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Taxation of Internet Sales - Where in the Cyberspace is Nexus?

By: Kathryn Kisska-Schulze, J.D., LL.M.*

I. Introduction

The advent of the Internet¹ in the 1980's revolutionized the world of computers, information technology and communication. The Internet, with its international broadcasting capabilities, is an instrument for broadcasting information and a medium for partnership and interaction between persons and their computers without regard to geographic setting.² Its viral capability has reinvented the way the world works, communicates, and deciphers information. Because of the Internet's instantaneous abilities, news spreads like wildfire around the world³, keeping secrets is virtually impossible, and persons and companies now have direct and immediate access to their target audience.

With the dawn of the Internet age, the corporate world also found a new and efficient way of doing business – via electronic commerce (“e-commerce”⁴). In the United States alone,

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¹ The Internet Tax Freedom Act defines “Internet” as “collectively the myriad of computer and telecommunications facilities, including equipment and operating software, which comprises the interconnected world-wide network of networks that employ the Transmission Control Protocol/Internet Protocol, or any predecessor or successor protocols to such protocol, to communicate information of all kinds by wire or radio.” Pub. L. No. 105-277, § 1104(4), 112 Stat. 2681-719, -720 (1998).

² See Barry M. Leiner, *Histories of the Internet*, INTERNET SOCIETY, <http://www.isoc.org/internet/history/brief.shtml> (last visited Dec. 2, 2011).

³ See Sheldon Levine, *How Fast the News Spreads Through Social Media*, SYSOMOS (May 2, 2011, 11:23 AM), <http://blog.sysomos.com/2011/05/02/how-fast-the-news-spreads-through-social-media/> (last visited Dec. 2, 2011).

As an illustration, Levine tracked how quickly the news spread of Osama Bin Laden's death. According to Levine's research, beginning at 10:30 PM (EST) on May 1, 2011, Tweets began surfacing regarding Bin Laden's death. By 10:45 (EST) the television news stations began broadcasting information on the incident, and by 11:30PM (EST) President Obama addressed the nation on the television. By 11:45PM (EST), Levine tracked that 500,000 Tweets, 796 blogs, and 507 published news articles had already surfaced about Bin Laden's death.

⁴ The Internet Tax Freedom Act defines “e-commerce” as “any transaction conducted over the Internet or through Internet access, comprising the sale, lease, license, offer or delivery of property, goods, services, or information, whether or not for consideration, and includes the provision of Internet Access.” Pub. L. No. 105-277, § 1104(3), 112 Stat. 2681-719, -725 (1998).

e-commerce retail sales grew from \$995 billion in 1999 to \$2,385 billion by 2006.⁵ A 2009 study out of the University of Tennessee estimated that e-commerce transactions are anticipated to rise from \$3 trillion in 2010 to \$4 trillion in 2012.⁶ This study further predicted that while \$45.9 billion dollars in sales taxes will be due by the states cumulatively in 2012⁷, only \$34.5 billion of that amount will actually be collected⁸, resulting in an anticipated overall U.S. sales tax loss of \$11.4 billion dollars in 2012 alone.⁹

Amidst these staggering numbers, can states do anything more to collect sales tax emanating from e-commerce sales? The answer to this question lies at the heart of the query: Where in the cyberspace is nexus? While this article does not attempt to define a solution to this question, its purpose is to present an overview of statutory rules currently in place pertaining to sales and use tax, with particular attention paid to the area of e-commerce sales; examine the Constitutional mandates in place regarding “nexus” and “physical presence”, with heavy emphasis placed on federal and state judicial case law; scrutinize the current situation between deficit-stricken state taxing jurisdictions and cyber-retailers seeking shelter under the umbrella of the Due process and Commerce Clauses; and provide observations for the need to create uniformity among the states in dealing with e-commerce transactions.

II. Sale and Use Tax and the Nexus Issue

⁵ Donald Bruce, Fox, William F. Fox, & LeAnn Luna, *State and Local Government Sales Tax Revenue Losses from Electronic Commerce*, THE UNIVERSITY OF TENNESSEE, April 13, 2009, at ii.

⁶ *Id.* at 3.

⁷ *Id.* at 8.

⁸ *Id.* at 4.

⁹ *Id.* at 5. To put this dollar amount into perspective, consider the fact that the anticipated U.S. budget deficit for 2011 will hit a record high of \$1.4 trillion. If the U.S. were to collect \$11.4 billion dollars in lost sales tax each year and put it towards the U.S. deficit, it would take approximately 123 years to pay off the U.S. debt (assuming the U.S. debt amount remained constant).

Sales tax is a state-specific tax generally imposed on the retail sale of tangible personal property and certain specified services.¹⁰ The tax is measured as a percentage of a particular item's retail price.¹¹ Generally, the vendor or retailer of any item of personal property sold is required to collect sales tax at the point of sale and remit it to the particular state's department of revenue.¹²

Use tax is an excise tax applied when the sales tax has not been, and is imposed on the use, storage or consumption of goods within a particular state.¹³ Use tax in any given state generally has the same tax rate base as the state's sales tax rate.¹⁴ The purpose of the use tax is to discourage persons from purchasing products in a state where they do not reside and which imposes no sales tax, and subsequently bringing such items back into the purchaser's state of residence for use; a state which happens to be a location which does in fact impose a sales tax.¹⁵ Unless a collection burden is actually imposed on the seller by the state, use tax is far more difficult for taxing authorities to collect than is the sales tax.¹⁶

Currently, forty-five states and the District of Columbia impose sales and use taxes, leaving only Alaska, Delaware, Montana, New Hampshire and Oregon as the only states which do not require such taxes.

¹⁰ See, e.g., WYO. STAT. ANN. § 39-15-103(a)(1)(A) which allows for the levy of tax on the sales price of every retail sale of tangible personal property within the state.

¹¹ BLACK'S LAW DICTIONARY 4566 (8th ed. 2004).

¹² See, e.g., IDAHO CODE ANN § 63-3619(b) which allows that an excise tax imposed on every retail sale be collected by the retailer from the consumer.

¹³ See, e.g., WYO. STAT. ANN. § 39-15-103(a)(i), (c)(i) and Colo. Rev. Stat. § 39-26-202(1)(a), (c).

¹⁴ See, e.g., COLO. REV. STAT. § 39-26-106(1)(a)(I) which imposes a 3% state sales tax rate as well as a use tax rate of 3%. See also COLO. REV. STAT. § 39-26-202(1)(a).

¹⁵ BLACK'S LAW DICTIONARY, *supra* note 11 at 4568.

¹⁶ Sidney S. Silhan, *Symposium on the Second Amendment: Fresh Looks: If It Ain't Broke Don't Fix It: An Argument for the Codification of the Quill Standard for Taxing Internet Sales*, 76 CHI.-KENT L. REV. 671, 676 (2000).

Sales and Use Tax and the Age of E-Commerce

Because state statutes and regulations regarding sales and use tax are not universal, a nationwide effort to align states' sales and use tax rules was established in March, 2000 via the Streamlined Sales Tax Project (SSTP).¹⁷ Comprised of forty-four states and the District of Columbia, the SSTP takes aim at the relatively untaxed realm of e-commerce and Internet sales.¹⁸ The main objective of the SSTP is to simplify and modernize sales and use tax collection and administration in the U.S. by creating a set of universal rules which member states agree to abide by.¹⁹

To accomplish its goals, in 2002 the SSTP established the Streamlined Sales and Use Tax Agreement (SSUTA).²⁰ The SSUTA's purpose is to simplify and modernize sales and use tax administration in order to substantially reduce the burden of tax compliance.²¹ The SSUTA encourages remote sellers selling over the Internet and by mail order to collect tax on sales to customers located in the streamlined states.²² The key to effective simplification of tax collection as proposed by the SSUTA is uniformity – uniform tax definitions, uniform and more simplified exemption administration, rate simplification, state-level administration of all sales

¹⁷ See Kathryn Kisska-Schulze & Christopher C. Reimer, *Non-Commercial Aircraft Sales – Planning Strategies to Ensure FAA Compliance and Minimize Taxes*, WYO.L.REV. 175, 180 (2010).

¹⁸ Christina T. Le, *The Honeymoon's Over: States Crack Down on the Virtual World's Tax-Free Love Affair With E-Commerce*, 7 HOUS. BUS. & TAX L.J. 395, 420 (2007).

¹⁹ See Kisska-Schulze, *supra* at 180.

²⁰ The Streamlined Sales and Use Tax Agreement was adopted Nov. 12, 2002 and amended through May 19, 2011.

²¹ See Streamlined Sales and Use Tax Agreement, Article I, Section 102, *available at* <http://www.streamlinedsalestax.org/uploads/downloads/Archive/SSUTA/SSUTA%20As%20Amended%2005-19-11.pdf> (last visited Dec. 2, 2011).

²² See Streamlined Sales Tax Governing Board, Inc., *What Is The Streamlined Sales and Use Tax Agreement?*, <http://www.streamlinedsalestax.org/index.php?page=faqs> (last visited Dec. 2, 2011).

taxes, uniform sourcing and state funding of administrative costs.²³ As of 2010, twenty three states had adopted the SSUTA.²⁴

While ninety percent of the states in the U.S. impose sales and use tax, only certain states impose a retail sales tax on electronically transferred content.²⁵ Failure to collect use tax on Internet purchases poses a major economic problem as can be seen by the 2011 U.S. Census Bureau (hereafter, “Census Bureau”) Retail E-Commerce Sales Reports.

The Census Bureau identified in the Third Quarter of 2011²⁶ that of the more than one trillion dollars spent on retail sales in this country, forty-six billion dollars were spent on e-commerce purchases alone.²⁷ Because the Census Bureau has indicated that thirty-three percent of state revenues derive from sales tax imposition²⁸, the failure to collect sales or use tax on Internet purchases adds pressure to already-burdened state economies.²⁹ Of remarkable interest is that of the states which rank in the top ten for sales and use tax revenue losses from e-commerce sales³⁰, four of them fall within the top ten states deemed to have the worst deficits for

²³ See *id.* at *How Does the Agreement Simplify Sales Tax Administration?*

²⁴ These states are: Arkansas, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Nebraska, Nevada, New Jersey, North Carolina, North Dakota, Ohio, Oklahoma, Rhode Island, South Dakota, Tennessee, Vermont, Utah, Washington, Wisconsin, West Virginia and Wyoming.

²⁵ Walter Hellerstein, *Symposium: State Taxation of Electronic Commerce*, 52 TAX L. REV. 425, 467 (1997), (citing Karl A. Frieden & Michael E. Porter, *The Taxation of Cyberspace: State Tax Issues Related to the Internet and Electronic Commerce*, 11 S. TAX NOTES 1371 (Nov. 11, 1996)). States which impose retail sales tax on electronically transferred content include: Connecticut, New York, Ohio, Pennsylvania and Texas.

²⁶ Data from the U.S. Census Bureau Quarterly Retail E-Commerce Sales for the 2nd Quarter of 2011 was released August 16, 2011.

²⁷ U.S. Census Bureau News, *Quarterly Retail E-Commerce Sales, 3rd Quarter 2011*, US DEPARTMENT OF COMMERCE (Nov. 17, 2011, 10:00 AM), http://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf (last visited Dec. 2, 2011).

²⁸ United States General Accounting Office Report to Congressional Requesters, *Sales Taxes Electronic Commerce Growth Presents Challenges; Revenue Losses are Uncertain*, UNITED STATES GENERAL ACCOUNTING OFFICE (June 2000), at 14, available at <http://www.gao.gov/new.items/g600165.pdf> (last visited Dec. 2, 2011).

²⁹ See *infra* Table 1.

³⁰ Donald Bruce Et. Al., *supra* note 5, at Table 5. These states are: California, Texas, New York, Florida, Illinois, Louisiana, Georgia, Arizona, Pennsylvania and Ohio.

2011³¹. To add insult to injury, of these same original ten states which rank in the top ten for sales and use tax revenue losses, five of them also rank in the top ten states having the worst debts in the country for 2011.³² As such, there is simply no question that in today's economic unsoundness legislators must look to innovative ways to approve new taxes to strengthen falling state revenues.³³

III. The Nexus Issue

Nexus is a term used to describe the minimum connection between a taxing jurisdiction and an out-of-state business that would be sufficient to allow that taxing jurisdiction to constitutionally impose a tax. Specifically, the U.S. Supreme Court held that whether or not a state may “tax value earned outside its borders rests on the fundamental requirement of both the Due process and Commerce Clauses that there be ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’”³⁴ Thus, a state is constitutionally prohibited under the Commerce Clause of the U.S. Constitution from taxing any business without nexus.³⁵ Conversely, a company with the requisite nexus may be subject to that state's sales or use taxes.

Based on the Supreme Court's holding above, determining whether an entity has nexus within a state requires two explorations of fact: (1) Is there a minimum connection with the taxpayer?³⁶ and (2) Is there a minimum connection with the activity the state seeks to tax?³⁷

³¹ toccata888, *Financial Crisis 2011: The Ten Worst States*, CHARLESTONTEAPARTY.ORG (Oct. 10, 2011), <http://charlestonteparty.org/financial-crisis-2011-the-ten-worst-states/> (last visited July 27, 2011). These states are: Arizona (ranked #1), California (ranked #2), Illinois (ranked #4) and New York (ranked #6).

³² *Id.* These states are: New York (ranked #4), Illinois (ranked #5), California (ranked #6), Louisiana (ranked #9) and Florida (ranked #10).

³³ See Daniel Tyler Cowen, *New York's Unconstitutional Tax on the Internet: Amazon.com v. New York State Department of Taxation & Finance and the Dormant Commerce Clause*, 88 N.C.L.REV. 1423, 1423 (2010).

³⁴ *Allied-Signal, Inc. v. Director, Div. of Taxation*, 504 U.S. 768, 777 (1992), (quoting *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344-45 (1954)).

³⁵ *Id.*

³⁶ *Wisconsin v. J.C. Penny Co.*, 311 U.S. 435, 444 (1940).

Determining whether a state may constitutionally apply nexus, and thus impose sales or use tax obligations to a particular business entity has resulted in a host of judicial interpretation beginning in the 1960's.³⁸

To be constitutional, the imposition of a state's tax must satisfy the Commerce and Due process Clauses. The Commerce Clause expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States."³⁹ Under the dormant interpretation, states are prohibited from levying a tax if it interferes with interstate commerce.⁴⁰ The Due process

³⁷ Hellerstein, *supra* note 25, at 434.

³⁸ See *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960) (The U.S. Supreme Court upheld a use tax collection obligation in Florida on a Georgia retailer which had no property or employees in Florida, but whose Florida representatives solicited sales on the company's behalf); *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S., 753 (1967), overruled in part by 504 U.S. 753 (1992) (The U.S. Supreme Court held that an out-of-state mail order vendor with no physical connection to the state of Illinois was not required to collect use tax on its sales to Illinois customers); *National Geographic Soc'y v. California Board of Equalization*, 430 U.S. 551 (1977) (The U.S. Supreme Court held that California could impose use tax collection liability on a nonprofit corporation's mail order operation since the corporation's presence of two offices in California provided sufficient nexus between the corporation and the taxing jurisdiction); *United Air Lines, Inc. v. Mahin*, 410 U.S. 623 (1973) (The U.S. Supreme Court upheld an Illinois statute which imposed use tax on the storage and loading of aircraft fuel within the state, even though some measurements of such fuel use occurred outside state boundaries while the aircraft is in flight); *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) (The U.S. Supreme Court held that a state cannot require an out-of-state vendor to collect and remit use tax unless the vendor has substantial nexus with the taxing jurisdiction.); *Goldberg v. Sweet*, 488 U.S. 252 (1989) (The U.S. Supreme Court upheld an Illinois collection tax obligation on interstate telecommunications charges originating or terminating in the State); *Bloomington's By Mail, Ltd. V. Commonwealth*, 567 A. 2d 773 (Pa. Commw. Ct. 1989) (A Pennsylvania Court held that even though in-state and out-of-state affiliates may use the same advertising themes and motifs, it did not find enough similarity to constitute nexus for use tax purposes); *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E. 2d 13 (S.C.), cert. denied, 510 U.S. 992 (1993) (The Supreme Court of South Carolina held that a corporation which exploits the markets of a state should be subject to the jurisdiction's income tax even though it lacks physical presence); *Orvis Co., Inc. v. Tax Appeals Tribunal*, 612 N.Y.S. 2d 503 (App. Div. 1994) (A New York Court held that in order to impose a use tax collection requirement on an out-of-state vendor, physical presence of the vendor is required, which must constitute more than the "slightest presence"); *Dept. of Revenue v. Share International, Inc.*, 676 So. 2d 1372 (Fla. 1996) (The Florida Supreme Court held that a Texas corporation with no offices or employees in Florida, but which sold products via mail-order to Florida residents, did not have sufficient nexus in Florida to uphold use tax collection requirements); *J.C. Penny Nat'l Bank v. Johnson*, 19 S.W. 3d 831 (Tenn. 1999) (A Tennessee Court ruled that an out-of-state bank which solicited credit card accounts to potential Tennessee customers does not have substantial nexus with the state even though the bank carried between 11,000 and 17,000 credit accounts with Tennessee residents); and *In re Appeal of InterCard, Inc.*, 14 P. 3d 1111 (Kan. 2000) (The Supreme Court of Kansas held that an out-of-state company in the business of installing card readers in certain Kansas store locations was not subject to use tax as the company's excursions to Kansas were "isolated, sporadic and insufficient" to establish nexus in the taxing jurisdiction).

³⁹ Sec. 8, Cl. 3, Art. I, U.S. Const.

⁴⁰ Cowan, *supra* note 33, at 1427.

Clause⁴¹ prevents states from depriving any person of life, liberty, or property without due process of law. Due process requires “some definite link, [or] minimum connection, between a state and the person, property, or transaction it seeks to tax.”⁴² As seen in the early years of judicial interpretation, the U.S. Supreme Court interpreted the Due process clause in less-than favorable light towards state taxing jurisdictions wishing to impose sales or use tax on out-of-state retailers without evidence of sufficient nexus or regular physical presence within the taxing jurisdiction. However, in more recent years a shift has occurred in state court jurisdictions where nexus is being linked to Internet retailers; and thus far the Supreme Court has denied certiorari to review such economic nexus issues. As such, an overview of some of the key cases highlighting the historical shift from the nexus requirements of brick-and-mortar stores to catalogue mail-order sales to cyber-retailers ensues.

Bellas Hess v. Department of Revenue⁴³

Incorporated in Delaware, National Bellas Hess, Inc. (hereafter, “Bellas Hess”) was a mail order company with its principal place of business located in Missouri.⁴⁴ Bellas Hess maintained neither office nor any other place of business or property in Illinois, nor did it have agents, salespersons, or representatives selling or soliciting orders in Illinois.⁴⁵ Bellas Hess’ only contact with Illinois was via U.S. mail or common carrier, which twice a year delivered for Bellas Hess catalogues to Illinois residents.⁴⁶ The catalogue mailings were supplemented by

⁴¹ Sec. 1, Amend. XIV, U.S. Const.

⁴² *Miller Brothers Co. v. Maryland*, 347 U.S. 340, 344-345; 74 S. Ct. 535; 98 L. Ed. 744 (1954).

⁴³ *National Bellas Hess, Inc. v. Department of Revenue of Illinois*, 386 U.S. 753 (1967), overruled in part by 504 U.S. 753 (1992).

⁴⁴ *Id.* at 754.

⁴⁵ *Id.*

⁴⁶ *Id.*

advertisement flyers occasionally mailed to prospective customers.⁴⁷ All goods purchased by Illinois residents from Bellas Hess were mailed from Bellas Hess' Missouri plant to their respective Illinois addresses via mail or common carrier.⁴⁸

Based on an Illinois statute which included in the definition of the term “retailer maintaining a business in the state” a retailer “engaging in soliciting orders within this State from users by means of catalogues or other advertising, whether such orders are received or accepted within or without this State”,⁴⁹ the Illinois Department of Revenue brought suit against Bellas Hess to recover use taxes and penalties associated with the goods Bellas Hess sold to Illinois customers. Bellas Hess took the side that the Illinois statute violated the Due process clause and unconstitutionally burdened interstate commerce.⁵⁰

The U.S. Supreme Court, in its review of the case, found that the Due process and Commerce Clauses are “closely related”.⁵¹ In making its determination that out-of-state retailers could be subject to sales and use tax if they have a substantial nexus with the taxing jurisdiction, the Court reiterated that “the Constitution requires ‘some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax.’”⁵² Thus, “a vendor whose only contacts with the taxing State are by mail or common carrier lacks the ‘substantial nexus’ required by the Commerce Clause.”⁵³ And as such, Bellas Hess was deemed

⁴⁷ *Id.*

⁴⁸ *Id.* at 754 – 755.

⁴⁹ Ill. Rev. Stat. c. 120, § 439.2 (1965).

⁵⁰ *Bellas Hess*, *supra* note 43 at 756.

⁵¹ *Id.* The Court stated that the two claims brought by Bellas Hess (i.e., Due Process and Commerce Clauses) “are closely related. For the test whether a particular state exaction is such as to invade the exclusive authority of Congress to regulate trade between the States, and the test for a State's compliance with the requirements of due process in this area are similar.” (citing, *Central R. Co. v. Pennsylvania*, 370 U.S. 607, 621-622 (1962) (concurring opinion of Mr. Justice Black)).

⁵² *Id.* at 756 (citing *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954) at 344-345; *Scripto Inc. v. Carson*, 362 U.S. 207 (1960) at 210 – 211; *See Also American Oil Co. v. Neill*, 380 U.S. 451 (1965) at 458.

⁵³ *Cowan*, *supra* note 33 at 1427 (citing *Quill Corp. v. North Dakota*, 504 U.S. 298, 310 (1992)). *See also Bellas Hess*, *supra* note 43 at 758-60.

not to have substantial nexus in Illinois, thus resulting in no tax collection obligation for the company in the state.

Quill v. North Dakota⁵⁴

In 1992, the U.S. Supreme Court granted Writ of Certiorari to a case with similar facts to those of its predecessor, *Bellas Hess*. The Quill case involved “a State’s attempt to require an out-of-state mail-order house that ha[d] neither outlets nor sales representatives in the State to collect and pay a use tax on goods purchased for use within the State.”⁵⁵

Quill was a Delaware corporation with offices and warehouses in Illinois, California and Georgia.⁵⁶ While none of Quill’s employees worked or resided in North Dakota, the company sold approximately one million dollars worth of office supplies and equipment via mail-order solicitation sales to residents in North Dakota.⁵⁷

Based on a North Dakota statute requiring every “retailer maintaining a place of business in the State to collect the tax from the consumer and remit it to the State,”⁵⁸ including a retailer “who engages in regular or systematic solicitation of a consumer market in the state,”⁵⁹ the state of North Dakota sued Quill to compel it to collect use tax from its North Dakota customers.⁶⁰

In its review of this case, the Supreme Court noted the nexus requirements imposed by the Due process and Commerce Clauses are not identical.⁶¹ Per the Court, while a Due process nexus test ponders the issue of whether “an individual’s connections with a state are substantial

⁵⁴ *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992).

⁵⁵ *Id.* at 301.

⁵⁶ *Id.*

⁵⁷ *Id.*

⁵⁸ N.D. Cent. Code § 57-40.2-07 (Supp. 1991).

⁵⁹ N.D. Cent. Code § 57-40.2-01(6). Note, in 1987 North Dakota amended its statutory definition of the term “retailer” to include this language.

⁶⁰ *Quill*, *supra* note 54 at 302-303.

⁶¹ *Id.* at 312. Note, this discussion was promulgated by North Dakota’s contention that the nexus requirements imposed by the due process and Commerce Clauses are equivalent and that if a mail-order house lacks a physical presence in the taxing state, it nonetheless continues to satisfy the due process “minimum contacts” test, thus meeting the Commerce Clause “substantial nexus” test. See *Quill* at 312.

enough to legitimate the State's exercise of power over him"⁶², the Commerce Clause focuses on the "concerns about the effects of state regulation on the national economy."⁶³

In its holding, the Court determined that while a mail-order business need not have a physical presence in the state in order to permit the state to require use tax collection from its in-state customers, physical presence in the state was required for a business to have substantial nexus with the taxing jurisdiction, as required by the Commerce Clause.⁶⁴ The U.S. Supreme Court also reaffirmed its holding in *Complete Auto Transit*,⁶⁵ which provides a four-prong test to uphold a tax against a Commerce Clause challenge. Under the test, a state tax does not violate the Commerce Clause if it meets four requirements: the tax (1) is applied to an activity with a substantial nexus with the taxing State, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State.⁶⁶

From the standpoint of the U.S. Supreme Court, "the purposes underlying the Commerce Clause gave rise to a nexus inquiry that focused on the burdens the tax collection obligation imposed on interstate commerce rather than on the fairness of imposing the obligation on the out-of-state vendor."⁶⁷ Because the Court's reaffirmation of the physical-presence test as noted in *Bellas Hess* was tied to a specific tax (i.e., sales and use tax) and on a specific industry (i.e., mail-order vending), it is arguable that *Quill* established a physical-presence standard only for sales and use taxes on the mail-order industry, thus perhaps insinuating that other industries and other taxes may be held to a more flexible balancing analysis.⁶⁸ Under this interpretation of

⁶² *Id.*

⁶³ *Id.*

⁶⁴ *Id.*

⁶⁵ *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)

⁶⁶ *Quill*, *supra* note 54 at 311, citing *Complete Auto Transit* at 279.

⁶⁷ Hellerstein, *supra* note 25, at 439.

⁶⁸ *Id.* at 440.

Quill, out-of-state companies engaged in e-commerce, whose activities in a state have no actual physical expression, may nonetheless be subject to the state's taxing jurisdiction.⁶⁹

National Geographic v. California Board of Equalization⁷⁰

In 1977, the U.S. Supreme Court affirmed the decision of the California Supreme Court which held that the state of California could impose use tax collection liability on an out-of-state nonprofit corporation which had two offices in California.⁷¹ National Geographic Society (hereafter, "National Geographic") was headquartered in the District of Columbia and held two offices in California which solicited advertising for National Geographic's magazine but which performed no sales activities in relation to the company's mail-order business which was run out of the District of Columbia office.⁷²

Based on a California statute⁷³ requiring retailers engaged in business in California and making sales of tangible personal property for use in the state collect use tax from purchasers, California imposed a use tax collection obligation on National Geographic. National Geographic defended that its activities in California did not constitute sufficient nexus to allow the state to impose a tax collection obligation on the company. More specifically, it argued that "its contacts with customers in California were related solely to its mail-order sales by means of common carrier or the mail, [and] that the two offices [in California] played no part in that activity."⁷⁴

The Court determined that National Geographic did indeed have a continuous presence in the state of California, regardless of the fact that there was no relationship between National Geographic's sales activity and its two advertising offices located in California.⁷⁵ More

⁶⁹ *Id.*

⁷⁰ *National Geographic Soc'y v. California Board of Equalization*, 430 U.S. 551 (1977).

⁷¹ *Id.* at 562.

⁷² *Id.* at 552.

⁷³ Ca. Rev. & Tax Code § 6203 (West Supp. 1976). *See also id.* at 553.

⁷⁴ *National Geographic*, *supra* note 70 at 560.

⁷⁵ *Id.* at 555 – 562.

importantly, the Court noted that National Geographic’s California offices had the advantages of the same municipal services as they would have if their activities had included assistance to the mail-order operations.⁷⁶ Thus, the Court determined that National Geographic’s continuous presence in the state in physical offices which solicited advertising for its magazine provided sufficient nexus to allow California to impose a use tax collection obligation on the company.⁷⁷

Goldberg v. Sweet⁷⁸

This 1989 U.S. Supreme Court case emerged from the issue of whether the state of Illinois had nexus substantial enough to impose an excise tax on a consumer’s purchase of an interstate telephone call.⁷⁹ The Illinois Telecommunications Excise Tax Act⁸⁰ (hereafter, “Excise Tax Act”) imposed a five percent tax on the gross charge interstate telecommunications (1) originated or terminated in Illinois and (2) charged to an Illinois service address, regardless of where the telephone call is billed or paid.⁸¹ In order to aid in collection, the Excise Tax Act required telecommunications retailers to collect the tax from consumers who charged calls to his service address.⁸²

After the inception of the Excise Tax Act, certain Illinois residents filed a class action lawsuit alleging that the Excise Tax Act violated the Commerce Clause.⁸³ In its review of the lower court’s decision, the U.S. Supreme Court affirmed the Illinois Supreme Court decision that the tax did not violate the Commerce Clause.⁸⁴ All parties to the case agreed that Illinois had

⁷⁶ *Id.* at 561.

⁷⁷ *Id.* at 562.

⁷⁸ *Goldberg v. Sweet*, 488 U.S. 252 (1989).

⁷⁹ *Id.* at 263.

⁸⁰ Ill. Rev. Stat., ch. 120, paras. 2001-2021 (1987).

⁸¹ *Goldberg*, *supra* note 78 at 256.

⁸² *Id.* at 256-257; *see also* Ill. Rev. Stat. ch. 120 para. 2005, § 5.

⁸³ *Id.* at 257.

⁸⁴ *Id.* at 259.

substantial nexus with the interstate telecommunications reached by the Excise Tax Act;⁸⁵ however, the taxpayers maintained that the tax was not fairly apportioned since Illinois taxes the gross charge of each call.⁸⁶

In its analysis, the Court allowed that “only two States have a nexus substantial enough to tax a consumer’s purchase of an interstate telephone call.”⁸⁷ The first is a state which taxes the origination or termination of an interstate telephone call charged to a service address in the state; and the second is a state that taxes the origination or termination of an interstate telephone call billed or paid within the state.⁸⁸ While the Court acknowledged the possibility that a taxpayer’s billing and service address could be in different states, thus availing that taxpayer to multiple taxing jurisdictions, such limited possibility is not sufficient to invalidate the Illinois Excise Tax Act.⁸⁹

Moreover, the Court distinguished the difference between endorsing apportionment formulas based on miles covered by large, moving physical objects (such as buses) versus the “intangible movement of electronic impulses through computerized networks”.⁹⁰ The clear magnitude of attempting to track such calls for apportionment purposes would be administratively and technologically painstaking.⁹¹ Thus, the Court found that Illinois’ Excise Tax Act which imposes tax on the origination or termination of interstate telephone calls charged to a service address in the state legitimate and fairly apportioned and does in fact constitute substantial nexus.⁹²

⁸⁵ *Id.* at 260.

⁸⁶ *Id.*

⁸⁷ *Id.* at 263.

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* at 264.

⁹¹ *Id.*

⁹² *Id.* at 267.

Geoffrey v. South Carolina Tax Commission⁹³

In what is deemed an “economic nexus” issue case, the *Geoffrey* court quarried whether the licensing of intangible trademarks within a state constitutes substantial nexus to an out-of-state company. Geoffrey, Inc. (hereafter, “Geoffrey”), a subsidiary of Toys R Us, was incorporated in Delaware where it also held its principle place of business.⁹⁴ Geoffrey owned certain trademarks and trade names, including “Toys R Us”.⁹⁵ Per a licensing agreement between the two entities, Geoffrey was allowed to use the Toys R Us trade name in certain states as well as receive a one percent royalty of the net Toys R Us sales.⁹⁶ In 1985, Toys R Us began doing business in South Carolina, and hence made royalty payments to Geoffrey based on its sales.⁹⁷ The South Carolina Tax Commission required Geoffrey to pay state income tax on the royalty income received from sales within the state.⁹⁸ Geoffrey brought an action against the South Carolina Tax Commission arguing that it neither did business in South Carolina nor had sufficient nexus to be taxed in the jurisdiction.⁹⁹

Citing *Quill*, the Court stated that “the nexus requirement of the Due Process Clause can be satisfied even where the corporation has no physical presence in the taxing state if the corporation has purposefully directed its activity at the state's economic forum.”¹⁰⁰ In making its determination that the tax on Geoffrey was constitutional, the South Carolina Supreme Court noted:

“Geoffrey's business is the ownership, licensing, and management of trademarks, trade names, and franchises. By electing to license its trademarks and trade names

⁹³ *Geoffrey, Inc. v. South Carolina Tax Commission*, 437 S.E. 2d 13 (S.C. 1993), *cert. denied* 510 U.S. 992 (1993).

⁹⁴ *Id.* at 15.

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.*

¹⁰⁰ *Id.* at 16, citing *Quill* at 304 - 307.

for use by Toys R Us in many states, *Geoffrey contemplated and purposefully sought the benefit of economic contact with those states*. Geoffrey has been aware of, consented to, and benefitted from Toys R Us' use of Geoffrey's intangibles in South Carolina. Moreover, *Geoffrey had the ability to control its contact with South Carolina* by prohibiting the use of its intangibles here as it did with other states.”¹⁰¹ (emphasis added).

The Court further noted that Geoffrey had a minimum connection with South Carolina, thus satisfying the Due process requirement, by having Geoffrey’s intangible in South Carolina, by creating an account receivable for sales by Toys R Us in South Carolina, and by the fact that Geoffrey had a franchise in the state.¹⁰²

Pertaining to the Commerce Clause, nexus in this case was established based on the presence of intangible property alone.¹⁰³ The *Geoffrey* court reiterated that taxpayers need not have a tangible, physical presence in a state for income to be taxable; the presence of intangible property by itself is sufficient to establish nexus in a jurisdiction.¹⁰⁴ In 1993 the U.S. Supreme Court denied certiorari of this case; and *Geoffrey* now stands as a strong reminder that a business which habitually exploits state markets should be subject to state taxing jurisdictions even though such business has no physical presence in the state.¹⁰⁵

Borders v. Board of Equalization¹⁰⁶

In 2005 the California Court of Appeals was faced with the issue of whether Internet sales can be constitutionally taxed. Borders Online, LLC (hereafter, “Borders Online”), a

¹⁰¹ *Id.* at 19.

¹⁰² *Id.*

¹⁰³ *Id.* at 23, citing *American Dairy Queen*, 93 N.M. at 747, 605 P. 2d at 255; *see also* *Int’l Harvester Co. v. Wisconsin Dep’t of Taxation*, 322 U.S. 435, 441-442, 64 S. Ct. 1060, 1063-64, 88 L.Ed. 1373, 1379 (1944); J. Hellerstein & W. Hellerstein, *State Taxation*, Para. 6.08 (2d ed. 1992).

¹⁰⁴ *Id.*

¹⁰⁵ *Id.*, citing J. Hellerstein & W. Hellerstein, *State Taxation*, Para. 6.08 (2d ed. 1992).

¹⁰⁶ *Borders Online v. State Board of Equalization*, 129 Cal. App. 4th 1179, 29 Cal. Rptr. 3d 176, 2005 Cal. App. LEXIS 875, 2005 Cal. Daily Op. Service 4593, 2005 D.A.R. 6278 (Cal. App. 1st Dist. 2005).

Delaware company, sold over \$1.5 million in online merchandise to California residents between 1998 and 1999.¹⁰⁷ Borders Online allowed consumers who purchased merchandise online through its site to return, exchange or receive credit for such merchandise at any Borders Books and Music Store (hereafter, “Borders Store”).¹⁰⁸ While Borders Online and Borders Store were separate legal entities, they shared a common parent company.¹⁰⁹ Based on the premise that Borders Store was deemed Borders Online’s representative operating in California “for the purpose of selling” Border Online’s goods, the California State Board of Equalization demanded that Borders Online collect and remit use tax from its California customers.¹¹⁰ Borders Online argued that it did not carry a sufficient presence in California to justify the imposition of the tax collection burden.¹¹¹ The Court’s decision hinged on whether Borders Online had a “representative” or “agent” in California acting under the authority of Borders Online in order to sell personal property.¹¹²

In affirming the lower court’s decision, the California Appellate Court observed that the trial court:

found that [Border’s] Online’s return policy posted on its Web site provided ‘undisputed evidence’ ‘confirm[ing] that Borders [Store] was [Border’s Online’s] authorized agent or representative for the purpose of accepting returns of Online merchandise from California purchasers. Its finding was supported by the fact that (1) each Borders [S]tore in the state would accept returns and provide a refund,

¹⁰⁷ *Id.* at 1184.

¹⁰⁸ *Id.*

¹⁰⁹ *Id.*

¹¹⁰ *Id.*

¹¹¹ *Id.*

¹¹² *Id.* at 1189. Cal. Rev. & Tax Code § 6203(a) provides that, “every retailer engaged in business in this state and making sales of tangible personal property for storage, use, or other consumption in this state ... shall, at the time of making the sales or, if the storage, use, or other consumption of the tangible personal property is not then taxable hereunder, at the time the storage, use, or other consumption becomes taxable, collect the tax from the purchaser and give to the purchaser a receipt therefor” Cal. Rev. & Tax Code § 6203(c)(2) defines “retailer engaged in business in this state” to include “Any retailer having any representative, agent, salesperson, canvasser, independent contractor, or solicitor operating in this state under the authority of the retailer or its subsidiary for the purpose of selling, delivering, installing, assembling, or the taking of orders for any tangible personal property.”

store credit or exchange of [Borders] Online's merchandise; (2) Borders [Store] encouraged its store employees to refer customers to [Borders] Online's Web site; and (3) receipts at Borders [S]tores sometimes invited patrons to 'Visit us online at www.Borders.com.'¹¹³

The Court reasoned that such facts asserted the existence of an agency relationship between Borders Online and Borders Store. In an effort to determine if Borders Store was actually selling Borders Online merchandise as a representative of the online entity, the Court sided with the Board of Equalization which proposed that:

When out-of-state retailers that make offers of sale to potential customers in California authorize in-state representatives to take returns, these retailers acknowledge that the taking of returns is an integral part of their selling efforts. Such an acknowledgement comports with common sense because the provision of convenient and trustworthy return procedures can be crucial to an out-of-state retailer's ability to make sales. *This is especially evident in the realm of e-commerce.*¹¹⁴ (emphasis added).

Taking into consideration the relationship between Borders Online and Borders Store, as well as the fact that Borders Store was selling Borders Online merchandise in California, the Court held that the trial court's ruling that Borders Online was subject to tax collection obligations in California was consistent with the Commerce Clause. Specifically, the Court determined that Borders Store's activities were extensively associated with Borders Online's ability to establish and maintain a California market.¹¹⁵ Hence, Borders Store's efforts to accept, exchange or refund Borders Online customers for merchandise purchased online; its practice of printing "Visit us online at www.Borders.com" on in-store receipts; its encouragement of employees to refer customers to use the Borders Online website, as well as offering a link from Borders Online's website to Borders Store; and Borders Online's \$1.5 million in sales in California provided enough evidence to support the inference that Borders

¹¹³ *Id.*

¹¹⁴ *Id.* at 1193.

¹¹⁵ *Id.* at 1196.

Online utilized Borders Store as a representative with physical presence in California and that Borders Store's activities were enough to create nexus between Borders Online and California's taxing jurisdiction.¹¹⁶

The Borders Online case attests to the fact that isolating an entity in cyberspace is not a safe tax haven for large corporations.¹¹⁷ Brick-and-mortar stores akin to Borders Store are finding themselves subject to state taxing jurisdictions based on their significant activities with their online shops, thus further removing the notion that cyberspace entities are immune from state taxing jurisdictions.¹¹⁸

Amazon.com v. New York

The recent Amazon.com cases¹¹⁹ are integral to the concept that states are cracking down on the online business sector and finding avenues to establish physical presence in the era of cyberspace. Beginning in 1995 Amazon.com LLC, a Delaware company, and Amazon Services LLC, a Nevada company, (collectively, "Amazon"), began operating as an online business and sold merchandise to consumers worldwide, including in New York.¹²⁰ Never since its inception had Amazon held an office, owned property or employed sales persons in New York.¹²¹

Amazon formed an "Associates Program" whereby participants (associates) contracted with associates to maintain links to Amazon.com on their own personal websites, and were then subsequently compensated a percentage of the cost of the sale for any sales made by consumers

¹¹⁶ *Id.* at 1199.

¹¹⁷ *Le, supra* note 18 at 419.

¹¹⁸ *Id.*

¹¹⁹ *Amazon.com LLC v. New York State Dept. of Taxation & Fin.*, 23 Misc. 3d 418, 877 N.Y.S.2d 842, 2009 N.Y. Misc. LEXIS 28 (2009) (hereafter, "Amazon I"); *aff'd* in part and modified in part by *Amazon.com, LLC v. New York State Dept. of Taxation & Fin.*, 913 N.Y.S.2d 129, 2010 N.Y. App. Div. LEXIS 7943 (N.Y. App. Div. 1st Dep't, 2010), (hereafter, "Amazon II").

¹²⁰ Amazon I, *supra* at 420.

¹²¹ *Id.*

by way of such links.¹²² Amazon also offered incentives to associates who directly referred customers to the Amazon Prime program through website links.¹²³ Of the hundreds of thousands of associations that Amazon maintains via this program, thousands of them reside in New York.¹²⁴

In New York, "every vendor of tangible personal property" is required to collect sales tax.¹²⁵ For purposes of this law, the term "vendor" is defined as "A person who solicits business...: (I) by employees, independent contractors, agents or other representatives . . . and by reason thereof makes sales to persons within the state of tangible personal property or services, the use of which is taxed by this article."¹²⁶ Per what is now known as the "Amazon Tax", in 2008 the governor of New York signed into tax law a statute requiring the collection of New York taxes from in-state residents by out-of-state sellers that contractually agree to pay commissions to New York residents for referring potential customers to them so long as more than ten thousand dollars was generated from such New York referrals during the preceding four quarterly periods.¹²⁷

Thereafter, Amazon filed suit against the New York Department of Revenue alleging that the commission-agreement provision of the statutes violates the Commerce and Due process

¹²² *Id.*

¹²³ *Id.*

¹²⁴ *Id.*

¹²⁵ See Tax Law § 1131 (1). See also Amazon I, *supra* note 119 at 421.

¹²⁶ See Tax Law § 1101 (b)(8)(i)(C). See also Amazon I, *supra* note 119 at 421 – 422.

¹²⁷ Amazon I, *supra* note 119 at 422. The language of Tax Law § 1101(b)(8)(vi) reads: "a person making sales of tangible personal property or services taxable under this article ('seller') shall be presumed to be soliciting business through an independent contractor or other representative if the seller enters into an agreement with a resident of this state under which the resident, for a commission or other consideration, directly or indirectly refers potential customers, whether by a link on an internet website or otherwise, to the seller, if the cumulative gross receipts from sales by the seller to customers in the state who are referred to the seller by all residents with this type of an agreement with the seller is in excess of ten thousand dollars during the preceding four quarterly periods . . . This presumption may be rebutted by proof that the resident with whom the seller has an agreement did not engage in any solicitation in the state on behalf of the seller that would satisfy the nexus requirement of the United States constitution during the four quarterly periods in question."

clauses as it required a tax collection obligation on businesses with no substantial nexus within the taxing jurisdiction.¹²⁸

In finding that the tax provision did not violate the Commerce Clause, the Supreme Court of New York reiterated decisions from past cases holding that in order to establish a "substantial nexus" with a taxing jurisdiction, the physical presence of a vendor is required, though need not be substantial.¹²⁹ Instead, physical presence must simply be more than a 'slight presence' and can be manifested by economic activities in the state performed by the vendor's personnel or on its own behalf.¹³⁰ In the Amazon scenario, New York's tax collection obligation is imposed only on out-of-state sellers which make a conscious decision to contract with New York residents and who collectively refer more than ten thousand dollars of New York-based businesses.¹³¹ In specifically targeting the ten thousand dollar threshold, the Court determined that the New York statute seeks only to impose a tax collection obligation on businesses with more than the slightest presence in the state, thus meeting the standard required under the Commerce Clause.¹³²

On appeal, the Court applied the four-prong test for determining whether a state tax will be upheld as against the Commerce Clause: (1) the tax is applied to an activity with a substantial nexus in the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the State.¹³³ In its review of the case, the Supreme Court of New York focused solely on the first prong of the test and reiterated

¹²⁸ *Id.* at 423.

¹²⁹ *Id.*, citing *Matter of Orvis Co. v. Tax Appeals Trib. Of State of N.Y.*, 86 NY2d 165, 178, 654 NE2d 954, 630 NYS2d 680 (1995) (citation omitted), *cert denied sub nom. Vermont Info. Processing, Inc. v. Commissioner, N.Y. State Dept. of Taxation & Fin.*, 516 US 989, 116 S Ct 518, 133 L Ed 2d 426).

¹³⁰ *Id.*

¹³¹ *Id.* at 425.

¹³² *Id.*

¹³³ *Amazon II*, *supra* note 119 at 194, citing *Matter of Moran Towing Corp. v. Urbach*, 99 NY2d 443, 449, 787 N.E.2d 624, 757 N.Y.S.2d 513 (2003) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S. Ct. 1076, 51 L. Ed. 2d 326).

that while a business must constitute more than a mere “slight presence” in the taxing jurisdiction, it can be manifested by either the presence in the taxing jurisdiction of the vendor's property or by the conduct of economic activities performed by the vendor's personnel or on its own behalf in such jurisdiction.¹³⁴ In applying the physical presence standard to the facts surrounding Amazon, the Supreme Court of New York concluded that the statute does not violate the Commerce Clause; that it imposes a tax collection obligation only on out-of-state vendors who enter into business referral agreements with New York residents, and only when such residents receive commissions based on the sales in New York.¹³⁵

Further, the Court refers to a specific document prepared by Amazon regarding its Associates Program which states:

Our compensation philosophy is simple: reward Associates for their contributions to our business in unit volume and growth. Amazon is a fast growing business and we want our Associates to grow with us... The Performance structure allows you to earn higher fees when you generate a sufficient volume of referrals that result in sales at Amazon.com during a month. The higher your referrals, the greater your earnings will be.¹³⁶

Thus, the Court indicated that not only does Amazon have more than a slight presence in the state, but also aggressively solicits sales in New York rather than merely advertising through the associates' websites.¹³⁷ Hence, the lower court's decision was upheld and once again a state case decision effectively minimized the protective umbrella hovering over online retailers hoping to escape tax collection obligations.

¹³⁴ *Id.* at 195, citing *Matter of Orvis Co. v. Tax Appeals Trib. Of State of N.Y.*, 86 N.Y. 2d 165, 654 N.E. 2d 954, 630 N.Y.S. 2d 680 (1995) (quoting *National Geographic v. California Equalization Bd.*, 430 U.S. 551, 556, 97 S. Ct. 1386, 51 L. Ed. 2d 631 (1977)).

¹³⁵ *Id.*

¹³⁶ *Id.* at 197.

¹³⁷ *See Id.*

KFC v. Iowa¹³⁸

While the KFC case revolves around an income tax collection obligation rather than sales and use tax collection, it continues the clear mission of states to uncover avenues where nexus can be applied to out-of-state businesses. In this economic nexus case, the Iowa Supreme Court held that nexus applied to an out-of-state taxpayer in Iowa resulting from the taxpayer's use of intangibles within the state. KFC Corporation (hereafter, KFC) is a Delaware company with its principal place of business in Kentucky. KFC licenses its system to independent franchise operators who own over three thousand restaurants throughout the U.S.¹³⁹ While KFC also licenses its system to related entities, all KFC restaurants in Iowa are owned by independent franchisees.¹⁴⁰

In 2001 the Iowa Department of Revenue assessed KFC approximately \$250,000 for unpaid corporate income taxes, penalties and interest on the basis that the requirements of the Commerce Clause were satisfied, arguing that under *Bellas Hess* and *Quill* the physical presence requirement is not necessary when a franchisor licenses intellectual property that generates income from the franchisor within the taxing jurisdiction from operations of independent franchisees.¹⁴¹ Further, the Iowa Department of Revenue claimed that KFC's royalty income based on its franchisees operations within the state was "taxable because it is derived from Iowa customers and is made possible by Iowa's infrastructure and legal protection of the Iowa marketplace."¹⁴² In its defense, KFC relied on the decision emanating from *Quill* that use tax

¹³⁸ *KFC Corporation v. Iowa Department of Revenue*, 792 N.W. 2d 308; 2010 Iowa Sup. LEXIS 149 (Iowa, 2010), *cert denied* 181 L. Ed. 2d 26; 2011 U.S. LEXIS 6624 (U.S., Oct. 3, 2011) (hereafter, KFC).

¹³⁹ *Id.* at 310.

¹⁴⁰ *Id.*

¹⁴¹ *Id.*

¹⁴² *Id.*

could not be imposed on a foreign corporation with no physical presence within the taxing jurisdiction.¹⁴³

Analyzing numerous nexus-related cases, including both *Bellas Hess*¹⁴⁴ and *Complete Auto Transit*¹⁴⁵, the KFC Court determined that the use of intangibles in a franchise arrangement satisfied the substantial nexus requirement. In examining numerous earlier state nexus cases including *Geoffrey*, the KFC Court concluded “that a physical presence is not required under the Dormant Commerce Clause of the United States Constitution in order for the Iowa legislature to impose an income tax on revenue earned by an out-of-state corporation arising from the use of its intangibles by franchisees located within the State of Iowa.”¹⁴⁶ Specifically, the Court noted that KFC licensed its intellectual property for use within the State of Iowa in order to produce income; thus invoking far more involvement with the state than merely the “slightest presence.”¹⁴⁷

The Court went even further in this case to solidify the argument that “physical presence” as required in *Quill* should move past the brick-and-mortar business entity:

The use of a “physical presence” test does, of course, limit the power of the state to tax out-of-state taxpayers, but it does so in an irrational way. For example, while in *Quill* the Court was concerned about the undue burden on interstate commerce caused by enforcement of sales and use taxes, “physical presence” within the state does not reduce that burden.¹⁴⁸ Further, the “physical presence” test may protect small vendors, but it also protects large vendors who are not unduly burdened.¹⁴⁹ In fact, ‘physical presence’ in today's world is not ‘a meaningful surrogate for the economic presence sufficient to make a seller the subject of state taxation.’¹⁵⁰ *Physical presence’ often reflects more the manner in which a company does business rather than the degree to which the company*

¹⁴³ *Id.*

¹⁴⁴ *Id.* at 314 – 316.

¹⁴⁵ *Id.* at 316.

¹⁴⁶ *Id.* at 328.

¹⁴⁷ *Id.* at 323.

¹⁴⁸ See John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century*, 38 GA. L. REV. 343, 361-62 (2003).

¹⁴⁹ *Id.* at 363.

¹⁵⁰ *Id.* at 392.

benefits from the provision of government services in the taxing state. Does it really make sense to require Barnes and Noble to collect and remit use taxes, but not impose the same obligation on Amazon.com, based on the difference in their business methods?^{151 152} (emphasis added).

One of the astounding aspects of this case is the determination by the Court that “physical presence” is not required under the dormant Commerce Clause in order for Iowa to impose an income tax on revenue earned by an out-of-state corporation arising from the use of intangibles by in-state franchisees.¹⁵³ Instead, by the mere licensing of franchises within the state, an out-of-state corporation receives “the benefit of an orderly society within the state” and is thus subject to the payment of income taxes.¹⁵⁴ Hence, franchisees beware – the economic nexus lynchpin just got a little tighter.

IV. The Road Ahead for Online Retailers

It is clear from recent state court decisions that the old-school belief that Internet transactions are untouchable by state taxing regimes is losing muster. States are strengthening their efforts to affirm their taxing rights on Internet sales, and the future of e-commerce may unavoidably result in more taxation on consumers.¹⁵⁵ Still, the fact is that a myriad of businesses reside in cyberspace only, without having any physical nexus in any jurisdiction where they sell goods to customers; and such sales transactions fall directly within the realm of interstate commerce.¹⁵⁶ Thus, the head-to-head battle between state taxing jurisdictions imposing sales and use tax and cyber-retailers seeking shelter under the umbrella of due process and the

¹⁵¹ See H. Beau Baez III, *The Rush to the Goblin Market: The Blurring of Quill's Two Nexus Tests*, 29 SEATTLE U.L. REV. 581, 582 n.8 (2006); Bradley W. Joondeph, *Rethinking the Role of the Dormant Commerce Clause in State Tax Jurisdiction*, 24 VA. TAX REV. 109, 135 (2004).

¹⁵² KFC, *supra* note 138 at 326.

¹⁵³ *Id.* at 328.

¹⁵⁴ *Id.*

¹⁵⁵ See Le, *supra* note 18 at 397.

¹⁵⁶ *Id.* at 401.

Commerce Clauses results in the need to create uniformity and equality among the states when dealing with e-commerce transactions.

As previously discussed, in 2008 New York became the first state to broaden the definition of nexus to cover web-only retailers by way of the Amazon tax. Certain other states, including Rhode Island¹⁵⁷, North Carolina¹⁵⁸, Illinois¹⁵⁹, Connecticut¹⁶⁰ and California¹⁶¹ have adopted similar laws to that of New York requiring online retailers with sales affiliates based within their state lines to collect sales tax. Further, South Dakota¹⁶² and Colorado¹⁶³ have both passed laws requiring online retailers to alert clientele that they owe use tax on purchases where sales tax is not collected. Thus, the stance moving forward seems to indicate that states are on a mission to find parameters within the confines of the Due Process and Commerce Clause clauses which require cyber-retailers to collect and remit sales and use tax on in-state customer sales.

V. Conclusion

Without a firm decision coming down from the U.S. Supreme Court¹⁶⁴ defining the standard of physical presence for out-of-state retailers, can nexus truly be found in cyberspace? The answer is emphatically: yes. With a U.S. national deficit currently sitting around one and a

¹⁵⁷ See R.I. Gen. Laws §44-18-15(a)(2) (Supp. 2009). Note, the gross receipts sales threshold in Rhode Island is \$5,000.

¹⁵⁸ See N.C. Gen. Stat. §105-164.8(b)(3).

¹⁵⁹ 86 Ill. Adm. Code §150.201(i).

¹⁶⁰ Conn. Gen. Stat §12-407(a)(12).

¹⁶¹ Cal. Stat. § 6203(c).

¹⁶² See Colorado HB-10-1193.

¹⁶³ See South Dakota SB 146.

¹⁶⁴ In October 2011 the U.S. Supreme Court denied certiorari on another nexus case out of Washington state - *Lamtec v. Washington Dep't of Revenue*. The issue on appeal was whether a New Jersey corporation with no facilities, offices or employees in the state of Washington was subject to the Washington B&O tax. Two to three times a year Lamtec Corporation sent three sales personnel to Washington to meet with customers. While the sales employees did not solicit sales directly, they offered information to customers regarding the company's products. The Supreme Court of Washington found that by sending sales personnel into Washington, the company was establishing and maintaining its market within the state, thus establishing nexus. See *Lamtec Corp. v. Department of Revenue of the State of Washington*, 170 Wn. 2d 838; 246 P.3d 788; 2011 Wash. LEXIS 77 (2011).

half trillion dollars, and state deficits hitting all-time highs, opportunities must be found to collect sales taxes stemming from e-commerce sales. The physical presence standard emanating from *Quill* is a barrier to effective taxation of many Internet sales transactions.¹⁶⁵ Thus, state governments must take action into their own hands in designing opportunities for sales and use tax collection from cyber-retailers.

State legislators should petition Congress to clarify the physical standard for online retailers under the Due process and Commerce clauses. Congress should be urged to pass streamlined, national standards regulating the taxation of cyber-retailers. Such clarification would enhance states' abilities to collect sales and use tax from online retailers, as well as infuse guidance to Internet and remote sellers in defining which activities will create a taxable presence in a state.¹⁶⁶ Without such standard in place, the litigation battles between the states and online retailers will continue to increase with the intensification of e-commerce sales.¹⁶⁷

Defining of the physical presence standard for cyber-retailers in a light favorable to state taxing jurisdictions similar to that of the Amazon.com tax will inevitably increase the amount of sales tax collected in most taxing jurisdictions, thus helping to reduce the inexcusably high state deficits currently haunting our nation's economic situation. Instilling a uniform, systematic tax collection obligation on cyber-retailers will simplify and modernize tax collection among the states. As such, there should be no question among on-line retailers as to the expectations of their sales tax collection obligations. Having such uniform standards will further encourage remote and online sellers to adapt to a nation-wide sales and use tax collection scheme without variation among the states.

¹⁶⁵ Edward A. Morse, *State Taxation of Internet Commerce: Something New Under the Sun?*, 30 CREIGHTON L. REV. 1113, 1166 (1997).

¹⁶⁶ Silhan, *supra* note 16 at 701.

¹⁶⁷ Le, *supra* note 18 at 423.

Table 1

Top Ten State and Local Sales & Use Tax Revenue Losses from E-Commerce Sales

(\$millions)¹⁶⁸

State	2010	2011	2012	Total	Financial ranking¹⁶⁹
California	\$1,441	\$1,694	\$1,905	\$3,155	Worst Deficit - Ranked #2 Worst Debt – Ranked #6
Texas	\$659	\$774	\$870	\$2,303	
New York	\$655	\$770	\$866	\$2,291	Worst Deficit - Ranked #6 Worst Debt – Ranked #4
Florida	\$608	\$715	\$804	\$2,127	Worst Debt – Ranked #10
Illinois	\$384	\$451	\$507	\$1,342	Worst Deficit - Ranked #4 Worst Debt – Ranked #5
Tennessee	\$311	\$366	\$411	\$1,088	
Georgia	\$310	\$365	\$410	\$1,085	
Louisiana	\$300	\$352	\$396	\$1,075	Worst Debt – Ranked #9
Arizona	\$280	\$329	\$370	\$979	Worst Deficit - Ranked #1
Pennsylvania	\$262	\$308	\$346	\$916	
Total	\$5,210	\$6,124	\$6,885	\$16,361	

¹⁶⁸ See Donald Bruce Et. Al., *supra* note 5, at Table 5.

¹⁶⁹ See toccata888, *supra* note 31.

Rockport Consulting Corporation
A Legal Case Study of Contract and Employment Law

By: Ronald Taylor, Professor of Legal Studies
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INTRODUCTION

This case study represents a potential tool to assist faculty teaching undergraduate business law and legal environment of business courses (collectively “undergraduate law courses”). The case is written and structured to provide faculty with maximum flexibility to determine the substantive legal scope of the case, the pedagogical fashion in which it is utilized by faculty, and the course learning objectives that it seeks to accomplish.

Graduate school case studies and, to somewhat lesser extent, undergraduate business school case studies, that are used in the instruction of core business school disciplines, such as management, marketing, and finance, typically relate to actual companies, past or present, and actual events or circumstances that are susceptible to documental and anecdotal verification. Legal case studies, on the other hand, tend to be based upon reported judicial decisions which typically include elaborate and detailed legal analysis, legislative or case law history, and sometimes indecipherable legal verbiage, which can boggle the mind of legal scholars not to mention mere undergraduate business students. In addition, candid opinions, goals, or occurrences of the participants are undoubtedly subject to the inevitable cloak of legal obfuscation and confidentiality and, therefore, typically unavailable.

In light of the foregoing, this case study of Rockford Consulting Corporation is predicated on a fictitious company, fictitious individuals, and fictitious events. This case study, however, is intended to replicate common, contemporary legal quandaries, considerations, and events, or their equivalents, that business students will confront in their respective careers.

This case study is comprised of a number of separate parts. This Part I is an introduction directed to readers of this case study and faculty who intend to utilize it in connection with instruction of their respective undergraduate law course. Part II below is the actual case of Rockport Consulting Corporation that is intended for distribution to students, together with guidelines and instructions for preparation of the students' case report. Part III is a Teaching Note that provides faculty with some suggestions for utilization of the case in their respective courses, grading and evaluation of the students' case reports, as well as some substantive research regarding some of the most current legal issues raised by the case.

CASE STUDY

I. INTRODUCTION

This case study is intended to provide you and your group with an opportunity to assess a typical business fact pattern, determine the legal issues that are present or may arise, and evaluate the relevant legal principles. For better or for worse, an understanding of the law and the ability to engage in legal analysis is an essential and integral aspect of conducting business in the contemporary business environment.

This project requires you to work as a team with certain classmates assigned by your professor. This case study requires appropriate legal research, disciplined legal and business analysis, and ultimately preparation and submission of a written group paper in accordance with your professor's instructions. Although the companies, individuals, and events in this case are purely fictional, the fact patterns and legal issues are intended to reflect dilemmas that business managers may encounter and have to resolve.

II. ROCKPORT CONSULTING CORPORATION

Rockport Consulting Corporation is a small software development firm in Greenwood Village, Colorado. Rockport specializes in the conceptualization, production, and implementation of proprietary software for human resource management for medical providers engaged in home care for the elderly. While the company has enjoyed significant success within this industry, the board of directors has determined that the industry offers only small upside potential because many of the medical providers in this field tend to be smaller companies that have only limited need for its products. Therefore, the Rockport board of directors has for some time been exploring ways for the company to expand into more opportunistic industries.

The Rockport board of directors has determined to target the medical hospice industry because general population demographics foretell steady growth for this industry and, moreover, the medical providers in this field tend to be larger entities, which would offer more lucrative contract potential. This strategic undertaking necessarily entails hiring an individual who has the requisite experience and expertise to spearhead this project as well as a significant expansion of the company's workforce, which currently numbers only about 20 employees.

Jason Edwards graduated two years ago with dual undergraduate degrees in Computer Information Systems and Management. He was originally hired by Rockford for his programming skills and knowledge, but he has recently been promoted to Manager of Employee Affairs, which he believes is a great opportunity for him. Nonetheless, he is still learning the ropes of his new position and is a work-in-progress. When the board assigned him the task of hiring a director for the company's new Hospice Health Care Division, he felt more than comfortable doing so given his educational background.

After conducting an exhaustive search, Jason has recommended to the board that the company hire Ms. Amy Martinez as Director of the company's new division. Amy has degrees in Computer Information Science from a regional state university and an MBA from the University of Denver. She is 32-years-old, has a domestic partner, Evangeline, and currently resides in Washington. Amy is an accomplished entrepreneur who successfully developed employment-related software for her own consulting firm, AM Management LLC. Amy recently sold AM Management to Hathaway Corporation, a publicly-traded human resource management firm. In her own company, Amy was the sole executive officer and chief programmer who worked in tandem with a few employees to develop proprietary software for managing employee benefits in the nursing home industry.

At a meeting of the board of directors, Jason recommended that Rockport extend an offer of employment to Amy, given her experience, skill set, and potential for helping the company achieve its strategic goals. The board generally concurred with Jason's assessment of Amy and agreed in principle that the company should extend an offer of employment to her. However, the board enumerated a number of general employment questions relating to the anticipated expansion of the company's workforce and yet additional questions specifically relating to the employment of Amy Martinez. These questions and concerns are set forth below.

The Rockport board of directors has charged Jason with responsibility to look into and provide answers to its questions prior to undertaking any employment initiatives. It has also instructed Jason to take direct control of the contractual process relating the employment of Amy as Director of its Hospice Health Care Division.

While Rockford has experienced success thus far during in its short existence, it is by no means flush with capital. The company is much too small to have its own in-house attorney and it has not even budgeted sufficient funds to retain outside counsel with whom the board and officers can consult regarding day-to-day business and legal affairs, such as the employment of Amy. The board instead expects its management team to conduct initial research and prepare a preliminary analysis of potential issues and to then relate their respective findings to the board for its consideration. In this manner the board can be better informed in its decision-making process and consultations with its attorneys when the need arises.

Jason realizes that his future with Rockport could very well be dependent on his success in meeting the board's requests. He has assigned your group to help him fulfill the board of directors' request for information and guidance. The unstated reality is that the future of your group at Rockport Consulting Corporation is also on the line in this endeavor.

III.PROJECT

Jason has requested your group to prepare the following work product for him to present to the board of directors. The assignment is comprised of the following two elements:

A. Prepare Discussion Memorandum regarding Global Employment Issues

Prepare a memorandum that succinctly analyzes the global employment issues that the Rockford board of directors has previously posed to Jason and that are set forth below. In order to validate your analysis, Jason has requested that the memorandum include at least one specific, current legal reference or other authority that supports your analysis for each question.

1. The company recently learned that negative comments about one of the company's supervisors had been posted by several of its employees on *Facebook* and somehow these back-and-forth communications had been read by employees of some of the company's clientele. The Rockford board of directors wants to know whether they can discipline or discharge these employees for their conduct.
2. The premiums for group medical insurance that the company provides for its employees are skyrocketing. One of its employees, for instance, recently required surgery and extensive medical care in order to treat the employee's breast cancer. The directors just learned that this employee had previously had genetic testing from which she learned that she had BRCA1 and BRCA2 genetic mutations, which indicate a significantly greater propensity to develop breast cancer during an individual's lifetime. The board would like to know if the company can require genetic testing for its employees or, at the very least, require them to disclose the results of any genetic testing that they have had.
3. Rockport has previously adopted a mandatory drug and alcohol testing program. It has come to the board's attention, however, that at least one of its employees is considering

obtaining a medical-marijuana card from the state in order to treat serious pain resulting from a covered medical condition. The board wants to be proactive and determine in advance whether the use of medical marijuana must be exempted under the company's drug and alcohol testing program.

4. In order to bolster productivity, Rockford has recently instituted a no-smoking policy for employees during work hours. Nonetheless, several employees, who admittedly smoke tobacco, noticeably smell like cigarette smoke at work although they all insist that they are adhering to the company's no-smoking work policy. The board suspects that some or all of these employees are surreptitiously smoking at work thereby reducing the employees' productivity. The directors want to know if the company can lawfully adopt a comprehensive no-smoking policy for employees, whether at work or not.

Instructions: You must research the foregoing issues and reference each legal decision or authority that supports your analysis. You may use your textbook as a guide in your research but referencing your textbook only is not adequate authority for your analysis and/or conclusions.

B. Prepare Draft of Employment Contract

Your group must also prepare a draft employment contract between Rockford Consulting Corporation and Amy Martinez. Separate terms of the contract must address each of the following: (a) each basic term of employment enumerated by the board of directors as set forth below, (b) each special term of employment stated by the board of directors as set forth below, and (c) at least five additional, relevant contractual terms that are commonly used in contracts, i.e., "boilerplate."

1. Basic terms of employment for Amy Martinez

The basic terms of employment that the Rockport board of directors has preliminarily determined to offer Amy Martinez include the following:

1. Initial position and title: Director of Health Care Division.
2. Term of employment: two years commencing January 1, 201__.
3. Base compensation: \$120,000 annual compensation payable monthly.
4. Duties: shall perform all of the duties set forth in the job description for this position and as otherwise stated from time-to-time by the board of directors.
5. Basic rules of employment are set forth in the Company Employee Handbook. However, the board of directors does not want the company to be legally required to adhere to the Handbook in its employment-related matters.

2. Special terms of employment relating to Amy Martinez

The Rockport board of directors has expressed particular concern about the following potential issues in connection with the corporation's employment of Amy Martinez:

1. Amy's employment is subject to Rockport first getting the contract to develop all of the proprietary human resource software for First Health Corporation, a nationwide chain of Christian hospital facilities.
2. All software and other creative work developed by Amy during the term of her employment shall belong to Rockport.
3. Amy will neither take any confidential information of Rockport nor use any such confidential information following the termination of her employment.
4. Amy will not compete against Rockport following termination of her employment with the company.

5. Rockport shall have the right to extend Amy's term of employment for an additional two years upon the same terms stated in her original employment contract.

6. Rockport shall have the right to terminate Amy at any time upon giving 30 days' prior written notice if the contract between Rockport and First Health Hospitals is terminated.

Instructions: Following each special term, you must explain why each such term should be included and identify the nature of each contractual term, e.g., option, condition precedent, etc.,

3. Boilerplate contractual terms

The draft of employment contract shall also include five additional, separate contractual terms that you think should be included in this contract.

Instructions: Following each term you must identify the nature of the contractual term included, e.g., arbitration, and explain why it is important to include this type of term.

IV. CASE STUDY GUIDELINES

A. Clarification of Facts

Within the next week or so, your professor may provide you with additional facts for your consideration. If this occurs, then the facts stated above, as supplemented, will constitute the operative facts that you will use for your analysis.

On or before _____, 201_ you may **email** to the professor up to **two** questions regarding **essential facts** relating to the case that you would like to be amplified upon or clarified. Your questions must be organized and literate, with each question separately numbered, clearly stated, and succinctly expressed. The professor will endeavor to respond to appropriate questions within a reasonable time.

B. Scope of Legal Analysis

All legal analysis for this group case study should be based upon general rules of business law as discussed in chapters _____ of the course textbook, federal law and the law of _____ (state). Attached as Exhibit A is a brief guide to several legal sources that

C. Case Study Guidelines

You must prepare and submit both a Discussion Memorandum and draft of Employment Contract in accordance with the instructions previously stated.

Each group shall work separately from all other students in this class and all other classes or students anywhere, past or present. All analysis, research, writing, ideas, and any other material or intellectual work product relating to this group study shall remain confidential with you. Any violation of the foregoing restrictions shall result in a grade of zero (0) for this assignment for each student who commits such violation and any other student who knows, or should know, that the product of such a violation is used in the preparation of his or her case study.

The foregoing two writings must be given to the professor by 5:00 pm MST on or before _____, ____, 201___. An electronic version of the case study must also be sent to the professor by this date and time. Late submissions of the employment contract will result in five points being deducted from your grade on this assignment for each day late until it has been both physically and electronically delivered to the professor.

D. General Writing Requirements

The general writing guidelines for the written project include the following: double-space, 1” margins, Times New Roman, 12-point font, and headings encouraged. Except as stated above, you should use APA format when writing your case study. To assist you, you should use the

attached Exhibit B, which summarizes APA rules for citing some of the more common legal references that you may use for this project.

When drafting the employment contract portion of this project you may choose to write original terms and/or you may use selected portions of form employment contracts that you find on the Internet or in print subject to two basic limitations: (1) you must properly and fully reference any source used and you cannot use any particular contract form as a resource for more than two (2) terms of the draft employment contract.

EXHIBIT A

CASE STUDY RESEARCH HANDOUT

A portion of your grade is based on the quality of your legal and business research undertaken in connection with your case study.

In order to keep this project manageable, you should confine your legal analysis to 1) statutory law of _____ (state), 2) federal statutes, 3) recorded judicial opinions of _____ (state) Supreme Court or _____ (state) Court of Appeals rendered in the past 10 years, and 4) recorded judicial opinions of the U.S. Supreme Court or U.S. Court of Appeals rendered in the past 10 years. You may also use secondary legal references or business references.

Some sources for legal research include the following:

1. www.law.cornell.edu
2. Lexis – Nexis
Access Lexis- Nexis website
Research tools
Databases A-Z
LexisNexis
US Legal
Hint – search terms – contract
3. Westlaw
Access Westlaw
Law
Hint – KeySearch Tip – Contracts
4. <http://www.findlaw.com>

EXHIBIT B

LEGAL REFERENCE CITATION HANDOUT

As discussed in the case, students are generally to cite references in accordance with APA 6th ed. (2009). You should use standard APA style for writing this case study and for citing articles, books, and other sources that may discuss the law, but are not official government sources. An example of this would be a law review article.

The APA rules for official legal sources references is premised in large part on another writing style that is used for legal works entitled *The Bluebook: A Uniform System of Citation* (16th ed.) (1996) Cambridge, MA: Harvard Law Review Association. You are not required to use *The Bluebook* for this case study.

The APA rules for citing legal references can sometimes be confusing. Therefore, this handout has been prepared for you as an aid to clarify the APA rules for citation of statutes, cases, and other official legal sources. You should follow this handout when citing to such legal resources. For any other official legal sources, you should use the Internet in order to find the appropriate citation format.

U.S. SUPREME COURT DECISIONS¹⁷⁰

Citation format for endnotes

Name v. Name, Volume number U.S. Page number (Year).

Example

American Tobacco Co. v. United States, 328 U.S. 781 (1946).

Note

The volume and page numbers refer to the U.S. Reports reporting service. Do not cite to the Supreme Court Reporter reporting service if the U.S. Reports citation is available.

¹⁷⁰ Westfield State University Ely Library, *APA Style – Citing Legal Materials*. Retrieved from <http://www.lib.wsc.ma.edu/legalapa.htm>.

Citation format for in-text references

Name v. Name (Year) when cited within a sentence.

(Name v. Name, Year) when cited at the end of a sentence.

Note

The name of a case cited in-text may be either underlined or italicized, i.e., Johnson v. United States (1950) or *Johnson v. United States* (1950).

Examples

The Supreme Court emphasized in *Spectrum Sports, Inc. v. McMullan* (1993) that Section 2 does not protect individual businesses from the working of the market.

The Supreme Court has emphasized that Section 2 does not protect individual businesses from the working of the market (Spectrum Sports, Inc. v. McMullan, 1993).

LOWER FEDERAL COURT DECISIONS

Citation format for endnotes

Name v. Name, Volume number Reporter abbreviation Page number (Court Name).

Reporter Abbreviations

F., F.2d or F.3d for Federal Reporter (U.S. circuit courts)

F. Supp. or F.Supp.2d for Federal Supplement (U.S. district courts).

Examples

Coastal Fuels of P.R., Inc. v. Caribbean Petroleum Corp., 79 F.3d 182 (1st Cir. 1996).

Citation format for in-text references

Name v. Name (Year) when cited within a sentence.

(Name v. Name, Year) when cited at the end of a sentence.

If quoting from a judicial opinion, then at end of the reference add p. Page number of reporter where statement is located.

Examples

In *United States v. Aluminum Co. of America* (1945), the Supreme Court recognized that the duality of purpose under the Sherman Act continued well into the 20th century.

This duality of purpose under the Sherman Act continued well into the 20th century (*United States v. Aluminum Co. of America*, 1945).

Justice Thomas stated that “(a) plaintiff must prove that the alleged predatory bidding led to below-cost pricing” (*Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.*, p. 1069, 2007).

OR

In *Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co.* (2007), Justice Thomas stated that “(a) plaintiff must prove that the alleged predatory bidding led to below-cost pricing” (p. 1069).

STATE COURT DECISIONS (Colorado used as example)

Citation format for endnotes

Name v. Name, Volume number Reporter abbreviation Page number (Court abbreviation Year). The Reporter abbreviation refers to the Pacific Reporter: P., P.2nd, or P3rd. The citation does not have to refer to the Colorado Reporter that was discontinued in 1980. The Court abbreviation is either to the Colorado Supreme Court, i.e., Colo. or to the Colorado Court of Appeal, i.e., Colo. Ct. App.

Example

Rocknell v. Smith, 455 P.3rd 401 (Colo. Ct. App. 2009).

Citation format for in-text references

Name v. Name (Year) when cited within a sentence.

(*Name v. Name*, Year) when cited at the end of a sentence.

Examples

In *Rocknell v. Smith* (2002), the Colorado Court of Appeals upheld the common law rule allowing minors to disaffirm an employment contract.

The Colorado Court of Appeals has upheld the common law rule allowing minors to disaffirm an employment contract (Rocknell v. Smith 2002).

U.S. AND STATE CONSTITUTIONS

Citation format for endnotes

U.S. Constitution - Abbreviate name of constitution and part (if applicable), Amendment number in roman numeral, Section number.

Colorado Constitution – Abbreviate name of constitution, art. Article number in roman numeral, § Section number.

Examples

U.S. Const., amend. I, § 1.

Colo. Const. art. II, § 29.

Citation format for in-text references

Same as citation format for endnotes (see above) except adjust parentheses depending on whether the citation is within or at the end of the sentence.

Examples

Equal legal treatment of men and women is guaranteed by Colo. Const. art. II, § 29.

Equal legal treatment of men and women is guaranteed by the Colorado constitution (Colo. Const. art. II, § 29).

FEDERAL STATUTES

Citation format for endnotes

Reference a federal statute: For current federal statutes that are not an appropriations law, cite a statute to its location in the U.S. Code. Cite generally is Number of title Abbreviation for United State Code Number of section (Year).

Reference is to an official legislative act: Name of Act § Section number, Volume number U.S.C. § Section number (Year).

Examples

25 U. S. C. 345 (2009).

Pregnancy Discrimination Act § 101, 42 U.S.C. § 4332 (1978).

Citation format for in-text references

See the examples below for the following references:

Cite to a specific federal statute(s).

Name of Act (Year) is used when referencing a particular act within a sentence.

(Name of Act of Year) is used when referencing a particular act at the end of a sentence.

Examples

Federal law generally prohibits employment discrimination based on the pregnancy of the employee (42 U.S.C. § 4332 (1978)).

The Pregnancy Discrimination Act (1978) generally prohibited employment discrimination based the pregnancy of the employee.

Federal law generally forbids employment discrimination on account of the pregnancy of an employee (Pregnancy Discrimination Act, 1978).

OR

Federal law generally forbids discrimination regarding the compensation paid to male and female employees performing the same work (Equal Pay Act of 1963).

STATUTES (Colorado used as example)¹⁷¹

Citation format for endnotes

Colo. Rev. Stat. Ann. Chapter number § Section number (Source Year).¹⁷²

Example

Colo. Rev. Stat. Ann. § 5-1-101 (LexisNexis 2010).

Citation format for in-text references

Colo. Rev. Stat. Ann. § 5-1-101 (2010).

(Colo. Rev. Stat. Ann. § 5-1-101, 2010).

FEDERAL AND STATE REGULATIONS (Colorado used as example)

¹⁷¹ Legal Information Institute, Cornell University Law School. Retrieved from http://www.law.cornell.edu/citation/7-500.htm#7-500_Colorado.

¹⁷² Legal Information Institute, Cornell University Law School. Retrieved from http://www.law.cornell.edu/citation/7-500.htm#7-500_Colorado.

Citation format for endnotes

Federal regulation - The citation is generally to the codified federal regulations which generally is comprised of the following: Title number of the regulation C.F.R. (for Code of Federal Regulations) § Section number Year of most recent compilation.

Colorado regulation – The citation is generally to the codified regulations for Colorado. Title number CCR (for Colorado Code of Regulations) § Section number, Rule number Year. Retrieved from Website address.

Example

21 C.F.R. § 231.10 (2008).

3 CCR § 708.1 (2010). Retrieved from http://www.dora.state.co.us/civil-rights/Statute_Regulations_Rules/30November2009RulesandRegulations.pdf.

**The Colorado Water for the 21st Century Act:
A Legislative Mandate Successfully Implemented***

Elizabeth McVicker, Assistant Professor, Metropolitan State College of Denver

Introduction

Most of the State of Colorado receives less than 20 inches of natural precipitation each year. Generally, agriculture must have more than 20 inches of precipitation per year to be successful, and, therefore, the state must rely on irrigation water to grow crops or urban landscapes.¹ Meanwhile, Colorado's population is projected to double by the year 2050², from around 5 million people to more than 10 million and, thus, the demand for water supply from municipal and industrial uses, agricultural, environmental and recreational interests will, in turn, increase exponentially. 80% of the state's population is on the east slope but 80% of Colorado's water is on the west slope³, and most of the state's irrigated agricultural lands are also on the eastern slope of the mountains. Thus, by 2050, Colorado will need an additional 200,000 to 600,000 acre-feet⁴ of water more than that planned for by local water providers.⁵ To consternate the situation, the current reliance on non-renewable groundwater, such as that which supplies the South Denver Metro municipal areas and counties, must be replaced with a new source.⁶ The source of much of the water in Colorado, the Colorado River, also supplies water to some of the most populated states in the nation, including California, Arizona and Nevada; the Colorado River Compact, signed by seven states in 1922, mandates that Colorado must deliver a certain amount of Colorado River water to the lower basin states; a "call" on the Colorado River could further curtail the supply of water to the State in the coming years.⁷ All of these factors point to a need to collaborate on future solutions in a way that addresses every stakeholder's interests.

In an attempt to face the state's potential water shortage crises with a vision of proactive problem solving articulated by all of the stakeholders in the state's river basins, the Colorado

General Assembly passed House Bill 05-1177, the Colorado Water for the 21st Century Act⁸ (the “Act”), in January of 2005. The Act defines a locally-driven process to address the gap between supply and demand of water resources in a manner that builds on good data, sound science and collaboration among diverse stakeholders.⁹ Six years later, the Act has motivated dialogue, funded studies and projects and mapped a response to meeting the demand of water needs of the citizens of the State of Colorado by 2050 that is not dependent on litigation, legislative management or the “status quo” of water management; this “vision” and subsequent actions would not have been possible without the intent of the General Assembly to pass this legislation. Indeed, the Colorado Water for the 21st Century Act is a funded, legislative mandate that has been embraced by the stakeholders upon whose participation and action the intent of the legislation depends.

The sense of urgency regarding Colorado’s water supply future has been amplified by the results of the studies conducted in the last few years which have revealed a significant gap that will exist between supply and demand of Colorado’s water resources by 2050 if actions are not taken now.¹⁰ The citizenry of the state has become very aware of the difficulty of facing trade-offs among the diverse stakeholders created by the limited water supply and the complexities of the legal system that oversees water allocation in the state.¹¹

This paper provides an overview of the history and purpose of the Colorado Water for the 21st Century Act and a summary of some of the salient accomplishments of the stakeholders in response to the statutory demands. This discussion is followed by a review of the suggested portfolio tool that the stakeholders have decided will be the best vehicle with which to proceed in answering the demands of all stakeholders. The paper will then conclude with suggestions for possible further actions on the part of the Colorado General Assembly and other state agencies.

The underlying theme of the paper focuses upon the power of a single state statute to answer future needs of the citizenry by mandating actions and discussions of that same citizenry for its own future sustainability. The Colorado General Assembly practiced good legislative management skills by clearly articulating statutory mandates expected of the stakeholders, funding those mandates, and then...stepping aside. The Colorado Water for the 21st Century Act illustrates the power of a government “of the people, by the people, and for the people.”

The Colorado Water for the 21st Century Act: An Overview

In September of 2004, the Director of Colorado’s Division of Natural Resources, Russ George, first described the idea of an interbasin compact where representatives from a diverse group of stakeholders from each of the state’s major river basins and the Denver metropolitan area would convene on a regular and ongoing basis to discuss how best to meet the state’s demands for water resources in the future.¹² In January of 2005, two members of the General Assembly—a Senator representing agricultural interests from the San Luis Valley and a Representative from the eastern plains of the state¹³--introduced House Bill 05-1177 (Colorado Water for the 21st Century Act-the “Act”) and by June of 2005, the Republican Governor of the State, Governor Bill Owens, had signed the Act establishing the Interbasin Compact Process. By the fall of 2005, following the dictates of the Act, each of the river basin Roundtables had met, elected officers, established by-laws, and elected representatives to serve as the liaison of each particular river basin Roundtable in the state on the Interbasin Compact Committee (IBCC).¹⁴ In March of 2011, Democratic Governor John Hickenlooper delivered a speech to the Statewide Roundtable Summit, noting that, thanks to the dedication and actions of the Roundtables and the IBCC over a course of more than six years, Colorado has the needed data, cooperation and collaboration to move forward with statewide goals.¹⁵ In the six years since the passing of the

Act, the state has not developed any new “wet water”¹⁶; however, per the mandates articulated in the Act, the IBCC and the Basin Roundtables have made progress in finding common ground and developing a plan for the future. The spirit of cooperation between previously warring factions has created a forum for water managers across the state to ink historic agreements that provide sustainability of water resources to citizens on both sides of the Continental Divide.¹⁷

The enabling legislation for the Colorado Water for the 21st Century Act begins in 2003 with SB03-110, the Statewide Water Supply Initiative (SWSI), which implemented a collaborative approach to the scientific study of water resources.¹⁸ The SWSI Act established Roundtables throughout the state—a Roundtable for each river basin in the state and one Roundtable for the largest urban area of the state, the Denver Metro area¹⁹---and directed the citizens on the Roundtables to use a common technical basis for identifying and quantifying water needs and issues.²⁰ The SWSI Roundtables also provided an understanding of the concerns and values of the residents of the basins around the state. In January, 2011, the SWSI Roundtables released an update and further detail into data and studies on the Statewide Water Supply.²¹

In 2005, the Colorado Water for the 21st Century Act provided a permanent forum for broad-based water discussion in the State. Similar to SWASI, the Act designates nine Roundtables and charges the Roundtables to develop needs-assessments for consumptive and non-consumptive water supply (in consumptive use every water molecule is used up and does not return to the hydrologic cycle, such as in municipal, industrial and agricultural water uses; in non-consumptive uses, water molecules stay in the stream and in the hydrologic cycle, such as with recreation and fish habitat). The Roundtables were then to determine the volume of unappropriated water—water that does not already belong to someone-- in each basin, and to

propose projects for meeting the needs of the basin and the entire state. Six years later, the nine basin Roundtables have met on a continuous basis—the South Platte Basin Roundtable, for instance, has met the second Tuesday of every month in Weld County since 2005—to fulfill the statutory dictates of the Act and to approve and fund projects in the basin and the state.²²

The philosophy behind the Act is that the state needs the flexibility created with the Roundtable structure to allow for stakeholders to address problems before the problems become a serious issue in a time of crisis. Negotiation of water agreements instead of intrastate legal water wars was one of the goals of the Act. Cooperation and collaboration were to replace litigation and wasted resources of time and money.²³ In fact, since the passing of the Act, although the water courts have been busy with water adjudication cases, change of use cases, and some adversarial speculation cases²⁴, fewer contentious, expensive water litigation has occurred in the State where a big Water Buffalo such as Denver or Aurora, aggressively tried to “take” water from another basin, such as the actions which were at the base of some of the most costly lawsuits of the 20th Century; examples include water court cases that involved bringing water to the eastern slope from the Taylor Reservoir and Union Park, cases involving Northern Water Conservancy District bringing water from the Colorado River and the South Park Conjunctive Use Project that aimed to mine the South Park aquifer for the City of Aurora.²⁵ In addition, an historical agreement between Front Range water managers—Denver Water, mainly—and water users and managers on the Western Slope may not have been possible without the forums for dialogue created by the Roundtable and IBCC process.²⁶

In 2006, the Colorado Legislature passed SB06-179 and created the Water Supply Reserve Account (WSRA), which directs the State Treasurer to annually transfer \$10 million from the Operational Account of the Severance Tax Trust Fund to the Water Supply Reserve.²⁷

Subsequently, the legislature passed HB06-1385, which created the Colorado Water Conservation Board's (CWCB) Intrastate Water Management and Development Section. This act implements SWSI, establishes the Water Supply Reserve Account (WSRA) which funds projects approved by the Roundtables, develops reconnaissance level water supply alternatives, and tracks and supports water supply projects and the planning processes.²⁸ Again, multiple stakeholders propelled the legislative directive and continue to benefit from it.

The WSRA funds have been available to the Basin Roundtables to fund water activities and projects. In the six years since the Roundtable process has been in place and the funds have been available, multiple water projects have been proposed and funded.²⁹ The list of funded projects by the Roundtables evidences the cooperation and collaboration envisioned by the legislature.³⁰ Despite the dire economic situation facing the State, especially since 2008, the State of Colorado through the legislature and directed agencies have continued to provide funding to WSRA for the Roundtables and local communities to evaluate proposed projects. State financial support has been crucial in meeting the state's water needs. The WSRA program has assisted over 140 water projects with over \$26 million, while leveraging over \$4million in local and federal funds.³¹ For example, WSRA funds provided financing and a \$1 million mitigation grant for the enlargement of Elkhead Reservoir near Craig, Colorado, in the far northwestern part of the State. This is a 12,000 acre-foot enlargement of the existing reservoir and, when completed, will be a \$30 million multi-purpose project, providing water supplies for long-term human and environmental needs.³² On the Front Range, another example of WSRA funds providing critical support for water projects include funds for the Chatfield Reservoir Storage Reallocation project; the Chatfield Reservoir, once enlarged, will provide storage for water resources that provide water for millions of Front Range citizens.³³ Likewise, in the South

Platte basin, farmers and ranchers on the eastern plains, upper mountain county communities, industrial users, municipal water managers, environmentalists, kayakers, duck hunters and fishermen have reached agreement on a plethora of issues and have authorized multiple projects in the basin and across the state.³⁴ Examples of these projects range from reservoir studies in the high mountain county of Clear Creek, to wet land mitigation projects in the far eastern part of the State, to a study of how to make federal permitting processes more efficient.³⁵ In his keynote address to the Statewide Roundtable Summit in March of 2011, the Governor recommended leaving Water Supply Reserve Account and CWCB funds intact.³⁶ The Governor recognized that the integrated approach to implementing projects inherent in the IBCC/Roundtable process is effective³⁷ and should continue. The IBCC was charged by the Governor to prioritize their projects for prompt action in 2011.³⁸

One of the goals of the Colorado Water for the 21st Century Act is to encourage different parts of the State to talk to each other instead of fight with each other. The state has faced expensive water fights with its neighbors.³⁹ If those same fights can be avoided among the citizens of the State of Colorado, a “new day” in state water deliberations can be realized. Progress toward this goal was evident in a “water parley that made history” in September 2007, when some of Colorado’s “most saavy water chieftains” held a historic meeting in Walden, Colorado.⁴⁰ In this meeting, the leadership of the South Platte and Yampa/White/Green Basin Roundtables met on “neutral ground” to discuss a possible transbasin project, a proposed \$4 billion, 227 mile pipeline that would carry 300,000 acre feet of water annually from the Yampa River in northwestern Colorado to the Front Range and the fast-growing communities on the West Slope. The meeting was important not only because of the substance of the issues discussed but also because it simply happened. Both basins, of course, had different perspectives

on the proposal, but sharing those different perspectives was the purpose of the meeting. As a newspaper article observed, the meeting “marked the first time under a new state law that formerly hostile interests have met voluntarily to discuss a water project before any money has been spent, before any decisions have been made, before lawsuits have been filed.”⁴¹

Since 2007, multiple meetings between the basin Roundtables on either side of the Continental Divide have occurred and the statewide IBCC meetings have culminated in a suggested portfolio approach—a mix of identified solutions—that will meet our water management objectives.⁴² The four key components of the portfolio approach will be explained later in this paper. As the different Roundtables experiment with the variations of this portfolio approach, each basin has begun to appreciate how connected the economies of this state really are: west slope ranchers now see the impact on their industry if water were to be curtailed to front range farmers that grow the alfalfa that west slope cattle depend on; west slope ranchers can now see the impact on their beef industry if water were not available for east slope packing houses.⁴³ The Roundtable and IBCC process made this mutual understanding possible.

The essence of the IBCC and the Basin Roundtables process created by the Colorado Water for the 21st Century Act is dialogue—bringing together different basins and different water users to increase awareness and understanding of the water challenges that the State faces, and to move projects forward such that we are posed to share the State’s water resources to meet our consumptive and nonconsumptive water supply needs. The more the population of Colorado grows, the greater the demand on the scarce water resources of this arid state, and, hence, the more important the dialogue. Without cooperation and understanding, meeting Colorado’s long-term water needs in a balanced way will be difficult. That balance must maintain all rights under the appropriation doctrine created in the years when Colorado was still a territory as well as

reckoning with the uncertain future of growth and demand. In his closing remarks at the Statewide Roundtable Summit in March of 2011, Governor Hickenlooper “stressed that the future of Colorado depends on meeting municipal and industrial needs without compromising agriculture or environmental and recreational resources.”⁴⁴ He then charged the Roundtables and the IBCC to continue their efforts in finding “collaborative solutions” to the challenges the State faces in finding a sustainable water supply for our future generations.⁴⁵ The Roundtables and the IBCC take seriously their legislative mandate and have articulated a detailed plan, one that is based on a four-prong, portfolio tool, on how Colorado will share its water resources to meet the state’s water supply needs for now and for the next forty years.⁴⁶

The Interbasin Compact Committee and Basin Roundtables

2012 will mark the 75th anniversary of the General Assembly’s 1937 legislation that created the Colorado River Water Conservation District (CCWCB), the Northern Colorado Water Conservancy District and the Colorado Water Conservation Board.⁴⁷ In those 75 years, the CCWB has provided financial support through loans and grants for a multitude of water projects; it holds a central role in supporting the ongoing implementation of the Colorado Water for the 21st Century Act.⁴⁸ The CWCB provides staff for each of the basin Roundtables and the IBCC and assists with the compilation and studies for water supply and demand information.⁴⁹ The CWCB also conducts the studies and technical analyses that the Roundtables request.⁵⁰

27 members, two from each Roundtable and legislative representatives, comprise the Interbasin Compact Committee (IBCC).⁵¹ The Committee, in its initial articulation of its mission, and per the statutory demands, defines its roles as follow:

1. Provide a forum to develop and disseminate information, create a positive environment for a statewide perspective and develop a vision for statewide water negotiations.

2. Serve as a forum for discussing and addressing the socio-economic, recreation and environmental impacts of water development and management, as well as potential impacts on the ability of the state to use its entitlements and meet its Interstate Compact requirements.
3. Assist in finding resources to enable Roundtables to develop basin-wide visions.
4. Encourage development of a common technical platform upon which negotiations can be based.
5. Guide the process of negotiating interbasin compacts and other agreements by providing a framework that creates incentives for successful deliberations, agreements and their implementation.
6. Perform all other roles and functions of the IBCC identified in legislation.⁵²

The IBCC spent the years from 2006-2008 establishing a level of trust and then articulated a vision statement per the demands of the legislation: “We envision a Colorado that balances municipal, industrial, agricultural, environmental, and recreational water needs and promotes cooperation among all water uses.”⁵³ Building on this vision, the IBCC has used its meetings and discussions to focus on the fourth objective listed above: the committee has explored different mixes of solutions for three different scenarios based on high, middle and low water demand coupled with high, middle and low water supply. Ranchers on the west slope and farmers on the eastern plains, metropolitan municipal water managers from the populous Front Range and environmentalists and recreations dedicated to saving the Western Slope rivers for fish habitat and kayaking, lawyers and politicians dedicated to representing their individual client and constituent interests have worked out an agreement to balance the needs of meeting all of their diverse needs –municipal, agricultural, non-consumptive. The Committee, from direction of the Roundtables, seeks to meet the needs of the state by using a mix of new water supply development for the future: 1) conservation; 2) identified projects and process (IPPs); 3) agricultural transfers (taking water from traditional farming and ranching operations and changing it to municipal and industrial uses); and 4) new water supply development in the Colorado River system.⁵⁴ The IBCC is committed to pursue each of these four tactics

concurrently so that no one sector of the state, such as agriculture, bears the burden of future water supply. A successful framework for new water supply must call on all the citizens in all parts of the State to share the burdens and benefits of the framework. This framework must also protect the water-dependent ecological and recreational resources of the State.⁵⁵

The Mix of Solutions: The Portfolio Process

In its August 2010 meeting, the IBCC agreed that the future mix of water supply solutions should include all of the four sources that the Roundtables had identified as sources to meet the water supply gap in Colorado.⁵⁶ In the fall of 2011, the IBCC and the CWCB staff presented to the Roundtables a comprehensive framework in a computer program platform where each Roundtable can study combinations of the mix of solutions—and the impact on every river basin in the State.⁵⁷ The Roundtables on the Western Slope, such as the Gunnison and the Colorado Roundtables, and those on the eastern slope, the Arkansas and South Platte Roundtables, have explored different combinations and scenarios of the mix of uses. The portfolio process has emphasized the fact of the interconnectivity of our State's water resources.

Following is a summary of the four basic principles enumerated above:

- 1) **Identified projects and processes (IPPs).** These represent the existing planned projects by water managers. Even these existing, planned projects, however, are not guaranteed; even if all of the IPPs were built, it is estimated that they could not meet all of the municipal and industrial water needs in the State. Projects such as the Northern Integrated Supply Project (NISP) which looks to expand reservoirs north of Greeley has been in the planning stage for 10 years and has met with opposition from a coalition of environmentalists.⁵⁸ The variety of state agencies that oversee this project as well as the federal agencies that must permit the project replicate each

others' works at times and are not communicating in such a way as to facilitate these important projects going forward.

To illustrate how the IBCC furthers the development of specific IPPs, the IBCC issued a Statement on the Role of the State in Supporting Water Supply Processes and Projects making specific recommendations which include the following: 1) how the state agencies involved in any one project can ameliorate their communications and sharing of information; 2) how the State can provide broader context about water issues facing the state to federal agencies with a role in water supply projects and processes; 3) how to explore ways to address barriers to projects; 4) how to perform a facilitating role where there is no consensus regarding a project and 5) how to potentially support projects.”⁵⁹

2) **Water conservation.** Since 2000, Colorado citizens have reduced their water use by an average of 18%, across the state.⁶⁰ Still, future conservation measures could produce approximately 154,000 acre-feet per year.⁶¹ The IBCC has articulated specific recommendations to further discuss additional water conservation measures.

These include the following:

“1) the State promote stewardship of water resources through statewide education and statewide messaging; 2) the State adopt and require water efficiency standards that meet or exceed EPA appliance specifications and that building permits and local building codes reflect a focus on water conservation; 3) the Governor issue an Executive Order for all state agencies to have a water use reduction plan; 4) the state agencies promulgate rules that would assist water utilities to minimize water loss in conveyance, storage, treatment and distribution, and to be consistent with rates; 5) the State adopt water efficiency standards that meet or exceed EPA’s specifications for all new landscaping plans and projects. Long term recommendations include amending state statutes to require conservation actions to promote those goals outlined above and assisting local governments in revising land use regulations to encourage water conservation.”⁶²

Conservation, however, has an impact on return flows to the river. The less water that flushes down toilets, the less water that goes through the treatment plant, and returns to the river basin. Thus, farmers on the lower South Platte Basin, for instance, or birds and wildlife that live in the wetlands along these parts of the lower South Platte, depend on excess water flowing back to the system.⁶³ In contrast, the environmental community has issued a study that focuses almost entirely on conservation as the answer to how to meet future water needs of the state⁶⁴, while farmers on the eastern plains see such a plan as the end of their livelihood.⁶⁵ The IBCC, therefore, must listen and consider all “opinions, needs, histories and demands”⁶⁶ as it compiles its list of suggestions and furthers discussion on this “contentious” part of the four part portfolio.

3) **Agriculture dry-up.** Agriculture is the third largest component of the economy of the

State of Colorado⁶⁷ and the industry uses almost 90% of the state’s water resources.⁶⁸

The IBCC’s report on agriculture emphasizes that “agriculture is an integral part of Colorado’s quality of life, culture, food security wetlands, open space and rural communities [and that] an inordinately large transfer of agricultural water to industrial and municipal use would have a negative impact on the state.”⁶⁹ The IBCC, therefore, continues its focus for recommendations concerning three of the four-prongs of the portfolio--conservation, IPPS and new development of water supply—“ with an objective of seeing less water transferred out of agriculture.”⁷⁰

Farmers and ranchers own the water they use to produce the food they grow; their water is a private property right, they can sell their water. Many of the state’s large municipalities and industries have bought valuable water at high prices from the eastern plains, and over the last half century, many exchanges have occurred; this change from agriculture use to municipal and industrial use is called “Ag dry-up” which has delivered significant amounts of water to

Colorado Springs, Aurora, Thornton and Denver over the years.⁷¹ Large-scale dry-up, however, is feared to result in social and economic impacts on the rural communities that could decimate those communities; likewise, environmentalists fear that the dry-up of agriculture will eliminate key wildlife habitat as well.⁷² All of these considerations are part of the on-going IBCC discussions.⁷³

The IBCC has made specific recommendations for alternatives to these “buy and dry” transfers of water use. These recommendations would help promote agricultural ownership of irrigation water rights and assist in keeping agricultural land in production. These include: rotational fallowing, interruptible supply agreements, leasing/fallowing agreements, water banks, purchase and lease-backs, deficit irrigation and changing crop type option.⁷⁴ The interaction, cooperation and respect between West Slope ranchers and Eastern Plain farmers on the Roundtables is a hallmark of the Roundtable process. As the different Roundtable members experiment with the excel spreadsheet that CWCBC to see results from their own experimental dictates, a new level of cooperation has come about. For example, when the Gunnison Roundtable input a high level of ag dryup and a high level of conservation with a low level of IPPs and a low level of new supply from the Colorado River, the ranchers on the Western Slope saw how such a scenario could result in such a water shortage as to shut down the meat processing plants on the eastern slope and the supply of alfalfa upon which those Western Slope ranchers depend. Likewise, the South Platte Roundtable saw that inputting a high level of water supply development from the Colorado River and a low ag dryup number, would have little impact on the South Platte in terms of new water supply.⁷⁵ The legislative mandates continue to be realized.

4) **New water supply trans-basin project.** Controversy surrounds any proposition for a new trans-basin diversion project that would bring Colorado River Water to the eastern slope. As noted earlier, 80% of the state's population is on the eastern side of the Rockies, 60% of Colorado's water is on the western slope. A successful combination of conservation, successful IPP completion, and agricultural transfer alternatives may supply needed water for the gap, studies of water supply from a new trans-basin diversion project continue as well, given that most of the state's water originates in the Colorado River. Any study of a trans-basin project must address possible Colorado River Compact curtailments because states such as Arizona, Nevada or California could call for more water from the Colorado River.⁷⁶

The IBCC has made specific suggestions to address concerns about new water supply projects. These include: "a risk management program that addresses water rights, conceptual outline for benefits and trade-offs, and a process for managing new supply projects."⁷⁷ The IBCC knows that "balancing the resistance and opposition to the discussion of new water supply projects" leads to the conclusion that permanent large agricultural transfers will be the default water source to fill the gap.⁷⁸ The IBCC has stated in their minutes that "this stark vision of the loss of our agricultural communities and the impact on our economy keeps the Roundtables talking and emphasizes the value of the portfolio "play."⁷⁹

The Roundtables and the IBCC, in their approval of grants for water projects, in their education outreach programs, in their statements to the State and the Governor, continue to focus also on Colorado's non-consumptive water needs. The Committee and the Roundtables have made specific suggestions in order to a) protect identified environmental and recreational values; b) promote recovery and sustainability of endangered, threatened and imperiled species; c)

protect and enhance economic values to local and statewide economies derived from environmental and recreational water uses; and d) recognize the importance of environmental and recreational benefits derived from agriculture water use, storage reservoirs and other consumptive water uses and management.⁸⁰ To imagine that an environmentalist and a farmer can actually agree on the importance of an endangered species or the restoration of a river for kayaking purposes was almost impossible six years ago. Another bit of evidence of the success of this legislation.

Suggestions: Reaching beyond interest-based, basin politics

While the Colorado Water Conservation Board will continue to lobby the legislature to continue support for programs and funding for the Interbasin Compact Committee and Roundtable process⁸¹, as well as keeping the legislature focused on the need for funding for IPPs and a possible trans-basin project, the Roundtable and IBCC process could be ameliorated. In a series of meetings of involved stakeholders during the Statewide Roundtable Summit in March of 2011⁸², suggestions ranged from development of water banks⁸³ to advocating for streamlining of the regulatory process involved in new IPPs to alternatives to ag transfers.⁸⁴ Some members of the Roundtables have voiced frustration in that, after six years, the Roundtables have no actual enforcement capabilities to push projects forward.⁸⁵ A more structured relationship between the Roundtables and the CWCB could be the subject of an amendment to the Act. In particular, the tireless service of the volunteer Roundtable members should be tapped in a more proactive manner at the Capital during the meetings of the interterm water resource legislative committee—the committee which meets between the actual legislative sessions and has direct authority over legislative actions during the session. If the actual Roundtable executive committees and other Roundtable members had a direct voice with the interterm committee and

with the Colorado Water Congress, communications would be more direct, proposed actions would be heard by those who they would directly affect (farmers, ranchers, water providers, environmentalists), and another level of isolation between the basins and the “powers that be” would be removed. If this involvement were authorized by a legislative amendment, the Roundtables would find a second wind for their efforts.

In his memo dated May 1, 2012, John Stulp⁸⁶, the IBCC Director who reports directly to the Governor, acknowledged that the focus of the Roundtable actions over the next twelve months will depend on Basin Roundtables implementation of projects and methods to meet consumptive and non-consumptive needs. The State has committed to continue funding the Water Supply Reserve Account funding and has agreed that direct CWCB support to help the Roundtables organize workshops and project proponents will be forthcoming; this will invigorate the Roundtable process. A continued focus on both short-term and long-term Basin Roundtable implementation of identified projects and methods is imperative for the Roundtables to see realization to their efforts. In addition, the State is committed to adopt the Roundtables’ recommendations to the SWASI 2010 work plan and to now involve the Roundtables in the current 6-year planning cycle for assessing Colorado’s long-term consumptive and non-consumptive water needs with a scheduled update to SWSI in 2016.⁸⁷

Some have suggested that Colorado water law should be changed to accommodate using water saved from agriculture through conservation efforts to meet future municipal and industrial demands.⁸⁸ Changing water law to provide more flexibility in court actions to change a use of water could reduce transaction costs for pursuing alternatives to ag transfer.⁸⁹ Municipalities need to be encouraged to pass comprehensive plans to attempt to meet water demands by 2050 or beyond; these could include water lease options.⁹⁰ A request to the Governor to issue an

Executive Order regarding the formation of a joint agency task force that would include representatives from all State agencies involved with water supply development is one of the more forceful suggestions, and one that could even have an impact on federal agency decision making.⁹¹ Other suggestions for legislative amendments include asking the legislature to amend existing interruptible supply agreement statutes to facilitate longer-term agriculture lease/fallowing programs.⁹² Involving Colorado legislators in these important decisions might also bring their attention to how effective they can be if and when they work together as a team, representing the entire state's citizenry. Imagine if such an effect could even reach to Washington.

Conclusion

The Colorado Water for the 21st Century Act and the Roundtable and IBCC process are implementing the portfolio process. The Roundtables have provided a forum to build understanding between river basin constituencies and have advocated solutions to meet consumptive and nonconsumptive water needs in the State. Some Roundtables have set examples with cross basin collaboration. The IBCC continues to focus on how to augment collaboration between the Western Slope, the Front Range, and the Eastern Plains. The IBCC framework described above is primed to serve as a template for an interbasin compact, not unlike those that the State has reached with all of its neighboring states.⁹³ Indeed, the IBCC has even imagined the possibility of the portfolio process to set acceptable guidelines across basins similar to those used in a global settlement process.⁹⁴ A need for greater structure and communication between the Roundtables might suggest the usefulness of an amendment to the Act and another mandate to the Roundtables.⁹⁵ Nevertheless, as Water 2012 kicks off,⁹⁶ and the citizens of the State are encouraged become engaged in water stewardship, it appears that this is a very effective

piece of legislation that has brought a “unity of focus to a divided populace, united in a vision for a secure future of a supply of clean, clear water.”⁹⁷ As this paper goes to publication in the Rocky Mountain Academy of Legal Studies of Business official proceedings, Colorado is witnessing its most severe drought on record; the collaborative efforts of the Colorado Water Conservation Board along with the Roundtables and the Department of Natural Resources and all other stakeholders have never been more important.

*The author of this paper has been a member of the Executive Board of Directors of the South Platte Basin Roundtable, one of the nine Roundtables created by the Colorado Water for the 21st Century Act, since its inception in 2005. The author serves on the Roundtable as a representative of the constituency of the headwaters of the South Platte River, having been appointed by the Center of Colorado Water Conservancy District (CCWCD), on whose Board the author has served since 1997. The author relies on the six years of service as recording secretary for the South Platte Basin Roundtable for much of the content of this paper.

¹ See Colorado Water Conservation Board website: <http://cwcb.state.co.us/water-management/water-supply-planning/pages/coloradoswatersupplyneeds.aspx>

² See the State of Colorado Office of State Demographer, Division of Local Affairs: <http://www.colorado.gov/cs/Satellite/DOLA-Main/CBON/1251590805419>.

³ Colorado’s river systems generate about 16 million acre-feet of renewable water each year. Approximately two-thirds of that is obligated to leave the state under interstate compacts and agreements. Of the 16 million acre feet, 80% is on the west slope. See notes from CFWE Legislative Lunch, February 24, 2010. Retrieved at: <http://cwcb.state.co.us/water-management/water-supply-planning/documents/legislativeupdatecowatersupplyfuture.pdf>

⁴ An acre foot of water is 365,000 gallons, or enough water to fill a square acre a foot deep, or enough water to supply the needs of two homes with an average of four people in each home.

⁵ See notes from CFWE Legislative Lunch, February 24, 2010. Retrieved at: <http://cwcb.state.co.us/water-management/water-supply-planning/documents/legislativeupdatecowatersupplyfuture.pdf>

⁶ *Id.*

⁷ The Colorado River Compact was signed in 1921, put into effect in 1922, and was revolutionary in its forward-thinking approach to sharing the water of this River that seven different states depend upon. One of the problems of that compact, however, is the fact that the River was flowing at unprecedented levels and the amount of water identified available has not been repeated since. The original act reads as follows: “The States of Arizona, California, Colorado, Nevada, New Mexico, Utah, and Wyoming, having resolved to enter into a compact under the Act of the Congress of the United States of America approved August 19, 1921. The major purposes of this compact are to provide for the equitable division and apportionment of the use of the waters of the Colorado River System; to establish the relative importance of different beneficial uses of water, to promote interstate comity; to remove causes of present and future controversies; and to secure the expeditious agricultural and industrial development of the Colorado River Basin, the storage of its waters, and the protection of life and property from floods. To these ends the Colorado River Basin is divided into two Basins, and an apportionment of the use of part of the water of the Colorado River System is made to each of them with the provision that further equitable apportionments may be made.”

<http://www.usbr.gov/lc/region/g1000/pdf/files/crcompct.pdf>

The State of Colorado has a federal obligation to release more water to the river for the lower basin states' use that can be sustained under current hydrologic conditions. In response, the CWCB is conducting the multi-phase Colorado River Water Availability Study (CRWAS) to determine how much water from the Colorado River Basin System is available to meet Colorado's future water needs under alternate hydrologies. The CRWAS seeks to answer the following questions: 1) how does historical hydrology compare to a longer hydrologic trace based on tree ring analysis under current water demands? 2) what is a reasonable projection for hydrology as affected by climate change? And 3) what quantitative estimates of the amount of consumptive uses, above existing levels, can occur within Colorado under certain compact assumptions and under current water demands. The CRWAS involves numerous state-sponsored programs including the IBCC and the basin roundtable processes, as well as the upcoming study of Colorado River Compact Compliance authorized by the Colorado General Assembly. For an in-depth summary of the Colorado River Supply Study see: <http://www.usbr.gov/lc/region/programs/crbstudy.html> and <http://cwcb.state.co.us/technical-resources/colorado-river-water-availability-study/pages>

⁸ C.R.S. § 37-92-501-503.

⁹ See Elizabeth McVicker *High Stakes for Stakeholders: Resolving Disputes in Pursuit of a Sustainable Future of Water Supply*; pp. 16-17, Rocky Mountain Academy of Legal Studies in Business Proceedings, March 2010.

¹⁰ See <http://cwcb.state.co.us/swsi/index.htm>

¹¹ C.R.S. § 37-92-101 et. seq.

¹² A history of the Colorado Water for the 21st Century Act appears on the website for the Colorado Water Conservation Board: <http://cwcb.state.co.us/about-us>

¹³ Representative Penry and Senator Isgor introduced House Bill 05-1177.

¹⁴ C.R.S. § 37-92-101 et. seq.

¹⁵ *Proceedings of the Statewide Roundtable Summit*, March 3, 2011, page 2, <http://cwcb.state.co.us/about-us/about-the-ibcc-brts/Pages/main.aspx>. Retrieved September 6, 2011.

¹⁶ "Wet water" is a term of art in Colorado Water law that refers to actual, available water molecules, legally decreed, and ready to deliver to a specific beneficial use. "Wet water" differs from "dry water," which refers to water rights described on paper in the water adjudication process.

¹⁷ See Bruce Finley, *Western Slope Water Deal Surfaces*, Denver Post, April 23, 2011, http://www.denverpost.com/news/ci_17912543.

¹⁸ C.R.S. § 37-92-501-503. See also the summary of the Colorado State Water Supply Initiative at http://cwcb.state.co.us/water-management/water-supply-planning/Documents/SWSI2010/SWSI2010ExecutiveSummary_v2.pdf.

¹⁹ The nine Roundtables correlate to the Metro area and the following eight river basins of the State: South Platte, Arkansas, Rio Grande, San Juan/Dolores, Gunnison, Yampa/White/Green, Colorado and North Platte. See <http://ibcc.state.co.us/Basins>.

²⁰ C.R.S. § 37-75-103 et seq.

²¹ Cite SWASI 2010

²² To see a complete list of each Basin Roundtable's meeting schedules, see <http://cwcb.state.co.us/water-management/basin-Roundtables/Pages/main.aspx>

²³ See *Colorado Water, Newsletter of the Water Center of Colorado State University*, Volume 22, Issue 4, August 2005.

²⁴ See, for example, *Application for Underground, Developed Water Rights From Nontributary Sources*, Case Number 2007CW251, District Court, Water Division No. 1, State of Colorado, Weld County Courthouse. October 30, 2007. This case, which resulted in defeat for the speculator, is explored in *A Lesson in Due Diligence: Nontributary Developed Water and The Dauntless Tunnel*, published in RMALSB proceedings from the 2010 RMALSB conference.

²⁵ See, for example, Colorado Supreme Court, April 8, 2002, No. 01SA50. *Board of County Comm'rs, County v. Park County Sportsmen's Ranch, LLP*. <http://www.cobar.org/opinions/opinion.cfm?opinionid=558&courtid=2>; See multiple cases involving Northern Colorado Water Conservancy District at <http://www.cobar.org/search/gmini.cfm?searchterm=Northern+Water+Conservancy+District>; See multiple decisions involving the Union Park Reservoir Project at <http://www.cobar.org/opinions/opinionlist.cfm?casedate=9/11/2006&courtid=2>

²⁶ See *Supra* note 16.

²⁷ See summary of SB06-179 at <http://cwcb.state.co.us/LoansGrants/water-supply-reserve-account-grants/Documents/WSRACriteriaGuidelines.pdf>

²⁸ C.R.S. § 37-75-104.

²⁹ *Id.*

³⁰ See list of approved Water Supply Reserve Account (WSRA) projects that the Roundtables have approved over the course of the last 6 years at: <http://ibcc.state.co.us/Basins/WaterActivitiesWaterSupplyReserveAccount>.

³¹ *Proceedings of the Statewide Roundtable Summit*, March 3, 2011, page 27, <http://cwcb.state.co.us/about-us/about-the-ibcc-brts/Pages/main.aspx>. Retrieved September 6, 2011.

³² See <http://ibcc.state.co.us/Basins/Yampa/Green/White/WaterActivitiesWaterSupplyReserveAccount>.

³³ For an explanation of the Chatfield Reservoir Reallocation Project see <http://www.chatfieldstudy.org/home/reallocatedreservoiruse.html>.

³⁴ The South Platte Basin Roundtable is the largest of the nine basins with 52 voting members on the Roundtable representing water conservancy districts, municipalities, industrial users, agricultural users, and environmental concerns. The Roundtable, per the Act, has authorized multiple projects. For a list of projects that have been authorized by the South Platte Basin Roundtable, *See* <http://ibcc.state.co.us/Basins/SouthPlatte/WaterActivitiesWaterSupplyReserveAccount>.

³⁵ See South Platte Basin Roundtable Meeting Minutes, 2006-2011, <http://cwcb.state.co.us/water-management/basin-Roundtables/Pages/SouthPlatteBasinRoundtable.aspx>. See also, *Army Corps of Engineers Shared Visioning Process*, Elizabeth McVicker, prepared for the AACSB Sustainability Conference, Denver, CO 2010.

³⁶ *Proceedings of the Statewide Roundtable Summit*, March 3, 2011, page 2, <http://cwcb.state.co.us/about-us/about-the-ibcc-brts/Pages/main.aspx>. Retrieved September 6, 2011.

³⁷ *Id.*

³⁸ *Id.*

³⁹ 1942 Republican River Compact, C.R.S. § 37-67-101. Colorado has spent more than \$50 million fighting Nebraska over the water that flows from Colorado to that State and is currently spending more than \$10 million a year to maintain a flow in the south Platte in Nebraska for purposes of the Endangered Species Act. *See* <http://cwcb.state.co.us>.

⁴⁰ See “Water parley makes history: River basin reps gather to discuss Yampa project”; Jerd Smith, *Rocky Mountain News*, September 27, 2007.

⁴¹ *Id.*

⁴² For a summary of the Portfolio process, see <http://cwcb.state.co.us/technical-resources/portfolio-tool/pages/main.aspx>

⁴³ See minutes from the 2011 South Platte Basin Roundtable meetings, available at <http://cwcb.state.co.us/water-management/basin-Roundtables/Pages/SouthPlatteBasinRoundtable.aspx>.

⁴⁴ *Proceedings of the Statewide Roundtable Summit*, March 3, 2011, page 2, <http://cwcb.state.co.us/about-us/about-the-ibcc-brts/Pages/main.aspx>. Retrieved September 6, 2011.

⁴⁵ *Id.*

⁴⁶ *Id.*

⁴⁷ C.R.S. § 37-60-100, et.seq. This historic legislation has been at the core of the Colorado Foundation for Water Education to initiate a year-long celebration of water called Colorado Water 2012 the purpose of which is to raise awareness across the state about water as a valuable and limited resource and to increase support for managing and protecting Colorado’s water and waterways. (See, Colorado Foundation for Water Education, *Colorado Water, Theme: Climate*, August/September 2011; Volume 28, Issue 4.)

⁴⁸ *Id.*

⁴⁹ See <http://cwcb.state.co.us/about-us/about-the-ibcc-brts> Retrieved September 11, 2011

⁵⁰ *Id.*

⁵¹ See *Supra* note 7.

⁵² *Id.*; See also *Supra* note 48.

⁵³ *Id.*

⁵⁴ Letter to Governor River and Governor-elect Hickenlooper, December 15, 2010; available at <http://cwcb.state.co.us/about-us/about-the-ibcc-brts>

⁵⁵ Interbasin Compact Committee Statement on Role of the State in Supporting Water Supply Processes and Projects, December 2010, cite: cswb.state.co.us/IBCC (pp. 27-36)

⁵⁶ *Id.*, p. 3

⁵⁷ See *Supra* note 41.

⁵⁸ For a summary of the NISP project, see <http://www.northernwater.org/WaterProjects/NISP.aspx/>.

⁵⁹ See *Supra* note 54.

⁶⁰ See <http://www.hydrosphere.com/services/WaterConservationinColorado.htm>.

⁶¹ IBCC's Water Conservation Sub-Committee report, p. 20, <http://cwcb.co.state.us>.

⁶² *Id.*

⁶³ *Id.*, See list from p. 22.

⁶⁴ Minutes from South Platte Basin Roundtable Meeting, July 2011, See *Supra* Note 35. See also the report from the Colorado Coalition for the Environment at <http://www.ourcolorado.org/search.jsp?query=IPPs&Submit2.x=11&Submit2.y=8>

⁶⁵ *Id.*

⁶⁶ See *Supra* note 55.

⁶⁷ See <http://cwcb.state.co.us/water-management/water-supply-planning/Pages/SWSI2010.aspx>

⁶⁸ *Id.*

⁶⁹ See *Supra* note 55.

⁷⁰ *Id.*

⁷¹ *Id.*

⁷² *Id.*, See also South Platte Basin Roundtable Minutes, *Supra* note 35.

⁷³ *Id.*

⁷⁴ IBCC Alternative Agricultural Water Transfers Subcommittee, p. 29. <http://cwcb.co.state.us>

⁷⁵ South Platte Basin minutes; July 2011. See *Supra* note 35.

⁷⁶ See *Supra* note 7.

⁷⁷ IBCC 2011 Workplan; <http://cwcb.state.co.us> page 34

⁷⁸ *Id.*

⁷⁹ *Id.*

⁸⁰ *Id.*; pp 35-36

⁸¹ See *Supra* note 5.

⁸² *Id.*

⁸³ *Id.*, p 18.

⁸⁴ *Id.*, p 50.

⁸⁵ See South Platte Basin Roundtable minutes, April 2011, *Supra* Note 35.

⁸⁶ John Stulp, Colorado Water for the 21st Century Updated Roadmap, May 1, 2012, see <http://cwcb.state.co.us/water-management/basin-roundtables/Pages/main.aspx>

⁸⁷ *Id.*

⁸⁸ See *Supra* note 77, p. 55.

⁸⁹ *Id.*; See also *Supra* Note 85.

⁹⁰ *Id.*; p. 56.

⁹¹ *Id.*

⁹² IBCC Framework and Public Feedback Overview, March 3, 2011, p. 14 Statewide Summit; <http://cwcb.state.co.us/about-us/about-the-ibcc-brts/Pages/StatewideRoundtableSummit.aspx>

⁹³ *Id.*

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ For a comprehensive explanation of Water 2012 and a list of activities, see <http://www.water2012.org/>

⁹⁷ See *Supra* note 90.