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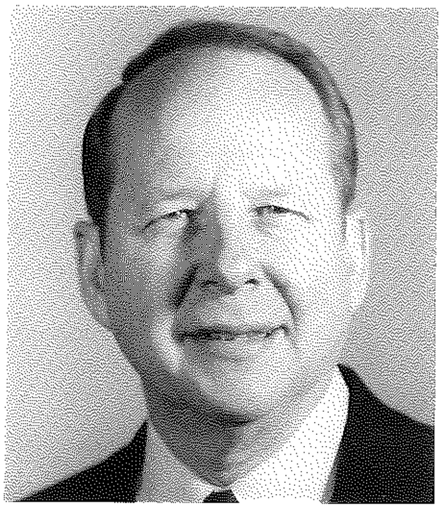

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The recent decision of the United States Court of Appeals for the Tenth Circuit in *FDIC v. Canfield*[1] should go a long way towards clarifying standards of conduct for directors and officers of insured depository institutions after the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA").[2] In a widely-discussed and surprising decision in 1991, the United States District Court for the District of Utah, in a decision now reversed by the Court of Appeals, held that FIRREA established a new, uniform and lower, federal gross negligence standard of conduct for insured institution directors which preempted higher as well as lower state standards.[3] This lower-court decision in *Canfield* was followed by another District Judge in Utah[4] and one in Minnesota,[5] but was otherwise universally criticized.[6]

The problem is created by a provision in FIRREA which states that a director of an insured depository institution may be held personally liable "for gross negligence, including any similar conduct or conduct that demonstrates a greater disregard of a duty of care."[7] This section obviously creates director liability for gross negligence, not merely ordinary negligence, in a suit under the section; it has therefore been referred to as a "heightened liability standard."[8] Just as obviously, the section was intended to preempt state law which would hold a director to a lower standard than gross negligence, for example intentional misconduct.[9] However, the District Court in *Canfield* was in error in holding that FIRREA intended to establish a uniform federal standard by this provision.[10] Section 1821(k) expressly refers to "applicable State law"[11] to define gross negligence, thus insuring a non-uniform standard since there is

1. 967 F.2d 443 (10th Cir. 1992) (en banc).

2. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified in scattered sections of 12 & 15 U.S.C.). *See generally*, Daniel B. Gail & Joseph J. Norton, *A Decade's Journey From "Deregulation" to "Supervisory Reregulation": The Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, 45 Bus. Law. 1103 (1990); Charles L. O'Brien & Lisa M. Cavage, *FIRREA: Retroactive Application, Due Process Issues, Right-Duty Analysis and the Statute of Limitations*, 108 Banking L.J. 308 (1991).

3. FDIC v. Canfield, 763 F. Supp. 533 (D. Utah 1991), *rev'd*, 967 F.2d 443 (10th Cir. 1992) (en banc).

4. FDIC v. Brown, Civ. No. NC 89-30G, 1991 WL 294524 (D. Utah, Nov. 18, 1991).

5. FDIC v. Swager, 773 F. Supp. 1244 (D. Minn. 1991). The *Swager* decision also cites supporting dicta in Gaff v. FDIC, 919 F.2d 384, 391 (6th Cir. 1990), *mod.*, 933 F.2d 400 (6th Cir. 1991).

6. *See* James P. Murphy, *The Standards Governing Conduct of Officers, Directors and Others* in CIVIL AND CRIMINAL LIABILITY OF OFFICERS, DIRECTORS, AND PROFESSIONALS: BANK & THRIFT LITIGATION IN THE 1990's 143 (1991) ("Section 212(k) is a limited preemption provision; its plain language and legislative history do not support the *Canfield* court's decision.") All other lower federal court decisions have rejected the district court's holding in *Canfield:* FSLIC v. Shelton, 789 F. Supp. 1360 (M.D. La. 1992); FDIC v. Williams, 779 F. Supp. 63 (N.D. Tex. 1991); FDIC v. Miller, 781 F. Supp. 1271 (N.D. Ill. 1991); FDIC v. Isham, 777 F. Supp. 828 (D. Colo. 1991); FDIC v. Black, 777 F. Supp. 919 (W.D. Okla. 1991); FDIC v. McSweeney, 772 F. Supp. 1154 (S.D. Calif. 1991); FDIC v. Fay, 779 F. Supp. 66 (S.D. Tex. 1991); FDIC v. Haddad, 778 F. Supp. 1559 (S.D. Fla. 1991); FDIC v. Burrell, 779 F. Supp. 998 (S.D. Iowa 1991); FDIC v. Baker, SACV No. 89-386 AHS (RWRx), 1991 U.S. Dist. LEXIS 16878 (C.D. Calif. June 24, 1991).

7. 12 U.S.C. § 1821(k) (Supp. II 1990). 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

(Continued in next column)

7. *(Continued from previous column)*

> (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 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. II 1990).

8. Home Savings Bank, F.S.B. v. Gilliam, 952 F.2d 1152, 1160-61 (9th Cir. 1991). Civil penalties may be imposed on a bank director even for nonnegligent violations of federal banking law. *See* Lowe v. FDIC, 958 F.2d 1526 (11th Cir. 1992) (inadvertent violation of insider loan provisions).

9. *See, e.g.*, Del. Code Ann. tit. 8, § 102(b)(7) (1991), which allows a provision in the certificate of incorporation to relieve directors of the corporation from liability for gross negligence. This section was added following the much criticized decision in Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) (directors held liable for gross negligence in approving cash-out merger). Other states have also adopted director protection statutes with standards lower than gross negligence; *see generally* EDWARD BRODSKY & M. PATRICIA ADAMSKI, LAW OF CORPORATE OFFICERS AND DIRECTORS: RIGHTS, DUTIES AND LIABILITIES §§ 2:04-2:05 (1984 & 1991 Cum. Supp.).

10. 763 F. Supp. at 536.

11. 12 U.S.C. § 1821(k) (Supp. II 1990). In the case of a state-chartered institution, the "applicable" State law is presumably the law of the State of incorporation; *see generally*, Norwood P. Beveridge, Jr., *The Internal Affairs Doctrine: The Proper Law of a Corporation*, 44 Bus. Law. 696 (1989) [hereinafter Beveridge]. The FDIC has sometimes argued for a uniform federal common law applicable to liability of directors and other connected with state-chartered institutions, but this seems clearly wrong. *See* Arthur W. Leibold, Jr., *Federal Common Law: What and Where?* in CIVIL AND CRIMINAL LIABILITY OF OFFICERS, DIRECTORS, AND PROFESSIONALS: BANK & THRIFT LITIGATION IN THE 1990's 153 (1991). The interaction between state and federal law in these suits is, however, a somewhat murky area. *See* Samantha Evans, Note, *An FDIC Priority of Claims over Depository Institution Shareholders*, 41 Duke L.J. 329 (1991) (noting conflict in cases as to whether state or federal law governs priority of FDIC claims against directors over shareholder claims).

no generally accepted definition of gross negligence.[12]

In any event, the question posed in *Canfield* was the opposite of that which the section was designed to answer. Where the state standard provides liability of a director for ordinary negligence, is this higher state standard preempted by the gross negligence standard of section 1821(k)? The section expressly states that "Nothing in this paragraph shall impair or affect any right of the Corporation [the FDIC] under other applicable law."[13] Since apart from section 1821(k), the FDIC has as conservator or receiver all of the rights of the insured depository institution, and its stockholders, depositors, officers, and directors with respect to the institution and its assets[14] and since the institution and its stockholders suing on its behalf have a cause of action under state law for simple negligence, it should be obvious that section 1821(k) was not intended to nullify that cause of action, even without resort to the legislative history.[15]

The legislative history also supports this interpretation. One of the primary purposes of FIRREA was "to strengthen the enforcement powers of federal regulators of financial institutions."[16] It would be inconsistent with that purpose to nullify an existing cause of action for damages. While the House Conference Report also says that the statute "preempts State law"[17] with respect to claims brought by the FDIC against institution directors, that does not point to a different interpretation since the section does preempt contrary state law. Senator Riegle made this clear during the floor debate when he stated that because of state statutes insulating directors from suit, the bill as reported "totally preempted State law,"[18] but that "in light of the State law implications"[19] the scope of the preemption had been scaled back. The Senate Report stated even more clearly that the statute would not prevent the FDIC from pursuing claims under state law "for violating a lower standard of care, such as simple negligence."[20]

A question not raised in *Canfield* is the effect of FIRREA section 1821(k) on the standard of conduct for directors of federally-chartered institutions. In *FDIC v. Miller*,[21] the court held that the federal common law liability of directors of federally-chartered institutions for ordinary negligence did not survive the adoption of section 1821(k), which now sets out the exclusive liability of such directors for gross negligence under the statute. However, the *Miller* court did not explain what would be the "applicable State law" under section 1821(k) to define the term "gross negligence" in such a case. Where the term "gross negligence" is used elsewhere in the statute,[22] it is used without reference to "applicable State law" and without a definition,[23] thereby presenting a pure question of federal law. In section 1821(k), the statutory language directs the court to use "applicable State law." Unless it can be said that the laws of some state "apply" to conduct of a director of a federal institution, in light of the legislative history, it might be concluded that the statute was simply not intended to apply to directors of such an institution.

Unfortunately, there is conflict in the cases on the question of whether federal or state law applies to the liability of a director of a federally-chartered institution for negligence. In *Amerifirst Bank v. Bomar*,[24] the court declined to find a federal common law cause of action against directors of a federally-chartered savings and loan, but there is contrary authority.[25] If such an action is governed by federal law, there is no applicable state law unless Congress has directed the court to find one. In that case, the internal affairs doctrine[26] will not avail, but the "most significant contacts" principles of the Restatement (Second) of Conflict of Laws[27] will locate one, probably either the state of the principal offices or the state where the challenged conduct took place.

12. W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS 212 (5th Ed. 1984), cited by the Court of Appeals in *Canfield*, 967 F.2d at 447. Actually, in the director-liability cases, the most common definition of "gross negligence" is failure to use the care of an ordinarily prudent person under the circumstances, which is the same as an ordinary care standard: *see e.g.*, Hun v. Cary, 82 N.Y. 65, 72 (1880). The standard developed in the nineteenth century by analogy to the standard for mandatories and gratuitous bailees, and one of the "circumstances" to be considered, was that the directors were serving in a part-time and uncompensated capacity. The standard also included the idea of non-liability for less than gross ignorance and gross error of judgment under the business judgment rule. *See generally*, Norwood P. Beveridge, Jr., *The Corporate Director's Duty of Care: Riddles Wisely Expounded*, 24 Suffolk U.L. Rev. 923 (1990). Oklahoma, for example, has a statutory definition of "gross negligence" which defines it as the "want of slight care and diligence," Okla. Stat. Ann. tit. 25, § 6 (West 1987). "Slight care and diligence" in turn is defined as that care which persons of ordinary prudence exercise "about their own affairs of slight importance," Okla. Stat. Ann. tit. 25, § 4 (West 1987). In an interesting development, Oklahoma has recently amended its banking code to provide that, effective August 9, 1989, no claim may be brought by the FDIC against any insured financial depository institution director or officer unless based on "gross negligence, or willful or intentional misconduct," Law 43rd Leg., 2d Sess., Ch. 295, § 28, 1992 Okla. Law. Serv. 1230 (West). The validity of this enactment is questionable, both because it purports to be retroactive and because it purports to apply only to suits by the FDIC and other federal banking regulatory agencies.

13 12 U.S.C. § 1821(k) (Supp. II 1990).

14. 12 U.S.C. § 1821(d)(2)(A)(i) (Supp. II 1990).

15. *See* FDIC v. McSweeney, 772 F. Supp. 1154, 1159 (S.D. Calif. 1991).

16. H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. *reprinted in* 1989 U.S.C.C.A.N. 432.

17. *Id.* at 437.

18. 135 Cong. Rec. S4278-79 (daily ed. April 19, 1989), cited by the Court of Appeals in *Canfield*, 967 F.2d at 448, note 6.

19. *Id.*

20. 135 Cong. Rev. S6912 (daily ed. June 19, 1989).

21. 781 F. Supp. 1271 (N.D. Ill. 1991); *accord* Resolution Trust Corp. v. Gallagher, No. 92C 1091, 1992 U.S. Dist. LEXIS 9778 (N.D. Ill. July 10, 1992).

22. *See* 12 U.S.C. § 1829(j)(1) (Supp. II 1990) and § 1955 (1988) (civil penalties for gross negligence).

23. *Cf.* 42 U.S.C.A. § 12672(b)(7) (1991) ("The term 'gross negligence' means voluntary and conscious conduct by a person with knowledge (at the time of the conduct) that the conduct is likely to be harmful to the health or well-being of another person.")

24. 757 F. Supp. 1365 (S.D. Fla. 1991); *accord* Curiale v. Reissman, 91 Civ. 6344 (MEL) 1992 U.S. Dist. LEXIS 9982 (S.D. N.Y. July 6, 1992).

25. *See* Eureka Federal Savings and Loan Ass'n. v. Kidwell, 672 F Supp. 436 (N.D. Calif. 1987); City Federal Savings and Loan Ass'n v. Crowley, 393 F. Supp. 644 (E.D. Wisc. 1975).

26. *See* Beveridge, *supra* note 11.

27. RESTATEMENT (SECOND) OF CONFLICT OF LAWS, §§ 6, 301 (1971).

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