United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]
[rev'd and remanded, Case No. 90-C-833-C (W.D. Wis. May 2, 1991)
(Bankruptcy Court lacks jurisdiction; remanded with instructions
to vacate ruling and dismiss action)]

Melvyn L. Hoffman, Trustee, Plaintiff, v.
Internal Revenue Service, Defendant
(In re Linmar, Inc., James B. and Barbara A. Hemker,
La Crescent Gas 'N Go., Inc., Paul W. and Marilyn J.
Hemker, Gas 'N Go, Inc., Village Chef, Inc., Dominic's Inc.,
Hemker Oil Company, Black River Enterprises, and
Goodtime Charlie's, Inc., Debtors)
Bankruptcy Case No. 84-00614-7, Adv. Case. No. A89-0030-7

United States Bankruptcy Court
W.D. Wisconsin, Eau Claire Division

August 3, 1990

Timothy A. Nettesheim, Whyte & Hirschboeck, S.C., for the plaintiff.
Mary E. Bielefeld, U. S. Department of Justice, for the defendant.

Thomas S. Utschig, United States Bankruptcy Judge.

MEMORANDUM OPINION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

INTRODUCTION

This case is a case made hard by the ineffectiveness of the U.S. Attorney's office, the incomprehensible actions of the Counsel for the I.R.S., the inevitable absence of the U.S. Trustee's office, the arrogance of a revenue officer, the contemptuous conduct of Paul Hemker, the architect of the Debtors' bankruptcy and the inexperience of the Trustee appointed to oversee one of the most convoluted consolidated bankruptcies this Court has ever seen.

Even so, this case could have been administered effectively and efficiently. All of the parties involved could have perceived satisfaction had more practical heads prevailed.

PROCEDURAL POSTURE

After two-and-one-half years of watching the Debtors' payroll tax liabilities climb to $1,000,000, James Kerkman, a revenue officer with the Internal Revenue Service, discovered a new source of funds to replace the government's lost revenues - Melvyn L. Hoffman, the Debtors' bankruptcy trustee. This matter comes before the Court on a complaint for declaratory relief filed by the plaintiff, Melvyn L. Hoffman, Trustee ("Trustee") on January 26, 1989, to determine the Trustee's responsibility for the

Debtors' employment taxes under the terms of the Court's order appointing Mr. Hoffman as trustee ("Appointment Order"). This Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 1334 and 157.

After much senseless and irresponsible delay on behalf of the I.R.S., the Court tried this adversary on July 26, 1989. To the Court's dismay and in utter disregard of the Court's pretrial order, the I.R.S. presented its case based not on the issues brought before the Court by the Trustee but on other issues the I.R.S. feared the Court would decide. Consequently, the resulting trial lacked focus and the past deliberations have been slow and difficult. Because of the I.R.S.'s confusion, delay, and unexplainable fixation with issues not before the Court, this case has taken longer than necessary to decide.

Timothy A. Nettesheim of Whyte & Hirschboeck, S.C., Milwaukee, Wisconsin, represents the Trustee; Mary E. Bielefeld of the United States Department of Justice represents the Internal Revenue Service.

FACTS

In April of 1984, Paul Hemker threw himself and his various businesses into bankruptcy hoping to buy enough time to pay himself very well and to pay his creditors little or nothing at all. During the next two-and-one-half years, Paul Hemker failed to file schedules, disclose records, develop a plan, or pay taxes. Instead, Paul Hemker regularly disobeyed court orders and successfully rallied sophisticated lenders and small creditors alike to his defense with promises of a payoff from the proceeds of his alleged six-million-dollar real estate holdings. When he wasn't making a fool out of his creditors and his government, Paul Hemker was taking an overactive role in the Debtors' cash management. Every night, Paul Hemker collected the cash - $6,000 to $30,000 - from the Debtors' cash registers and deposited enough money to pay the most pressing bills. Every night, Paul Hemker went to sleep a rich man with a zero balance in his checkbook. But not everyone was content to let Paul Hemker sleep peacefully.

In July of 1984, James L. Kerkman, a revenue officer for the I.R.S., began to monitor the Debtors' current tax deposits and returns. With 15 years of experience, Mr. Kerkman spent his time securing delinquent returns, collecting delinquent taxes, and recommending penalties. In April of 1985, Mr. Kerkman advised the special procedures staff that the Debtors were not remaining current on their tax deposits. In other words, Paul Hemker had his hand in the taxpayer's till, too. Mr. Kerkman requested that the special procedures staff, through the I.R.S.'s district counsel, request a motion from the U.S. Attorney's office for a conversion or dismissal of the case. The U.S. Attorney's office failed to convince this Court's predecessor, the Honorable William H. Frawley, that a fox roosted in the henhouse, and the I.R.S.'s request was denied by this Court in April of 1986. This first failure of the U.S. Attorney proved apocryphal. Mr. Kerkman continued to request legal assistance from the U.S. Attorney's office and the U.S. Attorney's office continued to fail him. Thus began for Mr. Kerkman an unfortunate spiral of anger and frustration directed from time to time at the Court, the U.S. Attorney's office, and finally at the Court-appointed Trustee, Melvyn L. Hoffman.

In October of 1986, the U.S. Attorney's office once again argued unpersuasively for a conversion or dismissal of the Debtors' Chapter 11 cases. The Debtors and several major creditors argued convincingly that the Debtors needed a trustee, not a conversion; converting the case would only reduce the liquidation value of the businesses substantially and put 170 people out of work unnecessarily. To satisfy the

I.R.S.'s fears, the Debtors agreed to pay taxes weekly and grant a right of automatic conversion to the I.R.S. should the Debtors fail to pay their taxes. With such an easily accessible remedy, the I.R.S. should not have had any difficulty protecting its own interests.

Near the end of this hearing, the creditors present reached an agreement that, should a trustee be appointed, that person should be Melvyn L. Hoffman. While Mr. Hoffman was neither present at the hearing nor ever appointed a trustee in the past, the creditors chose him for his expertise in bankruptcy. Accordingly, on October 28, 1986, the Court denied the I.R.S's motion and appointed Mr. Hoffman as trustee. The Court signed the Appointment Order on December 5, 1986.

The Appointment Order stated in pertinent part:

> 1. The motion of the United States of America to dismiss or convert this case is hereby denied. Provided, however, each of the debtors are [sic] ordered to make all required tax and withholding payments by deposit on a weekly basis. Such deposits shall be made on or before the second Monday following the end of each calendar week of the term of this Order. In the event that any such payment is not timely made, these cases shall be automatically converted from Chapter 11 proceedings to Chapter 7 proceedings following Twenty (20) days' written notice to all creditors.
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> 3. Each of the debtors is hereby ordered to file schedules of assets and liabilities and a statement of affairs within Forty-five (45) days of October 28, 1986...
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> 4. Each of the debtors is hereby ordered to file a plan of reorganization within Ninety (90) days of October 28, 1986...
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> 5. The debtors shall prepare and file monthly operating statements...
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> 8. A trustee is hereby appointed for each of these cases. The duties of the trustee shall be to supervise the operation of the debtors' businesses, to oversee the debtors' bank accounts, to review this matter in its entirety and to provide current and updated information to creditors, both secured and unsecured. The trustee shall not be responsible for preparing and filing schedules of assets and liabilities, statement of affairs, a plan, or monthly operating statements.

Following the signing of the Appointment Order, the Trustee began performing his duties. The Trustee established the Debtors' bank accounts, studied the Debtors' operation, arranged for appraisals, sold the Debtors' business assets, reported the results to creditors, administered pending lawsuits, and completed other tasks pursuant to his duties. In accordance with his understanding of the Appointment Order, the Trustee left the management of the Hemker businesses to Paul Hemker.

In supervising the Debtors' bank account, the Trustee ensured that sufficient funds existed to pay each check before signing each check. The Trustee was the only signatory and Paul Hemker could not withdraw money from the accounts on his own accord. However, this arrangement did not prevent Paul Hemker from continuing his over-active role in the Debtors' cash management. Further, Paul Hemker decided

who and when to pay; Paul Hemker completed the checks and paid all of the bills. As for the trust-fund taxes, Paul Hemker collected the cash, filled out the government forms, wrote the checks, and deposited the funds with the Bank. The Trustee merely ensured that sufficient funds existed to cover the checks deposited in the payroll tax account.

In January of 1987, Mr. Kerkman noticed the Debtors' payroll-tax liability climbing to new heights. Once again the I.R.S. had the opportunity to convert or dismiss the case and this time the I.R.S. also had the wherewithal to do so - the automatic conversion clause of the Appointment Order. However, instead of exercising their remedy through a quick and easy motion from the U.S. Attorney's office, Mr. Kerkman began to hound the Trustee with threats of penalties in an attempt to enlist the Trustee as Mr. Kerkman's collection agent. Throughout the winter and spring of 1987, the I.R.S. repeatedly informed the Trustee of the Debtors' delinquent payroll taxes and threatened to assess the Trustee with penalties equal to 100% of the payroll taxes owed by the Debtors. The Trustee always referred the I.R.S. to the Appointment Order, stating that his duties were limited and the I.R.S. was free to exercise its remedy of an automatic conversion or dismissal.

Finally Mr. Kerkman, after sitting on the I.R.S.'s rights for six months while the Debtors' payroll-tax delinquencies mounted, asked the U.S. Attorney's office to move the Court for an automatic conversion or dismissal. Unfortunately, when Mr. Kerkman asked the Assistant U.S. Attorney on May 14, 1987, to request an automatic dismissal or conversion, the Assistant U.S. Attorney responded that the case had been converted and that the file had been closed. However, the consolidated case had not been converted and the Assistant U.S. Attorney's blunder destroyed the I.R.S.'s chance to invoke the remedy which the Court had so carefully fashioned in the Appointment Order. Frustrated by the Assistant U.S. Attorney's feckless lawyering, the I.R.S. looked to its own formidable devices to stem the tide of the Debtors' delinquent payroll taxes.

The device of choice is the penalty assessed against a person who under 26 U.S.C. § 6672 is responsible for recording, collecting or paying the debtor's payroll taxes. The penalty is a separate nondischargeable tax liability of the "responsible person" equal to the amount of the delinquent payroll taxes. Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186, 1191 (7th Cir. 1989). Accordingly, nothing prevents the I.R.S. from collecting both the taxes withheld by the employer and the penalty owed by the responsible person for an amount several times greater than the taxes owed.

Even though the Trustee began to convert and dismiss the Debtors' cases at the end of 1987, on March 31, 1988, the I.R.S. assessed $44,882.09 in penalties against the Trustee for the Debtors' unpaid payroll taxes. Relying on the Appointment Order, Mr. Hoffman protested the assessments on the grounds that the Appointment Order burdened Paul Hemker with the accounting, collecting, and paying of the Debtors' payroll taxes. On October 26, 1988, the I.R.S. assessed $8,477.76 in penalties against the Trustee for the Debtors' unpaid payroll taxes. Mr. Kerkman based this assessment on nothing more than the Trustee's signature authority.

In August of 1988, the Trustee advised the I.R.S. that funds were available from which the taxes might be paid if the I.R.S. would file a proof of claim. Later, the I.R.S. stated that they had decided to aggregate all postpetition administrative claims (which, including all claims entitled to priority, would exceed $1,000,000), and to apply any payments received by the estate to the earliest taxes first, thereby allowing them to continue to proceed against the Trustee under I.R.C. § 6672. In other words,

the I.R.S. intended to recoup the losses suffered by the government due to its own incompetence from the personal assets of the Debtors' Trustee and any other "responsible person" that the I.R.S. could press into service.

Later, the I.R.S. assessed Paul Hemker for the § 6672 penalty and Paul Hemker accepted such assessment without contest.

ISSUES

1. Whether the Trustee's duties were circumscribed by the Appointment Order of October 28, 1986.

2. Whether the Trustee is entitled to indemnification from the estate for any payments made with respect to the 100% penalty assessed under 26 U.S.C. § 6672.

3. Whether any payments made by the Trustee as a "responsible person" to satisfy the 100% penalty constitute an administrative expense under 11 U.S.C. § 503(b)(1)(A).

4. Whether post-conversion payments made with respect to the 100% penalty assessed under 26 U.S.C. § 6672 constitute an administrative super-priority pursuant to 11 U.S.C. § 726(b).

DISCUSSION

1. Whether the Trustee's duties were circumscribed by the Appointment Order of October 28, 1986.

Included in the Bankruptcy Court's power to administer its decrees is the power to construe and interpret the language of an ambiguous original order. See S.E.C. v. Hermil, Inc., 838 F.2d 1151 (11th Cir. 1988). Clarifying an ambiguous order is not a material or substantive change. Kolasz v. Levitt, 63 A.D.2d 777, 404 N.Y.S.2d 914 (N.Y. App. Div. 1978).

A document is ambiguous when it is susceptible to more than one meaning. North Shore Laboratories v. Cohen, 721 F.2d 514 (5th Cir. 1983). The Appointment Order does not clearly relieve the Trustee's duty under 11 U.S.C. § 346(f) because the Appointment Order does not state that the Trustee shall not be responsible for withholding, reporting, and paying taxes under 26 U.S.C. § 6672. However, the Appointment Order does clearly burden the Debtors with the burden of making "all required tax and withholding payments by deposit on a weekly basis." Furthermore, the Appointment Order grants the I.R.S. the power to automatically convert the case in the event of an untimely payment. Finally, the Appointment Order clearly limits the Trustee's duty under 11 U.S.C. § 704, 11 U.S.C. § 1106(a)(2), and (a)(5). Without a specific clause limiting the Trustee's duty, the duty to make all required tax and withholding payments could belong to either the Trustee under 11 U.S.C. § 346(f), or to the Debtors under the terms of the Appointment Order, or to both. Accordingly, this Court finds the Appointment Order ambiguous.

When faced with an ambiguous order, a court must choose one meaning from the set of all possible meanings arising from the ambiguous order. See Chemerinsky, The Price of Asking the Wrong Question: An Essay on Constitutional Scholarship and Judicial Review, 62 Tex.L.Rev. 1207, 1239-40 (1984). In order to make such a choice, the court may refer to the record to determine what was decided. Kaspar Wire Works, Inc. v. Leco Engineering and Machinery, 575 F.2d 530 (5th Cir. 1978).

In the present case the October 1986 hearing revealed that responsibility for the Debtors' mounting tax liabilities and increasing bankruptcy delays belonged solely to Paul Hemker. Paul Hemker intentionally failed to pay taxes, to complete bankruptcy schedules, and to advance a plan of reorganization. Accordingly, this Court fashioned a remedy that made Paul Hemker solely responsible for paying his taxes and ending his delays, or he would face conversion or dismissal. To this end, the Court made the Debtors' creditors responsible for policing the Debtors' compliance. Thus, justice could be swift and sure. The Court made the Trustee responsible for supervising the operation and overseeing the accounts so that the case would move swiftly to its conclusion. Responsibility was fixed in such a discrete fashion to avoid the delay which inevitably arises when business goes from bad to worse and those parties which share responsibility do not wish to share the blame. Accordingly, the Appointment Order means that Paul Hemker was solely responsible for collecting, recording, and paying payroll taxes; the Trustee was not responsible for collecting, recording, and paying payroll taxes.

While this interpretation finds its basis in the words of the Appointment Order and the record of the appointment hearing, the Court's interpretation finds further validation in the post-appointment behavior of the Trustee and Mr. Hemker. The Trustee genuinely and reasonably believed his duties to be limited by the Appointment Order and he acted according to his beliefs. Paul Hemker acted as if he were solely responsible for collecting, reporting, and paying payroll taxes. The Court notes that Paul Hemker consented to collection of his 100% penalty while the Trustee chose to fight for his beliefs. To interpret the Appointment Order otherwise one must give no meaning to the words making Paul Hemker responsible for paying his payroll taxes, no meaning to the events which transpired before the appointment of the Trustee, and no meaning to the events which have occurred since. Such an interpretation simply would not reflect this Court's Appointment Order. The transcript of the October 1986 hearing and the Appointment Order make it clear that the Court expected any missed tax payment to be brought before the Court on a week's notice by the Government.

2. Whether the Trustee is entitled to indemnification from the estate for any payments made with respect to the 100% penalty assessed under 26 U.S.C. § 6672.

Assuming arguendo that the Trustee is a "responsible person" under 26 U.S.C. § 6672, the Trustee argues that a "responsible person" may seek indemnification from a corporate debtor who is primarily responsible for paying employment taxes to the government. The Trustee cites Reid v. United States. 558 F. Supp. 686 (N.D. Miss. 1983) and Wisconsin Barge Line, Inc. v. Barge Chem 300, 546 F.2d 1125, reh'g denied, 550 F.2d 41, 42 (5th Cir. 1977) for support. The I.R.S. argues that a "responsible person" does not have a right of indemnification against a corporate debtor because the "responsible person" owes his own debt to the government from which no claim against the corporate debtor arises. The I.R.S. cites Levit v. Ingersoll Rand Financial Corp., 874 F.2d 1186 (7th Cir. 1989) for support.

As it is bound to do so, this Court shall follow the decision of the Court of Appeals for the Seventh Circuit in Levit. While the Levit court did not examine a bankruptcy trustee's right to indemnification for payments as a "responsible person," it is clear that the identity and status of the "responsible person" do not affect the "responsible person's" right to indemnification after such a person has been declared a "responsible person" under 26 U.S.C. § 6672. One cannot say that this "responsible person" should be treated differently because he is a bankruptcy trustee. Such a distinction must be struck before the die is cast, before the bankruptcy trustee becomes a "responsible person." One can only say that this person should not be a

"responsible person" because he is a bankruptcy trustee whose duties have been limited by the court. Accordingly, assuming arguendo that the Trustee is a "responsible person" under 26 U.S.C. § 6672, the Court finds no right of the Trustee to indemnification from the Debtors.

3. Whether payments made by the Trustee as a "responsible person" to satisfy the 100% penalty constitute an administrative expense under 11 U.S.C. § 503(b)(1)(A).

The Trustee argues that payments of the 100% penalty constitute an administrative expense under 11 U.S.C. § 503(b)(1)(A) because such payments are expenses arising out of the Trustee's duties in overseeing the Debtors' reorganization. The Trustee further argues that just as Congress recognized the reluctance of postpetition creditors to lend more money to reorganizing debtors without receiving a priority position ahead of prepetition creditors, so too should the Court recognize the reluctance of trustees everywhere to administer reorganizations without receiving an administrative expense priority for 100% tax penalties. Finally, the Trustee argues that the Trustee deserves such an administrative expense priority because he achieved phenomenal results; the Trustee generated nearly $160,000 for the holders of administrative claims and unsecured creditors from Debtors whose assets appeared fully encumbered when the Trustee assumed his responsibilities.

The I.R.S. argues that payments of a 100% penalty do not constitute an administrative expense because neither a Trustee nor a debtor-in-possession is authorized to use Federal taxes to operate the estate. The I.R.S. further argues that the actual payment of the 100% penalty purchases no benefits for the estate.

Assuming arguendo that the Trustee is a "responsible person," this Court cannot grant the Trustee an administrative expense for payments of a 100% penalty. While failing to pay withholding taxes may have bought the Trustee time to realize more money on the sale of the Debtors' assets than the Trustee incurred by such delay, even such a good result cannot justify the means nor stave off the consequences. 11 U.S.C. § 346(f) provides that the Trustee "shall" withhold from any payment of claims for wages any amount required to be withheld or collected under applicable Federal tax law, and that the Trustee "shall" pay such amounts to the Government as required. Any trustee found to be a "responsible person" under 26 U.S.C. § 6672 has disobeyed his statutory duties under 11 U.S.C. § 346(f). Such action cannot be rewarded even in light of phenomenal results because Congress did not intend to finance businesses with payroll taxes. Accordingly, assuming arguendo that the Trustee is a "responsible person" under 26 U.S.C. § 6672, the Court finds that payments made by the Trustee as a "responsible person" to satisfy the 100% penalty do not constitute an administrative expense under 11 U.S.C. § 503(b)(1)(A).

4. Whether post-conversion payments made with respect to the 100% penalty assessed under 26 U.S.C. § 6672 constitute an administrative super-priority pursuant to 11 U.S.C. § 726(b).

Since payments of the 100% penalty are not allowed under 11 U.S.C. § 503(b), the Court finds no need to consider whether such a payment is entitled to super-priority under 11 U.S.C. § 726(b).

CONCLUSION

The Debtors' Trustee Melvyn L. Hoffman has done his job as directed by this Court in the Appointment Order. This cannot be said for all.

The U.S. Attorney's office did not do its job; they closed their file prematurely and left their client, the I.R.S., to fend for itself.

The I.R.S. Revenue Officer did not do his job; he allowed the Debtors' payroll taxes to rise for months and then he attempted to coerce the Trustee into collecting the Debtors' delinquent taxes for him.

The U.S. Trustee's office did not do its job; they chose to absent themselves from the case.

Although everyone shares responsibility for this fiasco, only one person bore the risk of failure - the Trustee. In a case such as this where some parties may face the crushing liability of a 100% penalty, it is not surprising, but it is unfortunate, that government employees should be able to wield their incompetence and their power with impunity, without the risk of failure that attends and tempers the enterprises of the private sector. See United States v. Sotelo, 436 U.S. 268, 291, 56 L.Ed.2d 275, 98 S.Ct. 1795 (1978) (dissent of Justice Rehnquist) ("So long as the Government in its zeal for the collection of the revenue may persuade a bankruptcy court that a corporate employee comes within the Court's Delphic construction of 26 USC § 6672 [26 USCS § 6672] and 11 USC § 35(a)(1)(e) (1976 ed) [11 USCS § 35(a)(1)(e)], such a person will be denied the "fresh start" which Congress clearly intended to enhance by the 1966 amendments to the Bankruptcy Act. Before the Government may randomly sweep such persons into a net whereby they are denied a discharge, not of their own tax liability but of a penalty imposed upon them for failure to pay over taxes which had been withheld by another, I would at least insist on a statute which seemed to point in that direction, rather than in the opposite one.") Mr. Hoffman did a credible job in this case. Should he be adjudged a "responsible person" under 26 U.S.C. § 6672, this Court can only hope that those government employees whom this Court holds responsible have the opportunity at some time in their lives to walk a mile in Mr. Hoffman's shoes. Thus will these government employees learn to exercise their power and authority gently.

This decision shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052 and Rule 52 of the Federal Rules of Civil Procedure.