

In the

ORIGINAL

Supreme Court of the United States

UNITED STATES,

Petitioner,

v.

NEW MEXICO, ET AL.

NO. 80-702

Washington, D. C.

December 8, 1981

Pages 1 thru 45

ALDERSON

REPORTING

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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 UNITED STATES, :

4 Petitioner :

5 v. : No. 80-702

6 NEW MEXICO, ET AL., :

7 Respondent :

8 - - - - - x

9 Washington, D.C.

10 Tuesday, December 8, 1981

11 The above-entitled matter came on for oral

12 argument before the Supreme Court of the United States

13 at 10:05 o'clock a.m.

14 APPEARANCES:

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 Petitioner.

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P R O C E E D I N G S

CHIEF JUSTICE BURGER: We will hear arguments first this morning in #80-702, United States v. New Mexico, et al. Mr. Jones, you may proceed whenever you are ready.

ORAL ARGUMENT OF GEORGE W. JONES, ESQ.

ON BEHALF OF THE PETITIONER

MR. JONES: Mr. Chief Justice, and may it please the Court:

The issue in this case is whether, under standard Atomic Commission management contracts, three private contractors received and disbursed funds of the United States as agents of the federal government and are, therefore, constitutionally immune from New Mexico's gross receipts and compensating use taxes.

Each of the contractors is a party to a management contract with the Department of Energy, a form of contract developed by its predecessor, the Atomic Energy Commission.

The United States filed this action in the United States District Court for the District of New Mexico, seeking declaratory judgment that sales of tangible personal property to the Department of Energy through the management contractors was a sale to the United States and therefore exempt from the New Mexico gross receipts and compensating taxes.

QUESTION: May I ask, Mr. Jones, you said this is

1 a standard form of contract developed by the predecessor of
2 FERC?

3 MR. JONES: Yes. The management contract concept,
4 I suppose it could be called, was developed by the Atomic
5 Energy Commission shortly after the World War II, and --

6 QUESTION: And I gather everything that it uses is
7 supplied by the government, isn't it? All the funds it
8 spends and everything else is supplied by the government.

9 MR. JONES: That's right.

10 QUESTION: Do they make a profit under these
11 contracts?

12 MR. JONES: Well, Sandia, one of the contractors,
13 makes no profit, receives no fee and does no other work,
14 other than the work it does for the government.

15 Zia and LACI, the two other contractors in this
16 case, receive a management fee. In addition, --

17 QUESTION: Is that substantial?

18 MR. JONES: I guess it's relative. If you compare
19 it to the amount of money they spend, it's not substantial,
20 it's a small percentage. I'm not sure of the fee that Zia
21 received, but it's not -- in the mid-seventies I think it
22 was not more than \$50,000.

23 QUESTION: What is it, the government does this
24 sort of thing just to get the management know-how of these
25 companies? Is that it?

1 MR. JONES: That's the primary reason. It really
2 started --

3 QUESTION: Rather than do the job itself.

4 MR. JONES: That's right. It would be very
5 difficult, I imagine, for the government to do the job
6 because they'd have to hire all of these people who have
7 expertise in particular areas who might well be working for
8 private companies in different areas using that expertise.
9 And very early on -- I think this is primarily historical.

10 The Manhattan Engineer District, which is
11 responsible for the development of the atomic bomb in World
12 War II, decided that the quickest and most efficient way of
13 getting the manpower and the knowledge and the know-how for
14 the development of the atomic bomb was to draw on the
15 resources of private industry. And Congress after World War
16 II when it created the Atomic Energy Commission and gave it
17 statutory authority to control the development of atomic
18 energy, it specifically indicated that the Commission should
19 be permitted to, or the Commission could continue this
20 policy of drawing on or relying on private contractors for
21 the carrying out of its functions.

22 And although the Atomic Energy Commission replaced
23 the Manhattan Engineers District in 1947 and then was in
24 turn replaced by the Energy Research and Development
25 Administration in, I guess, 1975, and then ERDA, the Energy

1 Research and Development Administration, was replaced by the
2 Department of Energy in 1977, they have all continued to use
3 these same kinds of management contracts for the purpose of
4 carrying out their responsibilities.

5 The United States filed this action seeking a
6 declaratory judgment that sales to the management
7 contractors were sales to its agents, and therefore, to the
8 United States. And as a result, immune or exempt from New
9 Mexico gross receipts tax.

10 The United States also sought declaratory judgment
11 that the funds disbursed by these three contractors were not
12 subject to either the New Mexico gross receipts tax or the
13 compensating tax.

14 On cross motions for summary judgment, the
15 district court held that the management contractors were, in
16 fact, agents, and that the sales of personal property to
17 them were exempt from both the gross receipts and
18 compensating taxes, and that the disbursements by the
19 contractors were also exempt from such taxes.

20 The Tenth Circuit reversed, holding that the
21 management contractors were not agents and consequently
22 subject to such taxes. The court of appeals explained its
23 decision by saying our reiterated antipathy to wholesale
24 deprivations of state treasuries without congressional
25 action requires at the least some special arrangement before

1 tax immunity attaches.

2 The relevance of the court of appeals' hostility
3 to federal immunity or deprivations of state treasuries
4 would be dubious in almost any case. And I will attempt to
5 show, that the court's stated antipathy is misdirected is
6 misdirected in this case.

7 QUESTION: Well, Mr. Jones, are you going to
8 elaborate on your footnote on page 27 of your brief of the
9 Carson-Roane and then repeal of 9(b) and then
10 Kern-Limerick? Because certainly, Congress itself was not
11 entirely happy with the Carson-Roane decision, I take it.

12 MR. JONES: But, Justice Rehnquist, there's a
13 substantial difference between saying that the -- everyone
14 or all of the contractors with the Atomic Energy Commission
15 are completely immune from state taxation and saying that
16 the contractor shall be immune to the extent that all other
17 contracts with the federal government would be immune. And
18 Congress clearly recognized the distinction because they
19 made it clear that all they were doing was repealing the
20 decision that this Court had interpreted as creating a
21 statutory immunity.

22 And I'm not sure what further elaboration on that
23 point you were seeking.

24 QUESTION: In other words, the government concedes
25 that these contractors are on the same footing as any other

1 sort of government contractors; they don't occupy any
2 special status by virtue of the earlier legislation that was
3 passed in the forties.

4 MR. JONES: We concede only that there's no
5 statutory immunity, such as Section 9(b), but it is not our
6 position that these contractors are like any other
7 contractors. I mean, their immunity from taxation is
8 determined in the same way that any other private
9 contractor's immunity would be determined, but the nature of
10 their relationship with the Atomic Energy Commission we
11 think is very different from that of many other private
12 contractors.

13 QUESTION: Mr. Jones, is it the position of the
14 government that it is immune from the state tax insofar as
15 it relates to the payments by these contractors for the
16 services of its employees?

17 MR. JONES: Yes. It's the position of the
18 government that the disbursements --

19 QUESTION: As well as the goods that are purchased.

20 MR. JONES: That's right. In our view, there is
21 no distinction, no reasonable distinction, to be drawn
22 between the disbursements by these contractors of funds for
23 the payment of services and their disbursement of funds for
24 the payment of goods, because in both cases, the contractors
25 are acting on behalf of the United States. They have no

1 interest in the money they use to purchase these things.

2 QUESTION: But you do conceive that the employees
3 work for the contractor and not the government.

4 MR. JONES: Well, they work for the contractor in
5 a very peculiar sense. Sandia is totally a creation or a
6 product of this arrangement with the government. It had no
7 existence until 1949. As I mentioned earlier, it receives
8 no fee from the government, it does no other work.

9 Furthermore, in the contract between the United
10 States and Sandia, and Sandia's parent company, Western
11 Electric Company, it indicates that if the contract is
12 terminated, Western Electric, which owns all of the stock of
13 Sandia, would be required to dispose of that stock as
14 directed by the Department of Energy, and before doing that,
15 required to designate a new board of directors, as indicated
16 by the Department of Energy.

17 The employees at Sandia were hired solely to
18 perform functions for the government in exactly the same
19 sense as Sandia's purchase of supplies from a third party
20 vendor are made solely for -- on behalf of the government.

21 Sandia is the largest of the three contractors and
22 it was created in 1949 as a special subsidiary of Western
23 Electric. From 1949 until the present time, Sandia has
24 carried on its responsibilities for the government,
25 notwithstanding the changes in the various government

1 agencies that had responsibility for the development of
2 atomic energy.

3 QUESTION: Well, it is -- it certainly is true,
4 though, that making the employees technically employees of
5 Sandia rather than the government distinguishes them in very
6 substantial ways from other employees of the government.
7 They aren't civil service people, they aren't subject to the
8 normal rules about government employees, are they?

9 MR. SCHEMBER: Sure. But it seems to me that
10 their distinction from ordinary government employees for
11 those purposes --

12 QUESTION: Is it in the record or is it agreed
13 what the real motivation was for moving into the Sandia type
14 operations? Did you say they just thought it was the best
15 way of drawing on the private sector?

16 MR. JONES: Yes. The --

17 QUESTION: And most efficient?

18 MR. JONES: The article that is cited most that
19 discusses the sort of general development of these things is
20 an article by -- I think the guy who is a former general
21 counsel of the Atomic Energy Commission, and he discusses in
22 some detail the development of these things. And it appears
23 that the -- it's by Highstein and Florshim, called The AEC
24 Management Contract Concept.

25 But it appears that the Manhattan Engineer

1 District needed to mobilize a great deal of knowledge and
2 resources and energy in a very short time and do it
3 secretly, and they decided that the best way to do it was to
4 hire private contractors to mobilize or draw on the
5 resources of private contractors.

6 QUESTION: And they would hire -- they would have
7 to pay what the market required them to pay for that kind of
8 skill.

9 MR. JONES: I'm not sure that that's what occurred
10 because of the circumstances.

11 QUESTION: I know, but Mr. Jones, these employees,
12 do they not, have the protections, for example, of the Fair
13 Labor Standards Act, the National Labor Relations Act, the
14 Davis-Bacon Acts and all the rest of them, don't they?

15 MR. JONES: Sure, they do.

16 QUESTION: And the same things that are applicable
17 to other private employees.

18 MR. JONES: That's right.

19 QUESTION: But they weren't Grade 18.

20 MR. JONES: That's right. But we are not sure
21 what their salaries are, and those are very carefully
22 controlled in some circumstances by the Atomic Energy
23 Commission, the Department of Energy now.

24 QUESTION: Are you familiar with the so-called
25 government-owned/contractor operated system that was in

1 effect during the war in all the munitions plants in the
2 country?

3 MR. JONES: No, I'm not.

4 The other contractor, LACI, which is Los Alamos
5 Constructors, Inc, was also -- is a subsidiary of Zia and
6 was also formed specifically to do work for the government.
7 It performs -- its only work is construction and repair and
8 alterations at the Los Alamos Scientific Laboratory.

9 Under these contracts, neither Sandia, Zia nor
10 LACI is required to spend any money in performance of the
11 contracts with the Department of Energy.

12 QUESTION: Mr. Jones, in that regard, I take it
13 you agree with New Mexico that there are over 10,000 other
14 contracts around the country using advanced funding
15 arrangements like this in which the contractors are not
16 apparently purchasing agents of the government.

17 MR. JONES: I don't think that's Mexico's
18 position. I think they say that there are 10,000 other
19 letter of credit arrangements. Most of those, as we point
20 out, most of those letter of credit arrangements are grants
21 to private individuals and not contractors.

22 So in our view, the fact that there are these
23 letters of credit available and used by other agencies in
24 other contexts for other purposes has no bearing at all on
25 whether the use of letters of credit by contractors to

1 purchase property, title to which passes directly to the
2 United States --

3 QUESTION: Well, does the record show us how many
4 comparable advanced funding arrangements there are in
5 existence that the government has? Comparable to these?

6 MR. JONES: Well, I am not sure the record
7 indicates anything specific about the nature of the other
8 contracts. If you look at the attachments to the deposition
9 of Mr. McGrath, you will see that they are -- that the
10 letters of credit are to institutions that are not doing
11 work for the government. There are about 40 or so attached,
12 and they are all to -- most of them are to grantees. There
13 is one from the Department of Health, Education and Welfare
14 -- it's not that anymore, it's Health and Human Services now
15 -- to a professional review board. But it's not clear what
16 the nature of the relationship between that organization and
17 HAS is. So it's not even clear that the one example they
18 point to is comparable to the contracts here.

19 Our impression, however, is that the type of
20 relationship that exists between the management contractors
21 and the Atomic Energy Commission here is virtually unique.
22 There may be other contracts in which various aspects of the
23 relationship are duplicated. But as far as we know, there's
24 no substantial number of government contracts in which you
25 have the unique combination of elements of a contract that

1 exist between the management contractors and Department of
2 Energy.

3 QUESTION: When you say unique, you don't mean
4 because they're Atomic Energy contractors, but because of
5 the nature of the relationship.

6 MR. JONES: That's right, the relationship created
7 by the contract is relatively unique.

8 None of these contractors spend any money under
9 the contract.

10 QUESTION: You mean of their own.

11 MR. JONES: Of their own.

12 QUESTION: Of course, these people aren't doing
13 this out of pure altruism, as indicated by the fact of -- is
14 it Sandia that gets licenses on any of the developments in
15 the laboratory work?

16 MR. JONES: Well, they give as much as they get,
17 however. We don't suggest that they're doing it because of
18 altruism. As the state points out in some detail, there are
19 benefits to the private contractors. I mean, the knowledge
20 and experience that's developed in these areas.

21 The dissenting opinion in Livingston points out in
22 great detail that these contractors receive a large number
23 of benefits from the government or in the course of their
24 work. That does not change the nature of their relationship
25 to the government, however.

1 Employees of the government learn a lot in the
2 course of their work for the government. A lot of young
3 lawyers work at the Justice Department for some time and
4 then go on to private practice, using what they've learned.
5 So we don't think that changes the relationship between the
6 two.

7 The New Mexico gross receipts tax involved in this
8 case is essentially a sales tax. It's assessed on the total
9 amount of money that is realized from the sale of goods or
10 from performing services, including professional and
11 construction services.

12 In addition, New Mexico has what's called a
13 compensating tax imposed on the use of property that is
14 imported into the state without the payment of a gross
15 receipts tax. Although use is one of the aspects of -- one
16 of the factors that triggers application of the tax, it is
17 not a use tax of the sort considered by this Court in Boyd,
18 which was a tax on the use per se of the property.

19 The use tax involved in this case is essentially a
20 complement to the gross receipts tax to protect New Mexico
21 businessmen from the unfair competition that would result
22 from businessmen, their competitors, being able to buy
23 property outside the state and bring it into the state
24 without paying a gross receipts tax.

25 Since 1819, it has been unquestionably clear that

1 the federal government and its instrumentalities are
2 constitutionally immune from any form of state taxation,
3 absent congressional consent. In our system, the tax
4 immunity of the federal government is the unavoidable
5 consequence of the supremacy declared by the Constitution.
6 Kern-Limerick establishes the principle that the federal
7 government's immunity from taxation is preserved even though
8 the federal government chooses to exercise or to perform its
9 work through private contractors or private agents.

10 Kern-Limerick rests very soundly on the truism
11 that the government can only function through employees or
12 agents. And if the individuals or entitites through whom
13 the government works can be taxed with respect to their
14 activities on behalf of the government, federal immunity
15 would be largely illusory.

16 Accepting this analysis, the court of appeals
17 nonetheless found that the management contractors in this
18 case are not agents for the purposes of procuring goods and
19 services for the United States. That conclusion is contrary
20 to every other court that has considered the question; this
21 Court's summary affirmative decision in *Livingston*, the
22 Ninth Circuit's decision in *Nevada Tax Commission*, and the
23 Tennessee Supreme Court's decision in *United States v. Boyd*,
24 which was not --

25 QUESTION: Are those entirely consistent with

1 County of Fresno?

2 MR. JONES: Yes. County of Fresno involved the
3 question of the state's power to tax an employee of the
4 government's interest, beneficial interest or beneficial use
5 of government-owned property.

6 Here, New Mexico hasn't purported to tax the
7 contractor's interest in or use of the government's
8 property. They have tried to impose a tax or interpreted
9 their gross receipts tax to apply to money that the
10 contractors have no interest in and no use of. They are
11 simply acting as agents for, disbursing agents, for the
12 government.

13 The money goes into the special account, or the
14 special account is set up in the name of the contractor and
15 the Atomic Energy Commission. The contractor acquires no
16 interest in the funds in that account; title always remains
17 in the government, and the contractor writes a draft,
18 executes a draft on the account --

19 QUESTION: May I interrupt on this advanced
20 spending point. Would the government's position be the same
21 if there were no advanced funding but there was merely a
22 cost plus arrangement, with the government reimbursing the
23 contractor?

24 MR. JONES: No.

25 QUESTION: Why would the legal incidence of the

1 tax be any different?

2 MR. JONES: Because in the latter case -- well,
3 our position might be the same depending on what other
4 aspects of the arrangement --

5 QUESTION: That's the only change. Everything
6 else is the same except instead of paying in advance, you
7 purchase on credit and then as soon as the contractor pays
8 the bill, the government reimburses the contractor, but the
9 legal liabilities are all exactly the same as here. Would
10 it be a different case?

11 MR. JONES: I think it probably would be a
12 different case, but as this Court's decision in
13 Kern-Limerick makes clear, the fact that the government
14 could have accomplished its goals in different ways by
15 adopting a different contract than the one it did, does not
16 indicate or nullify the effectiveness of the contract that
17 it did adopt. And it's our position that the relationship
18 here including the advanced funding for the purchase of
19 goods for the United States and services for the United
20 States indicates an agency relationship, at least as clearly
21 as the relationship indicated in Kern-Limerick.

22 QUESTION: Mr. Jones, did I understand you to say
23 that the use tax in Boyd is different from the use tax in
24 this case?

25 MR. JONES: Yes.

1 QUESTION: In what respect?

2 MR. JONES: In Boyd there were three taxes
3 involved. There was a gross receipts tax and a compensating
4 tax of the sort involved here, --

5 QUESTION: You have a gross receipts tax here also.

6 MR. JONES: That's right. A gross receipts tax
7 and a compensating tax that were of the sort, exactly the
8 same sort that are involved here. Those were not reviewed
9 by this Court. The only tax that was considered by this
10 Court was what the Tennessee Supreme Court described as a
11 use per se tax. It was a tax on the use of government
12 property, wholly without regard to who purchased it or where
13 it was purchased. And this Court --

14 QUESTION: Isn't the economic effect the same for
15 both types of use taxes as you describe them?

16 MR. JONES: I think not, because the use tax in
17 New Mexico is not a use tax; it's properly called a
18 compensating tax, --

19 QUESTION: Well, who uses it in New Mexico? Who
20 uses the property in New Mexico? Doesn't the contractor use
21 it?

22 MR. JONES: Certainly, but the tax is not on his
23 use. The tax is simply to collect the gross receipts tax
24 that was avoided by purchasing the property outside the
25 state.

1 QUESTION: But in the end in both situations, the
2 United States government pays the tax.

3 MR. JONES: Oh, that's for sure. But the holding
4 in Boyd is simply that the contractor's beneficial use of
5 the property of the government was a taxable interest.

6 QUESTION: Does all of this depend on precisely
7 the way that the state legislature writes the tax?

8 MR. JONES: Well, I don't know, precisely the way
9 the state legislature writes a tax. But it does depend on
10 the nature of the interest that the state purports to tax.

11 For example, this Court last term affirmed the
12 decision of the Tenth Circuit in a case, United States v.
13 State of Colorado precisely because the state of Colorado
14 purported to tax the use by a management contractor of a
15 facility, a government-owned facility, on its full value to
16 the contractor. And the Tenth Circuit held in that case
17 that there was no meaningful use that the state could tax to
18 the contractor.

19 If there are no further questions I'd like to
20 reserve the remainder of my time for rebuttal.

21 CHIEF JUSTICE BURGER: Mr. Friedman.

22 ORAL ARGUMENT OF DANIEL H. FRIEDMAN

23 ON BEHALF OF THE RESPONDENT

24 MR. FREIDMAN: Mr. Chief Justice, and may it
25 please the Court:

1 I'd like to begin by responding to Justice
2 Stevens' question because I think that question hit the nail
3 on the head. The only thing that is different, if anything
4 is different, about these contractors compared to the
5 contractors in the Kern-Limerick case or King & Boozer is
6 that they get their money up front instead of after the
7 fact. When you read particularly the reply brief of the
8 United States, it is clear that that is all that they are
9 saying.

10 Now, the benchmark I believe that would assist in
11 analyzing the contractors today is the Boyd case, the case
12 that this Court considered. It is true that there a use tax
13 was being considered rather than a gross receipts tax. But
14 principles were enunciated in that case which indicate that
15 this Court has already scrutinized standard management
16 contractors and said that the mere fact that they contract
17 with the United States, the fact that they operate in a
18 government facility, use advance funds, have a complete
19 absence of risk as a result of advanced funding, undertake
20 important federal duties, have the title to their purchases
21 passed to the United States, that all of this is simply
22 symptomatic of government contracting. It does not create
23 agents, it does not create instrumentalities.

24 An important concession found at page 201 of the
25 Appendix is the concession by the United States, which I

1 think is proper following the Boyd decision, that these
2 contractors are not instrumentalities. Now, I'm never sure
3 what an instrumentality is, but in some way I read that to
4 mean that the mere fact of a contractual association is not
5 enough to make you an agent. Advanced funding was used from
6 the beginning of the Atomic Energy Commission, it was used
7 at the time this Court decided Roane-Anderson, it is
8 continued to be used after Congress legislatively reversed
9 the Roane-Anderson case.

10 The United States is simply selecting one
11 contractual element of the relationship and after the fact
12 reading in great significance. There is really no
13 difference, as shown by the history of advance funding
14 within the Atomic Energy Commission.

15 We have cited in our brief and in the transcript
16 the fact that the Atomic Energy Commission has always viewed
17 these contractors as cost plus contractors. This Court in
18 Boyd called them cost plus contractors, even though they
19 were getting advanced funding.

20 QUESTION: Well, there's no plus in the Sandia
21 case.

22 MR. FREIDMAN: No, that is correct, Justice White,
23 and in the fourth part of our brief we discuss at some
24 length the benefits that accrue to Sandia. I believe
25 Justice Brennan pointed out licenses, payments effectively

1 of overhead to Western Electric, totaling some \$300,000 in
2 the year in which the interrogatory was responded to.

3 QUESTION: Those license might produce very
4 valuable results for Sandia, might they not?

5 MR. FREIDMAN: They might, indeed, Justice Burger,
6 and basically, it's important to remember, I believe, that
7 Sandia, although it was created to undertake these
8 contracts, was created, if you'll pardon the colloquial
9 expression, by the telephone company. Sometimes I feel as
10 if the telephone company is the government of the United
11 States, but that is only in jest.

12 Route 128 around Boston, Silicone Valley in San
13 Francisco, is surrounded by companies that are created to
14 work for the government, that only exist to work for the
15 government. The real comparison, I believe, is with the
16 corporations that the United States did set up in World War
17 II to build ships, to build munitions. There were reasons
18 why the United States has chosen to go the private route.

19 And as Justice Brennan asked about GOGCO plants,
20 government owned, contractor operated, I believe the
21 Michigan property cases are decisions by this Court
22 recognizing that even though you are working in a government
23 facility, using government property, you're still subject to
24 taxes.

25 I think what the United States confuses in looking

1 at advance funding is the difference between absence of
2 risk, which I say is endemic to government contracting. If
3 you're on cost plus, whether you get paid in advance or get
4 paid after, unless you're taking vacations in Tahiti with
5 the money, there is no risk. What the government is
6 confusing is the absence of risk compared to who has the
7 obligation.

8 QUESTION: What about the risk of loss of the
9 property?

10 MR. FREIDMAN: I believe that the risk of loss
11 becomes simply an element of the cost plus contract --

12 QUESTION: Well, not if it's the contractor's
13 fault.

14 MR. FREIDMAN: Well, in the case of Sandia I
15 believe that absent malfeasance, --

16 QUESTION: I know that may be true about Sandia,
17 but what about an ordinary cost plus contractor? If he
18 negligently -- if the property is negligently destroyed by
19 him, it's not going to go into his cost.

20 MR. FREIDMAN: That is correct, Justice White.

21 QUESTION: But here, I don't know. What about
22 Sandia?

23 MR. FREIDMAN: Sandia has a slightly higher
24 threshold of responsibility. There is still written into
25 the contract that if there is malfeasance at a high enough

1 level, that again there will be responsibility in that
2 sense, Justice White.

3 QUESTION: But the risk of loss of the property is
4 on the government for almost all purposes here?

5 MR. FREIDMAN: Yes, but again, I think it's hard
6 to show negligence in normal government contracting, also.
7 I don't think that contractors get burned very often.

8 QUESTION: Mr. Friedman, suppose we were to
9 determine that the lower court was correct, and that the
10 government is not immune from these taxes. And let's
11 further suppose that the contractor, Sandia or the others,
12 simply refused to pay them. Do you think New Mexico could
13 seize the property in that event?

14 MR. FREIDMAN: No. I think that it is established
15 in the case law, Justice O'Connor, that although a state is
16 free to tax a government contractor, it may not seize
17 property of the United States, it may not levy against the
18 United States.

19 QUESTION: Does that mean that the incidence of
20 the tax then is on the government?

21 MR. FREIDMAN: Apparently not. And an example
22 that I would give you is in the Boyd case, after the
23 decision in Boyd by this Court that the Boyd contractor was
24 subject to property taxes, it was paid from advance
25 funding. And I've cited in my brief from the pleadings in

1 that case indicating that it was the contractor who paid the
2 tax, but he paid it with advance funding.

3 The important point I believe from that
4 illustration is that it was the contractor's obligation to
5 pay the tax; he was the one that was liable. And turning to
6 a question that was asked, similarly with the employees.
7 And remember there are 7000 employees of these contractors,
8 only 160 of whom are involved in procurement, meaning
9 transactions with third parties.

10 Fifty-eight percent of all these contractors'
11 receipts are not in that classic agent relationship of
12 dealing with third parties; 58% are simply to meet the
13 payroll. And we are in a situation in which the United
14 States has conceded they are not instrumentalities; we are
15 not liable for their torts, we don't want to be involved in
16 their labor relations; we conceived that the contractors are
17 independent contractors in hiring and supervising these
18 employees, and yet when the taxman comes calling, suddenly
19 as the reply brief says, they are simply independent
20 contractors working for a fee for the Zia Company or for
21 Sandia.

22 This to me strains the concept of employee
23 greatly. The United States has made so many concessions in
24 this case about its relationship vis a vis the contractors'
25 employees that there is no way of finding that the

1 contractors' 7000 employees in some way have a direct
2 contractual relationship with the United States.

3 True, advanced funding is used to meet the
4 payroll, but the question is, is it the United States'
5 obligation to pay those employees or is it the contractor's?
6 I think the distinction has to be that under these
7 contracts, as under any cost plus contract, it is the United
8 States that has an obligation to Sandia, Zia and LACI to pay
9 them.

10 QUESTION: Do you think -- you don't think that an
11 employee or a vendor of goods to the contractor could ever
12 sue the United States?

13 MR. FREIDMAN: Your Honor, in the deposition of
14 Mr. McGrath, the Treasury Department representative, he says
15 that there is no way that a third party can go against the
16 letter of credit, can go against the Federal Reserve Bank,
17 can go against the --

18 QUESTION: So if the contractor somehow absconds
19 with the funds that have been advanced, whoever should have
20 been paid with them is out of luck.

21 MR. FREIDMAN: I think that he has to sue the
22 contractor. Yes, that is correct.

23 QUESTION: He couldn't get the money, but how
24 about suing the United States in the Court of Claims?

25 MR. FREIDMAN: I assume that there are various

1 mechanisms for end-running the process, Mr. Justice Stevens,
2 and frankly, --

3 QUESTION: What does that mean? That he could or
4 could not sue in the Court of Claims?

5 MR. FREIDMAN: I don't know the answer to that,
6 sir.

7 QUESTION: Well, if the United States is an
8 obligor, why couldn't he sue them?

9 QUESTION: I would think he could. But I thought
10 your message to us was that the only obligation that's owed
11 to any third parties is the contractor's obligation.

12 MR. FREIDMAN: I think that is indicated under the
13 purchase documents --

14 QUESTION: Well, if that is right, there is no
15 direct obligation or indirect of the United States to third
16 parties, including employees and vendors.

17 MR. FREIDMAN: I am sorry I am not familiar with
18 procedure in the Court of Claims, and so my answer is --

19 QUESTION: Well, let's just assume the answer --
20 that whether you can sue in the Court of Claims depends on
21 whether or not there is some kind of a contractual
22 obligation with the United States between the third party
23 and the United States. Is there or not?

24 MR. FREIDMAN: There is not, Mr. Justice White.
25 And looking at page, for example, --

1 QUESTION: Perhaps we can find out what the United
2 States' position is on that shortly.

3 MR. FREIDMAN: At page 120 of the Appendix, there
4 is a clear distinction drawn between the Zia Company as the
5 buyer. It is defined in the purchase documents as the
6 buyer, and indeed, the government in its reply brief
7 concedes; they call it the nominal buyer, I say it's the
8 buyer and that's what the purchase --

9 QUESTION: You say whatever authority the
10 contractor has in this case, it is your position I take it,
11 that it has no authority to obligate the United States.

12 MR. FREIDMAN: It has no authority any different
13 from that of any other cost plus contractor. I do not
14 understand them to have that.

15 As I indicate, by the concessions in this case,
16 there is no direct claim between the contractors' employees
17 and the United States, so that is one segment of these
18 receipts. In dealing with third parties, the contractors
19 are required to order in their own names. The purchase
20 documents indicate that the purchase orders could be
21 assigned to the United States, which to me indicates that
22 they are not parties to that purchase, but discovery reveals
23 that they never are assigned.

24 QUESTION: I suppose if -- well, never mind.

25 MR. FREIDMAN: In other jurisdictions, as

1 discussed in our brief I believe in the footnote at page 16,
2 the Atomic Energy Commission deliberately structured
3 transactions in a totally different way from these
4 transactions. It had the purchase orders assigned to it, it
5 made payments directly to the vendors. It was done
6 deliberately to avoid taxes.

7 The fact that those procedures have been viewed by
8 the Atomic Energy Commission as a means of avoiding state
9 taxes strongly suggests that the mere contractual interplay
10 that is at issue here does not amount to the same
11 relationship.

12 QUESTION: Help me again. I thought the district
13 court in this case found that the relationship insofar as
14 purchasing was concerned made these three companies
15 purchasing agents of the United States, which would seem to
16 me to mean they had the authority to obligate the United
17 States.

18 MR. FREIDMAN: Justice Stevens, this was done on
19 cross motions for summary judgment. The district court did
20 find that the contractor was an agent in all respects, based
21 on the contract documents and exhibits, none of which was
22 controverted. The Tenth Circuit reversed.

23 QUESTION: The Tenth Circuit reversed saying even
24 if that's true we would reverse.

25 MR. FREIDMAN: But also, the Tenth Circuit said

1 that given all the concessions in regard to the relationship
2 with the contractor's employees, given the fact that the
3 contractors were contractually required to order in their
4 own name, contractually required to use purchase forms that
5 said Zia is the buyer, not the United States, militated the
6 conclusion that the contractors were the only parties that
7 were obligated to the vendors.

8 I agree that it is easier to find agency in the
9 relationship with third parties. That is the classic agent
10 use of an agent. And therefore, also, that the relationship
11 with the employees is far more clearly a non-agent
12 relationship, particularly given the concession that these
13 contractors are not instrumentalities.

14 QUESTION: If one of these contractors buys from a
15 third party and he is required to order in his own name,
16 that's perfectly true. But upon delivery, the United States
17 owns the property.

18 MR. FREIDMAN: It does, Justice White, but --

19 QUESTION: And I suppose there have probably been
20 weaker claims of contract with the United States that have
21 prevailed in the court of claims than this one.

22 MR. FREIDMAN: Justice White, the United States
23 has advanced no claims in this case in the record or
24 elsewhere; they have purely argued that advanced funding
25 equal the relationship. They have not brought in examples

1 of litigation in the Court of Claims.

2 But the Boyd contractor in the Boyd case also
3 involving these same Atomic Energy Commission contractors,
4 title to the purchase is passed to the United States. That
5 was true in the Kern-Limerick case, it was true in the
6 Alabama v. King & Boozer case.

7 I believe that what this Court has consistently
8 said is that the mere fact that title is passed, and the
9 mere fact that contractors in some loose and general sense
10 are operating for the government, or acting as agents for
11 the government -- and this is from the Alabama v. King &
12 Boozer case -- does not amount to an agency relationship.

13 QUESTION: Your submission I suppose is if the
14 United States wants a tax immunity, it ought to either have
15 what might be called an instrumentality or they just ought
16 to do it with their own employees.

17 MR. FREIDMAN: That is correct, Justice White, and
18 I believe that that is what was said in the opinion in
19 Boyd. That the government knows how to make agents, it
20 knows how to use its own employees; if it wants to, let it
21 go ahead. That is the same contractors as we are dealing
22 with here. Yet, it is only two years into the case, and I'm
23 a trial lawyer.

24 In a contract case, if somebody starts changing
25 his contracts in the middle of the case, I start thinking

1 maybe he had a weak case. And even these contract
2 modifications are still reluctant to come out and say flat
3 out, I am designating you as an agent.

4 Our brief in the first section discusses at great
5 length documentation of the Atomic Energy Commission's
6 reluctance, its fear about designating its contractors as
7 agents, its fear that they will become enmeshed in exactly
8 the sort of red tape that leads the government in the first
9 place to use private companies.

10 Obviously, the government has, on other occasions,
11 created instrumentalities, on other occasions it has created
12 corporations. Yet that is not the thrust of federal
13 contracting.

14 QUESTION: Mr. Friedman, what about the first
15 question in the Boyd case that was not appealed? Isn't it
16 correct that the Tennessee court held that the contractor
17 was a purchasing agent and therefore was immune from the
18 sales tax?

19 MR. FREIDMAN: That is correct, Justice Stevens.

20 QUESTION: If that is still good law, why doesn't
21 that apply here?

22 MR. FREIDMAN: Because of the factual difference
23 between this case and that one. There, the Atomic Energy
24 Commission, following Roane-Anderson, had gone back and
25 rewritten its purchase documents to say nothing herein shall

1 preclude direct liability of the United States to the third
2 parties. So there is an excellent example of the Atomic
3 Energy Commission taking the standard contract form which is
4 supposed to have such magic and putting in much stronger
5 language in order to make sure that that happened.

6 QUESTION: Do you say that the legal issue here is
7 -- the bottom line is whether the United States had a direct
8 obligation to the vendor? That's really what we have to --

9 MR. FREIDMAN: Yes, and certainly in regard to the
10 employees, Justice Stevens. It is unlike the Kern-Limerick
11 case, unlike the Boyd case.

12 QUESTION: I don't understand what you mean by
13 with regard to the employees. They don't have
14 responsibility for labor negotiations and all that. I
15 understand that.

16 MR. FREIDMAN: Yes. I'm saying that unlike other
17 cases, the Kern-Limerick case purely involved a relationship
18 between a contractor and a third party supplier. In this
19 case, 42% of the receipts relate to that sort of
20 transaction; 58% of the receipts are simply meeting the
21 internal payroll of Sandia, Zia and LACI. And again, as to
22 those relationships, the government has disclaimed a direct
23 relationship with the contractors' employees.

24 The United States in its reply brief I think gives
25 a strained interpretation. If the government says, in

1 regard to the contract -- I'm sorry.

2 QUESTION: Maybe I'm confused on the facts a
3 little bit on this 48% and 52%. The tax that is sought to
4 be imposed here is on the receipts by the vendor in making --

5 MR. FREIDMAN: No. I'm sorry, Justice Stevens.
6 It is on the receipts of the contractors, and the question
7 is what did they do, what kind of transactions did those
8 receipts relate to.

9 QUESTION: Receipts by the contractors paid by
10 whom?

11 MR. FREIDMAN: The contractor draws from the
12 United States funds sufficient to meet its payrolls,
13 sufficient to pay its vendor.

14 QUESTION: And is the state of New Mexico seeking
15 to impose a tax on what the United States pays the
16 contractor for its labor costs?

17 MR. FREIDMAN: That is right, because it is a
18 gross receipts tax. I run a law firm; my law firm pays -- I
19 pay 4% on all my fees even though much of it goes for
20 internal costs. That is the nature of the gross receipts
21 tax.

22 QUESTION: Is it true that nearly 60% of that
23 total is payment to employees for salaries?

24 MR. FREIDMAN: Absolutely correct, Justice Burger.

25 QUESTION: There are 7400 employees?

1 MR. FREIDMAN: I forget the number, it's somewhere
2 in the neighborhood of 7000 employees.

3 QUESTION: Mr. Friedman, the gross receipts tax is
4 on the receipts by the contractor with respect to
5 employees. But what purchases? Is it also measured by his
6 advanced funding from the government for purchases?

7 MR. FREIDMAN: Yes.

8 QUESTION: Or is it how much -- or is the tax
9 collected by the vendors?

10 MR. FREIDMAN: At page 25 of the U.S.'s brief, it
11 is conceded that absent the finding of an agency
12 relationship, the legal incidence of this tax is on the
13 contractor, not on the United States.

14 QUESTION: I know that. But just mechanically, is
15 it the vendor who pays the tax and then adds it to the bill?

16 MR. FREIDMAN: No. The contractor pays the tax
17 based on what he has received from the United States. In
18 transactions in which there is also dealing with a second
19 party in the chain, there is a system of non-taxable
20 transactions.

21 QUESTION: So that the vendor of goods to the
22 contractor doesn't pay a gross receipts tax.

23 MR. FREIDMAN: He will pay a gross receipts tax.

24 QUESTION: But not on those sales.

25 MR. FREIDMAN: No. If they are not agents he will

1 pay that tax.

2 QUESTION: So there are two gross receipts on --

3 MR. FREIDMAN: No, I'm sorry, I appreciate the
4 correction, and let me explain it.

5 I'm saying -- there are non-taxable transaction
6 certificates made available to insulate one of those levels
7 of transaction. Perhaps that --

8 QUESTION: And if you tax the contractor, the
9 contractor's vendors are not going to have to pay that.

10 MR. FREIDMAN: Because he will have given a resale
11 certificate. That is still -- in New Mexico we have already
12 litigated against White Sands Missile Range contractors, Air
13 Force contractors, various civilian agency contractors. We
14 are negotiating with them to work out precisely those
15 transactions so that we can give them the non-taxable
16 certificates.

17 QUESTION: I take it that Sandia occupies quite a
18 bit of property around Albuquerque, and all of that property
19 is tax exempt.

20 MR. FREIDMAN: That is correct, Mr. Justice White.

21 I think underlying the Court's concern in this
22 area is the need to strike a balance between the needs of
23 the states for revenue and the need to protect the United
24 States from affronts to its supremacy. I think what
25 distinguishes this type of case from the type of case in

1 which there really is an attempt to tax the United States is
2 that here the affront is, in effect, self-created by the
3 United States.

4 If the tax burden is too onerous, that is for
5 Congress to adjust, if the amount is too great. As this
6 Court has said in other recent cases. But we are dealing
7 here with contract drafting by a federal contracting officer
8 designed to assure that there will be an affront to the
9 supremacy of the United States. And because of the
10 relationship between the Kern-Limerick case and the
11 underlying James v. Dravo case, which established the
12 general rule that federal contractors are liable for state
13 taxes, the arbiter of this balance between the state's needs
14 and the federal interests lies in the hands of individual
15 contracting officers.

16 QUESTION: Mr. Friedman, do you think that for you
17 to prevail, Kern-Limerick has to be overruled?

18 MR. FREIDMAN: Absolutely not, Justice White.
19 Because --

20 QUESTION: Anymore than Boyd had to overrule it,
21 is that it?

22 MR. FREIDMAN: Exactly, that is right. There is
23 no need to -- we rely on Boyd, and the difference between
24 this case and the Kern-Limerick case is that Kern-Limerick
25 dealt exclusively with transactions with third parties;

1 whereas here, 58% relate to employment relationships --

2 QUESTION: Is this case like Kern-Limerick to the
3 extent it has third party dealings --

4 MR. FREIDMAN: No. I wanted to continue, Justice
5 White.

6 QUESTION: Please do.

7 MR. FREIDMAN: Second, in Kern-Limerick the
8 government plastered the contracts and plastered the
9 purchase orders with clear statements: we will be bound,
10 they are merely our agents, we will pay. It was done
11 deliberately to conserve federal funds.

12 No such language is found here until July 1, 1977,
13 when very timid contractual modifications are inserted only
14 in the contracts, leaving the purchase orders exactly the
15 way they were, leaving all the relationships exactly the way
16 they were.

17 Third, Kern-Limerick inserted all this contractual
18 language long in advance of the taxman coming calling.
19 Here, the contracts are modified two years into a tax case.
20 I think this is a case in which putting in the -- it
21 indicates the government's interpretation of the
22 Kern-Limerick case. I don't believe that this Court
23 intended that the mere insertion of certain magic words at
24 the time the taxman came knocking was the intent of
25 protecting the government against affronts to its supremacy.

1 We are long past the days of McCulloch v. Maryland
2 when there was danger that discriminatory taxation by the
3 states would consume the newly-hatched federal government.
4 If anything, the shoe is on the other foot today. But
5 having given the power to federal contracting officers to
6 insert agency-creating clauses, whatever the wisdom of that
7 balance may be, it seems to me that great scrutiny should be
8 given when the affront to the supremacy of the United States
9 that is claimed is self-created, and when, in fact, these
10 contractors are indistinguishable from other cost plus
11 contractors. The only difference here is the advanced
12 funding.

13 Our brief indicates clearly that advanced funding
14 was viewed by the Atomic Energy Commission only as a
15 reimbursement method for cost plus contractors. You paid
16 them in advance, but later on you had an audit and you
17 netted out what you would have advanced against what would
18 otherwise be subject to reimbursement.

19 QUESTION: Didn't the contract in Carson also
20 involve advanced funding?

21 MR. FREIDMAN: It did, Justice Powell.

22 QUESTION: So why do you say that's the only
23 difference here?

24 MR. FREIDMAN: Well, it's similar. I'm sorry.

25 QUESTION: The contract is almost identical, isn't

1 it? The contract involved in Carson is almost identical to
2 the contract here.

3 MR. FREIDMAN: That is correct, Justice Powell,
4 and I think it is significant that at the time that Congress
5 reversed -- if you will pardon that expression --

6 QUESTION: Congress repealed Section 9(b),
7 following Carson.

8 MR. FREIDMAN: That's right. But they left intact
9 Section 4(c) which this Court had referred to in
10 Roane-Anderson.

11 Obviously, in repealing the Roane-Anderson
12 decision, I don't believe that Congress intended that chance
13 contractual clauses could be grouped together to equal an
14 agency relationship. That is simply the way the Atomic
15 Energy Commission has always done business. Thank you very
16 much.

17 CHIEF JUSTICE BURGER: Do you have anything
18 further, Mr. Jones?

19 ORAL ARGUMENT BY GEORGE W. JONES, ESQ.

20 ON BEHALF OF PETITIONER -- Rebuttal

21 MR. JONES: I have two points. First, in both
22 Sandia and -- Sandia's purchase order, the standard terms
23 and provisions of Sandia's purchase order, and the purchase
24 order or standard terms of Zia's purchase order they
25 indicate that any claims against the contractor arising out

1 of this subcontract, in effect, this purchase order, that
2 are not resolved by the contractor and the supplier must be
3 submitted to a government contracting officer.

4 The ERDA official or the Department of Energy
5 official who supervises the contract, and if --

6 QUESTION: Excuse me, that's sort of an
7 arbitration of a dispute.

8 MR. JONES: And if the dispute is not resolved at
9 that point, the supplier must seek redress before the
10 Department of Energy Contract Board of Appeals.

11 QUESTION: But that doesn't mean he wins; that
12 just tells him where to go to get --

13 MR. JONES: But that very clearly indicates that
14 he has a claim against the United States. And if he's not
15 satisfied with the conclusion of the Contract Board of
16 Appeals, his recourse is to seek judicial review.

17 QUESTION: Well, I don't know if that follows.
18 The contract might say that he has to go to the American
19 Arbitration Association, but it doesn't mean the American
20 Arbitration Association will be liable on the contract.

21 But let me ask you a different question.
22 Supposing there was a contract, an order to purchase
23 something for delivery in six months, and there was a --
24 then a cancellation of the order, which would be in normal
25 commercial terms, a breach of the contract. Would you say

1 that the vendor could then sue the United States directly?

2 MR. JONES: Yes. Sue both the contractor and the
3 United States.

4 QUESTION: Say the contractor went insolvent or
5 something like that. You say there's definitely a direct
6 obligation -- and that's the key to your case, is it? The
7 United States is obligated on the contract.

8 MR. JONES: Well, it follows from our position
9 that these guys are agents of the United States. It
10 necessarily follows. The consequence of having an agent act
11 for you is that you are bound by their actions --

12 QUESTION: That's even before they're paid, so you
13 really don't have to rely on advanced funding, if that's
14 right.

15 MR. JONES: Well, that's right, yes.

16 QUESTION: Let me ask one other question if I
17 may. With regard to the 50 or 60% of the receipts by the
18 contractor that are used to reimburse his own employees, not
19 to pay vendors, does the government contend that those
20 receipts are also immune from the tax?

21 MR. JONES: Yes.

22 QUESTION: You do?

23 MR. JONES: Yes, absolutely.

24 QUESTION: And the whole purchasing relationship
25 has nothing to do with that part of -- say you had a

1 contractor that didn't ever buy anything; had all the same
2 contractual setup, but all they did was do a lot of research
3 and services of one kind or another. You'd say they're
4 still immune?

5 MR. JONES: That's right, because the contractors
6 have no interest in the money. They purchase these services
7 of these third parties --

8 QUESTION: No, the third parties here are
9 employees.

10 MR. JONES: That's right, but they hire these
11 employees for the United States, to provide services to the
12 United States.

13 QUESTION: But the employees are not United States
14 employees.

15 MR. JONES: That's right.

16 QUESTION: And if the employees were not paid by
17 the contractor, the employees then go to the Court of
18 Claims, against the United States?

19 MR. JONES: I suppose they would have a contract
20 claim against the United States in the Court of Claims.

21 QUESTION: Well, was your answer yes?

22 MR. JONES: Yes.

23 And one final point. The contract modifications
24 in this case that the state makes so much of in 1977 simply
25 confirmed what nobody denied until 1967. Even the state of

1 New Mexico recognized that these contractors or contractors
2 of this sort were agents of the United States, even though
3 -- on all of their receipts from the United States except
4 their fees.

5 QUESTION: Well, if you're wrong on the -- you
6 think the case does turn on whether the United States is
7 obligated directly to the third parties and to the employees?

8 MR. JONES: No, I don't think it turns on that.
9 It seems, as I said, that --

10 QUESTION: What if you were wrong on that? Would
11 you lose the case?

12 MR. JONES: No. Well, I mean I can't be wrong on
13 that if these guys are agents. If the contractors are
14 agents for the United States, then the United States is
15 bound by their contractual undertakings on behalf of the
16 United States.

17 QUESTION: Within the scope of their authority.

18 MR. JONES: Within the scope of their authority,
19 as all agents.

20 CHIEF JUSTICE BURGER: Very well. Thank you,
21 gentlemen, the case is submitted.

22 (Whereupon, at 11:05 a.m. the oral argument in the
23 above-entitled matter ceased.)

24

25

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UNITED STATES v. NEW MEXICO

80-702

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BY Suzanne Young

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