TRANSCRIPT OF PROCEEDINGS

IN THE UNITED STATES SUPREME COURT

W. T. LANGLEY, ET UX.,)
)
Petitioners,)
)
v.) No. 86-489
)
FEDERAL DEPOSIT INSURANCE)
CORPORATION)

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Washington, D.C.

Wednesday, October 14, 1987

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 10:01 a.m.

APPEARANCES:

WILLIAM C. SHOCKEY, ESQ., Baton Rouge, Louisiana; on behalf of the petitioners.

RICHARD G. TARANTO, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the respondent.

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P R O C E E D I N G S (10:01 a.m.)

CHIEF JUSTICE REHNQUIST: We will hear argument first this morning in No. 86-489, W.T. Langley versus Federal Deposit Insurance Corporation.

Mr. Shockey, you may proceed.

ORAL ARGUMENT OF WILLIAM C. SHOCKEY

ON BEHALF OF PETITIONERS

MR. SHOCKEY: Mr. Chief Justice, and may it please the Court, this Court is called upon in this case first to resolve a question of statutory interpretation, what meaning do we give to 1823(e). The FDIC naturally urges a very broad reading of the statute. The Langleys, whom I represent, argue a very restrictive interpretation of that statute.

In looking at past decisions of this Court relative to statutory interpretation questions, I note that this Court looks first at the language of the statute, then, if necessary, at the legislative history, and finally at policy considerations, and I will take each of those in turn.

The language of the statute says no agreement which tends to diminish or defeat, et cetera, et cetera, shall be valid as against the corporation. No agreement. That is the key word. The statute does not say no claims. The statute says no agreement.

We concede that some of the things that were alleged by the Langleys in their original complaint are agreements that 1832(e) bars, things such as the interest rate being, supposed to have been different from what was in the note, the term of the loan, that it would not be due until the property was sold, and that the liability on the note was in rem. We concede those things. Those are agreements at variance with the documents. We do not have or concede that representations made by the bank president as alleged relative to the acreage in the tract of land in question or as to the mineral acreage and the status of the mineral rights in the property.

QUESTION: Why didn't the bank agree that those -- that much land would be delivered?

MR. SHOCKEY: Well, first, the bank, of course --

QUESTION: They did, didn't they?

MR. SHOCKEY: -- wasn't the true seller of the property.

QUESTION: Well, I know, but they made the deal.

MR. SHOCKEY: If Your Honor will refer to the mortgage itself, which is in the Appendix at Page 29, you will see the fact that there were 1,628.4 acres in the mortgage tract. It is specified in the mortgage.

QUESTION: What do you want us to look at? Where do you find it?

MR. SHOCKEY: On Page 29 of the appendix is -- that is one of the pages of the mortgage. If I recall, right in the middle of the page there is a reference in the mortgage itself to the property containing 1628.4 acres.

QUESTION: And you say that some substantially lesser acreage was in fact conveyed?

MR. SHOCKEY: Yes, ma'am, I do. If you will recall from the allegations in our complaint, the Langleys allege that the property in fact only contained 1522 acres.

QUESTION: In your complaint, did you seek to set aside the transaction or to simply counterclaim for the decreased value of the property?

MR. SHOCKEY: We counterclaimed. If you will recall, the suit began with a suit on the note by the bank. We filed suit in Federal District Court seeking to rescind the transaction and to collect treble damages under the Rico statute. This was prior to the time the bank closed. Our suit, as distinguished from all the other FDIC litigation that I have reviewed, and I have tried to review every FDIC case, our case was pending. Our case was pending at the time that the FDIC was appointed the receiver for Planters Bank.

QUESTION: Mr. Shockey, it seems to me you are saying that a promise is an agreement, but a representation of present fact is not an agreement. It doesn't seem to me a promise is any more literally an agreement than is a representation of present fact. If you want to really be technical about it, an agreement requires an exchange of promises. I don't know why the fact that I say I will charge you so much interest is any more an agreement than is the fact that I say the land has so many acres.

MR. SHOCKEY: Well, what the case boils down to at this point is the, and I will explain to you how it is different --

QUESTION: You argue that the promises are agreements, right?

MR. SHOCKEY: Promises that Mr. Caughfield as the president of the bank had the capacity to deliver, if you will, interest rate, term of loan, and things of those nature, okay, but Mr. Caughfield wasn't delivering the property. Actually, another seller, another -- a seller, a customer of the bank actually delivered the property, actually delivered the mineral interests. Mr. Caughfield was making representations about the quality of the thing that was to be the object of the sale, not necessarily things that would be as to the qualities and characteristics of the loan transaction itself.

QUESTION: Why wasn't he promising that that customer would deliver so many acres?

MR. SHOCKEY: Excuse me, Your Honor? I didn't follow your question.

QUESTION: Why wasn't the officer, the bank officer promising that the bank's customer would deliver so many acres?

MR. SHOCKEY: We in fact contend that he was promising that there would be. He represented that the tract, that he was familiar with the tract, and that it would include that many acres of property.

QUESTION: Why wasn't that as much an agreement as anything else?

MR. SHOCKEY: Well, Your Honor, the representations as to how many acres there would be and how many mineral rights he would get were an ingredient, if you will, of the sale between Leenerts Farms, who was the other bank customer, and my clients. Representations as to interest rate, term of loan, and that sort of stuff were an ingredient of the loan transaction.

You actually have two transactions between different parties.

QUESTION: Well, the promises that you now rely upon or the representations that you now rely upon were apparently made by the actual owner of the property who sold it to your client?

MR. SHOCKEY: No. We allege they were made by the bank president.

QUESTION: The owner of the property never said he had 1600 acres, or whatever it was?

MR. SHOCKEY: I believe it is alleged in our complaint that the Langleys met the seller at the closing.

QUESTION: And the document at closing included this document that you called our attention to?

MR. SHOCKEY: The documents at closing included a sale agreement, a deed, possibly you may refer to at common law, which is included --

QUESTION: For that number of acres?

MR. SHOCKEY: Right, and a separate document, a mortgage, which is the lien instrument under Louisiana law, which also contains the reference to the 1628.4 acres. Both instruments contain that reference.

QUESTION: I must confess I am kind of puzzled. Why wouldn't that have given them adequate information about the size of the tract?

MR. SHOCKEY: Well, the problem is, there was a representation --

QUESTION: There was an oral statement earlier that there was more acreage. Is that it?

MR. SHOCKEY: No, there was less acreage. Actually, a survey, as we allege in the complaint, reveals there was less acreage. In fact, over --

QUESTION: Less than 1628?

MR. SHOCKEY: Yes, I believe the exact figure is 1522, as alleged in the complaint.

QUESTION: Why do you have to rely on an oral statement about 1628? That is in the written documents.

MR. SHOCKEY: Well, I understand. The mortgage itself is not in the form sanctioned by the statute, as in approved by the board of directors, and this and that and the other.

QUESTION: Yes, but it surely cleared up any -- I mean, it surely made it clear that that is the amount of acreage that they were talking about.

MR. SHOCKEY: Well, it surely makes it clear that that is what the Langleys thought they were buying. I agree with you there.

QUESTION: I don't understand, though, why he has to rely on an oral statement.

MR. SHOCKEY: Well, would love to rely on my mortgage, and if the Court would rely on my mortgage I would be very enthralled, but the point is, I don't think the mortgage itself fits the requirements under 1823(e). You have got to have it not only in writing, but you have also got to have it approved by the board, and this and that and the other.

QUESTION: Well, in the mortgage, I assume the representation as to the acreage is a representation from your client to the bank rather than a representation from the bank to your client.

MR. SHOCKEY: Yes, and --

QUESTION: Isn't that right? I mean, in the ordinary mortgage, if there is something wrong with the acreage and it is less than indicated, is it the bank that is somehow responsible?

MR. SHOCKEY: The answer to your question is yes and no, and I will explain. You get to a question of state law there. You get to a question of who the lawyer who prepared the mortgage instrument is actually representing.

Now, we allege in our complaint that the lawyer who prepared the mortgage instrument was the bank's lawyer. He was the lawyer for the bank. So you get to a state law question at that point in terms of who is representing to who.

QUESTION: And the mortgage, by the way, that also wouldn't be an agreement, either, the representation as to what the acreage is?

MR. SHOCKEY: The representation contained in the mortgage, you know, that is a document prepared from, if you will, prepared from the same, the sale document. They have the same appendix with the property description. So I am not sure we can characterize that as an agreement. It is a document, you know, of course, prepared by the attorney who was representing the bank.

QUESTION: A mortgage is an agreement, certainly, but you would say that that portion of the mortgage consisting of the representation that there are so many acres in the land, that is not an agreement in and of itself?

MR. SHOCKEY: That is what I believe. Yes, sir.

QUESTION: Ordinarily a representation of a warranty or whatever you want to call it in a mortgage like that runs from the mortgagor to the mortgagee. It would run, someone said earlier, from your client to the bank, and not vice versa.

MR. SHOCKEY: Right, and of course, where did my client get the information? He got it from the bank.

QUESTION: Well, what has happened to your lawsuit against the bank president and the bank?

MR. SHOCKEY: The bank president, for your information, went into bankruptcy. In the bankruptcy proceeding, his discharge has been stayed pending the final outcome of the case.

QUESTION: And that is still pending.

MR. SHOCKEY: That is still pending.

QUESTION: Presumably your client could get some kind of adjustment on recovery in that lawsuit.

MR. SHOCKEY: Assuming the gentleman is solvent. Of course, as I indicated, he has gone into bankruptcy. His discharge has been stayed pending the final resolution of this case, be it in this Court or filed under remand.

QUESTION: Mr. Shockey, tell me if I am mistaken about what you are saying. In the ordinary contract, any representation of a material fact is automatically a condition on the performance of the other party. If that representation isn't complied with, the other party doesn't have to perform. Now, you can -- if you make a representation and don't express the condition, the condition is implied anyway. It simply is implied in fact. Now, suppose the condition in this case had been expressed, and instead of just saying, the banks just saying the land contains so many acres, the bank says, I agree that if the land does not contain so many acres, you will have no obligation under this contract.

Would that be an agreement?

MR. SHOCKEY: That would be an agreement.

QUESTION: So the only failure here is, what distinguishes an agreement from a nonagreement is spelling out the condition that exists anyway, whether you spell it out or not. That is the line you would have us draw?

MR. SHOCKEY: I believe that is the conclusion that we are left with.

MR. SHOCKEY: Yes, I think that is. You are comfortable with that?

MR. SHOCKEY: Obviously, I am not comfortable with the Superholder in due course statute. The statute is mean. It is tough. It is not fair. It is really not fair to the Langleys because their suit was pending seven months prior to the time the bank was closed.

Basically what this Court has got to determine is what is and what isn't beyond the scope of 1823. We have briefed to death the question of what is a representation and what is a warranty and all that. I mean, we couldn't cite another source other than possibly my mother for something like that.

I think what you've got to do is picture in your mind W.T. Langley and Roy Caughfield standing in the lobby of the Planters Bank in Opelousas, Louisiana, and think how this transaction went down, how -- what must one have said to the other and in what context, gleaned from the allegations of the complaint.

I simply don't have time to go through it, but if you will think of that in your mind, I think you will come to have a better appreciation of what was agreed upon between the gentlemen and what was in fact just represented and taken for granted by the other.

QUESTION: Mr. Shockey, let me pursue this same inquiry from a slightly different direction. Are the representations that are the focus of your petition here matters that would be defenses not available to a holder in due course under a Uniform Commercial Code approach in ordinary commercial law?

MR. SHOCKEY: Our defenses --

QUESTION: Would they be -- would they be things like warranties that normally would not be available against a holder in due course?

MR. SHOCKEY: They would not be available against a holder in due course who was otherwise a legitimate holder in due course to accrue value, no default, et cetera.

QUESTION: And what we have here is a statute that automatically makes the FDIC a holder in due course in legal effect, don't we?

MR. SHOCKEY: Except for two things, and let me respond to your question in two parts. The statute, mind you, the FDIC in a general sense is going to take these problem loans where they are defaulted, so holder in due course laws wouldn't apply anyway, where they are in default. I am saying the FDIC -- if you get these problem loans, they are in default, and of course if a loan is past due, a note past due, you can't be holder in due course. The representations that we are keying upon are really the representations that induced Mr. Langley to buy the property, not necessarily the representations that induced him to make the loan.

You have got to remember, the sale was between Leenerts Farms and Mr. Langley. The loan transaction was between Mr. Langley and the bank.

I refer this Court to its recent decision in Sedima regarding strict construction of language. Basically this Court --

QUESTION: Mr. Shockey, before you get into the legal argument, can I ask you a question about the facts? Is the agreement of October 3, 1980, in the papers before us?

MR. SHOCKEY: I believe so, Your Honor.

QUESTION: I can't seem to find it.

MR. SHOCKEY: No, sir, it is not in the appendix. It is in the record, of course.

QUESTION: It is in the record.

MR. SHOCKEY: I do believe so, yes.

QUESTION: Does it contain the normal boilerplate that all prior representations are merged into the agreement or something like that?

MR. SHOCKEY: Frankly, I cannot recall the provisions of the instrument in that specificity.

QUESTION: I see.

MR. SHOCKEY: I would like to refer you, as I indicated, to the Sedima case. That is about the last pronouncement of this Court that I am familiar with regarding statutory construction. I also refer this Court to the dissent in the Philadelphia Gear case, Philadelphia Gear versus FDIC. Justice Marshall wrote at that time, "Nevertheless, to reach this common sense result, the Court must read qualifications into the statute that do not appear there. We recently recognized that even when the ingenuity of businessmen creates transactions and corporate forms not contemplated by Congress, the Courts must enforce the statutes Congress has written."

Look at the words of the statute. Now, legislative history.

QUESTION: There still is a question of what does an agreement mean.

MR. SHOCKEY: What is an agreement? That is the question.

QUESTION: You say it means a promise.

MR. SHOCKEY: But it does not mean representations as to the quality of the thing that is the subject of another transaction between the borrower and another party.

QUESTION: More precisely, you say it means only express promises, because when you make a representation of a material fact, there is an implied promise that the deal is off if that fact isn't true. What you are saying is that an agreement consists only of an express promise and not of an implied promise.

MR. SHOCKEY: I don't follow your point.

QUESTION: I sell you a car and I say the car has -- I say, I warrant, this car has eight cylinders. If it doesn't have eight cylinders, it turns out to have four, you could rescind the transaction because there is implicit in that representation a promise that if it doesn't have eight cylinders you can get out of the transaction.

What you are saying here is that unless that promise is made express, it is not an agreement. If it is express, I promise that if it doesn't have eight you can get out of the transaction, if I make that express, you say it is an agreement, but if I leave it to be implied, it is not an agreement.

MR. SHOCKEY: But the difference between your analogy and our case is, you are talking about you selling to me, two parties to the transaction, and the party making the representation is the seller. In our case, the party making the representation is not the seller. The seller is somebody else. Roy Caughfield had no obligation, implied or otherwise, to make representations about the qualities of the thing.

QUESTION: But you are claiming that that representation goes to, goes to the validity of the deal between your client and the bank. You are saying it has something to do with that deal and was part of that transaction as well, wasn't it?

MR. SHOCKEY: Certainly. We look at legislative history only if the language of the statute is unclear, as this Court mentioned in the Blum versus Stenson case. The legislative history is sparse. Most of the legislative history that is available to the Court is actually testimony given by members of the FDIC and their counsel at committee hearings. The Langleys had no lobby in Washington in 1950.

QUESTION: Are you trying now to show us that the word "agreement" in the statute doesn't mean what one would ordinarily think "agreement" would mean?

MR. SHOCKEY: Well, I think it means what one would ordinarly think "agreement" means.

QUESTION: Well, then, why do you have to go to the legislative history?

MR. SHOCKEY: Because I am sure the legislative history is going to be relied upon by my opponent.

QUESTION: Okay.

(General laughter.)

QUESTION: Your opponent will say the same thing, no doubt, so we have to get into the legislative history. You are right.

MR. SHOCKEY: Most of the legislative history is sparse on this Act, more so than on any that I can recall before. Maybe it is the time. This Court has indicated and most of it has indicated FDIC personnel --

QUESTION: Isn't what you are trying to say, or perhaps you have already succeeded in saying it, is that there is a difference between an agreement as contained in the statute and a representation that is fraudulent that would be a basis for setting aside the transaction?

MR. SHOCKEY: That is what I am saying, because under, you know, at least under Louisiana law, and we have the Civil Code, but the idea of fraud is not that much different from what I learned in law school about the common law. Under our law, if there is fraud and it induces you into the transaction, then it is as if you didn't give your consent. It erases, vitiates, to use that word, the consent, and without consent there is no agreement, because an agreement is an accord of two minds and two wills.

QUESTION: Would you have won if this had occurred in the Eleventh Circuit?

MR. SHOCKEY: I think so. I think Gunter I would have won. I had the missing factual links that were not apparent in Gunter because if you will recall, in Gunter the borrowers conceded that the FDIC had no knowledge, and also, of course --

QUESTION: The FDIC knew the facts here?

MR. SHOCKEY: Yes, sir. As the appendix will reflect, the suit was filed well before the bank was closed, and the pendency of the suit was noted in two examination reports by the FDIC and rendered prior to the time the bank closed. That is a fact that distinguishes this case from every other FDIC case that I know about.

QUESTION: I don't understand your injecting fraud into the analysis all of a sudden. Whether it is an agreement or not depends upon the presence of fraud? You can have a fraudulent promise. There can be fraud in a transaction that consists of making a promise at the outset that you have no intention whatever to perform.

MR. SHOCKEY: Well, that's true. Such as, for example, I am going to give you an interest rate less than what is specified in the note. I am going to tie it to Chase and --

QUESTION: And you think that that prevents it, that would prevent it from being an agreement within the meaning of this statute?

MR. SHOCKEY: Yes, sir.

QUESTION: Well, then, why have you waived your rights on those other two? I thought originally those promissory elements you contested as not being agreements, I thought on this appeal you have acknowledged that they are agreements.

MR. SHOCKEY: Well, all of the Federal Circuit Courts have uniformly recognized that that sort of representation, if you will, the Gunter court went to the point of trying to distinguish between promissory fraud and fraud that did not involve a promise to deliver at some future point in time. I believe the issue in Gunter was to -- one of the issues in Gunter, as an example, was to make certain loans in the future, or it was in one of the other case. So the Federal Circuit Courts have uniformly held against me on that point, all of them, so when I came to the Fifth Circuit I was in a position of having to concede that point, and I came to this Court on the difference between the Gunter case and my case.

QUESTION: Well, you would most like us to say, then, that any fraud, whether it is promissory fraud or fraud in a representation, which is not an express promise, any fraud can't constitute an agreement, and failing that you would fall back on the fact that at least an implied promise is not an agreement. Is that --

MR. SHOCKEY: I would love for this Court to so hold. And basically, you know, I can live with Gunter. If this Court were to adopt Gunter and apply it to the facts of this case, I can live with that.

QUESTION: (Inaudible.)

MR. SHOCKEY: That's correct.

(General laughter.)

MR. SHOCKEY: The legislative history is really not of much help. The weight to be afforded remarks made in the legislative debate by others other than the drafter or sponsor this Court has indicated is entitled very little weight.

Further, that even the contemporaneous remarks of one legislator speaking about the purposes or intendments of enactment, this Court has previously recognized as not --

QUESTION: Mr. Shockey, I suppose that even if the statute didn't cover it, that we would fall back on the holding of the D'Oench case. Do you think the statute replaced that old common law holding?

MR. SHOCKEY: I think the statute replaces that common law holding in terms of --

QUESTION: Has any court so held?

MR. SHOCKEY: No, ma'am.

QUESTION: No. In fact, haven't they gone ahead and applied that case as well?

MR. SHOCKEY: There have been some Federal Circuit Courts that have applied that. Either I am missing the boat or my client ought to pay me double for my brilliance, but I haven't seen the first time that anybody has brought up in those cases the preemption question. Nobody has to my knowledge in those reported decisions urged that 1823(e) supplants the Dench case. I haven't seen it. And hopefully I shouldn't be penalized for that. I believe Federal common law still has application here. It has application for purposes of interpreting 1823(e), just as you had noted in the Philadelphia Gear case that you look to Federal law to determine what is a "deposit" for purposes of another statute under the Federal Deposit Insurance Act in determining whether or not the corporation would be required to make good on a deposit.

We can accept that Federal common law applies. We do not concede that Federal common law would apply in this case in terms of other defenses. Basically the U.S. v. Kimbell Foods case announced a three-prong test for determining whether or not Federal common law or state law should apply. I think if you will look at that case in light of the facts of this case, you will find that a state law rule or decision in terms of the fraud issue can be formulated that would not do violence to the Federal policies and what have you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Shockey.

We will hear now from you, Mr. Taranto.

ORAL ARGUMENT BY RICHARD G. TARANTO

ON BEHALF OF THE RESPONDENT

MR. TARANTO: Mr. Chief Justice, and may it please the Court, the question in this case is whether Federal law permits petitioners to rely on unrecorded oral understanding to defeat their straightforward written obligation to repay to the FDIC more than $450,000 in borrowed money.

That question has two parts because there are two sources of Federal law, Section 1823(e) and Federal common law. Our primary position is that Section 1823(e) requires petitioners to live up to their written obligation. Our secondary position is that Federal common law requires the same result.

There are two central reasons for both of our positions. First, it is necessary to the scccessful functioning of the Federal Deposit Insurance system. Thus long-standing Federal policy and the basic functioning of that system as Congress intended require that the FDIC be entitled to rely on the bank's written documents. Second, it is fair. With regard to who should bear the burden of the $450,000 at issue here, this case presents a choice between petitioners on the one hand who borrowed the money, the FDIC insurance fund, and possibly other creditors on the other hand.

QUESTION: Well, Mr. Taranto, you say it's fair, but do you really think Congress meant to totally repeal the doctrine of fraud and the inducement as applied to this kind of transaction?

MR. TARANTO: I think what Congress intended to do in Section 1823(e) was in effect to give by law the status of a holder in due course to the FDIC, and that status would, as Justice O'Connor suggested, preclude the assertion of personal defenses, including fraud in the inducement.

QUESTION: Fraud in the factum, so-called, survives holder in due course status.

MR. TARANTO: That's right.

QUESTION: How do you distinguish that kind of fraud from fraud in the inducement?

MR. TARANTO: Fraud in the factum, as I understand it, occurs when one person fraudulently induces somebody to sign a different document from the document that person thought they were signing, so it is akin to forgery or duress but it is different from what is alleged here, which I think is expressly in the complaint termed fraud in the inducement, that representations were made fraudulently that induced them to then sign the document that they had no difficulty reading or understanding.

QUESTION: Are there any factual misrepresentations by a bank officer that could ever give the borrower a real defense under the statute in your view?

MR. TARANTO: There could be fraudulent -- there could be fraud in the execution of an obligation assumed by the bank when it granted a loan. There is a case from the Ninth Circuit called FDIC against Mio in which a bank promised when being given a note to use the proceeds to purchase certain voting stock, I think, in the bank or in some corporation, and instead purchased nonvoting stock.

The Court said that was enforceable against the FDIC because the maker of the note was not negligent in failing to discover that the bank had fraudulently failed to do what it said it was going to do.

QUESTION: Would it make any difference that the FDIC in this instance did have actual knowledge before it took over the assets?

MR. TARANTO: We don't see how an actual knowledge requirement can be read into the statute. The statute simply says that no agreement that tends to diminish the value of an asset obtained by the FDIC shall be valid against the FDIC, and it doesn't make any distinction according to whether the FDIC knew on the eve of the bank closing, perhaps by getting a telegram, as has happened, somebody saying, hey, I have some objection to this, to this defense, and in fact no court, not one, to my knowledge, has suggested an actual knowledge requirement in the context of Section 1823(e). When some courts have gone on past 1823(e) and discussed the scope of federal common law protections, several of them have discussed an actual knowledge requirement. As it happens in Gunter itself an actual knowledge requirement was discussed, but there it was satisfied.

QUESTION: Mr. Taranto, can a fraudulent promise, a promise that the promisor has no intention of performing, can that constitute fraud in the inducement?

MR. TARANTO: I think it can constitute fraud in the inducement, but it would not be a permitted defense under 1823(e).

QUESTION: I understand, but my point is that even if we accept the interpretation of the word "agreement" that the petitioner would have us adopt, we would not have succeeded in establishing fraud in the inducement as a defense.

MR. TARANTO: That's right. As I understand petitioner's distinction and the distinction the Gunter Court alluded to and then the Sixth Circuit in the Hatmaker case more explicitly adopted, that distinction would say that certain kinds of fraud in the inducement are barred by 1823(e) but certain other kinds are not, depending on whether the fraudulent representation was a factual representation or was a promise to do something.

That distinction, too, we think, is simply inconsistent with the policies behind 1823(e), those policies being designed to allow the FDIC to look at the bank records and take those records at face value and not have to look outside the bank records.

QUESTION: Mr. Taranto, why aren't those policies equally implicated by fraud in the execution?

MR. TARANTO: The policies as we understand them are designed to allow people who make -- who assume obligations, make a note in this case, to insist that any term that they think is relevant to the note be placed in writing. There are certain cases like fraud in the execution --

QUESTION: Well, I understand that, but from the point of view of the FDIC, does it really make any difference whether the facts as your opponent alleges here, or just changed a little bit, supposing the bank president wrote up an agreement with the different sized acreage and he showed it to him and says, this is what the deal is going to be, and then he went home and substituted a page without telling him, and what shows up in the files is what we've got.

From the point of view of the FDIC, why is one any more -- any different from the other?

MR. TARANTO: Well, we do think that the statute places some limitations on the FDIC's protections. The FDIC can't simply say -- it can't win in all cases regardless of facts. The emphasis in the statute on the writing --

QUESTION: It seems ironic to say that the use of the actual knowledge doesn't matter. In one case actual knowledge of the FDIC they still can prevail. The other case they don't know but they lose.

MR. TARANTO: We think the critical distinction is whether the borrower had an opportunity to place in writing conditions he relied on and failed to exercise that opportunity. That is a distinction that we think comes out of the D'Oench case, which spoke about a borrower not even --

QUESTION: He had the opportunity in the fraud in the execution case, too.

MR. TARANTO: But as I understand your fraud in the execution case, the borrower didn't have any opportunity to prevent the bank from doing what later turns out to be fraud, as in the Mio case.

QUESTION: Mr. Taranto, don't you at some point have to come within the terms of the statute? What is your argument that makes these agreements?

MR. TARANTO: We think that any basis of the bargain, any representations, whether they are factual or promissory, constitute warranties which in ordinary commercial law are agreements. We also think that the fraudulent intent behind any of those representations cannot be relevant, because this rule, like a holder in due course rule, is intended to protect third parties, and where third parties are the object of the protection, the objective words exchanged are what has to matter. And as I suggested, that is a view that we think is supported first of all by the petitioner's concession at every level in this case that if the --

QUESTION: Wouldn't the fraud in the execution that Justice Stevens mentioned to you qualify as an agreement in those terms?

MR. TARANTO: If I understand that fraud in the execution example, that may well be a real defense in holder in due course doctrine.

QUESTION: Well, I know, but the statute doesn't say anything about holder in due course. It says an agreement. And if the bank says here is what you are going to sign, and then substitutes another document, there has been an agreement, there has been a representation.

MR. TARANTO: I am not sure --

QUESTION: It sounds to me like it is as much an agreement as --

MR. TARANTO: I am not sure that in that case the asset would be one that the petitioner can fairly be said to have obliged himself under, so that -- however one fits the -- that example into the language of the statute, there has never been any attempt by the FDIC to depart radically from the basic distinction in the holder in due course doctrine between the personal and the real defense. It is only when a borrower has an opportunity to protect himself and fails to take it that we think the statute applies, that there is an agreement that cannot be valid against the corporation.

QUESTION: One of the conditions to establish fraud in the execution, as I recall, is that the person asserting it not have had an opportunity to detect a fraud. That is, he can't come in and say, you know, the agreement that was presented to me was not the one I thought I was signing. The court would simply say, you know, was it given to you, and were you given an opportunity to read it, and if he said yes fraud in the execution wouldn't apply, would it? There has to be some chicanery that deprives him of the opportunity to see what he is executing.

MR. TARANTO: That would certainly be one way of accommodating that exception.

QUESTION: I don't know if it's a way of accommodating. Am I right on the law? Is that --

MR. TARANTO: As I understand, that is the essential rationale behind most, if not all of the real defenses, forgery, duress.

QUESTION: I am just repeating what the Chief Justice asked you earlier. Do you think Congress had this distinction in mind?

MR. TARANTO: There is no evidence specifically in the legislative history --

QUESTION: Or in the statute.

MR. TARANTO: -- or in the statute that Congress surveyed the whole range of questions that could arise when the FDIC seeks to enforce a note that it obtains from the bank, and I might add at this point that that is the primary reason why we think any argument about preemption of common law, if we were to get to that, cannot survive. That is, whatever Congress was doing in passing Section 1823(e), they were not saying, let's think about all possible defenses and then specify these defenses and only these defenses are to be forbidden. They simply addressed what I think they understood to be one problem, a problem that grew out of the D'Oench case and more specifically, as we show in our brief, out of a Third Circuit case that prompted the introduction of the legislation.

Now, it is true that our position, by reading Section 1823(e) to grant the FDIC holder in due course status as a matter of law puts the FDIC in a much more favorable position than the bank itself would be in, but as Justice Jackson said in the D'Oench decision, the corporation, the FDIC, did not simply step into the shoes of local banks. The purposes sought to be accomplished by it can be accomplished only if it may rely on the integrity of banking statements and banking assets.

That reliance is critical at at least two different places in the overall deposit insurance system.

QUESTION: When you talk about the integrity of banking statements and so forth, ordinarily that would not be thought to suggest that a statement of a bank showing a note payable for $300,000 was free of any defenses like fraud in the inducement. You wouldn't say that statement lacked integrity if they showed on their statement a note for $300,000. There may be defenses to a note like that.

MR. TARANTO: As against the bank?

QUESTION: Yes.

MR. TARANTO; Yes, and as against the bank officers in this case a fraud defense not only could be asserted but has been asserted and remains alive in this case.

QUESTION: So I don't see where you get into the sense of integrity of the bank statements.

MR. TARANTO: I think what Justice Jackson had in mind when referring to the integrity of banking statements was the FDIC in its several roles as examiner of the institution and then as the insurer that steps in once a bank fails must be able to take those bank statements in effect at face value the way a holder in due course would take a note purchased in good faith at face value.

QUESTION: But the inference from that observation would be that if the FDIC knows that there is no integrity to a bank statement, why should they win, if they know that this is a false statement?

MR. TARANTO: I think there is a statutory answer and then a policy answer. The statutory answer is that an actual knowledge requirement simply, we think, cannot be fitted into the language of 1823(e). The policy -- and all the courts have agreed to that. The policy answer is that unlike an ordinary holder in due course or good faith purchaser, the FDIC is not in a position to simply walk away from the transaction. The FDIC has certain obligations. One way or the other it is affected by the value of this asset. Either it has to pay the deposit insurance up to $100,000 for each depositor, or it has to infuse some of its own money into the system either to assist the bank or to arrange for a new bank to take over the failed institution, but the FDIC cannot simply upon hearing that there is a problem with the asset say, I won't have anything to do with it. The FDIC is in effect an involuntary creditor, and the protections should accordingly be stronger than in the ordinary holder in due course.

QUESTION: Mr. Taranto, the old common law rule under the D'Oench case, would that yield any different result possibly?

MR. TARANTO: I think that there are situations in which the O'Dench rule would cover -- that it would cover certain situations that in our view 1823(e) would not.

QUESTION: What type of situation would --

MR. TARANTO: Principally it applies and has been held consistently to apply to the FDIC acting in its capacity as receiver. There are in fact very few cases that apply D'Oench where in our view 1823(e) would not apply. There may be some situations, for example, where a failed bank has played the lead role, and a loan participation has been arranged. In many situations the participating bank has some kind of informal understanding that if the borrower defaults, then the loan participation comes to an end and the lead bank has to take it back.

What the FDIC is presented with in that situation is simply the lead bank's participation and the participant bank is coming in and saying not that that asset should be diminished, but that the bank has to take on a new obligation that doesn't appear in the books. We think that that, too, would be a situation that would be covered by D'Oench, because the bank, the participant bank would have lent themselves to a transaction that was likely to mislead bank examiners.

But on the whole, in our view Section 1823(e) as to the FDIC in its corporate capacity does in fact cover what D'Oench covers.

Now, the role that this statute plays if read as entitling the FDIC to rely on bank records as a holder in due course would, comes into play first of all in -- with respect to the FDIC's role with open banks, and that role is chiefly to ensure that those banking institutions don't in the end threaten the solvency of the fund. Congress has given the FDIC extensive powers to examine banks, and what is critical is that in those examinations the FDIC examiners be able to rely on the books and records of the banks as they appear and not have to be interviewing people outside the bank, investigating the particular law, of Louisiana in this case, and making its own assessment, not about the practical collectibility of particular assets, but about their legal enforceability if on their face they appear to be fully valid.

The second place in the system that this ability to rely on bank records is critical is when a bank fails. When a bank, an insured institution, fails, the FDIC has several options. It has long been recognized that the preferred option is not to close the bank and pay off depositors, but to try to keep the bank open, and that is done through a purchase and assumption transaction, whereby another bank, usually in the community, takes over the failed institution. That is preferable for a number of reasons. For one, all depositors are fully paid, not simply up to the $100,000. It keeps the bank open and avoids disruption of the banking services in the community, and it preserves the going concern value of the bank. An assuming bank is typically willing to pay some substantial amount of money to get new branches.

Congress itself has recognized these advantages. Even recently, this summer, since the briefing in this case was completed, Congress added yet a new method by which the FDIC can keep a bank open, create the possibility of a temporary bridge bank in Title 5 of the Competitive Equality Banking Act of 1987.

What is critical is that although that option is preferred under the statute, it may be exercised only if it is less costly than the principal alternative, simply closing the bank and liquidating it. And the ability to rely on the written assets of the bank is critical in three respects at this stage. First of all, of course, it increases the value of those assets and makes the preferred option more likely to be taken. Second of all, the determination of which option may be taken, that is, the assessment of which option is more or less costly, must be made very quickly, and that means that simply as a matter of ensuring the accuracy of the determination the FDIC should be able to rely on the bank's records.

And finally, when the bank fails, the question is not whether a loss is going to be avoided entirely. The question is who will bear the loss. Now, it is possible that in this case Mr. Caughfield or the other bank official involved can successfully be sued, and petitioners will not have to bear this loss, but as between petitioners and the FDIC, it seems to us quite clear who should bear that loss, because petitioners had an opportunity to protect themselves by insisting that these terms be placed in writing, and the FDIC, of course, did not. The FDIC came in after the transaction was completed. Here, in addition, it should be noted that unlike in the D'Oench case, all we are talking about is whether petitioners must repay money that wasn't theirs to begin with, that was borrowed from the bank.

In the D'Oench case this Court precluded a defense by the maker of an accommodation note and required that person to pay money that was his to begin with, that he had not borrowed, so we think fairness considerations as well as requirements of the FDIC system require the same results.

Let me say a word finally about the common law issue. As I have mentioned --

QUESTION: Do you think the result in D'Oench would have been different if the FDIC had known that the note was really not a note at all, it was a spurious note?

MR. TARANTO: We think D'Oench either expressly or all but expressly says that the result would not have been different, because it says whether bank examiners were in fact deceived or not is simply irrelevant to the issue. The only requirement for deciding that the notemaker as opposed to the FDIC fund should bear the loss is that the notemaker lent themselves to a transaction that would tend to deceive bank examiners. If those facts are enough, then an actual knowledge requirement is simply irrelevant.

Briefly, on the common law issue, our first point, as we suggested in our brief, is that 1823(e) cannot be read as a preemption of common law, of common law making power of the federal courts in these kinds of cases.

QUESTION: Well, do you ordinarily speak of that sort of thing as preemption?

MR. TARANTO: Well, I think some of this Court's cases have spoken about it as preemption. It is not preemption in the same sense as federal preemption of state law, but what we have here is a general jurisdictional grant by Congress and Section 1819 4th says that any case involving the FDIC arises under federal law. There is no suggestion in the legislative history, we think, or in the statute itself that what Congress was doing here was like what it was doing in the principal cases relied on by petitioner.

Congress did not, as I have suggested, survey the entire realm of possible defenses and make a considered judgment that these and only these defenses were to be precluded, and all other defenses available under state law were to be recognized. And we think that once the issue of preemption is out of the way and that it is acknowledged that if 1823(e) does not itself cover the facts here, that the common law making powers of this Court should lead the Court to reach the same result that the Fifth Circuit reached on statutory grounds. Under the Kimbell Foods analysis, all three factors, we think, lead to the result, first, there is a need for uniformity in the federal rule because there is a single nationwide deposit insurance fund that is threatened every time there is a half a million dollar loss threatened.

Second, federal policies, as I have tried to explain them and as they are reflected in 1823(e), would be frustrated by disabling the FDIC from relying on bank records. And finally, we don't think that there would be a serious interference with private practices based on state law, and the principal reason for that is that when an individual deals with a bank the norm is that obligations, promises and representations be placed in writing.

QUESTION: The bank is subject to the same fraud laws in most states as any other. If they lie or deceive a transaction can be set aside. This certainly changes that.

MR. TARANTO: It certainly does, but in both common law and now for 40 years in federal law with respect to the FDIC for those who come in after a bank fails to be in a better position, whehter they are a receiver or corporation.

QUESTION: Since you never know whether a bank is going to fail, it just alters a very substantial part of ordinary common law governing fraud, doesn't it?

MR. TARANTO: Well, the considerations that an individual would ordinarily be expected to take into account should include the considerations about what will happen if the bank fails, just as somebody buying a security of some type from a corporation should take into account priority rules that may occur if the corporation goes into --

QUESTION: It may be a desirable result but I don't think it is accurate to say that nothing would be changed if we did that.

MR. TARANTO: The principal change, we think, would be exactly the one that Congress intended to encourage in 1823(e), which is to add an extra measure of encouragement for people when dealing with banks to place everything that they understand to be a basis of the bargain in writing.

If the Court has no further questions.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Taranto.

Mr. Shockey, you have four minutes remaining.

ORAL ARGUMENT BY WILLIAM C. SHOCKEY

ON BEHALF OF THE PETITIONER - REBUTTAL

MR. SHOCKEY: When this bill that became this Act moved through the legislative process, it was amended on the House floor, as I recall, to change the word which was "simultaneously" in the original draft, talking about when this agreement must be placed in writing and all that sort of stuff, to the word "contemporaneously." Representative Walter handled the bill on the legislative floor, and he had some remarks which are important not only for purposes of 1823(e) and what does the statute mean, but also for federal common law.

He said, in part, and this is from 96 Congressional Record 10731 and 32, he said in part, "Prior to and up to the time of an unfortunate interpretation of the law it was believed that all legal agreements entered into by the bank and obligor were binding on the corporation, FDIC."

He goes on, at Page 732: "It was never the intention of Congress to give the corporation a stronger position than that of the bank, and the adoption of the amendment, my amendment, is offered to prove heretofore it was the intent of Congress that any agreement in the absence of fraud is binding on the corporation."

This is a fraud case.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Shockey.

The case is submitted.

(Whereupon, at 10:56 a.m., the case in the above-entitled matter was submitted.)

REPORTER'S CERTIFICATE

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LOCATION: The Supreme Court of the United States

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Supreme Court of the United States

Date: October 20, 1987

Margaret Daly
Official Reporter

HERITAGE REPORTING CORPORATION
1220 L Street, N.W.
Washington, D.C. 20005