

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' REPLY BRIEF

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The issue now before this Court is narrow and straightforward. The question on appeal is whether Volvo was entitled to write off, during the 1983 tax year, inventory that initially had been transferred to Sajak prior to April 1983 while the first contract was in effect. The parties agree on the substantive tax-law standard that governs this question, which permits the write-off so long as the taxpayer completed a bona fide sale of the inventory. *See* Volvo Opening Br. 23; Gov't Br. 9. The parties also agree, as Volvo has acknowledged from the outset of this litigation, that a bona fide sale was not effected while the first contract governed the rights over the inventory transferred to Sajak because that contract reserved significant legal control over the property to Volvo. And it is settled that Volvo *may* write off inventory governed by the terms of the second contract because that contract eliminated Volvo's reserved rights over the property. The dispositive question here, then, is whether, at the time that the second contract went into effect, that contract's terms came to control Volvo's and Sajak's rights in all inventory, including inventory transferred prior to consummation of the second contract.

As we explained in our opening brief, the second contract had exactly that effect. Because the second contract concerns the same subject matter as the first – the effectuation of bona fide sales that would allow Volvo to write off surplus inventory for tax purposes – it presumptively superseded the first agreement. And

all of the ordinary tools of contract interpretation (including an examination of the parties' mutual intent, the circumstances surrounding the formation of the second contract, and the course of performance of that contract) confirm the conclusion that the second contract surrendered Volvo's legal control over *all* the inventory held by Sajac, including that transferred while the first contract was in effect. The government's response fails to engage these points: its arguments are premised on a mischaracterization of our position, a misstatement of the controlling law, and a disregard for the record.

A. Ordinary Rules Of Contract Interpretation Apply In This Case

In defending the district court's grant of judgment as a matter of law, the government's principal contention, repeated throughout its brief, is that Volvo wants to have the "taxpayer's 'intent' ... override the terms of its contracts" (Gov't Br. 4) by "seeking to evade the terms of its contracts, and to substitute purported substance." *Id.* at 24. *See id.* at 40 (question here is "whether taxpayer's 'intent' and 'course of performance' can override the terms of a contract"); 41 ("taxpayer argues ... that this Court should reverse because taxpayer 'intended' that result"). This purported effort by Volvo to substitute "substance" for "form" must fail, the government continues, because special rules that govern "federal tax litigation" establish that "taxpayers are liable for the tax consequences of the transactions and contracts that they actually execute, not the ones that they may have,

hypothetically, ‘intended’ to execute.” *Id.* at 24, 25. *See id.* at 42-43 (“federal tax law does not permit taxpayers to alter the consequences of their transactions, including contracts, by presenting evidence as to their ‘real intent’”). But the government’s argument is wrong in both its premise and its conclusion.

First, the government simply misstates our position. Volvo has *never* contended that it should be permitted to evade or somehow recharacterize its contractual obligations. Quite the contrary: Volvo’s position is that its *actual* relationship with Sajac, *as established and defined by the terms of the controlling contracts*, determines the tax consequences of its sale of inventory to Sajac. Our opening brief therefore invokes the circumstances surrounding entry into the second contract and the extrinsic evidence bearing on the parties’ intent regarding that agreement, not to escape from the contract, but to identify the meaning and legal significance *of* the contract. This is a matter of basic contract law. As we explain in our opening brief (at 33-35), in Wisconsin, as in all jurisdictions, “[t]he lodestar of contract interpretation is the intent of the parties.” *Huml v. Vlazny*, 716 N.W.2d 807, 820 (Wis. 2006). *See* Volvo Opening Br. 33-34 (citing cases).¹

¹ The government grossly distorts our position when it says Volvo argues “that the Court should accord it ‘latitude’ in determining the federal tax consequences of its contract.” Gov’t Br. 42. The government presumably is referring to a quotation in our opening brief (at 33-34) from a decision of the Wisconsin Supreme Court, which held that *courts* have “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

Second, to the extent that the government means to contend that ordinary principles of contract law do not apply in this case to determine whether Volvo surrendered legal control over the inventory to Sajac, its position is insupportable. It is fundamental that, “in the application of a federal revenue act, state law controls in determining the nature of the legal interest which the taxpayer had in the property,” a conclusion that “follows from the fact that the federal statute creates no property rights but merely attaches consequences, federally defined, to rights created under state law.” *United States v. Nat’l Bank of Commerce*, 472 U.S. 713, 722 (1985) (internal quotation marks omitted). And it is a commonplace that contracts between private parties may determine the federal tax consequences of a transaction. *See, e.g., United States v. Bergbaeur*, 2008 WL 3906784 (D. Md. Aug. 18, 2008) (contract indicating intent for partners to be taxed immediately upon the sale of their consulting business determined tax consequences of the sale); *Cascade Designs v. Comm’r*, T.C. Memo. 2000-58 (principles of contract law used to determine that taxpayer was entitled to deduct payments as patent amortization expenses); *Estate of Holland v. Comm’r*, T.C. Memo. 1997-302 (applying contract principles to hold that transfer of property did not have the

should govern.” *State Farm Mut. Auto. Ins. Co. v. Langridge*, 683 N.W.2d 75, 87 (Wis. 2004). As made expressly clear in our opening brief, the court’s point was not that taxpayers should be permitted to conjure up a plausible interpretation of their contracts; it was that a reasonable interpretation of a contract is most likely to reflect the actual intent of the parties.

necessary degree of completeness to be recognized for Federal tax purposes). Indeed, the *only* reason offered by the district court for its award of partial judgment to the government in this case was its belief that the first contract preserved Volvo's legal right to control inventory transferred prior to April 1983; the answer to the question in this case therefore necessarily turns on whether the second contract superseded the first – and that inquiry must be resolved by application of the ordinary rules of contract interpretation.

The authority invoked by the government to escape this conclusion is entirely off the point. *See* Gov't Br. 24-25, 42 (citing *Boulware v. United States*, 128 S. Ct. 1168 (2008); *Comm'r v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134 (1974); *BB&T Corp. v. United States*, 523 F.3d 461 (4th Cir. 2008); and *Estate of Leavitt v. Comm'r*, 875 F.2d 420 (4th Cir. 1989)). Those decisions stand for the unexceptional proposition that “taxpayers are liable for the tax consequences of the transaction they actually execute and may not reap the benefit of recasting the transaction into another one substantially different in economic effect that they *might* have made.” *Estate of Leavitt*, 875 F.2d at 423 (emphasis added). Under this doctrine, “while a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, ... and may not enjoy the benefits of some other route he might have chosen to follow but did not.” *Boulware*, 128 S.

Ct. at 1176 n.7 (quoting *Nat'l Alfalfa*, 417 U.S. at 149 (ellipses added by the Court)). See also *BB&T Corp.*, 523 F.3d at 471. Thus, “once taxpayers have by their free negotiations chosen the form of a transaction, ... one of those taxpayers may not then try to alter one side of that bargain for tax purposes”; otherwise, there could be “inconsistent reporting of the same transaction” by the two parties to the contract as taxpayers tried to “‘whipsaw’ the Commissioner.” *Furman v. United States*, 602 F. Supp. 444, 455 (D.S.C. 1984) (citing *Nat'l Alfalfa*, 417 U.S. at 149), *aff'd*, 767 F.2d 911 (4th Cir. 1985).

Volvo, however, is *not* contending that it “might” have entered into a different contract or that “alternative routes may have offered better ... tax consequences.” *Boulware*, 128 S. Ct. at 1176 n.7. Its argument is now, and consistently has been, that the contract “actually execute[d]” surrendered legal control over the subject inventory to Sajac and thus effected a bona fide sale. *Estate of Leavitt*, 875 F.2d at 423. Volvo’s position is thus the opposite of the one attacked by the government: Volvo is seeking to enforce, and not to escape from, its contract with Sajac.

Third, it is not entirely clear what the government actually means to argue regarding the proper approach to contract interpretation in this context. The government maintains at several points in its brief that “one party’s purported ‘intent’ in entering into a contract” cannot “be used to override federal tax

consequences stemming from the express terms of that contract,” and that “federal tax law does not permit taxpayers to alter the tax consequences of their transactions, including contracts, by presenting evidence as to their ‘real intent’ in the transaction.” Gov’t Br. 42-43. But while the government thus declares that the *hidden* intent of *one* party may not dictate a contract’s tax consequences – a position we share completely – it carefully refrains from asserting that the contracting parties’ mutual intent may not be taken into account in determining the proper meaning of contracts that bear on tax liability, that extrinsic evidence may not be considered in construing those contracts, or that courts should not apply the usual rules of contract interpretation in reading those agreements.

There is good reason the government fails to make that argument: no court has adopted such a rule. To the contrary, this Court’s consistent position has been that determining the tax consequences of contracts “involv[es] the ascertainment of the parties’ intentions and motivations” – precisely the approach we advocate here. *Gen. Ins. Agency, Inc. v. Comm’r*, 401 F.2d 324, 329 (4th Cir. 1968).² For that

² See *Bergbauer*, 2008 WL 3906784, at *6 (“the Fourth Circuit, when faced with a tax recharacterization case, applies a two-pronged test that examines the tax consequences contemplated by the parties and the economic substance of the agreement”); *Wrangler Apparel Corp. v. United States*, 931 F. Supp. 420, 424 (M.D.N.C. 1996) (under *General Insurance*, “when addressing the tax consequences of a transaction the Court applies a two-prong test which examines (1) the intent of the parties; and (2) the economic substance of the transaction”); *Furman*, 602 F. Supp. at 456 (*General Insurance* “combined both the ‘economic reality’ and the ‘intent’ tests”).

matter, the Tax Court's decision in *Paccar, Inc. v. Commissioner*, 85 T.C. 754 (1985), *aff'd*, 849 F.2d 393 (9th Cir. 1988), which establishes the substantive rule of tax law that governs in this case, expressly declared that the determination whether a bona fide sale occurred "is essentially one of fact and is ascertained from the intention of the parties as evidenced by the written agreements read in light of the attendant facts and circumstances." 85 T.C. at 777 (citing *Grodt & McKay Realty, Inc. v. Comm'r*, 77 T.C. 1221, 1237 (1981)) (other citations omitted). And the government itself, at trial in this case, acknowledged "that we are looking at the intent of the parties as to whether [] Volvo intended to have control over those parts." Jan. 9, 1997 Tr. 6-7. *See id.* (the question is "whether [] Volvo intended, after transferring those parts out of its warehouse, to still have control over the parts"). The task of this Court accordingly is to determine, by reference to the state law that governs the construction of contracts, "whether what was done" in the second Volvo-Sajac contract surrendered Volvo's control over the previously transferred inventory and therefore effected a bona fide sale of Volvo's inventory within the meaning of federal law. *Boulware*, 128 S. Ct. at 1176 n.7.

B. The Intent Of The Parties That The Second Contract Govern Previously Transferred Inventory Should Be Given Effect

1. Because the government's argument sheds little light on the question whether the ordinary tools of contract interpretation lead to the conclusion that the second contract surrendered Volvo's legal control over *all* the inventory held by

Sajac, we begin with that point. The interpretive rules governing the second contract are settled. As we have noted, the Wisconsin courts, like those of all jurisdictions, apply one overarching principle to guide the inquiry into a contract's meaning: "The 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 also Steinmann v. Steinmann*, 749 N.W.2d 145, 153 (Wis. 2008) ("The primary goal in interpreting a contract is to determine and give effect to the parties' intent.").³

Determining the parties' intent starts with the agreement's text, but that language must be read in context and in light of the circumstances attending formation of the contract. To ascertain the parties' meaning, a contract is "interpreted consistent with what a reasonable person would understand the words to mean under the circumstances" (*Seitzinger*, 676 N.W.2d at 433), and a court accordingly must "give consideration to [the contract's] 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) (internal quotation marks omitted). As the Restatement recognizes, "meaning can almost never be

³ Although the government expresses some hesitancy on the point, it ultimately does not deny that Wisconsin law controls the inquiry here. It also recognizes that the governing principles are universal. *See Gov't Br.* 10 n.8, 31 n.21.

plain except in context”; “[w]ords and other conduct are interpreted in the light of all the circumstances, and if the principal purpose of the parties is ascertainable it is given great weight.” RESTATEMENT (SECOND) OF CONTRACTS § 212 cmt. b, § 202(1) (1981). This requirement that the court take account of the contract’s context makes it “invariably necessary, before a court can give any meaning to the words of a contract and can select a single meaning rather than other possible ones as the basis for the determination of rights and other legal effects, that extrinsic evidence be admitted to make the court aware of the ‘surrounding circumstances.’” 5-24 CORBIN ON CONTRACTS § 24.7 (2008).⁴

By the same token, even when the language of a contract for the sale of goods (such as the Volvo-Sajac contracts) appears unambiguous, the Uniform Commercial Code, as incorporated in Wisconsin law, specifically provides that a court *always* may consider the parties’ course of performance, which is the most

⁴ See 11 WILLISTON ON CONTRACTS § 32:7 (4th ed. 2008) (“the circumstances surrounding the execution of a contract may always be shown and are always relevant to a determination of what the parties intended by the words they chose”); *id.* § 33:4 (“what the parties said and did before and during the time when they were choosing the words they ultimately used in their final written expression – that is, the surrounding circumstances and the context in which those words were chosen – can shed significant light on the meaning of even apparently clear and unambiguous words”). This approach has been embraced by the Wisconsin courts. See, e.g., *First Am. Title Ins. Co. v. Dahlmann*, 715 N.W.2d 609, 613-14 (Wis. 2006) (restrictive definition of “land” in an insurance policy became ambiguous in light of the facts and circumstances surrounding execution of insurance policy); *Hanz Trucking, Inc. v. Harris Bros. Co.*, 138 N.W.2d 238, 241-42 (Wis. 1965); *Georgiades v. Glickman*, 75 N.W.2d 573, 577 (Wis. 1956).

probative form of extrinsic evidence. Wis. Stat. § 402.202(1) & cmts. 1(c), 2 (2003). Thus, with respect to an agreement that involves “repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objecting to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement.” Wis. Stat. § 402.208(1) (2003). In this respect, Wisconsin law broadens more restrictive common law rules governing the admission of extrinsic evidence as an aid to contract interpretation. *See, e.g., Fort Howard Paper Co. v. Standard Havens, Inc.*, 901 F.2d 1373, 1381-82 (7th Cir. 1990); *Pabst Brewing Co. v. G. Heileman Brewing Co., Inc.*, 1988 WL 237452, at *4-*6 (W.D. Wis. Aug. 19, 1988).

The government takes issue with none of this. Although, as we have noted, the government never explains precisely how it would go about interpreting the second contract here, it expressly accepts some of the premises described above. It acknowledges that, “in disputes between parties to a contract, the goal is to implement the parties’ intent, and when that intent is ambiguous, a court may resort to extrinsic evidence.” Gov’t Br. 41-42. And it recognizes that “[c]ourse of conduct may be relevant to determining the rights and obligations of parties to a contract in a dispute between those parties.” *Id.* at 52.

2. Here, all of the relevant indicia point clearly toward the conclusion that the second contract superseded the first and removed Volvo's legal control over the inventory that had been transferred to Sajac while the first contract was in effect. The second contract used bare-bones language, stating only that Sajac "agrees to purchase and [Volvo] agrees to sell, certain of [Volvo's] inventory," adding that "Sajac may purchase from [Volvo] from time to time, mutually agreed upon inventory." JA 210. This language, which does not specifically identify the inventory subject to its terms, is consistent with the notion that all inventory transferred by Volvo would be governed by the same terms on a going-forward basis.

Although the government insists that the second contract "on its face applies to transfers occurring *after* its execution" and "said nothing about the first contract" (Gov't Br. 28-29; *see also id.* at 49-50), the second contract – in notable contrast to other commercial agreements (*see* Volvo Opening Br. 43) – contains no express language making it prospective only; it certainly does not by its plain terms provide that Sajac retains rights in previously transferred inventory. At the worst (from Volvo's perspective), the second contract is silent on the point, and Wisconsin law "definitely rejects ... [a]ny assumption that because a writing has been worked out which is final on some matters, it is to be taken as including all the matters agreed upon." Wis. Stat. § 402.202, cmt. 1 (2003). *See also Harrison*

W. Corp. v. United States, 792 F.2d 1391, 1393 (9th Cir. 1986) (party that “want[s] to reserve its rights under the first contract ... should ... do[] so explicitly in the second”); *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).⁵

Any doubt on this score that is left by the second contract’s plain language is resolved when that contract is viewed in context as an attempt to effectuate bona fide sales that would allow Volvo to write off its inventory for tax purposes – sales that the parties recognized had not been consummated under the first contract. As we show in our opening brief (at 36-40), the principal purpose of the arrangement between Sajac and Volvo was to achieve such bona fide sales; it is undisputed that the parties abandoned the first contract and entered into the second for the sole and express purpose of eliminating those elements of Volvo’s control over the inventory that had precluded a tax write-off. Given that purpose, it would have been wholly irrational, and would have made no business sense at all for either Volvo or Sajac, not to have fixed the defect in the first contract so as to permit the

⁵ The government is incorrect in contending (at Gov’t Br. 27) that the first contract remained in effect because it was not canceled in accordance with its cancellation provision, which provided that it could be canceled by either party upon 60 days written notice. JA 209. As we showed in our opening brief (at 40 n.17), “case law clearly shows that a contract can be terminated in a manner other than that specifically set forth in the contract itself.” *Charles Slater Architects, Inc. v. Delp*, 361 N.W.2d 310 (1984) (table), 1984 WL 180027, at *2 (Wis. Ct. App. 1984) (per curiam). The government makes no response to this point.

write-off of previously transferred inventory. Unsurprisingly, there was direct testimony from Sajac's president (who signed the second contract on Sajac's behalf) that the parties had just that intent, adopting the second contract "to supersede this agreement [*i.e.*, the first contract]" so as to address "tax concerns." JA 182, 183.⁶

In arguing to the contrary, the government contends that the continued control over the inventory that the first contract guaranteed to Volvo "conferred valuable rights" and that "allowing a contract that provided a party with valuable rights ... to be superseded, without any compensation, makes no business sense." Gov't Br. 47-48, 50. But we know for a fact that this submission by the government is wrong. The point is proved conclusively by the second contract itself, in which Volvo, without additional direct compensation, expressly *did* surrender its control over inventory transferred to Sajac so as to qualify for a tax write-off – the very step that the government says no business would take. The government was more candid on this issue before the district court, where it recognized that the tax write-off was *more* valuable to customers than Sajac's inventory management role: customers "would not transfer inventory to Sajac

⁶ This testimony was offered at deposition, but the government evidently regards deposition evidence as relevant because it cites deposition testimony at several points in its brief. *See* Gov't Br. 10, 37 n.23. The testimony of Sajac's president on this point is especially credible because it was not self-interested; the case was tried after Sajac ceased operations.

unless they could write it off for tax purposes.” JA 6 (Dkt. No. 26, pp. 28-29). And the jury’s verdict (which in this respect was not disturbed by the district court) confirms that the theoretical right to control the inventory transferred to Sajac under the first contract was of *no* value to Volvo because it never exercised that control in practice. *See* Volvo Opening Br. 39-40. In these circumstances, it would indeed have been “cockeyed” for Volvo and Sajac not to have extended the second contract’s terms to previously transferred inventory. *Dispatch Automation, Inc. v. Richards*, 280 F.3d 1116, 1118 (7th Cir. 2002).⁷

Moreover, the parties’ course of performance – the most powerful evidence of a contract’s meaning – shows conclusively that Volvo and Sajac intended the terms of the second contract to govern inventory transferred prior to execution of that contract. As we showed in our opening brief (at 41-43), the evidence at trial established that Volvo exercised no control over *any* inventory after execution of the second contract, that Sajac did nothing to segregate or differentiate the

⁷ The government’s contention that it would not have made sense for Volvo to “abandon control over inventory worth, at a minimum[,] over \$6 million” – the purported valuation of the inventory transferred to Sajac under the first contract – and “to count on the open market for replacement” of the inventory (Gov’t Br. 48), cannot be squared with the record. As noted in text, Volvo in fact never exercised that control, which is hardly surprising because the record shows that Volvo regarded the inventory as virtually worthless. *See* Volvo Opening Br. 7. Moreover, even had the property retained value, canceling the buy-back provisions of the first contract would not have cost Volvo \$6 million, as the government implies (*see* Gov’t Br. 48, 49 n.25); whether or not the first contract remained in effect, Volvo would have had to buy back its inventory from Sajac (at the same price under the first and second contracts) if it wanted to reclaim the property.

previously from the newly transferred property after entry into that contract, and that Sajac did not provide the notice required by the first contract when it sold *all* of its Volvo inventory to Lippert Enterprises in 1991. This evidence is not offered to suggest that “‘substance’ should trump the terms of [the] first contract,” as the government again characterizes our argument (Gov’t Br. 51); our point, instead, is that the course of performance shows clearly that the contracting parties intended to abandon the terms of the first contract.

The government also is wrong in contending that “the evidence going to course of conduct was ambiguous” and that “there was evidence that Sajac did notify taxpayer about the impending sale” of all Volvo inventory to Lippert. Gov’t Br. 52 & n.26; *see id.* at 10, 37 n.23. The jury found for Volvo on the question whether Sajac *in fact* exercised control over all inventory after execution of the second contract, and on this the jury’s verdict is dispositive; that aspect of the verdict was upheld by the district court and was not challenged by the government on appeal. As for the sale to Lippert in particular, the government relies for its assertion of ambiguity in the record on deposition testimony from a witness who was not involved in preparation of the supposed notice to Volvo, and who suggested vaguely that notice “should have” been provided. JA 6 (Dkt. No. 22) (Armbruster Dep. 28-29, 44). But as we showed in our opening brief (at 42), the uniform and voluminous testimony *at trial*, from all of those actually involved in

the process, was that Sajac provided no advance notice of the sale. The conclusion is unavoidable: neither party thought the terms of the first contract still to govern rights over the inventory.

C. The Second Contract Supersedes The First Because The Two Agreements Address The Same Subject Matter And Contain Inconsistent Provisions

In addition, as we also argued in our opening brief (at 26-32), the second contract presumptively superseded the first as a matter of law because the two contracts addressed the same subject matter and contained inconsistent provisions. The government acknowledges that “substitution of one contract for another ... occurs when the second contract abrogates, or steps into the place of, the initial contract.” Gov’t Br. 32. But it insists that this principle does not apply here because “there is no unique or identical item that is the subject of both contracts” (*id.* at 34) and “the terms of the contracts here, although different, were hardly irreconcilable.” *Id.* at 36. The government therefore maintains that we have not shown how the situation here differs from the ““ordinary case”” in which transactions involving different sets of goods are treated as addressing different subject matter. It offers the analogy of an employer and employee who “execute an employment contract in the employee’s second year of employment that contains different terms [from those applying in the first year], like a higher salary or different duties”; in such circumstances, the government concludes, entry into

the new contract “does not mean that the higher salary is ‘substituted’ for the first year’s salary.” *Id.* at 35, 39.

The government’s own example, however, illustrates the flaw in its argument. In the government’s employment case, the transactions addressed in the first contract are closed and have no continuing consequences when the second contract is executed; the employee’s first year of work has been completed and the corresponding salary paid. Here, in contrast, the consequences of transactions initiated under the first contract are said by the government to continue long *after* execution of the second contract and, indeed, for the life of the Volvo-Sajac relationship (that is, Volvo is said to retain control over previously transferred inventory so long as the property remains in Sajac’s possession). That difference poses the obvious question – not presented in the government’s example – whether the change in the Volvo-Sajac relationship effectuated by the second contract governed Volvo’s *continuing* rights in previously transferred inventory. It is natural to assume that it did. Indeed, in circumstances much more closely analogous to those here than the government’s example, courts have held employment contracts superseded by subsequent agreements between the parties when the initial contracts had terms that extended beyond the date of entry into the second contract. *See, e.g., Stoncor Group, Inc. v. Campton*, 2005 WL 2030832 (W.D. Wash. Aug. 22, 2005) (contract containing covenant not to compete

superseded by subsequent contract omitting provision); *Caro, Inc. v. Roby*, 342 N.W.2d 182 (Neb. 1983) (same).

For reasons already discussed, the presumption that the second contract superseded the first is especially powerful in the context of this case. As we have explained, the point of the second contract was to make it possible for Volvo to effectuate bona fide sales; the contract modified the Volvo-Sajac relationship to accomplish that purpose. In the sense most important to the parties, the first and second contracts therefore concerned the same subject matter: the structuring of inventory sales in a manner that would, going forward, satisfy IRS standards regarding transfer of the benefits and burdens of ownership. And the terms of the contracts addressing this subject were manifestly inconsistent with one another, with the first reserving substantial rights in the inventory to Volvo and the second eliminating those reserved rights. The government cites no authority supporting its assertion that, in such circumstances, the first contract survives execution of the second.⁸

⁸ The three decisions the government offers in support of the proposition that “a new contract that involved different property” does “not substitute for, or supersede, the first” (Gov’t Br. 38) – all of which are more than 50 years old – are entirely off the point. None actually involved successive sales of different property. As for their analysis, two of these decisions expressly premised their holding that a subsequent contract did not displace the former on the “intention of the parties” (*Turner v. Turner*, 89 S.E.2d 245, 250 (N.C. 1955)), an inquiry that took account of “the circumstances surrounding [the contracts’] execution, the relation of the parties and the object to be accomplished, [which] are all to be

Instead, the government complains that ascertaining whether a later contract supersedes an earlier one as a matter of law should not turn on an inquiry into the parties' "intent." Gov't Br. 35. But as we have explained, it is almost always the case that courts must consider the context and the purpose of the agreement to make sense of a contract. Courts therefore routinely inquire into the parties' intent when determining whether a new contract superseded an earlier one. *See, e.g., Fanucchi & Limi Farms v. United Agri Prods.*, 414 F.3d 1075, 1082 (9th Cir. 2005) ("In deciding whether an agreement was meant to extinguish the old obligation and to substitute a new one, California courts seek to determine the parties' intent."); *Bradshaw v. Burningham*, 671 P.2d 196, 198 (Utah 1983) ("Authorities unanimously agree that the question of whether a new agreement is a substitute contract . . . depends upon the intention of the parties."); *Zinn v. Walker*, 361 S.E.2d 314, 320 (N.C. Ct. App. 1987) ("Whether a new contract between the same parties discharges or supersedes a prior agreement depends upon their intention as ascertained from the instrument, the relation of the parties and the surrounding circumstances."). Indeed, as we have just noted (at note 8, *supra*), that is exactly what the courts did in the decisions relied upon by the government.

consulted in arriving at the intent." *Commercial Nat'l Bank v. Charlotte Supply Co.*, 38 S.E.2d 503, 510 (N.C. 1946). That is the approach we advocate. In the third decision cited by the government, the later contract expressly provided "that on its breach judgment may be entered in a pending suit based on the original contract." *Wenzel v. Conrad Schmitt Studios*, 11 N.W.2d 503, 505 (Wis. 1943). Needless to say, that holding offers no support to the government here.

Here, every consideration that bears on contract construction confirms the presumption that the second contract superseded the first. And that legal presumption strongly supports the record evidence establishing that the parties intended the terms of the second contract to govern inventory transferred under the first.

D. Volvo Advanced Its Arguments In The District Court

Finally, we address a procedural issue raised by the government. It asserts that “[t]he question whether taxpayer’s ‘intent’ and ‘course of performance’ can override the terms of contracts is a new argument that does not appear to have been presented either to the jury or to the District Court.” Gov’t Br. 40; *see id.* at 16 n.14, 43-44. Of course, the proposition that one party’s *unilateral* intent may *override* contractual terms when calculating tax liability has *never* been our argument; our contention is that the parties’ mutual intent and course of performance bear on the meaning and legal significance of the second contract. But the government is wrong if it means to contend that Volvo is advancing new arguments on appeal or that the issues it is addressing now were not considered and decided below.

To begin with, the government simply has no basis for its statement that “[t]he jury was not asked to consider ... the question of taxpayer’s ‘intent’ in entering into the second contract, its ‘course of conduct,’ or the ramifications of

either as far as the first contract was concerned.” Gov’t Br. 44. The district court was unable to provide a record of either party’s opening or closing argument to the jury – presumably because that record was lost during the lengthy delay between the trial and entry of final judgment – and the parties agreed that they would be unable to reconstruct those arguments. See Letter regarding unavailable transcripts, Dkt. No. 30, Sept. 3, 2008.⁹ We therefore cannot know what the jury was “asked to consider.” But we do know that Volvo’s theory *necessarily* was that the second contract superseded the first: the 1981 and 1982 tax years had been closed, Volvo’s complaint sought a write-off in 1983 for inventory transferred in prior years, and Volvo consistently took the position below that entry into the second contract effectuated bona fide sales of inventory transferred prior to that date. See Volvo Opening Br. 11-13; JA 257-258; JA 17 ¶ 9; JA 9 (Dkt. No. 55, pp. 4, 16-17, 22); JA 10 (Dkt. No. 68, ¶ 3); JA 10 (Dkt. No. 76, pp. 5-6, 18); JA 271-73, ¶¶ 3, 9, 10, 11). Prior to trial, the government itself acknowledged that this was Volvo’s position. See JA 10 (Dkt. No. 26 pp. 34-35) (“[Volvo] [] contends that it

⁹ The government, of course, is not responsible for loss of the district court record. But it does bear some responsibility for the excessive delay preceding entry of final judgment. Although Volvo diligently pursued a settlement during this period, the government on one occasion waited for almost two years before rejecting Volvo’s settlement offer; on another, it waited almost 18 months. Volvo promptly sought a status conference to request entry of final judgment after the government’s rejection of Volvo’s third settlement offer. See JA 270-78.

lost control of the inventory transferred under the first contract once the parties agreed to the second contract.”).¹⁰

The government also argues that the question of the parties’ intent was not presented to the jury and that the verdict accordingly is not entitled to special deference. Gov’t Br. 40 n.24, 44. It is true that the district court did not expressly instruct the jury on the law governing contract interpretation. But the court did charge the jury that it had to decide “where the control of th[e] inventory” lay, setting out among the relevant factors for the jury to consider “whether the seller of

¹⁰ The government makes much of the district court’s decision to ask the jury to determine separately whether bona fide sales occurred between September 1, 1981, and April 6, 1983 (the period of the first contract), and between April 6, 1983, and December 1990 (the period of the second). The government contends that, “[b]y submitting the inventory transfers to the jury in that manner, taxpayer, in essence, conceded that each contract had an independent effect.” Gov’t Br. 44. But this argument is quite misleading. Volvo’s proposed instruction did *not* ask the jury to make separate findings as to the first and second contracts, instead posing the single question: “Did Volvo make bona fide sales of inventory to Sajac Company, Inc. (‘Sajac’) as alleged in the complaint?” JA 7 (Dkt No. 37, p. 1.) And the complaint, of course, alleged that, so far as transfers of inventory prior to execution of the second contract were concerned, the bona fide sales for tax purposes occurred in 1983, with the execution of the second contract. It was the district judge who sua sponte proposed the charge that differentiated between the first and second contracts, to which both parties acquiesced. *See* Jan. 13, 1997 Tr. 39-40. His charge asked the jury: “Did Volvo make bona fide sales of inventory to Sajac between September the 1st, 1981, and April the 6th, 1983, *as alleged in the complaint.*” JA 250 (emphasis added); *see id.* (same as to period between “April the 6th, 1983, and December 1990”). The charge’s reference to the allegations of the complaint could have led the parties to believe that the jury was being asked to determine whether inventory transfers prior to 1983 became bona fide sales with execution of the second contract; the complaint did not allege that bona fide sales occurred prior to April 6, 1983.

the inventory had the right, the contractual right to repurchase that which it had sold”; “which party controlled the retention or removal of the inventory”; and “which party [] had unrestricted rights of access to the inventory.” JA 245-46. And although the loss of portions of the record means that we cannot know what counsel argued to the jury, the terms of the first and second contracts were placed into evidence. JA 207-10. In these circumstances, it is fair to presume that the jury’s verdict reflects a finding that the parties regarded the terms of the second contract to be controlling, a conclusion to which this Court should defer. *Cf. TI Group Automotive Systems (North America), Inc. v. VDO North America, L.L.C.*, 375 F.3d 1126, 1133 (Fed. Cir. 2004) (“[t]his court reviews a jury’s conclusions on . . . the underlying findings of fact, whether explicit or implicit within the verdict, for substantial evidence.”); *Control Components, Inc. v. Valtek, Inc.*, 609 F.2d 763, 767 (5th Cir. 1980) (“[J]ury findings on the factual underpinnings were implicit in the general verdict.... [J]ury findings on disputed matters of fact will be upheld by the reviewing court if substantial evidence exists to support them.”); *Regents of University of Colorado v. K.D.I. Precision Products, Inc.*, 488 F.2d 261 (10th Cir. 1973) (“Implicit in the jury’s verdict is a finding of substantial performance of the contract. That finding is supported by competent evidence and it has binding effect here.”).

In any event, the government plainly is incorrect in contending that questions concerning the contracting parties' intent and their course of performance were not presented to the district court and therefore are "raised for the first time on appeal." Gov't Br. 40. In fact, the district court expressly referred to and addressed Volvo's arguments on these points. The court noted Volvo'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. And it expressly rejected both the factual and the legal prongs of this argument, declaring that "[t]here is nothing in the record" to show that the first contract's restrictions were superseded by the second contract and that the existence of the second contract "in no way affects the terms of the prior contract." *Id.* at 289; *see id.* at 290. There can be no doubt that Volvo may raise on appeal any issue that was actually considered and decided by the district court. *See, e.g., United States v. Stewart*, 256 F.3d 231, 239 (4th Cir. 2001). Even disregarding the jury's verdict, the district court's ruling on these points – which was manifestly wrong in finding "nothing in the record" to show that the parties modified the terms of the first contract, and which wholly disregarded the law governing superseding contracts – is clearly erroneous and should be set aside.¹¹

¹¹ This would have been so even had Volvo not clearly argued the controlling points to the district court. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 99 (1991) ("When an issue or claim is properly before the court, the court is not

CONCLUSION

For the foregoing reasons and those stated in the opening brief, 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.

Respectfully submitted,

Dated: December 22, 2008

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limited to the particular legal theories advanced by the parties, but rather retains the independent power to identify and apply the proper construction of governing law.”) (citing *Arcadia v. Ohio Power Co.*, 498 U.S. 73, 77 (1990)).

**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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I hereby certify that, on the 22nd day of December, 2008, a true and accurate copy of the foregoing Reply 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 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 Reply Brief by electronic mail and by third-party commercial carrier for overnight delivery on Appellee United States at the following address:

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