

LIBRARY
SUPREME COURT, U.S.
WASHINGTON, D.C. 20543

OFFICIAL TRANSCRIPT
PROCEEDINGS BEFORE
**THE SUPREME COURT
OF THE
UNITED STATES**

CAPTION: UNITED STATES, Petitioner v.

ENERGY RESOURCES CO., INC., ET AL.

CASE NO: 89-255

PLACE: Washington, D.C.

DATE: March 19, 1990

PAGES: 1 - 52

ALDERSON REPORTING COMPANY

1111 14TH STREET, N.W.

WASHINGTON, D.C. 20005-5650

202 289-2260

1 IN THE SUPREME COURT OF THE UNITED STATES

2 -----x
3 UNITED STATES, :

4 Petitioner :

5 v. :

No. 89-255

6 ENERGY RESOURCES CO., INC., :

7 ET AL. :

8 -----x
9 Washington, D.C.

10 Monday, March 19, 1990

11 The above-entitled matter came on for oral
12 argument before the Supreme Court of the United States at
13 10:02 a.m.

14 APPEARANCES:

15 ALAN I. HOROWITZ, ESQ., Assistant to the Solicitor

16 General, Department of Justice, Washington, D.C.; on
17 behalf of the Petitioner.

18 GUY B. MOSS, ESQ., Boston, Massachusetts; on behalf of the
19 Respondent.

C O N T E N T S

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

<u>ORAL ARGUMENT OF</u>	<u>PAGE</u>
ALAN I. HOROWITZ, ESQ. On behalf of the Petitioner	3
GUY B. MOSS, ESQ. On behalf of the Respondent	29
<u>REBUTTAL ARGUMENT OF</u>	
ALAN I. HOROWITZ, ESQ. On behalf of the Petitioner	49

P R O C E E D I N G S

(10:02 a.m.)

CHIEF JUSTICE REHNQUIST: We'll hear first this morning in Number 89-255, United States against Energy Resources Co.

Mr. Horowitz.

ORAL ARGUMENT OF ALAN I. HOROWITZ

ON BEHALF OF THE PETITIONER

MR. HOROWITZ: Thank you, Mr. Chief Justice, and may it please the Court:

This case involves two different bankruptcy court disputes that were consolidated on appeal in the First Circuit. They present a single issue: whether the bankruptcy courts erred in ordering the IRS to apply the periodic payments of priority taxes that are required under a Chapter 11 reorganization plan, applying those payments first to satisfy the debtor corporation's trust fund tax liability. That is, the withholding tax liability for which the corporation's responsible officers are separately and personally liable.

This order prevents the IRS from applying any of these periodic payments to the corporation's other, nontrust fund tax liabilities, for which there is no other source of collection, until the trust fund liability is completely satisfied. In the absence of this court order,

1 the IRS would apply the periodic payments in the reverse
2 manner, in accordance with its usual practice.

3 As the court of appeals frankly acknowledged --

4 QUESTION: Is there some basis in law for the
5 IRS allocation? They say they have the right to allocate
6 it -- they permit the taxpayer to do it with voluntary
7 payments.

8 MR. HOROWITZ: That's -- the IRS has a policy of
9 permitting the taxpayers to designate --

10 QUESTION: Well, is there some basis in law for
11 that?

12 MR. HOROWITZ: There is no, there is no legal
13 provision that directs the IRS how to allocate, either
14 voluntary or involuntary or any other kind of payment. So
15 this policy pretty much comes out of common sense. It is
16 pretty much the same way --

17 QUESTION: The IRS is just big hearted on
18 voluntary payments? I find that hard to believe. You
19 really think that you're --

20 MR. HOROWITZ: It's not a question of being --

21 QUESTION: -- that you're complying with some
22 common law rule?

23 MR. HOROWITZ: It's not a question of being big
24 hearted, I don't think, Justice Scalia. In a normal
25 commercial setting, when a debtor makes a payment to a

1 creditor and attaches a condition to it, the creditor
2 normally is forced to accept that condition, because if he
3 doesn't do that the debtor can pull back the payment and
4 say look, if you're not going to accept that condition,
5 then I am not going to pay you.

6 Now, the IRS is not quite in the same position,
7 because it has administrative remedies. It can assess the
8 tax and go out and levy on it. But the IRS prefers not to
9 do that. It prefers to get voluntary payments. It saves
10 a lot of costs of collection and what not. So the IRS has
11 a matter of policy of encouraging taxpayers to pay
12 voluntarily, rather than requiring the IRS to go to court
13 or to seize onerous designations of voluntary payments.

14 QUESTION: It seems to me there are other
15 penalties for forcing the IRS to go to court. They really
16 have to give them that free gift in order to induce them
17 not to go to court?

18 MR. HOROWITZ: I don't think --

19 QUESTION: It seems to me that you're doing this
20 for voluntary payments simply because that's what the law
21 is. That is how voluntary payments are. If I give you
22 money for X, you either accept it for X or you give it
23 back to me. That's the law in every other -- in private
24 transactions. Why wouldn't it be so with regard to the
25 IRS? If they want to use it for something else they say

1 I'm sorry, we can't accept the limitation, but if you
2 don't accept the limitation you don't accept the payment.

3 MR. HOROWITZ: Your Honor, that's --

4 QUESTION: You consider these to be involuntary
5 payments?

6 MR. HOROWITZ: Well, in this case these are
7 involuntary payments. Justice Scalia asked me about
8 voluntary payments, I think. I am just answering that.

9 That is true, the taxpayer can then withdraw the
10 payment, and the IRS would then have to go to court to get
11 it. So the situation is similar. The IRS has a little
12 more power. It doesn't have to go to court, excuse me.
13 It can also take administrative action and prefers not to
14 do that.

15 So, as a practical common sense way of
16 administering the tax laws in the same practical common
17 sense way that private debtors and creditors deal with it,
18 the IRS accepts these designations. It seems like a
19 perfectly reasonable thing to do, whether it is required
20 to do so by law, by something that is implicit in the
21 Code, maybe it is, maybe it isn't. But it has never
22 really been an issue.

23 QUESTION: Well, is it your claim in this case
24 that the district court was, that the bankruptcy court was
25 bound to respect the IRS policy with respect to

1 involuntary payments?

2 MR. HOROWITZ: Our position here is that the
3 bankruptcy court had nothing to do with how the IRS was
4 going to allocate payments. There is a payment -- the IRS
5 is owed a certain amount of taxes. Under the Bankruptcy
6 Code these taxes are of equal priority. No reason for the
7 bankruptcy court to distinguish between the nontrust fund
8 and the trust fund taxes.

9 QUESTION: But do you think there is some legal
10 -- some legal basis that you argue that the bankruptcy
11 court was wrong, namely that it should have -- it should
12 have preserved your right to get at this -- at the
13 officers?

14 MR. HOROWITZ: Well, we are -- we do argue,
15 which I plan to explain in more detail a little bit later,
16 that there are a lot of policies that are embodied both in
17 the Internal Revenue Code and the Bankruptcy Code that --
18 with which there is at least some tension with what the
19 bankruptcy court did here. There is no -- there is
20 obviously no specific provision in the Bankruptcy Code
21 that either permits or forbids the bankruptcy court from
22 doing this. Otherwise this case probably wouldn't be
23 here. This is --

24 QUESTION: The reason it is important to me, why
25 the IRS is -- does this with respect to voluntary

1 payments, is I have no idea what the difference is between
2 voluntary and involuntary, or where one looks for that
3 distinction, except you invite us to look to what the IRS
4 has done in the past. And you seem to assert that we
5 should be bound -- it is voluntary where the IRS says it
6 is voluntary, and it is involuntary where the IRS says it
7 is involuntary. What else do you tie that distinction to,
8 unless it is the will of the IRS?

9 MR. HOROWITZ: I think the IRS' own policy is
10 just tied to the will of the IRS. Now, you are suggesting
11 that there is some -- some law or something that requires
12 the IRS --

13 QUESTION: It's called the common law, it was
14 called.

15 MR. HOROWITZ: Well, I don't think there is any
16 common law rule that requires the IRS to do this, or that
17 the common law binds the IRS. And so now the bankruptcy
18 court held -- I'm sorry, the court of appeals held that
19 there was something that prevented the IRS from applying
20 its policy in this case, namely the bankruptcy court's own
21 authority to deal with these payments. And that is where
22 the issue is --

23 QUESTION: But you choose to call this
24 involuntary. And you want us to accept it because you
25 choose to call it involuntary.

1 MR. HOROWITZ: Well, I think to the extent that
2 some of the bankruptcy courts in this area have fought
3 over what the IRS' policy is, I think you are right.

4 That's the wrong place to fight the battle. The IRS'
5 policy is that this is involuntary, and as far as --

6 QUESTION: All the lower courts upheld that
7 conclusion, didn't they, that --

8 MR. HOROWITZ: All the courts of appeals have.
9 There are some bankruptcy courts --

10 QUESTION: That these were involuntary payments.

11 MR. HOROWITZ: Yes, that is correct.

12 QUESTION: Then the question we granted
13 certiorari on is whether the authority of the bankruptcy
14 court to allocate tax payments under these circumstances.

15 MR. HOROWITZ: Well, that's true. Just to
16 finish the point, it's a very sterile inquiry as to
17 whether this is the IRS' policy or not. I mean, we think
18 clearly it is, but if it isn't, if the court somehow takes
19 the view that the IRS is misapplying its own policy and
20 doesn't know what it means by the distinction that it has
21 drawn, then I imagine the IRS will probably clarify that.

22 And I think the real issue here is whether there
23 is some law, either the common law, and we think there is
24 nothing that has been suggested as any common law bar to
25 it, or whether there is something in the bankruptcy

1 court's power that prevents the IRS from applying these
2 payments which it receives, becomes its money on its
3 books, in a way that will preserve its security and its
4 ability to collect.

5 QUESTION: Mr. Horowitz, did the bankruptcy
6 court have the power to approve these plans over the
7 objections of the IRS?

8 MR. HOROWITZ: The bankruptcy court is required
9 under Section 1129 -- Section 1129 sets forth a lot of
10 requirements for confirmation of a plan, and the
11 bankruptcy court can only confirm a plan if it meets those
12 requirements. Whether or not the IRS objects, it would
13 object on a ground that one of those provisions of 1129
14 was not satisfied. So, the bankruptcy court can overrule
15 the IRS' objections if it concludes that the plan
16 satisfies the legal requirements.

17 QUESTION: Does the IRS have an express policy
18 in its manual to the effect that it will comply with
19 orders of the bankruptcy court?

20 MR. HOROWITZ: Absolutely. We will comply with
21 the order of the bankruptcy court, but we reserve the
22 right to appeal it, which is what we have done here. So
23 if we lose this case in the Supreme Court we will abide by
24 the designation.

25 QUESTION: One of these plans actually provided

1 for the prior allocation of these payments to the ordinary
2 tax liability.

3 MR. HOROWITZ: To the trust fund tax liability.

4 QUESTION: Yes.

5 MR. HOROWITZ: Yes. Well, what happened in the
6 Energy Resources case was that the -- one of the
7 requirements of Section 1129 is that all of the priority
8 taxes, which includes both components here, have to be
9 paid in full over, within a six-year period. So, when the
10 first payment was made in that case, the debtor sent a
11 letter saying we would like these payments to be applied
12 first to the non -- excuse me, to the trust fund taxes.
13 And the IRS wrote back and said well, we're not going to
14 do that unless you get a court order.

15 QUESTION: Yes.

16 MR. HOROWITZ: And then they went and got a
17 court order, which is where --

18 QUESTION: In the other case now, the other case
19 -- what about the other case?

20 MR. HOROWITZ: The other case, as I recall, they
21 just went and got a court order first.

22 QUESTION: Well, there was a -- I think there
23 was a provision in the plan, wasn't there, to pay --

24 MR. HOROWITZ: Well, there may have been a
25 provision in the plan to which the IRS objected, and

1 claimed that the bankruptcy court does not have the
2 authority to require us how to -- remember, what the
3 bankruptcy court has done here is -- there is no question
4 that the money is being paid to the IRS. The question
5 then is how the, once it becomes the IRS' money, how the
6 IRS is going to deal with it on its books, which liability
7 is it going to say has been satisfied.

8 QUESTION: You mean the question is whether it
9 becomes the IRS' money, until the IRS agrees to accept it
10 in the manner in which is it offered.

11 MR. HOROWITZ: Well, that I think is the
12 difference between what everyone agrees is a voluntary
13 payment and what we have here, because under Section 1129
14 there is no plan, unless the IRS -- these payments are
15 made to the IRS. The debtor has no discretion not to make
16 the payments if the IRS says we are not going to designate
17 them the way you want, then it's just too bad for the
18 debtor. He has no choice. (Inaudible).

19 QUESTION: If we were to rule against you in
20 this case, would the IRS in future reorganizations have
21 the capacity to object to a plan and block a
22 reorganization on the grounds that it objected to the
23 allocation?

24 MR. HOROWITZ: If you hold that the bankruptcy
25 court has the power to --

1 QUESTION: Right.

2 MR. HOROWITZ: No, I don't think so. We can
3 only object on the grounds --

4 QUESTION: In other words, as a creditor it
5 could not object to the approval of the plan?

6 MR. HOROWITZ: That is right. The IRS, as long
7 as the requirements for payment of taxes that are
8 specified in the statute are satisfied, if the plan
9 complies with that, then the IRS can't object. And if
10 there are, as in this case we contend, if there is no
11 other provision in the plan that somehow is violative of
12 law. But we -- the IRS does not have the authority to
13 just veto the plan because it doesn't like it.

14 QUESTION: I am surprised that you say that the
15 trust fund taxes and the other taxes are of the same
16 quality, or they --

17 MR. HOROWITZ: Same priority.

18 QUESTION: Same priority, is that what you say?

19 MR. HOROWITZ: Same priority.

20 QUESTION: But the trust fund taxes belong to
21 somebody.

22 MR. HOROWITZ: Well, they once belonged to
23 somebody. They once belonged to us.

24 QUESTION: Yes.

25 MR. HOROWITZ: There was a trust fund, and there

1 are a lot of rights that the IRS has in that trust fund as
2 long as it exists. In fact, as long as the trust fund can
3 be identified prior to bankruptcy, those funds don't go
4 into the estate at all.

5 QUESTION: That's right.

6 MR. HOROWITZ: But what's happened here is that
7 the trust funds have completely been dissipated by the
8 officers. There is no way of identifying any trust funds
9 in the estate. And so at this point all you have are tax
10 liabilities. There is no longer any fund to which the IRS
11 can make a claim of its own money. There are just tax
12 liabilities. And Congress has given the same priority to
13 both of these kinds of tax liabilities.

14 QUESTION: Well, the court of appeals ruled that
15 the equitable power of the bankruptcy court included the
16 power to prefer the restoration or the payment of these
17 trust fund taxes first.

18 MR. HOROWITZ: That is what the court of appeals
19 held, incorrectly in my view.

20 QUESTION: Were these monies generated after the
21 petition was filed or before the petition was filed?

22 MR. HOROWITZ: The payments that are being made?

23 QUESTION: Not the payments, the money that is
24 being used to make the payments. Was there a cash
25 surplus?

1 MR. HOROWITZ: I would guess that it was
2 generated after the petition was filed.

3 QUESTION: Because if it was generated before,
4 then it would have had to go to the IRS.

5 MR. HOROWITZ: I think the IRS had a claim, yes,
6 that it was not to be put in the bankruptcy estate at all,
7 but --

8 QUESTION: And it would have belonged definitely
9 in the trust fund --

10 MR. HOROWITZ: Right.

11 QUESTION: -- under your theory in this other
12 case.

13 MR. HOROWITZ: Yes. And if that happened, of
14 course, then the plan would only be paying out the
15 nontrust fund taxes and we would be getting paid those
16 taxes at the very beginning, instead of being pushed off
17 effectively to the very back end of the plan, which is
18 what is happening here.

19 As the court of appeals said at page 3(a) of its
20 opinion, the only thing that turns on this dispute is who
21 bears the risk that the reorganization will not be fully
22 successful. That is, that all the payments contemplated
23 in the plan will not be made. Is it the IRS and the
24 taxpaying public, or is it the responsible officers of the
25 corporation?

1 The designation provision that the court imposed
2 here works to the advantage of these officers at the
3 expense of the government.

4 QUESTION: You said the designation provision
5 which the court imposed. You mean the bankruptcy court?

6 MR. HOROWITZ: Yes, I mean the bankruptcy court.

7 QUESTION: And how would you describe it?

8 MR. HOROWITZ: The bankruptcy court ordered the
9 IRS to apply the payments that it receives first to all of
10 the trust fund liability of the corporation. And only
11 after the trust fund liability has been completely
12 satisfied, which in turn completely eliminates the
13 separate liability of the officers, because the IRS only
14 collects those liabilities once, only then can the IRS go
15 and apply any of the payments to the nontrust fund
16 liabilities.

17 QUESTION: But these payments are being made out
18 of the bankruptcy estate, right?

19 MR. HOROWITZ: That is correct.

20 QUESTION: And need the authority of the
21 bankruptcy court to make them.

22 MR. HOROWITZ: Well, the -- what the bankruptcy
23 court does is it confirms the plan of reorganization. And
24 then the debtor continues to operate the company within
25 the parameters of the plan. The plan requires that

1 certain payments be made on a schedule to the IRS. So
2 each time a payment is made I don't think the debtor has
3 to go to the court for approval. It has already been set
4 up by the plan, and in fact required by the plan.

5 QUESTION: You just follow the plan.

6 MR. HOROWITZ: You follow the plan, right.

7 QUESTION: There is no regulation, formal
8 regulation relating to this controversy, is there?

9 MR. HOROWITZ: As far as how the IRS allocates
10 payments?

11 QUESTION: Yes.

12 MR. HOROWITZ: No, there are various revenue
13 procedures about how the IRS allocates this money first.

14 Now, the only purpose of the designation is to
15 give an advantage to the responsible officers of the
16 corporation. The idea is so that the partial payments
17 that have been made, if the plan ends up failing and all
18 the payments are not made, will be used so as to minimize
19 those officers' personal liability under Section 6672. It
20 makes no difference to the debtor, and no direct
21 difference to the other creditors, how these payments are
22 designated.

23 The other party that cares about it is the IRS,
24 because what the designation does is it thwarts the
25 government's goal of ensuring collection -- of maximizing

1 the collection of all of its taxes.

2 QUESTION: The plan is silent on this point, I
3 take it, as to how the IRS is to apply the payments?

4 MR. HOROWITZ: No. There is a provision in the
5 plan that the IRS has to apply it to the trust fund taxes.
6 That is what the government is objecting to, the
7 bankruptcy court's power to include such a provision in
8 the plan.

9 QUESTION: In both cases, then, there is a
10 provision -- the plan specifies how the payments are to be
11 made?

12 MR. HOROWITZ: I believe so. Well, I'm sorry,
13 what do you mean by how, how the payments would be applied
14 --

15 QUESTION: Well, how the payments will be
16 applied by the IRS.

17 MR. HOROWITZ: There is a court order, I think
18 it's incorporated in the plan in at least one case --

19 QUESTION: I think it is in one and not in the
20 other. That's my --

21 QUESTION: They just went to court for the
22 order, but --

23 QUESTION: Well, what -- what if the debtor
24 here, if they simply, without any approval of the
25 bankruptcy court other than the plan, it simply made this

1 payment and said I want it applied to the trust fund
2 liabilities?

3 MR. HOROWITZ: Well, at what stage do -- you
4 mean before he went into bankruptcy?

5 QUESTION: No, no. Right now. At the point he
6 made this payment.

7 MR. HOROWITZ: Well, I don't know. If it's
8 before the confirmation of the plan, then he is not
9 subject to a court order requiring him to make that
10 payment. He is also, I am not sure he would be paying the
11 taxes at that point until a plan had been confirmed,
12 because the other creditors would be negotiating about it.
13 So I am not sure how that would come up. I think the IRS
14 -- if it was -- if they weren't already in Chapter 11, I
15 think the IRS' view would be that it would, the IRS would
16 have the power to allocate those payments. And if you
17 want to do that as a voluntary payment at that stage, then
18 the IRS would probably say well just wait until the plan
19 is confirmed.

20 But once they -- when the debtor goes into
21 Chapter 11 there is an automatic stay that goes into
22 effect invoking the protection of the bankruptcy court
23 holding off all the creditors, holding them at bay with
24 the powers of the court. But at the same time they have
25 to give up certain rights. And one of the rights they are

1 giving up is -- they are required to abide by a plan that
2 requires full payment of all these priority taxes. There
3 is no discretion left to the debtor at that point as far
4 as paying the taxes.

5 QUESTION: (Inaudible) before the bankruptcy
6 either. Did they have the discretion to pay or not to pay
7 their taxes before they went bankrupt?

8 MR. HOROWITZ: They were -- they were under a
9 legal obligation to pay, but they weren't subject to a
10 court order. And the IRS has taken the view, as I said
11 before, to encourage people to pay without having to go to
12 court or to seize their assets. We are going to allow
13 them to designate at that point.

14 QUESTION: And in fact they had a duty, I
15 suppose, to pay the trust fund obligation first. If they
16 didn't have enough money to pay both the general
17 obligation and the trust fund obligation, their duty would
18 have been to pay the trust fund obligation first --

19 MR. HOROWITZ: That is correct.

20 QUESTION: -- the day before bankruptcy.

21 MR. HOROWITZ: That is correct. There never
22 should have been a trust fund liability --

23 QUESTION: And that of course is just for the
24 benefit of the officers of the corporation in a sense.

25 MR. HOROWITZ: That would benefit, well --

1 QUESTION: It's the same, the same mix of
2 allocation of risks as you have the day after the
3 bankruptcy.

4 MR. HOROWITZ: Well, but the difference is, if -
5 - you are suggesting that there is no trust fund liability
6 in the bankruptcy at all --

7 QUESTION: No, no, no. I am saying -- I am
8 suggesting there is -- if there is money there, that the
9 duty is to discharge that obligation first, because it
10 isn't really a -- it's somebody else's money, it's the
11 employees' taxes that have to be paid.

12 MR. HOROWITZ: Well, if there is money there
13 then it's not part of the bankruptcy, and it is being paid
14 before the bankruptcy, whether you want to say it's
15 technically or really, but it is being paid outside the
16 bankruptcy. So then at that point when you get into the
17 bankruptcy the government is going to get the nontrust
18 fund tax payments in short order. So --

19 QUESTION: But you say the equities, or the
20 priorities should suddenly change the day the bankruptcy
21 petition is filed.

22 MR. HOROWITZ: It's not a question of the
23 priorities changing. I mean, it's just -- at that point
24 it's just money that is being paid. As I said, it's just
25 the satisfaction of a tax liability. There is no longer a

1 fund that belongs to the government. And what is
2 happening here is that the money is being applied for the
3 specific purpose of getting the responsible officers off
4 the hook.

5 QUESTION: Well, and for discharging a tax
6 obligation of all the former employees, too.

7 MR. HOROWITZ: Yes, but in a sense the tax
8 obligation is being paid -- is being guaranteed, shall I
9 say, by the government, not by the responsible officers
10 any more.

11 QUESTION: But it is a policy of the government,
12 is it not, to accelerate payments of the trust fund? Your
13 whole -- you whole argument here is that this is a vital
14 obligation that ought to be discharged, and that's --
15 whether or not there are any trust monies left, the policy
16 still remains, and the bankruptcy court's order accords
17 with that policy.

18 MR. HOROWITZ: I don't think there is a policy,
19 when you have two tax liabilities, that one has to be paid
20 ahead of the other, because dollars are dollars to the
21 IRS. What there is a policy is that officers of the
22 corporation are not supposed to borrow without permission
23 the government's money in order to run the corporation.
24 In order to enforce that policy there is a special
25 provision of the Code, Section 6672, that is supposed to

1 act as a very strong deterrent to having officers do that.
2 And it imposes a personal liability on them. Now,
3 hopefully --

4 QUESTION: Yes, but the reason for that is so
5 that the trust fund obligation is paid.

6 MR. HOROWITZ: Is paid on time, yes. So that -
7 -

8 QUESTION: And is paid before a general
9 corporate tax, if that is also due and owing. If you have
10 two to pay, you've got to pay the trust fund first.
11 That's the whole purpose of this, isn't it?

12 MR. HOROWITZ: Well, that is true, but again
13 that is because -- that's not the corporation making a
14 payment out of its own funds to the government. That's
15 the corporation holding the government's money in trust,
16 and it's supposed to turn it over to the government.

17 QUESTION: Whatever the reason, it gets the
18 officers off the hook. The corporation first has to
19 satisfy --

20 MR. HOROWITZ: If the officers turn over, if
21 they turn over the trust fund to the government they are
22 not on the hook in the first place. But what has happened
23 here is that the officers have ignored their statutory
24 duty. They have taken the money, spent it on the
25 corporate liabilities, there is nothing left, the whole

1 thing has been thrown into bankruptcy.

2 And now the government, having had all this
3 money stolen from it basically, at least wants to be able
4 to allocate the payments so as to protect the public fisc
5 in a way to maximize the government's ability to collect
6 taxes.

7 QUESTION: Mr. Horowitz, do you think the
8 government will be more likely to collect all its taxes
9 if, by insisting on this policy, it has the effect of
10 forcing the debtor into a Chapter 7 liquidation instead of
11 Chapter 11?

12 MR. HOROWITZ: The government's policy does not
13 force debtors into Chapter 7 liquidation.

14 QUESTION: Well, it could. I mean, the argument
15 of the other side, of course, is that the ability of the
16 bankrupt estate to be reorganized and carry on as an on-
17 going business may turn in part on the agreement of how
18 these taxes are to be allocated. And if that is the case,
19 and if the government declines to go along with that and
20 thereby causes the reorganization to fail, is the
21 government going to be more likely to collect all its
22 taxes?

23 MR. HOROWITZ: Well, I disagree with the premise
24 of your question, Justice O'Connor. The government is
25 never going to be forced -- the government's designation

1 is never going to force the debtor into liquidation. It
2 has nothing to do with the debtor. It is no difference to
3 the debtor how the IRS applies these payments. It is no
4 difference to the other creditors.

5 The only thing that the court of appeals seized
6 on here was the notion that the responsible officers would
7 try to negotiate their personal liability away by
8 threatening to do various things to the debtor, maybe to
9 force it into liquidation, if the IRS doesn't -- if they
10 are not able to get what is basically a personal
11 accommodation from the IRS in discharging their liability.
12 Now that is not the IRS' fault. That is the responsible
13 officers fault.

14 And I would say a few things about that. One,
15 we really think it is very inappropriate for the
16 bankruptcy court to kind of become an accomplice in this
17 scheme where the responsible officers take the
18 government's money and then threaten the vitality of the
19 reorganization in order to get out from under their
20 liability.

21 Secondly, the idea of Chapter 11 is that there,
22 is to give the corporation a chance to keep going as a
23 going concern. And there is no indication at all anywhere
24 in the Code and the legislative history that Congress
25 thought it was necessary to bribe the officers, to somehow

1 entice the officers into cooperating with this endeavor.
2 They are the officers of the corporation; they are trying
3 to keep their corporation going.

4 QUESTION: Mr. Horowitz, before bankruptcy, the
5 trust fund was dissipated before bankruptcy, I take it.

6 MR. HOROWITZ: Either before bankruptcy or
7 before anyone could get at it after the bankruptcy.

8 QUESTION: And so the officers -- it seems to me
9 the officers' obligation matured right then. They should
10 have paid and they didn't.

11 MR. HOROWITZ: They should have paid even before
12 that, probably.

13 QUESTION: Yes. All right, well, why shouldn't
14 the, why shouldn't you be able to just sue them now,
15 outside the bankruptcy?

16 MR. HOROWITZ: Well, we can sue them now, but -
17 -

18 QUESTION: And why shouldn't the -- is there a
19 trustee in this case, or these cases?

20 MR. HOROWITZ: There is a trustee in at least
21 one of the cases there is a trustee.

22 QUESTION: I would think the debtor could
23 collect from the officers the trust fund that was
24 dissipated, or at least they owe somebody, the officers,
25 they dissipated the trust fund, they should owe somebody

1 right now.

2 MR. HOROWITZ: Well, I don't know if the debtor
3 has an action against the officers or not, but the problem
4 with the IRS going after the officers directly is that the
5 officers can string out the litigation for quite a while
6 by posting a bond, litigating it, et cetera, et cetera.
7 It will take a while for the government to collect from
8 the officers.

9 During this time in which they are trying to
10 collect from the officers, the payments out of the
11 organization plan will be being applied to the
12 corporation's liability under provision of the plan and
13 reducing the officers separate liability. So it is not
14 necessarily a useful remedy for the IRS to go after the
15 officers.

16 Second of all, it is completely
17 counterproductive to what the court of appeals thought it
18 was doing, if the IRS is going to run out -- is going to
19 be induced by this to run out and go after the officers
20 immediately, that is not going to help the reorganization
21 at all --

22 QUESTION: Suppose you had a reorganization and
23 the officers said we are willing to make this company run,
24 but we want to make sure that our trust fund obligation is
25 discharged first by the corporation. Could the IRS say

1 well, in looking at all the circumstances we agree?

2 MR. HOROWITZ: The IRS could agree, yes. This
3 case is about whether the IRS can be forced to agree. I
4 say no.

5 I would like to reserve --

6 QUESTION: Mr. Horowitz, before you stop, what
7 do you say -- you started to talk about Chapter 11. You
8 say there is no provision in there that lets the court do
9 this. What do you do with Section 1123(b)(5), which says
10 that the plan may include any other appropriate provision
11 not inconsistent with the applicable provisions of this
12 title?

13 MR. HOROWITZ: Well, it's our position that --

14 QUESTION: So the issue is just whether this is
15 appropriate?

16 MR. HOROWITZ: That is right. Whether it is
17 appropriate, and whether it is inconsistent with other
18 provisions of this title.

19 QUESTION: Of this title.

20 MR. HOROWITZ: Yes, of this title.

21 QUESTION: You assert it's inconsistent with the
22 --

23 MR. HOROWITZ: Well, there is also -- well, we
24 think it is at least somewhat inconsistent with the
25 general idea in Chapter 11, which is specifically

1 embodied, I think, in Section 1123(a)(4), which is that
2 the court is not to distinguish among claims that have the
3 same priorities. So we do think there are some
4 inconsistencies with this title and with, of course, the
5 main provision that requires the IRS to be paid all its
6 priority taxes.

7 I would like to reserve the remainder of my
8 time.

9 QUESTION: Very well, Mr. Horowitz.

10 Mr. Moss.

11 ORAL ARGUMENT OF GUY B. MOSS

12 ON BEHALF OF THE RESPONDENT

13 MR. MOSS: Mr. Chief Justice, and may it please
14 the Court:

15 Where we seem to disagree is whether the
16 payments made under a confirmed plan are voluntary, and
17 the consequences if they are not. I think if there is one
18 word that is going to become the key to the decision here
19 it will be control. It is not a perfect word, but it is a
20 good word for this case.

21 We suggest that the tax payments under a plan
22 are voluntary because the debtor taxpayer controls the use
23 of the funds. And we say if that is not the conclusion
24 that this Court chooses to reach, then control must be in
25 the bankruptcy court, and as a result the court has the

1 power to designate the allocation of the taxes paid.

2 Let me start with a test that occupied the bulk
3 of Mr. Horowitz's time, and suggest an example that we can
4 discuss. A simple \$100,000 tax debt existing on the eve
5 of bankruptcy. Of that, \$60,000 constitute so-called
6 trust fund taxes and \$40,000 anything else: income,
7 excise, matching FICA, what have you.

8 Now, take the day before the bankruptcy filing.
9 The taxpayer is in hopeless financial trouble, is
10 insolvent. The IRS may have sent out notices, demands,
11 revenue agents, is all over the company. The risk upon
12 default is levy, seizure. And the corporation, a day or
13 two before the bankruptcy sends a check, let's make it a
14 certified teller's check, to the IRS and pays the \$60,000
15 in trust fund taxes, thereby helping the responsible
16 officers.

17 No issue here. IRS says that is fine. And
18 whether or not anyone is blameworthy, whether or not the
19 IRS position is impaired and it is stuck with the nontrust
20 fund taxes, that is fine. It reflects the common law. We
21 don't have a case.

22 Now let's take the case --

23 QUESTION: Yes, but in that case may not the
24 trustee claim that is a preference?

25 MR. MOSS: The trustee may, and I realize that

1 is a case working its way up to this Court.

2 QUESTION: It is here.

3 (Laughter.)

4 MR. MOSS: Depending -- and not decided yet.

5 I don't think that is relevant to this issue.

6 It may or may not be a preference and usually will not be,
7 because the test for a preference requires that the party
8 receiving it do better than it would upon bankruptcy. And
9 because the taxes are priority, it is relatively rare that
10 the IRS receiving a prepayment sum would be in that
11 position. Usually there are enough free funds to go
12 beyond the priorities, and that is why the usual
13 preference issue concerns payments to unsecured creditors.

14 Now, let's take the situation we have. After
15 the plan is confirmed, and we are in that situation right
16 now with these two cases. The taxpayer is now
17 rehabilitated. The plan has been confirmed by a
18 bankruptcy court. The plan has been found feasible. The
19 flexibility that Congress gave to the debtor to stretch
20 out tax payments over six years from date of assessment
21 has been utilized by the debtor. It won't happen in every
22 case, but it did here. The IRS is owed an undisputed sum.
23 The IRS has not sent out any notices or demands, because
24 it is now passively awaiting the payment of the taxes
25 under the plan.

1 The same risk of default exists as was the case
2 before. And the corporation sends out the same check,
3 although it is not likely it will be certified this time,
4 to the Service and pays the installment that is due under
5 the plan.

6 Now, I suggest there is little if any difference
7 in that scenario from the pre-bankruptcy, except that it
8 is better. And yet under -- it is better in the sense
9 that the debtor is more in control of its situation. It
10 has made its peace with its creditors. The plan has been
11 confirmed, et cetera, et cetera.

12 But this time when the IRS gets that check in
13 the mail somebody says wait a minute, it's involuntary.
14 Send it back because our policy, our interpretation of the
15 common law says we don't accept them when a letter
16 accompanies the check, as it did, allocating the payment
17 to the trust fund section of the taxes. So the irony is
18 that at a time the taxpayer has wider latitude than it did
19 before, the government has a harsher position, and this
20 fight ensues.

21 QUESTION: The tax law is full of irony, Mr.
22 Moss. Why -- what's the matter with this one? Why -- the
23 IRS says it has this policy, voluntary versus nonvoluntary
24 and that what makes the difference is whether there has
25 been a court proceeding and whether the payment is under

1 court order or not. It's a line, it's certainly a clear
2 line at least.

3 MR. MOSS: I think the irony lies simply in
4 examining the government's response along the continuum of
5 the common law situation, at least as we view it. When
6 things are at their harshest and most out of control there
7 is no issue between the parties, and when things are
8 calmest and most in control and a reorganization has been
9 structured, that probably maximizes the likelihood that
10 the entire creditor body will do better than it did
11 before, we wind up in this controversy.

12 QUESTION: Suppose that the IRS is taking the
13 position -- let's assume they are -- we don't have to
14 treat anything the way you want and let you designate,
15 that in fact we are the government. And any money we get
16 that you owe the government, we can attribute it to what
17 we like. Is there anything wrong in principle with
18 beginning from that standpoint and then saying out of the
19 goodness of our heart -- or really, not for that reason,
20 but in order to prevent litigation -- we are going to
21 adopt the rule nonetheless, even though we have the power
22 to treat it all the way we want, we won't treat it the way
23 we want if you haven't made us go to court. That makes
24 sense.

25 MR. MOSS: I think the best response I can offer

1 to that is the standard phrase it's a country of laws and
2 not men. The Internal Revenue Service is but one
3 creditor. It has an important function for the country,
4 which is to raise revenue.

5 But it doesn't act in a vacuum. And the many,
6 many provisions of Chapter 11 that affect the rights of
7 creditors as they have them pre-bankruptcy suggest that,
8 for the purpose of fostering reorganization, what a
9 particular creditor would like to do in a context of
10 nonbankruptcy it cannot do in a context of bankruptcy, and
11 Congress says that it should not do. I view this case as
12 really an extension of that.

13 Look at the various sections that go to that
14 observation. Preferences. Perfectly lawful payments that
15 are made pre-bankruptcy have to be disgorged for equitable
16 reasons. Rejection of executory contracts, which this
17 Court dealt with in *Bildisco*. Perfectly lawful contracts
18 that are terminated and made into pre-bankruptcy damage
19 claims. Limitations on the damage claims from contract
20 rejection. Section 502 artificially set limitations that
21 would not exist under state or federal law that applies.

22 Tax claims themselves are not all priorities,
23 even though revenue collection is certainly a policy that
24 we all feel is extremely important. Some taxes are
25 nonpriority, and those nonpriority taxes would be treated

1 the same as all the general unsecured creditors.

2 And in a straight bankruptcy if the assets were
3 not sufficient, those unsecured tax claims, or, I should
4 say those nonpriority tax claims, would not even be paid.
5 Penalties are subordinated under Section 726, IRS
6 penalties.

7 In your Whiting Pools case, under Section 543,
8 seized property might have to be disgorged to assist the
9 reorganization effort.

10 And the very provision that gave rise to this
11 dispute, tax claims may be paid over six years, under
12 Section 1129(a)(9). Now Congress, I think, put that in to
13 facilitate cash flow problems that would face a
14 reorganizing debtor. But when it did so, the IRS was put
15 at the mercy that, at some point as those six years
16 evolved, the debtor might not survive and might not be
17 able to make the payments.

18 In between these two periods that I mentioned,
19 the pre-bankruptcy day before when the check is paid, and
20 the post-bankruptcy day after when the check is paid,
21 let's look at what the government suggests is so important
22 here. Indeed, I think that one might even question how
23 relevant any of it is, because in light of our emphasis
24 upon control, what we think is fairly significant is that
25 on the day that those post-confirmations are being --

1 payments are being made, the debtor has received the
2 benefit of Section 1141, the assets have reverted in the
3 debtor, all creditors bound by the plan, and with full
4 control over and custody of the funds, the taxpayer makes
5 the payments.

6 But it is true that the cases have focussed
7 upon, to some measure, what takes place during the course
8 of the Chapter 11. So, notwithstanding my suggestion that
9 it may or may not be terribly relevant, let's look at the
10 arguments.

11 The debtor says -- I am sorry, the government
12 says the debtor lacks options. But as, I think, Justice
13 Scalia pointed out, the debtor always lacks options to pay
14 involuntary taxes. That is, taxes are involuntary in that
15 the law says they arise under certain circumstances. But
16 yet the debtor is afforded more options in a Chapter 11
17 than it had before, because it is given the six-year
18 provision and it is given the hiatus period to work out of
19 its troubles. The government says the tax is a priority.

20 QUESTION: But the debtor is somewhat different.
21 There is -- if you consider the plan a court order, the
22 debtor is under a court order to pay taxes every so often,
23 is it not?

24 MR. MOSS: It is not. The government made that
25 argument in its brief, and it made it to suggest that

1 there is some type of judicial activity taking place here
2 that is of the nature of involuntariness, like the court
3 approving a seizure or a levy or something of that. I
4 suggest that when we look at the applicable statute, which
5 I think is Section 1129 of the Bankruptcy Code, the one
6 that sets the standards for when a plan may be confirmed.
7 What that statute says is that the court shall confirm a
8 plan that meets the following requirements.

9 Now there are, I think, 11 requirements. Some
10 are relatively unimportant and some are very important.
11 The two that probably are germane to this case are
12 1129(a)(9), that says the plan shall provide for full
13 payment of priority taxes, but may do so over the course
14 of six years with interest, and the Section, I think,
15 1129(a)(11), that says the plan shall be feasible, or the
16 exact language is not likely to -- the corporation is not
17 likely to run into the immediate need of bankruptcy relief
18 again.

19 There is no court order in the sense that the
20 court says thou shalt do X, Y or Z. The court says that
21 the standards of 1129 have been met and the plan may be
22 confirmed. And then you go to Section 1141 that says that
23 when a plan has been confirmed, all creditors are bound by
24 it.

25 QUESTION: Let's break it down a minute, Mr.

1 Moss. Take, for example, the plans that were confirmed in
2 this case. What specifically did they say with respect to
3 the payment of taxes to the IRS?

4 MR. MOSS: Both plans provided that the priority
5 tax payments would be paid over a period of time with
6 interest. One plan --

7 QUESTION: Did they say anything about --

8 MR. MOSS: One plan may have used four years,
9 one six years.

10 QUESTION: Did they specify dates of payment?

11 MR. MOSS: Yes. Yes. You must, and indeed the
12 government objected to the Energy Resources --

13 QUESTION: Okay, but I'm not mentioning the
14 government's objection right now. Now, is there any
15 penalty or sanction that attaches to the debtor in this
16 case if it fails to make its tax payments, other than
17 simply having an overdue debt?

18 MR. MOSS: The penalty that attaches is the
19 penalty that existed before the Chapter 11. The debtor -
20 - Section 1141, and this is backing into your question
21 with a statutory observation --

22 QUESTION: You've been backing in quite a bit.
23 Let me ask you a more specific question, if I may.

24 MR. MOSS: Okay. The penalty -- I am prepared
25 to answer it.

1 QUESTION: Could the IRS apply to the bankruptcy
2 court for an order requiring the debtor to pay according
3 to the plan?

4 MR. MOSS: That depends on whether or not the
5 bankruptcy court still has retained jurisdiction over the
6 case.

7 QUESTION: Well, what is the typical situation?

8 MR. MOSS: The answer --

9 QUESTION: What is the typical situation?

10 MR. MOSS: The typical situation, I am not sure
11 there is one.

12 QUESTION: Well, what was the situation in these
13 cases?

14 MR. MOSS: The area of retained jurisdiction is
15 an area that counsel will often focus upon carefully.
16 Sometimes a creditors committee will negotiate. The
17 creditors committee is not a committee that worries about
18 the Service, but it will sometimes negotiate for retained
19 jurisdiction to watch over the plan, and sometimes will
20 not.

21 So in some cases the bankruptcy court loses
22 jurisdiction over the case before these tax payments are
23 completed, and in other cases, depending upon whether the
24 provision is in the plan, the court will keep it.

25 QUESTION: Now, in those cases where the court

1 has retained jurisdiction, could the IRS go to the court
2 and say there is a payment due here that was not made, you
3 tell the debtor to make it?

4 MR. MOSS: I believe that that is possible for
5 it to do.

6 QUESTION: That would be at least a different
7 situation than the pre-bankruptcy.

8 MR. MOSS: Well, it may and may not, because I
9 think more typically what the Service would do is invoke
10 its levy and seizure procedures.

11 QUESTION: Well, but supposing the Service
12 chooses to do it this way. That would be different from
13 pre-bankruptcy, would it not?

14 MR. MOSS: But in pre-bankruptcy I see no reason
15 that a, the Internal Revenue Service could not go to a
16 court of competent jurisdiction and ask for the same type
17 of order.

18 QUESTION: To order a taxpayer to pay? What
19 sort of a suit would that be?

20 MR. MOSS: Because money is owed. It would be a
21 collection suit. The IRS is unlikely to do it because its
22 powers are vast, and I think we all know that. So that
23 rather than go to the court like a typical plaintiff, it
24 has the ability more than any other creditor in this
25 country to take unitary action and seize assets after, I

1 believe, assessments are made.

2 . It could do that pre-bankruptcy, it could do
3 that post-confirmation. The only time it can't do it is
4 when the debtor is under court control, and that is during
5 the Chapter 11 period, prior to confirmation of the plan.

6 The government also cites that because a claim
7 was filed there is some significance that transfers this
8 from a controlled payment to an uncontrolled payment.

9 As Mr. Horowitz argued common sense, I might
10 also. Firstly, in a Chapter 11, under Section 1111(a), a
11 proof of claim need not even be filed if there is no
12 dispute over the debt. A debtor is obligated to file
13 schedules. They are done under oath, and they state what
14 the indebtedness is to each creditor it has.

15 If the Service looked at those schedules and
16 agreed, its failure to file a proof of claim would not
17 cause it any harm. The claim is deemed proved, allowed,
18 and must be dealt with under the plan. All the proof of
19 claim is is one piece of paper that has a signature and an
20 amount of money on it. It may be important when it is
21 due, but the fact of the matter is it isn't much. And in
22 the --

23 QUESTION: That's if it isn't scheduled.

24 MR. MOSS: It's quite important to the creditor,
25 without question, but I don't think that this one piece of

1 paper should be the touchstone between the court
2 determining that this is a controlled or voluntary payment
3 within the meaning of the common law --

4 QUESTION: Could you -- could you tell me, Mr.
5 Moss, did the bankruptcy court indicate any reason for
6 agreeing with the request to allocate these payments first
7 to the trust fund taxes?

8 MR. MOSS: Yes, in both --

9 QUESTION: And maybe another question is why did
10 the debtor request it this way?

11 MR. MOSS: Well, as to the first question, I
12 believe that the decisions in both cases and the record do
13 suggest that the court took into account reasons for doing
14 this.

15 QUESTION: What are they?

16 MR. MOSS: In the case of Newport, this was a
17 plan funded by a third party. An entity not before the
18 court ended up with 85 percent of the stock.

19 And there were a variety of tradeoffs that were
20 entered into at the time that the plan was structured.
21 The responsible officers had a wide variety of claims,
22 unsecured and secured, and as part of this array of
23 tradeoffs, they were put into a separate class. They
24 waived the secured claim. They reduced, I believe, the
25 unsecured claim. And they, I believe, bargained for this

1 tax designation provision as part of it. They also --

2 QUESTION: Because that provision would reduce
3 their -- would reduce their exposure.

4 MR. MOSS: Yes. Yes. There is no question that
5 such a provision reduces the exposure of the responsible
6 officers to the extent that the corporate tax payments
7 over time are not made.

8 QUESTION: And so those are -- that's really the
9 reason in both of these cases that the debtor wants to
10 have the tax payments applied in this way.

11 MR. MOSS: Well, the debtor recognized, and it
12 is worth noting that counsel for the debtor, by the way,
13 is not counsel for the responsible officers, or you would
14 never be appointed to that position at the start of the
15 Chapter 11.

16 QUESTION: Yes.

17 MR. MOSS: Chapter 11 is an endless process of
18 negotiation, and there are reasons, as Justice O'Connor
19 pointed out, one, why these tradeoffs are requested. One
20 which she noted was that you need an inducement, and it
21 makes sense to have that inducement to the people
22 controlling the corporation not to tank the company. So
23 that in a Chapter 7 the priority taxes will be paid off
24 the top first. And interestingly enough, they run a risk
25 by not doing so and by moving forward with a

1 reorganization plan.

2 QUESTION: But I take it it's really immaterial
3 to the debtor, I suppose, how these payments are --

4 MR. MOSS: No, it's -- the government took the
5 position that it is immaterial to creditors, and your
6 question, which I would like to answer with that
7 observation, says is it immaterial to the debtor.

8 You have an almost endless variety of things
9 that can occur in a Chapter 11. It doesn't follow. For
10 example, the responsible officers quite often will own the
11 company at the commencement of the case. Not always,
12 because sometimes they are not the equity holders and
13 sometimes they are fired. And certainly, as equity
14 holders, they often will strive to own the company at the
15 end of the case.

16 Now, in doing so, that means that in those types
17 of cases when it is reorganized they are still running it,
18 and they own it. And it would certainly be an odd kettle
19 of fish to find that, after doing that and possibly making
20 financial contributions to the plan, the Service is then
21 pursuing them on the trust fund taxes and possibly levying
22 upon their stock, which is their basis for owning the
23 company.

24 QUESTION: Well, after all, these taxes were
25 deducted from peoples' paychecks, weren't they?

1 MR. MOSS: Yes.

2 QUESTION: And they were used before bankruptcy
3 in a way that they shouldn't have been used for.

4 MR. MOSS: That is correct, but in one sense
5 that question asks if --

6 QUESTION: I would think -- I would think other
7 creditors would have, would want to go after the officers
8 rather than share the income of the company with -- with
9 the government.

10 MR. MOSS: There is no basis for going after the
11 officers. The primary party obligated to the tax creditor
12 is the corporation. And when the unsecured creditors
13 negotiate with the debtor and look at everything going on
14 to try to formulate the best possible result here, they
15 take into account that the debtor must pay these taxes.
16 The responsible officer is simply liable to the government
17 under a penalty assessment --

18 QUESTION: Well, then if the government could
19 have sued the -- the Chapter 11 proceeding doesn't
20 interfere with the government's right to sue the --

21 MR. MOSS: Not at all.

22 QUESTION: -- the officers immediately.

23 MR. MOSS: Not at all, and that is precisely
24 why, in the balancing of policies that we have argued in
25 the brief, the tax policy, however quite important, we

1 suggest is either not materially impaired, or at least is
2 taken into account in other ways.

3 QUESTION: Do you say there is no liability from
4 the officers to the debtor for their having
5 misappropriated the trust funds?

6 MR. MOSS: That's correct. I am not aware of
7 any liability for that purpose. Usually the trust fund
8 payments simply never existed. That is not to take away
9 the blame, and we are not here to praise any creditor, or
10 any debtor rather, who does not pay his creditor. The
11 reality is --

12 QUESTION: Have you given us --

13 MR. MOSS: -- the taxes simply -- net payroll
14 was made.

15 QUESTION: Mr. Moss, have you given us a
16 specific reason why the officers should be taken off the
17 hook?

18 MR. MOSS: I am not asking that they be taken
19 off the hook. The Section 6672 liability remains. Both
20 parties have cited, I think, the same cases in the brief.
21 Ours, if I recall, was Huckabee Auto saying that 6672 is
22 an independent source of collection for the government,
23 and that it is inappropriate, indeed impermissible, for
24 the bankruptcy court to enjoin the Internal Revenue
25 Service from pursuing those responsible officers.

1 The government could have pursued them pre-
2 bankruptcy, during bankruptcy and after bankruptcy, as
3 part of the policy, the federal policy toward tax
4 collection.

5 What's taking place here, I suggest, is a
6 balancing of interests. This Court recognized that --

7 QUESTION: Are you saying they are not taken off
8 the hook?

9 MR. MOSS: That is correct.

10 QUESTION: Their liability is eliminated to the
11 extent the trust funds are used.

12 MR. MOSS: Well, it's -- I'm sorry, it's a
13 question of my being careful how I interpret your
14 question.

15 At any given moment, to the extent the trust
16 fund taxes are due, they are not taken off the hook. But
17 what is at issue in this case is whether they benefit from
18 a payment that is allocated to the trust fund portion.
19 So, in my hypothetical, if the \$60,000 of trust fund taxes
20 out of \$100,000 were to be paid over five years, say, then
21 they would benefit as those payments ensue. But they
22 would also be subject to IRS attack also as those payments
23 ensue, because it would probably take two to three years
24 for those trust fund taxes to be paid in full.

25 QUESTION: What would happen if the IRS sued

1 them immediately and got all the money from them? What
2 would happen with the money that was supposed to be paid
3 to the government under the plan? Wouldn't that money go
4 to them? Wouldn't they have a cause of action to be
5 reimbursed by the corporation, or not? Or we don't know?

6 MR. MOSS: What -- no, I -- that has been an
7 interesting debate in a number of law firms. My view of
8 what probably should happen is that from the corporate
9 standpoint the taxes should be viewed as still due. The
10 government should receive those tax payments, which then
11 gives them in effect a double payment. They are not
12 looking for a double payment, but that is the result.

13 And then, upon the existence of a double
14 payment, the responsible officer can sue for a refund,
15 thereby keeping the government paid in full and ultimately
16 leaving the responsible officer in the position of a kind
17 of surety, with the debtor primarily paying and the
18 responsible officer secondarily liable.

19 QUESTION: That gets it out of the officers, and
20 I would think the other creditors would want to have the
21 plan revised, because it would enhance their ability to be
22 paid in full if the government gets their taxes, their
23 trust fund taxes out of the officers.

24 MR. MOSS: The creditors might want that, but it
25 doesn't mean that they -- that they can have it.

1 Interesting enough, those same creditors are often the
2 ones who benefit by what the corporation did with the
3 money --

4 QUESTION: Well can't the creditors usually
5 profit from the fact that a debtor has a surety, has a
6 guarantor?

7 MR. MOSS: No, not usually. The guarantor is
8 secondarily liable, and the debtor is forced to meet its
9 primary responsibility. In fact, while it is not the case
10 here, for reasons that are set forth in the Code, in an
11 unsecured, nontax situation, the guarantor, if he paid,
12 would be subrogated to the position of the creditor, and
13 the indebtedness would not go away.

14 QUESTION: Thank you, Mr. Moss.

15 MR. MOSS: Thank you.

16 QUESTION: Mr. Horowitz, you have two minutes
17 remaining.

18 REBUTTAL ARGUMENT OF ALAN I. HOROWITZ

19 ON BEHALF OF THE PETITIONER

20 MR. HOROWITZ: Thank you, Mr. Chief Justice.

21 I would like to make a couple points. First of
22 all, we completely disagree with the notion that the
23 debtor is not under a court order to make these payments
24 under the plan. If he doesn't pay, then the government
25 can move to dismiss the plan for not -- the Chapter 11

1 proceeding for non-compliance. That is under Section
2 1112(b)(8) of the Code. And if for some reason the court
3 no longer has retained jurisdiction over the case, the
4 case can be reopened in the event of noncompliance under
5 Section 350 of the Code.

6 QUESTION: Well, excuse me, if you move to
7 dismiss it for noncompliance, then you are back in the
8 situation you were in pre-plan, I assume, right?

9 MR. HOROWITZ: That is right.

10 QUESTION: You have the same legal remedies
11 under the statute that you had.

12 MR. HOROWITZ: Well, we would levy on them, and
13 it would be an involuntary payment and we would apply it
14 where we wanted.

15 QUESTION: It's not a very useful court order.
16 You're saying the penalty for not obeying the court order
17 is the court order is eliminated.

18 MR. HOROWITZ: And the protections against
19 creditors are eliminated, which is the reason why the --
20 don't forget Chapter 11 is a proceeding that is invoked by
21 the debtor to protect themselves against creditors, not
22 one that the IRS commences in order to collect.

23 Second, as far as the question of whether this
24 kind of order is appropriate, I would also like to point
25 to Section 523 of the Code, which specifically does not

1 allow a responsible officer to be discharged for a 6672
2 liability in his personal bankruptcy. This designation
3 provision here is nothing more than an attempt to use the
4 corporation bankruptcy to discharge his 6672 liability.

5 As far as the ability of the IRS to go directly
6 against the officers --

7 QUESTION: Well, that's not quite right. It's
8 not a discharge in the bankruptcy sense. The liability is
9 paid.

10 MR. HOROWITZ: I understand it's not a discharge
11 in the bankruptcy sense.

12 QUESTION: And it won't be discharged if it's
13 not paid. And normally when something is discharged in
14 bankruptcy the debt is extinguished even though it is not
15 paid.

16 MR. HOROWITZ: Well, if all the taxes are paid,
17 we have no complaint. But the idea is to manipulate the
18 corporate bankruptcy proceeding in such a way --

19 QUESTION: Then there is no need for a
20 discharge. The discharge term doesn't even arise if they
21 are paid.

22 MR. HOROWITZ: I just direct the Court's
23 attention to the footnote on page 3 of our reply brief,
24 the petition stage, which discusses the practical problems
25 with going against the officers first.

1 QUESTION: Let me ask -- may I ask you one
2 hypothetical? Supposing the court order directed
3 management to pay \$100,000 in taxes for six years to get
4 rid of all of these obligations, and gave management
5 discretion as to which ones to apply to the trust fund
6 obligations and which not. Voluntary or involuntary?

7 MR. HOROWITZ: Well, if you're talking about the
8 IRS' policy, we would not permit that designation. We
9 would view that as under the involuntary.

10 CHIEF JUSTICE REHNQUIST: Thank you, Mr.
11 Horowitz.

12 The case is submitted.

13 (Whereupon, at 11:02 a.m., the case in the
14 above-entitled matter was submitted.)

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

United States -v- Energy Resources Co., Inc., et al

89-255

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY *Lona M. May*

(REPORTER)

RECEIVED
SUPREME COURT, U.S.
MARSHAL'S OFFICE

'90 MAR 26 P4:18