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NO. 83579-9

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STATE OF WASHINGTON

SUPREME COURT OF THE STATE OF WASHINGTON

LAMTEC CORPORATION,

Petitioner,

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Respondent

ANSWER TO PETITION FOR REVIEW

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I. INTRODUCTION

This Court should deny Lamtec's petition for review because the Court of Appeals correctly applied a well-settled legal standard to determine that Lamtec, which sells over \$1 million worth of its products to Washington customers each year and regularly sends sales representatives into the state for marketing purposes, has sufficient nexus with Washington to be subject to Washington tax. Because Lamtec sends sales representatives into the state, who are physically present in Washington, it cannot take advantage of the "physical presence" rule that provides a safe harbor for out-of-state companies whose only contact with the state is through the mail or common carrier. Also, since Lamtec has a physical presence in Washington, this is not an appropriate case to determine whether the "physical presence" rule applies to Washington's B&O tax. Finally, the Court of Appeals decision does not conflict with any other decisions because it is entirely consistent with other courts, and the one decision Lamtec alleges is inconsistent does not address the same legal issue presented in this case. The Department of Revenue respectfully requests that the Court deny Lamtec's petition for review.

II. STATEMENT OF THE ISSUE

Does Lamtec have sufficient "nexus" under the Commerce Clause to be subject to Washington tax when it makes annual sales of over \$1.1

million to Washington customers, and its employees make regular, in-person visits to Washington customers, which Lamtec considers significant to its business and marketing program?

III. RESTATEMENT OF THE CASE¹

Lamtec sells over \$1.1 million of its goods to Washington customers each year. CP 429. Lamtec sells on a continuous basis to a handful of Washington customers, who purchase year-round and throughout the years.² CP 286-89; 339-40. Given this business model, rather than expending effort and resources to obtain new customers in Washington, Lamtec's marketing focus is on maintaining the customer base it already has. CP 285-86, 339-41, 372-73.

As part of its effort to maintain existing customers, Lamtec regularly sends sales representatives on personal visits to Washington customers. Three Lamtec employees regularly visited Washington for this purpose during the tax period for a total of at least 7-11 days per year. CP 76-78; 312; 335; 360; 372; 383-84; 389-98.

Lamtec admits that the purpose of these visits to Washington customers was to maintain the customer relationship in order to encourage

¹ The Court of Appeals opinion accurately sets forth the facts in this case. Lamtec does not complain in its Petition for Review that the Court of Appeals misstated or misunderstood any of these facts.

² Over the entire seven years of the tax period, Lamtec had at most 12 customers. CP 312-13.

continued purchases from Lamtec. CP 294-95; 337-40, 374. Although Lamtec in its briefing has described these visits as “social,” in depositions Lamtec sales representatives generally described the visits as providing information to customers, listening to customer concerns about Lamtec products, providing “good customer service,” participating in telephone calls with customers to Lamtec’s technical or customer service departments, fielding questions about potential price increases or new products, and general client relations. *See generally* CP 338-44; 371, 373-74; 385-86. As part of its marketing efforts, Lamtec sales representatives also sometimes left brochures and product samples when visiting with Washington customers. CP 343-45; 375; 408-13.

Although Lamtec sales representatives may not have solicited or accepted individual orders during their visits, Lamtec admitted that it was engaging in efforts to maintain Lamtec’s market in Washington. *E.g.*, CP 294, 298, 339-40. Lamtec considered the physical, in-person visits by its sales representatives significant to its business model and marketing program and would not even consider abandoning the visits. CP 295-96, 345-46.

IV. REASONS WHY THE COURT SHOULD NOT ACCEPT REVIEW

A. The Court Of Appeals Decision Applied Well-Established Commerce Clause Case Law To Reach The Correct Result.

This Court should not accept review under RAP 13.4(b)(3) because the Court of Appeals opinion applied well-established legal standards to determine that the Commerce Clause of the United States Constitution does not allow Lamtec to avoid Washington's B&O tax. A state tax is valid when applied to interstate commerce if it: 1) is applied to an activity with a substantial nexus with the taxing state; 2) is fairly apportioned; 3) does not discriminate against interstate commerce; and 4) is fairly related to the services provided by the State. *Lamtec Corp. v. Dep't of Revenue*, No. 37516-8-II, slip op. at 5 (Wn. App. Aug. 4, 2009) (quoting *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 48, 156 P.3d 185 (2007), *cert. denied*, 128 S. Ct. 1224 (2008)). Lamtec challenges only the nexus prong of this test. Pet. Rev. at 5.

With respect to the nexus prong, the United States Supreme Court and this Court long ago established the legal standard to determine whether an out-of-state corporation is subject to Washington's B&O tax. That standard is "whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to

establish and maintain a market in this state for the sales.” *Tyler Pipe Indus., Inc. v. Dep’t of Revenue*, 483 U.S. 232, 250, 107 S. Ct. 2810, 97 L. Ed. 2d 199 (1987) (reviewing and upholding this Court’s analysis in *Tyler Pipe Indus., Inc. v. Dep’t of Revenue*, 105 Wn.2d 318, 715 P.2d 123 (1986)). Subsequent decisions have confirmed and applied this test. *E.g.*, *General Motors Corp. v. City of Seattle*, 107 Wn. App. 42, 25 P.3d 1022, review denied, 145 Wn.2d 1014 (2001), cert. denied, 535 U.S. 1056 (2002). Even Lamtec agrees that this standard is “the ‘crucial factor’” in determining nexus. Pet. Rev. at 5 (quoting *Tyler Pipe*, 483 U.S. at 250).

The Court of Appeals correctly cited and applied the *Tyler Pipe* standard. *Lamtec*, slip op. at 7-8. Lamtec admits that the purpose of the visits to Washington by Lamtec sales representatives was to maintain Lamtec’s customer base in Washington to ensure continued sales. CP 294-95; 337-40; 374. Lamtec considered these visits significant to its business model and marketing program and would not even consider abandoning the visits. CP 295-96; 345-46. The Court of Appeals thus correctly concluded that these Washington visits, which constituted in-state activities of Lamtec, “are significantly associated with its ability to establish and maintain its market, particularly in light of Lamtec’s business model that entails maintaining a small number of high-volume customers long-term.” *Lamtec*, slip op. at 8 (citation omitted). The Court

of Appeals decision is also consistent with persuasive authority. *See Orvis Co., Inc. v. Tax Appeals Tribunal of New York*, 86 N.Y.2d 165, 654 N.E.2d 954, *cert. denied*, 516 U.S. 989 (1995) (upholding tax against Commerce Clause challenge where out-of-state company employees visited taxing state average of 41 times over 3 years); *Carr Lane Mfg. Co. v. Dep't of Revenue*, Bd. Tax Appeals No. 64917 (2001) (upholding Washington tax on out-of-state corporation that sent employees into state 2-3 times per year).³

This Court should deny review under RAP 13.4(b)(3) because the case does not present a significant constitutional question. The Court of Appeals applied a well-established legal standard that Lamtec does not even challenge to determine that Lamtec was subject to Washington tax. Accordingly, the Department respectfully requests that the Court deny Lamtec's petition for review.

B. Lamtec Cannot Rely On The Physical Presence Safe Harbor.

Lamtec claims in its petition for review that the Court of Appeals should have applied a "physical presence" requirement in this case, asserting that it is "undisputed" that Lamtec has no physical presence in Washington. Pet. Rev. at 8-9. This is incorrect for two reasons. First,

³ Board of Tax Appeals opinions can be persuasive authority. *Seattle Filmworks, Inc. v. Dep't of Revenue*, 106 Wn. App. 448, 459, 24 P.3d 460, *review denied*, 145 Wn.2d 1009 (2001).

Lamtec asserts that “[t]he ‘physical presence’ test requires the presence of a ‘small sales force, plant or office’ within the taxing state.”⁴ Pet. Rev. at 8. Thus, Lamtec claims that nexus is only sufficient if a business has a *permanent* physical presence in the state. There is no basis for this claim. The “crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.” *Tyler Pipe*, 483 U.S. at 250. No permanent physical presence is required. Employees or independent contractors who are temporarily physically present in the state will provide nexus if their “activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales.” *Id.*

Second, it is not “undisputed” that Lamtec has no physical presence in Washington. Throughout this litigation, the Department has argued that Lamtec does have a physical presence in Washington, and that Lamtec cannot take advantage of the “physical presence” safe harbor

⁴ Lamtec quotes *Quill Corp. v. North Dakota*, 504 U.S. 298, 315, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992) for this proposition. The quoted language from *Quill* looked to prior cases for examples of what would satisfy a physical presence requirement but did not hold that something akin to a small sales force, plant or office was required. *Quill*, 504 U.S. at 315. The Department is unaware of any published opinion that reads *Quill* as requiring a small sales force, plant or office to satisfy Commerce Clause nexus, and Lamtec cites none.

because it regularly sends its employee sales representatives into Washington, and the safe harbor applies only when a vendor's only contact with the taxing state is through the mail or common carriers. *E.g.*, Resp. Br. at 21 n.10, 25, 35; CP 86, 88, 490-91.

The "physical presence" rule is a safe harbor that allows taxpayers to avoid certain taxation by a state if they have no physical presence in the state. *Quill Corp. v. North Dakota*, 504 U.S. 298, 309-12, 112 S. Ct. 1904, 119 L. Ed. 2d 91 (1992). *Quill* was reviewing the "safe harbor" rule first established in an earlier decision, *National Bellas Hess, Inc. v. Dep't of Revenue of Ill.*, 386 U.S. 753, 87 S. Ct. 1389, 18 L. Ed. 2d 505 (1967). Both *Quill* and *Bellas Hess* involved a state's attempt to require an out-of-state mail-order business to collect and remit use tax when the mail-order business's "only connection with customers in the State [was] by common carrier or the United States mail." *Quill*, 504 U.S. at 301 (quoting *Bellas Hess*, 386 U.S. at 758). The *Bellas Hess* rule had been called into question because of the evolution of Supreme Court jurisprudence regarding due process "minimum contacts" and advances in technology that would address some of the concerns expressed in *Bellas Hess*. *Quill*, 504 U.S. at 314. The *Quill* Court acknowledged that "contemporary Commerce Clause jurisprudence might not dictate the same result were the issue to arise for the first time today" but upheld the *Bellas Hess* rule based on

principles of stare decisis and because the mail-order industry had relied upon the rule. *Id.* at 311. In upholding the rule, the *Quill* Court described it as a “safe harbor” and a “bright-line” test. *Quill*, 504 U.S. at 315.

Lamtec cannot take advantage of the *Quill* safe harbor because it regularly sent its sales representatives into Washington. Thus, Lamtec has stepped beyond the bright-line rule of merely sending products into the state by mail or common carrier. Moreover, as noted above, these regular visits to Washington were so significant to Lamtec’s business model that Lamtec would not even consider abandoning the visits. Accordingly, Lamtec cannot take advantage of the “physical presence” safe harbor, and its primary justification for review by this Court is unavailing.

C. Because Lamtec Has Physical Presence In Washington, This Is Not A Proper Case To Decide Whether The Physical Presence Test Is Limited To Sales And Use Taxes.

Quill dealt with sales and use taxes. Lamtec argues that the physical presence test applies to other kinds of taxes such as Washington’s B&O tax. Pet. Rev. at 6-8. However, that issue is not presented in this case because Lamtec does have a physical presence in Washington. Thus, the Department has not argued in this litigation whether the “physical presence” safe harbor applies to Washington’s B&O tax, nor does it do so now. However, the Department notes that Lamtec’s description of *Quill* and subsequent case law leaves out important details.

The *Quill* opinion itself gave several indications that the Court's holding applied only to a state's ability to require out-of-state companies to collect a sales or use tax.⁵ *E.g.*, *Quill*, 504 U.S. at 311 (“[W]e have not, in our review of other types of taxes, articulated the same physical-presence requirement that *Bellas Hess* established for sales and use taxes[.]”); at 315 (“Under *Bellas Hess* [vendors whose only connection with the taxing state is by mail or common carrier] are free from state-imposed duties to collect sales and use taxes”); at 315 (“Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes.”); at 316 (“a bright-line rule in the area of sales and use taxes also encourages settled expectations”); at 317 (declining to reject rule that *Bellas Hess* established “in the area of sales and use taxes.”)

Subsequent Washington cases have declined to extend *Quill* to local B&O taxes. *General Motors Corp. v. City of Seattle*, 107 Wn. App. at 55. *See also Vonage America, Inc. v. City of Seattle*, ____ Wn. App. ____, 2009 WL 2882833, *7 (July 6, 2009) (questioning application of

⁵ *Quill* did not involve the direct taxation of an out-of-state company, but a requirement that the out-of-state company collect a sales and use tax. Some commentators have suggested that the administrative burdens associated with a sales and use tax are greater than other taxes, such as Washington's B&O tax, and thus support requiring a physical presence only for sales and use taxes. *E.g.*, Walter Hellerstein & John A. Swain, *Classifying State and Local Taxes: Current Controversies*, 54 State Tax Notes 35 (October 5, 2009).

Quill physical presence requirement beyond sales and use taxes). Other jurisdictions addressing this question are not split evenly, as suggested by Lamtec. Pet. Rev. at 6 (citing one opinion that extended *Quill* beyond sales and use taxes and one that did not). Rather, the Department is aware of courts in only two jurisdictions that have extended *Quill* beyond sales and use taxes and at least eight (not including Washington) that have declined to extend *Quill* to other taxes.⁶

In any event, the present case, in which Lamtec could not take advantage of the *Quill* safe harbor because of its regular visits to Washington, is not an appropriate vehicle to address this issue.

⁶ *J.C. Penney Nat'l Bank v. Johnson*, 19 S.W.3d 831, 838 (Tenn. Ct. App. 1999) (holding that *Quill* applies to franchise and excise taxes), *cert. denied*, 531 U.S. 927 (2000); *Rylander v. Bandag Licensing Corp.*, 18 S.W.3d 296 (Tex. Ct. App. 2000) (reasoning that *Quill* applied to all taxes); *Geoffrey, Inc. v. Comm'r of Revenue*, 453 Mass. 17, 899 N.E.2d 87 (rejecting application of *Quill* to corporate excise taxes), *cert. denied*, 129 S. Ct. 2853 (2009); *Lanco, Inc. v. Director, Div. of Taxation*, 188 N.J. 380, 908 A.2d 176 (2006) (rejecting application of *Quill* to corporate income taxes), *cert. denied*, 551 U.S. 1131 (2007); *Tax Comm'r v. MBNA America Bank, N.A.*, 220 W. Va. 163, 640 S.E.2d 226 (2006) (rejecting application of *Quill* to franchise and corporate income taxes), *cert. denied*, 551 U.S. 1141 (2007); *Geoffrey, Inc. v. South Carolina Tax Comm'n*, 313 S.C. 15, 437 S.E.2d 13, 23, *cert. denied*, 510 U.S. 992 (1993) (rejecting “physical presence” rule for corporate income tax); *Bridges v. Geoffrey, Inc.*, 984 So.2d 115, 128 (La. Ct. App. 2008) (same), *writ denied*, 978 So.2d 370 (2008); *Geoffrey, Inc. v. Oklahoma Tax Comm'n*, 132 P.3d 632, 638-639 (Okla. Civ. App. 2005) (same); *MBNA America Bank, N.A. & Affiliates v. Indiana Dep't of Revenue*, 895 N.E.2d 140, 143 (Ind. Tax 2008) (same); *A & F Trademark, Inc. v. Tolson*, 167 N.C. App. 150, 605 S.E.2d 187 (2004), *cert. denied*, 546 U.S. 821 (2005) (concluding that where out-of-State company licenses trademarks to related in-State retail company, there exists substantial nexus with taxing State to satisfy commerce clause despite no physical presence).

D. The Court Of Appeals Decision Is Not Inconsistent With Any Other Court Of Appeals Case.

Lamtec argues that this Court should grant its petition for review under RAP 13.4(b)(2), apparently claiming that the Court of Appeals decision is in conflict with *City of Tacoma v. Fiberchem, Inc.*, 44 Wn. App. 538, 722 P.2d 1357, *review denied*, 107 Wn.2d 1008 (1986). Pet. Rev. at 9. Prior case law has considered and rejected this identical argument. In *General Motors*, the court rejected the taxpayer's attempt to rely on *Fiberchem* for a Commerce Clause analysis of state taxation of interstate commerce: "*Fiberchem* involved issues of intrastate commerce and relied on state constitutional due process law. The Commerce Clause of the federal constitution was not implicated."⁷ 107 Wn. App. at 53. This Court subsequently denied review and has cited *General Motors* favorably. *General Motors Corp. v. City of Seattle*, 145 Wn.2d 1014 (2001) (denying review), *cert. denied*, 535 U.S. 1056 (2002); *Ford Motor Co. v. City of Seattle*, 160 Wn.2d 32, 43, 156 P.3d 185 (2007) (citing *General Motors* favorably). Accordingly, the Court of Appeals opinion

⁷ Although *General Motors* used the term "state constitutional due process law," which was also adopted by the Court of Appeals in this case, slip op. at 8, *Fiberchem* did not rely on the state constitution but explicitly relied on "Washington rules of Fourteenth Amendment due process." *Fiberchem*, 44 Wn. App. at 544, 544 n.1. The quote should thus be understood to mean state law interpreting federal due process law.

does not conflict with other Court of Appeals opinions and the Court should not accept review under RAP 13.4(b)(2).

Nevertheless, Lamtec argues that *Fiberchem* is still relevant to a Commerce Clause analysis because it purported to apply the federal Due Process Clause in determining whether intrastate sales were subject to a city tax. Pet. Rev. at 10. Lamtec then argues that if a Due Process violation is found, a Commerce Clause violation would also be found because the Commerce Clause requires a greater relationship with the jurisdiction than the Due Process Clause. Pet. Rev. at 10.

The flaw in Lamtec's approach is that the very same United States Supreme Court case that established that the Commerce Clause requires a greater relationship with the taxing jurisdiction than the Due Process Clause also explicitly adopted a Due Process standard different – and far easier to satisfy – than the test set forth in *Fiberchem*. *Quill*, 504 U.S. at 308. The *Quill* court clarified that the Due Process clause required only that a taxpayer satisfy the “minimum contacts” test akin to the standard set forth in *International Shoe* and its progeny. *Id.* at 307-08 (citing *International Shoe Co. v. Washington*, 326 U.S. 310, 66 S. Ct. 154, 90 L. Ed. 95 (1945); *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 105 S. Ct. 2174, 85 L. Ed. 2d 528 (1985)). The *Quill* court thus upheld the tax

against a due process challenge, even though the taxpayer's only contact with the taxing state was through mail or common carrier. *Id.*

Therefore, rather than showing that *Fiberchem* can be applied to the present case to show a Commerce Clause violation, *Quill* instead implicitly overrules the *Fiberchem* holding that federal due process requires more than what a "minimum contacts" analysis requires. Accordingly, *Fiberchem* has no application to the Commerce Clause analysis in the present case.

In mistakenly relying on *Fiberchem*, Lamtec also proposes that this Court reject its prior holding in *Tyler Pipe* and ignore controlling United States Supreme Court precedent to adopt a new standard for determining whether taxation of interstate sales is prevented by the Commerce Clause. Pet. Rev. at 9, 13-14. Rather than look to the United States Supreme Court and this Court for a Commerce Clause analysis, as the Court of Appeals did, Lamtec instead offers a different test taken from the *Fiberchem* opinion, which did not even involve the Commerce Clause.⁸ Pet. Rev. at 9 (proposing a "reasonable relationship to sales in Washington" test). The Department respectfully requests that the Court

⁸ Even under the test proposed by Lamtec of a "reasonable relationship to sales in Washington," Lamtec would be subject to taxation in Washington. In a portion of the opinion not challenged by Lamtec in its petition, the Court of Appeals correctly concluded that Lamtec's in-state activity was significantly associated with the sales into Washington. *Lamtec*, slip op. at 8-9.

deny Lamtec's attempt to rewrite federal constitutional law by denying Lamtec's petition for review.

E. Public Policy Does Not Support This Court Accepting Review.

Finally, Lamtec argues that this Court should accept review under RAP 13.4(b)(4), alleging that the Court of Appeals has adopted a "any possible nexus" test. Pet. Rev. at 14. This argument mischaracterizes the Court of Appeals analysis. The Court of Appeals applied the proper legal standard originated by this Court and subsequently approved and adopted by the United States Supreme Court. Applying this standard, and based on undisputed facts, the Court of Appeals correctly determined that Lamtec's in-state activities were significantly associated with establishing and maintaining a market in this state. *Lamtec*, slip op. at 7-8.

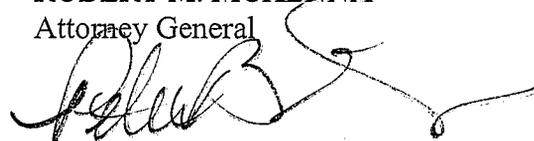
Moreover, this Court and the United States Supreme Court denied review of the *General Motors* decision over seven years ago, which applied the same legal standards as the Court of Appeals did here. *General Motors Corp. v. City of Seattle*, 145 Wn.2d 1014 (2001), cert. denied, 535 U.S. 1056 (2002). The Department respectfully submits that this Court should similarly deny review here.

V. CONCLUSION

The Court of Appeals applied well-established legal standards of Commerce Clause jurisprudence that have been approved by the United States Supreme Court and this Court to reach the correct result in this case. Accordingly, the Department respectfully requests this Court to deny review.

RESPECTFULLY SUBMITTED this 26th day of October, 2009.

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**SUPREME COURT
STATE OF WASHINGTON**

LAMTEC CORPORATION,

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DEPARTMENT OF REVENUE,
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Respondent.

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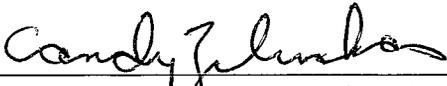
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I certify under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

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