Nos. 13-252 and 13-259

IN THE

Supreme Court of the United States

OVERSTOCK.COM, INC.,
Petitioner,

AND

AMAZON.COM LLC AND AMAZON SERVICES LLC,
Petitioners,

v.

NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE ET AL.,
Respondents.

On Petitions for a Writ of Certiorari to the New York Court of Appeals

BRIEF OF THE PERFORMANCE MARKETING ASSOCIATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE*

The Performance Marketing Association ("the PMA") is a non-profit trade association that represents the interests of the performance marketing industry.[1]

[1] Counsel for *amicus* represent that they authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *amicus*, its members or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Counsel for *amicus*

Thousands of small businesses within the performance marketing industry have had their incomes devastated as the result of the passage of the New York law at issue in these cases.

"Performance marketing" is a comprehensive term that refers to online advertising programs in which the retailer's advertising partners, also known as "affiliates," "associates," or "publishers," are paid to run advertisements when a specific action is completed, such as a sale. Performance marketing is similar to traditional display advertising in print publications or broadcast media with one key difference: how payments for advertisements are determined. With traditional display advertising, advertising fees typically are paid up front and do not depend upon an advertisement's success rate. In performance advertising, the retailer pays the publisher for displaying its advertisement after-the-fact and only if a potential customer takes a defined action, such as making a purchase from it.

Since its creation, the PMA has participated in efforts to persuade state legislatures not to adopt statutes like the New York law at issue here, which imposes sales and use tax collection responsibilities on non-resident retailers that utilize the performance marketing approach, in which publishers display passive advertisements for retailers on their websites and are paid when a consumer viewing that advertisement takes a specific action – such as purchasing one

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represent that all parties were provided notice of *amicus'* intention to file this brief at least 10 days before its due date and that all parties have consented to the filing of this brief. Overstock and Amazon have given general consent for *amici curiae* to submit a brief, and the PMA is submitting with the brief Respondents' consent to its participation in this proceeding.

of the retailer's products. The PMA also has obtained a lower court judgment against an Illinois law, modeled on the New York statute, which imposed tax collection obligations on out-of-state retailers that utilize the performance marketing approach. *Performance Marketing Ass'n v. Hamer*, No. 2011 CH 26333, Circuit Court of Cook County, *appeal pending*, S. Ct. Ill., No. 114496.

The PMA submits this Brief *Amicus Curiae* in support of the position of Petitioners Overstock.com ("Overstock") and Amazon.com ("Amazon") that the law requiring them to collect sales and use taxes on sales to New York residents (N.Y. Tax Law § 1101) is unconstitutional under the Dormant Commerce Clause of the Constitution (U.S. Const., Art. I, § 8). This statute improperly singles out and discriminates against out-of-state retailers that use the performance marketing channel, as opposed to other, more traditional forms of advertising. It also harms the public interest by punishing this highly efficient approach to advertising in e-commerce, which has allowed hundreds of thousands of entrepreneurs to become publishers of passive, electronic advertisements on the Internet.

Revenue streams generated under the performance marketing approach have allowed many small businesses to finance the availability of free content on their websites. It has thereby enhanced the diffusion of free information to the public that is the hallmark of the Internet.

The New York statute also has decimated the income of an estimated 15,000 publishers of passive Internet advertisements based in that state because many out-of-state retailers such as Overstock have terminated their performance marketing agreements with in-state websites to avoid imposition of tax collection responsibilities. Passage of the New York law had a domino effect. Twelve other states have followed its lead and have adopted a variety of statues, with inconsistent terms, which impose tax-collection responsibilities on out-of-state retailers that enter into performance marketing agreements with in-state website owners. The adverse effects of these laws on interstate commerce generally, and this fast growing sector of the advertising industry in particular, have been significant.

INTRODUCTION

The decision of the New York Court of Appeals conflicts with prior precedents of this Court and misapplies, to Internet-based advertising technologies, settled law governing the requirement of a substantial nexus before a state constitutionally may impose tax collection obligations upon out-of-state retailers that advertise in that jurisdiction. The decision below goes far beyond any prior decision of this Court in permitting states to impose tax collection obligations on out-of-state entities that have no physical presence in the taxing state.

The decision raises questions of vital importance to the free flow of interstate commerce and to the development of Internet-based business models in e-commerce that warrant review by this Court. First, New York has the third largest economy among the 50 states, and the challenged statute itself adversely affects a substantial volume of interstate commerce. Second, 12 other states have since followed New York's lead and imposed tax collection obligations on out-of-state retailers who have agreements with in-state website owners to display advertisements on their sites. The collective volume of commerce in the 13 affected states is quite substantial and further warrants review. Out-of-state retailers already have terminated relationships with an estimated 90,000 websites located in states that have passed statutes imposing tax collection obligations on foreign e-commerce retailers that follow the performance marketing approach.

The Court should grant review to consider the appropriate constitutional principles for determining whether a sufficient "physical presence" exists under the performance marketing approach to e-commerce to justify imposition of sales or use tax collection obligations. The Court previously has granted review in similar circumstances, in *National Bellas Hess, Inc. v. Department of Rev.*, 386 U.S. 753 (1967), and *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298 (1992), to determine whether tax collection obligations could be imposed based on hard copy advertising by out-of-state mail order and catalog retailers to in-state consumers. Catalogs typically are published directly by the retailer and sent to a specific list of recipients identified by geography. Internet performance marketing, however, utilizes new technologies in which advertisements are published by third-parties on their own sites and made available to the entire Internet – that is, to the world. These online advertisements do not target New York residents. It is a statistically random phenomenon whether New York residents ever see or click on these ads.

These cases – involving threshold challenges to the pioneer New York statute – afford the Court an ideal opportunity to determine the proper application of the "physical presence" test to the Internet-based performance marketing approach to advertising. The significance of this issue has been growing each year with the proliferation of mobile forms of telecommunications and advertising. For example, from 2011 to 2012, mobile advertising increased 111% from $1.6 billion to $3.4 billion.[2]

ARGUMENT

I. REVIEW IS WARRANTED BECAUSE THE NEW YORK STATUTE EFFECTIVELY PRECLUDES PERFORMANCE MARKETING ARRANGEMENTS, WHICH ARE A CRITICAL FORM OF ADVERTISING IN THE MODERN INTERNET ECONOMY

More than a century ago, John Wanamaker, a leading merchant of his time and the father of modern advertising, observed that "Half the money I spend on advertising is wasted; the trouble is I don't know which half."[3] The development of performance-based marketing has solved Wanamaker's dilemma in the rapidly growing field of e-commerce.

Under the performance marketing approach, an entity that publishes an on-line advertisement for a retailer on its own website is paid for its effort only after-the-fact, and only if a visitor to the site who views the advertisement clicks through to the retailer's website and takes a defined action, such as purchasing a product from the retailer. Thanks to the Internet and advances in software, it is now possible for on-line advertisers to determine, amongst thousands or

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[2] IAB Internet Advertising Revenue Report (April 2013) 4, available at http://www.iab.net/media/file/IABInternetAdvertisingRevenueReportFY2012POSTED.pdf (last visited Sept. 16, 2013).

[3] "John Wanamaker," Wikipedia.org, (last visited on September 11, 2013).

millions of viewers of their ads, precisely which advertisements generated which sales and to compensate the publisher only for those advertisements that led directly to sales.

These cases present a question that is of critical importance to online retailers and Internet advertisement publishers alike: whether a state may impose tax collection obligations on an out-of-state retailer based solely on a performance marketing agreement with an independent in-state operator that is not under the control of or an agent of the retailer.

A. Performance Marketing Arrangements Are an Important Form of Advertising in E-Commerce

The performance marketing approach to e-commerce utilized by Overstock, Amazon, and thousands of other Internet-based retailers builds upon the business model first developed by catalog retailers who communicate with potential customers through print advertising and take orders and fulfill sales from centralized locations.

The Internet-based performance marketing approach involves two steps. In the first step, the retailer signs a standardized agreement with multiple entities that run websites, known variously as "affiliates," "associates," or "publishers," to display electronic advertisements for its products on their sites. The advertisement, which the publisher generally receives by downloading material from the retailer, may take the form of a simple banner advertisement that appears on the screen of a user who accesses the publisher's website, or a "click-through" advertisement, on which the user can click and be connected directly to the retailer's website to make a purchase.

Under these standardized agreements, the publisher receives only the right to display the retailer's advertisements on its website and does not obtain the right to serve as the retailer's agent or to bind it. The agreements provide that the publisher will be paid a fee for displaying the advertisement only after-the-fact, based upon the number of successful contacts that the retailer receives from the publisher's website. An agreement may define a successful contact based on various metrics, such as the number of users who click through to the retailer's website or, more commonly and as with the standardized Overstock and Amazon agreements at issue here, on a percentage of the revenue generated by a sale to a customer who clicked through to the retailer's site.

In the second step, the visitor to the publisher's website (the "Web User") may, without any involvement by or notice to the publisher, view the retailer's electronic advertisement and decide to click through to its website. The publisher has no contact with the user or any visibility into the potential sales transaction during this second step. In fact, a single advertisement may be viewed by thousands of visitors, anywhere in the world. If the Web User decides to make a purchase, she deals directly with the retailer through its website. Upon completion of a sale, the retailer fulfills the order by sending the product or service directly to the Web User, either electronically or through physical delivery from a centralized order fulfillment center often located out-of-state.

In the e-commerce performance marketing process, each publisher simply displays to Web Users an advertisement provided by the retailer. Other than publishing the retailer's advertisement on its website, the publisher has no direct involvement in the sales and marketing process. The key points are as follows:

- The publisher does not directly sell any product to any Web User and does not have a sales force that affirmatively solicits potential customers for the retailer. It functions as a passive publisher of an electronic advertisement.
- The publisher does not receive payment from the Web Users who purchase a retailer's products or services.
- The publisher does not deliver a product or service to any person.
- The publisher generally does not know the identity of the visitors to its website, if any, who click through to the website of the retailer or whether those visitors ultimately purchase a product from the retailer.
- The publisher has no involvement in the final sales transaction between the Web User and the retailer through the retailer's website.

Under the performance marketing approach, the publisher provides a form of Internet-based advertising that is closely analogous to traditional advertisements printed by a newspaper publisher or aired by a television station. With traditional print advertisements, the potential customer views the contact information and then must seek out the retailer by phone, mail, over the Internet, or travel to a physical location. The novel features of the performance marketing approach to advertising in e-commerce are:

- The potential customer can access the retailer's point of sale quickly and with minimum effort by clicking the mouse on its computer. This electronic contact feature reduces the effort necessary for the consumer to take the intermediate step of responding to the advertisement.
- The retailer can determine precisely which advertisement on which publisher's website generated a sale and can limit its marketing outlays by paying only for the successful advertisements, after-the-fact.

B. Performance Marketing Arrangements Serve the Public Interest by Expanding the Universe of Entities that Can Efficiently Publish Internet Advertisements

The development of the Internet has resulted in significant reductions in both the costs that content producers face in assembling and distributing information and in the costs that Web Users incur in searching for information that is of interest to them. Technical advances have served the public interest by supporting a significant increase in the quantity and diversity of information available to the public for free on the Internet. A leading scholar of Internet-based commerce has observed:

> The power of the PC means that the ranks of "producers" - individuals who can now do what just a few years ago only professionals could do – have swelled a thousandfold. Millions of people now have the capacity to make a short film or album, or publish their thoughts to the world – and a surprisingly large number of them do. Talent is not universal, but it's widely spread . . . .

> The result is that the available universe of content is now growing faster than ever.

Chris Anderson, *The Long Tail* 54 (Hyperion 2008). As the Court found in *Reno v. American Civil Liberties Union*, 521 U.S. 844, 853 (1997), "[t]he Web is thus comparable, from the reader's viewpoint, to both a vast library including millions of readily available and indexed publications and a sprawling mall offering goods and services."

These technological developments have had substantial effects on e-commerce advertising. On-line retailers are no longer subject to the "tyranny of geography." Anderson, *supra*, at 162. Unlike traditional brick and mortar merchants, electronic retailers are not limited to residents of any particular geographic location. They may offer their information, goods, and services to potential customers located anywhere in the world, who can access their websites via the Internet and are interested in the substantive content displayed. As the court below correctly noted, "physical presence is not typically associated with the Internet in that many websites are designed to reach a national or even a global audience from a single server whose location is of minimal import." App. 8a.

The development of Internet-based technologies has also extended the scope of the advertising market by making it possible for retailers to deal with publishers whose audience size falls below the minimum efficient threshold for hard-copy print or broadcast advertising. These innovations have lowered the retailer's cost of dealing with publishers by permitting it to create a self-service system in which an interested website operator can apply on-line to become a nonexclusive publisher of its advertisements, whereby the publisher can download advertisements from the retailer and post them on its website.

Under the performance marketing approach, publishers are not paid an up-front fee for posting the electronic advertisements on their websites. Rather, they receive compensation only after-the-fact and only if a Web User clicks through to the retailer's website and completes a purchase. Since the transaction costs of signing up such a publisher are low, the retailer can afford to take the economic risk of dealing with a variety of publishers. The retailer can afford to run the risk that no Web User will ever react to its electronic advertisement on a particular website because it does not compensate the publisher unless and until a Web User clicks through to the retailer's site and completes a purchase. *Id.* at 213. In this way, the performance marketing approach has solved Wanamaker's dilemma in the field of e-commerce advertising.

On-line performance marketing is now the fastest growing advertising model. It is the only form of advertising that grew throughout the Great Recession and will continue to grow through the rapid spread of mobile telecommunications technologies.[4] Through the performance marketing channel, thousands of small, independent website businesses have been able to enter the advertising business, and the content posted on their websites may appeal to a wide variety of markets. The PMA estimates that there currently are over 200,000 websites in the United States that publish such passive advertisements for retailers.

The revenue flows provided by the performance marketing channel have played an important role in

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[4] IAB Internet Advertising Revenue Report, *supra*, at 18.

the diffusion of information through the Internet. Most of the entities that have been able to become publishers of advertising through this channel are small businesses. The revenues they receive from performance-based advertising have permitted them to remain in business, to finance the expansion of their websites, to create jobs, and to increase the amount of content they can generate and display to Web Users. The overall result is that more information has been made available to the public for free on the Internet, especially information of interest only to smaller niche markets of consumers that otherwise might not be available because of the costs of collecting, displaying, and refreshing it.

II. THE NEW YORK STATUTE VIOLATES THE DORMANT COMMERCE CLAUSE BECAUSE PERFORMANCE MARKETING ARRANGEMENTS WITH PUBLISHERS OF INTERNET ADVERTISEMENTS DO NOT MAKE THE OUT-OF-STATE RETAILER PHYSICALLY PRESENT IN THAT STATE

The New York statute is unconstitutional because it imposes tax collection obligations on out-of-state retailers engaged in performance marketing for sales in e-commerce to New York residents even though the retailers have no physical presence in the state. *Quill Corp. v. North Dakota ex rel. Heitkamp*, 504 U.S. 298 (1992); *National Bellas Hess, Inc. v. Department of Rev.*, 386 U.S. 753 (1967). These decisions establish a bright-line rule for application of the Dormant Commerce Clause, under which an out-of-state retailer's mere publication of electronic advertisements on New York-based websites does not constitute a constitutionally sufficient "physical presence" to permit New York to impose tax collections obligations.

The New York Court of Appeals disregarded this Court's teachings in holding that a contractual term under which out-of-state retailers compensate independent third-party publishers of passive electronic advertisements, based on a "commission," or percentage of revenue generated, satisfies the constitutional standard necessary for imposition of tax collection obligations on the retailer. Under Petitioners' performance marketing agreements, a publisher receives no up-front payment for displaying a passive advertisement on its website. It is compensated only after-the-fact, upon the retailer's completion of a sale to a consumer who actually clicked through on an advertisement displayed on the publisher's website. This payment model is designed to measure and improve the effectiveness of advertising. Nothing about inclusion of such a payment formula in a contract creates a constitutionally sufficient "physical presence" for the retailer in New York.

A. Governing Legal Principles

Under the Commerce Clause, a state may not require an out-of-state retailer to collect sales or use taxes on sales to in-state residents unless the retailer has a "substantial nexus" with the taxing state. This Court has established a bright-line rule under which the "substantial nexus" requirement is satisfied only if the out-of-state retailer has a "physical presence" in the taxing state. *See Quill*, 504 U.S. at 313-15; *National Bellas Hess*, 386 U.S. at 754-55. Display of advertising alone is not sufficient to create the required "substantial nexus." *Quill*, 504 U.S. at 313-16. "[C]ontinuous local solicitation" on the ground, by the retailer itself is necessary to establish the "physical presence" the Commerce Clause requires. *E.g., Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960).

This Court's precedents create a safe harbor against imposition of undue burdens on interstate commerce by exempting from tax collection obligations out-of-state retailers "'whose only connection with customers in the [taxing] State is by common carrier or the United States mail.'" *Quill*, 504 U.S. at 315, quoting *National Bellas Hess*, 386 U.S. at 758. In *Quill*, the out-of-state retailer had no employees or physical property in the state and did not engage, directly or indirectly, sales representatives who solicited potential customers for sales. Instead, it advertised in the state, but received and fulfilled the resulting orders outside the state, and delivered products to in-state consumers by common carrier or U.S. mail.

The Court held that under the Dormant Commerce Clause, an advertiser that solicited business through catalogs, advertisements in national periodicals, and telephone calls did not have the required "physical presence" in state to justify imposition of a duty to collect the use tax. 504 U.S. at 308; *see id.* at 302, 311-12.

B. Performance-Based Marketing Arrangements Do Not Establish the Necessary Physical Presence for an Out-of-State Retailer

The principles of *Quill* and *National Bellas Hess* apply fully to the new forms of advertising created by the ubiquitous nature of electronic communications.

> The rise of e-commerce on the Web in the early 1990s started by simply building on the catalog model with even more convenient ordering, larger

> selections, and broader reach at lower cost. The Internet provided a way of offering a catalog to everyone – with no printing and no mailing required. It would clearly work everywhere catalogs worked and then some.

Anderson, *supra*, at 47. In essence, the performance marketing system in e-commerce changes the method of delivery of the advertisements to consumers, in a completely anonymous way, while maintaining the out-of state order taking and fulfillment functions.

The court below accepted Petitioners' representations that they have no property, offices, or employees in New York. They do not engage on-the-ground sales representatives to drum up orders, consummate sales, or provide technical support to customers. Their only contacts with potential in-state customers are through advertisements. New York residents can order products only directly from these retailers' websites. All products they sell are shipped directly to customers from fulfillment centers located outside the state. Accordingly, under the Court's settled Commerce Clause precedents, these entities cannot constitutionally be required to collect the New York sales or use tax.

The lower court deemed Petitioners to have a "physical presence" in New York based on activities of independent third-parties with which they contracted to display "click-through" Internet advertisements. These entities are in the business of generating their own content and displaying it on their own websites. The performance marketing agreements give these websites the right to publish advertisements for Petitioners, but do not make them agents with the authority to bind the retailers or give Petitioners the power to control the publishers' activities. Once a Web

User clicks through to the retailer's website, the publisher has no further connection with the communications between the potential customer and the retailer concerning a transaction. The publisher also has no ability to insert itself in the electronic communications and influence the customer to make a purchase.

The court's reliance on putative contractual incentives for "solicitation" misunderstands the nature of the performance marketing approach to Internet advertising. This approach only scales successfully online, when an advertisement may potentially be viewed by the largest possible audience, worldwide. Advertising rates from retailers are low (typically from 1-7%) depending upon the product and volume of referred customers. Internet publishers only make money if many thousands of people view their ads, and a reasonable percentage click through to purchase. Soliciting through personal contact – taking the time to talk face-to-face and encourage people to click on advertisements – is not an economically viable proposition for the publisher in performance marketing. That investment of time does not scale and is the opposite of what Internet publishers need to do to make money.

In applying the *Quill* "physical presence" test to performance marketing, the most important facts are what the publishers of those click-through advertisements do not do. They:

- do not sell the retailer's product to any Web User.
- do not maintain a sales force that seeks to solicit business for retailers from Web Users.
- do not receive a payment from any Web User.

- do not deliver a product or service to any person.
- do not in general know the identity of the visitors to their websites who click through to the retailer's website and complete purchases.
- have no involvement in the final sales transaction between the Web User and the retailers.

In sum, the publishers of advertising do not engage in the kind of activities that, under *Quill*, make out-of-state retailers physically present in a state. Accordingly, under the Dormant Commerce Clause, New York may not constitutionally impose tax collection obligations on these retailers based on their engagement in performance marketing through e-commerce.

The passive electronic advertisements displayed on third-party websites are no different from the information that a consumer receives from reading a catalog, a magazine or a newspaper advertisement, or viewing a billboard. As a matter of practice, electronic advertisements typically contain much less information, due to size limitations. Electronic advertisements do not give the retailer a greater "physical presence" in the state than a traditional hard-copy advertisement.

Many electronic advertisements have a click-through feature, by which the Web User may access the retailer's website with minimum effort no matter how the advertising rate is paid. Nothing in *Quill* or *National Bellas Hess* suggests that imposition of a tax collection obligation would be constitutional when the Web User can contact the retailer through minimal on-screen activity, but would be unconstitutional if the reader of the same information published in a print or billboard format must activate her computer to access the retailer's website or to depress 10 buttons on a telephone keypad to dial the retailer's 800 number. Accordingly, the publication of an electronic advertisement on a third-party website cannot, by itself, create a constitutionally sufficient "physical presence" to justify imposition of tax collection obligations.

The New York court observed that "[t]he world has changed dramatically in the last two decades" and that "it may be that the physical presence test is outdated" because an entity may now "have a profound impact upon a foreign jurisdiction solely through its virtual projection via the Internet." App. 8a. However, only Congress has the authority to change the law and make Internet-based retailers subject to tax collection obligations without meeting current "physical presence" standards. Unless and until that happens, New York cannot ignore this Court's precedents and impose such an obligation based on an out-of-state retailer's passive advertising.

C. The Compensation Formula in Performance Marketing Agreements Does Not Establish a Physical Presence for Out-of-State Retailers

The court below held that New York's imposition of a tax collection obligation on Petitioners was constitutional because their standard agreements with websites that displayed their electronic advertisement provided that publishers would be compensated with a percentage of revenues generated from completed sales, as opposed to a fixed price arrangement. App. 10a. However, none of this Court's decisions go so far as to authorize imposition of tax collection responsibilities on a retailer that pays a publisher of advertisements on a commission basis, rather than on a flat fee or some other basis.

The governing rule is that to establish "the physical presence" necessary for such an obligation to be constitutional, the out-of-state retailer must have representatives engaged in "continuous local solicitation" on the ground, *Scripto, Inc. v. Carson*, 362 U.S. 207, 211 (1960), and their solicitation must be "significantly associated" with the retailer's ability to do business in that state, *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Rev.*, 483 U.S. 232, 250 (1987) (internal quotation marks omitted).

The court below erred by concluding that the mere characterization of a payment for an advertisement as a "commission" is sufficient to establish that the retailers had contracted for the services of an on-the-ground sales team of the type that might make those retailers physically present under *Quill* and *Scripto*. *See Quill*, 504 U.S. at 306-307 (refusing to "obliterate" the sharp distinction between mail-order sellers with retail outlets, solicitors, or property within a state, and those who only communicate with in-state customers by mail or common carrier); *Scripto*, 362 U.S. at 209-11.

The formula by which an electronic publisher is paid for displaying the retailer's advertisements is irrelevant under the "physical presence" test. There is no difference in the out-of-state retailer's "physical presence" in a state depending upon whether it compensates the publisher through an up-front fee or only upon completion of an individual sale, based on a percentage of revenue generated. In neither case do the payment terms themselves for published advertisements create a "physical presence" sufficient to allow a state to impose tax collection obligations on the retailer.

Indeed, the lower court's ruling would produce results that are prohibited by this Court's decisions. Retailers have long attempted to develop efficient pay-for-performance mechanisms for publication of advertisements. Contracts that pay publishers larger fees for advertising campaigns that generate revenues in excess of target levels are common in hard copy advertising. Under the logic of the decision below, out-of-state mail order retailers that merely send hard copy advertisements into New York that contain such pay-for performance features, and that under the *Quill* safe harbor cannot now constitutionally be required to collect taxes, would be subject to imposition of such an obligation if the payment arrangement involved a commission formula.

III. THE STATUTE IMPROPERLY BURDENS INTERSTATE COMMERCE AND ADVERSELY AFFECTS THE CONTINUED DEVELOPMENT OF E-COMMERCE

The decision below will significantly burden interstate commerce and thereby harm the public interest. The sheer magnitude of these adverse effects further justifies granting the Petitions.

First, the statute discriminates against performance-based marketing conducted by electronic publishers. The decision below made the constitutionality of the tax collection obligation turn on whether the publisher of an advertisement is compensated with a flat fee or percentage of revenue. The decision thereby creates an uneven playing field for web-based small businesses that are paid via performance marketing as compared to hard copy publishers. It threatens to slow future development of e-commerce by forcing online retailers to change to some other form of Internet-based advertising or shifting to a different type of advertising altogether – thus foregoing the benefits of the technology improvements that have solved John Wanamaker's dilemma in e-commerce and allow precise determination of which advertisement generated which sale.

The statute also discriminates against smaller electronic retailers with lesser known brands. They must either forego performance marketing advertising within the state or accept a pricing disadvantage to competitors that use different forms of on-line marketing.

Second, the imposition of tax collection obligations on e-commerce retailers has had and will continue to have devastating effects on large numbers of small Internet-based businesses that depend upon the revenues they receive through performance marketing programs. For example, to avoid the costs and burdens associated with the tax collection obligation, more than 1,000 out-of-state retailers, including Overstock, severed their advertising relationships with New York websites after the challenged statute was adopted. Similarly, both Amazon and Overstock, along with 1,000 other out-of-state retailers, terminated relations with websites in Rhode Island after that state adopted a law modeled on the New York statute. R.I. Gen. Laws § 44-18-15(a)(2). This has been a consistent pattern in all 13 states where similar laws were passed.

The loss of this revenue stream inflicted substantial harm on websites in these states and reduced their ability to continue creating and making valuable content available to the public without charge. Information collected by PMA suggests that approximately 90,000 websites lost income due to the passage of the

New York statute and similar laws in other states. Of those websites, one-third moved from the taxing state; one-third downsized; and one-third shut down completely. The states likely collected little or no new sales tax revenue from out-of-state retailers, and they also lost income tax revenue resulting from the devastation of all these small businesses.

This decision places websites in New York (and other states that have copied its approach) at a substantial disadvantage compared to their competitors. It creates an economic incentive for out-of-state retailers to contract with websites organized in other states, who can reach residents of a taxing state as easily as a website organized in-state. In Internet-based commerce, a visitor is attracted to a website by its domain name or content, and not by its physical proximity. The state of incorporation or physical location of a website's server is irrelevant to the Web User's decision whether to visit it. Accordingly, the owner can simply move the website to another state and thereby obtain an advantage over websites whose advertisements trigger a tax collection obligation.

Third, this Court adopted the bright-line "physical presence" requirement due in part to concern that if one state were permitted to impose a tax collection obligation on an out-of-state advertiser, then other jurisdictions would surely follow. It found that multiple variations in the laws of the country's many thousands of taxing jurisdictions "could entangle [the retailer] in a virtual welter of complicated obligations" and thereby adversely affect interstate commerce. *Quill*, 504 U.S. at 313 & n.6. That concern has now come to pass in e-commerce. Since New York passed its statute, 12 other states have adopted laws that impose similar tax collection obligations, but that are mutually inconsistent with respect to the factors that trigger such a duty. These 13 states collectively constitute a significant percentage of total commerce in the United States, and nearly half of the performance marketing industry.

These recent state actions demonstrate that the *Quill* bright-line rule remains an important protection to prevent imposition of a creeping burden on interstate commerce conducted over the Internet or mobile devices. As the court found in *American Libraries Ass'n v. Pataki*, 969 F. Supp. 160, 181 (S.D.N.Y. 1997), "[w]ithout the limitations imposed by the Commerce Clause, . . . inconsistent regulatory schemes could paralyze the development of the Internet altogether."

Finally, this Court also justified *Quill*'s bright line rule as necessary to protect interstate commerce by reducing the amount of litigation on tax collection obligations and by encouraging settled expectations that would foster investment and development of better advertising and distribution techniques. *Quill*, 504 U.S. at 315-16. Indeed, the Court observed in *Quill* that the dramatic growth of the mail order industry in the 25 years since *National Bellas Hess* was due in part to the existence of the bright-line rule. *Id.* at 316. The same considerations apply with full force in the e-commerce area.

Preservation of the bright-line rule is essential for continued development of more efficient e-commerce business models such as the performance marketing-based channel. In addition, the exponential development of e-commerce since *Quill* is undoubtedly due in substantial part to the settled expectations created by that decision that an electronic retailer whose only connection with a state consists of web-based advertisements displayed by independent third parties does not become subject to tax collection obligations. That understanding is now directly threatened by the decision of the New York Court of Appeals.

CONCLUSION

The Court should grant the Petitions for a Writ of Certiorari filed by Overstock and Amazon.

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