

*Response to Cross-Appeal Brief*

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DIVISION II

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**COURT OF APPEALS FOR DIVISION II  
STATE OF WASHINGTON**

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UNITED STATES  
TOBACCO SALES AND MARKETING  
COMPANY, INC.,

Respondent/Cross-Appellant,

v.

STATE OF WASHINGTON, DEPARTMENT OF REVENUE,

Appellant/Cross-Respondent.

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**REPLY BRIEF OF APPELLANT/CROSS-RESPONDENT**

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**ORIGINAL**

**TABLE OF CONTENTS**

I. REPLY TO TOBACCO SALES’ COUNTERSTATEMENT OF CASE.....1

    A. Tobacco Sales’ Counterstatement Of The Case Violates RAP 10.3(a)(4) By Improperly Containing Argument. ....1

    B. Tobacco Sales Misconstrues The Evidence In Setting Forth The Department’s Case-in-Chief. ....2

II. ARGUMENT .....3

    A. Tobacco Sales Failed To Prove That The Sale Of Its Products Between Its Affiliates Was A Fair Market Value Price Which This Court Defined As A Sale Between A Willing Buyer and a Willing Seller. ....3

        1. This Court instructed the trial court to compare Tobacco Manufacturing’s price with the “Fair Market Value” of its product, a question of fact not law. ....3

        2. Tobacco Sales’ expert testified that Tobacco Manufacturing was not a willing seller because it would never sell to any entity other than to its affiliate Tobacco Sales. ....5

    B. Tobacco Sales Failed To Measure the “Fair Market Value” At the Correct Level of Trade.....9

    C. Tobacco Manufacturing’s Wholesale Sales Price Under the Statute Was Not A Fair Market Value Price As That Term Is Defined Under This Court’s Decision.....10

    D. The Department Addressed The Correct Issue On Remand, Comparing Tobacco Manufacturing’s Price With The Fair Market Value Of Its Product. ....13

        1. Tobacco Sales’ appraisal expert measured the wrong level of trade to determine fair market value.....13

2.	The Ernst & Young Study does not prove fair market value. ....	14
3.	Under an excise tax, an actual sale price is a rebuttable presumption of fair market value. ....	15
4.	The Invoice price establishes the fair market value price. ....	18
III.	DEPARTMENT’S RESPONSE TO TOBACCO SALES’ CROSS-APPEAL.....	20
A.	The Trial Court Correctly Concluded That The Price Between Tobacco Manufacturing And Its Affiliate Was A Discounted Price. ....	20
B.	The Court of Appeals Does Not Review A Denial of Summary Judgment When There Has Been A Trial On The Merits.....	22
IV.	CONCLUSION .....	27

## TABLE OF AUTHORITIES

### Cases

<i>Adcox v. Children’s Orthopedic Hosp. and Medical Center</i> , 123 Wn.2d 15, 864 P.2d 921 (1993).....	23
<i>Argentine v. United Steelworkers of America, AFL-CIO</i> , 287 F.3d 476 (6 <sup>th</sup> Cir. 2002) .....	26
<i>Bird v. Lewis &amp; Clark College</i> , 303 F.3d 1015 (9 <sup>th</sup> Cir.), cert. denied, 538 U.S. 923 (2002).....	26
<i>Black v. J.I. Case Co.</i> , 22 F.3d 568 (5 <sup>th</sup> Cir. 1994) .....	27
<i>Bulman v. Safeway, Inc.</i> , 96 Wn. App. 194, 978 P.2d 568 (1999) rev’d on other grounds, 144 Wn.2d 335 (2001).....	25
<i>Chesapeake Paper Prods. Co. v. Stone &amp; Webster Eng’g Corp.</i> , 51 F.3d 1229 (4 <sup>th</sup> Cir. 1995) .....	27
<i>Cook v. Selland Constr., Inc.</i> , 81 Wn. App. 98, 912 P.2d 1088 (1996).....	25
<i>Crème Manufacturing Co. v. United States</i> , 492 F.2d 515 (5 <sup>th</sup> Cir. 1974) .....	16, 17
<i>Cruz v. Town of Cicero</i> , 275 F.3d 579 (7 <sup>th</sup> Cir. 2001) .....	26
<i>Daigle v. Liberty Life Ins. Co.</i> , 70 F.3d 394 (5 <sup>th</sup> Cir. 1995) .....	26
<i>Fairias v. Instructional Systems, Inc.</i> , 259 F.3d 91 (2 <sup>nd</sup> Cir. 2001).....	26
<i>Herring v. Dep’t of Social and Health Services</i> , 81 Wn. App. 1, 914 P.2d 67 (1996).....	24

<i>Johnson v. Rothstein</i> , 52 Wn. App. 303, 759 P.2d 471 (1988).....	24
<i>Kaplan v. Northwestern Mut. Life Ins. Co.</i> , 115 Wn. App. 791, 65 P.3d 16 (2003).....	25
<i>McLane Co., v. Dep't of Rev.</i> , 105 Wn. App. 409, 19 P.3d 119, review denied, 145 Wn.2d 1005 (2001).....	19
<i>Mercer v. City of Cedar Rapids</i> , 308 F. 3d 840 (8 <sup>th</sup> Cir. 2002) .....	26
<i>Novo Nordisk A/S v. Becton Dickinson &amp; Co.</i> , 304 F.3d 1216 (Fed. Cir. 2002) .....	26
<i>Port Townsend S. Railway Co. v. Barbare</i> , 46 Wash. 275, 89 Pac. 710 (1907).....	8
<i>Rhoads v. FDIC</i> , 257 F.3d 373 (4 <sup>th</sup> Cir. 2001) .....	26
<i>State v. Jackson</i> , 82 Wn. App. 594, 918 P.2d 945 (1996).....	24
<i>State v. Todd</i> , 101 Wn. App. 945, 6 P.3d 86 (2000).....	1
<i>U.S. Tobacco Sales and Marketing Company v. Dep't of Rev.</i> , 96 Wn. App. 932, 982 P.2d 652 (1999).....	passim
<i>University Village Ltd. Partners, v. King Cy.</i> , 106 Wn. App. 321, 23 P.3d 1090 (2001).....	25

**Statutes**

Internal Revenue Code § 482 (2003).....	2, 9, 10
RCW 82.08.010 .....	15
RCW 82.26.010(7).....	11

RCW 82.26.020(2).....	19
RCW 82.32.180 .....	12
RCW 82.45.030(1).....	16
RCW 82.45.030(4).....	15

**Other Authorities**

William Shakespeare, <u>MacBeth</u> , act 5, sc. 5.....	13
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**Treatises**

15B Charles Alan Wright & Arthur R. Miller & Edward H. Cooper, <u>Federal Practice &amp; Procedure</u> § 3914.28 (2d ed. 1987 & Supp. 2004) .....	26
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**I. REPLY TO TOBACCO SALES' COUNTERSTATEMENT OF CASE**

**A. Tobacco Sales' Counterstatement Of The Case Violates RAP 10.3(a)(4) By Improperly Containing Argument.**

Tobacco Sales' Counterstatement of the Case improperly contains argument. RAP 10.3(a)(4) requires every brief to contain "[a] fair statement of the facts and procedure relevant to the issues presented for review, without argument."<sup>1</sup> Tobacco Sales provides the Court a description of the second round of summary judgment motions and then argues that "The Department interpreted 'fair market value' to mean the price at which Tobacco Sales resells OTP to its unaffiliated customers-the very price that the Court had rejected in the first appeal."<sup>2</sup> Not only is the description argumentative, it is incorrect.

Tobacco Sales argues in its Counterstatement of the Case that "the Department did not identify or present any admissible, competent evidence to dispute Mr. Reilly's value opinion under the valuation standard that he was instructed to apply in making his appraisal."<sup>3</sup> The Department did in fact present evidence at trial disputing Tobacco Sales' appraiser expert's valuation opinion evidence in the form of testimony

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<sup>1</sup> RAP 10.3(a)(4); *See also State v. Todd*, 101 Wn. App. 945, 949, 6 P.3d 86 (2000) (Statement of the case considered argumentative in brief citing RAP 10.3(a)(4)).

<sup>2</sup> Tobacco Sales' Brief, Pg. 4.

<sup>3</sup> Tobacco Sales' Brief, Pg. 5.

from its own appraisal expert, Mr. Cook. He testified that in reviewing Mr. Reilly's report he "couldn't see where they necessarily matched up with what was needed for making a conclusion of what excise tax should be based upon. . . . What I discovered was that it appeared that the wrong thing was being measured for collection of the excise tax."<sup>4</sup> He further testified that he believed that the price between Tobacco Manufacturing and Tobacco Sales was a discounted price based upon the level of trade analysis.<sup>5</sup> Further, the Department presented evidence that in measuring an excise tax, one would look at actual sales. The Department countered the use of the Internal Revenue Code (I.R.C) § 482 (2003) analysis by Ernst & Young by pointing out that its intended use was for purposes other than measuring an excise tax.<sup>6</sup> Therefore, the Department presented evidence to dispute the opinion evidence presented by Tobacco Sales.

**B. Tobacco Sales Misconstrues The Evidence In Setting Forth The Department's Case-in-Chief.**

Tobacco Sales again wrongly asserts that "The Department presented no evidence to dispute the expert opinions, qualifications or credibility of Mr. Reilly and Mr. Lofti."<sup>7</sup> As indicated previously, the Department presented evidence challenging Tobacco Sales' experts and

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<sup>4</sup> RP Vol. II at 359-360, ll. 7-10, 4-6.

<sup>5</sup> RP Vol. II at 365-66, ll. 19-25, 1-13.

<sup>6</sup> RP Vol. II at 366-67, ll. 22-25, 1-13; 312, ll. 13-24; 323, ll. 9-18.

<sup>7</sup> Tobacco Sales' Brief, pg. 7.

challenged their opinions in cross-examination. The Department's experts provided opinions that the actual sales price should be the measure of the tax and that Mr. Reilly measured the fair market value at the wrong level of trade.<sup>8</sup>

Tobacco Sales also errs in stating that the "trial did not change the evidence or produce any material new evidence that had not been presented by the parties' second cross-motions for summary judgment."<sup>9</sup> The summary judgment motions did not present prices, but estimates of valuation. The trial presented stipulated facts and most importantly, the invoice prices, which reflected fair market value of the product.

## II. ARGUMENT

### A. **Tobacco Sales Failed To Prove That The Sale Of Its Products Between Its Affiliates Was A Fair Market Value Price Which This Court Defined As A Sale Between A Willing Buyer and a Willing Seller.**

#### 1. **This Court instructed the trial court to compare Tobacco Manufacturing's price with the "Fair Market Value" of its product, a question of fact not law.**

Tobacco Sales argues that this appeal concerns the meaning of "fair market value" and that this "definitional issue is a question of law, not fact."<sup>10</sup> But this Court in its prior opinion made it clear that

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<sup>8</sup> See RP Vol. 2, pg. 315-16, ll. 24-25, 1-20; pg. 319, ll. 10-12; pg. 360, ll. 4-6; pg. 361, ll. 3-6; pg. 367, ll. 2-13.

<sup>9</sup> Tobacco Sales' Brief, pg. 9.

<sup>10</sup> Tobacco Sales' Brief, pg. 11.

determining whether Tobacco Manufacturing's sale price to its affiliate, Tobacco Sales, was a discounted price compared to a fair market value price is a factual determination:

**Whether a price is discounted is a factual determination** and is evaluated without regard to the purchaser's corporate affiliation.

As discussed above, the statutory measure of the OTP tax is the manufacturer's list or invoice price; i.e., the fair market value of the products. Here, because Tobacco Manufacturing sells exclusively to an affiliate, its selling price does not necessarily reflect fair market value. Therefore, to determine whether Tobacco Manufacturing's price is discounted, the trier of fact must compare Tobacco Manufacturing's price with the fair market value of its products.

*U.S. Tobacco Sales and Marketing Company v. Dep't of Rev.*, 96 Wn. App. 932, 941-42, 982 P.2d 652 (1999) (emphasis added).

This Court also explained that the "fair market value" would be a price between a willing buyer and willing seller available to all customers rather than the price between Tobacco Manufacturing and its affiliate Tobacco Sales:

Because an "established price" is available to all customers, it reflects the fair market value of the products. "Fair market value" is the amount a willing buyer would pay a seller who is willing but not obligated to sell. In the case of affiliated companies, which, in effect, are obligated to buy and sell from each other, the "established price" must be based upon fair market value rather than the manufacturer's price to its affiliate.

*Id.* at 940 (footnote and citations omitted).

There were no list prices or invoice prices reflecting a price between Tobacco Manufacturing and Tobacco Sales. The “established price” generally available to Tobacco Sales’ customers, who are the distributors of the tobacco product in Washington was presented to the trial court in the form of invoices for the years 1991 and 1992 as \$1.41 per can, \$1.45 per can and \$1.55 per can.<sup>11</sup> The parties even stipulated that the sale price for a tobacco product to its customers, i.e., distributors, was always higher than the sale price between Tobacco Manufacturing and Tobacco Sales.<sup>12</sup> Based upon this evidence, the trial court properly determined that Tobacco Manufacturing’s selling price was a discounted price compared to the fair market value price as defined by this Court.<sup>13</sup>

**2. Tobacco Sales’ expert testified that Tobacco Manufacturing was not a willing seller because it would never sell to any entity other than to its affiliate Tobacco Sales.**

In its brief, Tobacco Sales “contends that fair market value is the market price at which a manufacturer would sell OTP to an unaffiliated distributor under the circumstances in which the parties otherwise held the same property interests and performed the same functions as are actually performed by the UST Inc. manufacturing and marketing subsidiaries.”<sup>14</sup>

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<sup>11</sup> Ex. 4, 5, 6.

<sup>12</sup> CP at 129-30; RP at 217, ll. 16-20.

<sup>13</sup> CP at 130, 134; See also Ex. 4, 5, 6.

<sup>14</sup> Tobacco Sales’ Brief Pg. 11-12.

Tobacco Sales' expert did not follow this valuation standard, because he admitted that Tobacco Manufacturing would never sell its products to unaffiliated distributors:

Q: (Mr. Hankins) Under my hypothetical that I gave you, isn't it true that manufacturing, if it sold directly to a distributor, it would not sell at a lower price than what it sells to Sales & Marketing?

A: (Mr. Reilly) Well, it's not a question of higher prices or lower price. **Manufacturing would never sell to a distributor whether it's a wholesaler or regional director or even a retailer other than through Sales & Marketing. . .**<sup>[15]</sup>

Tobacco Sales' valuation expert, Mr. Reilly, under cross-examination refused to answer the question whether Tobacco Manufacturing would sell to unaffiliated customers at the same price that it sold its products to Tobacco Sales:

Q: (Mr. Hankins) But you would agree with me, would you not, that if Manufacturing did so [sell] to customers and distributors, it would not sell it at the same price?

A: (Mr. Reilly) I can't agree only and just because that hypothesis is so unreasonable. It's like asking me if Manufacturing set up a factory on Saturn and started shipping to Mercury and then there are customers on the moon who moved to Pluto, what would the price be. That's just such an absurd hypothesis. I just can't answer that.<sup>[16]</sup>

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<sup>15</sup> RP Vol. 2 at 231, ll. 5-21 (emphasis added); *See also* RP Vol. 2 at 384, ll. 13-19.

<sup>16</sup> RP Vol. II at 232-33, ll. 18-25, 1-3.

However, in the very next question, Mr. Reilly agreed that Tobacco Manufacturing would not sell to customers and distributors at the same price it sold its product to Tobacco Sales. This is the same standard Tobacco Sales contends he was measuring, the fair market value between Tobacco Manufacturing and unaffiliated distributors:

Q: (Mr. Hankins) Mr. Reilly, earlier when I asked you isn't it true that you said that Manufacturing would not sell to customers and distributors at the same price it sold to Sales & Marketing?

A: (Mr. Reilly) Yes, absolutely.

Q: You said yes?

A: Yes, because we do know that, they would not sell at the same price.

Q: That's what I just asked you. Would you agree with me that manufacturing would not sell to customers and distributors at the same price that it sells-

A: That's not the question you just asked, but I do agree with that question, they would not sell at the same price.

Q: All right.

A: **They wouldn't sell at all.**<sup>[17]</sup>

Therefore, the Department demonstrated that Tobacco Manufacturing's price was a discounted or reduced price because (1) the price it would sell its product to customers and unaffiliated distributors

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<sup>17</sup> RP Vol. 2 at 233, ll. 4-20 (emphasis added).

would be higher than the price it “sold” its product to Tobacco Sales and (2) Tobacco Manufacturing was not a willing seller, as the “established price” was not available to all customers because Tobacco Manufacturing would not sell its products to anyone besides its affiliate.<sup>18</sup>

Tobacco Sales argues that “whether Tobacco Manufacturing would sell to others at that price is irrelevant to the fair market inquiry.”<sup>19</sup> It relies upon a 1907 condemnation property case to support its argument.<sup>20</sup> Tobacco Sales’ reliance on *Port Townsend* is misplaced. First, the case is distinguishable, because the present case does not involve a property tax or valuation of property, but the application of an excise tax, which is measured by actual sales.<sup>21</sup> Second, a condemnation proceeding by definition does not involve a willing seller. The government takes the individual’s property and pays the fair market value price for the property. In that context, it certainly would be irrelevant as to the seller’s willingness or unwillingness to sell its property, because the question is not “when will the sale occur”, but “how much”. In failing to prove Tobacco Manufacturing was a willing seller, Tobacco Sales failed to

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<sup>18</sup> RP Vol. 2 at 226-27, ll. 24-25, 1-3; RP Vol. 2, at 233, ll. 4-18; RP Vol. 1 at 189-190, ll. 12-25, 1-4; RP Vol. 1 at 56, ll. 6-19; Ex. 10, pg. 5.

<sup>19</sup> Tobacco Sales’ Brief, pg. 25

<sup>20</sup> Tobacco Sales’ Brief, pg. 25, citing *Port Townsend S. Railway Co. v. Barbare*, 46 Wash. 275, 89 Pac. 710 (1907).

<sup>21</sup> See RP Vol. 2, pg. 315-16, ll. 24-25, 1-20; pg. 319, ll. 10-12; pg. 367, ll. 2-13.

prove the price between the two affiliates was a fair market value price. In order to prove “fair market value”, one would have to look at the invoice prices which reflect a price between a willing seller and willing buyer.

**B. Tobacco Sales Failed To Measure the “Fair Market Value” At the Correct Level of Trade.**

Tobacco Sales argues that its valuation standard for fair market value is correct because it measured the “value added to the OTP by Tobacco Manufacturing, but does not include value added by Tobacco Sales.”<sup>22</sup> The Department, through its experts, presented testimony that the Ernst & Young study conducting the I.R.C. § 482 “transfer price study” analysis and Mr. Reilly’s appraisal both measured the wrong level of trade to determine the fair market value of the products:

A: (Mr. Cook) I was looking to see if the, first of all, if the definition of market value that would be appropriate was the one used for the Section 482 analysis. What I discovered was that it appeared that the wrong thing was being measured for collection of the excise tax.<sup>[23]</sup>

Mr. Cook opined that the price between Tobacco Manufacturing and Tobacco Sales was a discounted price, because the invoice price reflected a fair market value price, as a price between a willing seller and willing

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<sup>22</sup> Tobacco Sales’ Brief, pg. 12.

<sup>23</sup> RP. Vol. 2 at 360, ll. 1-6.

buyer.<sup>24</sup> The trial court properly held that the price between Tobacco Manufacturing and Tobacco Sales was a discounted price.<sup>25</sup>

Both the Department's experts noted that the transfer price study analysis conducted under I.R.C. § 482 and an appraisal provided an opinion on value of property. The tax imposed here measures actual sales and actual value.<sup>26</sup> The actual fair market value of the product in 1992 to unaffiliated customers/distributors averaged \$1.43 per can.<sup>27</sup> This is the price a willing buyer would pay a seller who is willing but not obligated to sell. This "established price" is the price sold into Washington and not the discounted price between the affiliates.

**C. Tobacco Manufacturing's Wholesale Sales Price Under the Statute Was Not A Fair Market Value Price As That Term Is Defined Under This Court's Decision.**

Tobacco Sales argues that the "law of the case" bars the Department from arguing that the fair market value price must be the price available to unaffiliated buyers/customers because this Court previously rejected such argument.<sup>28</sup> Further, Tobacco Sales argues that whether Tobacco Manufacturing would not sell to any unaffiliated entity is

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<sup>24</sup> RP. Vol. 2 at 365-66, ll. 15-25, 1-13.

<sup>25</sup> RP Vol. 3, pg. 451, ll. 15-18; CP at 135.

<sup>26</sup> RP Vol. 2, pg. 315-16, ll. 24-25, 1-20; pg. 319, ll. 10-12; pg. 367, ll. 2-13.

<sup>27</sup> CP at 130, 134; See also Ex. 4, 5, 6.

<sup>28</sup> Tobacco Sales' Brief, pg. 20-21.

irrelevant.<sup>29</sup> Tobacco Sales' arguments lack merit, because this Court framed the issue for the parties and the trial court to examine upon remand. This Court directed the trial court to compare "Tobacco Manufacturing's price with the fair market value of its products" in order to determine the statutory wholesale price defined under RCW 82.26.010(7).<sup>30</sup>

Under the statute, the "wholesale sales price" means an "established price", which this Court further defined as a manufacturer's price that "must be generally available, stable, fixed price, such as a list price or invoice price. Because an 'established price' is available to all customers, it reflects the fair market value of the products."<sup>31</sup> The Court defined "fair market value" as the "amount a willing buyer would pay a seller who is willing but not obligated to sell."<sup>32</sup> And the Court stated, "In the case of affiliated companies, which, in effect, are obligated to buy and sell from each other, the 'established price' must be based upon fair market value rather than the manufacturer's price to its affiliate."<sup>33</sup>

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<sup>29</sup> *Id.* at 21.

<sup>30</sup> *U.S. Tobacco Sales & Marketing Co. Inc. v. Dep't of Rev.*, 96 Wn. App. 932, 942, 982 P.2d 652 (1999).

<sup>31</sup> *Id.* at 939-40 (emphasis added).

<sup>32</sup> *Id.*

<sup>33</sup> *Id.*

Tobacco Sales bears the burden in an excise tax refund action to prove (1) that the tax as assessed by the Department is incorrect, and (2) to establish what the correct tax is.<sup>34</sup> Here, Tobacco Sales had the burden to prove that the “established price” between Tobacco Manufacturing and Tobacco Sales was a fair market value price available to all customers. Tobacco Sales failed to carry its burden. First, it failed to prove a fair market value price, because Tobacco Manufacturing was not a willing seller as required by the Court’s decision.<sup>35</sup> Second, the fair market value standard offered by Tobacco Sales’ experts measured the wrong level of trade. Third, the Department offered the invoice price that was available to all customers, which established that the price per can in 1992 was \$1.43 and not a guesstimated price of \$.72 per can, calculated eight years after the sales to its affiliates occurred.

There were no other entities for the Department to compare prices or the trial court to compare prices. As Tobacco Sales admitted in its brief, “There are no OTP transactions between arms’ length entities at the level of trade at which Tobacco Manufacturing sells to Tobacco Sales.”<sup>36</sup>

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<sup>34</sup> RCW 82.32.180.

<sup>35</sup> *See* RP <sup>35</sup> RP Vol. 1 at 100, ll. 13-16; RP Vol. 2 at 231, ll. 5-21; *See also* RP Vol. 2 at 384, ll. 13-19.

<sup>36</sup> Tobacco Sales’ Brief, pg. 24

Therefore, the only evidence before the trial court that demonstrated an “established price” or fair market value price, was the invoice price.

**D. The Department Addressed The Correct Issue On Remand, Comparing Tobacco Manufacturing’s Price With The Fair Market Value Of Its Product.**

**1. Tobacco Sales’ appraisal expert measured the wrong level of trade to determine fair market value.**

Tobacco Sales argues that the “Department all but ignores Mr. Reilly’s valuation report and testimony because it has no response to that evidence.”<sup>37</sup> If the Department gave little attention to that appraisal report, it is because the appraisal report is “full of sound and fury, signifying nothing.”<sup>38</sup> Mr. Reilly’s analysis measured the wrong level of trade for fair market value. He admitted that Tobacco Manufacturing is not a willing seller and therefore, the price between the affiliates is not a fair market value price.<sup>39</sup> As this Court indicated, “[B]ecause Tobacco Manufacturing sells exclusively to an affiliate, its selling price does not necessarily reflect fair market value.”<sup>40</sup> Since Tobacco Manufacturing would not sell to any entity other than Tobacco Sales, the invoice price for Tobacco Sales proved the manufacturer’s established price for the fair

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<sup>37</sup> Tobacco Sales’ Brief, pg. 26.

<sup>38</sup> William Shakespeare, *MacBeth*, act 5, sc. 5.

<sup>39</sup> RP Vol. 2 at 233, ll. 4-20; RP Vol. 2 at 226-27, ll. 24-25, 1-3; RP Vol. 2, at 233, ll. 4-18; RP Vol. 1 at 189-190, ll. 12-25, 1-4; RP Vol. 1 at 56, ll. 6-19; Ex. 10, pg. 5.

<sup>40</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 942.

market value of its product. It is at this level of trade that the fair market value of the product was to be measured. Therefore, as Tobacco Sales' expert measured the wrong level of trade, it is not necessary for this Court to consider Tobacco Sales' appraisal expert's opinion on value.

**2. The Ernst & Young Study does not prove fair market value.**

Tobacco Sales also argues that the “law of the case” bars the Department from pointing out the flaws of the Transfer Price Study conducted by Ernst & Young.<sup>41</sup> Tobacco Sales is wrong. This Court stated, “Likewise, that a profit-sharing formula is used or that a transaction occurs between affiliated entities is not determinative of whether a transfer price is a market price. The pertinent inquiry is what *is* the fair market value, not how it is determined, for what purpose, or by whom.”<sup>42</sup> This Court did not foreclose the Department from arguing that the transfer price did not prove fair market value. Allocating profits among the company for purposes of income tax does not demonstrate the fair market value price for purposes of the OTP tax because it does not demonstrate the actual price a willing buyer and willing seller would pay for the product based upon this Court's decision.

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<sup>41</sup> Tobacco Sales' Brief, pg. 27.

<sup>42</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 943. (emphasis in original).

**3. Under an excise tax, an actual sale price is a rebuttable presumption of fair market value.**

The OTP tax is an excise tax based upon the actual sale price.<sup>43</sup>

Tobacco Sales argues that “The Department cites no authority for its claim that an excise tax must be measured by an actual sales price.”<sup>44</sup> Such argument lacks merit. Not only was there testimony presented in the record,<sup>45</sup> but an excise tax such as the retail sales tax is based upon the “selling price expressed in terms of money paid” or actual price. *See* RCW 82.08.010.

Further, Tobacco Sales argues that “Valuations, as opposed to transaction prices, are used for other excise taxes. For example, the real estate excise tax is measured by the assessed value of the property if the actual selling price cannot be readily ascertained. RCW 82.45.030(4).”<sup>46</sup> Tobacco Sales neglects to cite to the Court the very first provision of the statute which provides that a rebuttable presumption exists that the selling price is the true and fair value of the property and that it is only when the consideration for the sale cannot be ascertained or the true fair market value of the property cannot be ascertained that an assessment of the

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<sup>43</sup> RP Vol. 2 at 366-67, ll. 22-25, 1; *See* RP Vol. 2 at 338, ll. 7-11; *See also* RP Vol. 2 at 316, ll. 16-20; RP Vol. 2 at 367, ll. 6-13.

<sup>44</sup> Tobacco Sales’ Brief, pg. 28.

<sup>45</sup> *See* RP Vol. 2, pg. 315-16, ll. 24-25, 1-20; pg. 319, ll. 10-12; pg. 367, ll. 2-13.

<sup>46</sup> Tobacco Sales’ Brief pg. 28.

property is obtained.<sup>47</sup> This same principle should be applied here. As the tobacco manufacturer does not sell to any other entity, but to its affiliate, it is not a willing seller. And more importantly, the Court must look to the “established price” or invoice price, which is the generally available, stable fixed price such as the invoice price available to all customers and reflects the fair market value of the product.<sup>48</sup> The price available to all customers was the invoice price of \$1.43 per can. This price is the fair market value price and the wholesale sales price subject to the OTP tax.

Tobacco Sales attempts to distinguish the case cited in the Department’s brief, *Crème Manufacturing Co. v. United States*, 492 F.2d 515 (5<sup>th</sup> Cir. 1974), by stating that the issue in *Crème* was different because it related to the presumption of the sufficiency of evidence of a “constructive sales price” established by the Internal Revenue Service.<sup>49</sup>

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<sup>47</sup>RCW 82.45.030(1) “As used in this chapter, the term “selling price” means the true and fair value of the property conveyed. If property has been conveyed in an arm’s length transaction between unrelated persons for a valuable consideration, a rebuttable presumption exists that the selling price is equal to the total consideration paid or contracted to be paid to the transferor, or to another for the transferor’s benefit.

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(4) If the total consideration for the sale cannot be ascertained or the true and fair value of the property to be valued at the time of the sale cannot reasonable be determined, the market value assessment for the property maintained on the county property tax rolls at the time of the sale shall be used as the selling price.”

<sup>48</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 940.

<sup>49</sup> Tobacco Sales’ Brief, pg. 28-9.

But the essential holding in *Crème* is identical to this case. The elements of a “fair market price” must be a “market” price that is available to independent buyers and represents the true worth of the product.<sup>50</sup> The evidence before the trial court established an invoice price of what the product was truly worth to independent buyers, that is \$1.43 per can and not the discounted price of \$.72 per can.

Tobacco Sales also argues this Court should not use the analysis in *Crème* because its analysis is not within the scope of the remand order and that the issue on remand “was the fair market value for Tobacco Manufacturing’s sales to Tobacco Sales.”<sup>51</sup> Tobacco Sales failed to prove a fair market value price. The price it demonstrated was not an “established price” available to all customers, between a willing buyer and willing but unobligated seller. *Crème* is consistent with this Court’s decision that on remand the trial court was to “compare Tobacco Manufacturing’s price with the fair market value of its products”<sup>52</sup> and such price for those products had to be a “market” price that would be available to buyers. The fair market value price of the product was not \$.72 per can, because this was a discounted price that was not available to

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<sup>50</sup> *Crème Manufacturing Co., Inc., v. United States*, 492 F.2d 515, 520 (5<sup>th</sup> Cir. 1974).

<sup>51</sup> Tobacco Sales’ Brief, pg. 30.

<sup>52</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 942.

<sup>52</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 942.

any independent distributor. The evidence demonstrated that Tobacco Manufacturing would not sell to any non-affiliated distributor or customer.

Tobacco Sales also asserts in its brief that the \$1.43 was not a fair market price, because the “trial court specifically found [it] was not fair market value” and that “the Department did not assign error to this finding.”<sup>53</sup> The Department specifically assigned error to the trial court’s finding that the fair market price was \$.82 per can. The fair market value price established in the record is the invoice price of \$1.43.<sup>54</sup>

**4. The Invoice price establishes the fair market value price.**

Tobacco Sales asserts the Department is barred by the “law of the case” by relying upon Tobacco Sales’ invoice prices that it sells to unaffiliated distributors because that is the product’s value at the time the tobacco product is brought for sale into the state.<sup>55</sup> Tobacco Sales misconstrues the “law of the case.” This Court’s remand required the trial court to “compare Tobacco Manufacturing’s price with the fair market value of its products.”<sup>56</sup> In the Conclusion of Law 3 drafted by Tobacco Sales, the trial court concluded:

To determine whether Tobacco Manufacturing’s selling price was a fair market value price, that price must be

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<sup>53</sup> Tobacco Sales’ Brief pg. 30.

<sup>54</sup> See Appellant’s Brief, pg. 1.

<sup>55</sup> Tobacco Sales’ Brief, pg. 31.

<sup>56</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 942.

compared to the market price at which a tobacco products manufacturer would sell OTP to an unaffiliated distributor, where the parties otherwise hold the same property interests, bear the same risks and performed the same functions as do Tobacco Manufacturing and Tobacco Sales.<sup>[57]</sup>

The evidence demonstrated that Tobacco Manufacturing would not sell to an unaffiliated distributor. Therefore, in order to determine a fair market value price, the trial court should have looked at a market price available to all customers. There was no price available to compare between Tobacco Manufacturing and an unaffiliated distributor except for the invoice price between Tobacco Sales and an unaffiliated distributor. The invoice price was the market price or fair market value of the product to an unaffiliated distributor at the time the product was brought into the state. *See* RCW 82.26.020(2). *McLane Co. v. Dep't of Rev.*, 105 Wn. App. 409, 19 P.3d 119, *review denied*, 145 Wn.2d 1005 (2001) supports the contention that the fair market value price would be measured at the time the product is brought into the state, because this price would reflect a market price or fair market value for the manufacturer's product.

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<sup>57</sup> CP at 135.

### III. DEPARTMENT'S RESPONSE TO TOBACCO SALES' CROSS-APPEAL

#### A. The Trial Court Correctly Concluded That The Price Between Tobacco Manufacturing And Its Affiliate Was A Discounted Price.

This Court directed the trial court to compare Tobacco Manufacturing's price with the fair market value of its products.<sup>58</sup> The trial court properly considered such evidence and concluded that because there would be no sale outside of a sale to its affiliate, the price advocated by Tobacco Sales was a discounted price:

This Court believes that Tobacco Manufacturing in selling to Tobacco Sales & Marketing is selling to an affiliated company based upon a discounted price. . . Mr. Reilly indicated candidly that he did not believe that there would be a sale from Tobacco Manufacturing to a nonaffiliated company because that just isn't the way thing work in this situation. That was in response to a question by Mr. Hankins in regard to, well, if there was a sale to a nonaffiliated distributor, wouldn't the price be higher. And Mr. Reilly never said the price would be higher, he never conceded that, but he said there wouldn't be a sale at all. This Court has put great weight in that understanding...<sup>[59]</sup>

The trial court properly concluded that the discounted price of \$.72 per can was not a fair market value price. Additionally, Tobacco Sales failed to prove a fair market value price because there was not a willing seller and willing buyer:

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<sup>58</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 942.

<sup>59</sup> RP Vol. 3, at 451-52, ll. 15-25, 1-11.

Based upon that I find that there was not a fair market value price even though that's been determined as supposedly arm's length and here's the reason. There's not a willing buyer and willing seller. I should say more specifically, there's not a willing seller.<sup>[60]</sup>

The trial court was free to reject the expert appraisal evidence, because (1) the evidence proved that the price between the affiliates was a discounted price and therefore not a fair market value price and (2) Tobacco Manufacturing was not a willing seller and, therefore, the price between the two affiliates was not a fair market value price.

Tobacco Sales asserts that the trial court inferred Tobacco Manufacturing was not a willing seller.<sup>61</sup> There was direct evidence, however, from Tobacco Sales' expert appraiser that Tobacco Manufacturing would not sell to entity other than to its affiliate.<sup>62</sup> This direct evidence supports the trial court's conclusion that Tobacco Manufacturing was not a willing seller. Therefore, no arms-length price or fair market value price existed between the affiliates. The trial court's only error was to then create a fair market value price outside of the evidence presented to the trial court.

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<sup>60</sup> RP Vol. 3 at 452-53, ll. 20-25, 1-5.

<sup>61</sup> Tobacco Sales' Brief, pg. 39.

<sup>62</sup> RP Vol. 2 at 231, ll. 5-21; 233, ll. 4-20; *See also* RP Vol. 2 at 384, ll. 13-19.

**B. The Court of Appeals Does Not Review A Denial of Summary Judgment When There Has Been A Trial On The Merits.**

Tobacco Sales continues to argue about the denial of its summary judgment motion, even though a trial on the merits was conducted. It asserts that the “parties’ dispute on remand boiled down to a dispute of law, not of fact.”<sup>63</sup> When this case was previously before this Court, it rejected the trial court’s summary judgment order in favor of the Department and affirmed the trial court’s order denying Tobacco Sales’ summary judgment motion:

The trial court's analysis was in error. Whether a price is discounted is a **factual determination** and is evaluated without regard to the purchaser's corporate affiliation. . . . The pertinent inquiry is what is the fair market value, not how it is determined, for what purpose, or by whom. . . . Tobacco Sales also challenges the denial of its motion for summary judgment. **Because disposition of this case entails a disputed factual issue**, the trial court was correct in denying the motion.<sup>[64]</sup>

If Tobacco Sales were correct that this was merely a question of law, the Court of Appeals would have reversed the trial court’s order and granted Tobacco Sales’ summary judgment. This Court also denied Tobacco Sales’ motion for reconsideration. Had this Court been

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<sup>63</sup> Tobacco Sales’ Brief, pg. 33.

<sup>64</sup> *U.S. Tobacco Sales*, 96 Wn. App. at 941, 943-44 (emphasis added).

convinced that the issue was legal and not factual, it would not have denied Tobacco Sales' motion for reconsideration.<sup>65</sup>

On remand, the trial court denied the parties' summary judgment motions. Tobacco Sales moved for discretionary review arguing again that it was a question of law not fact. The court commissioner rejected Tobacco Sales' argument and denied the motion for discretionary review.<sup>66</sup> A panel of this Court refused to reconsider the Commissioner's decision.<sup>67</sup> Tobacco Sales' worn argument that this is a question of law and not fact has been repeatedly rejected by this Court in the original appeal and on discretionary review. Yet again, Tobacco Sales asserts this Court should review the denial of summary judgment motion and not the record created at trial.

The trial court conducted a trial and a record was created. After a trial has been conducted, the denial of a summary judgment motion is not reviewable. In *Adcox v. Children's Orthopedic Hosp. and Medical Center*, 123 Wn.2d 15, 35, n.9, 864 P.2d 921 (1993), the Hospital assigned error not to the jury's verdict, but to the trial court's denial of its partial summary judgment motion. The Court rejected its argument stating:

The Hospital has assigned error not to the jury's verdict, but instead to the trial court's denial of its motion for

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<sup>65</sup> See appendix 1 (Order Denying Motion to Reconsider at 1).

<sup>66</sup> See appendix 2 (Commissioner's Ruling Denying Review).

<sup>67</sup> See appendix 3 (Order Denying Motion to Modify).

partial summary judgment on this issue. Accordingly, the Hospital relies on the summary judgment pleadings and the evidence submitted therewith. These arguments miss the mark. When a trial court denies summary judgment due to factual disputes, as here, and a trial is subsequently held on the issue, the losing party must appeal from the sufficiency of the evidence presented at trial not from the denial of summary judgment. *See Johnson v. Rothstein*, 52 Wn. App. 303, 759 P.2d 471 (1988).

*Id.* at 35 n. 9.

This Court has followed this same legal principle in both civil and criminal cases. In *Herring v. Dep't of Social and Health Services*, 81 Wn. App. 1, 914 P.2d 67 (1996), this Court refused to review the trial court's denial of summary judgment issue on appeal, since the trial court conducted a trial on the merits. The Court stated, "Moreover, the matter went to trial, and a ruling denying summary judgment 'based upon the presence of material disputed facts' is not reviewable after trial on the merits." *Id.* at 14 (citation omitted).

In *State v. Jackson*, 82 Wn. App. 594, 918 P.2d 945 (1996), this Court similarly refused to consider the trial court's denial of the defendant's motion to dismiss at the end of the State's case-in-chief in a criminal case, when the defendant went on to present a defense. *Id.* at 608. This Court stated it would apply this same legal principle in a civil case. *Id.* at 608 n. 41.

This same legal principle has also been applied in Division III. *See Cook v. Selland Constr., Inc.*, 81 Wn. App. 98, 101, 912 P.2d 1088 (1996) (court would not review an arbitrator’s denial of a summary judgment motion, when it fully litigated the issues in an arbitration).

Tobacco Sales asserts that even after a trial, a summary judgment motion may be reviewed if the disputed issue is legal rather than factual citing a Division I case. *Kaplan v. Northwestern Mut. Life Ins. Co.*, 115 Wn. App. 791, 799, 65 P.3d 16 (2003).<sup>68</sup> *See also University Village Ltd. Partners v. King Cy.*, 106 Wn. App. 321, 324, 23 P.3d 1090 (2001) (order denying summary judgment reviewable even after a trial on the merits if the summary judgment turned solely on a substantive issue of law). In another case, Division I agreed to review the denial of the summary judgment motion as it revolved around a substantive legal issue, but stated, “The Supreme Court has not decisively ruled on the issue; in dicta, it has agreed with *Johnson*, but made no reference to the distinction raised by *McGovern*.” *Bulman v. Safeway, Inc.*, 96 Wn. App. 194, 198, 978 P.2d 568 (1999), *rev’d on other grounds*, 144 Wn.2d 335 (2001) (footnote omitted). The state Supreme Court has not considered whether, on a pure

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<sup>68</sup> Tobacco Sales’ Brief pg. 34.

legal question, the Court would review denial of a summary judgment, when there has been a trial on the merits.

This Court should not follow Division I's flawed reasoning but should follow its own precedent. Federal appellate courts also do not review denial of a summary judgment motion, when there has been a trial on the merits. For example, in a procedurally similar case to the one at bar, *Argentine v. United Steelworkers of America, AFL-CIO*, 287 F.3d 476, 489-90 (6<sup>th</sup> Cir. 2002), plaintiffs, who won judgment on a jury verdict that was affirmed on appeal, argued that they should have been granted summary judgment on two counts. The Court refused to consider the denial of summary judgment. *Id.* The authoritative treatise of Wright & Miller cites many federal cases that have denied reviewing a summary judgment order when there has been a trial on the merits.<sup>69</sup>

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<sup>69</sup> See 15B Charles Alan Wright & Arthur R. Miller & Edward H. Cooper, Federal Practice & Procedure § 3914.28 (2d ed. 1987 & Supp. 2004). Denial of a summary judgment is not reviewable after a full trial on the merits. See, e.g., *Bird v. Lewis & Clark College*, 303 F.3d 1015, 1019 (9<sup>th</sup> Cir.), *cert. denied*, 538 U.S. 923 (2002) (District court's ruling denying summary judgment declined to be reviewed after a jury rendered its verdict); *Mercer v. City of Cedar Rapids*, 308 F. 3d 840, 847 (8<sup>th</sup> Cir. 2002) (order denying summary judgment not reviewable after a full trial on the merits); *Novo Nordisk A/S v. Becton Dickinson & Co.*, 304 F.3d 1216, 1221 (Fed. Cir. 2002) (A cross-appeal from denial of summary judgment was dismissed after the issue was litigated and decided at trial); *Cruz v. Town of Cicero*, 275 F.3d 579, 587 (7<sup>th</sup> Cir. 2001) ("Once a trial on the merits has occurred, we rely on the record developed at trial and will not review an earlier denial of summary judgment"); *Fairias v. Instructional Systems, Inc.*, 259 F.3d 91, 99 (2<sup>nd</sup> Cir. 2001) (Denial of summary judgment not considered after a jury verdict.); *Rhoads v. FDIC*, 257 F.3d 373, 381 n.5 (4<sup>th</sup> Cir. 2001) (Appellate court refused to consider pre-trial motion for summary judgment after a jury verdict); *Daigle v. Liberty Life Ins. Co.*, 70 F.3d 394, 396-97 (5<sup>th</sup> Cir. 1995) (Denial of the plaintiff's motion for partial summary judgment would not be reviewed following the plaintiff's loss after a full

Here, Tobacco Sales prevailed at trial and is now requesting this Court review its summary judgment motion because, “[h]ad the trial court properly decided this legal issue, it would have spared the parties and the courts the burden and expense of a pointless trial.”<sup>70</sup> Such issue is moot. As the case proceeded to trial, whether the Court should have granted the summary judgment is irrelevant. This Court should not review the denial of the summary judgment motion.

#### IV. CONCLUSION

Tobacco Sales failed to carry its burden to demonstrate a “fair market value.” The trial court erred in creating a “fair market price” for tobacco products distributed in Washington. Therefore, the trial court’s

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trial on the merits: "Once trial begins, summary judgment motions effectively become moot"); *Chesapeake Paper Prods. Co. v. Stone & Webster Eng'g Corp.*, 51 F.3d 1229, 1234-37 (4<sup>th</sup> Cir. 1995) ("Reviewing a pretrial denial of summary judgment after a full trial is inappropriate because the denial was based on an undeveloped, incomplete record, which was superseded by evidence adduced at trial"); *Black v. J.I. Case Co.*, 22 F.3d 568, 570 (5<sup>th</sup> Cir. 1994) ("[I]nterlocutory order denying summary judgment is not to be reviewed where final judgment adverse to the movant is rendered on the basis of a subsequent full trial on the merits")

<sup>70</sup> Tobacco Sales' Brief. Pg. 35-36.

judgment and order awarding Tobacco Sales a tax refund claim should be reversed and Tobacco Sales' tax refund claim should be denied.

RESPECTFULLY SUBMITTED this 26<sup>th</sup> day of May, 2004.

CHRISTINE O. GREGOIRE  
Attorney General

A handwritten signature in black ink, appearing to read "David M. Hankins", with a long horizontal flourish extending to the right.

DAVID M. HANKINS,  
WSBA No. 19194  
Assistant Attorney General  
Attorneys for Appellant/Cross Respondent

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

UNITED STATES TOBACCO SALES  
AND MARKETING COMPANY, INC.,

Appellant,

v.

STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,

Respondent.

No. 22676-6-II

ORDER DENYING MOTION  
TO RECONSIDER

FILED  
COURT OF APPEALS  
20 OCT 22 PM 9:42  
STATE OF WASHINGTON  
CLERK

APPELLANT moves for reconsideration of the court's decision terminating review, filed

August 20, 1999. Upon consideration, the Court denies the motion. Accordingly, it is

SO ORDERED.

DATED this 22<sup>nd</sup> day of October, 1999.

FOR THE COURT:

  
ACTING CHIEF JUDGE

# THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

JAN 22 2002

FILED  
COURT OF APPEALS  
DIVISION II  
02 JAN 17 AM 9:15  
STATE OF WASHINGTON  
BY [Signature]

UNITED STATES TOBACCO SALES  
& MARKETING COMPANY, INC.,

Petitioner,

v.

STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,

Respondent.

No. 28059-1-II

RULING DENYING REVIEW

United States Tobacco Sales and Marketing Co., Inc. seeks review of a Thurston County Superior Court order denying cross motions for summary judgment on the question of what is "fair market value" for the purposes of determining the correct measure of Washington's OTP tax on the smokeless tobacco products UST Sales purchases from its affiliate, UST Manufacturing.

This is the second time this matter has been before this court. The trial court granted the Department of Revenue's first motion for summary judgment, holding that the OTP tax should be based on the amount UST Sales was charging unaffiliated distributors. UST Sales appealed, contending that the proper measure was the amount it was paying UST Manufacturing for the products. This court reversed the trial court's judgment and remanded for further proceedings, holding that whether UST Manufacturing's price to UST

Sales is discounted is a question of fact, to be determined by comparing UST Manufacturing's price with the fair market value of its products.<sup>1</sup>

Thereafter, each party presented additional evidence, including expert opinions, and again moved for summary judgment. UST Sales contends that at that point, the trial court was presented with only a question of law, which it obviously erred in refusing to decide. This claim is not persuasive for the following reasons:

First, as the trial court noted, summary judgment is not proper if all of the facts necessary to determine the issue are not present. See *Ward v. Coldwell Banker*, 74 Wn. App. 157, 160, 168, *review denied*, 125 Wn.2d 1006 (1994). The trial court found that the experts' opinions needed clarification, and based on the record before this court, this court agrees. There appears to be insufficient data that is specific to the companies involved to permit an informed decision.

Second, there is a factual dispute regarding whether UST Sales added value to the products it resold to distributors, and if so, how much.

UST Sales having failed to satisfy the requirements of RAP 2.3(b), it is hereby ORDERED that review is denied.

DATED this 17<sup>th</sup> day of January, 2002

  
Court Commissioner

cc: William Severson  
Norman J. Bruns  
David M. Hankins  
Hon. Gary R. Tabor  
Thurston County Superior Court  
Cause number: 97-2-00883-0

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<sup>1</sup> *US Tobacco Sales and Marketing Co., Inc. v. Department of Revenue*, 96 Wn. App. 932 (1999)

IN THE COURT OF APPEALS OF THE STATE OF WASHINGTON

DIVISION II

UNITED STATES TOBACCO  
SALES & MARKETING  
COMPANY, INC.,

Petitioner,

v.

STATE OF WASHINGTON,  
DEPARTMENT OF REVENUE,

Respondent.

No. 28059-1-II

ORDER DENYING MOTION TO MODIFY

FILED  
COURT OF APPEALS  
DIVISION II  
02 MAR -8 PM 1:32  
STATE OF WASHINGTON  
BY DEPUTY

**PETITIONER** has filed a motion to modify a Commissioner's ruling dated January 17, 2002, in the above-entitled matter. Following consideration, the court denies the motion.

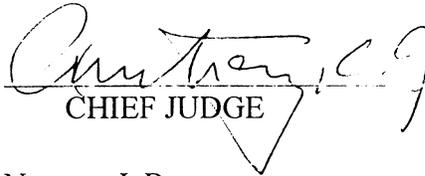
Accordingly, it is

**SO ORDERED.**

**DATED** this 8th day of March, 2002.

**PANEL:** Jj. Armstrong, Seinfeld, Houghton

**FOR THE COURT:**

  
CHIEF JUDGE

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RECEIVED

MAR 11 2002



Candy Zilinskas

Candy Zilinskas, Legal Assistant  
to David M. Hankins,  
Assistant Attorney General  
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SIGNED and SWORN to before me, this 26th day of May, 2004.

Sharon J. Kozar

Signature of Notary  
Public

Sharon J. Kozar

Printed Name

NOTARY Public in and  
for the State of  
Washington,  
residing at

Olympia

Commission expires:

10/4/05