

Supreme Court of the United States

OCTOBER TERM, 1969

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Docket No. 402

In the Matter of:

----- X
 THE UNITED STATES OF AMERICA :
 :
 Petitioner :
 vs. :
 :
 SHELDON A. KEY, TRUSTEE :
 :
 Respondent :
 :
 ----- X

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Place Washington, D. C.

Date January 21, 1970

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ENHAM

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM

)	
THE UNITED STATES OF AMERICA)	
)	
Petitioner)	
)	
vs)	No. 402
)	
SHELDON A. KEY, TRUSTEE)	
)	
Respondent)	
)	

The above-entitled matter came on for hearing at 11:20 o'clock a.m. on Wednesday, January 21, 1970.

BEFORE:

- WARREN E. BURGER, Chief Justice
- HUGO L. BLACK, Associate Justice
- WILLIAM O. DOUGLAS, Associate Justice
- JOHN M. HARLAN, Associate Justice
- WILLIAM J. BRENNAN, JR., Associate Justice
- POTTER STEWART, Associate Justice
- BYRON R. WHITE, Associate Justice
- THURGOOD MARSHALL, Associate Justice

APPEARANCES:

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 On behalf of the Petitioner

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 On behalf of the Respondent

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1 amended plan reflected an agreement approved by the District
2 Court and by the Interstate Commerce Commission for sale of
3 the debtor's principal asset, his Interstate Commerce Commis-
4 sion operating rights for truck freight services, to Hennis
5 Freight Lines, Incorporated.

6 The purchase price of \$935,000 was to be paid in
7 accordance with a schedule requiring \$300,000 to be paid with-
8 in 90 days of the Commission's approval of this sale and the
9 balance in 78 monthly installments. The amended reorganization
10 plan reflecting this sale agreement did not contemplate that
11 the debtor, Hancock Trucking would continue to exist.

12 The amended plan is, in effect, a liquidation plan.
13 The government made no objection to the terms of the sale
14 agreement. It's objection relate solely to the provisions for
15 payment of creditors in the amended reorganization plan.

16 Q This wasn't basically a liquidation plan and
17 not a continuing --

18 A That is correct.

19 Q Where were the installment payments going to
20 be generated?

21 A They are the payments being made by Hennis
22 Trucking Company which has purchased the Interstate Commerce
23 Commission rights to operate the freight lines.

24 Q Less than capital equipment, I take it?

25 A The capital equipment had previously been

1 disposed of.

2 Q I see.

3 A The major remaining asset was simply the
4 license.

5 Q Could you answer this for me: If the require-
6 ment provided for equal participation across-the-board which
7 nobody objected to, on a priority basis for the tax claims?

8 A We would be entitled to object to it, but the
9 Secretary also would have had discretion to accept the plan if
10 he wished.

11 Q He can, and sometimes does, accept; does he
12 not?

13 A Yes, he does, sir, especially when it will
14 contribute to the rehabilitation of the debtor and enable the
15 debtor to continue in business.

16 Q But you regard this as simply a voluntary
17 waiver by the government of the priority claim?

18 A That is our view; yes, Mr. Chief Justice.

19 The government contends that the provisions for
20 payment of creditors in the amended plan do not satisfy its
21 statutory priority of payment rights and the respondent
22 trustee admits in its brief that the government is entitled to
23 priority but contends that its rights are fully satisfied under
24 the plan and that is the issue in this Court.

25 The contested plan provides for an initial payment

1 of 100 percent of certain wage claims and certain state and
2 local tax claims, 20 percent of the claims of the general
3 unsecured creditors, which is all they will receive, and 10
4 percent of the government's tax claims and of the remaining
5 state and local tax claims.

6 The remainder of the amount due to the government and
7 to state and local tax authorities was to be paid in 78 monthly
8 installments secured by an assignment of the note and chattel
9 mortgage Hennis had executed in its purchase of the debtor's
10 operating rights. This amounts to initial payment on the
11 government's total claim of some \$375,400 of approximately
12 \$37,500, and 78 equal monthly installments thereafter of
13 approximately \$4,330 each. No interest was to be paid on the
14 monthly installments, which together with the initial payment
15 would simply total \$375,400 owing to the government.

16 As we point out in our brief, at the time of the
17 initial payment when lower-ranking creditors were to be paid
18 in cash, the discounted present value of the right to these
19 future payments to the government, plus the initial payment to
20 the government, would amount to approximately \$317,000, some
21 \$58,400 less than the \$375,400 owing to the government.

22 The government's position is that this does not
23 satisfy its priority rights, not because the government has a
24 right to immediate payment of all cash that is on hand, up to
25 the limit of its claims in Chapter 10 proceedings, which we do

1 not urge, and not because the government has a right to the
2 payment of interest, for any part of the post-petition period
3 preceding cash payment to lower-ranking creditors.

4 We recognize that there is no right to such interest
5 on the government's claim. Our contention is simply that the
6 government, as a priority creditor, cannot be required at the
7 time when nonpriority creditors are being paid in cash to
8 accept I.O.U.s payable only in the future, for part of its
9 claims.

10 Q Well, I guess I misunderstood it. I thought
11 your claim simply was that you are entitled to full payment.

12 A Well, it's admitted that we're entitled to full
13 payment --

14 Q Well, but you are not getting it.

15 A -- the issue is when.

16 Q Oh, no, you're not getting it on a \$374,000
17 tax claim against \$317,000 is not full payment. You don't
18 admit that you are getting full payment at all; you're not
19 getting it.

20 A I meant to say it's admitted by the Respondent
21 that we are entitled to full payment. That isn't the issue
22 between us.

23 Q I didn't understand that. I thought that you
24 would be satisfied if you would get installment payments which,
25 added up, would equal your full tax claim and discount it.

1 A That is our alternative contention, that we
2 have a right to take the discounting into account.

3 Q All your right is is to full payment; isn't
4 it in the circumstances of this case?

5 A Well, we also contend that we have a right to
6 be first satisfied under Section 3466 of the Revised Statute.

7 Q But you just said you don't have a right to
8 be paid now in cash simply because cash is available?

9 A What I just said was that in a Chapter 10
10 proceedings we do not claim a right to the immediate disburse-
11 ment of cash that is not being paid to creditors.

12 Q So what --

13 A We don't claim that because cash is on hand
14 and we are a creditor we have a right to the immediate payment
15 of our claim.

16 Q That's what I understood you to say.

17 A But, when cash is being paid to creditors, we
18 claim the right to be satisfied first.

19 Q Now, fully in cash?

20 A To the limit of what's being paid to creditors.
21 Yes, Mr. Justice. We claim a right to be paid ahead of non-
22 priority creditors when payments are being made to creditors.
23 We do not claim a right to insist that the payments be made
24 when other uses are being made of the money that the trustee
25 holds.

1 Q Well, 3466 gives you a priority; right?

2 A And that is what we understand to be the
3 meaning of the priority.

4 Q And you contend that's applicable in this case,
5 but so does the Bankruptcy Act give priority to -- under
6 Chapter 10 there are certain creditors who have priority, just
7 by virtue of the provisions of the Act, aren't there?

8 A There is no general priority provision in
9 Chapter 10, Mr. Justice. The only --

10 Q What about administrative expenses?

11 A There is a provision for administrative ex-
12 penses. It's the only other --

13 Q What about wages?

14 A There is no wage priority in Chapter 10.

15 There is a wage priority in Section 64 of the
16 Act, which by Section 102 of the act is expressly --

17 Q What about secured creditors in Chapter 10?

18 A There is nothing granting them priority in
19 Chapter 10, but there has been lengthy litigation about whether
20 they have a priority ahead of the 3466 --

21 Q I thought you relied on the cases on strict
22 priority. The strict priority doctrine that you have to pay
23 -- that you really have to satisfy priority creditors?

24 Q Like the case against Los Angeles.

25 A Well, we do contend that you have to abide by

1 the classes of priority creditors.

2 Q You really wouldn't suggest that a secured
3 creditor does not have some priority in Chapter 10; would you?

4 A It's been held in equity reorganization and
5 equity receivership proceedings that secured creditors, at
6 least the mortgagees, have priority ahead of the government's
7 priority under 3466 and there has been disagreement about other
8 secured creditors.

9 Q All right, let's take mortgagees, then. You
10 say they have priority under Chapter 10?

11 A We believe that the standards of priority that
12 prevail in equity receiverships have been carried over into
13 Chapter 10; yes, sir.

14 Q Well, now, just take a mortgagee. He's got
15 priority over unsecured creditors. Would you suggest that a
16 mortgagee may not be postponed in payment to unsecured
17 creditors who, say, have been scaled down to 25 percent of
18 their claim?

19 Let's assume the plan calls for satisfying the
20 secured debt over a period of ten years. But, unsecured
21 creditors are paid off when you value the property and you find
22 out what interest the unsecured creditors have, you find out
23 the only assets that are left for them are 25 percent. 25
24 percent of their claims are going to be paid, and they have the
25 cash to pay them and they decide just to get rid of them, and

1 they pay them off in cash in the plan but secured creditors
2 who are going to be paid in full, are postponed for ten years.

3 A Our understanding of the fair and equitable
4 rule is that if the secured creditors object to that they have
5 a right to insist on their payments being made first.

6 Q And that is essential to your case, isn't it?

7 A It's not essential to our case, Mr. Justice,
8 because we have a statutory right in revised statutes.

9 Q I know, but all you say that gives you is
10 priority

11 A Moreover, we have an explicit right in Section
12 199 of Chapter 10 to object to the plan if it doesn't satisfy
13 our rights.

14 Q Sure, you can object to the plan but then the
15 question is: what provision would be made for non-assenting
16 creditors and whether it's fair and equitable to do that?
17 But you don't claim that the use of 3466 gives you some kind of
18 a priority that's different from other priority creditors?
19 Assuming it's applicable to this case, it does give you a
20 priority. Is it any different priority than a secured creditor
21 has, for example?

22 A Well, I think it's more explicit that it's a
23 right to have our claim first satisfied. That's the language
24 used in Section 3466 where there is no explicit statutory
25 language giving the secured creditors such a right. They would

1 have to draw their rights from judicial interpretations of the
2 fair and equitable rule in equity receivership proceedings,
3 and there, arguably, would be more leeway for the courts to
4 consider making exceptions to some of the rules that have been
5 established in those proceedings.

6 Q I take it then, that you really do find it
7 essential to rely on 3466 in this case?

8 A Not essentially, because we don't think we
9 received the full payments right granted in Section 199, since
10 the discounting of our claims was never --

11 Q Except for that point, though, you aren't
12 just relying on being a priority creditor under Chapter 10.
13 You are relying on being a priority creditor under the other
14 section, 3466?

15 A Well, we also rely on the idea that Chapter 10
16 grants two priorities only. There are only two explicit
17 priorities in Chapter 10 and I'll turn to that right now.

18 One of them is reproduced on Section 43 of our brief.
19 That is Section 216, number 3, Subsection 3. "A plan of re-
20 organization under this chapter shall provide for the payment
21 of all costs and expenses of administration and other allow-
22 ances which may be approved or made by the judge." That is the
23 only statutory basis for the priority for administrative ex-
24 penses in Chapter 10. The terminology used is the same ter-
25 minology used for the government's tax claim priority, that the

1 plan -- the right is to have the plan provide for payment and
2 we believe that Section 199 which is the provision in Section
3 -- in Chapter 10 which gives us our priority rights insofar as
4 they can be found within that chapter, also, in body and
5 notion of priority.

6 Everyone has assumed right along in the administra-
7 tion of Chapter 10 that administrative expenses are entitled
8 to be first paid. They do have that priority.

9 Q Well, the cases have certainly adjudicated a
10 whole system of priorities; haven't they? And they may not
11 be set out in the statute, but the cases have certainly ad-
12 judicated, including administrative expenses?

13 A Well, no one, to my knowledge, has contested
14 that administrative expenses have priority.

15 Q Or, nobody's contesting that you have priority.

16 A That's just what is meant by priority that is
17 being contested here; that is correct.

18 Well, our claim is that as a priority creditor,
19 admittedly a priority creditor, the government cannot be
20 required, when the lower-ranking creditors are being paid in
21 cash, to accept a deferral-without-interest of a portion of its
22 payment; or to put the matter another way, we contend that no
23 lower-ranking creditor can, over the government's objection,
24 be paid until the government's claims have first been satis-
25 fied, which is what we understand to be the normal meaning of

1 priority, in bankruptcy.

2 In the alternative, we do contend that the government
3 is at least entitled to interest from the time of the payment
4 to the lower-ranking creditors until the time of the deferred
5 payment to it, to compensate it for the deferral.

6 But, our principal contention is that the government
7 as the priority creditor, should not be the one to bear the
8 risk that deferred payments will not materialize, but should,
9 instead, be paid first.

10 In making our contention we rely on several dif-
11 ferent guideposts; because, as I have already said, Chapter 10
12 does not include a specific, comprehensive provision setting
13 forth a hierarchy of priority as Section 64 does for ordinary
14 liquidating bankruptcy proceedings.

15 The more venerable source of the government's
16 priority rights in this case is Section 3466 of the Revised
17 Statutes, which is on page 41 of our brief and in Title 31 of
18 the United States Code. This provision originated in Acts of
19 Congress in the late 18th Century, which had their roots in the
20 sovereign priority of the Crown.

21 The statute expressly provides that debts due to the
22 United States shall be first satisfied whenever, as is the
23 undisputed case here, the debtor is insolvent and had committed
24 an Act of Bankruptcy.

25 Decisions of this Court, cited in our brief, have

1 established that tax debts owing to the United States, are
2 among those covered by the broad language of this provision.
3 The plan upheld by the courts below plainly does not comply
4 with this statutory requirement that the government's tax
5 claims shall be first satisfied and there is, on the face of
6 things, no reason why this provision is not controlling. It
7 manifests the continuous Congressional policy that the claims
8 of the Federal Treasury and the important public needs to be
9 served by the funds in that Treasury are to be placed ahead
10 of the also just claim of unsecured creditors who did business
11 with the debtor for profit.

12 In light of this important public purpose of the
13 priority statute, this Court has repeatedly said that only the
14 plainest inconsistency would warrant the finding of an implied
15 exception to the clear command of Section 3466. This was said
16 most recently in the United States Department of Agriculture
17 against Redmond, in Volume 330, U.S.

18 These considerations and others, led the Court of
19 Appeals for the Fifth Circuit to conclude five-and-a-half years
20 ago, in a thoughtful opinion by Judge Reeves, that Section
21 3466 is fully applicable to Chapter 10 proceedings. That's
22 United States against Anderson, which is discussed in our brief
23 and the same conclusion had earlier been reached by the Courts
24 of Appeals for the Second and Third Circuits in cases cited on
25 page 13 of our brief.

1 This Court has not previously had occasion to de-
2 cide whether this provision is applicable to Chapter 10.

3 The Court below came to the contrary conclusion that
4 Section 3466 is superceded by the provisions of Chapter 10.
5 And our contention is that the other courts of appeals were
6 correct in deciding that this statute is entirely compatible
7 with Chapter 10 and we go beyond that and contend that the
8 provisions of Chapter 10, themselves, in the light of their
9 legislative history and as interpreted by this Court, indepen-
10 dently provide a priority right for the government's tax
11 claims which the plan here did not satisfy.

12 The principal provision in Chapter 10 that is per-
13 tinent, is Section 199 on page 42 of our brief and the second
14 sentence is the pertinent language, beginning at the end of
15 Line 7 of Section 199. "If, in any proceeding under this
16 chapter, the United States is a secured or unsecured creditor
17 on claims for taxes or customs duties"--- the parenthetical may
18 be omitted ---"no plan which does not provide for the payment
19 thereof, shall be confirmed by the judge except upon the accep-
20 tance of a lesser amount by the Secretary of the Treasury,
21 certified to the Court," followed by a proviso which is irre-
22 levant here.

23 Nothing in this language which gives the Secretary
24 the right to demand or to forego full payment is inconsistent
25 with the command of Section 3466 as to the relative priority of

1 that right to payment as against other claims. "The
2 command of the government's claim shall be first satisfied."
3 And the history of the evolution of Section 199 recounted in
4 detail in our brief shows that Congress knew that Section 3466
5 had been applied in equity receivership proceedings involving
6 insolvent corporations and that, in enacting the statutory
7 successors to equity receivership, which culminated in Chapter
8 10, Congress manifested no intention to diminish the govern-
9 ment's priority rights and rejected a specific recommendation
10 that it do so, but instead, was concerned to provide for pro-
11 tection for the government in Section 199, not only as to
12 insolvent debtors, to whom Section 3466 applies, but more
13 generally as to all debtors involved in Chapter 10 reorganiza-
14 tions.

15 Of course, Congress also provided specifically in
16 Section 199 and its predecessor, that the Secretary of the
17 Treasury may compromise the government's rights and in appro-
18 priate cases this enables the Secretary to contribute to
19 Chapter 10's objective of fostering rehabilitation of the
20 debtor, when feasible. But, the granting of this power to
21 compromise did not imply that the rights themselves are dimini-
22 shed, and as I have already mentioned, on the face of the
23 statute, this language providing for payment is the only
24 language used when Congress wished to provide for a priority
25 right in Chapter 10.

1 And in any event, the contrast within Section 199
2 between payment and acceptance of the lesser amount shows to
3 us on the face of the statute that the government's rights were
4 not satisfied in this case.

5 There is another basis for the decision of the court
6 below, namely the provisions in Chapter 10 requiring that the
7 reorganization plan be fair and equitable; that these pro-
8 visions do not leave each District Court free to give effect
9 to its own notions of what is fair and equitable. In this
10 field, the words "fair and equitable," are terms of art which
11 acquired their meaning through judicial interpretations in
12 equity reorganization proceedings. That is what this Court
13 held with respect to Chapter 10, unanimously, in an opinion
14 Mr. Justice some years ago.

15 And, one aspect of the meaning of fair and equitable
16 is broadly stated that creditors of a junior class may not be
17 given something of value at the expense of non-consenting
18 creditors of the senior class; the so-called Rule of Absolute
19 Priority, which we believe is equally applicable to the dif-
20 ference between the government's statutory right to full pay-
21 ment and the claims of creditors who do not have such a right,
22 as it is to the classes of creditors to which it has been
23 applied by this Court.

24 But, whether or not the decision below actually
25 violates the fair and equitable provisions of Chapter 10, those

1 provisions surely do not justify the refusal of the Court
2 below to afford the government the rights specifically granted
3 Sections 3466 and 199.

4 I would like to reserve the balance of my time,
5 please.

6 MR. CHIEF JUSTICE BURGER: Mr. Beck.

7 ORAL ARGUMENT BY SIGMUND J. BECK, ESQ.

8 ON BEHALF OF RESPONDENT

9 MR. BECK: Mr. Chief Justice, and may it please the
10 Court: It's always been my view that all cases ought to be
11 viewed in the light of their facts and certainly it's true in
12 this instance in an equitable proceedings.

13 The facts are more fully elaborated in our brief, but
14 there are some highlights that I think should be brought out.
15 It's true that this case began in May of 1954. The original
16 plan was confirmed in 1957. Under the terms of that plan,
17 without going into detail, the reorganized debtor took over the
18 assets and property from the trustee in June of 1958, and
19 began operating without control of the Court.

20 In December of 1961 the trustee filed a petition for
21 final decree. The hearing was to be held on that in Marcy of
22 1962. In February of 1962 there became a change in the direc-
23 tors. The corporation had had financial difficulties and they
24 then entered into a contract of sale with Hennis Freight Lines
25 for \$1 million, principal and interest included, over a period

1 of time of 78 months.

2 Prior to the hearing on final decree, three creditors
3 who had come into being subsequent to the reorganized debtor
4 taking over the assets, asked the Court to have the trustee
5 retake the property and assets, alleging insolvency. This
6 took place; hearing was held and the court vested the trustee
7 with the assets and property of the debtor corporation.
8 Investigation took place; the trustee then moved to affirm the
9 contract of sale with Hennis. The court affirmed that contract
10 in August of 1962.

11 It took three years for the Interstate Commerce Com-
12 mission to finally approve the sale. When it did approve the
13 sale it added a restriction on the rights. The restriction
14 invented was a sort of limited restriction. It did not include
15 a reduction of mileage. The original contract provided that
16 should the ICC reduce the mileage then Hennis would be entitled
17 to a reduction.

18 There was a dispute between the trustee and Hennis as
19 to what the price should be. We finally reached an agreement
20 whereby the maximum amount of the sale was to be viewed as
21 \$935,000 instead of a million. That again, is inclusive of the
22 interest, payable over the same period of time; that in
23 addition, the trustee would offer in the plan a 20 percent
24 compromise to unsecured creditors. And any reduction of price
25 would redound then to Hennis.

1 Now, that, of course, are the facts bearing up to
2 this. The plan, then, of course, was approved subsequently
3 a hearing on approval, subsequent hearing on confirmation,
4 the plan was confirmed. The United States --

5 Q Unsecured creditors were to get only 20 per-
6 cent on their claims, or 20 percent reduction of their claims?

7 A Twenty percent of their claims.

8 Q Total?

9 A Total.

10 The government is correct; this is a plan of liquida-
11 tion. Now, bearing in mind that it's a plan of liquidation,
12 something else comes into play here and that is: What would
13 happen in the event of liquidation?

14 I would like to bring up two matters before I go --

15 Q It is still a reorganization plan.

16 A It is still a reorganization plan.

17 Q With a plan for complete liquidation.

18 A That is correct.

19 Q So, it's just by the rules of Chapter 10 --

20 A No question about that; no question about that.

21 It is our view, however, Mr. Justice, that in valuing the
22 assets in this case we obviously cannot value the assets on the
23 basis of a going concern, but only on the basis of liquidation,
24 the value of the asset which is being transferred.

25 Q Well, there is no argument about that; is there?

1 A No.

2 The Government takes as its viewpoint that they are
3 entitled to absolute priority of the 3466. We don't under-
4 stand what they mean by "absolute priority," frankly.

5 Absolute priority is set forth in the Case case. Case against
6 Los Angeles Lumber has to do with the relative priorities of
7 the senior creditors.

8 We contend that the priority granted by -- to the
9 United States, is incorporated in Chapter 10 in Section 199;
10 and that is the priority that they get.

11 Now, we never contended that they are not entitled
12 to priority; they are. We contend that they are getting it.
13 Now, we contend that the major question here is whether or not
14 Section 216(7) is applicable to the United States.

15 Let me ask you: Do you think the plan of reorganiza-
16 tion could take this particular claim of the United States and
17 provide that it be paid in full ten years from the date of con-
18 firmation of the plan? No payments prior to that time and all
19 other unsecured creditors are paid in full at the time of con-
20 firmation?

21 A No; I do not think so.

22 Q Why not?

23 A Because I don't think that at that particular
24 point that would be fair and equitable, because at that par-
25 ticular point you would be using money which rightfully belongs

1 to a senior creditor for the benefit of a junior creditor.

2 Q Would you think then, that a plan could be
3 fair and equitable and not really recognize in full a priority?

4 A I don't think that's quite true; I think it
5 must recognize its full priority. And I think this plan does
6 recognize in full a priority.

7 Q Well, there's available cash and it's paid to
8 junior creditors and not paid to a senior creditor.

9 A That is not quite true. The available cash
10 that's available comes in in installments. There will be
11 available cash --

12 Q Well, at the first distribution there is
13 \$18,000 paid to, for miscellaneous taxes and \$14,000 paid for
14 another tax claim, and certain damages for cargo loss. Large
15 amounts of money are paid out that are available and not paid
16 to the senior creditors.

17 A Well, let me put it this way, then: I don't
18 believe that this senior creditor is any more senior in this
19 particular program than the other tax claimants, nor the wage
20 claimant. And, remember that in this particular case it is not
21 just the United States that is being deferred; there are three
22 other tax creditors who are also being deferred, and they are
23 being protected by the assets, by the fund, which has been set
24 aside.

25 Q Where is the priority in the statute for

1 Ohio Use Tax?

2 A There is no priority in the statute. At this
3 particular time I would say that in my view we have to go on
4 what Congress has enacted, and it would appear that --

5 Q So, the United States tax claim is senior to
6 this Ohio Use Tax claim?

7 A In a straight Chapter 10, I would say yes.
8 I would not disagree.

9 Q Well, isn't this a Chapter 10?

10 A Yes, but I think we must view it in the light
11 of liquidation and what the bankruptcy priorities would be,
12 because what the alternative to this is --

13 Q You're really saying that the priority rules
14 and the rules of reorganization shouldn't apply to this case?

15 A I am saying that the rules of reorganization
16 are equitable rules and they are flexible, and as this Court
17 has decided time and again that the rules in equity proceed-
18 ings must be flexible, depending on the type of situation and
19 I think we have such a situation here.

20 Q What do you think about the holdings in the
21 Case opinion and in the Consolidated Rock?

22 A I think that we follow them. I think there is
23 no question.

24 Q Unless I missed it, in the Court of Appeals'
25 opinion they didn't refer to them or cite them; did I miss them?

1 Do you have a recollection of that?

2 A My recollection is I don't know whether they
3 cited the Case case in there or not. I didn't think that --

4 Q They cited four or five cases, but they didn't
5 mention either of those, if my memory is correct. I am a
6 little puzzled by that.

7 A Well, I can't answer that. We cited it and
8 we think we follow it, and we believe that this actually fits
9 the Case against Los Angeles' dictum, or reason that dictum
10 really is the policy, and that is: equity proceedings in Chap-
11 ter 10 reorganizations must be governed by flexible limits.

12 Q Well, even if the Court of Appeals thought they
13 were following Case

14 A I can't answer, of course, for the Judges of
15 the Court of Appeals.

16 Q Even though your lunch hour is short, you might
17 check that out for the Court.

18 A I'll be happy to.

19 With Your Honor's permission, I see we've got about
20 30 seconds and I will defer my charts until the opening of the
21 recess.

22 MR. CHIEF JUSTICE BURGER: Very well.

23 (Whereupon, the argument in the above-entitled matter
24 was recessed at 12:00 o'clock p.m. to be resumed at 12:30
25 o'clock p.m. the same day)

1 (The argument in the above-entitled matter resumed
2 at 12:30 o'clock p.m.)

3 FURTHER ARGUMENT OF SIGMUND J. BECK, ESQ.

4 ON BEHALF OF RESPONDENT

5 MR. BECK: Mr. Chief Justice, you asked before the
6 recess as to the Circuit Court's opinion with respect to this
7 case. Looking at it, the only reason that I can believe that
8 they did not cite the case of Consolidated proceedings, was
9 that they based their decision: (1) on the grounds of 3466
10 not applying, that Section 199, 216(7) and 221 are the pro-
11 visions of Chapter 10 which apply. And in talking in terms of
12 even the absolute priority rule, their view was written on
13 page 79 of the appendix in which they stated that in the case
14 at bar, the approved plan contemplates that the United States
15 will be paid in full.

16 Going on further, they say "We hold that the trial
17 courts did not err in permitting lesser-ranking creditors to
18 receive payment simultaneously. Under the plan the government
19 does not surrender its right to full payment."

20 Now, nowhere in the Act; in fact, nowhere can we find
21 that the government or anyone else, is entitled to cash pay-
22 ment in a Chapter 10 proceeding. I think perhaps it best can
23 be shown as to why we think the absolute priority rule --

24 Q But that isn't -- whether they are entitled to
25 cash payment may not be the question; it's whether they are

1 entitled to payment before a junior creditor.

2 A I don't believe there is any place in the Act
3 which says they must be paid before the junior creditor.

4 Q Well, is the United States a senior creditor;
5 or isn't it?

6 A I would say, in my view, whether the United
7 States is a senior creditor or a junior creditor, they are not
8 entitled to get paid before any other creditors receive any-
9 thing. They are entitled to be assured of satisfaction and
10 assured of their payment and this is done in this instance.

11 Q And you must take that position --

12 A Oh, yes; I do. I don't have any qualms about
13 taking that view.

14 Q That a senior creditor may be postponed in
15 payment for ten years as long as he is assured of being paid,
16 but junior creditors can be paid immediately?

17 A No; junior creditors may not take something
18 from the senior creditor, but in this case they are not taking
19 anything from the senior creditor; in fact, they are giving
20 something up and that's what I think we have to show.

21 Q Well, let's just take the case where a senior
22 creditor is provided for in the plan by promise and security
23 that he will be paid in full ten years from the date of con-
24 firmation of the plan.

25 A Yes.

1 Q And junior creditors are paid in full in cash
2 upon the date of confirmation.

3 A I am assuming now that we have valued correctly
4 and that they are entitled to that claim.

5 Q Exactly.

6 A I would say I find nothing wrong in terms of
7 that. There were other factors that would have to be con-
8 sidered as to other reasons for equitableness. It's just not
9 the question of whether they are going to be paid; it's the
10 question of how the security is fashioned, how it's going to be
11 paid out, and the fact that the --

12 Q Well, the senior creditor doesn't question in
13 my example the fact that he will be paid in ten years.

14 A But, I say it's --

15 Q Yes, he says, "I agree I'll be paid; there is
16 plenty of security there." But, he says, "I want my money now
17 before these junior creditors get it."

18 A I don't think he's entitled to it.

19 Q You have to take that position?

20 A I think I'm correct, in view of all of the
21 other cases.

22 Q If that isn't your position, you are in diffi-
23 culty, aren't you? There is no alternative position for you
24 to take?

25 A No; I wouldn't say that necessarily, but I will

1 stick by that position.

2 Q Well, another thing, isn't it possible that,
3 taking Justice White's hypothetical case, of the payment out
4 to all of the unsecured general creditors in full at the outset,
5 has at least the potential for so-undermining the position of
6 the debtor that they might never get to paying the United
7 States or the deferred creditors --

8 A I agree, and that's why you cannot take it out
9 of context.

10 Q Well, isn't that why the priority was granted
11 to the United States for tax purposes?

12 A No; I think that's not the historical reason
13 for priority. The historical reason for the priority, in at
14 least 3466, was the right of the sovereign to see to it that
15 its taxes were paid in order for the benefit of everybody.

16 Q Well, isn't that just what I said?

17 A Well, I must have missed the point; I must
18 have misunderstood.

19 Q To see that the United States is paid.

20 A Yes, and there is nothing in this case that
21 says they won't be; nor are there other cases where I can see
22 that solvency is an issue. Now, any true reorganization in-
23 volving the situation that Mr. Justice White contemplates,
24 would necessarily have to have a solvent corporation coming
25 out or the senior creditor would be jeopardized.

1 Let me indicate to you the practicalities of this
2 and why I say this is true in this instance, and I could think
3 of many others where it might not be.

4 (Whereupon, two large charts were set up in the
5 courtroom and Mr. Beck proceeded to demonstrate on the charts
6 with a pointer.)

7 This is the plan: The plan provides for a total
8 payout of \$925,600 under the plan. That's the total cost.
9 No one disagrees that the administration claims are entitled
10 to be paid first. There is some disagreement as to whether the
11 wages should be paid first in a true Chapter 10. There is no
12 such quarrel in a straight bankruptcy. This is the United
13 States' claim for \$375,000.

14 These are the other four taxing authorities. These
15 three, class 3, 4 and 5 receive -- are in the same position as
16 the United States. The first distribution indicates what
17 happens. The United States receives \$37,500; ten percent.
18 Indiana, Vanderburgh County and Ohio also receive their ten
19 percent.

20 The miscellaneous taxes, incidentally, some 30 other
21 taxing authorities, received this \$14,000, or 100 percent.
22 Thus, these two, which would ordinarily, in bankruptcy, at
23 least, have the same established priority, are out of the way
24 in order to solve the problem.

25 Q But that last item, 100 percent tax claims is

1 just to get rid of the cats and dogs.

2 A That's correct. But, in bankruptcy, would be
3 entitled to pro rata with the United States.

4 Now, these are all the general claims, and they are
5 receiving 20 percent. It will take, under the plan -- this is
6 how it will go -- at the end of 54 equal monthly payments, the
7 United States, together with the other three will have re-
8 ceived 72.3 percent on their debt. And at the end of the six-
9 and-a-half years they will have received the whole 100 percent.
10 The question is whether or not the value is there. I will come
11 to it in a minute.

12 But, I would like, at this particular point, to show
13 the other chart and what would happen in your plaintiff in the
14 bankruptcy.

15 Q Before you leave that chart may I ask you one
16 question: Is it the general creditors there getting 20 per
17 cent and the others getting ten?

18 A At the initial distribution.

19 Q Why is that?

20 A Because, Your Honor, the 20 percent is a com-
21 promise of their claims. As I will show in liquidation, they
22 would be entitled to anywhere from 26 to 36 percent, depending
23 upon the cost of the administration in the straight bankruptcy.

24 Q The settlement in full of their claim.

25 A That is correct.

1 Q And that's all they ever get?

2 A That's all they ever get.

3 Q That's the end of the line for them.

4 A That's the end of the line.

5 Q Whereas, all the others, you say, ultimately
6 get 100 percent?

7 A Get 100 percent.

8 Q Get 100 percent?

9 A Yes, sir; everybody else receives 100 percent,
10 except the creditors. The stockholders, of course, are wiped
11 out.

12 Q That is if the company is still in business
13 that the --

14 A Well, let me put it this way: there is no
15 question insofar as the record is concerned as to the capability
16 of Hennis to continue to pay it. The testimony in the court
17 indicates not only that the asset itself has increased in
18 value, remember that the asset which is being sold to Hennis is
19 still belonging to those four creditors under a chattel mort-
20 gage; a security agreement.

21 In addition to which, Hennis, is shown by the record,
22 is continually making a profit and continuing to grow. Now,
23 here is the alternative to the plan, because there is no
24 question that insofar as the sale of this asset is concerned,
25 I cannot foresee how the District Court is going to go back on

1 the sale that took so long to be approved.

2 Here is what happens in bankruptcy: This is the
3 order of priority. The administration costs, \$60,000, again
4 100 percent. \$15,000 for the wages, 100 percent. Remember now
5 that the United States under bankruptcy, shares equally with
6 the remainder of the taxing authorities. They, therefore, will
7 receive at the initial distribution, 42.5 percent. Nothing
8 gets paid to the general creditors.

9 At the end of January '75, in other words, about
10 four-and-a-half years, the United States then get paid in full.
11 So, it takes four-and-a-half years under bankruptcy for the
12 United States and the other taxing authorities to get paid in
13 full. At that point the general creditors then have 30.04
14 percent, which will be distributed to them in the remaining
15 two years. At that point that's what they are giving up.

16 If the administration expenses go up to a maximum
17 as in our brief, of \$90,000, and we don't anticipate it, that
18 would indicate they would still get 26 percent.

19 Q Counsel, if the United States is right on their
20 argument about the priorities, then these matters would become
21 irrelevant, because the wisdom of their challenging the plan
22 is not for us, if indeed, there is a priority?

23 A I contend that even with the priority they are
24 so bound by Sections 216(7) of the Act, which indicates that a
25 dissenting creditor can be satisfied by various means. And in

1 this case they are satisfied by two means: (1) the sale of
2 the property has been sold with their rights of taxing to it.
3 And in this case the United States does not have a specific
4 lien against it.

5 Q Now, there you are arguing the wisdom of it
6 again.

7 A No; I'm talking in terms of 216(7) and in talk-
8 ing in terms of 216(7) which is part of -- in the appendix to
9 our brief. We're talking in terms of the plan of reorganiza-
10 tion in this chapter "shall include and respect the creditors
11 generally, or some class of them, means or provisions for
12 altering or modifying their rights." This 216 was placed in
13 there under Chapter 10 for the very reason that we're here. A
14 dissenting class of creditors could not insist in being paid
15 out in cash as the old equity receiverships required. However,
16 in the old equity receivership there was no way for this to
17 happen, because the senior creditors had to be paid out in cash
18 if they insisted.

19 We contend that that's what 216(7) is for and we
20 also believe that there is nothing that excludes the United
21 States as a claimant from the application of 216. Now, this
22 is where we disagree with the government, and we contend that
23 this true in other cases, in other security cases where there
24 have been secured creditors on a particular piece of property,
25 there hasn't been any question that other claimants could get

1 paid, and that the secured creditors rights would be altered
2 in one of the many ways of 216(7).

3 Now, I think the big question here is the interest
4 question, because there we are talking in terms of a question
5 that Mr. Justice Stewart asked: are they getting a discounted
6 value? I contend they are not and the reason I am contending
7 they are not is because post-petition interest is not avail-
8 able to tax claims.

9 Q But that really isn't the point; is it?

10 A Well, I think it is.

11 Q Well, then you concede that they are entitled to
12 full payment?

13 A I do.

14 Q And full payment of \$375,000 now is not made by
15 paying installments that add up, arithmetically add up to that
16 sum over a period of many years. That's not full payment.

17 A Well, if Mr. Justice will allow me, I would say
18 this: I think the question is one of substance, not of fault.
19 If we were to continue these proceedings and begin to pay out as
20 the monies come in then the United States will not receive
21 interest and it will receive its full principal as we go along.
22 There is nothing, as a matter of fact, even in the first seven
23 chapters of the Bankruptcy Act, which provide that the United
24 States must be paid before anyone else; it provides that there
25 must be provisions made for the payment of the United States.

1 Now, that, to me, is the real crux of it. We're
2 talking in terms of substance or fault.

3 I would go further, of course, and that is this:
4 The government insists that 3466 applies. The Circuit Court
5 held it did not. I am convinced that 3466 does not apply in
6 Chapter 10 proceedings. I believe that Section 199 provides
7 the priority that the legislature granted the United States.
8 They indicated that this was to make certain that the United
9 States was going to be paid its taxes and custom duties and I
10 just don't think that that's the question.

11 Now, I don't even believe that there is a conflict
12 between U. S. against Anderson and this case. I think the
13 Court stated the difference, and that was that in the United
14 States against Anderson case they were talking about non-tax
15 debts. We're not talking about non-tax debts here; we're
16 talking about the priority granted by 199, because all of these
17 are taxes.

18 I think the question of the interest is important
19 only for one reason: if I am correct that the start of
20 these proceedings and continuing on is only one step in the way
21 and the Cyper case applies and the Edens case applies and the
22 government is not going to be entitled to the interest on its
23 money.

24 And for that reason I contend that it isn't a dis-
25 count and true, one more thing: there isn't any question that

1 if interest has to be paid the United States, that it has to
2 come out of the pockets of the general creditors. Now, that,
3 to me, is the real crux of it here.

4 If there are no further questions from the Court, I
5 will rest.

6 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Beck.
7 Do you have anything further, Counsel?

8 REBUTTAL ARGUMENT BY LAWRENCE G. WALLACE,
9 OFFICE OF THE SOLICITOR GENERAL

10 ON BEHALF OF PETITIONER

11 MR. WALLACE: I would just like to make two brief
12 points here, Your Honor.

13 In the first place, it seems apparent to us from
14 Counsel's own chart that somebody's taking something away from
15 the United States in this case, compared to what we would have
16 had in a liquidated distribution where the initial payment
17 would have been \$160,000; now it's \$37,500. It's not fair and
18 equitable under established principles for the priority claim-
19 ant to have to suffer the expense of giving something of value
20 to claimants with less priority.

21 Q Well, that rather begs the question; doesn't it?
22 I mean, you assume that the result must be exactly the same in
23 Chapter 10 as it is in straight bankruptcy, and that is the
24 question in this case.

25 A Well, this is not my assumption. The contention

1 is being put by the Respondent that this is the appropriate
2 comparison.

3 I wish to point out also that, depending on the cost
4 of administration, perhaps the unsecured creditors would, in
5 fact eventually get more, so that sum really should be dis-
6 counted by the period of waiting for it in addition to taking
7 into account the risk that it will not materialize and which
8 would be borne by the unsecured creditors in that situation.

9 Now, this Court has recognized in a recent opinion
10 of Mr. Justice White's, Protective Committee against Anderson,
11 that in Chapter 10 there is an authority in the Secretary of
12 the Treasury to bargain, to compromise and that bargain and
13 compromise among claimants plays a very important role in accom-
14 plishing the objectives of Section 10 and while it may seem
15 that in this case we are arguing for a rigid rule of priority
16 the fact is that it is the priority that gives the Secretary
17 the bargaining power to induce others to enter into these com-
18 promises and accomplish the objective.

19 We did bargain previously and accept a plan in 1957
20 in this very case, which shared our rights with others.

21 Thank you.

22 Q I don't know whether this record contains it,
23 but is there any indication of what the discounted value of
24 the \$375,000 is paid over that basis? I suppose it's somewhere
25 in seven years, around \$225,000 at 6 percent. So, in effect,

1 the government is saying to us, I take it, that, as a matter
2 of judgment, laying aside the priorities, judging the equitable
3 aspect of the plan the government's preference is to get
4 \$160,000 now than \$225,000 over a period of seven years with
5 the attendant risks that they might get all of it.

6 A That is correct, sir. Or, our own contention
7 would have been that we should be paid now what was being paid
8 under the plan. We have the right to be paid what was being
9 paid under the plan to the junior creditors, rather than this
10 particular comparison. We would look at the distributions
11 being made under the plan and certain of those we had a right
12 to, if we insisted on it.

13 Q I suppose it's not relevant here, but from what
14 you have said before I take it that some plan less than the
15 distribution under bankruptcy, but more than the one offered
16 might have been acquiesced in by the government?

17 A There is the authority to do that. We did pre-
18 viously acquiesce in such a plan in 1957 in this case. At that
19 time that plan had rehabilitative purposes and that is a
20 factor in our acquiescence.

21 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Wallace.

22 Q The other Counsel stated to me that payment
23 there to the other creditors in that first line was a payment
24 in full, but it looks like over at the last line it was not a
25 payment in full; what is that?

1 Q That was the other chart.

2 A In the other chart I think his contention was
3 that eventually there would be payment in full, even though the
4 initial payment was only 10 percent. His contention is that
5 our right is satisfied so long as the government will eventually
6 be paid 100 percent by the end of the 78 months.

7 Q One-hundred percent without interest.

8 A Without interest. I think that was the point he
9 was making when he said that we would get 100 percent.

10 Q And that the other creditors get 20 percent now
11 and that's all they ever get under the plan?

12 A That was the contrast he was drawing, so that
13 even though, initially, under the plan we get only 10 percent
14 compared to their 20 percent, we would get the additional pay-
15 ments.

16 Q I don't understand still that -- didn't you say
17 that that's all the creditors will ever get?

18 A General unsecured creditors. Well, this is not
19 the plan. This is --

20 Q I understand it, but what is that figure over
21 here for?

22 A This is the hypothetical figure that counsel
23 suggests as what the general unsecured creditors would even-
24 tually get if this were not a Chapter 10 proceeding, but an
25 ordinary liquidation.

1 MR. CHIEF JUSTICE BURGER: Thank you, Mr. Wallace, and
2 and thank you, Mr. Beck. The case is submitted.

3 (Whereupon, at 12:55 o'clock p.m. the argument in the
4 above-entitled matter was concluded)

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