No. 12-374

IN THE
Supreme Court of the United States

SCHOLASTIC BOOK CLUBS, INC.,
Petitioner,

v.

RICHARD H. ROBERTS,
COMMISSIONER OF REVENUE SERVICES,
Respondent.

On Petition for a Writ of Certiorari
to the Tennessee Court of Appeals

REPLY BRIEF IN SUPPORT OF PETITION FOR A WRIT OF CERTIORARI

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Petitioner Scholastic Books Clubs, Inc. ("Scholastic") respectfully submits this reply brief in support of its Petition for Certiorari (the "Petition"). For reasons set forth below and in its Petition, Scholastic asks the Court to grant *certiorari* in a Commerce Clause case where, as the lower court observed, "[t]he parties acknowledge that our sister jurisdictions … are split on this matter." *Scholastic Book Clubs, Inc. v. Farr*, 2012 WL 259979 (2012); App. at b12 (footnote omitted).

I. WHILE CHILDREN CANNOT ORDER BOOKS FROM SCHOLASTIC WITHOUT ADULT HELP, SUCH ASSISTANCE DOES NOT CREATE A "SUBSTANTIAL NEXUS" BECAUSE IT IS NOT UNDERTAKEN ON BEHALF OF SCHOLASTIC.

There is no dispute that schoolteachers (and parents in home schools) help schoolchildren in placing orders with Scholastic. Scholastic acknowledges that teachers and parents are important intermediaries for the basic reason that nursery and grade school students require the assistance of adults to select books, handle money, and place orders. Whether the assistance provided by teachers is in the form of selecting age appropriate books, adding those selections to a classroom order, or mailing a classroom order to Missouri, the teacher performs a function that students, because of their youth, cannot perform themselves. Nor is there any dispute that the loyalty and responsibility of teachers and parents run to students, not Scholastic. *See Vernonia School Dist.*

47J v. Acton, 515 U.S. 646, 654 – 55 (1995)(teachers stand *in loco parentis* and "the nature of their power is custodial and tutelary").

The legal dispute in this case, instead, goes to the question of whether the adults involved here—both teachers and parents—act on behalf of their students or on behalf of Scholastic when they help students select and purchase books. As Respondent repeatedly acknowledges in his Brief In Opposition ("Opp."), Scholastic only has a physical presence in Tennessee, and thereby the requisite "substantial nexus" required by the Commerce Clause, if teachers and parents act on Scholastic's behalf. *See, e.g.,* Opp. at 8, 9, 12, 16 (the touchstone is whether activities performed in-state are undertaken on behalf of the taxpayer). In other words, it is not enough that adults play a role, it must be shown that they do so on behalf of the retail seller, Scholastic.

Yet, in his brief, Respondent—just like the lower court—declines entirely to address the issue of whether teachers and parents act on behalf of Scholastic. He certainly presents no indicia of direction or control that would ordinarily be associated with a representative relationship. Indeed, he would have the Court simply deem the actions of schoolteachers and parents to be "those of the taxpayer" for purposes of its Commerce Clause analysis because of the active involvement of these adults in enabling children to place and receive orders. *See, e.g.,* Opp. at 1, 2, 4, 5, 7 (repeating the observation that children cannot order books without the assistance of teachers).

However, every "substantial nexus" case decided by this Court that involved third parties as the nexus-creating entity presents factual circumstances where the third party acted under a grant of legal authority from the seller, either as an employee, agent, or independent contractor.[1] In all of these cases, there was no question that the third party was

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[1]*See, e.g., Scripto, Inc. v. Carson*, 362 U.S. 207, 209 (1960)(finding that the instate activities of its commissioned independent contractors were "activities of the appellant" on whose behalf they solicited sales); *accord Tyler Pipe Indus., Inc. v. Washington State Dept. of Revenue,* 483 U.S. 232, 250 (1987)(instate activities must be performed "on behalf of the taxpayer," whether through agents, independent contractors, or employees). *See also Standard Pressed Steel Co. v. Washington Dept. of Revenue*, 419 U.S. 560, 562, 95 S. Ct. 706, 708 (1975)(nexus established by instate employee acting on behalf of the taxpayer). While the Court has made clear that the nomenclature used to describe the relationship had no constitutional significance, it is essential that such a relationship exist. *See, e.g., Tyler Pipe,* 483 U.S. at 250 (a finding of substantial nexus does not turn on terminology such as "agent" or "independent" contractor). *See also St. Tammany Parish Tax Collector v. Barnesandnoble.com*, 481 F. Supp. 2d 575, 581 (E.D. La. 2007)("In *Tyler Pipe* and *Scripto*, the Supreme Court was concerned that companies could avoid tax obligations merely by reclassifying employees, such as salespeople, as independent contractors.").

acting on behalf of the seller (usually in a solicitation or customer service capacity) and not acting at the direction or on behalf of the customers. For this Court, the "formalistic" label used to describe the person's specific legal role did not matter; however, what did matter, was the substance, *i.e.*, whether these individuals were legally authorized to act on the taxpayer's behalf. Respondent asks the Court to ignore this critical element. Opp. at 7 (urging the Court not to "dwell on the formalities of what legal relationship may exist between them").

Scholastic respectfully submits that it is the "on behalf of" requirement that illuminates *Quill*'s "bright line rule." *Quill Corp. v. North Dakota*, 504 U.S. at 315 (requiring at least the equivalent of "a small sales force, plant, or office" in the taxing state). Absent adherence to such a requirement, third parties like teachers (or even parents)—whose loyalties and obligations run only to their young students, not to Scholastic—could be deemed to constitute a physical presence on the part of an out-of-state seller. Respondent's approach could reach corporate purchasing agents, community group leaders who place collective orders on behalf of their members, and even mail clerks who collect orders from fellow employees for the purchase of office supplies. Like schoolteachers and parents, they stand as intermediaries between direct marketers and their ultimate customers. This expansion of the physical presence rule would apply even where, as here, the direct marketer neither controls nor compensates those individuals, and where it has no relationship with them beyond their status as

customers or persons acting on behalf of those customers.

The error of Respondent's position is manifest from its application to this case. Schoolteachers—who freely choose to help children order books—are transmuted, without any articulable legal principle or relationship, into an in-state physical presence of the retailer from which they and their students purchase goods. Since parents also help their children place orders with Scholastic in exactly the same way, they, too, would satisfy Respondent's new nexus standard. *See, e.g.,* App. at b10 ("[s]tudents give their book orders to their teachers and parents, together with payment for the books [and] … [t]he teachers and parents, in turn, entered their orders and those of their students on a master order form").

Unable to establish that teachers (and parents in home schools) act on behalf of Scholastic, Respondent turns to casting aspersions on Scholastic, contending—without record support—that the company "uses" teachers by "taking advantage" of them, "piggybacking on the teachers' unusual credibility with their students and the students' desire to please them …." Opp. at 4, 10, 15 – 16. In reality, however, teachers, parents, and students are all valued and respected customers of Scholastic, and the company has spent over sixty years establishing a reputation as a trusted source of reading materials for classroom and home use. Scholastic has succeeded not by "using" its customers, but by offering educationally appropriate, discount-priced books that appeal to parents, teachers, and children

alike, and which advance the pedagogical objectives of the classroom and promote literacy.[2]

II. THE LOWER COURT'S BLURRING OF THE COMMERCE CLAUSE'S PHYSICAL PRESENCE REQUIREMENT IS A REAL ISSUE OF NATIONAL SIGNIFICANCE.

In its factual findings, the lower court found that Scholastic had no property or offices in Tennessee, no "employees, agents, salesmen, independent contractors or representatives" in the state, and "no bank accounts, data, telephone listing, web address, or mailing address in Tennessee." App. at b9. Pet. at 6 – 7. In other words, Scholastic lacked each of the indicia of a physical presence that had been identified by this Court as relevant in its prior decisions. *See, e.g., Quill Corp., supra,* 504 U.S. at 315.

Thus, the decision below represents an expansion of state taxing power beyond where this Court has previously ventured. As importantly, it expands the concept of "substantial nexus" in ways that make it difficult for direct marketers like Scholastic to predict whether the activities of third parties, who they neither control nor compensate, might give rise to grave tax consequences, as here, including

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[2]Scholastic also awards bonus points tied to the size of classroom orders that can be redeemed for books, computers, and other educational items "for the students' use" in the classroom, a program that has no doubt increased Scholastic's popularity over the years. Opp. at 2, 15.

millions of dollars of unexpected use tax liability imposed retroactively. It becomes much more difficult, perhaps impossible, for them to determine when and under what circumstances the activities of third parties can legally be deemed to be *their activities* for Commerce Clause purposes. Opp. at 8 (the focus in determining whether sufficient nexus exists is "the nature and extent of the [taxpayer's] activities" in the taxing state)(quoting *Scripto, Inc. v. Carson, supra*)(bracketing in original).

As the lower court itself recognized, this lack of clarity and predictability is manifest in a confusing split of authority in the lower courts. *Scholastic Book Clubs, Inc. v. Farr*, 2012 WL 259979 (2012); App. at b12 ("our sister jurisdictions … are split on this matter"). Absent this Court stepping in to reconcile these decisions and provide additional clarity in its Commerce Clause jurisprudence, direct marketers will be left to guess at their potential tax liability even if they have scrupulously avoided retaining any personnel to act on their behalf. In taking *certiorari* here, the Court could reaffirm the sharpness of its bright-line test. As the Court recognized in *Quill* :

> a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter century is due in part to the bright-line exemption

> from state taxation created in *Bellas Hess*.

Id. at 316 (footnote omitted).

CONCLUSION

For all the reasons stated herein and in its Petition, Scholastic respectfully asks the Court to grant *certiorari* in this case to review the decision of the Tennessee Court of Appeals.

Respectfully submitted,

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