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STATE OF WASHINGTON

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

BY Cm
DEPUTY

DOT FOODS, INC.,

Respondent/Cross-Appellant,

v.

DEPARTMENT OF REVENUE, STATE OF WASHINGTON,

Appellant/Cross-Respondent.

DOT FOODS' RESPONSE BRIEF
AND BRIEF ON CROSS-APPEAL

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I. INTRODUCTION

Respondent Dot Foods, Inc. (“Dot Foods”) argues three issues in this Response Brief. First, in response to the Brief of Appellant Department of Revenue (the “Department”), Dot Foods argues that the trial court was correct in holding 2ESSB 6143, Laws of 2010, 1st Spec. Sess., ch. 23 (“2010 Legislation”), unconstitutional. Second, in support of its cross-appeal, Dot Foods argues that the trial court erred in rejecting Dot Foods’ contentions that the 2010 Legislation necessarily preserved the collateral estoppel effect of the judgment in *Dot Foods, Inc. v. Dept. of Revenue*, 166 Wn.2d 912, 215 P.3d 185 (“*Dot Foods I*”) (2009), and third, that if it did not, the 2010 Legislation violated separation of powers.

In keeping with standard jurisprudence, this case should be resolved on statutory grounds if possible, rather than constitutional grounds. *Ralph v. Dept. of Natural Resources*, 182 Wn.2d 242, 248, 343 P.3d 342 (2014) (citing *Community Telecable of Seattle, Inc. v. City of Seattle*, 164 Wn.2d 35, 41, 186 P.3d 1032 (2008)). In the 2010 Legislation providing for a retroactive amendment of RCW 82.04.423, the legislature specifically provided in Section 1706 that the amendment did “not affect any final judgments, not subject to appeal, entered by a court of competent jurisdiction before the effective date of this section.” This was a constitutionally superfluous provision. By including it, the legislature

expressed its intent not to affect the *taxpayer*, Dot Foods, including the claim and issue preclusion effects of Dot Foods' judgment. Moreover, under the specific terms of *Dot Foods I*, the judgment had continuing effect after the specific periods at issue, because the Court held that "Dot *remains qualified* for the B&O tax exemption to the extent its sales *continue* to qualify for the exemption." *Dot Foods I*, 166 Wn.2d at 926 ¶ 27. This effect was preserved by Section 1706.

As for due process, the Department argues that this case is on all fours with *In re Estate of Hambleton*, 181 Wn.2d 802, 335 P.3d 398 (2014), and that *Hambleton's* rejection of the taxpayers' due process arguments against a retroactive amendment controls the disposition of this case as well. The Department obfuscates the many differences between *Hambleton* and this case. In assessing the due process compliance of retroactive tax legislation, "it is necessary to consider the nature of the tax and the circumstances in which it is laid." *Welch v. Henry*, 305 U.S. 134, 147, 59 S. Ct. 121, 83 L. Ed. 87 (1938). Careful assessment of the facts and circumstances in this case will lead the Court to affirm the judgment.

As for separation of powers, this case falls within one of the narrow areas where a retroactive change of law in response to a judicial interpretation trespasses on the role of the judiciary in an unconstitutional manner. The legislature may not upset "previously litigated adjudicative

facts.” *Cornelius v. Dept. of Ecology*, 182 Wn.2d 574, 591, 344 P.3d 199 (2015). In *Dot Foods I*, the Supreme Court previously established the adjudicative fact that Dot Foods was entitled to the tax exemption under RCW 82.04.423 so long as its business operations remained unchanged. If indeed it was the legislature’s intent to terminate Dot Foods’ exemption at the close of the specific periods at issue in *Dot Foods I*, the 2010 Legislation violated separation of powers principles.

II. ASSIGNMENTS OF ERROR ON CROSS-APPEAL

1. The trial court erred in holding that the Legislature did not intend to preserve the effect of Dot Foods’ judgment in *Dot Foods I* when it stated that the amendment of RCW 82.04.423 did “not affect any final judgments . . . entered before the effective date of this act.” 2010 Legislation § 1706.

2. The trial court erred in holding that depriving Dot Foods’ judgment of its prospective effect, if such was the Legislature’s intent, did not violate separation of powers.

III. STATEMENT OF ISSUES PERTAINING TO BOTH PARTIES’ ASSIGNMENTS OF ERROR

1. Does a statute that purports to “clarify” previous legislation passed 27 years prior, thereby retroactively increasing tax liability, offend the Due Process Clause?

2. Did the Legislature intend to preserve the res judicata and collateral estoppel effects of Dot Foods's judgment when it stated that the 2010 Legislation did "not affect any final judgments entered before the effective date of this act"?

3. If the Legislature did intend to deprive Dot Foods' of the collateral estoppel effects of its judgment, did it trespass on the prerogatives of the judiciary, thereby offending separation of powers?

IV. RESTATEMENT OF THE CASE

Most of the facts relevant to this case were set out by the Supreme Court in *Dot Foods I* with respect to the period then under review. There were no material changes in facts for the subsequent period now at issue, May 2006 through December 2007 (the "Refund Period").

- In 1997, Dot Foods sought and obtained an interpretive ruling from the Department that it could qualify for the exemption from B&O tax under RCW 82.04.423 for out-of-state businesses that sharply restricted their in-state presence and sold products in Washington only through direct seller representatives (the "DSR Exemption"). See *Dot Foods, Inc. v. Dept. of Revenue*, 141 Wn. App. 874, 878 ¶ 4, 173 P.3d 309 (2007) ("*Dot Foods Appeals Court Decision*"), *rev'd*, *Dot Foods I*, 166 Wn.2d 912.

- Dot Foods is an Illinois corporation that “sells food products to dairies, meat packers, food processors, and other food service companies in Washington.” *Dot Foods I*, 166 Wn.2d at 916 ¶ 2.
- To obtain the DSR Exemption ruling, Dot Foods had to commit to (i) cease or avoid owning or leasing real property in Washington, (ii) cease or avoid maintaining a stock of product in Washington, (iii) cease or avoid making or soliciting sales through its own employees, and (iv) conduct those activities in Washington solely through a direct seller’s representative. *See* RCW 82.04.423(1) (requirements for exemption).
- “At all relevant times, Dot sold consumer and nonconsumer products through its direct seller’s representative, Dot Transportation, Inc. (DTI), and some of the consumer products ultimately ended up in permanent retail establishments.” *Dot Foods I*, 166 Wn.2d at 916 ¶ 2. Dot Foods’ sales in Washington were made “exclusively through its direct seller’s representative (DTI).” *Id.* at 921 ¶ 15.

- “Between 1997 and 2000, Dot received B&O tax-exempt status even though it sold both consumer and nonconsumer products. Also, Dot received this tax exemption during this time even though some of the products purchased from Dot were later sold to permanent retail establishments without Dot’s or DTI’s involvement.” *Id.* at 916 ¶ 3.
- At the end of 1999, the Department changed its interpretation of the DSR exemption, such that no seller would be eligible for the exemption if some of the consumer products were ultimately resold in permanent retail establishments. *Id.* at 915 ¶ 1; *id.* at 917 ¶ 6.
- Dot Foods did not change its tax reporting practices but continued to claim the exemption after the Department changed its interpretation. “The Department audited Dot based on the new interpretation for the years 2000 through 2004. Because some of Dot’s products eventually end up in permanent retail establishments, like grocery stores, the Department assessed a B&O tax against Dot for the tax periods during January 1, 2000 through December 31, 2003, for 100 percent of its instate sales.” *Id.* at 917 ¶ 6.

- Dot Foods paid the tax assessment and filed a refund action.¹ *Id.*, ¶ 7.
- The Supreme Court in *Dot Foods I* rejected the Department’s new interpretation and reversed *Dot Foods Appeals Court Decision*, holding that former RCW 82.04.423 was “unambiguous.” *Id.* at 926 ¶ 26. The statute required neither that all products sold through a DSR be consumer products, *id.* at 920-21 ¶¶ 10-13, nor that all downstream sales of the products occur outside permanent retail establishments. *Id.* at 926 ¶ 26.
- The Supreme Court held that “Dot *remains qualified* for the B&O tax exemption to the extent its sales *continue* to qualify for the exemption,” *id.*, and remanded the matter to the trial court. *Id.* at 926 ¶ 27 (emphasis added).

Following the decision in *Dot Foods I*, in late 2010, Dot Foods and the Department negotiated a settlement of the refund claim. The agreement provided Dot Foods a refund of approximately 97.97 percent of B&O taxes, interest, and penalties paid for the period at issue in the litigation. The taxes not refunded related to sales of equipment and

¹ In addition, Dot Foods began paying tax for periods subsequent to the 2000-03 audit period, and refund claims for those subsequent periods through April 2006 were also at issue in the litigation culminating in *Dot Foods I*. See *Dot Foods Appeals Court Decision*, 141 Wn. App. at 880 ¶ 7.

supplies, which Dot Foods conceded to be nonconsumer products, and sales of certain food ingredients sold in bulk, which Dot Foods did not concede to be nonconsumer products. *See* CP 360-61 (Decl. of David Tooley ¶¶ 2-4).

Dot Foods also submitted a refund request for additional B&O taxes paid for periods following the period directly at issue in *Dot Foods I* (*i.e.*, periods beginning with May 2006). *See* CP 354 (Decl. of William H. Metzinger ¶ 2).

In response to the Court’s decision in *Dot Foods I*, the Legislature purported to clarify RCW 82.04.423 to express what the Legislature asserted was its original intent in enacting the exemption. This asserted “original intent” of 1983 matched exactly the Department’s arguments in *Dot Foods I*. *See* 2010 Legislation §§ 401, 402. The amendments expressing this clarification were retroactive back to the original 1983 enactment. *Id.* § 1704. However, Section 1706 of the act provided:

Section 402 of this act [the amendment of RCW 82.04.423] does not affect any final judgments, not subject to appeal, entered by a court of competent jurisdiction before the effective date of this section.

The effective date of Section 1706 was May 1, 2010. *Id.* § 1708. *See* CP 349-51 (relevant session law sections).

In July 2010, the Department denied Dot Foods's refund request for periods beginning with May 2006 based on the retroactive effect of the 2010 Legislation. *See* CP 355, 357-58 (Metzinger Decl. ¶ 3 & Ex. 1).

During the Refund Period now at issue, neither Dot Foods nor DTI made any material changes in business practices from the practices that prevailed in the period directly at issue in *Dot Foods I*. *See* CP 361 (Tooley Decl. ¶ 6). DTI continued to serve as Dot Foods' DSR, and Dot Foods made sales to Washington customers exclusively through DTI. *See id.* The mix of products sold during the Refund Period was the same as in the prior period. *See id.*

The refund claim for the Refund Period is \$507,818 plus statutory interest. This amount reflects approximately 96.99 percent of all B&O tax paid by Dot Foods for the Refund Period. The amount of tax not subject to the refund claim reflects sales of nonconsumer products and of bulk ingredients, calculated on the same basis as the refund settlement for prior periods. *See id.* ¶¶ 7-8.

Following the Department's denial of the refund claim, Dot Foods filed suit in Thurston County Superior Court. CP 7-11. On cross-motions for summary judgment, the trial court held that the 2013 Legislation was unconstitutional under the due process principles stated in *United States v. Carlton*, 512 U.S. 26, 114 S. Ct. 2018, 129 L. Ed. 2d 22 (1994), as applied

in *Tesoro Ref. & Mktg. Co. v. Dept. of Revenue*, 159 Wn. App. 104, 246 P.3d 211 (2010) (“*Tesoro I*”), *rev’d on other grounds*, 173 Wn.2d 551 (2012). *Tesoro I* had held under *Carlton* that “it is not reasonable for the legislature to enact a retroactive amendment spanning 24 years in direct response to a taxpayer’s refund lawsuit.” 159 Wn. App. at 119.

The trial court opined that “*Tesoro I* controls the outcome in this case” and that the Department had failed to distinguish *Tesoro I* meaningfully. CP 468-74 (Letter Opinion, Oct. 2, 2013).

The *Tesoro I* case is very similar to the present case. Here, the legislature responded to a tax appeal by amending the law, as in *Tesoro I*. Here, the amendment was retroactive 27 years, rather than the 24 years in *Tesoro I*. In both cases, the legislature purported to “clarify” the intent of the legislature that enacted the tax code decades earlier. Such an attempt at discerning the original legislative intent is, as the appellate courts conclude, impossible.

CP 472-73.

The trial court also rejected Dot Foods’ contentions that the 2010 Legislation’s provision that preserved its final judgment necessarily also entailed protection of the judgment’s collateral estoppel effect and that the 2010 Legislation violated separation of powers principles, granting summary judgment to the Department on those issues. CP 469-71.

Although the trial court opined that the 2010 legislature’s claim that it knew the 1983 legislature’s intent was “impossible,” the court’s

order held that the 2010 Legislation was unconstitutional “as applied to Dot Foods for the May 2006 through December 2007 periods at issue.” CP 496. The court ordered the Department to refund the tax in question in the amount of \$507,818 plus interest as provided in RCW 82.32.060. CP 497. The Department has not made this payment.

The Department moved for reconsideration at the trial court, which the court denied. CP 549-50. The Department then filed this appeal. CP 551-58. Dot Foods filed a cross-appeal as to the collateral estoppel and separation of powers issues. CP 559-66.

V. ARGUMENT IN RESPONSE

Appellant Department of Revenue argues that the outcome of Dot Foods’ due process challenge is controlled by *In re Estate of Hambleton*. However, *Hambleton* does not make new law; it is an application of the rule enunciated by the U.S. Supreme Court in 1994 for a due process challenge to retroactive tax legislation in *Carlton*. This is the same analysis used by this Court in *Tesoro I*. *Hambleton* reaches a different result than *Tesoro I* because the facts are different. Thus the issue is whether this case is more like *Hambleton* or more like *Tesoro I*. Dot Foods shows first how the 2010 Legislation is invalid under the *Carlton* rational basis standard as explained in *Tesoro I* – the legislation had neither a wholly legitimate purpose nor was the means for effectuating

those purposes rational. Next, Dot Foods shows why *Hambleton* does not govern this case, assuming that *Hambleton* was decided correctly on its facts. Finally, Dot Foods argues that *Hambleton* was not correct.

A. The 2010 Legislation Does Not Meet the Rational Basis Test of *Carlton* as Correctly Applied in *Tesoro I*.

In *Tesoro I*,² this Court held that the 24-year retroactive amendment of another B&O tax provision, RCW 82.04.433, adopted by the Legislature in 2009 was “well beyond the limit of permissible retroactivity and retroactive enforcement of the amendment would violate due process.” *Id.* at 120 ¶ 29 (citing *State v. Pacific Tel. & Tel. Co.*, 9 Wn.2d 11, 17, 113 P.2d 542 (1941)). There are no materially distinguishing facts between *Tesoro I* and this case (except to make this

² The Department argues that *Tesoro I* is not precedential. Brief of Appellant at 26-27. This is a frivolous argument. Washington appellate courts frequently rely on the substantive holdings of lower courts that have been reversed on other grounds. The Supreme Court continues to rely on its own holdings when reversed on other grounds by the U.S. Supreme Court. *See, e.g., Gendler v. Batiste*, 174 Wn.2d 244, 253 ¶ 18, 274 P.3d 346 (2012). The Supreme Court also relies on the substance of court of appeals holdings that it has reversed on other grounds. *See, e.g., Beggs v. Dept. of Social & Health Servs.*, 171 Wn.2d 69, 83 ¶ 25, 247 P.3d 421 (2011); *State v. Kronich*, 160 Wn.2d 893, 903 ¶ 19, 161 P.3d 982 (2007) (citing appellate court holding, in otherwise reversed decision, that was “[p]articularly relevant here”); *One Pac. Towers Homeowners’ Ass’n v. HAL Real Est. Invs., Inc.*, 148 Wn.2d 319, 335, 61 P.3d 1094 (2002) (distinguishing appellate decision, reversed on other grounds, that was cited by party). The single case cited by the Department, *Tibbs v. Johnson*, 30 Wn. App. 107, 113, 632 P.2d 904 (1981), does not deny that a case overruled on other grounds may still provide valuable analysis; it simply held that the appellant in that case did not argue that the overruled case was precedential.

case stronger for Dot Foods, as shown below). The same result should follow.

1. The Facts in *Tesoro I* Are Very Similar to the Facts of This Case.

In *Tesoro I*, the 1985 Legislature adopted a deduction from B&O tax for “amounts derived from sales of [a qualifying] fuel.” *Id.* at 108-09 ¶ 4 (quoting former RCW 82.04.433(1)). The Tesoro company sought to apply this deduction to its B&O tax liability for bunker fuel sales under the manufacturing classification, *id.* at 109 ¶ 5, as the Department had permitted other fuel manufacturers to do. *Id.* at 114 ¶ 15. *See also Tesoro Ref. & Mktg. Co. v. Dept. of Revenue*, 173 Wn.2d 551, 554, 269 P.3d 1013 (2012) (“*Tesoro II*”) (noting prior inconsistent administration of the exemption by the Department). The Department refused to apply the deduction and Tesoro appealed to the Thurston County Superior Court. One day before the scheduled hearing, the governor signed a clarifying amendment to RCW 82.04.433 into law that expressly limited the applicability of the deduction to wholesale and retail activities, thereby more expressly excluding manufacturing activities. *Tesoro I*, 159 Wn. App. at 110. This new amendment purported to apply “both prospectively and retroactively” to 1985 when the tax deduction was originally enacted. *Id.* (quoting LAWS OF 2009, ch. 494, § 4). The Court of Appeals held

that “it is not reasonable for the legislature to enact a retroactive amendment spanning 24 years in direct response to a taxpayer’s refund lawsuit.” *Id.* at 119 ¶ 28.

In this case, the DSR exemption was enacted in 1983. *Dot Foods I*, 166 Wn.2d at 922 ¶ 16. From that time until late 1999, the Department interpreted the statute to permit companies that operated like Dot Foods to claim the exemption. *Id.* at 921 ¶ 13. Dot Foods received specific approval from the Department for a reorganization of its business to qualify for the DSR exemption. *Dot Foods Appeals Court Decision*, 141 Wn. App. at 878. In 1999, the Department changed its interpretation to exclude taxpayers who sold products through commissioned sales representatives (in addition to resellers) if the products were eventually resold in permanent retail establishments. *Dot Foods I*, 166 Wn.2d at 917 ¶ 6. Dot Foods continued to rely on the statutory exemption, and the Department assessed additional tax in 2004. *Id.* Dot Foods paid the tax and sought a refund.

In 2009 in *Dot Foods I*, the Supreme Court held that the Department’s new interpretation was not entitled to deference.

The Department’s argument for deference is a difficult one to accept, considering the Department’s history interpreting the exemption. Initially, and shortly after the statutory enactment, the Department adopted an interpretation which is at odds with its current

interpretation. One would think that the Department had some involvement or certainly awareness of the legislature's plans to enact this type of statute.

Id. at 921 ¶ 14. The Court then granted relief to Dot Foods on the Court's view that the express, unambiguous language of the statute applied to Dot Foods' sales practices.

In 2010, the Legislature responded by enacting a retroactive amendment of RCW 82.04.423, back to the original date of enactment, on the grounds that *Dot Foods I* had "broadened [the] interpretation of the direct sellers' exemption" beyond "the original intent of the legislature." 2010 Legislation § 401(3), (4).

2. *Tesoro I* Applied *Carlton*'s Principles Accurately and Its Analysis Applies in This Case.

Due Process protects private persons from "arbitrary and irrational legislation." *Carlton*, 512 U.S. at 30 (quoting *Pension Benefit Guar. Corp. v. R.A. Gray & Co.*, 467 U.S. 717, 733, 104 S. Ct. 2709, 81 L. Ed. 2d 60 (1984)). Under federal law a retroactive tax statute will be upheld against a Due Process challenge if it "is supported by a legitimate legislative purpose furthered by rational means." *Id.* at 30-31 (quoting *Pension Benefit*, 467 U.S. at 730). But, as the Supreme Court's opinion in *Carlton* illustrated, (i) an otherwise legitimate purpose may be tainted by an illegitimate purpose (such as targeting a specific taxpayer's claims, *id.*

at 32) and (ii) the rationality of the chosen means is contingent on circumstances (such that a retroactive change for a period that is more than “modest” in length, given the practicalities of the legislative process, is not rational, *id.*).

In *Tesoro I*, Court closely analyzed the deficiencies of the Legislature’s 24-year retroactive amendment of RCW 82.04.433 in a way that directly applies in this case. The *Tesoro I* Court noted that the 1987 amendment of the Internal Revenue Code at issue in *Carlton* was enacted just 14 months after the 1986 deduction in question, and that it “was intended as a curative measure that could be ‘reasonably viewed as a [correction of a] mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss’.” *Id.* at 117 ¶ 25 (quoting *Carlton*, 512 U.S. at 32). Indeed, in *Carlton*, the Supreme Court noted that the estate tax deduction in question was expressly intended to incentivize business owners to sell their company stock to employees “‘who helped them build the company, rather than liquidate [or] sell to outsiders’,” 512 U.S. at 31 (quoting a report of the Joint Committee on Taxation), and that Congress’s error was writing the deduction without any requirement of prior ownership and thus extending it far beyond the intended incentive. *Id.* at 32. The *Tesoro I* Court also emphasized the *Carlton* court’s holding that “‘Congress acted promptly and established

only a modest period of retroactivity’.” *Tesoro I*, 159 Wn. App. at 117 ¶ 25 (quoting *Carlton*, 512 U.S. at 32).

This Court found that the facts of *Carlton* were “readily distinguishable” from those in *Tesoro I*. *Id.* at 118 ¶ 26. In *Tesoro I* (as in this case), “the legislature has had ample opportunity since 1985 to restrict” the applicability of the deduction to the scope it suddenly desired in 2009. *Id.* Calling the amendment a “clarification” does not change the impact to taxpayers.

[T]he legislature may not apply a “clarification” retroactively for 24 years when it is in direct conflict with the reasonable expectations of qualifying taxpayers.

Id. (citing *Carlton*, 512 U.S. at 29-30, and *Bates v. McLeod*, 11 Wn.2d 648, 656, 120 P.2d 472 (1941)). The “reasonable expectations” of qualifying taxpayers are of course established by (1) an unambiguous statute – which the Washington Supreme Court held the DSR exemption to be – and (2) an administrative position that, for most of the exemption’s life, was fully consistent with the unambiguous meaning of the statute and that encouraged businesses like Dot Foods to rearrange business operations to meet the terms of the exemption.

The *Tesoro I* Court also contrasted the retroactive amendment of RCW 82.04.433, with its direct references to *Tesoro*’s lawsuit, to the *Carlton* court’s finding that there was no “improper taxpayer targeting” in

the amendment. *Id.* at 119 ¶ 27 (citing *Carlton*, 512 U.S. at 32-33). This factor weighs against the retroactivity of the DSR amendment as well, if the Legislature’s intent was indeed to deprive Dot Foods of the prospective benefits of its judgment.

Finally, the *Tesoro I* court reasoned that “[t]here is no colorable argument to suggest a legislative act creating a 24-year retroactive tax period is ‘prompt []’ or establishes a ‘modest period of retroactivity’,” as the Supreme Court found in the *Carlton* case. *Id.* ¶ 28 (quoting *Carlton*, 512 U.S. at 32-33). The Supreme Court’s decision in *Carlton* shows that a claim of “unintended consequences” will support a retroactive change or clarification only when the difference between legislative goals and actual results is readily apparent to roughly the same body of legislators that enacted the original statute. *Carlton* emphasized how the IRS promptly informed Congress of the perceived error in the statute in question, 512 U.S. at 33, and how the corrective measure was then promptly introduced and passed. *Id.* at 32. This process, in which taxpayers and the administrative agency test the consequences of a new tax statute, provides an appropriate context for legislative review and correction, if indeed unintended consequences arise.

3. Reinstating the Supposed Intent of a Legislature 27 Years Previously Demonstrates Both an Arbitrary, Illegitimate Purpose and an Irrational Means of Producing Current Revenue.

The fact that the Legislature sought to “clarify” a statute *ab initio* after 24 years in *Tesoro I* and 27 years in this case is itself irrational because the Legislature cannot know the intentions of a prior, distant legislature. The Legislature has asserted essentially that imprecision in statutory drafting by a prior generation, 27 years earlier, has led to consequences not intended by *them*. See 2010 Legislation § 401. As a question of cognition, the argument has no reasonable basis. The 2010 Legislature cannot rationally “channel” the 1983 Legislature in the face of a contrary, definitive interpretation by the State Supreme Court of the statute’s legislative intent.

The fiction that the current legislature can reinstate the “original intent” of a statute adverse to a victorious litigant has long been treated as an illegitimate legislative purpose in federal law. In *Forbes Pioneer Boat Line v. Bd. of Comm’rs of Everglades Drainage Dist.*, 258 U.S. 338, 42 S. Ct. 325, 66 L. Ed 647 (1922), in prior litigation, a boat line had sought a refund of unlawfully collected canal tolls and was victorious at the Florida Supreme Court. On the same day as the court’s ruling, the Florida legislature passed an act authorizing the tolls retroactively. *Id.* at 338-39.

Justice Holmes for the Court rejected the argument that this act ratified an authority that was innately proper. *Id.* at 339-40.

It would seem from the first decision of the Court below that the transaction was not one for which payment naturally could have been expected. To say that the Legislature simply was establishing the situation as both parties knew from the beginning it ought to be would be putting something of a gloss upon the facts. We must assume that the plaintiff went through the canal relying upon its legal rights and it is not to be deprived of them because the Legislature forgot.

Id. at 340. In this case, too, the 2010 Legislature's finding that it was merely reinstating the 1983 Legislature's original intent "would be putting something of a gloss upon the facts." The Legislature did not "forget" to correct an ambiguity in what the DSR Exemption was supposed to do for 27 years. Its assertion in 2010 of reaffirming the 1983 intention is an "arbitrary" element in its purposes, *Carlton*, 512 U.S. at 32, that taints any legitimacy that merely seeking additional revenues might have. *Id.*

Moreover, as the trial court noted, other courts have recognized that divining a remote legislature's intentions contrary to a definitive judicial interpretation is irrational and "impossible." CP 473. Courts in other states have similarly found that an assertion of subjective understanding at such a distance is not believable. "What later legislators thought is irrelevant to what an earlier legislature intended with an enactment." *Comcast Corp. v. Dept. of Revenue*, 356 Or. 282, 327, 337

P.3d 768 (2014) (citing *DeFazio v. WPPSS*, 296 Or. 550, 561, 679 P.2d 1316 (1984)). *See also, e.g., City of Modesto v. National Med, Inc.*, 128 Cal. App. 4th 518, 528, 27 Cal. Rptr. 3d 215 (2005) (“Here, the original ordinance was adopted in 1958. Thus it is not possible to divine the intent of *that enacting body.*”) (emphasis added); *San Carlos Apache Tribe v. Superior Ct.*, 193 Ariz. 195, 209, 972 P.2d 179 (1999) (observing that “a newly enacted statute may clarify ambiguities in an earlier version,” but also “to suggest that the 1995 Legislature knows and can clarify what the 1919 or 1974 Legislatures intended carries us *past the boundary of reality and into the world of speculation*”) (emphasis added).

A “modest period of retroactivity,” *Carlton*, 512 U.S. at 32, may be accepted where it is rationally balanced against citizens’ interest in finality and equality in tax treatment. *Cf. id.* at 37-38 (O’Connor, J., concurring). The Legislature’s action in this case, by contrast, is an abuse of this balance. To allow the Legislature license to “correct” “unintended consequences” in this case – more than two decades after the original enactment, during which period the Department expressly endorsed Dot Foods’ interpretation of the statute more than half the time – would improperly enshrine the recapturing of fictional history as a legitimate legislative purpose and as a rational means for furthering the Legislature’s

short-term budgetary purposes. It would violate the rational basis test of *Carlton*.

If the Legislature wishes to amend a tax statute retroactively, Due Process requires that the Legislature state the period of retroactivity explicitly and that this period reflect the practical legislative circumstances associated with promptly addressing the particular problems in the prior statute. *See id.* at 31-32. This did not occur in this case.

B. *Hambleton* Is Distinguishable.

Hambleton involved the retroactive imposition of an amendment to the State's stand-alone tax on estates. The period of retroactivity was eight years. The tax had originally been enacted in 2005 and was imposed on transfers on death occurring after the effective date. A question arose as to whether the termination of certain marital trusts upon the death of the second spouse constituted a "transfer" or whether the only transfer had occurred on the death of the first spouse prior to the effective date. The Supreme Court took the latter position in *In re Estate of Bracken*, 175 Wn.2d 549, 290 P.3d 99 (2012).

Helen *Hambleton* died in 2006 and Jessie Macbride died in 2007. *Hambleton*, 181 Wn.2d at 815. Each was the passive lifetime beneficiary of trust created by her husband prior to the 2005 legislation. *Id.* at 815-16. The *Hambleton* and Macbride estates contested liability for the new stand-

alone estate tax, but each case was ultimately stayed pending the outcome in *Bracken*. *Id.* The Supreme Court issued its decision in *Bracken* in October 2012. When the Legislature convened in 2013, it responded to the decision by amending the definition of transfer retroactive to the 2005 enactment, thereby purporting to impose the tax on the Hambleton and Macbride estates notwithstanding the court's decision in *Bracken*. *Id.* at 813-14.

Both estates contested the retroactive application of the law on several grounds, including due process.³ *Hambleton* thus involved a due process challenge to an eight-year retroactive amendment of the estate tax.⁴

The period of retroactivity and the rationale for retroactivity in *Hambleton* were markedly different from this case.⁵ In contrast to the eight-year retroactivity in *Hambleton*, here the Legislature sought to

³ Another ground was separation of powers, which is discussed in the section of this brief dealing with the cross-appeal, Part VI.B.

⁴ Dot Foods does not concede that *Hambleton* was correctly decided, but will contrast this case with *Hambleton* according to *Hambleton*'s terms. A petition for certiorari of the due process question in *Hambleton* is expected to be filed with the U.S. Supreme Court by early June. See U.S. S. Ct. Docket No. 14A1012, available at <http://www.supremecourt.gov/search.aspx?filename=/docketfiles/14a1012.htm>.

⁵ The Department also makes varied references to *W.R. Grace & Co. v. Dept. of Revenue*, 137 Wn.2d 580, 973 P.2d 1011 (1999), suggesting that it is a precedent for *Hambleton*, but *W.R. Grace* does not justify retroactivity by applying *Carlton*, but instead by viewing retroactivity as a remedy for unconstitutional taxes: "Retroactive application of the 1987 credit law, designed to cure the constitutional infirmities of the B&O tax exemption scheme, satisfies the requirements of federal due process as a postdeprivation remedy." *Id.* at 600 (quoting *Digital Equip. Corp. v. Department of Revenue*, 129 Wn.2d 177, 194-95, 916 P.2d 933 (1996)).

amend the DSR Exemption and retroactively apply its definition for 27 years to the passage of the original exemption in 1983. Sections 402 and 1704 of the 2010 SB 6143 amended RCW 82.04.423 retroactively to match the losing arguments made by the Department in *Dot Foods I*, even though from 1983 to 2000, the Department had interpreted the statute as the Supreme Court ultimately did in *Dot Foods I*.

The 27-year period for retroactive application was clearly far longer than that in *Hambleton* and irrational on its face. The 2010 Legislature could not possibly have known anything about the intentions of the 1983 legislature. The best indication of the 1983 legislative intent was the Department's contemporaneous understanding of the statute, the interpretation it enforced from 1983 until 2000, and the Supreme Court's definitive interpretation – not the Department's belated change that was overturned by the Supreme Court. The 2010 Legislature was not fixing a recent mistake; it was acting in a manipulative fashion to deny potential refund requests that might be premised on *Dot Foods I*.

The Department urges the Court to disregard the 27-year retroactive effect of the 2010 amendment on the grounds that the immediate impact to Dot Foods is limited to four years. Brief of Appellant at 24-25. Yet it is self-evident from Section 1704 of the 2010 Legislation that the amendment of RCW 82.04.423 reached back to the

original enactment in 1983. If the Legislature had wanted to *change* the statute substantively back for only four years, it could have done so. If the Legislature had wanted to *change* the statute only for periods open to refund claims, it could have done so. Instead, contrary to the Department's denial, the Legislature's insistence on reaffirming the "original intent of the legislature" demonstrates a 27-year "clarification. *See* 2010 Legislation § 401(4).

The parallel to the *Tesoro* litigation is again instructive. Although the Department argued that the period of amendment in that case should be treated as equal to the period of *Tesoro*'s own claims, *see* CP 528 (Giseburt Decl. Ex. 1, Department's Brief at 42 n.19), this Court gave that position no credence. The Supreme Court's ultimate disposition in *Tesoro II* supported this Court's understanding of the period of retroactivity and gives the lie to the Department's position in this case, given that the Supreme Court interpreted the *Tesoro* amendment as a mere clarification of the original statute. Its period of retroactivity was necessarily the full 24 years.

Moreover, the 2010 Legislation in this case does apply to a potentially much longer pipeline for other taxpayers. Tax disputes can last a long time before final resolution. *See, e.g., Dot Foods I* (over nine years from beginning of audit period to Supreme Court decision); *Qualcomm*

Inc. v. Dept. of Revenue, 171 Wn.2d 126, 130 ¶ 7, 249 P.3d 167 (2011) (over 13 years); *PACCAR, Inc. v. Dept. of Revenue*, 135 Wn.2d 301, 304, 957 P. 2d 669 (1998) (over 16 years). Taxpayers having an active dispute with the Department may have far more than four years at stake.

The rationale for retroactive application was also different here than in *Hambleton* and far less closely tied to the period of retroactivity. In *Hambleton*, the Legislature had declared that, in addition to raising revenue, the purpose of retroactivity was a desire to treat the estates of married and unmarried individuals equally and to treat the trusts at issue in the same way as other property subject to the marital deduction from the federal estate tax. 181 Wn.2d at 826. The Court opined that going back eight years was the only way that all estates would be treated the same; any shorter period would create winners and losers. *Id.* at 827.

Here, by contrast, the Legislature first expressed fear that “most out-of-state businesses selling consumer products . . . will either be eligible for the exemption” as interpreted in *Dot Foods I* “or could easily restructure their business operations to qualify for the exemption,” and that the “broadened interpretation . . . will lead to large and devastating revenue losses.” *Id.* § 401(3). The legislature went on to state that the direct seller exemption provided “preferential tax treatment for out-of-

state businesses over their in-state competitors” and “a strong incentive for in-state businesses to move their operations outside Washington.”

Retroactivity, however, is unrelated to these purposes. The DSR Exemption, by its very nature, applied only to out-of-state businesses selling consumer products into Washington via seller’s representatives that were not employees of the business. Typically, these representatives were employed by a subsidiary or other affiliate. Such an arrangement is *not* a common business model. And in 2010, a business could not restructure its operations to avail itself of the Court’s decision in *Dot Foods I* for any prior years. Nor could a business retroactively move operations into or out of Washington. The impacts cited by the Legislature related primarily to the prospective application of the new legislation.

The New York Court of Appeals recently considered a tax change that purported to apply retroactively to incentivize certain behaviors. *See James Sq. Assoc. LP v. Mullen*, 21 N.Y.3d 233, 993 N.E. 2d 374 (2013). The court found that creating “incentives” was not a proper purpose for retroactivity and violated due process:

[R]etroactively denying tax credits to plaintiffs did nothing to spur investment, to create jobs, or to prevent [abuses]. The retroactive application of the 2009 Amendments simply punished the Program participants more harshly for behavior that had already occurred and that they could not alter.

21 N.Y.3d at 250.

As to the revenue impacts, the Department asserts that the impact of *Dot Foods I* for the 2009-11 biennium was estimated at \$150 million, and the impact for the following biennium at nearly \$191 million. Brief of Appellant at 7. However, the Fiscal Note distinguishes between “refund impact” and “ongoing impact” – and the estimate of revenue losses from “refund impact” (which was presumably the target of the retroactive effect of the amendment) was less than \$60 million.⁶ By contrast, the “ongoing impact” from the change of reporting practices by taxpayers in the future was about \$95 million for the 2009-10 biennium and over \$90 million per year thereafter. In other words, the estimated refunds were equal to only 20% of the estimated prospective impacts over the following three fiscal years (58.8 divided by 285.6).

Carlton and *Hambleton* also require that a revenue loss be “unanticipated.” *Hambleton*, 181 Wn.2d at 825 (citing *Carlton*, 512 U.S. at 32.) The reason was well-stated in *James Square Associates*:

[R]aising money for the State budget is not a particularly compelling justification. Absent an *unexpected* loss of revenue, such a legislative purpose is insufficient to warrant retroactivity in a case where the other factors militate against it, as is the situation here. Raising funds

⁶ The Fiscal Note does not provide the back-up for its estimate of refund claims, and it is not believable on its face. At the time the 2010 Legislation passed, only two months remained in Fiscal Year 2010, but the Department estimated that refunds would be disbursed in exactly equal amounts in Fiscal Year 2010 and Fiscal Year 2011.

is the underlying purpose of taxation, and such a rationale would justify every retroactive tax law, obviating the balancing test itself.

21 N.Y.3d at 250 (emphasis added)

The 2010 Legislature did *not* say that these potential refund claims were “unanticipated,” only that they might be “large.”⁷ It would not be rational in this case to claim that they were “unanticipated.” For 16 years after enactment of the DSR exemption in 1983, with the apparent acquiescence of the Legislature, the Department itself publicly endorsed the interpretation that the state Supreme Court held was unambiguously correct. *See Dot Foods I*, 166 Wn.2d at 921 ¶ 13. *See also* Wash. Dept. of Revenue, Determination No. 87-233, 3 Wash. Tax Dec. 357, at 2 (1987) (upholding DSR exemption for out-of-state seller whose consumer products were resold in “customer’s stores”). Following the rule amendment in 2000, Dot Foods continued to take the exemption under the statute and the Department then assessed additional tax in 2004. *Dot Foods I*, 166 Wn.2d at 917 ¶ 6. Dot Foods paid the tax and sought a refund. *Id.*, ¶ 7. The Department could have and maybe did alert the Legislature to this challenge to its DSR policy, but the Legislature made no change to the statute to protect the Department’s position. Contrast this

⁷ If the Due Process issue is analyzed as an “as applied” claim, Dot Foods’ refund claim of approximately \$500,000 does not even qualify as “large” and certainly not “devastating” in this context.

situation to that *Tesoro I*, where the Department informed the Legislature of Tesoro's refund suit and the Legislature amended the statute on the eve of Tesoro's trial. *See* 159 Wn. App. at 110 ¶ 6.

In light of this history, no one could reasonably have understood that the Department's new position on the DSR Exemption was settled law before the decision in *Dot Foods I*. And the Legislature did *not* make that claim in the 2010 Legislation. The State simply could not have had "settled expectations" concerning tax payments in the 2000-07 period by businesses that had been exempt under the Department's original, 16-year interpretation of the statute.

Consequently, the Department's Brief makes an inaccurate analogy to the *Carlton* and *Hambleton* courts' identification of responding to a "significant and *unanticipated* revenue loss" as a legitimate legislative purpose. *See* Brief of Appellant at 20. Maybe the estimated refund claims of \$58.8 million were "significant," but they could not legitimately be called "unanticipated" under the facts of this case.

C. This Case Presents an Additional Issue Not Present in *Hambleton*.

In addition to the length of the retroactive period and its purpose, courts analyzing a due process challenge to retroactivity also consider whether the taxpayer had forewarning of the new legislation and the

reasonableness of reliance on the old law. *See, e.g., James Square Associates*, 21 N.Y.3d at 248. Such an analysis was not done in *Hambleton* because the parties did not argue that taxpayers created the QTIP trusts in reliance on state law. The state did not even have a stand-alone estate tax at the time the trusts were created.

Here it is obvious that Dot Foods acted in reliance on prior law. In 1997, Dot Foods sought and obtained an interpretive ruling from the Department that it could qualify for the DSR exemption. *See Dot Foods Appeals Court Decision*, 141 Wn. App. at 878 ¶ 4. This ruling required Dot Foods to cease or avoid owning or leasing real property in Washington, to cease or avoid maintaining a stock of product in Washington, and to cease or avoid making or soliciting sales through its own employees and to conduct those activities in Washington solely through a direct seller's representative. *See RCW 82.04.423(1)* (requirements for exemption). Dot Foods observed all these requirements through the end of December 2007.

When the Department changed its interpretation of the DSR exemption at the end of 1999, Dot Foods did not abandon *its* commitments and continued to stand on its statutory rights. It did not pay B&O tax in the early 2000s and was assessed additional tax on audit. *See Dot Foods I*, 166 Wn.2d at 917 ¶ 6. It initially fought the invalid 2004 assessment of

additional tax in the administrative channel at the Department, *see Appeals Court Decision*, 141 Wn. App. at 880 ¶ 7, and then paid the tax assessments as required by RCW 82.32.150 and .180 to authorize it to file suit. Payment of a tax assessment is not a voluntary payment under Washington law and a refund suit does not require payment under protest. *See Hansen Baking Co. v. City of Seattle*, 48 Wn.2d 737, 745, 296 P.2d 670 (1956); *see also Dexter Horton Bldg. Co. v. King Cnty.*, 10 Wn.2d 186, 196, 116 P.2d 507 (1941) (“The equitable principles and issues [in tax disputes] remain the same, regardless of whether the action is one to enjoin the collection of the tax or one to compel a return of the tax.”).

Dot Foods continued its appeals and was finally vindicated in 2009 in *Dot Foods I*. During the litigation, it did indeed file regular excise tax returns to avoid penalties and interest. CP 361 (Tooley Decl. ¶ 5). It relied on the strength of its legal position and on the State’s promise in RCW 82.32.180 (third paragraph) that it will refund illegally collected taxes without prior protest, and that it will pay interest to compensate for the taxpayer’s lost use of the funds. *See* RCW 82.32.060(4).

Dot Foods consistently acted promptly and in accordance with Washington law to vindicate its rights under RCW 82.04.423. It is the Department and the Legislature that bided their time. If the State had wanted to cut off Dot Foods’ future claims after its prior refund claims

were perfected in 2006, it could have enacted an amendment then, just as it did to block Tesoro's future claims on the eve of its trial. *See Tesoro I*, 159 Wn. App. at 110 ¶ 6. Instead, the State allowed Dot Foods to continue all the way to a definitive interpretation of the exemption by the state Supreme Court, and *then* it wants to pull the rug out. This process was neither legitimate nor rational government action.

D. To the Extent *Hambleton* Controls, It Should Be Overruled or Narrowed.

While this Court cannot clarify or overrule *Hambleton*, Dot Foods makes this argument to preserve it for possible Supreme Court review.

In *Hambleton*, the court essentially said the eight-year period was rational because only that period would provide the "revenue increase," 181 Wn.2d at 827, associated with adopting the Department of Revenue's position retroactively.

It provides the *necessary funds*, and the length of retroactivity is directly linked with the purpose of the amendment, which is to remedy the effects of *Bracken*.

Id. (emphasis added). In other words, the revenue increase from the chosen period justified the amendment, which in turn justified the chosen period. The period was self-justifying.

If this were the law generally, there would be no Due Process limitation on retroactive taxes, an idea rejected by the majority in *Carlton*,

but embraced in Justice Scalia's concurrence. "Revenue raising is certainly a legitimate legislative purpose, see U.S. Const., Art. I, § 8, cl. 1, and any law that retroactively adds a tax, removes a deduction, or increases a rate rationally furthers that goal." *Carlton*, 512 U.S. at 40 (Scalia, J., concurring). The majority in *Carlton* implicitly recognized that merely raising revenue for the current appropriations budget on the backs of completed events and transactions is of limited legitimacy. The majority in *Carlton* emphasized the "customary congressional practice" of enacting general revenue statutes with modestly retroactive effective dates generally "confined to short and limited periods required by the practicalities of producing national legislation." *Carlton*, 512 U.S. at 33 (quoting *U. S. v. Darusmont*, 449 U.S. 292, 296-97, 101 S. Ct. 549, 66 L. Ed. 2d 513 (1981)) (internal quotation marks omitted). *Darusmont* explains that the purpose for this short period of retroactivity is to "include profits from transactions consummated while the statute was in the process of enactment." *Id.* at 297-98 (quoting *U. S. v. Hudson*, 299 U.S. 498, 500 57 S. Ct. 309, L. Ed. 370 (1937)). In other words, retroactivity is a tool to avoid allowing taxpayers to change the timing of transactions after they receive notice of a pending change in the tax treatment of the transaction.

Moreover, the majority in *Carlton* could have, *but did not*, justify the 14-month retroactivity period in question merely on the need for additional revenue. Instead, it emphasized the prompt discovery of the drafting error in the original act, which was proven by legislative history and the original estimate of the revenue costs of the provision in question. 512 U.S. at 31-32. “Congress acted to correct what it reasonably viewed as a mistake in the original 1986 provision that would have created a significant and unanticipated revenue loss.” *Id.* at 32.

The *Hambleton* Court’s complete reliance on the fiscal note as justification for retroactivity ignores these precedents and appears to give carte blanche to the Legislature to use the fiscal notes prepared by the Department of Revenue to justify any and all retroactive tax increases. If this was the intent, it was not faithful to the Due Process requirements for retroactive tax increases under federal law.

VI. ARGUMENT ON CROSS-APPEAL

- A. **Section 1706 of the 2010 Legislation Preserved Both the Collateral Estoppel Effect of *Dot Foods I* and the Judgment’s Direct Application to Periods Up to the Date of Judgment**
 - 1. **Section 1706 of the 2010 Legislation Must Be Interpreted as Providing Collateral Estoppel Effect or It Was Superfluous.**

It is hornbook constitutional law that legislative reversal of a final judgment violates separation of powers and deprives the beneficiary of the

judgment of vested rights in violation of due process. *Haberman v. Washington Public Power Supply Sys.*, 109 Wn.2d 107, 144, 744 P.2d 1032 (1987) (legislature cannot retroactively “affect a final judgment” consistent with separation of powers); *Plaut v. Spendthrift Farms, Inc.*, 514 U.S. 211, 225, 115 S. Ct. 1447, 131 L. Ed. 2d 328 (1995) (“Our decisions . . . have uniformly provided fair warning that such an act exceeds the powers of Congress.”); *Forbes Pioneer Boat Line*, 258 U.S. at 340 (deprivation of refund claim established by final judgment violates 14th Amendment).

The question on cross-appeal is whether the Legislature’s express provision in Section 1706 of the 2010 Legislation that Section 402 “does not affect any final judgments” was meant merely as a redundant expression of constitutional law or something more. Because (a) the Legislature is presumed not to enact superfluous language, *e.g.*, *Applied Indus. Materials Corp. v. Melton*, 74 Wn. App. 73, 79, 872 P.2d 87 (1994), and (b) the legislative history demonstrates an intention to provide protection to Dot Foods in particular, Section 1706 must be read as providing Dot Foods’ judgment with prospective collateral estoppel effect.

a. *Dot Foods I* Had Collateral Estoppel Effect on the Day It Was Announced Until the Effective Date of the 2010 Legislation.

There can be no doubt that, when issued, *Dot Foods I* precluded the Department from relitigating Dot Foods' eligibility for the DSR Exemption unless the Department brought forward changes in fact or law on issues that were essential to the *Dot Foods I* judgment. This truth follows from Section 27 of the Restatement (Second) of Judgments, on which Washington courts have repeatedly relied.

When an issue of fact or law is actually litigated and determined by a valid and final judgment, and the determination is essential to the judgment, the determination is conclusive in a subsequent action between the parties, whether on the same or a different claim.

Restatement (Second) of Judgments § 27 (1982), *quoted in Nielson v. Spanaway General Medical Clinic, Inc.*, 135 Wn.2d 255, 262, 956 P.2d 312 (1998) (granting collateral estoppel). *See also Shoemaker v. City of Bremerton*, 109 Wn.2d 504, 508, 745 P.2d 858 (1987) (citing Section 27 in granting collateral estoppel).

Had the Legislature not changed the law retroactively, Dot Foods would have met the 4-part test for collateral estoppel:

(1) the issue decided in the prior adjudication is identical with the one presented in the second action; (2) the prior adjudication must have ended in a final judgment on the

merits; (3) the party against whom the plea is asserted was a party or in privity with the party to the prior adjudication; and (4) application of the doctrine does not work an injustice.

Nielson, 135 Wn.2d at 263 (citing cases). *See also Christensen v. Grant County Hosp. Dist. No. 1*, 152 Wn.2d 299, 307, 96 P.3d 957 (2004) (same) (citing authorities). Dot Foods has been very open that its business facts changed as of January 1, 2008, and the Department has conceded for purposes of this litigation that the business facts did not change until that date. CP 293. For the period of May 1, 2006, through December 31, 2007, therefore, the Department could not have shown a reason why *Dot Foods I* should not apply to periods after the refund period in question, because the Department had “had a full and fair opportunity to litigate [its] case.” *Nielson*, 135 Wn.2d at 262 (citing cases).

Therefore, up to the effective date of the 2010 Legislation, Dot Foods was entitled to the DSR exemption through December 31, 2007, by virtue of collateral estoppel.

b. Dot Foods’ Arguable Loss of Collateral Estoppel Rights Under Section 402 of the 2010 Legislation Was Reversed by the Exclusion in Section 1706 of the Bill.

The Department argues that by retroactively amending the DSR Exemption in Section 402, the Legislature deprived Dot Foods of a refund. An “intervening change in the applicable legal context” means that the

issue is not “identical.” Restatement (Second) of Judgments § 28(2)(b); *see also id.*, comment c; *Commissioner v. Sunnen*, 333 U.S. 591, 68 S. Ct. 715, 92 L. Ed. 898 (1948).

The Legislature did not leave the matter with Section 402, however. Even though black-letter law under separation of process and due process principles establishes that a retroactive law cannot reverse a final judgment, the Legislature went out of its way to state that the change in law “does not affect any final judgments, not subject to appeal, entered by a court of competent jurisdiction before the effective date of this act.” 2010 Legislation, § 1706. At the time the Legislature enacted this statement, Dot Foods was clearly entitled to a refund for 2006-07 under collateral estoppel principles. This exception to the retroactive amendment thus preserved both the res judicata and collateral estoppel effects of the judgment.

The primary rule of statutory construction is to give effect to the legislature's intent. *Lake v. Woodcreek Homeowners Ass'n*, 169 Wn.2d 516, 526, 243 P.3d 1283 (2010). Unambiguous statutory language is given its plain meaning. *In re Dependency of J.W.H.*, 147 Wn.2d 687, 696, 57 P.3d 266 (2002). Here the Legislature unambiguously stated that its retroactive statutory amendment did “not affect” Dot Foods’ judgment.

Inherent in that judgment is the interest of both Dot Foods and the judicial system in finality. Application of the doctrines of res judicata and collateral estoppel “is central to the purpose for which civil courts have been established, the conclusive resolution of disputes within their jurisdiction.” *Montana v. United States*, 440 U.S. 147, 153, 99 S. Ct. 970, 59 L. Ed. 210 (1979). The judgment in *Dot Foods I* was rendered in 2009 after years of litigation. To deprive Dot Foods of collateral estoppel clearly “affects” the judgment in the plain meaning of that term.

Even if the phrase, “does not affect any final judgments” were ambiguous, it would still preserve the collateral estoppel effect of Dot Foods’ judgment for 2006-07 because the legislative intent to preserve it is evident in other ways. In the House Bill Report on ESSB 6143, the Legislature stated: “The retroactive change will not impact *the taxpayer* that prevailed in the *Dot Foods* decision” See CP 453 (House Bill Report, ESSB 6143, at 16) (emphasis added). This report describes the bill as it passed the House, and although the intent section was reworked in ensuing versions, the exemption section was merely renumbered. Compare ESSB 6143 § 2106 with 2010 Legislation § 1706. This description makes it clear that the Legislature did not intend to apply the new law to *Dot Foods* retroactively for *any* period.

Moreover, courts “presume legislatures to act with integrity and with a purpose to keep within constitutional limits.” *In re Bond Issuance of Greater Wenatchee*, 175 Wn.2d 788, 811, 287 P.3d 567 (2012). When choosing between two interpretations of a statute, therefore, courts choose the “meaning consistent with the constitutionality of [the] enactment.” *Bracken*, 175 Wn.2d at 563. This case should be resolved in Dot Foods’ favor on this statutory ground, since this is a reasonable reading of Section 1706, rather than constitutional grounds. *See Ralph v. Dept. of Natural Resources*, 182 Wn.2d at 248.

2. *Dot Foods I Did Apply Directly to the 2006-07 Period; Section 1706 Preserves the Refund Right for That Period.*

Even without the principle of collateral estoppel, Dot Foods is entitled to a refund. The judgment in *Dot Foods I* specifically provided that Dot Foods continued to be eligible for the DSR Exemption so long as its business practices qualified. 166 Wn.2d at 926 ¶ 26. Section 1706 of the 2010 Legislation honored that holding by exempting the judgment from the effect of Section 402’s retroactive amendment. The judgment therefore directly provides for a refund of the tax paid for May 2006 through December 2007.

This is not a case where subsequent tax periods constitute separate “claims” against the State. Sometimes tax periods are indeed viewed as

providing separate “claims” for purposes of preclusion. *See* Restatement (Second) of Judgments § 28 comment c. For federal income tax purposes, for example, applying a judgment with regard to one “tax year” to another “tax year” as a question of “issue preclusion,” or collateral estoppel, not “claim preclusion” or res judicata. *Id.*; *see also Sunnen*, 333 U.S. at 598. As the *Sunnen* Court said, “Income taxes are levied on an *annual basis*. Each year is the origin of a new liability and of a separate cause of action.” *Id.* (emphasis added). *See also* 26 U.S.C. § 11 (“A tax is hereby imposed *for each taxable year* on the taxable income of every corporation.”) (emphasis added).

This principle does not apply in this case because the B&O tax is not an annual direct tax but an excise tax imposed continuously for the privilege of engaging in business. Consistent with this essential character of the tax, the specific exemption in question is a “status” exemption granted to “persons” with specified business attributes. RCW 82.04:423. *Dot Foods I* held that Dot Foods remained exempt so long as it retained those business attributes.

The B&O tax “is levied and shall be collected from every person a tax for the act or privilege of engaging in business activities. Such tax shall be measured by the application of rates against the value of products, gross proceeds of sales, or gross income of the business, as the case may

be.” RCW 82.04.220 (2008) (version in effect 2006-07), *amended prospectively by* 2010 Legislation § 102. The provision imposing tax in RCW 82.04.220 has no reference to “taxable year,” unlike the Internal Revenue Code. To the same effect, the definitions of the three alternative measures of tax, “value of products,” gross proceeds of sales,” and “gross income of the business” in RCW 82.04.450, 82.04.070, and 82.04.080, respectively, also completely lack any reference to “taxable years” or any other periodic measure.

Moreover, the DSR Exemption was granted by the Legislature as a status that removed eligible taxpayers from application of the tax – it created a *nonreporting* position.

This chapter shall not apply to any person in respect to gross income derived from the business of making sales at wholesale or retail if such person:

(a) Does not own or lease real property within this state; and

(b) Does not regularly maintain a stock of tangible personal property in this state for sale in the ordinary course of business; and

(c) Is not a corporation incorporated under the laws of this state; and

(d) Makes sales in this state exclusively to or through a direct seller’s representative.

RCW 82.04.423 (2008). Nothing about this exemption is linked to any “taxable year” or other periodic measure. It is an absolute exemption that

rests on several factual attributes, which could be gained and lost at any time. The principles of *Sunnen* and Section 28, comment c of the Restatement do not apply in this case.

For this reason, *Dot Foods I* expressly recognized that Dot Foods' exemption was based on its status, which did not depend on period but depended on factual attributes. The Supreme Court further recognized that the exempt status continued to apply so long as the sales in question met the exemption criteria.

Because we hold the express language of RCW 82.04.423(2) does not require downstream sales to be restricted from permanent retail establishments or to consist exclusively of consumer goods, *Dot remains qualified for the B & O tax exemption to the extent its sales continue to qualify for the exemption.*

Dot Foods I, 166 Wn.2d at 926 ¶ 26 (emphasis added). The judgment in *Dot Foods I* therefore applied directly not only to the initial refund period of 2000 to April 2006 but also to all periods through the date of judgment, so long as the sales continued to qualify. The judgment established Dot Foods' refund rights for all such periods so long as the facts remained the same. This period concluded with the change in business operations as of January 1, 2008.

The Legislature said it did not intend to “affect” this specific judgment. Therefore, Dot Foods is entitled to a refund under Section 1706 of the 2010 Legislation.⁸

B. If the Legislature Intended to Deny Dot Foods the Benefit of Its Judgment Through the Judgment Date, the 2010 Legislation Violated Separation of Powers as Applied to Dot Foods.

The principle of separation of powers was incorporated into the Washington State Constitution in 1889. This principle constrains the ability of the Legislature to change a law retroactively if the change would have the effect of negating a court decision:

We have also said that “[i]t is a fundamental rule of statutory construction that once a statute has been construed by the highest court of the State, that construction operates as if it were originally written into it.” *Johnson v. Morris*, 87 Wn.2d 922, 927, 557 P.2d 1299 (1976). In other words, it is within this court’s “appropriate sphere of activity” to determine what a particular statute means, and that determination relates back to the time of the statute’s enactment.

Hale v. Wellpinit Sch. Dist. No. 49, 165 Wn.2d 494, 506 ¶ 15, 198 P.3d 1021 (2009).

The 2010 Legislation violates separation of powers because it disturbs rights established by “previously litigated adjudicative facts.” In *Lummi Indian Nation v. State*, 170 Wn.2d 247, 241 P.3d 1220 (2010), the

⁸ As noted above in the due process section, to take away this refund right for the 2006-07 Refund Period would deprive Dot Foods of property without due process of law as held in the directly applicable circumstances of *Forbes Pioneer Boat Line*, 258 U.S. 338.

Court summarized a number of ways in which retroactive legislation “threatens the independence or integrity or invades the prerogatives of” the judicial branch. *Id.* at 262 ¶ 15 (citations and internal quotation marks omitted). For example, “legislative intervention to affect the rights of parties in a particular case would overstep the legislative function,” as would “[r]etroactive legislation that interferes with vested rights established by judicial rulings.” *Id.* (citations omitted). Violation of separation of powers is not disturbed if the “legislature made no attempt to apply the law to an existing set of facts, affect the rights of parties to the court’s judgment, or interfere with any judicial function.” *Id.* at 263 ¶ 17. “[W]hen the legislature passes a statute premised on finding an adjudicative fact, it may violate separation of powers.” *Id.* at 264 ¶ 18. And if the rights of a party “were litigated and adjudicative facts developed,” to upset those rights after judgment could violate separation of powers as well as due process. *Id.* at 265 ¶ 20.

Lummi Indian Nation makes it clear that the Legislature offends separation of powers by interfering with the rights of a party to a judgment, which indirectly interferes with the power of the courts; the Legislature does not need to directly “overrule” the Court. In this case, if the Legislature indeed intended to diminish Dot Foods’ rights under its judgment, it crossed the boundary of separation of powers.

Since the trial court issued its order on summary judgment in this case, the State Supreme Court has reconfirmed that legislation disturbing “previously litigated adjudicative facts” can violate separation of powers. *Cornelius*, 182 Wn.2d at 591. *Cornelius* was a follow-up case to *Lummi Indian Nation*. In the earlier case, the Court held that a retroactive amendment of the water rights statutes to define “municipal water supply purposes” was an appropriate “legislative policy decision—confirming existing rights—not a factual adjudication.” *Cornelius*, 182 Wn.2d at 591 (citing *Lummi Indian Nation*, 170 Wn.2d at 264-65). In *Cornelius*, the plaintiffs brought an as-applied separation of powers claim, asserting that the relevant agency’s application of the retroactive statute to determine whether Washington State University had water rights under the new municipal definition was unconstitutional. The Court disagreed:

Although we stated that retroactive application of this statute could unconstitutionally disturb previously litigated adjudicative facts, we must be faced with previously litigated adjudicative facts in order to find an as-applied constitutional violation.

Here, there are no previously litigated adjudicative facts regarding WSU’s past water rights. Accordingly, there is no way that the PCHB violated the separation of powers doctrine by applying the [municipal water law] to WSU’s certificates—there were no “adjudicative facts” the PCHB could have upset.

Cornelius, 182 Wn.2d at 591 (citing *Lummi Indian Nation*, 170 Wn.2d at 265).

The analysis in *Cornelius* shows that the 2010 Legislation violated the separation of powers doctrine, if the statutory interpretation exercise concludes that Section 1706 stripped Dot Foods of the benefits of its judgment during the interval between May 2006 and the judgment date. Dot Foods' right to a refund of B&O tax under the DSR Exemption was expressly litigated not only for periods ending in April 2006 but also as to its status in subsequent periods as long as its sales "continue[d]" to comply with the standards of the existing statute. *Dot Foods I*, 166 Wn.2d at 926 ¶ 26. The facts in this case coincide exactly with the circumstance that *Cornelius* identified as a constitutional violation.

VII. CONCLUSION

For the above reasons, this Court should affirm the trial court's judgment because the Legislature intended Dot Foods would be entitled to its refund and alternatively on the due process grounds determined by the trial court and the separation of powers grounds set forth above.

RESPECTFULLY SUBMITTED this 21st of May, 2015.

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The undersigned certifies under penalty of perjury under the laws of the State of Washington that on May 22, 2015, I caused to be served in the manner noted below a copy of Dot Foods' Response Brief and Brief on Cross-Appeal on counsel of record:

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