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Cover Page Footnote

The author wishes to thank Paul H. Haagen, Dennis J. Lehr, Roy A. Schotland, Peter H. Schuck and Peter L. Strauss for their generous and helpful comments on drafts of this paper. Special thanks are also due to Brian C. Murphy for enthusiastically and energetically securing much of the material on which the paper is based.



JUDICIAL RESPONSES TO THE RECENT ENFORCEMENT ACTIVITIES OF THE FEDERAL BANKING REGULATORS *

LAWRENCE G. BAXTER **

INTRODUCTION

WHO among us would want to be the author of a treatise on international relations, publication date January 1989? Perhaps worse, who would like to be the author of such a treatise, publication date July 31, 1990? Like the Defenestration of Prague on Ascension Day, May 23, 1618,¹ irritable—even tragi-comical—events were only dimly perceived as portending the avalanche of change during the past two years. So too, the disputes between Don Regan and Ed Gray,² the delay by Speaker Jim Wright of the passage of the first of the bailout measures in 1987,³ and the skirmishes between the banking agencies and the banking industry

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1. See G. Parker, *Europe in Crisis: 1598-1648*, 13 (1979).

2. See, e.g., M. Mayer, *The Greatest-Ever Bank Robbery: The Collapse of the Savings and Loan Industry* 133-39, 157-58 (1990) [hereinafter Mayer, *Bank Robbery*] (describing the disputes between the White House Chief of Staff and the Chairman of the Federal Home Loan Bank Board (FHLBB) over the latter's efforts to restrict the use by S&Ls of brokered deposits and direct investments, the former's opposition to the "reregulation" of the S&L industry, and Regan's efforts to have Gray replaced as chairman of the FHLBB); J. R. Adams, *The Big Fix: Inside the S&L Scandal* 235-37 (1990) [hereinafter Adams, *Big Fix*] (Gray's clashes with Regan); S. Pizzo, M. Fricker & P. Muolo, *Inside Job: The Looting of America's Savings and Loans* 177-84 (1989) [hereinafter Pizzo *et al.*, *Inside Job*] (similar). *But cf.* L. J. White, *The S&L Debacle: Public Policy Lessons for bank and Thrift Regulation* 126-28 (1991) [hereinafter White, *Debacle*] (explaining why the FHLBB's efforts to restrict brokered deposits was "misguided").

3. See House Comm. on Standards of Official Conduct, Rep. of the Special Outside Counsel in the Matter of Speaker James C. Wright, Jr., 101st Cong., 209-13 (1989). See generally, e.g., Mayer, *Bank Robbery*, *supra* note 2, 230-33; Pizzo, *et al.*, *Inside Job*, *supra* note 2, 212-18; Adams, *Big Fix*, *supra* note 2, ch. 12.

over the scope of the agencies' enforcement powers⁴ hardly alerted the nation to the crisis that was soon to break in the savings and loan and banking industries.

Yet, as we now know, all these events were symptoms of malaises that had surreptitiously corrupted the entire systems in which they took place. They were the signals of collapse, of the imminent demise of old orders and emergence of new ones. It is always difficult in the midst of such changes to identify from whence we have come and discern whither we are going. In the case of the S&L and banking crises, however, patterns are beginning to emerge.

In this paper I will examine the changing roles of the courts and the agencies in the enforcement of federal banking legislation in the wake of the Savings and Loan Crisis. These changing roles are reflections of the fundamental transformations that are occurring both within the financial services industry and in the broader political and regulatory environments. I will seek to demonstrate that, contrary to long-standing assumptions, parties challenging banking agency enforcement action on judicial review are frequently successful, and that it is quite possible that the courts will become even more active in striking down or modifying enforcement activities.

Two explanations will be offered for why judicial activism will continue and may even increase. First, the enforcement agencies are afflicted with conflicting missions concerning the maintenance of depository institution safety and soundness and the cleanout of the thrift and banking industries. This multi-faceted effort appears to be generating a substantial volume of litigation which, in turn, has led to a surprising degree of judicial intervention against the banking agencies. Second, the unprecedented exposure of taxpayers to the risk of depository institution failure is forcing the banking agencies to adopt a vigorous, formalistic, and unduly punitive approach to banking supervision. A regulatory model (which I call the "entrepreneurial state") has evolved, in which the agencies are, I will argue, obliged to engage in the secondary management of depository institutions by means of coercive enforcement techniques that seem sometimes inappropriate to the task. This is an approach that could be at least partly ineffective and possibly even counterproductive.

In conclusion, three lines of inquiry are proposed. First, the conflict of missions already referred to suggests a need for a greater degree of separation between the agencies that engage in general banking supervision and those that are charged with cleaning out the deadwood in the industry. Second, a clearer distinction should be drawn between the forms of enforcement action that are designed to exact retribution, reimbursement and compensation, and those that are designed primarily to prevent fur-

4. See *Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986); *Stoddard v. Board of Governors of the Federal Reserve System*, 868 F.2d 1308 (D.C. Cir. 1989); see also *infra* text accompanying notes 23-91.

ther deterioration in the institutions concerned. An acknowledgment of this distinction leads to the third and final inquiry, namely whether there should be instituted a greater degree of procedural and/or structural separation between the agency "prosecutors" (those initiating and prosecuting punitive enforcement actions) and the banking "supervisors" (those who require enforcement powers in order to prevent the failure of institutions).

I. THE TRANSFORMATION OF THE REGULATORY ENVIRONMENT

A. *The Old World Order*

The world of community banking, rendered secure for the nation by 'Old Hickory' Jackson in 1832 when he vetoed the extension of the charter of the Second Bank of the United States,⁵ and particularly the world of buildings associations and savings and loans, long functioned under the gentlest glow of public scrutiny. The traditional image of the local savings and loan association has been one of an institution intimately concerned with the savings and housing welfare of the neighborhood. As reporters of the S&L Crisis are wont to observe, this image was well captured (perhaps it is more accurate to say, nurtured) by Frank Capra's nostalgic 1946 movie, *It's a Wonderful Life*, in which the hero (played by James Stewart) refuses to capitulate to the predations of the local banking competitor and, at the brink of catastrophe, is saved by the support of a grateful and loyal community.

Of course, as the movie itself illustrates, there are good bankers and bad bankers, but the banking and thrift industries enjoyed, in 1946 and for another three to four decades, an almost unrivalled reputation for integrity, public-spiritedness and cooperative disposition toward federal and state regulators. Yet this did not mean that the industry was not heavily regulated: on the contrary, it has been, as the Supreme Court put it in 1947, "one of the longest regulated and most closely supervised of public callings."⁶ The banking agencies had promulgated regulations governing the powers of the industry "from its cradle to its corporate grave,"⁷ and the regulators have long been "equipped with a formidable array of sanctions."⁸

Partly because of this regulatory intensity⁹—this paternalistic ap-

5. See *Clarke v. Securities Indus. Ass'n*, 479 U.S. 388, 413 (1987) (Stevens, J., concurring, quoting the homily paid to President Andrew Jackson by Sen. Reed, during Congressional debate in 1925, for exercising his veto).

6. *Fahey v. Mallonee*, 332 U.S. 245, 250 (1947).

7. *People v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311, 316 (S.D. Cal. 1951); see also *Fidelity Fed. Sav. & Loan Ass'n v. De la Cuesta*, 458 U.S. 141, 145 (1982) (quoting *Coast Federal*).

8. *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321, 329 (1963).

9. "Partly" because there were surely many other contributing factors, such as the relative simplicity and narrow scope of the financial services industry, lack of competition from other quarters, and a shared creed among bankers and regulators, that contributed to its stability and cooperative disposition. See generally Department of the Treasury,

proach to banking regulation—the banking industry as a whole represented perhaps the last vestige of the “associational” ideal of the Hoover era.¹⁰ The prestigious and scholarly studies by the Attorney General’s Committee of the federal banking agencies¹¹ emphasized the need to treat the banking agencies differently from other federal agencies: the guarantees to members of the industry against arbitrariness and indiscriminate punishment at the hands of the agencies came not from procedural formalities but from the very nature of the agencies’ supervision¹² involving, as it did then (and still does), a close and continuous relationship between the regulators and the regulated, such that the resort to formal enforcement procedure was an exceedingly rare event.¹³ Speaking in reference to the enforcement powers of the Comptroller and the Federal Deposit Insurance Corporation (“FDIC”), the Committee concluded that

The paradox in the situation is that the sanctions are so compelling that the authorities almost never use them. Because the banks are so important in an industrial-commercial economy, compulsive steps which might shake confidence are withheld. Although there is in fact an iron hand within the velvet glove of the banking authorities, the glove is seldom removed.¹⁴

A decade or so later the efficacy of this system of paternalistic, associational regulation was celebrated by one of the Committee’s researchers (by then one of the foremost authorities on federal administrative law), Kenneth Culp Davis, as “superior in its efficiency” and “one of the most successful” systems of regulation then extant in federal governance.¹⁵ As

Modernizing The Financial System: Recommendations for Safer, More Competitive Banks I-25-27 (1991)[hereinafter “Modernizing the Financial System”](tracing changes in the financial marketplace as a contributory factor in increasing the instability of the banking industry); White, *Debauché*, *supra* note 2, 58-61 (describing the conditions in which thrifts operated during the postwar years of prosperity).

10. See T. McCraw, *Prophets of Regulation* ch. 4 (1984); Rabin, *Federal Regulation in Historical Perspective*, 38 *Stan. L. Rev.* 1189, 1236-42 (1986).

11. See *Administrative Procedure in Government Agencies*, Monograph of the Attorney General’s Comm. on Admin. Procedure, part 9, Federal Reserve System; *id.* part 13, Federal Control of Banking: Comptroller of the Currency and Federal Deposit Insurance Corporation, S. Doc. No. 186, 76th Cong., 3d Sess. (1940)[hereinafter *Monograph*].

12. See *Monograph*, *supra* note 11, part 9, at 32; see also *id.* part 13, at 42-43.

13.

The marked informality of the [Federal Reserve] Board’s procedure is readily explicable. So complete have been the pre-hearing conferences and examinations, and so reluctant has the Board been to proceed, that the hearing and the ultimate decision is and can be little more than a formal gesture superimposed upon what everyone, including the respondents, concede is a fait accompli. . . . The respondent’s attitude is significantly reflected in his unconcern as to whether he is to be heard before the Board, as he may elect, or before a subordinate, and by his failure to exercise the granted right of arguing before or submitting briefs to the Board.

Monograph, *supra* note 11, part 9, at 31.

14. *Id.* part 13, at 18.

15. 1 K.C. Davis, *Administrative Law Treatise*, § 4.04, 247-48 (1958).

Professor Davis observed,

[t]he striking fact is that whereas the nonbanking agencies administer their systems of requiring licenses and approvals by conducting formal adjudications in most cases involving controversies, the banking agencies use methods of informal supervision, almost always without formal adjudication, even for the determination of controversies. The contrast is a striking one with respect to each parallel problem; for instance, the problem of the extent of community need is about the same whether the application is for establishment of a bank, a television station, or an airline, and yet the problem is handled in the banking field by the methods of the businessman and in the other fields by the methods of the judge in his courtroom.¹⁶

Hence, as the Court noted in the *Philadelphia National Bank* case in 1962, "recommendations by the agencies concerning banking practices tend to be followed by bankers without the necessity of formal compliance proceedings."¹⁷ "To the efficacy of this system," Justice Brennan went on to remark, "we may owe, in part, the virtual disappearance of bank failures."¹⁸

Professor Davis was referring more directly to the chartering powers of the banking agencies than to their ensuing enforcement powers, but, as the observations of the Attorney General's Committee indicate, his comments seem to have been equally applicable to the latter. Because formal enforcement action was so rarely taken, litigation between the banking agencies and members of the industry appears largely to have been confined to entry and expansion disputes concerning matters like chartering, branching and product offerings. When enforcement actions were challenged, the courts accorded the agencies a degree of deference commensurate with the high standing of the agencies, the highly autonomous nature of banking regulation itself, and the relatively low level of pain inflicted by the enforcement sanctions.¹⁹ Even where there was no explicit statutory authority for the agency pressure, the courts remained tolerant. In 1958, for example, a panel of the Fifth Circuit rejected a complaint that the Federal Home Loan Bank Board ("FHLBB") had placed improper pressure on the directors of an S&L to resign, observing that "[w]hen a governmental agency holds such great powers over its offspring, even to the point of appointing a conservator or receiver to replace the management . . ., it is difficult to hold that an informal request, even demand, to clean house would amount to an abuse of the

16. *Id.* Professor Davis subsequently modified his views. See Davis, *Administrative Procedure in the Regulation of Banking*, 31 *Law & Contemp. Probs.* 713 (1966). Perhaps sensing the portents of things to come, the discussion of banking supervision was dropped from the second edition of his treatise in 1978.

17. *Philadelphia Nat'l Bank*, 374 U.S. at 330.

18. *Id.*

19. The development of a variety of graduated sanctions really only began in 1966, and even then these sanctions were quite mild by comparison with those now available to the banking agencies. See *infra*, text accompanying notes 59-64.

statutory powers and discretion of the agency."²⁰ It was possible for a banking lawyer to observe as recently as 1988 that "the traditional posture of reviewing courts" and the "traditional result in enforcement cases," when a banking agency is challenged in court, is that "the agency wins."²¹ The courts continue to incant, whenever a banking agency's enforcement action is challenged, that the agency is entitled to extreme deference on judicial review.²²

B. Transformation of the Regulatory Landscape

In little more than a decade the environment of banking regulation has completely changed. When it was a "wonderful life," the regulators possessed "life and death" powers that, precisely because they were so severe, never had to be exercised.²³ The Fed could seek cancellation of the rights and privileges of membership, thereby effectively terminating the existence of a national bank,²⁴ and could expel a member bank from membership of the Federal Reserve System.²⁵ The Fed and the Comptroller could, in limited circumstances, remove directors and officers of national and state member banks.²⁶ The Comptroller could revoke the charters of national banks,²⁷ and both the Comptroller and the FHLBB could seize national banks and federal S&Ls, respectively, and place them in receivership;²⁸ the FHLBB could terminate the membership of thrifts in the Home Loan Bank System;²⁹ and the FDIC and the Federal Savings and Loan Insurance Corporation ("FSLIC") could terminate federal deposit insurance.³⁰

20. *Miami Beach Fed. Sav. & Loan Ass'n v. Callander*, 256 F.2d 410, 414-15 (5th Cir. 1958) (quoted recently by Justice White in *United States v. Gaubert*, 111 S. Ct. 1267, 1279 (1991)). The court in *Miami Beach* acknowledged that the threat of serious sanctions was, "[r]ealistically, . . . the only pressure a representative of the Board could exert," and that the directors could have refused to comply with the alleged demands. *Miami Beach*, 256 F.2d at 415.

21. Huber, *Enforcement Powers of Federal Banking Agencies*, 7 Ann. Rev. Banking L. 123, 168 (1988).

22. See *infra* text accompanying notes 93-99. A similar attitude of deference prevailed even with regard to chartering and branching decisions, at least until 1965. See Scott, *In Quest of Reason: The Licensing Decisions of the Federal Banking Agencies*, 42 U. Chi. L. Rev. 235, 244-49 (1975).

23. For a comprehensive review of the early enforcement powers of the banking agencies, see generally Huber, *supra* note 21; M. A. Cobb, *Federal Regulation of Depository Institutions: Enforcement Powers and Procedures* (1984 & 1989 Cum. Supp. 1989) [hereinafter Cobb, *Enforcement Powers*, and Cobb, *Supplement*]. See also R. Serino, *The Intermediate Administrative Remedies of the Comptroller of the Currency* (Rutgers Univ. thesis 1975).

24. See 12 U.S.C. § 501a (1988).

25. See 12 U.S.C. § 327 (1988).

26. See 12 U.S.C. § 77 (repealed 1966).

27. See 12 U.S.C. § 93 (1988).

28. See, e.g., 12 U.S.C. §§ 191, 192, 1821(c) (1988)(Comptroller); 12 U.S.C. § 1464(d)(2) (1988) (FHLBB).

29. See 12 U.S.C. § 1426(i) (1988).

30. See, e.g., 12 U.S.C. § 1818(a) (1988)(FDIC); 12 U.S.C. § 1730(b) (1988)(FSLIC).

But as the industry grew more diverse and the degree of voluntary compliance began to recede, it became evident that these sanctions were too crude, too blunt, and too slow for efficient regulation; the regulators needed more refined instruments.³¹ In 1966 Congress first responded by granting the agencies temporary and permanent cease-and-desist powers, and modified suspension, removal and prohibition powers.³² Even then, however, an assumption persisted that these powers would only be necessary in the event of a worst-case scenario, and that the role of the federal regulators in the exercise of their enforcement powers against state-chartered institutions was to be properly confined according to the division of powers between state and federal government: "The purpose of the [federal] enforcement provisions" was "to quickly stop fraudulent practices, not to affirmatively recover for them."³³ The power of recovery had been allocated (appropriately, it was assumed) to the relevant state authorities.³⁴

The need for even more differentiated enforcement powers persisted, however, and in 1978 Congress further augmented the existing array of sanctions possessed by the banking agencies. Congress also granted them the power, then becoming increasingly common among federal agencies,³⁵ to impose modest civil money penalties upon industry recalcitrants.³⁶ Even so, this more complex array of sanctions remained relatively dormant during the Seventies, as the banking agencies continued to rely primarily upon informality, negotiation and moral suasion in order to secure regulatory compliance.

Then came a series of developments, the combined effects of which, given the prevailing economic context, led to disastrous results.³⁷ Among these was the general move toward banking "deregulation," a program that took many forms from the reduction in product, market and interest-rate restrictions³⁸ to the provision of substantial degrees of

31. See, e.g., Huber, *supra* note 21, at 130-31.

32. Financial Institutions Supervisory Act, Pub. L. No. 89-695, 80 Stat. 1028 (1966).

33. *Federal Sav. and Loan Ins. Corp. v. Fielding*, 309 F. Supp. 1146, 1149 (D. Nev. 1969). The court recognized the power of FSLIC to sue under assignment of rights, but not independently, for recovery with respect to injuries suffered by an insured association as result of fraud. See *id.*

34. *Id.* See also 1966 U.S. Code Cong. & Admin. News 3532, 3538, 3547.

35. See Diver, *The Assessment and Mitigation of Civil Money Penalties by the Federal Administrative Agencies*, 79 Colum. L. Rev. 1435 (1979); Goldschmidt, *An Evaluation of the Present and Potential Use of Civil Money Penalties as a Sanction by Federal Administrative Agencies*, 2 Rec. & Rep. Admin. Conference U.S. 896.

36. See Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641 [hereinafter Interest Rate Control Act]. The agencies were limited to the imposition of a maximum amount of \$1,000 per day. See *id.*

37. See generally White, Debacle, *supra* note 2, chs. 4-7; Symposium, *Savings & Loan Crisis: Lessons and Look Ahead*, 2 Stan. L. & Pol. Rev. 12-158 (1990).

38. See Interest Rate Control Act, *supra* note 36, (partially increasing the ceiling on federal deposit insurance); the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 [hereinafter DIDMCA] (mandating the phasing out of Regulation Q governing interest rates, generally increasing federal deposit

regulatory supervisory relief, partly because of efforts to reduce agency staff and costs,³⁹ and partly in response to the cry for "forbearance." Forbearance was the concept punted by the S&L industry and sympathetic politicians in order to prevent thrifts, which the industry believed were merely suffering from the effects of temporary adverse economic conditions, from being seized by the FHLBB.⁴⁰ Another development—which reduced market discipline at the very time when deregulation presupposed the operation of market forces—was the substantial increase in the coverage of federal deposit insurance or, in other words, the expansion of the federal safety net.⁴¹ The overall cohesion and internal discipline of the industry eroded rapidly, and the agencies found themselves increasingly having to rely upon their formal enforcement powers to secure industry compliance both with federal laws and regulations and with ever-broadening concepts of safety and soundness.⁴²

As S&Ls and banks started to fail at alarming rates, the congressional committees began to react, and the reaction took a form that has become all-too-familiar in recent years: the agencies were excoriated for lax enforcement.⁴³ The perception that lax enforcement has been at least partly to blame for the S&L crisis continued to intensify during the latter half of the 1980s,⁴⁴ with the agencies themselves rapidly revising in an

insurance from \$40,000 to \$100,000, and permitting banks and S&Ls to offer negotiable order of withdrawal (NOW) accounts); Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 [hereinafter Garn-St. Germain] (permitting S&Ls to offer money market accounts, engage in agricultural and commercial lending, accept demand deposits from individuals and commercial corporations, make increased amounts of consumer loans; increasing the amounts of loans that depository institutions could make to one borrower).

39. See, e.g., Report of the House Committee on Banking, Finance and Urban Affairs, Financial Institutions Reform, Recovery and Enforcement Act of 1989, H.R. Rep. No. 101-54, pt. 1, 101st Cong., 1st Sess. 297 (1989) (describing the difficulties in federal hiring, competition to deregulate at state level, and the huge reduction in California of supervisory and enforcement staff); see also White, *Debate*, *supra* note 2, 88-91 (documenting the dramatic reduction in FHLBB's field force regulatory scrutiny during the early 1980s); Markey, *Congress to Administrative Agencies: Creator, Overseer, and Partner*, 1990 Duke L.J. 967, 976-77 (describing the refusal by the Office of Management and Budget to cooperate with the efforts of FHLBB chairman Edwin Gray to increase or even prevent the reduction of the FSLIC's examination staff).

40. On the forbearance programs developed by the FHLBB and partly authorized by Congress in the Garn-St Germain and Competitive Equality Banking Acts, see E. Kane, *The S&L Insurance Mess: How Did it Happen?* 51-57 (1989); *Modernizing the Financial System*, *supra* note 9, at 1-20, 37-38; Mayer, *Bank Robbery*, *supra* note 2, at 156; White, *Debate*, *supra* note 2, 139-42.

41. See *supra* note 38.

42. See, e.g., Cobb, Supplement, *supra* note 23, S3-3-S3-4 (describing trends in enforcement during the 1980s).

43. See Comm. on Government Operations Fifty-seventh Report, *Federal Response to Criminal Misconduct and Insider Abuse in the Nation's Financial Institutions*, H. Rep. No. 98-1137, 98th Cong., 2d Sess. (1984).

44. See Comm. on Government Operations Seventy-second Report, *Combating Fraud, Abuse, and Misconduct in the Nation's Financial Institutions: Current Federal Efforts are Inadequate*, H. Rep. 100-1088, 100th Cong., 2d Sess. (1988); General Accounting Office, *Troubled Thrifts: Bank Board Use of Enforcement Actions*, GAO/

upwards direction their estimates of the proportion of "insider abuse,"⁴⁵ thereby helping to sharpen the focus of regulatory reform in large measure upon the need for a dramatic enhancement of agency enforcement powers.⁴⁶ The United States Attorney General added his own endorsement to this diagnosis and prognosis.⁴⁷

By the time of the passage of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"),⁴⁸ legislators were satisfied that an important factor contributing to the failure to prevent the epidemic of thrift and bank failures was the inadequate enforcement powers (and enforcement efforts) of the Federal regulators.⁴⁹ More than convinced of the need for a massive increase in the range and scale of the enforcement powers possessed not only by the banking agencies but also by the Attorney General, Congress swept aside objections by industry

GGD-89-68BR (1989); Troubled Thrifts: Use of Supervisory Enforcement Actions, GAO/GGD-89-105BR (1989). Cf. N. Strunk & F. Case, *Where Deregulation Went Wrong: A Look at the Causes Behind Savings and Loan Failures in the 1980s*, ch. 10 (1988).

45. A term that is used indiscriminately to cover all forms of misdeed, from serious errors of judgment and regulatory violations to outright fraud and other criminality.

The term "fraud" is bandied about as if the entire thrift industry were pervaded by fraudulent activity. This has no doubt spurred the nearly-hysterical reaction in Congress, but it is a gross exaggeration. See J.R. Barth, *The Great Savings and Loan Debacle* 44 (1991); cf. White, *Debacle*, *supra* note 2, at 117 ("The bulk of the insolvent thrifts' problems . . . did not stem from such fraudulent criminal activities [as those described in popular accounts of the crisis]. These thrifts largely failed because of an amalgam of deliberately high-risk strategies, poor business judgments, foolish strategies, excessive optimism, and sloppy and careless underwriting, compounded by deteriorating real estate markets") (emphasis in original). But cf. Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 *Notre Dame L. Rev.* 222, 225-28 (1989).

46. See *Hearings on H.R. 1278 Before the Criminal Justice Subcomm. of the House Judiciary Comm.*, 101st Cong., 1st Sess. (1989) (statement of Rosemary Stewart, then Director of Enforcement, FHLBB) (52 *Banking Rep. (BNA)* 734 (1989)). As Ms. Stewart noted elsewhere, the regulators, and particularly the FHLBB, had been trying to secure enhanced enforcement powers for some time. See *FHLBB, Justice Dept. Lawyers Outline S&L Bill Criminal Provisions at D.C. Meeting*, 52 *Banking Rep. (BNA)* 1150 (1989). A number of enforcement bills had been introduced in Congress.

47. See *Fraud in the Savings and Loan Association Area: Hearings on S. 413 Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 1st Sess. (1989) (statement of Dick Thornburgh, United States Attorney General); see also *Fraud in America's Depository Institutions: Hearings Before the Senate Comm. on Banking, Housing, and Urban Affairs*, 101st Cong., 2d Sess., 55 S.H.R.G. 1130 (1990) (statements of Richard L. Fogel, Ass't Comptroller General, and Benton E. Cup, Chairman of Banking, University of Alabama) (offering assessments of role of fraud in depository institutions); *Include \$50 Million in S&L Reform Bill, Att'y General Thornburgh Urges Congress*, 53 *Banking Rep. (BNA)* 44 (1989); *Hearings on H.R. 1278 Before the Subcomm. on Criminal Justice of the House Comm. on the Judiciary*, 101st Cong., 1st Sess. (1989) (statement of Joe Whitley, United States Assistant Attorney General).

48. Pub. L. No. 101-73, 103 Stat. 183 (1989) [hereinafter FIRREA].

49. See Report of the House Comm. on Banking, Finance and Urban Affairs, *Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, H.R. Rep. No. 101-54, Pt. 1, 101st Cong., 1st Sess. 464-65 (1989); Report of the Senate Comm. on Banking, Housing, and Urban Affairs, *Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, S. Rep. No. 101-19, 101st Cong., 1st Sess. 8-10 (1989).

representatives⁵⁰ and conferred upon the federal banking regulators the most extensive array of administrative sanctions ever possessed by American administrative agencies.⁵¹

Among the most important enforcement enhancements initiated by FIRREA are the following. FIRREA introduced the generic concept of an "institution-affiliated party" to cover persons such as directors, officers, employees, agents and "other persons participating in the affairs" of an institution.⁵² This has greatly extended the potential subjects of enforcement action, who now expressly include attorneys, appraisers and accountants.⁵³ Cease-and-desist authority was expanded to include expressly the power of banking agencies to order restitution or reimbursement, indemnification, guaranty against loss, as well as to order affirmative corrective action.⁵⁴ It has also been made easier for agencies to issue temporary cease-and-desist orders.⁵⁵ Removal, suspension and prohibition orders are also now easier to obtain⁵⁶ and, perhaps more importantly, removal and prohibition orders can be made on an industry-wide basis.⁵⁷ Such orders can now also be made against institution-affiliated parties who have already resigned, been terminated or have relin-

50. Members and representatives of the banking industry protested that the enhanced enforcement powers under FIRREA would be so severe as to deter able persons from accepting positions in banking institutions and to discourage cooperative negotiation between the industry and regulators, thus doing the industry more harm than good. See, e.g., *Hearings on H.R. 1278 Before the Subcomm. on Criminal Justice of the House Judiciary Comm.*, 101st Cong., 1st Sess. (1989) (statements of Edward Yingling, Executive Director of Government Relations for the American Bankers' Association, and John Villa, banking attorney); see also *FHLBB, Justice Dept. Lawyers Outline S&L Bill Criminal Provisions at D.C. Meeting*, 52 *Banking Rep.* (BNA) 1150 (1989). The then FDIC General Counsel, John Douglas, publicly acknowledged this danger. See *S&L Bill's Enforcement Provisions Could Hinder Negotiations, FDIC Attorney Says*, 52 *Banking Rep.* (BNA) 1060 (1989).

51. See FIRREA, Title IX. For a thorough analysis, see generally Malloy, *Nothing to Fear But FIRREA Itself*, 50 *Ohio St. L.J.* 1117 (1989); see also M. Malloy, *The Corporate Law of Banks* 101-33, § 3.2.6b (1990 Cum. Supp.) [hereinafter Malloy, 1990 Supp.]; McSpadden & Byrne, *FIRREA Expands Civil Enforcement Powers of Regulators, Increases Penalties Allowed*, 53 *Banking Rep.* (BNA) 427 (1989); Villa, *Reform Act Builds Regulators' Arsenal*, *Am. Banker*, Oct. 11, 1989 at 5-6, col. 1.

52. FIRREA, §§ 204(f)(6)(u), 901(a)(r), 103 Stat. at 193, 446 (to be codified at 12 U.S.C. §§ 1813(u), 1786(r)).

53. See, e.g., 12 U.S.C. § 1813(u)(4). For an analysis, see Kawasaki, *Liability of Attorneys, Accountants, Appraisers, and Other Independent Contractors Under the Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 42 *Hastings L.J.* 249 (1990); see also *infra* text accompanying notes 165-67.

54. See FIRREA, §§ 902(a)(1)(C), 902(b)(1), 103 Stat. at 450, 451 (to be codified at 12 U.S.C. § 1818(b)).

55. *Id.* §§ 902(a)(2)(A), 902(b)(2)(B), 103 Stat. at 451, 452 (to be codified at 12 U.S.C. § 1818(b)).

56. See *id.* §§ 903(a)(1), 903(b)(1), 103 Stat. at 453, 455 (to be codified at 12 U.S.C. § 1818(e)(1)). FIRREA no longer requires "substantial" financial loss or "serious prejudice" to be shown. See *id.*

57. See *id.* §§ 903(a)(3), (b)(3), 904(a), 904(b), 103 Stat. at 453, 455, 457, 458 (to be codified at 12 U.S.C. § 1818(e)).

quished their relationship with the depository institution.⁵⁸

Most significant of all, the occasions for, and amounts of, civil money penalties that can be imposed by both the agencies and the courts on institutions and institution-affiliated parties have been dramatically increased. There are numerous FIRREA provisions governing civil penalties: in the case of *agency* (as opposed to judicial⁵⁹) enforcement proceedings, three tiers of penalties have been created. The first tier consists of a maximum penalty of \$5,000 per day for violations of laws, regulations, written conditions and agreements.⁶⁰ The second tier prescribes a maximum penalty of \$25,000 per day in the case of reckless engagement in unsafe or unsound practices, or breaches of fiduciary duties, and where the violation is part of a pattern of misconduct that causes more than minimal loss to the institution, or gain to the party.⁶¹ The third tier imposes as much as \$1 million per day liability where the institution or party knowingly or recklessly causes substantial loss or gain through the violation.⁶² For the first time, final enforcement orders and modifications of all such orders were required to be published.⁶³

To prove that Congress was serious, the relevant legislative provisions were accompanied by exhortations from Congress to deploy these new powers to the maximum extent feasible: speaking in reference to the civil money penalty powers conferred by FIRREA, the Conferees urged that they be used without hesitation:

By greatly expanding the scope of misconduct covered by the civil penalty provisions and by making substantial increases to the penalty amounts, the Conferees intend for the Federal banking agencies to aggressively utilize this new authority, whenever it is justified in law and by the facts.⁶⁴

Nor were the enhanced sanctions contained in Title IX of FIRREA the only aspects of enforcement that Congress addressed. Another factor that had been identified as aggravating the S&L Crisis was the failure of the regulators to seize institutions before they became so hopelessly insolvent that their insured deposits were too expensive for the federal insurance funds to cover. "Forbearance"⁶⁵ was identified as a source of the problem, and the need for "early intervention" was (and continues to be)

58. See FIRREA, §§ 905(a), 905(b), 103 Stat. at 459, 460 (to be codified at 12 U.S.C. § 1818(i)); *infra* note 165. Similar amendments were effected in various related banking statutes. See Malloy, *Nothing to Fear But FIRREA Itself*, 50 Ohio St. L.J. 1117, 1151 n.326 (1989).

59. FIRREA § 951 prescribes judicially-imposed civil penalties of as much as \$5 million for certain violations of provisions in Title 18 of the U.S. Code.

60. See FIRREA, § 907(a), 103 Stat. at 462 (to be codified at 12 U.S.C. § 1818(g)(1)).

61. See *id.*

62. See *id.*

63. See *id.* § 913, 103 Stat. at 483.

64. See, e.g., Conference Report to Accompany H.R. 1278, Financial Institutions Reform, Recovery, and Enforcement Act of 1989, H.R. Rep. No. 101-222, 101st Cong., 1st Sess. 440 (1989).

65. See *supra* note 40.

prescribed as a cure.⁶⁶ To this end, Congress greatly facilitated the early seizure of depository institutions by the federal regulators through a variety of mechanisms, some direct and others more indirect.

One direct mechanism was an enlargement of the conditions under which a federal or state financial institution could be seized by the federal regulators and placed in conservatorship or receivership.⁶⁷ Simultaneously, indirect mechanisms increased the likelihood that the conditions for seizure would exist. Perhaps most important was the enhancement of capital standards as a focus of safety and soundness,⁶⁸ such that institutions that could not comply with the new and more intense capital requirements imposed by FIRREA or the agencies would be in greater danger of being judged to be unsafe and unsound and would therefore be more exposed to enforcement action (including seizure). The agencies added their own indirect mechanisms. For example, the Fed, with possible tacit endorsement by Congress,⁶⁹ attempted to expand the application

66. See, e.g., Report of the House Comm. on Banking, Finance and Urban Affairs, *supra* note 49, at 298 (identifying "regulatory and statutory accounting gimmicks," which facilitated the program of forbearance, as a source of the S&L crisis). Early intervention and prompt corrective action on the part of regulators continues to animate some of the most significant proposals for banking reform currently on the legislative agenda. See *Modernizing the Financial System*, *supra* note 9, 41 (the basis for the Treasury Department's bill, Financial Institutions Safety and Consumer Choice Act of 1991, H.R. 1505, which contains Subtitle E and is devoted to Prompt Corrective Action enforcement provisions); S. 543 (Riegle Bill requiring prompt corrective action by regulators, and strongly supported in recent congressional testimony by outside experts); H.R. 6 (House Banking Committee's bill requiring same); see also General Accounting Office, *Deposit Insurance: A Strategy for Reform* (GAO/GGD-91-26 1991) Ch. 3 (recommending earlier and more forceful intervention by regulators) [hereinafter "Strategy for Reform"]; *Three Banking Experts Strongly Support Prompt Action Provisions in Reigle Bill*, 56 *Banking Rep.* (BNA) 503, 505 (1991); Bacon, *Bruised by the S&L Fiasco, Lawmakers Now Try to Show they are Born Again Bank Guardians*, *Wall St. J.*, Mar. 19, 1991, at A26, col. 1.

67. See, e.g., FIRREA, § 204(x), 103 Stat. at 193-94 (to be codified at 12 U.S.C. § 1813)(definitions of default); *id.* § 212(a), 103 Stat. at 222-24 (to be codified at 12 U.S.C. § 1821) (amending Federal Deposit Insurance Act § 11(c)(4)&(5) concerning the grounds upon which the FDIC can appoint itself as conservator or receiver of a federally insured state depository institution); *id.* § 301, 103 Stat. at 282 (to be codified at 12 U.S.C. § 1464) (amending Home Owners' Loan Act § 5(d)(2) concerning the grounds for which the Director of OTS can appoint a conservator or receiver for a federal savings association); *id.* § 802, 103 Stat. at 442 (amending § 203(a) of the Bank Conservation Act concerning the grounds of appointment, by the Comptroller, of the FDIC as conservator of a national bank).

68. See *id.* § 301, 103 Stat. at 282 (to be codified at 12 U.S.C. § 1464) (adding new §§ 5(s) and 5(t) to the Home Owners' Loan Act, imposing minimum capital standards for savings associations, providing for the development and enforcement of these standards by the Director of OTS, and stipulating that the standards should be at least equal to those imposed on commercial banks).

69. In FIRREA, Congress imposed liability on "commonly-controlled depository institutions" for losses incurred by the FDIC in connection with the default of, or assistance provided to, sister institutions, and granted the FDIC power to assess the amount of compensation to be paid. *Id.* § 206(a)(7)(e), 103 Stat. at 201 (to be codified at 12 U.S.C. § 1815(e)) (adding to the FDI Act § 5(e)). This imposition of cross-liability on affiliate institutions might perhaps be regarded as implicit recognition of the principle underlying

of its controversial "source of strength" doctrine.⁷⁰ The doctrine was first upheld by the Supreme Court as a legitimate requirement for new bank holding companies.⁷¹ The "source of strength" doctrine has been used by the Fed in its attempt to impose upon bank holding companies the continuing requirement that they provide financial support for their ailing bank subsidiaries. Next Term the Supreme Court will resolve the question of whether this is a legitimate exercise of the Fed's regulatory powers;⁷² in the meantime, the doctrine has been deployed as a means of enhancing the regulators' combined powers over the banking conglomerates, providing a triggering mechanism for a chain of enforcement-related activity.⁷³

The 1989 reforms did not end the matter. Frustrated by the apparent ineffectiveness of the regulators' newly-enhanced enforcement powers when dealing with the more artful miscreants—so-called "S&L Kingpins"⁷⁴—Congress enacted the Crime Control Act,⁷⁵ which deals with, among other things, the administrative enforcement powers of the federal banking agencies. Title XXV of the Act is labeled the "Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990."⁷⁶ This legislation is primarily concerned with increasing the criminal penalties and disabilities attaching to financial-institution-related crimes and making provision for criminal and civil forfeiture; it does, however, augment significantly the administrative enforcement powers of the banking agencies as well.⁷⁷

In the case of a failing bank, thrift or credit union, the Crime Control Act permits the FDIC, conservators, the NCUAB and liquidating agents

the Fed's source of strength doctrine, although there is no indication in the legislative history.

70. 12 C.F.R. § 225.4(a)(1) (1990) (Regulation Y); *Policy Statement*, 52 Fed. Reg. 15707 (1987).

71. See *Board of Governors of the Fed. Reserve Sys. v. First Lincolnwood Corp.*, 439 U.S. 234 (1978).

72. See *MCorp Fin., Inc. v. Board of the Governors Fed. Res. Sys.*, 900 F.2d 852 (5th Cir. 1990), *cert. granted*, 111 S. Ct. 1101 (Mar. 4, 1991).

73. See *infra* text accompanying notes 113-17.

74. The "kingpin" rhetoric was embraced by Congress in the Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789 (to be codified at various sections of 18, 26 and 31 U.S.C.) [hereinafter Crime Control Act] which created a new financial crimes enterprise offense. See *id.* § 2510 ("Financial Crime Kingpin Statute")(to be codified at 18 U.S.C. § 225).

75. Crime Control Act, *supra* note 74.

76. Subtitle H of Title XXV stands independently as the "Financial Institutions Anti-Fraud Enforcement Act of 1990." For general preliminary analysis, see Buchman & Douglas, *The Comprehensive Thrift and Bank Fraud Prosecution and Taxpayer Recovery Act of 1990*, memorandum reprinted in Prentice Hall Law & Business, *Current Developments in Banking Litigation* 31 (1991) [hereinafter Current Developments]; Villa & Krasne, *A Preliminary Review of Banking Law Enforcement Provisions Contained in Title XXV of the Crime Control Act of 1990*, in Current Developments, *supra*, at 558.

77. For initial critical comment, see, e.g., Atkinson, *Bankers Worry About Effects of Crime Bill*, *Am. Banker*, Nov. 20, 1990, at 1; Glancz, Jordan & Metheson, *New Bank Fraud Law May Frighten Off the Competent*, *Am. Banker*, Jan. 29, 1991, at 4.

to apply to court for an order attaching the assets of any person designated by the respective agency, pending the resolution of the receivership or conservatorship.⁷⁸ The banking agencies are also empowered to seek prejudgment attachments to prevent the dissipation or removal of assets final resolution of any unresolved enforcement action involving money damages, restitution or civil money penalties.⁷⁹ The FDIC and NCUAB are given the power to prohibit or limit, by regulation or order, any golden parachute payment or indemnification agreement where the agency believes that: the beneficiary has engaged in fraud, a breach of trust or fiduciary duty; insider abuse has materially affected the depository institution or holding company, is substantially responsible for causing the institution's insolvency, or has violated various federal or state banking laws or regulations.⁸⁰ Banking agencies are now required to report their enforcement action publicly on a monthly basis, and are required to include consent agreements as well as final orders.⁸¹ The Resolution Trust Corporation ("RTC") also is required to maintain a special enforcement division to assist and advise the RTC "and other agencies" in "pursuing cases, civil claims, and administrative enforcement actions" under the RTC's jurisdiction.⁸²

It is likely that Congress, either through further legislation or by means of its oversight activities, will continue to mandate or encourage vigorous enforcement efforts. In its report to the Congress on the reform of the federal deposit insurance system, the General Accounting Office concluded that delays in the institution of formal enforcement proceedings have been partly responsible for the failure of some institutions that could have been saved,⁸³ and the report urges the adoption of legislation mandating earlier, more formal intervention by the agencies.⁸⁴ This report was followed up by another, based on a study of 72 troubled banks, in which it is demonstrated that earlier, vigorous enforcement action might well have saved some of the banks that failed.⁸⁵ The latter GAO report also strongly criticizes the Fed, FDIC, and the Office of the Comptroller of the Currency ("OCC") in particular, for having actually *reduced* the level of their enforcement activities during the period 1986-1989.⁸⁶

78. See Crime Control Act, *supra* note 74, § 2521(a), 104 Stat. at 4863 (to be codified at 12 U.S.C. §§ 1821(d), 1878(b)(2)).

79. See *id.* § 2521(c)(1), 104 Stat. at 4865 (to be codified at 12 U.S.C. § 1818(i)).

80. See *id.* § 2523, 104 Stat. at 4868 (to be codified at 12 U.S.C. §§ 1828(k), 1786(t)).

81. See *id.* § 2547, 104 Stat. at 4886 (to be codified at 12 U.S.C. §§ 1818(u), 1786(s)).

82. *Id.* § 2540, 104 Stat. at 4884 (to be codified at 12 U.S.C. § 1441a(b)(12)).

83. See GAO, Strategy for Reform, *supra* note 66.

84. See *id.* at ch. 3 (proposing the institution of a "tripwire" system, in terms of which graduated, and progressively more severe, enforcement responses on the part of the responsible supervising agency would be legislatively mandated according to the stages of a bank's deterioration).

85. See General Accounting Office, Bank Supervision: Prompt and Forceful Regulatory Actions Needed (GAO/GCD-91-69) [hereinafter "Bank Supervision"].

86. *Id.* at 33-45; see also H.R. 1505 (Treasury-sponsored bill containing numerous

The banking agencies seem to have got the message and have not hesitated to use their new powers. Enforcement activity has sharply increased, particularly at the OCC⁸⁷ and the Office of Thrift Supervision ("OTS");⁸⁸ the OTS issued a new capital directive immediately after the passage of FIRREA⁸⁹ and substantially reorganized and strengthened its enforcement operations;⁹⁰ the agencies have considerably increased the size of the penalties they have sought against institutions and institution-affiliated parties;⁹¹ under their expanded cease and desist powers, the

new enforcement provisions); S. 543, tit. II (Riegle bill); H.R. 6, tit. I (House Banking Committee Bill); *supra* note 66; *cf.* Comm. on Government Operations; *The U.S. Government's War Against Fraud, Abuse, and Misconduct in Financial Institutions: Winning Some Battles But Losing the War*, H. Rep. 101-982, 101st Cong., 2d Sess. (1990) (finding that serious misconduct continues to plague the industry, that the enforcement efforts by the Justice Department remain inadequate, and recommending, *inter alia*, that the banking agencies revise their procedures in order to ensure that "bad actors" are more effectively screened out of the industry (Title VIII)).

87. The Comptroller of the Currency has announced the following substantial increases in formal enforcement activities at the OCC:

OCC ENFORCEMENT ACTIONS AGAINST NATIONAL BANKS FOR 1989 AND 1990

| Type of Action | Total 1989 | Total 1990 |
|-----------------------|------------|------------|
| Cease & Desist Orders | 2 | 47 |
| Removals | 14 | 30 |
| Civil Money Penalties | 129 | 151 |
| Formal Agreements | 87 | 168 |

Source: B.A. Rehm, *Despite Errors, Clarke Says, Confirmation Not in Peril*, *Am. Banker*, June 11, 1991, at 1.

88. The following figures demonstrate the effect of FIRREA at the OTS:

OTS ENFORCEMENT ACTIONS AGAINST ALL THRIFT INSTITUTIONS FOR 1989 AND 1990

| Type of Action | Total 1989 | Total 1990 |
|--|------------|------------|
| Cease & Desist Orders | 34 | 63 |
| Removal, Prohibition & Suspension Orders | 47 | 78 |
| Civil Money Penalties | 0 | 26 |
| Formal Agreements | 267 | 347 |

Source: OTS Office of Congressional Relations & Communications

As the General Accounting Office found, the other agencies slightly reduced their formal enforcement activities during 1986-1989. *See* GAO, *Bank Supervision*, *supra* note 85, at 35. The response of the regulators, however, has been a defensive one, indicating that they will now take formal action whenever possible. *See, e.g., id.* Appendix III, at 70 (Comments from the OCC, stating that "OCC's 1990 report of enforcement actions . . . showed a total of 842 formal and informal enforcement actions initiated in a single year. . . . The GAO's report reflects that the OCC takes many more enforcement actions per regulated bank than either the FDIC or the Federal Reserve Board.")

89. Office of Thrift Supervision, *Capital Adequacy: Guidance on the Status of Capital and Accounting Forbearances and Capital Instruments Held by a Deposit Insurance Fund*, Thrift Bulletin No. 38-2 (Jan. 9, 1990) [hereinafter TB 38-2].

90. *See OTS Fills Key Enforcement Positions: Shifts Enforcement Personnel*, 56 *Banking Rep.* (BNA) 357 (Feb. 25, 1991).

91. OTS was seeking the payment of \$19.6 million by a former Texas thrift owner

agencies have begun to seek restitution and reimbursement for losses suffered by financial institutions;⁹² under the 1990 Act⁹³ they have successfully secured court orders freezing the assets of directors and officers pending agency enforcement proceedings;⁹⁴ and, in addition to their criminal referrals to the Justice Department, the FDIC and RTC have also pursued a number of large civil suits in the courts.⁹⁵ The enforcement environment has, in short, radically changed during the past decade.⁹⁶

II. RESPONSE OF THE COURTS

As already observed, the courts have tended in the past to display a

under a capital maintenance agreement signed by the former owner before his institution suffered severe losses. See Klinkerman, *Thrift Office, Enforcing Capital Pact, Seeks \$19.6 Million in Texas Case*, Am. Banker, Jan. 22, 1991, at 2. This report also cites former OTS director of enforcement, Rosemary Stewart, as knowing of "up to five similar proceedings."

92. See *id.*

93. See *supra* text accompanying note 74.

94. See, e.g., *N.J. District Court Freezes Assets*, 56 Banking Rep. (BNA) 528 (Mar. 18, 1991) (reporting that a New Jersey district court had placed restrictions on the assets of the former president and five officers of Ambase Corp., the holding company for Carteret Savings Bank of Morristown, New Jersey.); *OTS Files Charges Against Ambase Corp. Officers for Unsafe Thrift Practices*, 56 Banking Rep. (BNA) 367 (Feb. 25, 1991) (discussing underlying agency proceedings in Ambase case).

95. Perhaps the most publicized examples concern the suits filed against the law firm of Jones, Day, Reavis & Pogue. The most recent suit is *Resolution Trust Corp. v. Keating*, Case No. CIV-89-1509 PHX-RMB (MDL Docket No. 834) (D. Ariz. Apr. 4, 1991), in which the firm is being sued for \$50 million for having, inter alia, violated its fiduciary duties and for having concealed and failed to disclose unsafe and unsound practices at Lincoln Savings & Loan, "effectively prevent[ing] Lincoln from securing counsel to protect its own interests." *RTC Charges Jones Day with Assisting Lincoln S&L in Deceiving Regulators*, 56 Banking Rep. (BNA) 654 (Apr. 8, 1991) (also describing other RTC suits filed or in preparation). A suit filed earlier against Jones Day by the FDIC seeks \$150 million damages for the firm's alleged negligence and breaches of fiduciary duty in representing Texas thrifts. See, e.g., Duke & Marcus, *FDIC Sues Law Firm in Thrift Failures*, Wall St. J., Nov. 5, 1990, at B6, col. 5.

For some other recent cases, see *FDIC v. Mmahat*, 907 F.2d 546 (5th Cir. 1990), *cert. denied*, 111 S. Ct. 1387 (Mar. 25, 1991); *FSLIC v. Molinaro*, 889 F.2d 899 (9th Cir. 1989); *FDIC v. Dannen*, 747 F. Supp. 1357 (W.D. Mo. 1990); *FDIC v. Bernstein*, 1990 W.L. 198738 (E.D.N.Y. 1990); *FDIC v. Peterson (In re Peterson)*, 118 Bankr. 801 (Bkrcty D.N.M. 1990); see also RTC, *Office of Investigations Progress Report: September 30, 1990*, at 3, reprinted in *Current Developments, supra* note 76, at 7 (discussing RTC cases).

96. As a former chairman of the FDIC observed soon after the passage of FIRREA, "[w]ith respect to supervision, thrifts clearly have some changes in store, and banks are likely to see a new climate as well. For most of the past decade, supervision and enforcement have grown increasingly formal and adversarial. That trend will likely continue, if not accelerate." Isaac, *Meet the New FDIC*, A.B.A. Banking J. 47, 49 (Oct. 1989). For an indication of the disposition of the agencies themselves, see, e.g., *Daily Fine of \$1 Million to Banks Making Insider Loans, FDIC Warns*, 53 Banking Rep. (BNA) 628 (Oct. 30, 1989) (The FDIC Division of Bank Supervision Director has sent letters to state non-member banks warning them that "examiners will monitor banks closely and will not hesitate to slap the appropriate penalties on any member bank found violating the statutes.").

relatively high degree of deference toward administrative agencies as far as the choice of sanctions and means of enforcement are concerned.⁹⁷ Judge Scalia's dictum in *American Trucking Associations, Inc. v. Interstate Commerce Commission*⁹⁸ is representative of the general disposition of the courts when reviewing agency enforcement activity:

in designing the most appropriate means to enforce the law, agency discretion is at its zenith and judicial power at its nadir.⁹⁹

And this deferential approach was applicable in the context of banking agency enforcement,¹⁰⁰ as, indeed, the agencies themselves were well aware.¹⁰¹

Yet the doctrine of deference is not inscribed in stone: it reflects an *attitude* rather than a *principle of law*. Indeed, one of the cases most frequently cited in support of far-reaching, "hard look" judicial review, *Burlington Truck Lines, Inc. v. United States*,¹⁰² is itself a case involving the selection, by an agency, from among various options of a particular sanction, which selection was held by the Court to constitute an improvident exercise of the agency's discretion. The agency, said Justice White, should have disclosed the basis of its order, given a clear indication that it had exercised the discretion entrusted to it by Congress, it should have made findings supporting the decision, including findings "specifically directed to the choice between two vastly different remedies with vastly different consequences," and it should have articulated "a rational connection between the facts found and the choice made."¹⁰³ *Burlington Truck Lines* and other cases¹⁰⁴ have explicitly or implicitly recognized

97. See generally W. Gellhorn, C. Byse, P. Strauss, T. Rakoff & R. Schotland, *Administrative Law: Cases and Comments* 503-12 (8th ed. 1986) [hereinafter *Administrative Law*]. As the authors point out, however, the actions of the courts when reviewing agency enforcement action are unlikely to comport with the lore of deference: the courts, growing more familiar with reviewing the more structured sentencing process mandated by the U.S. Sentencing Guidelines, are likely to develop a more structured approach to the review of agency enforcement actions. See *id.* at 503-04. In addition, excessive severity (and possibly even excessive gentleness) in the imposition of sanctions is quite likely to "fuel court intervention." *Id.* at 508-11.

98. 697 F.2d 1146 (D.C. Cir. 1983).

99. *Id.* at 1153 (citing *Niagara Mohawk Power Corp. v. Federal Power Comm.*, 379 F.2d 153, 159 (D.C. Cir. 1967) in which Judge Leventhal observed that "the breadth of agency discretion is, if anything, at its zenith when the action assailed relates primarily not to the issue of ascertaining whether conduct violates that statute, or regulations, but rather to the fashioning of policies, remedies and sanctions, including enforcement and voluntary compliance programs in order to arrive at maximum effectuation of Congressional objectives."). Cf. *Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 186-89 (1973).

100. See *infra* text accompanying notes 100-02.

101. See, e.g., In the matter of *** and ***, as the Board of Directors of *** (Insured State Nonmember Bank), FDIC Enforcement Decisions and Orders ¶ 5014, at A-158 (1983) (P-H).

102. 371 U.S. 156 (1962).

103. *Id.* at 168.

104. See, e.g., *Jacob Siegel Co. v. Federal Trade Comm'n*, 327 U.S. 608, 613-614 (1946) (remanding cease and desist proceedings with instructions to the Commission to

that, even at the enforcement end of agency action, an agency's discretion is subject to judicial review according to the normal principles of administrative law relating to abuse of discretion.

In fact, the courts have frequently displayed an inclination to apply abuse-of-discretion standards to the enforcement actions of the federal banking agencies. This can be observed across the full spectrum of enforcement and enforcement-related activity. I will focus on what seem to me the four most important areas: first, and most generally, judicial review of agency selection and application of individualized sanctions; second, judicial review of agency enforcement of regulatory capital standards; third, judicial review of the discretionary seizure, by the banking agencies, of depository institutions; and, fourth, judicial treatment of potential tort liability on the part of the agencies for both the seizure and operation of institutions.

A. *Judicial Review of Agency Selection and Application of Individualized Sanctions*

Consonant with the low level of formal enforcement activity on the part of the agencies themselves, few cases involving judicial review of such activity were reported during the two decades that preceded the development of the savings and loan and banking crises. With one frequently-cited exception,¹⁰⁵ those decisions that were reported also tended to provide powerful precedents in favor of deference toward the agencies.¹⁰⁶

From about 1980, however, there has been a steady (and over the past two years, a sharp) increase in the number of reported decisions.¹⁰⁷

consider whether less drastic action would be sufficient); Administrative Law, *supra* note 93, at 507-11.

105. See *Manges v. Camp*, 474 F.2d 97, 100-01 (5th Cir. 1973). The court reversed an order by the Comptroller prohibiting stockholder from further participation in the affairs of a bank for clear departure from statutory authority.

106. See, e.g., *Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889, 895 (5th Cir. 1978); *First Nat'l Bank v. Dept. of the Treasury*, 568 F.2d 610, 611 (8th Cir. 1978); *Mid America Bancorp., Inc. v. Board of Governors of the Fed. Res. Sys.*, 523 F. Supp. 568, 577 (D. Minn. 1980). Cf. *First Nat'l Bank of Lamarque v. Smith*, 610 F.2d 1258, 1259 (5th Cir. 1980) (informal letter directives of Comptroller upheld as a "valid exercise" of latter's wide discretion); *Independent Bankers Ass'n of Am. v. Heimann*, 613 F.2d 1164, 1169 (D.C. Cir. 1979) (Comptroller's rulemaking powers can be used in place of cease-and-desist powers to prevent unsafe and unsound conduct); *Continental Bank and Trust Co. v. Martin*, 303 F.2d 214, 216-19 (D.C. Cir. 1962) (Fed's order to state bank to increase its capitalization held not to be final, reviewable agency action); *Miami Beach Fed. Sav. & Loan Ass'n v. Callander*, 256 F.2d 410, 415 (5th Cir. 1958) (FHLBB can use threat of more serious sanctions in order to pressure directors to resign).

107. See *Abercrombie v. Clarke*, 920 F.2d 1351 (7th Cir. 1990); *Northwest Nat'l Bank v. United States*, 917 F.2d 1111 (8th Cir. 1990); *Kronholm v. FDIC*, 915 F.2d 1171 (8th Cir. 1990); *Hoffman v. FDIC*, 912 F.2d 1172 (9th Cir. 1990); *Central Nat'l Bank of Mattoon v. United States*, 912 F.2d 897 (7th Cir. 1990); *First Nat'l Bank of Gordon v. Department of the Treasury*, 911 F.2d 57 (8th Cir. 1990); *Miller v. FDIC*, 906 F.2d 972 (4th Cir. 1990); *MCorp Fin., Inc. v. Board of Governors Fed. Reserve Sys.*, 900 F.2d 852 (5th Cir. 1990), *cert. granted*, 111 U.S. 1101 (Mar. 4, 1991); *Bullion v. FDIC*, 881 F.2d

Again, this seems obviously to correlate with the increasing frequency of formal agency action. Perhaps most important, however, is the fact that the deference so often said to be accorded the agencies by the courts is much more selectively observed in practice than the rhetoric would suggest.¹⁰⁸

1. The Predicate for Enforcement Action

The courts have usually respected the judgment, by a banking agency, that the object of its enforcement action has committed a violation of a law or regulation or, especially, that it has engaged in an unsafe or unsound practice. In the case of violations of law or regulation, the courts have applied the principle of *Chevron* deference, in terms of which the reasonable interpretation by an agency of an ambiguous statute must be upheld by the reviewing court if the statute is one for which the agency has primary administrative responsibility.¹⁰⁹ This form of deference existed in the arena of banking enforcement well before the *Chevron* case itself was decided in 1984.¹¹⁰

In the case of unsafe and unsound practices, and where these practices are not expressly identified in legislation, the courts have always recognized that the concept of safety and soundness is a highly flexible one best suited to expert discernment by the agency in the light of the circumstances giving rise to the enforcement proceedings.¹¹¹ So the basic

1368 (5th Cir. 1989); *Saratoga Sav. & Loan Ass'n v. FHLBB*, 879 F.2d 689 (9th Cir. 1989); *Currie State Bank v. FDIC*, 878 F.2d 215 (8th Cir. 1989); *Stoddard v. Board of Governors of the Fed. Reserve Sys.*, 868 F.2d 1308 (D.C. Cir. 1989); *Anaya v. FHLBB*, 839 F.2d 1349 (9th Cir. 1988); *Abercrombie v. Office of the Comptroller of the Currency*, 833 F.2d 672 (7th Cir. 1987); *Larimore v. Comptroller of the Currency*, 789 F.2d 1244 (7th Cir. 1986); *Sunshine State Bank v. FDIC*, 783 F.2d 1580 (11th Cir. 1986); *Fitzpatrick v. FDIC*, 765 F.2d 569 (6th Cir. 1985); *Brickner v. FDIC*, 747 F.2d 1198 (8th Cir. 1984); *Citizens State Bank v. FDIC*, 751 F.2d 209 (8th Cir. 1984); *Citizens State Bank of Marshfield, Missouri v. FDIC*, 718 F.2d 1440 (8th Cir. 1983); *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983); *del Junco v. Conover*, 682 F.2d 1338 (9th Cir. 1982); *Gulf Fed. Sav. & Loan Ass'n v. FHLBB*, 651 F.2d 259 (5th Cir. 1981); *Otero Sav. & Loan Ass'n v. FHLBB*, 665 F.2d 279 (10th Cir. 1981); *Bank St. Croix v. FDIC*, 755 F. Supp. 455 (D.D.C. 1991); *Spiegel v. Ryan*, 59 U.S.L.W. 2134 (C.D. Ca. 1990); [Anonymous] v. FDIC, 619 F. Supp. 866 (D.D.C. 1985); [Anonymous] v. FDIC, 617 F. Supp. 509 (D.D.C. 1985); *Somerfield v. FDIC*, 609 F. Supp. 128 (E.D. Tenn. 1985); *First Nat'l Bank of Scotia v. United States*, 530 F. Supp. 162 (D.D.C. Cir. 1982).

108. *Cf. Malloy*, 1990 Supp., *supra* note 51, § 3.3.2, at 141-49 (discussing the "mixed" results "[d]espite the generally wide judicial deference accorded the regulators in enforcement actions").

109. *Chevron v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984).

110. *See, e.g., supra* text accompanying notes 100-02. For subsequent cases expressly applying *Chevron*, see *Abercrombie*, 920 F.2d at 1357; *First National Bank of Gordon*, 911 F.2d at 64; *Saratoga Sav. & Loan*, 879 F.2d at 691; *Anaya*, 839 F.2d at 1351.

111. *See, e.g., Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127, 1145-46 (10th Cir. 1991) ("Whether a financial institution is in an unsafe or unsound condition is largely a predictive judgment (i.e., what may happen if this practice continues), and reviewing courts should be particularly deferential when they are reviewing an agency's predictive judgments, especially those within the agency's field of discre-

question as to whether there ought to be liability for *some* kind of sanction has generally been entrusted to the final judgment of the agency concerned. This is hardly surprising, given the fact that, at least in the past, formal enforcement action has always followed only after a fairly lengthy series of informal interactions between the agency and the depository institution or institution-related party: it is unlikely that the object of enforcement will have been unaware of the fact that the activity forming the predicate for enforcement action was disapproved by the agency.

Yet even with the safety and soundness concerns underlying the decision to impose sanctions, there have been exceptions. Two major rebuffs to the banking agencies provide illustrations; both deal with attempts by the agencies to enforce the strengthening and maintenance of capital levels at ailing institutions, and both occurred in the Fifth Circuit.

The first case was *First National Bank of Bellaire v. Comptroller of the Currency*.¹¹² The Comptroller had issued a complex cease-and-desist order requiring, among other things, the bank to raise its equity capital to a certain level within 180 days and to maintain that level thereafter.¹¹³ Although the court upheld the Comptroller's findings and orders with respect to most of the other violations,¹¹⁴ it ruled that the Comptroller's finding that the banks' existing capital level was unsafe and unsound was not supported by substantial evidence, even though the court fully recognized that it should defer to the reasonable conclusions of the Comptroller. In the court's view, there was no rational connection between the existing capital level being maintained by the bank and the Comptroller's conclusion that this constituted an unsafe and unsound practice.¹¹⁵ The *Bellaire* decision was effectively overruled by Congress soon afterwards when Congress conferred on the regulators the express power to set general and specific capital requirements and to treat as inadequate the failure to maintain adequate capital levels as an unsafe and unsound

tion and expertise"); *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 688-89 (5th Cir. 1983); *First Nat'l Bank of Lamarque v. Smith*, 610 F.2d 1258, 1265 (5th Cir. 1980); *Independent Bankers Ass'n of Am. v. Heimann*, 613 F.2d 1164, 1168-69 (D.C. Cir.), *cert. denied*, 449 U.S. 823 (1980); *Groos Nat'l Bank v. Comptroller of the Currency*, 573 F.2d 889, 897 (5th Cir. 1978).

The courts have also recognized that "unsafe and unsound," in the banking context, is a concept that is not unconstitutionally vague. *See, e.g., Fahey v. Mallonee*, 332 U.S. 245, 250 (1947) (this and other concepts are "regulatory. They do not deal with unprecedented economic problems of varied industries. They deal with a single type of enterprise and with the problems of insecurity and mismanagement which are as old as banking enterprise."); *Farmers State Bank v. Bernau*, 433 N.W.2d 734, 741 (Iowa 1988) (reliance on such terms is not tantamount to proceeding without standards or acting upon the basis of "secret law"). Whether the assumptions upon which these decisions are based are still valid will be considered later. *See infra* text accompanying notes 207-12.

112. 697 F.2d 674 (5th Cir. 1983).

113. *Id.* at 679 n.3.

114. *See id.* 681-83, 687. The court also ruled against the Comptroller with respect to an alleged violation, concerning one of the bank's borrowers, of the loans-to-one-person lending limit contained in 12 U.S.C. § 84. *See id.* at 683-84.

115. *See id.* at 684-87.

practice.¹¹⁶

The second rebuff, also in the Fifth Circuit, came in the well-publicized *MCorp* case,¹¹⁷ in which the Fifth Circuit recently ruled that the Fed had no authority to treat the failure by a holding company to provide financial support to its banking subsidiaries as an unsafe and unsound banking practice justifying the imposition of sanctions.¹¹⁸ In fact, the panel went so far as to rule that the Fed's long-standing "source of strength doctrine"¹¹⁹ constituted a "clear departure from statutory authority" and the action of the Board was therefore not subject to the protection of the statutory preclusionary clause preventing judicial review.¹²⁰ The final outcome of this case awaits determination by the Supreme Court, which has granted certiorari to this specific question.¹²¹

MCorp and *Bellaire* are not the only examples, however, of judicial intervention to strike down the determination by a banking agency that the predicate for enforcement action has occurred.¹²²

2. The Selection of a Sanction

When it comes to the *selection* by the agency of the *kind* of sanction or enforcement action to be applied, the courts have proved to be even less reticent. In this context, too, the courts have often recognized that agencies are entitled to great deference in the exercise of discretion in shaping

116. International Lending Supervision Act of 1983, Pub. L. No. 98-181, § 908, 97 Stat. 1280, 12 U.S.C. § 3907 (1983); see also *infra* note 134.

117. *MCorp Fin., Inc. v. Board of Governors of the Fed. Res. Sys.*, 900 F.2d 852 (5th Cir. 1990), cert. granted, 111 S. Ct. 1101 (Mar. 4, 1991).

118. See *id.* at 859-62.

119. *Id.* See also *supra* text accompanying notes 69-73. According to one report, the source of strength doctrine "had been part of the Fed's regulatory arsenal for more than 30 years." Linda Greenhouse, *High Court to Review a Fed Policy on Banks*, N.Y. Times, Mar. 15, 1991.

120. See *MCorp*, 900 F.2d at 857 (applying the exception recognized by the Supreme Court in *Leedom v. Kyne*, 358 U.S. 184 (1958)). The preclusionary clause in question is contained in 12 U.S.C. § 1818(i).

121. For a review of some of the conflicting policy concerns raised by the source-of-strength doctrine in the *MCorp* context, see Vartanian, *When Subsidiaries Stumble, Parents Face Tough Choices*, Am. Banker, Sep. 12, 1990.

122. See, e.g., *Saratoga Sav. & Loan Ass'n v. FHLBB*, 879 F.2d 689, 695-96 (9th Cir. 1989) (Board's cease & desist order reversed because Board's regulation governing acquisition, development and construction loans did not apply to acquisition and development loans); *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 683-84 (5th Cir. 1983) (Comptroller had incorrectly concluded that the object of a cease and desist order was not protected by a statutory exception); *Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish v. FHLBB*, 651 F.2d 259, 264-65 (5th Cir. 1981), cert. denied, 458 U.S. 1121 (1982) (FHLBB could not treat the S&L's method of charging interest, which deviated from its advertised rate but which conformed to accepted practice, as an unsafe or unsound practice violating consumer interests and serving as a basis for enforcement action against the S&L); *Manges v. Camp*, 474 F.2d 97 (5th Cir. 1973) (Comptroller could not use fact that M had pled guilty to a charge of making a false statement to the Small Business Administration as the basis for prohibiting M from further participation in the conduct of the affairs of a bank).

an appropriate remedy,¹²³ but this has not rendered judicial review a futile exercise for those who have had enforcement orders entered against them. On the contrary, there are numerous examples where litigants have been successful in securing rulings to the effect that particular sanctions applied by the agencies were either not permitted by statute or were inappropriate or disproportionate in view of the underlying violations.

a. *Sanctions Unauthorized by Statute*

In the first place, the courts have usually adopted a strict approach to the question of whether the actual sanction or remedy selected by the agency has a statutory basis at all. An example is *Otero Savings and Loan Association v. Federal Home Loan Bank Board*.¹²⁴ The FHLBB had correctly determined that Otero had been offering automatic transfer system ("ATS") and negotiable order of withdrawal ("NOW") accounts in violation of the statutory prohibitions then in force. Because the accounts had become legal by the time the Board had determined the violation, the Board decided to impose an "equitable" order, in terms of which Otero was prevented from opening any new such accounts for a period of 268 days following the effective date of the order. This remedy was designed to redress the fact that Otero had gained a 268 day competitive advantage over other institutions by offering such accounts before being permitted to do so. Although the Tenth Circuit panel agreed that the accounts had been prohibited,¹²⁵ a majority of the panel refused to defer to the Board regarding the "equitable" sanction, finding that the Board lacked such remedial powers.¹²⁶

More recently, and prior to the general extension by FIRREA of the

123.

[E]ven if we were inclined to agree that the Comptroller was being excessively severe . . . , we would not be justified in setting aside his order. The general posture of a court reviewing agency decisions is deferential; how deferential depends among other things on the nature of the issue. The more open-ended it is, and hence judgmental, and the more a sound exercise of judgment requires a specialized knowledge possibly possessed by the agency but certainly not by the court, the lighter the judicial hand. Here . . . the choice of sanctions is judgmental—an exercise of administrative discretion entitled to judicial respect . . . — and depends on particulars of the banking industry to which the generalist federal judiciary is not privy.

Central Nat'l Bank of Mattoon v. United States Dept. of Treasury, 912 F.2d 897, 904 (7th Cir. 1990)(Posner J.); see also *Brickner v. FDIC*, 747 F.2d 1198, 1203 (8th Cir. 1984) ("Administrative agencies have considerable latitude to shape their remedies within the scope of their statutory authority." *Canadian Tarpoly Co. v. U.S. Int'l Trade Comm'n*, 640 F.2d 1322, 1326 The relation of remedy to statutory policy is peculiarly a matter for the special competence of the administrative agency. See *American Power Co. v. SEC*, 329 U.S. 90 . . . (1946). Thus, an agency's choice of remedies is generally not to be overturned unless the reviewing court finds that it is unwarranted in law or without justification in fact." (citations omitted).

124. 665 F.2d 279 (10th Cir. 1981).

125. See *id.* at 281-83.

126. See *id.* at 286-89, 291-92. The dissent argued that the court should defer to the Board. See *id.* at 293.

agencies' enforcement powers, panels in the Seventh, Eighth and District of Columbia Circuits refused to defer to the Comptroller, the FDIC and the Fed, respectively, where these agencies had attempted to adapt their cease and desist powers to give effect to "equitable"-type reimbursement orders¹²⁷ or to extend sanctions to individuals who had already resigned their positions in the depository institutions concerned.¹²⁸ The confusion resulting from these decisions, which stood in contrast to those of other courts and which highlighted the inconsistencies between the enforcement powers of the various agencies,¹²⁹ was addressed by Congress in FIRREA, which expressly granted to the agencies the powers they had claimed in the earlier litigation,¹³⁰ but it would be sanguine to assume that disputes concerning the validity of these powers are completely over.¹³¹ In any event, even with their extended statutory authority, the agencies have still to pass muster under the rationality review, to which we now turn.

b. *Inappropriate or Disproportionate Sanctions*

Even where it is clear that the particular kind of sanction imposed by the agency was one within the bounds of the agency's general discretion-

127. See, e.g., *Larimore v. Comptroller of the Currency*, 789 F.2d 1244, 1255-56 (7th Cir. 1986) (Comptroller had no authority under his cease and desist powers to require directors personally to compensate bank for losses caused by approval of excessive loans); *Citizens State Bank v. FDIC*, 751 F.2d 209, 216-219 (8th Cir. 1984) (FDIC lacked power to order reimbursement to consumers by bank for overcharges arising from technical Truth in Lending violations).

128. See *Stoddard v. Board of Governors of the Fed. Res. Sys.*, 868 F.2d 1308, 1310-12 (D.C. Cir. 1989) (Board lacked jurisdiction to order removal of Stoddard from directorship and office, or to impose further prohibitions upon him, because Stoddard had already resigned his positions before the removal proceedings had been instituted).

129. Other circuits and panels had affirmed similar claims by other banking agencies. See *Hoffman v. FDIC*, 912 F.2d 1172, 1174-75 (9th Cir. 1990); *Anaya v. FHLBB*, 839 F.2d 1349, 1351 (9th Cir. 1987); *Sunshine State Bank v. FDIC*, 783 F.2d 1580, 1581-84 (11th Cir. 1986); *del Junco v. Conover*, 682 F.2d 1338, 1343 (9th Cir. 1982), *cert. denied*, 459 U.S. 1146 (1983); *First Nat'l Bank v. Dept. of Treasury*, 568 F.2d 610, 611 (8th Cir. 1978).

130. See FIRREA, §§ 902, 103 Stat. at 450 (to be codified at 12 U.S.C. §§ 1818(b), 1786(e)). FIRREA grants to the agencies express authority to include orders of restitution and reimbursement as part of cease and desist orders. *Id.* § 905, 103 Stat. at 459 (to be codified at 12 U.S.C. §§ 1818(i), 1786(k))(thereby permitting removal and prohibition orders to be made, for a period of six years, against persons who have already severed their connection with the depository institutions in question). For commentary, see Report of the Comm. on Banking, Finance and Urban Affairs, *supra* note 49, at 467-68 (discussing the *Larimore* decision); *Id.* at 468-69 (discussing the *Stoddard* decision).

131. In *Citizens State Bank v. FDIC*, 751 F.2d 209 (8th Cir. 1984), the court expressed misgivings about the constitutional validity under Article III of any statutory authorization to the agency which might permit it to order that the bank reimburse consumers for overcharges. *Id.* at 219. Because the banking industry is so closely regulated, however, and because there remains the protection of judicial review, it is likely that the power of the banking agencies, as part of an enforcement action, to adjudicate liability between institutions and their affiliated parties would not violate Article III. See *Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 587 (1985); see also *Commodity Futures Trading Comm'n v. Schor*, 478 U.S. 833, 834 (1986).

ary powers, the courts have not always accepted that the sanctions were appropriately applied to the cases at hand. In some proceedings, for example, courts have remanded the proceedings to the agencies after engaging in the most exacting, "hard look" review in ways that have been fully consistent with the most rigorous standards of review applicable elsewhere in administrative law.¹³²

There have also been rulings declaring the scope of the remedy inappropriately broad, given the inadequacy of the agency's explanation or underlying findings,¹³³ or because of the temporary nature of the proceedings.¹³⁴ And even though the courts have been willing to accept the imposition of fairly severe sanctions,¹³⁵ they have sometimes found civil penalties to be improperly determined because of a failure to take into account all relevant considerations.¹³⁶

B. *Judicial Review of Agency Enforcement of Regulatory Capital Standards*

The courts have even been remarkably interventionist, though so far only at the district court level, in one highly controversial area of enforcement activity: namely, the enforcement by the OTS of the new capital maintenance and accounting standards imposed by Congress in

132. See *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156 (1962); *Greater Boston Television Corp. v. FCC*, 444 F.2d 841 (D.C. Cir. 1970), cert. denied, 403 U.S. 923 (1971); see, e.g., *Citizens State Bank v. FDIC*, 718 F.2d 1440, 1444 (8th Cir. 1983) (articulating hard look review and citing the standard precedents for such review, *Motor Vehicle Mfr. Ass'n v. State Farm Mutual Auto. Ins. Co.*, 463 U.S. 29, 31 (1983); see also *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674, 680-81 (5th Cir. 1983) (using similar, hard look language); [Anonymous] v. FDIC, 617 F. Supp. 509, 514 (D.D.C. 1985) (also citing *State Farm* for principles of judicial review of discretionary agency action).

133. See, e.g., [Anonymous] v. FDIC, 619 F. Supp. 866, 866 (D.D.C. 1985) (preliminary injunction granted; inadequate justification supplied by the agency for imposing an industrywide prohibition or suspension from current employment).

134. See, e.g., *Spiegel v. Ryan*, 59 U.S.L.W. 2134, 55 Banking Rep. (BNA) 306 (C.D. Cal. 1990) (temporary cease & desist power an inappropriate vehicle for making an order requiring correction of past actions). The Crime Control Act of 1990, § 2596(b), overruled the effects of this decision by permitting the banking agencies to include orders for affirmative relief within the scope of temporary cease and desist orders. For an example of a case, in which the exercise of the new temporary cease and desist powers have been upheld, see *Bank St. Croix v. FDIC*, 755 F. Supp. 455 (D.D.C. 1991).

135. See, e.g., *Abercrombie v. Clarke*, 920 F.2d 1351, 1352 (7th Cir. 1990) (assessment of moderately severe penalties affirmed); *Central Nat'l Bank v. United States Dept. of the Treasury*, 912 F.2d 897, 903-05 (7th Cir. 1990) (Comptroller's revocation of bank's trust powers, though severe, held not to be disproportionate to wrong committed).

136. See, e.g., *Bullion v. FDIC*, 881 F.2d 1368, 1370 (5th Cir. 1989) (partial reversal and remand for redetermination of penalty assessed against one party because of failure by agency to take into account party's ability to pay). Cf. *Miller v. FDIC*, 906 F.2d 972, 973 (4th Cir. 1990) (remand to trial court for reassessment of agency's imposition of civil penalties because of possible failure by trial court to appreciate that Change in Bank Control Act, under which the penalties were assessed, requires de novo review by trial court).

FIRREA on S&Ls.¹³⁷ Because the cases involved have generated a jurisprudence and controversy of their own, they will be treated as a separate issue in this paper. But a connection between them and the cases already discussed should not be overlooked. To the extent that the agencies are expressly authorized to take enforcement action against, including even seizure of, an institution by reason of its failure to maintain required capital standards,¹³⁸ the power to impose such standards by the Director of OTS (DOTS)—even in the face of agreements to the contrary between the OTS's predecessor and the thrift concerned—constitutes an extremely far-reaching weapon in the regulator's bag of supervisory instruments.

Disputes concerning the exercise of this power have revolved around four main issues. First, has Congress effected a taking by requiring those thrifts that had secured forbearance agreements to write down their regulatory goodwill over a period shorter than that provided for in the agreements? If so, it might follow that, while the DOTS is authorized to enforce the write down, the United States would be liable for compensation under the Fifth Amendment. On the other hand, the FDIC might be liable to make restitution to the investors of the seized institution for the amount by which the institution's value had been enhanced as a result of their contributions made in reliance on a forbearance agreement.¹³⁹ Second, and in the alternative, did Congress intend to preserve the rights of those thrifts that had secured forbearance agreements, such that the OTS, as successor to the FHLBB, is contractually bound by the agreements? Third, if breaches of the agreements by the agency have taken place, can declaratory and injunctive relief be secured in the federal district courts, or does the principle of sovereign immunity require that a suit for damages be brought in the United States Claims Court? Finally, can the refusal by the DOTS to grant a discretionary exemption from the application of the capital standards be subjected to ordinary APA-type judicial review for abuse of discretion?

In addressing these issues in various procedural formats, the decisions

137. See generally, Note, *Abrogation of Forbearance Agreements: Unauthorized by FIRREA and Unconstitutional*, 59 Geo. Wash. L. Rev. 157 (1990).

138. See 12 U.S.C. §§ 1464(s)(3), (t)(6)(E), (t)(7)(E) (1988) (providing that failure to maintain adequate capital may be treated by the DOTS as an unsafe and unsound practice); *id.* § 3907(b)(1) (International Lending Supervision Act of 1983). The connection between capital standards and enforcement is underlined by the fact that this provision of the International Lending Supervision Act was enacted in response to the decision in *First Nat'l Bank of Bellaire v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983), which had struck down that portion of the Comptroller's cease and desist order that had required the bank to maintain a specific level of capital as being unsupported by substantial evidence. The Act expressly permitted the agencies to treat the failure to maintain adequate capital standards as an unsafe and unsound practice. See Cobb, Supplement, *supra* note 23, S2-23-S2-25; Huber, *supra* note 21, at 147-48.

139. See *Far West Fed. Bank v. Director of the OTS*, 930 F.2d 883 (Fed. Cir. 1991) (affirming jurisdiction of district court to consider claim for restitution as a cause of action independent from a takings claim).

at the district court level have gone in every direction and (perhaps in reaction against perceived regulatory overkill¹⁴⁰) usually against the OTS. One court has dismissed a thrift's takings and estoppel claims because it found no waiver of sovereign immunity,¹⁴¹ but other courts have granted preliminary relief either because they have found the rights created by the forbearance agreements to have been protected by FIRREA itself, or because the DOTS' implementation of the capital standards under FIRREA has been inflexible and therefore unreasonable.¹⁴² After a full trial, another court concluded that FIRREA did not abrogate a conversion and forbearance agreement entered into between the FHLBB and an ailing thrift, and that the repudiation by DOTS of the conversion agreement constituted an unconstitutional taking.¹⁴³ The Claims Court has found in one case that the government intended to enter into a binding contract, but the question of liability is still pending.¹⁴⁴

On the other hand, the circuits that have ruled so far on the merits¹⁴⁵ have both found in favor of the government, although not without entirely eliminating the confusion surrounding the disputes.¹⁴⁶ First, in *Franklin Federal Savings Bank v. Director, Office of Thrift Supervision*,¹⁴⁷ the Sixth Circuit (in a 2-1 decision) concluded that Congress did intend in FIRREA to abrogate the forbearance agreements,¹⁴⁸ that the DOTS is

140. Cf. Wayne, *Bank Regulators: Too Much Zeal?*, N.Y. Times, Mar. 7, 1991, at C2, col. 1.

141. *Olympic Fed. Sav. & Loan Ass'n v. Director of the OTS*, 1990 WL 134841 (D.D.C. 1990). But the court held that it had jurisdiction over the thrift's administrative law claims. *Id.* at *10.

142. See *Carteret Sav. Bank v. OTS*, 762 F. Supp. 1159 (D.N.J. 1991); *Hansen Sav. Bank v. OTS*, 758 F. Supp. 240 (D.N.J. 1991). Rodriguez J. noted that "[i]n this case, there is no evidence of mismanagement. [Hansen Savings] did not receive gratuitous forbearances. Plaintiffs contributed substantial assets and agreed to absorb a failing thrift's losses in order to help relieve the government of its insurance obligation." *Id.* at 247.

143. See *Far West Fed. Bank v. Director of the OTS*, 746 F. Supp. 1042, 1044 (D. Or. 1990), *aff'd*, 930 F.2d 883 (Fed. Cir. 1991). Count IV of the plaintiff's complaint, seeking rescission of the forbearance agreement and restitution for the amount by which the FSLIC Resolution Fund was enriched as a result of the agreement, was not tried because the Federal Circuit had granted a stay pending determination of whether, on this issue, the district court had jurisdiction instead of the Claims Court. The Federal Circuit has now affirmed the jurisdiction of the district court and dissolved the stay. See *id.*

144. See *Winstar Corp. v. United States*, 21 Cl. Ct. 112 (U.S. Cl. Ct. 1990). The Claims Court has recently rejected the takings claim by American Continental Corporation with respect to the seizure of Lincoln Savings and Loan Association, but this case did not involve the regulatory capital and forbearance issues. See *American Continental Corp. v. United States*, 22 Cl. Ct. 692 (1991).

145. See, e.g., *Far West Fed. Bank v. Director of the OTS*, 930 F.2d 883 (Fed. Cir. 1991) (affirming jurisdiction of district court to determine claim seeking rescission of forbearance agreement and restitution from relevant government fund); *First Fed. Sav. Bank v. Ryan*, 927 F.2d 1345 (6th Cir. 1991) (declining to reach the merits and holding that OTS had not yet taken final action that would be ripe for review).

146. Other appeals are still pending. See 3(7) *Bank/Thrift Lit. & Enf. News* 4-5 (2/18/91).

147. 927 F.2d 1332 (6th Cir. 1991).

148. See *id.* at 1334, 1337.

authorized to disregard the limitations contained in the forbearance agreements, but that this would constitute a taking for which compensation would have to be paid.¹⁴⁹

The Eleventh Circuit has also ruled in favor of the OTS, reversing the decision of the district court in *Guaranty Financial Services* to grant a preliminary injunction against the OTS.¹⁵⁰ The district court had found there was substantial likelihood on the merits of the plaintiff's claim that it had a binding agreement with the OTS concerning supervisory goodwill, and that the rights, duties and obligations thereunder had been protected by FIRREA.¹⁵¹ The Court of Appeals, on the other hand, while accepting that the agreement between the FHLBB and the thrift constituted a contract, construed the contract as a conditional one. The agreement had defined regulatory capital and regulatory capital requirements in accordance with federal regulations including "any successor regulation," and the agreement explicitly recognized that all regulations to which it referred might be amended.¹⁵² The Court ruled that the contract therefore anticipated changes, including the tightening of capital requirements.¹⁵³ In reaching this result, the court applied a well-established canon of construction in terms of which "one who wishes to obtain a contractual right against the sovereign that is immune from the effect of future changes in law must make sure that the contract confers such a right in unmistakable terms."¹⁵⁴

Having concluded that the agreement between Guaranty Financial and the FHLBB did indeed reserve to the Congress and the agencies the right to change the regulatory standards,¹⁵⁵ the court went on to consider whether Congress, in FIRREA, had intended to preserve Guaranty Financial's existing rights under the agreement. Like the Sixth Circuit,¹⁵⁶ the Eleventh Circuit concluded, after an extensive review of the legislative history, that Congress did indeed intend to abrogate the regulatory capital standards contained in agreements such as the one entered into between Guaranty Financial and the FHLBB.¹⁵⁷ Hence Guaranty Financial's rights under the contract had changed as a result of FIRREA.

149. *Id.* at 1341.

150. *Guaranty Fin. Serv., Inc. v. Ryan*, 928 F.2d 994 (11th Cir. 1991), *reversing* 742 F. Supp. 1159 (M.D. Ga. 1990).

151. *See id.* at 995.

152. *Id.* at 999.

153. *Id.*

154. *Id.* at 1001 (quoting *Western Fuels-Utah v. Lujan*, 895 F.2d 780, 789 (D.C. Cir.), *cert. denied*, 111 S. Ct. 47 (1990)). The court also emphasized the Supreme Court's admonition, as expressed in *Bowen v. Public Agencies Opposed to Social Security Entrapment*, 477 U.S. 41 (1986), "that contracts should be construed, if possible, to avoid foreclosing exercise of sovereign authority." *Id.* at 52-53.

155. The agency could hardly have contracted to prevent Congress from exercising the power to change the regulatory system: at most, this exercise of Congress' police power might give rise to a claim for compensation under the Takings Clause.

156. *See supra* text accompanying notes 142-43.

157. *Guaranty Financial*, 928 F.2d at 994.

The court's approach in *Guaranty Financial* would not entirely eliminate the possibility of a successful claim against the government where the terms of the agreement were sufficiently clear. Turning as it does on the specific terms of the contract itself, *Guaranty Financial* does not settle the question of whether agreements that did not contemplate a change in the specific capital requirements of the thrift concerned should be regarded as binding, FIRREA notwithstanding. But the conclusion of both the Sixth and Eleventh circuits that Congress clearly intended to abrogate the capital forbearances contained in the agreements entered into between the FHLBB and thrifts prior to the enactment of FIRREA suggests that the disputes concerning those thrifts which can establish clear and binding agreements will now turn into disputes concerning just compensation, and that injunctive relief from the courts, at least where this interpretation of FIRREA is followed, is likely to be foreclosed.

Because of the uncertainty as to whether the Sixth and Eleventh circuits' interpretation is correct, a most important decision is pending appeal in *Far West Federal* in the Ninth Circuit. The district court, after a full bench trial, had granted injunctive and declaratory relief on the basis that a conversion agreement between the FHLBB and the plaintiff was binding on the government, that the agreement had not been abrogated by FIRREA, and that the repudiation of the agreement by the OTS constituted an unconstitutional taking.¹⁵⁸

Although the OTS is claiming victory in the wake of its successes in the *Franklin Federal* and *Guaranty Financial* cases, the claim seems premature given the variety of views, both in the circuit panels and in the district courts, and given the unresolved takings issue. It seems inevitable that the dispute will have to be resolved by the Supreme Court.

C. *Judicial Review of Discretionary Seizures*

The most drastic action a banking agency can take is to seize the institution and place it in conservatorship or receivership. This is not only the most far-reaching enforcement power possessed by the agencies, it is also the one which the courts have long been most loath to burden with due process requirements beyond those provided for by Congress.¹⁵⁹ It is, moreover, extremely difficult, if not impossible, to establish that the

158. See *Far West Fed. Bank v. Director of the OTS*, 746 F. Supp. 1042, 1042 (D. Or. 1990). The district court denied an OTS motion to sever one of the counts and transfer it to the U.S. Claims Court. The Federal Circuit granted a temporary stay pending appeal but on appeal then affirmed the district court and lifted the stay. See *Far West Fed. Bank v. Director of the OTS*, 930 F.2d 883 (Fed. Cir. 1991).

159. See *Fahey v. Mallonee*, 332 U.S. 245 (1947); *Woods v. FHLBB*, 826 F.2d 1400 (5th Cir. 1987), cert. denied, 485 U.S. 959 (1988); *Haralson v. FHLBB*, 655 F. Supp. 1550 (D.D.C. 1987); *Farmers State Bank v. Bernau*, 433 N.W. 2d 734 (Iowa 1988). Cf. *FDIC v. Mallen*, 486 U.S. 230 (1988) (need for prompt governmental action also justifies summary removal of director from office long prior to full administrative hearing and final determination on merits. The *Mallen* case involved the same parties as those in *Farmers State Bank*, supra).

seizure would constitute a taking for the purpose of the Just Compensation Clause.¹⁶⁰ Furthermore, even though Congress may have implied a broader standard when it directed district courts to determine "upon the merits" whether the appointment was sustainable,¹⁶¹ many courts have indicated that they will apply the normal arbitrary-and-capricious standard when reviewing challenges to the appointment of conservators or receivers.¹⁶² Finally, the courts have refused to grant injunctive relief to ward off the regulators before seizure takes place; instead, the statutory remedy of post-seizure challenge has been held to be exclusive.¹⁶³

In 1990, the OTS won a major victory when the seizure of Lincoln Savings and Loan by its predecessor, the FHLBB, went to trial before Judge Stanley Sporkin in the District Court of the District of Columbia.¹⁶⁴ Many of the facts surrounding *Lincoln* are well known: Charles Keating, the chairman and chief executive officer of Lincoln's holding company, American Continental Corporation ("ACC"), was a focal figure in the inquiry into the ethical conduct of the "Keating Five" senators, that led to a recommendation for the censure of Senator Alan Cranston.

The FHLBB placed Lincoln in conservatorship in April 1989, and the following August, the Board converted the conservatorship into a receivership. The Board determined that Lincoln was "in an unsafe and unsound condition to transact business" and that there had been a substantial dissipation of Lincoln's assets as a result of regulatory violations and unsafe and unsound practices.¹⁶⁵ Among the numerous reasons for the Board's action were certain arrangements between ACC and Lincoln, including a "tax sharing agreement," under the terms of which

160. See *American Continental Corp. v. United States*, 22 Cl. Ct. 692 (1991).

161. See 12 U.S.C. § 203(b)(1) (national banks); *id.* § 1464(d)(2)(E) (formerly 1464(d)(6)(A), S&Ls); *id.* § 1821(c)(7) (state insured banks; appointment by FDIC).

162. See *Franklin Sav. Ass'n v. Director, Office of Thrift Supervision*, 934 F.2d 1127, 1141-42 (10th Cir. 1991); *Woods v. FHLBB*, 826 F.2d 1400, 1406-09 (5th Cir. 1987), *cert. denied*, 485 U.S. 959 (1988); *Guaranty Sav. & Loan Ass'n v. FHLBB*, 794 F.2d 1339, 1342 (8th Cir. 1986); *Lincoln Sav. & Loan Ass'n v. Wall*, 743 F. Supp. 901, 904-05 (D.D.C. 1990); *San Marino Sav. & Loan Ass'n v. FHLBB*, 605 F. Supp. 502, 508 (C.D. Ca. 1984); *Washington Fed. Sav. & Loan Ass'n v. FHLBB*, 526 F. Supp. 343, 350, 353-54 (N.D. Ohio 1981). *But cf.* *Franklin Sav. Ass'n v. Director of the OTS*, 742 F. Supp. 1089, 1095-99 (D. Kan. 1990) (indicating that a somewhat wide, "hybrid," scope of review than that contemplated by the APA-type "arbitrary and capricious" review is contemplated), *rev'd*, 934 F.2d 1127 (10th Cir. 1991); *Haralson v. FHLBB*, 655 F. Supp. 1550, 1557-60 (D.D.C. 1987) (same); *Collie v. FHLBB*, 642 F. Supp. 1147, 1149-52 (N.D. Ill. 1986) (same); *Telegraph Sav. & Loan Ass'n v. FSLIC*, 564 F. Supp. 862, 869-70 (N.D. Ill. 1981) (same), *aff'd on other grounds*, 703 F.2d 1019 (7th Cir.), *cert. denied*, 464 U.S. 992 (1983); *Fidelity Sav. & Loan Ass'n v. FHLBB*, 540 F. Supp. 1374, 1377 (N.D. Ca. 1982) (same), *rev'd on other grounds*, 689 F.2d 803 (9th Cir. 1982), *cert. denied*, 461 U.S. 914 (1983).

163. See *American Bank v. Clarke*, 933 F.2d 899 (10th Cir. 1991); *Shemonsky v. OTS*, 733 F. Supp. 892, 895 (M.D. Pa. 1990).

164. *Lincoln Sav. and Loan Ass'n v. Wall*, 743 F. Supp. 901 (D.D.C. 1990).

165. See *Lincoln Savings*, 743 F. Supp. at 903 (quoting the statutory grounds for appointment of a conservator or receiver).

Lincoln was required to remit to ACC the amounts of tax it would ostensibly owe on the basis of its net profits. ACC would then merge this tax liability with its own, on a consolidated basis, and, because ACC had large stored-up operating losses, ACC was able to keep the amounts received from Lincoln. In other words, the arrangement created a means whereby ACC was able to "upstream" \$94 million from Lincoln, thereby dissipating Lincoln's assets to the detriment of Lincoln's own safety and soundness and, of course, at great cost to the federal deposit insurance fund.¹⁶⁶

Judge Sporkin found the upstreaming agreement and many other practices fully proved by the FHLBB's successor, the OTS, and he found that they amply justified the Board's seizure of Lincoln. The regulator's action survived scrutiny not only under the arbitrary-and-capricious standard that Judge Sporkin determined was applicable to reviews of thrift seizures, but also under "each of the other standards that are utilized to review an agency action."¹⁶⁷ In addition to excoriating ACC, Lincoln, and its directors and officers, Judge Sporkin also added a special post-script in which he raised concerns about the conduct of the lawyers and accountants, particularly with regard to their failure to disassociate themselves from the obviously improper transactions between ACC, Lincoln, and others. Moreover, he seemed to provide strong encouragement to the bank regulators to intensify their enforcement action against "institution-affiliated" professionals.¹⁶⁸ Certainly, this is how his observations were received by the regulators, particularly the OTS,¹⁶⁹ which had

166. *See id.* at 908-911.

167. *Id.* at 905. Presumably Judge Sporkin meant to include by this phrase both the "substantial evidence" standard (see *id.* at 919) and, because he had considered whether the statutory phrase "upon the merits" might suggest review *de novo*, *de novo* review as well. His analysis of the evidence upon which the Board's action was said to be based certainly seems to support this interpretation.

168. *See id.* at 919-21.

169. Soon after Judge Sporkin's decision, officials at the OTS and RTC indicated their intention to take strong enforcement action against attorneys and other professionals. *See, e.g.,* Duke & Noah, *Thrift Agency is to Sue Some Attorneys, Others in Wake of Lincoln S&L Decision*, Wall St. J., Aug. 27, 1990, at B6, col. 4; Knight, *S&L Regulators Vow to Hold Professionals Responsible*, Wash. Post, Aug. 25, 1990, at D11, col. 1. *See also* McCoy, Schmitt & Bailey, *Hall of Shame: Besides S&L Owners, Host of Professionals Paved Way for Crisis*, Wall St. J., Nov. 2, 1990, at A4, col. 1 (reporting on the role of professionals in the S&L "catastrophe"). Two weeks later it was reported that the OTS was planning to clamp down on accountants and lawyers who had advised abusive thrift managements. *See* Zuckerman, *Thrift Office Planning Penalties Against Accountants, Attorneys*, Am. Banker, Nov. 14, 1990, at 1. Five days later the OTS recirculated another story confirming the same trend. *See* Knight, *S&L Crisis Breeds Tough Group of Regulatory Enforcers*, Wash. Post., Nov. 19, 1990, at A2. On the same day a similar article, reporting the increased likelihood of enforcement against directors and officers, was published. *See* Welling, *Directors and Officers Face Greater Risk of Liability*, Am. Banker, Nov. 19, 1990, at 4.

See generally Villa, *Accountants, Lawyers Face an Enforcement Threat*, Am. Banker, April 10, 1991, at 4. *Cf. also* Duke, *OTS Is trying to Regulate the Accounting Profession*, Thrift Regulator, Dec. 14, 1990; Tolchin, *Accounting Firm's Pact On S.&L.'s*, N.Y. Times, Dec. 13, 1990, at D7, col. 6 (reporting on a cease and desist agreement reached

hailed the *Lincoln* decision as a major victory.¹⁷⁰

The OTS' *Lincoln* victory was followed in 1991 by another in the Tenth Circuit. In *Franklin Savings Association v. Director, Office of Thrift Supervision*,¹⁷¹ a unanimous panel reversed the district court holding that the Director of OTS had acted arbitrarily and capriciously in appointing a conservator, "not for the purpose of liquidation," but only to prevent further deterioration in Franklin's condition. In the panel's view, the record amply supported the Director's decision to appoint the conservator and the trial judge had failed to accord sufficient deference to the Director's findings concerning Franklin's safety and soundness. The appeals court did emphasize that the case did "not involve the more severe decision to appoint a conservator for the purpose of liquidation."¹⁷² Nevertheless, the opinion is thoroughly reasoned and constitutes, in this author's opinion, a correct exposition of the principles of administrative law applicable to reviewing the appointment of both conservators and receivers.¹⁷³

Yet even against this background of strong judicial support for the seizure and broadened enforcement powers of the banking agencies, a series of recent decisions have gone against the regulators. These include one that was reached after a full bench trial,¹⁷⁴ two that were decided on motions for summary judgment,¹⁷⁵ and one that was decided on a motion to dismiss.¹⁷⁶

In the case that went to trial, *Franklin Savings Association v. Director of the Office of Thrift Supervision*,¹⁷⁷ the OTS appointed a conservator for Franklin. The S&L challenged this appointment and, after an eighteen-day trial, Judge Saffels found that the OTS and its agents had drawn arbitrary conclusions and had acted arbitrarily and capriciously in numerous respects concerning the treatment of Franklin's assets and liabili-

between the accountants and OTS, about which the Director of OTS, T. Timothy Ryan, was quoted as saying: "This is a significant case It says loud and clear that we hold accountants, lawyers and other professionals accountable for their actions, just as we do S.&.L. directors and officers.")

170. See *Judge Sporkin Upholds FHLBB Takeover of Keating's Lincoln Savings and Loan*, 55 Banking Report (BNA) 344, 345-46 (Aug. 27, 1990).

171. 934 F.2d 1127 (10th Cir. 1991).

172. *Id.* at 1141.

173. The OTS also secured a minor victory in the Fourth Circuit on a collateral appeal in which the Fourth Circuit reversed a district judge's ruling that the former Director of OTS, M. Danny Wall, could be deposed concerning his mental processes in reaching the decision to appoint a conservator. See *Franklin Sav. Ass'n v. Ryan*, 922 F.2d 209 (4th Cir. 1991) (applying the well-established *Morgan* principle that such questions, absent extraordinary circumstances, are clearly improper. See *United States v. Morgan*, 313 U.S. 409 (1941)).

174. See *Franklin Sav. Ass'n v. Director of the OTS*, 742 F. Supp. 1089 (D. Kan. 1990).

175. See *MCorp v. Clarke*, 755 F. Supp. 1402, 1404 (N.D. Tex. 1991); *Texas Am. Bancshares v. Clarke*, 740 F. Supp. 1243, 1254 (N.D. Tex. 1990).

176. See *Senior Unsecured Creditors' Comm. of the First Republicbank Corp. v. FDIC*, 749 F. Supp. 758 (N.D. Tex. 1990).

177. 742 F. Supp. 1089 (D. Kan. 1990), *rev'd*, 934 F.2d 1127 (10th Cir. 1991).

ties. Taking the view that this was "not a case involving an infamous or notorious savings and loan association" or one "involving fraud, corruption, or self-dealing by the management or directors," the judge reached the conclusion that "[e]ssentially, this case boils down to a dispute over accounting practices."¹⁷⁸ OTS' action, Judge Saffels opined, was most likely "motivated by the disturbing events that had occurred earlier with regard to Silverado Savings and Loan in Colorado and . . . [OTS/Topeka's] difficulty with Franklin's unique and innovative operations."¹⁷⁹ Among the many grounds for the OTS's action was the relationship between Franklin Savings and its parent company, Franklin Savings Corporation ("FSC"): like Lincoln Savings and American Continental Corporation,¹⁸⁰ Franklin Savings and FSC had mutual tax agreements; unlike the case in *Lincoln Savings*, however, the agreements had long been known to the FHLBB and OTS, had been acquiesced in by them, and were not designed to upstream funds from the thrift to its parent. The court ruled that OTS' treatment of the agreements as raising concern about the safety and soundness of Franklin Savings was arbitrary and capricious.¹⁸¹ The court ordered the OTS to remove its conservator.¹⁸²

The remaining cases were in the Northern District of Texas, although each was adjudicated by a different judge. All involved the seizure of bank subsidiaries of large holding companies: in the *Senior Unsecured Creditors'* case,¹⁸³ the holding corporation was First RepublicBank Corporation, the rescue of whose flagship bank by the FDIC was, at the time, "the largest bank rescue effort in history."¹⁸⁴ The rescue failed and all 41 of the First RepublicBank Corp's subsidiary banks were declared insolvent and seized by the Comptroller. Unsecured creditors' committees of the holding corporation and one of its subsidiaries brought suit against the FDIC claiming, among other things, that the FDIC, in providing open bank assistance to the flagship bank, had devised the assistance in a manner designed to manufacture the insolvency of the sister banks; had engaged in transfers in contemplation of insolvency; and had discriminated as between creditors in violation of the National Bank

178. *Id.* at 1094. As two commentators have noted, the court went to unusual lengths to reevaluate the expert testimony of accounting experts at the trial. See Dobbins & Davis, *The Franklin Decision and the Limits of Regulatory Authority*, 3 Banking L. Rev. 3, 6 (Winter 1991).

179. *Franklin Savings*, 742 F. Supp. at 1124. Judge Saffels went on to note that Franklin had not, however, shown that the regulators' actions were motivated by bias, prejudice or bad faith. *Id.*

180. See *supra* text accompanying notes 164-170.

181. See *Franklin Savings*, 742 F. Supp. at 1119.

182. The Tenth Circuit immediately thereafter granted a stay, and subsequently reversed the decision. See *Franklin Savings*, 934 F.2d 1127 (10th Cir. 1991); see also *supra* text accompanying notes 171-73 (discussing tenth circuit decision).

183. *Senior Unsecured Creditors' Comm. of First Republicbank Corp. v. FDIC*, 749 F. Supp. 758 (N.D. Tex. 1990).

184. *Id.* at 760 (quoting Tr. Oral Arg. at 1 (John L. Rogers, III, Esq., counsel for the FDIC)).

Act.¹⁸⁵ Although the court dismissed many of the other claims, and also appeared somewhat skeptical of the validity of those just mentioned, Judge Fitzwater declined to dismiss the claims concerning the manufacturing of insolvency, transfers in contemplation of insolvency, and the alleged inequitable impact of the FDIC's purchase and assumption transactions on creditors.¹⁸⁶ Even if the FDIC ultimately is vindicated on the facts and law, the decision undoubtedly will impose a significant fetter on the agency's freedom to act in large-scale bank seizures.

This view is reinforced by the other decisions. *Texas American Bancshares*¹⁸⁷ involved the seizure of Texas American's twenty-two national and two state bank subsidiaries. The seizures by the Comptroller (in the case of ten of the national banks) and the Texas Banking Commissioner (in the case of the two state banks) had taken place after the FDIC had notified the Comptroller that these banks, which were otherwise solvent and were creditors of the (by then) insolvent lead subsidiary bank, would receive no more than sixty-seven percent of the face amounts of the obligations owed them by the lead bank. This default rendered the remaining banks insolvent. The holding company, the ten "solvent" national banks, and the two state banks, then brought an action against the Comptroller and the Texas Bank Commissioner, alleging that their insolvency had been engineered by the FDIC in order to enable the FDIC to sell the entire TAB bank system as a package. The FDIC was alleged to have deliberately devalued the assets placed by the solvent banks in the insolvent lead bank. The Court found strong support for this allegation¹⁸⁸ and took the view that the FDIC was under an obligation to treat all creditors, including the sister subsidiaries, equitably.¹⁸⁹ The court concluded that "the facts of this case indicate an equally egregious use of the FDIC's extensive (but not unlimited) powers by manipulating the recovery of affiliated banks on the obligations owed to them in order to make those banks insolvent as well."¹⁹⁰ Citing the Ninth Circuit in *First Empire*¹⁹¹ and quoting from its own circuit, the court concluded in terms extremely critical of the banking agencies:

This Circuit has been similarly wary of the FDIC's and the Comptroller's claims of unbridled discretion. The Fifth Circuit warned [that] . . . [t]he Comptroller must not become so obsessed with protecting the integrity of the national banking system that individual banks are

185. See 12 U.S.C. § 194. This provision has been amended by FIRREA, § 212(a), which the court held to have prospective force only. 749 F. Supp. at 773-74; *First Empire Bank-New York v. FDIC*, 572 F.2d 1361 (9th Cir.), cert. denied, 439 U.S. 919 (1978); *Texas Am. Bancshares, Inc. v. Clarke*, 740 F. Supp. 1243, 1248 (N.D. Tex. 1990).

186. See *Senior Unsecured Creditors*, 749 F. Supp. at 768, 771, 772, 776.

187. *Texas Am. Bancshares, Inc. v. Clarke*, 740 F. Supp. 1243 (N.D. Tex. 1990).

188. *Id.* at 1247.

189. On the equal treatment principle formerly contained in the National Bank Act, see *supra* note 115.

190. *Texas American Bancshares*, 740 F. Supp. at 1253.

191. *First Empire Bank-New York v. FDIC*, 572 F.2d 1361 (9th Cir.), cert. denied, 439 U.S. 919 (1978).

arbitrarily treated unfairly.' . . . in the FDIC's rush to salvage what all admit to be a difficult situation, it could not violate Congress' explicit directive to treat creditors equally by choosing among creditors only those whom it considered worthy of full payment.¹⁹²

In the same vein, Chief Judge Porter in the much-publicized *MCorp* case,¹⁹³ granted summary judgment in favor of the plaintiff holding company (and holding company/subsidiary) and against the Comptroller and FDIC. *MCorp* claimed that the FDIC had conspired with the Comptroller to engineer, by means of the conditions attached to the FDIC's open bank assistance and the manipulation of the access on the part of *MCorp*'s subsidiary national banks to the Federal Reserve Bank discount window, the insolvency of the entire MBank system, in order that the FDIC would be able offer the entire package to prospective buyers. The court found that the FDIC deliberately chose not to close the MBanks as they became insolvent; instead, the agency decided to wait until it was in a position to create the insolvency of an additional twelve MBanks as well. Judge Porter, finding that the court had jurisdiction to entertain the suit for damages,¹⁹⁴ rejected the various defenses raised by the FDIC and the Comptroller, found that, as in the previous two cases, the principle of equal treatment of creditors had been violated. Additionally, the Court found that the claim by *MCorp* that the FDIC had plotted with the Comptroller to engineer the insolvency of the entire MBank system was supported by the evidence.¹⁹⁵ Indeed, the opinion records some embarrassing evidence from the minutes of two 1988 FDIC meetings at which this objective was frankly discussed, and apparently agreed upon, by the FDIC Board and its staff.¹⁹⁶ The court ordered the parties to prepare briefing on the amount of damages,¹⁹⁷ and the case has subsequently been settled on terms a good deal more adverse to the FDIC, it seems, than the agency had originally expected.

It remains to be seen whether the Fifth Circuit, unlike the Tenth Circuit, will sustain the district courts in their rigorous attitude toward the agencies. For the time being, however, the banking regulators can hardly be described as enjoying clear sailing in every case in which they have chosen to use their ultimate enforcement weapon: seizure of the institution.

192. *Texas America Bancshares*, 740 F. Supp. at 1254 (quoting, in part, from *First Nat'l Bank v. Comptroller of the Currency*, 697 F.2d 674 (5th Cir. 1983)).

193. *MCorp v. Clarke*, 755 F. Supp. 1402 (N.D. Tex. 1991).

194. The court's jurisdictional analysis is somewhat questionable insofar as it seems to confuse some distinct jurisdictional issues. *See id.* at 1407-12.

195. *See id.* at 1408.

196. *See id.* at 1414-15.

197. *See* 755 F. Supp. at 1423.

D. *Potential Tort Liability of the Banking Agencies for the Seizure and Operation of Depository Institutions*

The Supreme Court recently averted a potential nightmare for the regulators concerning the possibility of tort liability under the Federal Tort Claims Act ("FTCA")¹⁹⁸ for the negligent operation of depository institutions already seized. The FTCA waives sovereign immunity on the part of the United States with respect to tort liability, but it contains a "discretionary function exception," in terms of which immunity is retained in the case of claims based upon acts involving the "exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee, whether or not the discretion involved be abused."¹⁹⁹

The discretionary function exception has proved difficult to apply in practice,²⁰⁰ but in the case of *seizures* of depository institutions, there has been clear agreement in the courts that it operates to protect the regulators from suits claiming negligence in the initial determination of insolvency and the decision to seize the institution.²⁰¹ On the other hand, the Fifth Circuit ruled in 1989 that the exception would not apply where, having seized the institution, the regulators then mismanaged it so badly as to cause loss.²⁰² The effect of this decision would have been to expose the FDIC and the RTC to enormous claims for damages in the case of institutions under their conservatorship and receivership which continued to deteriorate (as many, perhaps most, certainly do) after seizure.

In *United States v. Gaubert*,²⁰³ however, the Supreme Court has scotched such potential suits by reversing the Fifth Circuit in broad and unequivocal terms. In its unanimous decision,²⁰⁴ the Court emphasized that, whenever the agency or its employees exercised judgment "involving the necessary element of choice and grounded in the social, economic, or political goals of the [governing] statute and regulations," they are protected by the immunity.²⁰⁵ These choices include the "[d]ay-to-day management of banking affairs" which, "like the management of other businesses, regularly require judgment as to which of a range of permissible courses is the wisest," and "discretionary conduct is not confined to the policy or planning level."²⁰⁶ The effect of the Court's inter-

198. 28 U.S.C. § 2671 (1988).

199. 28 U.S.C. § 2680(a) (1974).

200. For a survey of recent developments in the field, see Byse, *Recent Developments in Federal Administrative Law: Damage Actions Against the Government or Government Employees*, 4 Admin. L.J. 275, 287-91 (1990), and references cited therein.

201. See *FDIC v. Irwin*, 916 F.2d 1051, 1054-55 (5th Cir. 1990); *Golden Pacific Bancorp. v. Clarke*, 837 F.2d 509, 512 (D.C. Cir.), *cert. denied*, 488 U.S. 890 (1988).

202. See *Gaubert v. United States*, 885 F.2d 1284, 1290 (5th Cir. 1989), *rev'd*, 111 S. Ct. 1267 (1991).

203. 111 S. Ct. 1267 (1991).

204. Scalia delivered a separate concurrence, but agreed with "much of the opinion of the Court." *Id.* at 1280.

205. *Id.* at 1270.

206. *Id.* at 1275.

pretation of the discretionary function exception in the context of banking conservatorships and receiverships is to restrict very severely the range of actions on the part of the regulators that could conceivably give rise to liability in tort. Examples of the latter would be the failure to carry out a non-discretionary mandate contained in an applicable statute or regulation, or negligent decisions resting on "mathematical calculations" involving "no choice or judgment in carrying out the calculations."²⁰⁷

The *Gaubert* decision obviously came as a major relief to the regulators,²⁰⁸ although, as the *MCorp* case indicates,²⁰⁹ the relationship between liability under Administrative Procedure Act principles and liability in tort has yet to be worked out, and it may well be that the regulators still run the risk of liability where they have abused their powers in order to create an insolvency. In any event, as the *Franklin Savings* case²¹⁰ illustrates, non-monetary relief might still be available where arbitrariness can be established.²¹¹

III. THE REGULATORY DILEMMA

Whether or not one agrees with the outcome of all the judicial disputes surveyed in the preceding sections, there can be no doubt that litigants have frequently achieved success in the courts and that, with respect to many aspects of enforcement activity, the courts have played an active role in curbing the actions of the banking agencies, their rhetoric of deference notwithstanding. In an environment of increasingly formal enforcement action, it clearly pays some institutions and their "affiliates" to seek judicial review of the agencies' actions, and the threat of costly judicial proceedings might well become an inhibiting factor, for good or ill, in the minds of agency enforcers. An important question to be considered, then, given the extra burden that judicial review places upon the bailout and supervisory processes, is this: is the frequency of litigation likely to continue, or will the law relating to enforcement become clarified, thereby reducing the incidence of litigation?

The answer proposed here is that, while the questions concerning pre-FIRREA capital agreements are likely soon to be settled by the Supreme Court, and while highly specific disputes concerning agency powers (such as whether the Fed's source of strength doctrine may be enforced)

207. *Id.* at 1278.

208. See Garsson, *High Court Backs Regulators In Suit by Failed S&L's Chief*, *Am. Banker*, Mar. 27, 1991, at 2.

209. See *MCorp v. Clarke*, 755 F. Supp. 1402 (N.D. Tex. 1991); see also *supra* text accompanying notes 193-197 (discussing *MCorp*).

210. See *Franklin Sav. Ass'n v. Director of the OTS*, 942 F.Supp. 1089 (D. Kan. 1990), *rev'd*, 934 F.2d 1127 (10th Cir. 1991); see also *supra* text accompanying notes 177-82 (discussing case).

211. Note the distinction between "abuse of discretion" for FTCA purposes and "abuse of discretion" for APA purposes and suits challenging the appointment of conservatorships and receiverships.

are also likely soon to be settled by the Supreme Court and Congress, substantial litigation concerning the way in which the agencies' enforcement powers are used is likely to continue and, as the post-FIRREA enforcement orders begin to reach the courts, might significantly increase until the enactment of substantial reforms, concerning both the allocation of power among the banking agencies and the availability of deposit insurance.

There are three reasons for this conclusion. First, while some process of adjustment to a more formal and vigorous enforcement environment is likely to take place, the resulting decrease in uncertainty and the sense of unfairness (which might be driving some of the current judicial activism) is unlikely to have a major impact on the number of cases reaching the courts. Second, the banking agencies (and the FDIC in particular) are caught up in a cross-current of conflicting purposes, generating at the very least the *appearance* of improper motivation for some of the most serious enforcement action taken—an appearance which is likely to create, as it already has, a good deal of sympathy on the part of judges towards the “victims” of enforcement action. Until a strong institutional separation is created between the agency responsible for the cleanup and the agencies responsible for enforcement, this state of affairs could persist.

Third, the industry and the agencies have to operate in an increasingly diverse commercial environment, yet they also have to continue acting on the basis of assumptions that are less likely than before to be mutually shared. The concept of safety and soundness, except where it is explicitly defined by statute or rule, is hardly likely to be “generally understood” in the diverse world of modern financial services. At the same time, the agencies have been forced into the position of having to exercise much more conscious watch over the well-being of depository institutions because *taxpayers' money is at stake*. The agencies have become, in other words, “equity holders” in each insured institution. This is beginning profoundly to influence, in a controversial way, their perception of what constitute unsafe and unsound practices. It is quite possible that the disagreements surrounding the bases for enforcement actions will be reflected by the courts on judicial review and, given the almost infinitely varied contexts in which the disputes are likely to arise, it is hard to see how the Supreme Court could add much certainty.

A. *Adjustment Problems?*

The evolution of a more formal enforcement environment, and the great enhancement of enforcement powers, probably are factors contributing to the increase in enforcement litigation and, in turn, to the closer scrutiny that courts appear to be giving enforcement actions. The penal-

ties are serious and so must be taken more seriously by the courts;²¹² background constitutional anxieties (which troubled Congress itself when it increased the scope and scale of the enforcement powers)²¹³ are likely to continue to operate as a constraint against deference in the minds of judges;²¹⁴ and the agencies have to cover so broad a field of operations that mistakes requiring correction on review seem inevitable.

212. *Cf.* *Fitzpatrick v. FDIC*, 765 F.2d 569, 578 (6th Cir. 1985) (small size of civil penalty significant in determining that the penalty was not arbitrary and capricious).

The power of agencies to enforce, through their own proceedings, very large and essentially punitive civil penalties creates some cause for concern. The Administrative Conference of the United States, which has commissioned two major studies on the administrative imposition of civil penalties, has always assumed that extremely large penalties should be imposed through the judicial process and not through the agencies' own administrative adjudications. In encouraging the adoption of civil penalties as an agency sanction, it was never envisaged that agencies should substitute for the courts in imposing essentially punitive sanctions. *See* Admin. Conference of the U.S., *Civil Money Penalties as a Sanction*, Recommendation No. 72-6, 1 C.F.R. § 305.72-6 (1990).

213. The House Judiciary Committee took into account, in its deliberations on the House version of FIRREA (H.R. 1278), the recent decision of the Supreme Court in *United States v. Halper*, 490 U.S. 435 (1989). *See* H. Rep. No. 101-54, pt. 5, Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Report of the Comm. on the Judiciary, at 6 (June 1, 1989). *Halper* was a case involving double jeopardy: in joint criminal and civil judicial proceedings, Halper had received both criminal punishment and a civil fine for engaging in Medicare-related fraud; subsequently, a government agency imposed on him a civil penalty which was so large that, as the Court held, it bore no rational relationship to the loss suffered by the government and it therefore crossed "the line between remedy and punishment," 490 U.S. 450, thereby exposing Halper to double jeopardy. Although the Court emphasized that its decision was confined to the question of double jeopardy, *id.* at 436, the Court's insistence on looking to the substantive nature of the penalty, as opposed to its "civil" label (a "functional" rather than "formal" approach), when determining whether the penalty was primarily punitive or remedial, *id.*, suggests that there might be due process, Article III, and trial-by-jury problems with the administrative imposition of very large penalties which bear no relation to the actual losses inflicted. The Judiciary Committee did not investigate these broader implications, confining itself only to a concern for the constitutionality of the civil penalty provisions relating to *judicial* proceedings. On the implications of *Halper* for judicial enforcement proceedings, see Glickman, *Civil Sanctions and the Double Jeopardy Clause: Applying the Multiple Punishment Doctrine to Parallel Proceedings after United States v. Halper*, 76 Va. L. Rev. 1251 (1990).

214. *Cf.* *Citizens State Bank v. FDIC*, 751 F.2d 209 (8th Cir. 1984).

In addition to concerns raised by the *Halper* decision, discussed in the immediately preceding note, another recent decision of the Supreme Court conceivably has potential implications for the agency sanction system established by FIRREA. In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33 (1989), a majority of the Court recommitted itself to the principle of trial by jury under the Seventh Amendment where the adjudication of "private rights" is at stake and the suit resembles an action at common law. *Id.* at 50-55. The power to order restitution and reimbursement, incorporated by FIRREA into the banking agencies' cease and desist powers involves an allocation of liability between parties (institution-affiliated parties and the depository institutions which they have harmed) and might conceivably give rise to a right to trial by jury. But it is more likely that such "private rights" would be regarded as having acquired a "public" complexion by virtue of the valid delegation of this adjudicative power to the agencies the government's interest in the safety and soundness of the institutions concerned, the provision of federal deposit insurance, and the closely regulated nature of banking. *See id.* at 52-55; *see also* Paul v. OTS, No. 90-2496-CIV-DAVIS (S.D. Fla. filed Dec. 4, 1990) (reproduced in Current Developments, *supra* note 76, 118-27) (rejecting plaintiff's Seventh Amendment claim).

On the other hand, the development by the agencies of a structured set of principles governing enforcement, whether through rules²¹⁵ or as a result of the increased volume and publicity of agency adjudication, should do much to reduce the uncertainty regarding the manner in which enforcement sanctions will be applied in areas where the basis for enforcement itself is not in dispute. Furthermore, the results on judicial review are likely to have a feedback effect on the agencies as their administrative law judges take into account principles articulated by the courts in prior cases.

The adjustment factor, I would therefore suggest, is not likely in itself to generate unusual difficulties concerning judicial review of enforcement action. More important are the structural and conflict of interest problems associated with the changed environment of banking enforcement.

B. *Supervision or Bailout?*

A deeper problem is the conflict of purposes toward which the banking agencies, and the FDIC in particular, are directed. On the one hand, each of the supervisory agencies is under immense public pressure to prevent the growth of, and indeed to eliminate as far as possible, the insider abuses that have played so important a role in the S&L and banking crises. They are expected, in other words, to engage in a general cleanup of the industry in order to protect the deposit insurance funds from further losses. To this end, they have been directed to use their enforcement powers to the fullest extent, and they are also being encouraged to engage in preemptive action, or "early intervention."²¹⁶

At the same time, the FDIC (and the RTC²¹⁷) are also required to engage in a general "cleanup" of the industry. The FDIC has the unenviable task of implementing a badly underfunded "bailout" of both the thrift and banking industries through the discharge of its open bank, conservatorship and receivership duties, a good proportion of which involve the sale of ailing institutions, or at least their best assets, as quickly as possible and with the least possible further expense to the insurance funds and the taxpayers: it is simply not politically feasible to obtain adequate resources from the public fisc. The FDIC must, in other words, try to sustain the bailout "on the cheap," by selling off the deadwood in the industry to the healthy section of the industry.

215. See, e.g., Federal Financial Institutions Examination Council, *Interagency Policy Regarding the Assessment of Civil Money Penalties by the Federal Financial Institutions Regulatory Agencies*, 45 Fed. Reg. 59,423 (1980); OTS, Orders Nos. 90-331, 90-332, and 90-333 (effective Feb. 12, 1990)(stating enforcement policies, specific policies relating to imposition of civil money penalties, and OTS' statutory powers and procedures used in initiating and pursuing formal investigation).

216. See *supra* text accompanying notes 83-92.

217. Given the partial institutional isolation and the highly specific tasks of the RTC, the comments in this section do not apply to the RTC itself.

It should come as no surprise, therefore, that charges of conspiracy by the FDIC with other supervisory agencies to engineer the insolvencies of saleable bank systems have been made, and that these charges appear to have been established by credible evidence in the courts.²¹⁸ Could the pressure to appear to be doing something successful also be the explanation for the OTS' apparent eagerness to seize thrifts (either because of disagreements concerning accounting principles,²¹⁹ or because, though seemingly viable at the time of seizure, they had fallen foul of the Office's new capital standards, often precisely because they had earlier taken on dead thrifts of which the OTS' predecessor could not otherwise dispose)?²²⁰ No doubt the OTS would protest this explanation and would assert error on the part of the courts involved, but it is unlikely that the sympathy of so many courts towards the victims of these forms of enforcement action could be so completely misplaced.

At any rate, what remains disturbing is that some of the cases suggest perhaps more than just the *appearance of impropriety* on the part of the agencies. While perhaps politically satisfying in the short term, summary action is not always going to be fair to those exposed to the agencies' enforcement powers, and, if some enforcement action has actually been taken merely to slake a public thirst for vengeance, or to produce apparent successes in conducting the cleanup, this would actually be contrary to the public interest insofar as the unsalable deadwood institutions would continue to lose more and more money.²²¹ If the complaints are based on something more than self-serving rhetoric, then it seems entirely possible that courts, faced firsthand with the effects of drastic enforcement action on the particular institutions, will continue to adopt a relatively interventionist role in protecting these institutions against the regulators.²²²

C. *Depositors and Taxpayers or Bankers and Stockholders? The "New Entrepreneurial State"*

An even deeper difficulty, and one that is likely to be more pervasive and enduring, is the incongruous new enforcement environment that has evolved in response to the S&L and banking crises. The nation still needs

218. See *MCorp v. Clarke*, 755 F. Supp. 1402 (N.D. Tex. 1991); *Texas Am. Bancshares v. Clarke*, 740 F. Supp. 1243, 1250 (N.D. Tex. 1990). Cf. *Senior Unsecured Creditors' Comm. of First Republicbank Corporation v. FDIC*, 749 F. Supp. 758 (N.D. Tex. 1990) (court apparently skeptical about the creditors' claims).

219. See *Franklin Sav. Ass'n v. Director of the OTS*, 742 F. Supp. 1089, 1109-15 (D. Kan. 1990).

220. See the "regulatory goodwill" cases discussed *supra* text accompanying notes 136-54.

221. Cf. *Hansen Sav. Bank v. OTS*, 758 F. Supp. 240, 247 (D.N.J. 1991) ("By enforcing FIRREA's capital standards on [Hansen Savings], the OTS will create the situation it seeks to avoid: creating an insolvent thrift which becomes part of the public charge. The result is far from being in the public interest.").

222. See *supra* note 167 (discussing the comments of Judge Saffels in the *Franklin Savings* case).

the financial services that are provided by thrifts and banks. There is no state-owned bank industry. The agencies therefore also have a responsibility to permit—indeed, foster—the prosperity, and therefore the entrepreneurial activities of the (privately-owned and operated) industry. Even if they so wished, they would never have the managerial resources to do otherwise. At this point, the function of the regulators is to maintain boundary control, leaving the members of the industry free to get on with banking and thrift business as long as they remain within the parameters set by Congress and the regulators. As far as it goes, this *regulatory model* is quite consistent with the roles performed (at least in theory) by many federal agencies.

Because of the special importance of banking to the money supply, however, it has also always been accepted that the role of banking regulators must be much more intrusive than is the case for other industries. In order to sustain the circulating medium²²³ and in order to protect depositors, the regulators have long been charged with ensuring the safety and soundness of the institutions they supervise. It is not enough that these institutions refrain from violating norms of fair or proper behavior: wherever possible, they must be protected from engaging in conduct that might lead them to fall into insolvency. So we have tended to refer to the banking agencies as supervisors, as well as regulators. Under this *supervisory model*, it was entirely appropriate that the regulators should for so long have worked in such close, continuous and informal cooperation with the industry.²²⁴

The S&L and banking crises have, however, led to a subversion of the supervisory model. In angry response to the public cost of the S&L crisis, and to the abuses that are responsible for so much of this cost, Congress has enthusiastically conferred massive enforcement powers on the banking agencies.²²⁵ In the process, Congress has quite consciously and dramatically enhanced the *law enforcement role* of these agencies, and it has done so because of the exposure of the taxpayers through the deposit insurance system. The old form of close, but informal, regulation, which was followed by an interlude of irresponsible deregulation,²²⁶ might have been displaced by a new “reregulation” that could well result in an acute

223. This monetary policy aspect of deposit insurance sometimes tends to be forgotten.

[I]t is clear from both the statements and actions of many proponents and administrators of bank-obligation insurance systems that the primary object has not been to guard the individual depositor or noteholder against loss but, instead, to restore to the community, as quickly as possible, circulating medium destroyed or made unavailable as a consequence of bank failures. In this view, bank-obligation insurance has a monetary function, and the protection of the small creditor against loss is incidental to the achievement of the primary objective.

Golembe, *The Deposit Insurance Legislation of 1933: An Examination of its Antecedents and its Purposes*, 75 Pol. Sc. Q. 181, 189 (1960)

224. See *supra* text accompanying notes 13-18.

225. See *supra* text accompanying notes 48-51.

226. See *supra* text accompanying notes 37-42.

case of regulatory mismatch.²²⁷ Formal, retributive sanctions constitute part of the technique available for shaping decisions and strategies that really ought to be based on sensitive, highly discrete and differentiated business judgments.

At the same time, as guardians of the deposit insurance funds, whether direct (as in the case of the FDIC) or indirect (as in the case of the Fed, OCC and OTS), the agencies have had to become, in many respects, "equity holders" in the banking industry.²²⁸ Paradoxically, therefore, the agencies also have a greater interest than ever in fostering the *prosperity* of the banking industry, and the entrepreneurial risks that are inevitably associated with the furtherance of this prosperity in an increasingly competitive and complex financial services environment.²²⁹

This, in turn, has produced a major convolution in the role of the regulators. The combined imposition upon the banking agencies of the law enforcement model, on the one hand, and the equity holder perspective, on the other, seems in the banking arena to have led to the emergence of an unusual form of regulation that we might call the *entrepreneurial state*. The entrepreneurial state created by the combination of events just outlined takes the form of agencies with a powerful law enforcement mission, vested with the responsibility not only for policing the boundaries of fair play but also with: punishing and incapacitating the miscreants; cleaning out the industry deadwood; protecting and regenerating the federal insurance funds; fostering the general prosperity of the industry; facilitating the diversification of the industry in the face of increasing and possibly fatal competition from other sectors of the financial services industry; and, of course, regulating the money supply!

Because the easiest aspect for Congress to deal with in assisting the agencies with these tasks is the "law and order" aspect, among the most extensive and readily available tools that have been conferred on the agencies are their enhanced enforcement powers. The result that might well be developing is that of a law-enforcement tail attempting to wag an entrepreneurial dog. In other words, the bureaucratic techniques of traditional formal agency enforcement sanctions are being used to direct,

227. See, e.g., S. Breyer, *Regulation and its Reform 191-96* (1982)(discussing regulatory mismatches); C. Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* 89 (1990)(same).

228. See, e.g., Garten, *Regulatory Growing Pains: A Perspective on Bank Regulation in a Deregulatory Age*, 57 *Fordham L. Rev.* 501 (1989) (describing the shift, on the part of the banking regulators, from the role of debtholders to that of equityholders). For early recognition of this development, see Serino, *supra* note 23, at 155 ("Since the regulator functions initially to protect the depositors and the shareholders, he should be given the tools to ensure that management is performing with the best interests of the bank in mind. Where management does not, it, not the bank, should suffer.").

229. New developments and innovations in the financial services industry, many of which are placing competitive stresses on the traditional banking and thrift industries, are being reported in the media on an almost daily basis. For a good overview, see *A Survey of International Banking*, *The Economist*, Apr. 7, 1990.

on an after-the-fact basis, the entrepreneurial decisions of the owners and managers of depository institutions.

The effects of this schizoid model are already beginning to manifest themselves. For example, the Chief Counsel of the OTS, Harris Weinstein, has espoused two controversial theories upon the basis of which he contends that the OTS is justified in taking vigorous enforcement action against institution-affiliated parties.²³⁰ The first relates to the fiduciary duties of officers, directors, and other parties involved in the management of depository institutions,²³¹ and the second relates more specifically to the ethical responsibilities of attorneys rendering services to depository institutions.²³²

As far as institution-affiliated parties in general are concerned, Counsellor Weinstein, employing one of the law's "most exotic species,"²³³ argues that, because depositors expect that they will receive repayment of their deposits, and because federal deposit insurance guarantees this repayment, the directors and officers of depository institutions owe a fiduciary duty to the federal insurer: "[E]very fiduciary of a federally insured depository institution owes the federal insurer, at the very minimum, the very same high fiduciary duties that are owed depositors," including "the duty not to risk insolvency and the resulting loss of funds deposited with the institution."²³⁴

230. It is not clear whether Counsellor Weinstein also expresses the views of the other banking regulators. The OTS view that the agencies have a responsibility to impose fiduciary standards based on the federal statutes (and not merely according to relevant state law), see *OTS Issues C&D Order Against Neil Bush for Engaging in Conflicts of Interest*, 56 Banking Rep. (BNA) 761, 762 (Apr. 22, 1991), is certainly shared at the OCC, see *OCC Can Narrow, Deny Outer Limits of State-Granted Fiduciary Powers*, 55 Banking Rep. (BNA) 991 (1990), and is surely correct. On the other hand, when it comes to the proper interpretation of the required standards insofar as these apply to attorneys, the General Counsel of the FDIC is on record as declining to go quite as far as the OTS Chief Counsel. See *FDIC General Counsel Declines to Embrace Higher Duty for Fiduciaries in Failing Banks*, 55 Banking Rep. (BNA) 941-42 (1990).

231. See, e.g., *Speech by OTS Chief Counsel Weinstein on Duties of Depository Institution Fiduciaries*, 55 Banking Rep. (BNA) 510 (Sept. 24, 1990) (text of speech delivered at Southern Methodist University, Sept. 13, 1990); *Bank, Thrift Attorneys React to Duties Outlined by OTS Chief Counsel Weinstein*, 55 Banking Rep. (BNA) 547 (Oct. 1, 1990) (reporting on further remarks by Chief Counsel Weinstein to the Exchequer Club, Sept. 19, 1990).

232. See, e.g., *Advice on How to Exploit Loopholes May be Unethical, OTS' Weinstein Says*, 56 Banking Rep. (BNA) 616 (1991) (reporting on a panel discussion sponsored by the Administrative Conference of the United States entitled "Where were the Lawyers?," Washington, D.C., Mar. 21, 1991); *Ohio, Louisiana Draft Bills Would Limit Liability of Bank and Thrift Attorneys*, Daily Rep. for Executives (BNA), Apr. 17, 1991 (reporting proceedings of the Spring Meeting of the American Bar Association's Section of Business Law, where Weinstein elaborated further on his "whole law" concept) [hereinafter *Draft Bills*].

233. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation*, 1988 Duke L.J. 879, 923.

234. *Speech by OTS Chief Counsel Weinstein on Duties of Depository Institution Fiduciaries*, 55 Banking Rep. (BNA) 510, 511 (Sept. 24, 1990) [hereinafter *Weinstein Speech*]. Weinstein bases this conclusion on three "Hornbook principles": the federal insurer is

By way of illustration, Weinstein uses the hypothetical of a savings bank that has had to increase its loan loss reserves because the value of its primary real estate market has declined. Hoping that the economic downturn causing the decline is about to hit bottom, the bank's board is considering the possibility of engaging in a large urban residential development which, though risky, would be very profitable if the real estate market actually recovers. On the other hand, the board is aware that the failure of the project would have a "devastating impact" on the bank's current capital position. In these circumstances, Weinstein asks, "[w]hat are the board's duties—and to whom are they owed?" "The only conscientious legal conclusion," he argues, "is that the directors owe a fiduciary duty to the holder of the potentially unlimited negative equity risk, e.g. [sic] the United States government, and that directors who fail to consider the potential effect of the transaction on the government breach their duty."²³⁵ The directors would therefore be in breach of their duty if they decided to evaluate the risk exclusively from the point of view of the common shareholders and take the risk of investing in the project because the potential benefits greatly outweigh the potential loss.

As to Counsellor Weinstein's position regarding the professionals engaged by depository institutions (and attorneys in particular), he maintains that they have an ethical and enforceable obligation to practice "whole law," by which he means that an attorney advising or acting on behalf of a depository institution must determine "his or her true obligations by reference to regulatory requirements, concepts of safety and soundness, and fiduciary responsibilities."²³⁶ Attorneys who, when advising their depository institution clients, restrict themselves to furnishing advice on how to exploit regulatory or legislative loopholes, namely those who fail to make further enquiries as to whether prudent legal advice has been furnished with regard to other, related aspects of the activities they are reviewing when they see "red flags" indicating that such advice should be obtained, are liable to attract the attention of the enforcement staff of the OTS.²³⁷ For example, it is not enough for an attorney to advise whether a federally-chartered thrift may legally convert to a state charter; "broader questions of law" must also be considered.²³⁸

Counsellor Weinstein's views, backed up as they are by the enormous

subrogated to the rights of the depositors, who have the right to seek restitution and money damages from fiduciaries; deposit insurance is analogous to equity, and corporate fiduciaries therefore owe a duty to the government; and the government is in the position of a creditor to a nearly-insolvent or insolvent debtor, hence the fiduciaries of such "debtors" "should . . . be primarily concerned with the interests of that institution's largest creditor, e.g. [sic] the U.S. government. The closer an institution is to [in]solvency, the more paramount does the duty to the government become." *Id.*

235. *Id.* at 512.

236. *Advice on How to Exploit Loopholes May Be Unethical, OTS' Weinstein Says*, 56 *Banking Rep. (BNA)* 616 (April 1, 1991) [hereinafter *How to Exploit Loopholes*].

237. *See id.* at 617.

238. *Id.*

enforcement powers of the OTS and the actual use of these powers,²³⁹ have caused some degree of consternation in the legal profession. The novel, uncertain and controversial nature of these standards of professional conduct,²⁴⁰ not to mention their retroactive application, have led to protests from the bar.²⁴¹ Members of the accounting profession have registered their own complaints²⁴² (perhaps somewhat less vigorously, however, since it has long been recognized that accountants perform an important "public watchdog" function, requiring them to ascertain independently the veracity of their client's financial statements,²⁴³ and, in the case of clients subject to federal securities laws, to inform the SEC of deficiencies in the client's financial statements where the client fails to do so²⁴⁴). Returning to Counsellor Weinstein's strict views with respect to the fiduciary duties of directors and officers, it also comes as no surprise that bankers have protested that it is difficult to anticipate the expectations of the regulators as far as their duties are concerned.²⁴⁵

Yet the position espoused by Weinstein is understandable given the unusual position in which the federal banking agencies find themselves. The federal deposit insurance funds *are* providing the backup for depository institution activity. The questions of safety and soundness that now fall under the surveillance of the banking agencies in an increasingly diversified, volatile and competitive financial services market, and the political atmosphere in which government is expected to "do something," have all combined to propel the banking agencies into a position where

239. See *supra* note 88; see also Labaton, *Putting Lawyers Under Scrutiny*, N.Y. Times, Mar. 21, 1991, at C2, col. 1.

240. It is not clear, for example, whether Counsellor Weinstein's standards of professional conduct to be observed by attorneys would comport with the lawyer's duties of confidentiality (ABA Model Rule 1.6) and loyalty (ABA Model Rule 1.7) to his or her client. More fundamentally, while an attorney may render advice concerning extra-legal issues of morality, economics, social and political factors (ABA Model Rule 2.1), and in the context of banking surely ought to, it is unclear what the ultimate *scope* of this advice ought to be. As one attorney, addressing Counsellor Weinstein's expectations and referring to the obvious risk inherent in all banking decisions, has protested, "[o]ne man's unsafe and unsound practice is another's business opportunity." *Draft Bills, supra* note 225. It is difficult fairly to base serious enforcement action on so intangible a duty.

241. See *Weinstein Speech, supra* note 227, at 547-48; *How to Exploit Loopholes, supra* note 229, at 618. As one attorney put it, if Counsellor Weinstein's "whole law" approach "means that when you're in doubt you consult the agency, I think there are a lot of practitioners who will disagree about that." *Id.* Legislation is being prepared in two states (Ohio and Louisiana) that would attempt to restrict the scope of the OTS' "whole law" concept. *Id.*; see also Villa, *supra* note 76, (suggesting that "the resolve of professionals to contest the agencies' actions is building").

242. See *OTS is Trying to Regulate the Accounting Profession*, Thrift Regulator, Dec. 14, 1990 (No. 90-47).

243. See *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984); see generally, Murphy, *Standards Governing Conduct of Officers, Directors and Others*, in *Current Developments, supra* note 76, at 389, 399-402.

244. See *Mishkin v. Peat, Marwick, Mitchell & Co.*, 658 F. Supp. 271, 274 (S.D.N.Y. 1987); Murphy, *supra* note 242, at 400-01.

245. See Porter, *Regulators Increase the Risk for Bank Officers, Directors*, Am. Banker, Feb. 6, 1991, at 4.

they have to adopt the views urged by the OTS Chief Counsel. It is no wonder that Counsellor Weinstein is attempting to recruit to his aid additional "policemen"²⁴⁶ in the form of attorneys and accountants who might have privileged access to information which the agency itself would not discover until long after the damage has been done. And it is also no wonder that he is attempting to deter as much risk-taking as possible.

Even if the position of the agencies is an understandable one, however, it might not be practical. The central problem is that safety and soundness is inextricably tied to the question of business judgment.²⁴⁷ Banking regulators do, it is true, acquire considerable expertise in such matters and so are well-qualified to evaluate banking decisions for their safety and soundness. But in one respect they nearly always enjoy an advantage that makes punitive enforcement action unfair and ineffective as a tool for directing the welfare of the industry: they make their evaluations with the benefit of hindsight and, if the theories of Counsellor Weinstein do indeed express a legitimate basis of enforcement action, they do so according to very high standards of prudence. In short, they operate according to a "should-have-known standard"²⁴⁸ which is not only as unfair, in the case of honest institutions and institution-affiliated parties, as is Monday morning quarterbacking, but which precisely because such judgments cannot be made in advance is ineffective as a means of directing an institution in the future. On the contrary, the chilling effect that is likely to result from heavy-handed enforcement based upon prophylactic principles of professional duty might well lead professionals and, in turn, their depository institution clients, to err on the side of excessive caution, perhaps even to the ultimate detriment of the general prosperity of the industry.

CONCLUSION

Two fundamental problems have been identified as far as the intensified enforcement activities of the banking regulators are concerned. First, there is a conflict of purposes between the cleanout effort and the continuing responsibility to ensure the maintenance of depository institution safety and soundness. There is some indication that the banking

246. See *How to Exploit Loopholes*, *supra* note 235, at 617-18 (suggestion by member of the bar that this is what Weinstein is expecting attorneys to become).

The complicated policy implications associated with enforcement efforts to impose this form of "gatekeeper" liability on accountants, lawyers, and other individuals involved with corporate organizations are explored in Krakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 *Yale L.J.* 857 (1984).

247. Cf. Vartanian, *Woes in Financial Industry Challenge Outside Directors*, *Am. Banker*, Apr. 6, 1990, at 4 ("many argue that the business judgment rule that normally protects board decisions has been preempted and even trampled by the regulatory business judgment rule").

248. *How to Exploit Loopholes*, *supra* note 235, at 618 (one attorney's criticism of Weinstein's "whole law" theory).

agencies might not always have acted solely in the interests of safety and soundness when they have closed some institutions; they may sometimes have acted for other motives, such as fulfilling the appearance of implementing an effective cleanup operation.

Second, the pressure to engage in vigorous enforcement, the exposure of taxpayers in the event of insolvencies, and the increasingly complex nature of the markets in which the depository institutions operate (as well as the polycentric characteristics of the business decisions that must be made in that environment), have all combined to create a situation in which both the basis for enforcement action and the appropriate ensuing sanctions are bound to remain controversial and likely to spawn continuous challenges in court.

The resolution of these difficulties is inevitably bound up with the broader structural and functional reform of the banking industry as a whole. For example, the possible reduction in the coverage of federal deposit insurance²⁴⁹ would, by reducing the degree of taxpayer exposure to the costs of banking failure, help to reduce the pressure on the agencies to take inappropriate punitive action against depository institutions. A transfer of the power to determine whether an institution is "too big to fail,"—involving "systemic risk" and monetary policy judgments—from the FDIC to the Fed and Treasury,²⁵⁰ would help to separate monetary and macroeconomic policy concerns from safety and soundness issues, and might in turn help to reduce the number of arbitrary enforcement results as between institutions.

Further lines of inquiry are, however, also worth pursuing. First, as far as the outright seizure of institutions is concerned, it is questionable that the agencies, because of their close relationship at the level of the FDIC Board, should be in a position to engineer insolvencies merely in order to be able to sell off more attractive institutions. A fairer solution might be to require a clear institutional separation between the agencies charged with supervising and closing institutions and the agency charged with performing the receivership functions. (Here the RTC model might be appropriate, except that under this model there might still be too much contact between one of the supervisory agencies (FDIC) and the receivership agency (RTC)).

Second, it is time for Congress and the courts to be more frank about the punitive aspects of the banking agencies' cease-and-desist, removal and prohibition, and civil money penalty powers. There is no doubt that these enforcement powers were authorized and are being used (perhaps even quite appropriately) in order to punish past wrongdoing as well as to prevent further abuse and mismanagement. Nor is this necessarily objectionable or incongruous, since the general and specific deterrent ef-

249. A reduction in the coverage of federal deposit insurance would be effected by the Treasury' proposed legislation. Financial Institutions Safety and Consumer Choice Act, H.R. 1505, § 101 [hereinafter FISCCA].

250. *See id.* § 103(a) (new § 13(c)(4)(C) of the Federal Deposit Insurance Act).

facts of such punitive action help to influence future decisions. But if the enforcement powers can be used punitively, it is quite possible that they will encourage heavy-handed regulation, with the regulator using the big stick as a prophylactic measure—especially when the regulators are subjected to intense political pressure to engage in early intervention. It is at this point that the wooden features of the formal enforcement powers become unfair and quite possibly counterproductive.

A clearer distinction might profitably be drawn between those enforcement powers that refer to past violations and have a punitive effect (e.g., permanent removal and prohibition orders, civil penalties and restitution orders) and those which are primarily designed to prevent further deterioration in the institution concerned (e.g., capital maintenance agreements, temporary removal orders and restrictions on “new financial activity”²⁵¹). The agencies could be subjected to stricter standards when applying sanctions that are punitive in nature, so that they could not use them as a means of bludgeoning institutions and their managements into complying with agency requirements that are based merely on business judgments and not on clear violations of rules or well-established unsafe and unsound practices.

Third, and in implementation of the distinction between punitive and remedial sanctions, it is possible that procedural and structural modifications within the agencies would help to maintain the barrier between punishment and management. At least three possibilities could be considered.

A helpful procedural modification, and one that has already been urged by the Administrative Conference of the United States,²⁵² might be the adoption of an analogy to the “Wells Submission” employed by the Securities and Exchange Commission (“SEC”).²⁵³ Persons faced with the prospect of having formal enforcement action taken against them are given an opportunity by the SEC to present a statement of their interest and position in the dispute to the enforcement staff before the formal action is actually instituted, even if such action has already been authorized by the Commission. One advantage of such a procedure in the banking enforcement context is that it would bring into direct contact, on a regular and centralized basis, the agency enforcement officials and the persons with respect to whom enforcement action is being contemplated before the dispute has assumed too adversarial a posture. This would help to obviate the possibility that formal enforcement action might be

251. See FISCCA, *supra* note 248, § 251(a).

252. Recommendation of the Administrative Conference of the United States, No. 87-12, Adjudication Practices and Procedures of the Federal Bank Regulatory Agencies, 1 C.F.R. § 305.87-12 (1990) (Recommendation No. 5).

253. On Wells Submissions, see, e.g., J.D. Cox, R.W. Hillman & D.C. Langevoort, Securities Regulation: Cases and Materials 1010-11 (1991); McLucas, Hamill, Shea & Dubow, *An Overview of Various Procedural Considerations Associated With the Securities and Exchange Commission's Investigative Process*, 45 Bus. Law. 627, 689-93.

instituted upon the mere recommendation of officers in the field, many of whom are not lawyers.

If more substantial measures turn out to be necessary, the model supplied by the National Labor Relations Board ("NLRB") offers an example of a possible structural modification. The Labor-Management Relations Act of 1947²⁵⁴ created a structural division within the NLRB between the prosecutorial and adjudicatory functions of the agency.²⁵⁵ The General Counsel's office, which prosecutes unfair labor practice disputes before the Board, is independent of the Board's supervision and review. Until a charge is brought by the General Counsel, the Board may take no enforcement action.²⁵⁶ Such a model goes further than the present Administrative Procedure Act requirements applicable to the banking agencies²⁵⁷ and might be appropriate for punitive enforcement actions by the banking agencies. The enforcement staff at the agency would be required to refer formally the prosecution of some of the charges available to the agencies (civil money penalties, removals, etc.) to the independent office, which, insulated from pressure by the agency itself, would then decide whether to bring formal charges. In the interim, the agency itself could take emergency action where necessary through the use of temporary orders (e.g., certain cease and desist orders and suspensions), and it could prosecute other enforcement action which is primarily corrective or preventative in nature (e.g., capital maintenance agreements and restraints on new activities).

The second structural possibility is that of a more thorough-going "split enforcement" model, such as those which operate in federal occupational safety and health and mine safety administration.²⁵⁸ Under such models, the responsibility for adjudicating enforcement proceedings brought by the agency is assigned to a wholly independent agency. For example, the Occupational Health and Safety Review Commission ("OSHRC") adjudicates enforcement actions brought by the Occupational Health and Safety Administration ("OSHA"). Although there are difficult problems of coordination and inter-agency deference involved,²⁵⁹

254. 61 Stat. 136.

255. See, e.g., *NLRB v. Local 23, United Food and Commercial Workers Union*, 108 S. Ct. 413, 418-20 (1987); A. Cox, D. Bok & R. Gorman, *Cases and Materials on Labor Law* 104-07 (10th ed. 1986).

256. *NLRB v. Sears, Roebuck & Co.*, 421 U.S. 132, 155-59 (1975).

257. See 5 U.S.C. § 554(d) (1988) (providing for a functional separation between investigative and prosecuting staff on the one hand, and adjudicators on the other).

258. See Johnson, *The Split-Enforcement Model: Some Conclusions From the OSHA and MSHA Experiences*, 39 Admin. L. Rev. 315 (1987). A similar proposal has been advocated for the enforcement of federal aviation safety regulations. See Fallon, *Enforcing Aviation Safety Regulations: The Case for a Split-Enforcement Model of Agency Adjudication*, 4 Admin. L.J. 389 (1991). The Administrative Conference of the United States adopted many of Fallon's proposals, but not this one, in its own recommendations to the Congress. 1 C.F.R. § 305.90-1 (1990).

259. See the discussion and guidelines expressed in the Recommendation of the Administrative Conference of the United States, No. 86-4, *The Split Enforcement Model for Agency Adjudication*, 1 C.F.R. § 305.86-4 (1990). Cf. *Martin v. Occupational Safety and*

the split enforcement model is thought by many to ensure that persons subjected to agency enforcement action are provided with, or at least will feel that they have been provided with, fairer procedures and better protection from over-zealous regulators than is the case with a unitary adjudication system.²⁶⁰ Given the potential and temptations for over-zealous enforcement by the banking agencies, the same argument could be made in the banking enforcement context. Indeed, it might even be argued that enforcement adjudication should be centralized for *all* the federal banking agencies, though an instant rejection of this suggestion would be anticipated by anyone familiar with the turf-protecting proclivities of each of these agencies.

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These suggestions are somewhat tentative and obviously require careful further investigation, particularly in light of the general direction that banking reform might take in the coming months. It does seem, however, that a more discriminating approach to the application by the banking agencies of their enforcement powers might be necessary, if charges of agency abuse and unfairness are to be countered, and if the enforcement actions of the agencies are to be constructive in the long term.

Health Review Comm'n, 111 S. Ct. 1171 (1991) (deciding that OSHRC should defer to OSHA and the Secretary concerning interpretations of the Secretary's regulations).

260. See Fallon, *supra* note 258, at 419-20; Johnson, *supra* note 258, at 344-46.