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Director Liability Under FIRREA Redux: Moving Toward Synthesis

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I. Introduction

It started out as a not very complex problem. When Congress was adopting the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA"),[1] it was concerned that many states were moving to insulate corporate directors from liability for negligence by passing statutes which provided, with certain exceptions, that directors could only be held liable for intentional misconduct, willful or wanton conduct or the like.[2] The reasons behind this movement stemmed from a 1985 decision of the Delaware Supreme Court finding director liability for gross negligence in approving the cashout merger of the Trans Union Corporation, which had caused a crisis in the Directors and Officers liability insurance market.[3]

Since the federal government was footing the bill for an astounding number of bank and thrift failures at this time,[4] the Congress understandably wanted to hold directors to a standard of care higher than intentional misconduct. The obvious solution was to preempt contrary state laws. As originally proposed in the Senate, the bill would have held directors liable for "any cause of action available at common law, including...simple negligence."[5] However, not all states held directors liable for simple, as opposed to gross negligence,[6] so that the undesirable effect of such a provision would have been to increase director exposure to liability in such states, and the statute as finally enacted provided only that "a director of an insured depository institution may be held personally liable for monetary damages...for gross negligence."[7] A savings clause added, "Nothing in this paragraph shall impair or affect any right of the Corporation [the FDIC and the RTC] under other applicable law."[8] As enacted, the section clearly preempted any state law which purported to shield a director from liability for gross negli-

1. Pub.L.No. 101-73, 103 Stat. 183 (1989)(codified as amended in scattered sections of 12 & 15 U.S.C.).

2. *See, e.g.*, Del. Code Ann., tit 8, § 102(b)(7) (Michie 1994 Cum. Supp.) ("intentional misconduct or a knowing violation of law"). *See generally*, WILLIAM E. KNEPPER & DAN A. BAILEY, LIABILITY OF CORPORATE OFFICERS AND DIRECTORS (hereinafter "KNEPPER & BAILEY"), ch. 16 (5th Ed. 1993)(summarizing statutory law).

3. The Delaware case was Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985). *See* KNEPPER & BAILEY, *supra* note 2 at § 16-1.

4. *See* Kenneth E. Scott, *Never Again: The S & L Bailout Bill*, 45 Bus. Law. 1883 (1990)(by the end of 1988, the Federal Savings and Loan Insurance Corporation was insolvent by over $56 billion, not counting 365 insolvent thrifts still in operation).

5. FDIC v. Canfield, 967 F.2d 443, 448 n. 6 (10th Cir.)(en banc), *cert. dismissed*, 113 S.Ct. 516 (1992).

6. The Delaware Supreme Court in Smith v. Van Gorkom, 488 A.2d 858, 873 (Del. 1985) had confirmed that the "concept of gross negligence" was the proper standard for determining director liability under the business judgment rule, citing Aronson v. Lewis, 473 A.2d 805 (Del. 1984). The terms fraud, negligence, and gross negligence have been used virtually interchangably in the director liability cases for over 150 years, but there is little agreement as to what they mean, *see* Norwood P. Beveridge, *The Corporate Director's Duty of Care: Riddles*

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6. *(Continued from previous column)*

Wisely Expounded, 24 Suffolk U. L Rev. 923 (1990). *See generally*, 1 ALI PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, Part IV, Duty of Care and the Business Judgment Rule (1994).

7. 12 U.S.C. § 1821(k) (Supp V 1994). The full text of the section reads as follows:

> 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 Corporation, which action is prosecuted wholly or partially for the benefit of the Corporation--
>
> (1) acting as conservator or receiver of such institution,
>
> (2) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed by such receiver or conservator, or
>
> (3) acting based upon a suit, claim, or cause of action purchased from, assigned by, or otherwise conveyed in whole or in part by an insured depository institution or its affiliate in connection with assistance provided under section 1823 of this title,
>
> 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 Corporation under other applicable law.

The Corporation referred to is the Federal Deposit Insurance Corporation, 12 U.S.C. § 1811 (Supp. V 1994) and its successor, the Resolution Trust Corporation, 12 U.S.C. § 1441a (Supp. V 1994). The Resolution Trust Corporation will go out of business no later than December 31, 1995, after which the FDIC will resume its role as receiver for failed institutions, 12 U.S.C. § 1441a(m) (1) (Supp. V 1994).

8. 12 U.S.C. § 1821(k) (Supp. V 1994).

gence or worse conduct.[9] The question was, what else (if anything) did it do?[10]

II. The First Hurdle: State Law Liability for Ordinary Negligence

The first development was that directors argued that the effect of the FIRREA standard was to preempt all state law standards for insured depositary director liability and substitute a federal standard of gross negligence.[11] Therefore, in a state which previously had held directors liable for simple, or ordinary negligence, the RTC now arguably could hold directors liable only for gross negligence. After some initial confusion, the vast majority of United States district courts and four United States Courts of Appeal rejected this argument.[12] Therefore, although FIRREA preempts lower, it does not preempt higher, state standards for director conduct, and the RTC can therefore pursue any state cause of action for simple negligence in a state where it is available.

III. The Second Hurdle: Federal Common Law Liability for Ordinary Negligence

The next argument to be made was that even if FIRREA does not preempt higher state standards of director conduct, it does preempt (or supersede) federal common law on director liability. Therefore, even if federal common law would make directors liable for ordinary negligence,[13] under FIRREA directors can only be liable for gross negligence as a matter of federal law. The significance of this argument is that while the liability of state-chartered bank directors may be a question of state law,[14] the liability of federally-chartered bank directors may be a question of federal law.[15] Therefore, if an institution has a federal charter, a state law cause of action for ordinary negligence is arguably not available.

After conflicting decisions in the lower federal courts, the United States Court of Appeals for the Seventh Circuit, acting in the case of a federally-chartered institution, held that FIRREA does indeed preempt federal common law on director liability, whatever the content of that law may be.[16] This holding was embraced by three other circuits, the Sixth and Tenth, acting in the case of a federally-chartered institution, and the Fifth, acting in the case of a state-chartered institution.[17] It has been very recently rejected by the Third Circuit, acting in the case of a federally-chartered institution.[18] A district court in the Ninth Circuit, in a case involving a federally-chartered thrift, has also held that FIRREA does not supersede federal common law and has certified the question for interlocutory appeal.[19]

In a later case in the Seventh Circuit also involving a federally-chartered institution, the government unsuccessfully tried to persuade the court that even if federal common law is preempted by FIRREA, the liability of directors of federally-chartered institutions is governed by state law.[20] Therefore, if state law provides liability for ordinary negligence, the directors may be sued under state law.[21] Over the dissent of Chief Judge Posner, the court ruled that under the internal affairs doctrine, federal law governs the liability of directors of federally chartered institutions.[22]

If the Seventh Circuit is right, some very bizzarre consequences follow from the adoption of FIRREA, which was designed to strengthen the hand of government regulators, not weaken it:[23]

1. the statute adopts a *lower* standard of care for directors of federal banks and thrifts than existed before FIRREA.

2. the statute adopts a *lower* standard of care for directors of federal banks and thrifts than that which applies to directors of state-chartered institutions operating in the same state.

3. the statute creates a perverse incentive to directors of federal banks and thrifts to encourage the failure of the institution, since the *lower* standard of care applies only to post- failure suits by the government.[24]

At least one district court in the Tenth Circuit has agreed with the government's position that even if FIRREA has preempted federal common law, state law which provides an ordinary negligence standard will be applied to federal institutions.[25] Other district courts have also held that state law on director liability applies to directors of federal banks and thrifts,[26] but there is contrary authority which supports the Seventh Circuit.[27]

9. O'Melveny & Myers v. FDIC, 114 S.Ct. 2048, 2054 (1994)(Section 1821(k) permits claims for gross negligence, regardless of whether state law would require greater culpability)(dictum). *See* RTC v. Vanderweele, 833 F. Supp. 1383, 1385 (N.D. Ind. 1993)(Indiana statute setting liability standard at willful or wanton conduct preempted by FIRREA).

10. For recent surveys of the torrent of litigation that ensued, *see* James T. Pitts, Eric W. Bloom & Monique M. Vasilchik, *FDIC/RTC Suits Against Bank and Thrift Officers and Directors--Why Now, What's Left?*, 63 Fordham L.Rev. 2087 (1995)(arguing that the regulators unfairly harassed innocent directors and officers); Michael P. Battin, Note, *Bank Director Liability Under FIRREA*, 63 Fordham L.Rev. 2347 (1995)(arguing for a simple negligence standard).

11. *See* Norwood P. Beveridge, *Duty of Care of Directors of Insured Depository Institutions Under FIRREA: Understanding the Gross Negligence Statutory Provisions*, 47 Consumer Fin. L. Q. 67 (1993).

12. FDIC v. Canfield, 967 F.2d 443 (10th Cir.)(en banc), *cert. dismissed*, 113 S.Ct. 516 (1992); FDIC v. McSweeney, 976 F.2d 532 (9th Cir. 1992), *cert. denied*, 113 S.Ct. 2440 (1993); RTC v. Chapman, 29 F.3d 1120, 1122 (7th Cir. 1994); RTC v. Cityfed Financial Corp., 57 F.3d 1231 (3rd Cir. 1995); *but see* Gaff v. FDIC, 919 F.2d 384, 386-87 (6th Cir. 1990), mod., 933 F.2d 400 (6th Cir. 1991) and FDIC v. Bates, 42 F.3d 369, 370 n. 1 (6th Cir. 1994) (FIRREA totally preempts state law) (dictum); RTC v. Zimmerman, 853 F.Supp. 1016 (N.D.Ohio 1994) (same); FDIC v. Swager, 773 F.Supp. 1244 (D.Minn. 1991) (FIRREA preempts all state law). RTC v. O'Bear, Overholser, Smith & Huffer, 840 F.Supp. 1270 (N.D.Ind. 1993) also held that FIRREA preempted all state law claims, but that holding has presumably been overruled by *Chapman, supra*. Since the institution in *O'Bear* had a federal charter, however, the result there was the same due to *Chapman's* holding that state law claims are not available in such a case, *see O'Bear*, 886 F.Supp. 658, 668 n. 8 (N.D.Ind. 1995).

13. Not surprisingly, there is no agreement as to the content of federal common law on director liability or on the difference between ordinary and gross negligence, *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. Bank. L. 169 (1994)(federal common law standard is gross negligence); Norwood P. Beveridge, *Director Liability Under FIRREA: Negligence and Gross Negligence in the Courts*, 48 Consumer Fin. L. Q. Rep. 77 (1994)(U.S. Supreme Court has disapproved of terms ordinary and gross negligence to describe director liability standard).

14. There is no agreement on this point, either. *Compare* FDIC v. McSweeney, 976 F.2d 532, 537 (9th Cir. 1992) (it doesn't matter because both federal common law and California state law have an ordinary negligence standard, and FIRREA doesn't preempt or supersede either), *cert. denied*, 113 S.Ct. 2440 (1993) *with* RTC v. Miramon, 22 F.3d 1357, 1363-1365 (5th Cir. 1994)(it doesn't matter because the FIRREA statutory gross negligence standard preempts federal common law and Louisiana state law also has a gross negligence standard).

15. But it isn't, *see* discussion *infra* at Part IV.

16. RTC v. Gallagher, 10 F.3d 416 (7th Cir. 1993).

17. RTC v. Miramon, 22 F.3d 1357 (5th Cir. 1994); FDIC v. Bates, 42 F.3d 369 (6th Cir. 1994); RTC v. Frates, 52 F.3d 295 (10th Cir. 1995).

18. RTC v. Cityfed Financial Corp., 57 F.3d 1231 (3rd Cir. 1995).

19. RTC v. Smith, 872 F.Supp. 805 (following *McSweeney*, n. 11 *supra*), *question certified*, 879 F. Supp. 1059 (D.Or. 1995); *accord*, RTC v. Gladstone, No.CIV.A. 93-11255-NG (D. Mass. July 18, 1995), 1995 WL 464917).

20. RTC v. Chapman, 29 F.3d 1120 (7th Cir. 1994).

21. *Id.*

22. 29 F.3d at 1123.

23. *See generally*, Vicki O. Tucker, Patti G. Meire, Phyllis M. Rubinstein, *The RTC: A Practical Guide to the Receivership/Conservatorship Process and the Resolution of Failed Thrifts*, 25 U. Rich. L. Rev. 1 (1990)(explaining the background and purposes of FIRREA).

24. Not only is the FIRREA standard inapplicable to suits against directors by the bank or in a derivative suit by its shareholders, but the director must be concerned about fines and other significant penalties which may be imposed by government regulators for unsafe or unsound banking practices, *see* Heidi Mandanis Schooner, *Fiduciary Duties' Demanding Cousin: Bank Director Liability for Unsafe or Unsound Banking Practices*, 63 Geo. Wash. L. Rev. 175 (1995).

25. RTC v. Williams, 887 F.Supp. 1415 (D.Kan. 1995)(distinguishing *Frates*, 52 F.3d 295).

26. RTC v. Heiserman, 839 F.Supp. 1457 (D.Colo. 1993), 856 F.Supp. 578 (D.Colo. 1994), & 898 P.2d 1049 (Colo. 1995); RTC v. Fiala, 870 F.Supp. 962 (E.D.Mo. 1994); RTC v. Gregor, 872 F.Supp. 1140 (E.D.N.Y. 1994); RTC v. Rahn, 854 F.Supp. 480 (W.D. Mich. 1994); FDIC v. Benson, 867 F.Supp. 512 (S.D.Tex. 1994); RTC v. Shuck, Civ.A.No 93-12057-WGY (D.Mass. March 29, 1995), 1995 WL 170137; RTC v. Scott, 887 F.Supp. 937 (S.D.Miss. 1995); FDIC v. Raffa, 882 F.Supp. 1236 (D.Conn. 1995); FDIC v. Stahl, 840 F.Supp. 124 (S.D.Fla. 1993); RTC v. Gibson, 829 F.Supp. 1103 (W.D.Mo. 1993); *cf.* RTC v. Everhart, 37 F.3d 151, 153 (4th Cir. 1994)(rejecting internal affairs doctrine and applying state law to question of tolling of state statute of limitations); Michael E. Baughman, Comment, *Defining the Boundaries of the Adverse Domination Doctrine: Is There Any Repose For Corporate Directors?*, 143 U.Pa.L.Rev. 1065, 1066 (1995)(state law governs the tolling of statutes of limitations under FIRREA). See generally, Eric G. Zajac, Comment, FIRREA and Federal Common Law: The Extent to Which They Preempt State Law Regarding the Duties and Standard of Liability Imposed Upon Financial Institution Directors, 37 Vill. L. Rev. 1461 (1992)(trend is towards application of state law to state and federally chartered institutions).

27. *See* RTC v. Cityfed Financial Corp., 57 F.3d 1231, 1244-49 (3d Cir. 1995); RTC v. Cambi, 861 F.Supp. 1121 (D.Conn. 1994); RTC v. Hess, 820 F.Supp. 1359 (D.Utah 1993); RTC v. Gladstone, n. 19 *supra* at *7.

IV. Historically, State Law Has Governed the Duties of Directors of Federally Chartered Institutions

The history of federally chartered banks and thrifts goes back to the earliest days of the Republic.[28] After the charter of the first Bank of the United States, incorporated by Congress in 1791, had expired in 1811, there was a challenge to the creation of a successor.[29] The incorporation of the Second Bank of the United States in 1816 was contested as being beyond the powers of Congress under the Constitution in the famous case of *M'Culloch v. Maryland*.[30] The U.S. Supreme Court upheld the power of Congress to incorporate a bank as within the implied, if not the enumerated, powers of the Congress under the Constitution.[31] The Court further held that the Bank could rightfully establish a branch in the State of Maryland[32] and that Maryland could not tax the operations of the Bank, although it could in a nondiscriminatory way tax the real property owned by the Bank or tax any interest in the Bank held by citizens of Maryland.[33]

The Court was very soon to revisit the issue in the case of *Osborn v. Bank of the United States*.[34] The State of Ohio had levied an annual tax of $50,000 on the operations of the Bank of the United States branch in that State and authorized the State Auditor to enforce the tax by seizing the money or goods of the Bank if the tax were not paid.[35] The Supreme Court struck down the Ohio tax on the authority of *M'Cullough*,[36] and, more importantly for present purposes, upheld the right of the Bank to sue in the courts of the United States.[37] The Court held that the charter granted the Bank the right to sue in federal court, consistent with the requirement under the Constitution that the case arise "under a law of the United States."[38] Since the Bank was a creation of the United States, its charter was itself a "law of the United States," and the Bank could in fact not be a party to a case which did not arise under the laws of the United States.[39]

The first general statute allowing the incorporation of banks under federal law was the Act of 1863, superseded by the National Bank Act of 1864.[40] The Supreme Court upheld a Kentucky tax on the stock of the First National Bank of Louisville although the tax was to be collected by and paid to the State by the Bank cashier on pain of personal liability if it were not paid.[41] Rejecting an argument that the Bank, being an instru-

28. For a concise history of national banks, *see generally*, ALFRED M. POLLARD, JOSEPH G. PASSAIC, JR., KEITH H. ELLIS, & JOSEPH P. DALY, BANKING LAW IN THE UNITED STATES, Ch. 2, History and Concepts of Banking Regulation (1988).

29. A period of economic upheaval which led to a banking crisis in the United States existed during and following the War of 1812, *see* CHARLES A. CONANT, A HISTORY OF MODERN BANKS OF ISSUE 616-19 (6th Ed. 1969).

30. 17 U.S. 316 (1819). This was an action of debt brought by John James for himself and the State of Maryland against James William McCulloch, the cashier of the Bank branch which issued the bank-notes in question without paying the $15,000 due or using the stamped paper required by State law.

31. 17 U.S. at 424.

32. *Id.*

33. 17 U.S. at 436.

34. 22 U.S. 738 (1824). The action was brought by the Bank against Ralph Osborn, Ohio State Auditor, H.M. Curry and S. Sullivan, the former and present Ohio State Treasurers, and J.L. Harper, employed by Osborn to collect the tax, who had proceeded "by violence" to the office of the Bank at Chilicothe, Ohio and there taken $100,000 in specie and bank notes.

35. *Id.*

36. 22 U.S. at 867.

37. 22 U.S. at 827-828. The Supreme Court had held in the case of the first Bank of the United States that the Bank, a corporation chartered by Congress, could not sue or be sued in the federal courts, Bank of the United States v. Deveaux, 9 U.S. 61 (1809). That suit had been brought by the Bank to challenge a tax imposed by the State of Georgia, and the Court held that the suit could not be maintained in federal court either as a federal question under the Bank's charter or as a matter of diversity jurisdiction, the Bank not being a citizen for that purpose. The Court did uphold diversity jurisdiction, however, based upon the supposed citizenship of the Bank's shareholders, who were considered the real parties to the suit. *Deveaux* was overruled in 1844 in the case of state chartered corporations, *see* Carden v. Arkoma Associates, 494 U.S. 185, 188 (1990).

38. 22 U.S. at 823.

39. *Id.* This reasoning was followed in the recent case of American National Red Cross v. S.G., 112 S.Ct. 2465 (1992), in which the federal charter of the Red Cross, a membership corporation incorporated in 1905, was held to give federal court jurisdiction to all cases to which the Red Cross is a party. By statute, federally chartered stock corporations no longer have automatic access to the federal courts unless the United States owns more than one-half the stock, 112 S.Ct. at 2469.

40. Act of March 3, 1863, 12 Stat. 670, superseded by Act of June 3, 1864, 13 Stat. 99, *see* Veazie Bank v. Fenno, 75 U.S. 533 (1869) (upholding constitutionality of related federal tax on state bank notes).

41. National Bank v. Kentucky, 76 U.S. 353 (1869).

mentality of the Federal government, could not be subject to such State laws, the Court said that even federal instrumentalities are not wholly withdrawn from the operation of State legislation.[42]

> They [the national banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional.[43]

The interplay between state law and the National Bank Act has proven a fertile source of litigation. In *Farmers' and Mechanics' National Bank v. Dearing*,[44] the U.S. Supreme Court held that where the Act prohibits charging more than the rate of interest allowed by local state law and prescribes forfeiture of the interest as a penalty, New York state law which requires a forfeiture of the principal as well as the interest is not applicable. Similarly, where the Act provides for the equal distribution of the assets of insolvent national banks among unsecured creditors, the Court held that a New York state statute giving a preference in bank insolvency to debts due to savings banks would not apply to national banks.[45] On the other hand, where Massachusetts state law prohibited preference of creditors by insolvent debtors, this was held not to conflict with any federal law and therefore to be applicable to preference of national banks.[46]

The criminal conviction of the President of a national bank for violation of an Iowa state statute making it a felony for any bank officer to accept a deposit knowing that the bank was insolvent was reversed by the U.S. Supreme Court.[47] The Court rejected an argument that the state intended to benefit all banks by requiring a higher degree of diligence on the part of bank officers,[48] saying that Congress had already dealt with the subject of insolvency of national banks and that "it is not competent for state legislatures to interfere, whether with hostile or friendly intentions."[49]

Where the directors of an insolvent national bank had been sued at common law in state court for negligent misrepresentation of the financial condition of the bank in a report required by the National Bank Act to be filed with the Comptroller of the Currency and published, the Court reversed the judgment.[50] The Court held that liability for a report required by federal law was exclusively a federal question, and the federal statute required a knowing violation of the act, not a negligent one.[51] The Court later added that where there is a deliberate refusal to investigate an alleged violation of the Act, this is in effect an intentional violation of the statute.[52]

In 1913, when Congress established the Federal Reserve Board, it gave the Board authority to allow national banks to act as trustee, executor, administrator, or registrar of stocks and bonds "when not in contravention of state or local law."[53] The Supreme Court reversed a decision of Michigan Supreme Court holding that Congress acted in excess of its powers, holding that Congress could grant national banks additional powers where desirable to meet competition from state-chartered institutions.[54]

Where the State of Kentucky adopted a statute requiring inactive bank accounts to be transferred to the State Department of Revenue, which assumed the obligations of the bank to the depositor, the Supreme Court held that this was enforceable against a national bank.[55] On the other hand, a statute of the State of New York which prohibited national banks from using the words "saving" or "savings" in their business or advertising was held invalid as directly contradicting the Federal Reserve Act provisions authorizing national banks to receive time and savings deposits and to pay interest on them.[56]

The fiduciary duties of directors of national banks, including the duty of care, have never been the subject of exclusively federal jurisdiction. Although the rule in *Osborn v. Bank of the United States*, previously discussed,[57] was that any suit to which a national bank was a party granted the federal courts federal question jurisdiction, Congress changed this result by legislation making national banks the same as state-chartered banks

42. 76 U.S. at 362.

43. *Id. Accord*, Union Pacific Railroad Co. v. Peniston, 85 U.S. 5 (1873) (Union Pacific Railroad Company, a corporation created by Congress in 1862, was properly subject to a tax on its real and personal property imposed by the State of Nebraska).

44. 91 U.S. 29 (1875).

45. Davis v. Elmira Savings Bank, 161 U.S. 275 (1896); *see also*, Jennings v. U.S. Fidelity & Guaranty Co., 294 U.S. 216 (1935) (reversing decree granting state preference in favor of payee of unsatisfied negotiable instrument collected by insolvent national bank). The Court in *Davis* stated, 161 U.S. at 283:

> National banks are instrumentalities of the federal government, created for a public purpose, and as such necessarily subject to the paramount authority of the United States. It

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> follows that an attempt by a state to define their duties or control the conduct of their affairs is absolutely void, wherever such attempted exercise of authority expresly conflicts with the laws of the United States, and either frustrates the purpose of the national legislation or impairs the efficiency of these agencies of the federal government to discharge the duties for the performance of which they were created.

46. McClellan v. Chipman, 164 U.S. 347 (1896).

47. Easton v. Iowa, 188 U.S. 220 (1903).

48. 188 U.S. at 231.

49. 188 U.S. at 238.

50. Yates v. Jones National Bank, 206 U.S. 158 (1907). The Court later reinstated the judgment, holding that the violations had been knowing as required by federal law. Jones National Bank v. Yates, 240 U.S. 541 (1916).

51. 206 U.S. at 179-80. *See* Chesbrough v. Woodworth, 244 U.S. 72 (1917) (director liable for false report under federal law).

52. Thomas v. Taylor, 224 U.S. 73 (1912); Corsicana National Bank of Corsicana v. Johnson, 251 U.S. 68 (1919).

53. First National Bank of Bay City v. Fellows, 244 U.S. 416, 420 (1917).

54. 244 U.S. at 425-27.

55. Anderson National Bank v. Luckett, 321 U.S. 233 (1944).

56. Franklin National Bank of Franklin Square v. New York, 347 U.S. 373 (1954).

57. *See supra* notes 34-39 and accompanying text.

in this regard.[58] Therefore, when a stockholder of a national bank brought a derivative action at common law on behalf of the bank against its directors for mismanagement, the Supreme Court dismissed the action for lack of federal jurisdiction, there being no diversity of citizenship in the suit.[59]

The Supreme Court in the famous case of *Briggs v. Spaulding*[60] held that while directors of national banks have duties under the National Bank Act, they also have duties under the common law, and in fact it was the directors common law duties that were at issue in that case.[61] As the Court pointed out in a later case,[62] a violation of the National Bank Act is not actionable unless it was intentional, while director liability at common law might be found for negligence.[63]

While the federal courts lacked jurisdiction of a national bank shareholders' derivative suit alleging breach of common law duties in the absence of diversity, the state courts did not. In *Gallin v. National City Bank*,[64] the court held that the same common law duties were applicable to the national bank directors as were applicable to the directors of a state chartered subsidiary of the bank.[65] The state courts might also enforce common law rights of shareholders of national banks to inspect the bank's books and records,[66] or even, by statute, inquire into the due election of bank directors.[67]

The Supreme Court in *Briggs v. Spaulding*[68] was presumably applying federal general common law under the nearly century-long reign of *Swift v. Tyson*.[69] Consequently, the Court cited indiscriminately federal, English, New York, New Jersey, Pennsylvania, and Louisiana cases, among others, on director liability. It didn't matter, since there was no difference between state and federal common law on director liability. As already seen, a derivative suit charging national bank director common law negligence was not within the jurisdiction of the federal courts.[70] The fact that under *Swift v. Tyson* the Supreme Court might be applying federal general common law in *Briggs v. Spaulding* was not of any significance to the decision.

After *Erie R.Co. v. Tompkins*[71] the issue of national bank director liability was still a question of the common law, but since there was no longer any federal general common law,[72] it was now a question of state common law.[73] Federal judges continued to cite *Briggs v. Spaulding* as they had before *Erie*,[74] but they cited state cases as well.[75] State courts continued to apply state common and statutory law to the internal affairs of federally chartered institutions.[76]

Federal common law has not evolved with the expansivity envisioned by Judge Friendly in his famous 1964 article,[77] certainly not in the area of a federal common law of corporate responsibility of directors and officers of publicly held corporations.[78] The Supreme Court called a halt to that notion in 1975 in its development of the doctrine that since corporations are creatures of state law,[79] the federal courts will not create a parallel universe of federal corporate law merely because of the presence of federal question jurisdiction.[80]

In the area of banking law, Judge Friendly was quite correct in pointing out that the Supreme Court has to some limited extent applied federal common law to the exclusion of state law.[81] However, a unanimous Supreme Court has very recently made it clear that judicial creation of a special federal rule is justified only in a very "few and restricted" group of cases where there is a "significant con-

58. *See* Whittemore v. Amoskeag National Bank, 134 U.S. 527 (1890).

59. *Id. Accord*, Herrmann v. Edwards, 238 U.S. 107 (1915). *Cf.* Petri v. Commercial National Bank of Chicago, 142 U.S. 644 (1892) (national bank can sue in federal court on basis of diversity of citizenship).

60. 141 U.S. 132 (1891).

61. 141 U.S. at 145-46.

62. Bowerman v. Hamner, 250 U.S. 504 (1919).

63. 250 U.S. at 510-11.

64. 273 N.Y.S. 87 (N.Y.Sup.Ct. 1934).

65. 273 N.Y.S. at 96.

66. Guthrie v. Harkness, 199 U.S. 148 (1905); Matter of Ochs v. Washington Heights Federal Savings and Loan Assoc., 215 N.E.2d 485 (N.Y. 1966)(enforcing common law inspection rights of member of federally chartered savings and loan).

67. Stone v. Auslander, 212 N.Y.S.2d 777 (N.Y.Sup.Ct. 1961); *In re* Election of Directors of Baldwinsville Federal Savings &

(Continued in next column)

67. *(Continued from previous column)*

Loan Ass'n, 51 N.Y.S.2d 816 (N.Y.App.Div. 1944); *cf.* State v. Barboglio, 226 P. 904 (Utah 1924)(state has constitutional power to inquire into national bank director election, but the Utah state statute does not grant that power); Cupo v. Community National Bank & Trust Co., 438 F.2d 108 (2d. Cir. 1971) (federal courts have original jurisdiction without jurisdictional amount of action to review election of national bank directors).

68. *See supra* notes 60-61 and accompanying text.

69. 41 U.S. 1 (1842).

70. *See supra* notes 58-59 and accompanying text.

71. 304 U.S. 64 (1938).

72. 304 U.S. at 78.

73. Seven months after *Erie*, in a case which had just been remanded by the Supreme Court for determination of the common law liability of national bank directors, a federal appellate judge said that after *Erie* the common law to be applied was the common law of the state where the action is brought, Kentucky in that case, Atherton v. Anderson, 99 F.2d 883, 897 (6th Cir. 1938)(Simons, C.J., dissenting). His fellow judges did not correct him on that point, although they did disagree with him as to the sufficiency of the evidence.

74. Hoehn v. Crews, 144 F.2d 665 (10th Cir. 1944); Michelsen v. Penney, 135 F.2d 409, 417 (2d Cir. 1943)(directors have liabilities under the National Bank Act and under the common law); FDIC v. Mason, 115 F.2d 548 (3d Cir. 1940)(national bank directors held liable for breach of common law duty).

75. *See e.g.*, Hoen v. Crews, 144 F.2d 665, 672-73 (10th Cir. 1944). The *Hoen* standard of national bank director common law duties is still applied in the Tenth Circuit, *see* FDIC v. Appling, 992 F.2d 1109 (10th Cir. 1993).

76. See *supra* notes 66-67 and accompanying text.

77. Henry J. Friendly, In Praise of Erie--and of the New Federal Common Law, 39 N.Y.U.L.Rev. 383 (1964).

78. 39 N.Y.U.L.Rev. at 413-14.

79. Cort v. Ash, 422 U.S. 66 (1975)(director liability in shareholders derivative suit for violation of federal statute prohibiting corporate contributions to federal office candidates is question of state law).

80. Kamen v. Kemper Financial Services, 500 U.S. 90 (1991)(necessity for demand on directors in derivative suit charging violations of federal statute would be resolved by reference to state law, not federal common law); Virginia Bankshares, Inc. v. Sandberg, 501 U.S. 1083, 1093 n. 6 (1991)(a corporate transaction's fairness is not, as such, a federal concern); Santa Fe Industries, Inc. v. Green, 430 U.S. 462 (1977)(breach of fiduciary duty as such does not give rise to federal cause of action without allegations of deception); Burks v. Lasker, 441 U.S. 471 (1979)(special litigation committee decision to terminate shareholder suit charging violations of federal law would be respected if allowable under state law).

81. Friendly, *supra note 77*, 39 N.Y.U.L.Rev. at 408-9. *See* Deitrick v. Greaney, 309 U.S. 190 (1940)(violation of National Bank Act makes state law inapplicable in determining liability of national bank director on note sued on by bank receiver); D'Oench, Duhme & Co., Inc. v. FDIC, 315 U.S. 447 (1942)(policy of Federal Reserve Act makes liability on note acquired by governmental insurer as collateral for loan to state bank question of federal, not state law), *see* Chris Atkinson, Note, *Defensing the Indefensible: Exceptions to D'Oench and 12 U.S.C. § 1823(E)*, 63 Fordham L. Rev. 1337 (1995); Clearfield Trust Co. v. United States, 318 U.S. 363 (1943)(liability of United States on government check with forged endorsement is question of federal law).

flict" between some federal policy or interest and the use of state law.[82]

It is not possible to find a "significant conflict" between federal policy and the application of state law on director duty of care after FIRREA, since Congress has already made its determination that application of state law to directors of insured depositary institutions is not in conflict with federal interests except to the extent provided in section 1821(k): no state may immunize a director from liability for gross negligence or worse conduct, as those terms are defined by state law.[83] It is irrational to distinguish between state chartered and federal chartered institutions in this regard, and if federal common law applies to both state and federally chartered institutions, we didn't need FIRREA section 1821(k) in the first place.[84] The policy of Congress since 1864 has been to equalize the competitive position of national and state banks to the extent possible, not to treat them differently.[85] Federal programs such as those run by the Federal Reserve System and the Federal Deposit Insurance Corporation are available to both state and federal institutions.[86]

Application of state common and statutory law to federal banks and thrifts with respect to their operations and even their internal affairs has been the rule rather than the exception, as discussed above. Congress could clearly have made this a federal matter a long time ago, but it has deliberately chosen not to do so. The issue of director liability, as described above, which used to be a common law issue, is becoming increasingly subject to state statutes, some of them expressly applicable to federal institutions.

For example, Kansas in 1993 adopted a statute expressly applicable to federal savings associations and federal savings banks immunizing directors from liability except for willful or gross and wanton negligent breach of duty.[87] The statute was to be retroactive to all causes of action not finally determined as of its effective date, and for that reason, it was recently held unconstitutional by the Supreme Court of Kansas.[88] A similar statute in Oklahoma, also retroactive and also applicable to federal institutions, was also held unconstitutional.[89] On the other hand, a similar Mississippi statute was recently held constitutional as applied to a federal institution, the court being of the view that for due process purposes, no vested property right in a tort action arises until after it has been reduced to judgment.[90] Aside from the issue of retroactivity, it does not seem reasonable to distinguish between state common law and state statutory law in this regard.

The Seventh Circuit in *Chapman*[91] held that the internal affairs doctrine mandated application of federal law to the internal affairs of a federal institution. The internal affairs doctrine is a conflicts of law doctrine[92] which is not of any help in deciding questions of conflict between state and federal law.[93] If there is a conflict between state and federal law, federal law wins because of the supremacy clause, but it must be a "significant conflict" to bring federal common law into the picture.[94]

V. Conclusion

As outlined above, the gross negligence standard of FIRREA has been held not to bar state law suits against directors based on state law ordinary negligence standards. If the law applicable to directors of federally chartered institutions is a federal common law ordinary negligence standard, FIRREA should not reasonably be held to change that absent specific language to that effect.[95] However, it is submitted that state law standards have historically been applied to directors of federal institutions, and nothing in FIRREA changes that. If the result is that, at least prospectively, states can change the standard from ordinary to gross negligence, that is simply the consequence of the course Congress has chosen.

82. O'Melveny & Myers v. FDIC, 114 S.Ct. 2048, 2055 (1994). The Ninth Circuit on remand said that *O'Melveny* has overruled *D'Oench, Duhme*, *see* FDIC v. O'Melveny & Meyers, 61 F.3d 17, 18 (9th Cir. 1995); *see also* RTC v. Kennelly, 57 F.3d 819, 822 n. 3 (9th Cir. 1995)(serious doubt whether *D'Oench* survives *O'Melveny.*).

83. *See* text of § 1821(k), *supra* note 7.

84. *See* cases cited *supra* at note 26.

85. *See* Lewis v. Fidelity & Deposit Co. of Maryland, 292 U.S. 559, 564-65 (1934)(national bank may give general lien on its assets where authorized by Congress to enable it to compete for state funds with state chartered institutions; equalization of national and state banks has been consistent policy of Congress).

86. *See* BANKING LAW IN THE UNITED STATES, *supra* note 28, Ch. 4, explaining the outlines of the dual banking system.

87. *See* RTC v. Fleischer, 892 P.2d 497 (Kan. 1995).

88. *Id.*

89. RTC v. Alexander, No. CIV-92-507-T (W.D.Okla. Feb. 24, 1993), 1993 WL 761299; RTC v. Conner, 871 F.Supp. 1424 (W.D.Okla. 1993); RTC v. Wright, 868 F.Supp. 301 (W.D.Okla. 1993).

90. RTC v. Scott, 887 F.Supp. 937 (S.D.Miss. 1995).

91. *See supra* note 12.

92. *See* Norwood P. Beveridge, *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 Bus. Law. 693 (1989).

93. *RTC v. Shuck*, *supra* note 26, at *2 (doctrine concerns choice of law as between states).

94. *O'Melveny & Meyers*, *supra* note 82.

95. *See* U.S. v. Texas, 113 S.Ct. 1631, 1634 (1993)(presumpti[illegible] against statutory displacement of federal common law).