# OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 84-1972

TITLE FEDERAL DEPOSIT INSURANCE CORPORATION, Petitioner V. PHILADELPHIA GEAR CORPORATION

PLACE Washington, D. C.

DATE March 4, 1986

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IN THE SUPREME COURT OF THE UNITED STATES

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FEDERAL DEPOSIT INSURANCE :
CORPORATION, :
Petitioner, :
v. : No. 84-1972
PHILADELPHIA GEAR CORPORATION :

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Washington, D.C.

Tuesday, March 4, 1986

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:08 o'clock a.m.

APPEARANCES:

CHARLES A. ROTHFELD, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C; on behalf of the petitioner.

GERALD F. SLATTERY, JR., ESQ., New Orleans, Louisiana; on behalf of the respondent.

C O N T E N T S

PROCEEDINGS

CHIEF JUSTICE BURGER: We will hear arguments first this morning in Federal Deposit Insurance Corporation against Philadelphia Gear Corporation.

Mr Rothfeld, you may proceed whenever you are ready.

ORAL ARGUMENT OF CHARLES A. ROTHFELD, ESQ.,
ON BEHALF OF THE PETITIONER

MR. ROTHFELD: Mr. Chief Justice, and may it please the Court, the issue in this case is a narrow one, whether a standby letter of credit issued by a bank and backed by a contingent note provided by the bank's customer represents a deposit that is insured by the Federal Deposit Insurance Corporation.

While this question obviously is a technical one, reduced to its essentials, the issue here is actually very straightforward, and can be resolved simply by bearing in mind the central purpose of the deposit insurance program, protecting funds that depositors entrust to banks.

This case is typical of commercial transactions that make use of so-called standby letter of credit to guarantee credit by one of the parties, and a look at the facts of the transaction here may help put the issue in focus.

The case began when the Orion Manufacturing Corporation arranged to purchase materials from the respondent. To guarantee that it would pay for the materials when they were delivered, Orion obtained a standby letter of credit from the Penn Square Bank for the benefit of respondent.

This letter of credit, like all letters of credit, functioned as a guarantee mechanism, and worked very much like a line of credit. Under the letter, Penn Square was obligated to pay respondent upon the receipt of respondent's signed statement that Orion hadn't paid its bills to respondent when those bills came due.

As security for Penn Square, Orion gave the bank a contingent so-called backup note in the amount of the letter of credit which the bank would draw upon for reimbursement if it was forced to pay out to respondent under the letter of credit.

Although this note was labeled a promissory note and on its face appeared uncontingent, both Orion and Penn Square understood that nothing would be considered due on the note and the note would bear no interest unless and until the bank was forced to pay respondent under the letter of credit.

QUESTION: Well, Mr. Rothfeld, are you suggesting in your description of this note that it was not therefore a promissory note within the language of the statute?

MR. ROTHFELD: That's correct, Your Honor.

QUESTION: You are saying that this particular note was not a promissory note within the language of the statute?

MR. ROTHFELD: That is correct, although --

QUESTION: Is that because there was a side understanding setting forth certain contingencies?

MR. ROTHFELD: Essentially that is correct, Justice O'Connor.

QUESTION: Does it make any difference at all whether the note bore interest or not, or was in fact easily negotiable because of its lack of interest?

MR. ROTHFELD: I think that the note here functioned simply as an elaborate reimbursement agreement, but the note didn't represent any actual liability on the part of the maker of the note.

QUESTION: Well, on its face, of course, it did. Theoretically, it would have been negotiable at a discount for money.

MR. ROTHFELD: It could have been, arguably could have been negotiated by the holder of the note on its face, although given the contingencies attached to the note, it is difficult -- the value of the note would have been practically nill.

QUESTION: -- in due course.

QUESTION: It certainly wouldn't be of no value if the market could just discount it to make up for the lack of interest.

MR. ROTHFELD: Well, I think there are two points to make in response to that. While it could have been negotiated to a holder in due course, as Justice Rehnquist says, anyone who took the note with knowledge of the conditions attached to it between the parties who originally were involved in the transaction would be subject to the defense that --

QUESTION: Well, you are not a holder in due course if you do that.

MR. ROTHFELD: Well, that is true. Anyone who took with knowledge of those limitations would not be able to obtain value against Orion based on the note.

QUESTION: How about someone who took without knowledge?

MR. ROTHFELD: Someone who took without knowledge arguably would be, although --

QUESTION: And what about if Orion wasn't paid and collected on the letter of credit in the bank? The bank could surely sue the maker of the note.

MR. ROTHFELD: That is true.

QUESTION: On the note. So that certainly is -- the note is not just a nil. It certainly is a meaningful note. It represented an obligation.

MR. ROTHFELD: Again, let me give two responses to that. First, the note certainly was meaningful as a reimbursement agreement between Orion, the maker of the note, and the bank, and the only rights the bank had under the note, given the whole nature of the transaction here, were that it could use the note to obtain reimbursement.

QUESTION: Why does that make it not a note?

MR. ROTHFELD: It was labeled a note. It can be termed a note. The question that we are addressing here is whether it is a promissory note within the meaning of the statute.

QUESTION: Exactly, and I still don't understand why it is that just by calling it a reimbursement --

MR. ROTHFELD: Well, to be termed a note within the meaning of the statute, I think you have to look at what precisely Congress had in mind in drafting the statute in the way that it did. Congress when it wrote the Federal Deposit Insurance Act, when it created the deposit insurance program, was legislating against the background of Depression era prices in the banking community, and its purpose in creating the program, I think it left no doubt about that, was to protect deposits.

QUESTION: Would you be here arguing if this note didn't have the conditions attached to it that were a freely negotiable note, like any other note, and there were no side agreements at all, just a promissory note?

MR. ROTHFELD: No, if there --

QUESTION: Would you be here making this argument?

MR. ROTHFELD: No, we wouldn't, Your Honor. If this note were a fully uncontingent negotiable note that were not limited by any side agreements, it would be a note backing a letter of credit within the meaning of the statute.

QUESTION: Regardless of whether Orion had given a lien or any backup security for the note?

MR. ROTHFELD: That is correct. If it was an uncontingent, fully enforceable note which created a present obligation on the part of Orion, then it would be as good as Orion's money, which Orion --

QUESTION: So for you the whole case turns on whether there is a side contingency agreement?

MR. ROTHFELD: For us, the case turns on whether this was a -- I suppose that is right, Justice

O'Connor, whether or not this is a contingent or uncontingent instrument. I think an example --

QUESTION: Did the conditions appear on the face of the note?

MR. ROTHFELD: No, they didn't, Your Honor, although the Court of Appeals found as a matter of fact that it was in fact a controlling agreement between Penn Square --

QUESTION: So this case doesn't turn upon a letter of credit on whether this letter of credit was the kind of a letter of credit that should -- that the FDIC should pay on.

MR. ROTHFELD: That is correct, Justice White. In our view the case turns on whether the letter is funded or unfunded, not what appears on the face of the letter, but whether the depositor, the bank's customer gives the bank funds or something that is equivalent to funds that backs the letter. It is only when the bank's depositor actually gives the bank something of value --

QUESTION: Has this always been your position throughout this litigation?

MR. ROTHFELD: It has been our position.

QUESTION: Mr. Rothfeld, in the question presented in the petition for writ of certiorari, the question is whether a standby letter of credit is a deposit within the meaning of 12 USC for purposes of the Federal Deposit Insurance Corporation. In your brief, it has changed, so it reads, whether an unfunded standby letter of credit is a deposit.

MR. ROTHFELD: That I think is done simply for purposes of clarity, Justice Rehnquist, because standby letters of credit --

QUESTION: But you just told me it didn't make any difference whether there was security backing up the note, that it made no difference.

MR. ROTHFELD: No, that's -- I should make myself clear. It is not whether security backs up the note. The note can be secured or unsecured. The question is whether the note is contingent or uncontingent, whether or not the note creates a present absolute liability on the part of the maker of the note or whether it doesn't, and that, I think, ties into what Justice Rehnquist is concerned about, whether or not the letter of credit is funded or unfunded.

Standby letters of credit are invariably unfunded, and we put the term unfunded in simply to make clear that we are talking about whether or not there are funds in the bank supporting the letter of credit or not.

QUESTION: In looking at the statute, the relevant statute, it says the unpaid balance of money or its equivalent up in the first part of the sentence, and then it says provided that, without limiting the generality of the term money or its equivalent. We regard an instrument as the equivalent of money if it is issued in exchange for a promissory note upon which the person obtaining any such credit or instrument is primarily or secondarily liable.

Does that provide that that sentence just drop out of the case because Philadelphia Gear is not liable on the Orion promissory note? Do we even have to concern ourselves with that last proviso?

MR. ROTHFELD: I think you do, Justice O'Connor. I think the question is whether the bank's customer here, Orion, provided a promissory note within the meaning of the statute in exchange for a bank instrument such as a letter of credit.

QUESTION: Well, is the person obtaining such credit or instrument -- who is the person obtaining the credit or instrument? I thought it was Orion.

MR. ROTHFELD: Orion has attained it for the benefit of respondent, Philadelphia Gear. Orion is the bank's customer.

QUESTION: Well, is it the person obtaining the promissory note or the person obtaining the letter of credit referred to in that phrase?

MR. ROTHFELD: Well, the bank would be obtaining the promissory note. It would be the person who obtains the letter of credit, and the bank here issued the letter of credit for its customer, Orion, although the beneficiary of the letter of credit was a third party.

QUESTION: Yes, but I am just asking whether the language in the statute refers to the person obtaining the promissory note or the person obtaining the letter of credit.

MR. ROTHFELD: That, I think, refers to the bank, the bank receiving the promissory note in exchange for the letter of credit. The focus of Section 1813(L)(1) defines the term deposit and the deposit insurance program as a whole is whether the bank has received something of value which it is holding for its customer, and it is put at risk in the event of a bank failure, and that is why the nature of the note in our view is important here.

I think an example may make our position clear. If, for example, a customer gives a bank a $1,000 uncontingent promissory note in exchange for a bank instrument such as a certificate of deposit, which is one of the instruments listed with letters of credit in the deposit definition, and the bank then fails, the customer will have lost $1,000.

The certificate of deposit will have lost its value, and the promissory note, which is uncontingent, will end up in the hands of the bank's receiver, who will be free to collect $1,000 in cash from the bank's customer. The bank's customer will be in the same position as if he had given the bank $1,000 cash for the certificate of deposit, had lost that $1,000 when the bank failed. That customer obviously is entitled to the protection of deposit insurance.

In contrast, if the bank customer gives the bank a contingent backup note of the kind at issue here in exchange for a letter of credit or a line of credit and the bank fails, the customer has lost nothing. He can no longer draw on the letter of credit or the line of credit but he will never have to pay out on the note, because the note will end up in the hands of the bank's receiver. It will be essentially in the position of the bank. It will be unable to collect on it, because the bank has never paid out on the line of credit or the letter of credit. He will not have lost money or its equivalent, which is the central definitional phrase in the statutory language. He won't be out of pocket a cent.

I think if you look at the line of credit situation, it is obvious that the customer shouldn't be able to demand that the FDIC insure his right to draw on a line of credit, but that essentially is what respondent was asking for here, because a standby letter of credit is in essence a line of credit that the customer gets for the benefit of the third party.

So, again, the crucial question here is whether the customer of the bank has deposited anything within the bank, whether the bank is holding something that is put at risk in the event the bank becomes insolvent, and that is lost when the bank actually fails.

The statutory language is somewhat convoluted here. There certainly is no doubt that when Congress created the program against the background of the bank failures during the Depression and against the runs on banks and ultimately against the National Bank Holiday in 1933, Congress had absolutely no doubt about what it was trying to accomplish.

QUESTION: I don't see why then on that rationale why it would make any difference if this note was an ordinary negotiable promissory note.

MR. ROTHFELD: I think what is crucial is whether or not the note is as good as money to the depositor at the time that he finally gives it to the bank in exchange for one of these bank instruments. It is the instrument, the letter of credit, the certicate of deposit, or whatever, which is insured, and the question is whether that is backed by something held by the bank that the customer will lose if the bank fails.

QUESTION: But I just don't think that reads the statute very accurately, because up to the proviso it talks about money or its equivalent, and then it says provided that without limiting the generality of the term money any such encounters must be regarded as evidencing the receipt of the equivalent of money when credit or issuing checks -- in exchange for checks or for a promissory note.

It seems to me that cuts a lot of the ground out from your kind of common sense let's talk it over approach.

MR. ROTHFELD: I think that it is fairly clear from the background of this deposit definition that the FDIC put that proviso in its original regulatory definition of deposit, and Congress borrowed it and put it in 1813(L)(1) simply to make it clear that deposits include things in addition to cash, that anything of value that is given to and entrusted to a bank that is put at risk and is lost when the bank fails is entitled to the benefits of deposit insurance.

And that is why it listed checks and drafts, which create unconditional liability which are as good as cash to the depositor, an promissory notes were put in for the same purpose, because the depositor who gives an uncontingent promissory note to the bank may as well have given the bank cash.

And in fact, as we explain in our brief, in the 1930's, at the time when this original definition was first written, it was understood that for a variety of purposes the term promissory note should not be deemed to include contingent notes. The Federal Reserve used such a definition for its discount purposes, for example.

QUESTION: May I ask this question? You used the term unfunded note. Let's assume, for example, that the note were secured by a second mortgage on unimproved real estate supported by some appraisal as to the estimated value of that real estate. Would that be funding?

MR. ROTHFELD: Again, I think, Justice Powell, that it would be funded only if -- well, that you would have to look at the note itself and decide whether or not the note created an uncontingent liability, whether or not --

QUESTION: Assume the note on its face was not contingent, but it was funded in the sense of security having been provided rather than having a deposit in equal amount of the note or perhaps getting a government bond or something that was absolutely a gold-plated security, it gave something that was perhaps speculative or at least subject to a good deal of litigation before you could realize on it. I don't know. I was just posing that question.

MR. ROTHFELD: In our view, the question would be whether the letter of credit rather than the note is funded. That would be the crucial question. Whether or not the note was secured by situations such as you describe wouldn't make any difference so long as the note was uncontingent. The note, the note itself is the funding, which is the money or its equivalent which is insured, if I am making myself clear.

QUESTION: But you get back to whether there was any basic value in the deposit, don't you, as to whether or not the letter of credit was funded by anything that made it the equivalent of money.

MR. ROTHFELD: That is correct. I think that is absolutely --

QUESTION: -- question of fact, I would

suppose.

MR. ROTHFELD: Our view is that if the letter of credit is uncontingent, and creates an absolute liability which to the depositor is as good as cash, that that is enough to make it the equivalent of money within the meaning of the statute. Congress, I think, was concerned with people giving things like that to banks and being at risk in the event that the bank failed, but they would have lost the face value of that note if someone would be able to collect it against them.

I think that was the clear Congressional understanding, clear regulatory understanding when this definition was first promulgated in 1935, and it was the Congressional understanding when Congress took that regulatory definition and put it in the statute. In fact, when the -- the FDIC originally promulgated that particular language, the language that Justice Rehnquist focused on, must be regarded as the equivalent of money in 1935, immediately after the creation of the deposit insurance program, and from that time the FDIC has consistently informally but publicly inconsistently taken the position that unfunded letters of credit are not insured because they do not have value put in the bank which is at risk in the event of a bank failure.

QUESTION: Well, the argument in this case is that this one was funded by the promissory note. And no one suggests -- there is no argument in this case that the completely unfunded the letter of credit is insured, is there?

MR. ROTHFELD: No, I don't think there is, Justice White.

QUESTION: No. The argument here is that this note funds the letter of credit just as much as an unrestricted note.

MR. ROTHFELD: That is true. That is the argument. But our submission is that that argument iswrong.

QUESTION: You are saying the reality does not support that argument.

MR. ROTHFELD: That is absolutely correct, Your Honor, and again, I can provide an example which I think may make our position clear. Even -- I suppose I should break this into two parts. The first is that if the letter of credit was drawn upon and there was no funding, there was no backing at all, no reimbursement agreement, no note, no anything, Orion, the maker -- well, Orion, the customer who obtained the letter of credit, would still be obligated as a matter of commercial law under the UCC to reimburse the bank for whatever the bank paid out on the letter of credit under Article 5, Section 114.

The fact that that obligation is firmed up by a written reimbursement agreement or by a contingent note doesn't change the nature of the transaction at all. The fact remains nothing was put in the bank. There were no funds given to the bank. The bank never held anything. And in fact, given the way the transaction here was structured, it was impossible ever for the bank to have held onto its customers' money for any period of time, because the bank could only draw on the note after it had already paid an equivalent amount of money to respondent, so it would simply have been drawing on the note for reimbursement for its own funds which it had spent to cover the letter of credit giving it to respondent.

It seems clear that that could not be the purpose of the federal deposit insurance program, because there was no deposit, there was no money given to the bank, there was no asset at risk in the event that the bank failed, and nothing was lost by the bank's customer when the bank failed. As I suggested before, the FDIC has consistently taken this position since the very language that the Court is focusing on was put in the regulatory definition.

QUESTION: Have there been other claims like this which the FDIC has routinely rejected?

MR. ROTHFELD: I am not aware of any claims for insurance under such a letter. The FDIC, however, has never assessed an insurance premium on such an unfunded letter of credit.

QUESTION: But you are aware of no examples like this where they had a claim that has been made for the recovery of insurance which has been denied?

MR. ROTHFELD: Other than this litigation and the currently ongoing litigation in the Sixth Circuit, I am not aware of any claim in which that has arisen, although in the 1950's, even before the statutory definition was put -- well, even before the proviso was put in the statute, the District Court of New York recognized and endorsed the FDIC's view that it is only when the depositor puts his money at risk to back a letter of credit that the letter is insured. It was the Urban Trust case, which we cite in our brief, and which was cited to Congress at the time that Congress put the definition in the statute as it now appears.

QUESTION: If I understand your argument correctly, it is that because this instrument may be negotiable does not mean that it is the equivalent of hard money. Is that it?

MR. ROTHFELD: That is absolutely correct, Your Honor, whether or not this instrument was negotiable, it was not an immediate obligation of the maker of the instrument, and the maker of the instrument was not liable to pay out any funds. To the extent that the bank attempted to negotiate and succeeded in negotiating this instrument to a holder in due course who is unaware of this underlying transaction, the bank would have defrauded its customer, and the customer would be able to have -- would have a cause of action against the bank for reimbursement and was forced to pay out on the note.

So the customer never had any of its funds at risk during the course of this transaction at any point. It seems perverse to insist that the deposit insurance program protect this type of transaction. It would simply make the federal government the guarantor of business transactions that --

QUESTION: May I ask a question about -- does the record tell us what happened to Orion?

MR. ROTHFELD: It does not, Your Honor. My understanding is that Orion is now insolvent, but that is not reflected in the record.

QUESTION: It doesn't tell us whether the bank made any attempt to collect on this note against Orion, does it?

MR. ROTHFELD: The bank did not attempt --

QUESTION: I mean, or the liquidator after the bank.

MR. ROTHFELD: No, it does not.

QUESTION: Mr. Rothfeld, I understand there is a bill pending in Congress to eliminate from the definition all letters of credit. Do you know what the status of that proposed legislation is?

MR. ROTHFELD: Well, again, let me make two points in response to that, Justice Blackmun. First, it would not reduce -- it would not remove all letters of credit from protection of deposit insurance. It would only remove unfunded letters of credit. It would preserve something very much like the current Section 1813(L)(3), which specifically provides for funded letters of credit.

Secondly, as far as I am aware, no action has been taken on that bill. It has been introduced, but there has been no action on it.

QUESTION: May I come back to what constitutes an unfunded letter of credit? Is there any definition in the regulations? Or has the FDIC ever identified a definition of it? I think you are arguing about a standard that there has to be a deposit in the face amount of the letter of credit. Is that the position?

MR. ROTHFELD: Well, our view is that there must be a deposit either of funds or of the equivalent of funds.

QUESTION: Well, you can fund in various ways, but you are saying that the only acceptable funding based on 50 years of history and practice is where a deposit in the amount of a letter of credit is available to make sure it is paid. Is that correct?

MR. ROTHFELD: That is correct, Justice Powell, and let me expand on it just a little bit. To the extent that the funds don't cover the face amount of the letter of credit, the letter would be insured to whatever extent funds were in the bank backing it. The second point is that there must be a deposit backing a letter of credit, but whether or not that deposit was actually cash given to the bank or an uncontingent promissory note or a check or a draft, it would be insured nonetheless, but there must be something which is the equivalent of money given to the bank.

If there are no further questions at the moment, I will reserve.

CHIEF JUSTICE BURGER: Very well.

Mr. Slattery.

ORAL ARGUMENT OF GERALD F. SLATTERY, JR., ESQ.,

ON BEHALF OF THE RESPONDENT

MR. SLATTERY: Mr. Chief Justice, and may it please the Court, I would like to begin, if I may, with an answer to a question Justice O'Connor posed to the Solicitor General.

You asked, I believe, Justice O'Connor, whether the statutory words, the person obtaining any such credit or instrument, refers to the bank's customer or to the beneficiary of the letter of credit. The words refer to the bank's customer, Orion, and the words mean in respondent's view the person at whose request the bank issues the letter of credit to the beneficiary.

And the primary or secondary liability reference, of course, refers to the customer's liability on the promissory note that he has delivered to the bank.

Further, in regard to a question that Justice Blackmun asked about the status of S. 750, which has recently been introduced by Senator Jake Garn at the FDIC's request and is now before the Senate Committee on Housing, Banking, and Urban Affairs.

I believe that the text of that bill removes all letters of credit from the protection of the deposit insurance program, not merely on funded letters of credit. I recall reading an official version of the bill, and I also recall that the trade publication that the FDIC cites in its reply brief letter of credit update contains the text of the bill.

If memory serves me correctly, I believe the bill completely removes letters of credit not just unfunded letters of credit, but all letters of credit from the ambit of the protection of the deposit insurance program.

The FDIC --

QUESTION: Mr. Slattery, do you think that the FDIC's long-standing decision not to charge insurance premiums, in effect, for unfunded or for standby letters of credit constitutes an administrative interpretation of the Act which we owe some deference in resolving this question?

MR. SLATTERY: I do not, Your Honor. The FDIC has made the statement in its opening brief that it has never assessed letters of credit of the sort that were issued to respondent in this case, nor has it ever paid claims on letters of credit of this sort.

I believe it is problematic at best whether the failure by the FDIC to assess deposit insurance premiums is purposeful or unconsidered. I believe it was unconsidered because I cannot believe that a purportedly long-standing and consistent administrative interpretation could completely escape mention in any of the legislative or regulatory history of the statutes. But that is the case here.

One may quarrel with the --

QUESTION: But it has to be a decision, in effect, not to collect insurance premiums.

MR. SLATTERY: As I say, Your Honor, it is problematic. It appears that there was some vague and undefined notion within the FDIC that standby letters of credit, for example, may not have been subject to deposit insurance programs while commercial letters of credit may have been. That, at least, is the suggestion made in the reply brief. That is a distinction without a difference, however, because it appears from earlier regulations that the FDIC has provided that that is not a basis upon which to distinguish funded from unfunded letters of credit.

It appears from Assessment Decision Number 109, for example, that virtually all letters of credit are unfunded, commercial and standby. In Assessment Decision Number 109 -- I am paraphrasing, but I believe my paraphrase is very close to the actual words of the regulation -- the FDIC stated that commercial letters of credit normally are not sold for cash, but are issued against an agreement to reimburse the bank for drafts paid on the letter of credit.

The FDIC goes on to say in that Assessment Decision Number 109 that if that reimbursement agreement does not constitute a promissory note, then in that event the letter of credit is not accessible as an insured deposit, the inescapable conclusion being only this, what the statute says, that if the agreement is a promissory note, then the letter of credit is insured and is assessed.

I note also, Justice O'Connor, in further response to your question, that the distinction between funded and unfunded letters of credit has been drawn by the FDIC in other contexts where at least prior to this litigation it was considered important. I refer to the lending limits regulations that were promulgated and also those dealing with financial statement disclosure.

It does not aappear interestingly, and in respondent's view very tellingly, however, in the very regulations that the FDIC promulgated entitled Clarification and Definition of Deposit Insurance Coverage. This is 12 CFR Part 320. Any distinction between funded and unfunded letters of credit that would be important for the purposes of deposit insurance certainly would have been mentioned in the very regulations that were issued to define and clarify deposit insurance coverage, yet no distinction is made there.

Likewise, 12 CFR Part 327, dealing with -- .

QUESTION: You mean no distinction between funded and unfunded?

MR. SLATTERY: That is -- pardon me, Your Honor?

QUESTION: You say there is no distinction between funded and unfunded drawn in the regulations?

MR. SLATTERY: That is correct, Your Honor. In more than merely in the regulations dealing with the clarification and definition of deposit insurance --

QUESTION: Of course, you don't need to convince us that completely unfunded letters of credit are insured, do you? All you have to do is to say that if it takes funding, this one was funded

MR. SLATTERY: Your Honor asked counsel for the FDIC if it could not be considered funded by having been issued in exchange for the promissory note. In our view, Congress defined money or its equivalent as being a letter of credit issued in exchange for just such a promissory note. So, in answer to your question, it can be considered --

QUESTION: Is that your primary argument? Are you making the general submission that if there hadn't been any funding at all, no promissory note by Orion given to the bank, wouldn't, as you say, the letter of credit would have been insured?

MR. SLATTERY: I would not say it would be insured in that event, Your Honor. We have here --

QUESTION: You really are -- you are resting on the fact that a note was given.

MR. SLATTERY: Yes, I am, Your Honor. And that is because the statute unequivocally defines money or its equivalent not in the limited sense that the FDIC has defined it here today, but Congress has made the task easy.

QUESTION: Well, the statute refers to promissory note. And you just stop there. You say, well, this is a promissory note.

MR. SLATTERY: That is correct, Your Honor.

QUESTION: But what the SG in effect is saying is that the term promissory note should be defined in terms of federal law, not ordinary state commercial law, that promissory note has a federal definition, and in this context that federal definition means there can't be side contingencies attached to it. Now, what is your response to that?

MR. SLATTERY: I disagree with that position advanced by the FDIC. Your Honor has correctly characterized it, but it is incorrect as a matter of law. The sources cited as support by the FDIC for that statement were a Treasury regulation dealing with the status of notes that are eligible for discount at federal reserve banks and also a tax decision that addressed a promissory note given by a man to his wife and children for no consideration, and the issue in that case was the deductibility of interest on that note.

Those cases hardly stand for the proposition that Orion's note was not a note, and that really is the question the FDIC is trying to raise, when is a note not a note. It may look like a note and say it is a note and bear all of the customary hallmarks of a note, but it is not.

Further in regard to that question the FDIC has stated that it is a matter of federal law in its reply brief, and has cited the Court to, I believe, two federal cases. It is important to remember, however, that if you look at those cases, what do those cases say about what federal common law is? Where do they tell us to go?

QUESTION: Mr. Slattery, I wonder if we are not getting into kind of a semantic dispute. Certainly as long as Congress has used the term promissory note in this statute defining the liabilities of the FDIC, that is a question of federal law, what a promissory note means and what every other word in the statute means. I take it what you are rejecting is the government's argument that when Congress used the term promissory note here it meant something quite different from the ordinary meaning of the term promissory note.

MR. SLATTERY: That is correct, Your Honor. I think the federal law is that the ordinary common meaning of promissory note is what was meant to apply, and the state court cases that deal with the definition of promissory note are not irrelevant. To the contrary, federal law, federal common law directs us to look to those analogous state cases to find out what a note is.

QUESTION: But I suppose there is no denying that there was no liability on this note unless the bank paid out some money to the holder of the letter of credit.

MR. SLATTERY: There is no denying that, Your Honor. You are correct.

QUESTION: May I ask you -- excuse me.

QUESTION: Go ahead.

QUESTION: May I ask you in that connection, what if the note on its face said this instrument does not create any present obligation to pay anything to the bank. It merely creates an obligation in the event that

Orion -- the bank is required to make some payments to Philadelphia here.

MR. SLATTERY: That is a good question, Justice Stevens, and it raises the fact pattern, incidentally, that is before the Sixth Circuit Court of Appeals in Allen versus FDIC. It is still a note. Conditions on the face of a promissory note do not render it not a promissory note.

QUESTION: Assuming for a moment it is still -- is it a deposit, do you think?

MR. SLATTERY: Yes, it is, Your Honor. I believe it is a deposit simply because Congress said that it is. Congress only asks us to look whether the instrument that the bank has issued is a letter of credit, and to look whether the instrument it has received is a promissory note. It was not an unreasonable decision by Congress to have made.

QUESTION: Well, but the note -- this kind of a note in this context didn't give the bank anything that it wouldn't have had without the note.

MR. SLATTERY: I don't believe -- perhaps --

QUESTION: But the bank had paid out -- issued the letter of credit, unfunded letter of credit, and the paydown on the letter could have recovered its payments from its customer.

MR. SLATTERY: That is true as a conceptual matter, Your Honor.

QUESTION: Well, and so he sues the customer, and in the one case he has got this promissory note. In the other case he hasn't got a promissory note. He has just got the Uniform Commercial Code. Now, what is the difference between the two situations?

MR. SLATTERY: The difference is very important, Your Honor. Promissory notes generally, as Congress looked at the question in 1960, can have provisions that reimbursement agreements or the mere statutory obligation to reimburse do not encompass. Example, specific provisions related to the timing of repayment of principle and interest. The remedies of a lender --

QUESTION: Let's just talk about this note and this case.

MR. SLATTERY: Yes, Your Honor.

QUESTION: What did it give the bank that the bank wouldn't have had under the Uniform Commercial Code?

MR. SLATTERY: I have the note reproduced in the joint appendix at Pages 27 and 30, and there are specific remedies the specifics of which I cannot recall at this time, but which go far beyond the mere statutory obligation of Orion to reimburse. These are remedies relating to the repayment of principle and interest, rights of the lender upon default, and other matters that are not covered in the statutory obligation to reimburse.

In that connection, it is important --

QUESTION: May I just follow up, because I just want to be sure I understand your position. Your position, of course, is that Orion is the depositor, and it becomes a depositor at the time it turns over the instrument, the note. Is that correct?

MR. SLATTERY: No, Your Honor, that is not correct. My position is that my client, Philadelphia Gear, is the depositor because it holds the credit instrument that the bank has issued, its letter of credit.

QUESTION: But your client didn't make -- you don't claim your client gave anything of value to the bank.

MR. SLATTERY: No, I do not, Your Honor.

QUESTION: The only deposit that has been made, if there is a deposit, is the delivery of the promissory note. Isn't that right?

MR. SLATTERY: Your Honor, I believe that question in a sense presupposes the rather narrow view of deposit that the FDIC has articulated here today. Congress -- and that is the failing of the FDIC's conceptual argument. When people who are not familiar with the Federal Deposit Insurance Act think of the term deposit, they think of it in the sense that the FDIC has presented it here today, the garden variety savings account and checking account, the concept of a physical thing or a physical object left in the custody of the bank almost.

In actuality, a deposit is nothing more than a liability, an obligation, and Congress decided that certain persons who theretofore, before the Federal Deposit Insurance Act, had not been recognized as depositors in the traditional sense, would now be treated as depositors, it expanded the class.

A good example is in Section 1813(L)(4), which gives insured depositor status to many persons who have not entrusted anything of value to the bank. Example. A check that the bank writes to pay its water bill or its light bill may be an insured deposit.

A check that it writes to an attorney for a retainer or to its landlord for rent, these are examples of credit instruments that the bank has issued where the person who is the owner of the deposit obligation has not entrusted anything of value to the bank, yet the Act clearly recognizes the holders of those instruments as insured depositors. It does so because its purpose was far broader than the narrow purpose the FDIC has tried to paint here today.

It was not merely to prevent runs on banks or to protect the hard earnings that Chief Justice Burger referred to in a question. It was to ensure that persons holding certain credit instruments of a bank in the circumstances outlined in the statute would be brought within the ambit of Congress's new expanded definition of deposit. Respondent Philadelphia Gear was just such one of those persons.

QUESTION: Let me pursue a thought I didn't quite finish on. If the promissory note -- the promissory note is still central to your claim that there is a deposit, is it not?

MR. SLATTERY: Yes, Your Honor.

QUESTION: And must it not be a promissory note upon which the person obtaining the credit is primarily or secondarily liable?

MR. SLATTERY: That is correct, Your Honor.

QUESTION: So that is it not essential to your claim that Orion was primarily or secondarily liable on the note at the time it was delivered to the bank?

MR. SLATTERY: Yes, Your Honor.

QUESTION: And it wasn't, was it? It didn't owe the bank --

MR. SLATTERY: I think that the enforceability of the note should not be confused with the question of --

QUESTION: Whether it created a present obligation.

MR. SLATTERY: Exactly. Orion from the moment --

QUESTION: It didn't create any obligation, did it?

MR. SLATTERY: It created the obligation on Orion's part to reimburse the bank for any drafts that were paid on the letter of credit. That was an obligation that was in existence from the moment Orion executed the note.

QUESTION: And it was the only one that was liable on the note, primarily or secondarily.

MR. SLATTERY: Orion was the only one that was liable on the note. That is correct, Justice White.

QUESTION: How can you say it is liable on the note when the note gives rise to no liability? There has never been a payout to Philadelphia Gear.

MR. SLATTERY: I think an example may help to answer that question, Your Honor. Banks routinely when involved in interim financing will enter into a loan agreement and in connection with the loan agreement the customer will sign a promissory note that would obligate it to pay such amounts as the advances from time to time as the builder borower draws down, so to speak. One couldn't claim that the builder in that circumstance were not liable on the note even before the bank had extended funds.

The builder is liable in the sense that he must hold himself ready to perform at the time that his performance is due, and that is what the word liable means. Must perform when performance is due. Not the narrow limited sense of a presently existing debt on which interest is running. Liability in my view as Congress used the term means that one must hold oneself in a position ready to perform in accordance with the document that one has signed.

QUESTION: Would the case be different if instead of a promissory note there was just a long written agreement describing all the contingencies pursuant to which the letter of credit were issued?

MR. SLATTERY: It might very well be, Your Honor.

QUESTION: Even though it created the same kind of contingent liabilty?

MR. SLATTERY: Possibly, and that raises the very good point that Congress drew some bright lines where it in effect wrote this insurance policy in 1960, and that, I believe, is the reason for some of the -- what appear at first blush to be anomalies in the statute right now.

Congress knew in 1960 that when it was drafting this insurance policy it had to clearly delineate between the insurance risks that were covered and those that were not covered. It chose to hold without equivocation that letters of credit issued in exchange for promissory notes were insured deposits.

QUESTION: May I ask this question? Did your client, the Philadelphia Gear Corporation, know that a promissory note had been deposited, had been delivered to the bank?

MR. SLATTERY: I would say they did not, Your Honor.

QUESTION: Did not? So it did not rely on the existence of that one way or the other?

MR. SLATTERY: No, it did not, Your Honor. It relied on the creditworthiness of the bank and on the liability of the bank to pay on its letter of credit. It did not rely on the existence or nonexistence of deposit insurance. At least there is no support in the record as I read it for that reading. I do not think reliance is important under the statutory scheme, for example, because as a matter of practice the holder of the letter of credit very rarely, if at all, will be privy to the negotiations between the issuing bank and its own customer.

An example is, even if a letter of credit were fully funded as the FDIC has acknowledged -- pardon me. Even if a letter of credit were funded in the sense that the FDIC uses the term, the FDIC would acknowledge that that letter of credit is an insured deposit and the beneficiary of that letter of credit would have no more idea whether it was funded or not than Philadelphia Gear in this case had whether Orion had submitted a promissory note or not.

The question of reliance appears to be irrelevant under the statutory scheme, and even under the FDIC's own theory of the case.

QUESTION: Do you agree with the Solicitor General that the FDIC for half a century has consistently disagreed with the position you take today?

MR. SLATTERY: No, Your Honor, I do not.

QUESTION: Is there any evidence one way or the other on that in the record?

MR. SLATTERY: There is no evidence in the record. There is some evidence in the regulations and in the legislative history which indicates either that the FDIC has simply not considered the question before or that where it has spoken on the issue it has failed to draw this fundamental distinction between funded and unfunded letters of credit in the context of deposit insurance with which we are concerned today, but has drawn it in other contexts, which suggests that if the distinction were important here, it would have been expressed here as well.

QUESTION: But it is true that no premiums have been collected by FDIC on notes that were held to be unfunded, whatever that means?

MR. SLATTERY: That is true, Your Honor. And it raises a very interesting point. The FDIC concedes that an unconditional, as it uses the term, promissory note does give rise to an insured deposit obligation, yet in its reply brief in support of its petition for certiorari it made what to respondent appears to be the rather startling admission that it doesn't maintain the records it needs to determine whether even those letters of credit that it acknowledges are insured deposits are being assessed.

It is stated on Page 4, in Footnote Number 3 of its reply brief, that it maintains no records of the amount of standby letters of credit that are backed by promissory notes. This is especially telling, I think, in view of the importance that the statute itself places on prommissory notes, and also in view of the importance that the FDIC has placed in its brief on even some promissory notes.

So, that again is another indication in respondent's view of the FDIC's failure to consider. It is problematic whether the FDIC has considered it or not, and the regulatory and the legislative history points either to a conclusion that it has not been considered or to a conclusion -- well, it points to a conclusion that it has not been considered in the context of deposit insurance.

QUESTION: Is there an industry practice to issue unqualified promissory notes to back up a letter of credit? It seems to be an unlikely kind of transaction.

MR. SLATTERY: I do not know the answer to that question, Justice Stevens. I think that a letter of credit transaction probably can be structured in as many different ways as an ordinary loan, for example, can be structured, or the circumstances under which a cashier's check might be issued.

The statute tells us in what circumstances the holders of these credit instruments are insured depositors within the meaning of the Act and under what circumstances they are not.

QUESTION: Well, I guess it is just possible that Penn Square Bank had some looser banking practices than one might normally find.

MR. SLATTERY: I would note in response to that question, Your Honor, that the bank officer who executed this letter of credit refused to testify at trial, citing the Fifth Amendment privilege against self-incrimination. I think that is definitely true, Your Honor.

The amount of deference that the FDIC's interpretation is due in this case depends, of course, upon the familiar principles that the Court enunciated in the Skidmore versus Swift and Company case. These are the validity of its reasoning, the thoroughness of its consideration, and the consistency with its earlier and later pronouncements on the issue.

I believe that the reasoning that the FDIC has advanced is patently invalid. It flies in the face of the statute. Congress -- the FDIC, of course, today is attempting to limit or to narrow the class of persons that the deposit insurance program clearly protects.

This attempt to narrow the statutory language flies in the face of Section 1813(L)(5) in which Congress, specifically focusing upon the authority granted to the FDIC in the area of defining deposit insurance coverage, gave the FDIC only the power to expand the scope of deposit insurance coverage.

Nowhere in the statute is there any authority for the FDIC to narrow the coverage clearly afforded by the statute, least of all under Section 1819 10th, which merely gives it rulemaking power to carry out Congressionally expressed intent.

Moreover, the FDIC's position in this case has been positively contradicted. This isn't just a case of the FDIC assuming sub silencio, as it were, that unfunded letters of credit are not insured deposits. Their distinction in two other contexts between funded and unfunded letters of credit, lending limits, and financial statement disclosure, while not making the distinction in the context of deposit insurance, suggests that there is no room for that arbitrary unwarranted gloss on the clear statutory language in this case.

The consistency of the FDIC's position with its earlier and later pronouncements on the issue must, of course, also be examined as the Court determines the amount of deference to which the FDIC's interpretation is due.

In this regard, it is perhaps true that Assessment Decision Number 109 promulgated by the FDIC in 1956 has an importance that cannot be overemphasized. That assessment decision states plainly, and it is set out in our brief, that if -- that commercial letters of credit, letters of credit used in commerce, normally are not sold for cash, but are issued against an agreement to reimburse the bank for drafts paid.

The FDIC goes on to say therein that if the reimbursement agreement is not a promissory note, then in that event the letter of credit is not assessable, the clear unescapable implication being that if the reimbursement agreement is a promissory note as Orion gave Penn Square Bank in this case, the letter of credit is insured and is assessable.

I was struck listening to -- reading the FDIC's briefs and listening to the FDIC's arguments this morning by the similarity between the FDIC's arguments in this case and the arguments that the Federal Reseve Board presented in the Dimension Financial Corporation case which the Court decided just this past January.

As the Court will recall, the issue faced by the Court in that case was whether the Federal Reserve Board in its attempts to expand its regulatory authority over non-bank banks could put an unwarranted gloss on the statutory term demand deposits in the Bank Holding Company Act.

Where the Court rejected this attempt by the Federal Reserve Board to usurp the authority of Congress so should it reject the FDIC's similar attempt in this case. Respondent's position begins and ends where the statute begins and ends. Where the statute says letter of credit, the FDIC says funded letter of credit. Where the statute says promissory note, the FDIC says uncontingent promissory note. Or note that in a meaningful economic sense is the equivalent of money.

The unadorned language of the statute is free of the equivocations that have been proferred by the FDIC throughout the history of this case in different ways. The respondent submits that the decision of the Court of Appeals, firmly routed, as it was, in the plain statutory language, was correct and should be affirmed.

Thank you.

CHIEF JUSTICE BURGER: Mr. Rothfeld, do you have anything further?

ORAL ARGUMENT OF CHARLES A. ROTHFELD, ESQ.,

ON BEHALF OF THE PETITIONER - REBUTTAL

MR. ROTHFELD: A couple of points, Your Honor, which I will try to make quick. First, as to the crucial question, the meaning of a promissory note in a case, that clearly must be defined by reference to federal law, and it must be determined in light of the meaning of the statute and the Congressional purpose. It can't be enough if something is a promissory note that it has the term promissory note written across the top.

QUESTION: Is the note that we are talking about, is that the note that appears at Page 27 of the joint appendix?

MR. ROTHFELD: That is correct, Your Honor, which -- and the note is characterized explicitly as a backup note to the letter of credit, which clearly indicates that it is to be drawn upon only when the letter of credit is itself drawn upon.

It is impossible to imagine why Congress would have wanted to insure a letter of credit that is backed by this sort of contingent --

QUESTION: On that point, what is your response to his argument that there are a lot of things that the term deposit includes that are not what an old-fashion note of deposit is? In other words, checks written in payment of services, utility bills, and all that. He refers to them on Page 15 of his brief.

MR. ROTHFELD: Well, I should make two points in response to that, Your Honor. First, so far as 1813(L)(1) itself is concerned, which is the part of the statute that is at issue here, everything is defined in terms of money or its equivalent, and it is very difficult to imagine why Congress would have wanted to list something like an incontingent note to say that it must be regarded as money or its equivalent.

As to the instruments that the respondent has listed, those all appear in Section 1813(L)(4) of the statute, which is the only part of the deposit definition that is not put in terms of money or its equivalent.

QUESTION: But they all suggest that the purpose of this statute was to extend credit to a number of bank creditors for whom no deposit in the old-fashioned sense had been made, that he fits into that general class, and therefore fits into the overall Congressional purpose. That is as I understand his argument.

MR. ROTHFELD: Again, I think there are several points to make in response to that. First, the types of instruments listed in Section 1813(L)(4) are all things for which the bank generally has received cash, such as a cashier's check, or has received services, has received some value for someone.

And again, Congress singled out those types of bank instruments such as cashier's checks as the only things which were not defined in terms of money or its equivalent received or held by the bank. So those, I think, to the extent that they they don't fall into the category of claims that the FDIC is talking about are in a special separate category, and Congress recognized that.

QUESTION: Well, and do you say an unconditional note would qualify for insurance?

MR. ROTHFELD: That is correct, Justice White. An unconditional loan is money or its equivalent in a meaningful sense to the depositor of the note. It appears that the respondent's explanation as to why this note should be treated as money or its equivalent is that it gives the bank additional rights to reimbursement it was forced to pay out on the letter of credit, but the crucial point there is that he is talking about reimbursement of the bank's own funds that the bank has paid out. It is not customer's funds that the customer has given to the bank. Those funds don't have to appear in the form --

QUESTION: Let's assume that the bank hadn't failed, but there was some payment on the letter of credit by the bank, and then they call on the customer to pay. And they sue -- and he doesn't pay and they sue on the note. They do collect interest just by the terms of the note.

MR. ROTHFELD: Under the terms of the note they would, although it is not clear what the side agreement in this case would have provided for. But in any event that is really simply like a reimbursement agreement that provided for interest. Whether or not it is a note is irrelevant. In fact, the logic of respondent's argument reduces the note to irrelevancy. It is simply the fact that the lawyers for the parties to this transaction happen to make use of something in the form of a note and wrote Promissory Note across the top.

QUESTION: But is that right? Supposing there had been a default, and they paid out half of the amount covered, say $75,000 on it. Then wouldn't the obligation on the note have become a real obligation under your theory, and then it wouldn't have been an insured deposit?

MR. ROTHFELD: Well, again, the particulars of the agreement between Orion and the bank aren't clear for the record, but to the extent that the note would have -- to the extent the bank could have drawn on the note for reimbursement only for what it has paid out, again, it is simply getting reimbursement for its own funds that it has paid out. There has been no commitment of funds that the bank is holding.

QUESTION: I see. There would be no obligation on the note for the balance that had not been paid out on the letter of credit.

MR. ROTHFELD: That is correct, Your Honor. And again, that is the crucial question.

Thank you.

CHIEF JUSTICE BURGER: Thank you, gentlemen. The case is submitted.

(Whereupon, at 11:06 o'clock a.m., the case in the above-entitled matter was submitted.)

CERTIFICATION

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

#84-1972 - FEDERAL DEPOSIT INSURANCE CORPORATION, Petitioner V.

PHILADELPHIA GEAR CORPORATION

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