Resolution Trust Corporation: Waste Management and the S&L Crisis

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INTRODUCTION

Throughout its history, the savings and loan industry has dedicated itself almost exclusively “to promoting home ownership through mortgage lending.”1 By 1989, however, the industry was brought to a near collapse due to fundamental flaws in the system’s structure, changing economic conditions, deregulation and fraud. Congress and the Bush Administration responded by formulating and enacting a massive industry bailout bill, the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA").2 The primary purposes of FIRREA are to provide affordable mortgages and housing opportunities by enhancing federal housing credit programs and resources; to create the agencies and procedures to fund the resolution of failed thrift cases and dispose of their assets; to reinforce the barriers between the regulatory and insurance functions of the thrift industry; to establish more stringent capital requirements for thrifts; and to enhance regulation and enforcement of the savings institutions regulatory agencies to protect against waste, fraud and insider abuse.3

This Note provides a detailed look at the Resolution Trust Corporation ("RTC"), which was established to “contain, manage, and resolve failed savings associations.”4 Part I explores the history of the savings and loan ("S&L") crisis. Part II sets forth the basic structure and duties of the RTC. Part III describes how the RTC obtains and uses its funding and explains the role of the Resolution Funding Corporation ("REFCORP"). Part IV examines the programs implemented by the RTC to resolve failed S&Ls, including an in-depth discussion of its asset disposition policies, with particular attention paid to real estate and securities. Lastly, Part V analyzes relevant case law influencing the RTC’s mission. This Part concentrates on the doctrine that gives the RTC authority to recover on certain loans it acquires from failed S&Ls, even where those loans were voidable because they were fraudulently made by the S&Ls. In addition, it discusses a venue provision in FIRREA that is having a large impact on the litigation in which the RTC is involved. Finally, Part V focuses on a decision that grants the RTC the power to supercede state bank branching laws and analyzes its effect on future litigation.


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I. HISTORY OF THE S&L INDUSTRY AND CRISIS

The thrift industry was created to enable American families to buy homes with affordable financing. The industry was severely disabled, however, in the 1930s by the Great Depression when borrowers could no longer pay their mortgages, thus causing thousands of thrifts to fail. Anxious depositors withdrew their money from the system, accelerating its collapse. Congress passed a blitz of legislation to restore confidence in the nation's financial systems, and created the Federal Savings and Loan Insurance Corporation ("FSLIC"). Congress intended the FSLIC to insure small depositors, "thus encouraging the public to reinvest their funds in savings and loans."

Skyrocketing interest rates and record inflation during the late 1970s and early 1980s led the Federal Reserve to institute a policy of controlling growth in the money supply. Subsequently, the cost of money to thrifts dramatically increased, while their assets were still locked into long-term, low-yield, fixed-rate mortgages. Congress and several state legislatures responded by enacting legislation which was intended to enable the thrift industry to remain viable and competitive.

In 1980, Congress phased out regulations that capped the interest rates thrifts could pay depositors. Thrifts were then able to compete with other financial service providers by paying higher interest rates to depositors. Regulations, however, still prohibited them from making similar adjustments in their mortgage and asset portfolios. Thus, by 1981, thrifts were paying an average of eleven percent for funds while their

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15. See id.
mortgage portfolios were earning only ten percent.16

In 1982, President Reagan signed into law the Garn-St Germain Depository Institutions Act,17 which substantially deregulated the financial services industry. The Act authorized thrifts to invest in a host of non-real estate assets, including corporate debt securities, commercial loans, and brokered deposits,18 enabling the thrifts to increase earnings on assets and remain competitive.19 "[A] number of thrift managers [however] did not have the expertise needed to utilize these new powers, and as a whole the industry had great difficulty in exercising its newfound powers in a safe and sound manner."20 As the number of thrift insolvencies began to increase, the foundation for the current S&L crisis was laid.21

Regulatory gimmicks masking the capital levels of the thrifts further contributed to the crisis by enabling thrifts to avoid technical insolvency and thus avert seizure by the FSLIC.22 Because capital provides the cushion to absorb losses, the accounting gimmicks created the illusion that these undercapitalized thrifts were healthy.23 Mismanagement and fraud also caused S&L failures.24 Indeed, the Resolution Trust Corporation later found that forty percent of failures could be attributed to fraud.25

These factors increased the number of S&L failures, overwhelming the FSLIC,26 which by this time insured depositors up to $100,000 on their accounts.27 By the end of 1988, the General Accounting Office, Congress' investigatory agency, estimated that the FSLIC was insolvent by at

19. Brokerage houses and other financial institutions package their funds for deposit in the S&Ls, providing needed cash. For the brokerage house, placing the funds in the S&L provides a safe, no-risk (the deposits are federally insured), high-yielding investment. See Villains of the S&L Crisis, supra note 5, at 55.
20. See P.Z. Pilzer, supra note 7, at 142.
23. See id.
least $56 billion, almost four times greater than its insolvency at the end of 1987.  

Low depositor confidence in the savings and loan industry (demonstrated by record deposit outflows), the need to combat fraud and abuse, and the severe insolvency of the FSLIC, made the need for a resolution imperative. Attempting to salvage the thrift industry, President Bush offered a plan in February 1989 that was introduced to Congress as the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"). Congress approved the plan, and on August 9, 1989, FIRREA became law.

II. Basic Structure and Duties of the RTC

"Virtually overnight [with the passage of FIRREA and the establishment of the RTC], the administration and Congress ... set in place an organization, with assets twice that of the largest bank in the Nation."

Congress designed the RTC with the goals of (1) resolving cases involving FSLIC-insured institutions placed in conservatorship or receivership between January 1, 1989 and August 9, 1992; (2) liquidating the Federal Asset Disposition Association ("FADA"); and (3) conducting

32. A conservator is charged with protecting the assets of a troubled S&L while a permanent solution to the institution's financial problems are worked out. See Barron's Dictionary of Banking Terms 142 (1990). The S&L operates as normally as possible under different management (for our purposes, the FSLIC or RTC). An S&L declared to be insolvent is placed into receivership and its assets are sold. See id. Essentially, the institution no longer functions as a going concern.
33. FADA was chartered by the Federal Home Loan Bank Board ("FHLBB") in November of 1985. See House Banking Committee Report, supra note 1, at 302, reprinted in 1989 U.S. Code Cong. & Admin. News, at 98. It was designed to assist the FSLIC by bringing in a group of experts to help manage the growing number of assets coming under FSLIC control through seizure of insolvent thrifts. See id. Congressional investigation however, discovered that FADA was managed poorly, with no clear mandate and rife with conflicts of interest. See Federal Asset Disposition Association, Hearing before the Subcomm. of Financial Institutions Supervision, Regulation and Insurance of the House Comm. on Banking, Finance and Urban Affairs, 100th Cong. 1st Sess. 37 (1987)(statement of Rep. Fernand St Germain, Chairman of the subcommittee). The General Accounting Office ("GAO") found that FADA was losing money and had not demonstrated that it could dispose of property any more efficiently than the FSLIC. See id. Despite a bipartisan call from the House Banking Committee to terminate FADA, the Bank Board refused. See House Banking Committee Report, supra note 1, at 302, reprinted in 1989 U.S. Code Cong. & Admin. News, at 98.
operations in order to maximize recovery on acquired assets, minimizing
the impact on local markets, making efficient use of funds, minimizing
losses incurred in resolving cases, and preserving a supply of affordable
housing.\textsuperscript{34} Congress also mandated that the RTC review certain costly
deals that the FSLIC made with investment specialists between January,
1988 and August 9, 1989, and "exercise any and all legal rights to
modify, renegotiate, or restructure such agreements where savings would
be realized."\textsuperscript{35}

The RTC was established as a mixed-ownership government corpora-
tion\textsuperscript{36} with the Federal Deposit Insurance Corporation ("FDIC") as its
manager.\textsuperscript{37} In order to ensure that the RTC was operating with the
broadest policy mandate, FIRREA created an Oversight Board to super-
vise and answer for the RTC.\textsuperscript{38} Members of the Oversight Board include
the Secretary of the Treasury, Chairman of the Board of Governors of
the Federal Reserve System, Secretary of Housing and Urban Develop-
ment, and two independent members.\textsuperscript{39} The Board's primary responsi-

\begin{itemize}
\item[]{34. See FIRREA, supra note 2, § 501(b)(3)(C), 103 Stat. at 369-70 (to be codified at
Report].}
\item[]{35. FIRREA, supra note 2, § 501(b)(11)(B), 103 Stat. at 373 (to be codified at 12
U.S.C. § 1441a(b)(11)(B)). In 1988 and early 1989, the FSLIC and the FHLBB resolved
199 insolvent thrifts. See GAO Releases Report on Controversial 1988 Thrift Resolutions
by Bank Board, 55 Banking Rep. (BNA) No. 12, at 482 (Sept. 24, 1990). The purchaser
was provided long-term financial assistance in 96 of these transactions. See id. Because
the FSLIC was bankrupt when it negotiated these deals, it issued promissory notes, with
the interest payable to the thrift instead of providing cash assistance to the investors
acquiring the insolvent S&Ls. See Agency Sees Way to Cut Bailout Costs, L.A.
Times, Sept. 19, 1990, at D4, col. 4. The RTC also guaranteed profits on assets and provided
with tax breaks. See id.}
\item[]{36. See FIRREA, supra note 2, § 501(b)(2), 103 Stat. at 369 (to be codified at 12
U.S.C. § 1441a(b)(2)).}
\item[]{37. See FIRREA, supra note 2, § 501(b)(1)(C), 103 Stat. at 369 (to be codified at 12
U.S.C. § 1441a(b)(1)(C)). The FDIC's Board of Directors is the Board of Directors for
the RTC; the Chairman of the FDIC acts as chairman of the RTC. See Conference
\item[]{38. See FIRREA, supra note 2, § 501(a)(2), 103 Stat. at 364 (to be codified at 12
U.S.C. § 1441a(a)(2)).}
§ 1441a(a)(3)(A)).}
\end{itemize}
bility is developing overall strategies for case resolution, asset disposition, and financing.40

The RTC will dissolve by December 31, 1996.41 If at that time it is still acting as conservator or receiver for an institution, the FDIC will assume the RTC's responsibilities.42 Any assets or liabilities of the RTC at that time will be transferred to the FSLIC Resolution Fund.43

III. REFCORP AND RTC FINANCING

The RTC requires funds for two distinct purposes: to pay depositors at failed thrifts the amount of their insured accounts and to provide working capital to finance acquired assets until they are sold.44 The REFCORP was established to provide the RTC with funds to pay depositors.45 REFCORP is managed by a Directorate consisting of the Director of the Office of Finance of the Federal Home Loan Banks, as well as the Presidents of two Federal Home Loan Banks selected by the Oversight Board.46

FIRREA authorizes REFCORP to issue $50 billion in long-term securities47 which the RTC will use to pay insured depositors at failed thrifts.48 The principal on these securities will be paid from the proceeds of long-term government securities that REFCORP purchased with money contributed by the twelve Federal Home Loan Banks.49 Interest will be paid from proceeds the RTC earns in resolving failed thrifts,50 from contributions by Federal Home Loan Banks,51 and from the United States Treasury.52

FIRREA also authorizes the RTC to borrow funds from the United

41. See id. § 501(o)(1), 103 Stat. at 391 (to be codified at 12 U.S.C. § 1441a(o)(1)).
42. See id.
43. Id. § 501(o)(2), 103 Stat. at 391 (to be codified at 12 U.S.C. § 1441a(o)(2)).
45. See FIRREA, supra note 2, § 511(a), 103 Stat. at 394 (to be codified at 12 U.S.C. § 1441b(a)).
46. See id. § 511(c)(1), 103 Stat. at 395 (to be codified at 12 U.S.C. § 1441b(c)(1)).
48. See RTC Hearing, supra note 44, at 10 (statement of L. William Seidman, Chairman, FDIC and RTC).
51. See id. § 511(f)(2)(C), 103 Stat. at 401 (to be codified at 12 U.S.C. § 1441b(f)(2)(C)).
52. See id. § 511(f)(2)(E), 103 Stat. at 401-2 (to be codified at 12 U.S.C. § 1441b(f)(2)(E)).
States Treasury and issue notes to obtain its working capital. The total amount of these notes and obligations is limited, however, by a specific formula. Under this formula, the sum of the contributions the RTC receives from REFCORP, plus its outstanding obligations, may not exceed the RTC's available cash, plus eighty-five percent of the fair market value of its other assets, by more than $50 billion. While this mandated cap on borrowing provides the RTC with a capital cushion, in order to use the full $50 billion in REFCORP funding the RTC must slow down resolutions and disbursements to depositors to coincide with the sale of acquired assets in order.

IV. RESOLUTION OF FAILED THRIFTS

The RTC is the successor-in-interest to the FSLIC for all thrifts placed into conservatorship or receivership between January 1, 1989 and August 9, 1992. It also manages and resolves new cases placed into conservatorship by the Office of Thrift Supervision ("OTS").

A. The Resolution Process

The RTC resolves failed thrifts in three ways. The first is liquidation of the S&L's assets, the proceeds of which are used to pay depositors of the insolvent institution up to the amount of their FSLIC-insured deposits. The second is through merger, consolidation, or reorganization; the entire thrift, including all its assets and liabilities are purchased or merged into an existing thrift. Finally, the thrift may be sold or dismantled: the deposits are sold to other S&Ls or banks rather than liqui-

53. See id. § 501(i), 103 Stat. at 384 (to be codified at 12 U.S.C. § 1441a(i)).
54. See FIRREA, supra note 2, § 501(j)(1), 103 Stat. at 384 (to be codified at 12 U.S.C. § 1441a(j)(1)).
56. See RTC Hearing, supra note 44, at 11 (statement of L. William Seidman, Chairman, FDIC and RTC).
dated, and the assets are marketed and sold. Regardless of the resolution method, the RTC must find some way to dispose of the thrifts' component assets and liabilities.

With a mandate to maximize "the net present value return from the sale or other disposition of [seized thrifts]," the RTC is subject to competing pressures: to resolve cases as quickly as possible to save the costs of managing the thrifts and their assets, and to find the highest realizable value in their sale. However, because thrifts can lose value while they are under RTC control, the RTC risks being caught in a Catch-22 situation: the longer it waits for the best deal to materialize, the lower the ultimate price it may recover. One commentator noted that "[s]eized thrifts are like fresh fruit. They rot very quickly the longer they sit on the shelf."

There are two factors that cause thrifts to lose value. First, a decrease in a thrift's core deposit base immediately reduces the amount that the RTC can realize from a sale. Core deposit runoff often occurs because depositors at a thrift move their funds elsewhere. The deposits of a thrift are normally purchased by another institution at a one to six percent premium. Thus, if the core deposits at an S&L decrease by $1 billion, and the purchaser was willing to pay three percent for the deposits, the RTC would receive $30 million less for the deposits than if the runoff had not occurred. Second, when a thrift is not making new loans, new assets are not being generated, and thus, the value of the thrift decreases. "The asset side atrophies and it takes a long time to regenerate . . . ." After an inactive period, the problem is exacerbated by difficulties in rebuilding relationships with realtors, who are a valuable source of new mortgage customers. A shrinking asset base with little hope for recovery does not leave the RTC in a position to attract bidders.

To avoid a loss in value of seized thrifts, the RTC instituted the Accel-

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61. For a discussion of asset disposition, see infra notes 78-134 and accompanying text.
62. In analyzing the resolution process it is important to realize that a thrift's balance sheet is the reverse of a corporation's balance sheet. Assets are made up of the thrift's loan portfolio, as well as other tangibles such as real estate. See R. Thorn, Introduction to Money and Banking, at 36-37 (1976); Banking Terminology (A.B.A.), at 19 (1989). Deposits in the thrift are liabilities. See Thorn, supra at 52-55; Banking Terminology, supra at 109, 209.
63. FIRREA, supra note 2, § 501(b)(3)(C)(i), 103 Stat. at 369 (to be codified at 12 U.S.C. § 1441a(b)(3)(C)(i)).
65. One thrift, Gibraltar Savings of Simi Valley, California, lost about one-third of its deposits from the time it was seized on March 31, 1989, until December 31, 1989. See How One S&L Lost Value Under the RTC, supra note 64, at 16, col. 3.
66. See id. at 16, col. 4. The purchaser pays the premium in the hope that customers will keep their funds in the accounts, thus attracting other customers. See Bailout Agency Races to Sell Insolvent S&Ls, Investor's Daily, June 8, 1990, at 1, col. 3.
67. See How One S&L Lost Value Under the RTC, supra note 64, at 16, col 5.
68. Id.
erated Resolution Program ("ARP"). The program is designed to increase the price recovered by the RTC for seized thrifts and minimize the costs to the taxpayers. Under the ARP, the RTC markets a failing thrift for sale before it is actually placed in conservatorship. All of the assets are transferred to the purchaser or sold to another buyer before the thrift passes through receivership into the new owner's control. The program allows the RTC to search for a buyer "while [the thrift] still ha[s] a somewhat attractive core deposit base, and before any stigma associated with the conservatorship program can be attached to [it]. . . ." The first round of sales under the ARP was completed the end of 1990 with seemingly positive results. Deposit runoff has been greatly reduced, and there are many qualified buyers for the thrifts.

The ARP appears to be the most effective approach to enable the RTC to sell insolvent thrifts. While the RTC has the authority to sell a thrift in conservatorship or receivership, the thrifts in the ARP have not yet been placed under the RTC's control. Whether the RTC and OTS are acting within the law in lining up a purchaser for a thrift while that thrift is still under its own management is still open for debate. Other litigation involving the RTC, however, has already demonstrated that the courts are ready to give the RTC very wide latitude in interpreting its powers under FIRREA.

B. Asset Disposition

When a thrift is placed in conservatorship or receivership, the RTC acquires and assumes control over all of the thrift's assets. FIRREA directs the RTC to maximize the return from the sale and disposition of these assets. The assets acquired from the seized thrifts include a wide

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70. See id.
71. The OTS must find that the thrift is "in danger of failing and possess[es] the financial characteristics that would cause it to be placed in RTC conservatorship within one year." Id.
72. See id.
73. See OTS Will Hasten Transfer of Sick Thrifts to Strapped RTC, Am. Banker, Nov. 14, 1990, at 5, cols. 2-3. This receivership period is a mere formality as control is given to the RTC and turned over to new owners in the same day. See id.
74. Disposition of Assets by the Resolution Trust Corporation: Hearing Before the Subcomm. on Financial Institution Supervision, Regulation and Insurance, RTC Task Force of the House Comm. on Banking, Finance, and Urban Affairs, 101st Cong., 2nd Sess. 12 (March 27, 1990) (Statement of William Roelle, Director, Resolutions and Operations Division, RTC) [hereinafter Asset Disposition Hearing].
75. See OTS Will Hasten Transfer of Sick Thrifts to Strapped RTC, supra note 73, at 5, col. 4.
76. See id. at col. 5.
77. For a further discussion of this litigation, see infra notes 135-192 and accompanying text.
78. See FIRREA, supra note 2, § 501(b)(3)(C)(i), 103 Stat. at 369 (to be codified at 12 U.S.C. § 1441a(b)(3)(C)(i)).
variety of investments normally made by an S&L, the largest percentage being in real estate and securities.

1. Real Estate Disposition

FIRREA mandated that the RTC establish a Real Estate Asset Division ("READ") to manage the disposition and sale of its real estate holdings.79 READ is charged with regularly publishing the RTC's properties and identifying those properties with "natural, cultural, recreational or scientific values of special significance."80 Typical real estate holdings consist of single-family homes, condominium developments, office buildings, apartments and commercial lots, as well as agricultural, mining and unimproved land.81 These assets must be sold at the highest possible price, in a manner that minimizes the impact on local real estate markets and that maximizes the availability of affordable housing for low- and moderate-income individuals.82

To accomplish this goal, FIRREA authorizes the RTC to utilize the private sector in the sale of assets where "practical and efficient."83 Using local expertise, Congress reasoned, would ensure greater market stability because local realtors can better gauge the appropriate number of properties to sell at any given time.84 The RTC currently enlists local real estate brokers to list properties and publishes its holdings for public inspection to facilitate sales.85 Its goal is to simplify purchasing procedures.86

To determine the market value of the real estate assets it sells, FIRREA authorizes the RTC to establish an appraisal or other valuation

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79. FIRREA, supra note 2, § 501(b)(12)(F), 103 Stat. at 375 (to be codified at 12 U.S.C. § 1441a(b)(12)(F)).
80. See id. This additional responsibility to "tag" certain properties has been criticized. See Resolution Trust Corporation Task Force Natural Cultural and Recreational Resource Policy as it Relates to the Disposition of Assets by the RTC: Hearing Before the Subcomm. on Financial Institutions Supervision, Regulation and Insurance, Resolution Trust Task Force of the House Comm. on Banking, Finance and Urban Affairs, 101st Cong., 2nd Sess. 17-18 (Sept. 7, 1990) (statement of Rep. Parris). Estimates are that three to five percent of the properties have been identified as having "significant value," but that ninety percent of these are beachfront condominiums. See id. at 3, 15. Representative Stan Parris (R-Va.), the ranking minority member of the Task Force, criticized the RTC for delaying the sale of thousands of properties while they are inspected for "significant value" without making a determination of their marketability. See id.
82. See FIRREA, supra note 2, § 501(b)(3)(C)(i), (ii), and (v), 103 Stat. at 369-370 (to be codified at 12 U.S.C. § 1441a(b)(3)(C)(i), (ii) and (v)).
86. "The aim is to make buying . . . as easy as walking into the local real estate broker and agreeing to a contract on the house down the street." Id. at D1, col. 3.
method. FIRREA also required that the RTC prescribe "appropriate standards" for the performance of real estate appraisals, since extensive Congressional studies had found that fraudulent real estate appraisals were used by "unscrupulous thrift management." Congress intended that the RTC look for the fair value of these assets; in other words, the price that reasonably might be expected in a current sale on an open market, not the price received in a forced or liquidation sale.

The RTC requires an appraisal for all real estate transactions valued at over $50,000. These include sales, purchases or leases of real property, and use of real property as security for a lease. The appraisal provides an objective and realistic opinion of market value, which helps the RTC determine a selling price for seized property.

The RTC's reliance on appraisals, however, has been criticized for hampering the pace of sales because appraisals can overstate the value of the property. Appraisers tend to be overly cautious and conservative in their appraisals of RTC assets. An appraiser may overvalue a property in an attempt to avoid a situation where the RTC sells the property for the appraised value and then the purchaser resells the property for a substantial profit. Inflated appraisal prices, therefore, hamper the RTC's sales efforts.

Appraisals are based on past sales, current revenues, market conditions and trends, and replacement costs. These standards, however, may not reflect a realistic appraisal price in the markets where the RTC operates. There are few current sales, little income potential because of high vacancies, and replacement costs are not measurable where there is little or no ongoing building development.

Responding to slow sales, and possibly acknowledging that its appraisal prices were too high, the RTC instituted a markdown policy on

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87. See FIRREA, supra note 2, § 501(b)(12)(D)(ii), 103 Stat. at 374 (to be codified at 12 U.S.C. § 1441a(b)(12)(D)(ii)).
91. See 12 C.F.R. §§ 1608.2, 1608.3.
95. See id.
96. See 12 C.F.R. § 1608.4.
97. See Keogh, supra note 93 at col. 3; Heller, Letter to the Editor, Am. Banker, May 29, 1990, at 6, col. 3.
its real estate assets. Properties unsold after six months are repriced at fifteen percent below the original appraised value; if unsold after three more months, the price is reduced an additional five percent.98 This price-cutting policy led to concern about the effect on local real estate markets, since the RTC's price-slashing places downward pressure on the prices of other properties in the area. The RTC officials rationalized this pressure by concluding that too many unsold properties on a market causes it to be even more depressed.99 RTC officials also reasoned that failure to sell property increases costs to the RTC by as much as twenty percent a year.100

This new markdown policy appears to contradict FIRREA's mandate that the RTC avoid selling property in depressed areas for less than ninety-five percent of market value.101 The RTC officials countered stating that appraisals, reviews, brokers' opinions, market analyses and evaluations based on offers received and comparable sales are factors which will supplement appraisals in determining market value.102

In addition to its new markdown policy, the RTC began selling some of its real estate holdings by auction in 1990.103 If marketed properly, auctions can expose properties to many purchasers, thus increasing the opportunity to maximize the realizable amount for the property.104 Builders and real estate experts encouraged the RTC's use of auctions because they establish a more accurate price gauge which correlates better to market conditions than do appraisals.105

Because of FIRREA's stringent standards for minimum selling prices,106 the RTC formulated rigid guidelines for the auctioning process.107 Property may be sold "absolute," without a minimum price, only if its market value is below $100,000 and if it was widely exposed to the market.108 Property valued at over $100,000 can be sold at an auction with a minimum price no less than seventy percent of appraised value.109 This standard was set because the RTC believed that a higher minimum price standard would discourage participation and reduce the

99. See id. at D5, col. 2.
100. See id.
104. See id.
106. See supra note 101 and accompanying text.
108. See id.
109. See id.
aggregate net present value on the property.\textsuperscript{110} Property eligible for the Affordable Housing Program,\textsuperscript{111} however, may never be sold at an auction. Lastly, the RTC may reject any offers made in an environment of non-competitive bidding.

Despite the detailed regulations the RTC’s auction program got off to an inauspicious start. The RTC planned to auction off up to $300 million worth of property during the fall of 1990,\textsuperscript{112} but the auction was canceled when the company hired to run the auction failed to meet its security obligations for the auction. This incident generated skepticism about the RTC’s methods in selecting and dealing with private contractors.\textsuperscript{113}

a. Affordable Housing Disposition

Although the S&L industry has always promoted home ownership,\textsuperscript{114} it neglected this goal in the deregulation of the 1980s. FIRREA sought to resuscitate this goal by directing the RTC to “foster home ownership opportunities for low- and moderate-income individuals in those cases where it is prudent and reasonable to expect that suitable repossessed homes will not be readily sold at market prices.”\textsuperscript{115} Because the portfolios of many insolvent thrifts contain housing units that Congress wanted to make available to working class families,\textsuperscript{116} FIRREA outlined detailed procedures for the sale of these units.\textsuperscript{117}

Property to be set aside for low- and moderate-income families is termed “eligible residential property” and defined by a formula spelled out in the National Housing Act.\textsuperscript{118} When the RTC acquires property

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\item \textsuperscript{110} See id.
\item \textsuperscript{111} See infra note 118 and accompanying text.
\item \textsuperscript{112} See How U.S. Is Easing Realty Sale, supra note 81, at D6, col. 2; All Eyes Are on Auctioneer Hired by RTC, and He Loves It, Banking Week, June 4, 1990, at 2, col. 1.
\item \textsuperscript{113} See RTC’s Satellite Auction Stays on the Launch Pad, Am. Banker, Sept. 19, 1990, at 1, col. 4. The auction company admitted that it had not met its obligations, but defended its actions by saying that the RTC had pulled some of the more attractive properties off the auction block, causing several investors to withdraw. The RTC was fully within its contractual powers to remove these properties, however. While the auction company’s defense appears to be self-serving, the episode indicates some indecisiveness on the part of the RTC. One commentator has said that it raises a “red flag” for companies considering contracting with the RTC. See id. at 19, cols. 3-4 (statement of G. David Fensterheim, Executive Director, Real Estate Capital Recovery Association, a trade group for asset management companies).
\item \textsuperscript{118} See FIRREA, supra note 2, §§ 501(c)(9)(D)(ii), 501(c)(9)(F)(ii), 103 Stat. at 380 (to be codified at 12 U.S.C. §§ 1441a(c)(9)(D)(ii), 1441a(c)(9)(F)(ii)). Eligible multi-family homes are defined at 12 U.S.C. 1715(l)(d)(3)(ii), and are currently valued at between
that meets this formula, it gives qualifying households, public agencies
and non-profit organizations a ninety-day right of first refusal to
purchase the property.\textsuperscript{119} A minimum twenty percent of the units sold
during this ninety-day period is reserved for families whose income does
not exceed fifty percent of the median income of the area, and an addi-
tional fifteen percent of the units sold is reserved for families whose in-
come does not exceed eighty percent of the area's median income.\textsuperscript{120}

FIRREA authorizes the RTC to provide financing for sales of eligible
property and to sell such property at below the net realizable market
value in order to achieve the lower income occupancy requirements.\textsuperscript{121}
Interest on the RTC-financed mortgages provided to meet these require-
ments are also set at below market interest.\textsuperscript{122} Through these statutory
provisions, Congress intends to promote affordable housing opportuni-
ties, and return the S&L industry to its original course and goals.

2. Securities and Loan Disposition

Although the RTC's real estate assets have received the most atten-
tion, they account for only thirty percent of the RTC's total assets. The
other seventy percent are in financial instruments.\textsuperscript{123} These include
mortgages on family and vacation homes, investment securities such as
stocks and bonds, mortgage-backed securities, construction and other
loans.\textsuperscript{124} Thus they cover the "hodge podge" of investments a typical
S&L might make.\textsuperscript{125}

Marketable securities, like Treasury securities, mortgage-backed secur-
ities, stocks and bonds, are readily traded on the public market, much
more liquid than real estate and, therefore, easier to sell. These securities
do however, require the RTC to balance its sales carefully so that it
neither sells too many securities too quickly, which would disrupt the
capital markets, nor sells them too slowly, which would increase the
RTC's finance and handling costs.\textsuperscript{126}

$28,032 and $58,392 per unit. See Conference Report, \textit{supra} note 34, at 416, \textit{reprinted in}
U.S. Code Cong. & Admin. News, at 455. Eligible single-family units are defined at 12
U.S.C. 1709(b)(2), and are currently valued at less than $67,500. See id.
\textsuperscript{119} See FIRREA, \textit{supra} note 2, § 501(c)(2)(B), 103 Stat. at 376 (to be codified at 12
U.S. Code Cong. & Admin. News, at 455-56; Affordable Housing Disposition Program,
\textit{supra} note 117, at 35,566.
\textsuperscript{120} See FIRREA, \textit{supra} note 2, § 501(c)(3)(E), 103 Stat. at 377 (to be codified at 12
U.S.C. § 1441a(c)(3)(E)); Affordable Housing Disposition Program, \textit{supra} note 117, at
35,569.
\textsuperscript{121} See FIRREA, \textit{supra} note 2, § 501(c)(6), 103 Stat. at 378 (to be codified at 12
U.S.C. § 1441a(c)(6)).
\textsuperscript{122} See id.
\textsuperscript{123} See \textit{S&L Loans May Be Sold To Nomura}, Wall St. J., Oct. 26, 1990, at C1, col. 6,
C11, col. 3.
\textsuperscript{124} See \textit{Bailout Aide's $130 Billion Burden}, N.Y. Times, Aug. 29, 1990, at D1, cols. 4-
5 (graph).
\textsuperscript{125} See id. at D1, cols. 3-4.
\textsuperscript{126} See id. The RTC is also one of the country's largest holders of junk bonds. \textit{See}
Smaller assets, such as auto loans, individual mortgages, construction and consumer loans, are more difficult to sell than marketable securities because the costs associated with them are high. The RTC developed a plan to "securitize" these assets, grouping them together and issuing a security backed by the package, which will create a securities-type market for them. The desired result is to encourage banks and investment houses to purchase these "securities" from the RTC and to offer them to capital markets.

Poor records and questionable collateral also make potential buyers very wary of some assets. Consequently the RTC provides representations and warranties on many securities and assets. The RTC representations ensure against problems that might arise from inadequate documentation. "If the documentation ... is very bad, [the RTC] might as well sell it at the maximum price and have the buyer come back to [the RTC] with any problems and then try to work them out later." Moreover, interested buyers can avoid costly "due diligence" prior to bidding because of the representations and warranties. The due diligence process of analyzing all of an S&L's assets and insuring that each is properly collateralized often discourages potential buyers. But with the RTC's new provisions, due diligence can be done at the back end of a sale.

V. RTC IN THE COURTS

The RTC, along with the FDIC, is estimated to be a party to some 110,000 lawsuits. The government's legal tab exceeded $500 million in 1990. While most of the S&L suits are fairly small and routine, some...
are complex and involve millions of dollars.\textsuperscript{137} This Note will now address some of the seminal cases involving the RTC, and will analyze the implications of their holdings.

A. The D'Oench, Duhme Doctrine and Asset Recovery

Most of the litigation involving the RTC is an attempt to recover assets of a failed S&L after the RTC has taken control. Many of these assets were in the form of loans that were acquired through fraud. Thrifts would make a profitable loan, for example, but not provide adequate documentation, hiding the transaction from bank examiners or directors.\textsuperscript{138} Other loans were made to further schemes in which investors were persuaded to borrow money from the thrift to invest in fraudulent partnerships.\textsuperscript{139} In another recurring scenario, an unscrupulous loan officer would have a customer sign a blank promissory note and keep the money himself.\textsuperscript{140} On first impression it seems that the RTC would have difficulty recovering because such loan agreements would be voidable.\textsuperscript{141} However, the D'Oench, Duhme doctrine, which evolved from the Supreme Court's 1942 decision in D'Oench, Duhme & Co. v. Federal Deposit Insurance Corporation,\textsuperscript{142} has given the RTC tremendous power in recovering the assets of failed S&Ls under its control.

In D'Oench, Duhme, the Supreme Court found "a federal policy to protect [the FDIC], and the public funds which it administers, against misrepresentations as to the securities or other assets in the portfolios of the banks which [the FDIC] insures or to which it makes loans."\textsuperscript{143} The Court stated that it was "irrelevant" whether the creditor was injured or deceived,\textsuperscript{144} holding that the notemaker could not escape liability based on a secret arrangement between himself and the bank because such an arrangement violates public policy.\textsuperscript{145} The Court said

\begin{quote}
[1]he test is whether the note was designed to deceive the creditors or the public authority, or would tend to have that effect. It would be sufficient in this type of case that the maker lent himself to a scheme or arrangement whereby the banking authority on which [the FDIC] re-
\end{quote}

\begin{footnotes}
\item[137] See id. at 30.
\item[139] See id.
\item[140] See id. at 3, col. 2.
\item[141] See id. at 3, col. 2.
\item[143] See 31 U.S. 447 (1942). In that case, a bank obtained a promissory note from a preferred client which enabled the bank's books to avoid reflecting a loss. There was an understanding between the notemaker and the bank that the bank would not enforce the note and that the interest paid would be remitted to the notemaker. The bank subsequently failed, and the FDIC, upon seizing the bank and its assets, attempted to collect on the note. The notemaker contended he owed nothing because of his arrangement with the bank. See id. at 449-50.
\item[144] Id. at 457.
\end{footnotes}
lied in insuring the bank was or was likely to be misled.\footnote{146}

The \textit{D'Oench, Duhme} doctrine was eventually codified at 12 U.S.C. 1832(e).\footnote{147} This section reads:

No agreement which tends to diminish or defeat the right, title or interest of the [FDIC] in any asset acquired by it under this section, either as security for a loan or by purchase, shall be valid against the [FDIC] unless such agreement (1) shall be in writing, (2) shall have been executed by the bank and the person or persons claiming an adverse interest thereunder, including the obligor, contemporaneously with the acquisition of the asset by the bank, (3) shall have been approved by the board of directors of the bank or its loan committee, which approval shall be reflected in the minutes of said board or committee, and (4) shall have been, continuously, from the time of its execution, an official record of the bank.\footnote{148}

The underlying purpose of the section is to allow federal and state bank examiners to rely on a bank’s records in evaluating the worth of the bank’s assets.\footnote{149} “[N]either fraud in the inducement nor knowledge by the FDIC is relevant to the section’s application.”\footnote{150}

Courts have held that the \textit{D'Oench, Duhme} doctrine and § 1823(e) preclude a number of defenses used by notemakers in refusing payment to the government agency that had obtained the note. These include fraudulent inducement,\footnote{151} oral side agreement,\footnote{152} lack of considera-
tion and fraud. FIRREA extended all of the provisions of Section 1823(e) to the RTC, and courts have applied relevant case law under the D'Oench, Duhme doctrine and Section 1823(e) to the RTC as well. The practical effect of this application is that the RTC will be able to collect on a variety of loans and notes made by S&Ls even though they may have been induced by fraud.

Extending the doctrine will also help the RTC in asset disposition. The D'Oench, Duhme doctrine promotes purchase and assumption transactions by insulating the purchaser of the assets protection from secret agreements that may diminish the practical value of the acquired assets. One court has said that extending D'Oench, Duhme to transferees of assets from RTC... provides RTC with greater opportunity to protect the failed institutions' assets. Moreover, if the protections enjoyed by RTC did not run with the notes in purchase and assumption transactions, the market for such notes would be drastically reduced. Any reduction in the market would negatively effect ... [the] RTC's ability to protect assets of failed institutions.


155. See FIRREA, supra note 2, § 501(b)(4), 103 Stat. at 370 (to be codified at 12 U.S.C. § 1441a(b)(4)). "The [RTC] shall have the same powers and rights . . . as the Federal Deposit Insurance Corporation has under sections 11, 12, and 13 of the Federal Deposit Insurance Act [12 U.S.C. §§ 1821, 1822, 1823]." Id.


The RTC may therefore be better able to find purchasers for these assets.

B. The RTC and the Venue Game: Now You See It, Now You Don’t

Little noticed during formulation and debate, an obscure clause in FIRREA is beginning to have a large impact on the litigation in which the RTC is involved. Congress gave the RTC tremendous removal authority with this provision, and its full impact is just now being felt.

Under FIRREA, the RTC is substituted as a party in any civil action to which either the FSLIC or the institution for which the RTC is serving as conservator or receiver was party.\(^{160}\) If the suit arises out of the actions of the RTC as conservator or receiver for an institution, the suit can be removed to the U.S. district court for the district where the institution’s principal place of business is located.\(^{161}\) Additionally, the RTC may “remove any such action . . . from a State court to the United States District Court for the District of Columbia.”\(^{162}\) This provision has led to what one district court judge has termed “legal gymnastics,”\(^{163}\) has pointed out flaws in FIRREA’s drafting, and has exasperated the D.C. district judges.\(^{164}\)

The legislative history is silent as to what Congress intended by granting the RTC such broad removal and venue authority.\(^{165}\) One argument that the RTC advances is that Congress wanted the District Court in the District of Columbia to gain special expertise in RTC and FIRREA litigation.\(^{166}\) This “acquired-expertise” rationale might pertain to cases which call for an application of FIRREA, but many, if not most of the cases to which the RTC is party, involve state law issues. It is with these cases that the “legal gymnastics” of the removal and venue game are most apparent.

In *Piekarски v. Home Owners Savings Bank*,\(^{167}\) a bank employee brought a wrongful termination suit against his former employer, Home Owners Savings Bank.\(^{168}\) The suit was to be tried in a bifurcated liability/damage trial in the District Court of Otter Tail County, Minnesota.\(^{169}\) Following phase one of the trial, in which all of the defendants were found liable, Home Owners was declared insolvent and the RTC was appointed as conservator.\(^{170}\) Under the provisions of FIRREA, the

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160. See FIRREA, supra note 2, § 501(l)(2), 103 Stat. at 389 (to be codified at 12 U.S.C. § 1441a(l)(2)).
161. Id. at § 501 (l)(3), 103 Stat. at 389-90 (to be codified at 12 U.S.C. 1441a(l)(3)).
162. Id. (emphasis added).
164. See infra notes 178-185 and accompanying text.
169. See id. at 40.
170. See id.
RTC was substituted as a party for Home Owners. 171

The RTC attempted to remove the case to the United States District Court in Minnesota, but was rebuffed by the federal district court judge. 172 This ruling was apparently based on a previous decision that held that if claims did not arise from any actions of the RTC, removal may be made only to the District Court in D.C. 173 The RTC then removed the case from the Otter Tail County Court to the Federal District Court in D.C. 174

After its successful removal to the federal court, the RTC moved to transfer the case to the District Court in Minnesota, 175 the same court that refused to hear the case on removal from the Otter Tail County Court. The D.C. District Court granted the motion, ruling that pursuant to 28 U.S.C. § 1404(a) transfer was proper. 176 "[W]hile th[e case] could not be removed to the federal court in Minnesota from a state court, it can be transferred there from the United States District Court for the District of Columbia. . . ." 177

Judge Thomas F. Hogan, who presided at the proceeding, "acknowledge[d] that this is an exercise in legal gymnastics. However, the Court can see no other way to act on the intent of Congress, both with regard to FIRREA and the change of venue statute." 178 Other cases involving the RTC have followed a similar path from state court to the D.C. District Court, and back to a federal district court in the state where the action arose. 179 Another case appears to be headed in a similar path. 180

171. See id.
175. See id. at 42.
176. 28 U.S.C. § 1404(a) provides: "For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought." Id. The D.C. District Court ruled that the RTC was not barred from transferring the case back to U.S. District Court in Minnesota after having it removed from a state court in Minnesota to the D.C. District court. "Once the action has been removed to federal court, it should proceed as if it had been brought in federal court originally." Piekarski, 743 F. Supp. at 42 (citing Wright, Miller & Cooper, Federal Practice and Procedure: Jurisdiction 2d § 3843 at 323).
177. Piekarski, 743 F. Supp. at 44.
178. Id.
The judges of the D.C. District Court have not been hesitant to criticize the situation. As Judge Gerhard Gesell stated, "Congress could not conceivably have envisioned that the trial judges [of the D.C. District] would become expert in the laws of all 50 states and territories." He continued:

The only specialized knowledge developed to date has related to the parsing of the removal provisions themselves, made more difficult by the fact that [the] RTC does not speak with a single voice on this matter but delegates it to an array of private counsel who advance a range of differing arguments against transfer and/or remand. Judge Hogan said he "wonder[ed] whether Congress realized the extent to which its broad language would force suits out of state court into the federal courts." He later directly commented that:

Congress would be wise to revisit the FIRREA removal provisions to consider whether a federal forum is necessary in every case involving [the] RTC (particularly those involving only issues of state law), and to consider whether parties such as those in this case will be forced to first remove to [the D.C. District Court], and then present a motion for transfer to a forum more suited to complete the litigation.

In the meantime, the courts have been forced to apply the FIRREA removal provisions literally. Parties to the litigation are compelled to endure the cost of the procedural hopscotch. The situation leads to "uncertainty and, ultimately, to a rather awkward and time-consuming transfer pattern that does more justice to a Rube Goldberg cartoon than to conventional notions of due process."

C. The RTC and State Banking Laws: A 400 Pound Gorilla

FIRREA gave the RTC the power to authorize emergency acquisitions of failed or failing savings associations by other institutions. This is the same power granted to the FDIC under Section 13(k) of the Fed-

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180. Hellon & Assocs. v. Phoenix Resort Corp., 755 F. Supp. 280 (D. Ariz. 1990). The RTC simultaneously moved for removal and substitution of proper party. The court granted the motion for substitution, but remanded the case back to state court. Because the case did not arise from any action of the RTC, the only appropriate jurisdiction for removal is the D.C. District. The court concluded by saying it had "reservations about remanding a matter involving only state law issues that will probably be removed to the District of Columbia, only to be transferred back to this Court after one of the parties files a motion to transfer. Still, the Court sees no other way to interpret Congressional intent with regard to FIRREA's removal provision." Id. at 284.


182. Id.


184. Id. at 44.


186. See FIRREA, supra note 2, § 501(b)(4), 103 Stat. at 370 (to be codified at 12 U.S.C. § 1441a(b)(4)).
eral Deposit Insurance Act. Using its authorized power, the RTC proposed a rule that permitted insured banks to retain and operate branches of failed or failing thrifts despite state laws that prohibit such activity. "[The] RTC believe[d] that such State laws present a serious impediment to emergency acquisitions of troubled thrifts by banks and increase the cost of resolution of these thrifts." This RTC rule was upheld by the Eighth Circuit in *Arkansas State Bank Commissioner v. Resolution Trust Corporation.* The court agreed with the RTC's position that Section 501(b)(12)(A) of FIRREA granted the RTC wide latitude in issuing rules and regulations. The decision of the Eighth Circuit "adds to the RTC's arsenal for enticing private capital in its sale of thrift assets and suggests that future preemption by the RTC of other state barriers - such as prohibitions against insurance activities - will survive judicial review."

**CONCLUSION**

Congress prescribed a monumental task for the Resolution Trust Corporation. Although managing the resolution and sale of failed savings and loan institutions at the time of FIRREA's enactment was difficult, the ever-increasing number of S&L failures makes the RTC's job even more burdensome.

The RTC seems to have been given the proper authority and foundation to perform successfully, but the complexity of the current situation continues to test its capacity to perform effectively. To accomplish its mission, the RTC must be flexible in its programs and operations, and

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190. See id. at 162.
192. The RTC is also considering testing its ability to supercede state rent-control and stabilization laws. It recently seized a New York City condominium. Some of the units were occupied by rent-controlled tenants who did not purchase their apartments at conversion. The RTC threatened to have these tenants evicted in order to sell the units, despite New York laws prohibiting such evictions. See In S.&L. Bailout, U.S. Is Moving to Evict 8 Rent-Regulated Tenants, N.Y. Times, Sept. 12, 1990, at B1, col. 2. The RTC withdrew its eviction threat however, when the New York Attorney General stated that his office would challenge the evictions in court. See S.&L. Crisis Muddies Market Outlook, N.Y. Times, Nov. 18, 1990, § 10 (Real Estate), at 1, col. 2.
critics will have to remain patient. The factors that brought about the S&L crisis evolved over a decade of changing economic conditions and shifting political tides. Sifting through the rubble of collapsed savings institutions, salvaging their assets, and restoring confidence in the industry will take the RTC some time.

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