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**IN THE COURT OF APPEALS, DIVISION II,  
OF THE STATE OF WASHINGTON**

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FPR II, LLC,

Appellant,

v.

STATE OF WASHINGTON DEPARTMENT OF REVENUE,

Respondent.

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**BRIEF OF APPELLANT**

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## I. INTRODUCTION

In this tax refund action, FPR II, LLC (“FPR”) appeals the trial court’s order granting summary judgment to the Washington Department of Revenue (the “Department”). At issue is the appropriate Business and Occupation (“B&O”) tax classification for FPR’s activities at Washington recycling plants, which are called “MRFs” (an acronym of “Material Recovery Facilities”).<sup>1</sup> The trial court found as a matter of law that FPR was engaged in neither “manufacturing” nor “wholesale sales.” This Court should reverse and, given the facts stipulated by the Department below, it should instruct the trial court to enter judgment in favor of FPR.

## II. ASSIGNMENTS OF ERROR

1. The trial court erred in granting summary judgment when it concluded, despite the evidence before it, that FPR was not engaged in “manufacturing” under RCW 82.04.120.

2. The trial court erred in granting summary judgment when it concluded, despite the evidence before it, that FPR was not engaged in “wholesale sales” under RCW 82.04.060.

### *Issues Pertaining to Assignments of Error*

1. RCW 82.04.120 provides: “‘To manufacture’ embraces all activities of a commercial or industrial nature wherein labor or skill is

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<sup>1</sup> The acronym is pronounced “MURF” (plural, “MURFS”).

applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property is produced for sale or commercial or industrial use . . . .” Starting with nearly valueless commingled recycling material, FPR applies labor by hand and machinery to create valuable and useful commodities for sale to downstream manufacturers. FPR’s activities change the form, quality, and properties of the original material. Does the processing of commingled recycling material at MRFs cause a significant change in that material, and does it produce a new, different, or useful article of tangible personal property? (Assignment of Error 1)

2. RCW 82.04.060 provides that a “wholesale sale” includes services defined as a retail sale in RCW 82.04.050(2)(a)—namely, the “installing, repairing, cleaning, altering, imprinting, or improving of tangible personal property of or for consumers . . . .” FPR cleans, alters, and improves the tangible personal property of its customers (MRF owners). Those customers resell the cleaned, altered, and improved property to industrial end users, and they give FPR reseller permits and exemption certificates. Is FPR engaged in wholesale sales? (Assignment of Error 2)

3. The Department concedes that FPR engages in activities that, if not manufacturing, qualify either as sales at retail or as sales at

wholesale. May the Department nevertheless apply a B&O classification that expressly excludes both retail and wholesale sales? (Assignment of Error 2)

### **III. STATEMENT OF THE CASE**

#### **A. FPR's Activities**

After a person places recyclable materials in a mixed recycling bin for collection, that commingled material must be cleaned, sorted, and processed before it can be sold for use as a feedstock in manufacturing new products. CP 212, 224, 485. The commingled recycling material is sorted and processed at MRFs. CP 224. A MRF is a specialized facility that combines machinery and labor to clean, sort, and process commingled recycling material into separate, recyclable commodities that are resold to secondary processors or end users. CP 212, 224.

FPR contracts with the owners of MRFs in Washington to supply them with trained workforces to operate their MRFs. CP 102, 104.<sup>2</sup> Although FPR's customers own the equipment and the material processed at the MRFs, FPR operates the equipment and supplies workers to perform all tasks necessary to process the commingled material. CP 108, 124. FPR collects reseller permits and exemption certificates from its customers, the

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<sup>2</sup> FPR, an Oregon limited liability company, does business in Washington as Leadpoint USA. CP 68.

MRF owners. CP 611–17.

1. The MRFs receive commingled recycling material, a mixture of garbage and recyclable items that is not otherwise marketable or usable.

At the MRFs, FPR processes one commodity—commingled recycling material—into separate products that can be resold by the MRF owners to end users or secondary processors. CP 115, 123. MRF owners purchase the commingled recycling material, which is collected by municipalities or private companies as part of a single-stream recycling collection system, for processing and resale. CP 123, 124. A “single-stream” recycling collection system allows people to place all types of recyclable materials, such as glass, paper, cardboard, plastics, and metals, in a single bin for collection. CP 123, 306. Because the items that people place in the single-stream recycling collection system are not always recyclable, the commingled recycling material delivered to the MRFs contains an average of 20 percent of non-recyclable material or garbage. CP 123, 140.

The commingled recycling material that arrives at the MRF has no commercial value to end users or secondary processors because they cannot use the uncleaned, unsorted, loose, and commingled material in their own manufacturing operations. CP 485–86. The only market for that commodity (i.e., commingled recycling material) is to sell it to MRFs. CP

224. During the tax period at issue, MRF owners purchased the commingled recycling material for \$6 per ton. CP 143.

Once commingled recycling material has been cleaned, sorted, and processed into separate products comprising specific recyclable material types, MRF owners can resell the cleaned, sorted, and compressed bales of metals, paper, cardboard, and plastics for a much higher price than they paid to purchase the commingled material. CP 142, 146. Even the cleaned and processed glass, which is less marketable overall than other recyclable materials, can be marketed to secondary glass processors at a cost savings to the MRF owners. CP 145, 475.

2. Using machinery and labor, FPR processes the commingled recycling material into separate, marketable products.

FPR processes the commingled recycling material at the MRFs into separate marketable products using a combination of mechanical and manual methods. CP 185–87. FPR cleans the material by removing garbage and non-recyclable materials, sorts the material by underlying material type, and then compresses each discrete material type. CP 125–32. The MRF owners sell the resulting products. CP 133.

FPR's processing of the commingled material begins with loading the commingled recycling material that is piled on the tipping floor into a large metering container, which is operated by an FPR employee. CP 125,

180. A conveyor belt at the bottom of the metering container moves the commingled recycling material through a drum feeder to an initial sorting area, called the pre-sort deck. CP 125.

At the pre-sort deck, FPR employees examine the commingled material as it passes by on a conveyor belt to identify and remove large contaminants, plastic bags, hazardous materials, and items that may damage the processing equipment. *Id.* After the commingled material passes through the pre-sort deck, it is conveyed through a series of mechanical screens, which sort the different material types (cardboard, glass, paper, metal, and plastics) from the commingled recycling material as the material passes through the system. CP 125–32.

Corrugated cardboard<sup>3</sup> is the first type of recyclable material that is separated from the commingled material. CP 125. Corrugated cardboard is sorted from the commingled material using a large mechanical screen, or filter, which is designed to separate the larger pieces of cardboard from the smaller items in the commingled material. CP 125–26. The large cardboard that has been separated by the screen is then carried by another conveyor belt past FPR employees, who examine the material to ensure that no other types of materials or contaminants are in the cardboard

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<sup>3</sup> Corrugated cardboard is paperboard with corrugated layers. It does not include boxboard, such as that used to make cereal boxes. CP 229.

stream. CP 126. If an FPR employee identifies a non-cardboard item in the cardboard stream, the employee removes it and, depending on what the item is, places it either in a garbage bunker or back onto the main conveyor belt for further processing. *Id.* The separated cardboard is then conveyed to a bunker for baling. CP 132.

The next material that is sorted from the commingled recycling material is glass. CP 126. The commingled material left over from the cardboard screen is conveyed to a debris roll screen. *Id.* The debris roll screen crushes any glass items in the commingled material; the pieces of glass and other small particles drop down through the screen to a glass clean-up system. CP 126–27. The glass clean-up system separates the heavier pieces of crushed glass from smaller, lighter materials, such as pieces of paper or plastic bottle caps. CP 127. The glass pieces are then moved to a storage bunker and later sold to glass recyclers. CP 132–33.

The material remaining on the conveyor belt after the glass and small particles have been removed continues on the main conveyor belt and is manually examined by another set of FPR employees before it continues through the system. CP 186. FPR manually examines the remaining material in order to remove any garbage or other materials that the equipment failed to properly sort. *Id.*

The material next passes through a series of paper-fiber screens designed to sift out different types of paper from the commingled material, based on the end user's needs. CP 127–28. The first fiber screen is designed to remove newspapers, which are then a routed to a newspaper bunker for baling. CP 128. FPR's employees also monitor the stream of material at this screen to ensure that only newspapers are passing over the screen, with everything else falling through to the next fiber screen. *Id.*

The material remaining after the newspaper screen then passes over a second fiber screen that removes mixed paper, including junk mail, magazines, and colored paper. CP 128. The mixed paper is then further separated by fiber type using computerized optical sorting equipment, which differentiates between brown-fiber and white-fiber paper and directs each type of paper into separate bunkers for baling. CP 470–71. FPR's employees monitor the stream passing to the second fiber screen to make sure that any plastic bags, garbage, or other misplaced materials are removed from the material stream. CP 128, 186.

The material left over after the first two fiber screens is passed over a final screen that separates any small particles, leaving only plastic and metal containers on the main conveyor belt. CP 128–29. The removal of the smaller particles ensures that the containers on the conveyor belt are

free from debris, which is a requirement for making a marketable product that end users will buy. CP 129, 137.

The metal and plastic containers are then moved to the container line, where they are separated by material type. CP 129. To accomplish this, the mixed containers are first conveyed under a magnet that separates ferrous metal, such as soup cans, from the other containers and moves the ferrous metal onto a separate conveyor belt. *Id.* FPR employees review the materials on this ferrous metal conveyor line and remove any non-ferrous material before the ferrous metal is transferred to a bunker for baling. *Id.*

Back on the main conveyor line, the remaining containers are moved through an “Eddy Current,” which electromagnetically charges the aluminum containers on the conveyor belt, causing them to jump over a divider and onto a separate conveyor belt for aluminum containers. CP 129. The diverted aluminum is also reviewed by FPR’s employees for contaminants and non-aluminum materials before it is moved into a bunker for baling. *Id.*

Anything left on the main conveyor belt that was not separated by the Eddy Current continues through the processing system. CP 130. At this point in the process, most of the material left on the main conveyor belt is plastic containers, which consist of both lower-density polyethylene terephthalate (“PET”) containers, such as water bottles, and high density

polyethylene (“HDPE”) containers such as laundry detergent bottles. CP 130, 306. Depending on the facility, the PET and HDPE plastics are separated by grade through use of an optical sorter or manually by FPR employees. CP 130.

In facilities using the optical sorter, the material is conveyed under a computer-linked camera. *Id.* The computer, which is programmed to identify material of a certain density, triggers a jet of compressed air whenever it detects a PET container to direct PET containers to another conveyor belt. *Id.* The non-PET containers continue down the conveyor line and pass under another optical sorter that is programmed to differentiate between colored and natural HDPE. *Id.* As with the other types of materials, the separated plastic containers are examined by FPR employees for quality-control purposes prior to being moved into bunkers for baling. *Id.* At this point, FPR employees also examine any remaining materials on the main conveyor line to capture any missed containers or other recyclable materials before the remaining material is sent to trash containers. CP 132.

As each type of material is sorted and separated, it is conveyed to a storage bunker for that type alone. CP 132. With the exception of glass, once each bunker is filled with a type of recyclable material, it is emptied onto a conveyor belt that feeds the material into a baler. *Id.* The baler is a

machine that takes the loose material, compresses it using hydraulic force, and secures it with baling wire. CP 132–33. The effect of the baling machine is that the material is densified and assumes the shape of a cube or bale. *Id.* Each type of recyclable material is baled separately. CP 133.

Once the recyclable material has been baled, it is moved to a quality control area. There FPR employees examine the bales to ensure that no contaminants or other materials remain. CP 132. FPR employees use hand tools to remove any contaminants identified in the bales during their inspection. CP 133, 140. The bales are then stored in a warehouse until they are sold to end users. CP 132. The bales of each type of recyclable material are the commodities that FPR’s customers sell to end users. CP 133. The only recyclable material received by the MRF that is not processed into bales consists of large pieces of steel and the crushed glass that is processed in the MRF system. *Id.* These materials are also sold by FPR’s customers to end users, though not in bale form. *Id.*

FPR employees at each MRF process up to 800 tons per day of commingled recycling material into distinct, segregated bales of cardboard, newspaper, paper, PET plastic, HDPE colored plastic, HDPE natural plastic, aluminum, and ferrous metal. CP 124. The processing of the commingled recycling material into distinct, compact bales allows FPR’s customers to sell those bales to its end-user customers, such as

paper mills and beverage manufacturers. CP 133, 472. FPR's recycling-industry customers would not be able to sell the commingled recycling material to their end-user customers without the processing that occurs at the MRFs. CP 133, 472, 485.

3. FPR's processing of the commingled recycling material is driven by end-user demands and specifications.

The process described above is driven by end-user demands and specifications. CP 133, 137. The production of each material type is governed by minimum industry standards and, in some cases, the buyers' contractual requirements. CP 137. The specifications, which vary by recyclable commodity type, specify the percentage of contaminants or prohibitives that can be in the end product. *Id.* "Prohibitives" is an industry term that means materials of different types that cannot be processed together into a final product. CP 306. For instance, a paper mill cannot use recycled cardboard that contains waxed paper, such as paper milk cartons, because the wax melts during processing at the mill and lowers the quality of the recycled paper. CP 233. By processing the commingled recycling material that comes into the MRF, FPR transforms that material into products that meet customer specifications and can be resold by the MRF owners. CP 111, 137.

*a. Recycled Cardboard*

End users of recycled corrugated cardboard include paper mills that use the recycled cardboard to manufacture boxes, packing material, and paperboard. CP 141, 168. Paper mills require that the cardboard bales they purchase contain minimal residue (as little as 0.5 percent) in order for the cardboard to be usable in their process. CP 486. In some cases, the commingled material delivered to the MRFs may contain 10 percent residue by weight. *Id.* FPR's process removes the residue in the commingled recycling material delivered to the MRF to the low levels required to sell the recycled cardboard to end users. *Id.*

After FPR removes residue and sorts the corrugated cardboard, it compresses the cardboard with hydraulic force into dense bales that weigh close to 1,500 pounds, CP 146:



CP 395. The baling of the cardboard not only makes the cardboard easier

to store and transport; it also serves a role in the paper mill's use of the cardboard in its own processing operations. CP 476. Asked what purpose baling the materials served, FPR's expert witness, John Lucini, explained:

So they'll receive it. As I mentioned before, it helps with transportation. But once it gets to the mill, they can inventory it and then they have a known quantity—a known—a way of measuring a known quantity of product going into their process. So in this company's case, they make a grade called recycled boxboard, which is made by using a combination of cardboard fibers, newspaper fibers, maybe some other—like white paper, and they mix it in a recipe in a pulper, hydropulper, and so it helps—the baling helps them measure the input that, you know, one bale of this, two bales of that to come up with the recipe to produce what they want.

CP 476. Most paper mills require that the cardboard they receive be compressed and baled before they will purchase it. CP 133, 485. Only a small fraction of mills will accept loose cardboard. CP 485.

b. *Recycled Glass*

Glass containers can be remanufactured into glass jars and bottles or into fiberglass, or they can be turned into an aggregate that can be used in place of sand, gravel, or fill. CP 235. FPR's process at the MRF separates glass containers from the commingled recycling material, crushes them into small pieces, and removes non-glass particles such as paper and bottle caps. CP 126–27.

Unlike other commodities produced at a MRF, such as cardboard, the market price for crushed glass is sometimes negative. CP 475. This

means that sometimes the MRF owner has to pay a secondary processor to take the crushed glass, as opposed to the secondary processor's purchasing the material from the MRF owner. *Id.* Even in such cases, it is more profitable for the MRF owners to pay to dispose of the crushed glass at a secondary processor than it would be to dispose of it at a landfill. *Id.*

The value of the glass is dictated by the amount of contamination that is in it. CP 238. Secondary glass processors charge more (or pay less) for loads of crushed glass that are more contaminated, because contamination results in increased costs related to the disposal of non-glass residue in landfills, longer processing times for contaminated loads, and lower percentages of marketable glass. CP 241–42.

*c. Recycled Paper*

FPR must remove the glass containers from the commingled recycling material in order to prevent contamination of the other commodities that it is producing. CP 240. Glass particles can contaminate the paper products produced at the MRFs, thereby reducing their value and salability. *Id.* Glass is a significant problem for paper mills, as it can damage mill equipment and affect paper quality by causing streaking or becoming imbedded in the final paper product. CP 256. Removal of glass particles from recycled paper increases the value of the paper products produced at the MRFs. CP 240.

In addition to having glass and other contaminants removed, the paper within the commingled material must be sorted by fiber type in order to be marketable to the end users. CP 470–71. Paper mills in the United States use recovered fiber as either a primary or a secondary raw material to manufacture paper products. CP 469. But paper mills cannot use the commingled material that is delivered to the MRF, because it is either too heavily contaminated or is mixed with too many different types of prohibitives. CP 471. Paper mills will accept only mixed paper that complies with industry standards, which prescribe the amount of contaminants and prohibitives that can be contained in a bale of mixed paper. CP 187. Unless and until the other recyclables and contaminants have been removed from the mixed paper, there is no market for that material. *Id.*

Additionally, different paper mills produce different types of paper products with recovered fiber, and each of them has differing needs based on the type of paper product it is producing. CP 128, 470. Some mills make craft liner board, while others make tissue and still others make printing and writing paper or newsprint. *Id.*; CP 469. A paper mill that produces white paper with recycled paper material cannot use mixed paper, such as junk mail, because it contains both brown and white fibers. CP 470–71.

As is the case with cardboard, paper mill end users depend on the compression and baling of recycled newspaper, mixed paper, and white paper in their mill operations. CP 472. Paper mills must store enough inventory of recovered paper to meet their processing demands. *Id.* Compacting the recovered paper into bales helps the paper mills to manage their inventory and assists with effective storage of the feedstock for the mill. *Id.*

Baling also allows paper mills to accurately manufacture the new paper. *Id.* Paper mills have specific recipes to make new paper, including required levels of fiber, chemicals, and water. *Id.* Because the bales they purchase are metered and weighed, the mills can effectively measure the amount of fiber being used in each batch of paper they manufacture. *Id.* Without the baled paper, the mills would not be able to effectively measure the amount of fiber being used in each batch of new paper. *Id.*

#### *d. Recycled Metals*

FPR's process cleans, sorts, and compresses ferrous and aluminum metals into bales for sale to end users. CP 129. End users that purchase the bales of ferrous metal require the compacted bales to be free of contaminants or other non-metal materials so that they can melt the metal bales down for use in creating new products. CP 483. The metal must also

be flattened and compressed to reach the right combustion point for processing by metal recyclers. CP 458.<sup>4</sup>

Separating and baling aluminum is just as critical to the end users of that metal. CP 483. Beverage companies that purchase the compact bales of recovered aluminum require the bales to be free of plastics and other metals, because the process of melting the aluminum to create new cans is very sensitive to contamination. *Id.* If the contamination level of the feedstock is too high, “it creates either damage to their equipment or imperfections in what they’re trying to make.” CP 483. As is the case for ferrous metals, recycled aluminum must be compressed for it to melt properly in the furnace used to reprocess the metal. CP 458.

*e. Recycled Plastic*

FPR’s process of sorting and densifying plastic containers, like its other operations, is driven by market forces. CP 482. The different grades and densities of plastic containers make them significantly more valuable if they are separated by grade. CP 482; *see* CP 396 (below, photo of baled HDPE colored plastic).

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<sup>4</sup> The trial court excluded paragraph 7 of the Declaration of John Lucini in Opposition to the Department’s Motion for Summary Judgment. There Mr. Lucini opined that ferrous and non-ferrous cans must be flattened and compressed during the baling process in order to reach the right combustion point and melt properly. RP 28. This Court reviews all the evidence presented to the trial court, regardless of whether it was excluded by the trial court. *See Folsom v. Burger King*, 135 Wn.2d 658, 663, 958 P.2d 301 (1998) (an appellate court reviewing a summary judgment must “examine *all* the evidence presented to the trial court, including evidence that had been redacted.”) (emphasis in the original).



In addition, separation of different grades of plastic is necessary for the end user to be able to repurpose the containers to manufacture new plastic products. CP 483. Because different types of plastic melt at different temperatures, they do not all process the same way. *Id.* Unless the grades of plastic are carefully separated, it is difficult for the end user to be able to mix the recycled plastic material directly into new products. *Id.*

**B. The Parties' Dispute**

In 2009, the Department issued a letter ruling to FPR in which it concluded that FPR's activities at the MRFs constituted "manufacturing" under Washington's tax laws. CP 64–67. In accordance with that decision, FPR paid B&O taxes at the 0.484 percent rate applicable to the manufacturing and wholesaling tax classifications. CP 2. In 2015, the Department audited FPR for the 2011–14 tax period and assessed

additional tax in the amount of \$416,368. CP 67. The Department based the additional tax liability on its conclusion that FPR was not engaged in manufacturing or wholesaling and, therefore, was subject to the higher B&O tax rate applicable to the “Service & Other Activities” classification. CP 68–71.

FPR appealed the assessment to the Department’s Administrative Review and Hearings Division, challenging the taxation of its activities under the Service & Other Activities classification. CP 73–82. The Department denied FPR’s appeal as well as its petition for reconsideration. CP 73–82, 84–93. After the final denial, FPR paid the disputed assessment. CP 2.

On October 24, 2017, FPR filed this action in Thurston County Superior Court under RCW 82.32.180, seeking a refund of \$673,139.85 in overpaid B&O tax for the tax period January 1, 2011, through December 31, 2016. CP 1–9. After the close of discovery, the Department moved for summary judgment. The Department sought an order that, as a matter of law, FPR was not engaged in “manufacturing” under RCW 82.04.120 and that FPR was not making “wholesale sales” under RCW 82.04.060.<sup>5</sup> CP 10–56.

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<sup>5</sup> The Department also sought summary judgment on the issue of whether it was estopped from assessing Service & Other Activities B&O tax on FPR based on its 2009 tax ruling. CP 21. FPR did not pursue that claim below, explaining that discovery had confirmed the

FPR opposed the Department's motion on the basis that genuine issues of material fact precluded a determination regarding the issue of manufacturing, as well as on the basis that the Department was not entitled to judgment on either the manufacturing or the wholesaling issue. CP 435–56. On reply, the Department expressly adopted the additional facts FPR raised in its opposition but argued that, even under those facts, FPR was not engaged in either manufacturing or wholesaling as a matter of law. CP 696–706.

At the conclusion of a hearing on April 19, 2019, the trial court entered an order granting the Department's motion for summary judgment on all issues and dismissing FPR's complaint with prejudice. CP 716. FPR timely filed this appeal. CP 718.

#### **IV. STANDARD OF REVIEW**

This Court's standard of review for an order of summary judgment is de novo; the Court performs the same inquiry as the trial court. *Jones v. Allstate Ins. Co.*, 146 Wn.2d 291, 300, 45 P.3d 1068 (2002). Accordingly, this Court must view the facts and the reasonable inferences from those facts in the light most favorable to the nonmoving party, FPR. *Id.* It reviews questions of law de novo. *Mountain Park Homeowner's Ass'n*,

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correctness of the 2009 ruling. CP 440 n. 2. Estoppel is likewise not an issue in this appeal.

*Inc. v. Tydings*, 125 Wn.2d 337, 341, 883 P.2d 1383 (1994). A motion for summary judgment is properly granted only where “there is no genuine issue as to any material fact and . . . the moving party is entitled to a judgment as a matter of law.” CR 56(c).

## V. ARGUMENT

### A. **FPR was engaged in manufacturing at the MRFs because its activities produced new, different, or useful articles for sale or commercial or industrial use.**

The trial court erred in granting the Department’s motion for summary judgment because the facts—which the Department does not dispute<sup>6</sup>—demonstrate that FPR’s activities at the MRFs produced new, different, or useful articles for sale or commercial or industrial use and, therefore, constituted “manufacturing” under Washington’s tax statutes.

Under Washington law, a person that engages in business as a manufacturer is subject to a B&O tax rate of 0.484 percent. RCW 82.04.240. A “manufacturer” is a person that “manufactures for sale or for commercial or industrial use” “articles, substances, or commodities” “from his or her own materials or ingredients.” RCW 82.04.110(1). Any person that performs manufacturing activities on materials owned by another is taxed as a processor for hire at the same rate as a manufacturer.

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<sup>6</sup> If, on appeal, the Department argues facts that it contended below were undisputed or asks the Court to draw factual inferences in its favor, then this Court must reverse and remand for a trial of the disputed factual issues. *See* CR 56(c) (summary judgment inappropriate where genuine issues of material fact exist).

WAC 458-20-136(3)(a) (“[A] processor for hire is any person who would be a manufacturer if that person were performing the labor and mechanical services upon his or her own materials.”); *compare* RCW 82.04.280(c) (processors for hire are taxed at rate of 0.484 percent), *with* RCW 82.04.240 (same tax rate for “manufacturer” classification).

In this case, FPR contends that it should be taxed as a processor for hire because it conducts manufacturing activities. The Department’s rules cover this precise situation:

There are occasions where a manufacturing facility and ingredients used in the manufacturing process are owned by one person, while another person performs the actual manufacturing activity. The person operating the facility and performing the manufacturing activity is a processor for hire. The owner of the facility and ingredients is the manufacturer.

WAC 458-20-136(3)(e). The Department does not dispute that FPR’s customers own the materials processed at the MRFs. The critical question is whether FPR’s activities at the MRF meet the statutory definition of “manufacturing.” If so, FPR must be taxed as a processor for hire under RCW 82.04.280(c).

Under RCW 82.04.120(1), the term “to manufacture” “embraces all activities of a commercial or industrial nature wherein labor or skill is applied, by hand or machinery, to materials so that as a result thereof a new, different or useful substance or article of tangible personal property

is produced for sale or commercial or industrial use . . . .” The statute identifies several examples of manufacturing, including the “[c]rushing . . . of rock, sand, stone, gravel, or ore.” RCW 82.04.120(1)(d). The Department admits that FPR was engaged in commercial or industrial activities in which labor or skill was applied by hand or machinery. It disputes only that FPR thereby created a “new, different, or useful substance or article of personal property,” as required under RCW 82.04.120(1).

In determining whether a “new, different, or useful” substance has been produced by a taxpayer’s activities, Washington courts compare the end product with the article before it was subjected to the process and consider whether a significant change has been accomplished. *Bornstein Sea Foods, Inc. v. State*, 60 Wn.2d 169, 175, 373 P.2d 483 (1962). Under that test, the end product is “the product as it appears at the time it is sold or released by the one performing the process.” *Id.*

To assist in determining whether a “significant change” has occurred as a result of the taxpayer’s actions, the Washington Supreme Court has identified several factors to consider: “changes in form, quality, properties (such changes may be chemical, physical, and/or functional in nature), enhancement in value, the extent and the kind of processing involved, differences in demand, et cetera . . . .” *McDonnell & McDonnell*

*v. State*, 62 Wn.2d 553, 556–57, 383 P.2d 905 (1963). In applying these factors, courts must keep in mind that “to manufacture” is a legislatively defined term that “is not necessarily confined to a classical or orthodox definition of manufacturing, which, in common understanding, usually would connote a . . . fabrication process.” *Id.* at 557; *see also Bornstein*, 60 Wn.2d at 173 (noting that the statutory definition of “to manufacture” is broader than the common understanding and that “we have come to the position now where we are classifying as ‘manufacturing’ activities which realistically are not manufacturing in the ordinary sense at all”).

1. FPR’s activities resulted in new, different, or useful articles by transforming a nearly valueless material into usable and valuable products.

Courts have uniformly held that a taxpayer’s actions cause a significant change and result in a new, different, or useful substance if the taxpayer’s actions make an item more usable and more valuable than it was at the beginning of the process. *Bornstein*, 60 Wn.2d at 177 (stating that a crucial factor is whether taxpayer’s actions changed a product to make it more usable); *McDonnell*, 62 Wn.2d at 557 (enhancement in value among factors to consider when evaluating whether a significant change has occurred); *Valley Fruit v. State Dep’t of Rev.*, 92 Wn. App. 413, 419, 963 P.2d 886 (1998), *review denied*, 137 Wn.2d 1017 (1999) (“The crucial point was whether the process made the product more usable.”). In

particular, courts have held that a significant change occurs when the taxpayer's process changes a material that is otherwise useful only to the processor into a usable and saleable consumer product. *See Cont'l Coffee Co. of Wash. v. State*, 62 Wn.2d 829, 832, 384 P.2d 862 (1963) (activity of roasting green coffee beans was manufacturing because the process "change[d] . . . green coffee beans, useful only to coffee processors, to a roasted and blended coffee, a usable consumer item . . .").

For example, in *J & J Dunbar & Co. v. State*, 40 Wn.2d 763, 245 P.2d 1164 (1952), the Supreme Court held that a taxpayer was engaged in manufacturing when the taxpayer transformed raw unusable whisky into whisky that could be sold and consumed. In that case, the taxpayer purchased raw whisky in charcoal-lined oak barrels and passed the raw whisky through a series of filters to remove charcoal and other objects. *Id.* at 764. After the whisky had been filtered, the taxpayer diluted it with water and bottled it for sale. *Id.* at 765. The Supreme Court held that the process employed by the taxpayer constituted manufacturing because it transformed "[a] raw whisky not suitable for consumption as a beverage . . . into one that is capable of being used as such." *Id.* at 766.

Similarly, in *Bornstein* the Supreme Court held that the taxpayer's process of filleting, packaging, and freezing fish was "manufacturing." 60 Wn.2d at 177. In reaching that conclusion, the Court focused on the fact

that the taxpayer’s activities changed a product to make it more usable: “The process of filleting transforms near valueless whole bottom fish into useful and salable consumer items. This change is significant.” *Id.*; see also *Valley Fruit*, 92 Wn. App. at 419 (taxpayer’s cleaning and waxing of whole apples, which made them shelf stable for 11 months, “significantly change[d] the apples into a more useful product,” because without the process, the apples would decay within a month).<sup>7</sup>

In this case, FPR’s activities at the MRFs significantly changed the commingled recycling material received by the facilities by transforming that material into products that were both more usable and more valuable. Just like the whisky in *J & J Dunbar*, the material purchased by the MRF owners cannot be used by consumers in its raw form. CP 471 (when first delivered to the MRF, the commingled material is “not useful as a raw material in an end use”). Because that material contains 20 percent trash or other non-recyclables, and because the recyclables are mixed together, it cannot be sold to anyone other than a MRF, and it cannot (absent processing at the MRF) meet industry standards for use as feedstock to downstream manufacturers. CP 111, 137, 140. These end users of recycled

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<sup>7</sup> The Legislature subsequently amended RCW 82.04.120 to exclude the specific activity at issue in *Valley Fruit* from the definition of manufacturing. See RCW 82.04.120(2)(d). But the Legislature did not change the broad standard set forth in RCW 82.04.120(1) that the Court applied in *Valley Fruit* and that FPR relies on here.

commodities cannot use the material received by the MRF, because they require recyclable materials that are cleaned and sorted by type and grade in order to use the materials in their manufacturing processes. *See, e.g.*, CP 483 (aluminum recyclers require bales to be free of plastics and other metals, because melting process is very sensitive to contamination; plastic recyclers need grades of plastic separated for use in manufacturing new plastic products). Like raw whisky, the material at the MRFs becomes a saleable and usable commodity only after FPR has applied its multistep process.

Moreover, like the fish in *Bornstein*, FPR's processing of the commingled recycling material at the MRFs increases the value of the material, which is otherwise not marketable to end users. The value of the commingled recycling material is dramatically enhanced as a result of the process that FPR employs. *See* CP 485–86 (“[T]here’s no value to the end user to the commingled materials because they can’t use it for a number of reasons.”). The Department concedes this. CP 699 (“[T]he Department does not dispute that the compressed bales of separated recyclables are more valuable to its customers than the mixed materials that arrive at the [MRF]).”

And just like the coffee beans considered in *Continental Coffee Co.*, FPR's processing activities change a material that is useful only to

MRFs into products that are usable and can be sold to consumers—in this case, industrial firms that use the products in their aluminum smelters, paper mills, steel mills, and plastics plants. *See* CP 471 (commingled recycling material “not useful as a raw material in an end use”); CP 485 (the commingled material only has value to a MRF or someone capable of processing it). Without FPR’s activities, the material received at the MRFs is valueless to and unusable by these end users and suitable only for a landfill. Because FPR’s activities at the MRFs transform a nearly valueless material into more usable and valuable products, those activities result in a significant change in the material that is initially delivered to the MRFs. This Court should hold that FPR is engaged in manufacturing under RCW 82.04.120 because it is producing a new, different, or useful article.

2. FPR’s activities resulted in new, different, or useful articles because there are differences in demand for the commingled recycling material and the end products.

A difference in demand between the initial material and the end product also indicates that a “significant change” has occurred as a result of the process applied. *McDonnell*, 62 Wn.2d at 557. For example, in *McDonnell* the taxpayer was processing whole, raw peas into split peas. *Id.* at 554–56. The Court concluded that the taxpayer’s process constituted “manufacturing,” noting that “[t]here are differences in the demand for the

respective products—whole peas v. split peas—the demand dependent in part upon the personal preferences of the ultimate consumers.” *Id.* at 556. “Without such a difference in demand, there would be no practical reason to engage in the operation of splitting peas.” *Id.*

As with the peas in *McDonnell*, FPR’s process of cleaning, sorting, and processing the commingled recycling material is driven by end-user preferences. End users of recycled material require that the commingled material be cleaned, sorted, compressed, and baled in order to use the resulting products in their own manufacturing activities. CP 471 (end users cannot use the commingled recycling material). Moreover, end users have exacting and specific requirements for the amount of contamination and prohibitives allowed in the end products, which do not exist for the commingled recyclable material. CP 137 (end users are “looking for . . . cardboard, newspaper, whatever it is, obviously in its purest form where there is nothing but that commodity in that bale”).

Absent FPR’s processing of the commingled material, there is no demand by end users for that material or anything in it. CP 485. Thus, like the process of creating split peas in *McDonnell*, the demand for the end product in this case is what drives the use of the process in the first instance. If there were no greater demand for the cleaned, sorted, compressed, and baled recyclables than for the initial commingled

material, the process at the MRFs would not exist.

The difference in demand for the material initially received at the MRFs and the end product indicates that a significant change has occurred as a result of FPR's processing activities. Therefore, FPR's activities have created a new, different, or useful article.

3. FPR's activities resulted in new, different, or useful articles because they changed the form, quality, and properties of the commingled recycling material.

Changes in the form, quality, or properties of the substance initially received by a taxpayer are also considered by courts in determining if a taxpayer's activities have resulted in a new, different, or useful article. *McDonnell*, 62 Wn.2d at 557. Although the Court in *McDonnell* suggested that such changes "may be chemical, physical, and/or functional in nature," the Supreme Court has consistently held that the underlying substance of the initial material does not need to change in order for the process to create a "new, different, or useful article." *See id.* at 556; *Bornstein*, 60 Wn.2d at 174.

For instance, in *Bornstein*, the Supreme Court rejected the argument that no significant change had occurred in the fish as a result of the taxpayer's activities because the fish, at the end of the process, was still fish, just in fileted form. 60 Wn.2d at 174. The Court explained that "[t]he fact that the end product is still fish does not mean that the end

product is not new and different after the process of filleting is accomplished.” *Id.* at 177. Rather, the Court held that a significant change had occurred through the fileting process because that process had “transform[ed] near valueless whole bottom fish into useful and salable consumer items.” *Id.*

The Court in *McDonnell* reiterated the same point: “The argument, in effect, that ‘pigs is pigs,’ or that peas are peas, and an identical substance—whether whole as at the inception or split as at the conclusion of the pea-splitting process—and, therefore, the processing should not be considered as manufacturing, was made and rejected in *Bornstein*.” 60 Wn.2d at 556. Thus, the Court in *McDonnell* held that a taxpayer that processed whole peas into split peas created a new, different, or useful product under the statutory definition of manufacturing, despite the fact that the underlying substance of both the beginning and end product was the same: peas. *Id.*; see also *Cont’l Coffee Co.*, 62 Wn.2d at 832 (processing of green coffee beans into roasted coffee beans was “manufacturing”); *Valley Fruit*, 92 Wn. App. at 419 (processing that involved cleaning and treating whole apples was “manufacturing”).

In this case, the evidence demonstrates beyond any doubt that FPR’s activities change the form, quality, and properties of the commingled recycling material initially delivered to the MRFs.

First, FPR’s activities change the *form* of the material by separating it by material type and by crushing the glass and compressing and baling the cardboard, paper, plastics, and metals. The initial material delivered to the MRFs for processing is a single commodity of commingled recycling material, made up of a mixture of garbage, glass, paper, plastic, aluminum, metal, and cardboard:



CP 394; *see* CP 471 (material that comes into the MRF is a commodity “recognized as a specific product,” which is made up of a “mixture of different commodities.”).

Through its process, FPR removes contaminants and garbage from the commingled material and sorts the underlying recyclable materials by type and grade. CP 125–32 (describing process of cleaning and sorting by

material type and grade). FPR also crushes the glass bottles and jars into smaller pieces and compresses and bales the cardboard, paper, aluminum, metal, and plastic into densified cubes. CP 471–72. Thus, FPR’s process changes the shape and structure of the loose commingled recycling material delivered to the MRF by separating the material into distinct commodities by material type and either crushing or compressing the materials. Below is an example of a bale of PET plastic after that material has been cleaned, sorted, compressed, and baled:



CP 396. When this final product is compared to the initial commingled material delivered to the MRF, it is clear that FPR’s process changes the form of original material.

This change in the form of the initial material received at the facility is functional. Among other things, cleaning, sorting, and then compressing and baling different types of materials makes storage and transportation of those products much easier. CP 472 (FPR's processing allows for handling and transportation of the end products). It also serves the end user's needs. *See* CP 476 (describing benefits to end user of baled commodities). End users cannot use the commingled recycled material in their operations because they are too contaminated. CP 472. Indeed, they cannot use separated recyclables in loose form but insist that those recyclables be compressed and baled at the MRF. CP 133 (end users will not buy loose material but require it to be baled); *see also* note 5 above.

As the Department must admit, FPR's activities change the *properties* of the material that is initially delivered to the MRFs, which consists of loose, unsorted recyclables commingled with contaminants and trash. FPR's process changes those properties—loose, contaminated, and commingled—as it converts the material into crushed glass and bales of compacted and densified paper, plastic, cardboard, aluminum, and ferrous metal.

FPR's process also changes the *quality* of the material received at the MRFs. As noted above, the commingled recycling material is nearly valueless and has no market outside of those who have the ability to

process it. FPR's activities remove contaminants, sort the material by product type, and process the material into a form that is usable by crushing the glass and compacting and baling the paper, cardboard, plastics, and metals. FPR's process turns something that is unusable to anyone other than a MRF owner into discrete products that can be sold on the market and used as industrial feedstocks. These changes all evidence a difference in the quality of the beginning material.

The Department may contend that the underlying substance of the single-stream material received at the MRF does not change and therefore that no "new, different, or useful article" is being produced. That contention is both wrong as a matter of fact and legally irrelevant. As in *Bornstein*, the fact that the commingled material entering the MRFs contains paper, plastic, and metals does not mean that end products consisting of paper, plastic, and metal have not undergone a "significant change." See 60 Wn.2d at 177 ("The fact that the end product is still fish does not mean that the end product is not new and different after the process of filleting is accomplished."). FPR need not melt metals or pulp papers itself for its activities at the MRFs to qualify as "manufacturing."

As explained in *Bornstein*, when determining whether there has been a significant change, and therefore, whether a new, different, or useful article has been produced by the taxpayer, a court must compare the

end product to the material before it was subjected to the taxpayer's process. In this case, when the end products—cleaned, sorted, compacted, and baled plastic, metal, paper, and cardboard, as well as crushed glass—are compared with the material before it was processed—commingled, loose recycling material, garbage, and other contaminants—the evidence demonstrates beyond any doubt that FPR's activities at the MRFs change the form, quality, and properties of that material. Because FPR's processing of the commingled recycling material at the MRFs results in new, different, or useful products, FPR is engaged in a manufacturing activity.

4. The extent and nature of FPR's process show that new, different, or useful articles have been produced.

*McDonnell* notes that the “extent and the kind of processing involved” is a factor that should be considered when determining if a “substantial change” has occurred between the initial material and the end product. 62 Wn.2d at 557. If screening and filtering raw whisky was sufficient to constitute manufacturing in *J & J Dunbar*, then FPR's extensive, industrial-scale activities surely qualify. *See* 40 Wn.2d at 766.

5. Department precedent supports the conclusion that FPR's activities constitute manufacturing.

The Department's own precedent shows that FPR was engaged in “manufacturing” under RCW 82.04.120. In Determination No. 95-170, 16

WTD 43 (1995) (the “Metal Cube Case”), the Department determined that a taxpayer that sorted, cleaned, and compacted scrap sheet metal into cubes for use by others was engaged in manufacturing. *See* CP 42–46. Like FPR, the taxpayer in that case processed recycled material acquired and owned by the taxpayer’s customer. Specifically, the taxpayer processed a single stream of recycled material: loose scrap metal collected from “automobile wrecking yards, landfills, and waste energy plants . . . .” CP 42.

The taxpayer’s customer in the Metal Cube Case purchased “large piles of steel items, i.e., cars and appliances, and tin, i.e., sheet metal and other small steel items.” CP 43. The taxpayer sorted the recycled metals by removing non-metallic items and separating out larger items. *Id.* The taxpayer then used a mobile crane to load a compactor with the remaining material and compacted it into 2x2x3-foot cubes using a large ramrod. *Id.* The taxpayer had previously reported under the Service and Other Activities B&O tax classification but argued that it should be taxed as a processor for hire, performing a manufacturing activity. CP 42–43.

The Department agreed with the taxpayer and concluded that sorting and compacting recyclable scrap metal into cubes for use as feedstock by downstream manufacturers constituted the manufacturing of a new, different, or useful substance under RCW 82.04.120. CP 44–46. In

support of that conclusion, the Department noted that “steel mills that recycle the metal can’t economically utilize the loose sheet metal in its non-compacted form because it does not have sufficient density.” CP 43. Density is critical to using recycled metal as feedstock because “[i]f only loose sheet metal is put into the pots approximately 75% of the metal would be burned up by the process. However, if compacted sheet metal cubes are used, the metal melts instead of burning and the loss is reduced to 5%.” *Id.* The Department concluded that:

there is a ***substantial change in form*** from the large pile of unsorted scrap sheet metal to the 2x2x3 foot compacted metal cubes. The ***quality of the metal also changes***, since it has now been ***sorted and many large impurities have been removed***. Furthermore, Taxpayer testified that there has been a significant change in the ***physical properties*** of the metal. In its compacted form the ***metal cubes are much easier to handle, store, and transport than in the loose and unsorted piles***. More importantly, however, ***the metal scraps can now be melted down into molten steel without burning up***.

CP 45 (emphasis added). For these reasons, the Department agreed that the taxpayer’s activities increased the value of the recycled metal and constituted a significant change resulting in a new, different, or useful substance within the meaning of RCW 82.04.120. CP 45–46.

In this case, FPR’s employees perform work that is nearly identical to that considered in the Metal Cube Case. FPR employees sort metals and other mixed recyclables, remove contaminants, and either crush or compact the sorted commodities, making them denser and easier to

handle, store, transport, and use. Thus, like the taxpayer in the Metal Cube Case, FPR's employees are causing substantial changes in form, quality, and physical properties of the commingled recycling material. *See* 16 WTD 43. As the Department admitted in its deposition, there is no meaningful distinction between the facts considered in the Metal Cube Case and those present here. CP 644.

6. The Department conceded in discovery that FPR was engaged in activities that qualify as manufacturing.

As part of its discovery in this case, FPR deposed the Department under CR 30(b)(6). *See* CP 619–664. The Department's 30(b)(6) designee, Jon Yrjanson, conceded that FPR's employees working in a MRF are engaged in manufacturing activities. For instance, Mr. Yrjanson was asked to assess the treatment of aluminum cans that arrive in the MRF as part of the commingled recycling material. CP 630. He agreed that, if the MRF separated aluminum cans from the other recyclables, crushed them into 1,000-pound blocks, and sold them to an aluminum smelter—one lacking the ability to process individual cans for its purposes—“there could be a good argument for that being a new, different or more useful product . . . .” CP 631. Mr. Yrjanson offered similar testimony regarding mixed paper sold to a paper mill that requires its feedstock to be uniform in size and grade to produce new paper from recycled paper. When asked in this

context whether a bale of mixed paper is a new, different, or useful product, Mr. Yrjanson answered, “I believe so.” CP 633.

Although these scenarios were posed to Mr. Yrjanson as hypotheticals, they are accurate descriptions of the activities in which FPR employees engage and the manner in which the resulting products are used. FPR’s expert witness, John Lucini, explained that purchasers of recycled aluminum cans, such as Alcoa, require their feedstock to be processed by the MRF into clean compressed bales because their process is “very, very, very sensitive to contamination . . . .” CP 483. If the contamination level of the feedstock is too high, it does not react the same way, creating “either damage to their equipment or imperfections in what they’re trying to make.” *Id.* Mr. Lucini further testified that baling is critical to purchasers of recycled paper. Mr. Lucini explained that a downstream manufacturer of recycled paper products requires feedstock that is sorted by grade, baled, and meets industry standards for decontamination. He provided the following example:

So in this company’s case, they make a grade called recycled boxboard, which is made by using a combination of cardboard fibers, newspaper fibers, maybe some other—like white paper, and they mix it in a recipe in a pulper, hydropulper, and so this helps—the baling helps them measure the input that, you know, one bale of this, two bales of that to come up with the recipe to produce what they want.

CP 476.

Mr. Yrjanson conceded that FPR's activities in the MRF satisfy the *McDonnell* factors, too. He agreed that bales of cardboard, paper, plastic, ferrous metal, and aluminum produced in the MRF from commingled recycling material, as well as barrels full of crushed glass, have changed in form: "From where we're starting with the loose products to now a baled product, yes, I would certainly say there is some change to the form of the—being that it is a baled product." CP 638.

Mr. Yrjanson also agreed that a bale of cut and compressed cardboard that enters the MRF as commingled recyclable material "could meet somebody's definition of a change in the quality, yes." CP 638. He further agreed that baled items that are compressed to a greater density in the MRF undergo a change in their physical properties. *Id.* And he admitted that the MRF turns out products that are more valuable than its inputs. "There would certainly be—yeah, I think there is a—a demand or a market for the final product, versus what's brought into the MRF." CP 641.

Despite its own precedent and CR 30(b)(6) testimony, the Department argued below, and the trial court agreed, that FPR was not engaged in manufacturing. This Court should reverse that erroneous conclusion and hold that FPR's activities qualify as manufacturing under RCW 82.04.120.

**B. Alternatively, FPR was engaged in wholesale sales.**

If the Court determines that FPR was engaged in manufacturing as defined in RCW 82.04.120, it need not reach the issue of whether FPR was also engaged in “wholesale sales.” Instead, it must rule for FPR. *See* RCW 82.32.180. If, however, the Court reaches the issue of whether FPR was engaged in wholesale sales, it should rule that the trial court erred in concluding that, as a matter of law, FPR was not engaged in wholesale sales. The record reflects that FPR sold services qualifying as “wholesale sales” and that it sold those services to resellers.

RCW 82.04.270 provides that a person engaged in the business of making wholesale sales is subject to a B&O tax rate of 0.484 percent. As relevant here, a “sale at wholesale” or a “wholesale sale” is defined as “[a]ny sale, which is not a sale at retail, of . . . [s]ervices defined as a retail sale in RCW 82.04.050(2)(a) or (g) . . . .” RCW 82.04.060(1)(b). RCW 82.04.050(2)(a), in turn, defines cleaning, altering, or improving tangible personal property of or for a consumer as a “retail sale.”<sup>8</sup> The term “consumer” is defined in RCW 82.04.190 as including, among other things, “[a]ny person who is an owner, lessee, or has the right of

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<sup>8</sup> The definition of “wholesale sale” also includes “[a]ny charge made for labor and services rendered for persons who are not consumers, in respect to real or personal property, if such charge is expressly defined as a retail sale by RCW 82.04.050 when rendered to or for consumers.” RCW 82.04.060(2).

possession to personal property which is being constructed, repaired, improved, cleaned, imprinted, or otherwise altered by a person engaged in business.” RCW 82.04.190(5).

The Washington Supreme Court has held that the ordinary meaning of the term “retail sale,” as used in the sales tax statutes, means a sale to the ultimate consumer. *Standard Oil Co. of Cal. v. State*, 57 Wn.2d 56, 61, 355 P.2d 349 (1960). Wholesale sales, therefore, are sales that are not to the ultimate consumer. *Id.* (“The wholesale sales are defined as all sales not classified as retail sales, that is, not sales to consumers . . .”).

In its motion for summary judgment, the Department conceded that FPR was cleaning, altering, and/or improving the tangible personal property of its customers. CP 27–28.<sup>9</sup> Accordingly, the only issue for this Court is whether FPR’s sale of those services to its customers, the MRF owners, was a “non-retail sale.” The answer to that question is “yes.”

1. FPR was engaged in wholesale sales because it sold its services to resellers.

Central to the definition of a wholesale sale is the requirement that the sale not be a retail sale. A “non-retail sale” means a sale that is not to the ultimate consumer. *Standard Oil*, 57 Wn.2d at 61 (“retail sale” means

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<sup>9</sup> The Department’s concession was compelled by overwhelming evidence that FPR’s activities constitute cleaning, altering, and improving tangible personal property. *See, e.g.*, CP 591–664.

“a sale to the ultimate consumer”). A sale to a reseller, therefore, is not a “retail sale,” because the buyer of the services (i.e., the reseller) is not the ultimate consumer. *See id.* (holding that “wholesale sales” are “all sales not classified as retail sales, that is, not sales to consumers”). This is also confirmed by RCW 82.04.050, which expressly excludes from the definition of “retail sale” a sale of services to a reseller. *See* RCW 82.04.050(14) (the term “retail sale” “does not include the sale for resale of any service described in this section if the sale would otherwise constitute a ‘sale at retail’ and ‘retail sale’ under this section”).

Thus, although the legislature has defined “consumer” to include owners of property which is being improved, cleaned, or altered by another person, RCW 82.04.190(5), other provisions of the tax statutes demonstrate that, if the service is being sold to a reseller, it does not constitute a “retail sale.” *See* RCW 82.04.050(14).

In this case FPR sold its services, which consist of cleaning, altering, and/or improving personal property, to its clients, the MRF owners. The MRF owners were not the ultimate consumers of those services or of the personal property which FPR was cleaning, altering, and/or improving. Instead, the MRF owners were in the business of reselling that personal property to secondary processors or end users. As the Department admitted in its deposition, it treats recycling businesses,

including FPR's clients, as "resellers of the products that they recycle." CP 622, 649, 661.

The evidence also shows that FPR collected reseller permits and exemption certificates from the owners of the MRFs. CP 611–17. As relevant here, under RCW 82.04.470, "[a] seller may meet its burden of proving a sale is a wholesale sale rather than a retail sale by taking from the buyer, at the time of sale or within a reasonable time after the sale as provided by rule of the department, a copy of a reseller permit issued to the buyer by the department under RCW 82.32.780 or 82.32.783." Thus, the reseller permits and exemption certificates that FPR collected from the owners of the MRFs establish that FPR was engaged not in retail sales but rather in wholesale sales of its services.

*Corix Utilities (US), Inc. v. State of Washington Dep't of Rev.*, 2017 WL 5999414 (Wash. Bd. of Tax Appeals May 1, 2017), upon which the Department relied below, is not to the contrary. In that case, the BTA considered whether a taxpayer's maintenance of meter radios owned by another company constituted a "retail sale." *Id.* at \*1. The BTA concluded that the taxpayer's sale of maintenance services was a "retail sale," and not a "sale for resale," because the evidence demonstrated that the company that owned the meters retained ownership of the meters after the taxpayer performed its maintenance services. *Id.* at \*3. The BTA also

noted that the owner of the meters had refused the taxpayer's request for a reseller permit or resale exemption certificate. *Id.* at \*3.

Thus, *Corix* is distinguishable from this case for two reasons. First, the evidence here shows that FPR's customers do not retain ownership of the products produced at the MRFs after FPR processes them but rather sell them to end users or secondary processors. Second, unlike the taxpayer in *Corix*, FPR obtained reseller permits and exemption certificates from its customers. This establishes that FPR was engaged in wholesale sales. *See* RCW 82.04.470(1).

The fact that FPR's customers are not the ultimate consumers of FPR's services or the products that FPR cleans, alters, and/or improves is sufficient to establish that FPR is engaged in wholesale sales. FPR's collection of reseller permits and exemption certificates from its customers makes that conclusion inescapable. Because FPR was engaged in wholesale sales under the statutory definition of that term, this Court should reverse the trial court's ruling to the contrary.

2. If FPR was not engaged in wholesale sales, then it must have been selling its services at retail.

If this Court were to determine that FPR's customers are somehow "consumers" (they are not), then the proper tax classification for FPR's activities would be retail sales, not "Service & Other Activities." As the

Supreme Court explained in *Standard Oil*, the legislature “intended that every sale should be taxed, unless it was expressly excepted from the operation of the statute.” 57 Wn.2d at 60. This means that activities defined as sales in Washington are either retail sales or wholesale sales.

The same conclusion is confirmed by the plain language of the “Service & Other Activities” tax classification statute, RCW 82.04.290. This serves as a catchall provision, one that applies a 1.5 percent tax rate to business activities that are not explicitly covered by another statute. RCW 82.04.290(2)(a). The statute applies to “persons engaged in the business of rendering any type of service which does not constitute a ‘sale at retail’ or a ‘sale at wholesale.’” RCW 82.04.290(2)(b). Thus, the higher tax rate under RCW 82.04.290(2) can be applied to a service only if the service does not qualify as a retail sale or a wholesale sale.

Retail sales are taxed at the same B&O rate as wholesale sales (0.484 percent) or at a lower rate of 0.471 percent. *See* RCW 82.04.250. As noted above, both retail sales and wholesale sales have been broadly defined by the legislature to expressly include the sale of services in which the seller cleans, alters, or improves the personal property of another. *See* RCW 82.04.060; RCW 82.04.050(2)(a); *Standard Oil*, 57 Wn.2d at 60 (“A reading of these statutes in their entirety will show that the legislature was at some [pains] to insure [*sic*] that a narrow definition of the terms

‘wholesale sale’ and ‘retail sale’ would not be implied, and even went so far as to include labor and services within these definitions.”).

Here, the Department has conceded that, contrary to the position taken in its administrative decisions, *see* CP 73–82, 84–93, FPR cleans, alters, or improves the tangible personal property of its customers. CP 27–28. Its sole argument against applying the wholesale sales classification is that FPR’s customers were “consumers” rather than resellers. *Id.* Even if the Department were correct about this (it is not), FPR’s services would then have to be treated as retail sales, not “Service & Other Activities” as the Department has insisted. *See* RCW 82.04.290(2)(b) (persons engaged in services can be taxed at higher Service & Other Activities rate only if the “type of service . . . does not constitute a ‘sale at retail’ or a ‘sale at wholesale.’”). The Department conceded this in its administrative determination when it said: “If [FPR’s] clients are consumers, services provided by [FPR] would be retail services subject to retailing B&O tax . . . .” CP 87 (Determination No. 16-0326R, at 4 n.13).

The more relevant concession, however, was made by the Department in its deposition. There Mr. Yrjanson, on behalf of the Department, stated: “If we are agreed—if we agree that this is an altering activity, I believe wholesaling would most likely be the proper classification.” CP 663.

## VI. CONCLUSION

FPR's activities qualify either as manufacturing or as wholesale sales. Therefore, the trial court erred in entering summary judgment for the Department. This Court should reverse the order of the trial court and remand with instructions to enter judgment for FPR. If the Court determines that the concessions made by the Department in its motion were only tactical (i.e., they do not bind the Department if the court denies summary judgment), this case should be remanded for trial and detailed findings of fact on, among other things, each of the factors listed in *McDonnell* as indicative of manufacturing, as well as the status of FPR's customers as resellers.

DATED this 22nd day of July 2019.

Respectfully submitted,

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