to treat the sale of MLI's stock as a taxable sale of its assets under federal IRC § 338(h)(10). (App'x Vol III, pp 866a–873a (June 2016 Alt Req); App'x Vol I, pp 468a–469a, ¶ 7.1(e) (Purchase Agr).) Vectren claims "[t]he assets that were deemed sold in the stock sales included [MLI's] capital assets and intangible assets of receivable, retainages, cash, prepaid expenses, inventory and goodwill." (App'x Vol III, pp 866a–873a (June 2016 Alt Req).)

On January 13, 2012, MLI filed its Michigan Business Tax (MBT) return for tax period January 1, 2011 through March 31, 2011. (*Id*. at 874a–883a.) While MLI properly included the sale of its business assets in the business income and gross receipts tax bases in its MBT return, it improperly included the sale of its business assets in the denominator of the sales factor apportionment. (*Id*. at 886a (AROF); *id*. at 874a, ln 11b (2011 Michigan Ret).) Similarly, in its request for alternative apportionment, Vectren acknowledged that MLI's tax base included gross receipts and income from the MLI sale. (*Id*. at 868a–869a (June 2016 Alt Req).)

Under the MBTA, a taxpayer with business activities both within and outside of Michigan will apportion its tax base using the sales factor apportionment formula. The sales factor is a fraction, the numerator of which is total sales of the taxpayer made in Michigan during the tax year and the denominator of which is total sales everywhere made by the taxpayer during the tax year. MCL 208.1303. "Sales" is statutorily defined as amounts received by the taxpayer as consideration from:

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> The transfer of title to, or possession of, property that is stock in trade or other property of a kind that would properly be included in the inventory of the taxpayer if on hand at the close of the tax period or property held by the taxpayer primarily for sale to customers in the ordinary course of the taxpayer's trade or business.
> [MCL 208.1115(1)(a).]

More, as to service providers, MCL 208.1115(1)(b) defines "sales" as the amounts received by taxpayers as consideration for the "performance of services that constitute business activities."

In its 2010 MBT return, MLI properly included operational sales in both the numerator and denominator of the sales apportionment factor, which did not include the sale of business assets as reported in its 2010 Federal Forms 4797. (App'x Vol III, p 893a, ln 11b (2010 Michigan Ret); *id*. at 905a–912a (2010 Forms 4797); *id*. at 886a (AROF).) But in its 2011 MBT return, MLI erroneously included in the sales denominator the gain from its federal Schedule D and sale of business assets from its federal Forms 4797. (*Id*. at 874a, ln 11 (2011 Michigan Ret); *id*. at 913a–959a (2011 Fed Ret); *id*. at 886a (AROF).) The net effect of this is that the percentage gets smaller as the denominator gets larger.

Thus, MLI attempted to apportion using a smaller sales factor percentage—i.e., 14.9860% to be applied to the 2011 MBT tax base instead of 69.9761%. (App'x Vol III, pp 962a–963a (Audit Workbook); *id*. at 886a (AROF).) Accordingly, while Vectren now claims that the gain on the MLI asset sale should not be included in MLI's tax base, MLI's as-filed returns properly reported this gain as part of the tax base, and MLI did not file any amended returns.

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Treasury's Audit

Treasury performed a MBT audit for the period January 1, 2010 through March 31, 2011 (hereinafter, "audit period"). (App'x Vol III, p 884a (AROF).) In reviewing the sales factor apportionment, the auditor determined, among other things, that MLI overstated sales everywhere (sales denominator) for the 2011 tax period by including the gain from Schedule D and proceeds from the sale of business property. (*Id*. at 886a.) By improperly including the sale of the business as part of the denominator, the auditor determined that the denominator was overstated by approximately $77,372,495, which lowered the sales apportionment factor by approximately 54.9711%. (*Id*.; *id*. at 962a–963a (Audit Workbook).) On April 4, 2016, Treasury issued a notice of intent to assess, assessment no. U071593. (*Id*. at 971a–972a.)

Request for Alternative Apportionment

Contrary to Vectren's statement that MLI "timely requested the use of an alternative apportionment method" (App'x Vol III, p 1012), Vectren did not originally request alternative apportionment, but instead merely used its preferred method (including gains from business sale in the sales denominator) on its 2011 MBT return. Then, *seeking forgiveness instead of permission*, after the audit and following receipt of Treasury's notice of intent to assess, MLI formally requested alternative apportionment by letter dated June 24, 2016. (*Id*. at 866a–873a.) MLI later supplemented its request with additional information in a letter dated

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December 14, 2016. (*Id*. at 975a–982a.) On February 8, 2017, Treasury denied MLI's alternative apportionment request. (*Id*. at 983a–985a.)

In its request for alternative apportionment, MLI requested that Treasury treat all of the receipts and income resulting from its sale of its stock under IRC § 338(h)(10) as sales under MCL 208.1115(1) and sourced to Minnesota. (*Id*. at 866a–873a (June 2016 Alt Req).) MLI thus requested alternative apportionment for what it already reported in its 2011 MBT return. In the alternative, MLI requested that all of the receipts and income resulting from the sale of its business under IRC § 338(h)(10) be treated as non-operational, non-business receipts and income not subject to tax or includible in the apportionable tax bases in Michigan. (*Id*.)

MLI later proposed two additional apportionment methods. The first alternative method would apportion gain on tangible operational assets based on asset value and location of the asset; the gain on the sale of intangible assets would be sourced to Michigan to the extent the intangible assets are associated with Michigan activities. (*Id*. at 984a (Treasury Denial).) Details as to how this would be determined were not provided to Treasury. (*Id*.) The second alternative method would apportion the gain on the sale of the business assets on a ten-year average of sales under the statutory formula. (*Id*.)

Treasury denied MLI's request for alternative apportionment, as MLI failed to provide sufficient information and documentation to support alternative apportionment under MCL 208.1309. MLI was required to prove by clear and

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cogent evidence that the formula does not fairly represent the taxpayer's business activity in this state and leads to a grossly distorted result. See MCL 208.1309. But MLI failed to provide "any evidence to the Department that the business activities in Michigan did not contribute to the gain realized or that the formula does not provide Michigan with an equitable allocation of income." (App'x Vol III, p 984 (Treasury Denial).) Accordingly, MLI's request for alternative apportionment was denied. On March 23, 2017, Treasury issued a final assessment. (*Id*. at 973a–974a.)

Vectren, as successor-in-interest to MLI, appealed from the final assessment to the Michigan Court of Claims.

Prior proceedings

Vectren alleged four counts below. First, it alleged that Michigan's apportionment formula as applied to the sale of MLI violates the Commerce Clause and Due Process Clause because it is out of all appropriate proportion to the business transacted and activities conducted in Michigan. (App'x Vol I, pp 64a–68a, ¶¶ 30–63, (Am Compl).) Second, in the alternative, Vectren alleged that the gain from the sale of MLI's stock is non-apportionable and non-business income, and that its inclusion in the MBT tax base results in taxation of extraterritorial values in violation of the Equal Protection, Due Process, and Commerce Clauses. (*Id*. at 70a–72a, ¶¶ 64–78.) Third, Vectren alleged that MLI was sold by its shareholders, and, therefore, is not considered business activity of the entity, for which reason any gains on the sale of the business are not subject to MBT. (*Id*. at 73a–75a, ¶¶ 79–

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95.) Fourth, Vectren alleged that even if MLI was liable for additional MBT tax, it should not be subject to a penalty because MLI's delay in not paying the additional tax was due to reasonable cause and not willful neglect. (*Id*. at 75a–76a, ¶¶ 96–102.)

The parties filed cross motions for summary disposition. On August 14, 2018, the Court of Claims granted Treasury's motion, finding that the asset sale was attributable to MLI's business activities and reported separately to its shareholder, for which reason it constituted "business income." (App'x Vol I, pp 18a–19a (08/14/2018 COC Op).) Further, Vectren had not demonstrated that the MBTA's apportionment formula had distorted MLI's Michigan business activity ("[Vectren] does not dispute [MLI's] sales in Michigan for the 2011 Short Year, nor does Vectren dispute the validity of the sales-apportionment formula"), but instead that number manipulation could lead to a smaller liability. (*Id*. at 21a.) And while the court rejected that there was taxation beyond Michigan's borders, it noted that even had Vectren made this showing, some extraterritorial taxation "does not amount to a constitutional violation." (*Id*. at 23a.) Finally, the court rejected Vectren's argument that the penalty should be waived. "Although [MLI] requested, in accordance with Rule 205.013(3), a penalty waiver in its request for informal conference, the request was conclusory and it failed to state, in any meaningful fashion, the reasons relied in support of the penalty waiver." (*Id*. at 25a.)

Vectren, as successor-in-interest to MLI, appealed. The Court of Appeals reversed, relying heavily on Vectren's attorney representations as memorialized in a

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letter to Treasury. Specifically, the Court of Appeals found that "[t]he value of [MLI's] business and its assets was built up over many years and attributable to activity in many states." (App'x Vol I, p 32a (03/12/2020 COA Op).) The Court of Appeals reasoned that an unproven historical seven-percent Michigan sales figure in past years (as compared to "70 percent of the gain of the Sale") is "evidence that well over a majority of the value inherent in MLI stemmed, not from its activity in Michigan during the Short Year . . . but from intangible assets built-up [sic] in multiple other states over time." (*Id.* at 34a.) Yet the only piece of "evidence" that Vectren proffered for the historical seven-percent sales figure was a "Letter Request" drafted by Vectren's counsel "explain[ing] its filing methodology," and "that the standard method was distortive." (App'x Vol III, p 1012 (Vectren's 12/07/2018 COA Br); App'x Vol I, pp 60a–78a (Am Compl).) The Court of Appeals ultimately remanded the matter "for the parties to determine an alternate method of apportionment." (App'x Vol I, p 36a (03/12/2020 COA Op).)

Treasury filed an application for leave to appeal to this Court. In lieu of granting Treasury's application, this Court vacated the Court of Appeals' opinion and remanded for a determination of whether the statutory apportionment formula was properly applied. (*Id.* at 37a (11/25/2020 MSC Order).) On remand, the Court of Appeals remanded the matter to the Court of Claims to decide this issue. (*Id.* at 38a (04/19/2021 COA Order).) The Court of Claims agreed with Treasury's application of the statutory formula. (*Id.* at 39a–48a (05/25/2021 COC Op on Remand).) The Court of Appeals then issued an opinion and order agreeing that the

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statutory apportionment formula was properly applied, but that it is unconstitutional as applied against Vectren. (*Id*. at 49a–52a (09/30/2021 COA Op).) Accordingly, the Court of Appeals remanded the matter to the Court of Claims for proceedings consistent with both its original opinion and its opinion on remand. The same issues raised and preserved in Treasury's prior application to this Court, therefore, remain.

Treasury renewed its application for leave to appeal to this Court, which ordered oral argument on the application and supplemental briefs.

STANDARD OF REVIEW

"[A] reviewing court or tribunal must first find, upon a showing of clear and cogent evidence by the challenging party, that the total business activity attributed to Michigan is out of all appropriate proportion to the actual business transacted in this state or leads to a grossly distorted result." *Trinova Corp v Dep't of Treasury*, 433 Mich 141, 146 (1989) (*Trinova I*).

ARGUMENT

I. Vectren does not support its alternative apportionment proposals with clear or cogent evidence.

The MBTA's apportionment statute is rebuttably presumed to fairly represent the taxpayer's business activity in Michigan. MCL 208.1309(3). And Vectren's proposal must be "reasonable." MCL 208.1309(1). Accordingly, Vectren has the burden to rebut the presumption of fair representation and articulate a

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reasonable alternative. But Vectren does not do so because it fails to support its claims with evidence.

In submitting various proposals for alternative apportionment, Vectren makes various leaps without evidentiary support: "[t]he record establishes the location of the assets at the time of the [MLI] Sale," (App'x Vol III, p 1025a.) Vectren cites to VEC000910–000913, which is a Michigan personal property statement. This document contains amounts reported for machinery and equipment, including "grand totals"—but no indication where the machinery and equipment was physically located or for what projects they were used, and *no supporting schedules or documentation*. It is merely a unilateral declaration with no proof (see also *id*. at 1040a n 29.) In vain will this Court search for any evidence concerning where the assets were located or for what business activities they were used. And Vectren's statement that "[g]ain on goodwill is normally allocated to a company's headquarters where the activities that create goodwill are performed," with dubious attribution to Bradley Hirsch, (*id*. at 1034a, citing Hirsch Aff, ¶ 19) is also without real support. As the Court of Claims noted, "[p]aragraph 19 of Hirsch's affidavit simply explained what Hirsch believed to be goodwill." (App'x Vol I, p 22a n 3 (08/14/2018 COC Op).) It has no basis in law, and, therefore, does not support Vectren's claim. Second, even if the affidavit did support Vectren's statement, it is impeached by Mr. Hirsch's testimony that he did not value MLI "at a state-by-state level." (App'x Vol II, pp 821a–822a (Hirsch Dep Tr).) Thus, he

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could not know whether the company's goodwill was due to Michigan business activity. MRE 602.

Vectren claims that "[o]n December 14, 2016, [Vectren] provided additional supplemental information to support its request for alternative apportionment in response to the Department's request." (App'x Vol III, p 1013a.) Vectren then cites its own Appendix No 9, VEC000039–000211. (*Id.*) But none of these items (which include the Confidential Offering Memorandum) provided sufficient information to support Vectren's proposed alternative apportionment. For example, one of its proposed methods seeks to allocate the gain based on the location of the asset. But again, Vectren failed to give any explanation as to what assets, how the assets were valued, or the value of those assets in Michigan compared to assets everywhere. This is despite Treasury's meeting with Vectren to give it an opportunity to provide additional support. Accordingly, none of Vectren's proposed alternative apportionment schemes were shown to be a more appropriate formula than what the statute provides. For that reason, Vectren's citation to *Norfolk & Western Ry Co v Missouri State Tax Comm*, 390 US 317 (1968) (App'x Vol III, p 1029a) is unavailing. Unlike Vectren, the *Norfolk & Western Ry Co* appellants "showed that the rolling stock usually employed in [Missouri] comprised only about 2.71% by number of units." 390 US at 326.

Further, Vectren claims that "[MLI] rented the equipment needed to perform its portion of the project. [MLI] brought in ten employees and five pieces of equipment. The rest of the equipment needed was temporarily rented, and

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additional labor needs were temporary hires from the local union shop." (App'x Vol III, pp 1007a–1008a.) But Vectren did not provide this information to Treasury in its request for alternative apportionment, did not identify any tangible property or the value of the tangible property, did not distinguish between rented property and its own five pieces of equipment, and did not identify the intangible property or its value.

Vectren's agreement with the amount of Michigan sales and activity belies its claim that there is any distortion of that amount. While it claims that "the Department . . . improperly conclude[ed] that Appellant had not met the first part of the statutory test (existence of distortion)" (*id.* at 1013a), Vectren itself cannot show any distortion—it plainly admits that the Enbridge contract "represented the largest contract the Company had ever performed in Michigan and . . . [f]ortuitously, the project afforded the Company to earn revenue during the off-season" (*id.* at 1008a)—and has not demonstrated that there is any extraterritorial taxation. While Vectren mentions "a Letter Request" drafted by Vectren's counsel "explain[ing] its filing methodology," and "that the standard method was distortive" (*id.* at 1012a; App'x Vol I, pp 60a–78a (Am Compl)), merely saying so without on-point documentary evidence does not make it true. This is especially so if the "Letter Request" is the work of an attorney memorialized in a letter (neither of which is evidence) instead of a business record generated in the ordinary course of Vectren's business operations. MCR 2.110; *People v Benton*, 294

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Mich App 191, 202 (2011). And none of the underlying source documents provided by Vectren show any indication of distortion.

For example, Vectren failed to explain what portion of MLI's net working capital (e.g., accounts receivable, cash, etc.) is attributable to its activities in Michigan, especially given the fact that during the several months prior to its sale in March of 2011, MLI purportedly was working on the Enbridge contract during its off-season months. (Pl's Br in Opp'n, pp 4, 23–24.) The inference being that most, if not all, of the net working capital is attributable to MLI servicing the Enbridge contract in Michigan.

Vectren also failed to explain what portion of the value of MLI's intangible assets (i.e., customer relations, backlog, trade name, assembled workforce, and implied goodwill), based on future projected earnings at the time of the sale, are attributable to its activities in Michigan. Mr. Hirsch, a business valuation expert from KPMG, acknowledged the value of MLI's identifiable intangible assets were based on future projected earnings. (App'x Vol II, pp 823a–824a.) Thus, the question is what portion of the value of those identifiable assets, based on future projected earnings at the time, are attributed to MLI's business activities in Michigan. Mr. Hirsch also testified that he believed that it was possible to value those identifiable intangible assets on a state-by-state basis, but that he did not do so. (*Id*. at 821a–822a.)

Finally, Vectren failed to provide supporting evidence to establish what portion of MLI's fixed assets are attributable to MLI's business activities in

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Michigan. The depreciation schedules do not show use, location, or "sales" of assets (in Michigan or in other states)—instead they show the depreciation amounts for various items, both in a limited period of time and cumulatively:

Minnesota Limited, Inc.
Depreciation Expense Report
As of December 31, 2010

Book = Tax
FYE Month = December

Sys No	Ext	In Svc Date	Acquired Value	P T	Depr Meth	Est Life	Salv/168 Allow Sec 179	Depreciable Basis	Prior Thru	Prior Accum Depreciation	Depreciation This Run	Current YTD Depreciation	Current Accum Depreciation	Key Code
001774	000	03/27/07	3,342.02	P	MF200	05 00	0.00	3,342.02	11/30/10	2,378.64	32.11	385.34	2,763.98	
001775	000	03/22/07	13,277.92	P	MF200	05 00	0.00	13,277.92	11/30/10	9,453.88	127.47	1,529.62	10,983.50	
001776	000	03/22/07	13,277.93	P	MF200	05 00	0.00	13,277.93	11/30/10	9,453.89	127.47	1,529.62	10,983.51	
001777	000	04/09/07	2,661.00	P	MF200	05 00	0.00	2,661.00	11/30/10	1,907.41	25.12	301.44	2,208.85	
001778	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001779	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001780	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001781	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001782	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001783	000	04/12/07	20,900.00	P	MF200	05 00	0.00	20,900.00	11/30/10	14,880.80	200.64	2,407.68	17,288.48	
001784	000	04/05/07	12,700.00	P	MF200	05 00	0.00	12,700.00	11/30/10	9,042.40	121.92	1,463.04	10,505.44	
001785	000	04/05/07	12,700.00	P	MF200	05 00	0.00	12,700.00	11/30/10	9,042.40	121.92	1,463.04	10,505.44	
001786	000	04/05/07	12,700.00	P	MF200	05 00	0.00	12,700.00	11/30/10	9,042.40	121.92	1,463.04	10,505.44	
001787	000	04/05/07	12,700.00	P	MF200	05 00	0.00	12,700.00	11/30/10	9,042.40	121.92	1,463.04	10,505.44	

Further, the disposal schedules Vectren references say nothing about MLI's use of the assets or business activity in Michigan as opposed to other states:

Minnesota Limited, Inc.
Disposal Report
01/01/2010 to 12/31/2010

Description	Cl	In Svc Date	Disposal Date	D M	Acquired Value	Current Accum Depreciation	Net Proceeds
D7N HYSTER WINCH	2	04/24/87	11/01/10	A	$ 2,102.00	$ 2,102.00	$ 0.00
D4D HYSTER WINCH	2	04/24/87	11/01/10	A	1,174.65	1,174.65	0.00
318 CAT GENERATOR	2	05/15/87	11/01/10	A	2,000.00	2,000.00	0.00
TRIPLEX T/A PUMP	2	05/27/87	11/01/10	A	3,500.00	3,500.00	0.00
HYSTER D7D WINCH	2	05/27/87	11/01/10	A	600.00	600.00	0.00
FILL-TEST PUMP	2	06/04/87	11/01/10	A	7,733.00	7,733.00	0.00
SIDE BOOM ATTACHM	2	06/04/87	11/01/10	A	954.00	954.00	0.00
ROSCOE BROWN AUG	2	06/04/87	11/01/10	A	7,155.11	7,155.11	0.00
WACKER RAMMER	2	07/27/87	11/01/10	A	2,008.70	2,008.70	0.00
AZTEC VIBRATOR	2	07/27/87	11/01/10	A	639.00	639.00	0.00
1000B HOLE HOG	2	08/14/87	11/01/10	A	5,409.71	5,409.71	0.00
FISHER M SCOPE	2	09/11/87	11/01/10	A	550.00	550.00	0.00
125KVA ELEC POWER	2	09/04/87	11/01/10	A	2,800.00	2,800.00	0.00
30" AUTO RELEASE T	2	11/12/87	11/01/10	A	1,417.75	1,417.75	0.00
187A ILLUMINATOR	2	11/13/87	11/01/10	A	821.50	821.50	0.00
RUPP SANDPIPER PU	2	11/09/87	11/01/10	A	1,065.30	1,065.30	0.00
232 MAG BASE DRILL	2	11/23/87	11/01/10	A	500.00	500.00	0.00
CAT 583 SIDEBOOM	2	11/18/87	11/01/10	A	18,929.80	18,929.80	0.00
D-8 CAT	2	01/11/88	11/01/10	A	7,000.00	7,000.00	0.00
PIPE CUTTING MACH	2	02/18/88	11/01/10	A	2,085.85	2,085.85	0.00
2CC-BR PIG	2	02/09/88	11/01/10	A	3,023.00	3,023.00	0.00
BALDERSON P.A.T. D	2	03/07/88	11/01/10	A	2,407.50	2,407.50	0.00
MIDWESTERN SIDEB	2	03/07/88	11/01/10	A	1,819.00	1,819.00	0.00
1980 TRAILER TANDE	3	06/21/88	11/01/10	A	1,500.00	1,500.00	0.00
1976 SCHOOL BUS	3	06/30/88	11/01/10	A	2,000.00	2,000.00	0.00
1972 LOAD KING 353	3	06/27/88	05/05/10	S	14,840.00	14,840.00	5,520.00
1980 SCHOOL BUS	3	07/13/88	11/01/10	A	2,250.00	2,250.00	0.00
1967 WELDING RIG	3	07/13/88	11/01/10	A	4,200.00	4,200.00	0.00
KNAPHEIDE BODY	3	03/30/89	11/01/10	A	3,498.00	3,498.00	0.00
1988 FRUEHAUF TAN	3	03/30/89	09/01/10	S	3,760.00	3,760.00	500.00
84" SWEEPSTER BRO	2	06/13/88	11/01/10	A	1,696.00	1,696.00	0.00

There are no locations for the assets above, no indication of where they were used—indeed, no information at all that has anything to do with showing distortion

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of MLI's business activity in Michigan. The same is true for the rest of Vectren's "1,200 pages of documentation"—none of the schedules Vectren provides support its claims concerning MLI's business activity in Michigan as opposed to other states.

It is telling that despite all these documents, Vectren's only support for its claims concerning distortion and business activity in Michigan *in its appellate briefing* (and the only "evidence" the Court of Appeals relied on) was a footnote referring to an attorney-prepared letter to Treasury (dated June 24, 2016) and its own pleading. (App'x Vol III, p 1032a nn 21–22 (Pl's 12/07/2018 COA Br); App'x Vol I, pp 60a–78a (Am Compl).) But Vectren still has yet to address why it believes that a letter written by its attorney constitutes evidence, and still has yet to otherwise show any evidence of distortion of MLI's Michigan business activity. The letter merely cites to past sales activities of MLI, without any explanation as to how those historical sales activities contribute to MLI's current value as of 2011. In short, no valuation study was provided by Vectren that establishes what portion of the value of MLI is attributable to its business activities in Michigan.

II. Vectren has not shown violations of the due process or commerce clauses.

The Due Process Clause of the Fifth and Fourteenth Amendments "require[ ] 'some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.' " *South Dakota v Wayfair, Inc*, ___ US ___; 138 S Ct 2080, 2093 (2018), citing *Miller Brothers Co v Maryland*, 347 US 340, 344–345 (1954). While the Due Process and Commerce Clauses "may not be identical or

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coterminous, [ ] there are significant parallels." *Id*. Under the Commerce Clause, a State "may tax exclusively interstate commerce so long as the tax does not create any effect forbidden by the Commerce Clause." *Complete Auto Transit, Inc v Brady*, 430 US 274, 285 (1977). Courts sustain a tax if it "applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." *Id*. at 279.

In determining whether a State's taxation falls within these Constitutional parameters, the United States Supreme Court has long recognized and upheld a State's use of an apportionment formula, rather than any type of geographical or transactional accounting. *Container Corp of Am v Franchise Tax Bd*, 463 US 159, 164–165 (1983). This is because, as the U.S. Supreme Court has recognized, "arriving at precise territorial allocations of 'value' is often an elusive goal, both in theory and in practice." *Id*. at 164. State legislatures are "faced with the impossibility of allocating specifically the profits earned by the processes conducted within its borders." *Underwood Typewriter Co v Chamberlain*, 254 US 113, 120–121 (1920). "Allocating income among various taxing jurisdictions bears some resemblance . . . to slicing a shadow." *Trinova Corp v Michigan Dep't of Treasury*, 498 US 358, 373–374 (1991) (*Trinova II*).

The U.S. Supreme Court has further recognized that "[s]eparate [geographical] accounting, while it purports to isolate portions of income received in various States, may fail to account for contributions to income resulting from

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functional integration, centralization of management, and economies of scale." *Container Corp*, 463 US at 178–179. "Because these factors of profitability arise from the operation of the business as a whole, it becomes misleading to characterize the income of the business as having a single identifiable source." *Trinova II*, 498 US at 378.

Accordingly, "[i]t has long been settled that the entire net income of a corporation, generated by interstate as well as intrastate activities, may be fairly apportioned among the States for tax purposes by formulas utilizing in-state aspects of interstate affairs." *Exxon Corp v Wisconsin Dep't of Revenue*, 447 US 207 (1980) (internal quotation marks and citation omitted). A state's formula is fair if it is both internally consistent and externally consistent.

"To be internally consistent, a formula must result in no more than one-hundred percent of the taxpayer's business activity being taxed if all taxing jurisdictions employed the same formula." *Trinova I*, 433 Mich at 158. Vectren does not dispute Michigan's apportionment statutory formula is internally consistent.

The second component, external consistency, "requires that the choice of factors used in the formula must actually reflect a reasonable sense of how the business activity is generated." *Id*. (internal quotation marks and citation omitted). "[T]he test for fair apportionment is not whether a formula results in inadequate or even inaccurate apportionment." *Id*. at 160. Rather, the test is whether "the income attributed to the State is in fact out of all appropriate proportions to the

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business transacted in that State, or has led to a grossly distorted result." *Container Corp*, 463 US at 170 (internal quotation marks and citation omitted).

A taxpayer challenging the constitutionality of a state's apportionment formula carries a heavy burden. This is because, as previously stated, states are entitled to great latitude in devising formulas to apportion their tax bases despite their imperfections. For example, the United States Supreme Court has "repeatedly held that a single-factor formula is presumptively valid" even though the formula may "occasionally over-reflect or under-reflect income attributable to the taxing state." *Moorman Mfg Co v Blair*, 437 US 267, 273 (1978). This presumption of validity equally applies to the single-factor sales formula.

In *Ford Motor Co v Beauchamp*, 308 US 331 (1939), the U.S. Supreme Court upheld Texas's franchise tax applying a single-factor gross-receipts sales formula to apportion the value of all the taxpayer's assets, including outstanding capital stock to Texas. In that case, the taxpayer had sales of approximately $34 million in Texas, which accounted for 3.85 percent of total sales. Thus, the taxpayer was taxed on approximately 3.85 percent or $23 million of its assets despite only having $3 million of assets in the state of Texas. The Court determined that the tax did not violate the Due Process or Commerce Clause since "[i]n a unitary enterprise property outside the state, when correlated in use with property within the state, necessarily affects the worth of the privilege within the state." *Ford Motor Co*, 308 US at 336. The U.S. Supreme Court recognized that "[t]he weight, in determining the value of the intrastate privilege, given the property beyond the state boundaries

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is but a recognition of the very real effect its existence has upon the value of the privilege granted within the taxing state." *Id.*

Thirty-nine years later, the U.S. Supreme Court again upheld the single-factor sales formula. In *Moorman*, the U.S. Supreme Court sustained the constitutionality of an Iowa statute that prescribed the single-factor sales formula[3] for apportioning interstate corporations' income for state income tax purposes. The Court came to this determination while recognizing that unlike separate accounting, the state statute "does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State." *Moorman Mfg*, 437 US at 273. "[D]espite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula." *Id.*

For these reasons, Courts will only "strike down the application of an apportionment formula if the taxpayer can prove by 'clear and cogent evidence' that the income attributed to the State is in fact out of all appropriate proportions to the business transacted in that State, or has led to a grossly distorted result." *Container Corp*, 463 US at 170 (citation omitted).

Here, absent a showing that the MBTA's formula is grossly distortive or otherwise out of all proportion to Michigan business activity, taxpayers must be

[3] State courts have also upheld the single-factor sales formula on constitutional grounds in the context of selling a business. See *State Tax Assessor v Kraft Foods Grp, Inc*, 235 A3d 837 (2020).

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taxed based on their tax base as calculated in accordance with the MBTA. There has been no unequal treatment under the law, proper application of which is not a constitutional violation. See *Syntex Laboratories v Dep't of Treasury,* 233 Mich App 286, 293 (1998). Neither has Vectren demonstrated that Treasury taxed extraterritorial values. While Vectren correctly cites *Allied Signal, Inc v Director, Div of Taxation*, 504 US 768 (1992), for the statement that "a State may not tax value earned outside its borders," Michigan courts have acknowledged that "the constitution requires neither a perfect formula nor a perfect apportionment." *Trinova I*, 433 Mich at 162, citing *Hans Rees' Sons v North Carolina*, 283 US 123 (1931). Even if it had, however, this is not by itself a violation of the Due Process or Commerce Clauses. *Id.*; see also *Container Corp*, 463 US at 164. "In any event, state taxation is not unconstitutional merely because it *might* tax some activity that occurred outside the taxing state; such variances are recognized and accepted in this area of jurisprudence." *Sidney Frank Importing Co, Inc v Dep't of Treasury*, unpublished per curiam opinion of the Court of Appeals, issued December 4, 2012 (Docket No. 306742), *7 (App'x Vol I, p 58a).

This Court has rejected alternative apportionment claims with significant (and demonstrably real) distortions. For example, in *Trinova I*, this Court considered an apportionment of compensation that was "forty times greater than [the plaintiff's] actual Michigan compensation," as well as depreciation that was "approximately one thousand times greater than its actual Michigan depreciation." Yet this Court determined that the apportioned tax base was not "out of all

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appropriate proportion to [the plaintiff's] Michigan business activity or results in a grossly distorted apportionment figure." 433 Mich at 164. Specifically, while the plaintiff's true compensation and depreciation figures "represent a very small percentage of [the plaintiff's] total business activity, they are offset by its Michigan sales figure . . . ." *Id.*

But here, unlike in *Trinova I*, Vectren does not dispute that MLI had the amount of business activity determined by Treasury—i.e., MLI had a significant contract with Enbridge to clean up the Kalamazoo River oil spill. In other words, *Treasury accurately determined MLI's business activity for the 2011 short period*. Therefore, unlike in *Trinova I*, there is—as matters of both fact and law—no proven[4] distortion of MLI's business activity for the tax period at issue. If the *Trinova I* distortions of "forty times" and "one thousand times" the actual amount of business activity in Michigan is not a gross distortion or otherwise out of all appropriate proportion to the actual business activity, *a fortiori* an apportionment

[4] In order to prove gross distortion, Vectren must first establish by clear and cogent evidence the actual value of MLI that is attributable to its business activities in Michigan. Without this reference point, it is impossible to determine whether the income attributed to Michigan is in fact out of all appropriate proportions to the business transacted in Michigan, or has led to a grossly distorted result. Vectren has failed to carry this heavy burden.

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with zero proven distortion is neither a gross distortion nor otherwise out of all appropriate proportion to Michigan business activity.[5]

It is telling that Vectren offers a 1931 case (*Hans Rees' Sons, Inc v North Carolina*, 283 US 123, 126 (1931)) in support of its argument otherwise. (App'x Vol I, p 68a, ¶ 63 (Am Compl).) *Hans Rees' Sons* involved a New York entity that had a manufacturing plant in North Carolina. *Hans Rees' Sons*, 283 US at 126. While the taxpayer demonstrated that its average income from North Carolina for the years at issue was 17%, an average of nearly 80% of its income was allocated to North Carolina for the same years. *Id.* at 127. The U.S. Supreme Court specifically noted that the taxpayer provided *significant and detailed information* to support this conclusion:

> Without burdening this opinion with *detailed compilations set out in the record*, the evidence offered by the petitioner tends to show that, for the years 1923, 1924, 1925, and 1926, the average income having its source in the manufacturing and tanning operations within the state of North Carolina was 17 per cent. [*Id.* (emphasis added).]

The U.S. Supreme Court determined that the statutory method was thus "out of all appropriate proportion to the business transacted by the appellant in that

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[5] The Court of Appeals determined that Vectren did meet its burden of proof by clear and cogent evidence. But that Court erroneously relied on unsubstantiated "evidence," i.e., that the value of MLI and its assets *was built up over many years and attributable to activities in many states, much of which never had any connection to Michigan*. *Vectren Infrastructure Servs Corp v Dep't of Treasury*, 331 Mich App 568, 578 (2020). But Vectren has not put forth evidence to support this proposition. For instance, nothing in the record explains whether the current value of MLI, as of 2011, is more heavily weighted on past business activities as opposed to current business activities, which may include new operations, new assets, new services, new markets, improvements recently made to existing services, new customers, new technologies, etc.

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state." *Id*. at 135. But the Court was careful to distinguish its holding from prior decisions in *Underwood Typewriter Company v Chamberlain*, 254 US 113 (1920); *Bass, Ratcliff & Gretton Limited v State Tax Commission*, 266 US 271 (1924); and *National Leather Company v Massachusetts*, 277 US 413 (1928). In all of these cases, the taxpayers failed to provide sufficient evidence that the method of apportionment employed by the states was unconstitutional.

Yet unlike in *Hans Rees' Sons*, here Vectren has not made any demonstration that it, in fact, did not have the business activity in Michigan that Treasury determined. To the contrary, it is undisputed that MLI had a significant Michigan contract and then sold to Vectren during the tax period at issue. Thus, Vectren has failed to make the showing that the *Hans Rees' Sons* petitioner did.

Vectren may argue that, regardless of its own reported business activity in Michigan, application of the sales factor itself, examined by the tax year at issue, creates distortion. Yet, Vectren asks the Court to engage in an historical analysis of the sales factor based on geographic accounting. This request disregards that the purpose of apportionment—and taxation generally—in any given year is to capture the business activities of the taxpayer within the parameters of that snapshot in time, i.e., the tax year. It also disregards that the value of a business is a forward-looking proposition.

In short: Vectren cannot show Due Process or Commerce Clause violations. The statutory metric for the apportionment of gain from the sale of MLI to Michigan based on its in-state activities is a fair determination based both on Vectren's own

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returns and its actual business activity in Michigan. And Vectren offers no other metric in its place as a fairer alternative.

III. It is Treasury's exclusive authority to approve any alternative apportionment method.

MCL 208.1309(2) provides that "[a]n alternate method may be used only if it is approved by the department." This provision cannot be clearer—Treasury has the exclusive authority to approve an alternative apportionment method. The statute says nothing about Treasury working with a taxpayer to decide the question of apportionment.

In its initial opinion, the Court of Appeals recognized that any alternative apportionment "must ultimately be approved by the Department." (App'x Vol I, p 35a (03/12/2020 COA Op).) Yet, on the very next page, the Court of Appeals remanded the matter "for *the parties* to determine an alternative method of apportionment." (*Id.* at 36a (emphasis added).) Then, in its opinion on remand, the Court of Appeals sent the case back to the Court of Claims "with directions to determine an appropriate alternative apportionment method if the parties are unable to agree upon one." (*Id.* at 51a (09/30/2021 COA Op).)

There are four problems with these directives. First, they are contrary to the statute, which gives Treasury the exclusive authority to approve an alternative apportionment method. MCL 208.1309(2). Second, the decisions create separation of powers problems insofar as this determination lies within the province of the executive branch, not the judiciary. *Id.*; Const 1963, art 3, § 2. Relatedly, the

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decisions usurp the authority of the Legislature to prescribe the procedures for alternative apportionment, including Treasury's exclusive authority for approving any such method. Third, the decisions are effectively contradictory, and, therefore, impossible to administer on remand. Fourth, Vectren did not put in any evidence below to support its alternative methods for apportionment. Instead, it referred to an attorney-prepared letter containing various unproven assertions (which is not evidence, *Benton*, 294 Mich at 202), as well as depreciation schedules that did not show where any assets were located or for what business activities they were used. Simply, no court has authority to order the parties to negotiate. And even if the statute contemplated negotiations, there is no basis or evidence for Treasury to make any determination as to an alternative apportionment method.

Vectren exacerbates the confusion, using language such as "work[ing] together" and "engag[ing] in good faith efforts" and "collaboration." (Pl's Br in Opp'n, pp 26–27 n 11, pp 26–28.) "[T]here is no reason, statutory or otherwise, that would prohibit the Department and the taxpayer to engage in good-faith efforts to review the multiple alternative methods previously proffered by MLI." (*Id*. at 27–28.) Further, "[s]uch good-faith collaboration is the statutory basis for the use of alternative apportionment." (*Id*. at 28.)

But the statute makes no mention of "good faith" or "collaboration" or "working together." Rather, the statute is clear and simple: Treasury has the exclusive authority to approve any alternative apportionment method. See MCL 208.1309. While Treasury may elect to work collaboratively to determine an

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alternative apportionment method, *neither a court nor a taxpayer may usurp the statutory authority conferred on Treasury and force it into negotiation*—but this is precisely what Vectren and other taxpayers seek based on the Court of Appeals' decisions here.[6] Negotiation is an end-run around the statutory scheme that relieves taxpayers of any burden to demonstrate their entitlement to alternative apportionment.

CONCLUSION AND RELIEF REQUESTED

The Court of Appeals' decisions are erroneous as a matter of law, rely on purported facts that are not in evidence and create separation of powers problems. These decisions should be reversed, and Michigan's statutory framework for alternative apportionment preserved.

Accordingly, Treasury respectfully asks that this Court affirm the Court of Claims' determination that Vectren is not entitled to alternative apportionment.

Respectfully submitted,

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[6] While Vectren cites *Detroit Edison Co v Dep't of Treasury*, 498 Mich 28, 56 (2015) as somehow "notably" indicative of "work[ing] together," (Pl's Br in Opp'n, p 27 n 11), the end result was not precedential but instead the function of alternative dispute resolution employed by the Court of Claims as a matter of judicial economy.