OFFICIAL TRANSCRIPT

PROCEEDINGS BEFORE

THE SUPREME COURT

OF THE

UNITED STATES

CAPTION: WILLIAM FIELD AND NORINNE FIELD, Petitioner v. PHILIP W. MANS

CASE NO: No. 94-967

PLACE: Washington, D.C.

DATE: Monday, October 2, 1995

PAGES: 1-45

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IN THE SUPREME COURT OF THE UNITED STATES

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WILLIAM FIELD AND NORINNE FIELD, :

Petitioners :

v. : No. 94-967

PHILIP W. MANS :

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Washington, D.C.

Monday, October 2, 1995

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 1:00 p.m.

APPEARANCES:

CHRISTOPHER J. SEUFERT, ESQ., Franklin, New Hampshire; on behalf of the Petitioners.

ALAN JENKINS, ESQ., Assistant to the Solicitor General, Department of Justice, Washington, D.C.; on behalf of the United States, as amicus curiae, supporting the Petitioners.

W. E. WHITTINGTON, IV, ESQ., Norwich, Vermont; on behalf of the Respondent.

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P R O C E E D I N G S

(1:00 p.m.)

JUSTICE STEVENS: We'll hear argument in Field v. Mans, Number 94-967.

Mr. Seufert, you may proceed.

ORAL ARGUMENT OF CHRISTOPHER J. SEUFERT

ON BEHALF OF THE PETITIONERS

MR. SEUFERT: Justice Stevens, may it please the Court:

The common law of fraud: Justice Easterbrook in his opinion in the matter of Mayer stated, an intentional deceit concerning a material proposition is fraud whether or not a more alert target would have smelled a rat, as victims of intentional torts need not take special precautions.

Under the common law as laid out in the Restatement of Torts section 545(a), a plaintiff's reliance on an intentional fraud must only be justifiable. His conduct does not have to conform to that of a reasonable man, because fraud is an intentional tort. The victim of such is not required to exercise the care of a reasonable man, just that of a reasonable victim.

QUESTION: At common law, must the reliance be justifiable, however, for fraud?

MR. SEUFERT: Yes, Justice O'Connor.

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Justifiable does not equate with reasonable, and the common law spells out the difference between the two.

QUESTION: Do you think there is a requirement of justifiability at least?

MR. SEUFERT: There has to be a requirement of materiality, because the elements of false pretenses, false representations, or actual fraud, are not laid out in 523(a)(2)(A).

QUESTION: Do you think there has to be intent and materiality?

MR. SEUFERT: There has to be materiality, and the reason --

QUESTION: And intent?

MR. SEUFERT: Yes.

QUESTION: Mm-hmm.

MR. SEUFERT: Because fraud is an intentional crime.

QUESTION: And possibly justifiability.

MR. SEUFERT: Correct, and the reason that is so is that a balancing act is done in the common law between the culpability of a defendant versus the culpability of his victim.

QUESTION: Do we know what the difference is between, what are the three categories, false pretenses, false representation, and actual fraud? Are those three

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different things, do you think?

MR. SEUFERT: They are, Justice -- may I explain? -- similar to a shell game. If you were to be walking in a common or a park, and there were to be a gentleman there, and he has three cups out. If we were talking about false representations, the person who is going to be running the shell game would tell you that I have put the nut in the middle cup. Let's play the game.

You can't win, because he hasn't put the nut in the cup. The cups are empty. But he tells you the nut's there, and he has you play. He tells you. He makes a false representation.

False pretenses. Say, for instance, the same scenario, we have the same three cups, you walk along in the park, and he's there. He doesn't tell you there's no nut in the cups, but he has the three cups out, and he says, let's play.

He puts those facts in place to lead you to the pretence that he's going to play the game honestly and that there's a nut. You still can't win, because there's no nut, but he hasn't misrepresented fraudulently. He's -- by false pretenses, by subterfuge.

Actual fraud would be that he takes the nut, has the three cups, you walk along, he puts it in the cup, and then by a flick of the wrist takes the nut back out, so he

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actually does something, an overt act.

Three types of fraud. Each one of them has the scienter of intent. He's intending to defraud you one of three ways. You still can't win the game because the fraud's there, and fraud has to be intentional under the Bankruptcy Code. This Court --

QUESTION: What about reliance? Does the reliance have to be justifiable with respect to the false pretence and the false representation claim at common law?

MR. SEUFERT: The reliance must be justifiable if it's an intentional fraud, because there's -- there's fraud --

QUESTION: Well, each of these -- you have just described each of these as intentional, haven't you?

MR. SEUFERT: That's correct.

QUESTION: So you are saying that at common law there must be a justifiable reliance in each of the three categories, not just fraud, but the representation and pretense.

MR. SEUFERT: And the reason it must be justifiable is because there has to be some materiality under the common law between the fraud and the loss of the victim.

QUESTION: I must say, I'm interested to hear this difference among the three described so clearly in

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the context of a shell game. I looked up the common -- or actually had a hapless law clerk look up the common law, and I don't find that there's any such thing as a common law action for misrepresentation. There is for false pretenses and for fraud, but if there is one, it's news to us.

MR. SEUFERT: I believe the case of Matter of Weinstein, page 809, describes the differences between the false representations and false pretenses.

QUESTION: Page 809 of what?

MR. SEUFERT: Page 809 of the Matter of Weinstein, 31 Bankruptcy Reporter, 504, a 1983 case, Justice.

QUESTION: 19 --

MR. SEUFERT: 1983. I believe it's cited in our Joint Appendix.

QUESTION: Okay, but that is a bankruptcy case that's already dealing with this language.

MR. SEUFERT: It's dealing with the difference between false pretenses and false representation.

QUESTION: Within the meaning of the statute.

MR. SEUFERT: Within the meaning of.

QUESTION: I would have rather seen an old common law case that talked about a cause of action for misrepresentation, and I'm not sure -- misrepresentation

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is an element of a lot of other causes of action, but --

MR. SEUFERT: There's the very old U.S. Supreme Court case of Neal v. Smith that's cited also in the Joint Appendix. What that case concerns is that the fraud must be fraud, an intentional fraud, not that implied by law, because there is some implicit fraud implied by law.

QUESTION: But fraud is always an intentional tort. I thought you conceded that.

MR. SEUFERT: Justice, there can be fraud implied by law. New Hampshire and many other States have a fraudulent conveyances act, which means that if you sell property or give away property for less than fair value when you are about to be sued, or about to incur debts, that the State law considers that's a fraudulent conveyance, even though you had no intent to be fraudulent, you were making a gift.

QUESTION: Let's go back in this case before there was any representation. Suppose the debtor here had simply transferred that property without saying one word to the creditor. Do I understand that the debt would then be dischargeable? There would be no representation at all, just in violation of the agreement the debtor sells the property, transfers the property. The creditor hasn't -- doesn't know anything about it till the bankrupt -- gets notice of the bankruptcy and finds out.

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Dischargeable, right?

MR. SEUFERT: While that is not the facts of this case, I would agree with you, it would be dischargeable.

QUESTION: Well then, can you explain to me the consistency between saying that if the debtor does something to alert the creditor, then the debt will not be discharged, but if he says nothing at all, then it's going to be discharged? So if he does something that's helpful to the creditor at least in raising a red flag, some kind of alert that something's going on in the mind of the debtor, that maybe he's going to transfer this property, then it's not dischargeable, but if he just goes ahead and does it, it is. What sense does that make?

MR. SEUFERT: If I can maybe explain, if the property would have had to have been transferred without any notification or any back and forth correspondence, that would be fraud under the Fraudulent Conveyances Act in the State of New Hampshire. However, that would be fraud implied by law, so we would have --

QUESTION: Just without telling me whether it's fraud implied by law, the debt is dischargeable?

MR. SEUFERT: It would be dischargeable, but that is not the facts of this case. If my -- I mean, we could assume that my client would have found out through

some other means, perhaps, that the transfer --

QUESTION: But don't you think that there's a certain anomaly between the debtor being really bad and not saying one word and just doing it, and the debtor saying -- giving some tipoff to the creditor? Why should the one be dischargeable, that is, where -- the worst conduct that we can attribute to the debtor, saying nothing, lead to a dischargeable debt, and if the creditor, the debtor has said something, then it's not dischargeable?

MR. SEUFERT: It may not have been a tipoff, Justice, if I may explain.

The letters -- if you want to get into a particular fact, the letter that went out to my client says, we know about the due-on-sale, and we do not want to trigger it, therefore we want your consent, making a representation that they knew and wouldn't violate that section, and subsequently they did violate that section when they sent that letter out, and the trial court said that was fraud. That was false pretenses, so that was fraud.

If the letter -- if the letter had not gone out and there was no representation, well, I know about it and I don't want to violate it, we'd have a tougher -- tougher case here before this Court.

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Those aren't the facts, though, because we have the actual fraud taking place at the time, and there was a finding of the fraud.

But the trial court turned on that we needed reasonable reliance. The trial court in the appendix, pages 43 and 44, a party -- this was the trial court's findings: A party is not entitled, you know, to be in good faith and just not objectively reasonable. An objective reasonable man standard applies.

That would be the standard. If we're using this balancing act and we're looking at negligent representation under the law versus intentional representation, because the law does this balancing act, and if there's intent, scienter, bad intent, evil intent on behalf of the perpetrator, then the law protects the victim by saying, okay, you don't have to prove the reasonableness, you just have to prove that you, in good faith, did rely --

QUESTION: Well, hasn't it always been the law that under fraud you have to show the reliance was justifiable?

MR. SEUFERT: Yes.

QUESTION: That's the word they use, and I never heard in this whole case, anywhere, anybody until now, making a distinction between reasonable and justifiable.

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As I read the First Circuit opinion and the bankruptcy judge and everything, they were all using the term reasonable to mean the same thing.

In other words, do you lose, then, if I think it's the same? If I think all they meant was it had to be justifiable reliance, then you lose the case? I mean, I thought there was this: you know, I go out and I say, hey, will you lend me a million dollars? You say, have you any security? I say, sure. I'll give you the Isle of Elba. I'm Napoleon --

(Laughter.)

QUESTION: Okay? Now, if you're so stupid as to rely on that, totally unreasonable, unjustifiable, I'm very sorry, you lose. I mean, that's what I thought the law was. Whether they called it unjustifiable, unreasonable, it didn't make that much difference.

MR. SEUFERT: The Fosco case, Your Honor --

QUESTION: There may be some cases that say it's different. I'm just saying, as I've read these cases, I think that the other side won't mind if we were to say, okay, what is necessary here is that the -- to be dischargeable you have to show that it was unjustified reliance -- do you see what I mean? -- where they use the word unjustified instead of reasonable.

QUESTION: I'm not following. Is this because

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Napoleon did not own the Isle of Elba?

(Laughter.)

QUESTION: That's right. Very few people know he didn't.

MR. SEUFERT: Justice Breyer, there must be a material nexus between --

QUESTION: Mr. Seufert, stay in front of the microphone so we can all hear you.

MR. SEUFERT: There must be a material nexus between the fraud and the loss. If the reliance is so far-fetched that it couldn't even be justifiable, if Napoleon did not own the Isle of Elba and everybody knew it -- everybody knew it -- then --

QUESTION: I don't -- my problem is, I don't understand these technical words, and I usually try to interpret them in ways that aren't that technical, and as I read through these briefs, I thought the issue in this case is whether there is a requirement in section (a) that the person who is the victim have to have behaved reasonably or justifiably in the circumstance.

I didn't think there was that big a difference between the two, and although Judge Cyr -- I think it was Judge Cyr, is that right? -- said -- well, said reasonable and unreasonable, I thought I would have reached the same result if he used the word justifiable and unjustifiable.

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Now, for the first time I'm hearing something different, and it probably is my fault, not focusing on it, but I'd like to get you to focus on that and why it makes a difference.

MR. SEUFERT: In our brief, Your Honor, we pointed out that contributory negligence is not a defense when you have an intentional tort.

When Congress wrote the two sections 523(a)(2)(A) and (a)(2)(B), you can see a clear distinction that Congress made by including in 523(a)(2)(B) that even if the victim proves reasonable reliance, he also must prove intent to deceive. He has to prove those two elements, the intent and reasonable. That is a departure from the common law, which says if you prove the evil intent, you don't have to prove reasonable reliance. You only have to prove subjective, justifiable reliance.

QUESTION: May I ask a question which goes to this distinction? I don't have the quotations from the Restatement literally in front of me, but they're in the briefs.

I thought one distinction, and I think this is raised by your contributory negligence point, is that there is no duty to investigate under a justifiable reliance standard, but there may be under a reasonable

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reliance standard, is that fair to say?

MR. SEUFERT: That's correct.

QUESTION: Okay.

MR. SEUFERT: I believe we had the example --

QUESTION: That's why, if you should have investigated but didn't, it's not imputed against you as contributory negligence.

MR. SEUFERT: That's correct, Your Honor. We did put the example in our brief regarding the, if you say you own the property and you're going to give me a mortgage, I'm going to give you a mortgage and you own the property outright, there's no mortgage -- or if there is a mortgage -- I could have checked on it by going right next door to the registry and saying, looking it up, and looking it up and find that there was a mortgage, but I believed you.

QUESTION: Okay. In the Island of Elba example, I suppose there would be neither justifiable nor reasonable reliance.

MR. SEUFERT: I'm not good on answering --

QUESTION: Everybody knows that he doesn't look like Napoleon, at least I think he doesn't look like Napoleon --

(Laughter.)

QUESTION: -- but -- and Napoleon is dead, and

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Justice Breyer is very lively, but once you get out of such an obvious example, then your distinction between the duty to investigate and no duty to investigate would -- could make a crucial difference and I suppose you -- of course you would argue that it does here.

MR. SEUFERT: Well, there is no duty to investigate if you prove evil intent, the evil empire, on the perpetrator of the fraud.

QUESTION: Well, we're talking about evil. I'd like you to tell me why this obligation was obtained by fraud, because your answer to the question, if he has the debt, the creditor-debtor relationship is established, the debtor says nothing and just sells the property -- dischargeable.

The debtor says something, but still he obtained the credit originally long before there was any representation, so why does this fit within obtained-by fraud, the obtained-by language?

MR. SEUFERT: The extension of credit is what we relied upon before the trial court, because there is a -- there was a due-on-sale clause that called forward not only the original note but front-loaded all of the interest that this mortgage was supposed to pay out over its next 10 years immediately up front if the property was transferred without a written consent for transfer.

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QUESTION: But in fact nothing formal happened, and what happened is the same thing as if the debtor had said nothing. The due-on-sale clause would have kicked in had the creditor known about it.

MR. SEUFERT: That's right.

QUESTION: You have two situations where the creditor didn't know about it, and everything remained the same.

There was no new activity, there was no formal extension of the debt, there was just a debt obtained originally without regard to any fraud, and then a continuation of that same debt with no renewal, so I don't understand why we would say this debt was obtained by the fraud where if the debtor had said nothing it would not have been obtained by the fraud.

QUESTION: When we're looking at an intentional fraud, fraud in its purest sense, we have to find it wasn't intentional, because there are some negligent frauds, or fraudulent misrepresentations, negligent misrepresentation. There's a difference.

If I -- I understand your question, if he had done nothing in this case and just transferred the property and not spoken to my client, not given out deceiving letters, it probably would have been dischargeable, Judge, but we have his intent to attempt to

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deceive by him sending those letters, that I know it's due on sale, and I don't want to trigger it, therefore will you give me consent.

When the consent wasn't given, he did it anyways, and he did it during the course of time when he's sending letters back and forth to my client, and that's the evilness. When there is that evilness, Justice, you don't discharge a bad person, or a bad debt in bankruptcy against an innocent victim.

QUESTION: Mr. Seufert, your time has expired.

MR. SEUFERT: Thank you, Your Honor.

QUESTION: Mr. Jenkins.

ORAL ARGUMENT OF ALAN JENKINS

ON BEHALF OF THE UNITED STATES, AS AMICUS CURIAE, SUPPORTING THE PETITIONERS

MR. JENKINS: Justice Stevens, and may it please the Court:

QUESTION: Mr. Jenkins, can I ask you a preliminary question? Do you think that the meaning of these terms, the false pretenses, representation, and actual fraud, is a matter of Federal law under this statute?

MR. JENKINS: We do, Justice O'Connor. In fact --

QUESTION: We don't look to State law

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definitions, then?

MR. JENKINS: I think that's correct.

In fact, we disagree with petitioners that the common law elements of fraud, whatever they may be, are controlling in this case. We think the ordinary rules of Federal statutory construction, in particular the language, the structure, and the history of the Bankruptcy Code, are better tools for discerning Congress' intent in this case.

QUESTION: Well, might we look to the common law definition for the meaning of the terms that Congress used?

MR. JENKINS: I think that's possible, Your Honor, but I think the better source is, again, the structure of the code, and in particular the word, fraud, which is used elsewhere in the bankruptcy Code, is used in other Federal statutes which this Court in Grogan v. Garner indicated are better sources for discerning Congress' intent when it used the term fraud.

For example, in the False Claims Act, a Federal fraud statute, reasonable reliance is not required. In the securities laws, reasonable reliance is sometimes required, but in particular situations such as failure to disclose, or a fraud on the market theory, reasonable reliance is not required, and so we think that the element

of reasonable reliance that was required in this case is not inextricably bound with the term fraud as Congress likely intended it.

QUESTION: But isn't the difference here that the word fraud occurs in a series, and the other two terms in the series are obviously common law terms?

MR. JENKINS: Well, I think, Your Honor, it's unclear whether false representations and false pretenses are common law terms or whether they in fact are statutory terms. Fraud certainly is a common law term, but we think that in --

QUESTION: Yes, but there's no definition of them anywhere in the statute, which is a pretty good indication that there is a reference to some place else, and the some place else is State common law, isn't it?

MR. JENKINS: Well, that may be, but we think that's not the best explanation.

In 1978, when Congress created the Bankruptcy Code, revised the Bankruptcy Act of 1898, it introduced the term, actual fraud, and looked to this Court's decision in Neal v. Clark, and that decision indicated that the term fraud means scienter, and that was the purpose that Congress had in mind when it introduced the fraud language.

QUESTION: Maybe I should know this, but how do

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we know that Congress looked to that case? Is that in the legislative history?

MR. JENKINS: It is in the legislative history, and it's cited in our brief, I believe footnote 5.

QUESTION: Okay.

MR. JENKINS: As I've said, we think that the better tool of statutory construction here is the structure of the Bankruptcy Code. Section 523(a)(2) exempts from discharge two independent categories of fraudulently incurred debts. Paragraph (B) is limited to false statements of financial condition, expressly includes reasonable reliance as one of its elements. Paragraph (A) exempts all other fraudulently incurred debts and contains no such requirements.

In our view, the juxtaposition of those two provisions requires the conclusion that reasonable reliance is necessary -- must be proved only in the narrower category of false financial statement cases.

We think Congress would have had no reason to create two independent provisions, paragraphs (A) and (B), if, as the respondent argues, it had intended for the elements of those provisions to be identical. Congress could instead have simply created -- introduced a single reasonable reliance requirement in a unified section 523(a)(2).

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QUESTION: Or it could -- I'm sorry.

QUESTION: Go on.

QUESTION: Or it could simply have had a separate section and said, if it's a representation about financial condition, it's going to be in writing, and that's all it would have done.

MR. JENKINS: That's correct.

QUESTION: Yes.

MR. JENKINS: That's correct. It would have treated them the same, as it did in section 17(a)(2) of the Bankruptcy Act.

QUESTION: I take it you agree that materiality is required for fraud?

MR. JENKINS: We do not, Your Honor, as to paragraph (A). Materiality --

QUESTION: Materiality is not required?

MR. JENKINS: That's correct. We look at the language in paragraph (A), a debt obtained by fraud, and argue that requires scienter, which is derived from the fraud language, and causation. Causation generally will require, in all circumstances will require actual reliance, that the listener actually relied on the false statement and that's how the debt was created.

QUESTION: Well, you've just destroyed your prior argument, then. If you say that the materiality

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element is enough to distinguish (B) from (A), why do you have to also say that the scienter -- that the lack of reliance is necessary to distinguish (B) from (A)? Why can't you distinguish (B) from (A) -- (2)(B) from (2)(A) on the basis of any one of those features in (B), that it's materially false, on which he reasonably relied, caused to be made published with intent to deceive? You could say any one of those three.

MR. JENKINS: Well, Your Honor, we do say that those two provisions have different elements. Scienter is required in both.

QUESTION: Yes.

MR. JENKINS: But that is the only element we think, except for causation, that is required in both (A) and (B).

QUESTION: But it's only necessary to find one element in (B) that is not necessary for (A) in order to distinguish the two.

MR. JENKINS: Well, I suppose that's true, Your Honor, and I think in addition we've noted that the legislative history indicates what Congress was trying to do in splitting former 17(a)(2) into 523(a)(2) (A) and (B), and it indicates that the reasonable reliance requirement was at the heart of that.

QUESTION: But they didn't know at that time, I

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take it, what the courts were going to hold about this thing, about -- there was some split, I gather, and the finance companies came in to them and said a lot of people make these representations in writing, and we want to be certain there's reasonable reliance, the consumer group said. I mean, they had that before them.

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

QUESTION: What possible sense could it make to say, if I go in writing, and I use my Napoleon example -- you know, it's a surrogate for any ridiculous thing, where you're being very unreasonable.

I do it in writing, and you agree, if you're so silly as to rely on this statement, you can't recover, because it falls under (B). Is that right?

MR. JENKINS: That's correct, under (B).

QUESTION: And what could Congress have in mind if I do exactly the same thing, but I happen to say it orally, and you're so silly as to rely on that statement. Then, however, I can't be discharged in bankruptcy. What could be the theory of such a thing?

What could be the theory that wouldn't explain, well, they changed (B) because they focused on (B)?

MR. JENKINS: Well, I --

QUESTION: They didn't change (A) --

MR. JENKINS: Right.

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QUESTION: -- because nobody asked them to do it.

MR. JENKINS: I think -- given the structure of the act, I think the answer to that is that if someone foolishly relies, or is particularly gullible under paragraph (A), Congress intended that that person be protected, that as between an intentionally dishonest debtor on the one hand, and an unwary creditor on the other hand, that the creditor should prevail, except where there had been a pattern of abuse in precode cases, and --

QUESTION: You mean, in other words, they want to protect this very, very foolish creditor, the very foolish lender, like General Motors Access Corporation or something. I mean, they want to protect these very foolish lenders where the debtor comes and says something orally but not in writing, and my only question is, why would that be? I don't know what --

MR. JENKINS: Well, Your Honor, the difference between (A) and (B) is not that it's orally versus in writing, it's that it's a false financial statement case.

An oral statement about a financial condition would not be covered at all under (A) or (B). That's a category that's --

QUESTION: Same question. Same question.

MR. JENKINS: If I understand your question,

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what would Congress' motivation be --

QUESTION: Yes.

MR. JENKINS: -- in protecting the foolish creditor, I think equitable principles that underlie the Bankruptcy Code --

QUESTION: No, why in the one and not the other?

MR. JENKINS: Well, because there was a pattern of abuse by consumer finance companies that Congress identified as to (B), and that was the purpose for expressly including the elements of (B), materiality being one, reasonable reliance being another, that that would provide added protection to debtors in that category, but again, I think the structure of the code indicates that Congress intended to provide that added protection only in that category.

QUESTION: It seems to me -- you know, the language, we've been talking as though they're common law causes of action, false pretenses. It doesn't say false pretenses, false representation or actual fraud, it says false pretenses, a false representation or actual fraud.

It doesn't seem to me like they're talking in terms of common law causes of action at all, and if there is a reasonable reliance recorded it seems to me it comes about simply because we would not interpret the language, to the extent obtained by, to include something that is

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obtained through unreasonable reliance. The causality does not exist.

And I think that's the same way the common law came to its conclusion with respect to fraud. It's not obtained by fraud, if, indeed, the reliance is so unreasonable that no -- causality is broken by the stupidity of the person who relied when he shouldn't have.

MR. JENKINS: Your Honor, I think that would be respondent's best argument, but I think --

QUESTION: Yes. Well, why don't we read it that way?

MR. JENKINS: I think it's not a winning argument, because the term fraud does not uniformly, or even in most cases, require mater -- pardon me, reasonable reliance.

QUESTION: No, I acknowledge that --

MR. JENKINS: Yes.

QUESTION: -- and certainly a false representation does not --

MR. JENKINS: Mm-hmm.

QUESTION: -- but what about the language, obtained by?

MR. JENKINS: Well, I think --

QUESTION: Isn't it reasonable --

MR. JENKINS: Pardon me.

QUESTION: -- to say there has to be a causality, and the causality is broken when there is -- when that person shouldn't have relied?

MR. JENKINS: May I answer?

QUESTION: Yes.

MR. JENKINS: We do think that the obtained-by fraud language requires causality. Causation, however, we believe refers to actual reliance.

If someone foolishly relies on an intentionally false statement that was intended to deceive the listener, then that statement has caused the underlying debt, whether or not the person happened to be particularly gullible, and that would be particularly true if the speaker knew of this frailty of the listener and used that knowledge in order to incur the debt, but certainly causation would be there, and the obtained-by language would be satisfied.

QUESTION: Thank you, Mr. Jenkins.

MR. JENKINS: Thank you.

QUESTION: Mr. Whittington.

ORAL ARGUMENT OF W. E. WHITTINGTON, IV

ON BEHALF OF THE RESPONDENT

MR. WHITTINGTON: Justice Stevens, and may it please the Court:

I intend first to address the issues raised by

Justice O'Connor and Justice Souter as to the differences between false pretenses and the other two in the threesome in 523(a)(2)(A), and then to deal with the subject of whether in fact in false pretenses reasonableness has been required, and then to deal with Justice Breyer's question concerning difference, if any, between reasonable and justifiable.

If there's more time after those subjects, I will address other aspects of the plain meaning in the legislative history.

We believe that there are actually differences between false pretenses and the second two in the triumvirate. That is, false pretenses is where there never was an intention to pay the debt at all, whereas in false statement, or false representation, or actual fraud, there may have been an intention to pay the debt, but there was a misrepresentation as -- usually to security.

Obviously, false pretenses can be included in the second category, and the typical false pretenses cases are the credit card cases, where, for example, the borrower has already maxed out his credit card, and so the argument is made that at the time you incurred this debt, you had absolutely no intention of repaying it at all, as opposed to the typical actual fraud case, where the argument is, where you intended to pay it, but you fudged

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a little on what your means were as to whether you were able to.

QUESTION: Mr. Whittington, what is your authority for these distinctions?

MR. WHITTINGTON: I have five cases that make these distinctions.

QUESTION: Okay. It's common law case law, then?

MR. WHITTINGTON: Yes, it is.

QUESTION: These are common law cases, or bankruptcy cases trying to make sense out of this unfathomable statute?

MR. WHITTINGTON: Bankruptcy cases, Your Honor.

QUESTION: Yeah, well, I don't -- I think they're pulling it out of the air to try to give some meaning to the statute. I would like to see some common law cases that gave those meanings to these words before Congress invented them.

MR. WHITTINGTON: I do agree with that, and in fact I looked for some and was unable to find them.

QUESTION: May I ask this question: is this language in (A) the same language that was in the statute before 1978?

MR. WHITTINGTON: Yes, it is, with one minor difference, and that is the third of the threesome, actual

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fraud, was added, and most courts that have addressed that --

QUESTION: But is it correct that actual fraud had been thought to be part of it because of the -- what's the old case in 95 U.S. -- there's a case that your opponent cited.

MR. WHITTINGTON: Neal, U.S. -- Neal --

QUESTION: Yes, Neal. Neal was the case. Did not that include actual fraud within the statute?

MR. WHITTINGTON: I believe that's correct.

QUESTION: So that would it be correct to say that at least insofar as the reenactment of (A) is concerned, that was thought to just be a codification of existing law?

MR. WHITTINGTON: I think that's correct.

QUESTION: So that construing (A), we could look at pre-1978 cases to find out what that means?

MR. WHITTINGTON: That's correct.

QUESTION: And if we look at Neal, what do we find about reliance?

MR. WHITTINGTON: I can't answer the question with respect to Neal, Your Honor, but with respect to other pre-'78 cases, which we've cited at page 15 of our brief in footnote 13, there are, I believe, at least three cases in the 1970 to 1978 timeframe which did, in fact,

require reasonable reliance as to 523(a)(2)(A).

QUESTION: May I ask one other sort of basic question? Is it your position that you would have prevailed under pre-1978 law, or that -- or maybe you argue both -- the change in 1978 by the addition of (B) gives you an argument that you would not previously have had?

MR. WHITTINGTON: We would have prevailed under both, in our view. That is, (A)23(a)(2)(A) in the prior version did, in fact, include actual fraud, actual reasonable reliance, whereas what was then (B), the second part of old 17(a)(2), the cases split, and in order to strengthen the (B) part with respect to written financial statements, Congress added the word, reasonableness, to clarify it. In fact, the Government's brief in footnote 12 at pages 12 and 13 makes this very point, I believe.

Reading from the line that starts on page 12 and goes to 13, "In any event, Congress clearly concluded that any judicial trend toward a proof of reasonable reliance requirement in financial statement cases was not so well established as to obviate the need for express inclusion of the requirement."

I think that shows the congressional intent that they wanted to make what is now (B) just as strong as what now is now (A).

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QUESTION: With respect to the pre-'78 common law cases, how do you account for what seems to be a disparity of standards between the cases that you rely on and the Restatement, because I take it the Restatement, in talking about justifiable reliance, really is talking about a less strict standard?

MR. WHITTINGTON: I don't think that's correct. the distinction between justifiable and reasonable, which is the question that Justice Breyer raised, we believe that it's the same in both. The principal case which has used the term justifiable as opposed to reasonable is the Kirsh case in the Ninth Circuit, which in reality was a 1-1-1 split. The majority opinion said that justifiable was different, and there were two votes for that. The third position was that reasonableness was all that was required, and then, splitting the other way, two justices said that, whichever word it is, it was either reasonable or justifiable.

The explanation given by the Ninth Circuit was that justifiable includes reasonableness plus other factors, that reasonableness is only "one of the factors in the mix," and our position is, if we look at the various potential factors in the mix, they could include whether the lender is alerted by some fact, as in our situation, and/or whether the creditor had a duty to

investigate.

QUESTION: But you are conceding, I guess, then, to the extent that you are basing your discussion on the Ninth Circuit, that there is at least some distinction to be made between reasonable and justifiable.

MR. WHITTINGTON: Other courts have disagreed with that, and --

QUESTION: Well, how about you? What do you say?

MR. WHITTINGTON: I think it's the same both ways.

QUESTION: So the Ninth Circuit was wrong. The factors should be exactly the same.

MR. WHITTINGTON: If the Ninth Circuit was right, our position would still be that there was justifiable reliance --

QUESTION: Because of the facts of this case, as you've --

MR. WHITTINGTON: That's correct.

QUESTION: -- argued them, but so far as the legal standard is concerned, you're taking a different position from the Ninth Circuit. You're saying they're identical.

MR. WHITTINGTON: That's correct, and in fact --

QUESTION: And you say that with respect to the

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duty to investigate.

MR. WHITTINGTON: That's correct.

QUESTION: The duty to investigate is always the same on each one.

MR. WHITTINGTON: Well, there may not be a duty to investigate. It may depend --

QUESTION: But if there is, it will be the same whether we're talking justifiable or reasonable.

MR. WHITTINGTON: That's correct, and that's the point of the Mayer case, I believe. The Mayer case says, in the first instance, there's no duty to nose out the truth. Then it goes on to say, but an investor or a lender cannot close his eyes to known risks, to known information.

That, in our view, is, in fact, the reliance-balancing which is necessary. It's a factual determination of the factfinder which can be affirmed either direction that it goes on the clearly erroneous standard.

And so in our view it doesn't matter if the Ninth Circuit is correct, in terms of semantics, that they choose justifiable instead of reasonable. Either way, it should be the process of balancing those factors.

I might add that the Ninth Circuit also points to the fact that in California the listing of the common

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law elements of fraud uses justifiable, which they take out of Prosser in the Second Restatement, which is one of the reasons that the majority opinion in Kirsh looks to the language justifiable as opposed to reasonable.

Now, turning to the plain language of the statute, the petitioners say that --

QUESTION: Before you -- well, this is the plain language. I would like to know what you think is covered by (B) that wouldn't be covered by (A).

MR. WHITTINGTON: Written. Written financial statements.

QUESTION: Oh, only because --

MR. WHITTINGTON: In other words, our view is --

QUESTION: Oh --

MR. WHITTINGTON: I'm sorry?

QUESTION: Oh.

MR. WHITTINGTON: In other words, our view is the reason that Congress took the trouble to list out the elements, to give us a laundry list, as you were, in section (B), is because they've changed the common law in two ways: writing, and financial statements.

Other than those two factors, they exactly track the common law, in our view, which is why there was no need to list out the elements in 523(a)(2)(A). Instead, they could simply give us legal shorthand, if you were, a

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common law definition, which to lawyers with long jurisprudence connotes all those subsidiary elements in it.

QUESTION: Do you agree that (B), the test of satisfying (B) is less strict than the test of satisfying (A), or do I have it backwards?

MR. WHITTINGTON: No. I think that they're equally strict, and in the '70 to '78 case period under the prior law, there was some disagreement as to that.

That is, some courts were construing (B) as being less strict, and Congress was concerned about that, so to clarify that, that they didn't want (B) less strict, they threw in the word reasonableness to clarify it, so our position is that (A) and (B) are both equally strict with respect to reliance.

QUESTION: Do you agree, though, that (B) was specifically directed at finance companies that relied on written statements that they should not reasonably have relied on?

MR. WHITTINGTON: I think the tightening up of the statute was specifically directed at that.

In fact, Judge Berry gave testimony to the House subcommittee that considered this, in which he delivered to them a decision in a case where there was no reasonableness, and he had ruled that therefore there was

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no fraud, and his view was that that was not appropriate.

And then in the language that's been quoted by both the petitioners and the Solicitor General, Congress in both the Senate and the House reports states that it's concerned about finance companies who might even encourage lenders to leave something out. What Judge Berry gave to them was the actual forms that didn't even leave enough room to put the information on there, which was one of the abuses that Congress was concerned about.

QUESTION: Do the general creditors care which way this argument comes out?

MR. WHITTINGTON: I don't think so. This is a --

QUESTION: I don't think -- I don't think so.

MR. WHITTINGTON: This is a Chapter 7 liquidation case, so if we were under a different chapter, perhaps, but certainly not in this case.

QUESTION: Under Chapter 13, would they care?

MR. WHITTINGTON: No, I don't think so either, because there's a discharge as of the date -- the debtor would have to pay out of future acquired assets, I'm guessing, so I think the answer is no again.

Finally, as to the plain language, and why I believe that (A) is simply a laundry list, legal shorthand, is the fact that several justices have pointed

out each of the other normal elements of the common law fraud action, although not expressly stated in (A), are read into (A), and I cite the Court to pages 12 and 13 of the respondent's brief -- let me just confirm that -- which list several cases at the circuit court level that have read those requirements in. We're not aware of any cases that have refused to read those elements in.

QUESTION: Well, if you're right, then this case turns entirely on whether we think reasonable reliance is the same as justifiable reliance.

MR. WHITTINGTON: I don't agree with Your Honor. I think that Mr. Mans should win in either event, because whether the term reasonable is used, or justifiable, on the facts of this case it wasn't possible for Field to be either one.

In fact, the Court will recall that in this case Mr. Field had actual knowledge that a Mr. DeFelice was on the property claiming to be the owner, and that was the alleged implicitness representation. That's the term of the bankruptcy court, was that Mr. Mans had implied that he hadn't transferred it, and our view is, whether you use -- whether the Court would use reasonable or justifiable, it's neither one for Mr. Field to simply do nothing, not even ask Mr. Mans when he sees him on numerous occasions, golly, is it correct that you've

transferred the property to Mr. DeFelice.

QUESTION: Your position is, then, that here there was a duty to investigate?

MR. WHITTINGTON: Not initially. That duty to --

QUESTION: Well, at least at the time of the alleged misrepresentation.

MR. WHITTINGTON: That's correct. That would be our position.

QUESTION: But you allege there was one, but do you -- you don't also agree it was necessary that there be a duty to investigate.

MR. WHITTINGTON: No. I think that once he became aware of facts which called into question the representation, then a duty arose.

Now, I'm engaging right now in factual determinations, which is not the appropriate thing for us to be doing at this Court, but that's the thought process that the trier of fact, the bankruptcy judge in this case, should be undertaking.

QUESTION: We're talking as though the duty to investigate and the unreasonableness of the reliance are two separate things. They're really just one thing, aren't they?

MR. WHITTINGTON: I agree.

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QUESTION: It's unreasonable to rely with what you have.

MR. WHITTINGTON: I agree.

QUESTION: Which means you should have done something more.

MR. WHITTINGTON: That's correct.

QUESTION: So do we have to get into that? Do we have to get into a duty to investigate? I mean, I thought here -- you try these things, do you, quite a lot? Are you involved in bankruptcy cases quite --

MR. WHITTINGTON: Well, I have not tried a lot of these.

QUESTION: Well, all right then. I was -- my imaginative idea of this is the fellow comes up and he says, well, I know that there was somebody else out here who claimed to be the owner of the property, and I know that if the other guy is the owner of the property, I should have called in this debt immediately. I know both of those things, but still I relied on some letter written 3 years ago that said, I won't -- it didn't even said that. It said, I haven't sold the property yet. I haven't transferred it yet.

So you'd say, you didn't rely on that. That's ridiculous. He says, yes, I did. So okay, if you're that stupid, you lose anyway. I mean, that's how I imagine

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this case going. Is -- do you see what I'm trying to -- what is the practicality of it?

MR. WHITTINGTON: Our view is, those are all factors in the mix to be considered by the bankruptcy court, and as an advocate at the trial court level, those are the facts that I'm playing with. Those are the facts that I'm trying to establish, that the creditor was on notice, that the creditor maybe was sophisticated, that the creditor maybe is required by Federal law to do certain investigations and has failed to do that if it's a bank, that the creditor had a special relationship with the debtor that would cause him to normally undertake an investigation -- as an advocate at the trial court level, those are all factors in the mix which I would be trying to urge on the factfinder.

But the question before the Court, in our judgment, is, should the factfinder be engaging in that analysis, and to that answer -- to that question, the answer has to be yes, in our view.

QUESTION: Mr. Whittington, what about the argument that you made last in your brief that I asked your adversary about. You say that this, in any event all of this is academic, because the credit here was not obtained by the fraud, so whether there's a requirement of reasonable reliance or justifiable reliance is beside the

point if the credit wasn't obtained by the fraud.

MR. WHITTINGTON: I welcome that question. This was an issue that absolutely slipped through, perhaps because Mr. Mans was unrepresented below, but under the clear language of the statute, there has to be an extension of credit in connection with the fraud. It has to be obtained by the fraud, and we have a 4-month gap here. The money is out, all of the money, $187,000 --

QUESTION: May I interrupt you for just a second? Do you think we granted cert to decide that issue?

MR. WHITTINGTON: No, I don't. That's why --

QUESTION: And with respect to issues bearing on the question we did grant cert to resolve, did you make this argument in your brief in opposition to the cert petition?

MR. WHITTINGTON: There was no brief in opposition filed. I was not yet retained, and Mr. Mans was unrepresented at that point.

QUESTION: Thank you.

MR. WHITTINGTON: Next, I would like to address the collateral estoppel issue, which hasn't been spoken about here today. This Court stated in 1991 in the Grogan v. Garner case that collateral estoppel principles are important, particularly in section 523(a)(2)(A) cases. In

Grogan, of course, you decided that the appropriate standard of proof was preponderance as opposed to clear and convincing, and the reason that the Court gave that -- decided that was so that collateral estoppel principles would be furthered between State or Federal court actions and the bankruptcy court actions.

Under the same analysis, in order for collateral estoppel to work, there needs to be the same grouping of factors in the two types of cases, and in fact there are situations where a case may go to trial first in the State court, let's say, on a common law fraud action, by which it's determined -- by which the debtor prevails, let's say, because there was no reasonable reliance, and then some months later, after there's a filing in bankruptcy, there is an inconsistent ruling in the bankruptcy court, or it could be the other way around, if the bankruptcy ruling under 523(a)(2)(A) could be determined first, and there be an inconsistent result the other direction later in State or Federal court.

Finally, I'd like to address a subject that was mentioned, I believe by Justice Scalia, which is the role that the reliance element really plays, and I think the answer to that question is that it is the principal tool of the factfinder in determining whether there's actual causation, a link between the misrepresentation on the one

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side and the action taken by the creditor on the other.

That language is expressly picked up by the Kirsh case, quoting Prosser, and that's the reason that it's important for this Court, in our judgment, to maintain the reliance requirement so that in fact judicial factfinders have this important tool to determine that in fact there is a causal link, which is a real one.

Thank you very much, and unless there are questions -- I thank you.

JUSTICE STEVENS: Thank you, Mr. Whittington.

The case is submitted.

(Whereupon, at 1:51 p.m., the case in the above-entitled matter was submitted.)

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BY Ann Mari Federico

(REPORTER)