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Note

FDIC CLAIMS OF PRIORITY IN THE CASE OF THE FAILED BANK

I. INTRODUCTION

Between 1865 and 1933 more than 19,000 banks, holding deposits of about ten billion dollars, failed. This "crisis of confidence" reached its zenith between 1930 and 1933, during which an average of 2,300 banks failed annually. In response to this severe banking crisis brought on by the nation's economic depression, Congress created the Federal Deposit Insurance Corporation (FDIC). The FDIC's purpose was to safeguard the earnings of individuals by establishing a system of federal deposit insurance. No system of federal deposit insurance existed prior to the enactment of the Banking Act of 1933. In establishing the regulatory scheme within which the FDIC would oversee banking operations, Congress conferred upon the agency the broad powers necessary to preserve the integrity of the banking system, thereby guaranteeing the safety of depositors' accounts.

1. By 1933, one third of the banks which were open in 1929 had closed. FDIC v. Philadelphia Gear Corp., 476 U.S. 426, 432 (1986). As a direct result of this collapse of the banking system, Congress created the FDIC. Id.


3. See Philadelphia Gear, 476 U.S. at 432 (Congress created FDIC primarily for purpose of safeguarding savings of individuals).


5. Banking Act of 1933, ch. 89, § 8, 48 Stat. 162 (codified at 12 U.S.C. §§ 1811-31). Congress intended the 1933 Act to provide temporary insurance of up to $2,500 per depositor. Burgee, supra note 4, at 1148. In 1935, Congress enacted a plan for permanent insurance, with a limit of $5,000 of coverage per depositor. Id. Congress increased the amount incrementally between 1935 and 1974, when it approved the current limit of $100,000 per account. Id.

6. See Burgee, supra note 4, at 1147.

7. Id. at 1149.

8. See, e.g., 12 U.S.C. § 1819 (Supp. II 1990). Section 1819 confers on the FDIC all powers specifically granted by the statute and all powers incidental to those specifically granted which are necessary to carry out its statutory purpose. Id. The most important of the express powers are the powers to realize upon the assets of the failed bank, and to enforce the individual liabilities of the directors and shareholders of failed banks. 12 U.S.C. § 1821(d) (Supp. II 1990).

(1151)
After the establishment of the FDIC and before the early 1980s, this regulatory scheme worked well. Bank failures during those years were held to a minimum.9 Beginning in the early 1980s, however, the bank failure rate began to climb steadily.10

The banking and savings and loan industries are currently mired in crisis. Commentators estimate that the government will have to spend from 500 billion to nearly one trillion dollars to bail out failing thrifts.11 Furthermore, commentators fear that similar losses may soon beset the banking industry.12 Due to these increasing problems, the nation has become concerned with the extent of the powers delegated to the FDIC.13

The United States Court of Appeals for the Eleventh Circuit recently addressed an issue that becomes increasingly important with each new bank failure: Whether the FDIC possesses a priority over the shareholders of a failed bank when both the FDIC and the shareholders assert claims against the officers and directors of the failed bank.14 In FDIC v. Jenkins, the Eleventh Circuit held that the FDIC possessed no such priority.15 Subsequent to the Eleventh Circuit’s decision, the United States Court of Appeals for the Sixth Circuit addressed the very same issue in Gaff v. FDIC.16 The Sixth Circuit reached the result contrary to Jenkins holding that the FDIC does possess a priority.17

This Note will briefly discuss the crisis which currently engulfs the banking and thrift industries18 and will examine the means available to

9. See England, A Run For Our Money, NAT’L REV., Sept. 17, 1990, at 36. After 4,000 bank failures in 1983, a mere 61 banks failed in 1984, the year after the enactment of the National Banking Act. Id. The number of banks failing annually between 1984 and 1943 remained below 100 per year. Id. The rate of bank failure dropped to an almost imperceptible level between 1943 and 1981, averaging less than 10 per year. Id.
10. Id. In 1985, 120 banks failed; in 1989, 206 banks failed, the greatest number since the establishment of the FDIC in 1933. Id.
11. See Schoenberg, The S & L Black Hole: How It Will Suck You In, MONEY, July 1990, at 8 (cost of bailing out savings and loans could reach $500 billion including interest); Greenwald, No End in Sight, TIME, Aug. 13, 1990, at 50 (speculating that cost may reach $1 trillion dollars over next 30 years).
12. See England, supra note 9, at 38 (government sponsored research reveals that between 150 to 500 banks are insolvent, and delay on part of FDIC in dealing with crisis could lead to problem in banking industry similar to that of savings and loans).
13. See, e.g., Greenwald, supra note 11, at 50 (poll showed that 53% of respondents had become more concerned about nation’s savings and loan crisis).
15. Id. The FDIC asserted that it was entitled to such a priority under either statutory law or federal common law. Id. For a discussion of the Jenkins case, see infra notes 82-103 and accompanying text.
16. 919 F.2d 384 (6th Cir. 1990).
17. Id. at 396. For a discussion of the Gaff case, see infra notes 104-44 and accompanying text.
18. For a discussion of the crisis engulfing the banking and savings and loan industries, see infra notes 24, 26, supra notes 10-12 and accompanying text.
the FDIC in dealing with failed banks and savings institutions under the present regulatory scheme. This Note will then analyze and compare the reasoning employed by the two courts of appeal in reaching divergent conclusions while addressing the same issue.

II. BACKGROUND

A. *The Function of the FDIC*

A basic understanding of the various capacities in which the FDIC interacts with financial institutions is necessary to appreciate the nature of the problem faced by the Jenkins and Gaff courts. First, the FDIC acts as a regulatory agency. Second, the FDIC is statutorily authorized to act as the receiver of failed banking institutions. Finally, the FDIC acts in a corporate capacity when it purchases assets from a failed bank, such as loans made by the failed bank, or when it asserts the failed bank's claims against its officers and directors.

19. For a discussion of the means by which the FDIC handles bank failures, see *infra* note 22 and accompanying text.

20. Federal Deposit Insurance Act, ch. 967, § 2, 64 Stat. 873 (1950) (codified at 12 U.S.C. §§ 1811-31 (1988 & Supp. II 1990)). In its regulatory capacity, the FDIC is responsible for conducting periodic examinations of those banks which are a part of the federal bank system in order to insure that the banks are in compliance with federal banking laws and regulations. *Id.*

21. The FDIC is authorized to act as the receiver of failed banking institutions pursuant to appointment by the comptroller of the currency, or, in the case of a state bank, the relevant state banking authorities. 12 U.S.C. § 1821(c) (Supp. II 1990).


In a purchase and assumption transaction, FDIC-receiver sells the failed bank's acceptable assets to a healthy bank. Burgee, *supra* note 4, at 1154. The assuming bank also purchases the failed bank's liabilities. *Id.* at 1154-55. Because the value of the assets purchased by the assuming bank is usually less than the value of the liabilities assumed, the FDIC as receiver will transfer cash to the assuming bank to equalize the level of assets and liabilities. *Id.* at 1155. In order to generate sufficient cash necessary for such a transfer, the FDIC as receiver will sell those assets deemed "unacceptable" by the assuming bank to the FDIC as insurer. *Id.* These unacceptable assets may include causes of action against the former officers and directors of the failed institution. *Id.* at 1158. The FDIC as insurer will then attempt to collect on those returned assets. Gunter, 674 F.2d at 865. For a more complete discussion of the mechanics involved in a purchase and assumption transaction, see Burgee, *supra* note 4, at 1154-59.
Since its inception, the FDIC has successfully protected the stability of the banking system.\textsuperscript{28} Recent developments in the banking and thrift industries, however, have posed a serious challenge to the continued success of the FDIC in maintaining the integrity of the nation's financial system.\textsuperscript{24} The troubled state of the thrift industry may be directly attributed to the self-dealing, fraud, and speculative real estate deals of officers and directors of savings and loans.\textsuperscript{25} Mounting estimates of the savings and loan bailout cost,\textsuperscript{26} and the looming threat of even larger scale banking institution failures,\textsuperscript{27} have left the public increasingly concerned about the future of such financial institutions and the costs imposed by those which succumb.\textsuperscript{28}

2. Legislative Reform

In the fall of 1989, Congress enacted the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA)\textsuperscript{29} in an effort to address the problems that presently besiege the banking and savings and loan industries.\textsuperscript{30} By enacting FIRREA Congress attempted to bolster the nation's financial system.

at 1156. Yet, the FDIC is not required by statute to employ a purchase and assumption transaction; its use is purely discretionary. 12 U.S.C. § 1821(d) (Supp. II 1990).

\textsuperscript{23} See Burgee, supra note 4, at 1149. Between 1934, the FDIC's first year of operation, and 1977, only 541 banks failed. Id. In dealing with such failures, the FDIC "paid or made available to depositors" 99.6% of the deposits held in the failed banks. Id. (footnote omitted).

\textsuperscript{24} H.R. REP. No. 101-54(I), 101st Cong., 1st Sess. 2, reprinted in 1989 U.S. CODE CONG. & ADMIN. NEWS 86, 99 [hereinafter HOUSE REPORT]. As of 1988, 25% of insured savings institutions had a capital to assets ratio of less than 3%, while the industry average was about 9%. Id. These institutions have lost a combined $15.8 billion. Id. Another 364 thrifts had a negative net worth. Id. Estimates for the cost of the savings and loan bailout have ranged as high as $1 trillion over the next 30 years. Greenwald, supra note 11, at 50.

\textsuperscript{25} For a discussion of the alleged causes for the numerous failures in the thrift industry, see infra note 34 and accompanying text.

\textsuperscript{26} See generally Greenwald, supra note 11 (reporting White House projections of $160 billion over 10 years, and speculating that cost may reach $1 trillion over next 30 years); Schoenberg, supra note 11 at 68 (reporting figure of $500 billion including interest and cost to bail out thrifts declared insolvent). For a discussion of the cost of the savings and loan bailout, see supra note 11.

\textsuperscript{27} For a discussion of the threat of looming bank failures, see England, supra note 9, at 38. See also Greenwald, supra note 11, at 50 (in first eight months of 1990, 112 banks failed). These figures are a stark contrast to the pre-FDIC figures cited by Burgee, supra note 4, at 1147 (between 1865 and end of 1933 more than 19,000 banks failed).

\textsuperscript{28} See Greenwald, supra note 11, at 50 (citing poll indicating 53% of respondents have become more concerned about nation's savings and loan problems, and that nearly 40% have "not very much" confidence in federal government's ability to correct problems).


\textsuperscript{30} See HOUSE REPORT, supra note 24, at 87. Among other measures, FIRREA abolished the Federal Savings and Loan Insurance Corporation (FSLIC)
ster the administrative enforcement of banking law in the thrift industry.31 Perhaps most importantly, as one commentator has pointed out, FIRREA provided that the directors and officers of financial institutions could "be held personally liable for monetary damages in any civil action brought by, on behalf of, or at the request or direction of the FDIC."32 As a part of this effort to better regulate both banks and savings and loans, Congress transferred all of the regulatory powers formerly belonging to the Federal Savings and Loan Insurance Corporation to the FDIC.33

The enforcement provisions of FIRREA are particularly significant given the extent to which the alleged fiduciary breaches by the officers and directors of savings and loan institutions caused current losses and insolvencies.34 In addition to the more stringent enforcement provisions contained in FIRREA,35 the FDIC continues to possess other means by which it may pursue redress against the officers and directors of failed banks and thrifts.36 For example, the FDIC, having purchased in its corporate capacity the claims and assets of a failed bank from the

and established the Office of Thrift Supervision, the Resolution Trust Corporation and the Federal Home Finance Board. Id. FIRREA also transferred the FSLIC's regulatory functions to those three agencies and the FDIC. Id. FSLIC formerly served as the regulatory agency with authority for overseeing and insuring the deposits of savings and loans. Id. By conferring the former FSLIC functions on the FDIC and the other three aforementioned agencies, Congress attempted to consolidate and reform federal regulation of financial institutions. Id. at 86; see also Dilloff, Banking Reform Act Advances, NAT'L L.J., Sept. 4, 1989, at 15, col. 1 (claiming FIRREA contemplates increased civil prosecutions by FDIC). FIRREA awarded the Resolution Trust Corporation the authority to resolve cases involving insolvent institutions formerly handled by the FSLIC. Mitchell, The New Savings and Loan Bailout Bill, N.Y.L.J., Sept. 27, 1989, at 3, col. 1.

31. See Dilloff, supra note 30, at 15, col. 1.


33. See House Report, supra note 24, at 87 (Congress abolished FSLIC and established Office of Thrift Supervision, Resolution Trust Corp. and Federal Housing Finance Board to perform former FSLIC duties under authority of FDIC).

34. Fraud estimates seem to vary almost as much as estimates of the total cost of the bailout, ranging from former bailout chief L. William Seidman's guess of one third of the 673 failures since 1987, to consultant Bert Ely's guess of 4% of all failures. See Schoenberg, supra note 11, at 69; see also Greenwald, supra note 11, at 51 (claiming government officials estimate fraud played role in 50% of all failures).

35. For a discussion of provisions in FIRREA providing for stepped up enforcement of banking laws, see supra notes 30 & 32.

36. See, e.g., FDIC v. Former Officers and Directors of Metropolitan Bank, 884 F.2d 1304 (9th Cir. 1989) (FDIC sued former officers and directors for breach of fiduciary and statutory duties), cert. denied, 110 S. Ct. 3215 (1990); FDIC v. Paul, 735 F. Supp. 375 (D. Utah 1990) (FDIC sued former officers and directors for negligence, breach of fiduciary duties and breach of contract for mismanagement of assets); cf. 12 U.S.C. § 1467a(g)(5) (Supp. II 1990) (FDIC may also obtain cease and desist order against officers and directors of failed
FDIC-receiver, may assert such claims against the officers and directors of the failed institution.\(^{37}\) The claims asserted vary from case to case, but fall within a general pattern of allegations of fraud or breach of fiduciary duty.\(^{38}\) Despite the proliferation of such claims, whether any of these measures have contributed even marginally to the recovery of insurance funds lost through the fraud or mismanagement of failed thrifts is not clear. The amounts that the FDIC has recovered thus far represent a mere pittance when compared to the amounts allegedly lost due to the improper conduct of the officers and directors.\(^ {39}\)

bank ordering cessation of violations and prohibiting further participation in banking industry).

37. See Burgee, supra note 4, at 1158.

38. See, e.g., FDIC v. Paul, 735 F.2d 375 (D. Utah 1990). Paul recites a fairly typical, though non-exhaustive laundry-list of charges which arise against the directors and officers of institutions, including: the failure to properly supervise loan portfolios, the pursuit of unsafe lending practices, the failure to maintain sufficient liquidity to meet obligations, the failure to maintain sufficient capital, the pursuit of managerial policies harmful to the bank and the failure to provide adequate leadership. Id. at 376-77; see also Metropolitan Bank, 884 F.2d at 1306 (FDIC filed claim asserting officers and directors mismanaged portfolio of bank); cf. Fix, Mind-boggling Bill for S & L's, Philadelphia Inquirer, Sept. 9, 1990, at 1-C, col. 1 (many savings and loans failed either because officers invested in high risk junk bond ventures or because officers paid themselves excessively high salaries and made worthless loans to themselves and friends; shaky real estate investments also played role in failure of many thrifts).

39. See Gray, Grapevine, Time, Aug. 6, 1990, at 13, col. 4 (Attorney General reporting that in 1989 only $2,700 of $3.1 million in court ordered payments for fraud cases in Dallas was received, and that through first seven months of 1990, government had collected only $50 out of $2.5 million in ordered payments); see also Greenwald, supra note 11, at 51 (arguing that authorities expect to recover very little of stolen money).

Typically, the officers and directors will respond to the FDIC’s allegations by claiming that the agency was contributorily negligent in its conduct as regulator or receiver of a failed institution. See, e.g., FSLIC v. Burdette, 718 F. Supp. 649 (E.D. Tenn. 1989) (defendants claimed FSLIC was contributorily negligent and failed to mitigate damages); FDIC v. Coble, 720 F. Supp. 748 (E.D. Mo. 1989) (defendant asserted affirmative defense of contributory negligence); FDIC v. Carlson, 698 F. Supp. 178 (D. Minn. 1988) (defendants alleged contributory negligence on part of FDIC); FDIC v. Butcher, 660 F. Supp. 1274 (E.D. Tenn. 1987) (defendants asserted contributory negligence as defense and counterclaim). As a general matter, however, the courts have rejected officers’ and directors’ claims of contributory negligence when asserted against the FDIC as an affirmative defense or a cross-claim. See, e.g., FDIC v. Carlson, 698 F. Supp. 178 (D. Minn. 1988). In Carlson, the defendants claimed that the FDIC, acting as receiver for an insolvent bank, committed acts of contributory negligence by failing to maximize recovery on bad loans after the bank’s failure. Id. at 179. The district court, relying on FSLIC v. Roy, No. 87-1227 (D. Md. June 28, 1988) (1988 WL 96570), held that the statutory authority under which the FDIC acts as receiver of an insolvent institution does not create a duty of care on the part of the FDIC toward the institution’s former officers and directors. Carlson, 698 F. Supp. at 179. In the absence of any duty to the defendants, the court held that it must dismiss the asserted defense of contributory negligence. Id. The court in FDIC v. Greenwood, 719 F. Supp. 749 (C.D. Ill. 1989), appropriately identified the policy underlying the denial of any contributory negligence defense: any
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B. The Derivative Claim Rule and Exceptions

1. The Rule

When a banking institution fails, the FDIC will assert claims against the officers and directors of the failed institution. The shareholders of the failed bank will also sue the officers and directors, claiming damages done either to themselves as individuals, or to the value of their stock. In many cases, the FDIC will assert that claims filed by the institution's shareholders, or on the shareholders' behalf, are derivative claims for harm to the bank itself, which therefore belong solely to the FDIC as receiver of the failed bank, or its assignee, FDIC-corporate.

Courts have generally held that suits against directors and officers for their failure to manage the failed institution adequately are derivative in nature when the shareholders allege no injury distinct from the diminution of stock value. Furthermore, courts have similarly held that imposed upon the FDIC to maximize its collection of the failed bank's assets runs not to the officers and directors of the failed institution, but to the public-at-large. In Greenwood, the FDIC charged bank officers and directors with negligence. The defendants asserted the affirmative defense of contributory negligence. The court held for the FDIC on grounds of public policy.

The court in FDIC v. Butcher, 660 F. Supp. 1274 (E.D. Tenn. 1987), extended Carlson's "no duty" rationale. In Butcher, the FDIC filed suit against the officers for breach of common law, statutory and contractual duties. Pursuant to statute, the FDIC had performed periodic examinations of the bank. The officers and directors, in an attempt to shift responsibility for the safe operation of the bank to the FDIC, asserted that they relied on the FDIC examinations. The court held that a duty to discover fraud and misconduct within the institution vests solely in the officers and directors, and not in the FDIC as regulator of the institution. The court maintained that it could not impose, nor shift to the FDIC, a duty properly placed on the bank's officers and directors simply because the FDIC insured the bank. The Butcher court noted that the purpose of deposit insurance was to protect the depositors of an institution, not its officers and directors. Therefore, the court held that the FDIC was not liable to the officers and directors for its failure to discover or disclose financial irregularities or fraud in the course of performing statutorily authorized inspections of the institution. The court concluded that the FDIC owed no duty to the former officers and directors incident to its activities as insurer or regulator; that the FDIC does not assume supervisory duties by performing inspections; and that officers and directors are not entitled to rely on FDIC inspections to escape or mitigate their liability for failing to perform their duties.

40. For a discussion of the type of claims which the FDIC asserts against the officers and directors of failed banks, see supra note 36 and accompanying text.


42. For a discussion of the different capacities in which the FDIC acts when resolving a bank failure, see supra notes 20-22 and accompanying text.

43. See Empire Life Ins. Co. v. Valdak Corp., 468 F.2d 330 (5th Cir. 1972). The court in Empire Life stated that the reason the suit must be derivative is because each shareholder "suffer[s] relatively in proportion to the number of shares he own[s] and each [will] be made whole if the corporation obtain[s] compensation or restitution from the wrongdoer." Id. at 335; see also Gaff v. FDIC,
that suits that allege damage to shareholders due to the directors' and officers' depletion of corporate assets are actually claims for damage inflicted upon the corporation, and only indirectly affect the shareholders because the depletion of corporate assets causes the value of their stock to drop.\textsuperscript{44} These causes of action fail to assert any distinct injury to the shareholders as individuals and thus are derivative.\textsuperscript{45} As a result, the shareholders' claims are barred because the shareholders lack standing.\textsuperscript{46} Therefore, the cause of action rightly belongs exclusively to the FDIC as receiver of the failed bank.\textsuperscript{47}

2. The Exceptions

There are three exceptions to the general rule. First, if the shareholder can show that the injury suffered as a result of the directors' and officers' conduct was personal, some courts have allowed the shareholder to maintain a cause of action on his or her own behalf.\textsuperscript{48} Second, the court in Harmsen v. Smith\textsuperscript{49} held, contrary to the overwhelming

\begin{itemize}
\item 44. For a discussion of shareholder claims alleging depletion of corporate assets, see supra note 43 and accompanying text.
\item 45. For a discussion of the reasons why shareholder suits claiming only damage to the value of stock are not deemed to assert injury personal to the shareholders, see supra note 43 and accompanying text.
\item 46. For a discussion of cases in which shareholders failed to allege sufficiently personal injury to sustain a non-derivative claim, see supra note 43 and accompanying text.
\item 47. For a discussion of the FDIC-receiver's rights to all claims of the failed bank, see supra note 43 and accompanying text.
\item 48. See, e.g., Harmsen v. Smith, 542 F.2d 496 (9th Cir. 1976). In Harmsen, the court held that the plaintiff shareholder could maintain a suit in his own name where he could show that the damages suffered were distinctly personal. Harmsen, 542 F.2d at 500. The holding in Harmsen, however, was limited to suits which involved violations of \$93 of title 12 of the United States Code. Id. Section 93 imposes liability on bank directors for damages caused to the bank or its shareholders whenever the directors knowingly violate or allow others to violate the provisions of the federal banking laws. 12 U.S.C. \$93 (1988 & Supp. II 1990). Therefore, presumably, Harmsen's rationale would not always be applicable when there are statutory violations. The Harmsen court's opinion did not address whether this rule would apply to other statutory provisions. Harmsen, 542 F.2d at 500.
\item 49. 542 F.2d 496 (9th Cir. 1976). In Harmsen, plaintiff shareholders filed claims against the directors of an insolvent bank for violations of federal banking and securities laws, as well as a claim for breach of fiduciary duty. Id. at 498.
\end{itemize}
weight of authority, that where fraud or misrepresentation induces reliance, the diminution in the value of a shareholder's stock is a sufficiently personal injury to enable the shareholder to maintain an individual cause of action against the institution's officers and directors.\textsuperscript{50} Similarly, the court in \textit{Zimman v. FDIC}\textsuperscript{51} held that a shareholder may maintain an individual cause of action where the only damage asserted is to the stock price of the corporation, provided that the complaint clearly states on its face that the damage asserted is personal to the shareholder.\textsuperscript{52}

Finally, some commentators advocate that stockholders who can show that they purchased their stock in the now-insolvent bank as a result of fraudulent misrepresentations made by the directors relating to the financial health and stability of the bank should be allowed to maintain an action directly against the directors.\textsuperscript{53} Such a claim of fraud in the inducement is easily distinguishable from those claims that assert

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The FDIC, as receiver, moved to intervene in the case, and asked the court to dismiss the shareholders as plaintiffs. \textit{Id.} The district court granted the FDIC's motion to intervene, but refused to dismiss the shareholders as plaintiffs. \textit{Id.} The defendant directors moved for dismissal of the shareholders' action. \textit{Id.} The district court denied this motion. \textit{Id.} The district court certified the question of whether the shareholders could maintain an action in their own right where the only damage alleged was to the value of their stock. \textit{Id.} The Ninth Circuit Court of Appeals held that damage to the value of the shareholders' stock may be a sufficiently personal injury to sustain a non-derivative action. \textit{Id.} at 498-99.

\textsuperscript{50} \textit{Id.} at 502. The court limited its ruling by explicitly noting that the rule as pronounced would apply only to violations of the National Banking Act by the directors of a national bank, and not to violations of any other part of title 12 of the United States Code. \textit{Id.} at 501. In his dissent, Judge Hufstedtler stated that diminution in the value of stock was not a sufficiently personal injury, and that cases which recognized the exception to the general rule usually involved the sale or purchase of securities or a contract between shareholders, directors, other shareholders or other relevant third parties. \textit{Id.} at 504 (Hufstedtler, J., dissenting).


\textsuperscript{52} \textit{Id.} at 246. As part of a plan under which the FDIC agreed to render financial assistance to First Pennsylvania Bank ("First Pennsy"), the bank granted warrants to purchase First Pennsy stock at a discount off the market price to the FDIC and also to the banks which had participated in the FDIC bailout. \textit{Id.} at 245. The plaintiff shareholder filed suit on behalf of himself and a class of similarly situated shareholders, claiming that the issuance of the warrants without preemptive rights for First Pennsy shareholders would lead to the dilution in the value of their shares in the event that the FDIC exercised the warrants. \textit{Id.} at 245-46. The defendant asserted that the plaintiff could only pursue the suit as a derivative claim. \textit{Id.} at 246. The court stated that the loss of control and dilution of share value in the event of the exercise of the warrants would be a direct personal injury. \textit{Id.} The court asserted that the allegations in the plaintiff's complaint must be viewed in their entirety when determining whether the claims asserted by a shareholder are derivative. \textit{Id.}

\textsuperscript{53} See, e.g., Note, \textit{Right of Defrauded National Bank Stockholder to Rescind}, 45 \textit{Yale L.J.} 942, 943 (1936) (stockholder induced to purchase shares by fraud should have right of action against defrauding officers and directors).
that the directors’ fraudulent or negligent use of bank assets for their own personal benefit contributed to the bank’s failure, thereby damaging the value of the bank’s assets and the shareholder’s stock.\textsuperscript{54}

C. Priority

The FDIC has sought to establish that, even where the shareholders are able to assert direct, non-derivative claims, the FDIC nevertheless possesses a priority to the assets of former directors and officers of failed banking institutions, enabling it to recover ahead of the shareholders.\textsuperscript{55} The FDIC has urged the courts to grant it such a priority on two grounds: first, by an expansive reading of the “incidental powers” language of the Federal Deposit Insurance Act;\textsuperscript{56} second, by creating a rule of priority under federal common law.\textsuperscript{57}

1. Statutory Priority

The FDIC argued in \textit{Jenkins} that the court should judicially grant it a priority over the claims of shareholders under language in the Federal Deposit Insurance Act granting the FDIC all powers incidental to carrying out its express powers.\textsuperscript{58} The court refused to grant a priority on statutory grounds, noting that the FDIC had cited no authority adopting

\textsuperscript{54} Id. (plaintiff shareholder allowed to rescind where induced to purchase securities by fraudulent misrepresentations of officers and directors).

\textsuperscript{55} See, e.g., FDIC v. American Bank Trust Shares, Inc., 558 F.2d 711 (4th Cir. 1977), on remand, 460 F. Supp. 549 (D.S.C. 1978), aff’d, 629 F.2d 951 (4th Cir. 1980). Although the claims asserted by shareholders under § 16(b) of the Securities and Exchange Act of 1934 were not derivative, such claims against officers and directors nonetheless belonged to the FDIC as receiver. 558 F.2d at 716. The court reasoned that the FDIC deserved priority to recover the profits reaped by corporate insiders by virtue of their misconduct, and asserted that the shareholders could only assert their claims when the FDIC failed to do so. Id.

\textsuperscript{56} The FDIC had priority to these claims in its capacity as receiver of the insolvent corporation. \textit{Id.} The court directed that the trial court hear and determine issues raised by the defendants in their counterclaims. \textit{Id.} at 713. On remand, the trial court made no further finding on the question of whether the FDIC had a priority over the shareholders. 460 F. Supp. 549.

\textsuperscript{57} See, e.g., \textit{Jenkins}, 888 F.2d at 1545. The Federal Deposit Insurance Act reads, in pertinent part: “[The FDIC has the power] to exercise by its Board of Directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this chapter, and such incidental powers as shall be necessary to carry out the powers so granted. . . .” 12 U.S.C. § 1819 (Supp. II 1990) (emphasis added).

\textsuperscript{58} See, e.g., \textit{Jenkins}, 888 F.2d at 1545. The FDIC asked the court in \textit{Jenkins} to create this rule under the framework established by the United States Supreme Court in United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). \textit{Jenkins}, 888 F.2d at 1545. The \textit{Jenkins} court refused this invitation. \textit{Id.} at 1546. The court in \textit{Gaff v. FDIC}, 919 F.2d 384 (6th Cir. 1990), however, explicitly adopted the \textit{Kimbell Foods} framework and created a rule of priority in favor of the FDIC. \textit{Id.} at 396. For a discussion of federal common law and the \textit{Kimbell Foods} analysis, see infra notes 70-73 and accompanying text.

\textit{Jenkins}, 888 F.2d at 1543.
such a broad interpretation of the statute.\textsuperscript{59} The statutory argument was not raised as an issue in \textit{Gaff}.

2. \textit{Federal Common Law}

More than fifty years ago, in \textit{Erie Railroad Co. v. Tompkins},\textsuperscript{60} the Supreme Court stated that “there is no federal general common law.”\textsuperscript{61} Shortly thereafter, however, in \textit{Clearfield Trust Co. v. United States},\textsuperscript{62} the Court held that, in the absence of congressional action, the federal courts must assume responsibility for establishing the rules which govern the rights and duties of the federal government.\textsuperscript{63} Since that time, federal common law has developed in certain specialized areas.\textsuperscript{64}

The first question to answer when determining whether to create a rule of federal common law, is whether federal law or state law applies.\textsuperscript{65} When determining whether federal law applies, the court will look to federal statutes and their underlying policies to see if Congress intended to preempt state law.\textsuperscript{66} Where the application of state law would frustrate the policies underlying the federal statute, the court will apply federal law.\textsuperscript{67} Furthermore, where the federal government exercises a power granted to it under the Constitution, state laws may not limit the exercise of that power.\textsuperscript{68}

The second question that a court must address when deciding whether to create a rule of federal common law, is whether to formulate a uniform national rule or to incorporate state law as the federal rule of decision.\textsuperscript{69} The United States Supreme Court adopted a three part test for determining whether or not to create a uniform federal law in \textit{United States v. Kimbell Foods}.\textsuperscript{70} First, the court must consider whether or not

\begin{itemize}
\item \textsuperscript{59} \textit{Id.}
\item \textsuperscript{60} 304 U.S. 64 (1938).
\item \textsuperscript{61} \textit{Id.} at 78.
\item \textsuperscript{62} 318 U.S. 363 (1943).
\item \textsuperscript{63} \textit{Id.}
\item \textsuperscript{64} \textit{Gaff}, 919 F.2d at 391. The \textit{Gaff} court indicated that Congress has federalized many areas of law, and, as a result, a body of federal common law has developed in those areas. \textit{Id.} Among these fields are banking, labor relations, environmental protection and pensions. \textit{Id.}
\item \textsuperscript{65} \textit{Id.} at 387.
\item \textsuperscript{66} \textit{Id.}
\item \textsuperscript{67} D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447, 461-62 (1942); see also Deitrick v. Greaney, 309 U.S. 190, 201 (1940). For a discussion of the application of federal law to questions involving federal deposit insurance, see infra note 108 and accompanying text.
\item \textsuperscript{68} \textit{Clearfield Trust Co. v. United States}, 318 U.S. 363, 366 (1943).
\item \textsuperscript{69} \textit{Gaff}, 919 F.2d at 388.
\item \textsuperscript{70} 440 U.S. 715 (1979). In \textit{Kimbell Foods}, the Court considered the issue of whether contractual liens resulting from loans guaranteed by federal agencies had a priority over private claims in the absence of a federal statute prescribing such a priority. \textit{Id.} at 718. The Supreme Court, although concluding that federal law governed the issue, refused to create a uniform federal rule of decision.
\end{itemize}
the federal interest involved requires the application of a uniform rule of
decision.71 Second, it must ascertain whether application of state law
would interfere with the objectives of the federal programs.72 Third, the
court must inquire into "the extent to which application of a federal
rule would disrupt commercial relationships predicated on state law."73

In conclusion, the FDIC has asserted two arguments in attempting to
defeat the claims advanced by the shareholders of the failed bank
against the bank's former officers and directors. First, that the claims of
the shareholders are derivative in nature and therefore belong to the
FDIC as receiver of the failed bank.74 Second, that FDIC claims against
the assets of the former officers and directors receive a priority over
those of the shareholders, under either statutory law or federal common
law.75

III. Discussion

A. Facts and Procedural History

Both cases that are the focus of this Note involve essentially the
same issue: competing claims between the FDIC and the shareholders
of the bank against the assets of the former officers and directors of a
failed bank.76 These claims arose after the banks had failed and the
FDIC had accepted the appointment as receiver of the banks' estates.77
In both cases, the FDIC chose to employ a purchase and assumption
transaction, whereby FDIC-corporate purchased, among other assets, the
claims and actions of the failed bank.78

Subsequent to the insolvency, shareholders filed claims against the

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71. Id. at 728.
72. Id.
73. Id. at 729.
74. For a discussion of derivative claims and the types of claims which
courts have held to be derivative, see supra note 43 and accompanying text.
75. See, e.g., FDIC v. Jenkins, 888 F.2d 1537 (11th Cir. 1989). For a discussion
of federal common law, see supra notes 60-73 and accompanying text.
76. See Gaff, 919 F.2d at 386; Jenkins, 888 F.2d at 1538.
77. Jenkins, 888 F.2d at 1538. Jenkins involved the failure of a state bank. Id.
Under 12 U.S.C. § 1821(e) (Supp. II 1990), when a state bank fails, the FDIC
must accept the appointment as receiver if it is offered by state banking
authorities. In Jenkins, the Florida Department of Banking and Finance declared
the bank insolvent and offered the appointment to the FDIC. 888 F.2d at 1538. Gaff
involved the failure of a federally chartered bank. 919 F.2d at 385. Pursuant to
12 U.S.C. § 1821, the Comptroller of the Currency declared the bank insolvent
and appointed the FDIC as receiver, which the statute requires. Gaff, 919 F.2d at
385.
78. Gaff, 919 F.2d at 385-86; Jenkins, 888 F.2d at 1538. For a discussion
of the technical aspects of the purchase and assumption transaction, see supra note
22 and accompanying text.
former officers and directors of the failed banks.\textsuperscript{79} The FDIC then filed suits against the former officers and directors, asserting claims for negligence and breach of fiduciary duty.\textsuperscript{80} The FDIC asserted that its claims possessed a priority over those of the shareholders, and sought to enjoin the shareholders from recovering from the assets of the former officers and directors until the FDIC's claims had been satisfied.\textsuperscript{81}

B. Opinion of the Jenkins Court

The Eleventh Circuit Court of Appeals, in evaluating the FDIC's claims to priority, analyzed both arguments asserted by the FDIC. First, the court considered whether the FDIC was statutorily entitled to a priority as the insurer of the bank's deposits.\textsuperscript{82} Second, the court considered whether the FDIC was entitled to a priority under federal common law.\textsuperscript{83} In reversing the district court's holding, the court rejected the FDIC's claim to a priority on both grounds.\textsuperscript{84}

1. Refusal of Priority Based on Statute

The FDIC argued that it required absolute priority for its claims against directors and officers to accomplish most effectively its statutory mandate of replenishing the permanent bank insurance fund.\textsuperscript{85} The court responded, however, by relying on legislative history, and emphasized the position of Representative Glickman during the congressional debate on FIRREA.\textsuperscript{86} Representative Glickman argued that an absolute priority for the FDIC's claims would hinder the prosecution of private lawsuits.\textsuperscript{87}

\textsuperscript{79} See Jenkins, 888 F.2d at 1538. The shareholders in Jenkins alleged violations of securities laws, fraud, civil conspiracy, negligence and civil theft. \textit{Id.}; see also Gaff, 919 F.2d at 386. Gaff shareholders asserted both derivative claims and direct claims under state law. \textit{Gaff}, 919 F.2d at 386.

\textsuperscript{80} Gaff, 919 F.2d at 386; Jenkins, 888 F.2d at 1538. In Jenkins, the FDIC also asserted that the claims brought by the shareholders were derivative. \textit{Jenkins}, 888 F.2d at 1538.

\textsuperscript{81} Jenkins, 888 F.2d at 1539. In Gaff, the FDIC sought dismissal of the shareholder claims on the grounds that the plaintiff had not alleged injury sufficiently personal to maintain a direct cause of action. \textit{Gaff}, 919 F.2d at 386. The district court held for the FDIC on this motion. \textit{Id.} On appeal, the Sixth Circuit considered the issue of priority, holding that the FDIC's claims did indeed have a priority over those of the shareholders. \textit{Id.} at 396.

\textsuperscript{82} Jenkins, 888 F.2d at 1539-44. The court also considered whether the FDIC had absolute priority for claims against solvent \textit{third parties}. \textit{Id.} at 1539-41.

\textsuperscript{83} Id. at 1544. The FDIC asked the court to create a federal common law rule of absolute priority. \textit{Id.}

\textsuperscript{84} Id. at 1546.

\textsuperscript{85} Id. at 1540.

\textsuperscript{86} Id. n.5.

\textsuperscript{87} Id. The court also noted that the FDIC recovered $59 million from bank related defendants in 1987, at a cost to the agency of $54 million. \textit{Id.} at 1540. Furthermore, the court reasoned that, due to governmental/administrative inertia, numerous other suits would be lost due to the expira-
While the court acknowledged the general importance to the public in allowing the FDIC to replenish its permanent insurance fund, it refused to recognize an absolute priority for the FDIC over all claims against a failed bank's directors and officers. The court asserted that the granting of such a priority is more properly the function of Congress.

Although the court opined that the FDIC should take all reasonable measures within its power under the statute, it would not expand that power by judicial fiat. The court considered the specific statutory language of the Federal Deposit Insurance Act which permitted the FDIC to employ "all powers specifically granted by the provisions of this chapter, and such incidental powers as shall be necessary to carry out the powers so granted," and concluded that an absolute priority in favor of the FDIC over all other claims was not within the purview of the statutory language.

2. Refusal of Priority Under Common Law

The court also rejected the FDIC's request for the judicial creation of a priority for agency claims under federal common law. The Eleventh Circuit acknowledged that under general principles of bankruptcy law, the shareholders of a failed corporation were not entitled to recover their losses from corporate assets until all other creditors were satisfied. The court then distinguished the facts in Jenkins by noting that Park Bank's shareholders sought recovery not from corporate assets, but rather from "third-parties" (i.e., Park Bank's former directors and officers) via non-derivative shareholder suits.

88. Id. at 1541 (preservation of permanent insurance fund vital to continued health of national banking system).
89. Id.
90. Id. at n.6.
91. Id. The court, however, did not define nor offer a construction as to what the limits of those powers might be. Id. The question seems particularly relevant considering statutory language which authorizes the FDIC to employ all incidental powers in carrying out its mandate. See 12 U.S.C. § 1819 (Supp. II 1990).
92. Jenkins, 888 F.2d at 1541. The court stated that, because the Federal Deposit Insurance Act contained no mention of an intention to create an absolute priority, it would neither create, nor recognize, an absolute priority. Id.
94. Id. § 1819(a).
95. Jenkins, 888 F.2d at 1543 (FDIC had not cited, nor had court discovered, any case law interpreting statutory language as granting absolute priority).
96. Id. at 1545. The FDIC urged the court to adopt the framework for fashioning federal common law rules of priority laid down by the United States Supreme Court in U.S. v. Kimbell Foods. Id.
97. Id. at 1544-45.
98. Id. at 1545. The court stated that under the 1978 Bankruptcy Code, the
Finally, the court rejected the FDIC's request to fashion a federal common law rule of priority under *Kimbell Foods*. The *Jenkins* court refused to create a federal common law rule of absolute priority in favor of the FDIC because the Federal Deposit Insurance Act does not require the FDIC to pursue claims against the officers and directors in order to replenish the permanent insurance fund. The court went on to state that Congress did not seem to contemplate that such a priority was a necessary tool for the FDIC to wield in restoring the permanent insurance fund. Therefore, the court concluded that it could not properly create such a priority under federal common law. The court concluded that it need not establish a common law rule of priority because the FDIC presented no evidence that such a priority was necessary to effectuate any congressional policy.

C. Opinion of the Gaff Court

The Sixth Circuit Court of Appeals applied a two-step approach in creating a priority in favor of the FDIC. First, the court applied the *Kimbell Foods* analysis to determine whether it should create a rule of federal common law. Second, the court looked to provisions of federal bankruptcy law and FIRREA and concluded that it should establish a rule of priority in favor of the FDIC.

1. Does Federal Common Law Apply?

The court began its analysis by inquiring whether federal law had preempted state law. The court noted that federal law traditionally shareholders may be able to assert their claims against solvent third-parties on an equal footing with the general creditors. *Id.* The court concluded without elaboration that the claims were non-derivative suits. *Id.*

99. *Id.* For a discussion of federal common law and the three part test established by the *Kimbell Foods* decision, see supra notes 60-73 and accompanying text.

100. *Jenkins*, 888 F.2d at 1546.
101. *Id.*
102. *Id.*
103. *Id.* The court indicated that granting the FDIC an absolute priority over claims against third parties, such as officers and directors, would not necessarily be of any value to the FDIC in fulfilling its statutory mission, because the analysis performed by the FDIC in determining whether or not to do a purchase and assumption is done with great speed, and it is not possible to assess the potential value of a lawsuit in that time frame. *Id.* Therefore, the establishment of a priority in favor of the FDIC would not be of any assistance in deciding whether or not to do the purchase and assumption because the potential value of the claims could not be included with the other bank assets. *Id.*

105. *Id.* at 387.
106. *Id.* at 389-91.
107. *Id.* at 387.
applies to cases involving federal deposit insurance.\textsuperscript{108} After noting that federal law consistently applied to the FDIC when acting in its corporate capacity, based on the traditional application of federal law to federal programs which involve the disbursement of funds by the government, the court concluded that federal law applied to the case at hand.\textsuperscript{109}

Having concluded that federal law applied, the court utilized the Kimbell Foods three part test to determine whether to create a uniform federal law or to incorporate state law as the federal rule.\textsuperscript{110} The court asserted that, by its nature, the federal deposit insurance system requires national uniformity.\textsuperscript{111} The court noted that, unlike the agencies involved in Kimbell Foods, the FDIC "has not prepared itself for the application of state law to its transactions."\textsuperscript{112} Furthermore, the FDIC must

\textsuperscript{108} Id. at 387-88.

\textsuperscript{109} Id. Most significantly, the court noted, the Supreme Court applied principles of federal common law in a case involving national bank insurance. Id. at 387 (citing Deitrick v. Greaney, 309 U.S. 190 (1940)). In Deitrick, a bank accepted a promissory note from one of its directors in exchange for shares of its own stock illegally purchased. Deitrick, 309 U.S. at 191-92. The purpose of the transaction was to disguise the exchange and prevent the stock from appearing among the bank's assets. Id. at 195. There was an understanding between the bank and the director that the director was not to repay the note. Id. at 192. The bank became insolvent, and the receiver brought suit against the director for an assessment on his shares of stock and for recovery on the sham note. Id.

The Court allowed the receiver to recover based on the policies underlying the National Bank Act. Id. at 201. The Court has subsequently permitted bank receivers to rely solely on written bank records, stating that noteholders could not assert defenses under state law which did not appear on the face of their notes. See D'Oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942). The Court based this decision on policy grounds. Id. at 461-62. The Court asserted that to allow secret agreements as defenses to the enforcement of otherwise valid notes would defeat the federal policy of protecting the stability of the banking system. Id.

These decisions led the Court to conclude that "[w]hen the United States disburses its funds or pays its debts, it is exercising a constitutional function or power." Clearfield Trust Co. v. United States, 318 U.S. 363, 366 (1943). The Court noted that these powers are in no way dependent upon the laws of the states. Id. Federal courts have repeatedly applied federal law to the FDIC when acting in its corporate capacity. See, e.g., Trigo v. FDIC, 847 F.2d 1499, 1502 (11th Cir. 1988) (when acting in corporate capacity, rights and obligations of FDIC are governed by federal law, not state law); Gunter v. Hutcheson, 674 F.2d 862, 869 (11th Cir. 1982) (federal law always applies to FDIC when acting in its corporate capacity).

\textsuperscript{110} Gaff, 919 F.2d at 388. For a discussion of the Kimbell Foods three part test, see supra notes 70-73 and accompanying text.

\textsuperscript{111} Gaff, 919 F.2d at 388-89.

\textsuperscript{112} Id. at 389. In Kimbell Foods, the Court noted that the Small Business Administration (SBA) individually negotiated each transaction in which it was involved, carefully following state law when entering into these transactions. Kimbell Foods, 440 U.S. at 730. Indeed, the SBA Manual reflected the agency's assumption that its operations were governed by state law. Id. at 730-31. Moreover, employees in the local SBA offices were said to be well versed in state law. Id. at 732.
act quickly in deciding how to proceed when a bank fails. The court reasoned that subjecting the FDIC to state law defenses would hinder the agency's ability to choose between a purchase and assumption transaction and other methods of handling bank failures.

Next, the court noted that the application of state law would prevent the FDIC from accomplishing the objectives of the deposit insurance program. The court found that, without a priority over the claims of the shareholders, the agency would be unable to protect the strength of the banking system.

Turning to the third and final part of the Kimbell Foods test, the court concluded that the creation of a uniform federal rule would not interfere with established state commercial relationships. The court reasoned that the shareholders' potential claims against the officers and directors are not the primary commercial expectations created by a bank. Finally, the court maintained that because shareholders' direct actions are difficult to establish against former officers and directors, any such potential claims are not "settled commercial practices."

The court also looked to three provisions in the recently enacted FIRREA for support for the establishment of a federal rule of law. First, the court noted a provision vesting in the FDIC "all rights, titles, powers, and privileges of the . . . institution, and of any stockholder . . . with respect to the institution and the assets of the institution . . . ." Because suits against directors and officers for bad management involve the assets of the bank, any recovery which the FDIC obtains above the amount that it paid for the bad assets of the failed bank, goes to the receiver for ultimate distribution to bank creditors and shareholders. Any amount recovered by the FDIC, therefore, increases the possibility that the creditors and shareholders will receive some of their money

113. Gaff, 919 F.2d at 389.
114. Id.
115. Id.
116. Id. The court concluded that interfering with the FDIC's decision regarding how to handle a bank failure would frustrate the effectiveness of the deposit insurance system. Id.
117. Id.
118. Id. The primary expectations involve deposits and loans made, the court asserted. Id. Furthermore, the court pointed out that the possibility of bank failure does not really play a significant part in the parties' commercial expectations. Id. (citing FDIC v. Bank of Boulder, 911 F.2d 1466, 1476 (10th Cir. 1990)).
119. Id. at 390. Were these claims settled commercial practices, state law would apply. Id.
120. Id.
122. Id.
back. Such cases are covered by federal law.

Second, the court also found support for its conclusions in the FIRREA provision which states that, upon payment of insurance proceeds to a depositor, the FDIC is subrogated to the rights of that depositor "[n]otwithstanding any other provisions of Federal law, the law of any State, or the constitution of any State . . . ." The court asserted that this provision, which was not in the previous law, is evidence of Congress's intent to preempt state law by "occupying the field of national bank insurance."

Finally, the court pointed to a third FIRREA provision as evidence of Congress's apparent intent to nationalize the law of officers' and directors' liability. The court concluded that Congress intended federal law to govern the FDIC's right to pursue actions and state law only to define the standard of care. Since a shareholder's claim may interfere with the FDIC's pursuit of recovery, and because Congress has demonstrated its intent that federal law control the FDIC's pursuit of recovery, the court concluded that federal law must therefore also govern the shareholder's direct action.

After applying the Kimbell Foods three part test, the court concluded that the situation required the formation of a uniform federal law. The court next confronted the issue of what that uniform law should be.

2. What Is the Substance of the Federal Law?

The court asserted that two sources of law point to a priority in favor of the FDIC: first, bankruptcy law and second, FIRREA.

Bankruptcy law recognizes a distinction between shareholders and creditors. Because shareholders share in the profits of the corporation, equity requires that they bear the primary risk that the corporation will fail. Conversely, because creditors do not share in corporate profits, equity requires that their claims take priority over the claims of shareholders. The court found that depositors, who do not share in the bank's profits, were similar to creditors. Accordingly, the court reasoned that the principles underlying bankruptcy law support the posi-

123. Id.
124. Id.
125. Id. (quoting 12 U.S.C. § 1821(g) (Supp. II 1990)).
126. Id. at 391.
127. Id.
128. Id.
129. Id.
130. Id.
131. Id.
132. Id.
133. Id. at 392.
134. Id.
tion that the bank’s shareholders, and not its depositors, assume the primary economic risk for the failure of the bank. The court then concluded that allowing the shareholders to recover ahead of, or on a parity with, the FDIC, would have the effect of creating an unfair priority in favor of the shareholders. The court also found support for its position in the provisions in the Bankruptcy Code dealing with shareholder rescission claims, under which claims by investors seeking rescission of their investment from a bankrupt corporation share not with other creditors, but are subordinated along with all other shareholders.

The court concluded that the officers’ and directors’ actions harmed not only the shareholders but the bank’s creditors and depositors as well. Because federal law applied, the court decided that it would be appropriate to incorporate the prioritization policies of the bankruptcy law.

The court also relied on provisions of FIRREA to justify its establishment of a rule of priority for the FDIC. As previously noted, FIRREA expanded the subrogation rights of the FDIC. The court reasoned that, because the depositors have rights superior to those of the shareholders, and because, pursuant to FIRREA, the FDIC succeeds to the depositors’ rights, then the FDIC too must enjoy such a priority.

IV. Analysis

A. Statutory Authority of the FDIC

The Jenkins court’s reasoning, which relies on the legislative history of FIRREA is far from convincing. The court divined congressional intent in the enactment of FIRREA from the remarks of a single con-

135. Id.
136. Id. The court reasoned that this conclusion is comparable to the bankruptcy doctrine of equitable subordination, under which the court may evaluate all circumstances surrounding a claim and subordinate it where fairness so requires. Id. at 992-93. The court stated that in an action against the officers and directors, the question of who has a priority to their assets depends on who was hurt more by their conduct, the corporation or the shareholder. Id. at 993. Where the shareholder asserts an injury suffered not only personally, but by all creditors and stockholders similarly, then the trustee must have a priority. Id.
137. Id. (citing 11 U.S.C. § 510(b) (1988)).
138. Id. at 394.
139. Id.
140. For a discussion of these expanded subrogation rights, see supra notes 126-27 and accompanying text. 141. Gaff, 919 F.2d at 394.
142. For a discussion of the Jenkins court’s interpretation of, and reliance on, the legislative history of FIRREA, see supra notes 86-87 and accompanying text.
gressman. Though the final version of the Act did not include a priority in favor of the FDIC, this fact does not convey an overwhelming congressional intent permanently to bar the FDIC from obtaining an absolute priority ahead of claims asserted by shareholders. Nonetheless, the court regarded this aspect of the legislative history to be highly probative of congressional intent.

By contrast, the Gaff court noted that the legislative history's failure to disclose why the FDIC was not granted a priority explicitly by FIRREA, indicates that Congress most likely intended the courts to decide the issue on a case-by-case basis. Rather than rely on legislative history as a guide to uncovering congressional intent, however, the Gaff court interpreted Congress's intent by relying on the provisions of the statute itself. While one may argue with the Gaff court's conclusion, its approach to interpreting congressional intent seems superior. The words of the statute are clear and thus, there is no reason to resort to legislative history to interpret Congress's intent.

B. Priority Under Common Law

1. Application of Bankruptcy Law Principles

In Jenkins, the court concluded that bankruptcy principles of priority were not applicable because the shareholders sought recovery not from

143. Jenkins, 888 F.2d at 1538 n.1.
144. Id.
145. Gaff, 919 F.2d at 396. The court endeavored to distinguish Jenkins from Gaff, noting that it was not clear whether the injuries claimed by the shareholders in Jenkins affected them as individuals, or damaged the corporation generally. Id. Furthermore, the court intimated that because the bank involved in Jenkins was a state chartered bank and not a national bank, the policy considerations for applying federal law differed from those in the Gaff case. Id.

It is not clear why the policy considerations in Gaff are any different from those in Jenkins simply because in Jenkins the bank was a state bank. The FDIC is required by law to accept the appointment as receiver of a state bank if offered. 12 U.S.C. § 1821(e) (Supp. II 1990). Furthermore, the FDIC carries out its functions no differently when a state bank is involved. The FDIC operates as a federal agency disbursing federal funds when dealing with a failed state bank, so seemingly the same considerations supporting the creation of a rule of priority under federal common law would apply. The Gaff court further stated that the court in Jenkins, by refusing to expand the express powers granted to the FDIC by statute, may have given too little weight to "the large body of federal common law that accords the FDIC many rights that exceed the specific grants of power in the Federal Deposit Insurance Act and subsequent amendments." Gaff, 919 F.2d at 396.

146. For a discussion of the Gaff court's analysis of FIRREA and its conclusion that in enacting the statute Congress intended to preempt state law, see supra notes 107-09 and accompanying text. For a discussion of the Gaff court's conclusion that the policies behind FIRREA support the establishment of a uniform federal rule of priority in favor of the FDIC, see supra notes 120-31 and accompanying text.

147. For a discussion of the Gaff court's interpretation of the provisions of FIRREA, see supra notes 120-31 and accompanying text.
the corporate assets, but rather, from the assets of "solvent third parties."148 While this distinction is technically accurate,149 such a characterization is somewhat disingenuous, for the so-called "solvent third parties" are the former officers and directors of the bank.150 Such "solvent third parties" are the individuals who, either through negligence or theft, caused the bank's insolvency and often personally benefitted from their improper conduct.151 Thus, these "third parties" caused the bank to descend into insolvency at great expense not only to the bank's shareholders, but also to the FDIC and thus the general public as well.

As the Gaff court pointed out, stockholders take last in the event of a dissolution because they share in the profits of the corporation and therefore must bear the greatest risk of failure.152 The Gaff court concluded that there is no reason to alter this rule when recovery is sought against the personal assets of the former officers and directors.153 The court in Gaff concluded that these bankruptcy law principles could be used to create a priority for the FDIC as a rule of federal common law.154

The Gaff court's reasoning is supported by prior cases that have barred the assertion of contributory negligence by former directors and officers as an affirmative defense in suits brought by the FDIC. These cases reason that the directors and officers, and not the public, should bear the cost of the FDIC's errors in judgment as receiver of the failed institution.155 That is, the public should not bear the entire cost of bailing out institutions which failed because of the directors' and officers' improper conduct, if complete or partial recovery can be obtained from solvent former directors and officers. Similarly, the court should not compel the public to bear the loss to the permanent insurance fund which will most assuredly result if the bank's shareholders are entitled to maintain claims in addition to those asserted by the FDIC and to share equally in any recovery from the former directors and officers of the failed bank.

148. Jenkins, 888 F.2d at 1545.
149. Id. at 1538 (shareholder suits were filed against former officers and directors of failed bank, in addition to other related defendants, as opposed to corporate entity known as Park Bank).
150. Id. at 1545.
151. For a discussion of the claims asserted against the former officers and directors of Park Bank, see supra note 80 and accompanying text.
152. Gaff, 919 F.2d at 392.
153. Id. For a discussion of the Gaff court's analysis of the applicability of bankruptcy principles to suits against solvent third parties, see supra notes 135-39 and accompanying text.
154. For a discussion of the applicability of bankruptcy law to creating a rule of priority under federal common law, see supra notes 133-39 and accompanying text.
155. For a discussion of cases which have argued that the alleged wrongdoers, and not the public, should bear the cost of FDIC errors in judgment, see supra note 39.
2. Application of Kimbell Foods

The Jenkins court refused to employ the Kimbell Foods framework to create a federal common law rule, asserting that the Federal Deposit Insurance Act does not compel the FDIC to seek recovery against third parties such as officers and directors. The court reasoned that the request for such a priority was not grounded in any definable congressional policy. The Gaff court, by comparison, found a clear congressional policy of promoting stability in the banking system. The court stated that without this priority, the FDIC would be hindered in determining the best way to handle a bank failure, and thus would not be able to protect the stability of the banking system. This conclusion is in sharp contrast to the Jenkins court’s assertion that a priority over the claims of shareholders would be of no value to the FDIC in determining whether or not to pursue a purchase and assumption transaction.

The Gaff court recognized that the failure to create a priority in favor of the FDIC would have the practical effect of unfairly benefitting the shareholders by essentially subsidizing their equity investment. The Jenkins court, in its discussion of the federal common law issue, failed to consider this problem. Shareholders share in the profits of the corporation, and therefore must bear the primary burden in the event of failure. Those who make equity investments must expect that their investments may become worthless in the event of dissolution. Federal bankruptcy law explicitly acknowledges this state of facts. A court should not give a failed corporation’s shareholders the opportunity to mitigate their business losses, the risks of which were inherent in the nature of their investments, by allowing them to share equally with the FDIC in any recovery against the former officers and directors. Because the officers and directors possess only limited assets, any recovery by the shareholders must necessarily reduce the size of any recovery by the FDIC, thus hindering the agency’s ability to replenish the deposit insurance fund. The shareholders’ recovery thus comes at the expense of the FDIC.

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156. Jenkins, 888 F.2d at 1546.
157. Id.
158. Gaff, 919 F.2d at 391. For a discussion of the Gaff court’s analysis of the policies supporting a priority in favor of the FDIC, see supra notes 133-39 and accompanying text.
159. Gaff, 919 F.2d at 391-96.
160. For a discussion of the Jenkins court’s contention that a priority in favor of the FDIC over the shareholders of the failed bank would be of no value to the FDIC, see supra note 103 and accompanying text.
161. Gaff, 919 F.2d at 392. For a discussion of the Gaff court’s analysis of bankruptcy law provisions which subordinate the claims of shareholders and the policies underlying these provisions, see supra notes 133-39 and accompanying text.
162. Jenkins, 888 F.2d at 1545-46.
163. For a discussion of the treatment of shareholder claims under federal bankruptcy law, see supra notes 133-39 and accompanying text.
of the insurance fund, and ultimately the taxpaying public. Courts should not follow a policy of forcing the taxpayers to reimburse shareholders for their investment losses.

C. The Jenkins Court’s Finding That the Shareholder Claims Were Non-Derivative

The Jenkins court’s finding that the shareholders had asserted non-derivative claims is curious upon closer analysis. The court did not make any finding of a distinctive personal harm to any of the plaintiff shareholders. In order to assert a cognizable claim under general principles of corporation law, a plaintiff shareholder must claim damage to his personal interests, and not merely assert damage to the assets or stock value of the corporation. Diminution in the value of the shareholders’ stock due to the wrongful actions of directors or officers is insufficient to amount to personal harm, for it is considered to constitute a wrong committed upon the corporation as an entity, and not the shareholder individually.

The shareholder plaintiffs in Jenkins asserted claims for securities fraud, common law fraud, conspiracy, negligence and civil theft. In seeking the declaratory judgment, the FDIC specifically excluded the securities fraud claims from its assertion that the shareholders claims were derivative and therefore invalid. On their face, the remaining claims do not establish any damage to the shareholders which is distinct from that suffered by the corporation. Unless the shareholders claim “fraud in the inducement,” or allege the breach of a fiduciary duty by the former directors and officers which was directly owed to the shareholders separate from that owed to the bank, the claims which they asserted do not establish any sufficiently personal harm to permit the maintenance of a non-derivative action. Without a more extensive analysis of the claims advanced by the shareholders, the Jenkins court’s conclusion that

164. Jenkins, 888 F.2d at 1545. The court concluded, without analysis, that the claims were not derivative and were therefore permissible. Id.
165. For a discussion of when a shareholder plaintiff may maintain a non-derivative cause of action, see supra notes 48-54 and accompanying text.
166. For a discussion of the circumstances under which the claims of shareholder plaintiffs are deemed to be derivative, see supra notes 45-47 and accompanying text.
167. For a discussion of cases considering the question of whether damage to the stock or assets of a corporation constitutes an injury sufficiently personal to the shareholders so as to enable them to maintain non-derivative causes of action, see supra note 43 and accompanying text.
168. Jenkins, 888 F.2d at 1538. For a discussion of the claims asserted by the shareholder plaintiffs in Jenkins, see supra note 79 and accompanying text.
169. The FDIC did not seek a judgment that the securities claims were derivative under Florida and federal law. Id. at 1538. The court concluded that the claims were actionable non-derivative claims asserted against solvent third parties. Id. at 1545.
the shareholder suits were non-derivative, and, therefore permissible, was not appropriate.

V. Conclusion

The courts in Jenkins and Gaff reached completely different conclusions on the same issue when confronted with almost the same factual scenario. These conclusions reflect the courts' differing attitudes towards the concept of federal common law and the role of the federal courts in making law. While the Gaff court was obviously willing to take action in order to fill in a gap left by Congress, the Jenkins court seemed far more willing to wait until Congress acted. The result is also somewhat reflective of varied approaches toward statutory interpretation. While the Eleventh Circuit found the legislative history of FIRREA to conclusively indicate Congress's intent that the FDIC not have a priority over the shareholders, the Sixth Circuit did not see such a clear indication, and in fact found in the statute itself indications of a congressional policy favoring the establishment of just such a priority. Such confusion can only make less certain the already unstable field of federal deposit insurance. The end result of these differing approaches to the issue is that the Jenkins court, but not the Gaff court, succeeded in shifting the burden of paying for the officers' and directors' negligent conduct from those best able to protect themselves from such conduct, the shareholders, to those who are completely unable to protect themselves, the tax-paying public.

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