

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 86-251

TITLE ROCKFORD LIFE INSURANCE COMPANY, Appellant V.
ILLINOIS DEPARTMENT OF REVENUE, ET AL.

PLACE Washington, D. C.

DATE March 31, 1987

PAGES 1 thru 41



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1 IN THE SUPREME COURT OF THE UNITED STATES

2 -----X
3 ROCKFORD LIFE INSURANCE COMPANY, :

4 Appellant :

5 v. :

No. 86-251

6 ILLINOIS DEPARTMENT OF REVENUE, :

7 ET AL :

8 -----X

9 Washington, D.C.

10 Tuesday, March 31, 1987

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States
13 at 1:55 p.m.

14 APPEARANCES:

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17 behalf of Appellant.

18 MS. PATRICIA ROSEN, ESQ., Assistant Attorney General,
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20 Illinois; on behalf of Appellees.

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P R O C E E D I N G S

CHIEF JUSTICE REHNQUIST: We will hear arguments now in No. 86-251, Rockford Life Insurance Company against Illinois Department of Revenue, et al.

Mr. Griswold, you may proceed when you are ready.

ORAL ARGUMENT OF ERWIN N. GRISWOLD

ON BEHALF OF APPELLANT

MR. GRISWOLD: May it please the Court, this case is here on appeal from the Supreme Court of Illinois.

The question, summarily stated, is whether certificates of the Government National Mortgage Association, popularly known as Ginnie Mae and I shall refer to it as Ginnie Mae in the argument, guaranteed as to interest and principal by the full faith and credit of the United States, pursuant to an Act of Congress, are subject to an ad valorem property tax of the State of Illinois.

I will seek to show that the bonds are exempt from taxation. First, under general constitutional principles, including the Supremacy Clause, since the unqualified Government guarantee which they contain is the key and essential element in carrying out an important policy deliberately adopted by the Government

1 of the United States under the Commerce Clause and in
2 providing for the general welfare.

3 And, second, pursuant to the express terms of
4 Section 742 of Title 31 of the United States Code, in
5 which the Congress has long provided, since the Civil
6 War, that, and I quote:

7 "All stocks, bonds and other obligations
8 of the United States shall be exempt from
9 State taxation."

10 Rockford Life Insurance Company bought the
11 bonds involved here in 1977 at a time when Illinois did
12 not impose its property tax on Ginnie Mae bonds.

13 However, on December 31, 1978, the Illinois
14 Department of Local Government changed its rule and
15 imposed the tax for 1978.

16 That led to administrative and Court
17 proceedings, as a result of which the tax was sustained
18 by the Supreme Court of Illinois. Rockford then brought
19 the case here and this Court noted probable jurisdiction
20 on November 10th.

21 In considering both the constitutional and the
22 statutory questions, it is important to have a clear
23 picture of the history of the Government National
24 Mortgage Association and the role which it plays in the
25 housing policy of the United States. The origins go

1 back more than 50 years, to 1934. Some of us remember
2 and others have learned that real estate markets then
3 were moribund.

4 Housing starts had dropped from 937,000 units
5 in 1925 to 93,000 in 1933. Foreclosures were at
6 epidemic levels, as this Court's decision in Home
7 Building and Loan Association against Blaisdell clearly
8 records.

9 Before that time, many efforts had been made
10 by insurance companies and others to insure mortgage
11 debt but the experience was disastrous.

12 It was in this situation that President
13 Roosevelt established a Commission to explore housing
14 finance and out of its report came the First National
15 Housing Act, enacted in 1934.

16 One of the proposals embodied in that Act was
17 the grant of authority for the creation of Federally
18 chartered, privately owned national mortgage
19 associations with power to buy and sell mortgages and
20 issue bonds against them to the general public.

21 Several national policy objectives were
22 expressed. One, to provide new sources of mortgage
23 funds.

24 Two, to provide liquidity for mortgage
25 lenders. That is, marketability and I suggest that is a

1 very key element here.

2 Three, to lower the cost of mortgage funds by
3 increasing the supply of funds.

4 And four -- and this is another important one
5 -- to move mortgage funds from localities where funds
6 were available to areas where credit was in shorter
7 supply.

8 Despite the authorization and the hopes that
9 lay behind it, the program under the 1934 Act was a
10 complete failure. No private mortgage association was
11 ever established under the program and in 1948, fourteen
12 years later, the program was repealed.

13 In 1938 the Federal National Mortgage
14 Association, sometimes called Fannie Mae, was
15 chartered. One of its purposes was to create a
16 secondary market for mortgages, thereby channeling
17 Federal credit to the housing industry but Fannie Mae
18 did not issue mortgage backed securities.

19 In 1954 it was reorganized under a new charter
20 as a mixed ownership Government corporation. It's
21 secondary market function was to be financed by bonds,
22 by funds borrowed in the private market and these
23 obligations were not secured by the United States.

24 It was a number of years later, in 1968,
25 thirty-four years after the beginning of only meagerly

1 successful efforts in this area, that Fannie Mae was
2 divided into two corporations.

3 One of these, Ginnie Mae, Government National
4 Mortgage Association, was established as a wholly-owned
5 Government corporation.

6 The other corporation retained the Fannie Mae
7 name and Government ownership in it was terminated on
8 September 30, 1968.

9 By the terms of the statute, Ginnie Mae is,
10 and I quote Section 1717(a)(2)(A) of Title 12 of the
11 U.S. Code:

12 "Ginnie Mae is in the Department of
13 Housing and Urban Development. It has
14 no Board of Directors and its powers are,
15 by statute, exercised by the Secretary of
16 Housing and Urban Development. It has a
17 President who is nominated by the President
18 and confirmed by the Senate. Its other
19 officers are appointed by the Secretary of
20 Housing and Urban Development."

21 Thus Ginnie Mae is unquestionably an
22 instrumentality of the United States and its obligations
23 are clearly, in the normal sense, obligations of the
24 United States.

25 QUESTION: Mr. Griswold, who is the obligor on

1 these bonds?

2 MR. GRISWOLD: The only obligor on these bonds
3 is the United States.

4 QUESTION: There isn't any intermediary
5 between the holder or the payee of the bond and the
6 United States?

7 MR. GRISWOLD: There is an understructure but
8 the only obligation is the United States. The Joint
9 Appendix at Pages 56 to the end, has in bold type the
10 text of the bond. I have lodged with the clerk one of
11 the exhibits which shows what they look like.

12 Actually, the original is a little more
13 impressive. It's got a green background and a brown
14 border and this is the Seal of the United States in the
15 center of it. But the language is on Page 58. It's
16 also on the bond or the certificate, a copy of which has
17 been given to you.

18 QUESTION: Well, there it says at the
19 beginning on Page 56, "The Issuer, Named Below". Now,
20 is that the United States?

21 MR. GRISWOLD: No. That is the entrepreneur
22 who assembles the package and takes the lot to the
23 Government National Mortgage Association.

24 QUESTION: Well, here it says, "The Issuer,
25 Named Below, Promises to Pay to the Order of:". That is

1 certainly some form of a promise of payment.

2 MR. GRISWOLD: But, Mr. Chief Justice, let me
3 just point a little further in it. Page 58 of the Joint
4 Appendix, the upper righthand corner of the certificate:

5 "Except as hereafter undertaken, this
6 certificate does not constitute a liability
7 of nor evidence any recourse against the
8 issuer"

9 and then the things which are hereafter undertaken is
10 that the issuer promises that these are true and valid
11 bonds and properly handled but no promise to pay and
12 then, at the bottom of Page 58 appears the Guaranty.

13 QUESTION: Mr. Griswold, may I interrupt.
14 The Joint Appendix at 56 reads this way:

15 "The Issuer, Named Below, Promises to Pay
16 to the Order of Rockford Life Insurance
17 Company",

18 and the issuer named below is the Kissell Company.
19 Doesn't that make the Kissell Company --

20 MR. GRISWOLD: That's what it says, Mr.
21 Justice, but also it says on Page 58:

22 "Except as hereafter undertaken, this
23 certificate does not constitute a liability
24 of nor evidence any recourse against the
25 issuer",

1 and it is perfectly clear, I submit, that the holder of
2 this certificate could not sue the issuer and get a
3 judgment.

4 QUESTION: And nobody contends in this case
5 that is the case; do they?

6 MR. GRISWOLD: Nobody contends that that is
7 the case.

8 QUESTION: Including the Government?

9 MR. GRISWOLD: Yes, I think the Government
10 agrees in its amicus brief. The issuer is an agent. He
11 remains an agent for Ginnie Mae. He collects a service
12 fee. He makes what he gets on the original sale of the
13 bonds but he carries no liability to the holder of this
14 instrument, despite what it says in the first, because
15 that's taken back.

16 QUESTION: Mr. Griswold, who does make the
17 payments? Who does pay to the Rockford Life Insurance
18 Company the money that's --

19 MR. GRISWOLD: That all depends upon what
20 actually happens along the way. In normal course, I
21 suppose it's the mortgagor who pays. He pays in
22 wherever he is supposed to pay, which has been arranged
23 by the issuer to accumulate the funds and the issuer
24 then makes the payment, if he has the funds and is able
25 and hasn't gone bankrupt and various other things, to

1 the holder of the certificate.

2 QUESTION: Well, wouldn't the issuer's
3 stockholders object to that and sue the issuer, if the
4 issuer doesn't have any obligation to make those
5 payments?

6 I mean, you're telling us that the issuer has
7 no obligations.

8 MR. GRISWOLD: No, on the contrary. The
9 issuer has obligations, as stated here, to collect the
10 amounts and to account for them and to remit them as
11 they are collected but he has no obligation to the
12 holder of the certificate. His obligation is to Ginnie
13 Mae.

14 QUESTION: But he's paying the money to the
15 holder of the certificate.

16 MR. GRISWOLD: That's because that's the
17 nature of the arrangement.

18 QUESTION: It's because somewhere there must
19 be a promise to do it, because otherwise he would be
20 sued to death by his stockholders.

21 MR. GRISWOLD: His promise is effectively to
22 Ginnie Mae as the underlying guarantee to help Ginnie
23 Mae to be in the position to carry out its unqualified
24 guarantee of the payment of interest and principal.

25 I think we cannot overlook that language which

1 is printed on Page 58, which is clear and straight. The
2 only obligation, suable obligation on this bond is that
3 undertaken by Ginnie Mae, pledging the full faith and
4 credit of the United States.

5 QUESTION: Is there another -- you're saying
6 that the holder of the bond is a third-party beneficiary
7 of an agreement between the issuer and Ginnie Mae?

8 MR. GRISWOLD: Of that he is, but he is the
9 direct promisee of the unqualified pledge of the full
10 faith and credit of the United States made pursuant to
11 an Act of Congress by the Government National Mortgage
12 Association and that is the heart of the case and it is
13 because of that unqualified guarantee that these things
14 have worked. Contrary to the prior experience, where
15 mortgage financing was not very successful, Ginnie Mae
16 bonds are now approaching a 120 billion dollars. Not
17 million but billion.

18 As Senator Dirksen used to say, "After a while
19 it adds up to quite a lot of money."

20 QUESTION: Mr. Griswold, can I interrupt you
21 again?

22 Toward the bottom of Page 57, there's a
23 sentence:

24 "The issuer shall remit to the holder all
25 such monthly payments required under this

1 certificate by the fifteenth (15th) day of
2 each calendar month."

3 Does not that mean that pursuant to this instrument, the
4 Kissell Company has a duty to pay over to the Rockford
5 Life Insurance Company the monthly payments?

6 MR. GRISWOLD: That language says that and
7 that calls upon the issuer to perform under an
8 obligation to Ginnie Mae but the only obligation on this
9 certificate, as clearly stated at the top of Page 58, is
10 by Ginnie Mae and it does not constitute a liability of
11 nor evidence any recourse against the issuer.

12 QUESTION: Is it your view that if the Kissell
13 Company just kept the monthly payments and took them to
14 South America with them and just turn them over, they
15 would not be liable to Rockford Life Insurance Company?

16 MR. GRISWOLD: It is my view that there is
17 nothing that the holder could do except to sue Ginnie
18 Mae and, incidentally, it would clearly have a good case
19 in the now United States Claims Court because of a
20 contractual obligation of the United States to the
21 holder of the certificate.

22 QUESTION: But Ginnie Mae can do some things to
23 it; can't it?

24 MR. GRISWOLD: Ginnie Mae could do things;
25 yes. Ginnie Mae can remove the issuer. It can require

1 the transfer, not only of the custody of the mortgages
2 but their title. It can deal with them. It can do all
3 kinds of things but the only obligation to the holder,
4 is that of Ginnie Mae.

5 Now, Ginnie Mae is unquestionably an
6 instrumentality of the United States. Its obligations
7 are clearly, in the normal sense, obligations of the
8 United States. The Congressional reports leading up to
9 this suggested the creation of a mortgage-backed
10 securities program and the desirability of Federal
11 Government guarantee of such securities.

12 Congress adopted such a program, including for
13 the first time the Federal guarantee. The program has
14 been a great success and it is quite clear that making
15 the Federal Government's credit available through the
16 guarantee has been the key to that success.

17 QUESTION: Mr. Griswold, one thing strikes me
18 rather peculiarly on the instrument you've given us, and
19 that's in the Joint Appendix, the Kissell Company is
20 named but there isn't anyone who purports to sign on
21 behalf of the Kissell Company, in contrast to
22 immediately below, Ginnie Mae's Secretary and President
23 both attest.

24 Is there any significance in that?

25 MR. GRISWOLD: Well, that is a point made in

1 our brief, that the only signer of this is Ginnie Mae.
2 The only obligation expressed on it with a signature is
3 Ginnie Mae and the terms of the document are that the
4 only liability which is carried by the instrument is
5 that of Ginnie Mae.

6 QUESTION: You wouldn't need a signature to
7 have liability on it. I mean, you can type your name
8 and be rendered liable. There's nothing in the law that
9 requires you to have a signature. It looks nicer.

10 But you could type in the Kissell Company and
11 that's enough to make you liable.

12 MR. GRISWOLD: But I think it is irrelevant in
13 view of that language, "Except as hereinafter
14 undertaken". It could hardly be clearer and was
15 intended.

16 There's an aspect of the 1968 reorganization
17 which seems of special significance. Two corporations
18 were established by that Act.

19 One of these, Fannie Mae, is privately owned
20 and Congress expressly provided, twice in the Federal
21 Housing Act, now found in Section 1719 of Title 12:

22 "The corporation -- "

23 That is Fannie Mae.

24 " -- shall insert appropriate language

25 in all of its obligations issued under this

1 sub-section, clearly indicating that such
2 obligations, together with the interest
3 thereon, are not guaranteed by the United
4 States and do not constitute a debt or
5 obligation of the United States or of any
6 Agency or Instrumentality thereof, other
7 than the corporation."

8 And the contrast with the powers granted to Ginnie Mae,
9 just two sections later, is very great.

10 I may add that Ginnie Mae issues are quoted
11 daily in the Wall Street Journal. This is the current
12 column -- it's not all Ginnie Mae -- Ginnie Mae is down
13 here under the heading Government Agency Issues. Ginnie
14 Mae futures are quoted in the New York Times daily.
15 Baron's, which is a widely-used financial sheet under
16 the heading Bonds, Government, has two places where
17 Ginnie Maes are quoted. One of futures.

18 Mortgage securities dealers make primary and
19 secondary cash markets in these securities, providing
20 for both immediate and future transfer. There are
21 futures markets in Ginnie Maes and on major exchanges,
22 and exchange-based Ginnie Mae options have been
23 authorized by the Securities and Exchange Commission.

24 Any broker can get current quotations on
25 Ginnie Mae bonds by ticker.

1 QUESTION: Mr. Griswold, can I ask you another
2 question?

3 Some of these underlying mortgages, as I
4 understand the record here, are also guaranteed by the
5 Federal Housing Authority or the Veterans Administration.

6 MR. GRISWOLD: All of these mortgages have to
7 be guaranteed by the Veterans Administration, the
8 Federal Housing Authority and one or two other --

9 QUESTION: Do those guarantees precede the
10 liability of Ginnie Mae?

11 MR. GRISWOLD: They precede it and that is the
12 explanation of why, as appears in the briefs, for the
13 two State briefs, that Ginnie Mae has only paid a
14 nominal sum under its guarantee. The underlying
15 guarantee has Ginnie Mae protected by the fact that it --

16 QUESTION: If they were already guaranteed by
17 one or two other Government agencies, would there have
18 been obligations by the United States within the meaning
19 of the statute, even if they didn't have the Ginnie Mae
20 guarantee?

21 MR. GRISWOLD: Very likely not. And this is
22 one reason why I have been stressing this marketability
23 quoted, treated like bonds. The Veterans Administration
24 undertaking is mortgage-by-mortgage. You're still
25 responsible if you have the mortgage, if they don't pay,

1 you've got to go out and find them and if there has to
2 be foreclosure, you have to do it.

3 The Federal Housing Administration is an
4 insurance program and there are a number of limitations,
5 including the fact that the interest isn't insured.

6 The thing that has made these things
7 marketable and which has attracted large sums of money
8 into it, is this unqualified promise of the United
9 States, pursuant to an Act of Congress, pledging the
10 full faith and credit of the United States.

11 QUESTION: Mr. Griswold, this has troubled me
12 from the outset in this case. Do you have any notion
13 as to what the phrase, "Except as hereinafter
14 undertaken" means in that magic paragraph?

15 MR. GRISWOLD: Yes, I think I do.

16 QUESTION: I keep reading it and reading it
17 and I can't find anything that's hereinafter undertaken.
18 It says, "Except as hereinafter undertaken".

19 MR. GRISWOLD: It is certified that this
20 certificate is legal and regular in all respects. If
21 Kissell has forged them in some way or has not complied
22 with the law, they would still be liable and,

23 "It is duly and validly issued, pursuant to
24 Title 3 of the National Housing Act and that
25 no rule, regulation or other like issuance and

1 no contract or other agreement of either the
2 Government National Mortgage Association or
3 the issuer, or both, adversely affects the
4 rights."

5 That is really a guarantee of regularity.

6 QUESTION: That much is a commitment of the
7 Kissell Company and nothing else. I see.

8 MR. GRISWOLD: Now, there is a good deal of
9 talk in the other side's briefs about the case of Smith
10 and Davis. That is dealt with extensively in our brief
11 and in our reply brief and I think I will leave it to
12 that now.

13 The introduction of the full faith and credit
14 of the United States in the Ginnie Mae certificate
15 opened the floodgates. Thereafter, the financing of
16 home mortgages was like traffic on a four-lane highway,
17 with the money flowing freely to a total now
18 approaching, as I've said, 120 billion dollars.

19 Prior to that, without the guarantee,
20 mortgages were not effectively marketable. In those
21 pre-Ginnie Mae days it was like a winding country road
22 with speed blocks and the money only trickled, and this
23 serves, as I have said, to distinguish the Ginnie Mae
24 certificates from Veterans Administration guarantees or
25 from FHA Insurance.

1 Congress has spoken in broad and unqualified
2 terms in Section 742. Within both the ordinary and the
3 technical meaning of the language, the certificates
4 clearly state an obligation involving the full faith and
5 credit of the United States. There is no reason to give
6 that language an artificial construction. Whether the
7 language is too broad is essentially a political
8 question.

9 The statute can be changed by Congress where
10 the many competing factors can be appropriately
11 considered and I would call attention to the State's
12 brief, Page 33/34 where they say essentially that.

13 The statutory language seems unusually clear
14 and applicable and it should not be rewritten by this
15 Court. The judgment below should be reversed.

16 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
17 Griswold.

18 We'll hear now from you Ms. Rosen.

19 ORAL ARGUMENT OF PATRICIA ROSEN

20 ON BEHALF OF APPELLEES

21 MS. ROSEN: Mr. Chief Justice and may it
22 please the Court.

23 I would like to first talk for a moment, if I
24 might, about the Ginnie Mae certificates themselves and
25 who is obligated on the face of the certificates.

1 As the Court pointed out, the certificate
2 itself states that the issuer, who is named on the face
3 of the certificate, undertakes to promise to pay to
4 Rockford Life Insurance Company payments of both
5 principal and interest on the certificate.

6 In addition, I would like to point out that as
7 the Appellate Court noted in its opinion, the
8 certificates involved in this case are what is
9 generically known as modified pass-through
10 certificates. That is, the issuer undertakes to pay
11 both principal and interest, not only as a straight
12 pass-through, that is, as those payments are received by
13 the mortgagor -- paid in by the mortgagor, but whether
14 or not those payments are received.

15 Specifically, I would like to invite the
16 Court's attention to page 57, in the center of the
17 second paragraph. The line I'm referring to reads:

18 "However, the issuer shall pay to
19 holder, whether or not collected by
20 the issuer, and shall remit as set
21 forth below, monthly payment on both
22 principal and interest."

23 QUESTION: Ms. Rosen, do you agree, however,
24 that the liability of the issuer is without recourse?

25 MS. ROSEN: Yes, Your Honor, I agree that the

1 holder of the certificate has no recourse against the
2 issuer. However, counsel for the taxpayer here tries to
3 make that the determinative factor in the case and we
4 strongly disagree with such excessive reliance on simple
5 enforceability by the holder of the certificate.

6 There are other agreements, as pointed out by
7 both the Appellate Court and the Supreme Court, in
8 rejecting this argument of the taxpayer. The issuer has
9 promised, not only on the face of the certificate but
10 also in the guarantee agreement which is signed with
11 Ginnie Mae and, as pointed out by the Court in the
12 opening argument, Ginnie Mae is the one who enforces
13 this obligation of this issuer. It is not the holder of
14 the certificate but it is Ginnie Mae.

15 But certainly the issuer, in this case the
16 Kissell Company, is liable on these certificates and
17 that liability is enforced.

18 QUESTION: But not liable to the holder?

19 MS. ROSEN: That's correct.

20 QUESTION: But liable to Ginnie Mae?

21 MS. ROSEN: That's correct.

22 As to the nature of the constitutional and
23 statutory immunity which is being discussed in this
24 case, --

25 QUESTION: Well, I thought the reason it might

1 be important that there was an obligor to respond to any
2 complaints on the part of the holder, other than a
3 Government corporation, was part of the language in
4 Smith against Davis, where it says that one of the
5 characteristics of the obligation of the United States
6 is a binding promise by the United States to pay
7 specified sums and specified dates.

8 MS. ROSEN: But I believe what the Court was
9 referring to in Smith versus Davis is that the promise
10 should not be, as it is in this case, only activated in
11 the event of the default on the basis of the primary
12 obligor, but it should be a binding promise from the
13 beginning.

14 In other words, a bond, a stock, something
15 where the United States is obligated to --

16 QUESTION: The primary obligor is the --

17 MS. ROSEN: Yes. And here, the United States
18 is not the primary obligor.

19 QUESTION: Who is?

20 MS. ROSEN: The Kissell Company, in this
21 instance that we are discussing.

22 The primary obligor --

23 QUESTION: What obligations does it have?

24 MS. ROSEN: It's obligated to make payments of
25 principal and interest, in this case, whether or not it

1 receives those payments.

2 QUESTION: So you just disagree with Mr.
3 Griswold about its obligations?

4 MS. ROSEN: Yes, we do as the Appellate and
5 the Supreme Court disagree with Mr. Griswold that the
6 Kissell Company is not the primary obligor in the
7 certificates.

8 QUESTION: If I understand it, you say it is
9 the obligor but can't be sued to enforce its obligations?

10 MS. ROSEN: It can only be sued by Ginnie Mae
11 to enforce its obligations. It cannot be sued by the
12 holder of the certificate.

13 It's not that the obligation is
14 unenforceable. The obligation, number one, is there.
15 It's printed on the face of the certificate. It is in
16 the guarantee agreement, so it is obligated.

17 QUESTION: If it doesn't collect from the
18 people who signed the mortgages.

19 MS. ROSEN: Ginnie Mae does sue.

20 QUESTION: I know, but Ginnie Mae can't sue
21 this company.

22 MS. ROSEN: Kissell Company. Yes, they can.

23 QUESTION: Suppose all the mortgagees default
24 -- all the mortgagors default? The mortgagors just
25 default. They don't pay.

1 MS. ROSEN: Yes, Your Honor.

2 QUESTION: Now, is the Kissell Company
3 independently liable to Ginnie Mae --

4 MS. ROSEN: Yes, Your Honor, under the
5 language --

6 QUESTION: -- for the amount that is not paid
7 to it?

8 MS. ROSEN: Yes, Your Honor. Under the
9 language which I just read to you, which I quoted to
10 you, that's the difference between a straight
11 pass-through certificate and a modified pass-through.

12 Under a straight pass-through the mortgagor is
13 the primary obligor.

14 Under a modified pass-through, which is what
15 we have here, the Kissell Company itself undertook -

16 QUESTION: If we disagree with you on that,
17 what if we agree with Mr. Griswold, then do you lose the
18 case?

19 MS. ROSEN: Let me understand what you're
20 disagreeing with me on.

21 QUESTION: The extent of the obligation of the
22 Kissell Company.

23 MS. ROSEN: If you agree that Ginnie Mae is
24 the one who has the primary obligation here -- is that
25 what you are --

1 QUESTION: If we agree with Mr. Griswold that
2 this company, the issuer, has no obligation except to
3 Ginnie Mae. It has no obligation to the holder of the
4 certificate, does it?

5 MS. ROSEN: It is obligated under the terms of
6 the certificate to pay the amounts to the holder. That
7 obligation cannot be enforced by the holder. It can
8 only be enforced by Ginnie Mae.

9 QUESTION: So it has no obligation to the
10 holder?

11 MS. ROSEN: Yes.

12 QUESTION: That's almost -- it sounds like a
13 little bit of gobbledy-gook because on Page 57 it says,
14 "However the issuer shall pay to the
15 holder, whether or not collected by
16 the issuer, and shall remit as set
17 forth below, monthly payments --" et
18 cetera.

19 Now, I would think that would help you in your
20 case if that meant what it says but you are saying, in
21 effect, it doesn't mean what it says.

22 MS. ROSEN: I'm saying it does mean what it --
23 I don't understand why -- it means what it says but that
24 obligation cannot be enforced by the person holding the
25 certificate.

1 QUESTION: But it says you shall pay to the
2 holder but it can't be enforced by the holder.

3 MS. ROSEN: Yes. The holder has no recourse
4 against the person issuing the certificate.

5 QUESTION: It's an obligation to the holder,
6 without recourse?

7 MS. ROSEN: Yes.

8 QUESTION: That's what it is.

9 MS. ROSEN: That's correct.

10 QUESTION: It's an obligation without recourse.

11 QUESTION: But what does it mean, "whether or
12 not collected by the issuer"? That sounds the very
13 opposite of a non-recourse obligation.

14 MS. ROSEN: Because that's the nature of the
15 modified pass-through program, is that the issuer must
16 pay whether or not he collects from the mortgagor.

17 QUESTION: But he must pay to the holder; is
18 that what you're saying?

19 MS. ROSEN: Yes.

20 QUESTION: But the holder can't enforce it?

21 MS. ROSEN: But it's enforceable by Ginnie
22 Mae, not the holder.

23 Essentially, the language which is relied upon
24 by the taxpayer in this case, is simply the language of
25 the Federal guarantee itself and that is, that in the

1 event of a default -- and only in the event of a default
2 -- the liability of the United States, under the terms
3 of its guarantee, is triggered and in the event of a
4 default -- and when I say default, I'm referring to the
5 default of the issuer or the primary obligor on the
6 certificate. In the event of a default, then the holder
7 of the certificate turns to Ginnie Mae.

8 QUESTION: May I ask you another question
9 about the intervening layers here?

10 MS. ROSEN: Yes, Your Honor.

11 QUESTION: Supposing somebody defaults on a
12 mortgage. It is guaranteed by the Veterans
13 Administration.

14 MS. ROSEN: Yes, Your Honor.

15 QUESTION And eventually the Veterans
16 Administration makes good on the mortgage and so forth,
17 what happens in the interim?

18 Now, the issuer here must continue to make the
19 monthly payments and it eventually reimburses itself
20 from the Veterans Administration; is that right?

21 MS. ROSEN: Yes.

22 QUESTION: So that in a normal default
23 situation, Ginnie Mae doesn't have to become involved at
24 all?

25 MS. ROSEN: That's correct.

1 Under the circumstances which, hopefully, I
2 have just described to you, the question involved in
3 this case concerns the ability of the States, in
4 particular Illinois here, to impose a tax on these
5 mortgage-backed securities which are guaranteed by
6 Ginnie Mae.

7 More broadly, it involves a question of the
8 doctrine of intergovernmental tax immunity, which
9 unquestionably provides that both the State Governments
10 themselves, and the Federal Government, the property of
11 those Governments, their instrumentalities and their
12 obligations must be free from taxation by the other
13 Government.

14 The purpose of this doctrine is to allow both
15 Governments, both at the State and Federal level, to
16 coexist without undue interference by the other
17 Government, through the exercise of its taxing power.

18 It is important, when deciding any question
19 under this doctrine, however, to recognize that the
20 power to raise revenue by taxation is, itself, essential
21 to the operation of any sovereign Government, because it
22 is the only way through which that Government is able to
23 raise the funds necessary to its operation and,
24 therefore, this Court has always been unwilling to
25 broadly interpret either the constitutional or the

1 statutory immunity from taxation.

2 QUESTION: Of course, Illinois has not always
3 taxed these; have they?

4 MS. ROSEN: No. That's correct, Your Honor.

5 QUESTION: All right.

6 MS. ROSEN: I believe because, under an
7 earlier interpretation by the Department of Local
8 Government Affairs, they didn't think they were able to
9 impose the tax. There was a question raised at the
10 Appellate Court and Supreme Court level of estoppel,
11 relying on a previous interpretation of the Department,
12 which was later changed.

13 It is unquestionably true that any securities
14 which are issued directly to raise money for the
15 operation of a Government cannot be taxed. And examples
16 of those securities would be stocks, bonds, certificates
17 of indebtedness, Treasury bills and the like. However,
18 we submit that this immunity should not be extended to
19 cover obligations which are issued by private
20 institutions merely because they are Federally
21 guaranteed and the investor has no recourse against the
22 private issuer, in the event the issuer defaults.

23 The taxpayer in this case wants the Court to
24 focus upon this investment transaction from the
25 perspective of the private investor in a default

1 situation and we submit that this is an inappropriate
2 focus for the Court, for several reasons.

3 First of all, it gives a distorted view of the
4 program and does not take into consideration the primary
5 focus of the Court should be on the degree of
6 interference caused with the operation of the Federal
7 Government and the operation of the program itself.

8 As pointed out by amicus on National Governors
9 Association and the like in their brief, 38 States and
10 the District of Columbia, impose not property taxes but
11 income taxes, which would also be barred under the
12 interpretation which is being advanced by the taxpayer
13 in this case, since neither the obligations themselves,
14 nor the income from those obligations could be subject
15 to State taxation, if you adopt the view proposed by the
16 private taxpayer here.

17 QUESTION: How many states impose a tax like
18 Illinois?

19 MS. ROSEN: Very few impose a property tax.
20 In fact, Illinois no longer imposes the tax which is at
21 issue in this case. Only four states were listed as
22 imposing a property tax on Ginnie Mae bonds but 38 and
23 the District of Columbia tax the income from the bonds.

24 QUESTION: Was there a replacement tax of some
25 kind? Why did they repeal this?

1 MS. ROSEN: Yes, there were a number of
2 replacement taxes issued. Under the Illinois
3 constitution, all taxation of intangible personal
4 property was repealed and the State legislature was
5 required to enact replacement taxes, to cover the income
6 which would be lost by abolishing those taxes.

7 QUESTION: What kind of taxes?

8 MS. ROSEN: I believe it was a wide variety
9 and I can't specifically name a particular -- they were
10 state-wide taxes, called replacement taxes but the tax
11 itself was not abolished having anything to do with the
12 issues which are presented by this Court. It was
13 abolished along with all other property taxes on
14 intangibles.

15 And as I pointed out previously, focusing on
16 the recourse by a private investor in the event of a
17 default, is inappropriate because it gives a distorted
18 view of the Ginnie Mae program.

19 Default, as pointed out by the statistics
20 which are reproduced in several of the briefs, are quite
21 rare and, therefore, it has not been shown that the
22 State taxation imposes any real impediment to the
23 success of the Federal program or interferes in any
24 significant way with the operation of the program.

25 As of fiscal 1984, as the briefs point out,

1 the cumulative total of the securities issued by Ginnie
2 Mae was in excess of 215 billion dollars. Contingent
3 liability as of that year was 175 1/2 billion dollars a
4 actual liability amounted to \$98,532.

5 To require the States to refrain from taxing a
6 program in excess of 215 billion dollars on the basis of
7 liability somewhat less than \$100,000, is not a sensible
8 construction of constitutional or statutory tax immunity.

9 Furthermore, the task which the taxpayer
10 proposes in this case completely ignores the real
11 consideration whenever this Court seeks to determine
12 whether securities should be exempted from State
13 taxation. The focus here should be exclusively on the
14 degree of interference with the Federal Government's
15 program and such interference has not been shown here.

16 In this case, the immunity which the taxpayer
17 seeks, would primarily serve to shield private
18 investments from State taxation. So that immunity is
19 not mandated either by the Constitution or by the
20 Statute.

21 Unlike stocks, bonds or Treasury bills, Ginnie
22 Mae certificates are issued by private banking
23 institutions, not the Government and those private
24 institutions are primarily liable on these certificates.
25 The Government's liability is contingent and

1 unliquidated.

2 The issuance of Ginnie Maes does not increase
3 the public debt, nor does it secure funds for the
4 operation of the Federal Government and these were
5 essentially the tasks which this Court stressed in the
6 Smith case.

7 In Smith the Court looked to several factors,
8 but the factors which essentially we would ask the Court
9 to consider here are, first of all, there is no credit
10 instrument or instrument which is utilized by the
11 Federal Government in order to raise revenue. This is
12 the most important factor because, essentially, what
13 this Court is doing when it says the State cannot impose
14 a tax on these obligations, it is excluding an entire
15 area from the ability of the States to impose taxes.
16 Where the area relates to the ability of the Federal
17 Government to raise revenue, certainly the function
18 involved is an essential one to the operation of --

19 QUESTION: What will be the economic result of
20 permitting taxation? It will probably require the
21 interest rate to be raised on the instruments or what?

22 MS. ROSEN: Well, these instruments, as I
23 pointed out, at least the income on the instruments is
24 already taxed and, so, I don't --

25 QUESTION: So this would be an additional tax?

1 MS ROSEN: No. To date neither the Department
2 of Housing and Urban Development, nor Ginnie Mae itself,
3 nor any branch of the Federal Government, has ever --
4 nor any case has ever found that these Instruments were
5 Federally tax exempt, so they are taxed in most states.

6 QUESTION: What will be the economic effect of
7 the tax, if any?

8 MS. ROSEN: I don't know that there would be a
9 direct economic impact.

10 QUESTION: Who pays this tax?

11 MS. ROSEN: Well, in this case, Rockford
12 Life. We pay the tax.

13 QUESTION: Do you think if it knows it is
14 going to have to pay the tax, that it would be as eager
15 to buy these certificates in the future or not? At that
16 interest rate.

17 MS. ROSEN: That is the argument which is
18 advanced by the taxpayer in attempting to argue that
19 there is an interference with the Federal program.

20 QUESTION: If it would force the interest rate
21 to rise, it will certainly increase the potential
22 liability of Ginnie Mae.

23 MS. ROSEN: Well, Your Honor, I would point
24 out first of all, that there has -- since tax is
25 imposed, at least on the income on these certificates in

1 most States, there hasn't been shown to be any serious
2 adverse impact on the operation of the program. Ginnie
3 Mae started issuing these certificates in 1970. By
4 approximately 1980 the cumulative total issued was
5 something like 82 billion and by 1984 it was 215 billion.

6 QUESTION: And you say that Ginnie Mae isn't
7 complaining?

8 MS. ROSEN: Ginnie Mae has not complained and
9 certainly under those statistics, should not complain.
10 This program has been phenomenally successful without
11 any declaration that these securities are tax exempt.

12 QUESTION: Well, Ms. Rosen, I understood the
13 Solicitor General's position to be that they are subject
14 to tax and that the interest rates and costs of these
15 certificates have already taken that into effect.

16 Am I wrong?

17 MS. ROSEN: No, Your Honor, that is correct
18 and that is the point I'm attempting to make, is that
19 these are taxed and there has been no adverse impact on
20 the program to date and, therefore, I don't see that
21 there would be any additional impact if you sustain this
22 tax, Your Honor.

23 QUESTION: May I ask this question?

24 These instruments are guaranteed to the extent
25 of the full faith and credit of the United States.

1 MS. ROSEN: That's correct.

2 QUESTION: Has the United States Government
3 ever had to pay anything on any of them?

4 MS. ROSEN: Yes, Your Honor, they have.

5 As I pointed out a little bit earlier when I
6 went through the statistics for 1984, it's about one
7 thousandth of one percent per year and that statistic
8 has held valid. I checked six years and, basically,
9 it's been less than one thousandth of one per cent of
10 the total outstanding liability each year that I checked.

11 QUESTION: The issuers are required to furnish
12 bonds to guarantee, fidelity bonds and bonds to
13 guarantee the payments that they undertake to make?

14 MS. ROSEN: Yes, Your Honor, that is correct.
15 That is part of the initial agreements which are entered
16 into. When a mortgage lending institution wants to
17 become an issuer of Ginnie Maes, they assemble a pool of
18 mortgages generally in excess of a million dollars and
19 then they apply to become an issuer and, in doing that,
20 their financial situation is scrutinized and also they
21 must supply fidelity bonds to guarantee performance..

22 Essentially, what the taxpayer seeks to do in
23 this case is to expand the doctrine of Federal tax
24 immunity to cover a Federally guaranteed, private
25 investment transaction. Such immunity should not be

1 conferred in the absence of a decision that it is
2 necessary to the success of the Federal program and we
3 submit that decision is one which should be made by
4 Congress.

5 Here Congress has never indicated either in
6 the statute creating Ginnie Mae, that these bonds --
7 that it intended to, in the language itself nor in the
8 legislative history, is there any indication that it
9 intended, when it authorized Ginnie Mae to guarantee
10 these obligations, that it intended to confer immunity
11 from State taxation and this Court has many, many times
12 indicated that the question of whether the
13 constitutional and statutory immunity should be expanded
14 is one which is best left to Congress, because it is a
15 question which is essentially legislative in nature.

16 Congress here has not indicated that immunity
17 from State taxation is necessary to the success of this
18 program. The program has been phenomenally successful
19 without immunity from State taxation and we would ask
20 this Court to agree with the decisions of the Illinois
21 Appellate and Supreme Courts and to hold that Ginnie Mae
22 securities are not obligations of the Federal Government
23 and they are not entitled to either statutory or
24 constitutional immunity.

25 Thank you.

1 CHIEF JUSTICE REHNQUIST: Thank you, Ms. Rosen.

2 Mr Griswold, you have two minutes remaining.

3 REBUTTAL ARGUMENT OF ERWIN N. GRISWOLD

4 ON BEHALF OF THE APPELLANT

5 MR. GRISWOLD: Ms. Rosen's final argument
6 simply ignores Section 742, which is the whole basis of
7 our claim for exemption.

8 QUESTION: If you win, would State income
9 taxes on the interest earned be immune?

10 MR. GRISWOLD: That question isn't here.

11 QUESTION: Well, I'm asking.

12 MR. GRISWOLD: I have thought about it and I
13 can see arguments on both sides of it.

14 QUESTION: Under the section you rely on,
15 doesn't it say interest?

16 MR. GRISWOLD: It says "income" but the
17 question is whether the income is actually paid by the
18 United States or is paid by the mortgagees through the
19 issuer to the holder.

20 That is a real problem. It is not here and --

21 QUESTION: In any event, States have been
22 taxing the income?

23 MR. GRISWOLD: In any event, States have been
24 taxing the income.

25 On the other hand, States generally did not

1 impose property taxes. There are only four states which
2 now impose property taxes. They came to it lately,
3 particularly after there was an Illinois decision
4 sustaining it and now Illinois has abandoned the
5 property tax.

6 It is perfectly clear that the key to the
7 success of this program is the Government guarantee.
8 Using patent language, "that was a stroke of genius".
9 It changed things from one level to a wholly higher
10 level.

11 As one of the witnesses in this record, Joint
12 Appendix on Page 54, said:

13 "But rather than taxpayer money for it, the
14 Ginnie Mae was one of the real beautiful
15 devices that has come along to attract private
16 capital but you use the Government's credit
17 in order to make it credit worthy."

18 And this is a situation where the Government
19 has wisely and successfully used its credit but it is
20 the Government's credit which is being used through an
21 instrumentality of the United States and that should
22 make it not subject to State property taxes.

23 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
24 Griswold.

25 The case is submitted.

1 (Whereupon, at 2:46 p.m., the case in the
2 above-entitled matter was submitted.)
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#86-251 - ROCKFORD LIFE INSURANCE COMPANY, Appellant V.

ILLINOIS DEPARTMENT OF REVENUE, ET AL.

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BY Paul A. Richardson

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