

No. 08-1080

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

VOLVO CARS OF NORTH AMERICA, LLC, and VOLVO GROUP NORTH
AMERICA, INC.,

Plaintiffs-Appellants,

v.

UNITED STATES OF AMERICA,

Defendant-Appellee

Appeal from the United States District Court for the District of
North Carolina, Greensboro Division, No. 2:95-cv-00571-WLO

APPELLANTS' OPENING BRIEF

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DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

Only one form need be completed for a party even if the party is represented by more than one attorney. Disclosures must be filed on behalf of all parties to a civil or bankruptcy case, corporate defendants in a criminal case, and corporate amici curiae. Counsel has a continuing duty to update this information. Please file an original and three copies of this form.

No. 08-1080

Caption: Volvo Cars of North America, LLC, and Volvo Group North America, Inc. v. United States of America

Pursuant to FRAP 26.1 and Local Rule 26.1,

Volvo Cars of North America, LLC who is Appellant
(name of party/amicus) (appellant/appellee/amicus)
makes the following disclosure:

1. Is party/amicus a publicly held corporation or other publicly held entity?

YES NO

2. Does party/amicus have any parent corporations?

YES NO

If yes, identify all parent corporations, including grandparent and great-grandparent corporations:

Ford Motor Company is the parent corporation of Volvo Cars of North America, LLC.

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity?

YES NO

If yes, identify all such owners:

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(b))?

YES NO

5. Is party a trade association? (amici curiae do not complete this question)

YES NO

If yes, identify all members of the association, their parent corporations, and any publicly held companies that own 10% or more of a member's stock:

6. Does this case arise out of a bankruptcy proceeding?

YES

NO

If yes, identify any trustee and the members of any creditors' committee:

s/Charles Rothfeld

(signature)

October 14, 2008

(date)

DISCLOSURE OF CORPORATE AFFILIATIONS AND OTHER INTERESTS

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No. 08-1080 Caption: Volvo Cars of North America, LLC, and Volvo Group North America, Inc. v. United States of America

Pursuant to FRAP 26.1 and Local Rule 26.1,

Volvo Group North America, Inc. who is Appellant
(name of party/amicus) (appellant/appellee/amicus)

makes the following disclosure:

1. Is party/amicus a publicly held corporation or other publicly held entity?
 YES NO
2. Does party/amicus have any parent corporations?
 YES NO

If yes, identify all parent corporations, including grandparent and great-grandparent corporations.

Please see attached.

3. Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity?
 YES NO

If yes, identify all such owners:

Please see attached.

4. Is there any other publicly held corporation or other publicly held entity that has a direct financial interest in the outcome of the litigation (Local Rule 26.1(b))?
 YES NO
5. Is party a trade association? (amici curiae do not complete this question)
 YES NO

If yes, identify all members of the association, their parent corporations, and any publicly held companies that own 10% or more of a member's stock:

6. Does this case arise out of a bankruptcy proceeding?

YES

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s/Charles A. Rothfeld

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IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

VOLVO CARS OF NORTH AMERICA,)
INC.)
))
Appellant,)
))
v.)
))
THE UNITED STATES OF AMERICA)
))
Appellee.)

Case No.: 08-1080

**ATTACHMENT TO DISCLOSURE OF CORPORATE AFFILIATIONS
AND OTHER INTERESTS FORM**

Appellant Volvo Group North America, Inc. (“Volvo”)¹ attaches the following responses to its Disclosure of Corporate Affiliations And Other Interests Form:

ITEM 2: Does party/amicus have any parent corporations? If yes, identify all parent corporations, including parent and great-grandparent corporations.

Yes. VNA Holding, Inc. (“VNA”) is the parent of Volvo. VNA is a U.S. Corporation and owns 100% of the stock of Volvo.

AB Volvo (publ.) (“AB Volvo”) is the grandparent of Volvo. AB Volvo is a Swedish Corporation. AB Volvo owns 100% of VNA.

ITEM 3: Is 10% or more of the stock of a party/amicus owned by a publicly held corporation or other publicly held entity?

Yes. AB Volvo owns 100% of VNA, and VNA owns 100% of Volvo. Therefore, AB Volvo, through its wholly owned interest in VNA, indirectly owns 100% of

¹ Volvo Cars of North America, Inc., has been succeeded by Volvo Group North America, Inc., which is the successor in interest to Volvo GM Heavy Truck Corporation, an entity formed by Volvo Cars of North America, Inc. and General Motors Corporation.

Volvo. AB Volvo is a publicly held entity whose shares are traded on the Stockholm stock exchange. AB Volvo is not listed on any U.S. exchange.

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INTRODUCTION

In 1980, White Motor Corporation contracted with Sajak Corporation for the purpose of selling its excess inventory for scrap value; Volvo Group North America, Inc. (“Volvo”), which was the ultimate successor in interest to Volvo White Truck Corporation, subsequently acquired White Motor and assumed its Sajak contract. A principal point of the contract with Sajak was to make it possible for White Motor (and subsequently Volvo) to write off the inventory for tax purposes, which is permissible when an owner disposes of inventory for scrap value by means of a bona fide sale. In 1983, however, the Internal Revenue Service determined that agreements like the 1980 Sajak-White Motor contract did not effect bona fide sales for tax purposes because the provisions of such contracts allowed the manufacturer to retain control over the inventory even after it was transferred to Sajak.

In 1983, Volvo and Sajak accordingly entered into a revised contract for the sale of Volvo inventory that eliminated the provisions allowing Volvo to exercise continued control over the property. Volvo understood the terms of the new contract governed inventory, still in Sajak’s possession, that had been transferred in 1981 and 1982, thus completing those sales for tax purposes. This meant that Volvo could write off that inventory for tax purposes in 1983. When the IRS nevertheless denied Volvo’s write-off claim for 1983 and subsequent years, Volvo

initiated this action for a refund. The jury ruled for Volvo, but the district court granted the government's motion for judgment as a matter of law, holding that the first contract continued to govern rights over the inventory that had been transferred prior to execution of the second contract in 1983.

The district court's decision to set aside the jury's verdict and deny Volvo's 1983 refund claim is wrong. Under controlling principles of contract law, a contract is presumed to be superseded by – and to merge into – a subsequent agreement between the same parties that addresses the same subject matter as, but contains provisions that differ from those of, the first contract; that is the situation in this case. Moreover, the evidence before the jury shows that the parties intended the terms of the second contract to govern control of inventory that had been transferred to Sajac while the first contract was in effect and that was still in Sajac's possession: Volvo and Sajac entered into the second contract specifically to eliminate the provisions of the first contract that made a tax write-off unavailable; it would have made no business sense for the parties to have made the second contract wholly prospective while leaving the problematic provisions of the first contract in place to govern completed transfers of inventory; and the course of dealings between the parties confirms that they did not intend the first contract to remain controlling after 1983. Because it is undisputed that Volvo is entitled to a

refund for the 1983 taxable year if the second contract controls, the district court's contrary decision should be set aside.

STATEMENT OF JURISDICTION

The district court had subject matter jurisdiction under 28 U.S.C. § 1331 and 26 U.S.C. § 7422. *See* Joint Appendix ("JA") 16. The district court entered final judgment on November 30, 2007. JA 292. On December 27, 2007, Volvo filed a timely notice of appeal of the final judgment pursuant to Fed. R. App. P. 4(a)(1)(B)). JA 293. This Court has jurisdiction under 28 U.S.C. § 1291.

STATEMENT OF ISSUES PRESENTED FOR REVIEW

1. Whether the 1983 contract superseded the earlier one between the same parties because it concerns the same subject matter as, and terms that are inconsistent with those of, the earlier contract.

2. Whether there is evidence in the record to support the jury's finding that Volvo was entitled to a refund for 1983 as alleged in the complaint because the parties intended the second contract to supersede the first.

STATEMENT

A. Statement of the Case

On August 1, 1995, Volvo filed suit in the District Court for the Middle District of North Carolina seeking a refund of federal income taxes for the 1983, 1985 through 1987, and 1989 taxable years. JA 15. The matter was tried to a jury from January 8, 1997, through January 13, 1997; the jury returned a verdict in

favor of Volvo. On August 12, 1997, the district court granted partial judgment as a matter of law to the government, setting aside the jury's verdict and denying recovery to Volvo for the 1983 taxable year but confirming the jury's verdict for Volvo as to the other taxable years at issue. JA 263-268. After subsequent post-trial motions were filed by both parties, it was not until nearly ten years later, on November 30, 2007, after the government rejected three settlement offers by Volvo regarding the 1983 taxable year that upon Volvo's insistent urging that the district court resolve the matter, the court entered final judgment. JA 275-276 (Pl. Motion for Status Conference ¶¶ 25, 26, 27); JA 279-292 (2007 Mem. Op.) Volvo now appeals the portion of the final judgment denying recovery for the 1983 taxable year.

B. Statement of Facts

1. This case concerns the import of contracts between Volvo and Sajac, a firm that was in the business of purchasing slow-moving and excess inventories from major companies throughout the United States. Sajac's business model "was to buy obsolete, slow moving or superseded new parts ... from original equipment manufacturers, to warehouse them in our own warehouses, to inventory them into our own warehouses, and then to offer them for sale generally." Jan. 10, 1997 Tr., at 43 (Falk cross). Thus, as the district court explained, "Sajac purchased excess inventory from manufacturers at scrap prices, speculating that the manufacturers

would repurchase a significant portion of the inventory at a considerable mark-up from the scrap price. Sajac also sold its inventory to scrap and surplus dealers.” JA 280-81 n. 1.

Sajac advertised its acquisition of excess inventory as having three benefits for manufacturers. “First, the manufacturer is relieved of the financial and managerial burden of inventorying and warehousing spare parts. Second, while the manufacturer no longer has control over the spare parts it might need in the future, these parts are still available through SAJAC at a price usually less than current market value.” JA 216. Third – and most important for present purposes – Sajac represented that, “as a result of selling excess inventory to SAJAC at scrap metal prices, the manufacturer will have incurred a tax deductible inventory loss substantiated by an actual sale.” *Id.* This tax treatment would be appropriate, Sajac explained, because “[a] sale to SAJAC is ... a complete and closed transaction since under the terms of the purchase agreement the seller’s right to and control over the inventory absolutely expire,” “thereby giving rise to tax deductible inventory losses.” *Id.* at 217.¹

¹ There is no dispute that, under proper circumstances, inventory may be written off for tax purposes, resulting in favorable treatment for the taxpayer. Pursuant to regulations issued under Internal Revenue Code § 471, 26 U.S.C. § 471, a seller may “exclude from inventory goods sold ... title to which has passed to the purchaser.” *See* Treas. Reg. § 1.471-1. Thus, once inventory is sold (so long as the sale is a bona fide sale) the taxpayer may write off the inventory, which has the effect of decreasing the value of the taxpayer’s ending inventory. *See, e.g., Robert*

In 1981, Volvo entered into the business of heavy truck manufacturing by acquiring White Motor, which was then bankrupt and undergoing liquidation. At the time of the acquisition, White Motor and Sajak were parties to a contract (referred to below as “the first contract”), executed on April 16, 1980, under which White Motor sold its excess inventory to Sajak for a price based on the inventory’s scrap value. JA 207-09; Jan. 8, 1997 Tr., at 119 (Fletcher cross). As suggested by its business model, Sajak then placed the inventory in a long-term storage warehouse for sale at market prices to manufacturers, surplusers, and scrap dealers. Jan. 8, 1997 Tr., at 44-47 (Fletcher direct). Although the contract provided that title to the property passed to Sajak upon delivery, it also contained several provisions that allowed White Motor (and later Volvo) to retain control over the inventory after its transfer to Sajak and that restricted Sajak’s ability to sell the inventory to third-party purchasers, including: (1) an option that allowed White Motor to repurchase any of the inventory it sold to Sajak on demand at a price below “standard cost”; (2) a provision requiring Sajak to notify White Motor in advance of any planned disposition of inventory; and (3) a provision requiring

Bosch Corp. v. Comm’r, T.C. Memo. 1989-655. A decrease in the value of the ending inventory increases the cost of goods sold. And because cost of goods sold is deducted from total revenue to determine taxable income, an increase in the cost of goods sold results in a decrease in taxable income. See *Thor Power Tool Co. v. Comm’r*, 439 U.S. 522, 530 (1979).

Sajac to provide White Motor with periodic listings of available inventory and allowing White Motor to audit the inventory being held by Sajac. JA 207-09.

As part of the purchase of White Motor, Volvo acquired White Motor's manufacturing assets and inventories and assumed most of White Motor's contracts pursuant to a blanket assumption clause in the White Motor Asset Purchase Agreement, including the first contract between White Motor and Sajac. Among the assets that Volvo acquired from White Motor was the latter's existing truck parts inventory (which had not yet been sold to Sajac). This inventory, which was in considerable disarray at the time of the Volvo transaction (Jan. 9, 1997 Tr., at 118-19 (Lachmann direct)), was considered by the bankruptcy court and the parties to be virtually worthless; after the acquisition, Volvo began to sell the obsolete White Motor parts it no longer needed to Sajac at scrap value pursuant to the first contract between White Motor and Sajac. Jan. 8, 1997 Tr., at 19-21 (Stella direct).

2. By 1983, Sajac had become concerned that the terms of its existing contracts might not convey to it adequate control over the property it acquired to permit the manufacturer to write the property off for tax purposes (*see* Jan. 9, 1997 Tr., at 132-33 (Lachmann cross)); indeed, in early 1983, the Internal Revenue Service ruled that a manufacturer may not write off its inventory based on sales of the property at scrap value when, under the sales arrangement, the manufacturer

continues to possess the benefits and burdens of ownership. IRS Rev. Ruling 83-59.² Sajac accordingly entered into revised contracts with its customers, including Volvo, that modified the problematic contract provisions to ensure the availability of favorable tax treatment. *See* JA 281 n.2 (district court noted that “Sajac modified its standard contract with manufacturers as the result of several Tax Court decisions finding that no bona fide sales had occurred under terms virtually identical to those of the first contract.”).

In particular, to address concerns that the restrictive terms of the first contract precluded the transfers of White Motor inventory to Sajac from effecting bona fide sales of the inventory for tax purposes, Volvo executed such a revised contract (“the second contract”) with Sajac on April 6, 1983. Jan. 9, 1997 Tr., at 133 (Lachmann cross); Jan. 13, 1997 Tr., at 8 (Dolesh direct); *see* JA 210. The second contract addressed the same subject matter as the first contract – Volvo’s sale of inventory to Sajac – but omitted the repurchase, notice, and audit provisions that had allowed Volvo to exercise control over the inventory and thus precluded

² Sajac’s manner of doing business subsequently was examined by the Tax Court in three separate cases—*Paccar, Inc. v. Comm’r*, 85 T.C. 754 (1985), *aff’d* 849 F.2d 393 (9th Cir. 1988); *Clark Equip. Co. v. Comm’r*, T.C. Memo. 1988-111; and *Robert Bosch Corp. v. Comm’r*, T.C. Memo. 1989-655. In all three cases, although legal title and possession of the inventory had been transferred to Sajac, the Tax Court concluded that the substance of the transactions did not effect a bona fide sale for tax purposes because the manufacturer retained control over the inventory despite the form of the transaction. Neither Volvo nor White Motor was a party to those cases and the parties in this proceeding agreed not to mention *Paccar* or any of the other Sajac cases by name before the jury.

the transfers from ripening into bona fide sales for tax purposes. *See* JA 210. Instead, the second contract provided simply that Sajac “agrees to purchase and [Volvo] agrees to sell[] certain of Seller’s inventory” at a specified price. *Id.* After the execution of the second contract, Volvo continued to sell its excess, obsolete, and slow-moving inventory to Sajac until 1991. Jan. 13, 1997 Tr. at 14-15 (Dolesh direct).

The evidence at trial permitted the jury to find that at no time, even prior to the execution of the second contract, did Volvo exercise control *in practice* over the inventory transferred to Sajac. Jan. 8, 1997 Tr., at 53 (Fletcher direct); Jan. 9, 1997 Tr., at 120 (Lachmann direct), 133 (Lachmann cross). Thus, once Sajac purchased inventory from Volvo, Sajac exercised all rights of ownership over it. Jan. 8, 1997 Tr., at 45 (Fletcher direct). Sajac actively marketed and sold inventory acquired from Volvo to third parties on a daily basis. *Id.* at 46-50 (Fletcher direct). Sajac never obtained permission before scrapping or selling Volvo parts to third parties (*id.* at 50-51, 56 (Fletcher direct)) and, although Sajac did periodically provide Volvo with lists of parts available for sale, it did so only on an informational basis. *Id.* at 51 (Fletcher direct), 115 (Fletcher cross). Volvo never audited the existence or quantity of the materials it sold as scrap to Sajac

(Jan. 9, 1997 Tr., at 129 (Lachmann direct))³ and Sajac never held inventory for Volvo for a set period of time. Jan. 9, 1997 Tr., at 46 (Fletcher direct). Further, there were occasions when Volvo wished to buy a part back from Sajac, but that part was no longer available. Jan. 8, 1997 Tr., at 56-57 (Fletcher direct). Although the parties submitted conflicting evidence on these points, the district court found that, at least for the period after execution of the second contract, “a reasonable jury could conclude that Sajac exercised control of its Volvo inventory, and, moreover, did not hold the inventory pending repurchase by Volvo.” JA 267.

In 1991 Sajac informed Volvo, without prior notice, that it had disposed of all of its Volvo inventory by selling it to a third party, Lippert Enterprises. Jan. 8, 1997 Tr., at 67-68 (Fletcher direct); Jan. 9, 1997 Tr., at 130 (Lachmann direct); *id.* at 154-55 (Cranford direct). Volvo was not made aware of this sale until after the fact. Jan. 8, 1997 Tr., at 67-68 (Fletcher direct); Jan. 9, 1997 Tr., at 67 (Fletcher cross); Jan. 9, 1997 Tr., at 130 (Lachmann direct), 142 (Lachmann cross), 154-55 (Cranford direct); Trial Ex. E.

3. The Internal Revenue Service conducted an audit of Volvo’s 1981-83 tax returns and disallowed the write-off for inventory transferred to Sajac. Because the

³ The evidence demonstrated that there was only one known occasion when a Volvo representative visited the Sajac warehouse. Stan Dolesh, who at the time was Volvo’s materials manager, once visited Sajac’s warehouse to assess Volvo’s internal scrapping procedures and ensure that Volvo’s records on sales to Sajac were accurate. Jan. 9, 1997 Tr., at 91-92 (Fletcher cross). There was no evidence that Mr. Dolesh was at the Sajac warehouse to audit Volvo inventory.

first contract had authorized White Motor and Volvo to exercise a degree of control over the inventory subject to that contract's terms after the inventory was conveyed to Sajac (even if, as the evidence indicated, that control never was exercised in practice), Volvo agreed with the Service that transfers of inventory to Sajac undertaken in 1981 and 1982 could not be treated as bona fide sales so long as the first contract remained in effect. The parties accordingly settled and closed the 1981 and 1982 taxable years. *See* JA 271 n.3.⁴ But Volvo claimed a deduction *on its 1983 tax return* for the inventory transferred prior to April 6, 1983, including the transfers that had occurred while the first contract was in effect, on the theory that Volvo's second contract with Sajac effected bona fide sales *of the previously transferred inventory* by removing all impediments to Sajac's control of that inventory.⁵ Volvo also took the position that transfers of inventory to Sajac in

⁴ The parties initially disagreed on whether the settlement of the 1981 and 1982 taxable years precluded Volvo from seeking a deduction in 1983 for inventory that had been physically transferred to Sajac in 1981 and 1982. The question whether Volvo could properly account in 1983 for transfers of inventory that took place in 1981 and 1982 was characterized as the "opening balance sheet issue" in the pleadings before the district court because it related to the proper treatment of inventory appearing on Volvo's opening balance sheet when it acquired White Motor. But the government eventually conceded that, as a legal matter, Volvo was entitled to seek a refund in 1983 for the 1981 and 1982 transfers, and the opening balance sheet issue is not now before this Court. *See* Gov't Reply Br. to Pl.'s Br. In Sup. Of Refund at 9 (March 14, 1997).

⁵ It is not uncommon for the Internal Revenue Code to defer deductions until an impediment to the passing of legal title is removed. *See, e.g.*, 26 U.S.C. § 83(a) & (h) (value of property paid to an employee as compensation (*e.g.*, non-statutory

subsequent years, which plainly had been subject to the terms of the second contract, were bona fide sales.

When the Service nevertheless disallowed deductions for *all* sales to Sajac, including those claimed in 1983, Volvo submitted a protest letter that elaborated on its position regarding the deductions taken for the 1983 taxable year, explaining that the parties had intended the terms of the second contract to govern the treatment of inventory that previously had been transferred to Sajac under the first contract:

The WMC-SAJAC Agreement terminated in March, 1983 and was replaced by the [Volvo]-SAJAC Agreement, which does not give [Volvo] the right to repurchase scrapped items sold to SAJAC. [Volvo] did not repurchase any scrap material when the WMC-SAJAC Agreement terminated. Therefore, in 1983, [Volvo] lost the right to repurchase the excess parts inventory it had sold to SAJAC in 1981 and 1982. Thus, if the repurchase option in the WMC-SAJAC Agreement caused transactions under that agreement in 1981 and 1982 not to constitute sales for federal income tax purposes, termination of the repurchase option in March, 1983 caused all the items previously delivered to SAJAC

stock option) is not includable in the employee's gross income, so long as the property is subject to forfeiture under certain conditions and the employee's rights in the property are not transferable; employer may not deduct the value of the property paid until the employee's rights are not subject to forfeiture or are transferable); 26 U.S.C. §§ 673(a), 674(a) (retention of certain indicia of control by trust grantor causes the income to be taxed to the grantor even if the trust is intended to be for the benefit of others, until the legal impediment to ownership is removed). Similarly, in the area of inventory accounting, a reduction in inventory for damaged or obsolete goods must occur in the year that the goods become obsolete. *See, e.g., Thor Power Tool Co. v. Comm'r*, 439 U.S. 522 (1979).

subject to the repurchase option to be sold to SAJAC, for federal income tax purposes, when the repurchase option terminated...Therefore, [Volvo] was correct in recognizing in 1983 the loss on items sold to SAJAC for their scrap value in that year.

JA 257-258.

Volvo submitted its administrative claim for refund on June 12, 1991. JA 19 (Compl. ¶ 14). Its refund claim for the 1983 taxable year totaled \$2,807,902. This amount consisted of two components: (1) a deduction for inventory physically transferred and sold to Sajak in 1983 (\$1,025,700); and (2) inventory transferred to Sajak in 1981 and 1982 (\$1,782,202).⁶ After the Service denied the claim for a refund regarding all sales of inventory to Sajak, on August 1, 1995, Volvo filed this suit seeking a tax refund for the years 1983, 1985 through 1987, and 1989. Volvo took the position in its complaint that the pre-April 6, 1983, transfers became bona fide sales for tax purposes on April 6, 1983, when Volvo and Sajak entered into the second contract, which eliminated (or removed) the former restrictions over Sajak's control of the inventory remaining in its possession. The complaint alleged that the "written agreement" governing the inventory at issue for the 1983 taxable year – including the inventory transferred in 1981 and 1982 – was the second

⁶ Because the record does not establish when during the year the 1983 transfers took place (that is, before or after execution of the second contract), all of the 1983 transfers are being treated for purposes of this appeal as having occurred under the first contract.

contract, executed “in 1983.” JA 17 (Compl. ¶ 9). *See also* JA 23 (Amended Cmpl., ¶ 24). In its answer, the government generally denied that, for tax purposes, bona fide sales of inventory took place between Volvo and Sajac at *any* time. JA 34, ¶ 15; JA 35, ¶¶ 35, 39. Although the government moved for partial summary judgment, the district court deferred its decision on the motion until after trial.⁷

At trial, the government took the position that Volvo retained control over the inventory throughout the *entire* period at issue, notwithstanding execution of the second contract, and that none of the transfers to Sajac constituted bona fide sales. As the district court noted, the parties drew very different pictures of the degree of control exercised by Sajac over the inventory: they “presented conflicting evidence as to whether Sajac had the discretion to reject inventory offered for sale by Volvo”; they “disagree[d] as to whether the evidence proved that Sajac did not hold inventory for Volvo”; and they “presented conflicting evidence as to whether Volvo exercised control over the disposition and storage of the Volvo parts after they had been sold to Sajac.” JA 265. But the evidence did show unequivocally that the treatment of the inventory by the parties did not

⁷ The district court referred the government’s motion to a magistrate judge, who opined that “summary judgment may be granted to the United States regarding taxable years 1981 through 1989,” but also suggested that, “in the alternative, summary judgment may be denied in view of the relative sparsity of the legal authority on the issue before the court and in the interest of judicial economy.” JA 206.

change after execution of the second contract; the testimony uniformly established that “we didn’t do anything any different prior or after ... the new contract was issued.” Jan. 9, 1997 Tr., at 133 (Lachmann cross); *see* Jan. 8, 1997 Tr., at 53 (Fletcher direct) (“We operated the same way with all of our customers the full time I was there.”); Jan. 9, 1997 Tr., at 120 (Lachmann direct); Jan. 13, 1997 Tr., at 14 (Dolesh direct). There was no evidence that, after the second contract was executed, the parties gave inventory differential treatment depending upon which contract had been in effect at the time of the inventory’s transfer.

At the close of evidence, the district court instructed the jury that “[m]anufacturers ... may not write off inventory for tax purposes, and at the same time control and continue to maintain and offer [it] for sale at list prices” (JA 244), adding that, “[a]lthough the form of the transaction may be that of a sale, it is not bonafide [*sic*], and it is not to be treated as a sale, where the substance of the transfers is that the seller retains effective control over what is sold.” JA 244-45. The court then listed more than a dozen considerations for the jury to take into account in determining whether Volvo maintained control over the inventory, among them “whether the seller of the inventory had the right, contractual right to repurchase that which it had sold.” JA 246.⁸ The court also submitted two special

⁸ This standard is derived from *Paccar, Inc. v. Commissioner*, 85 T.C. 754 (1985), *aff’d*, 849 F.2d 393 (9th Cir. 1988), which the parties agree states the governing rule.

interrogatories to the jury pertaining to the two contracts governing the Volvo-Sajac transactions, asking the jury to determine whether bona fide sales occurred under each contract:

1) Did Volvo make bona fide sales of inventory to Sajac between September 1, 1981, and April 6, 1983, as alleged in the complaint?

2) Did Volvo make bona fide sales of inventory to Sajac between April 6, 1983, and December of 1990, as alleged in the complaint?

JA 243. The jury found for Volvo on both questions.

4. On the government's motion for judgment as a matter of law, the district court upheld the jury's verdict as it applied to inventory transferred *after* execution of the second contract. Reviewing the testimony, and "[v]iewing the conflicting evidence in a light most favorable to Volvo," the court found that "there is a legally sufficient basis upon which a reasonable jury could conclude that Sajac exercised control [over] its Volvo inventory, and, moreover, did not hold the inventory pending repurchase by Volvo." JA 267. The court therefore ruled "that the jury reasonably determined that the sales of inventory to Sajac ... pursuant to the second contract were bona fide sales." *Id.* The government has not challenged this determination on appeal, and the jury's verdict for Volvo regarding inventory transferred pursuant to the second contract therefore must be regarded as conclusive for present purposes. *See, e.g., Helvering v. Pfeiffer*, 302 U.S. 247,

250-51 (1937) (“[A]n appellee cannot without a cross-appeal attack a judgment entered below.”).

The court reached a different conclusion regarding the jury’s verdict on inventory transferred *prior* to execution of the second contract. As to these transfers, the court simply stated that “there is no legally sufficient basis upon which a reasonable jury could have found that, under the terms of the first contract, Volvo relinquished control of the inventory.... The court finds that Volvo exercised control over the inventory sold pursuant to the first contract and will grant Defendant’s renewed Motion for Judgment as a Matter of Law in relation to inventory transfers made from 1981 through April 6, 1983.” JA 266. The court therefore set aside the jury’s verdict regarding inventory transferred prior to execution of the second contract and denied Volvo’s 1983 claim. In particular, the court specifically rejected Volvo’s argument that the 1981 and 1982 transfers became bona fide sales for tax purposes once the second contract was executed in 1983.⁹

Volvo subsequently urged the court to reconsider the issue whether the second contract governed the pre-April 6, 1983, transfers, as alleged in Volvo’s complaint. *See* Pl’s Resp. to U.S. Mot. to Alter or Amend J., ¶ 3; JA 274, ¶ 18 (Pl.

⁹ The court affirmed the jury’s separate decision that Volvo was entitled to deduct in 1990 the interest owing on its 1981 through 1983 tax liabilities. JA 268. That determination has not been challenged by the government and is not at issue here.

Mot. for Status Conference) . The court did not rule on this motion for more than ten years. During that period, the parties agreed on the amount of the refunds due Volvo for the 1985, 1986, 1987, and 1989 taxable years. As for the 1983 taxable year, Volvo unsuccessfully attempted on three occasions to resolve the matter by settlement. *See* JA 275-276, ¶¶ 25-27 (Pl. Mot. for Status Conference). After the last of these proposals was rejected by the government, Volvo pressed the district court to rule on its long-pending motion for reconsideration and to enter final judgment.

In response to that request, on September 7, 2007, the district court issued a memorandum opinion reaffirming its prior conclusions. While recognizing that “the record as to the nature of the interaction between Volvo and Sajac under the second contract” provided a “legally sufficient basis upon which a reasonable jury could conclude that Sajac exercised control [over] the Volvo inventory,” the court found “unpersuasive Plaintiff’s contention that the transfers that took place under the first contract were somehow transformed into bona fide sales once Volvo entered into the second contract with Sajac.” JA 288. In the court’s view, transfers that took place prior to execution of the second contract “were still bound by the terms of the first contract. There is nothing in the record that indicates otherwise.” JA 289. The court added that “the existence of a legitimate sales contract under which later inventory is sold in no way affects the terms of the prior

contract.” *Id.* Because the court therefore believed that “Volvo retained control of the inventory acquired from WMC in 1981 pursuant to the terms of the contract through 1983,” and saw “nothing in the record to show that the terms of the first contract were ever modified to affect Volvo’s control over the transferred inventory,” it held that Volvo “is not entitled to a refund for [inventory transferred prior to execution of the second contract].”¹⁰ JA 290. This appeal followed.

SUMMARY OF ARGUMENT

The question before the Court is whether the terms of the second contract superseded those of the first and therefore, at the time that the second contract went into effect, came to control the parties’ rights in the inventory that had been transferred *prior* to consummation of the second contract. If the second contract did have that effect, at the time that contract was executed in 1983 Volvo surrendered control over the inventory that had been transferred to Sajac pursuant to the first contract – and if that is so, Volvo was entitled to write off that inventory for tax purposes in 1983. In rejecting this argument and overturning the jury’s verdict for Volvo regarding its 1983 tax claim, the district court offered two rationales: it believed that: (1) execution of the second contract had no legal effect on the parties’ prior agreement and (2) there is no evidence showing that the

¹⁰ The court also rejected Volvo’s argument that the transfer of certain inventory to Sajac in 1983 took place after execution of the second contract, declining to consider a post-trial affidavit addressing the point. JA 282-288. Volvo has not challenged that determination, which is not now before this Court.

parties intended the second contract to modify the first. Both of these conclusions are wrong.

A. It is a fundamental principle of contract law that a contract complete in itself will be deemed to supersede and discharge a prior contract between the same parties concerning the same subject matter, when the terms of the second contract are inconsistent with those of the first. That is the case here. The second Volvo-Sajac contract is complete in itself; the two contracts are between the same parties; they concern the same subject matter, the sale of Volvo excess inventory to Sajac; and the terms of the first contract, which reserved substantial rights in the inventory to Volvo, are inconsistent with those of the second, which did not. In these circumstances, the language of the second contract is most naturally read as superseding the first so as to complete the sale of the previously transferred inventory – a sale that had been impeded by the first contract’s reservation of rights in the inventory to White Motor (and Volvo). The district court accordingly misunderstood the legal import of the second contract.

B. Even if the first contract does not supersede the second as a matter of law, the governing legal principles dictate that a contract be interpreted to effectuate the parties’ intent. To this end, a court that is construing a contract should look to the reasonable understanding of the words used by the parties, the purpose of the contract, the circumstances surrounding the contract’s execution,

and the subsequent conduct of the parties. The court also should strive to interpret the contract as a rational business instrument that makes economic sense to the parties. Here, the district court wholly disregarded the substantial evidence in the record that bears on these inquiries.

First, reading the second contract to supersede the first is by far the more reasonable and probable understanding of the agreement, and the only one that effectuates the manifest intent of the parties. A principal purpose of the agreement with Sajac was to accomplish bona fide sales that would allow Volvo to write off its inventory for tax purposes; the parties entered into the second contract to achieve precisely that end. Given that the point of executing the second contract was to effectuate such sales, a failure to extend the second contract's terms to the previously transferred inventory would mean that Volvo and Sajac – for no evident reason at all – chose not to fix a fundamental defect in their prior agreement, leaving the tax status of the previously transferred inventory in limbo. The parties should not be thought to have contracted in a manner that works such an unreasonable result.

Second, this conclusion is confirmed by the course of dealings between the parties. There is no evidence that, after execution of the second contract, Sajac distinguished in *any* respect in its treatment of inventory transferred under the first and second contracts. To the contrary, the evidence is uncontroverted that Sajac

took no steps to modify its performance after execution of the second contract, which strongly suggests that Sajac did nothing to segregate or differentiate the previously transferred inventory – and that the parties accordingly thought the restrictive terms of the first contract to be superseded.

Indeed, there could have been no imaginable commercial reason for the parties to have treated parts differently based upon the date the parts had been transferred, or to have maintained in place two differing contractual regimes. The point is proved by the parties' course of performance, culminating in Sajac's disposal in 1991 of its *entire* inventory of Volvo parts (necessarily including those initially transferred to Sajac under the first contract) without providing the advance notice to Volvo that was required by the first but *not* by the second contract. The most obvious conclusion from this course of performance is that the parties understood that the terms of the first contract no longer governed rights over the inventory. The second contract should be interpreted to effectuate that intent.

STANDARD OF REVIEW

“To grant [a] motion [for judgment as a matter of law] the district court must examine the evidence in the light most favorable to the non-moving party and determine ‘whether a reasonable trier of fact could draw only one conclusion from the evidence.’” *Brown v. CSX Transp., Inc.*, 18 F.3d 245, 248 (4th Cir. 1994) (quoting *Townley v. Norfolk & W.Ry.*, 887 F.2d 498, 499 (4th Cir. 1989)). When

reviewing a district court's grant of such a motion, "this Court applies the same standards *de novo*" (*id.*) and "[n]o deference is due the trial court's decision." *Smithy Braedon Co. v. Hadid*, 825 F.2d 787, 790 (4th Cir. 1987). More generally, this Court reviews *de novo* a district court's legal conclusions, including the assessment here whether the second contract governed the pre-April 6, 1983 transfers. *See Rawl v. United States*, 778 F.2d 1009, 1014 & n. 9 (4th Cir.1985); *see also In re Peanut Crop Ins. Litig.*, 524 F.3d 458, 470 (4th Cir. 2008) (Court reviews *de novo* district court's assessment of a contract, "in that issues of contract interpretation constitute questions of law").

ARGUMENT

There are significant areas of common ground between the parties in this case. There is no dispute about the substantive standard that governs the availability of an inventory write-off for tax purposes, which is stated in *Paccar, Inc. v. Commissioner*, 85 T.C. 754 (1985), *aff'd*, 849 F.2d 393 (9th Cir. 1988), and was summarized in the jury instructions below as requiring the taxpayer's disposition of the inventory by means of a bona fide sale that relinquishes control over the property. For its part, Volvo has acknowledged that, so long as the first contract set the rights of Volvo and Sajac over the inventory at issue, the *Paccar* standard was not satisfied; Volvo and the IRS settled the 1981 and 1982 taxable years accordingly. And it is now settled that the *Paccar* test *is* met as to inventory

governed by the terms of the second contract; the district court upheld the jury's finding for Volvo on that point, and the government did not challenge that determination on appeal.

Against this background, there is only one narrow question now before this Court: whether the terms of the second contract superseded those of the first and therefore, at the time that the second contract went into effect, came to control the parties' rights in *all* inventory transferred from Volvo to Sajak, including inventory transferred prior to consummation of the second contract. If the second contract did have that effect, at the time the second contract was executed in 1983 Volvo surrendered control over – and therefore, for tax purposes, sold – the inventory that had been transferred to Sajak pursuant to the first contract. And if that is so, Volvo was entitled to write off that inventory in 1983.

The jury, which was instructed to “consider whether the seller of the inventory had the right, [the] contractual right to repurchase that which it had sold” (JA 246) – and also was told to determine whether Volvo made sales to Sajak “as alleged in the complaint” (JA 243), which specified that the sale of the inventory at issue took place in 1983 with execution of the second contract (JA 17, Compl. ¶ 9) – found for Volvo. In setting aside that verdict on the ground that that “the transfers that took place under the first contract” were not “transformed into bona fide sales once Volvo entered into the second contract with Sajak” (JA 288), the

district court offered two rationales, one legal and one factual. It believed that the execution of a second contract “in no way affects the terms of the prior contract.” JA 289. And it opined that there is “nothing in the record to show that the terms of the first contract were ever modified to affect Volvo’s control over transferred inventory.” JA 290. Both of these conclusions are incorrect.

In evaluating these issues, one point bears emphasis: a jury’s verdict may be set aside only “if ‘there is no legally sufficient evidentiary basis for a reasonable jury to have found’” in favor of the winning party. *Brown*, 18 F.3d at 248 (quoting Fed. R. Civ. P. 50(a)). “To grant the motion [for judgment as a matter of law] the district court must examine the evidence in the light most favorable to the non-moving party and determine ‘whether a reasonable trier of fact could draw only one conclusion from the evidence.’” *Id.* (quoting *Townley*, 887 F.3d at 499 (4th Cir. 1989)). *See, e.g., Anderson v. G.D.C., Inc.*, 281 F.3d 452, 457 (4th Cir.2002); *Anheuser-Busch, Inc. v. L & L Wings, Inc.*, 962 F.2d 316, 318 (4th Cir. 1992). And when reviewing a district court’s grant of such a motion, “this Court applies the same standards *de novo*” (*Brown*, 18 F.3d at 248), and “[n]o deference is due the trial court’s decision.” *Smithy Braedon Co. v. Hadid*, 825 F.2d 787, 790 (4th Cir. 1987). *See, e.g., Lowery v. Circuit City Stores, Inc.*, 206 F.3d 431, 437 (4th Cir. 2000). Thus, this Court is “bound to view the evidence in the light most favorable to [Volvo] and to give it the benefit of all inferences which the evidence

fairly supports, even though contrary inferences might reasonably be drawn.” *Cont’l Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 696 (1962). Applying that standard, it should be evident that, in this case, there was ample evidence to support the jury’s verdict for Volvo and that, in finding to the contrary for the 1983 taxable year, “the district judge improperly assumed the jury’s role.” *Anheuser-Busch*, 962 F.2d at 318.

A. The Second Contract Supersedes the First Because the Two Agreements Address the Same Subject Matter and Contain Inconsistent Provisions

One prop for the district court’s decision to set aside the jury’s verdict was the court’s belief that “the existence of a legitimate sales contract under which later inventory is sold in no way affects the terms of the prior contract” (JA 289), so that transfers of inventory under the first contract could not have been “somehow transformed into bona fide sales once Volvo entered into the second contract with Sajac.” *Id.* at 288. In reaching this legal conclusion, the district court pointed to no authority and engaged in no examination of the relevant contract law. That was a fatal error. Under fundamental principles of contract law, the second contract is presumed to have superseded the first, meaning that its terms governed the rights of the parties in, and control over, inventory initially transferred pursuant to the first contract.

I. Under Wisconsin law a contract is presumed to supersede a prior agreement between the same parties that concerns the same subject matter and contains inconsistent provisions.

The second contract provided that it would be governed by Wisconsin law. See JA 210, ¶ 4.¹¹ And under the law of that State – which in this respect reflects the common law of contracts – “[a] contract complete in itself will be conclusively presumed to supersede and discharge another one made prior thereto between the same parties concerning the same subject matter, where the terms of the later [one] are inconsistent with those of the former.” *Tennies Corp. v. Wagner Iron Works*, 98 N.W.2d 399, 402 (Wis. 1959) (internal quotation marks omitted). Thus, “[w]here a later contract is entered into between the same parties in relation to the same subject matter as the earlier one ... the later contract supersedes the earlier

¹¹ This Court has adopted the majority view that federal courts should apply the choice of law rule used by the State which the court sits. See *In Re Merritt Dredging Co.*, 839 F.2d 203, 205-206 (4th Cir. 1988) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)). See also, e.g., *Welles v. Turner Entm't Co.*, 503 F.3d 728, 734 (9th Cir. 2007) (applying contract's choice of law provision). Thus, North Carolina choice of law rules apply here. North Carolina has adopted the U.C.C. choice of law provision, which expressly provides that the parties may choose the law that governs the contract. See Revised U.C.C. Article 1-105 (as it existed prior to Revised U.C.C. 1-301, effective 2001); N.C. GEN. STAT. ANN. § 25-1-105 (as it existed in 1983); *Volvo Const. Equip. North Am., Inc. v. CLM Equip. Co.*, 386 F.3d 581, 602-03 (4th Cir. 2004) (“Despite North Carolina's adherence to the presumptive rule of *lex loci contractus*, contracting parties in North Carolina are entitled to agree that a particular jurisdiction's substantive law will govern their contract, and such a provision will generally be given effect”) (citing *Torres v. McClain*, 535 S.E.2d 623, 625 (N.C. 2000)).

one, which is deemed merged in it.” 17A CORPUS JURIS SECONDUM CONTRACTS § 418 (2008).¹²

Under generally recognized contract law principles, this is so “even though there is no express agreement that the new contract shall have that effect.” *Decca Records, Inc. v. Republic Recording Co.*, 235 F.2d 360, 363 (6th Cir. 1956). As a consequence, contractual rights that appeared in the first agreement but were

¹² This has long been a basic principle of contract law. *See, e.g., United States ex rel. Int’l Contracting Co. v. Lamont*, 155 U.S. 303, 310 (1894) (“having made [the contract] and executed it, their mouths are closed against any denial that it superseded all previous arrangements.”) (quoting *Gilbert & Secor v. United States*, 75 U.S. 358 (1869)); *McCormack v. Citibank, N.A.*, 100 F.3d 532, 539 (8th Cir. 1996); *Housekeeping Publ’g Co. v. Swift*, 97 F. 290, 294 (8th Cir. 1899) (“A subsequent contract completely covering the same subject-matter, and made by the same parties, as an earlier agreement, but containing terms inconsistent with the former contract, so that the two can not stand together, rescinds, supersedes, and is substituted for the earlier contract, and becomes the only agreement of the parties on the subject.”); *Archambo v. Title Lawyers Ins. Corp.*, 646 N.W.2d 170, 177 n. 16 (Mich. 2002) (“[I]f the later contract covers the same subject matter ... and contains terms that are inconsistent with the terms of the earlier contract, the later contract may supersede the earlier contract...”); *Izold v. Gumina*, 1986 WL 12544, at *1 (Ohio Ct. App. Nov. 5. 1986) (unpublished) (“[A] written contract may be rescinded by the substitution of another contract which has terms inconsistent with the original contract.”); *Holi-Rest, Inc. v. Treloar*, 217 N.W.2d 517, 524 (Iowa 1974) (“The general rule is well settled that parties to a contract may rescind it by making a new contract inconsistent with the first.”); *Turner v. Turner*, 89 S.E.2d 245, 249 (N.C. 1955) (“It is well-settled law that the parties to a contract ... may rescind it, or substitute another contract for it, by making a new contract inconsistent therewith.”); *Wardman v. Wash. Loan & Trust Co.*, 90 F.2d 429, 431 (App. D.C. 1937) (“As a general rule, where the new contract is in regard to the same matter and has the same scope as the earlier contract and the terms of the two contracts are inconsistent either in whole or in a substantial part, so that they cannot subsist together, the new contract abrogates the earlier one *in toto* and takes its place.”) (internal quotation marks omitted).

omitted from the second are “abandoned upon the signing of a second contract which was complete in itself, covered the same subject matter, and contained no reservation of rights;” a party that “want[s] to reserve its rights under the first contract ... should ... do[] so explicitly in the second.” *Harrison W. Corp. v. United States*, 792 F.2d 1391, 1393 (9th Cir. 1986). See, e.g., *Mitsubishi Aircraft Int’l Inc. v. Brady*, 780 F.2d 1199, 1202 (5th Cir. 1986) (“silence is insufficient” to preserve rights when an initial agreement is superseded); *Tennies*, 98 N.W.2d at 402. In such circumstances, the latter contract is construed as a matter of law to discharge the former,¹³ leaving the second contract as the sole instrument governing the parties’ rights. See, e.g., *Mitsubishi*, 780 F.2d at 1202.

2. *The second contract supersedes the first.*

This presumption that a second contract supersedes the first applies here. The second Volvo-Sajac contract unquestionably is “complete in itself.” *Tennies*, 98 N.W.2d at 402. The first and second contracts are between “the same parties” (*id.*), as Volvo was White Motor’s successor and assumed its contractual rights. The contracts “concern[] the same subject matter” (*id.*), addressing the sale of Volvo excess inventory to Sajac and the terms under which that inventory could be

¹³ See, e.g., *Parduhn v. Bennett*, 61 P.3d 982, 985 (Utah 2002); *Pasotex Petroleum Co. v. British-American Oil Producing Co.*, 431 P.2d 373, 380 (Okla. 1966); *O’Dell v. O’Dell*, 26 N.W.2d 401, 413 (Iowa 1947); *Kester v. Nelson*, 10 P.2d 379, 380 (Mont. 1932); *Townsend & Freeman Co. v. Tabor*, 228 S.W. 6, 7 (Ky. Ct. App. 1921).

repurchased by Volvo. And “the terms of the later [contract] are inconsistent with those of the former” (*id.*): the first contract reserved very substantial rights in the property to Volvo, including the right to repurchase any and all of the inventory, to have Sajac not sell the inventory to another purchaser in a manner that would be “injurious to any right or interest” of Volvo, to advance notice of any disposition of the inventory by Sajac, and to receive a periodic listing of Volvo inventory held by Sajac. JA 207-09. All of those reserved rights were omitted from the second contract. JA 210.

Although the district court did not spell out in any detail its reasons for finding that the second contract left the first undisturbed, it evidently believed that the two contracts did not concern the same subject matter in the relevant sense because, in the court’s view, the first contract was directed at a discrete set of earlier transactions and the second concerned a separate set of “later inventory” sales. JA 289. To be sure, that sort of analysis would be correct in the ordinary case where successive sales, and the contracts governing those sales, are wholly unrelated to one another – for example, where a merchant sells a purchaser a dishwasher subject to a warranty in 2005 and sells the same purchaser a different dishwasher subject to a different warranty in 2008. But this case is of a fundamentally different character.

Here, it is undeniable (as the district court itself acknowledged, see JA 281 n.2) that the parties entered into the second contract specifically to cure defects in the first that threatened to make the desired tax treatment for transferred inventory unavailable. Indeed, the reservation in the first contract of Volvo's right to control the inventory was so substantial as to prevent consummation of a bona fide "sale" (at least for tax purposes) so long as that contract continued to govern the inventory. In this setting, when the parties entered into the second contract – under which Sajac "agree[d] to purchase and [Volvo] agreed to sell[] certain of Seller's inventory" (JA 210) without specifying the particular items addressed by the agreement – that contractual language is most naturally understood to complete the sale of the previously transferred (but not yet "sold") inventory, and thus to govern the parties' respective rights in that inventory.

And that is especially so because there is no commercial reason for the parties to have allowed the first contract to continue to govern the inventory that had been transferred while that contract was in place. If the second contract is understood to have left the first contract in place, Volvo would simultaneously have been conducting its relationship with Sajac under two different, parallel agreements. This is not a plausible understanding of the second contract. After all, "words and phrases [in a contract] cannot be considered in isolation; rather, the court must consider a contract as a whole to provide each provision with the

meaning intended by the parties.” *Foskett v. Great Wolf Resorts, Inc.*, 518 F.3d 518, 522 (7th Cir. 2008) (applying Wisconsin law). For that reason, the two contracts here must be understood to concern the same subject matter, and the second contract accordingly to supersede the first one.¹⁴

Moreover, in addition to furthering the sale of the inventory for tax purposes, the subject matter of both contracts concerned the treatment of the inventory *after* it was sold to assure that favorable tax treatment was available to the seller. For this reason as well, both contracts addressed the same subject matter and the second superseded the first.

B. The Intent of the Parties that the Second Contract Govern Previously Transferred Inventory Should be Given Effect

If we are correct that the second contract supersedes the first as a matter of law because the two contracts address the same subject matter and satisfy the other

¹⁴ See, e.g., *Sid Richardson Carbon & Gasoline Co. v. Interenergy Resources, Ltd.* 99 F.3d 746, 753-754 (5th Cir. 1996) (mutual rescission of an agreement operates retroactively to restore the parties to the status quo); *Wells v. 10X Mfg. Co.*, 609 F.2d 248, 256 (6th Cir. 1979) (mutual rescission of a contract governed by the U.C.C. operates to abrogate it and undo it from the beginning); *Metcalf v. Comm’r*, T.C. Memo. 1982-273 (“When by mutual agreement a contract is rescinded, it is wiped out and the parties are restored to the positions they would be in if the contract had not been entered into.”); *Abdallah, Inc. v. Martin*, 65 N.W.2d 641, 644 (Minn. 1954) (“Rescission has been defined as the unmaking of a contract [I]t has also been stated that to rescind a contract is ... to abrogate and undo it from the beginning.”); *Mueller v. Michels*, 197 N.W. 201, 204 (Wis. 1924) (“The general rule applicable [is that] [t]o rescind a contract is ... to annul the contract and restore the parties to the relative positions which they would have occupied if no such contract had ever been made.”).

elements of the *Tennies* test, the decision below must be reversed and the case is at an end. But even if the second contract does not discharge the prior one on its face, the district court still erred in concluding that “there is nothing in the record to show that the terms of the first contract were ever modified to affect Volvo’s control over transferred inventory.” JA 290. In fact, the record clearly demonstrates the contrary: the parties intended that the terms of the second contract control previously transferred inventory. Because the terms of the second contract are not categorically inconsistent with Volvo’s reading – that contract does not specifically describe the inventory to which it applies or indicate when that inventory had to have been transferred – under governing contract law the intent of the parties should be given effect.

1. Contracts should be interpreted to effect the parties’ intent.

In Wisconsin, as in essentially all jurisdictions, it is fundamental that “[t]he primary goal in contract interpretation is to give effect to the parties’ intentions.” *Seitzinger v. Cmty. Health Network*, 676 N.W.2d 426, 433 (Wis. 2004). *See, e.g., State Farm Mut. Auto. Ins. Co. v. Langridge*, 683 N.W.2d 75, 86 (Wis. 2004) (“[O]ur goal is to give effect to the intent of the parties.”). To achieve this goal, the contract’s language must “be interpreted consistent with what a reasonable person would understand the words to mean under the circumstances” (*Seitzinger*, 676 N.W.2d at 433), with the court exercising “some latitude to deem an

interpretation plausible and therefore reasonable because the court is specifically empowered to consider the consequence of the interpretation in determining which competing interpretation should govern.” *State Farm*, 683 N.W.2d at 87. The “more reasonable meaning” should attach “on the probability that persons situated as the parties were would be expected to contract in that way as opposed to a way which works an unreasonable result” (*id.*), and “the court will ‘look to the purpose of the contract and the circumstances surrounding its execution.’” *Id.* at 86 (citation omitted). In all this, “[a] court must be careful not to lose sight of the goal of judicial construction, which is to advance the reasonable expectations of the parties.” *Id.* at 87.

This means that a contract should not be interpreted “in a vacuum, with complete disregard of pertinent facts and surrounding circumstances”; instead, “we look not only to the actual wording of the contract, but also give consideration to its subject matter, the facts relating to the controversy in issue and the surrounding circumstances, in order to determine the intention of the parties as reflected in the words used.” *Fujimoto v. Rio Grande Pickle Co.*, 414 F.2d 648 653-54 (5th Cir. 1969).¹⁵ Of particular relevance here, courts “should adopt a

¹⁵ Courts will consider extrinsic evidence in making this determination except in cases where “the intent of the parties can be determined with reasonable certainty” from the plain language of the contract. *Pabst Brewing Co. v. G. Heileman Brewing Co., Inc.*, No. 88-C-078-C, 1988 WL 237452 at *4 (W.D. Wis. Aug. 19, 1988) (citing Wisconsin law). See *Seitzinger*, 676 N.W.2d at 433 (in such

construction that will render the contract a rational business instrument so far as reasonably practicable.” *Gottsacker v. Monnier*, 697 N.W.2d 436, 442 (Wis. 2005). See *Columbia Propane, LP*, 661 N.W.2d 776, 787 (Wis. 2003) (“the more reasonable, fair and just construction, which conforms with established business practices”); *Bitker & Gerner Co. v. Green Inv. Co.*, 76 N.W.2d 549, 552 (Wis. 1956) (citation omitted) (contract “should be given a construction which will make it a rational business instrument and will effectuate what appears to have been the intention of the parties”). As then-Chief Judge Posner put it for the Seventh Circuit:

When a contractual interpretation makes no economic sense, that’s an admissible and, in the limit, a compelling reason for rejecting it....The presumption in commercial contracts is that the parties were attempting to accomplish something rational. Common sense is as much a part of contract interpretation as is the dictionary or the arsenal of canons.

Dispatch Automation, Inc. v. Richards, 280 F.3d 1116, 1119 (7th Cir. 2002). Thus, an “interpretation which makes a rational and probable agreement must be preferred.” *Sutter Ins. Co. v. Applied Sys., Inc.*, 393 F.3d 722, 726 (7th Cir. 2004) (Posner, J.).

circumstances “evidence extrinsic to the contract itself may be used to determine the parties’ intent”).

2. *The parties intended the terms of the second contract to govern control of inventory previously transferred under the first contract.*

a. In this case, there can be little doubt that reading the second contract to supersede the first – and to apply the second contract’s terms to inventory previously transferred under the first – would be the more rational and probable understanding of the agreement, as well as the only one that implements the intent of the parties. It is undisputed that a principal purpose of the arrangement between Volvo and Sajac was to effectuate bona fide sales that would allow Volvo to write off its inventory for tax purposes. Sajac marketed its program on the basis that, “as a result of selling excess inventory to SAJAC at scrap metal prices, the manufacturer will have incurred a tax deductible inventory loss substantiated by an actual sale.” JA 216. This tax treatment would be appropriate, Sajac explained, because “[a] sale to SAJAC is ... a complete and closed transaction since under the terms of the purchase agreement the seller’s right to and control over the inventory absolutely expire,” “thereby giving rise to tax deductible inventory losses.” JA 217. *See* Jan. 10, 1997 Tr., at 44 (Falk cross) (Sajac “obviously did sell the fact that it was our belief that a company, when they sold these parts to Sajac, that they could take the tax write-off on them.”).

As the IRS called into question whether inventory transfers made pursuant to agreements like the first contract effected bona fide sales, Sajac reformulated its

contracts – including the second contract with Volvo – specifically to address the problematic provisions identified by the IRS and to allow a tax write-off to Sajac’s suppliers. The district court itself recognized this reality (*see* JA 281 n.2), and the government cannot deny that Volvo and Sajac entered into the second contract with the specific goal of accomplishing this purpose. Indeed, Volvo and Sajac executives met shortly after execution of the second contract to “[d]iscuss [the] present IRS situation” (JA 218); testimony of a Volvo employee at trial expressly confirmed that, in response to “a tax case” involving Sajac and “one of their other customers,” “the management of our company and Sajac sat down and looked at things, and ... the contract that was assumed from White Motors, and we rewrote [the] contract at that point.” Jan. 9, 1997 Tr., at 132-33 (Lachmann cross). *See also* Jan. 13, 1997 Tr., at 8-9 (Dolesh) (jury out).¹⁶

¹⁶ It may be added that deposition testimony expressly supported this unsurprising point – and specifically confirmed as well that the second contract was intended to rescind and replace the first. The president of Sajac, who signed the second contract with Volvo, explained that, as “the tax issue became more of an issue with our customers, on the advice of our general counsel, we rewrote all of our contracts and wrote a new standard agreement.” JA 173 (Wellensiek deposition). This was done to remove contractual language “that would indicate any sort of [seller’s] control over the inventory.” *Id.* at 174. *See id.* at 177. And the purpose of the new contract “was to *supersede this agreement* [*i.e.*, the first contract] that our legal counsel and other people felt was not a desirable agreement with the new standard form of agreement” so as to address “tax concerns.” *Id.* at 182, 183 (emphasis added). Although this deposition testimony was not placed before the jury, it was in the record at the time the government submitted its motion for judgment as a matter of law; because the district court had not at that time ruled on the government’s pending summary judgment motion (a motion that the court

This background offers compelling evidence that the parties intended the second contract to supersede the first and meant its terms to govern the parties' respective rights in inventory initially transferred pursuant to the first contract. Given that the central point of entering into a revised contract was to effectuate bona fide sales that would support a tax write-off, a failure to extend the second contract's terms to that inventory would mean that Volvo and Sajak – for no evident reason at all – chose not to fix a fundamental defect in their prior arrangement, leaving the tax status of previously transferred inventory in limbo. And as previously noted, it would have made no commercial sense at all for Sajak and Volvo to have required differential treatment of the inventory depending on the date of transfer through the simultaneous operation of two parallel contracts. As Judge Posner put it in similar circumstances, such an intent on the parties' part “would have been cockeyed – it would have been contrary to [the parties'] own interests as they then appeared.” *Dispatch*, 280 F.3d at 1118. Reading the contract that way therefore surely would depart from the stricture that courts favor the “construction which will make [the contract] a rational business instrument and will effectuate what appears to have been the intention of the parties.” *Bitker & Gerner Co.*, 76 N.W.2d at 552.

evidently regarded as merged into the motion for judgment as a matter of law) – as to which the deposition testimony plainly was admissible and material – the court may have regarded this testimony as having some bearing on the proper disposition of the case.

In fact, such an understanding cannot be reconciled with the government's own theory of the case. The government's contention is that transfers of inventory effected under the first contract (and under the second, for that matter) were not bona fide sales, had no economic substance, and were undertaken simply to obtain a tax benefit. But if that is so, it would have been irrational for Volvo and Sajak to have modified the contract so that inventory transferred in the future could be written off, while failing to apply the terms of the second contract to inventory that already had been transferred – when (1) by the government's own hypothesis, obtaining tax benefits was the purpose of the prior transfers, and (2) it would have been a simple and cost-free matter for the parties to apply the terms of the second contract to the previously transferred inventory. The government cannot have it both ways; if the principal point of the initial transfers was to obtain a tax write-off, as the government asserts, it would have been perverse for the parties not to have applied the corrective second contract to those transfers so as to make favorable tax treatment available. The parties should not be thought to have contracted in a “way which works [such] an unreasonable result.” *Columbia Propane*, 661 N.W.2d at 787 (quoting *Carey v. Rathman*, 200 N.W.2d 591, 594 (Wis. 1972)).

This is especially so because applying the terms of the second contract to inventory transferred prior to that contract's execution was in the interest of both

parties. In taking that step, Sajac gave up nothing (and in fact gained increased legal control over the inventory), while maintaining the goodwill of an important customer. For its part, Volvo surrendered a theoretical ability to control the inventory, but in exchange it obtained a more valuable tax write-off. In fact, the record shows that the contractual right to control the inventory conferred by the first contract was of *no* importance to Volvo, as there is substantial evidence that Volvo never exercised that control in practice. *See* page 9-10, *supra*. And that point is confirmed by Volvo's agreement to enter into the second contract, in which it affirmatively chose to surrender its contractual right over the inventory in the interest of qualifying for favorable tax treatment.¹⁷

¹⁷ The conclusion that the parties intended the second contract to supersede the first is not undermined by a provision in the first contract providing that either party could terminate the agreement by providing written notice to the other. JA 209 (Gov. Ex. B, ¶ 9). A clause requiring cancellation to be in writing does not prevent the parties from mutually rescinding the original contract. *See ABC Outdoor Adver. v. Dolhun's Marine, Inc.*, 157 N.W. 2d 680, 685-86 (Wis. 1968) (clause requiring cancellation of contract to be in writing did not prevent parties from mutually rescinding the contract because parties cannot limit their ability to control their legal relations by future mutual agreement) (citing 4 WILLISTON ON CONTRACTS § 592 (3d ed.)), and 6 CORBIN ON CONTRACTS § 1295. *See also Harrison W. Corp.*, 792 F.2d at 1392-93 (execution of second contract, which presumptively rescinded inconsistent first contract, rendered question whether the first contract was properly terminated moot on appeal); *Charles Slater Architects, Inc. v. Delp*, 361 N.W.2d 310 (table), 1984 WL 180027, at *2 (Wis. Ct. App. 1984) (per curiam) ("case law clearly shows that a contract can be terminated in a manner other than that specifically set forth in the contract itself"); *Haering Oil Co. v. Beasley*, 254 S.W.2d 951, 951-52 (Ark. 1953) (contract subject to termination by either party at the end of a one year anniversary was terminable by mutual consent of the parties, even though it was not yet the anniversary date of the contract);

b. The conclusion that the parties intended the terms of the second contract to govern inventory transferred prior to execution of that contract is confirmed by the course of performance. Under Wisconsin law, “[c]ourse of performance is *always* relevant to determine the meaning of an agreement” for the sale of goods (*Pabst Brewing Company v. G. Heileman Brewing Co.*, No. 88-C-078-C, 1988 WL 237452, at *5 (W.D. Wisc. Aug. 19, 1988) (quoting Wis. Stat. Ann. § 402.208) (emphasis added by the court)), and “that evidence seems particularly probative here.” *Id.* See, e.g., *Fort Howard Paper Co. v. Standard Havens, Inc.*, 901 F.2d 1373, 1381 (7th Cir. 1990) (applying Wisconsin law); *Tigg Corp. v. Dow Corning Corp.*, 822 F.2d 358, 363 (3d Cir. 1987). On this point, the uncontroverted evidence in the record shows that the parties meant the second contract to govern control of previously transferred inventory.

There was substantial evidence, credited by the district court, establishing that Sajac exercised control over the Volvo inventory and was not constrained by the terms of the first contract, at least after execution of the second contract. See JA 264-265 (citing trial testimony). And there is absolutely was no evidence that, after execution of the second contract, Sajac distinguished in *any* respect in its treatment of inventory transferred under the first as opposed to the second contract,

Alexander Hamilton Inst. v. Hart, 192 N.W. 481, 483 (Wis. 1923) (even if a contract contains a clause stating that it is not subject to revocation, such language does not prohibit a mutual cancellation, which may be express or inferred from the acts of the parties).

or even was aware of which inventory was which. Indeed, the evidence was uncontroverted that Sajac did not change its performance after execution of the second contract. *See* Jan. 8, 1997 Tr., at 53 (Fletcher direct) (“We operated the same way with all of our customers the full time I was there.”); Jan. 9, 1997 Tr., at 120 (Lachmann direct); Jan. 9, 1997 Tr., at 133 (Lachmann cross); Jan. 13, 1997 Tr., at 14 (Dolesh direct). This necessarily supports the reality that Sajac did nothing to segregate or differentiate the previously transferred inventory – and thus that it applied the terms of the second contract to *all* inventory, including that transferred prior to execution of the second contract.

The point is proved conclusively by Sajac’s conduct at the time it ended its contractual relationship with Volvo. At that time, Sajac disposed of *all* of its inventory of Volvo parts – including inventory originally transferred under the first contract – by selling it to a third party, Lippert Enterprises. Although the first (but not the second) contract required advance notice to Volvo of Sajac’s intent to dispose of Volvo parts (*see* JA 208, ¶ 4), Sajac provided no notice in advance of this sale. Instead, it informed Volvo of the disposal of the property “approximately a week to a week and a half after the sale was completed.” Jan. 9, 1997 Tr., at 130 (Lachmann direct). *See* Jan. 8, 1997 Tr., at 68 (Fletcher direct); Jan. 9, 1997 Tr., at 154-55 (Cranford cross). Volvo did not protest this action. The most obvious

conclusion to draw from this course of performance is that neither party viewed the terms of the first contract still to govern rights over the inventory.¹⁸

* * * *

In this setting, all of the ordinary tools of contract interpretation point to the conclusion that the terms of the second contract governed the control of inventory that originally was transferred pursuant to the first. The language of the second contract is, at a minimum, susceptible to that construction. *Compare B-S Steel of Kan., Inc. v. Tex. Indus., Inc.*, 229 F. Supp. 2d 1209, 1225-26 (D. Kan. 2002) (second contract does not supersede when it is “expressly limited to *future transactions*”). And the intent of the parties – which, in these circumstances,

¹⁸ Indeed, the evidence on this score is so strong that, had the parties not executed a superseding contract that displaced the first one, the restrictions of the first contract would be deemed rescinded by mutual agreement. It is settled law that an “agreement [to rescind a contract] need not be expressed in words. Other conduct may show an intent by the parties to abandon their contract.” RESTATEMENT (SECOND) OF CONTRACTS, § 238, cmt. a. (1981). “Sometimes mere inaction on both sides, such as failure to take any steps looking toward performance or enforcement, may indicate an intent to abandon the contract.” *Id.* See, e.g., *Parduhn*, 61 P.3d at 985 (“A contract may be rescinded or discharged by acts or conduct of the parties inconsistent with the continued existence of the contract, and mutual assent to abandon or rescind a contract may be inferred from the attendant circumstances and conduct of the parties.”) (emphasis omitted; quoting 17A AM. JUR. 2D CONTRACTS § 558 (1991)); *O’Dell*, 26 N.W.2d at 414 (Iowa 1947) (“Whether or not ... an executory contract has been rescinded by mutual consent is a question of fact which need not be proved by express terms, but may be inferred from the attendant circumstances and the conduct of the parties.”). Here, evidence that Sajac did not provide notice required by the terms of the first contract and that Volvo acquiesced in that failure indicates that the parties had abandoned that contract.

should be decisive – is unambiguous: it was in both parties’ interest to apply the terms of the second contract to previously transferred inventory; the second contract makes sense as a “rational business instrument” only if construed in that way; and the course of performance confirms that the parties treated the restrictive terms of the first contract as superseded once the second contract was executed in 1983.

Viewing this evidence in the light most favorable to Volvo, as this Court must given the jury’s verdict, there can be no doubt that there is a substantial factual basis to support that conclusion that the second contract supersedes the first. The district court therefore was wrong to opine that there is “nothing in the record to show that the terms of the first contract were ever modified to affect Volvo’s control over transferred inventory.” JA 290. And because this Court’s goal must be to “give effect to the intent of the parties” (*State Farm*, 683 N.W.2d at 86), that conclusion is dispositive here. The terms of the second contract controlled inventory transferred to Sajac under the first contract, there accordingly was no impediment to consummation of bona fide sales of that inventory in 1983, the jury was correct in so finding – and the district court’s contrary conclusion should be set aside.

CONCLUSION

The holding of the district court that there was an insufficient legal and factual basis to support the conclusion that the second contract superseded the first should be set aside; the judgment of the district court granting the government's motion for judgment as a matter of law regarding the 1983 taxable year, and the final judgment denying Volvo a refund for the 1983 taxable year, accordingly should be reversed.

STATEMENT CONCERNING ORAL ARGUMENT

Pursuant to Federal Rule of Appellate Procedure 34(a) and this Court's Rule 34(a), Volvo requests oral argument. The record and lengthy course of proceedings in this case is complex, and those complexities have a direct bearing on the legal issues of before the Court. Oral argument will enable the parties to address those issues and may provide material assistance to the Court in the resolution of the case.

Respectfully submitted,

Dated: October 14, 2008

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**UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT**

No. 08-1080 **Caption: Volvo Cars of North America, LLC and Volvo Group North America, Inc. v. United States of America**

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s/Charles A. Rothfeld

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CERTIFICATE OF SERVICE

I hereby certify that, on the 14th day of October, 2008, a true and accurate copy of the foregoing Brief of Appellants was filed with the Clerk of the Court using the CM/ECF System, which will send notice of such filing to all registered CM/ECF users. I further certify that I deposited eight copies of the Brief and six copies of the Joint Appendix with a third-party commercial carrier for overnight delivery to the Clerk of the Court as required by Local Rule 31(d), and I served two copies of the Brief and one copy of the Joint Appendix by electronic mail and by third-party commercial carrier for overnight delivery on Appellee United States at the following address:

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