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ARTICLES

THE CHAOS OF 12 U.S.C. SECTION 1821(k): CONGRESSIONAL SUBSIDIZING OF NEGLIGENT BANK DIRECTORS AND OFFICERS?

Steven A. Ramirez*

INTRODUCTION

On April 15, 1996, the United States Supreme Court granted certiorari to Atherton v. FDIC.1 Atherton involves claims against the former directors of City Federal Savings Bank ("City Federal"), a federally-insured savings and loan ("S&L"). Beginning in 1985, the former directors of City Federal approved several large construction loans which had little prospect of being repaid. The loans entailed a high degree of risk because the bank failed to take reasonable steps to secure either sufficient collateral or borrower wherewithal to assure repayment. The Resolution Trust Corporation ("RTC") alleges that the bank did not verify financial information provided by the borrowers, did not obtain an adequate appraisal of the proposed collateral, and did not follow its own lending policies and procedures.2 The loans resulted in $100 million in losses.3 City Federal subsequently failed. The government stepped in, paid off all depositors of City Federal, and absorbed any losses resulting from a shortfall in City Federal's assets. The government brought director liability claims, based upon long-standing federal common-law authorities, for negligence against City Federal's former board. The district court dismissed the claims,

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1. 116 S. Ct. 1415 (1996), granting cert. sub nom. to RTC v. Cityfed Fin. Corp., 57 F.3d 1231 (3d Cir. 1995). Oral arguments for Atherton are scheduled to be heard on November 4, 1996. 65 U.S.L.W. 3165, 3180 (Sept. 10, 1996). This Article addresses only one of the two issues decided by the Third Circuit; that is, the viability of federal common law claims arising from mismanagement of failed banks against the banks' directors and officers. This Article does not address the viability of state law claims arising from the failure of federally-chartered banks. See 57 F.3d at 1236 (noting that the RTC asserted claims under both state and federal law).

2. Id. at 1237. Atherton arrived at the Supreme Court on interlocutory appeal, after the Third Circuit reversed the dismissal of negligence-based claims. See id. at 1249. Thus, the Third Circuit accepted the RTC's allegations of fact as true.

3. Id. at 1237.
holding that only claims for gross negligence may be pursued. The Third Circuit reversed. The Supreme Court will therefore address a pivotal question remaining from the bank crisis of the 1980s that has caused sharp division among the lower courts: Who should bear these types of losses—the negligent directors of the failed bank or the U.S. taxpayer?

The question before the Supreme Court cannot be understood without providing some perspective on the bank crisis of the 1980s and the government's response to the unprecedented taxpayer bailout of the federal deposit insurance fund. The government responded to the crisis by enacting a broad legislative revision of our nation's banking regulatory framework. This legislation is at the heart of the standard of liability for managers of failed banks, and its meaning must be resolved by the Supreme Court.

In August, 1989, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"). At the time of this legislation, the long-brewing bank failure crisis only recently had splashed into the nation's consciousness; this subject was addressed directly only after the 1988 presidential election. From the very incipience of the federal government's remediation efforts, the issues underlying the allocation of the cost of, and responsibility for, the bank crisis dripped with political gamesmanship.

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4. In a bygone era the very thought that bank directors would be liable only for gross negligence was repugnant:

   It seems to me that it would be a monstrous proposition to hold that trustees, entrusted with the management of the property, interests and business of other people, who divest themselves of the management and confide in them, are bound to give only slight care to the duties of their trust, and are liable only in cases of gross inattention and negligence; and I have found no authority fully upholding such a proposition.

Hun v. Cary, 82 N.Y. 65, 72 (1880).

5. This Article will use the term "failed bank" to mean any federally-insured depository institution put into conservatorship or receivership by federal agencies. As such, the term encompasses: banks, savings banks, S&L, credit unions, and savings associations. The term "Federal Liquidators" refers to any federal agency charged with liquidating a failed bank. Primarily this is the RTC and the Federal Deposit Insurance Corporation ("FDIC").


8. See Walter Shapiro, What Debates Don't Tell Us, Time, Oct. 19, 1992, at 32, 33 ("Never mentioned was the fast-escalating savings-and-loan crisis [in the 1988 presidential debates]."); see also James Greiff, Banking Calamity Fears Ebb: Record Profits Avert 'December Surprise', Orange Co. Reg., Apr. 11, 1993, at KO1, available in Westlaw, 1993 WL 8297624 ("The untold story of this presidential election is how the Bush administration's bank regulators have sought to postpone a commercial bank crisis until November. Then, soon after the election, the administration will suddenly discover that there is—surprise!—a major banking crisis." (quoting Michael Waldman, December Surprise: Bush's Deferred Banking Crisis, The New Republic, June
ing system has since stabilized, the law applicable to bank director

9. "For the past three years many banks on both sides of the Atlantic have been enjoying an unusually long run of record profits and soaring share prices." *International Banking: System Failure*, The Economist, Apr. 27-May 3, 1996, at 5, 5. Still, even though most people ... assume that banking is nowadays under control, with the danger of failures, panics and runs abolished by careful regulation and the widespread system of deposit insurance. ... [the fact is that] the world's banking system may be becoming even more dangerous than it used to be, and the need for a thorough reform even more urgent. *How Safe is Your Bank?*, The Economist, Apr. 27-May 3, 1996, at 15, 15.

Several emerging risks present novel threats to the entire international banking system. First, banks have extensive exposure to the international derivatives, futures, and securities markets. For example, several large American banks have between 200% and 600% of their equity invested in derivatives. *International Banking: Dangerous Deriving?*, The Economist, Apr. 27-May 3, 1996, at 9, 9 [hereinafter Dangerous Deriving]. Further, according to the Bank of International Settlements, the total amount of outstanding over-the-counter derivatives held by banks has reached $41 trillion. *Id.* at 10. This type of exposure is responsible for the recent failure of Britain's Barings Bank. *Id.* Similarly, in March of 1996, the 21 largest Japanese banks recognized $86 billion in losses, resulting in part from the weakness of the Japanese stock market. *International Banking: Coping with the Ups and Downs*, The Economist, Apr. 27-May 3, 1996, at 3, 3 [hereinafter Coping with the Ups and Downs].

This exposure is exacerbated by the fact that, in 1996, lax internal controls at even the largest banks still persist. Thus, a single bond trader at the New York branch of Japan's Daini Bank accumulated $1.1 billion in trading losses over a period of 11 years without being detected. *Dangerous Deriving, supra*, at 10.

These risks are even more disturbing because of the increasing interdependency of banks within the international banking system. This interdependence poses a risk because the world's wholesale payments systems—networks among international banks that permit the settlement of securities and foreign exchange transactions—operate on a daily basis without any underlying security to assure payment of the transactions from one bank to another that occur continuously between the banks. On any given day, some professionals estimate that up to $6 trillion passes through these wholesale payment systems, via both private and public intermediaries. *International Banking: Can't Pay, Won't Pay*, The Economist, Apr. 27-May 3, 1996, at 13, 13. If an important international bank were to default, for any reason, the international payment system would devolve into chaos, and, perhaps, lead to a string of failures. *Id.*

Of course, the banking industry continues to face traditional risks as well. Banks periodically will fail the old-fashioned way, often in great waves. *See Office of the Comptroller of the Currency, Bank Failure: An Evaluation of the Factors Contribu-
and officer liability actions is more confusing than ever.\footnote{10} This Article

ing to the Failure of National Banks (1988), reprinted in [1988-1989 Transfer Binder] Fed. Banking L. Rep. (CCH) ¶ 87,387, at 93,981-82 [hereinafter Bank Failure] (finding that "poor management and other internal problems" are the "common denominator[s]" of failed banks, and identifying the following factors as major causes of bank failures: (i) 81% of failed banks had nonexistent or poorly followed loan policies; (ii) 42% of failed banks had overly aggressive or excessively growth-minded boards of directors; (iii) 81% of failed banks had excessive credit exceptions such as missing borrower financial statements and poor collateral documentation; and (iv) 35% of failed banks were victims of insider abuse). It is truly amazing that, in this era of business sophistication and complexity, the U.S. taxpayer is being saddled with a 30-year, trillion dollar obligation for such fundamental and basic banking mishaps. \cite{Strunk & Case, Where Deregulation Went Wrong 14-16 (1988), reprinted in Michael P. Malloy, The Regulation of Banking: Cases and Materials on Depository Institutions and Their Regulators 126-127 (1992) (finding that the S&L crisis was precipitated by, \textit{inter alia}, directors' uncontrolled use of new operating authority permitting risky and speculative investment powers, and managements' ventures into credits and markets in which they had little experience).}

will examine why the law in this area is so chaotic and will attempt to propose a sensible approach to the interpretation of 12 U.S.C. § 1821(k), which is the primary provision of FIRREA addressing the liability of directors and officers of failed banks.

The government systematically has obscured the full cost of the 1980s bank crisis. Estimates of the total cost to the U.S. taxpayer now exceed $1 trillion.\(^\text{11}\) Even estimates of losses discounted to present value are $150-215 billion.\(^\text{12}\) In addition, the deposit insurance funds, maintained by premium payments paid by the banks, lost billions more.\(^\text{13}\) The bank crisis also led to a total loss of stockholders' equity in failed banks, and caused approximately $400 billion in losses to the nation's stock of productive capital.\(^\text{14}\) Ultimately, these staggering losses had macroeconomic effects that diminished the nation's gross national product ("GNP"); the Congressional Budget Office estimated that the S&L crisis led to a "whopping" $500 billion in forgone GNP.\(^\text{15}\) Such enormous numbers obviously require context for full comprehension: If the total cost of the bank crisis is $1 trillion, then

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Finally, courts have held that § 1821(k) supersedes federal common law without addressing the impact on state law. See RTC v. Frates, 52 F.3d 295, 296 (10th Cir. 1995); FDIC v. Bates, 42 F.3d 369, 373 (6th Cir. 1994); RTC v. Miramon, 22 F.3d 1357, 1365 (5th Cir. 1994); RTC v. Gallagher, 10 F.3d 416, 425 (7th Cir. 1993); FDIC v. Gonzalez-Gorrondona, 833 F. Supp. 1545, 1553 (S.D. Fla. 1993); RTC v. Farmer, 823 F. Supp. 302, 307 (E.D. Pa. 1993); FDIC v. Miller, 781 F. Supp. 1271, 1276 (N.D. Ill. 1991).

Additionally, there are countless unreported decisions addressing the issues discussed in this Article.


14. CBO Study, supra note 12, at 31 and app. B.

15. Id. at 40.
that represents approximately eighteen percent of the entire annual output of the economy of the United States.\footnote{16} It seems odd that, in light of this catastrophe, Congress would pass protective legislation insulating the managers of failed banks, specifically the directors and officers, from liability.\footnote{17} Protection of such managers is particularly strange given that the causes of the crisis included pervasive mismanagement.\footnote{18} Yet, the majority of circuit courts have reached this result when interpreting § 1821(k).\footnote{19}

Individuals were protected from the crisis by deposit insurance funds. The deposit insurance funds, backed by the full faith and credit of the United States, protected insured depositors, prevented bank runs, and forestalled the massive disintermediation, i.e., withdrawal of capital from the banking system, of the 1930s.\footnote{20} Consequently, the nation avoided a possible depression. The Federal Liquidators had rescued the depositors but were left holding an enormous tab.\footnote{21}

The government financed the taxpayer bailout over the course of thirty years, thereby obscuring the taxpayer burden.\footnote{22} Thus, there were no angry depositors or taxpayers to lead public outcry for reform or to demand that responsibility be appropriately borne by those who caused the crisis. Deposit insurance and the structure of the bailout

\footnote{16} The GNP was $5.34 trillion for 1994. U.S. Dep't of Commerce, Bureau of Econ. Analysis, BEA 95-51, Com. News, at 7, Table 2 (Oct. 27, 1995).

\footnote{17} The management of a bank is generally under the direction of the board of directors. See 12 U.S.C. § 71 (1994); 12 C.F.R. § 544.1(7) (1996) ("The [bank] shall be under the direction of a board of directors . . . "); 12 C.F.R. § 552.6-1 (1996) ("The business and affairs of the association shall be under the direction of its board of directors."). Of course, the directors are permitted to appoint officers to manage the day-to-day affairs of the bank. 12 C.F.R. § 544 (app. § 9).

\footnote{18} See infra notes 327-30 and accompanying text.

\footnote{19} One explanation for this incongruous result could be political. In fact, after years of being left to common law development, there recently has been an explosion of political activity aimed at limiting director liability. See, e.g., James J. Hanks, Jr., Evaluating Recent State Legislation on Director & Officer Liability Limitation and Indemnification, 43 Bus. Law. 1207 (1988) (analyzing state legislation from 40 jurisdictions which limit director liability). Recently, Representative William McCollum introduced legislation aimed at drastically limiting director liability in the context of failed banks. H.R. 316, 104th Cong., 1st Sess. §§ 2, 3, 5 (1995). This legislation has not been enacted. Bank lobbying groups have also been active in bank manager liability cases by submitting amicus briefs. See, e.g., RTC v. Gallagher, 10 F.3d 416, 417 (7th Cir. 1993) (acknowledging a brief submitted by American Bankers Association); see also Alex Elson & Michael L. Shakman, The ALI Principles of Corporate Governance: A Tainted Process and a Flawed Product, 49 Bus. Law. 1761, 1763-68 (1994) (noting that political lobbying by lawyers representing the interests of corporate management regessively influenced the ALI and restricted director and officer accountability).

\footnote{20} President's News Conference, supra note 7, at D8 ("In all the time since creation of the deposit insurance savers have not lost one dollar of insured deposits, and I am determined that they never will.").

\footnote{21} See FIRREA Report, supra note 12, at 61.

defused and diffused the type of political pressure for radical change that was present in the 1930s. Nevertheless, the bank crisis provoked public concern over the cost of the bail-out; no politician suggested that any action be taken except to lower the cost to the government.\(^2\)

In contrast, directors and officers of failed banks actively sought to restrict their liability for the bank crisis. These individuals were being haled into court across the country to answer for the sins and excesses of the 1980s.\(^4\) The directors and officers, by the nature of their positions, were both well-heeled and well-connected. They also had an incentive to take their plight to the press; in fact, numerous press reports attacked the government’s efforts to recover losses from directors and officers.\(^5\) Litigation is both expensive and unpleasant; thus, they also had a great incentive to exert political pressure to ease the efforts to enforce their duties in court.\(^6\) Still, it seems more likely that confusion, rather than the directors’ lobbying efforts, is responsible for the anomalous result that a majority of circuit courts have insulated officers and directors from preexisting liabilities.

On the eve of enactment of FIRREA, the circuit courts’ approach to the issue of the source of law applicable to define the duties of bank managers was chaotic at best. For example, federally-insured failed banks could be chartered or incorporated either federally or in any of the fifty states. This raised questions as to the appropriate source of the law defining the duties of a bank’s directors and officers. Courts were split, moreover, on the effect of federal deposit insurance on the

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25. See, e.g., Gretchen Morgenson, *What Did Pop Expect to Happen When He Gave the Kid His Credit Card?*, Forbes, Sept. 28, 1992, at 95, 96 (describing the FDIC as “a government agency utterly out of control, terrorizing innocent bystanders and frequently costing the taxpayers far more in legal fees than it is recovering”).

law applicable to directors and officers of failed banks. Thus, federal courts have split sharply on whether federal common law applies to federally-chartered banks, as well as whether federal common law applies to state-chartered, federally-insured banks.

The cyclical nature of bank failures exacerbated the confusion regarding the applicable law. Prior to the 1980s, there were small waves of failures in the sixties and the forties, but the last great wave of bank failures was in the 1930s, meaning that much of the case law governing the duties of directors and officers of federally-insured banks was well-seasoned. The *Erie* doctrine, for example, did not exist when much of this case law was developed. Prior to *Erie*, federal courts did not engage in detailed analysis as to the source of the law being applied in a given case. Thus, much of the relevant case law does little to clarify the appropriate source of law.

Furthermore, by 1988, many states had reacted to lobbying by directors and officers to greatly restrict their liability. The impact of


28. *See* D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) (applying federal common law to state-chartered bank and distinguishing Erie R.R. v. Tompkins, 304 U.S. 64, *cert. denied*, 305 U.S. 637 (1938); *see also* supra note 26 (discussing how some courts have struck down as unconstitutional state statutes hostile to federal banking agencies). Compare FDIC v. Bierman, 2 F.3d 1424 (7th Cir. 1993) (applying federal common law to state-chartered bank) *with* Gregor, 872 F. Supp. at 1144-45 (finding that federal common law does not apply even to federally-chartered banks). The operation of federal common law continues notwithstanding the *Erie* doctrine, which limited federal common law from varying state law with respect to state claims, in areas of paramount federal interest. *See infra* part II (discussing extensively the viability of federal common law in the context of federally-chartered and federally-insured banks).

29. *Erie*, 304 U.S. at 78-80 (holding that state common law, not federal common law, governs claims based upon state law).

this insulating legislation on the duties of bank managers was uncertain and increased the confusion regarding the appropriate source of law. In short, even legal experts were unsure of the law applicable to directors of failed federally-insured banks. At the time of FIRREA’s enactment, the executive branch and Congress could only have been confused by the state of the law on even such basic threshold issues as which law to apply. This underlying uncertainty profoundly influences the meaning of the legislation.

One thesis of this Article is that when the political branches enacted FIRREA and § 1821(k) to address the issue of director and officer liability, the courts were so hopelessly divided that Congress could not enact legislation that would address each circuit’s law. The political branches did not comprehend the state of the law at the time because of the extreme judicial confusion surrounding the issues; therefore, any interpretation assuming that Congress did is untenable. The political branches instead had only general policy objectives for FIRREA as a whole, and § 1821(k) was intended to vindicate these objectives in a limited way. These policy objectives included: minimizing the cost of resolving the bank crisis; recovering losses from those responsible for the crisis; retreating from the “lax” financial institution regulation of the 1980s; and preventing future bank failures. There is no indica-
tion that the political branches desired to extend a subsidy to negli-
gent directors and officers in the form of insulating legislation.

This Article examines issues critical to the recent jurisprudence of § 1821(k), including the intent of the political branches, Erie considerations, and the application of federal common law. Part I of this Article discusses the judiciary's interpretation of § 1821(k), highlighting the two main circuit court approaches to the statute's construction. Furthermore, part I explores the common law background of this issue, at both the state and federal level, and notes that common law has always imposed a standard of liability of ordinary care upon bank directors. Once part I sets forth the complexity of the choice of law issues, two conclusions follow: first, § 1821(k) was enacted by the political branches in the face of great uncertainty over choice of law issues and in pursuit of general policy objectives that are utterly inconsistent with insulating directors and officers from duties for which they knowingly bargained; and second, § 1821(k) must operate to preserve preexisting federal common law duties of ordinary care for officers and directors of federally-insured banks. This, directors and officers fully expected. Part II notes the compelling governmental interest in federally-insured banks and asserts that federal common law is consistent with § 1821(k). Thus, part II concludes that federal common law should apply to federally-insured banks, including banks that are state-chartered. Next, part III examines both the congressional and presidential intent behind FIRREA and § 1821(k), as well as several overlooked rules of statutory construction, all of which support the conclusion that FIRREA does not preempt federal common law. Finally, part IV considers a possible economic justification for the proposition that § 1821(k) supersedes federal common law. Part IV posits that the only logical economic conclusion is that § 1821(k) does not preempt federal common law. This Article concludes that § 1821(k) must be interpreted in light of the political branches' general policy objectives, which did not include an unstated and undeclared subsidy to negligent bank directors and officers. Thus, irrespective of state law considerations, these directors and officers should be held personally liable if they negligently breach their duties under federal common law. Personal liability of directors and officers is the best way to

32. See, e.g., FDIC v. Bierman, 2 F.3d 1424, 1432 (7th Cir. 1993) (stating that bank "[d]irectors must exercise ordinary care and prudence in the administration of the affairs of a bank" (quoting Briggs v. Spaulding, 141 U.S. 132, 165 (1891))); FDIC v. Appling, 992 F.2d 1109, 1113 (10th Cir. 1993) (upholding jury instruction stating that "directors and officers of a bank must use the same degree of care, skill and diligence used by ordinarily prudent and diligent bank directors and officers" (citing Hoehn v. Crews, 144 F.2d 665 (10th Cir. 1944), aff'd sub nom., Garber v. Crews, 324 U.S. 200 (1945)); Rankin v. Cooper, 149 F. 1010, 1013 (C.C.W.D. Ark 1945)) ("Directors are charged with the duty of reasonable supervision over the affairs of [a] bank."); Litwin v. Allen, 25 N.Y.S.2d 667, 678 (Sup. Ct. 1940) ("Undoubtedly, a director of a bank is held to stricter accountability than the director of an ordinary business corporation.").

33. See infra part I.E.
avoid another bank crisis and to protect the deposit insurance fund; in the context of the banking system this is the only sensible economic approach, particularly in the face of a historic bank crisis of monumental proportions.

I. GOVERNMENTAL RESPONSE TO DISASTER: EASE LONG-STANDING AND SETTLED RULES OF DIRECTOR AND OFFICER RESPONSIBILITY?

This part compares the primary approaches courts have taken in interpreting § 1821(k) and the common law as it existed on the date of FIRREA’s passage. In addition, this part explores the settled expectations and understandings of bank directors and officers regarding their duties.

Bank managers have been subject to a common law duty of ordinary care for at least a century. Bank managers have always been well-aware of this duty. It is unreasonable to conclude that the political branches intended to lessen these duties in the wake of the 1980s bank crisis. Nonetheless, the courts have varied in their interpretation of § 1821(k), and several have held that Congress did in fact lessen the duties of failed bank directors and officers. A comparison of RTC v. Gallagher,34 which concludes that directors of failed federal banks do not have a federal common law duty of ordinary care with RTC v. Cityfed Financial Corp.,35 which concludes the opposite, illustrates the two primary approaches of the circuit courts to the construction of 12 U.S.C. § 1821(k).

12 U.S.C. § 1821(k) appears to be relatively straightforward, providing:

A director or officer of an insured depository institution may be held personally liable for monetary damages in any civil action by, on behalf of, or at the request or direction of the [Federal Liquidators] . . . acting as conservator or receiver of such institution . . . for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care (than gross negligence) including intentional tortious conduct, as such terms are defined and determined under applicable State law. Nothing in this paragraph shall impair or affect any right of the [Federal Liquidators] under other applicable law.36

Certainly the political branches did not intend to create a uniform standard of liability, for otherwise they would have simply stated: The Federal Liquidators may only sue directors and officers of failed banks for gross negligence. The clear text of the statute therefore sets a floor on the duties of directors and officers while preserving any

34. 10 F.3d 416 (7th Cir. 1992).
existing rights of the Federal Liquidators. Still, the courts have assumed varied and inconsistent positions with respect to the standard of care applicable to directors of failed banks pursuant to § 1821(k).37

A. The Seventh Circuit Approach

The Seventh Circuit held in *RTC v. Gallagher*38 that the Federal Liquidators may not pursue any federal common law claims for ordinary negligence against directors of failed banks in light of § 1821(k).39 Shortly after *Gallagher*, the Seventh Circuit ruled in *RTC v. Chapman*40 that the Federal Liquidators may not pursue any state law claims against directors of failed banks that are federally-chartered.41 Instead, under *Chapman*, only state-chartered banks enjoy state law based causes of action against directors and officers. Thus, the Seventh Circuit interprets § 1821(k) as if it stated: Directors and officers of federally-chartered banks may be sued exclusively for conduct amounting to a minimum of gross negligence; directors and officers of state-chartered banks may be sued for gross negligence or for any claims under state law.

The Seventh Circuit approach is based upon two principles. First, if Congress “speaks directly” to an issue by exercising its legislative power in a given matter, then federal common law is superseded.42 Second, if directors are sued for breaching their duties to a corporation, then the jurisdiction of incorporation provides the substantive law governing the litigation.43

1. *Gallagher’s* Supersession Analysis

In *City of Milwaukee v. Illinois*,44 the Supreme Court held that Congress, by enacting an “all-encompassing” program of interstate water pollution regulation, intended to occupy the field of interstate water pollution and, therefore, superseded federal common law remedies provided by nuisance claims.45 The Court distinguished *Illinois v. City of Milwaukee*,46 which held that legislation merely “touching interstate waters” was inadequate to supplant federal common law.47 At no point in either decision did the Court intimate that the only test for determining supersession of federal common law is whether Congress “spoke directly” to the issue previously addressed by federal common

37. See supra note 10.
38. 10 F.3d 416 (7th Cir. 1993).
39. Id. at 424.
40. 29 F.3d 1120 (7th Cir. 1994).
41. Id. at 1122.
42. *Gallagher*, 10 F.3d at 419.
43. *Chapman*, 29 F.3d at 1122.
45. Id. at 317-19.
47. Id. at 101-04, 102 n.3.
law. Rather, the Court plainly asked not just whether Congress had "spoken" but also whether Congress's regulation was sufficiently "comprehensive" to indicate an intent to occupy the field. The Court stated:

We conclude that, at least so far as concerns the claims of respondents, Congress has not left the formulation of appropriate federal standards to the courts through application of often vague and indeterminate nuisance concepts and maxims of equity jurisprudence, but rather has occupied the field through the establishment of a comprehensive regulatory program supervised by an expert administrative agency.

Thus, the comprehensive nature of the regulation, rather than simply the regulation itself, indicated Congress's intent to occupy the field.

Under the Supreme Court's analysis, the *Gallagher* court found that FIRREA comprehensively spoke to the issue of bank director regulation and "created" expert administrative agencies to supervise and administer the FIRREA regulatory scheme. The court stated that FIRREA expanded federal authority over directors of federally-insured banks. Based upon these conclusions, the court applied the reasoning of *City of Milwaukee* and determined that FIRREA superseded preexisting federal common law.

The *Gallagher* court did not ignore the content of the statute, but rather focused its inquiry on whether the substance of § 1821(k) "spoke directly" to the issue of director and officer liability. The court concluded that the "plain language" of the statute spoke directly to the issue of failed bank director liability. The *Gallagher* court therefore found that FIRREA superseded federal common law.

The Seventh Circuit then searched the legislative history of FIRREA to support its statutory construction. In construing § 1821(k), the *Gallagher* court found that the use of "may" in § 1821(k) does not refer to, nor qualify, the gross negligence standard but instead refers to the ability of the Federal Liquidators to sue. In other words, according to *Gallagher*, the use of "may" is simply a statutory reaffirmation that the Federal Liquidators are not required to sue for gross negligence.

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49. Id. at 317.
50. *Gallagher*, 10 F.3d 416, 424 (7th Cir. 1993). Although FIRREA did create expert administrative agencies, the Seventh Circuit was plainly wrong to conclude that FIRREA somehow increased the occupation of the field in this manner; for each FIRREA-created agency, another agency was abolished. Thus, the Office of Thrift Supervision ("OTS") replaced the Federal Home Loan Bank Board ("FHLBB"), and the RTC replaced the FSLIC.
51. Id. at 424.
52. Id.
53. Id. at 419.
54. Id. at 419-20.
55. Id. at 421-23.
56. Id.
negligence.\textsuperscript{57} The court then found that the last sentence of § 1821(k), also known as the "savings clause," would render the remainder of the statute surplusage if it preserved federal common law.\textsuperscript{58} Specifically, the Seventh Circuit found that preserving ordinary negligence claims would render meaningless the "substantive" portion of the statute.\textsuperscript{59} Instead, the court found that the savings clause actually refers only to enforcement powers granted the government under § 1818.\textsuperscript{60} Finally, the court highlighted legislative history supporting its restrictive reading of § 1821(k).\textsuperscript{61} Based upon these conclusions, the court found that § 1821(k) demonstrated an intent by Congress to preempt federal common law.\textsuperscript{62}

2. \textit{Chapman} and State Law Claims

\textit{Gallagher} specifically declined to address the availability of state law based claims arising from the failure of a federally-chartered thrift.\textsuperscript{63} In \textit{RTC v. Chapman},\textsuperscript{64} the Seventh Circuit shut the door on any such claims; this decision thus limits the Federal Liquidators to claims for only gross negligence when pursuing directors of failed federal banks in the Seventh Circuit.\textsuperscript{65} In other words, § 1821(k) was interpreted as if it were written to provide that directors of failed banks may only be liable for gross negligence except in the case of state-chartered banks.\textsuperscript{66}

Chapman's analysis depends upon the internal affairs doctrine as embodied in the Restatement (Second) of Conflict of Laws § 302.\textsuperscript{67} Specifically, under the internal affairs doctrine, unless another jurisdiction has a more substantial interest in the dispute, the jurisdiction creating a corporation defines the duties of the directors of the corporation. \textit{Chapman} applied this choice of law rule to federally-chartered banks to conclude that no state law based claims were available to the Federal Liquidators.\textsuperscript{68} \textit{Chapman} thus concluded that choice of law

\begin{itemize}
\item \textsuperscript{57} \textit{Id.}
\item \textsuperscript{58} \textit{Id.} at 420.
\item \textsuperscript{59} \textit{Id.}
\item \textsuperscript{60} \textit{Id.} at 420-21.
\item \textsuperscript{61} \textit{Id.} at 421-23.
\item \textsuperscript{62} \textit{Id.} at 424. The \textit{Gallagher} court also discussed the impact of a legislative effort to clarify § 1821(k)'s savings clause to preserve common law standards of ordinary negligence. \textit{Id.} at 423. Since the \textit{Gallagher} opinion, however, legislation has also been introduced, but not passed, to modify § 1821(k) to extend insulation from liability to directors. H.R. 316, 104th Cong., 1st Sess. (1995). Thus, for now, the only conclusion that can be drawn from post-legislative activity regarding § 1821(k) is that Congress is hopelessly distracted on this vital issue.
\item \textsuperscript{63} \textit{Gallagher,} 10 F.3d at 424.
\item \textsuperscript{64} 29 F.3d 1120 (7th Cir. 1994).
\item \textsuperscript{65} \textit{Id.} at 1123.
\item \textsuperscript{66} \textit{Id.}
\item \textsuperscript{67} \textit{Id.} at 1122 (citing Restatement (Second) of Conflict of Laws § 302 (1971)).
\item \textsuperscript{68} \textit{Id.} at 1123.
principles rendered § 1821(k) the exclusive standard of liability for directors and officers of failed federal banks.69

Interestingly, in the Seventh Circuit, federal common law appears to provide for an ordinary negligence standard of care for claims against directors and officers of failed state-chartered, federally-insured banks not subject to FIRREA.70 Therefore, in cases not involving bank failure, or arising prior to FIRREA, bank directors must exercise ordinary care to avoid liability.71 Furthermore, state-chartered but federally-insured banks often present the same risks to the national treasury as federally-chartered banks; nonetheless, failed state banks are apparently subject, under Chapman, to fifty different state legislatures or state supreme courts to define the liabilities of their directors. The RTC raised these anomalies in Gallagher and Chapman, but the Seventh Circuit did not address the basis of these anomalies.72 Therefore any policy support for such distinctions remains obscure.

Chief Judge Posner of the Seventh Circuit correctly termed the combined effect of Gallagher and Chapman as "crazy!"73 Judge Posner found no policy basis for the result that a bank director is liable for a higher duty of care—ordinary care rather than gross negligence—prior to failure rather than after failure.74 Judge Posner was similarly at a loss for the policy basis supporting the distinction in the duty of care owed by directors and officers of state banks compared to that owed by directors and officers of federal banks.75 Posner concluded that, because FIRREA was intended to impose more stringent standards upon bank managers, "[t]he statute has been turned on its head."76

69. Id. at 1124-25.
71. For instance, in FDIC v. Appling, 992 F.2d 1109 (10th Cir. 1993), the Tenth Circuit described the standard of care for directors and officers of a federally-chartered bank "as requiring such care and diligence as an ordinarily prudent man would exercise with reference to the administration and management of such a moneyed institution." Id. at 1113 (quoting Hoehn v. Crews, 144 F.2d 665, 672 (10th Cir. 1944), aff'd sub nom., Garber v. Crews, 324 U.S. 200 (1945)); see also FDIC v. Bierman, 2 F.3d 1424, 1432 (7th Cir. 1993) ("Ordinary care, in this matter as in other departments of the law, means that degree of care which ordinarily prudent and diligent men would exercise under similar circumstances." (citing Rankin v. Cooper, 149 F. 1010, 1013 (C.C.W.D. Ark. 1907))); FDIC v. Wheat, 970 F.2d 124, 130-31 (5th Cir. 1992) (imposing liability based upon jury instruction requiring verdict against bank directors if failure to exercise "due care" or "ordinary care" is found). Each of these circuits requires a showing of gross negligence for post-FIRREA claims.
72. But see Chapman, 29 F.3d at 1125-28 (Posner, C.J., dissenting) (discussing the various states laws regarding the liability of bank directors and officers).
73. Id. at 1127.
74. Id.
75. Id. at 1126.
76. Id. at 1127.
B. The Third Circuit Approach

In *RTC v. Cityfed Financial Corp.*, the Third Circuit addressed the very issue previously disposed of in *Gallagher*—whether § 1821(k) superseded the federal common law liability of directors and officers of failed banks. In *Cityfed*, the Third Circuit concluded that § 1821(k) does not supersede the federal common law rights of the Federal Liquidators to pursue directors of failed federal banks. The court therefore reversed the district court’s order requiring the RTC to pursue claims only for gross negligence.

The Third Circuit based its holding on a plain reading of the savings clause of § 1821(k). In so doing, the court explicitly rejected the Seventh Circuit’s conclusion that the savings clause only preserved the government’s rights under § 1818 to terminate the deposit insurance of banks. Rather, the *Cityfed* court observed that in other portions of FIRREA, Congress specifically limited other savings clauses, such as § 1821(E)(3)(c)(ii), § 1821(c)(4), and § 1821(c)(3)(B), to certain sources of law; Congress did not so limit the savings clause of § 1821(k). In *Patterson v. Shumate*, the Supreme Court, in fact, interpreted a similar savings clause in precisely this manner.

*Cityfed* also differed with *Gallagher’s* analysis of the legislative history of § 1821(k). In a painstaking analysis of all the available legislative history, *Cityfed* found two items of legislative history controlling. The court noted:

Section 1821(k) was enacted as part of FIRREA, a massive 371-page legislative package that had among its primary purposes, as evident in the opening provision of the statute, “strengthen[ing] the enforcement powers of Federal regulators of depository institutions” and “strengthen[ing] the civil sanctions and criminal penalties for defrauding or otherwise damaging the depository institutions and their depositors.” An overriding purpose in enacting this legislation was to facilitate an effort to “seek out and punish those that have committed wrongdoing in the management of the failed institutions,” not to protect such directors and officers from claims of ordinary negligence.

The court also relied on the section-by-section report of the Senate Banking Committee:

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78. *Id.* at 1249.
79. *Id.*; see also *Id.* at 1247 n.16 (declining to select between ordinary and gross negligence); *Id.* at 1249-50 n.2 (Mansmann, J., concurring in part and dissenting in part) (noting that the majority suggests a standard of ordinary negligence).
80. *Id.* at 1238.
81. *Id.*
This report is consistent with other contemporaneous legislative history, and it makes clear that § 1821(k) did not disturb any claims, available as a matter of state or federal law, that would hold directors and officers liable for conduct less culpable than gross negligence: This subsection does not prevent the FDIC from pursuing claims under State law or other applicable Federal law, if such law permits the officers or directors of a financial institution to be sued . . . for violating a lower standard of care, such as simple negligence.84

Thus, the court determined that the legislative history supported the preservation of federal common law.

Having concluded that both the plain meaning and legislative history of § 1821(k) require that all federal common law claims be preserved, the court next addressed whether federal common law was superseded by § 1821(k). Because the court already found congressional intent to preserve federal common law claims, and because the entire issue of common law supersession turns on congressional intent, the court's analysis was predictable. The court cited Mobil Oil Corp. v. Higginbotham for the proposition that it is proper for federal common law to fill gaps left by congressional silence, but improper to rewrite Congress’s rules with federal common law.86 The Third Circuit’s statutory analysis had already concluded that Congress intended to preserve the Federal Liquidator's rights to proceed under federal common law.87 Thus, consistent with the approach of Mobil Oil, federal common law could fill the gaps left by § 1821(k).

The court also noted that before its receivership, the thrift involved in Cityfed had a right to bring an action against its officers and directors under federal common law.88 Further, under § 1821(k), upon receivership, the Federal Liquidators obtain all the rights of City Federal that existed prior to receivership.89 This provision, defining the powers of the Federal Liquidators upon receivership, clearly evinced congressional intent to preserve all preexisting common law duties owed by directors of failed banks by operation of 12 U.S.C. § 1821(d)(2)(A)(i).

The Third Circuit concluded that the congressional intent underlying the enactment of § 1821(k) was not to insulate directors and officers of failed banks from federal common law liability for conduct less culpable than gross negligence. Rather, § 1821(k) was enacted to ensure that directors and officers could not escape liability to the Federal Liquidators under the shield of state insulating statutes.90

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84. Cityfed, 57 F.3d at 1241 (citing 135 Cong. Rec. S6912 (daily ed. June 19, 1989)).
86. Cityfed, 57 F.3d at 1245.
87. Id.
88. Id.
89. Id. (citing O’Melveny & Myers v. FDIC, 114 S. Ct. 2048, 2054 (1995)).
90. Id.
gress intended § 1821(k) to strengthen, not weaken, the Federal Liquidators’ ability to recover for director and officer misconduct.91

Finally, the court addressed the concern raised in Gallagher that permitting federal common law claims would render § 1821(k) surplusage:

Given the RTC’s concession that it can only bring federal common law claims against directors and officers of federally chartered institutions and not against their state-chartered counterparts, the answer to the . . . question is clear. Concluding that § 1821(k) does not displace federal common law does not render this provision “redundant, meaningless surplusage” because the RTC still needs § 1821(k) to bring actions for gross negligence against directors and officers of institutions chartered in states with statutes insulating them from such liability.92

Accordingly, the preservation of federal common law was not inconsistent with § 1821(k) because the statute would still be necessary in certain state actions.

The dissent in Cityfed urged the adoption of the Gallagher approach.93 The dissent also questioned the majority’s supposed conclusion that the main body of § 1821(k) does not apply to federally-chartered thrifts.94

C. The Approach of Other Courts

Although Cityfed appears consistent with the Ninth Circuit,95 every other circuit court that has addressed the issue directly has agreed with Gallagher.96 The Tenth Circuit has adopted the Gallagher approach, but has assumed somewhat inconsistent positions in some cases.97

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91. Id. at 1248 (citing RTC v. Chapman, 29 F.3d 1120, 1127 (7th Cir. 1994) (Posner, C.J., dissenting) (“What would otherwise be a more stringent standard, that of simple negligence, is diluted by interpretation of a statute intended to make the liability of such directors more stringent.”)).

92. Id. at 1249.

93. Id. (Mansmann, J., dissenting).

94. Id. at 1252.

95. See FDIC v. McSweeney, 976 F.2d 532, 538 n.7 (9th Cir. 1992), cert. denied, 508 U.S. 950 (1993); see also RTC v. Smith, 872 F. Supp. 805, 816-17 (D. Or. 1995) (holding that McSweeney preserved federal common law).

96. See RTC v. Frates, 52 F.3d 295, 297 (10th Cir. 1995); FDIC v. Bates, 42 F.3d 369, 372 (6th Cir. 1994); RTC v. Miramon, 22 F.3d 1357, 1359-60 (5th Cir. 1994).

97. FDIC v. Canfield, 967 F.2d 443, 446 n.3 (10th Cir. 1992), cert. denied, 506 U.S. 993 (1992). For example, the court read “may” as a “permissive term” that “does not imply a limitation on the standards of officer and director liability.” Id. at 446 (citing Rose v. Rose, 481 U.S. 619, 626-27 (1987) (refusing to read “may” as establishing anything but discretionary power)). The court refused “to construe the first sentence of the section as saying that an officer or director may only be held personally liable for gross negligence.” Id. RTC v. Frates, 52 F.3d 295 (10th Cir. 1995), which held that a standard of simple negligence is insufficient under § 1821(k), is difficult to reconcile with this approach.
The district courts have also frequently addressed the proper construction of \$ 1821(k). The results have not been consistent. Some courts have held that \$ 1821(k) has no preemptive or superseding effect on the rights of the Federal Liquidators, but rather only preempts state law to the extent that it insulates directors from liability for gross negligence. Some have held that \$ 1821(k) preempts federal common law, but allows state law claims even against directors of federal banks. Finally, some courts have held that it preempts both state and federal law.

Surprisingly, despite courts' varying approaches to the construction of \$ 1821(k) and its impact on source of law questions, no court addressing the issue has held that federal common law provides for other than an ordinary care standard of liability for bank directors. Of course, all of the tempest regarding \$ 1821(k) would be for naught if federal common law provided a gross negligence standard of care.

D. Preexisting Common Law Approach to Bank Directors' Duty of Care

Thus far, plaintiffs, defendants, and courts all appear to agree or assume that federal common law provides an ordinary care standard of liability. This section demonstrates that federal common law does require ordinary care, and that, therefore, all of the litigation regarding the viability of federal common law, despite the enactment of \$ 1821(k), really does matter.

Both federal and state common law courts traditionally have drawn distinctions between duties of bank directors and duties of directors of ordinary corporations. Because the banking business involves the

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98. See supra note 10.
103. Henry W. Ballantine, Ballantine on Corporations 158 (2d ed. 1946) (rejecting gross negligence standard for directors generally, and noting higher standard of care for bank directors); 3A William M. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations \$ 1042.10 (perm. ed. rev. vol. 1994) (stating that the standard of care for bank directors requires a "strong emphasis on supervision and attention to the bank's business" (citing Briggs v. Spaulding, 141 U.S. 132, 165-66 (1891); Martin v. Webb, 110 U.S. 7, 15 (1884))); Norman D. Lattin, The Law of Corporations 279 (1971) (noting that directors' duties are particularly demanding in the context of banks); McCoy, supra note 8, at 1033 ("[C]ourts have scrutinized a wide array of substantive bank decisions for negligence out of concern for undue risk to depositors and deposit insurance funds."); see also I Michael P. Malloy, Banking Law and Regu-
custody of public funds and normally implies an assurance of safety and soundness in the use of those funds,\textsuperscript{104} courts have long ago set a higher duty of care for directors of banks.\textsuperscript{105} Directors of banks are guardians of shareholder funds and public depositor funds. The justification for protecting depositors applies equally to protecting the deposit insurance fund guaranteed by the federal government.

First, like the public depositors, the deposit insurance fund does not have the ability to negotiate independently with directors. Directors of federally-insured banks are selected by the shareholders and other equity-holders of the financial institution, not the federal deposit insurance fund. Therefore, there is no basis for limiting the traditionally high duty of care imposed upon bank directors, because the risk formerly borne by depositors is now borne by a deposit insurance fund. Second, to the extent that deposit insurance shields the depositors from risk of loss, the government should be and is subrogated to the rights of the depositors; in other words, the government has stepped into the shoes of depositors.\textsuperscript{106}

Courts have also recognized the crucial role banks play in a modern, industrialized economy. When a bank approaches insolvency or becomes insolvent, public confidence can be shaken and catastrophic bank runs may occur. Declining deposits may, in turn, lead to less lending, higher interest rates, and consequential damage to the general economy.\textsuperscript{107} In fact, FIRREA was enacted in the face of this very
problem.\textsuperscript{108} Thus, courts have recognized that public policy requires that bank directors be held to strict accountability for negligent decisions.\textsuperscript{109}

The public policy requiring prudence and soundness in the operation of federally-insured banks is evidenced by the statutory scheme regulating an insured bank's activities as a quid pro quo of deposit insurance. In fact, that statutory scheme specifically imposes upon bank directors the obligation to act in a safe and sound manner.\textsuperscript{110} Arguably this statutory standard of care is even higher than the common law standard of care requiring bank directors to act with ordinary care.\textsuperscript{111} Regardless of this potential distinction, there clearly is no basis for undercutting this statutory framework for monitoring banks by easing the standard of care that has traditionally been required of


\textsuperscript{109} E.g., Wichita Fed. Sav. and Loan Ass'n v. Black, 781 P.2d 707, 712 (Kan. 1989) (affirming that bank directors play a special role in the economy and imposing liability for negligence); Hun v. Cary, 82 N.Y. 65, 71 (1880) (stating that bank directors owe a higher duty because even a "breath of suspicion" could cause a bank run and destroy the bank); Broderick v. Marcus, 272 N.Y.S. 455, 461 (Sup. Ct. 1934) (stating that maintenance of safe and sound banking is essential to "help the wheels of industry revolve"); see also 6 Zolman Cavitch, Business Organizations § 1207.01 (1995) ("Directors of banks . . . are held to stricter accountability than directors of other types of corporations, because of their special relationship to depositors and the general public."); Robert S. Stevens, Handbook on the Law of Private Corporations § 151 (1949) (noting that the director's standard of liability is ordinary care and that amount of care depends upon the character of the corporation; in "banking and insurance companies, there is a public interest in maintaining careful and efficient management"). Any doubts regarding the need for special protection of the banking industry, can be resolved by a primer on the Great Depression: "Most people remember vaguely that a banking crisis helped tip the world into the Great Depression of the 1930s, with all its horrifying consequences for the second half of the century." \textit{How Safe is Your Bank?}, supra note 9, at 15. While Nazism and Communism seem only remotely related to pervasively sloppy banking, a system-wide bank panic can have a "devastating effect on the real economy." \textit{Coping with the Ups and Downs}, supra note 9, at 4. As banks fail, credit tightens and loans are called. In the 1930s, when 9000 banks failed in America, a world-wide credit crunch "made the Depression 'Great.'" Id.

\textsuperscript{110} Lawrence G. Baxter, \textit{Fiduciary Issues in Federal Banking Regulation}, 56 Law & Contemp. Probs. 7, 8 (1993) (stating that the "long standing [and] reasonably well understood . . . duty not to engage in 'unsafe and unsound' conduct" protects the deposit insurance fund more than any fiduciary duty running directly to the insurance fund (emphasis omitted)). No case has found the safe and sound banking mandates of the statutory regime to support a private right of action by a bank, or its successors, the Federal Liquidators, against its directors; this issue only becomes relevant if a duty of ordinary care is obliterated by the judiciary in the context of applying § 1821(k).

\textsuperscript{111} Heidi M. Schooner, \textit{Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices}, 63 Geo. Wash. L. Rev. 175, 214 (1995) (concluding that the application of safety and soundness principles results in a higher standard of care for directors).
It is illogical to argue that, because the federal government insures deposits and, therefore regulates risks, the traditionally high duty of care required of bank directors or officers should be lessened. To lessen the duty of care defeats the whole purpose of regulation—to reduce risk—and imposes excessive monitoring costs upon taxpayers. Thus, the Supreme Court has long held that the detailed statutory scheme of bank regulation did not operate to lessen the common law duty of ordinary care.\textsuperscript{113}

1. Federal Common Law

Despite a certain revisionism\textsuperscript{114} regarding the precise standard of care applied to bank directors prior to the enactment of FIRREA, federal common law courts have always applied an ordinary care standard. The long-standing common law tradition imposed duties of due care upon bank directors with little, if any, allowance for the operation of the business judgment rule.\textsuperscript{115} Uniformly the cases state that

\textsuperscript{112} But see Ronald W. Stevens & Bruce H. Nielson, The Standard of Care for Directors and Officers of Federally Chartered Depository Institutions: It’s Gross Negligence Regardless of Whether Section 1821(k) Preempts Federal Common Law, 13 Ann. Rev. Banking L. 169, 178-86 (1994) (discussing the lack of federal case law regarding the standard of negligence required for director and officer liability and concluding that federal common law should be developed through the incorporation of state law, which sets a standard of at least gross negligence). The authors’ analysis is curious. First, the authors claim there is confusion as to whether the standard of liability for bank directors is gross negligence or ordinary negligence under federal common law; yet, the authors cite no federal common-law authority that states or holds that bank directors are liable \textit{only} for gross negligence, and they admit that federal common law authorities have universally invoked an “ordinary prudence and diligence” standard. \textit{Id.} at 186. Second, while arguing for a gross negligence standard of liability under federal common law authorities, the authors ignore the numerous federal cases that hold that allegations of mere negligence are sufficient to state a claim against bank directors. See FDIC v. Mason, 115 F.2d 548, 551-52 (3d Cir. 1940) (reversing dismissal of claims alleging violations of bank directors’ duties for failure to exercise “ordinary prudence”); Hughes v. Reed, 46 F.2d 435, 437 (10th Cir. 1931) (reversing dismissal of claims of “improvident” lending decisions); Robinson v. Hall, 63 F. 222, 228 (4th Cir. 1894) (reversing dismissal of claims against negligent bank directors). Under the gross negligence standard divined by the authors, these cases would have been dismissed for improper pleading. Third, the authors’ reliance on their own value-laden analysis of the facts underlying the federal common law authorities ignores a fundamental canon of our litigation system; it is for the finder of fact to determine if a given legal standard is breached as is the issue of what constitutes ordinary care. See Warner v. Penoyer, 91 F. 587, 593 (2d Cir. 1898) (“[E]ach case has to be determined in view of all the circumstances.” (citation omitted)). It makes no sense to urge a change in the legal standard of liability based upon the authors’ perception of specific factual applications of the standard of liability.


\textsuperscript{114} See supra note 112.

\textsuperscript{115} See, e.g., FDIC v. Wheat, 970 F.2d 124, 130-31 n.13 (5th Cir. 1992) (approving jury instruction for business judgment rule requiring exercise of “due care” or “ordinary care” for protection of the rule); RTC v. Gladstone, 895 F. Supp. 356, 369 (D. Mass. 1995) (holding that the business judgment rule only protects decisions under-
taken with "due care"); see also McCoy, supra note 8, at 1032 ("[S]cholars thus have failed to grasp the vast extent to which courts have second-guessed decisions of bank directors on the merits... for the past hundred years."). But see Washington Bancorp. v. Said, 812 F. Supp. 1256, 1267-68 (D.D.C. 1993) (applying business judgment rule and gross negligence standard to bank directors).

The recent transmogrification of the business judgment rule adds to the ability of some commentators to create confusion regarding the standard of liability of bank directors. Traditionally, the business judgment rule operated in a majority of jurisdictions to protect decisions of directors made with a reasonable basis and with due care. As such, the business judgment rule merely precluded liability for decisions that turned sour if the decision process was reasonably sound. See Ballantine, supra note 103, § 63a (noting that the business judgment rule presupposes that reasonable diligence and care have been exercised); Robert C. Clark, Corporate Law § 3.4 (1986) (stating that the business judgment rule should only protect judgments arrived at in a non-negligent manner); Harry G. Henn & John R. Alexander, Laws of Corporations § 242 (3d ed. 1983) (stating that the business judgment rule presupposes an honest, unbiased judgment reasonably exercised); see also McDonnell v. American Leduc Petroleums, Ltd., 491 F.2d 380, 384 (2d Cir. 1974) ("The business judgment rule protects only reasonable acts of a director or officer."). Nevertheless, "[c]ourts have been far too lenient in their treatment of directors who do not direct under whatever rule they adopt as a test of liability." Lattin, supra note 103, at 274. In fact, Professor Joseph Bishop, Jr. found that "[t]he hard fact is that cases in which directors of business corporations are held liable, at the suit of stockholders, for mere negligence are few and far between." Joseph W. Bishop, Jr., Sitting Ducks and Decoy Ducks: New Trends in the Indemnification of Corporate Directors and Officers, 77 Yale L.J. 1078, 1095 (1968) (emphasis added). This apparent divergence between the law and reported decisions has given ostensible support to a reformulation of the business judgment rule, essentially extending the rule to substantively insulate directors from liability. Compare ALI, Principles of Corporate Governance and Structure: Restatement and Recommendations § 4.01 (Tentative Draft No. 1, 1982) (imposing liability for negligently made decisions) with ALI, Principles of Corporate Governance and Structure: Analysis and Recommendations §§ 4.01, 4.02 (1994) (imposing liability only for irrational decisions).

Even assuming that it is appropriate to modify legal doctrine based upon an assumption that courts are disingenuous regarding the standard of liability they articulate and a value-laden factual analysis of the outcomes of only reported decisions, however, this reasoning has no applicability to banks. Professor Bishop himself noted that decisions imposing liability upon directors for negligence involved "special" categories or circumstances, such as cases involving banks, particularly insolvent banks where recoveries would benefit depositors rather than shareholders. Bishop, supra, at 1095. There is only scant authority for applicability of a business judgment rule requiring more than negligent decision processes for liability in the banking context. See McCoy, supra note 8.

The pronounced trend away from a standard of liability conducive to director liability for negligence has manifested itself in many jurisdictions through an explicit adoption of a gross negligence standard of liability, most notably in Delaware. See Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985). The use of a gross negligence standard had long been a minority, and even discredited, position. Lattin, supra note 103, at 274.

The use of the term gross negligence in connection with the banking industry may be particularly misleading. Many authorities have stated that "[w]hat would be properly regarded as slight negligence in a director of a railroad or manufacturing company might well be regarded as gross negligence in the case of a bank." Ballantine, supra note 103, at 158. Thus, when courts use the term gross negligence in connection with banks it could well reflect the application of a more rigorous ordinary care standard. See Hun v. Cary, 82 N.Y. 65, 72 (1880). Stated simply, the standard of liability for bank directors is so rigorous that acts of negligence are considered grossly negli-
bank directors and officers owe a duty of "utmost diligence," "ordinary care," "ordinary diligence," or "proper prudence." In all events, these formulations of the standard of care must be deemed an ordinary negligence approach. Moreover, the cases articulate no real business judgment rule in contrast to cases from the same era involving non-banking corporations.

Many of these cases are dated well before *Erie Railroad v. Tompkins*. Theoretically, under pre-Erie law, the common law applied in federal courts could have provided a totally different standard of care than the common law applied in state courts. In fact, there is a

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See *Preston v. Prather*, 137 U.S. 604, 608-09 (1891) (stating that gross negligence is nothing more than failure to exercise reasonable care under the circumstances); *Wallace v. Lincoln Sav. Bank*, 15 S.W. 448, 453-54 (Tenn. 1891) (stating that if bank directors are "inattentive" to their duties, they are guilty of "gross neglect" and that bank directors are liable for acts of negligence).

Additionally, long ago most bank directors apparently served without compensation. The fiduciary duties of gratuitous agents have always been more lax than those who are compensated. See *Restatement (Second) of Agency* § 388 (1958). Therefore, as could be expected, some cases express reluctance to hold gratuitous bank directors liable for conduct short of gross negligence. E.g., *Wheeler v. Aiken County Loan & Sav. Bank*, 75 F. 781, 785 (D.S.C. 1896) (stating that bank directors "[b]eing gratuitous mandataries . . . are only liable for fraud or gross negligence"); *see also Swentzel v. Penn Bank*, 23 A. 405, 414 (Pa. 1892) ("It cannot be the rule that the director of a bank is to be held to the same ordinary care that he takes of his own affairs. He receives no compensation for his services. He is a gratuitous mandatory."); *see also generally Albert S. Bolles, The Duty and Liability of Bank Directors*, 12 Yale L.J. 287, 289 (1903) (stating that despite formulations invoking an ordinary care standard of liability, facts usually indicate that liability is imposed under general common law only for gross negligence because bank directors are "rarely paid"). Thus, authorities from this era which purport to uphold a gross negligence standard must be viewed skeptically because of the widespread conviction that bank directors served gratuitously. This Article takes no position regarding the duties of gratuitous bank directors.

At some point, however, authorities began to recognize that directors were usually compensated in both monetary and non-monetary means, and the approach to the question of duty was modified accordingly.

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116. *Briggs v. Spaulding*, 141 U.S. 132, 147 (1891) ("There are many things which, in their management, require the utmost diligence . . . . [T]he duties imposed are presumed to call for nothing more than ordinary care . . . ."); *Hughes v. Reed*, 46 F.2d 435, 437 (10th Cir. 1931) ("[T]he defendants failed faithfully and diligently to discharge their duties as directors . . . ."); *Warner v. Penoyer*, 91 F. 587, 592 (2d Cir. 1898) (requiring "ordinary prudence" for bank directors); *Rankin v. Cooper*, 149 F. 1010, 1013 (C.C.W.D. Ark. 1907) ("It is their duty to use ordinary diligence in ascertaining the condition of its business, and to exercise reasonable control and supervision over its affairs."); *Hun v. Cary*, 82 N.Y. 65, 74 (1880) (stating that directors of banks must use "proper care and diligence").

117. *See Fletcher*, supra note 103, § 1042.10, at 77 ("[T]he business judgment rule, with some exceptions, is usually not invoked as a defense against bank director liability for mismanagement."); *Compare Leslie V. Lorillard*, 18 N.E. 363, 365 (N.Y. 1888) (finding that "[m]ere errors of judgment" are not sufficient to support liability) *with Hun*, 82 N.Y. at 72 (holding bank directors to stricter duty of care). *But see Amerifirst Bank v. Bomar*, 757 F. Supp. 1365, 1376 (S.D. Fla. 1991) (holding that allegations of fraud, recklessness, and negligence were sufficient to overcome bank directors' business judgment rule defense on a motion to dismiss).

remarkable similarity in approach. Regardless of a bank's jurisdiction of incorporation, or the jurisdiction deciding the case, one message was loud and clear: bank directors are subject to a standard of liability of ordinary care.\textsuperscript{119}

Some commentators have urged that the courts should not be taken at face value when they discuss the bank director's duty of care in terms of ordinary negligence.\textsuperscript{120} These commentators have urged that, in fact, a gross negligence standard was applied notwithstanding a court's explicit statement of a simple negligence standard.\textsuperscript{121} Even a cursory review of the cases, however, belies this argument.

*Bates v. Dresser*,\textsuperscript{122} a Supreme Court case that predates *Erie*, illustrates the federal common law approach to bank director and officer liability. In *Bates*, the receiver of a national bank sued the directors for losses incurred as a result of theft by an employee.\textsuperscript{123} Although the court did not impose liability upon the outside directors for failing to detect a novel fraud, the court held the president liable for negligence.\textsuperscript{124} Justice Holmes affirmed the circuit court judgment for the outside directors stating that the "fraud was a novelty in the way of swindling a bank so far as the knowledge . . . had reached [in] . . . 1910."\textsuperscript{125} In fact, the fraud had even escaped the detection of federal bank examiners.\textsuperscript{126} Still, the Court concluded that the president should have affirmatively investigated unexplained shortages.\textsuperscript{127} Despite the novelty of the well-concealed fraud, two Supreme Court justices, and the district court, wanted to hold even the outside directors liable for negligence.\textsuperscript{128} In imposing liability on the president, Justice Holmes relied upon federal common law authorities which had long stated that bank directors owe duties of ordinary prudence.\textsuperscript{129} Thus, *Bates* demonstrates that federal common law, as articulated by the Supreme Court as early as 1884, imposed liability on negligent managers of federal banks.\textsuperscript{130}

\begin{itemize}
\item \textsuperscript{119} See Michelsen v. Penney, 135 F.2d 409, 417 (2d Cir. 1943) (holding directors negligent under federal common law); Fletcher, *supra* note 103, § 1042.10, at 77.
\item \textsuperscript{120} Stevens & Nielson, *supra* note 112, at 186.
\item \textsuperscript{121} Id.
\item \textsuperscript{122} 251 U.S. 524 (1920).
\item \textsuperscript{123} Id. at 526.
\item \textsuperscript{124} Id. at 529-31.
\item \textsuperscript{125} Id. at 529.
\item \textsuperscript{126} Id. at 528.
\item \textsuperscript{127} Id. at 530-31.
\item \textsuperscript{128} Id. at 532.
\item \textsuperscript{129} Id. at 530 (citing Warner v. Penoyer, 91 F. 587, 592 (2d Cir. 1898), and holding directors liable for neglect of proper supervision).
\item \textsuperscript{130} The Supreme Court articulated a common law standard of care for directors and officers of federally-chartered depository institutions over 100 years ago in *Briggs v. Spaulding*, 141 U.S. 132, 152 (1891) ("In any view the degree of care to which these defendants were bound is that which ordinarily prudent and diligent men would exercise under similar circumstances . . . "). *Briggs* arose before *Erie*; thus, although addressing the liability of directors and officers of a nationally-chartered bank, it did
\end{itemize}
Federal decisions following Bates demonstrate the high degree of care that federal common law imposed upon directors. For example, in Gamble v. Brown, the Fourth Circuit imposed liability upon outside directors of a national bank for failing to exercise reasonable care in protecting the bank from embezzlement by appointing an audit committee. The court articulated the standard of care as "that which ordinarily prudent men would exercise under similar circumstances." In Atherton v. Anderson, the court held outside directors liable for failing to detect the deteriorating condition of the bank because of the president's affirmative scheme to deceive the board. The court rejected the directors' defense that they were ignorant of the facts because directors have a "duty to know the facts." In Hughes v. Reed, the Tenth Circuit reversed the dismissal of claims that national bank directors had negligently approved certain loans. The court specifically found that allegations that the directors failed to "faithfully and diligently" discharge their duties and protect the bank from "improvident" loans were sufficient to state a cause of action.

not label the articulated standard as one of federal common law. Such a distinction, however, is immaterial to the issue of the duty of care of a bank director. All common law authorities imposed essentially the same duty of ordinary care. It is true that Briggs, as well as other cases, held that the particular directors at issue were not culpable. The primary basis for this conclusion, however, was that the Court did not desire to impose a duty upon directors to review a bank's books and records. Id. at 163-64. In other words, the Court simply required some basis for the directors to have notice of dangerous conditions.

Similarly, some courts have found that the conduct at issue was not just negligent, but grossly so. Bowerman v. Hamner, 250 U.S. 504, 511 (1919); see Stevens & Nielson, supra note 112, at 183-87. Nevertheless, the standard remained the same. Certainly, these courts knew that gross negligence was available as a standard of care. Despite the grossly negligent conduct at issue, the courts nonetheless specified, and therefore reaffirmed, a standard of ordinary care. See Anderson v. Atherton, 302 U.S. 643, 643 (1937) (reversing the circuit court and directing it to determine bank directors' "common law liability for negligence"); Bowerman, 250 U.S. at 513 (holding director liable for breaching duty to act in accordance with the conduct of "ordinarily prudent and diligent men, accepting election to membership in a bank directorate"); Martin v. Webb, 110 U.S. 7, 15 (1884) (stating that bank directors have a duty "to use ordinary diligence in ascertaining the condition of [a bank's] business, and to exercise reasonable control and supervision of its officers."); see also Preston v. Prather, 137 U.S. 604, 615 (1891) (holding bank managers liable for failure to exercise "ordinary care" and rejecting gross negligence standard where bank was apparently operated as a partnership).

131. 29 F.2d 366 (4th Cir. 1928), cert. denied, 279 U.S. 839 (1929).
132. Gamble, 29 F.2d at 371-72 (finding directors "culpable" for their "neglect" in appointing an auditing committee).
133. Id. at 370.
134. 99 F.2d 883 (6th Cir. 1938) (imposing liability for improvident loans despite Master's findings to the contrary).
135. Id. at 888-91.
136. Id. at 889.
137. 46 F.2d 435 (10th Cir. 1931).
138. Id. at 443; see Robinson v. Hall, 63 F. 222, 223 (4th Cir. 1894) (reversing dismissal of claims against negligent directors).
139. Hughes, 46 F.2d at 437.
Gibbons v. Anderson imposed liability for "negligence" upon directors for failing to heed warnings that the primary managing officer was diverting funds to his own use. Clearly, these courts applied an ordinary negligence standard and imposed liability for losses caused by another's intentional misconduct.

Therefore, even discounting the Supreme Court's explicit statements regarding the duty of care expected from a bank or a financial institution director, it appears that federal common law courts, sitting as trier of fact in an equity context, found negligent conduct to give rise to liability for breach of the duty of ordinary care.

2. State Common Law

State common law has long been consistent with the duty of ordinary care imposed in the federal courts. In Litwin v. Allen, the New York Court of Appeals recognized that directors of banking institutions held a special public trust because of their custody over depositors' as well as shareholders' assets, and owe a higher duty of care than directors of an ordinary business corporation. Litwin imposed liability based upon a conclusion that a board business decision was negligent; specifically, the bank at issue bore the risk of capital loss with no prospect for capital gain when purchasing convertible debentures. The great weight of other state decisions has stated the same rule and found liability in situations involving negligence.

140. 80 F. 345 (W.D. Mich. 1897).
141. Id. at 349 (stating that directors may not simply confide the operations of a bank to trusted officers).
142. 25 N.Y.S.2d 667 (1940).
143. Id. at 727.
144. Id. at 699-700.
145. Hoye v. Meek, 795 F.2d 893, 896 (10th Cir. 1986) (applying Oklahoma law and requiring "ordinary care"); Magale v. Fomby, 201 S.W. 278, 280 (Ark. 1918) (holding that unsecured loans to new business ventures were negligent); Chicago Title & Trust Co. v. Munday, 131 N.E. 103, 105 (Ill. 1921) (holding that "when one takes a position as a director of a bank he becomes trustee for the depositors as well as for the stockholders, and is bound to the observance of ordinary care and diligence"); Wichita Fed. Sav. & Loan Ass'n v. Black, 781 F.2d 707, 712 (Kan. 1989) (imposing "stricter" duty of care upon bank officers and directors); First Nat'l Bank v. Doherty, 161 S.W. 211, 214 (Ky. 1913) (stating that banking industry demands "exceptionally" high duties of directors); Medford Trust Co. v. McKnight, 197 N.E. 649 (Mass. 1935); Prudential Trust Co. v. Brown, 171 N.E. 42, 44 (Mass. 1930); Williams v. McKay, 18 A. 824, 828 (N.J. Ch. 1889) (holding an ordinary care and prudence standard to apply to bank directors); Neese v. Brown, 405 S.W.2d 577, 581 (Tenn. 1964) (holding that general allegations of negligence against directors of a trust company are sufficient to state a claim); Green v. Officers & Directors of Knoxville Banking & Trust Co., 182 S.W. 244, 249 (Tenn. 1915) (holding that allegations of simple negligence were sufficient to overrule demurrer); Wallace v. Lincoln Sav. Bank, 15 S.W. 448, 453-54 (Tenn. 1891) (stating that negligence is sufficient for liability); Warren v. Robison, 57 P. 287, 290-91 (Utah 1899) (requiring even unpaid directors to exercise reasonable prudence); Marshall v. Farmers' & Mechanics' Sav. Bank, 8 S.E. 586, 590 (Va. 1889) (holding directors personally liable for their negligence); see also Francis v. United Jersey Bank, 432 A.2d 814, 829 (N.J. 1981) (holding that a bank director is negligent and personally
3. Modern Federal Common Law

Modern federal courts have consistently applied a common law duty of ordinary care for liability to attach to bank directors. For example, the Seventh Circuit in *FDIC v. Bierman* imposed liability upon directors of a failed bank under federal common law authorities for failure to exercise “reasonable control and supervision over its affairs.” The court held the directors liable for a series of loan transactions that were approved by the bank. *Bierman* relied upon the formulation of a bank director’s duties set out by the Supreme Court in *Briggs v. Spaulding* as a starting point for its decision.

Finally, pre-FIRREA federal courts were unanimous with respect to a core issue, i.e., how a jury should be instructed to resolve a dispute regarding mismanagement of a bank. For example, in *FDIC v. Wheat*, the Fifth Circuit upheld a jury verdict against failed bank directors even though the jury instructions required only a finding that the board did not exercise “ordinary care.” Similarly, in *FDIC v. Appling*, the Tenth Circuit upheld a jury instruction that was essen-

lial for failure to prevent misappropriation of funds by other directors who were also officers and shareholders of the corporation, thereby imposing a stricter standard of accountability than that for a director of an ordinary corporation. But see Washington Bancorp. v. Said, 812 F. Supp. 1256, 1266 (D.D.C. 1993) (holding that bank directors must satisfy either a simple negligence or a gross negligence standard of care depending on the circumstances in which they operate during any given act).

146. 2 F.3d 1424 (7th Cir. 1993).
147. Id. at 1432 (citing Rankin v. Cooper, 149 F. 1010, 1013 (C.C.W.D. Ark. 1907)); see also Fitzpatrick v. FDIC, 765 F.2d 569, 576 (6th Cir. 1985) (affirming FDIC enforcement decision and finding breach of duty of ordinary care under federal law); Hoehn v. Crews, 144 F.2d 665, 673 (10th Cir. 1944) (applying an ordinarily prudent person standard of liability but finding no proximate cause or negligence), aff’d sub nom., Garber v. Crews, 324 U.S. 200 (1945); Michelsen v. Penney, 135 F.2d 409, 417 (2d Cir. 1943) (holding a bank director liable and stating that directors’ standard of liability requires that bank directors “exercise that degree of care which ordinarily diligent and prudent men would exercise under the circumstances”); FDIC v. Mason, 115 F.2d 548, 551-52 (3d Cir. 1940) (reversing dismissal of claims against bank directors for failing to exercise ordinary prudence to prevent embezzlement by an assistant cashier); FDIC v. Greenwood, 739 F. Supp. 450, 452 (C.D. Ill. 1989) (ordering jury instructions requiring directors to exercise degree of care of “reasonably prudent director” of a bank); FSLIC v. Kidwell, 716 F. Supp. 1315, 1317 (N.D. Cal. 1989) (finding that federal common law requires bank directors to act with ordinary prudence), vacated in part sub nom., Eureka Fed. Sav. & Loan Ass’n v. Kidwell, 937 F.2d 612 (9th Cir. 1991); FDIC v. Butcher, 660 F. Supp. 1274, 1279 (E.D. Tenn. 1987) (stating that common law held bank directors liable for mere negligence); Anderson v. Akers, 7 F. Supp. 924, 928 (W.D. Ky. 1934) (imposing liability upon directors for failure to act as "reasonably prudent" bank directors), aff’d in part, rev’d in part sub nom., Atherton v. Anderson, 86 F.2d 518 (6th Cir. 1936), rev’d, 302 U.S. 643 (1937).

148. Bierman, 2 F.3d at 1437.
149. Id. at 1432. Ironically, although *Bierman* was a pre-FIRREA decision, *Bierman* was decided only three months prior to the *Gallagher* court’s evisceration of the federal common law standards stated in *Bierman*.

150. 970 F.2d 124 (5th Cir. 1992).
151. Id. at 131 n.13.
152. 992 F.2d 1109 (10th Cir. 1993).
tially identical to the ordinary care formulation in Wheat.\textsuperscript{153} Virtually all of the post-\textit{Erie}, pre-FIRREA federal courts took the same approach as the courts in \textit{Bierman}, \textit{Appling}, and \textit{Wheat}.\textsuperscript{154}

The long-standing duty of ordinary care for bank directors, recognized by both state and federal common law, suggests that courts should not surmise that Congress intended to obliterate federal common law. Similarly, because this common law duty has existed in tandem with pervasive banking regulation for so long, courts should not lightly conclude that Congress intended to supersede federal common law. Thus, the federal common law provides for a standard of liability of ordinary care, and the longevity and nature of this authority strongly suggests that those asserting that § 1821(k) eliminates federal common law have a difficult argument to make.\textsuperscript{155}

\section*{E. Did Directors and Officers Understand and Bargain for Duties to Exercise Ordinary Care?}

Whether directors understood and bargained for the duty to exercise due care is a significant issue separate from the legal duty itself. If, in fact, directors and officers did bargain for and assume a duty of due care, relieving negligent directors from financial liability that derives from that duty by the magic of statutory interpretation is effectively a subsidy. Because the government insures only deposits, not negligent directors and officers, it would be strange indeed to find that the political branches, without discussion or debate, defeated directors’ and officers’ settled expectations and gave negligent directors such a subsidy in the face of a historic bank crisis.

Every director of a national bank or federal thrift is required to take an oath of office.\textsuperscript{156} The oath requires that the director “will . . . diligently and honestly administer the affairs” of the bank.\textsuperscript{157} State-chartered, federally-insured banks also frequently require a similar oath.\textsuperscript{158} Although courts have held that the oath does not rise to the level of a contract, the substance of the oath certainly puts bank directors on notice that merely avoiding gross negligence is insufficient.

\begin{itemize}
\item \textbf{153.} \textit{Id.} at 1113.
\item \textbf{154.} \textit{See supra} notes 102-09 and accompanying text.
\item \textbf{155.} \textit{See supra} notes 103, 113, 115, 116, 122-41, 146-53 and accompanying text.
\item \textbf{156.} 12 U.S.C. § 73 (1994). The point is not that directors can be sued based upon violations of their oath. \textit{E.g.}, \textit{Davis} v. \textit{McFarland}, 15 F.2d 612, 613 (5th Cir. 1926) (finding no liability for negligence under oath requirement imposed by predecessor to § 73), \textit{cert. denied}, 273 U.S. 754 (1927); \textit{Thompson} v. \textit{Kerr}, 555 F. Supp. 1090, 1097 (S.D. Ohio 1982) (denying recovery under § 73). Rather, the point is that federal bank directors knowingly bargained for duties of ordinary care.
\item \textbf{157.} 12 U.S.C. § 73.

In addition, there are several guidelines that inform directors and officers of their duties. For example, on May 8, 1985, the FHLBB, the primary thrift regulator prior to FIRREA, published interpretative guidelines,159 referred to as Memorandum R-62, that addressed a director's responsibilities. Generally, Memorandum R-62 states that directors have broad fiduciary duties “to exercise reasonable care and due diligence” in supervising the management of their institution’s affairs. The publication then details how a thrift board member discharges this duty in the context of the banking industry. Memorandum R-62 cites case law, such as *Joy v. North*,160 which held directors liable for damages caused by the breach of the broad duties that the FHLBB detailed. This memorandum was published in the United States League Federal Guide, the primary trade publication for the thrift industry. Moreover, the FHLBB routinely provided these types of guidelines to insured S&Ls.161

Additionally, on August 2, 1977, the FHLBB issued Memorandum R-42,162 which set forth detailed guidelines that directors should follow when setting officer compensation. The board stated that, in establishing fees to be paid to members of the board, each director should be keenly aware of his fiduciary responsibilities, and directors should understand that their “primary responsibilities [are] to establish policies which will protect the assets of the association.”163 These detailed standards belie a gross negligence duty.

Furthermore, on April 19, 1982, the FHLBB published detailed appraisal guidelines for the management of federally-insured thrifts.164

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161. *See* Haralson v. FHLBB, 678 F. Supp. 925, 926-27 (D.D.C. 1987) (finding that Memorandum R-41b was provided to all insured savings and loans).


163. *Id.*

Because most thrifts' assets consisted of real estate loans, these guidelines applied to the primary business of every S&L. The detailed guidelines regarding appraisals demanded a degree of involvement by management far beyond that contemplated by a gross negligence standard. The appraisal guidelines cover issues ranging from the amount of information required in an appraisal to mandatory procedures for reviewing appraisals. On September 11, 1986, Memorandum R-41b was superseded by Memorandum R-41c. Memorandum R-41c provided even more stringent standards for appraisals and specified that the duty to assure appropriate appraisals rests not just on management generally, but specifically upon the board of directors.

The banking industry is also the subject of many trade publications, which traditionally have supplied directors with an enormous volume of material detailing the duties of directors. These publications discussed challenges facing directors in the newly deregulated banking industry and reminded directors of their duty of care. These trade publications also contained periodic discussions of legal developments which included recent cases where director duties were litigated. These duties were always cast in terms of ordinary care. Thus, directors and officers of banks have access to numerous sources informing them of their duty of ordinary care.

Although industry publications, regulatory guidelines, and oaths certainly informed directors of their duties, the directors' knowledge of the legal authorities defining their duties should not be discounted.


166. Id.

167. E.g., Robert E. Barnett, Bank and Bank Holding Company Directors 9 (1991) ("Directors have a duty to use ordinary care and prudence in the administration of [the bank]."); Office of the Comptroller of the Currency, The Director's Book: The Role of a National Bank Director 56 (1987) (stating that bank directors have a duty to act with ordinary diligence); ABA, Section of Corporation, Banking and Business Law, Corporate Director's Guidebook, 33 Bus. Law. 1591, 1604 (1978) (stating that directors are liable for decisions that lack a reasonable basis); see also John P. Austin, Directors of Financial Institutions: Special Problems, 31 Bus. Law. 1243, 1245 (1976) (stating that bank directors are required to act with "ordinary care and diligence"); Weinstock, supra note 31, at 436-42 (explaining statutory and common law violations for bank directors to avoid). Many of these publications are published on a regular, if not periodic, basis. See Francis v. United Jersey Bank, 432 A.2d 814, 821 n.1 (N.J. 1981) (citing Robert E. Barnett, Responsibilities & Liabilities of Bank Directors (1980)).

168. E.g., William T. Marshall, A Director's Guide to Commercial Lending, Directors Digest, July/Aug. 1983, at 8, 8-12 (explaining board obligations with respect to hiring personnel, promulgating policies, and regulating practice for newly granted commercial lending powers).

169. E.g., Dr. Roger Fritz, The Six Vital Signs of Board Leadership, Directors Digest, Nov. 1980, at 2, 3 (stating that negligence claims against corporate directors have increased 300%).
After all, financial institutions universally have access to expert legal services. The common law defining bank director and officer duties has been harmonious and clear for at least 100 years. In addition, the statutory and regulatory framework for banks was even clearer. Only one conclusion is therefore possible: Directors understood their duties to include the exercise of ordinary care.

II. Does Federal Common Law Govern the Duties of Directors of Federal Banks?

This part explores the government's compelling interest in federally-insured banks, and notes that federal common law does not conflict with Congress's specific objectives or standards in the enactment of § 1821(k). In addition, this part discusses the history of deposit insurance in the context of federal common law. This part concludes that federal common law should apply to federally-insured banks, regardless of whether the banks are state or federally-chartered.

Generally, a two-pronged inquiry determines the viability of federal common law in a given context: first, whether the issue is properly subject to federal power; and second, whether federal common law conflicts with Congress's specific objectives or standards in the enactment of § 1821(k). This part concludes that federal common law should apply to federally-insured banks, regardless of whether the banks are state or federally-chartered.

170. McCoy, supra note 8, at 1033 ("For over a century courts have scrutinized a wide array of substantive bank decisions for negligence out of concern for undue risk to depositors and deposit insurance funds.")

171. See infra part II.


173. The Supreme Court has long recognized that the federal government has "plenary" power over federally-chartered and federally-insured banks. Fidelity Fed. Sav. & Loan Ass'n v. De La Cuesta, 458 U.S. 141, 159 (1982) (holding that federal regulation preempted state law with respect to due-on-sale clauses in home mortgages). The logic of De La Cuesta compels the conclusion that the "plenary" authority of the FHLBB, which is now replaced by the OTS, would extend to the definition of director duties. 12 C.F.R. § 545.2 (1995). The OTS, and before it, the FHLBB, have always held directors to very high standards. For example, regulations require directors to manage a federal savings association in a safe and sound manner. See 12 C.F.R. § 552.6-1 (1995) (requiring that the business of federal savings associations "shall be under the direction" of the board of directors); 12 C.F.R. § 544.1 (1995) (requiring federal savings association applicants to file a charter before approval); 12 C.F.R. § 563.161 (1995) (requiring "safe and sound" management and financial policies). Similarly, in 1985, the FHLBB released a detailed policy statement reiterating the high duties owed by directors. Memorandum R-62 provided that "directors have a primary responsibility to assure that the institution is operated prudently and in a safe and sound manner." Memorandum R-62, supra note 159, at 2784.3. Simply stated, every regulatory statement of the FHLBB, OTS, or other banking agency is utterly inconsistent with a gross negligence standard. It is axiomatic that legislation should be construed, if possible, harmoniously with preexisting legislation, including regulatory legislation. Therefore, § 1821(k) should be harmonized with the above regulatory statements to permit ordinary negligence actions.
is an appropriate means of governing an issue.\textsuperscript{174} This second prong necessarily involves a weighing of the federal interest in the creation of a federal common law rule.\textsuperscript{175} The federal interest in federally-chartered and federally-insured banks is best manifested in the regulatory system established for such banks.

Federally-insured and federally-chartered financial institutions are relatively unique creatures in the corporate law universe. By chartering banks, the federal government is responsible for the creation and structuring of these entities. Normally, the jurisdiction that charters and creates a business entity provides the rules of law for the internal affairs of the business association.\textsuperscript{176} The federal government's deposit insurance program, which insures both federally-chartered and state-chartered banks, exposes the government to risks arising from the operations of such depository institutions. The bank crisis of the 1980s proved that these risks can be enormous. Thus, the federal government has an important, even compelling, stake in federally-insured banks, even if chartered by states.

As could be expected, the federal insurance and chartering programs are accompanied by detailed statutory and regulatory requirements.\textsuperscript{177} The operations of a federally-chartered bank are provided for in 12 U.S.C. §§ 21-216.\textsuperscript{178} This statutory scheme serves as a corporate code for national banks, much like a state corporation act governs the operations and structure of a state-created corporation. Issues such as bank formation, director qualifications, voluntary dissolution, and merger are addressed in this statutory scheme.\textsuperscript{179}

Similarly, federal thrifts are incorporated pursuant to statutory regulations administered by the OTS.\textsuperscript{180} These regulations provide for the incorporation of federal savings associations. They also address

\textsuperscript{174} E.g., United States v. Kimbell Foods, Inc., 440 U.S. 715, 718 (1979) (holding "that a national rule is not necessary to protect the federal interests underlying [a] loan program"); Clearfield Trust Co. v. United States, 318 U.S. 363, 367 (1943) ("In absence of an applicable Act of Congress it is for the federal courts to fashion the governing rule of [federal] law according to their own standards."); see also Henry J. Friendly, In Praise of Erie—and of the New Federal Common Law, 39 N.Y.U. L. Rev. 383, 410 (1964) (stating generally that Clearfield decided the issue of whether the federal courts should adopt a uniform nation-wide rule or should follow state law").

\textsuperscript{175} See O'Melveny & Myers v. FDIC, 114 S. Ct. 2048, 2055 (1995). The Supreme Court has noted: "Principles formulated by federal judicial law have been thought by this Court to be necessary to protect uniquely federal interests." Banco Nacional de Cuba v. Sabbatino, 376 U.S. 398, 426 (1964) (citing Clearfield, 318 U.S. 363; D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942)).

\textsuperscript{176} See Restatement (Second) of Conflicts of Law § 302 (1971).

\textsuperscript{177} For an example of these regulatory requirements, see the six volumes of Title 12 of the Code of Federal Regulations relating to Banks and Banking.


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numerous operational and structural issues, even going so far as to provide for mandatory form by-laws and charters.181

Further, bank deposit insurance is accompanied by detailed regulatory requirements designed to control the level of risk an insured bank may absorb. Lending activities, appraisal policies, diversification of investments, and loans to insiders are all regulated in a detailed fashion.182 Moreover, the bank regulatory authorities are given broad powers to assure that directors of banks do not permit their institutions to engage in "unsafe or unsound" banking practices.183 Section 1818 of 12 U.S.C. allows the agencies to terminate the deposit insurance of a bank's accounts if operating in an unsafe or unsound manner; to order a bank to cease or desist from unsafe or unsound banking practices; and to prohibit directors and officers from affiliating with banks if they engage in an unsafe or unsound banking practice.184 Directors of a national bank are also subject to liability under 12 U.S.C. § 93 for violating federal laws, such as approving illegal loans.185

The pervasive regulatory scheme set by Congress and the regulatory agencies has a consistent touchstone: Banks are to be operated in a safe and sound manner.186 The political branches have clearly manifested a compelling interest in assuring safe and sound banking.187 This concern is not new. Prior to FIRREA, essentially the same regulatory structure persisted for nearly six decades,188 although it was partially administered by agencies such as the FHLBB and the FSLIC,

182. E.g., 12 C.F.R. §§ 563-64 (providing detailed regulations for the operation of a savings association).
183. The “authoritative definition” of “unsafe or unsound” is:
Generally speaking, an “unsafe or unsound practice” embraces any action, or lack of action, which is contrary to generally accepted standards of prudent operation, the possible consequences of which, if continued, would be abnormal risk or loss or damage to an institution, its shareholders, or the agencies administering the insurance funds.

186. E.g., 12 C.F.R. § 563.161 (1995) (requiring “safe and sound” management and financial policies). Note that the operations of federal banks are under the direction of the board of directors. See supra note 17.
187. Baxter, supra note 110, at 23-31 (arguing that any fiduciary duty owed directly to the insurance fund is subsumed in the statutory duty to maintain safe and sound banking practices).
188. See Schooner, supra note 111, at 188 (“Principles of safety and soundness have been a source of directors’ duties since as early as 1933 when Congress authorized removal proceedings against national bank directors for unsafe or unsound banking practices.” (citing Banking Act of 1933, ch. 89, § 30, 48 Stat. 162, 193-94)).
which were abolished by FIRREA. This continued pervasive regulatory framework militates for the conclusion that Congress is determined to impose every possible protection consistent with safe and sound banking; it also militates in favor of recognition of the federal government's compelling interest in both federally-chartered and federally-insured banks. Nevertheless, the question remains whether this wide-ranging regulation of federal banks, which reflects a compelling governmental interest, means that the federal government cannot avail itself of federal common law regulation, as Gallagher suggests.

### A. Supersession of Federal Common Law by FIRREA

Fiduciary duties of care are neither amenable to, nor traditionally regulated by, statutory regulation. Most states traditionally chose not to promulgate statutes that address the duties of care for directors, and instead regulated these duties through state common law. This ability to regulate through common law existed at the federal level as well. In the context of regulating business entities such as federal banks, the federal government has acted more akin to a state government. Additionally, in the context of insuring bank deposits, the in

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189. For a general discussion of FIRREA's impact upon the federal banking regulatory regime, see Michael P. Malloy, Nothing to Fear But FIRREA Itself: Revising and Reshaping the Enforcement Process of Federal Bank Regulation, 50 Ohio St. L.J. 1117, 1136 (1989) (discussing the regulatory realignment imposed by FIRREA including the abolition of FSLIC and FHLBB).

190. Most recently, Congress required the bank regulatory agencies to adopt detailed standards for safe and sound banking in areas such as management, asset quality, and compensation. 12 U.S.C. § 1831p-1 (1994).

191. Most courts have held that federal chartering of banks supported the application of federal common law to govern the internal affairs of those banks, including the duties of directors and officers, prior to FIRREA. Barany v. Buller, 670 F.2d 726, 731 (7th Cir. 1982) (applying federal common law to quo warranto proceedings brought by ousted officers of a federal credit union); Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609, 614–15 (2d Cir. 1967) (finding federal common law remedy for request for shareholder list of federal savings association); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 826–27 (N.D. Ill. 1975) (applying federal common law to define corporate opportunity doctrine for federal bank); City Fed. Sav. & Loan Ass'n v. Crowley, 393 F. Supp. 644, 656 (E.D. Wis. 1975) (finding that fiduciary duties of directors and officers of federal banks are defined by federal common law); Beverly Hills Fed. Sav. & Loan Ass'n v. FHLBB, 371 F. Supp. 306, 313 (C.D. Cal. 1973) (holding that federal common law applies to fiduciary duties of federal savings association's directors).

Similarly, federal common law applied to state-chartered, but federally-insured banks to the extent that the risks imposed upon the federally-backed insurance fund were in issue. See D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 472–73 (1942) (holding that a federally-insured bank cannot use state law as a defense in an attempt to misrepresent its assets to public examiners); FSLIC v. Sajovich, 642 F. Supp. 74, 77 (C.D. Cal. 1986) (finding that federal common law defines fiduciary duties of state-chartered directors); First Hawaiian Bank v. Alexander, 558 F. Supp. 1128, 1132 (D. Haw. 1983) (applying federal common law to define fiduciary duties of state bank directors); see also FDIC v. Bierman, 2 F.3d 1424, 1432 (7th Cir. 1993) (applying federal common law to directors of state bank).

192. RTC v. Chapman, 29 F.3d 1120, 1123 (7th Cir. 1994).
herent risk of the government acting as a surety requires enormous monitoring costs and stringent regulation. Director and officer liabilities have long been subject to common law development, and it makes little sense to deny the federal government the ability to protect its compelling interest through common law.193

Nevertheless, in recent decades the clear trend of the Supreme Court has been to limit and restrict the applicability of a federal common law.194 To the extent that the availability of federal common law is tied to the strength of a federal interest, however, it would appear that federally-insured and federally-chartered financial institutions imply a maximum interest of the federal government.195 In addition to an interest resulting from the creation of federally-chartered financial institutions, the government has an ownership interest in these banks; after all, the government is the ultimate residual holder of negative equity claims.

The federal government's ownership interest is best understood as a potential "unlimited negative equity interest."196 In those instances where the deposit insurance fund is exhausted, the U.S. government must absorb any unpaid depositor claims. In the banking industry, the largest liabilities of banks are generally deposits. When excessive risk becomes structurally pandemic in the banking industry, as demonstrated in the 1980s, or when the industry suffers cost shocks, as it did in the 1970s, the insurance fund is quickly exhausted. In these circumstances, the federal government is the holder of residual claims of the financial institution to the extent those claims are below zero. This is a manifest and compelling federal interest because it directly exposes the treasury to claims that are potentially worth billions of dollars.

The compelling interest of the federal government concerning the regulation of federally-chartered and federally-insured banks supports the application of both federal statutory law and federal common law to failed bank director and officer liability. First, the political

193. See Rettig, 405 F.Supp. at 825 (stating that it is impossible to define every practice that constitutes a breach of fiduciary duty); see also D'Oench, 315 U.S. at 470 ("Were we bereft of the common law, our federal system would be impotent."); Bowerman v. Hamner, 250 U.S. 504, 510 (1919) (noting that National Bank Act does not relieve director of obligation to act diligently).

194. See, e.g., City of Milwaukee v. Illinois, 451 U.S. 304, 314 (1981) (finding that federal common law is used as a "necessary expedient" when Congress has not spoken to a particular issue); Erie R.R. v. Tompkins, 304 U.S. 64, 65 (holding that there is no general federal common law), cert. denied, 305 U.S. 637 (1938).


196. Harris Weinstein, Address at Southern Methodist University (Sept. 13, 1990), in Speech OTS Chief Counsel Weinstein on Duties of Depository Institution Fiduciaries, 55 Banking Rep. (BNA) 510, 511 (Sept. 24, 1990) [hereinafter Weinstein, SMU Speech]; see Baxter, supra note 110, at 16 (discussing Weinstein's view that the federal government is owed a high degree of care because of the equity interest involved).
branches can be expected to pass legislation with the expectation that common law will operate on an interstitial basis in areas of compelling federal interest. This is especially so where the interest is long-standing and federal common law traditionally has operated. Second, there is no discernible policy basis for courts refusing to utilize federal common law to provide interstitial legal principles to even detailed statutory schemes so long as it is consistent with the intent of the political branches. On the contrary, courts frustrate legislative action when they attempt to aggrandize judicial power by refusing to allow federal common law to operate where the legislature intended federal common law to apply. Third, in many areas of compelling federal interest, long-standing common law principles are inherently necessary to give full meaning to the acts of the political branches.

Gallagher fails to appreciate these concerns in its mechanical application of the *City of Milwaukee v. Illinois* test. A careful review of the Supreme Court’s jurisprudence regarding federal common law fully supports the results reached in *Cityfed*.

1. The *City of Milwaukee* Litigation

The *City of Milwaukee* litigation does not support the abolition of federal common law to define the duties of directors and officers of failed banks for at least three reasons. First, the federal common law standards for bank director duties do not conflict with specific policy objectives and statutory standards. Second, the government has specifically relied upon the operation of federal common law in an area of compelling interest—specifically, federally created and insured banks. Third, the political branches have not intended to occupy the field of director and officer liability.

a. Federal Common Law Does Not Conflict with Specific Objectives and Standards

*City of Milwaukee v. Illinois* involved a case where Congress had specified acceptable water effluent standards; the Court therefore held preexisting federal common law addressing effluent standards to be superseded. In prior litigation of the suit, however, the Court found that Congress’s activity in this area was insufficient to eliminate nuisance remedies for excessive effluents under federal common

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198. This Article focuses only upon the applicability of federal common law in the context of federally-insured banks. For a thorough analysis of the issue of the availability of federal common law, see generally, Field, supra note 195, at 983 (concluding that federal common law is available "whenever federal interests require a federal solution" (emphasis omitted)).
200. Id. at 307.
Thus, the dispute between the State of Illinois and the City of Milwaukee provides a paradigm that illustrates the viability of federal common law despite statutory enactments in areas related to the pre-existing common law.

_City of Milwaukee_ specifically involved § 301 of the Federal Water Pollution Control Act. Section 301 specified detailed water effluent limitations. The Act also created a new federal agency to issue discharge permits and regulate the field in detail. The Court concluded that allowing federal common law to vary the specific requirements of the Act would frustrate Congress's policy objectives in passing the Act. In addition, the Court held that Congress occupied the field of permissible water effluent levels by speaking directly to the issue of specific levels of permissible discharges.

In _Illinois v. City of Milwaukee_, the Court addressed the same dispute but prior to the Act's enactment. Instead of a detailed specification of permissible effluent levels, federal statutory regulation was less comprehensive. There were several legislative enactments that touched upon regulation of effluent levels but no specification of acceptable levels. Thus, the court held in _Illinois v. City of Milwaukee_ that federal common law continued to operate to provide remedies for excessive effluents.

No circuit court has held that § 1821(k) sets a uniform standard of gross negligence for director liability. In fact, the circuit courts have uniformly recognized that allowing a negligence standard to operate in tandem with the gross negligence language of § 1821(k) is precisely what the political branches intended, at least insofar as state claims for negligence are of some continued viability. Therefore, the possibility of a direct conflict between statute, i.e., § 1821(k), and federal common law does not exist, as it did in _City of Milwaukee_. Instead, under all interpretations, including _Gallagher_, Congress specifically understood that § 1821(k) could accommodate the application of both negligence and gross negligence standards to different types of banks, depending on whether the bank was chartered under state or federal law.

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203. _Id._
204. _Id._
205. _Id._ at 324.
207. _Id._ at 101.
208. _Id._ at 104.
209. See supra notes 95-97 and accompanying text.
210. _Id._
b. Governmental Reliance upon the Operation of Federal Common Law in an Area of Compelling Interest

When Congress enacted the Financial Institutions and Interest Rate Control Act of 1978, the House Committee on Banking, Housing and Urban Affairs noted:

[B]oards of directors of financial institutions have a fiduciary responsibility for the institution they are managing. Service on a board of directors is not simply an honorary position. It is a position charged with the responsibility for the operations of the institution, for the safety of depositor's money, for the stockholders' investments, and for fulfilling its charter's commitment to serve a community.

Similarly, 12 U.S.C. § 1464(d), as well as regulatory statements, had also long assumed that board members of federal banks owed their institutions fiduciary obligations.

Yet, no statute or regulation defines the fiduciary duties of officers or directors of federal banks. Instead, the fiduciary duties of directors of federal financial institutions have been left to common law development for at least 100 years. At no point in time did Congress or any president ever express an intent to destroy this important leg of the regulatory triad that Congress consistently imposed upon the banking industry. Statutes, administrative agencies and regulations, and common law work together to protect the federal treasury. It would appear counter-intuitive for Congress to eliminate the federal common law aspect of regulation for failed banks in the midst of a bank crisis of historic proportions. In fact, there is legislative history which demonstrates Congress's reliance upon the continued operation of federal common law to complement FIRREA. The Senate Banking Committee report specified that § 1821(k) preserved the right of the Federal Liquidators to pursue "simple negligence" claims under "applicable Federal law." The plain meaning of the savings clause seems to contain, therefore, an implicit, and perhaps even an explicit, directive for courts to continue to apply federal common law.

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214. See supra notes 192-93 and accompanying text.
216. "[T]he duties and responsibilities imposed upon fiduciaries and those in positions of trust by generally accepted ... common law principles are implicit" in the scheme of federal banking regulation. Beverly Hills Fed. Sav. & Loan Ass'n v.
c.  Congress Did Not Occupy the Field of Director and Officer Liability

In FIRREA, Congress added only two statutes—§§ 1821(k) and 1821(l)—that relate directly to the traditional civil liability of directors and officers. The former statute expressly preserves all other law. The latter statute merely mandates that awards in all claims against directors and officers include both principal and interest losses. Notably, § 1821(l) specifies that damages are available for “improvident” conduct;217 the use of this term is at odds with the conclusion that § 1821(k) sets an exclusive gross negligence standard.

If Congress had intended to occupy the field of director and officer liability, it would have been logical to address causation standards, the applicability of the common law doctrine of director adverse domination to toll the statute of limitations, the effect of regulator negligence or liquidator negligence, joint and several liability, contribution rules, settlement bars, defenses such as reliance upon experts or outside professionals, a director’s liability for voting against a given measure, and a director’s liability if absent for a given measure.218 These issues are of crucial importance to the field of director and officer liability; yet, FIRREA has left each of these issues decidedly unoccupied.

Moreover, the operations of federally-insured, and in particular, federally-chartered, financial institutions have long been heavily regulated. For more than sixty years, a large body of statutes, regulations, and several agencies have done so. Some of those statutes directly affected the liability of directors. For example, 12 U.S.C. § 93 imposed liability on directors of national banks who knowingly approved loans in excess of certain limits.219 Other statutes permitted regula-


218. E.g., FDIC v. Bierman, 2 F.3d 1424, 1434 (7th Cir. 1993) (defining federal common law on proximate cause); Farmers & Merchants Nat'l Bank v. Bryan, 902 F.2d 1520, 1523 (10th Cir. 1990) (adopting the doctrine of “adverse domination” as the federal law of the Tenth Circuit in claims against directors); RTC v. Platt, 853 F. Supp. 294, 297 (S.D. Ill. 1993) (applying federal common law rules of contribution and settlement bars to action against directors of failed bank); FDIC v. Butcher, 660 F. Supp. 1274, 1278 (E.D. Tenn. 1987) (addressing claims of regulator negligence); see also H.R. 316, 104th Cong., 1st Sess. (1995) (proposing detailed standards relating to causation, regulator conduct, the business judgment rule, attachment of assets, and other matters relating to bank manager liability litigation).

219. E.g., Corsicana Nat'l Bank v. Johnson, 251 U.S. 68 (1919) (holding a director of a national bank liable for damages resulting from an excessive loan).
tory agencies to impose civil penalties for certain misconduct. Yet, throughout that time, the federal courts found it appropriate for federal common law to provide an additional basis for liability of directors and officers and to fill the gaps left by the statutes and regulations.

The political branches cannot be imputed with ignorance of eight decades of common law in such an important area. Consequently, the political branches, by acquiescing to this well-developed rule of law, must have intended not to occupy the field of director liability and instead have chosen to rely upon the well-developed common law in this area. Given the Supreme Court's recent holding in United States v. Texas that statutes are presumed not to displace existing federal common law and the Court's reaffirmation of that principle in BFP v. RTC, the political branches must be entitled to rely on the operation of long-standing federal common law, especially in areas imbued with a compelling federal interest. Under these circumstances, the fact that Congress is active in an area supports the application of federal common law.

It appears difficult to conclude that City of Milwaukee mandates the destruction of the federal common law definition of duties to bank directors and officers, given that: (i) there is no conflict between a specified uniform statutory standard and federal common law; (ii) the political branches relied upon the continued operation of federal common law; and (iii) the political branches do not appear to have intended to occupy the field of director liability. Consequently, far from a directive not to apply federal common law, § 1821(k) appears more like a directive to apply federal common law. The savings clause of § 1821(k), the Senate Banking Committee Report, and the purposes provision of FIRREA support this conclusion.

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221. E.g., Bowerman v. Hamner, 250 U.S. 504, 510 (1919) (finding that the National Bank Act does not relieve directors of duty to act diligently); Hoehn v. Crews, 144 F.2d 665, 672-73 (10th Cir. 1944) (holding that directors may be liable both under statutes such as 12 U.S.C. § 182 and under federal common law), aff'd sub nom., Garber v. Crews, 324 U.S. 200 (1945); Michelsen v. Penney, 135 F.2d 409, 417-19 (2d Cir. 1943) (acknowledging that directors can be held liable both under 12 U.S.C. § 93 for knowing violations of federal statutes and under the federal common law duty to use reasonable care); Hughes v. Reed, 46 F.2d 435, 438, 440 (10th Cir. 1931) (acknowledging statutory liability, common law liability in tort, and common law liability for breach of contract for directors of federally-chartered institutions).
223. Id. at 534 (“[C]ourts may take it as a given that Congress has legislated with an expectation that . . . [federal common law] . . . will apply except ‘when a statutory purpose to the contrary is evident.’” (citations omitted)).
224. 114 S. Ct. 1757, 1764 (1994) (decided only three weeks before O'Melveny).
225. See supra text accompanying note 84.
226. See supra text accompanying note 83.
2. Deposit Insurance and Federal Common Law

Two Supreme Court cases addressing the viability of federal common law in the context of federal deposit insurance warrant further analysis.

a. D'Oench, Duhme & Co. v. FDIC

In *D'Oench, Duhme & Co. v. FDIC*, the Supreme Court assessed the applicability of federal common law to federally-insured banks in the wake of *Erie*. *D'Oench* involved a state-chartered bank that was federally-insured. The court concluded that, because the FDIC was a federally-created corporation and was an instrumentality charged with furthering the federal policy of deposit insurance, federal common law would operate to insulate the FDIC from undisclosed deficiencies in the assets of banks it assumed and took over pursuant to deposit insurance pay-outs.

*D'Oench* involved a note that was actually worthless, but appeared as an asset on an insolvent bank’s books and records. The court stated that the statutory scheme providing for deposit insurance reveals “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 respondent insures or to which it makes loans.”

Justice Jackson’s concurring opinion in *D'Oench* expanded upon the majority’s federal common law analysis. Jackson’s federal common law analysis begins with the premise that *Erie* did not destroy federal common law, notwithstanding Justice Brandeis’s statement in *Erie* that “there is no federal general common law.” Jackson stated:

I do not understand Justice Brandeis’s statement . . . that “[t]here is no federal general common law,” to deny that the common law may in proper cases be an aid to, or the basis of, decision of federal questions. In its context it means to me only that federal courts may not apply their own notions of the common law at variance with applicable state decisions except “where the constitution [sic], treaties, or statutes of the United States [so] require or provide.” Indeed, in a case decided on the same day . . . Justice Brandeis said that “whether the water of an interstate stream must be apportioned between the two States is a question of ‘federal common law’ upon

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228. Id. at 454.
229. Id. at 456-62.
230. Id. at 454.
231. Id. at 457.
232. Id. at 469 (Jackson, J., concurring) (quoting *Erie R.R. v. Tompkins*, 304 U.S. 64, 78, *cert. denied*, 305 U.S. 637 (1938)).
which neither the statutes nor the decisions of either State can be conclusive.”

Jackson reasoned that depriving the government of the ability to govern through federal common law was senseless: “Were we bereft of the common law, our federal system would be impotent. This follows from the recognized futility of attempting all-complete statutory codes, and is apparent from the terms of the Constitution itself.”

Jackson then highlighted some areas where the drafters of the Constitution specifically allowed federal common law to operate. Jackson concluded that although a federal court sitting in a non-diversity case may see fit for special reasons to give the law of a state highly persuasive or even controlling effect, in the final analysis it applies federal law; and federal law is found in the federal Constitution, statutes, and common law.

Jackson also found that the scheme perpetrated by the bank and the creditor specifically deceived the FDIC in its capacity as a “supervising authorit[y].”

b. O’Melveny & Myers v. FDIC

Fifty years after D’Oench, the Court revisited the interplay of federal common law and federal deposit insurance. In O’Melveny & Myers v. FDIC, the FDIC argued that federal common law should operate to enhance its rights in claims to which it succeeded as liquidator beyond those enjoyed by the failed bank. The Court ruled that the FDIC, as receiver, generally enjoys the same rights that the failed bank enjoys, no more, no less. As Justice Scalia stated: “Section 1821(d)(2)(A)(i), which is part of a Title captioned ‘Powers and duties of [the FDIC] as ... receiver,’ states that ‘the [FDIC] shall ... by operation of law, succeed to—all rights, titles, powers, and privileges of the insured depository institution ...’”

The FDIC’s argument was that its attorney malpractice claim against counsel for the failed bank it took over, admittedly governed by California law in general, should benefit from a special federal common law rule essentially destroying any imputation defense. If this defense were eliminated, the FDIC would not be hindered by the fact that an agent of the failed bank had knowledge of the facts counsel allegedly should have disclosed.

233. Id. at 469-70 (footnote omitted) (alteration in original) (citing Hinderlider v. La Plata River & Cherry Creek Ditch Co., 304 U.S. 92, 110 (1938)).
234. Id. at 470.
235. Id. at 470-71.
236. Id. at 471-72.
237. Id. at 474-75.
239. Id. at 2054.
The problem with the FDIC's argument was twofold: first, the recognition of such special federal common law rules requires a significant conflict between an identifiable federal policy and state law; and second, the FDIC's argument is directly contrary to the express statement of the political branches that, as liquidator, it merely succeeds to the rights of the failed bank.\(^2\)

Justice Scalia succinctly restated the FDIC's argument with respect to a state law conflict with federal law:

The closest respondent comes to identifying a specific, concrete federal policy or interest that is compromised by California law is its contention that state rules regarding the imputation of knowledge might "deplet[e] the deposit insurance fund," . . . [b]ut neither FIRREA nor the prior law sets forth any anticipated level for the fund, so what respondent must mean by "depletion" is simply the foregoing of any money which, under any conceivable legal rules, might accrue to the fund.\(^2\)

Worse yet, although not highlighted by Justice Scalia, at oral argument, the FDIC not only failed to raise a conflict with state law, but affirmatively stated that no conflict was clear.\(^2\) Given that there was no direct conflict posed by state law, the FDIC's argument essentially urged the Supreme Court to render an opinion approaching advisory status. In fact, on remand, the Ninth Circuit applied California law to eliminate the imputation defense.\(^2\) The litigation in the Supreme Court had no substantive bearing upon the case.

With respect to the nature and strength of the federal interest—the supposed protection of the federal fisc and the deposit insurance fund—the political branches had already weighed those interests and codified § 1821(d)(2)(A)(i) to give the FDIC, as receiver, all rights of the failed bank. Justice Scalia noted that the general rule is that the Federal Liquidators succeed to all rights of the failed bank; only limited statutory enhancements to those rights are provided.\(^2\) Justice

\(^{241}\) Id. at 2055-56.

\(^{242}\) Id. at 2055 (alteration in original) (quoting Brief for Respondent at 32).

\(^{243}\) Counsel for the FDIC engaged in the following exchange with the Court:

QUESTION: Well, what is the State law with regard to the imputation defense in these circumstances?

MR. BENDER: It's not entirely clear, Justice O'Connor. We believe that State law would hold, as would the law of most States, as most Federal courts that have had to guess what State law was in this area have held, that State law would hold that this imputation defense is not available to petitioner in these circumstances, because the people who are suing are not the wrongdoers.

QUESTION: Well then, why do we need a Federal rule?

MR. BENDER: You need a Federal rule in case State law should hold otherwise.


\(^{244}\) FDIC v. O'Melveny & Myers, 61 F.3d 17, 19-20 (9th Cir. 1995).

\(^{245}\) O'Melveny, 114 S. Ct. at 2054.
Scalia provided a list of exceptions to this general rule, including *inter alia*, § 1821(k), and found that no exception was provided for imputation defenses.246

*Inclusio unius, exclusio alterius.* It is hard to avoid the conclusion that § 1821(d)(2)(A)(i) places the FDIC in the shoes of the insolvent [bank], to work out its claims under state law, except where some provision in the extensive framework of FIRREA provides otherwise. To create additional "federal common-law" exceptions is not to "supplement" this scheme, but to alter it.247

The FDIC's initiative to federalize the law of attorney malpractice was therefore rejected.

The *O'Melveny* court did not cite *D'Oench*, which was discussed at oral argument and relied upon by the FDIC. Courts have stated that *D'Oench* was thereby overruled by *O'Melveny*.248 This conclusion is not sound, at least insofar as *D'Oench* operates to define the appropriate standards for the application of federal common law to state-chartered, but federally-insured, banks. Rather, *D'Oench* is fundamentally distinguishable from *O'Melveny*. First, the rule recognized in *D'Oench* vindicated a federal interest that transcended the FDIC's role as liquidator. Specifically, *D'Oench* served a non-liquidator interest by assuring that the FDIC, in regulating banks, could rely upon the accuracy and completeness of a bank's books and records.249 Second, Congress had not specifically addressed the consequences of fraud on the regulators as it addressed the scope of rights to which the FDIC succeeds.250

c. *O'Melveny, D'Oench, and § 1821(k)*

At least two members of the Supreme Court have interpreted § 1821(k) to be preemptive of state laws requiring culpability in excess of gross negligence for claims against directors and officers of failed banks. The *O'Melveny* court specifically discussed § 1821(k):

Respondent argues that § 1821(d)(2)(A)(i) should be read as a nonexclusive grant of rights to the FDIC receiver, which can be supplemented or modified by federal common law; and that FIRREA as a whole, by demonstrating the high federal interest in this area, confirms the courts' authority to promulgate such common law. This argument is demolished by those provisions of FIRREA which specifically create special federal rules of decision regarding claims by, and defenses against, the FDIC as receiver. . . . [including] § 1821(k) (permitting claims against directors and officers for gross

247. 114 S. Ct. at 2054.
248. See *O'Melveny*, 61 F.3d at 18-19; see also *Murphy v. FDIC*, 61 F.3d 34, 40 (D.C. Cir. 1995) (holding that FIRREA superseded *D'Oench* doctrine).
250. Id. at 464.
negligence, regardless of whether state law would require greater culpability.\footnote{114 S. Ct. at 2054.} 

A similar reference was made in oral argument when the court inquired whether § 1821(k) was specifically enacted to enhance the rights of the Federal Liquidators, and counsel for the FDIC admitted it was enacted for that purpose.\footnote{The relevant text of the oral argument reads: \textquote{QUESTION: Mr. Bender, was it in FIRREA that they specifically provided for directors' liability in certain cases where the liability might have been doubtful under State law? \textquote{MR. BENDER: Yes. \textquote{QUESTION: Isn't that a pretty good reason to assume that Congress did it's [sic] picking and choosing when it decided the extent to which State common law might need to be modified to protect the Federal interest? \textquote{Oral Argument of Paul Bender on Behalf of Respondent at 41, O'Melveny & Myers v. FDIC, 114 S. Ct. 2048 (1994), available in Westlaw, 1994 WL 665048, at *44.}}}

This reading obviously gives the most natural meaning to the savings clause of § 1821(k). This interpretation also harmonizes § 1821(k) and § 1821(d)(2)(A)(i). Section 1821(k) is merely a statutory enhancement of the Federal Liquidators' rights—rights that otherwise would be governed by § 1821(d)(2)(A)(i). Congress was protecting the Federal Liquidators from the operation of potentially inimical state legislation. The plain meaning of the first clause is preserved by reading it to preempt state laws to the extent that they would operate to insulate failed bank directors for conduct more egregious than gross negligence. In no event does this interpretation render any part of § 1821(k) surplusage. At the very least, until a clear right to proceed against bank directors and officers of failed banks for ordinary negligence under federal common law, regardless of where the banks were chartered, was recognized by the Supreme Court, this protection was needed to protect the Federal Liquidators from state legislation that insulated directors from negligence actions. This protection was needed, most notably, in the Fourth, Second, and Eighth Circuits, each of which left doubtful the availability of a federal common law right against managers of, at least, state banks, even if federally-insured.\footnote{RTC v. Everhart, 37 F.3d 151, 153-54 (4th Cir. 1994); RTC v. Gregor, 872 F. Supp. 1140, 1146 (E.D.N.Y. 1994). Both of these cases hold that federal common law does not impose duties upon directors of failed banks without even citing D'Oench. See supra note 27.}

Assuming this to be the correct statutory construction, as this Article argues, there is no basis for § 1821(k) to preempt preexisting federal common law under the rationale of \textit{O'Melveny} and \textit{D'Oench}. First, the recognition of a federal common law duty of ordinary care for failed bank directors does not conflict with § 1821(d)(2)(A)(i). Even under the Seventh Circuit approach, the institution may bring a federal common law claim for negligence against a director before fail-
All of the circuit courts that have addressed this issue have reached the same conclusion. *Gallagher* interprets § 1821(k) to destroy federal common law claims that the Seventh Circuit recognized a few weeks earlier in *Bierman*. *Gallagher* therefore conflicts with § 1821(d)(2)(A)(i) by destroying preexisting institution rights once the institution is transferred to the Federal Liquidators. Consequently, recognition of a federal common law right to pursue directors and officers of failed banks furthers the manifest intent of the political branches in promulgating § 1821(d)(2)(A)(i).

Second, like *D'Oench* and unlike *O'Melveny*, an important regulatory interest is at stake beyond simply protecting the federal fisc. By depriving the Federal Liquidators of the ability to pursue a federal common law remedy for breach of the director's duty of due care, a critical element of the government's regulatory program is undermined. For example, the costs of constructing a program that would detect the particulars of all director and officer misconduct prior to receivership could well be politically prohibitive. Yet many claims for misconduct cannot be pursued after the bank fails if a gross negligence standard applies. It is unlikely that the nation can support, both politically and economically, over the long-term, a bank regulatory program that reviews and monitors every potentially negligent banking transaction that may ultimately result in failure. Moreover, to the extent that directors and officers perceive that § 1821(k) may offer shelter, a perverse incentive to seek insolvency is created. A post-failure gross negligence standard at best encourages reckless conduct by relaxing the consequences of failure to bank managers, and at worst encourages intentional misconduct by making insolvency attractive to managers. Clearly, the government's regulatory interest transcends its role as liquidator, for its ability to prevent the failure of banks is undermined.

Third, any federal common law right found to exist under § 1821(k) would not contradict any other statutory provision; instead, recognition of a federal common law right would be consistent with FIRREA and would vindicate the reliance of the federal branches upon the operation of federal common law. The proposed statutory construction urged in this Article is consistent with both § 1821(k) and § 1821(d)(2)(A)(i)—unlike the *Gallagher* opinion, which, in light of *Bierman*, directly conflicts with § 1821(d)(2)(A)(i).

The federal government's interest in entities it creates and owns, at least as residual holder of negative equity claims, is manifest and compelling. As such, unless the political branches specify otherwise, federal common law should be allowed to operate with a latitude reflective of the intent of the political branches, the reliance and ex-
pectations of the political branches, and the weight of the federal interest.

The supersession analysis the Court has applied with respect to the Federal Rules of Evidence reflects these considerations because the federal government's interest in providing procedural rules in federal courts is as great as its interest in regulating entities it incorporates and insures. In fact, it would be difficult to argue that the federal interest in procedural rules outweighs the federal interest in failed banks; no trillion dollar debacle hangs in the balance of the application of the Federal Rules of Evidence. The Court's approach to the Federal Rules of Evidence is also analogous to the banking law context because preexisting common law provides meaning to the legislation and supplements the legislation to allow it to operate in a more complete manner.

In the context of the Federal Rules of Evidence, Congress enacted a comprehensive statutory scheme addressing many facets and details of the law of evidence in a unified statutory codification. Nevertheless, the Supreme Court consistently has recognized that preexisting federal common law of evidence continues to be viable to the extent that it is not inconsistent with specific rules of evidence. Simply stated, preexisting federal common law "fits" as well with § 1821(k) as preexisting federal common law is often found to "fit" with the Federal Rules of Evidence.

The Supreme Court's jurisprudence suggests that federal common law can continue to operate in an area of compelling interest even if Congress speaks to an issue and occupies a field, if Congress intended

256. For example, in United States v. Abel, 469 U.S. 45 (1984), the Supreme Court recognized that the common law doctrine of bias for impeachment survived the codification of the Federal Rules of Evidence. Id. at 50. Chief Justice Rehnquist stated that Congress certainly intended to preserve those preexisting common law principles relating to bias. Id. The Court therefore held that the common law principles that were consistent with the statutory codification without creating a conflict with congressional intent remained viable. Id. at 51.

The Supreme Court's approach to the preemptive effect of the Federal Rules of Evidence on preexisting common law was demonstrated again in Bourjaily v. United States, 483 U.S. 171 (1987). In Bourjaily, the Court interpreted Rule 104 of the Federal Rules of Evidence, which plainly provides a mechanism for preliminary questions of fact relating to evidentiary issues. The Court therefore found long-standing common law that required a coconspiracy to be shown by clear and convincing evidence to be "superseded." Id. at 178-81. In Bourjaily, the Rules spoke specifically to the proof allowed in preliminary determinations of fact. Preexisting federal common law therefore gave way. Id.

In 1993, the Supreme Court again addressed the supersession issue in Daubert v. Merrell Dow Pharmaceuticals, 509 U.S. 579 (1993). The Court noted that the Federal Rules of Evidence "occupy the field," but also noted that, in many areas, federal common law continued to operate in those situations where the common law rule is "entirely consistent" with the rule and where it was likely that the drafters had intended common law to operate. Id. at 587-88. Based upon this test, the Court held that the common law Frye test was superseded because it could not be consistent with Rule 702 which defines standards for expert testimony. Id. at 587-89.
common law to have continued effect. Given the clear evidence that the political branches have relied upon courts to regulate the fiduciary duties of bank managers by common law, *D'Oench* supports the continued force of federal common law. The approach of the Court regarding the Federal Rules of Evidence is the approach that should govern in cases of compelling federal interest because it recognizes that depriving the political branches of the ability to rely upon common law is as much a judicial power-grab as any free-wheeling concept of federal common law. Section 1821(k), in other words, should be viewed as an enabling statute for long-standing and preexisting federal common law.

**B. Does Federal Common Law Apply to Federally-Insured State Banks?**

Before 1938, the choice of law issues relating to federally-insured but state-chartered banks were somewhat less convoluted because the federal courts applied only federal common law. Also, when dealing with the duties of care owed by directors and officers of financial institutions, state law and federal law were essentially indistinguishable. Since 1938, however, state and federal law regarding director's duties have diverged substantially. In fact, throughout the 1980s, a number of states enacted insulating statutes restricting or eliminating liability for breaches of the duty of care owed by directors.²⁵⁷

During the 1980s, without any real debate about the underlying policy basis, the contractarian view of director's duties also gained impressive momentum.²⁵⁸ This approach to directors' duties viewed the entire law of fiduciary duty as merely a default for the inability of parties to contract appropriately for all foreseeable disputes. A fuller understanding of the law of fiduciary duty, however, reveals that the concept of fiduciary duties was also created in order to encourage and discourage specific types of conduct that were found to be important to a broader public interest than simply the particular rights and obligations of the parties directly contracting.²⁵⁹ Thus, for example, it can be argued that even in the context of an ordinary non-federally-insured corporation, directors owe duties of ordinary care that cannot be contracted away because of the state's interest in assuring that the corporation it creates and subsidizes through a grant of limited liability serves the supposed policy goal of expanding the economy. Re-

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²⁵⁷. *See supra* note 30.

²⁵⁸. *See id.* (listing the statutory restrictions enacted to insulate directors from liability); *see also* FDIC v. Benson, 867 F. Supp. 512, 521-22 (S.D. Tex. 1994) (granting motion to dismiss bank director negligence claims based upon Texas business judgment rule); FDIC v. Stahl, 854 F. Supp. 1565, 1571 (S.D. Fla. 1994) (entering directed verdict based upon Florida business judgment rule).

²⁵⁹. Baxter, *supra* note 110, at 17 ("The fiduciary concept was developed in equity from the primary concept of the trust and in *counterpoint* to the common law concepts of contractual obligation. It was never conceived as a 'gap-filler.'").
Regardless of the outcome of this debate, it is clear that the state statutes and common law doctrines aimed at restricting director liability have only a minimal amenability to the federally-insured bank policy matrix.

Courts are sharply divided over whether the federal insurance program is left to the whim-and-vogue of state law to define its ability to recover the insurance payments it makes and to enforce the director duties owed to state banks it regulates. *D'Oench* provides a model for the application of federal common law to state-chartered banks. As previously discussed, *D'Oench* seems to require two elements to support such an application of federal common law: first, that the common law is not inconsistent with Congress's legislation; and second, that the common law is necessary to support a substantial regulatory interest beyond the Federal Liquidator's receivership capacity.260

The duty of care of directors of federally-insured banks appears to fulfill the *D'Oench* requirements. Directors are responsible for managing the business affairs of a corporation.261 If a regulator cannot define or enforce the managers' duty of care, it can never hope to control the risks absorbed by the corporation. Risk control is at the heart of the federal deposit insurance program. Therefore, *D'Oench* appears to support the application of federal common law as a tool in the federal regulatory arsenal, to state-chartered, federally-insured banks, insofar as the duties of directors and officers are concerned.

*D'Oench* was decided in an era when the federal ownership interest implicated by federal deposit insurance was poorly understood. Up until the 1980s, there had been no taxpayer bail-out of the industry-financed deposit insurance fund. In 1996, the federal government knows better than to assume the fund will always render the federal ownership interest only theoretical. This realization provides additional policy support for the application of federal common law. Whether a state-chartered or federal-chartered bank fails, the consequences to the federal government are the same. There is no basis for defining the duties of managers differently. The federal government has a substantial regulatory interest in regulating duties of directors and officers in all federally-insured banks regardless of whether the banks are state-chartered or federally-chartered.

A fair reading of § 1821(k) and § 1821(d)(2)(A)(i), as well as other evidence of legislative history, supports only the conclusion that FIRREA was intended to give the Federal Liquidators all the rights of the institution and to shield the Federal Liquidators from state legislation insulating directors and officers from liability. Therefore, federal

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260. See *supra* notes 227-37 and accompanying text.
common law can and should apply to define the duties of managers of federally-insured banks.

III. MUST § 1821(k) BE CONSTRUED TO ELIMINATE FEDERAL COMMON LAW LIABILITY FOR MANAGERS OF FAILED BANKS?

In the previous part, this Article concluded that Congress intended, indeed relied upon, § 1821(k) to operate to preserve the preexisting federal common law duties of managers of federally-insured banks. The analysis underlying this conclusion subsumes most of the analysis regarding the proper statutory construction of § 1821(k). This part completes the analysis of the proper statutory construction of § 1821(k).

The single most important element of statutory construction is the intent of the political branches in passing the statute at issue. There are a number of rules of construction that shed light on the intent of the political branches in passing § 1821(k). This part addresses these rules as well as the major arguments on each side of the issue.

A. The Surplusage Issue

In RTC v. Gallagher, the court relied upon the “cardinal principle of statutory construction” that statutes are to be interpreted to avoid a result that renders a part of the statute meaningless. Gallagher concluded: “Reading the ‘savings clause’ as preserving a federal common law standard of liability for less culpable conduct than gross negligence would render the substantive portion of § 1821(k) surplusage.”

The Gallagher argument is based upon the supposition that Congress knew that federal common law applied to define the duties of directors and officers in both federally-chartered and state-chartered banks, if federally-insured. Otherwise, the “substantive” portion of § 1821(k) would operate to defeat state insulating statutes from shielding directors from liability if state law were held applicable. Indeed, the Seventh Circuit appeared to hold in Bierman that federal common law imposed liability upon directors of a state-chartered bank for ordinary negligence. Many courts, however, indeed a clear majority, have reached different results. Congressional intent should not be imputed with such a ridiculous level of sophistication or with the ability to address the law in all of the circuits. Even in Ci-

262. See Norman J. Singer, Sutherland Statutory Construction § 45.05 (5th ed. 1992).
263. 10 F.3d 416 (7th Cir. 1993).
264. Id. at 420 (quoting Central Commercial Co. v. Commissioner, 337 F.2d 387, 389 (7th Cir. 1964)).
265. 10 F.3d at 420.
266. See FDIC v. Bierman, 2 F.3d 1424 (7th Cir. 1993).
267. See supra notes 27, 253.
The court so erred. The Third Circuit addressed the surplusage issue by stating that there is no applicable federal common law to define the duties of directors and officers of state-chartered banks. This part of Cityfed is unnecessary if § 1821(k) is viewed from the perspective of the chaos surrounding this issue when Congress acted in 1989.

In 1989, when FIRREA was passed, Congress could have had, at best, only a minimal understanding of the rather sophisticated conflict of law issues inherent in defining the duty of care of a director of a failed bank. First, Congress would have had to understand rules underlying the Erie doctrine because there necessarily would be a potential conflict between the applicability of state and federal laws regarding the issue of director liabilities. Second, Congress would have had to fully understand the degree to which either federal insurance or federal chartering supported the applicability of federal common law to any given question. Third, Congress would have had to understand the evolving, and somewhat confused, tension between federal common law and federal statutory law. This matrix of issues was not only beyond the ken of congressional analysis and resolution, but has not yet been satisfactorily resolved within the judiciary. If the Seventh Circuit and Third Circuit, not to mention the district courts, cannot resolve these issues, Congress could not have fully comprehended these issues when enacting FIRREA.

Specifically, in 1989, when FIRREA was passed, most courts addressing the issue reached novel and often diametrically opposed conclusions regarding which law formed the source of a director's duty of care. Frequently, the issue of whether state or federal law provides a duty of care for a financial institution's directors and officers was completely overlooked. Courts therefore addressed the issue, at best, impliedly and, at worst, not at all. The surplusage approach to the statutory construction of § 1821(k) cannot operate to indicate legislative intent when it is impossible for the legislature to have intelligently understood the law creating the apparent surplusage. Similarly, when courts are sharply divided, it is not appropriate for a court to assume that only its law was known to Congress in order to find surplusage; what is surplusage in one circuit may not be nationally. In fact, the circuits were split on whether federal common law is recognized for

268. See supra note 77.
270. See supra note 27.
271. See, e.g., Atherton v. Anderson, 99 F.2d 883, 897 (6th Cir. 1938) (addressing only briefly whether a federal statute preempts common law liability).
state-chartered banks when FIRREA was enacted; no part of § 1821(k) was surplusage when FIRREA was enacted because federal common law was held inapplicable to state-chartered institutions by many courts.

B. Congressional Intent in Light of Chaos

The more appropriate analysis is to determine Congress’s general policy objectives in enacting FIRREA, rather than to divine congressional consciousness regarding a specific issue that is immersed in a legally chaotic environment. Given the confused state of the law on this issue, Congress’s legislative conduct regarding FIRREA and § 1821(k) can only be understood as an attempt to restrict the impact of the movement to narrow director duties in the context of failed financial institutions. To expect Congress to have considered all of the uncertainties of § 1821(k) would require Congress to deliberate endlessly upon the intricacies of the law as it stood in 1989. Even if it had done so, the current confusion in the state of the law applicable to bank director duties demonstrates that a prescient legal mind would be required to resolve these issues. Congress did not and cannot engage in such dilatory legislative conduct. Congress had a major crisis with which to deal and wanted to fix a major problem.

After all, at the time FIRREA was passed, the country was just beginning to appreciate the total losses suffered as a result of the savings and loan and banking crisis of the 1980s. Clearly, FIRREA evinces an attempt to minimize losses to the deposit insurance fund and to minimize the United States Treasury’s exposure to the reckless conduct which gave rise to the financial institution crisis.

For example, Congress gave the RTC protection against many defenses, expanded statutes of limitation, and permitted the RTC to repudiate employment or other contracts with directors that might provide directors with offsetting claims or defenses. Congress also specifically took steps to increase the damage awards that the RTC

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272. See supra note 27.
273. See supra note 30. The potential impact of the nationwide effort to restrict the liability of corporate managers was at the forefront of regulatory concerns when FIRREA was passed. In fact, Julie C. Williams, general counsel of the FHLBB, authored a memorandum which addressed the viability of the insulating statutes to restrict the liability of bank managers. She apparently concluded that the statutes were not likely to affect the liability of managers of federal thrifts, but may operate to insulate managers of state-chartered, but federally-insured thrifts. See Weinstock, supra note 31, at 450 n.58. This regulatory analysis explains why the political branches enacted § 1821(k), i.e., to preserve the liability, for at least gross negligence, of all directors of federally-insured thrifts. Like Congress, the regulators could not, short of a Supreme Court opinion, have divined the extent to which federal common law defined the duties of bank managers, given the confusion among the circuits.
could recover from officers and directors by taking away the federal court's discretion to deny prejudgment interest to the RTC.\footnote{277} Congress directed the RTC to "maximize[,] the . . . return from the . . . disposition of . . . [thrift] assets" that it acquires, including the claims of failed institutions.\footnote{278}

There was only scant discussion about protecting directors. The Gallagher court cited Senators Riegle, Heflin, and Sanford as supportive of a more lenient standard of liability for failed bank directors and officers.\footnote{279} These statements, however, are simply the views of three senators.\footnote{280} The relevance and influence of these three senators' views is minimized in light of the hundreds of other members of Congress.\footnote{281} To exalt this scant discussion over the big picture of FIRREA is to miss the forest for the trees.

C. The Missing Piece of the Puzzle: Presidential Intent

Courts have occasionally used presidential intent, or the intent of a state governor, to analyze the meaning of legislation.\footnote{282} For example, unlike the Gallagher court, the Third Circuit specifically relied, in part, upon the statements of President Bush at the time he proposed the FIRREA legislation.\footnote{283} Presidential intent seems particularly appropriate as a tool of statutory analysis in those circumstances where the President is substantially involved in promoting legislation.\footnote{284}

FIRREA appears to have been hatched sometime before February 6, 1989. On that date, President Bush announced he was proposing an "overhaul" of the federal system of bank regulation.\footnote{285} The

\footnotesize{\begin{itemize}
\item \footnote{277}{See 12 U.S.C. § 1821(l) (1994).}
\item \footnote{278}{12 U.S.C. § 1441a(b)(3)(C)(i) (1994).}
\item \footnote{279}{RTC v. Gallagher, 10 F.3d 416, 422 (7th Cir. 1993).}
\item \footnote{280}{For this very reason, authorities have concluded that the testimony of individual legislators, even if committee members or sponsors of legislation, is an inappropriate means of proving legislative intent. See Gwendolyn B. Folsom, Legislative History: Research for the Interpretation of Laws 16-17 (1972) (citing Hust v. Moore-McCormack Lines, Inc., 328 U.S. 707, 733 (1946)).}
\item \footnote{281}{See generally Singer, supra note 262, § 48.13 (discussing reasons for discounting value of individual legislator's statements).}
\item \footnote{282}{Center for Auto Safety v. Peck, 751 F.2d 1336, 1341 (D.C. Cir. 1985) (Scalia, J.) (relying on the Reagan administration's press release announcing an intent to modify various regulations); Singer, supra note 262, § 48.05. The use of presidential intent to construe statutes is not without controversy. Commentators have argued that excessive use of presidential intent could undermine the Constitution's principle of separation of powers. See generally Brad Waites, Note, Let Me Tell You What You Mean: An Analysis of Presidential Signing Statements, 21 Ga. L. Rev. 755, 777-86 (1987) (concluding that the publication of presidential signing statements for use in statutory interpretation would inject presidential policy into the congressional and judicial branches, thus eroding separation of powers).}
\item \footnote{283}{See RTC v. Cityfed Fin. Corp., 57 F.3d 1231, 1239 (3d Cir. 1995); see also President's Plan to Restructure Regulation of Thrifts, Am. Banker, Feb. 8, 1989, at 4 (outlining President Bush's proposal to resolve the problems in the S&L industry).}
\item \footnote{284}{Waites, supra note 282, at 764.}
\item \footnote{285}{President's News Conference, I Pub. Papers 60 (1989).}
\end{itemize}}
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President also stated that the intent of his proposals was to “restore our entire deposit insurance system to complete health.”286 The President stated that “unconscionable risk taking” was a substantial factor in precipitating the bank crisis.287 Therefore, FIRREA included regulations to limit risk taking. The President wanted to intensify law enforcement efforts to “seek out and punish those that have committed wrongdoing in the management of” the failed banks.288 The President proposed the creation of a $50 billion financing corporation to pay for the bank crisis, but was hopeful that some of these funds might be replaced by “recovery of funds from the wrongdoers.”289

On August 9, 1989, President Bush made further remarks immediately prior to signing FIRREA into law.290 He stated that FIRREA was a direct result of the plan he submitted on February 6, 1989. That plan included a design to “abolish lax regulations” and to increase “penalties for wrongdoing by officers and directors of insured institutions.”291 The President stated: “[S]tarting today, tougher requirements for safe and sound operating practices will begin to take effect.”292 Most importantly, President Bush signed FIRREA because he felt it would put the financial system on solid footing and assure that “these problems will never happen again.”293 Noticeably absent from the President’s remarks was any mention of an intent to relax the duties owed by directors of failed banks or relieve them from responsibility under federal common law for mismanaging failed banks.

D. Playing “Gotcha!” with Congress?

Chief Judge Posner of the Seventh Circuit has observed that applying novel and obscure rules of construction or law to subvert congressional intent amounts to a game of “Gotcha” with Congress, whereby unexpected and under-appreciated legal doctrines operate to materially alter the plain meaning and intent of statutory legislation.294 Judge Posner argued in Chapman that this was the net effect of Gallagher, which eliminated federal common law liability for directors of failed federal banks, and Chapman, which eliminated state law. Posner argued that the doctrine of federal common law supersession, as applied to § 1821(k), turns congressional intent on its head.295 As previously demonstrated, the federal common law supersession doctrine

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286. Id.
287. Id.
288. Id.
289. Id.
291. Id. at 1072-73.
292. Id. at 1073.
293. Id. at 1072.
295. Id. at 1126.
need not be applied to pervert the intent of Congress and the President in enacting FIRREA.

Posner’s argument is premised on the conclusion that Congress did not wish to insulate directors but, instead, was placing limits on the effect of state insulating statutes: “There is no evidence that Congress believed it was creating a new immunity for directors of federal S & Ls . . . .”296 Judge Posner is clearly correct; those courts that have held that § 1821(k) supersedes a bank director’s federal common law duty of care indeed essentially have perpetrated a game of “Gotcha!” with Congress, by ignoring the intent of the political branches. By failing to listen to the content of Congress’s message and exalting formalism over the substance of § 1821(k), courts have irretrievably garbled the essential statutory intent as reflected on the face of § 1821(k) and the clear weight of legislative history.297 As shown, Gallagher and its progeny similarly have ignored the content of the Supreme Court’s jurisprudence articulated in City of Milwaukee v. Illinois298 and its progeny.

E. Overlooked Rules of Construction

In addition to congressional and presidential intent, there are alternate rules of statutory construction that, at times, are overlooked. Examination of some of these rules of construction further indicates that § 1821(k) does not preempt federal common law.

1. The Common Law Rights of the United States Government Cannot Implicitly Be Preempted

Generally, the common law is deemed not to have been preempted by legislation unless congressional intent to preempt the common law is unmistakable.299 The Ninth Circuit applied this principle to the rights of the government in the specific context of § 1821(k): “Judicially construing an implied loss of existing remedies is particularly inappropriate when applied to the rights of the government.”300

Thus, whatever the effect of the rule announced by City of Milwaukee in situations not involving federal government agencies or compelling federal interests, there can be no implied preemption of the federal common law rights of the government, acting through its agencies, the Federal Liquidators. Section 1821(k) does not contain an ex-

296. Id.
297. See supra notes text accompanying 83-84.
299. See Norfolk Redev. & Hous. Auth. v. Chesapeake & Potomac Tel. Co., 464 U.S. 30, 35-36 (1983) (citing Fairfax’s Deviser v. Hunter’s Lessee, 7 Cranch 603, 623 (1813)); see also Singer, supra note 262, § 61.01 (stating that “[i]f a change is to be made in the common law, the legislative purpose to do so must be clearly and plainly expressed”).
300. FDIC v. McSweeney, 976 F.2d 532, 538 (9th Cir. 1992), cert. denied, 508 U.S. 950 (1993).
press preemption of the federal common law, and, therefore, the courts holding that the government's rights under preexisting common law are implicitly preempted are incorrect as a matter of formal statutory construction.

2. Statutes Should Be Construed to Avoid Internal Inconsistencies

A statute should be construed, if at all possible, to avoid producing inconsistencies among its parts. A separate provision of § 1821, subsection (d)(2)(A)(i), provides that the Federal Liquidators succeed to all claims of the failed bank, which would include claims against officers and directors under federal common law. Thus, interpreting § 1821(k) to preempt federal common law claims transferred to the Federal Liquidators by § 1821(d)(2)(A)(i) would produce internal inconsistencies.

Such an interpretation would conflict also with § 1821(l), which immediately follows § 1821(k). Section 1821(l) provides that damages awarded to the Federal Liquidators in proceedings against directors, officer, and certain others must include appropriate interest. In the course of providing for interest awards, § 1821(l) characterized the proceedings that the Federal Liquidators may bring against directors and officers as based on claims for "improvident" or "otherwise improper" conduct. Yet, "improvident" is a term used by the courts interchangeably with simple negligence; it is not synonymous with either gross negligence or intentional torts. Congress would not have provided for simple negligence claims in § 1821(l) if, in the immediately preceding § 1821(k), it had deprived the government of the authority to file such claims in the case of federally-chartered institutions.

3. Statutes Should Be Construed to Avoid Absurd Results

In construing a statute, "absurd results are to be avoided." Interpreting § 1821(k) to eliminate the government's federal common law rights would produce absurd results.

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302. See Gaff v. FDIC, 919 F.2d 384, 390 (6th Cir. 1990), modified on other grounds, 933 F.2d 400 (6th Cir. 1991).

303. E.g., McSweeney, 976 F.2d at 538 (allowing FDIC to bring claim under federal or state common law); FDIC v. Shelton, 789 F. Supp. 1360, 1364-65 (M.D. La. 1992) (holding that federal law is supplemented by state law as consistent with FDIC rights under § 1821(k)).


Section 1821(k) operates only after a financial institution fails. Accordingly, as interpreted by Gallagher, § 1821(k) holds officers and directors of federally-chartered institutions to a simple negligence standard of liability under federal common law at all times while the institution remains open, but to a gross negligence standard—with respect to the same pre-failure conduct—once the institution fails. This double standard would provide a “perverse” incentive to directors and officers of financial institutions. As the Ninth Circuit stated:

[W]e agree with the district court that adopting the officers’ interpretation of § 1821(k) would lead to absurd results, creating “the perverse incentive for a director in an institution that is having financial difficulty to permit the thrift to fall into ruin . . . since the director’s own exposure would be greatly reduced upon the institution of a receivership.”

Before the failure of a thrift and the involvement of federal regulators, liability would attach for simple negligence. After failure, however, § 1821(k), as interpreted by Gallagher, would preclude negligence liability. The Tenth Circuit discussed this issue in FDIC v. Canfield:

As the institution struggles, therefore, section 1821(k) would create an incentive for the officers and directors to allow the bank to fail. It simply cannot be that FIRREA would indirectly encourage such behavior when it was designed in part, according to its stated purposes, “to curtail . . . activities of savings associations that pose unacceptable risks to the Federal deposit insurance funds.”

Accordingly, § 1821(k) should not be interpreted to preclude federal common law.

IV. Is There An Economic Justification for Gallagher?

The articulation of federal common law standards necessarily involves weighing competing policy goals. With respect to the federal common law standard to apply pursuant to, or in tandem with, § 1821(k), it is at least arguable that Congress has already weighed the policy goals and concluded that simple negligence is the appropriate standard of liability, as reflected in the Senate banking committee report. Nevertheless, given the importance of banking to the economy, it is appropriate to also consider the economic implications of the standard of failed bank managers. This part considers the economic justification of the view that § 1821(k) supersedes federal com-

306. McSweeney, 976 F.2d at 540 (quoting the district court in FDIC v. McSweeney, 772 F. Supp. 1154, 1159 (S.D. Cal. 1991)).
309. See supra note 84 and accompanying text.
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mon law, and concludes that the only tenable economic conclusion is that § 1821(k) does not preempt federal common law.

No amount of microeconomic modeling or hypothesizing can answer the question of the appropriate standard of care for bank directors in light of the tragedy of the 1980s. Microeconomic theory hinges upon Pareto Efficiency, because only that concept is theoret-

310. The deregulation of the S&L industry has been blamed for much of the loss from failed banks:

Unfortunately, the otherwise appealing objective of getting government out of the affairs of business was ill-advised for a bankrupt industry able to use government-backed deposits as its principal, indeed almost exclusive, source of capital. By lowering net worth requirements and allowing highly permissive accounting procedures, by encouraging S&Ls to grow rapidly and to enter new activities quickly, by opening up the industry to developers and others with conflicts of interest, and curtailing supervision and examination, the policies created incentives and opportunities for risk taking and abuses that remained in place for years.

FIRREA Report, supra note 12, at 41; see also Bank Failure, supra note 9, at § 87,387 (describing factors contributing to failure of national banks); Strunk & Case, supra note 9, at 126-27 (identifying a number of factors which caused the failure of the S&L business).

The deregulation of industry is a darling of microeconomic theorists in that government regulation of business is antithetical to perfect competition. Because of the microeconomic focus of the law and economics movement, "[l]aw and economics has also contributed significantly to the deregulation movement." Richard A. Posner, Overcoming Law 96 (1995) [hereinafter Posner, Overcoming Law].

311. Pareto Efficiency is defined as "an allocation of resources in which it is impos-

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sible by reallocation to make some consumers better off without simultaneously mak-

sible by reallocation to make some consumers better off without simultaneously mak-

ing others worse off." Richard G. Lipsey & Peter O. Steiner, Economics 952 (6th ed. 1981). A perfectly competitive economy achieves Pareto Efficiency. Edwin Mansfield, Microeconomics 447 (4th ed. 1982) (stating that "a perfectly competitive economy satisfies the three sets of conditions for welfare maximization"). A perfectly competitive economy requires: (i) that the product of any one seller, in a given mar-

ket, is the same as all other sellers, i.e., homogeneity; (ii) that no market participant has sufficient power to affect price—all market participants are price takers; (iii) that all resources are perfectly mobile; and (iv) that all market participants have perfect knowledge of relevant economic data. Id. at 248-49. Note that Pareto Efficiency is not the same as saying that maximum GNP has been achieved. Allan M. Feldman, Welfare Economics, reprinted in The New Palgrave, The World of Economics 715 (J. Eatwell et al. eds., 1991). Certain further assumptions must be made to achieve Pareto Efficiency, specifically: (i) that the economy produces no externalities, such as pollution, ancillary adverse health effects to consumers, etc.; (ii) that there is no technologi-

ical change; (iii) that there are no other dynamic considerations, such as risk. Mansfield, supra, at 449 n.7. A fundamental assumption to all of economics is that people will rationally maximize their utility, i.e., happiness. Richard A. Posner, Economic Analysis of Law 3 (4th ed. 1992) [hereinafter Posner, Economic Analysis of Law]. Some commentators, in recognition of the rather prodigious assumptions of microeconomics, have sought shelter in other, more obscure, definitions of efficiency, such as "Kaldor-Hicks" efficiency. Id. at 14. Changing the definition of efficiency from Pareto Efficiency, however, serves only to weaken the utility of the analysis; only Pareto Efficiency theoretically supports welfare maximization and general equi-

librium. Also, Kaldor's work has been shown to be internally inconsistent. See Feld-

man, supra, at 720; see also Jules L. Coleman, Efficiency, Utility, and Wealth Maximization, 8 Hofstra L. Rev. 509, 519-20, 527 (1980) ("Unlike happiness or well-

being, wealth is not something of intrinsic value.").
Welfare maximization, or general equilibrium, is the microeconomic analysis which hypothesizes that all resources are optimally allocated. Microeconomic modeling and analysis can, therefore, only address the concept of Pareto Efficiency and not which standard will give rise to a maximum level of GNP. Pareto Efficiency also fails to address the issue of which standard will avoid another taxpayer-financed bail-out, and the attendant macroeconomic consequences. These values, however, are the crucial economic stakes at issue. More pointedly, it is essential to avoid repetition of this trillion dollar disaster. This case is, then, a classic example of the failure of microeconomic theory to address policy considerations underlying law.

Gallagher does not have a strong economic policy basis. When the federal government's interest in deposit insurance, and its macroeconomic consequences, is properly considered in the calculus of bank director duties, any possible economic justification for the Gallagher articulation of the liability of a failed financial institution's directors evaporates. Much work has been undertaken on an economic analysis of director duties in a conventional business association. Much of the recent economic analysis has centered on a contractarian point of view emphasizing that Pareto Efficiency demands that managers and equity holders of businesses be permitted to freely contract amongst themselves for items such as the duty of due

312. See Mansfield, supra note 311, at 440, 447-49.
313. See id. at 438-39.
314. "Microeconomics deals with the economic behavior of individual units such as consumers, firms, and resource owners; while macroeconomics deals with the behavior of economic aggregates such as gross national product and the level of employment." Mansfield, supra note 311, at 1.
316. The limits of microeconomic theory are well-recognized in both law and economics. Economists have long struggled to explain the inability of welfare economics, i.e., Pareto Efficiency, with its general equilibrium analysis, to explain macroeconomic phenomena such as large-scale unemployment, credit crises, business-cycle fluctuations, or even wide-spread bank failures. Peter Howitt, Macroeconomics: Relations with Microeconomics, reprinted in The New Palgrave, The World of Economics 394, 394 (J. Eatwell et al. eds., 1991). Judge Richard Posner has also recognized the limits of economic efficiency, as well as the validity of its underlying assumptions. Posner, Overcoming Law, supra note 310, at 419 ("People are not in fact rational maximizers, prices do not in fact equal marginal cost, markets are never in equilibrium."). Professor Ronald Dworkin has questioned the utility of any efficiency talisman, at least to the extent it conflicts with goals of justice. Ronald Dworkin, Why Efficiency?, 8 Hofstra L. Rev. 563 (1980).
317. RTC v. Gallagher, 10 F.3d 416, 419-21 (7th Cir. 1993).
care, if any, that a manager owes the business entity. Whatever the benefits of requiring legal policy to track conditions for Pareto Efficiency, such an analysis is fundamentally unsound in the context of deposit insurance. Federally guaranteed deposits give the federal government an "unlimited negative equity interest" in every financial institution which is federally-insured. As such, at the very least, no negotiations between management and equity holders can adequately reflect the interest of the federal government in maintaining a sound banking system. There is no practical means for extending to the government a means of negotiating with respect to the duty of care—short of requiring enormous regulatory and monitoring costs. Therefore, such duties must necessarily be addressed legislatively or through common law. The macroeconomic effects of competing duties of care for bank directors must also be considered. Although one may argue that a given standard of care would either enhance or diminish GNP, currently there is no economic theory which allows such fine tuning adjustments to be analyzed in terms of aggregate output. Simply stated, there is no clear link between microeconomic Pareto Efficiency and macroeconomic effects. In the absence of any analysis showing a given duty of care to create a macroeconomic benefit, hypothesizing about the macroeconomic effect of a certain duty of care is fraught with uncertainty.

On the other hand, there may well be economic consequences to a duty of care that is greater than or equal to the gross negligence standard. These consequences are difficult to quantify or analyze in terms of macroeconomic effect; nevertheless, to the extent a given standard

318. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, The Economic Structure of Corporate Law, 92-93 (1991) (Because the fiduciary principle is a rule for completing incomplete bargains . . ., it makes little sense to say that 'fiduciary duties' trump actual contracts.

319. Professor Romano has recognized the difficulty in associating a given rule of law relating to corporate governance to macroeconomic productivity. Roberta Romano, The Genius of American Corporate Law 140 (1993).

320. Weinstein, SMU Speech, supra note 196, at 511.

321. The Commission charged with determining the causes of the S&L crisis and making recommendations to prevent a repeat of the crisis recognized these enormous costs by making the following recommendation:

Each federal agency responsible for regulating institutions receiving federal financial insurance or guarantees should require that every institution under its jurisdiction appoint an inspector general ("business practices officer") who would periodically review and report upon the practices of the institution. The inspector general should be appointed for a fixed term (e.g., five years) with approval of the federal regulatory authority. The inspector general should be eligible for reappointment for no more than one additional term. In no case could this officer be removed by an institution except with the approval of the federal regulatory authority.

FIRREA Report, supra note 12, at 15. Query whether the federal government could afford an on-site full-time "inspector" for each insured bank; that is why the commission required the bank itself to hire the inspector.

322. See supra note 314 and accompanying text.
of care leads to a greater level of bank failures and losses to the federal treasury, macroeconomic consequences ensue. For example, in assessing the causes of the S&L crisis of the late 1980s, many studies have concluded that the crisis and the bailout had a significant impact on both fiscal and monetary policy. The additional federal borrowing that resulted from the S&L bailout was significant and certainly had a monetary effect on the economy.\footnote{See CBO Study, supra note 12, at 12-15.} No microeconomic analysis can explain this impact of the bank crisis. Stated simply, the additional borrowing from the S&L crisis would have created a restrictive monetary policy influence to the degree that it resulted in increased interest rates. Similarly, although the massive bailout increased demand, as a matter of fiscal policy, this influence was offset by lost demand and a reduction in the trade balance from the losses in productive capital.\footnote{See id. at 19.} Unfortunately, the science of economics has yet to create a system that allows the measurement in precise terms of economic impact of such developments. The Congressional Budget Office has estimated the macroeconomic consequences of the disaster: up to $500 billion in lost GNP between 1981 and 2000.\footnote{Id. at xi.} These macroeconomic effects continue until 2017.\footnote{See supra note 9.}

Thus, the appropriate policy response must be to prevent another bank crisis. As such, any policy objective must be tied to the causes of the crisis, as best they can be determined. Several detailed studies, both privately-funded and government-sponsored, have considered this issue. The causes of the bank crisis are multifarious. Nevertheless, one cause is always regarded as significant, i.e., the failure of directors and officers to manage appropriately their banks. Managers of banks face a classic “moral hazard” because they do not bear the risks of their own misconduct.\footnote{See Patricia H. Werhane, Introducing Morality to Thrift Decision Making, 2 Stan. L. & Pol'y Rev. 125, 127 (1990) (concluding that thrift managers and directors did not take seriously their responsibility for making viable loans). “Moral hazard” is a term used to describe actions by agents that further their own interest at the expense of their principal. Deposit insurance creates moral hazard because the benefits of risks may accrue to managers (agents) while the costs are absorbed by the institution (principal) and the insurance fund. See CBO Study, supra note 12, at 11; see also Posner, Economic Analysis of Law, supra note 311, at 108 (“The tendency of an insured to relax his efforts to prevent the occurrence of the risk that he has insured against because he has shifted all or part of the expected cost of the risk to an insurance company is known as ‘moral hazard.’”).} Instead, “[t]he deposit insurance system presented managers with a situation in which the institution got to keep the rewards if the roll of the dice paid off, but the government’s insurance fund was liable if the gambles failed.”\footnote{CBO Study, supra note 12, at 10.} Thus, directors and officers pursued reckless strategies.\footnote{See id.} “[T]hirts largely failed be-
cause 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.”

While most S&L operators did not succumb to the temptation, the ability to use insured deposits for risky investment was too tempting for some. The profit potentials produced imprudent risk-taking, abusive practices, and fraud. There was a continuum of abusive practices running from aggressive pursuit of profit and search for regulatory loopholes, to out-and-out fraud. Abusive practices in one form or another, mainly by S&L managers and owners, but also by unscrupulous attorneys, accountants, appraisers, and investment bankers, resulted in substantial taxpayer losses. There was unprecedented fraud in the industry; despite its repugnance and its unacceptable extent, however, it is the Commission’s judgment that “fraud probably accounted for only 10 to 15 percent of total losses.”

Therefore, it appears clear that a general federal policy of avoiding bank failures by demanding that managers of federally-insured banks exercise stringent oversight over management to avoid unnecessarily risky business conduct is an appropriate economic basis for the government to pursue in the absence of any clear economic indications otherwise. Indeed, the most persuasive argument in favor of a more lenient standard of care for directors is that the prospect of liability makes for timid, risk-averse directors; but no real authority demonstrates that risk-averse directors, chilled and overly-cautious by the prospect of burdensome duties, in anyway contributed to the bank crisis.

The economic justification of stricter monitoring of directors and officers would seem to argue persuasively for a negligence standard of

330. White, supra note 13, at 117 (emphasis omitted).
331. FIRREA Report, supra note 12, at 8.
332. There is no indication in any of the studies that any director shortage contributed to the fiasco; nor was director qualifications as opposed to diligence found to be a cause. Some authorities have speculated that a negligence standard of care would discourage qualified individuals from being directors. See RTC v. Gallagher, 10 F.3d 416, 424 (7th Cir. 1993). There is no evidence supporting this, however, especially given that such a standard has been applied for 100 years without any director shortage arising. See supra notes 116-45.
333. McCoy, supra note 8, at 1033-34. “Most significant, however, is what the banking industry’s experience says about avoiding risk aversion, the classic justification for the business judgment rule. As the thrift and bank crisis of the 1980s showed, far from inducing undue caution in the banking system,” imprudent and reckless thrift and bank decisions led to cascading losses. Id. at 1033. “Whatever can be said about this latest banking debacle, undue risk aversion was not a problem. Thus, when viewed against the backdrop of the judiciary’s long involvement in substantive bank regulation, last decade’s events raise interesting questions about the risk aversion rationale” to the applicability of the business judgment rule in the banking context. Id. at 1033-34.
liability. First, it appears both intuitively and empirically sound.\textsuperscript{334} Second, it would seem that the bank managers are in the best position to avoid bank failures, particularly compared to taxpayers, and, therefore, are the most efficient cost-avoiders. Thus, there seems to be a strong economic basis for concluding that bank managers should be subject to a negligence standard. As such, the economic calculus underlying the duty of care issue for federally-insured banks and S&Ls weighs decidedly in favor of the \textit{Cityfed} standard and against the \textit{Gallagher} standard.

**Conclusion**

The \textit{Gallagher} court's destruction of the long-standing federal common law ordinary care standard of liability for bank managers has no substantial legal or policy basis. The decision cannot be defended on the basis that federal common law should be restrictively extended because federal common law has a uniquely appropriate basis for the governance of federally-chartered and federally-insured institutions. The decision cannot be defended on the basis of formalistic legal analysis; traditional legal analysis dictates that the content of congressional statements is more important than the mere fact of the statement itself. From an economic viewpoint, the only coherent policy objective must be discouraging excessive risk-taking. Thus, \textit{Gallagher} is a decision in search of a legitimate basis.

The \textit{Cityfed} court's approach to the duties of bank directors enjoys the support of decades of common law development. The common law, both state and federal, and both before and after \textit{Erie}, has consistently stated and applied a duty of due care for directors of banks. There is no evidence that Congress intended to relax this duty; only that Congress intended to preserve the duties of directors from state attack. Under \textit{Cityfed}, the manifestly evident economic policy is to discourage bank failures.

It is of no moment that Congress failed to address or resolve the choice of law conundrum implicit in federally-chartered and federally-insured banks. To the degree the supposed intent of Congress should affect the plain meaning of the statute, Congress's intent should not be deemed burdened by choice of law issues that courts themselves cannot resolve. This means that arguing for a federal common law standard of ordinary care for all directors of federally-insured banks does not render any part of § 1821(k) surplusage; at the time it was passed, as now, there was only confusion and chaos regarding what law applied under which circumstances. Instead of focusing on this issue, courts should focus on the political branches' general objective to re-

cover losses against responsible managers. Only this explains the meaning of Congress's legislative exercise in enacting § 1821(k).

Finally, there is no basis for insulating directors and officers from liability. No such subsidy was intended by any politician. Nor is such insulation appropriate. Imposing a duty of due care and enforcing personal liability eliminates problems of moral hazard. While it may be speculated that a lower duty of care may serve some economic policy, no such policy is evident. According to every detailed study of the causes of this trillion dollar nightmare, to grant such a subsidy is tantamount to telling taxpayers: "Keep that checkbook open!"

The *Gallagher* court's hollowly formalistic approach must give way to the historically, legally, and economically sound approach of the *Cityfed* court. In addition, there is little basis for restricting the availability of federal common law to federally-chartered banks only; the *Cityfed* court's recognition of federal common law should be extended to federally-insured banks generally.