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COURT OF APPEALS

STATE OF NEW YORK

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OVERSTOCK.COM, INC.,

Appellant,

-against-

No. 33

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

Respondents.

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AMAZON.COM, LLC, et al.,

Appellants,

-against-

No. 34

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

Respondents.

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20 Eagle Street  
Albany, New York 12207  
February 6, 2013

Before:

CHIEF JUDGE JONATHAN LIPPMAN  
ASSOCIATE JUDGE VICTORIA A. GRAFFEO  
ASSOCIATE JUDGE SUSAN PHILLIPS READ  
ASSOCIATE JUDGE ROBERT S. SMITH  
ASSOCIATE JUDGE EUGENE F. PIGOTT, JR.

1           Appearances:

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Sharona Shapiro  
Official Court Transcriber

1 CHIEF JUDGE LIPPMAN: 33 and 34, Overstock  
2 and Amazon.

3 Counselor, do you want any rebuttal time?

4 MR. CONNOLLY: I would, Your Honor. I  
5 would ask for two minutes.

6 CHIEF JUDGE LIPPMAN: Two minutes. Go  
7 ahead, counselor.

8 MR. CONNOLLY: My name is - - - may it  
9 please the court, my name is Daniel Connolly of  
10 Bracewell & Giuliani, and I represent the appellant,  
11 Overstock.com.

12 CHIEF JUDGE LIPPMAN: How does your case  
13 differ from Amazon?

14 MR. CONNOLLY: The cases are essentially  
15 the same, Your Honor. At this point there are two -  
16 - - essentially two arguments before this court: a  
17 facial challenge on the commerce clause - - -

18 CHIEF JUDGE LIPPMAN: Right.

19 MR. CONNOLLY: - - - and a facial challenge  
20 on the due proc - - -

21 CHIEF JUDGE LIPPMAN: Right.

22 MR. CONNOLLY: - - - process clause.

23 CHIEF JUDGE LIPPMAN: And it's in both  
24 cases?

25 MR. CONNOLLY: As to both cases. We have,

1 by prior arrangement with the court, agreed to split  
2 our time.

3 CHIEF JUDGE LIPPMAN: Yes.

4 MR. CONNOLLY: I'm going to handle the  
5 commerce clause facial challenge.

6 CHIEF JUDGE LIPPMAN: Okay.

7 MR. CONNOLLY: And Mr. Mastro, on behalf of  
8 co-appellant, will handle the due process facial  
9 challenge.

10 CHIEF JUDGE LIPPMAN: What's the test in  
11 the commerce clause?

12 MR. CONNOLLY: The test is - - - and it's  
13 clear and it's unambiguous, and it is Quill - - -  
14 Quill v. North Dakota, out of United States Supreme  
15 Court, and it creates a bright line, and the bright  
16 line in a commerce clause circumstance like this is  
17 that a foreign entity must have a substantial nexus  
18 to the state that is attempting to exercise taxing  
19 authority over it.

20 CHIEF JUDGE LIPPMAN: What about presence  
21 in the state? How much presence do you have to have?

22 MR. CONNOLLY: Well, it requires a physical  
23 presence. Substantial nexus requires physical  
24 presence. This court - - -

25 JUDGE READ: That's the small sales force,

1 plant, or office; is that what you're arguing?

2 MR. CONNOLLY: That's correct. And this  
3 court has, in the case of Orvis, given further  
4 elucidation on that point, talking about demonstrably  
5 more than the slightest presence. And - - - and in  
6 the Or - - -

7 CHIEF JUDGE LIPPMAN: So what does that  
8 mean - - -

9 MR. CONNOLLY: Well, in the Or - - -

10 CHIEF JUDGE LIPPMAN: - - - in your mind?

11 MR. CONNOLLY: In the Orvis case, what that  
12 meant is sending down folks from Vermont, where Orvis  
13 was headquartered, into New York State, working with  
14 the nineteen wholesalers here in the state, and  
15 making the market for them in New York. That's what  
16 - - - and that met this court's standard of  
17 demonstrably more than the slightest presence.

18 Here's what can never, under any  
19 circumstances, either in the jurisprudence of this  
20 court or in the Supreme Court, ever constitute  
21 substantial nexus, and that is mere advertising.

22 JUDGE PIGOTT: Let's talk about soliciting  
23 a bit, because it seems to me that the technology  
24 keeps changing. If you're on your computer and, you  
25 know, all of a sudden - - - there could be ads for

1 any number of things, but let's pick on Overstock.  
2 If - - - and there's an ad for Overstock. If you  
3 then say I'm interested in a pair of shoes, and you  
4 go look for a pair of shoes, if the next time you  
5 turn on your computer the Overstock ad is for shoes,  
6 does that amount to soliciting? Because all of a  
7 sudden, it seems, Overstock knows there's somebody  
8 here who wants to buy shoes and I'm going to show  
9 them shoes.

10 MR. CONNOLLY: Well, I think - - - you  
11 know, there's no question that Internet - - - the  
12 Internet adds a new dimension to this, but quite  
13 frankly, it's a new dimension to an old story. You  
14 know, back in the day of Quill, what we were talking  
15 about was, you know, did the fact that I was sending  
16 catalogues to you, and I know that you bought those  
17 shoes at one time, so I may be targeting you, and  
18 from my - - - my, you know, out-of-state  
19 headquarters, I may be targeting you with a  
20 catalogue; the court, in Quill v. North Dakota, said  
21 not enough. It has - - -

22 JUDGE SMITH: Isn't the question not so  
23 much whether it's solicitation but who's doing the  
24 soliciting?

25 MR. CONNOLLY: It's - - - the question is -



1 serious interest here?

2 MR. CONNOLLY: The state has - - - this  
3 state and the other - - -

4 CHIEF JUDGE LIPPMAN: Yeah.

5 MR. CONNOLLY: - - - quite frankly, the  
6 other 9,000 taxing jurisdictions within the United  
7 States of America have a stake in maximizing revenue.  
8 And the commerce clause stands as this sentinel to  
9 protect us, drafted 200-plus years ago, protect our  
10 structure for a national commerce.

11 CHIEF JUDGE LIPPMAN: So what does the  
12 State have to do to not unduly burden you?

13 MR. CONNOLLY: Precisely what it did before  
14 this statute. Here's the thing; this statute is in  
15 fact superfluous.

16 CHIEF JUDGE LIPPMAN: If they were  
17 soliciting beforehand it was taxable anyway, right?

18 MR. CONNOLLY: Exactly right. And so - - -  
19 and that's, I think, a very important part of this  
20 analysis.

21 JUDGE GRAFFEO: What about your affiliate  
22 program, though? Are you receiving revenue from  
23 those affiliates that advertise on your behalf?

24 MR. CONNOLLY: We're not receiving revenue  
25 from the affiliates. The affiliates are advertising.

1 They're akin to the billboard or the advertisement in  
2 The New York Times, except that it's sort of the  
3 Internet version of that. And the advertiser, who is  
4 the New York resident, will receive compensation - -  
5 -

6 JUDGE GRAFFEO: And that's not activity in  
7 New York State, when you ask them to advertise your  
8 services?

9 MR. CONNOLLY: It's advertising activity,  
10 which is clearly on the other side of the bright  
11 line. And so this is where Quill is unambiguous.

12 JUDGE GRAFFEO: Well, they get paid, don't  
13 they, if your products are sold - - -

14 MR. CONNOLLY: They do.

15 JUDGE GRAFFEO: - - - on their Web sites?

16 MR. CONNOLLY: They get paid just like The  
17 New York Times gets paid for its advertisements when  
18 - - -

19 JUDGE SMITH: But The New York Times  
20 usually gets a flat fee for the space, doesn't it?

21 MR. CONNOLLY: It does.

22 JUDGE SMITH: But isn't that what the whole  
23 case turns on, whether the fact that these affiliates  
24 get, essentially, contingent revenue, whether that  
25 turns them into solicitors?

1 MR. CONNOLLY: Unfortunately, that's not  
2 the case. I mean, I actually still think that would  
3 be a problem, but the statute doesn't capture just  
4 commission-based sales. The statute captures all - -  
5 - the new statute captures all advertising where the  
6 - - -

7 CHIEF JUDGE LIPPMAN: What would - - -

8 MR. CONNOLLY: - - - by commission.

9 CHIEF JUDGE LIPPMAN: What would you have  
10 to do to be covered, beyond advertising, to make it  
11 okay for New York to tax?

12 MR. CONNOLLY: If I had an arrangement  
13 wherein I was directing a sales force to solicit on  
14 my behalf, obviously if I had a physical presence in  
15 the state, which there's no dispute that we don't. I  
16 mean, there are a variety of ways. And, quite  
17 frankly, you could run the program and change it and  
18 say in exchange for your compensation don't just  
19 advertise; we're going to now ask you to do door-to-  
20 door sales. I mean, in Scripto - - -

21 JUDGE GRAFFEO: I guess my question is do  
22 those affiliates become - - - serve the same purpose  
23 as if you had an advertising force in New York?

24 MR. CONNOLLY: No. I mean, that really is  
25 part of the problem. I mean, part of the problem is

1 this statute creates a sort of false paradigm. And  
2 what it attempts to do is it attempts to capture the  
3 single missing piece of the existing tax statute.

4 JUDGE GRAFFEO: Well - - -

5 MR. CONNOLLY: And the existing tax statute  
6 is constitutionally sound, and by trying to go this  
7 next step, trying to capture - - -

8 CHIEF JUDGE LIPPMAN: So how do you  
9 characterize the affiliates? What are they?

10 MR. CONNOLLY: They're advertisers. The  
11 affiliates are advertisers. They're not making the  
12 market. They're not - - - they play no role.

13 CHIEF JUDGE LIPPMAN: No solicitations?

14 MR. CONNOLLY: No solicita - - - I mean - -  
15 -

16 JUDGE PIGOTT: Let me be provincial for - -  
17 -

18 MR. CONNOLLY: - - - you could - - -

19 JUDGE PIGOTT: - - - for a min - - - I'm  
20 sorry.

21 MR. CONNOLLY: That's okay.

22 JUDGE PIGOTT: Go ahead, why don't you  
23 finish?

24 MR. CONNOLLY: I mean, you could imagine a  
25 circumstance where that is the case, but it doesn't

1 flow naturally from the presumption. And by the way,  
2 this statute doesn't care about that; this statute  
3 just says if you're getting paid for advertising - -  
4 -

5 JUDGE SMITH: You're relying on commission  
6 or other consideration.

7 JUDGE READ: Directly or indirectly.

8 JUDGE SMITH: But they actually - - - but  
9 the State is taking a narrower view of that. They  
10 say it covers only contingent compensation; am I  
11 right about that?

12 MR. CONNOLLY: That is correct. And that's  
13 - - -

14 JUDGE SMITH: And you - - - so you - - -  
15 and as often happens in these cases, you want to - -  
16 - you say no, no, no, the statute is absolutely  
17 brutal to me, and they say, no, it's a very gentle  
18 statute that doesn't do you any harm - - -

19 MR. CONNOLLY: And I - - -

20 JUDGE SMITH: - - - at all.

21 MR. CONNOLLY: And fundamental perceptions  
22 of statutory construction mandate that this court and  
23 other courts look at what the plain language of the  
24 statute is, and this is one of the areas where the  
25 Appellate Division erred. They took the State's

1 invitation; said, let's excise out "or other  
2 consideration" or "indirectly", and let's pretend  
3 those aren't there. And by doing so, we think that  
4 makes it constitutionally sound.

5 JUDGE SMITH: Suppose - - - suppose you're  
6 wrong about that; does that make the statute  
7 constitutional?

8 MR. CONNOLLY: No.

9 JUDGE SMITH: Why not?

10 MR. CONNOLLY: Because even with a  
11 commission, even if it's just a pure commission  
12 perspective, it still goes too far. There is - - -  
13 there is no rational connection - - - it is - - - and  
14 Mr. Mastro is going to speak about this in greater  
15 detail - - - between the notion of a - - - that  
16 necessarily if there is commission it leads to  
17 solicitation. We've been given - - -

18 JUDGE SMITH: That - - - I mean, that goes  
19 beyond the due process - - - that's relevant to the  
20 commerce clause as well as the due process - - -

21 MR. CONNOLLY: Absolutely.

22 JUDGE SMITH: - - - claims.

23 MR. CONNOLLY: There's no question about  
24 that.

25 JUDGE PIGOTT: Wait. I wanted to ask you

1 this in a provincial way. So what you're saying is,  
2 let's split Amazon and Overstock up, and one of them  
3 is in New York and one of them isn't, and if we were  
4 to find for you, and Amazon has a - - - has a base  
5 here in New York, they would be very wise to go to  
6 the most remote part of - - - of the United States  
7 and say if we're sitting in Utah, all we've got to do  
8 is worry about anything that the 600,000 people in  
9 Utah have to pay in taxes and the rest of them we  
10 don't care about. So it's much, much better,  
11 commercially, for us - - - I'm talking about the  
12 commerce clause - - - to leave New York and to be in  
13 either Utah or Idaho with our business, because that  
14 way we avoid all of these tax issues.

15 MR. CONNOLLY: I think you're - - - I think  
16 you're making an interesting point, Your Honor, but I  
17 would say this, that - - - I mean, again, we have to  
18 - - - the commerce clause serves as a inhibitor on  
19 the power of this state, but also the other 8,999  
20 taxing authorities. And that's how we end up in 2013  
21 with a national economy.

22 CHIEF JUDGE LIPPMAN: Okay.

23 MR. CONNOLLY: And absent that - - -

24 CHIEF JUDGE LIPPMAN: Okay. You'll have  
25 your rebuttal time.

1 MR. CONNOLLY: Thank you, Your Honor.

2 MR. MASTRO: Thank you, Your Honor. If I  
3 could please reserve two minutes - - -

4 CHIEF JUDGE LIPPMAN: Go ahead.

5 MR. MASTRO: - - - of my time as well?

6 CHIEF JUDGE LIPPMAN: Go ahead.

7 MR. MASTRO: Thank you, Your Honor.

8 CHIEF JUDGE LIPPMAN: Proceed.

9 MR. MASTRO: Randy Mastro for appellant-  
10 plaintiff Amazon.

11 I want to come right to the question that  
12 you asked, Chief Judge, and that you asked, Judge  
13 Smith, about the presumption; what is the standard?  
14 And I'm going to assume, for purposes of this  
15 question, that commissions are part of the equation,  
16 even though the statute is written much more broadly.  
17 Now, for purposes of a facial due process challenge,  
18 this court and the Supreme Court have laid out a very  
19 clear standard. The issue of whether a presumption,  
20 a mandatory presumption like this one, is rational  
21 and enforceable for purposes of the due process  
22 clause is the following test: whether in common  
23 experience it is federal standard - - - more likely  
24 than not, this court's standard even tougher - - -  
25 there's a reasonably high degree of probability that

1 the fact presumed - - - I mean, the fact proven - - -  
2 the fact proven here being that retailers from out of  
3 state - - -

4 CHIEF JUDGE LIPPMAN: Right.

5 MR. MASTRO: - - - advertise on in-state  
6 Web sites and pay on a commission basis, leads  
7 inexorably, or even logically, to the fact presumed  
8 that that transforms those Web sites into what the  
9 State calls a, quote, "virtual sales force".

10 JUDGE SMITH: What - - -

11 MR. MASTRO: It is not so.

12 JUDGE SMITH: What - - - what precisely, in  
13 your view, is the fact presumed? You say it's that  
14 they're soliciting, but what is it that they're  
15 soliciting for - - - for Amazon?

16 MR. MASTRO: Correct, Your Honor. They  
17 become, in essence, a virtual sales force - - -

18 JUDGE SMITH: Is it - - -

19 MR. MASTRO: - - - for Amazon in the state.

20 JUDGE SMITH: - - - as though they're going  
21 out knocking on doors telling people - - -

22 MR. MASTRO: Correct - - -

23 JUDGE SMITH: - - - to buy from Amazon?

24 MR. MASTRO: - - - because this has to be  
25 solicitation for constitutional purposes under Quill.

1 That means physical presence, on the ground, door-to-  
2 door, active - - -

3 CHIEF JUDGE LIPPMAN: Literally - - -

4 MR. MASTRO: - - - localized solicitation.

5 CHIEF JUDGE LIPPMAN: Literally, or there  
6 are kind of in-between steps that might constitute -  
7 - -

8 MR. MASTRO: Well - - -

9 CHIEF JUDGE LIPPMAN: - - - solicitation -  
10 - -

11 MR. MASTRO: Well, this is - - -

12 CHIEF JUDGE LIPPMAN: - - - other than,  
13 obviously, door-to-door.

14 MR. MASTRO: This is an - - - this is an  
15 important point, Your Honor, and there are ways to  
16 solicit, but as this court held in Orvis, as the  
17 Supreme Court has held in Tyler Pipe and Scripto,  
18 that literally means, on the solicitation point, that  
19 you are soliciting sales in the state - - -

20 JUDGE SMITH: But if you - - -

21 MR. MASTRO: - - - directly and on the  
22 ground.

23 JUDGE SMITH: If you - - - in the pre-  
24 Internet days, if Amazon is a book - - - a book  
25 publisher in Utah or Seattle, and it has a little

1 distributor in Manhattan, where they don't sell any  
2 books but you can come in and give your orders, that  
3 would be a physical presence, wouldn't it?

4 MR. MASTRO: Your Honor, but that would not  
5 have been sufficient with the Supreme Court standards  
6 articulated in Quill and National Bellas and Tyler  
7 Pipe, that you have to have a physical presence that  
8 involves local, continuous solicitation,  
9 significantly - - -

10 JUDGE SMITH: Hold on. But - - -

11 MR. MASTRO: - - - associated with your  
12 ability to do business.

13 JUDGE SMITH: - - - I'm interested in a  
14 hypothetical where there's an Amazon office in New  
15 York. Surely that would do it.

16 MR. MASTRO: If it were an Amazon office,  
17 brick-and-mortar physical presence, yes.

18 JUDGE SMITH: Or, yes - - -

19 MR. MASTRO: Amazon has no brick-and-  
20 mortar.

21 JUDGE SMITH: Yes, a brick - - - or a  
22 distributor, not necessarily with Amazon across the  
23 door but a distributor with seventeen clients but  
24 Amazon's one of them.

25 MR. MASTRO: But that is not what we're

1 talking about here, Your Honor.

2 JUDGE SMITH: But if it were, that would do  
3 it?

4 MR. MASTRO: If they actually had a  
5 distributor relationship actively involved in local  
6 sale solicitation, that would be a different  
7 situation.

8 JUDGE SMITH: So isn't really the question  
9 whether these Web sites, which are apparently owned  
10 by people who are physically in New York, are the  
11 equivalent of your distributors, or are they more  
12 like advertisers, like The New York Times?

13 MR. MASTRO: Correct - - - correct, Your  
14 Honor, and they are more like advertisers for the  
15 following reason. They're no different than print,  
16 TV, magazine, other media advertisements, for the  
17 following reasons, Your Honor. It is essential that  
18 the court appreciate that just because a Web site is,  
19 in some ephemeral sense, located in New York, doesn't  
20 mean its target audience is in New York. They're  
21 geographically untethered. A Web site seeks to  
22 attract a nationwide audience; it is a worldwide  
23 audience.

24 CHIEF JUDGE LIPPMAN: What step do they  
25 take beyond that, in your mind, short of knocking on

1 doors? What else, if they did, would constitute then  
2 - - - then you're under - - -

3 MR. MASTRO: Your Honor, I am now talking -  
4 - -

5 CHIEF JUDGE LIPPMAN: Is there something -  
6 - - is there anything in between - - -

7 MR. MASTRO: There - - -

8 CHIEF JUDGE LIPPMAN: - - - and include  
9 Judge Smith's hypothetical in that - - -

10 MR. MASTRO: Yes.

11 CHIEF JUDGE LIPPMAN: - - - what, short of  
12 that - - - you've agreed that would do it; is there  
13 anything short of that that would qualify?

14 MR. MASTRO: Well, Your Honor, I'm now  
15 going to explain where I think the line is drawn.

16 CHIEF JUDGE LIPPMAN: Sure. Go ahead.

17 MR. MASTRO: Why the presumption - - - why  
18 the presumption is irrational and so far off the mark  
19 you don't even get close to drawing that line. The  
20 presumption is that because I merely advertise, just  
21 like Amazon advertises in The New York Times, that  
22 from there, simply because payment is on a commission  
23 basis, payment that in the modern age of technology  
24 and e-commerce you can actually track for efficient  
25 business purposes. So Amazon is out no money unless

1           there is a sale.

2                       JUDGE SMITH:  Do they - - -

3                       MR. MASTRO:  And the Web site pays nothing  
4           to advertise.

5                       JUDGE SMITH:  The - - - you know, people  
6           who - - - the people who advertise in The New York  
7           Times would happily pay them on a commission basis if  
8           they could, right?

9                       MR. MASTRO:  Correct, Your Honor, and there  
10          isn't a single person here in this courtroom today  
11          who would say that advertising in The New York Times,  
12          if you printed it with a phone number or a Web site  
13          and you could track that, that merely advertising in  
14          The New York Times, a New York based company, would  
15          constitute the kind of constitutional solicitation -  
16          - -

17                      JUDGE SMITH:  That wouldn't make The New  
18          York Times your sales force.

19                      MR. MASTRO:  And that is absurd - - -

20                      JUDGE PIGOTT:  Can you solicit - - -

21                      MR. MASTRO:  - - - and he will not say  
22          that.

23                      JUDGE PIGOTT:  Can you solicit by means of  
24          the computers?  Can you - - - I mean, you say you  
25          don't, but - - -

1 MR. MASTRO: We - - -

2 JUDGE PIGOTT: - - - can you, if you choose  
3 to?

4 MR. MASTRO: We are not doing that, and - -  
5 -

6 JUDGE PIGOTT: I understand that. Let's  
7 make it another company. But can another company  
8 solicit with a computer such as to create a presence  
9 in the State of New York even though they don't have  
10 brick and mortar?

11 MR. MASTRO: It is theoretically possible  
12 that an out-of-state retailer could solicit directly  
13 into New York over the Internet, but - - - but - - -

14 JUDGE SMITH: Well, that would be just like  
15 sending a catalogue, wouldn't it?

16 MR. MASTRO: But that's exactly what I was  
17 going to say, Your Honor. That's the same as sending  
18 the ten thousands and thousands of catalogues that  
19 were done in Quill. And the Supreme Court rejected  
20 this very argument in the 1990s in Quill. There was  
21 Internet in the 1990s, and the Supreme Court of North  
22 Dakota had said, oh, the world has changed; we have  
23 Internet, we have all sorts of things that are  
24 breaking down geographic boundaries, and the Supreme  
25 Court said no; physical presence, continuous local

1 solicitation significantly associated with ability to  
2 do business. This is no different than advertising  
3 in The New York Times. And I have to say, Your Honor  
4 - - -

5 JUDGE GRAFFEO: Why do you use the  
6 affiliates? Why don't you just advertise on the  
7 Internet?

8 MR. MASTRO: Well, we - - -

9 JUDGE GRAFFEO: You know, on that pop-up -  
10 - - any time you order or look for any item on the  
11 Internet, the bar pops up on the right-hand side that  
12 has Amazon.

13 MR. MASTRO: Your Honor, it is no different  
14 than using those wonderful magazines and newspapers  
15 in New York that have worldwide audiences to  
16 advertise in. It's driving traffic circulation;  
17 that's why you run an advertisement, and - - -

18 JUDGE GRAFFEO: But if the mail order  
19 companies - - - I know it probably sounds far-  
20 fetched, but if they hired people to go and drop the  
21 catalogue off on people's doorsteps, that - - -

22 MR. MASTRO: But that's not what happens,  
23 Your Honor.

24 JUDGE GRAFFEO: - - - that wouldn't be  
25 covered by Quill. That's a substantial nexus,

1 correct?

2 MR. MASTRO: But, Your Honor, that's not  
3 what happens here.

4 JUDGE GRAFFEO: So is it - - -

5 MR. MASTRO: These Web sites - - -

6 JUDGE GRAFFEO: Is it different when you  
7 make these arrangements with these affiliates?

8 MR. MASTRO: Absolutely, Your Honor,  
9 because these affiliates are themselves a form of  
10 content-based site. I urge you to look at page 723  
11 and 727 of the record for examples. The New York  
12 Times now has its own online Web site. It draws its  
13 audience from around the world. It is absurd to  
14 suggest that Amazon, running a click-through ad on  
15 The New York Times Web site, has converted The New  
16 York Times into a virtual sales force in New York.  
17 And I ask you to please ask this gentleman whether he  
18 would say that The New York Times on its Web site  
19 having a click-through ad for Amazon transforms The  
20 New York Times into a sales force for Amazon.

21 JUDGE SMITH: Before I ask him that - - -

22 MR. MASTRO: It is absurd and it's  
23 unconstitutional.

24 JUDGE SMITH: Before I ask him that - - -

25 MR. MASTRO: Thank you.

1                   JUDGE SMITH: - - - I want to ask you,  
2 really, a practical question. I understand why you  
3 say that putting the burden on you to rebut the  
4 presumption isn't kosher, that they can't make an  
5 irrational presumption. But why, as a practical  
6 matter, does that not work? If these people really  
7 aren't solicitors and they have regulations that seem  
8 to make it clear that all they've got to do is  
9 promise not to solicit and verify it every year, why  
10 is this not a purely theoretical problem we have  
11 here?

12                   MR. MASTRO: There's a - - - Your Honor,  
13 three parts to that, please. First - - - you don't  
14 even get to the point of your rebuttability for three  
15 fundamental reasons. It's an irrational presumption  
16 to begin with.

17                   JUDGE SMITH: That's the question I was  
18 trying not to ask.

19                   MR. MASTRO: Okay.

20                   JUDGE SMITH: I mean, I understand why you  
21 should win the case - - - why you say you should win  
22 the case anyway. I'm still - - - I'm asking what's  
23 the practical problem; why don't you just relax and  
24 rebut the presumption?

25                   MR. MASTRO: Because in the age of the

1 Internet, there are now all sorts of publications  
2 that are on the Internet that are like print and  
3 media and newspaper advertising. These are content-  
4 based sites that try and get a wide audience. We  
5 have relations with thousands of them around the  
6 country and around the world. For a company like  
7 Amazon - - -

8 JUDGE SMITH: You're saying just the sheer  
9 complexity and burden of rebutting the presumption,  
10 it's going to - - - something's going to slip through  
11 and you're going to wind up paying sales tax.

12 MR. MASTRO: And the way the presumption  
13 has been set up, these independent third parties who  
14 have advertisements from multiple sources, where you  
15 can click through, just like the The New York Times  
16 has advertisements - - -

17 JUDGE PIGOTT: You say you're too big to  
18 tax - - -

19 MR. MASTRO: - - - all through the paper.

20 JUDGE PIGOTT: - - - it's going to get  
21 scary here.

22 MR. MASTRO: But - - -

23 JUDGE PIGOTT: You say you've got too many  
24 people doing this that you can't keep track of them  
25 all?

1 MR. MASTRO: It's - - - that's not exactly  
2 what I'm saying, Your Honor. What I'm saying is that  
3 we advertise in a lot of different media. Some of  
4 them are Web sites.

5 JUDGE SMITH: You're really saying - - -

6 MR. MASTRO: Some of them newspapers. Some  
7 of them are TV. Some of them are magazines.

8 JUDGE SMITH: But - - -

9 MR. MASTRO: But to say that we - - -

10 JUDGE SMITH: - - - to simplify it - - -

11 MR. MASTRO: - - - have to - - - yes?

12 JUDGE SMITH: - - - are you really saying  
13 that if ten fish slip through your net, somehow, and  
14 there are a lot of fish out there, that you're going  
15 to be paying tax on all your sales in New York?

16 MR. MASTRO: Yeah, we are - - -

17 JUDGE SMITH: Is that the gist of it?

18 MR. MASTRO: Correct, Your Honor. We are  
19 ensnared when - - - these are independent third  
20 parties who are ensnared by any one of them. And it  
21 has both civil and criminal penalties - - -

22 CHIEF JUDGE LIPPMAN: Okay, counselor.

23 MR. MASTRO: - - - and that is wrong.

24 CHIEF JUDGE LIPPMAN: Thanks.

25 MR. MASTRO: That is unconstitutional.

1 CHIEF JUDGE LIPPMAN: Thanks, counselor.

2 MR. MASTRO: Thank you, Your Honors.

3 CHIEF JUDGE LIPPMAN: You'll have your  
4 rebuttal time. Thank you.

5 MR. MASTRO: Much appreciated, Your Honors.  
6 Thank you.

7 CHIEF JUDGE LIPPMAN: Thank you.

8 Counselor?

9 MR. WU: May it please the court, Steven Wu  
10 for the State of New York.

11 This statute is not about advertising.  
12 What it's premised on is solicitation, which is the  
13 word that's used - - -

14 CHIEF JUDGE LIPPMAN: But they're - - -

15 MR. WU: - - - in the statute itself.

16 CHIEF JUDGE LIPPMAN: But they're saying  
17 they don't solicit, that there's no solicitation  
18 whatsoever.

19 MR. WU: That is a fact question that is  
20 raised in the attempt to rebut the presumption, which  
21 again, is expressed in the statute. And it's not  
22 something to be made - - -

23 JUDGE SMITH: Well, isn't - - -

24 MR. WU: - - - on a judicial challenge.

25 JUDGE SMITH: - - - isn't the question

1           whether it's - - - I put an ad on your Web site. You  
2           have the Steven Wu Web site, I put an ad on it; is it  
3           reasonable to infer from that that you are soliciting  
4           business from me - - - for me?

5                       MR. WU: But this statute is not based upon  
6           - - -

7                       JUDGE SMITH: Is it - - -

8                       MR. WU: - - - advertisements.

9                       JUDGE SMITH: Have I correctly stated the  
10          question?

11                      MR. WU: No, this statute is not based upon  
12          advertisements. What it is based upon is a contract-  
13          based relationship with New York residents to refer  
14          business to an out-of-state retailer - - -

15                      JUDGE SMITH: So if I have a contract - - -

16                      MR. WU: - - - on a commission basis.

17                      JUDGE SMITH: Okay. Let me change the  
18          hypothetical, then. I have a contract with you that  
19          you will put my name on your Web site and I will  
20          share with you the revenue I get as a result. Does  
21          that - - - is it rational to infer from that that you  
22          are soliciting business for me?

23                      MR. WU: And it is, and the reason is  
24          because - - -

25                      JUDGE SMITH: Okay.

1 MR. WU: - - - the commission - - -

2 JUDGE SMITH: The hypothetical's  
3 essentially correct; you agree that that's  
4 essentially the question?

5 MR. WU: Yes, and the reason that there's a  
6 rational - - -

7 CHIEF JUDGE LIPPMAN: Counsel - - -

8 MR. WU: - - - presumption there - - -

9 CHIEF JUDGE LIPPMAN: - - - are you saying  
10 that they don't do, or have to do, any actual  
11 solicitation, nothing; it doesn't matter, the  
12 presumption carries, that's it?

13 MR. WU: It does not carry; it is  
14 triggered. The presumption is triggered, and they  
15 have an opportunity that the statute provides to  
16 rebut that presumption if it is true that their  
17 affiliates do not engage in solicitation.

18 CHIEF JUDGE LIPPMAN: But what about your  
19 adversary's argument - - -

20 MR. WU: They raise that as a fact matter.

21 CHIEF JUDGE LIPPMAN: - - - that they do  
22 this in so many different ways, business world is so  
23 complicated today, the economy, and it goes through  
24 the Internet and all these kind of things; how are  
25 they going to capture all of these things,

1 demonstrate to you that there's no solicitation; is  
2 that really a practical approach?

3 MR. WU: Well, a couple of comments.

4 CHIEF JUDGE LIPPMAN: Assuming - - -  
5 assuming that there actually is no solicitation.

6 MR. WU: There's a couple of points. One,  
7 this is a facial challenge. Not every retailer in  
8 the world is like Amazon or Overstock, and they have  
9 not shown that for every retailer to whom this  
10 statute would apply they have the same problems with  
11 - - -

12 JUDGE SMITH: Is it really - - -

13 MR. MASTRO: But they're - - -

14 JUDGE SMITH: I understand - - - I  
15 understand that there are things. Is it really the  
16 case that if you can think of one strange outlier for  
17 whom the statute would be valid then no facial  
18 challenge works?

19 MR. WU: But it's not a strange outlier  
20 here, because the very premise - - -

21 JUDGE SMITH: You don't really go that far,  
22 do you?

23 MR. WU: We don't have to go that far,  
24 because here the very core of the statute has a  
25 constitutional sweep. And in a facial challenge,

1 that's enough to sustain it.

2 JUDGE READ: But you rely on Moran?

3 MR. WU: We rely on Moran, we rely on  
4 Washington Grange, which emphasized that regardless  
5 of the debate about no set of circumstances - - -

6 JUDGE READ: So you rely on the no set of  
7 circumstances?

8 MR. WU: As long as there's a legitimate  
9 sweep to the statute, it's sustained on a facial  
10 challenge. But the way these retailers would rebut  
11 is really a nonexhaustive list. One, they have  
12 information about their affiliates. They're the ones  
13 who contract with them, who get that information.  
14 Number two, the operating agreements that they have  
15 with their affiliates require their affiliates to  
16 disclose, on demand, any communications that they  
17 have with visitors to their Web site. That's on page  
18 183 of Overstock's record, on page 403 of Amazon's  
19 record.

20 JUDGE SMITH: Let me ask you - - -

21 JUDGE GRAFFEO: If they didn't - - -

22 MR. WU: They could ask their affiliates.

23 JUDGE GRAFFEO: If they didn't share - - -  
24 share commissions with the affiliates, if they just  
25 paid a flat fee, would that be different?

1 MR. WU: It would be different, and it  
2 wouldn't even trigger the presumption in that case.

3 JUDGE GRAFFEO: That fee would be more akin  
4 to The New York Times advertisement?

5 MR. WU: That's correct. What this statute  
6 makes clear - - -

7 CHIEF JUDGE LIPPMAN: That would not  
8 trigger the presumption?

9 MR. WU: It would not. The tax department  
10 has made that absolutely clear. What triggers the  
11 presumption is a commission-based contract to refer  
12 business - - -

13 JUDGE SMITH: So what - - -

14 MR. WU: - - - to the out-of-state  
15 retailers.

16 JUDGE SMITH: So what if The New York Times  
17 is able to do a commission deal, and they put a  
18 little - - - they have - - - you know, people used to  
19 clip - - - clip coupons out of newspapers, and they  
20 put a little number on the back. And if you clip it  
21 out of The New York Times, The New York Times gets a  
22 penny on your sale. Would that - - - would that  
23 create The New York - - - make The New York Times a  
24 sales agent for its advertisers?

25 MR. WU: No, because The New York Times

1 would not be an independent contractor or  
2 representative of the out-of-state retailer.

3 JUDGE SMITH: Well - - -

4 MR. WU: I just - - -

5 JUDGE SMITH: - - - wait a minute. The New  
6 York Times is an independent contractor for every  
7 retailer that it - - - that advertises.

8 MR. WU: No, it's a vendor for these  
9 retailers. What happens is these people sign - - -

10 JUDGE SMITH: It's a vendor?

11 MR. WU: - - - these out-of-state retailers  
12 sign contracts with these where they dictate what  
13 these affiliates do, what they're allowed to say to  
14 people, and how they describe their relationship.  
15 And the reason there's a rational presumption here -  
16 - - I mean, look, even assuming that it would trigger  
17 the presumption, in The New York Times example, the  
18 question in that case becomes if it's rational,  
19 extended across the range of all of these independent  
20 third parties. And the reason it's a rational  
21 presumption - - -

22 JUDGE SMITH: I'm not quite sure what you  
23 just said. You're saying you concede that The New  
24 York Times would not be a solicitor, but you're  
25 saying that if there are some who would be, the

1 presumption's still okay?

2 MR. WU: That's correct. They could show,  
3 for instance, if they did have an independent  
4 contractor relationship with The New York Times, they  
5 could show The New York Times is not soliciting on  
6 their behalf.

7 JUDGE SMITH: But it would be okay to shift  
8 the burden to them? It would be okay to presume that  
9 The New York Times is soliciting?

10 MR. WU: It is okay to shift the burden to  
11 them, because a presumption is basically an  
12 evidentiary rule, and the State is allowed to set  
13 those evidentiary rules here.

14 JUDGE SMITH: Isn't the question, though,  
15 whether - - - really does it come down to whether  
16 it's rational or probable, or whatever the standard  
17 is, whether you can infer from the fact that I - - -  
18 that I - - - that you have this affiliate  
19 relationship with these Web sites to infer that they  
20 are, in effect, telling their customers go buy from  
21 Amazon?

22 MR. WU: Yes, and the reason - - -

23 JUDGE SMITH: Why - - - what bothers me  
24 about that is nobody - - - nobody goes out saying go  
25 buy - - - come to our Web site so you can buy from

1 Amazon. Anybody can go to Amazon's Web site.

2 MR. WU: No, that's incorrect, Your Honor.

3 And in fact, we have evidence in the record - - -

4 JUDGE SMITH: Okay.

5 MR. WU: - - - directly to the contrary.

6 JUDGE SMITH: The charitable organizations,  
7 they do do it.

8 MR. WU: It's not just charitable  
9 organizations; it's also schools, which are not  
10 charitable organizations, and churches. And the  
11 reason that's relevant here is because Amazon itself  
12 tells its affiliates, go out there, tell us about the  
13 link. And the way they do it is not through a banner  
14 advertisement on the Web site. Amazon drafts e-mails  
15 for their affiliates to send to targeted parties  
16 saying use our link and we will get ten percent of  
17 the revenue. Make all of your purchases on Amazon,  
18 and you will support our organization.

19 JUDGE SMITH: Well, what - - -

20 JUDGE PIGOTT: Will that apply the other  
21 way? I was picking - - - I was being provincial with  
22 your opponents, but does that mean that every other  
23 state in the union can do this to every New York  
24 State business and say there's a presumption to  
25 Stewart's Ice Cream or Buffalo Chicken Wings that if

1           you sell your wings outside of the State of New York  
2           you better find out if Illinois is selling them, how  
3           many they're selling, and there's a presumption that  
4           you owe Illinois sales tax?

5                     MR. WU: Well, they can - - - they can put  
6           on that presumption if there is a contract-based  
7           relationship.

8                     JUDGE PIGOTT: Doesn't that have an effect  
9           on interstate commerce?

10                    MR. WU: It does not, and here is why.  
11           Number one, there is no risk of multiple taxation  
12           here. You know exactly where it is that the tax will  
13           be applied. Number two, there is an affirmative act  
14           that every business has to go through to decide to  
15           enter into these contract-based relationships. These  
16           businesses entered into and created a physical  
17           presence deliberately in New York by setting up these  
18           affiliate programs.

19                    CHIEF JUDGE LIPPMAN: Counselor, why isn't  
20           the statute superfluous - - - the whole business? If  
21           there's solicitation, it's taxable; why do you need  
22           the statute for? What is the purpose of the statute?

23                    MR. WU: The statute here does what every  
24           presumption does, which it sets a rule of evidence  
25           and clarifies who comes forward with that evidence

1 here.

2 CHIEF JUDGE LIPPMAN: Yeah, but I asked you  
3 a question. Why - - - why do we need this statute in  
4 New York when if there's solicitation, it's taxable?

5 MR. WU: Because it clarifies the burden of  
6 who comes forward with that evidence. Without this  
7 statute, they could argue that they don't need to  
8 come forward with any evidence about their own  
9 affiliates. Under this statute - - -

10 CHIEF JUDGE LIPPMAN: So the statute is  
11 necessary so you can put in place the presumption.

12 MR. WU: That's correct. And the reason it  
13 makes sense here is because presumptions are often  
14 put in place - - -

15 CHIEF JUDGE LIPPMAN: It's got to be, again  
16 - - -

17 MR. WU: - - - to make sure - - -

18 CHIEF JUDGE LIPPMAN: - - - a rational  
19 presumption.

20 MR. WU: Right, but the presumptions are  
21 often put in place to make sure that the party that  
22 uniquely has the information produces it. That was  
23 true in Casse, the horse-trainer case, as well as in  
24 the coal miner case of Usery. And the fact - - -

25 JUDGE SMITH: Could we go back - - -

1                   MR. WU:   - - - of the matter of here is  
2 these parties - - -

3                   JUDGE SMITH:   - - - for a moment to the  
4 dialogue - - -

5                   MR. WU:   - - - have that information.  
6 Sorry.

7                   JUDGE SMITH:   Go ahead.  If you're finished  
8 answering the Chief's question, I'll - - -

9                   MR. WU:   Let me - - - one more sentence.  I  
10 mean, these parties have the information and they  
11 have more ready access to it than anybody else,  
12 including the tax department.

13                   JUDGE SMITH:   If I can go back to the  
14 dialogue we were having before, you were pointing out  
15 to me, I think, that there are, let's say, a lot of  
16 entities that will indeed ask their customers,  
17 essentially, look; to support us, to do us a favor,  
18 go through our link to Amazon.  Would you agree,  
19 though, that that's - - - those are atypical cases?

20                   MR. WU:   No.

21                   JUDGE SMITH:   Most people's customers are  
22 not - - - not trying to do them a favor.  Sure, if  
23 you're a church or a school, but if you're an  
24 ordinary guy with a Web site, you don't have this  
25 loyal following who is going to come to you and buy

1 on Amazon through you in order to enrich you.

2 MR. WU: No, I don't think that's true at  
3 all. And first of all, these are all factual  
4 assertions that Amazon has made - - -

5 JUDGE SMITH: Well - - - well - - -

6 MR. WU: - - - and Overstock - - -

7 JUDGE SMITH: - - - well, you say factual  
8 assertion, but don't we have to say what common  
9 experience teaches us about how likely the presumed  
10 fact is to follow from the proved fact?

11 MR. WU: And here what that common  
12 experience says is that commissions, as a historical  
13 matter, have always been associated as an incentive  
14 for solicitation. That's why salesmen, in all the  
15 cases where the court has found solicitation, were  
16 paid by commission.

17 JUDGE SMITH: Okay. I see - - -

18 MR. WU: And it's like the example - - -

19 JUDGE SMITH: I see that point, but doesn't  
20 the Internet change the world a little bit because  
21 it's - - - commission is always the most efficient  
22 way to compensate somebody, it's just that it's very  
23 hard to do. But now with the Internet, it's easy, so  
24 you compensate everyone on commission.

25 MR. WU: No, commissions are not just

1           efficient; commissions also exist directly for that  
2           incentive purpose. And the reason that these  
3           companies chose commissions instead of some other  
4           form of compensation is because they want to  
5           encourage the referral of business to them. Amazon  
6           makes that explicit in its description of the  
7           affiliate program. They tell their affiliates the  
8           more business you refer, the more money you will make  
9           on the basis of your activity.

10                   JUDGE SMITH: And if they told The New York  
11           Times the more business we get from your ads, the  
12           more we're going to pay you, would that make The New  
13           York Times a sales agent for - - -

14                   MR. WU: Well - - -

15                   JUDGE SMITH: - - - for Amazon?

16                   MR. WU: - - - it wouldn't. It might  
17           trigger the presumption, but then if they could show  
18           The New York Times - - -

19                   JUDGE SMITH: So you really say that on  
20           those facts The New York Times could be presumed to  
21           be a sales agent for Amazon?

22                   MR. WU: And they would rebut it just by -  
23           - -

24                   JUDGE SMITH: I understand that they can  
25           rebut it, but if the presumption doesn't meet the

1 test of common experience, then they shouldn't have  
2 to rebut it.

3 MR. WU: No, that's not - - -

4 JUDGE SMITH: You can't - - -

5 MR. WU: That's not correct; presumptions  
6 are never perfect. I mean, the horse trainer  
7 presumption, to take the example of Casse, says that  
8 if a horse is drugged, it's presumed that the trainer  
9 is responsible, regardless of who was in the stable  
10 or what the trainer actually did.

11 JUDGE SMITH: Okay. And that seems - - -  
12 that sort of meets the test of common experience; the  
13 - - - obviously, sometimes people sneak past the  
14 trainer, but common experience tells you that if the  
15 horse turns up drugged, you suspect the trainer. I -  
16 - - I have trouble getting common experience to tell  
17 me that because I have an ad on a Web site, the owner  
18 of the Web site is my sales agent.

19 MR. WU: It's not an ad on the Web site.  
20 It's because you pay the owner by commission only for  
21 getting a sale to be completed on your outside Web  
22 site, there's a presumption that they are engaged in  
23 some acts of solicitation.

24 And I want to clarify one thing.  
25 Solicitation, here, does not mean going door to door.

1 You can solicit by e-mail, by phone, by other forms  
2 of communication. And part of what this limited  
3 record has already shown is that there are affiliates  
4 of Amazon - - -

5 CHIEF JUDGE LIPPMAN: Can you solicit  
6 without any presence?

7 MR. WU: - - - who engage in solicitation.  
8 I'm sorry?

9 CHIEF JUDGE LIPPMAN: Can you solicit  
10 without any presence?

11 MR. WU: Well, you can solicit without  
12 presence, but here, all of the affiliates are New  
13 York residents. That is the triggering factor of  
14 this presumption. So we start from the premise that  
15 these are New York residents who are engaged in some  
16 economic activity on behalf of these outside  
17 retailers.

18 JUDGE PIGOTT: How do you know they're New  
19 York residents?

20 MR. WU: Because this is what the statute  
21 requires, and they sign - - -

22 JUDGE PIGOTT: But pick one. Tell me how  
23 you know - - - I mean, how does this work? I think  
24 I'm missing something here.

25 MR. WU: Well, I mean, they sign up, these

1 affiliates, and these affiliates give them New York  
2 addresses. That's how we know that they're New York  
3 residents in this case.

4 CHIEF JUDGE LIPPMAN: But the target is not  
5 necessarily New York, right? They could have a New  
6 York agent and they're not - - -

7 MR. WU: But this is a - - -

8 CHIEF JUDGE LIPPMAN: - - - it's not - - -

9 MR. WU: But this is another commonsense  
10 presumption. I mean, it is true that there are Web  
11 sites out there - - -

12 CHIEF JUDGE LIPPMAN: In the - - -

13 MR. WU: - - - that have no - - -

14 CHIEF JUDGE LIPPMAN: In the computer age  
15 and with modern technology, that's a commonsense  
16 presumption - - -

17 MR. WU: Yes.

18 CHIEF JUDGE LIPPMAN: - - - that the target  
19 has to be New York?

20 MR. WU: It's a commonsense presumption  
21 that they can rebut. I mean, just to give an  
22 example, this court's Web site is directed, in large  
23 part, at fellow New Yorkers. My office's Web site is  
24 directed at New Yorkers.

25 CHIEF JUDGE LIPPMAN: I think that's a

1 little different situation.

2 MR. WU: But we give examples, as well, of  
3 schools and synagogues and restaurants and many local  
4 businesses, including many in this city, that would  
5 target local residents. Local newspapers target  
6 local residents. Classified ads target local  
7 residents. Again - - -

8 CHIEF JUDGE LIPPMAN: But - - -

9 MR. WU: - - - the presumption does not  
10 have to be - - -

11 CHIEF JUDGE LIPPMAN: But the business  
12 world is a little different, isn't it? I mean, today  
13 - - - the global economy, the national economy - - -  
14 you're not necessarily geared towards New York - - -

15 MR. WU: But you don't have to - - -

16 CHIEF JUDGE LIPPMAN: - - - I mean, again,  
17 for a reasonable presumption.

18 MR. WU: But that's the key phrase here.  
19 You don't have to necessarily be targeting New York,  
20 there just has to be a reason to believe that you are  
21 targeting.

22 JUDGE PIGOTT: Well, one of the two - - - I  
23 forget which brief I read it in - - - said, you know,  
24 we used to have people in New York; we got rid of  
25 them all because we don't want to pay this tax.

1 MR. WU: That was Overstock, but - - -

2 JUDGE PIGOTT: If - - - all right, if we  
3 say - - - if we agree with you and say if you have a  
4 Web site in New York and this goes on, they've got to  
5 pay the tax, aren't they going to just say all right,  
6 we're not going to sign up anybody that has a Web  
7 site in New York?

8 MR. WU: That - - -

9 JUDGE PIGOTT: I mean, I'm worried about  
10 our New York economy here.

11 MR. WU: Right, well, but - - -

12 JUDGE PIGOTT: So if you're in  
13 Pennsylvania, Canada, Connecticut, Delaware, anywhere  
14 else, you know, you could be an Amazon affiliate, but  
15 you can't be if you're in New York.

16 MR. WU: But that's a choice that they can  
17 make. And I think - - -

18 JUDGE PIGOTT: That's okay with you?

19 MR. WU: And that's okay with us, because,  
20 I mean, Amazon has had that choice for the last two  
21 years, and unlike Overstock - - -

22 JUDGE PIGOTT: Well, they're saying that -  
23 - -

24 MR. WU: - - - they have decided to  
25 preserve that program.

1                   JUDGE PIGOTT: - - - that they're making a  
2 legal argument.

3                   MR. WU: Well, they're making a legal  
4 argument, but keep in mind the purpose of these  
5 affiliate programs. They're not there for show;  
6 they're there to generate revenue for the company,  
7 and in the same way that a traditional sales agent is  
8 there to generate revenue - - -

9                   CHIEF JUDGE LIPPMAN: Yeah, but you're  
10 generating - - -

11                  MR. WU: - - - these representatives are  
12 there - - -

13                  CHIEF JUDGE LIPPMAN: You're generating  
14 revenue for the state; that's why you're doing this,  
15 right?

16                  MR. WU: That's correct.

17                  CHIEF JUDGE LIPPMAN: So - - -

18                  MR. WU: And it's important - - -

19                  CHIEF JUDGE LIPPMAN: So if you can't use  
20 anybody in New York, in the long run, is this a good  
21 thing, in terms of what we're trying to do in the - -  
22 - what you're trying to do in the best interests of  
23 the state?

24                  MR. WU: I mean, we think it is, and the  
25 legislature thought it was. There was a debate about

1 this very issue - - -

2 CHIEF JUDGE LIPPMAN: All right. What the  
3 legislature thought.

4 MR. WU: - - - and the legislature decided  
5 it. I mean, one point to really emphasize here is  
6 the tax that is being collected is not being paid out  
7 of the pockets of these companies. It is a tax that  
8 is indisputably owed, and the state has no way of  
9 getting to this tax - - -

10 JUDGE PIGOTT: Yeah, the - - -

11 MR. WU: - - - as a practical matter - - -

12 JUDGE PIGOTT: - - - the taxpayers give it  
13 - - -

14 MR. WU: - - - unless the vendor collects.

15 JUDGE PIGOTT: No; don't the taxpayers give  
16 it to you when they send their income tax forms in?

17 MR. WU: That is an incredibly low  
18 percentage - - -

19 JUDGE PIGOTT: Oh.

20 JUDGE READ: Surprise.

21 MR. WU: - - - as a practical matter. And  
22 the Supreme Court has recognized, since National  
23 Geographic in the '70s - - -

24 JUDGE PIGOTT: I was kidding.

25 MR. WU: Right - - - that this is not the

1 way to collect the tax. You do it through vendor  
2 collection. I mean, the state really has a  
3 compelling interest here in reaching this tax revenue  
4 through the vendors. And what the State has done  
5 with this statute is to say that if you choose to  
6 establish a physical presence through signing these  
7 in-state representatives to promote your products,  
8 that's a physical presence - - -

9 JUDGE PIGOTT: Do you have any idea how  
10 much we're talking about here in terms of sales tax,  
11 just in your late moments figuring out how much is  
12 involved?

13 MR. WU: It's between 50- to 100-million  
14 dollars a year. I mean, we have collected an  
15 enormous amount of money - - -

16 JUDGE READ: Well, I suppose you've been -  
17 - -

18 MR. WU: - - - in a short period of time.

19 JUDGE READ: You've been collecting under  
20 protest?

21 MR. WU: That's correct. Well, these two  
22 have protested. Many retailers have not. And these  
23 are not the only retailers - - -

24 JUDGE SMITH: The 50 to 100 million just  
25 from Amazon or - - -

1           MR. WU: No, no, there are several dozen,  
2           at least, retailers the tax department believes are  
3           covered by this presumption. The money has been  
4           collected from them this whole time and it has been a  
5           substantial amount of revenue. Again, there is no  
6           dispute in this case that the tax is owed and should  
7           be paid, and the only question is how the state does  
8           it.

9           One point that I want to emphasize is the  
10          test under the dormant commerce clause is a highly  
11          lenient one. It is not one that requires a  
12          substantial physical presence. If Amazon - - -

13          CHIEF JUDGE LIPPMAN: What's the test?

14          MR. WU: It's if there's demonstrably more  
15          than the slightest physical presence. And as this  
16          court made clear in Orvis, that could be established  
17          by a single - - -

18          JUDGE READ: So it's not Quill?

19          MR. WU: - - - a single employee. No.

20          JUDGE READ: It's not Quill?

21          MR. WU: No, Quill said that it would not  
22          estab - - - it would not meet that test, which well  
23          pre-dates Quill, if you just solicited by mail order  
24          catalogue. That's - - - it's essentially - - - or  
25          through the U.S. Mail or through common carrier.

1                   What this court made clear in Orvis is that  
2                   you just need demonstrably more than the slightest  
3                   presence, which would satisfy - - -

4                   JUDGE READ: But in Orvis the facts were  
5                   different, you would agree with that? There was an  
6                   active sales force in New York.

7                   MR. WU: It was not an active sales force.  
8                   There were employees from Vermont - - -

9                   JUDGE READ: Okay.

10                  MR. WU: - - - who came into New York  
11                  occasionally - - -

12                  JUDGE READ: Okay.

13                  MR. WU: - - - to conduct sales.

14                  JUDGE READ: Okay. That's what I would  
15                  call an active sales force, but - - -

16                  MR. WU: No, but - - - but the reason  
17                  that's different is because - - - the reason that's  
18                  comparable here is because Orvis tried to argue that  
19                  they did not come in enough, and what the Supreme  
20                  Court and this court has made clear is a single  
21                  employee in the state - - - that was the facts of  
22                  Standard Pressed - - - would be enough to impose the  
23                  tax; a single office unrelated to their sales would  
24                  be enough under the dormant commerce clause. If they  
25                  had back-office support, technical support with four

1 employees - - - that was the factor of National  
2 Geographic - - - that would be enough under the  
3 dormant commerce clause.

4 What these retailers have done - - -  
5 Overstock, before it abandoned the practice - - - is  
6 to sign up thousands of New Yorkers to promote their  
7 products on their Web sites. This is more than  
8 sufficient to establish a physical presence for the  
9 commerce clause. And the way that this statute  
10 determines whether that physical presence - - -

11 JUDGE SMITH: But you would admit that they  
12 could advertise in that many thousands of New York  
13 magazines and not have a physical presence?

14 MR. WU: That's correct. But the reason  
15 that's true is Tax Law 12(c) expressly says Internet  
16 advertising shall not give rise to a tax-collection  
17 responsibility. The definition of a vendor says  
18 advertising alone will not give rise to the tax-  
19 collection responsibility. There is no way to read  
20 this statute, in the context of the overall tax  
21 legislation, that makes it cover advertising.

22 JUDGE SMITH: Well - - -

23 MR. WU: What it - - -

24 JUDGE SMITH: - - - but you acknowledge  
25 that it does, essentially, cover any advertiser who's

1           paid on commission.

2                   MR. WU:  It covers commission payments to  
3           refer business, which - - -

4                   JUDGE SMITH:  Well, I think you  
5           acknowledged a while ago that The New York Times  
6           would be covered if they got a contingent payment for  
7           their efforts.

8                   MR. WU:  I mean, this might be a difference  
9           in terminology.  Advertisements are not paid by  
10          commission, and there's a reason they're not paid by  
11          commission.  Again, these - - - these out-of-state  
12          retailers made a choice here.  They could have paid  
13          these Internet users.

14                   JUDGE SMITH:  Advertisers are sometimes  
15          paid on commission; there are those coupons with the  
16          little numbers on the back.  And you say that - - -  
17          that converts the advertiser into the - - - into the  
18          - - - converts the medium into the advertiser's  
19          physical presence in New York.

20                   MR. WU:  I don't - - - I'm not sure that  
21          that's a commission here.  A commission is what  
22          Amazon and Overstock have done in their agreements,  
23          which is to give people a percentage of sales that  
24          are directed from the New York resident.  That's a  
25          straight-up - - -

1 JUDGE SMITH: Isn't that the point - - -

2 MR. WU: - - - commission.

3 JUDGE SMITH: - - - of those little numbers  
4 on the back of the coupons, so you can give your  
5 percentage to the advertiser?

6 MR. WU: No, but that's, at best, an  
7 imperfect mechanism for capturing it. Not everybody  
8 who's actually referred by the ad will give that  
9 coupon. This is a straight-up commission that says  
10 every sale that results from your referral will give  
11 you four, six, eight percent of the business. And  
12 the very reason they chose that, instead of a flat-  
13 fee advertising model - - - which they could have  
14 adopted - - - the reason they chose that was to  
15 incentivize people to make completed sales. I mean,  
16 the purpose of a commission is to incentivize  
17 completed sales, and the evidence of the record shows  
18 that that's what these affiliates did; they went out,  
19 they - - -

20 JUDGE SMITH: Is it really practical to do  
21 a flat-fee advertising model when you're talking  
22 about Web sites - - -

23 MR. WU: Oh.

24 JUDGE SMITH: - - - which could be  
25 somebody's Web site in his basement or it could be -

1           - - or it could be of the most popular Web site on  
2           the Internet?

3                       MR. WU:  It's not just possible; it is  
4           actually implemented by these companies.  They have  
5           click-through models that pay by the click.  They  
6           have what are called impression models that are paid  
7           every time somebody sees the Web site.

8                       JUDGE SMITH:  So payment by the click would  
9           not do it.

10                      MR. WU:  No, because what that incentivizes  
11           is just getting people to the Web site.  
12           Advertisement gets people to the door of the  
13           business; solicitation takes them to the register.  
14           And that's what the incentive here is meant to  
15           accomplish.

16                      CHIEF JUDGE LIPPMAN:  Okay, counselor.

17                      MR. WU:  Thank you.

18                      CHIEF JUDGE LIPPMAN:  Thanks.

19                      Counselor, rebuttal?

20                      MR. CONNOLLY:  Thank you, Your Honor.  Very  
21           briefly.  I think Judge Smith asks the exact right  
22           question.  Under this statutory scheme, The New York  
23           Times, on its Web site where they get paid - - - can  
24           be paid in the same way as other Internet  
25           advertisers, is captured - - - brings a foreign

1           entity into this scheme. That, in and of itself,  
2           violates - - - is an undue burden on interstate  
3           commerce and violates the Constitution.

4                    JUDGE READ: Well, why don't you pay flat  
5           fees rather than commissions? I know you're not  
6           paying anybody now, but why not do it on - - - if  
7           they're saying that's okay.

8                    MR. CONNOLLY: Well, first of all, they're  
9           saying it's okay today, Your Honor.

10                   JUDGE READ: I know that's - - -

11                   MR. CONNOLLY: That's not what the statute  
12           says.

13                   JUDGE READ: I know, it's a bulletin, but  
14           in any event, let's assume - - - let's take them at  
15           their word.

16                   MR. CONNOLLY: Okay. And, well - - -

17                   JUDGE READ: It's a business practice.

18                   MR. CONNOLLY: And again, their word - - -  
19           just in fairness, their word is valid today under  
20           that bulletin, and can be withdrawn at any time.

21                   JUDGE READ: I understand that.

22                   MR. CONNOLLY: But I think the exercise  
23           here today, Your Honor, is to what are the words of  
24           the statute saying.

25                   CHIEF JUDGE LIPPMAN: Yeah, but what's the

1 answer to the judge's question?

2 JUDGE READ: What's the business answer?

3 MR. CONNOLLY: The answer to - - - the  
4 answer to your question is that the Internet - - -  
5 Internet providers can use all kinds of means to  
6 compensate advertisers, and they've chosen a more  
7 efficient one.

8 Judge Smith is once again correct that  
9 there's a longstanding history in trying to utilize  
10 what's called the performance marketing - - - we talk  
11 about this in the briefs - - - the performance  
12 marketing advertising method, which allows people to  
13 maximize the efficiency of their spend, of their  
14 dollars on advertising. And so, I mean, if we lived  
15 in a world where you could click the billboard on the  
16 New York State Thruway and therefore compensate the  
17 billboard owner, we would use that, right? And this  
18 is really just the Internet version of that. And by  
19 the way, on a billboard, you could have a thousand  
20 physical billboards in the State of New York on the  
21 New York State Thruway, and that still doesn't  
22 constitute physical presence in the state. And so I  
23 think that is the next - - - they are capturing - - -  
24 you - - - I think Judge Smith has captured exactly  
25 how far this statute goes by its own words. And all

1 the effort of the State at this point is to take you  
2 away from the words of the statute; don't look at  
3 that.

4 And the final point that I would make is  
5 the no set of circumstances - - - just to be clear,  
6 in Salerno, that standard has never, ever been used.  
7 It has never been a decisive factor in any decision -  
8 - -

9 CHIEF JUDGE LIPPMAN: In commerce.

10 MR. CONNOLLY: - - -by the United States  
11 Supreme Court and never in the commerce clause. And  
12 in Moran - - - let's not forget, in Moran we weren't  
13 talking about a foreign entity. The decision in  
14 Moran - - -

15 JUDGE READ: So you don't think we have to  
16 overrule Moran?

17 MR. CONNOLLY: You don't; you'd have to  
18 distinguish Moran.

19 JUDGE READ: We'd have to distinguish  
20 Moran.

21 MR. CONNOLLY: In fairness, because Moran  
22 was a New York corporation.

23 CHIEF JUDGE LIPPMAN: Okay, coun - - -

24 MR. CONNOLLY: And - - -

25 CHIEF JUDGE LIPPMAN: Thank you.

1 MR. CONNOLLY: Thank you, Your Honors.

2 CHIEF JUDGE LIPPMAN: Appreciate it.

3 Counselor, rebuttal?

4 MR. MASTRO: Yes. Thank you, Your Honors.

5 Judge Read, it is about efficiency in the  
6 e-commerce age. A commission-based system, as  
7 opposed to having to pay a lot of money to The New  
8 York Times for Amazon to run an ad there, with no  
9 certain result, in the e-commerce age, it is  
10 efficient and works for both parties on Web sites  
11 that we pay nothing if there's no benefit that comes  
12 out of it, but if something comes out of it, there is  
13 an amount that comes from the actual sales that  
14 occurred. That's efficient; it costs the Web site  
15 nothing to put a click through. The New York Times,  
16 it costs them money to run an ad, and it costs Amazon  
17 money to produce one.

18 Now, I'm here on behalf of Amazon. This  
19 was such a brazen end-run around the commerce clause  
20 by the state legislature that they openly called it  
21 the Amazon tax. We're paying the lion's share of an  
22 unconstitutional tax.

23 Now, Your Honors hit it right on the head.

24 JUDGE SMITH: But your customers are paying  
25 it.

1                   MR. MASTRO: Yeah, we are required to  
2 collect and remit.

3                   Now, Chief Judge, you hit it exactly right.  
4 This is a superfluous piece of legislation. This is  
5 a burden shifting, because it is always the state's  
6 burden, in the first instance, to show that it has  
7 the constitutional authority under the commerce  
8 clause to tax my client and other Internet retailers.  
9 And it is shifting the burden because, of course,  
10 those who are engaged in solicitation already were  
11 having to collect and remit under the existing  
12 regime. And that's why in Illinois a direct attempt  
13 to tax based on Internet affiliations, or to impose  
14 tax question obligations, was struck by the circuit  
15 court there. Here, in the guise of a presumption, an  
16 artifice, a fiction, a false construct, they have  
17 shifted, unconstitutionally, the burden to us and to  
18 run around Quill and an irrational presumption,  
19 because in this modern age - - - he admitted it,  
20 okay? He was forced to say hey, The New York Times,  
21 if it could be paid on commissions, would suddenly be  
22 our virtual sales force - - -

23                   JUDGE GRAFFEO: Well, but - - -

24                   MR. MASTRO: - - - in New York. That is  
25 absurd.

1 JUDGE GRAFFEO: - - - is it irrational to  
2 say there's a difference between providing  
3 information to the consumer advertising versus - - -  
4 versus the completion of the transaction, the actual  
5 sale of the good?

6 MR. MASTRO: And please understand, Your  
7 Honor, that the only thing that happens here is that  
8 there is a posting - - - a posting; this is what it  
9 looks like.

10 JUDGE GRAFFEO: Yeah, but you're not - - -

11 MR. MASTRO: This is - - -

12 JUDGE GRAFFEO: - - - you're not making any  
13 revenue unless the item is sold.

14 MR. MASTRO: But - - -

15 JUDGE GRAFFEO: That's - - -

16 MR. MASTRO: But Your Honor - - -

17 JUDGE GRAFFEO: Isn't that part of the deal  
18 - - -

19 MR. MASTRO: - - - we're not having - - -

20 JUDGE GRAFFEO: - - - with the affiliate?

21 MR. MASTRO: - - - we're not having to pay  
22 anything for the advertising. It's an efficient  
23 system in an e-commerce world. Your Honor, the point  
24 is this. The point is this. This is what one of  
25 these sites looks like.

1                   JUDGE GRAFFEO: I guess I'm asking why is  
2                   that not a rational distinction for the legislature  
3                   to look at?

4                   MR. MASTRO: No, Your Honor, because it's  
5                   completely an artifice, in the following sense.  
6                   There is no rational basis for concluding that it's  
7                   more likely than not, or applying this court's  
8                   standard that there's a reasonably high degree of  
9                   probability that just because a Web site advertiser  
10                  gets paid by commission, it suddenly converts that  
11                  Web site advertiser into a sales force actively  
12                  soliciting, for Quill purposes, in New York. And  
13                  that's the absurdity of their position. The New York  
14                  Times is not and would never be converted into a  
15                  virtual sales force. These Web sites are content  
16                  based, whether it's The New York Times concurring  
17                  opinions, a magazine about the law, you can't even  
18                  tell whether it's from New York. You can click  
19                  through to ten different sites off of this. Does  
20                  this convert the authors of this site on page 723 of  
21                  the record into a virtual sales force for Amazon?  
22                  It's absurd, and it's absurd for him to have  
23                  suggested that suddenly there's a burden on us that  
24                  we have to rebut that The New York Times becomes our  
25                  sales force because they're a content-driven site,

1 publication, newspaper distributed worldwide that  
2 drives people and subscribers because of their  
3 content.

4 Your Honors, this is obviously an extremely  
5 important case, if I might just make one last point.  
6 It's - - -

7 CHIEF JUDGE LIPPMAN: One last point,  
8 counselor.

9 MR. MASTRO: It's a - - -

10 CHIEF JUDGE LIPPMAN: Go ahead.

11 MR. MASTRO: It's a case where New York led  
12 the way by passing this unconstitutional legislation  
13 so that so many others around the country are now  
14 trying the same gambit; over 6,000 taxing  
15 jurisdictions, many states now trying this same  
16 gambit. It's a case that will go up. And Your  
17 Honors, I will simply say that one of the hallmarks  
18 of this court is that it respects the federal  
19 Constitution and it gets it right. This law is  
20 unconstitutional and needs to be stricken.

21 CHIEF JUDGE LIPPMAN: Thank you, counsel.

22 MR. MASTRO: Thank you, Your Honors.

23 CHIEF JUDGE LIPPMAN: Thank you all. Much  
24 appreciated.

25 MR. MASTRO: Thank you.

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CHIEF JUDGE LIPPMAN: Thank you.

(Court is adjourned)

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C E R T I F I C A T I O N

I, Sharona Shapiro, certify that the foregoing transcript of proceedings in the Court of Appeals of OVERSTOCK.COM, INC. v. NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, ET AL., No. 33 and AMAZON.COM, LLC, et al. v. NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, ET AL., No. 34, was prepared using the required transcription equipment and is a true and accurate record of the proceedings.

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