OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: UNION BANK, Petitioner V. HERBERT WOLAS, CHAPTER 7 TRUSTEE FOR THE ESTATE OF ZZZZ BEST CO., INC., Respondent.

CASE NO: 90-1491

PLACE: Washington, D.C.

DATE: Tuesday, November 5, 1991

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IN THE SUPREME COURT OF THE UNITED STATES

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UNION BANK, :

Petitioner, :

v. :

HERBERT WOLAS, CHAPTER 7 : No. 90-1491

TRUSTEE FOR THE ESTATE OF :

ZZZZ BEST CO., INC., :

Respondent. :

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Washington, D.C.

Tuesday, November 5, 1991

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 2:00 p.m.

APPEARANCES:

JOHN A. GRAHAM, ESQ., Los Angeles, California; on behalf of the Petitioner.

HERBERT WOLAS, ESQ., Los Angeles, California; on behalf of the Respondent.

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P R O C E E D I N G S

(2:00 p.m.)

CHIEF JUSTICE REHNQUIST: We'll hear argument next in No. 90-1491, Union Bank v. Herbert Wolas.

Mr. Graham.

Spectators are admonished to not talk until you get outside the courtroom. The Court remains in session.

ORAL ARGUMENT OF JOHN A. GRAHAM

ON BEHALF OF THE PETITIONER

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

The issue in this case is the proper interpretation and application of section 547(c)(2) of the Bankruptcy Code. Section 547(c)(2) is one of several statutory limitations on a bankruptcy trustee's right to recover payments from creditors, and it protects ordinary course of business payments.

The plain meaning of the statute exempts all ordinary course payments, and the statute does not limit its protection to any particular class or type of creditor. We submit that the statute must control the result in this case, because this is not one of those rare cases where the literal words of the statute are in conflict with congressional intent.

I also submit that this is one of -- this is a

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very straightforward plain meaning case, because what is different in this case, as opposed to some of the other court cases, is that Congress amended the statute and deleted a specific time restriction which was contained in the 1978 Bankruptcy Code. Under the 1978 Bankruptcy Code, payments were only protected if they were made within 45 days of when the debt was incurred.

Under --

QUESTION: Mr. Graham, before you get into the legislative history of the prior statute, sticking for the moment with the plain language of the statute, how big was this loan?

MR. GRAHAM: $7 million.

QUESTION: And are $7 million loans, borrowings, made in the ordinary course of business?

MR. GRAHAM: Yes, for Union Bank, which is a large commercial lender --

QUESTION: No, but for the -- is it the ordinary course of business for the bank or the ordinary course of business of the borrower?

MR. GRAHAM: The statute requires it to be in the ordinary course of both the borrower and the lender.

QUESTION: No, but my question is, is it the ordinary course of this borrower to make $7 million unsecured loans? Isn't that the -- under plain language,

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isn't that the issue for us -- or one of the issues?

MR. GRAHAM: That would be a factual issue that would need to be determined in the trial court. It is this --

QUESTION: If this is the only loan of this magnitude it had ever made, and never borrowed more than $1,000 before, what would you say?

MR. GRAHAM: Then I would say that as to that particular corporation or business' operation it was not ordinary.

But the statute in this case, was determined by the Ninth Circuit not to apply to any long-term (inaudible).

QUESTION: I understand. I understand that.

MR. GRAHAM: I do agree with Your Honor that there is a standard of ordinariness that must be analyzed on a factual basis.

QUESTION: Both with respect to incurring the debt, and also with respect to the payments.

MR. GRAHAM: That's correct, and I would turn -- just for example -- to Black's Law Dictionary that says something that is ordinary is normal and customary, and not characterized by peculiar or unusual circumstances.

QUESTION: On that same point, suppose there

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were a balloon payment, that this was a loan with monthly principal and interest payments. Suppose there's a balloon payment made just before bankruptcy, according to the terms of the note?

MR. GRAHAM: Then I believe that if it was customary for that type of debtor to borrow money and pay by balloon payment, that it would not be considered to be unusual and out of the ordinary course.

QUESTION: The test is what is customary for the particular business?

MR. GRAHAM: Yes, I think there would have to be an analysis both of -- both of what occurs in the industry, and possibly what was proper and appropriate to this particular business -- for instance, measuring their net worth, and an examination of their balance sheet at that time.

QUESTION: Let's assume a small business that incurs a substantial loan at the outset of the business to purchase the real estate in which the business operates. You'd say that payments made off -- made on that initial loan, which is far and away greater than any other debt the business incurred -- that would not be allowable because it's not in the ordinary course?

MR. GRAHAM: No, I -- in answering the other Justice's question, I thought what I was saying is you

would have to test it from a factual circumstance, by examining the particular business. For --

QUESTION: Well, the particular business, this is the only loan of that magnitude it ever took out. But that's standard for a lot of small businesses.

MR. GRAHAM: And I would agree --

QUESTION: So it isn't just the particular business, you say. It's businesses in general.

MR. GRAHAM: I would agree with your point. For instance, many individuals only take out one, large mortgage to buy their home.

QUESTION: Of course.

MR. GRAHAM: Yet that would not be considered to be unusual for that particular individual to buy a home and incur a large amount of debt for his personal residence.

QUESTION: Quite so. And I think it would be the same for a business, wouldn't it?

MR. GRAHAM: Yes, I agree, so long as that particular business, for instance, let's say, only needed one large working capital loan. So long as other businesses of that type also needed one working capital loan, I don't think that that makes it unusual or out of the ordinary.

But the problem in this case is that the

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decision of the court below ruled, as a matter of law, that no long-term lender was entitled to protections of the statute -- I don't think because they concluded that it was out of the ordinary course of business. They did not make a factual determination that this particular loan was out of the ordinary course of business. They simply concluded, on what a -- we submit is a very, inadequate legislative history, that Congress could not have possibly intended to extend the protection of this statute to long-term lenders.

The critical language of the statute, which I think the Court obviously needs to focus on, is as follows, quote, "a debt incurred by the debtor in the ordinary course of business or financial affairs."

And we submit that there really is no reason for this Court to qualify the word "debt," or to guess at legislative intent as to what Congress meant by the word "debt." And that is because debt is a statutorily defined term in the Bankruptcy Code, and it means liability on a claim -- which surely includes long-term lenders.

The Court need not make up a special definition of debt for this particular statute.

Turning to the judicial -- to the sometimes exception that there might be a judicial rule of longstanding or pre-Code practice, which would require

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this Court to look in a different direction than the plain meaning. For 80 years, prior to the enactment of the 1978 Bankruptcy Code, there was never any distinguishment between long-term lenders and short-term lenders.

And there was never any reason, nor was there any purpose in the statute to distinguish the protections and -- at the expense of long-term lenders. All creditors were protected, regardless of the time limits of their debt. When Congress eliminated the 45-day rule, what it really did was return bankruptcy law to a traditional state of affairs that had existed for 80 years.

Also, most interestingly, many cases below, and commoners have put tremendous emphasis on the fact that only trade creditors and consumer lenders testified at the hearings from 1980 to 1984. And they say that because other groups didn't testify, there is no reason to extend the protections to those groups.

I submit to this Court that the trustee's position that divining legislative intent by conducting a head count of the witnesses that appeared before Congress is really an absurd way of analyzing legislative history. The fact that one group sat on the sidelines and chose not to participate, either voluntarily or by subpoena to be called and testify, doesn't prove anything. In fact, in this example, the long-term lenders may have been quite

content to sit on the sidelines, since the plain meaning of the statute was going to plainly protect them.

If this Court were to part from the plain meaning, it would also have to deal with another vice that is not solved by the trustee's position. From the inception of Congress' analysis in 1980 to change the statute, the first group that triggered that review was the commercial-paper issuers. And they complained that the statute, which had an artificial time limit of 45 days, was excluding them from the protections of the ordinary course rule.

And throughout the 4-year period, it was made clear that those commercial paper issuers were to be protected by the new statute -- in fact, so much so, that Senators Dole and DeConcini, on the floor of the Senate, made statements to that effect right before the legislation was passed.

The problem is that if this Court were to part from the plain meaning of the statute, you would be required to write in another special exemption to the statute for commercial paper issuers.

The 1984 Congress made it clear that its goal was to promote and protect normalized business dealings.

QUESTION: That was the year in which the 45-day provision was repealed?

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MR. GRAHAM: Yes, Mr. Chief Justice. It did follow a 4-year legislative review in which the 1978 Bankruptcy Code, which became effective in October of 1979 -- less than 1 year later complaints were laid at the doorstep of Congres and the investigation and congressional hearings ensued to determine what to do about the statute.

It is petitioner's view that there is no reason to exclude long-term lenders because the goal of the 1984 Congress was to promote and protect normalized business dealings, and that -- they held that that could be accomplished while discouraging unusual action in a race to the courthouse.

I would point --

QUESTION: It certainly narrowed the -- preferences that could be recovered.

MR. GRAHAM: The new statute, Your Honor?

QUESTION: Yeah.

MR. GRAHAM: That's correct. But I don't know if --

QUESTION: But they -- so be it. That's -- they intended to do so.

MR. GRAHAM: Right, and while some people complain about that policy, I think it's interesting to note that the very creditors who would be protected by

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collectively bringing in preference payments and distributing them equally, were the same group that went to the 1984 Congress and said this is not a protection that we seek. We would prefer to have our normal -- normal business transactions immune from preference of tax, so long as they're within the ordinary course of both the debtor and the creditor's business.

QUESTION: Yeah, we would rather enjoy preferences than have -- having -- have them be covered.

MR. GRAHAM: Well, I imagine that's --

QUESTION: I mean, so to speak.

MR. GRAHAM: So to speak. I think, though, that the concern of Congress was that the statute, as written with the artificial limitation, was requiring businessmen to change their practices. And that was the problem that the Congress addressed.

We submit that since the key goal was to protect and promote normalized business -- dealings, and to prevent a race to the courthouse, it makes absolutely no sense to carve out and exclude long-term lenders from that process.

Long-term lenders usually hold the power to bring a debtor's business to a halt. In most cases, there is one or two key long-term lenders. And if the goal is to prevent a race to the courthouse, why exclude that

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lender from the protections of the statute? At that point, you've taken away the very incentive that Congress gave that long-term lender to deal with the debtor on a day-to-day, regular basis. If he's not going to get to keep his regular ordinary payments, why not call the loan covenant? Why not take more aggressive action?

I would also point out that although there is much said about the idea of encouraging trade creditors to deal with the debtor on a repetitive basis, and to supply goods and services to that debtor, that is a policy which is covered under subsection c(4) of 547. In that subsection, Congress permitted a creditor who may have received a preferential payment, that if he continues to do business with the debtor, he will be able to offset any future goods or services he delivers to the debtor against that preference liability.

So there is a specific statutory exception which responds to the concern and the policy of promoting creditors and trade suppliers to do business with the debtor.

I also think that the Court need not attempt to try to reconcile the 1984 Congress' different view of what was the more important policy. The problem in this case is that since the statute is not ambiguous, if the Court attempts to reconcile the 1978 Congress' policy, which

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there -- which favored more than quality of distribution policy, it puts the Court in the improper role, I believe, of trying to determine whether the 1984 Congress allegedly forgot in passing this statute, and deleting the artificial limitation to harken back to what, in 1978, was considered to be a more important policy.

We submit that the case of West Virginia v. Casey states that that is exactly what this Court should not do, where the statute is clear, and therefore there's no reason.

This is a case in which the Court cannot be faulted for literalism in applying the statute. The words which created the distinction and previously allowed trade creditors to benefit and sometimes other creditors not has been deleted from the statute. Once that artificial time limit was removed, the statute applies to all creditors.

And we submit that the Court should reject the trustee's attempt to add words back into the statute which would change the statutory definition of the word debt.

Mr. Chief Justice, unless there are any questions, I would reserve my time.

QUESTION: Yes, Mr. Graham, if there -- should we look at the fees that are due each month and the interest payments? Now, I understand this is a line of credit arrangement.

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MR. GRAHAM: Yes.

QUESTION: Is there any distinction between the fees and the monthly payments of interest, and the actual pay-down of the principal?

MR. GRAHAM: In this --

QUESTION: Do the fees and the interest payments become -- are they due monthly, or are they long-term debt also?

MR. GRAHAM: Let me answer the question factually, first, as to this case.

In this case, it was a revolving line of credit -- although much larger, very -- similar to a person who has a bank Master Charge. The choice of whether to pay just interest or also pay principal down, in any particular month, was the borrower's choice by the express terms of the document.

And so in this case, the payments which are at issue happen to be interest payments, since the loan was not what we would call a fully amortized loan.

When it came due, at the end of its term, the principal would have to be paid in full, or the borrower would have to renegotiate for a renewal or an extension of the loan.

However, if I might add a point, the American Bankers Association has filed an amicus brief and made the

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point that the debt of interest, which is distinguished from the debt of principal, probably was a short-term debt, because it was incurred month to month and paid month to month on a regular basis.

But we submit to the Court that the issue that has been presented on the writ for certiorari is whether long-term lenders, whether they receive ordinary payments of interest or principal, whether they are excluded from the protection of the statute simply because someone has divined legislative intent based on who testified and some very unpersuasive statements in the legislative history.

Mr. Chief Justice, I would reserve the balance of my time.

QUESTION: Very well, Mr. Graham.

Mr. Wolas, we'll hear from you.

ORAL ARGUMENT OF HERBERT WOLAS

ON BEHALF OF THE RESPONDENT

MR. WOLAS: If it please the Court, Mr. Chief Justice:

We are here to determine whether or not, when Congress amended the statute in 1974, it intended to change, in totality, the preference rules.

QUESTION: 1984, you mean.

MR. WOLAS: '84. I stand corrected.

Between 1979 and 1984, every bankruptcy court in

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the United States understood that when they were looking at section 67 -- 547(c)(2), that statute incorporated what was known as the current expense exception to the Preference Recovery Act. That is, everybody knew that these short-term, in-and-out transactions whereby suppliers of goods, utility companies, insurance premium payments, were not within the preference provisions; that these were part of the two-step discussion of contemporary exchanges which do not diminish the estate. Likewise, the current exchange -- current expense theory provided assets for distribution to creditors.

The question we have here, is is the Ron Pair decision applicable to this case. And I suggest that this statute, the 1984 statute, is -- has not been written on a clean slate. It carries with it a long line of judicial and statutory interpretation.

We should remember that 547(c)(2) is part of a larger statutory scheme. You start off with the basic -- concept of 547(b), which is the preference rule. And the rule there says very clearly that if you received a preference within 90 days of bankruptcy, while the debtor was insolvent, you have to put the money back in the pot, and everybody shares in the dollars.

The 547(c) exceptions are the exceptions to the general rule. If we are to look at the exceptions,

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exceptions are looked at narrowly and precisely. We have all kinds of exceptions, very precise exceptions.

We should remember that Union Bank has made one major mistake in its brief. I quote it. At page 12, it makes a statement, that the Bankruptcy Act of 1898 protected most ordinary course payments as a preference, and that did not distinguish between short-term and long-term debt.

Half that statement is correct. The statute did not distinguish between long-term and short-term debt. The statute did not protect ordinary course payments. A preference was a preference no matter what. And this is shown to us in the -- this Court's decision in National City v. Hodgkiss. That's a 1913 decision, Justice Holmes.

That case involved a day loan. The day loan was made to the broker at 10:00 a.m. in the morning for the purposes of financing an underwriting. The broker became insolvent at noon. At 2:00, the bank took a preference, took security; at 4:00, in bankruptcy, involuntary.

The decision of that court: it was a day loan; it was a preference -- short term or long term. It was paid in the ordinary course. It was, the bank got a preference.

Right after that we see that the creation of two

separate, overlapping and similar theories. One is the -- contemporaneous exchange concept. And that's a concept where dollars came in, and dollars went out. And nobody really got hurt. Property came in and dollars went out. The debtor was really the same, and creditors were not -- were not adversely affected.

This shows up in the case of Dean v. Davis, a 1917 decision of this Court. In that particular case, there was a loan of money; a mortgage was signed and security given. The mortgage -- the loan was on day 1; the mortgage was signed on day 7; the mortgage was recorded and perfected against creditors on day 8. The Court, in that case, bent the plain meaning of the statute, and said, well, it was substantially contemporaneous; nobody was really hurt. We allow that transaction.

Subsequent to 1917, we see developing two, judicially-created exceptions to the bankruptcy preference laws. One is the one I just talked about. The other one is the current expense exception. And that current expense exception first started in the world of involuntary bankruptcies.

QUESTION: You're saying though, that the current expense exception was not statutory under the 1898 --

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MR. WOLAS: It was not statutory, Your Honor. It is judicially created. Because the plain meaning of the statute would not make an exception for either current expense or for substantially contemporaneous. Contemporaneous is protected, but substantially is, you know, just a little bit pregnant, and how far down the stream are you out of luck, when it's not any longer contemporaneous.

So, we have developing this current expense exception. And the current expense exception deals with payment for wages; it deals with the suppliers receiving money for inventory just supplied, payments to the utility companies, payments to the rent, the landlord. And there's a whole line of cases talking about the current expense, and they use words like it was paid in the ordinary course of business, that start off in the involuntary area, and it was switched. Let me back up.

Started in the involuntary area, because to put a debtor into bankruptcy, you had to allege an act of bankruptcy. And the most common act of bankruptcy was a preference. So you had to prove that the payment made to the utility company or for the wages was a preference. The Court did not accept that. It started off saying but these are necessary. They enhance the debtor. There was no diminution of the estate. We preserve -- we protect

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the transaction. Debtor, you're not in involuntary bankruptcy.

This, then, got switched over. And then in the cases where the creditor was sued because of the alleged preference, the payment, the creditor defended, hey, I was different; I provided inventory, ordinary course. I provided utilities, labor. And that's where the current expense exception came about.

We have, now, a study of the bankruptcy laws from 1970 on up through 1979, with the intention of changing the bankruptcy laws dramatically. What they didn't change dramatically were the preference statutes.

In the Bankruptcy Commission Report to Congress in 1973, they suggested to Congress a couple of revisions: (1) to make the law easy to understand, and (2) to make it fair.

The easy-to-understand portion was they eliminated the reasonable cost to believe that the debtor was insolvent. And they put -- they also made the presumption the debtor was insolvent when it took place. Because those were two areas that were subject to litigation. You had a swearing contest between the debtor and the creditor as to whether or not the creditor should have known the debtor was insolvent, had reasonable cause.

And also, the evidentiary problem of a trustee

in bankruptcy to prove insolvency is tough, because the records are terrible. So now we have a presumption.

At the same time, the Bankruptcy Commission -- and it was also picked up in the proposed judge's bill -- recommended the incorporation of what we call the contemporaneous exchange exception, and the current-expense exception. This was done by suggesting to Congress that the definition of antecedent debt, an old bill, be modified to read: (1) a bill that was paid within 5 days is not an antecedent debt; (2) personal earning -- personal services were not an antecedent debt; (3) if you pay the utility within ninety days, that was not an antecedent debt; and (4) if you paid for inventory which was purchased under ordinary trade terms and it was paid for in 90 days, in the ordinary course of business -- that was included in the suggested language -- it was not a preference.

From 1973 to 1979, because the Congress did not move too quickly, there were numerous hearings. And at mock -- at a mockup -- a number of mock-up meetings -- the intention was to make the law move more smoothly. Various interests said (1) 90 days was too long on protecting the sale of merchandise and the utility company. Also, by calling out utility company, and calling out the trade creditor, you leave other people who are current suppliers

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out in the cold. Is the service man who provides you xerox paper, is this inventory of the business?

So what we get is 547(c)(1), which codifies the judicially-created, contemporaneous-exchange exception; and we get 547(c)(2) which codifies the judicially created current-expense exception. But the drafters wanted to make life easier. They said, let's give everybody a bright-line test on what is an old bill. And that bright-line test is 45 days.

I'll represent to this Court that every bankruptcy decision -- or virtually every one -- from 1979 to 1984 fully understood that 547(c)(2) was a codification of the current expense exception -- every case. The cases that the Union Bank relies on, my cases -- all the cases in the middle talk about did 1984 change this current expense exception.

Now, what do we really have? In the 1980 -- '80, '81, '82, '83 -- three groups came to Congress. The banks didn't come to Congress, because they didn't -- in their wildest imagination -- think they were going to be exempt, under any stretch of the imagination.

The three groups that came to Congress were one, the trade creditors. And they said, we've got a problem. 45 days as a bright-line test doesn't work -- in the toy business, in the clothing business, in the sporting goods

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business -- dating is different. You ship in July, and you pay for the toys the day after Christmas. So 45 days kills those people.

The second group that came to Congress was the lenders to individuals, the consumer lenders. And they said, my God, we know we make long-term debt, and we know we're under-secured most of the time; we've lent on the household goods. Protect us, because 45 days hurts us; we're in trouble with that.

Who else came to Congress? The commercial paper holders. And they said, you know, we've got a problem. Commercial paper is written on a very short-term basis -- but beyond 45 days. If you look at the statute as it's written, if the debtor goes insolvent, we have a give-back problem, okay?

QUESTION: This is unsecured, commercial paper?

MR. WOLAS: Unsecured commercial paper.

Unsecured commercial paper -- let me take -- that's the easiest one. Unsecured commercial paper is available to limited companies. Only the biggest and the best can deal in commercial paper. A few of them have gone insolvent. We have a terrible economy. But generally, the rating services say this company can issue commercial paper, and it's a regular, going market.

When the statute was amended on the floor of the

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Senate, the question was -- by Senator Dole to Senator DeConcini -- does this statute now, protect the commercial paper holders? And DeConcini says yes. And in the reading -- and the brief quotes the exact language, and I won't try to do that -- but the essence of it was, yes. And he wasn't talking about whether it's long-term debt or long -- or short-term debt. What he said was in the buying and selling of commercial paper between the monied people and the debtor, we presume that this is done in the ordinary course of business of both the commercial paper lender, and the commercial paper borrower. It was in the ordinary course of business. That was the key to that.

With reference to --

QUESTION: Mr. Wolas, I don't -- I don't see where you're going -- or I think I do see where you're going -- so these were the three groups who had the complaint. But Congress satisfied those complaints by adopting a particular text. And the text simply eliminates the distinction between long-term and short-term debt. It takes out the 45 days, and doesn't put in any other -- any other language that contains a distinction between long term and short term.

Which satisfies these three people. These three groups are all satisfied. Now, it also happens to do other things. But so what?

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MR. WOLAS: Your Honor --

QUESTION: Very often Congress enacts a provision that solves a problem and then goes beyond that. The way they chose to solve the problem, your brother says, is a way that happens -- that happens to benefit his clients.

MR. WOLAS: Justice Scalia, in Chambers, you explain that to us very carefully. You said, and I quote you, "Statutory construction is a holistic endeavor." Then you went on to say, "A major change in existing rules would not likely have been made without specific provisions in the text of the statute. It is most improbable that it would have been made without any mention in the legislative history."

And the briefs are full of the statement that there's very little legislative history on the change of, quote, "long-term " or "short-term debt." Because never, in their wildest dreams, did the banks think that this change was being made.

QUESTION: You don't need legislative history to tell you that the 45-day rule is gone. That's right in the statute.

MR. WOLAS: That is correct. I don't disagree. The 45-day rule is gone.

But was the statute intended to change and to

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emasculate the entire preference provisions of 547(b), because if this statute is to be read as the banks would like it read, there is virtually few transactions that are now preferences. And here then we have the exception to the rule swallowing the rule. And it's gone.

And that is the real problem. It is --

QUESTION: Do you apply your argument to both the interest payments and payments of the principal?

MR. WOLAS: Oh, principal is even worse.

QUESTION: I know, but so you say yes.

MR. WOLAS: I would say principal and interest are not protected under the bank --

QUESTION: Well, isn't it that when you pay interest you're paying right now for the use of money?

MR. WOLAS: No, Your Honor. I think that's where the Iowa Premium Court went astray. You're paying for a debt that you incur when you made the loan.

QUESTION: Well, that may be, but you're keeping the loan from being called.

MR. WOLAS: That is correct.

QUESTION: And you're paying your interest, and you're getting the use of money for another month.

MR. WOLAS: No, you've already --

QUESTION: Or isn't that just like buying anything else, for cash?

MR. WOLAS: One could say that, but you've already obligated yourself for the debt --

QUESTION: But that wouldn't cover the payments on principal.

MR. WOLAS: No, if the -- if we were to read the statute the way the bank wants us to read the statute --

QUESTION: It would cover the principal, too.

MR. WOLAS: -- the payment of principal would also --

QUESTION: Oh, sure.

MR. WOLAS: -- be involved.

QUESTION: Well, you have to read it that way because it's written that way. It isn't -- it doesn't say paid in the ordinary course. It says incurred in the ordinary course. And both the -- both the debt for the principal and the debt for the interest are incurred the say way, at the same time. Isn't that right?

MR. WOLAS: That is -- that is correct.

QUESTION: So the two would seem to go together, wouldn't it?

MR. WOLAS: That's right; that is correct. But, was the debt incurred in the ordinary course of the business of the debtor?

The question was raised about a long-term mortgage on black acre, which is the only mortgage that

that business makes. If it's an isolated transaction, I would say it is not in the ordinary course. If it's XYZ corporation, that has 50 locations, and historically it finances each of those pieces of property with a mortgage, a different argument could be made.

In this case -- and there's no dispute -- in this case, (1) it was a one-loan transaction of $7 million; (2) the bank procured the authority -- it's in the brief -- to tack the account. It took the money out of the account by itself. It didn't need the debtor to pay it. It controlled the date it got paid.

Now, I also suggest to Your Honor that bank borrowings are not ever in the ordinary course of business. And I will submit to this panel -- to this Court, I apologize -- that there isn't a bank that makes a loan to a corporation that doesn't require that corporation to execute a corporate resolution. Why? Because it's not in the ordinary course. Corporate resolutions are not necessary for incurring debt for trade, landlords, et cetera.

Section 364 of the Bankruptcy Code allows a trustee or debtor in possession to incur debt in the ordinary course of business, without a court order. I will submit to this Court that there is not -- there is not a bank lawyer in the United States that would allow

his client to lend money to a debtor without a court order.

QUESTION: Well, maybe that's because other creditors are not as fussy as banks are.

MR. WOLAS: Well, I don't think banks are so fussy these days, Your Honor, but it's quite possible.

QUESTION: Well, they used to be.

(Laughter.)

MR. WOLAS: It's quite possible.

QUESTION: Or are not loaning as much money. I mean, certainly it's a lot of trouble to ask a corporation to go through that for a small loan. It's not a lot -- it's not unreasonable to ask them to do it when there are substantial sums involved.

MR. WOLAS: They -- yes, Your Honor.

I would submit that it makes no sense, there is no basis in the statute to say that the court came to the conclusion it did, when -- let me -- I apologize. Let me back up.

I believe that the normal rules of statutory construction is that if Congress intends to change a major, underlying legal theory, it does so precisely. And I think that was Justice Blackmun's --

QUESTION: But they did. There was a 45-day limit, and that is gone. What comes in to replace it?

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What is your theory of what constitutes ordinary course versus not ordinary course?

MR. WOLAS: The theory of ordinary course is what is necessary to keep the debtor going from day to day: the purchase of inventory, the purchase of materials, the pur -- the payment of labor, the payment of rent. If everything else -- everything the debtor does is ordinary course. Borrowing $7 million from the bank, if that's ordinary course, what else is left to 547(b)? The tail destroys the dog.

QUESTION: May I just interrupt with this? As I understood your opponent, when I asked him similar about this ordinary course, he said that's a question of fact that you resolved on remand. And if he wins, you can still make all the arguments we're making now, as I understand his response.

MR. WOLAS: Well, I would like to win without remand, Your Honor. I would like us to get a bright-line test from this Court. That's the hopeful result. Because --

QUESTION: Well, would your bright -- what would your bright-line test do with the case? Say, you have a very large debtor that borrowed $7 million every week. They were constantly borrowing big, revolving loans, just a huge company. So it was really a very routine

transaction for them, and they were repayable in 7 or 8 months.

But would that be ordinary course or not, under your view?

MR. WOLAS: There is a --

QUESTION: It was so frequent they didn't need corporate resolutions. They had a general authority that the president is authorized to borrow these amounts of money at weekly intervals.

MR. WOLAS: Assuming your -- assuming your facts, Your Honor, there is a case which protected lenders in this situation. I don't have the citation. But it was a lender who was a real estate lender and did numerous real estate transactions. And in that case, they determined that this, for this lender -- for this debtor, it was its ordinary course of business.

So, yes, there may be a factual step that's missing. But hopefully we got this far to get a bright-line rule.

QUESTION: Well, what I'm suggesting is even your rule isn't entirely bright.

MR. WOLAS: Well, those are the problems. We look at the -- we happen to look at everything now with a microscope, which we -- which I wish we would have looked at more carefully at the trial court level.

I would like to also point out, if I might -- I still have some time left -- that the cases that are -- that supposedly brought us here, really have to be looked at much more carefully.

For example, Iowa Premium. Iowa Premium, the court didn't deal with what is ordinary course of business. I call the Court's attention to the fact that that was stipulated to, that the transactions were in the nature of ordinary course. That was a stipulated issue.

The Iowa Premium court, in my opinion, got confused over the 45-day period and how you counted it and when the debt arose. That's my personal opinion. Because almost all of the cases that deal with when was debt incurred disagree with Iowa Premium's conclusion, and say you date when the debt was incurred, when the loan was made, when the dollars were paid. That's when the asset was consumed. And the interest is not being paid today. It is -- it was being paid for what was consumed later. That's different with -- from the inventory. In the inventory situation, you're paying this week for what came in last week or 4 weeks ago.

So I submit that Iowa Premium is not applicable to this situation. And if you read Iowa Premium carefully, that court points out that they understood that before 1984, the current expense exception was the law.

And that was what 547(c)(2) was all about.

We next turn -- I have 5 minutes -- we next turn to --

QUESTION: Iowa Premium was an Eighth Circuit case, wasn't it?

MR. WOLAS: Yes, Your Honor. Yes, Your Honor.

QUESTION: Do you remember who the panel was?

MR. WOLAS: It was an en banc re-hearing, Your Honor. It was 5:3 on the re-hearing. And I commend the Court to the minority decision. I think it is absolutely correct.

In the Fidelity case, the Fidelity case is one clearly dealing with 547(c)(2). And in Fidelity, the Court made the finding that -- the Court discussed the commercial paper situation. The debtor in that case was in the business of making small loans to a lot of people, and acquiring its money by issuing certificates to many, many people -- not too dissimilar from the Lincoln Savings situation.

The Fidelity case found that the -- yeah, Fidelity -- found that in this particular situation, it was a normal course of the business of this debtor to borrow from all of these people, and repay them on a regular basis, and reloan to all these people.

It also leaned very heavily on the DeConcini-

Dole discussion, and likened the transactions to ordinary -- to commercial paper transactions.

Next, in the In re Finn case, that was the retailer -- the consumer loan transaction. That court sent the case back to the bankruptcy judge, to make a determination as to whether or not the borrowing was in the ordinary course of the financial affairs of the debtor.

I respectfully submit that when 547(c)(2) was amended in 1984, it carried with it 90 years' worth of baggage; it carries with it substantial historical precedents -- both legal and judicial. And that if Congress really intended to emasculate 547(b) -- the statute -- the statutory history would have discussed it.

Unless there are any questions --

QUESTION: Well, they could just have put in an -- in a parenthesis, and said we really mean what this -- what these words mean.

MR. WOLAS: They could have done a lot of things. But they didn't.

QUESTION: But they did use these -- you don't say that it's an irrational construction of the statute, just on its face?

MR. WOLAS: I think it's an unreasonable interpretation, Your Honor.

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QUESTION: But only because of history.

MR. WOLAS: It was interesting that in Mid-Atlantic, you took language that was absolutely clear -- clear language from the statute -- the trustee may abandon property. And this Court said you can't look at just the language, when there judicial history, legislative history behind it. And that was judicially created restrictions on the trustee's ability to abandon --

QUESTION: Well, there isn't any legislative history here to speak of. There's just history.

MR. WOLAS: They're substantial judicial history. And the legislative history shows what was being dealt with on a very limited basis. What interest was being protected, and what interests were not being protected.

May I thank you for letting me participate in this exercise.

QUESTION: It's more than exercise, Mr. Wolas. Thank you.

Mr. Graham, you have 13 minutes remaining.

REBUTTAL ARGUMENT OF JOHN A. GRAHAM

ON BEHALF OF THE PETITIONER

MR. GRAHAM: Thank you, Mr. Chief Justice.

QUESTION: Mr. Graham, before you get into it,

would you tell me what you consider not in the ordinary course? Now, you say the distinction is not between long term and short term, which is what the court below held.

What is not in the ordinary course?

MR. GRAHAM: Well, I can refer to definitions of what is not considered ordinary -- things that are exceptional, unusual, not customary. But the problem, of course, is that the word "ordinary," you have to put it in a factual situation in order to measure that ordinariness.

And I thought that one of the other Justice's question regarding a large business, General Motors, for instance, obviously a $7 million loan cannot be considered out of the ordinary for a company of that size.

And later I will reintroduce myself to Mr. Wolas, because I am one bank lawyer who would not require, necessarily, great formality in loaning $7 million to General Motors.

I mean, that simply -- if it was in accordance with ordinary business terms -- you know, there is a third part of the test that would assist Mr. Wolas factually in a particular case. And that is, that the loan must also be in accordance with ordinary business terms. So if you had a $7 million loan to General Motors that was large enough to support that type of loan, and the bank was a large commercial bank, where its lending limits were not

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being exceeded and there was no fraud at the bank level, then you would still have to go to the third part of the test, which is whether the loan was being made -- being paid -- being made in accordance with ordinary business terms.

QUESTION: Well, suppose you've got -- you simply have an unsecured -- you've issued an unsecured promissory note and you promise to pay it in 90 days. And the bank comes to you at the end of 30 days and says look, we're not really happy without any security. Give us some security. Now that is certainly not in the ordinary course of business, is it?

MR. GRAHAM: Most probably not -- if the facts show that one of the reasons the bank was asking for security was a concern with respect to the credit. In fact, the five cases cited by Mr. Wolas to prove that there's a judicial history, that in some of those cases, the action of the creditor was in response to a declining financial situation of the debtor. And the attempt to gain advantage by changing the terms of the loan or changing the rules of the loan, clearly -- in those cases the trustee would be entitled to recover the preference.

Congress sought to promote normalized business relationships. But when those transactions deviate from

the ordinary course -- including if they're not --

QUESTION: Well, certainly, if you've got an acceleration clause in your promissory note, and there's a failure to make an installment payment, it's ordinary business course to accelerate.

MR. GRAHAM: Usually it is, if there's no reason why -- acceptable reason to the lender why the borrower is not making the payment. In fact --

QUESTION: Well, we're talking about whether it was incurred in the ordinary course, not whether the payment was made in the ordinary course, right? I mean, isn't that --

MR. GRAHAM: Well, the test --

QUESTION: Just to keep our eye on the ball? Isn't that what the statute says?

MR. GRAHAM: Well, there are three balls here, Justice Scalia. It has to be incurred by both the debtor and creditor in the ordinary course, and it also has -- the payment has to be made in the ordinary course.

QUESTION: Yeah, but the difference between long-term and short-term debt is a difference that hinges on (a) whether -- whether the debt was incurred in the ordinary course or not.

MR. GRAHAM: That's correct, so long as the terms of the loan are also according to ordinary business

terms.

QUESTION: Right, now, the example you gave a minute ago about loaning $8 million to General Motors leads me to believe that maybe you're backing off from a position you took earlier -- I must say I rather invited you to take the position, but maybe I shouldn't have -- and that was you now seem to say that whether it's in the ordinary course depends upon whether it's ordinary for the particular business, not whether it's ordinary for all businesses, for example, to make one enormous borrowing at the beginning of their business life.

MR. GRAHAM: I believe --

QUESTION: Do you recall that exchange we had earlier?

MR. GRAHAM: Yes, I do. And I believe there are actually two parts to the test. As to a particular debtor, the trial court would have to test whether or not the size of the loan was ordinary and customary as to that debtor's balance sheet. For instance, $7 million would not be extraordinary for General Motors. But if for a small manufacturer who might borrow 60 or 70 percent of its asset base, there might be a question about whether that was in the ordinary course of that particular business.

I believe there would also be a secondary test,

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which is that is to whether or not in the business community of that type of debtor, whether that type of loan was out of the ordinary course and unusual. And the fact that there are --

QUESTION: We don't have to decide here whether this loan was in the ordinary course or not. All you want us to decide is that the mere fact that it was a long-term debt does not disqualify it from this provision?

MR. GRAHAM: Yes. And I believe that with respect to Mr. Wolas' statement to this Court that there is a judicially recognized exception of longstanding, which he calls the current expense rule, I must respectfully disagree.

There are a smattering of cases referenced in Colliers where the courts, under the old Bankruptcy Act, struggled with certain types of debts, in unique circumstances. The classic example is the example of the landlord who is usually paid at the first day of the month, as opposed to the last day. And sometimes in those cases, he received the payment in the middle of the month or towards the end of the month.

And the court, not wanting to declare that an act of bankruptcy, or the court not wanting to consider that preferential, said that that was a current expense and not for an antecedent debt. Those cases as focused on

the concept of what was antecedent.

And in the new Bankruptcy Code, you have section (c)(1), which says that the payment, the exchange between the creditor and the debtor, does not have to be precisely contemporaneous. It has to be substantially contemporaneous. And if those cases were presented, there would have to be a factual determination as to the debtor and creditor -- whether it was substantially contemporaneous within the conduct of their business.

But I would invite the Court to look at those cases, and you will discover that they dealt with either rent, or they dealt with creditors who had a given value to the debtor, after receiving a preferential payment. And the court did not want to assess that creditor with the full preference he had received before.

For example, if he had received $10,000 on an antecedent claim, but then had re-delivered $5,000 of merchandise to the debtor, the court struggled with the concept by saying, well, he was assisting the debtor in the current operations, and therefore would not be subject to preference liability for the full $10,000. That concept is embodied in section (c)(4) of 547, in which we bankruptcy lawyers tend to call the net result rule.

If you have received $100,000 preference payment, but the debtor says ship me some goods, I'm in

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trouble, I need some additional goods -- if you ship the debtor $60,000 of goods, you will only be subject to the trustee's right to recover $40,000.

That concept is already embodied in the 1980 -- has been embodied throughout the 1978 Bankruptcy Code. And there really is no judicial rule of longstanding. In fact, search as you may, you will never find the word "current expense rule" ever discussed in the 1978 legislative history, let alone the 1984 legislative history.

The result in this case should be controlled by the case of West Virginia v. Casey. Because what Mr. Wolas is asking this Court to do is to try to reconcile his view of the 1984 statute with a prior congressional intent. And I think in the West Virginia case the Court pointed out that it is not the role of the Court to try to mesh inconsistent legislation between a past Congress' enactment and a new Congress' enactment -- unless the statute is ambiguous.

Then, when it's ambiguous, you have no choice but to go into the two statutes and try to reconcile them and make sense out of them. But there's no reason to do that here, because the statute is plain on its face. There was a simple time limitation which created this statute's artificial limitation to most -- which allowed

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most trade creditors to be protected under the old law.

When Congress deleted that statement, there really was nothing further to prevent the statute to be applied to all.

Finally, if I have been mistaken in my brief with respect to the fact that the 1990 -- the 1898 Bankruptcy Act did not draw a distinction between avoidability of preferential payments on short-term debt and avoidability of preferential payments on long-term debt, then so is the respondent -- at page 16, footnote 35. He says the same thing.

We both agree that under the old Bankruptcy Act --

QUESTION: Are you both wrong or are you both right?

(Laughter.)

MR. GRAHAM: We are both right, Your Honor.

(Laughter.)

MR. GRAHAM: And that could have been the only way my answer came out.

QUESTION: Now -- now you are.

MR. GRAHAM: It's very clear that there was never a distinction drawn on the classification of a debtor, whether they were long term or short term. The fact that for 1 year there was a statute that created an

artificial limitation, and the fact that there was a stampede to Congress to get that statute changed, the Court should follow the plain meaning of that new statute.

Thank you.

CHIEF JUSTICE REHNQUIST: Thank you, Mr. Graham.

The case is submitted.

(Whereupon, at 2:56 p.m., the case in the above-entitled matter was submitted.)

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No. 90-1491 UNION BANK, Petitioner, V. HERBERT WOLAS, CHAPTER 7 TRUSTEE FOR THE ESTATE OF ZZZZ BEST CO., INC., Respondent.

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

BY Lora M. Mayo

(REPORTER)