

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

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

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 85-519

TITLE WILLIAM C. RANDALL, ROGER E. AUSTIN, TOM W. ANDERSON AND
MYREL A. NEUMANN, Petitioners V. B. J. LOFTSGAARDEN, ET AL

PLACE Washington, D. C.

DATE April 2, 1986

PAGES 1 thru 34

AR
ALDERSON REPORTING

(202) 628-9300

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

IN THE SUPREME COURT OF THE UNITED STATES

- - - - -x

WILLIAM C. RANDALL, ROGER E. :

AUSTIN, TOM W. ANDERSON AND :

MYREL A. NEUMANN, :

Petitioners :

v. : No. 85-519

B. J. LOFTSGAARDEN, ET AL. :

- - - - -x

Washington, D.C.
Wednesday, April 2, 1986

The above-entitled matter came on for oral
argument before the Supreme Court of the United States
at 10:46 o'clock a.m.

APPEARANCES:

ROBERT A. BRUNIG, ESQ., Minneapolis, Minn.; on
behalf of the Petitioners.

LAWRENCE G. WALLACE, ESQ., Deputy Solicitor
General, Department of Justice, Washington, D.C.;
for United States and the SEC, as amici curiae in
support of Petitioners.

JOHN M. FRIEDMAN, JR., ESQ., New York, New York;
on behalf of the Respondents.

C O N T E N T S

<u>ORAL ARGUMENT OF</u>	<u>PAGE</u>
ROBERT A. BRUNIG, ESQ.,	3
on behalf of Petitioners.	
LAWRENCE G. WALLACE, ESQ.;	12
for United States and the SEC, as amici curiae in	
support of Petitioners.	
JOHN M. FRIEDMAN, JR., ESQ.,	16
on behalf of Respondents.	
ROBERT A. BRUNIG, ESQ.	30
on behalf of Petitioners - rebuttal	

1
2
3
4
5
6
7
8
9
0
1
2
3
4
5
6
7
8
9
0
1
2
3
4
5

2
3
4
5
6
7

4

5

6
7

8
9
0
1
2

3
4
5
6
7
8
9

0
1
2
3
4
5

1 The offering memorandum projected losses for
2 tax purposes in 1973 through 1976 which ranged from
3 slightly above \$20,000 to \$476, and thereafter taxable
4 income. The taxable income for the entire period
5 through 1991 was estimated to be \$96,000, and that these
6 people would be required to pay taxes of over \$52,000
7 during that period.

8 Instead, they got something else. They got
9 certain tax deductions which led to lesser tax payments
10 in the amounts ranging from \$29,000 to slightly more
11 than \$38,000 per unit. The reason that they got greater
12 tax benefits was because B. J. Loftsgaarden, the general
13 partner, created greater losses, either operating losses
14 or greater deductions for other items that were
15 involved, and those were not disclosed, and those were
16 amounts which benefited him either directly or
17 indirectly or benefited his affiliates.

18 There was less income, in addition, because
19 for example the motel could not operate as it was
20 anticipated. Sixty of 159 rooms were not able to be
21 occupied whenever it rained because Mr. Loftsgarden's
22 wholly owned corporation, 2361 Building Corporation, had
23 built a building that leaked through the walls. He of
24 course did not sue himself or the architects, which was
25 a firm of which he was a 30 percent stockholder.

1 Now, to take that along, we look at that in
2 the statutory context, and this is a question of
3 statutory construction. The first question to be looked
4 at is under Section 12(2) of the Securities Act of 1933,
5 which provides that any person in a similar circumstance
6 may recover the consideration paid for the security,
7 with interest thereon, less the amount of any income
8 received thereon, upon the tender of such security, and
9 it offers an alternative remedy for those who have sold
10 their securities, that is, damages.

11 The Eighth Circuit at a number of points
12 characterized this under Section 12(2) as a damage
13 case. It is not, as the Eighth Circuit held in Austin
14 One, a damage case. It is an actual rescission case.
15 There was a tender, and in fact the formula applies:
16 consideration paid, together with interest, less income
17 received.

18 The Eighth Circuit held that what is called
19 tax benefits are not a reduction in consideration paid,
20 and that's logical sense. If in fact a person bought
21 gasoline for his or her automobile and used it for
22 business purposes, and the price was \$10, there would be
23 no reduction in the consideration paid, just as here
24 there was no reduction in the consideration paid. Each
25 partnership unit had the consideration of \$35,000.

1 Respondents asked the Court, despite the lack
2 of a counterpetition, to review that holding. It should
3 not, both because it's not logical and because it's not
4 appropriately before the Court.

5 So, the case then goes to, do in fact the
6 reductions in the taxes paid by these individual
7 petitioners constitute income received. These tax
8 benefits, as they are called, are not such income
9 received.

10 QUESTION: Is it possible, Mr. Brunig, that
11 the tax benefit features of a particular investment
12 might be part of a bargained for exchange, or part of
13 what caused the investors to make the investment in the
14 first instance?

15 MR. BRUNIG: First of all, the short answer is
16 yes. Every investment involves tax consequences,
17 whether it be one which is characterized as an
18 artificial deduction, or any other deduction. Every
19 investment, as we know, has tax consequences and the
20 Internal Revenue Code imposes those tax consequences.

21 QUESTION: Well, can they have a market value
22 in the mind of the investor such as would affect the
23 damages recoverable in the event such becomes necessary?

24 MR. BRUNIG: Well, every investor, including
25 these, looked on this as an opportunity to recover a

1 profit from the investment and to have certain tax
2 consequences flow from that investment. That's true of
3 every investment. But to look to the benefit of the
4 bargain, respondents would have the Court look only at
5 the income received aspects and say, well, there were
6 tax benefits which flowed from it.

7 The actual bargain is one which would have
8 provided \$96,000 in taxable income over a period of
9 time, plus calculable appreciation. If we are to look
10 at this as a benefit of the bargain case, we should be
11 allowed to recover the entire benefit of our bargain.

12 At the time of the investment, that projected
13 stream of income had a valid -- and we are not being
14 allowed to recover any of that, and if we were allowed
15 to we would be more than happy to go back and sue for
16 the benefit of the bargain because we'd get much more.

17 QUESTION: Well, in this case I guess the --
18 your clients brought the action under both Section 10(b)
19 and 12(2)?

20 MR. BRUNIG: That's correct, as well as --

21 QUESTION: And 12(2) provides just for
22 rescission?

23 MR. BRUNIG: In the case of these investors it
24 provides only for rescission. If they had in fact sold
25 the securities, they might get damages but this provides

1 only for rescission, that's correct.

2 QUESTION: Does 10(b) provide a different
3 measure of damages?

4 MR. BRUNIG: 10(b) has no expressed statutory
5 remedy. It has a limitation on a damage remedy provided
6 by Section 28(a) which says you are limited to actual
7 damages. That term itself is not described, although
8 this Court in opinion prior to the adoption of the
9 Securities Act of 1933 and the Exchange Act of 1934 had
10 considered cases in which actual damages were involved,
11 the L. P. Larson case, for example, and there the Court
12 refused to consider the tax consequences under actual
13 damages. It must be presumed that Congress was aware of
14 that.

15 QUESTION: Well, when the two sections are
16 both brought into the picture, then is it up to the
17 plaintiff to select which measure of damages, or what do
18 you do? Are you limited only to rescission because
19 you've combined 12(2)?

20 MR. BRUNIG: The plaintiff is allowed to elect
21 after the jury has returned a verdict, and the trial
22 court in this case under 12(2) has made factual
23 findings. The litigant may choose the result most
24 favorable to himself or herself.

25 QUESTION: Both issues in -- rescission and

1 benefit of the bargain were submitted to the jury for
2 findings of damages?

3 MR. BRUNIG: No, that's not correct.

4 Rescission was submitted to the trial court, as it was
5 here, and the trial court made specific written findings
6 of fact with regard to Section 12(2). The 10(5)-5, the
7 state Securities Act and the common law fraud claims
8 were submitted to the jury.

9 The trial court considered the result of the
10 answers to the special interrogatories submitted to the
11 jury in making his own findings, but he made much more
12 extensive findings which are part of the Petition
13 Appendix.

14 QUESTION: Was an election then made by the
15 plaintiffs?

16 MR. BRUNIG: What happened was, the trial
17 court said that the result was the same, that there was
18 \$35,000 per unit plus interest available to these
19 people. The trial court also held that under a benefit
20 -- out of an out-of-pocket measure of damages, it would
21 also obtain the same result because in an out-of-pocket
22 measure it would have the price paid, less the value of
23 the security at the date of the discovery of the fraud.

24 The trial court held that as of the date of
25 the discovery of the fraud the securities were

1 worthless, and because they were worthless you get the
2 same amount back, that is \$35,000 per unit.

3 In any event, when we talk about income
4 received, the respondent's expert at the time of the
5 retrial testified that these tax benefits were in fact
6 not income. The Internal Revenue Code, both at the time
7 of the adoption of the Securities Act of '33 and the
8 Exchange Act of '34 would not have considered what are
9 characterized as tax benefits to be income received.

10 This Court, in United Housing Foundation,
11 considered what we have here, that is, tax deductions
12 which are available to a person and which may create a
13 benefit because of other income which is had, as not
14 being income or profit when looking at the definition of
15 a security as it exists in Section 2 of the Securities
16 Act of 1933, and said it was not income.

17 In sum, this is not income received. Now, to
18 look at the analysis which the respondents would have
19 the Court adopt, they would say that you look first to
20 Section 10(b) and Rule 10(b)-5, and the limitation
21 imposed by Section 23(a) of the Securities Exchange Act
22 of 1934 which limits recovery to actual damages. And
23 they say, that must mean economic effect.

24 Then, they would have the Court construe the
25 Securities Exchange Act in pari materiae with the

1 Securities Act of 1933, and say, because the standard
2 under the '33 Act is negligence, and say any is required
3 under the '34 Act, you can't get a greater remedy.

4 We believe that that analysis is reversed, and
5 it should go to the express remedy created by Congress
6 in attempting to determine what Congress intended as the
7 measure of damages. Clearly, the legislative history
8 says that the person is to get his or her money back, to
9 recover his or her purchase price. There is no
10 suggestion that tax benefits which are created only by
11 investors' other income, there are no tax benefits but
12 for other income.

13 One of the problems that will be created in
14 the future will be one that is demonstrated in Freschi
15 versus Grand Coal Venture. What happens if the
16 individual investor determines that the deductions which
17 are shown on the K-1 do not appear to be appropriate,
18 and doesn't take the deduction on his or her individual
19 income tax return? Is he then to be faced with a
20 question that he has failed to mitigate his damages by
21 taking deductions which he believed to be fraudulent?

22 That will be the issue to arise. We believe
23 that Section 28(a) does not impose this kind of
24 question. What Section 28(a) does is, it says that you
25 can't get identical remedies under state and federal law

1 and have two recoveries for those, and double up your
2 recovery. It says that you cannot under the Securities
3 Exchange Act obtain punitive damages.

4 What we have here is a situation in which a
5 promoter claims that he should be allowed to use the
6 federal treasury to support his fraud, and to reduce his
7 damages. As this Court has repeatedly said, the intent
8 of the federal securities laws is to protect the
9 investor, and to deter fraud by a promoter. That is
10 based on the legislative history of the Act including
11 President Roosevelt's remarks.

12 In any event, if people are allowed to do
13 this, the more money that they bleed from the limited
14 partnership assets, the greater the tax deductions
15 available to the limited partners and the less money the
16 promoter will be required to pay to the defrauded
17 investor.

18 CHIEF JUSTICE BURGER: Mr. Wallace.

19 ORAL ARGUMENT OF LAWRENCE G. WALLACE, ESQ.

20 FOR UNITED STATES AND THE SEC,

21 AS AMICI CURIAE IN SUPPORT OF PETITIONERS

22 MR. WALLACE: Mr. Chief Justice, and may it
23 please the Court:

24 Tax incentives are provided by Congress to
25 stimulate certain kinds of investment or economic

1 activity, not to subsidize securities fraud. That is a
2 basic reason why we submit that the proper approach to
3 this case and to others like it which are in the wings,
4 is to calculate restitutionary relief or other damage
5 awards under the securities laws, wholly without regard
6 to the tax effects of the securities transaction on the
7 various participants, and to leave the further tax
8 consequences after the fraud award to be determined
9 between the Internal Revenue Service and each taxpayer,
10 under principles prescribed by the Internal Revenue Code.

11 This approach has the twin virtues of, number
12 one, preserving without diminution both the deterrent
13 and the restitutionary effects of the statutory remedies
14 against securities fraud, and, number two, allowing the
15 tax consequences to be determined by the normal
16 operation of the Internal Revenue Code, and under our
17 annual tax accounting system that will provide for some
18 recapture of revenue by the Treasury by means of the tax
19 benefit rule or other mechanisms, and it will further
20 assure that any remaining tax benefits, after it has all
21 been sorted out, will rest with the persons upon whom
22 Congress conferred those tax benefits rather than being
23 transferred to the perpetrators of securities frauds.

24 As this Court knows from its 1983 decision in
25 Hillsboro National Bank, it can be a complex and time

1 consuming task to sort out the tax consequences in such
2 situations, and the results can vary depending on other
3 aspects of the particular taxpayer's circumstances in
4 the taxable years at issue.

5 But, that is the method that Congress and the
6 courts have prescribed for applying the Internal Revenue
7 Code to interrelated events that stretch out over more
8 than one taxable year. The fundamental error of the
9 Court of Appeals in our view, in this case, lies in its
10 attempt through strained interpretation of the statutory
11 terms to improve upon the system that Congress has
12 prescribed by creating an unwieldy amalgam of securities
13 law and tax issues to be resolved up front in the fraud
14 suit.

15 It is a bit like trying to solve an equation
16 containing too many variables without any firm starting
17 point in doing that, and the danger of such a
18 contrivance is that it distorts the results ordained by
19 each statutory scheme and thereby undermines the
20 statutory policies of both Acts.

21 The fact that the Eighth Circuit here and the
22 Second Circuit have disagreed on the details of how to
23 create such an amalgam is, in our view, merely
24 symptomatic of the basic error of undertaking that
25 enterprise in the first place.

1 QUESTION: Basic error by both courts?

2 MR. WALLACE: By both courts, of undertaking
3 to make an amalgamation of the securities issues and the
4 tax issues in the first place in the fraud suit, rather
5 than applying each statute on its own terms and pursuant
6 to its own processes in a straightforward way, seriatim,
7 as the tax law provides and as this Court recognized in
8 the Hanover Shoe case is the proper approach to these
9 cases.

10 We agree with the petitioner that perhaps the
11 most egregious misinterpretation of this statute is to
12 characterize tax benefits as income of an amount due is
13 a right if the taxpayer has generated other income
14 through his labor or his capital, to get the government
15 to refrain from applying as much tax to that other
16 income as it otherwise would apply.

17 But, the tax benefit is not the income itself
18 and it is not the economic activity that generates
19 income. There would be no economic activity if the only
20 income people had was tax benefits.

21 And so, we believe that that is the
22 fundamental error, rather than of the detailed
23 differences in analysis between the two courts.

24 If there are no further questions --

25 CHIEF JUSTICE BURGER: Mr. Friedman.

1 ORAL ARGUMENT OF JOHN M. FRIEDMAN, JR., ESQ.

2 ON BEHALF OF THE RESPONDENTS

3 MR. FRIEDMAN: Mr. Chief Justice, and may it
4 please the Court:

5 There is no question here --

6 QUESTION: Mr. Friedman, before you start,
7 could I ask whom you represent?

8 MR. FRIEDMAN: All the respondents, sir, Mr.
9 Loftsgaarden and his corporation.

10 QUESTION: Mr. Loftsgaarden must be out of the
11 picture now. He is an old St. Paul lawyer, as I recall.

12 MR. FRIEDMAN: He is very much in the picture,
13 sir.

14 QUESTION: Where is the juice in this case?
15 Is this a test case, or where is the juice that keeps it
16 going?

17 MR. FRIEDMAN: I'm not sure I follow you.

18 QUESTION: Well, where is the financial
19 responsibility?

20 MR. FRIEDMAN: With Mr. Loftsgaarden
21 exclusively, and his corporations.

22 QUESTION: Is there money in these
23 corporations?

24 MR. FRIEDMAN: I don't believe the -- well, I
25 don't know the status of the corporations.

1 QUESTION: You've come out of New York, a
2 large firm. I'm just wondering who's paying the bill.
3 Mr. Loftsgaarden can't be paying the bill.

4 MR. FRIEDMAN: Mr. Loftsgaarden is not paying
5 the bill, sir.

6 The investors have invested in a tax shelter.
7 The tax shelter promised them savings on their taxes,
8 and returned what was promised. Section 28 of the 1934
9 Act says that no person shall recover a total amount in
10 excess of his actual damages on account of the act
11 complained of.

12 All measures of damage under the 1933 Act
13 contemplate a return as well to the status quo ante. No
14 punitive damages are awardable under either Act. The
15 courts have held this for many years.

16 QUESTION: Is it your position that deterrence
17 is not one of the functions of the securities law?

18 MR. FRIEDMAN: Deterrence is a function of the
19 securities laws, sir, yes.

20 QUESTION: Deterrence, by implication,
21 embraces the idea of a penal sanction, does it not?

22 MR. FRIEDMAN: Yes, and penal sanctions are
23 found in the securities laws, but the provisions of the
24 securities laws to be construed by the Court in this
25 case are compensatory in nature. They are the civil

1 damage remedies and no court has sanctioned an award of
2 anything beyond such remedy in interpreting those
3 sections.

4 The lower courts tried to apply that principle
5 carefully to the facts of this case, and examined the
6 investment each investor made and the returns, the
7 economic benefits, that each investor received from this
8 investment.

9 The plaintiffs and the Government would have
10 this Court ignore the returns so received by the
11 investors, not because they were unreal, not because
12 they lacked value, not because they were speculative and
13 not because the petitioners failed to receive them, but
14 because they feel as a matter of policy that making the
15 petitioners more than whole would later violations of
16 the Securities Act or otherwise serve tax policy.

17 The difference in an award made by the lower
18 court, taking tax benefits into account, and an award
19 sought by the petitioners, is the difference between an
20 award of \$20,000-some oil, and an award of close to
21 \$300,000, the \$280,000 penalty that is sought to be
22 enforced against the petitioners -- excuse me, against
23 the respondents -- even though the petitioners are not
24 out of pocket anything.

25 Now, I would propose to address --

1 QUESTION: In terms of conventional policy in
2 antitrust cases, for example, you have a trebling of
3 damages, do you not?

4 MR. FRIEDMAN: Yes, sir.

5 QUESTION: And that is for deterrence, isn't
6 it?

7 MR. FRIEDMAN: Yes, it is.

8 QUESTION: There's nothing expressed in the
9 Securities Act about trebling the damages, is there?

10 MR. FRIEDMAN: That is correct. There is not.

11 QUESTION: Well, would you suggest that this
12 large amount would not function as a deterrent with
13 respect to other people similarly situated?

14 MR. FRIEDMAN: I expect it may. There is
15 nothing in the record, or nothing I am aware of, to
16 suggest that since Austin One was decided some four
17 years ago, there has been an abatement of tax shelter
18 litigation and I don't know that enhancing the penalty
19 here would create such an abatement or would encourage
20 people to sue or not, or would act as a deterrent. But
21 as to the economics matter, it seems logical that the
22 more penalty associated with an action, the less the
23 action will occur, yes, sir.

24 I'd like to talk about the arguments raised by
25 the Government that to follow the rule of the Eighth

1 Circuit and Second Circuit constitutes subsidizing
2 fraud, and I would also like to address the statutory
3 construction argument made by Mr. Brunig earlier.

4 The Government and the petitioners are fond of
5 speaking of fraud here. The statutes to be construed do
6 involve fraud under the '34 Act, but the '33 Act statute
7 is a negligence statute. In addition, Section 11 of the
8 '33 Act, which would govern public offerings of tax
9 shelters is a strict liability statute.

10 The subsidy, so called, can best be viewed in
11 the context, I think, of one of the petitioners, and I
12 propose to use Dr. Austin as the example there. Dr.
13 Austin originally invested \$35,000. He was returned
14 \$33,000 through his tax benefits, and he stands out of
15 pocket now \$2,000.

16 The so-called subsidy is represented by this
17 \$33,000 contribution of the government. The government
18 is not subsidizing a fraud.

19 QUESTION: Mr. Friedman, do you know to what
20 extent, if a rescission is obtained as a result of the
21 securities fraud litigation, that IRS could come back
22 later on the investor, seeking a recoupment of some of
23 the tax benefits previously taken?

24 MR. FRIEDMAN: Depending on the situation, the
25 normal result would be that following rescission the

1 monies received would be treated as income by the
2 petitioners here. However, the income would not be
3 taxed at anything like the 100 percent rate.

4 Again, consider again Dr. Austin, who has
5 already received a permanent tax benefit of \$33,000. If
6 he would receive his \$35,000 back at this time, the most
7 the government would take would be \$17,000 or so,
8 leaving him with a \$15,000 windfall on this investment,
9 contrary to the expressed requirements of Congress as
10 the statutes have been interpreted by the courts, that
11 he receive compensation and be made whole, and no more.

12 So, the notion that the Ninth Circuit, for
13 example, has advanced that tax benefits will be
14 completely recaptured by the government, the government
15 will get all its money back in some sense, is just
16 false, an erroneous statement of tax law.

17 The subsidy, though, is something worth
18 addressing because the government is not subsidizing
19 fraud. The government is subsidizing a motel. The
20 motel is built and is functioning. I believe you can go
21 to Rochester, Minnesota and find it functioning today.

22 The government has --

23 QUESTION: I know that motel.

24 MR. FRIEDMAN: I'm not sure how to take that,
25 but --

1 (Laughter.)

2 MR. FRIEDMAN: The motel is functioning.
3 Carpenters were employed, electricians, plumbers,
4 masons, road pavers, roofers, whoever makes lumber, two
5 by fours, in the Pacific Northwest have this factory
6 running a little longer to help finish this motel.

7 This is what the government sought to bring
8 about. This is what was brought about by the building
9 of this motel. And the notion that the government is
10 somehow entitled to any measure of damages now to get
11 back some of that money is preposterous. That's exactly
12 what the Second Circuit held.

13 They faced it this way: they said, the
14 government is not banking a fraud, which was the
15 expression used by the Ninth Circuit and by the
16 petitioners today. The government is banking exactly
17 what it agreed to bank, which is a type of economic
18 activity.

19 Having gotten that, I used the word
20 "preposterous" and perhaps "disingenuous" would be a
21 better word, the government is not entitled to get it
22 back. The subsidy here is not a fraud. Injuries caused
23 by fraud, Dr. Austin's \$2,000 out of pocket loss, have
24 been restored to him. That is what the Eighth Circuit
25 did. There was no subsidy of the fraud.

1 Now, I think the clearest way to illustrate
2 this point, and I don't want to beat this horse to
3 death--

4 QUESTION: I suppose that if the fraud hadn't
5 taken place in the first place there wouldn't have been
6 any tax savings?

7 MR. FRIEDMAN: Well, let me examine that very
8 scenario. Let's suppose that at the outset in 1973 the
9 petitioners came to Mr. Loftsgaarden and said, we wish
10 to rescind, take back our units, and he did, and return
11 them each for \$35,000 per unit.

12 What would happen then? What would happen is,
13 the motel would have been built and all the tax benefits
14 associated with it would have gone to the owner of the
15 units, Mr. Loftsgaarden. He would have received the tax
16 benefits, not the petitioners.

17 An that is the same economic --

18 QUESTION: That may be so, but these people
19 who invested, if they had -- they probably wouldn't have
20 invested if they had known what they should have known.

21 MR. FRIEDMAN: That's right.

22 QUESTION: Or they may have acquired a tax
23 benefit that was caused by the fraud.

24 MR. FRIEDMAN: Yes, it was caused by the
25 investment, induced by the fraud, that is correct. I

1 don't know --

2 QUESTION: Your clients were not entirely
3 blameless for causing the --

4 MR. FRIEDMAN: No, they weren't. But as with
5 any investment --

6 QUESTION: The government suffered from the
7 tax benefit?

8 MR. FRIEDMAN: I don't think the government
9 has suffered, and I think that's a vital issue here, and
10 I think that's exactly what --

11 QUESTION: At least it didn't collect these
12 taxes from these investors.

13 MR. FRIEDMAN: But, it never encouraged --

14 QUESTION: And it may never be able to collect
15 them from anybody?

16 MR. FRIEDMAN: It may not, but the reason it
17 may not is because it sought to induce a kind of
18 economic activity that was in fact induced, and brought
19 about.

20 QUESTION: Well, did the government lose
21 anything by the fraudulent nature of the transaction
22 that it wouldn't have lost if the transaction had not
23 been accompanied by --

24 MR. FRIEDMAN: Not at all, not at all, and
25 that is what the Second Circuit meant when it said, the

1 government is banking exactly what it agreed to bank.
2 All the deductions and tax credits that led to the tax
3 savings by the investors here have been audited, and
4 were found to be completely proper.

5 This is not a case where the government was
6 cheated out of some tax revenues it otherwise might have
7 received. The fraud went only to the incremental
8 investment made by each of these investors, and they
9 have been made whole.

10 The illustration I used, which invited the
11 Court to effect this rescission in 1973, I think shows
12 that. The economic position of the parties would have
13 been, had the transaction either not occurred or been
14 rescinded right away, is the exact economic position
15 they find themselves in today by reason of the action of
16 the Eighth Circuit.

17 QUESTION: Do you think the United States,
18 then, has a financial interest in this case at all, or
19 is it just, they think this would be a sort of deterrent
20 way of enforcing the securities laws?

21 MR. FRIEDMAN: Well, they do have a financial
22 interest. If the petitioners were awarded \$300,000
23 instead of \$20,000-some odd, there would be more money
24 to tax, and some of those tax benefits that the
25 government gave out would come back, by no means all of

1 them, but some would come back despite the fact that
2 what the government sought to bring about by granting
3 those tax benefits has occurred.

4 QUESTION: So, the United States would stand
5 to collect some more taxes?

6 MR. FRIEDMAN: If the award was increased,
7 yes, they would.

8 QUESTION: Well, I suppose the government
9 might have an interest in appearing as amicus before any
10 court reviewing any sort of awards to plaintiffs, urging
11 that the awards be increased on that basis because the
12 government would get more tax money?

13 MR. FRIEDMAN: Well, they would have an
14 incentive to do that, yes.

15 I would like to turn, if I may, to the
16 statutory interpretation argument that Mr. Brunig has
17 made this morning, because I think it is erroneous. We
18 have argued in our brief, and by no means abandoned the
19 position, that the nature of these tax benefits is
20 properly considered as a restoration of consideration
21 paid for the investment by the investor.

22 I won't rehash the arguments made in the brief
23 because I want to address the income point, because I
24 feel that if the investment is not regarded as a return
25 of consideration, it must be treated as a form of

1 income. And I think as a result, compelled in part by
2 the Court's decision in the Norfolk and Western Railway
3 case in which the Court decided a few years ago that in
4 determining the earnings of a railwayman killed in an
5 accident for the purpose of awarding his wife his lost
6 earnings, the taxes he would have to pay must be
7 deducted like any other costs of his former wife before
8 the net amount was determined.

9 And it seems to me that if the Court is
10 recognizing, as it does, that the payment of a tax
11 liability is a cost to be subtracted from income
12 determining net amount, that it follows that relief from
13 a tax liability is properly regarded as income, at least
14 in an economic sense. And I don't want to suggest it's
15 taxable income, but in an economic sense the status of a
16 person both before and after he invested in a tax
17 shelter is different.

18 Tax benefits enhance a person's wealth by
19 reducing his taxes, and in that sense constitute
20 economic income regardless of whether it constitutes
21 taxable income. Indeed, Section 61 of the Internal
22 Revenue Code, which I concede is not strictly applicable
23 here, has underlying it an economic principle. It says
24 that the forgiveness or release of indebtedness
25 constitutes income.

1 QUESTION: What may constitute income for
2 purposes of the Internal Revenue Code can be quite
3 different from what we think of normally as income, can
4 it not?

5 MR. FRIEDMAN: Yes. Yes, it can. I think
6 people normally think of increments to one's wealth as
7 income. The man on the street may not --

8 QUESTION: Do you regard that as income too?

9 MR. FRIEDMAN: Pardon?

10 QUESTION: Do you regard capital gains the
11 same as income?

12 MR. FRIEDMAN: They are a form of income, yes,
13 sir. They're not the same as earned income, obviously,
14 but --

15 QUESTION: They're taxes somewhat differently,
16 aren't they?

17 MR. FRIEDMAN: And they are taxed differently,
18 certainly. But from an economic standpoint they can be
19 a return on investment and a form of income in that
20 sense.

21 Now, I think if we stand back from this
22 statute, and I'm referring here to Section 12, the
23 purpose of this statute, and the Government appears to
24 agree with this as well as the petitioners, the purpose
25 is to effect a rescission and restitution, to return the

1 parties to the status quo ante.

2 I think an interpretation of income which
3 closes its eyes to the economic necessities in achieving
4 that end is a misinterpretation of the word "income" in
5 the statute, and unless the word "income" is interpreted
6 to include all the economic benefits that an investor
7 receives from his investment, there will be
8 misconstruction and the parties will not be returned to
9 the status quo.

10 That is an important fact in the statutory
11 interpretation here. The purpose of the statute is to
12 return the parties to the status quo ante. That can't
13 be done unless the economic benefits received from the
14 investment by the investors are taken into account.

15 The Court, I believe, should not close its
16 eyes to that principle. I think it's easy to lose sight
17 of the facts of this case before the Court. It is
18 essentially a simple case. An investment was made.
19 benefits were returned from the investment. The
20 plaintiffs have been made whole. They have the same
21 amount of money in their pockets they had before they
22 got into this investment.

23 No policy requires making them more than whole
24 in the face of statutes whose purpose and whose
25 limitation is to avoid actual damages or compensation on

1 account of the acts complained of.

2 Thank you.

3 CHIEF JUSTICE BURGER: You have five minutes
4 remaining, Mr. Brunig.

5 ORAL ARGUMENT OF ROBERT A. BRUNIG, ESQ.

6 ON BEHALF OF PETITIONERS - REBUTTAL

7 MR. BRUNIG: Thank you, and may it please the
8 Court:

9 Counsel would say, we would like to return the
10 parties to the status quo ante. Counsel does not
11 suggest that Mr. Loftsgaarden would be returned to the
12 status quo ante and required to disgorge the \$70,000
13 which he paid to his wholly owned corporation as rent
14 during 1973.

15 He does not suggest that he be required to pay
16 the in excess of \$100,000 which the partnership paid
17 over and above what was disclosed as the cost of
18 constructing a motel. He does not suggest that Mr.
19 Loftsgaarden pay the \$23,100 mortgage commitment fee
20 which he paid to Property Development Research Company,
21 his 100 percent owned corporation, or the \$23,100 he
22 paid to Lyman Colt, a member of the board of directors
23 of Alotel Associates.

24 He does not suggest that Mr. Colt repay the
25 undisclosed \$25,000 real estate commission that he was

1 paid. He does not suggest --

2 QUESTION: Yes, but what about the
3 relationships between the investors and him?

4 MR. BRUNIG: I'm sorry, I don't understand the
5 question.

6 QUESTION: Well, are they being -- are their
7 relationships being returned to what they were before,
8 the investors' relationship to Mr. -- what's his name?

9 MR. BRUNIG: Loftsgaarden.

10 QUESTION: Loftsgaarden.

11 MR. BRUNIG: Mr. Loftsgaarden got all the
12 money to which he was entitled, plus a great deal more.

13 QUESTION: Well, I know, but aren't these
14 investors being returned to their pre-deal commission?

15 MR. BRUNIG: Hal they hal --

16 QUESTION: Yes or no.

17 MR. BRUNIG: They are not being returned under
18 the present status --

19 QUESTION: In what respect?

20 MR. BRUNIG: Because as was the testimony of
21 petitioner Newmann, for example, he was looking at a
22 variety of very similar deals, all of which would have
23 provided him with similar tax deductions, similar tax
24 benefits. He cannot get that with the several thousand
25 dollars which he's being awarded under the Eighth

1 Circuit's holding, because he would have had both the
2 tax deductions and the real estate investments.

3 QUESTION: And the profit?

4 MR. BRUNIG: And the ultimate profit, the
5 capital gain on the apartment buildings in which he had
6 invested previously, and would have invested at this
7 time.

8 What Mr. Loftsgaarden is saying is, the
9 Treasury should pay out the \$280,000 which he wishes to
10 keep and would otherwise have had to pay back. So,
11 really, if these people had not had other income from
12 other sources, there would have been no tax benefits and
13 he would not have been able to deduct one penny from the
14 recovery, even under the Eighth or Second Circuit
15 holdings.

16 But, there is no way to give these people
17 their lost investment opportunity back again. They were
18 the people at risk. They took certain risks, and Mr.
19 Loftsgaarden imposed unilaterally other risks upon them.

20 QUESTION: Did they get some benefit for the
21 use of the money, for the money that was returned to
22 them?

23 MR. BRUNIG: They were allowed to take certain
24 deductions, but they got nothing other than that. Part
25 of the deductions were obtained in a different way.

1 It cost real dollars. These people had to
2 make loans to the partnership which they were not-
3 allowed to recover by the district court, because the
4 district court held that they had learned of the fraud
5 before making the loan, therefore there was no reliance
6 and therefore no recovery.

7 So, these people put in money to be used for
8 operating capital which was lost because of the fraud,
9 and that is not and will never be returned, even if we
10 should succeed, and certiorari be used to reverse the
11 decision of the Eighth Circuit.

12 So, that money is lost. These people were
13 required to make those loans to get these deductions.
14 It was real money. It was not artificial deductions.

15 To answer the earlier question, would there be
16 some recoupment by the government, certainly the
17 mitigation provisions under Sections 1311 to 1314 allow
18 the government to recoup some of that money, because
19 when the status is changed by a subsequent judicial
20 decision as we've noted in the brief, the government has
21 a mechanism available in addition to the tax benefit.

22 If there are no further questions --

23 CHIEF JUSTICE BURGER: Thank you, gentlemen.

24 The case is submitted.

25 (Whereupon, at 11:25 o'clock a.m., the case in

1 the above-entitled matter was submitted.)
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

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:

#85-519 - WILLIAM C. RANDALL, ROGER E. AUSTI, TOM W. ANDERSON AND MYREL A. NEUMANN, Petitioners V. B. J. LOFTSGAARDEN, ET AL.

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

BY Paul A. Richardson

(REPORTER)

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

'86 APR -9 P 3:42