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FDIC Priority in Gaff: An Unwarranted Victory for the Principle of Brotherly Shove

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NOTE

FDIC Priority in *Gaff*: An Unwarranted Victory for the Principle of Brotherly Shove

When banks went out of business during the Depression, lines formed. More than sixty years later, as American society reacquaints itself with the term "bank failure," lines are forming once again.

This time, however, the lines do not consist of scared depositors of little means waiting outside the bank's front door for a chance to withdraw their money. Today's lines consist of creditors and big-money customers who are standing in line at the courthouse door for a chance to sue the people who ran the bank.

The chief plaintiff in these lines is the Federal Deposit Insurance Corporation (FDIC). The FDIC is best known to the banking public as the federal agency that insures deposits up to $100,000.[1] But with the litany of failures that have plagued United States financial institutions in recent years, another FDIC duty has become increasingly noticed—that of receiver of the broke bank.[2]

In recent cases, the FDIC, as receiver, has put a new coat of paint on an old argument—that when plaintiffs line up against the failed bank's management, the FDIC should be free to push its way to the head of the line. The Agency has contended that courts should place FDIC claims against a bank's officers and directors ahead of those filed by all other parties—even claims brought solely on behalf of the shareholders and depositors as individuals. Most federal courts have refused to grant such a priority. The Sixth Circuit, however, recently broke with this approach and sided with the FDIC, creating a split in the federal appellate courts.

This note will explore the ramifications of this split. Section A will explain the broad powers already available to the FDIC as receiver of

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1. 12 U.S.C. § 1821(a)(1)(B) (1988).

2. 12 U.S.C. § 1821(c)(2)(A)(ii) (1988) provides that "[t]he Corporation [FDIC] shall be appointed receiver, and shall accept such appointment, whenever a receiver is appointed for the purpose of liquidation or winding up the affairs of an insured Federal depository institution or District bank by the appropriate Federal banking agency. . . ."

When the FDIC acts as a receiver, its function is similar to that of a receiver appointed to take over a failing business corporation. A "receiver" has been adequately defined as a custodian of assets that are involved in litigation, who is the managing agent of property for the benefit of parties. Black's Law Dictionary 1268 (West 6th ed. 1990).

a failed bank, and the basis for the FDIC's contention that those powers require depositors and shareholders to stand aside. Section B will discuss the legal basis for the FDIC's argument that its claims are entitled to priority. Sections C through F will explain the less-than-convincing way in which the Sixth Circuit attempted to distinguish conflicting jurisprudence and how it ignored congressional intent and previous jurisprudence in recognizing an FDIC priority. Finally, Section G will argue that the Sixth Circuit's recognition of an FDIC priority goes beyond the Agency's congressionally created powers and that the court's reasoning is an aberration that future courts should be reluctant to follow.

A. *FDIC as Receiver: "We're From the Government, and We're Here to Help"*

There are three situations in which the FDIC may become the receiver of a troubled bank. First, if the FDIC liquidates a federally insured national bank, federal law requires that the appropriate federal banking agency appoint the FDIC as receiver.[3] Second, the FDIC may accept an appointment as receiver of a federally insured state bank when the supervising state agency makes the appointment.[4] Third, the FDIC may appoint itself as receiver,[5] although the requirements for this are more complex. To appoint itself, the FDIC must determine that a receiver already has been appointed, that the bank has been in receivership for at least fifteen consecutive days, and that one or more depositors is unable to withdraw any amount of an insured deposit or that state officials have closed the bank pursuant to state law.[6] The FDIC also must conclude that one or more of eight reasons for appointment existed when the proper authority appointed the receiver or closed the bank, or that any of the eight reasons existed any time during the receiver's appointment or while the bank was closed.

The reasons most likely to apply to failed banks are: the bank has more liabilities than assets (balance-sheet insolvency), the bank likely will be unable to meet its depositors' demands or pay its obligations in the normal course of business (cash-flow insolvency), or the bank has incurred, or is likely to incur, losses that will deplete all, or substantially all, of its capital, with no reasonable prospect for replenishment with federal assistance.[7]

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3. 12 U.S.C. § 1821(c)(2)(A)(ii) (1988).

4. 12 U.S.C. § 1821(c)(3)(A) (1988). The basic difference between a state bank and a national bank is that a state bank receives its charter according to applicable state law, while a national bank is chartered under the National Bank Act (12 U.S.C. §§ 21-216 (1988)).

5. 12 U.S.C. § 1821(c)(4) (1988).

6. *Id.*

7. 12 U.S.C. § 1821(c)(5) (1988).

Once the FDIC becomes a receiver, it has several options. It can take over the bank and operate it with all powers of a private operator until a buyer is found.[8] It can merge the bank into another institution.[9] It can liquidate the bank and put it out of business.[10] Generally, the Agency as receiver has the power to take any action that is necessary to return the bank to a sound and solvent condition.[11] When the FDIC acts as receiver, it is not subject to the direction or supervision of any other government agency, state or federal, except an appropriate federal banking agency.[12]

In addition to this pervasive power, there are two more important sources of FDIC authority that lie at the heart of the present split in the federal appellate courts. Once the FDIC pays a depositor in connection with any bank it insures or assumes any of the bank's deposits, the Agency becomes subrogated to all rights of the depositor against the bank to the extent of the payment or assumption.[13] The FDIC also succeeds to all rights, titles, powers and privileges of the bank "and of any stockholder, member, accountholder, depositor, officer or director. . . ."[14]

B. *FDIC's Role for Other Plaintiffs: "Get Thee Behind Me"*

The FDIC has used these provisions to fashion an argument that is appealing in its simplicity: If the FDIC is subrogated to *all rights of the depositor* and succeeds to *all rights of any shareholder* against the bank, any claim a shareholder or depositor has against the bank's management must stand behind the FDIC's similar claims. The FDIC has argued that the policy of the statute—to ensure a strong national banking system—strongly supports a general priority in favor of the FDIC on *all* personal claims against the failed bank's management. In its simplest terms, the FDIC believes that all plaintiffs must stand aside until the FDIC refills its cash drawer.

This issue is of vital importance to shareholders and big-money depositors of failed banks. When a bank goes under, there is little chance that the bank's assets will fully compensate these parties. As a result, aggrieved investors and depositors logically target the bank's officers and directors. This is especially true where there is a connection between the bank's failure and instances of fraud, mismanagement, or breach of fiduciary duty by officers and directors.

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8. 12 U.S.C. § 1821(d)(2)(B) (1988).
9. 12 U.S.C. § 1821(d)(2)(G) (1988).
10. 12 U.S.C. § 1821(d)(2)(E) (1988).
11. 12 U.S.C. § 1821(d)(2)(D) (1988).
12. 12 U.S.C. § 1821(c)(2)(C)-(D) (1988).
13. 12 U.S.C. § 1821(g)(1) (1988).
14. 12 U.S.C. § 1821(d)(2)(A)(i) (1988).

In the recent parade of financial institution failures, federal regulators found pervasive internal mismanagement and self-dealing. A 1989 United States government General Accounting Office (GAO) study of bank and savings and loan failures found that fraud and insider abuse existed in every instance of savings and loan failure.[15] A similar GAO study of banks revealed that sixty-four percent of failed banks experienced instances of insider abuse.[16] Actual insider fraud was present in thirty-eight percent of the failed banks.[17] Most pointed was this GAO conclusion: The thing that most often separated financial institutions that failed from those that were healthy was that healthy institutions lacked significant insider abuse and fraud.[18]

Against this background of rampant fraud and insider abuse in failed banks, it is hardly surprising that angry investors and depositors take aim at the failed bank's management. But if the FDIC is correct in asserting that all claims, even those brought on behalf of the depositors and shareholders as individuals, must yield to the FDIC, the consequences are serious for aggrieved investors. Unless the officers and directors are extremely wealthy, and unless they have assets that litigants easily can reach, after the FDIC is finished, the investors and depositors may find nothing left but the bleached bones of a financial skeleton. This is so because the causes of action investors often invoke against the bank's managers are the same ones the FDIC uses—negligence, breach of fiduciary duty, breach of contract (express or implied), common-law fraud and the Racketeer Influenced and Corrupt Organizations Act (RICO).[19] RICO is an especially tempting action for any plaintiff who pursues a fraud-based action against bank officers and directors because a successful claim can bring treble damages and attorney's fees.[20]

C. Gaff v. FDIC: *Where the Trouble Begins*

Most recently, the FDIC's claim of priority reached the appellate court level in *Gaff v. Federal Deposit Insurance Corp.*[21] In *Gaff*, the FDIC took over National Bank & Trust Co. of Traverse City, Michigan when the bank went insolvent. The FDIC, as receiver, sold the bank's

15. *Examination and Supervision of Depository Institutions: Hearing Before the House Comm. on Banking, Finance, and Urban Affairs*, 101st Cong., 1st Sess. (Jan. 13, 1989), noted in Renae V. Stevens, Note, *Insider Abuse and Criminal Misconduct in Financial Institutions: A Crisis?*, 64 Notre Dame L. Rev. 222, 227 (1989).

16. *Id.* at 228.

17. *Id.*

18. *Id.*

19. Carol Galbraith & Joseph Seidel, *FDIC vs. Imprudent Banking Officials: The Enforcement Apparatus*, 104 Banking L.J. 92, 122 (1987).

20. 18 U.S.C. § 1964(c) (1984).

21. 919 F.2d 384 (6th Cir. 1990).

questionable and non-performing assets to itself (the FDIC) in its corporate capacity. These assets included the right to sue the bank's former officers and directors for fraud and mismanagement.

However, the FDIC was not the first plaintiff to sue the officers and directors. Before the bank went under, a bank stockholder filed suit against the former officers and directors, asserting state law derivative and direct actions.[22] Once the FDIC took over the bank as receiver, it intervened in the stockholder's suit and removed the case to federal court. A federal district judge then stopped the plaintiff-shareholder from proceeding in his derivative action until the court resolved the FDIC's claims.

The FDIC went further. It argued that the court also should prevent the plaintiff from prosecuting claims he asserted on behalf of himself and other shareholders, until the court disposed of the FDIC's own actions against the officers and directors. The court sided with the FDIC, holding that the agency's claims must have priority over those of shareholders or depositors. The court reasoned that under 12 U.S.C. § 1821(g), when the FDIC sues officers and directors, it sues not only on behalf of a bank; it also sues on behalf of the bank's depositors. This status, the court said, creates a priority. The court said that it is undisputed that a bank's depositors have rights that are superior to those of the bank's stockholders. Because the FDIC succeeds to the depositors' rights, the court said, the FDIC is entitled to this same priority.[23]

The court also noted that if the officers and directors had any money left over after the FDIC collected, the plaintiff-shareholder could proceed with his action. The court analogized the FDIC's priority to principles of the Federal Bankruptcy Code,[24] which puts corporate shareholders last in line behind other creditors.[25]

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22. The plaintiff brought the derivative actions on behalf of the bank corporation. He filed the direct suit as a class action on behalf of himself and other stockholders. *Id.* at 386.

There is, of course, a basic difference between derivative and direct actions. A shareholder files a derivative action to collect damages on behalf of the corporation in which he owns stock. A shareholder who files a direct action seeks to collect damages for injuries personally suffered. The corporation collects any damages won in a derivative action, while it is not entitled to any part of a shareholder's recovery on a direct claim.

23. *Gaff*, 919 F.2d at 394.

24. The court specifically referred to 11 U.S.C. § 510(b), which says, in relevant part:

> [A] claim arising from rescission of a purchase or sale of a security of the debtor or of an affiliate of the debtor, for damages arising from the purchase or sale of such a security . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security, except that if such security is common stock, such claim has the same priority

The Sixth Circuit's analysis in *Gaff*, however, is at odds with the Eleventh Circuit's analysis. In *Federal Deposit Insurance Corp. v. Jenkins*,[26] the court held that the FDIC has no such priority over the individual claims of the bank's shareholders.

The facts of *Jenkins* are similar to *Gaff*. In *Jenkins*, the Florida Department of Banking and Finance declared a state-chartered bank insolvent and appointed the FDIC as receiver. As in *Gaff*, the FDIC, as receiver, sold certain assets to itself in its corporate capacity. After the insolvency, several bank shareholders filed lawsuits based on Florida securities law, common-law fraud, civil conspiracy, negligence, civil theft, and RICO against the bank's officers and directors.

The FDIC then brought an action against the shareholders, seeking a declaratory judgment that all shareholder claims, except those based on federal and state securities law, were derivative actions and thus the FDIC's property. The FDIC also sought a declaratory judgment that its actions against the officers and directors should have priority over the shareholders' similar claims.

The FDIC argued that in a purchase and assumption transaction (where the FDIC arranges a sale of the insolvent bank's assets to a solvent bank), the FDIC needs an absolute priority in suits against third parties. This priority, the FDIC contended, would assist the Agency in replacing money paid out of the permanent insurance fund. The court agreed that ensuring the integrity of the permanent insurance fund is important to achieving the goal of a sound national banking system. However, the court declined to grant the FDIC an absolute priority for a very simple reason—the FDIC's authorizing legislation does not provide for it.[27]

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as common stock.

Gaff, 919 F.2d at 394.

25. The court observed: "Because this case must be decided under federal law, this national policy of priorities imported from bankruptcy law will be pursued, not state law policies that might be to the contrary." *Gaff*, 919 F.2d at 394.

It should be noted that the FDIC and the bank's shareholders eventually settled their dispute. In an effort to assist this settlement, the Sixth Circuit modified its original opinion to include this additional rule: Where a settlement would be assisted by prior adjudication of the legal sufficiency of shareholder claims, the district court may lift the stay on prosecution of shareholder claims and determine their sufficiency. However, this modification did nothing to alter the Sixth Circuit's previous recognition of a priority for the FDIC and the stay on shareholder claims that it says must occur when the FDIC sues the bank's officers and directors. *See* Gaff v. FDIC, 933 F.2d 400 (6th Cir. 1991).

26. 888 F.2d 1537 (11th Cir. 1989).

27. The court said:

> While we do not necessarily disagree with the policy considerations advanced by the district court, we note that as the Federal Deposit Insurance Act indicates no such priority, a decision to give the FDIC such a priority is more properly

The court also declined an FDIC request to recognize a common-law priority for the FDIC as a general creditor. As in *Gaff*, the court considered an analogy to federal bankruptcy law, which subordinates the claims of stockholders to those of general creditors. The court found this analogy unconvincing because the shareholders in *Jenkins* were trying to collect against solvent third parties in a non-derivative suit, unlike a creditor in bankruptcy, which proceeds against the bankrupt party (in this case, the failed bank). The *Jenkins* court's analysis recognizes a vital distinction—the difference between a shareholder who files a derivative claim and one who files a direct claim against the officers and directors of the bankrupt corporation for injuries personal to the shareholder.

There is little argument that a corporation's general creditors should stand ahead of the stockholder who is trying to recover corporate assets. The shareholder's role is that of risk-taker. He provides capital. In exchange, he anticipates a larger return on his investment than someone who merely lends money to the corporation. The general creditor, who has a limited return on his investment, expects greater security and a priority claim on corporate assets. This arrangement ultimately works to the shareholder's advantage, since it lowers the cost of borrowing money and thus increases the corporation's chances of making a profit.

This justification for general creditor priority vanishes when the lawsuit is a personal action against the corporation's officers and directors. The lack of priority is a natural result of the separate nature of the corporation and the individuals who run it. Creditors have long recognized this. It is for this reason that creditors of closely-held corporations usually require that officers and directors sign personal guaranties before the creditors will lend money to the corporation.

As a result, the FDIC's analogy to bankruptcy law does not withstand logical scrutiny. Without a personal guaranty, a bankrupt corporation's general creditors have no priority over the shareholders on a claim against the corporation's officers and directors that alleges injuries personal to the shareholder. The general creditor's priority should apply only where corporate assets are involved—when, for instance, suit is filed on behalf of the corporation against the officers and directors. When a bank's depositors and shareholders sue the officers and directors in their individual capacity to collect for injuries that are personal to the depositors and shareholders, they are not seeking assets of the failed bank.

> within the domain of Congress. We decline the FDIC's invitation to act on arguments based on equity or on "implicit" powers.

Id. at 1541 n.6.

D. *Reconciling* Gaff *and* Jenkins: *A Distinction Without a Difference*

The Eleventh Circuit and the Sixth Circuit obviously have taken different approaches to the question of FDIC priority. Since *Jenkins* was the first case on this subject, the Sixth Circuit was forced to reconcile its holding with the Eleventh Circuit's approach. The Sixth Circuit found that *Jenkins* was not controlling for two reasons. The stockholders in *Jenkins* asserted causes of action granted by statute, namely state and federal securities laws. The court found the *Jenkins* opinion unclear on whether the stockholders claimed fraud-based injuries that were distinctly theirs or injuries which affected the corporation generally. The court also found *Jenkins* not controlling because the failed bank in *Jenkins* was a state-chartered bank, which the court said may involve different policy reasons for applying federal law.

These distinctions, however, are unconvincing. There is little reason for the Sixth Circuit to question whether the *Jenkins* shareholders' causes of action were particular to themselves or whether they belonged to the corporation generally. The Eleventh Circuit specifically found that the *Jenkins* shareholders were "proceeding against solvent third-parties *in non-derivative shareholder suits*."[28] The term "non-derivative" indicates that the shareholders' causes of action had nothing to do with injuries to the corporation. The shareholders were attempting to collect for injuries *to themselves*. With little basis for doing so, the Sixth Circuit seems to question the Eleventh Circuit's interpretation of Florida law. This seems inappropriate, since Florida sits within the Eleventh Circuit. The Eleventh Circuit frequently decides questions of Florida law in federal diversity cases, and it is far more competent to determine whether the shareholder claims were derivative.

In addition, the Sixth Circuit's attempt to distinguish *Jenkins* because it involved a state bank is unconvincing under the FDIC's own statement of the law's policy—maintaining the integrity of the national bank system. This interest is no less strong when the FDIC takes over a failed state bank. The health of the nation's financial system depends on a functioning network of banks, both state and federal, engaged in the free circulation of capital. As a result, a failed state bank is just as damaging to the system as a failed national bank.

The Sixth Circuit implicitly recognized that its holding in *Gaff* was inconsistent with *Jenkins*. It concluded that the Eleventh Circuit may have weighed too lightly the policies behind the application of federal law to the FDIC. The Sixth Circuit took issue with the Eleventh Circuit's statement that it would "not approve of judicial expansion of the express

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28. *Id.* at 1545 (emphasis added).

powers and rights granted to the FDIC . . . by Congress."[29] The Sixth Circuit said this statement does not do justice to the large body of federal common law that gives the FDIC rights that exceed the specific grants of power in the Federal Deposit Insurance Act and its amendments.

The Eleventh Circuit, however, did not simply look at the statutory text and conclude that because Congress did not expressly give this priority to the FDIC, it does not exist. Instead, it looked to the legislative history of the disputed provision. There, it found powerful evidence of congressional intent to preclude such a priority.

E. *What* Gaff *Giveth, Congress Already Hath Taken Away*

The Eleventh Circuit noted that the type of priority the FDIC requested was, at one point, included in congressional amendments to 12 U.S.C. § 1821. The congressional conference committee, however, removed this item from the bill for several reasons.[30] First, Congress had not carefully studied the proposal.[31] In addition, the proposal appeared on its face to be fundamentally unsound as a policy matter.[32] Representative Dan Glickman of Kansas, however, may have stated the most important reason, when he said the creation of such a priority would undermine fraud enforcement efforts.[33] The priority, he said, would be

> potentially unfair to private plaintiffs who were innocent victims of wrongdoing, and would be at cross purposes with the thrust of the savings and loan legislation. If the FDIC was granted an absolute priority, private parties would have little chance of recovery and as a result would no longer bring fraud suits against bank officers and others guilty of wrong-doing . . . such a priority would therefore have a serious adverse impact on enforcement efforts. Private actions, the SEC stated, are a necessary supplement to the enforcement efforts of the SEC and the Department of Justice, which do not have the resources to enforce the law on their own.[34]

Representative Harley Staggers, Jr. of West Virginia echoed these views.[35] He said that if the FDIC received a priority over shareholders

29. *Id.* at 1541.
30. 135 Cong. Rec. 108, H 4985 (August, 1989).
31. *Id.*
32. *Id.*
33. *Id.*
34. *Id.*
35. *Id.* at H 4989.

and depositors, these private plaintiffs no longer would bring fraud-based actions. He predicted this would dramatically harm enforcement efforts and lead to more fraud. In addition, Representative Staggers said that most conferees felt the priority was manifestly unfair. For instance, he said, the priority rule would allow the FDIC to intervene in a suit that private plaintiffs had been litigating for years, stay the action, and deplete the defendant's resources.[36] Conferees felt that such a priority rule would not benefit the American taxpayers. Since it would undermine efforts to curb fraud, the proposal ultimately would cost the taxpayers more money. Finally, Representative Staggers said, conferees observed that if investors have no recourse when bank officers obtain investments by fraud or misrepresentation, the law would be discouraging investment itself.

The Sixth Circuit's response in *Gaff* was to contend that the legislative history "says nothing about why the Senate did not include this proposal."[37] The court went on to say that the best explanation for why Congress did not include the proposal is that Congress believed the law of priorities in bank receiverships should be developed by the federal courts on a case-by-case basis.

Although the statement of two legislators is not a definitive indication of legislative intent, the Sixth Circuit's reading of the legislative history borders on the absurd. A conference committee had the opportunity to consider a rule directly on point with the issue in both *Gaff* and *Jenkins*. That the conference committee chose to exclude it, and that Congress chose to accept the committee's recommendation, speaks rather loudly in favor of a reading that Congress thought the priority was a bad idea.

F. Other Courts Line Up Behind Jenkins

Other federal courts agree with the *Jenkins* analysis. In *In Re Sunrise Securities Litigation*,[38] the Third Circuit extended the *Jenkins* rule to cover suits filed by depositors against the bank's officers and directors. The court said that when depositors allege individual, non-derivative claims against officers and directors, the FDIC has no priority over their claims. Ultimately, though, the court distinguished *Jenkins*, holding that the plaintiffs-depositors' cause of action was derivative and thus subordinate to the FDIC's action.

The Fourth Circuit also has followed the *Jenkins* approach. In *Howard v. Haddad*,[39] the court expressly adopted the Eleventh Circuit's

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36. Rep. Staggers observed: "No other Federal agency has been granted such broad power to prejudice the rights of individuals." *Id.* at H 4989.

37. Gaff v. FDIC, 919 F.2d 384, 396 (6th Cir. 1990).

38. 916 F.2d 874 (3d Cir. 1990).

39. 916 F.2d 167 (4th Cir. 1990).

analysis, declaring there was no reason to recognize a priority for the FDIC on non-derivative claims.

> Howard's claims on the defendants' assets do not, however, arise out of his status as a Bank shareholder; again, it was the allegedly fraudulent inducements to buy the stock that form the basis of his claims. We cannot see why the fact of liquidation should somehow deprive Howard of these causes of action.[40]

A recent federal district court decision also follows this approach. In *In Re: Atlantic Financial Federal Securities Litigation*,[41] the Resolution Trust Corporation (RTC), an FDIC agency created to deal with the liquidation of failed savings and loans, unsuccessfully argued for priority over the claims of stockholders. The court cited with approval the reasoning of *Jenkins*, including the Eleventh Circuit's reading of the legislative history. More importantly, the court recognized an important reason why the FDIC or the RTC should not have priority over shareholders on private causes of action.

> [T]he risk discussed by the RTC normally bargained for by shareholders—that the officers or directors will mismanage the corporation—is not the problem about which the plaintiffs in this type of suit are complaining. Here, the plaintiffs are complaining that the officers and directors fraudulently induced them to purchase stock. This type of risk is not bargained for when someone chooses to purchase stock, and should not be included in the calculus of priority among creditors to a corporation.[42]

The court also shot down two arguments FDIC raised as to why *Jenkins* should not apply: 1) that *Jenkins* dealt only with the FDIC as "insurer" and not "receiver" and 2) that the *Jenkins* court failed to recognize that the RTC also represents the depositors and other creditors of the failed bank. The court characterized both arguments as simple misreadings of *Jenkins*.

On the first point, the court said the characterization of the FDIC as "insurer" was made only in the summary of the court's holding. Throughout the rest of the Eleventh Circuit's opinion, it acknowledged the FDIC's role as receiver and conservator. On the second point, the court noted that the Eleventh Circuit said the FDIC claimed priority "as a general creditor of [the bank] and assignee of any causes of action owned by [the bank]."[43] Therefore, the *Atlantic Financial* court

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40. *Id.* at 170.

41. 1991 U.S. Dist. No. 89-0645-Civ-A (E.D. Pa. May 29, 1991) (1991 WL 98757, 1991 LEXIS 7439). Fed. Sec. L. Rep. (CCH) P 96,038 (E.D. Pa. 1991).

42. No. 89-0645-Civ-A (1991 WL 98757 at *5, 1991 LEXIS at *7).

43. FDIC v. Jenkins, 888 F.2d 1537, 1538-39 (11th Cir. 1989).

determined that the Eleventh Circuit did recognize on whose behalf the FDIC was operating.

As for *Gaff*, the district judge noted, without comment, that the Sixth Circuit had factually distinguished *Gaff* from *Jenkins*. Without inquiring further, the district judge said that was sufficient to make *Gaff* inapplicable, since the court found the facts of *Jenkins* a closer fit.

The *Atlantic Financial* court's decision to follow the Eleventh Circuit's reading of the legislative intent is another indication of *Jenkins*' logical appeal. But the Eleventh Circuit did not dangle *Jenkins* by the bare thread of legislative intent. The opinion also carried the force of years of jurisprudence that consistently rebuffed the FDIC's attempt to assert a priority over individual claims.

G. FDIC Priority: A Bad Idea Whose Time Never Came

The tendency of upset shareholders to go after the bank's management is not a modern phenomenon. It is not even limited to the post-Depression FDIC era. In *Chesbrough v. Woodworth*,[44] decided almost seventy-five years ago, a group of bank shareholders successfully maintained a cause of action against bank directors when the bank filed false reports with the Comptroller of Currency. The trial court recognized that not every claim brought by shareholders against a bank's officers and directors is derivative. The court found the damages were "personal to the plaintiff. He sues in his own right, not for the association."[45] The Supreme Court upheld the trial court's decision and recognized a private cause of action for shareholders under the National Bank Act.

In its tireless effort to keep bank shareholders out of court, the FDIC has long tried to dismantle the distinction between private rights and bank rights. The FDIC usually argues that shareholder claims are more appropriately classified as derivative actions. If the FDIC wins this battle, it has won the war against shareholders, since the FDIC, as receiver, clearly has the sole right to bring actions on behalf of the failed bank.

This was the precise issue in *Harmsen v. Smith*.[46] There, the FDIC tried to prevent minority shareholders from maintaining a class-action suit against directors of a failed bank. The FDIC argued that only it had the right to assert the claims of the bank's shareholders. The FDIC did not articulate this argument as a "priority," as it has done in later efforts to displace shareholder-plaintiffs. But the intended result and rationale was the same: that the FDIC has unchallenged power to collect

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44. 244 U.S. 72, 37 S. Ct. 579 (1917).
45. *Id.* at 77, 37 S. Ct. at 582.
46. 542 F.2d 496 (9th Cir. 1976).

against a failed bank's management, and private parties are entitled to get their chance at the management's money only after the FDIC gets its cut.

The court ruled against the FDIC, deciding that the shareholders were entitled to maintain individual actions in their own right. In reaching this conclusion, the Ninth Circuit used an analysis similar to that later used by the Eleventh Circuit in *Jenkins*. It simply said that since Congress failed to give the FDIC a priority claim, the court would not second-guess Congress' wisdom.

> We realize this interpretation creates the possibility of two sets of claims against certain directors, both of which have their origin in activities related to affairs of an insolvent bank. Each set, however, is distinct from the other. The recovery with respect to one is not a recovery with respect to the other. While the extinguishment or subordination of claims of the insolvent bank against such directors, might be sound legislative policy, we have discovered nothing that indicates that Congress intended this result.[47]

That same year, a federal district court ruled against a similar FDIC attempt to gain priority over bank shareholders. In *Imperial Supply Co. v. Northern Ohio Bank*,[48] the court rejected the FDIC's contention that policy considerations warranted the dismissal of the plaintiff-shareholders' federal securities suit against the bank, its officers and directors and the bank's independent auditor.

It is possible, however, to find many cases in which a court has stayed shareholders' claims against officers and directors until the FDIC was able to bring its claims. But in every instance, the court so ruled because it found the shareholders' claims to be *derivative* and not truly personal to the shareholders.[49]

This critical distinction is not always easy to make. If a plaintiff-shareholder wants to avoid losing his place in line to the FDIC, he must be prepared to argue that his cause of action is entirely separate from any cause of action the failed bank may have against the officers and directors. Sometimes it can be difficult to draw a line between what an officer or director owes the bank and what the officer or director owes the bank's owners and investors. If the plaintiff cannot draw this

47. *Id.* at 501.

48. 430 F. Supp. 339 (N.D. Ohio, E.D. 1976).

49. *See, e.g.*, FDIC V. American Bank Trust Shares, Inc., 460 F. Supp. 549 (S.C., Charleston Division 1978) and Palmer v. Metropolitan Bancorporation, Nos. 82-141 Civ-T-WC and 82-565 Civ-T-WC, slip op. (M.D. Fla., 1983), dismissed 751 F.2d 392 (11th Cir. 1984).

line with some clarity, even a court that rejects the Sixth Circuit's approach in *Gaff* may be unwilling to let the plaintiff proceed.

H. Conclusion

The Sixth Circuit's approach in *Gaff* remains an anomaly. Through the years, many courts have considered whether an FDIC suit against the officers and directors of a failed bank necessarily displaces similar actions by shareholders and depositors. The courts uniformly have said that no such priority exists.

The weakness of the Sixth Circuit's approach can be seen in its heavy reliance on the alleged policy of, and the amended portions of, 12 U.S.C. § 1821. The court's conclusion that Congress included no mention of priority because it meant to leave those determinations to the courts simply does not make sense. If Congress had failed to consider whether the FDIC has priority over the personal actions of shareholders and depositors, the Sixth Circuit's position might have some merit. Congress indeed may choose to let federal courts decide certain questions based on their common-law authority. But it is quite a different situation for Congress to put a specific provision into a proposed statute and then take the affirmative step of removing it before final adoption. Such an action does not suggest that Congress meant to let courts consider the merits of the position. It plainly suggests that Congress rejected the proposal as a bad idea.

Another interpretive guide weighs against the Sixth Circuit's approach. It is an accepted principle that when a court rules one way on legislation, and the legislature fails to overrule the court, it can be presumed that the legislature is satisfied with the courts' interpretation of the law.[50] In this instance, not only has Congress failed to adopt legislation to overrule previous decisions that failed to recognize an FDIC priority, but Congress has expressly declined to include such a provision in subsequent legislative amendments.

The Sixth Circuit's reading of 12 U.S.C. § 1821 is understandable in one respect. There is hardly an American today, either on the bench or off, who is not dismayed by the staggering cost of the bailout of failed savings and loans. As this litigation reaches the federal appeals

50. The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific. Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection, 474 U.S. 494, 106 S. Ct. 755, *reh'g denied*, 475 U.S. 1090, 106 S. Ct. 1482 (1986). Thus, it is proper to consider that Congress acts with knowledge of existing law, and without a clear manifestation of contrary intent, a newly-enacted or revised statute is presumed to be harmonious with existing law and its judicial construction. Wood v. C.I.R., 909 F.2d 1155 (8th Cir. 1990).

courts—and as new litigation over failing commercial banks begins—there may be a feeling that Congress intended the amended banking laws to maximize FDIC recovery of money lost in these failures. The title of the amendment, "Financial Institutions Reform, Recovery and Enforcement Act" (FIRREA), suggests such an intent. A skeptic might even observe that Congress intended this result not just to stabilize the national banking system, but to reduce the possible political fallout from an electorate that will pay much of the bill for financial institution failures.

However, there is nothing in the new sections to indicate that Congress meant to give the FDIC the priority it so doggedly seeks. If Congress felt strongly enough about maximizing FDIC recovery to the exclusion of shareholders and depositors, there was a simple way to express this concern: leave the priority rule in the amendment.

Since Congress chose not to do so, future courts would seem well advised to view the Sixth Circuit's approach in *Gaff* as an aberration. Congressional intent, backed up by a line of jurisprudence, indicates that in the effort to prevent fraud and self-dealing in commercial banks, two plaintiffs (or more) really are better than one.

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