OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: COY R. GROGAN, ET AL, Petitioners v.

FRANK J. GARNER, JR.

CASE NO: 89-1149

PLACE: Washington, D.C.

DATE: October 29, 1990

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IN THE SUPREME COURT OF THE UNITED STATES

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COY R. GROGAN, ET AL., :

Petitioners :

v. : No. 89-1149

FRANK J. GARNER, JR. :

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Washington, D.C.

Monday, October 29, 1990

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 12:59 p.m.

APPEARANCES:

MICHAEL J. GALLAGHER, ESQ., Kansas City, Missouri; on behalf of the Petitioners.

JOHN G. ROBERTS, JR., ESQ, Deputy Solicitor General, Department of Justice, Washington, D.C.; on behalf of United States, et al., as amici curiae, in support of the Petitioners.

TIMOTHY K. McNAMARA, ESQ., Kansas City, Missouri; on behalf of the Respondent.

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PROCEEDINGS

(12:59 p.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument now in No. 89-1149, Coy R. Grogan v. Frank J. Garner.

Mr. Gallagher.

ORAL ARGUMENT OF MICHAEL J. GALLAGHER

ON BEHALF OF THE PETITIONERS

MR. GALLAGHER: Mr. Chief Justice, and may it please the Court:

The question presented in this case concerns the appropriate standard of proof which a bankruptcy court must apply when deciding questions of nondischargeability under section 523(a)(2) of the Bankruptcy Code. Is it a preponderance of the evidence standard that is ordinarily applied in civil cases or is it, as the Eighth Circuit held in this case, that the creditor must prove each element of section 523 by clear and convincing evidence.

QUESTION: What is your understanding of in the Eighth Circuit's view what happens on remand? Is it open to prove in the bankruptcy court that there was clear and convincing evidence, and you have a new trial?

MR. GALLAGHER: We requested that the Eighth -- we filed a motion for rehearing with the Eighth Circuit and requested that on -- that the court specify what would happen on remand, so that we could retry either under (a)(2)

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or, as we had alleged originally in the adversary complaint, try it under (a)(6), because there were punitive damages assessed in the underlying fraud claim, and we believe we had additional grounds for nondischargeability under the theory that it was a malicious -- intentionally malicious injury to the property of the creditors. We asked the Eighth Circuit to clarify that and our motion for rehearing was denied.

As I understand the controlling precedent of this Court, upon a simple remand the case will go back and be retried -- had this petition for cert. not been granted, it would go back and be retried under (a)(2), under the clear and convincing evidence standard, and could be retried again under (a)(6) should the bankruptcy court in the first instance or the court of appeals thereafter determine that (a)(6) -- that the standard under (a)(6) is different from the standard under (a)(2), that is preponderance of the evidence, as two circuit courts have held.

QUESTION: Well, has (a)(6) been pursued at all?

MR. GALLAGHER: It was pursued and the bankruptcy judge declined to rule on (a)(6) because he ruled in favor of the creditor under -- creditors under (a)(2), and said a decision under (a)(6) was unnecessary.

QUESTION: It would seem to me the briefs up here completely ignored (a)(6).

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MR. GALLAGHER: That is correct, Your Honor, and the reason for that is because the petition for cert. merely put the question of the proper standard of proof under (a)(2), and it was my belief and understanding that the question of the proper standard of proof under (a)(6) is not before this Court. It is not why the Court granted cert.

QUESTION: Say that last again. It was your understanding that what?

MR. GALLAGHER: That the question of the appropriate standard of proof under (a)(6) is not before the Court. Of course, the Court may consider it, but it was not part of the question put in --

QUESTION: It seems to me in some respects that's a much better subsection than (a)(2).

MR. GALLAGHER: For my clients it is, Your Honor.

QUESTION: Mr. Gallagher, in this case you already had a judgment from the State court.

MR. GALLAGHER: Yes, Your Honor.

QUESTION: What -- Justice Stevens probably knows this, but I haven't done any bankruptcy work. Suppose there hadn't been a judgment. Suppose you just came into the bankruptcy proceedings saying I have a claim for fraud.

MR. GALLAGHER: Yes.

QUESTION: It hasn't been tried yet in State court.

MR. GALLAGHER: Yes. Unliquidated.

QUESTION: Yeah.

MR. GALLAGHER: What would happen?

QUESTION: What would happen? What burden of proof would -- it would be a State law claim?

MR. GALLAGHER: It would be a State law claim controlled by the State law. And if the claim had -- if the tort claim had contacts with the State of New York where clear and convincing as the standard of proof for common law fraud, then the burden --

QUESTION: What would govern under Erie? You would follow the State law?

MR. GALLAGHER: That is correct, Your Honor.

QUESTION: So, if -- let's see. If we said that the bankruptcy law requires just a preponderance and the State law -- no. If we say that the bankruptcy law requires clear and convincing, but the State law requires just a preponderance, what would the bankruptcy court do? Decide the case both ways -- first?

MR. GALLAGHER: It would decide the case under the clear and convincing standard, which of course would carry the day with respect to the adversary brought under rule 4007 of the Bankruptcy Rules.

QUESTION: I see. And it would be the same if it was reversed. Whichever is the higher is the one, because

you would have to win under both, right? It's like going high/low.

MR. GALLAGHER: That is correct, you would have to win under both in order to -- well, no, there would really be two separate issues. One question would be do you have a claim, and that would be decided under State law under the decision of this Court in Vanston Bondholders v. Green, which was a 1946 decision cited in the Solicitor's Brief at page 17. It is clearly, that is controlled by State law. And it is important to the creditor to know that he has a claim or not, because he will share pro rata in the distributions from the bankruptcy estate. But beyond that it is important to adjudicate the issue of nondischargeability, which means that the debt continues.

QUESTION: Then it is your view that if the creditor here had come into bankruptcy court with an unliquidated claim, no State court judgment in back of it, and the rule in Missouri was clear and convincing evidence, the rule adopted by this Court were preponderance of the evidence, all you would have to show in the bankruptcy court is a preponderance of the evidence, notwithstanding Missouri law?

MR. GALLAGHER: No, Mr. Chief Justice. Well, it depends on the question. If the rule were clear and convincing to obtain a State court fraud judgment there

would be no debt, unless the creditor could establish in the proof of claim process that the creditor had a valid claim for common law fraud. And you would never get to the stage of deciding dischargeability because there would be no debt.

QUESTION: So you come in with an unliquidated claim arising in a State like Missouri. Let's assume it has the clear and convincing evidence standard. Even though this Court says that in this case, if we were to say preponderance of the evidence, you would still have to prove initially by clear and convincing evidence?

MR. GALLAGHER: That is correct, Your Honor, because the State law controls the determination of the existence of the debt.

QUESTION: That doesn't make much sense though, does it? At least it doesn't to me.

MR. GALLAGHER: Well, I believe it makes perfect sense, because the issue of tort liability is quite apart from the issue of dischargeability. If you don't have liability for fraud in the first instance, then you never get to the second question of dischargeability.

QUESTION: What would happen if we said that the standard for bankruptcy is clear and convincing, and you have a State law that says it is only preponderance, and -- this case, and it's an unliquidated claim however? You come into the bankruptcy court, suppose the bankruptcy court

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determines that there is not clear and convincing evidence. Then what happens?

MR. GALLAGHER: Then there is no debt.

QUESTION: Does the bankruptcy court go on to adjudicate whether there is a debt or not, or just dismisses it and then --

MR. GALLAGHER: The terminated -- the proof of claim would be filed asserting a claim for common law tort, an unliquidated tort claim. And the court would adjudicate the existence of that debt first, and then --

QUESTION: Upon a preponderance basis?

MR. GALLAGHER: Well, if that were the State law.

QUESTION: Yeah, well, that's what he posed.

QUESTION: Well, that's what I'm saying. I mean, you would still have claim with the general creditors, even if you had no preferences, right?

MR. GALLAGHER: Yes, that is correct.

QUESTION: So the State would then have to go on. Having decided first that there is no clear and convincing, it would then go on and decide secondly whether there is a fraud by a preponderance. It would decide the claim, wouldn't it?

MR. GALLAGHER: It would decide the claim in the first instance, and then if the creditor asked, would decide whether it were dischargeable.

QUESTION: So it would have to take two cuts at the thing to decide.

MR. GALLAGHER: Although it would occur in the same proceeding.

QUESTION: Yes.

MR. GALLAGHER: Because in the bank -- under the bankruptcy procedures when an adversary is filed, and an adversary proceeding must be filed, then all the issues that are bound up in that determination, both the existence of the debt and the dischargeability issue, come together and are tried at the same time.

QUESTION: What fun.

QUESTION: Would you be satisfied -- would you be satisfied in this case if the rule were that whatever the State rule is governs in the bankruptcy court? Governs dischargeability as well as --

MR. GALLAGHER: Yes. My clients would be satisfied. That's correct.

QUESTION: And do you think that's the proper rule?

MR. GALLAGHER: I do not, Your Honor. I believe that the issue --

QUESTION: Why?

MR. GALLAGHER: -- of dischargeability is a separate question which is a matter of Federal law which

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this Court must decide. The appropriate standard of proof to apply in 523(a) proceedings, it is our position, is a question of Federal law, which this Court -- and the legislative history doesn't speak to the issue. This Court has never decided the issue. And when there is no constitutional implication, as there is not in this case, and when the legislative history or statute doesn't make it clear, then the Court must prescribe the appropriate standard of proof.

QUESTION: Well, if the Federal interest is one in giving special consideration in the event there has been fraud, why not let the State standard control?

MR. GALLAGHER: I think that --

QUESTION: Isn't the Federal interest satisfied there? Why should we have a special Federal rule to determine dischargeability based on burden of proof? Why not just accept whatever the State norm of conduct is, and the State burden of proof for adjudicating that norm?

MR. GALLAGHER: There would be no harm from that rule, because if the State standard is preponderance, the same burden would apply with respect to dischargeability. And if the State standard were clear and convincing, the same standard would apply in dischargeability, and there would be no effect one way or the other.

QUESTION: Wouldn't that simplify things and

vindicate Federal policy?

MR. GALLAGHER: It would -- it would simplify things and it would satisfy my clients. However, I believe that because the Constitution gives the Congress of the United States exclusive bankruptcy jurisdiction, that there is some expediency in having a uniform rule in the bankruptcy courts. But I understand I am arguing against my position here, potentially hurting myself in that position.

QUESTION: I suppose if you applied that follow the State rule to fraud, there would be no reason not to apply it to everything else as well. So if some States imposed higher burdens of proof for some of the other matters, I suppose we would have to follow them too, just in order to be logical.

MR. GALLAGHER: Yes, and I think that would be inappropriate under this section, because the issue of dischargeability is just a monetary dispute. It is just a dispute between two private litigants about the amount of money which is owed or not owed. And the ordinary civil preponderance rule ought to apply in nondischargeability proceedings under 523(a), whether it is (a)(2) or (a)(6).

The debt in question arose from a judgment that was obtained basically in a civil action that was filed concerning the sale of stock. The underlying claims were

for common law fraud, breach of fiduciary duty, and violation of Securities and Exchange Rule 10(b)(5). A jury verdict, unanimous jury verdict, awarded the petitioners in this case $498,000 in actual damages, $49,000 in punitive damages, and the court later assessed a substantial amount of prejudgment interest with respect to the 10(b)(5) claim.

While the appeal of this case was pending in the Eighth Circuit, and by the -- I am talking about the appeal from the underlying judgment, the debtor defendant -- judgment creditor below filed bankruptcy, and the petitioners filed an adversary compliant seeking to determine the nondischargeability of that fraud judgment.

Shortly after the bankruptcy was filed, the Eighth Circuit court of appeals affirmed the $500,000 -- $500,000 plus judgment in favor of the petitioners here in all material respects on all three counts, common law fraud, breach of fiduciary duty, and rule 10(b)(5).

When the adversary was tried in this case the petitioners relied on collateral estoppel exclusively, and the evidence that was presented to the bankruptcy court was documentary. The complaint filed in the underlying civil action was made an exhibit to explain the issues raised in the underlying action. The jury instructions were offered into evidence to establish the fact questions that were presented to the jury. The jury verdict was introduced into

evidence to show how those facts or questions were resolved. And the final judgment of the district court and the opinion of the Eighth Circuit court of appeals affirming the underlying judgment were introduced into evidence to show that those fact determinations were made in a final and binding judgment against the judgment debtor. No additional evidence was offered except the oral testimony of the debtor himself, who just generally denied liability.

QUESTION: And the district court charged the jury in the underlying case that the burden of proof was by a preponderance of the evidence?

MR. GALLAGHER: By a preponderance of the evidence, Your Honor, as required by Missouri pattern instructions, which is essentially a preponderance of the evidence instruction. And there is no dispute in this case, I don't believe, that with respect to money judgments for fraud in Missouri, according to the Supreme Court of Missouri en banc, the proper standard of proof is a preponderance of the evidence.

Now, the bankruptcy court held that the five factual elements necessary to establish nondischargeability under section 523(a)(2) were in fact actually tried in the underlying action, and that issue preclusion was appropriate under this Court's decision in Brown v. Felsen. And the court rejected the argument that clear and convincing

evidence was required to prove the factual elements of nondischargeability under section 523(a)(2). The district court affirmed that judgment, but the Eighth Circuit court of --

QUESTION: The district court didn't disagree that to establish the claim a preponderance was enough?

MR. GALLAGHER: The district court in the underlying -- I'm not sure I understand the question.

QUESTION: Did the district court rule that they had no claim? They didn't. It said they had a claim, didn't it?

MR. GALLAGHER: Yes, the district court in the underlying action is the court that tried the original common law fraud case, and it affirmed. Then the district court reviewed the bankruptcy court decision which, using collateral estoppel, had determined that that underlying fraud debt was nondischargeable. Okay, so we had two separate district court proceedings. One on the issue of fraud. A second subsequent action 2 years later respecting the issue of nondischargeability.

Now the Eighth Circuit court of appeals reversed the district court. The Eighth Circuit found essentially that collateral estoppel had been improperly applied in this case, because the fraud claim was tried under preponderance of the evidence standard, that section 523, according to the

Eighth Circuit, requires proof of the factual elements to establish nondischargeability by clear and convincing evidence, and accordingly, since there were different standards, use of the doctrine of collateral estoppel for factual issue preclusion was improper.

So we are left with the question what is the appropriate standard of proof under section 523(a)(2). The petitioners' key point in this case is that issues of nondischargeability regarding fraud judgments are simply a private dispute about money, which is not the kind of case which requires a heightened standard of proof.

QUESTION: But of course many States do require a heightened standard of proof for fraud in private disputes between parties about money.

MR. GALLAGHER: That is correct. That is correct, Your Honor. That occurs in many States, but that is not the rule in Missouri. And whether or not --

QUESTION: Well, you're saying it's just an issue of dischargeability, but the issue of dischargeability turns upon whether there has been fraud.

MR. GALLAGHER: Well, but that's already determined in this case. The opprobrium associated with the finding of fraudulent misconduct has already been made under the standard that is applied in the local jurisdiction. And the issue is simply --

QUESTION: But we have to adopt a rule that is going to apply where it is not discharged too. What -- you mean we would come out with a different -- you wouldn't be able to make that argument if it had been an unliquidated claim, would you?

MR. GALLAGHER: Yes.

QUESTION: How could you?

MR. GALLAGHER: Because the determination could likewise be made in the bankruptcy court that the creditor -- that the debtor was a fraud feasor under a preponderance of the evidence, if that is the State rule.

QUESTION: Mr. Gallagher, let me just be sure I understand your position. You take the position that the same Federal standard applies to all sections of the dischargeability provision, and that it is a preponderance of the evidence standard.

MR. GALLAGHER: That is correct.

QUESTION: That the clear and convincing standard is only in establishing the claim, not in --

MR. GALLAGHER: That is correct.

QUESTION: Okay. I --

MR. GALLAGHER: In some States, not in all.

QUESTION: I understand. But it doesn't matter, because as far as the Federal standard is concerned it is always the same under all sections of this -- so you have

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a really kind of a very simple approach to the problem.

MR. GALLAGHER: Yes. And the reason for that is that this is just like any other form of defense or exemption in an ordinary civil case. If I can move to that point, several justifications are offered for a heightened standard of proof. The fresh start policy, the fact that the standard is ordinarily applied in common law fraud cases, or that the standard -- heightened standard -- is necessary to overcome the opprobrium associated with a fraud determination.

But the decisions of this Court, Addington v. Texas, Price Waterhouse, which was decided last year, Price Waterhouse against Hopkins. In Herman & MacLean v. Huddleston, which is a 10(b)(5) case establishing the appropriate standard of fraud proof under 10(b)(5), it is preponderance of the evidence under Federal law. All recognize that the heightened standard of proof is an extraordinary unusual change in the burden of proof, which is only applied in those cases where personal liberty, constitutional associational rights, or the freedom of speech is --

QUESTION: Well, Mr. Gallagher, would you explain -- I still am confused about your position. Suppose you were in a State in which a clear and convincing standard was required in order to establish the debt. And the claim is

as yet unliquidated and unlitigated, and there is a bankruptcy proceeding, Federal bankruptcy proceeding, and the creditor comes in with that claim. What standard?

MR. GALLAGHER: The debt, the existence of the fraud debt must be established by clear and convincing evidence.

QUESTION: In the Federal bankruptcy court.

MR. GALLAGHER: In the Federal bankruptcy court, that is correct. Because when the bankruptcy court decides who owes who what it applies State law to -- with respect to tort claims, contract claims, UCC claims, State laws are applied in determining the existence of the debt.

QUESTION: Mr. Gallagher, who are the Federal district judges involved?

MR. GALLAGHER: Scott O. Wright, the chief judge --

QUESTION: I know. Go ahead, give me the other name.

MR. GALLAGHER: Dean Whipple.

QUESTION: Sir?

MR. GALLAGHER: Dean Whipple.

QUESTION: Okay.

MR. GALLAGHER: Judge Whipple was the person, was the judge that decided the issue respecting bankruptcy, and Judge Wright was the trial judge in the underlying common

law fraud case.

With respect to the need to have a heightened standard of proof, the argument is made that the fresh start policy of bankruptcy justifies that standard, and we suggest that it does not.

QUESTION: Thank you, Mr. Gallagher.

Mr. Roberts, we'll hear now from you.

ORAL ARGUMENT OF JOHN G. ROBERTS, JR.

ON BEHALF OF UNITED STATES, ET AL.,

AS AMICI CURIAE, IN SUPPORT OF THE PETITIONERS

MR. ROBERTS: Thank you, Mr. Chief Justice, and may it please the Court:

In May 1985 a jury found respondent liable for common law fraud and securities fraud, and he was ordered to pay damages. In the wake of that verdict, 5 months later, he resorted to bankruptcy court. The Bankruptcy Code, however, section 523(a)(2)(a), specifies that debts arising from fraud are not dischargeable. That would seem to make this a simple case. Debts arising from fraud are not dischargeable. Respondent's debt to petitioners is based on a judgment for fraud, and therefore it should not be dischargeable.

The decision below, however, makes the case much more complicated. According to the Eighth Circuit, petitioners must try their fraud case a second time in

bankruptcy court, and this time they must prove fraud by a higher standard than was applicable when they established the existence of the debt in the first place.

Why is that? Because Congress said so? No, everyone agrees that the statute is silent on this point. All that Congress said is that debts arising from fraud are not dischargeable. This is a case in which the Court must provide the appropriate standard of proof. And the question is why the Court should depart from the normal standard applicable in civil cases and adopt the heightened standard, when doing so will have two very adverse consequences for the bankruptcy court system.

First, it will require full-blown relitigation in bankruptcy court of fraud cases when the debt arising from fraud was previously established by a preponderance of the evidence, as was the case here under Missouri law, and as is typically the case under the Federal antifraud provisions, the securities laws, the commodities laws, the False Claim Act, Medicare and Medicaid fraud, and a variety of financial institution antifraud provisions.

The second adverse consequence is that the heightened standard of proof would make the bankruptcy court a haven for fraudulent debtors, contrary to the intent of Congress, to this very real extent. To the extent that the victims of fraud are not able to try their case a second

time, either because of the expense or because evidence has become stale, and to the extent that they may be able to prove fraud by a preponderance, as they are allowed in their particular State or under the Federal law, but not by a clear and convincing standard.

Now, given those adverse consequences, why should the Court adopt the heightened standard of proof? Respondent gives basically two reasons. One, the fresh start policy of the Bankruptcy Code, and two, that that was the prevailing view at common law. With respect to fresh start, that policy doesn't apply under section 523. That is an exception to the fresh start policy. Fresh start applies to the -- what this Court has termed the "honest but unfortunate debtor," but that is not respondent, who was found by a jury to have committed fraud that was sufficiently willful, wanton, and malicious to support the award of punitive damages.

QUESTION: But doesn't that beg the question, because isn't the question how clear we ought to be that the debtor is not honest before we make the exception?

MR. ROBERTS: It is clear that under Missouri law in this case and under the Federal securities law that he is guilty of fraud. That establishes a debt. The question is whether the Federal bankruptcy law to implement some policy should have a higher standard for establishing fraud.

In other words, in weighing the debtor's interest in obtaining a discharge against the victim's interest in compensation, Congress has said when there is fraud the victim's interest prevails. And there is no reason to suppose that Congress intended to tip the scales in favor of the debtor in making that determination.

QUESTION: Of course it's not just the victim's interest in compensation. It's the victim's interest in getting greater compensation on his claim than all other debtors -- all other creditors get.

MR. ROBERTS: Yes, Your Honor. And Congress has made that decision. If fraud is shown, the Congress has decided that that is a type of debt that we don't discharge in bankruptcy. And again, the fresh start policy doesn't lead you to tip the scales one way or the other when you are dealing with an express statutory exception to the fresh start policy.

Now the other reason that respondent gives for departing from the normal rule and adopting a heightened standard of proof is that Congress, in 1978 when it codified this provision, must have been presumed to be aware that the prevailing view was that fraud must be shown by clear and convincing evidence. Now whether that sort of presumption in the face of congressional silence is valid would seem to depend on how dominant a prevailing view we are talking

about. There are statements here and there in this Court's decisions that suggest fraud is shown by clear and convincing evidence, but they tend to be more ambiguous than respondent would suggest.

For example, respondent cites Addington against Texas as holding that fraud must be proved by clear and convincing evidence. What the Court actually said, 441 U.S. at page 424, is that some jurisdictions apply that higher standard. More importantly, careful examination of the common law shows that, while fraud must be proved by clear and convincing evidence in some jurisdictions, I think a bare majority of the jurisdictions, it is in no sense a dominant view such that Congress must be presumed to have intended that view to apply.

The petitioners, the respondent, and the Government all come up with different counts for which States apply the preponderance standard and which States the clear and convincing. We think about 20 States apply the preponderance standard, petitioners think there are a few more, and respondents a few less. But the point is not to quibble over the nose count. This isn't a situation which whoever comes up with the most States wins.

The point is, even respondent concedes that there are 11 States applying the preponderance standard, and he puts 6 more in a gray area. The point is that if you asked

a lawyer in 1978 does fraud have to be proved by clear and convincing evidence, the only answer he could have given was it depends. It depends if you are in California, which is a preponderance State, or New York, which is a clear and convincing State.

QUESTION: Mr. Roberts, can I interrupt you just to be sure I have got your position on one thing? You are arguing on the fraud exception (a)(2). Do you, would you say the same standard applies to the entire section 523?

MR. ROBERTS: Yes, Your Honor, we think it does, and we think that is the most reasonable interpretation. It is not impossible that there would be different standards, but you would have expected Congress to say so if that was their intent.

QUESTION: And I understand that most States with an (a)(6) type injury apply simply the preponderance test?

MR. ROBERTS: I believe that is correct, Your Honor, yes. And the Combs decision from the Fourth Circuit, Judge Wilkenson's opinion in that case applied a preponderance test to the discharge question as well under (a)(6).

QUESTION: Do you have a view whether or not this claim is more properly tried under (a)(2) or (a)(6) in this case?

MR. ROBERTS: Well, it seems to fit comfortably

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under both. There was a jury finding of willful and wanton or malicious conduct to support the punitive damages, which would seem to trigger the application of (a)(6). But there was also, of course, a jury finding of fraud, which the district court found was clearly supported by the evidence, as did the Eighth Circuit on appeal. So we think that (a)(2) is also equally applicable.

The point is that the prevailing --

QUESTION: Of course, does (a)(2) cover all types of fraud?

MR. ROBERTS: It covers what is known as actual fraud. There was in the early years of the Bankruptcy Code a suggestion that it may cover something known as implied fraud, and Congress made clear that it covers only actual fraud. Certainly the type of fraud at issue here, common law fraud under Missouri law or under 10(b)(5) of the Securities Code.

QUESTION: Well, it applies to money, property, services, or an extension renewal or refinancing of credit to the extent obtained by. I think there are other things. We might have a situation where the individual did not get money or property or services, but nevertheless was defrauded.

MR. ROBERTS: I suppose that is true, but in the bankruptcy context you need to establish the debt in the

first instance, so --

QUESTION: But that was this case, actually, wasn't it? The corporation -- I mean, he just induced money to go to some other corporation. He did not obtain the money.

MR. ROBERTS: The respondent was enriched by the fact that the petitioners, whom he defrauded, did not choose to participate in the opportunity that he had available and fraudulently declined to advise them about. So he was enriched to the extent that they were defrauded of the money, the property --

QUESTION: But he didn't obtain the money?

MR. ROBERTS: What he got was more valuable because the petitioners didn't get to share in it. So I do think that he obtained money or property of value, the shares in the stock in the payout.

QUESTION: Did the claim that was allowed, did it include punitive damages?

MR. ROBERTS: Yes. 10 percent. The compensatory damages for each petitioner was $249,000. The jury added $24,900 as punitive damages.

QUESTION: I take it that the victim, if there is a bankrupt estate, let's assume that all creditors are going to get 10 percent. The victim of the fraud gets 10 percent too.

MR. ROBERTS: Yes. He participates in the discharge.

QUESTION: Exactly.

MR. ROBERTS: The question remains --

QUESTION: Then the remainder just isn't discharged.

MR. ROBERTS: That is right. That is still a debt that he can collect if the debtor makes more money after his discharge.

QUESTION: It's a fresh start.

MR. ROBERTS: A fresh start, yes. Thank you, Your Honor.

QUESTION: Thank you, Mr. Roberts.

Mr. Gallagher -- oh, I'm sorry. Mr. McNamara. Excuse me.

ORAL ARGUMENT OF TIMOTHY K. McNAMARA

ON BEHALF OF THE RESPONDENT

MR. McNAMARA: Mr. Chief Justice, and may it please the Court:

I would like to first address Justice Kennedy's question early on with which I agree with the petitioner, and that is that Congress intended that there be a uniform bankruptcy law. That, of course, is what the Constitution in article I, section A suggests is a uniform law of bankruptcy. And that is exactly what petitioners suggest,

and we agree certainly that to preclude inconsistent results between various bankruptcy courts and to discourage forum shopping, that there should be one standard.

QUESTION: Would Justice Kennedy's standard encourage forum shopping? I would think that whatever bankruptcy court you go into would apply the law of the State in which the claim arose.

MR. McNAMARA: If the courts were to do that, Judge, I think it would -- Justice, exactly what would happen is that they would encourage forum shopping, in that you could have State A, which requires a mere preponderance, State B, of which there are a majority, requiring clear and --

QUESTION: But it would depend on where the underlying transaction had occurred. I mean, you can't just after the fact say it happened in Kansas if it actually happened in Missouri.

MR. McNAMARA: Well, if the underlying court were going to apply that burden, but by filing your action in one State or another you could dictate what your burden of proof would be if you had a choice.

QUESTION: But you can sue someone in Kansas presumably if you can get personal service on them there on a claim that arose in Missouri. And the courts of Kansas, Federal or State, would apply Missouri law, would they not?

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MR. McNAMARA: Yes, they would. But the problem that creates, Mr. Chief Justice, is an inconsistency of result between bankruptcy courts and if Congress intended for bankruptcy courts to apply the law of the States in this respect, I think they certainly would have told us. They did that with respect to Section 522 in exemptions, where in fact Congress designated that certain State exemptions may apply and that debtors have the option of selecting between the designated Federal exemptions and the respective State exemptions. There is no such indication in the legislative history that Congress intended such a result.

We believe there are three reasons why this Court should affirm the Eighth Circuit court of appeals and declare a uniform standard of clear and convincing evidence. The first is what Chief Justice Rehnquist alluded to at the conclusion of the Solicitor's argument, and that is to give life and meaning to the fresh start policy, the fresh start policy, which is the cornerstone, the very foundation of our bankruptcy laws. The second --

QUESTION: Mr. McNamara, can I interrupt you, because I want to be sure I have your position. Is it your position the clear and convincing standard should apply to all sections of -- all subsections of 523? I know that is not squarely presented; we have to think about it a little bit.

MR. McNAMARA: It would be our position, Justice Stevens, that yes, it should apply to, at least to (a)(2), (a)(4), and (a)(6), which are 3 of the 10 grounds for exception.

QUESTION: Well, but then there might be a different one for (a)(1), which is a tax or custom duty, something like that? You wouldn't ask for clear and convincing standard on that, would you? Or would you?

MR. McNAMARA: Under the -- no, we would not, Justice. But under those other seven exceptions, typically they are self-executed. There is no need, and the -- a creditor in such a case is not required to bring an adversary proceeding to declare a debt nondischargeable pursuant to any one of those other seven types of nondischargeable debts. It is only (a)(2), (a)(4), and (a)(6), all of which involve some fraudulent or wrongful type conduct.

QUESTION: Is Federal securities fraud (a)(6)?

MR. McNAMARA: No, it would be under (a)(2), Justice Kennedy.

QUESTION: And is Federal securities fraud, outside the bankruptcy context, preponderance of the evidence, is it not?

MR. McNAMARA: Outside the bankruptcy context it is, much like a minority of States.

QUESTION: That's a rather odd policy to have one Federal standard to establish the liability and the other to establish the discharge, if it's a fraud -- if it's a fraud component in the action.

MR. McNAMARA: And we would suggest that if Congress finds that policy choice to be an unfair one, or one which unfairly favors certain judgment debtors, that Congress, as it has in the False Claims Act and various other laws, is free to amend the Bankruptcy Code to --

QUESTION: Well, I am suggesting that there is an illogic on its face, and that is why we shouldn't adopt your standard.

MR. McNAMARA: Well, there is going to be, regardless of which standard the Court would adopt, there inevitably, inevitably will be some relitigation, depending upon what the facts are in the underlying case and what the burdens of proof are. And whether collateral estoppel is applied offensively or defensively, it could be the creditors who get the second bite at the apple, not the debtor.

QUESTION: Well, not if the petitioners' counsel is correct that the higher State standard always controls because that establishes the debt.

MR. McNAMARA: Only for purposes of establishing the debt. But if you had a State where in fact the burden

of proof to show fraud was clear and convincing, as most are, and then in that case Mr. Garner had won, had received a defense verdict at trial, and then you got to bankruptcy and this Court were to declare that the burden of proof under 523(a) is a mere preponderance, they would get a second bite at the apple. Because in the same sense that a criminal defendant who is adjudged not guilty under a reasonable doubt standard does not -- he is not able to raise defensive collateral estoppel in a subsequent civil action under a lesser burden of proof.

QUESTION: But he needs a cause of action. He doesn't have a State cause of action.

QUESTION: There is no debt.

QUESTION: There is nothing to try in the bankruptcy court. It has been adjudged that he has no State claim. That is the only possible subject of the bankruptcy proceeding as far as he is concerned.

MR. McNAMARA: If that is the only debt involved --

QUESTION: Right.

MR. McNAMARA: -- that would be true. That is true.

QUESTION: Do you say that in case of a claim that is not liquidated, and the creditor comes in and wants to get a -- files a claim for fraud in the bankruptcy

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proceeding. In proving up that claim you don't suggest that the State law does not control, do you?

MR. McNAMARA: No, we do not, Justice White, as to --

QUESTION: But you say the clear and convincing standard would just apply to dischargeability.

MR. McNAMARA: As to dischargeability. And in an effort to --

QUESTION: So in that case there is not going to be two trials, because there is no debt.

MR. McNAMARA: In the case of -- if he walked -- he'll come into bankruptcy court with a claim and have to prove it up there, as opposed to there having been a prior State or Federal court case on which you have a judgment debt, then you would be trying your case for the first time in the bankruptcy court.

QUESTION: And the State standard would control.

MR. McNAMARA: As to the creation of the debt.

QUESTION: But you say as to dischargeability then it's a uniform standard. But dischargeability, the factors to be proved are identical with what is to be proved in the State claim, aren't they?

MR. McNAMARA: Only as to the elements of the claim. And what we are here today to talk about, and the reason the Eighth Circuit reversed this decision, is because

there ought to be a higher standard with respect to dischargeability. Dischargeability --

QUESTION: But what are -- the elements of dischargeability are the mirror image of the claim, aren't they? Of the State law claim?

MR. McNAMARA: As to the legal elements of the claim.

QUESTION: What more is there?

MR. McNAMARA: Well, there is the burden of proof.

QUESTION: Yeah, but I mean what other substantive elements to be proved are there?

MR. McNAMARA: There would be no other substantive elements to be proved.

QUESTION: So you really are talking about -- you say that it's one claim to -- or one step to prove your claim in the bankruptcy court and another thing to prove dischargeability, or to prove no -- but you are proving exactly the same elements in each case, aren't you?

MR. McNAMARA: With respect to the legal elements of the cause of action, that is correct. But to ensure that a debtor receives the broadest possible relief, which is exactly what Congress said at the time of the passage of the 1978 Bankruptcy Code, something more needs to be done.

QUESTION: Well, you know, you could argue that Congress never should have made any claims nondischargeable,

if you wanted to give the debtor the broadest possible relief. I mean, Congress was obviously drawing lines on both sides of the spectrum, wasn't it?

MR. McNAMARA: They certainly had to draw lines, Chief Justice, but the notion of dischargeability is treated throughout the legislative history and within the code as a separate, distinct act, and one which is the very essence of the fresh start, which is described as the very essence of our modern bankruptcy laws. And Congress went to great trouble to spell that out in 1978 when it passed the new code, and throughout the House report in particular, Congress again and again talks about the importance of the discharge, and how exceptions to discharge are contrary to the very two most fundamental elements of the bankruptcy law, one of which is the fresh start and the other of which is equality of treatment of debts and creditors.

QUESTION: Do they say why these provisions, why these nondischargeability provisions were written in if they were contrary to that principle?

MR. McNAMARA: Well, those are the few exceptions to the concept of discharge where Congress has determined that if a debt is fraudulently obtained that it should not be excepted. So that is where that line has been drawn. But they also, Congress went to great pains to ensure that, as this Court has noted in the past, exceptions to discharge

should be strictly construed against the creditor and in favor of the debtor.

Congress added 523(a)(2)(b), which requires reasonable reliance by a lending creditor on a false financial statement. That was new to the code. Congress also added 523(d), ensuring that debtors could obtain attorney's fees if a creditor brought a nondischargeability action in bad faith. Congress declared that the concept of provability of debts was eliminated, thus expanding the claims that would be accepted from discharge. They also stated there could be no waiver of the discharge. And they codified this Court's decision in Perez v. Campbell with respect to antidiscrimination.

QUESTION: Why is a preponderance of the evidence standard incompatible with the fresh start?

MR. McNAMARA: It is incompatible, Justice Blackmun, because the fresh start, being the cornerstone of the bankruptcy laws as this Court noted in Local Loan Company v. Hunt, that is a matter of public interest and it is a matter of great private interest as well for the debtor. And to ensure that Congress' intent is effectuated and that the fresh start is available, the preponderance test is simply not enough. Something greater than the mere preponderance test needs to be shown before denying the debtor what is the very essence of the bankruptcy law.

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Congress repeatedly talks about the importance of bolstering the fresh start. This Court on various occasions --

QUESTION: Well, you have said that about 10 times now. I just wonder if you have answered my question.

MR. McNAMARA: It's insufficient not only because of the fresh start, Justice, but also because of the history, as just -- Chief Justice Rehnquist noted, of having to prove claims of fraud by something more than a mere preponderance. That has been treated as a virtual truism. This Court, admittedly in dicta, but on numerous occasions has acknowledged that civil cases alleging fraud typically require the clear and convincing evidence standard of proof. This is not a civil monetary dispute. It is not a mere civil monetary dispute. We are talking about branding someone as having engaged in fraudulent conduct, and denying them a discharge, treating their debt differently from all other creditors.

In the Winship case this Court talked about the preponderance test as being susceptible to misinterpretation because it calls on the trier of fact merely to perform an abstract weighing of the evidence in order to determine which side has produced the greater quantum, without regard to its effect in convincing the trier's mind of the truth of the proposition asserted. The mere preponderance test does exactly that. It engages in this abstract way.

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The instruction given in this case in the underlying damage suit merely called upon the jury as follows. The burden of causing you to believe a proposition of fact is upon the party whose claim or defense depends upon that proposition. And the converse, if this evidence does not cause you to believe that proposition, then you should not hold in favor of that party. That abstract weighing is susceptible to that misinterpretation, and at a minimum it seems that the evidence ought to be something more than a mere preponderance. If in fact congressional intent to grant a debtor the broadest possible relief, as Congress has said it wished to do, and if this Court will -- is going to effectuate the fresh start policy, as Congress said in its legislative history that it intended to do, then something more than a mere preponderance is necessary.

Also an argument has been made that allowing a mere preponderance standard to prevail will allow the bankruptcy courts to become a haven for wrongdoers. That is a very similar argument as that made in the Pennsylvania Department of Public Welfare v. Davenport case last term, and in that case the Court found that because of the congressional intent that in fact criminal restitution claims may be dischargeable under Chapter 13.

The bankruptcy laws will not be a haven for

wrongdoers in light of 523(a)(7) and the Kelly v. Robinson case, and the exceptions to the automatic stay in 362(b)(4).

The guiding light for this Court should be the fresh start policy. This Court has noted that when Congress fails to specifically spell out in the plain language of the statute what the burden of proof ought to be, and absent any compelling, clear legislative history, in the Midlantic case and in Kelly v. Robinson this Court spoke of looking to the whole law and to its objectives and policies.

And certainly the legislative history that does exist with respect to the fresh start policy and with respect to the right of discharge speaks to interpreting this law in favor of the debtor, and strictly construing it, as this Court did in 1915 in the Gleason v. Thaw case against the creditors.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. McNamara.

Let's see. Mr. Gallagher, your time has expired.

The case is submitted.

(Whereupon, at 1:45 p.m., the case in the above-entitled matter was submitted.)

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