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Arthur S. Miller

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STATE POWER OVER THE FEDERAL CONTRACTOR: A PROBLEM IN FEDERALISM*

ARTHUR S. MILLER**

INTRODUCTION

Striking a proper balance between the oft-conflicting claims of the central and local governments is the continuing problem of a federal system. The problem arises in two main ways. On the one hand, it involves splitting up the jobs which any government must do between the two governments and then ironing out conflicts when overlaps occur. Here, the balance is often struck between the needs for uniformity of treatment and the interests served by viable local governments. Regulation of economic activities in interstate commerce furnishes a ready example. Or it deals, on the other hand, with the direct relationships between the two governments, their agencies and instrumentalities. Illustrative of this aspect is the wobbly path trod by the United States Supreme Court in the development of the doctrine of the intergovernmental tax immunity.

A facet of this second half of the problems of federalism has recently become evident in the field of federal contracting. Brought about by the continuing large-scale entry of the national government into the commercial market, chiefly in the form of expenditures by the military departments, the treatment to be accorded the federal contractor is a problem of increasing importance. With the contract device in frequent use by Congress as a means of attaining desired objectives in addition to fulfilling basic matériel requirements,¹ the need has come for establishing the legal status of the federal contractor and of setting out the law applicable to federal contracts.² To a large extent problems of status revolve around the question of whether the contractor with the federal agency is also amenable to state law and regulation. This, in turn, raises in a new context ancient doctrines of federal supremacy and intergovernmental relations. My purpose here

* This article is an expansion of remarks made by the author as a participant in the Fourth Annual Institute on Government Contract Law held at George Washington University in April, 1957.

** Professor of Law, Emory University; on leave of absence, 1957-58, as a Guggenheim Fellow.

1. A discussion of the use of the contract device by the federal government to attain certain nonprocurement objectives may be found in Miller, *Government Contracts and Social Control: A Preliminary Inquiry*, 41 VA. L. REV. 27 (1955). A considerable amount of government regulation of business activity does take place through resort to conditions attached to federal contracts.

2. The literature of government contract law is rapidly increasing, mostly in the form of articles in legal periodicals. That a separate body of law—a federal common law of government contracts—is being created cannot be doubted.

is that of inquiring into the questions involved in the status problem. The focus will be dual in nature: (a) on the question of how far the state may tax federal contractors and (b) on the state's power to regulate those contractors under the broad scope of its police powers.

The question of state power over the federal contractor is one which is peripheral to the main perspective of the procurement contract. It does not deal with the technicalities of contract interpretation, or with the principal preoccupations of either the federal procurement officer or the contractor. Nevertheless, it is an important problem, one which can have a very real effect on expenditures of the federal government and on the activities of the contractor.³ The precise outer boundaries of the problem area have not been fixed, although the comparatively greater amount of litigation in the taxation field has resulted in a greater development of the law. There have been few regulation cases; and in those, the courts have displayed a tendency to use tax cases as precedent in deciding regulation matters. Pending before the Supreme Court at this writing are cases on both taxation and regulation which are awaiting argument and decision in the term beginning in October 1957; these will be discussed in detail below. When decided, they may clarify much of what is still uncertain in the law relating to the status of the federal contractor vis-à-vis the various state governments.

In large measure both the federal officials, whose job it is to enter the commercial market to fulfill the government's matériel needs, and the federal contractor, wherever he may be and of whatever size he may be, tend to look upon attempts by states to tax or regulate with a skeptical eye. The state appears as some alien interloper whose activities result only in hardship and delay to the contractor and consequent annoyance and financial cost to the federal government. By

3. The billions of dollars being spent annually makes the entire question of federal procurement an important one in the national economy. Walton Hamilton has recently made the following observations: "[T]hrough the placing of contracts, the Government has alike the power and opportunity to affect the industrial structure. As the percentage which the military budget bears to the national income rises, its capacity to shape the pattern of the national economy is enhanced. The military has exhibited a preference to deal with the few rather than the many; it has shown reluctance to break down a large order which can be filled only by a giant concern into a series of smaller orders which will invite independents to bid. Thus the military, with an eye solely to defense, gives an impact to the trend toward concentration. . . . In many areas of industry, growth or decline, success or bankruptcy, depends upon how the military throws its weight around." HAMILTON, *THE POLITICS OF INDUSTRY* 21-22 (1957).

"A budget for defense which takes a substantial part of the total product of industries carries a vast power to shape the pattern of the economy. The Department of Defense, for reasons which in military terms may be sound, prefers to deal with the few rather than the many and to place orders with single concerns for large quantities of matériel. . . . The result is that the largest aggregate of purchasing power in the country is employed as an instrument for the concentration, rather than the diffusion, of economic wealth and power." *Id.* at 98.

and large, accordingly, a prevailing idea in the federal procurement circles seems to be that of avoiding, whenever possible, the impact of state intervention into contractual matters. Running through the procurement regulations is a thread of policy which has the effect of trying to insulate federal contracting from state power of whatever type. That this is not entirely justified is one of the conclusions which will be reached in this Article.

BACKGROUND OF THE PROBLEM

Before setting out the detailed state of legislation and judicial decision in the problem area, it may be helpful to fit it into the larger pattern of federal-state relations. This can be done in brief form.

Conflicts between the state and national governments have traditionally given rise to considerable litigation. A large amount of classical constitutional law deals with the definition of the proper scope of activity of each government and with their relationship to one another. Speaking broadly, the historical pattern has been one of judicial delineation of a system whereby both governments were accommodated side by side, each performing its job without undue interference from the other. This was early set in its pattern with the reiteration by Chief Justice John Marshall of the principle of federal supremacy in the area of the national government's delegated powers. The case was *McCulloch v. Maryland*⁴ and the date was 1819. Thereafter came the rise of the doctrine of reciprocal immunity of each government with respect to the other—immunity from regulation and immunity from taxation. Even so, it was not an entirely equal position in which the two governments found themselves: the scale has always reflected Marshall's belief that it should be tipped on the side of the federal government. This was particularly true in taxation, but also in regulation. To some extent, this federal pre-eminence was articulated in the notion that activities of state governments can be split into "governmental" and "proprietary" functions, while all federal activities are considered to be "governmental."⁵

McCulloch is the seminal case which set the pattern of doctrinal development in both tax and regulation matters. It established the doctrine of federal immunity from state taxation, basing it on the notion of federal supremacy, and became the landmark case in the history of the intergovernmental tax immunity.⁶ Shortly thereafter, in another tax case, the Supreme Court uttered a dictum which seems to be the first Court statement on the question under inquiry here:

4. 17 U.S. (4 Wheat.) 316 (1819).

5. See Rakestraw, *The Reciprocal Rule of Governmental Tax Immunity—A Legal Myth*, 11 FED. B.J. 3 (1950).

6. See Rakestraw, *supra* note 5, for a discussion.

Can a contractor for supplying a military post with provisions, be restrained from making purchases within any State, or from transporting the provisions to the place at which the troops were stationed? or could he be fined and taxed for doing so? We have not heard these questions answered in the affirmative. It is true, that the property of the contractor may be taxed, as the property of other citizens; and so may the local property of the Bank. But we do not admit that the act of purchasing, or of conveying the articles purchased, can be under State control.⁷

So far as regulation is concerned, the decisions, relatively sparse, have again set out what is essentially a situation of reciprocal immunity, but which is again slanted in favor of the national government. In the cases which have been decided, a distinction is made between the activities under state scrutiny—whether it is an actual federal instrumentality (as the Post Office Department) or whether it is a private organization doing business with the government. The leading case is *Johnson v. Maryland*,⁸ in which Justice Holmes used the *McCulloch* rationale to strike down a state attempt to require Post Office truck drivers to get state drivers' licenses.

In large measure, thus, the historical pattern has been one of the Supreme Court providing constitutional warrant for the unifying forces of American society. Any local regulation of a federal activity, whether or not it is part of the national government's actual activities, has usually been invalidated. On the other hand, federal attempts to regulate the activities of the states have at times been upheld.⁹ The Court has given its imprimatur not only to national regulation of economic matters under the interstate commerce clause, but also to the few efforts of the federal government to tax or regulate the actual activities of state governments.

It is against that background that the question of state power to tax and regulate the federal government can be viewed. The basic question involves a determination of whether the undoubted immunity of the federal government and its agencies from interference of any type by state governments is to be extended to an entity which is an instrumentality of the national government but not actually a part of it. Also involved is the subsidiary question of the power of Congress in this area, and the extent to which that body can either immunize federal instrumentalities from state intervention or remove such immunities.

THE STATE GOVERNMENTS VIS-A-VIS THE FEDERAL CONTRACTOR

The question of state power over the federal contractor has be-

7. *Osborn v. United States Bank*, 22 U.S. (9 Wheat.) 738, 867 (1824).

8. 254 U.S. 51 (1920).

9. One of the most recent is *California v. Taylor*, 353 U.S. 553 (1957).

come important only in recent years, largely because of the massive continuing interventions which the federal government now makes into the marketplace. As the largest buyer by far in the market, it has a pervasive influence.¹⁰ With regard to state governments the fundamental principle followed by procurement officials is that of avoiding as much state intervention into federal contracts as is possible. This is done largely through administrative decision, for Congress has usually been silent on the point. And in this tactic of avoidance of state power the federal government has found a really ally in the private contractor.

State Power to Tax the Federal Contractor

Speaking generally, states have no power to tax the federal government or any of its agencies. This notion found early expression in Chief Justice Marshall's dictum that "the power to tax involves the power to destroy" which he enunciated in *McCulloch v. Maryland*.¹¹ But a federal contractor is a private entity, one which acts autonomously save as limited by contract. Hence it is not, by the very fact that it has a consensual agreement with a federal agency, immune from state taxation. Its immunity, if any, only comes if it can be considered to be so intimately connected with the national government that it becomes, in a legal sense, a part of the Government. We have noted above the doctrinal development which serves to insulate the federal government from any state interference. To some extent the problem of state taxation of the federal contractor requires an application of the same concepts. In another sense, the problem requires that a balance be struck between the interests served by federal immunity from state intervention and the undoubted power of the states to tax whatever exists within their respective jurisdictions.

In its decisional development the Supreme Court has tended to follow a conceptual path. Rather than make what would be economic judgments about the impact of a tax and what burden in fact a tax imposes upon the federal government, the Court has erected what can be called a "legal incidence" test of validity of the tax. Accordingly, it is clear that states cannot tax a federal contractor if the legal incidence of the tax falls directly on the federal government.¹²

10. In addition to HAMILTON, *op. cit. supra* note 3, see Miller, *Military Procurement Policies: World War II and Today*, 42 AM. ECON. REV. 453 (Supp. No. 2, 1952): "For over a decade, military appropriations and expenditures have been the principal exogenous factors affecting the levels of employment, output, and expenditure in the economy."

11. 17 U.S. (4 Wheat.) at 431. Later answered by Justice Holmes when he said that "The power to tax is not the power to destroy while this Court sits." *Panhandle Oil Co. v. Mississippi ex rel. Knox*, 277 U.S. 218, 223 (1928), and termed by Justice Frankfurter to be a mere "seductive cliché," *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 489 (1939).

12. A recent illustration is *Kern-Limerick, Inc. v. Scurlock*, 347 U.S. 110 (1954).

The opposite is true: A state can tax a federal contractor if the incidence of the tax is on the contractor even though the financial burden of the tax is eventually passed on to the federal government. In this manner, the Court escapes the necessity of measuring the actual burden of the tax. At the same time, by dealing in concepts it is able to use the type of language which lawyers are accustomed to hearing.¹³

This legal incidence test characterizes a great many of the tax cases—perhaps all of them. Whatever the type of tax the state seeks to levy—whether it is a property, gross income, privilege, sales or use tax—the chief inquiry seems to be on the question of who has to bear the initial burden of the tax. If it is the federal contractor, then the tax is deemed proper and upheld; if it is the Government, then the tax is bad and invalidated. The fact that the ultimate result in both would be about the same, that is to say, the fact that the economic burden would fall in both instances on the national government and with about the same impact, has not altered the result.

Thus a state cannot tax either real or personal property the title to which is vested in the United States government. The leading case is *United States v. County of Allegheny*, decided in 1944.¹⁴ There the Supreme Court held that an ad valorem general property tax on machinery owned by the federal government and leased to one of its contractors could not be taxed by the state. But it may be significant that the state in this litigation sought to tax the entire value of the property in question, not the leasehold value of the property in the hands of the lessee. Would the result have been different had the tax been levied on the possessory interest of the contractor, rather than on the entire value of the machinery?

This question is not yet definitively resolved. Authority both ways exists, but there has been no authoritative pronouncement by the Supreme Court. Two California cases and a recent Wisconsin decision indicate that some state courts have upheld taxes on federal property when levied on less than the full ownership interest. In *Kaiser Co. v. Reid*¹⁵ an ad valorem property tax was levied on the possessory interest which Kaiser had as the tenant of shipyards owned by the United States. Calling Kaiser a "tenant for years," the California court found that such an interest was a real property interest and hence taxable. The court rejected the claimed immunity predicated

13. Cf. POWELL, VAGARIES AND VARIETIES IN CONSTITUTIONAL INTERPRETATION 139 (1956).

14. 322 U.S. 174 (1944). The fact that the United States owns some 25% of the entire nation indicates the magnitude of tax loss involved. See Miller, *State Taxation of Federal Contractors: A Proposal*, 4 J. PUB. L. 299 (1955); Deming, *Tax-free U.S. Industrial Property a Problem*, 43 NAT'L MUNIC. REV. 95 (1954).

15. 30 Cal. 2d 610, 184 P.2d 879 (1947).

on the *Allegheny County* case, on the basis that in that case "had there been an attempt . . . to segregate . . . [the] possessory interest [of the bailee] from that of the United States, the tax on [the bailee's] interest would have been upheld."¹⁶ And in *Timm Aircraft Corp. v. Byram*¹⁷ the same court reached a similar result in a case involving an ad valorem tax on a bank deposit which the federal government had established to assist the contractor in financing the contract. In 1957 Wisconsin's Supreme Court, in *American Motors Corp. v. Kenosha*,¹⁸ also found a taxable interest in federal property in the hands of a contractor.

Contrary results have been reached by other courts. Presently in the course of litigation in California, for example, are cases in which Los Angeles County attempted to tax the possessory interest of contractors in certain items of personalty. The tax was levied on the interest the contractors were asserted to have in airplanes and other military end-items in the possession of the contractors. At this writing, the only decision has been in the trial court. There, an oral decision was rendered March 22, 1957, striking down the tax, Judge Vernon W. Hunt stating that "this personal property was, on the tax date, merely in the temporary permissive custody and use" of the contractors; hence, the contractors' interest was not "personal property 'capable of private ownership' within the meaning of the California Constitution."¹⁹ And in *Detroit v. Murray Corp.*,²⁰ the Court of Appeals for the Sixth Circuit reached a similar conclusion. Using *Allegheny County* as controlling precedent, the court invalidated an attempt to tax items in the contractor's possession, the technical legal title to which had passed to the federal government through operation of the "partial payment" clause of the standard procurement contract.²¹ This case, combined with two others, is presently on the docket of the United States Supreme Court and should reach decision during the October 1957 term of the Court.

Whether the highest Court will uphold these conceptual attempts to evade past conceptualism of the Court is uncertain. Certainly it is the demand of the procurement officials of the federal government that it not do so. Large sums of money are involved, running into millions of dollars. The impact on the military budget, if the taxes

16. 184 P.2d at 890.

17. 34 Cal. 2d 632, 213 P.2d 715 (1950).

18. 274 Wis. 315, 80 N.W.2d 363 (1957).

19. Judge Hunt said that he was bound in his decision by *Douglas Aircraft Co. v. Byram*, 57 Cal. App. 2d 311, 134 P.2d 15 (1943). This case has great financial significance, for millions of dollars of potential tax are involved.

20. 234 F.2d 380 (6th Cir. 1956), *cert. granted*, 352 U.S. 963 (1957).

21. Under the partial payment clause, title to the property upon which the partial payment is made prior to completion of the contract vests in the government in its condition at the time of payment.

were to be upheld, could be substantial.²² On the other hand, loss of the potential tax income to the states could make a considerable dent in state and local revenues. The Court has not displayed any particular concern in the past for the fiscal needs of the states, an occasional statement to the contrary notwithstanding (for example, "interstate commerce must pay its way"), so it may well be that the decision will be that of refusing to recognize dual interests in personal property and thus invalidating the taxes. Some evidence to the contrary may be found in the five to four decision in 1956 in *Offutt Housing Co. v. County of Sarpy*.²³ In that case the five majority justices found a congressional expression of consent that state taxation be allowed of a leasehold of land on an Air Force base. In the course of the opinion, Justice Frankfurter had this to say: "Petitioner also argues that the state tax, measured by the full value of the buildings and improvements, is not the 'lessee's interest' but is on the full value of property owned by the Government. Labeling the Government as 'owner' does not foreclose us from ascertaining the nature of the real interests created and so does not solve the problem."²⁴ This may be a straw in the wind, portending a possible decision in which split property interests are recognized.

The other types of taxes exhibit patterns similar to that in property taxation. Thus in *James v. Dravo Contracting Co.*,²⁵ decided in 1937, the gross income of an independent federal contractor was found to be the property of the contractor; accordingly, a state gross receipts tax on that income was not invalid merely because it could be and was in fact passed on to the federal government. It is noteworthy that the federal government, in a rare burst of generosity, argued for the validity of the state's exaction in this case.²⁶ It soon repented, however, and strongly opposed the imposition of state sales and use taxes on its contractors a few years later. But the change in heart came

22. The taxes involved in the litigation in Los Angeles City and County would eventually run into many millions of dollars. See note 19, *supra*. Federal procurement officers have, without statutory warrant but relying on judicially-created law, consistently opposed attempts by states to tax federal property and federal contractors. In addition to the use of the partial payment clause, see note 21, *supra*, as a device to avoid taxes, the Armed Services Procurement Regulation contains the following statement of policy: "As a general rule, Government purchases are exempt from state and local taxes. This exemption shall be made use of to the fullest extent available, by means of purchase on a tax exclusive basis and execution of an approved tax exemption certificate." 32 C.F.R. § 11.301 (1954). Even so, the federal officials recognize that contractors are required to pay some state taxes and make appropriate provision for reimbursement. See 32 *id.* § 11.401.

23. 351 U.S. 253 (1956); Note, 18 GA. BAR. J. 202 (1956).

24. 351 U.S. at 261, citing *Millinery Center Bldg. Corp. v. Commissioner*, 350 U.S. 456 (1956). See *Fort Dix Apartments Corp. v. Borough of Wrightstown*, 225 F.2d 473 (3rd Cir. 1955).

25. 302 U.S. 134 (1937).

26. An account of this singular act may be found in 1 FREUND, CONSTITUTIONAL LAW: CASES AND OTHER PROBLEMS 701 (1954).

too late to stem the tide: in the companion cases of *Alabama v. King & Boozer*²⁷ and *Curry v. United States*²⁸ such taxes were upheld when imposed on independent cost-plus-fixed-fee federal contractors. In both of these cases, the Supreme Court found that the contractor was not an agent or instrumentality of the government. Had it done so, the result probably would have been different, as witness the 1954 decision in *Kern-Limerick, Inc. v. Scurlock*.²⁹ And in 1953 a state tax laid upon the storage of federally-owned gasoline was upheld as being a tax on the privilege of storing, and thus on the contractor, not on the property itself.³⁰ Again, the dominant principle was, to use the late Thomas Reed Powell's term, not "who is hurt, but who is hit."³¹

In two other doctrinal areas states have been inhibited in taxing the federal contractor. The first of these is the exemption which goods shipped in interstate commerce enjoy from state taxation. The federal procurement officials have seized upon this judicially created constitutional doctrine to build another method of tax avoidance. The technique is to designate a point at which the federal government takes title and delivery to property beyond the territorial boundaries of the state of manufacture.³² Military end-items, for example, which are delivered across state lines are not subject to local sales taxes, the legal incidence of which falls on the federal contractor. The cases are relatively sparse on the precise point, but a 1938 decision, *J. D. Adams Manufacturing Co. v. Storen*,³³ clearly sets out the prevailing rule. Of course, this scheme of tax avoidance could not work where partial payments are used by the procurement officials, with the consequent passage of legal title on making of such payments.

The other inhibition on state power to tax is one which is the creature of the individual states. Some state tax statutes have provisions that a purchaser who buys items for resale does not have to pay a sales tax on the first sale. The question has come up in state courts of whether a federal cost-plus-fixed-fee contractor is a purchaser for resale and thus exempt from local sales taxes. The few cases which have so far been decided indicate that this area of immunity from local taxation may also be available to some federal contractors.³⁴

The foregoing outlines in brief form the existing state of the law on state power to tax federal contractors. In sum, tax doctrine is based on a rather arid conceptualism which the Supreme Court has followed. Since the impact of taxes is economic or financial, it would seem

27. 314 U.S. 1 (1941).

28. 314 U.S. 14 (1941).

29. 347 U.S. 110 (1954).

30. *Esso Standard Oil Co. v. Evans*, 345 U.S. 495 (1953).

31. POWELL, *op. cit. supra* note 13, at 141.

32. See, for a brief discussion, Miller, *supra* note 14, at 311-12.

33. 304 U.S. 307 (1938).

34. See Miller, *supra* note 14, at 313-14.

that a more realistic approach would be that of assessing the economic impact of various state taxes on the federal government. But this the Court has not done. And neither has Congress seen fit to enter the scene and indicate its desires. Even though under prevailing law Congress has power to immunize federal contractors from state taxation or to remove existing immunities,³⁵ it has not succeeded in doing more than peck around the edges of the problem area.³⁶ At stake here are two economic interests which must be balanced—the interest in military and other federal procurement being carried on at as low a cost as possible and the interest in financially viable state and local governments. The failure of the Supreme Court to come to grips with the real problem and the failure of Congress to do anything about it at all is an unedifying commentary on the activities of those two august branches of government.³⁷

State Power to Regulate the Federal Contractor

Compared with taxation, little litigation has arisen over the extent of state power to regulate federal contractors. Consequently, there is considerable doubt as to the permissible limits of such regulation. As Corwin recently put it, "The extent to which States may go in regulating contractors who furnish goods or services to the Federal Government is not as clearly established as their right to tax such dealers."³⁸ Those cases which have been decided, moreover, are somewhat contradictory.

The most recent statement by the Supreme Court came in December 1956, in *Leslie Miller, Inc. v. Arkansas*.³⁹ In that case an attempted regulation of construction contractors was invalidated. The Air Force solicited bids for the construction of refueling facilities on an air base in Arkansas. A state statute required all contractors on any construction project of \$20,000 or over to obtain a license from the state. The low bidder, a Fort Worth, Texas firm, received the contract, but did not obtain the license. Arkansas fined the contractor under the terms of the statute. After the state's supreme court had upheld the statute,

35. See *e.g.*, *Carson v. Roane-Anderson Co.*, 342 U.S. 232 (1952), later overruled by Act of Aug. 13, 1953, c. 432, 67 Stat. 575 (1953).

36. Congress has had before it bills to provide for payments to local governments in lieu of taxes on federally owned property. See, *e.g.*, S. 2473, 83rd Cong., 1st Sess.; *Hearings before the Senate Committee on Government Operations on S. 2473*, 83rd Cong., 1st Sess. (1953). But it has not enacted any important legislation in the field. In the 1955 report of the Kestnbaum Commission, it was recommended that the federal government "inaugurate a broad system of payments in lieu of property taxes to State and local governments." U.S. COMM'N ON INTERGOVERNMENTAL RELATIONS, REPORT TO THE PRESIDENT 108 (1955).

37. Cf. POWELL, *op. cit. supra* note 13, at c. 4.

38. CONSTITUTION OF THE UNITED STATES, ANALYSIS AND INTERPRETATION 726 (Corwin ed. 1953).

39. 352 U.S. 187 (1956), 10 VAND. L. REV. 857 (1957).

resort by the contractor and the Air Force to the United States Supreme Court brought a reversal and invalidation of the licensing requirement so far as it applied to federal projects. In a per curiam decision in which *Johnson v. Maryland*⁴⁰ was cited as controlling, the Court said:

Subjecting a federal contractor to the Arkansas contractor license requirement would give the State's licensing board a virtual power of review over the federal determination of "responsibility" [of bidders] and would thus frustrate the expressed federal policy of selecting the lowest responsible bidder.⁴¹

The principle of federal supremacy was the controlling factor.

To that decision three other cases should be compared. In *Penn Dairies, Inc. v. Milk Control Comm'n*⁴² a Pennsylvania statute regulating the price of milk being sold to the Army was upheld. The fact that an economic burden was passed on to the federal government did not taint the regulation by the state. The Court relied principally on the notion that a valid local interest was being pursued at the cost of only slight interference with a federal activity. A balance of the interests involved was struck in favor of local regulation. A companion case, *Pacific Coast Dairy, Inc. v. Dept of Agriculture*,⁴³ reached a somewhat different result, but should not be thought to be contradictory. In it, the Court struck down a state attempt to set milk prices in sales to the military because the sale and delivery took place on a federal enclave. And in *James Stewart & Co. v. Sadrakula*,⁴⁴ a New York safety requirement for electrical wiring was upheld in its application to a federal contractor.

Based on the four cases just mentioned—evidence too sparse to formulate more than tentative conclusions—it would appear that a state regulation of a federal contractor will be upheld when the degree of interference is relatively slight as compared to the interest being served by the state action. Thus, in the *Leslie Miller* case the interference was major (in effect, substituting state judgment for federal in choice of contractor) while the local interest was comparatively insignificant. (Left unstated, but perhaps present, was the view that the Arkansas statute in that case could have been looked upon as an attempt to favor local business interests at the expense of out-of-state firms. Such a "balkanizing" policy could scarcely have

40. 254 U.S. 51 (1920). The most that can be said about using the *Johnson* case as controlling authority is that it is irrelevant. The factual situations of the two cases are not even remotely similar. The per curiam opinion by the Court leaves, as do many of the recent opinions by various justices, much to be desired so far as clarity is concerned.

41. 352 U.S. at 190.

42. 318 U.S. 261 (1943).

43. 318 U.S. 285 (1943).

44. 309 U.S. 94 (1940).

been viewed with favor by the Supreme Court.) And in the milk-price cases, the added economic burden on the federal government is slight viewed against the state interest being protected. The same may be said for the *Sadrakula* case. The end result may well be a "substantial burden" test of the permissible limits of state regulation of federal contractors. Under that test, any regulation of a private enterprise which substantially interferes with a federal function would be stricken. Under such a test the Supreme Court is engaging in an interest-balancing endeavor, rather than mechanically applying concepts.

Whether that conclusion is valid or not may well be determined by the decision in a case now pending before the United States Supreme Court: *United States v. Public Utilities Comm'n.*⁴⁵ At issue is a 1955 amendment to the state's Public Utilities Code. This amendment⁴⁶ changed the former policy of special treatment of truck shipments of United States property by providing that "the Commission may permit common carriers to transport property at reduced rates for the United States . . . to such extent and subject to such conditions as it may consider just and reasonable." Contesting the validity of this amendment on the dual grounds of an unreasonable and unnecessary burden on the federal government and also of an unreasonable burden on interstate commerce, the United States prevailed before a three judge federal court. The court agreed on the former ground and did not find it necessary to rule on the latter. It invoked General Nathan Bedford Forrest's oft-quoted admonition "To git thar fustest with the mostest men" and concluded that the amendment was "invalid, void and of no effect, as contravening the provisions of the United States Constitution relating to the national defense. . . ."⁴⁷

Were this a case where state regulation would merely add a rather small pecuniary burden on the federal government little doubt exists that the regulation would be upheld by the Supreme Court. The *Penn Dairies* case would be directly in point. But the government has treated it as more than that. All stops were pulled out by the military departments before the district court. Invoked, in addition to the shade of General Forrest, was the horrible possibility that state regulation would end in "an administrative morass out of which we would never fight our way, [and] *we would never win the war!*"⁴⁸ (Left unmentioned was what war the court had in mind.) Also, the problem of maintaining the security of secret military goods was raised, in addition to the view that state regulation would greatly add to the cost of transportation. An array of high-ranking officers appeared as wit-

45. 141 F. Supp. 168 (N.D. Cal. 1956). For a contrary result see *Hughes Transportation v. United States*, 128 Ct. Cl. 221, 121 F. Supp. 212 (1954).

46. CAL. PUB. UTIL. CODE ANN. § 53 (Deering, Supp. 1957).

47. 141 F. Supp. at 190.

48. *Id.* at 176.

nesses, all testifying to the chaos which they envisaged would result from enforcement of the state law. All of these representations were accepted by the court, which seemingly was overwhelmed by the display of military officialdom and the graciousness of the officers even to appear in court. Judge Lemmon's rather florid opinion ended on the following note:

In a dictatorship, the warlords do not even *demand*—much less *request*—authority to negotiate with private parties for the supply of their war needs. Autocrats *take* what they want!

It is therefore a heartening spectacle, in a constitutional democracy, to see a group of military men, speaking for the sovereign itself, appear in a civil court to *plead* to be allowed to carry out their constitutional functions by being permitted to contract freely with privately owned carriers to supply the government's transportation needs.⁴⁹

Whether such an array of military brass using similar arguments would also overawe and persuade the United States Supreme Court remains to be seen. Recent Court decisions indicate that present-day justices are able to place hyperbole in its proper perspective. Accordingly, it is likely that the Court will weigh the greater, albeit slight, added burden to the federal activity against the state's interest in the regulation of common carriers. In striking a balance between the two, whatever the result may be, the Court will have the opportunity to clarify some of the present doubt about the extent of permissible regulation of federal contractors.

If the California statute is invalidated, it will not necessarily mean that all state action setting prices for federal contractors, as a part of a greater regulatory scheme encompassing all similar business interests within the state, will also be invalid. State rate regulation of intrastate shipments of government property could continue to be valid. The crux of the opposition to California's statute seems to be, not the added cost to the military departments, but the possibility that additional, though unknown (and repudiated by California officials), regulation could take place. California's law seeks to empower the Public Utilities Commission to "impose such conditions as it may consider just and necessary." (Unless additional conditions are in fact imposed, conditions which could be called an undue or substantial burden, would the statute be invalid? Probably not, for it is not the statute as written, but as administered, which is important. The mere existence of a possible threat, a possibility which may never eventuate, is not by itself sufficient to allow challenge of its constitutionality.)⁵⁰ Other state statutes which seek merely to require that carriers

49. *Id.* at 190. The charitable view to take of Judge Lemmon's opinion is that, as the quotation indicates, he is begging the question before the court.

50. Otherwise, a judicial decision would be an advisory opinion, something federal courts do not render.

must haul for all at the same rate would not necessarily come within a decision invalidating California's statute. Georgia, for example, has a statute⁵¹ which does not mention the federal government; in the administration of this statute, the state officials seek to have the federal government treated identically with other contractors for intrastate shipments of goods. Although the Comptroller General of the United States thought otherwise, this could easily be held to be distinguishable from the California case.⁵²

In any event, here is a problem area in need of some clarification. So long as the national government and its activities occupied only a minor role in American life, there was little need to establish the status of the federal contractor vis-à-vis state governments. But when, as is now the case, the federal government makes continuing major interventions into the marketplace, it has become important that the status of the federal contractor become clear. It would be desirable from three standpoints—the federal procurement officer, the state officials, and the contractor himself—to know how far a state can go in regulating the federal contractor, as well as how far the state can go in taxing that contractor.

Here, again, Congress has undoubted power to step in and set the matter straight. But again, Congress has been even more reluctant to do so than in the taxation field. At stake here is not the financial burdens involved in the problem of state taxation of federal contractors, but of balancing the state's exercise of its police powers with

51. GA. CODE ANN. § 68-614 (1957).

52. In Decision B-128238, 36 Comp. Gen. 218 (Sept. 18, 1956), the Comptroller General cited the California case as controlling the question of whether a state may set rates for the intrastate truck shipments of federal property.

It is worthy of mention that such a decision does not render a state powerless. For example, the Georgia Public Service Commission retaliated to the Comptroller General's decision by ordering a trucker to show cause why his certificate of convenience of necessity should not be revoked for failure to comply with the Georgia law setting rates for truck shipments. The trucker had bid on a Navy contract for the shipment of household goods at rates other than those prescribed by the Public Service Commission. The Commission suspended the trucker's certificate until it was demonstrated that violations had ceased. *Rule Nisi Against Flanigan The Moving Man, Inc.*, File No. MCA-8789, Docket No. 1134-M, Ga., May 20, 1957. It would seem, thus, that the federal government may, in some instances at least, find itself unable to enter into any contracts for some required services unless it is willing to dispense with its price competition policies.

It is also noteworthy that the Hoover Commission recommended that the practice of hauling federal property free or at reduced rates in interstate commerce be eliminated. See U.S. COMM'N ON ORGANIZATION OF THE EXECUTIVE BRANCH OF THE GOVERNMENT, SUBCOMMITTEE REPORT ON TRANSPORTATION 31-55 (1955): Recommendation No. 21 of the Commission (see their Report on Transportation c. VIII) reads in part as follows: "That the National Transportation Policy, as set forth in the Interstate Commerce Act, the Civil Aeronautics Act and the Merchant Marine Act, be studied and revised by the Congress to make it more definite and detailed. When this is done the Government in its capacity as a user of transportation should conform to that policy with respect to its commercial-type traffic." *Id.* at 96.

the interest in the unfettered operation of national governmental activities.

SOME CONCLUDING OBSERVATIONS

It was recently maintained that "the increasing participation of public authority in contracts creates the wider and as yet generally unexplored problem of the dual function of the state, as a superior and as an equal."⁵³ The position of the federal government as a contractor is in need of clarification, both with regard to its position vis-à-vis the contractors themselves and with regard to whether the traditional immunities of the federal system will be held to apply to its contractors. Much of the law applicable to federal contracts is not yet settled; much of it is in the process of formation, drawing varying interpretations.⁵⁴

The organ of government in the best position to accomplish this job of clarification is Congress. But it is improbable that it will be so done. Congress has shown little interest in wanting to deal comprehensively with the problem or with any of its facets.⁵⁵ Left, accordingly, to the judiciary will be the problem of establishing doctrinal categories at such times as the accident of litigation has brought a sufficient number of diverse factual situations before the courts. When the job is being done—ultimately by the Supreme Court—no doubt one of the chief motivations will be considerations of federalism, the notions of the proper sphere of activity for the two systems of government. Certainly no major departure from the historical doctrinal pattern can be forecast. However, it is entirely possible that some regulation, as well as some taxation, of federal contractors by the states will be upheld. The contractor will probably have to obtain local licenses,⁵⁶ and may well be subject to some price regulation.

53. FRIEDMANN, *LAW AND SOCIAL CHANGE IN CONTEMPORARY BRITAIN* 44 (1951).

54. See Pasley, *The Interpretation of Government Contracts: A Plea For Better Understanding*, 25 *FORDHAM L. REV.* 211 (1956).

55. It may well be that the only people who are really interested in preserving the essentials of a viable system of dual federalism are some Supreme Court Justices—for example, Justice Frankfurter, who in some of his opinions displays concern for the maintenance of such a system—and some academicians, see the several articles compiled in *FEDERALISM: MATURE AND EMERGENT* (MacMahon ed. 1955). Neither of these have, in final analysis, the power to do much about establishing and maintaining such a system. Congressmen elected from local districts and even state governors have not been particularly interested in doing anything significant about changing the present-day system of national federalism, the pious protestations in too numerous political speeches to the contrary. In this regard the reaction of state governors to President Eisenhower's proposal in June 1957 to return some federal power to the states is instructive. See note 58, *infra*.

56. Compare the recent decision in *Public Housing Administration v. Bristol Township*, 146 F. Supp. 859 (E.D. Pa. 1957) (upholding state requirement of license for federal contractor on a housing project) with Decision B-131556 of the Comptroller General of the United States, rendered May 27, 1957, 25 *U.S.L. WEEK* 2587 (June 11, 1957) (no state license required for construction contract at an Air Force base in California, the decision being based on the *Leslie Miller* case).

For the state governments, the job would be that of building as compelling a case as is possible for the necessity of overall state regulation to protect important local interests. In addition to that, there is the opportunity for the legal craftsman to help the Supreme Court steer its way out of the conceptual paths it has gotten itself into. This would be true for both taxation and regulation. More than conceptualism is involved here: the use of concepts hides the real policy choices to be made. And so long as Congress retains the power, under the principle of federal supremacy, to protect any federal activity, Chief Justice Marshall's dictum that the power to tax is the power to destroy has little validity. Moreover, as was recently stated, "Today . . . this original concept [enunciated by Marshall] is now available as a tool for the former potential victim to throttle the former potential destroyer."⁵⁷ Even under a conceptual approach, it may be possible to avoid the impact of the legal incidence test of taxation of federal property by creating persuasive arguments to show that a taxable interest in federally-owned property rests in the possessor (the contractor) of the property.

Taxation and regulation, although dealt with together in the cases, may possibly end with differing results. It is easily provable that states have a valid interest in additional revenue to come from the federal contractor; and it is true that the burden of such taxes would at most be economic. The states provide services for the contractors—fire protection, police protection, schools for the employees, and so on—which are benefits conferred on the contractor. It is equitable that the state be in turn reimbursed for these services by the recipients of the benefits. A compelling case can be constructed for more taxation, a case which in essence would look for the preservation of strong local governments.⁵⁸ The fiscal requirements of the states would not be satisfied by allowing for more taxation of federal contracting activities, but it would be at least a step in that direction.

57. Statement by Congressman D'Ewart of Montana, appearing in *Report on Taxes and Other In-lieu Payments on Federal Property VII* (report prepared by LEGISLATIVE REFERENCE SERVICE, LIBRARY OF CONGRESS, under title of FEDERAL LAND OWNERSHIP AND THE PUBLIC LAND LAWS, 83d Cong., 2d Sess. 1954).

58. In an address at the Conference of State Governors on June 24, 1957, President Eisenhower challenged the states to reassert their traditional powers and responsibilities. See *N.Y. Times*, June 25, 1957, p. 16, col. 2. This was essentially a call for both "states' rights" and "states' responsibilities." The reception the President received was lukewarm at best, the governors displaying a remarkable lack of interest in shouldering more responsibilities. Apparently some of them were horrified that anyone, least of all the President, would take their speeches about "states' rights" seriously.

Nevertheless, there are values for the preservation of which a viable system of dual federalism may be the best vehicle. See, in this regard, WHITE, *THE STATES AND THE NATION* (1953); ANDERSON, *THE NATION AND THE STATES, RIVALS OR PARTNERS?* (1955); Freund, *Federalism in America*, 10 *PERSPECTIVES USA*, Winter 1955, p. 5.

But regulation poses different questions, and when imposed, is designed to further different interests. Here it may be more difficult to build a strong case for the local interests which should be served. Here the substantiality of the resulting burden on the federal government may well be the touchstone of validity. When the regulation is one for fire protection or other safety measures, then the state power should, and doubtless would, be upheld. If, however, the regulation is one for furthering some such interest as the lessening of out-of-state competition, as may have been true in the *Leslie Miller* case, then the local interest is slight indeed and should be struck down. Price regulation of shipments of federal property intrastate should, it would seem, be upheld, for the slight additional economic burden is of no consequence to the federal government.

In either instance—taxation or regulation—the federal contractor should not be completely immune from state power. Save in examples of actual substantial conflict with a federal activity, the private contractor should be subject to the same laws as are other private business firms in the state. It receives the benefits and protections of state law, and it should have the responsibility of adhering to it and helping pay for it. It is understandable that federal procurement officials would wish to minimize state intervention into contracting matters. Their job is one of extreme complexity and great difficulty. Adding further elements of uncertainty and further cost to the budget, while certainly not insuperable would add to the complexity and difficulty. But if there are interests to be served by strong state and local governments, then the additional burden should not be held to control the course of judicial decision. A regard for the niceties of a viable federal system will cut through resort to outmoded concepts. A regard for the values to be protected by a viable system could well have some influence on the flow of decisions, whether legislative or judicial in origin.⁵⁹

59. Cf. the dissenting opinion of Mr. Justice Murphy in *Pacific Coast Dairy, Inc. v. Department of Agriculture*, 318 U.S. 285, 303 (1943).